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Monetary and Credit Information Review

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Monetary Policy

Third Bi-monthly Monetary Policy Statement, 2018-19

Resolution of the MPC

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting held on August 1, 2018, decided to increase the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 6.5 per cent. Consequently, the reverse repo rate under the LAF stands adjusted to 6.25 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 6.75 per cent.

The decision of the MPC is consistent with the neutral stance of monetary policy in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent while supporting growth. (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=44636)

Developmental and Regulatory Policies

The various developmental and regulatory policy measures announced by RBI on August 1, 2018 are:

Regulation and Financial Inclusion

Extension of MSF to Scheduled Primary (Urban) Cooperative Banks, and extension of LAF and MSF to Scheduled State Cooperative Banks

As part of the Reserve Bank's continuous efforts in improving the transmission of monetary policy to money market rates, it has been decided to allow access to (i) the marginal standing facility (MSF) to scheduled primary (urban) co-operative banks, complying with the eligibility criteria prescribed for MSF; and, (ii) the liquidity adjustment facility (LAF) and MSF to scheduled state co-operative banks, complying with the eligibility criteria prescribed for LAF / MSF. Detailed guidelines will be issued by the end of September 2018.

Investment in Non-SLR Securities by Primary UCBs

In order to bring further efficiency in price discovery mechanism and as a step towards harmonisation of regulations for urban and rural co-operative banks, the Reserve Bank permitted primary (urban) co-operative banks to undertake eligible transactions for acquisition/sale of non-SLR investment in secondary market with mutual funds, pension/provident funds, and insurance companies. This is in addition to undertaking eligible transactions with scheduled commercial banks and primary dealers. Detailed guidelines will be issued by the end of September 2018.

Co-origination of Loans by Banks and NBFCs for Lending to the Priority Sector

To provide the much-needed competitive edge for credit to the priority sector, all scheduled commercial banks (excluding Regional Rural Banks and Small Finance Banks) can co-originate loans with non-banking financial companies - non-deposit taking- systemically important (NBFC-ND-SIs), for the creation of eligible priority sector assets. The co-origination arrangement should entail joint contribution of credit by both lenders at the facility level. It should also involve the sharing of risks and rewards between the banks and NBFCs for ensuring appropriate alignment of respective business objectives, as per their mutual agreement. Guidelines in this regard will be issued by the end of September 2018.

Financial Markets

Review of Foreign Exchange Derivative facilities for Residents

It is now proposed to undertake a comprehensive review of foreign exchange derivative facilities for residents (FEMA 25), in consultation with the Government of India, to, inter alia, reduce the administrative requirements for undertaking derivative transactions, allow dynamic hedging, and allow Indian multinationals to hedge the currency risks of their global subsidiaries from India. Draft circular on the revised guidelines will be released for public comments by the end of September 2018.

Comprehensive Review of Market Timings

The Reserve Bank would set up an internal group to comprehensively review timings for certain market segments (namely, currency futures, over-the-counter (OTC) foreign exchange market, and others) and the necessary payment infrastructure for supporting the recommended revisions to market timings. The proposed group will submit the report by the end of October 2018.

Review of SGL/CSGL Guidelines

In order to facilitate greater participation in the government securities (G-Secs) markets and to provide market participants further operational ease in opening and operating of subsidiary general ledger (SGL) and constituent subsidiary general ledger (CSGL) accounts, the Reserve Bank would review comprehensively the SGL/CSGL guidelines. Notifications and Directions in this regard will be issued by the end of October 2018.

Customer Education and Protection

Review of Internal Ombudsman Mechanism in Banks

With a view to strengthening the internal grievance redressal mechanism at banks, the Reserve Bank decided to enhance the independence of the Internal Ombudsman (IO) as the apex authority for redressal of customer complaints while simultaneously strengthening the monitoring system over the functioning of the IO mechanism. Revised instructions in this regard will be issued by the end of September 2018. (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=44637)

Banking Regulation

Reference Rate

The Reserve Bank on August 2, 2018 advised all scheduled and non-scheduled banks that banks shall use the conversion rate announced by Financial Benchmarks India Private Limited (FBIL) for the purpose of converting foreign assets/liabilities for reporting in Form 'A' return and Form VIII return. The change is effective from the reporting fortnight ending July 20, 2018.

