

*India at an Inflection Point: Some Thoughts**

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I am happy to be back at the FIBAC annual conference. This conference is special as it brings together industry leaders, financial sector players and regulators on a single platform to discuss vital issues of contemporary relevance. I would like to congratulate the FICCI and the IBA for organising this annual conference.

The Indian economy is now at a critical juncture. Massive changes are taking shape in various economic sectors and markets; and the country is geared for orbital shifts. Our nation's journey towards becoming an advanced economy is drawing strength from a unique blend of factors: a young and dynamic population, a resilient and diverse economy, a robust democracy, and a rich tradition of entrepreneurship and innovation.

In this background, I have chosen to speak on the topic "India at an Inflection Point: Some Thoughts". I have structured my talk under four major themes. First, I would speak on India's growth prospects and the approach that we need to follow going forward. Second, I would dwell upon recent developments in inflation and monetary policy. Third, I propose to highlight certain issues relating to strengthening our financial sector. Finally, I would spell out certain expectations from the financial sector.

I. Growth Prospects

The Indian economy rebounded strongly from the COVID-19 induced contraction, growing at an impressive annual average rate of 8.3 per cent during the last three years. For the current financial year, the

Reserve Bank has projected a growth rate of 7.2 per cent. The IMF has also revised India's GDP growth upwards to 7.0 per cent, citing improved prospects for private consumption, particularly in rural areas. Two days ago, the World Bank has also upgraded India's growth forecast to 7.0 per cent for 2024-25.

The National Statistical Office (NSO) has placed India's GDP growth at 6.7 per cent in Q1 of 2024-25. Notwithstanding the moderation in growth from the previous quarter and below our projection for Q1, the data shows that the fundamental growth drivers are gaining momentum. This gives us confidence to say that the **Indian growth story remains intact**.

Private consumption, which is the mainstay of aggregate demand with a share of around 56 per cent in GDP, has rebounded to 7.4 per cent growth from a feeble 4 per cent growth in the second half of the previous year. This reconfirms the revival of rural demand. The other important driver of growth, *i.e.*, investment, which accounts for around 35 per cent of GDP, grew at 7.5 per cent, keeping up with its recent momentum. Thus, more than 90 per cent of GDP expanded at a robust pace and materially above 7 per cent. The headline number, however, came lower against the backdrop of muted government expenditure of both the Centre and the States, perhaps due to the Lok Sabha elections. Excluding government consumption expenditure, GDP growth works out to 7.4 per cent.

On the supply side, while agriculture grew modestly at 2 per cent in Q1, it is likely to perform better, going forward, on the back of good progress of monsoon, improved *kharif* sowing, and good moisture conditions for *rabi* crops. Industry and services recorded a growth of 7.4 per cent and 7.7 per cent respectively in Q1, underscoring continued strength in economic activity. Construction activity remained robust growing at 10.5 per cent.¹

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¹ After growing by 9.9 per cent during 2023-24, construction activity continued to grow at a rapid pace of 10.5 per cent in Q1 of 2024-25.

According to the RBI's latest data², bank credit to agriculture and allied activities remained robust and increased by 18.1 per cent (y-o-y). Credit to industry surged by 10.2 per cent (y-o-y) in July 2024 as compared to 4.6 per cent in July 2023. Within industry, credit to MSMEs also grew at 14.4 per cent (y-o-y). Bank credit to industries such as chemicals and chemical products; food processing; petroleum, coal products and nuclear fuels; and infrastructure has been quite strong in July 2024. The enhanced credit flow to industry along with an all-time high-capacity utilisation points to an upturn in the investment cycle, as reflected in the NSO data.

It is evident that India is on a sustained growth path. Consumption and investment demand, the two main drivers of growth, are growing in tandem. Government expenditure of the centre and the states is likely to pick up pace in line with the Budget Estimates in the remaining quarters of the year. Strong balance sheets of banks and corporates have created congenial conditions to further support private capex. Corporate profits (net) have grown by 14.2 per cent in Q1:2024-25.³ Government capex continues to be strong. Overall, the Reserve Bank's projection of GDP growth at 7.2 per cent for 2024-25 does not appear out of place.

As regards growth prospects in the medium to long-term, it is felt that the Indian economy is on the cusp of transformational shifts. The fact that growth is on a rising trend, despite modest global growth and continuing global challenges, shows that structural drivers are playing a bigger role in India's macroeconomic outcomes. These drivers include: policy push on creating robust physical infrastructure; our fast growing digital public infrastructure;

innovation and technological advancements across sectors; and critical reforms in key areas.

To realise the aspiration of transitioning from an emerging to an advanced economy by 2047, **the Indian economy would need a multi-pronged and a multi-sectoral approach.** Our focus should be on employing all engines of growth from both supply and demand sides. The supply side focus must encompass agriculture, industry and services. We should be mindful of the fact that agriculture possesses huge potential in India. Agri-commercial activities in horticulture, edible oils, dairy, poultry, food processing, etc. could be the focus areas. Our approach should be to enhance productivity as well as quality of our produce so that we gain a significant share in world exports, while meeting our domestic requirements.