As regards conversion of assets/liabilities in other currencies, for which reference rate is not available from FBIL, banks may continue to use New York closing rate pertaining to the day end of the reporting Friday, for converting such currencies into USD. Banks may use the reference rate of FBIL for USD/INR of the same day for conversion into INR.

Background

FBIL has taken over the process of computing and disseminating reference rate for INR/USD and exchange rate for the other major currencies with effect from July 10, 2018. Banks were advised to be guided by the reference rate announced on the Reserve Bank's website for converting foreign assets/deposits into INR for reporting in Form 'A' Return.(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11355&Mode=0)

Co-operative Bank Regulation

LAF and MSF for Scheduled Co-operative Banks

The Reserve Bank decided that with effect from August 20, 2018, LAF will also be extended to scheduled state co-operative banks (StCBs) which are core banking solution (CBS) enabled and have the capital to risk (weighted) assets ratio (CRAR) of at least 9 per cent.

Further, in order to provide an additional window for liquidity management over and above what is available under LAF, the Reserve Bank decided that with effect from August 20, 2018, MSF will be extended to scheduled (urban) co-operative banks (UCBs) and StCBs which are CBS enabled and have CRAR of at least 9 per cent. The terms and conditions for availing LAF and MSF would be as per the instructions issued by Financial Markets Operation Department (FMOD) of the Reserve Bank from time to time.

The names of such scheduled co-operative banks which meet the eligibility norms to participate in LAF and MSF (positive list), and of those scheduled co-operative banks found ineligible (negative list), will be communicated shortly to the FMOD by Department of Co-operative Bank Regulation (DCBR) under intimation to the banks concerned. The eligibility status of the banks in the positive list will be reviewed on an ongoing basis to ensure that the CRAR requirement is being complied with.(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11361&Mode=0)

Investments in Non-SLR Securities by Primary UCBs

As a step towards harmonisation of regulations for urban and rural co-operative banks, the Reserve Bank on August 16, 2018 decided to permit UCBs to undertake eligible transactions for acquisition/sale of non-SLR investment in secondary market with mutual funds, pension/provident funds and insurance companies, in addition to undertaking transactions with commercial banks and primary dealers.

All the primary UCBs were advised that all transactions for acquisition/sale of non-SLR investments in the secondary market may be undertaken only with commercial banks/primary dealers as counterparties. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11360&Mode=0)

Mint Street Memo

How have MSME Sector Credit and Exports Fared?

The Reserve Bank on August 17 2018, published the thirteenth in the series of Mint Series Memo titled "**How have MSME Sector Credit and Exports Fared?"** by Harendra Behera and Garima Wahi.

This study analyses the recent credit dynamics and export performance of Micro, Small and Medium Enterprises (MSMEs). Demonetisation led to a further decline in the already decelerating credit growth of the MSME sector, while Goods and Services Tax (GST) implementation does not seem to have had a significant impact on overall credit to MSMEs. The growth in credit to MSMEs has recovered since the lows of late 2017 to reach the mid-2015 level. Microcredit to MSMEs, including loans by banks and non-banking financial companies (NBFCs), shows a particularly healthy rate of growth in recent quarters. In contrast to credit growth, MSME exports appear to be affected more by GST implementation.

Despite significant contribution to economic growth, MSMEs face several bottlenecks inhibiting them from achieving their full potential. A major obstacle for the growth of MSMEs is their inability to access timely and adequate finance as most of them are in niche segments where credit appraisal is a major challenge. The challenges faced by MSMEs in accessing finance are due to lack of comprehensive formal documentation relating to accounts, income and business transactions. As a result, loans are provided to the MSMEs mainly through appraisal of their collaterals rather than assessing their true business potentials. Further, banks do not trust start-ups, view such loans as risky and thus do not prefer extending finance to MSMEs.