The potential contribution of manufacturing will be pivotal to generate additional employment. Initiatives such as 'Make in India', 'Start up India', 'One District One Product (ODOP)' and 'Production Linked Incentive (PLI)' scheme, among others, are helping the manufacturing sector gain competitiveness and grow faster. The MSME sector, in particular, holds a lot of promise to step up growth and employment opportunities. Overall, the manufacturing sector must take the lead in niche areas to compete globally.

The services sector, which has remained the mainstay of growth over the last several decades, must explore new vistas of opportunities with focus on higher value-added services. In addition, requisite focus on research and development (R&D) is also vital for productivity and competitiveness. Together with government initiatives, including higher fund allocations for R&D, the private sector may also be an active partner in this field.

As I stated earlier, key demand drivers like consumption, investment and exports of goods and services will have to move in tandem. Higher

² Sectoral Deployment of Bank Credit- July 2024 (data released by RBI on August 30, 2024).

³ Net profits of 2,934 listed private non-financial corporates grew by 14.2 per cent in Q1: 2024-25 as against 6.4 per cent in Q4:2023-24. (Performance of Private Corporate Business Sector during Q1:2024-25, released by RBI on August 30, 2024).

domestic consumption would help insulate the economy from the vagaries of external uncertainties. Investment remains critical for sustainable growth of the economy and, given the current confluence of favourable factors, it is time for the private corporate sector to come forward in a big way. The potential of external demand can be utilised to our advantage by getting integrated into the global supply chains.

A holistic approach to nurture and accelerate a broad-based growth of the economy would also necessitate **preservation of the gains of past reforms and accelerating India's reform journey with more reforms**. From an economic perspective, reforms that have imparted paradigm shifts and buttressed our stability and growth story would include: (i) shifting from administered exchange rate of the rupee to a market determined regime; (ii) stoppage of automatic monetisation of budget deficit financing by the Reserve Bank; (iii) enactment of the Fiscal Responsibility and Budget Management (FRBM) Act; (iv) introduction of the flexible inflation targeting framework; (v) enactment of the Insolvency and Bankruptcy Code (IBC); and (vi) implementation of the Goods and Services Tax (GST). Each of these six reforms have yielded long term positive outcomes. These reforms need to be augmented by reforms in land, labour and agricultural markets. While we have made some progress in these areas, lot more needs to be done both at the national and sub-national levels. Improvements in ease of doing business, especially at local levels, will boost our competitiveness.

II. Inflation and Monetary Policy

In early 2022, the flare up in food, commodity and energy prices, following the outbreak of the war in Ukraine, led to a sharp increase in inflationary pressures. This was further compounded by a series of adverse domestic weather shocks. The decisive steps taken by the Reserve Bank, supply side measures from the government and cooling of international commodity prices have led to downward shift in

inflation from early 2023-24. Nevertheless, the pace of disinflation is frequently interrupted by volatile and elevated food inflation. It is the headline inflation that matters. It is the headline inflation with food inflation having a weight of 46 per cent that the people understand. With the monsoon progressing well and the healthy *kharif* sowing raising prospects of better harvest, there is greater optimism that food inflation outlook could become more favourable over the course of the year.

We have to remain watchful of how the forces impacting inflation play out. **The balance between inflation and growth is well-poised**. We must successfully navigate the last mile of disinflation, and preserve the credibility of the flexible inflation targeting (FIT) framework which is a major structural reform. The best contribution that monetary policy can make for sustainable growth is to maintain price stability.

III. Financial Sector – Strengthening the Foundations for Future

India's financial sector has repeatedly demonstrated its ability to overcome challenges and crises. The financial sector showed remarkable resilience during and in the aftermath of the COVID-19 pandemic. Today, all key indicators of the financial sector demonstrate its robust health⁴. This resilience, combined with other forces, can act as critical driving forces for India's future.

In this milieu, the financial sector needs to even further deepen financial inclusion, broaden access to credit and other financial products, and support overall

⁴ GNPA ratio of banks was 2.7 per cent at end-June 2024, the lowest since end-March 2011. The annualised slippage ratio, which measures new NPA accretions as a percentage of standard advances, continued to decline to reach at 1.3 per cent at end-June 2024. The provision coverage ratio (PCR) continued to improve to reach at 76.5 per cent by end-June 2024. Capital to risk-weighted assets ratio (CRAR) stood at 16.8 per cent at end-June 2024, much above the regulatory threshold. The annualized profitability indicators, namely, return on assets (RoA) and return on equity (RoE) stood at 1.4 per cent and 14.2 per cent, respectively, at end-June 2024, showing continued improvement.

inclusive growth. It also needs to drive innovation in digital banking, foster sustainable finance, and build a robust financial ecosystem that can withstand emerging challenges and facilitate a higher trajectory of growth.

With the financial sector now in a strong position, it is our collective responsibility to safeguard this stability, especially in an environment of heightened global uncertainty. Financial institutions must continuously assess and refine their business models, recognise and deal with the emerging risks, and remain focused on capitalising on every new opportunity.

This brings me to the important issue of inclusive growth. While traditional metrics of economic growth like GDP and per capita GDP are important indicators of progress, they alone do not capture the full picture of what it means for a nation to be truly developed.

India has made remarkable⁵ progress in extricating people out of poverty. A truly developed India must ensure that every citizen, regardless of their socio-economic status, has access to financial services and has the required financial literacy. By expanding access to banking, credit and insurance, and by harnessing the power of digital platforms, the financial sector can drive inclusive growth that extends to the most marginalised sections.

The Priority Sector Lending (PSL) programme remains crucial in addressing credit gaps for underserved segments. Introduction of Business Correspondents (BCs) has further enhanced financial outreach. The Financial Inclusion Index, introduced by the Reserve Bank, has improved from 53.9 in 2021 to 64.2, reflecting the strides made in providing access to financial services. There is, however, still more to

be done to improve the usage and quality of these services.

Two more key drivers need to be prioritised: enhancing financial literacy and leveraging technology. The Reserve Bank has engaged in both self-driven and collaborative approaches to promote financial literacy. We run multimedia public awareness campaigns and outreach programmes as well as targeted financial literacy awareness programmes. Collaborating with other financial regulators, the Reserve Bank has assisted in establishment of the National Centre for Financial Education (NCFE) to bolster financial literacy efforts. With the support of banks and NGOs, 2,421 Centres for Financial Literacy have also been set up, covering almost all the blocks in the country.

On the technology front, the Reserve Bank has taken a number of initiatives to facilitate development of digital public infrastructure and innovation. The Unified Payments Interface (UPI) has revolutionised the digital payments space. Other initiatives like the Regulatory Sandbox and the Innovation Hub, have fostered a robust environment for enriching our fintech ecosystem. The commencement of the Reserve Bank's pilot project for frictionless credit, *i.e.* the end-to-end digital platform of the Unified Lending Interface (ULI) is expected to revolutionise access to credit, especially for farmers and MSMEs.

IV. Expectations from the Financial Sector

Having spoken about safeguarding financial stability and financial inclusion, I would now like to highlight some specific areas where I believe the financial sector can contribute to India's growth aspirations.

(a) Improving female labour participation

India's female labour force participation remains lower than the global average. This gap underscores the urgent need for targeted initiatives such as improving girls' education, skill development, workplace safety, and addressing societal barriers.

⁵ As per a discussion paper on Multidimensional Poverty in India released by the Niti Aayog. Multidimensional poverty in India was found to decline from 29.17 per cent in 2013-14 to 11.28 per cent in 2022-23 with about 24.82 crore people escaping poverty during this period. Multidimensional Poverty in India since 2005-06 - A Discussion Paper By Prof. Ramesh Chand and Dr. Yogesh Suri, Niti Aayog, January 2024.

Entrepreneurship is a vital component of economic empowerment; yet in India, less than one fifth of MSMEs are owned by women. Women entrepreneurs often face significant challenges including limited access to capital, restrictive societal norms, and difficulties in accessing affordable finance. The financial sector has a crucial role to play in bridging this gender gap by implementing supportive policies, creating tailored financial products, and leveraging fintech innovations to offer better access to finance. This can be pursued on two fronts – one, by providing higher employment opportunities to women in financial institutions; and two, by supporting women entrepreneurs, through Government sponsored schemes as well as banks' own schemes tailored to suit businesses promoted by women. Banks could also actively explore onboarding larger number of women BCs *i.e.* 'bank saathis' or 'sakhis', especially from among SHG members.

(b) Supporting MSMEs

With our large young population, we need to fully tap the potential of MSMEs to drive employment and economic development. Despite their importance, many MSMEs remain small-sized and unable to scale up effectively due to various challenges, with access to affordable finance being one of the barriers.

The financial sector may play an active role in supporting MSMEs. Banks and financial institutions

may develop tailored financial products and services that cater specifically to the needs of MSMEs. This includes offering flexible credit options, improving access to working capital, and providing financial support that accommodates the unique cash flow cycles and growth stages of MSMEs. This can propel MSMEs to expand, enhance their productivity, and contribute more significantly to job creation.

Conclusion

Let me now conclude. The Indian economy is forging ahead with macroeconomic and financial stability, and a favourable growth-inflation balance. The policy mix pursued in the recent years has strengthened the underlying fundamentals of the economy and augmented the buffers. Consumption, which had been our main driver of growth, has picked up pace, with recovery in rural demand. Investors' confidence is at an all-time high; banks and corporates demonstrate robust balance sheets; and structural reforms are playing a big role in pushing forward our growth frontier.

We are living in a dynamic and uncertain world, and we need to remain vigilant and continue to build stronger buffers. New opportunities are knocking at our doors and when I look at the entrepreneurial zeal and the talent of our younger population, it makes me more confident of India's long-term growth prospects.

Thank you. Namaskar.