The main findings of the study are:

- Credit growth in the MSME sector had started decelerating even before demonetisation and declined further during the demonetisation phase. In contrast, GST implementation does not seem to have had any significant impact on credit. Overall, MSME credit and especially microcredit to MSMEs, including loans by banks and NBFCs, shows a healthy rate of growth in recent quarters. During the quarter April-June 2018, bank credit to MSMEs increased on average by 8.5 per cent (y-o-y), mirroring the level of growth during April-June 2015, with credit to micro and small enterprises growing at an even healthier rate.
- In contrast, MSME exports were affected more adversely by issues relating to GST implementation than demonetisation due to delay in refund of upfront GST and input tax credit affecting cash-driven working capital requirements. (https://rbi.org.in/Scripts/MSM_Mintstreetmemos13.aspx)

Speech

Innovation in Retail Payments[1]

Dr Urjit R. Patel, Governor, Reserve Bank of India, on August 16, 2018, launched the Unified Payments Interface (UPI) Version 2 in Mumbai and delivered a talk on "Innovation in Retail Payments". Shri Biswamohan Mahapatra, Chairman, National Payments Corporation of India (NPCI), Shri Nandan Nilekani, Shri Dilip Asbe, MD and CEO, NPCI, bankers and other distinguished guests, were present.

Acknowledging the strong foundations laid down by the predecessors in making rapid progress in the area of digital payments, Governor, in his address, highlighted the Reserve Bank's contribution in recent years in the area of digital payments.

Excerpts from the Governor's Speech

Recognising that payment and settlement systems are at the heart of a modern economy, the Reserve Bank has, over the years, initiated measures that have resulted in the payment systems in India gaining international recognition, Governor stated and added that India is regarded as a pioneer in introducing (i) second factor authentication; (ii) a unified payments structure; and (iii) the Bharat QR protocol. The recent past has witnessed significant developments in this area, which have brought in a sea-change in the way the citizens use technology-based systems and products to take care of their funds transfer requirements, he said.

Highlighting the Reserve Bank's vision for the payment and settlement systems to encourage greater use of electronic payments by all sections of society, the Governor stated that while the Reserve Bank will continue to pay focused attention to appropriate enabling regulation, strong infrastructure, apposite supervision and customer centricity, due attention must be paid by operators towards cybersecurity, effective customer grievance redress arrangements and reasonableness of customer charges.

Urging the operators to ensure that no corner is cut regarding cybersecurity, the Governor said, "After all, in a network environment we are only as strong as the weakest link. We owe it to ourselves that we do not compromise the integrity of the system by individual (in) action – in this context, cost savings should be eschewed."

Speaking on the genesis and the rationale behind setting up the NPCI in 2008, the Governor said that the proximate objective behind NPCI is provision of convenient, "anytime anywhere" payment services that are secure and easy-to-use and further added "An attendant goal is to facilitate an affordable payment mechanism to benefit the common person and to catalyse financial inclusion as well."

Referring Unified Payments Interface (UPI) as one of the more successful products of NPCI in making itself a veritable conduit for retail funds transfers, Dr Patel, talked about UPI that powers multiple bank accounts into a single mobile application (of any participating bank) for immediate fund transfers and a variety of payments without parting with sensitive information. UPI supports merchant payments, utility bill payments, "over-the-counter" payments, QR code (scan and pay)-based payments and the like, through mobile devices on a 365x24x7 basis, he stated.

Launching the enhanced version of UPI to widen the scope and to increase digital payments in India, Dr Patel stated that UPI 2.0 will open new areas, such as, retail applications for initial public offerings of companies, which can now be processed through UPI. He said he is confident that UPI 2.0 will take simplicity, security and seamlessness to the next level which will serve as a benchmark for other products in the eco-system.

Governor in his talk highlighted the enhanced features of the new version of the UPI which are:

- Invoice in the Inbox: This allows a person who has used UPI to make a payment to view the document pertaining to the payment, such as, a bill or an invoice before authorising the payment, so the payer is fully aware of the purpose of his payment.
- Signed Intent/QR: This enables a person to authorise payment for transactions initiated on a compatible application on the same mobile device without separately opening the UPI application, thereby resulting in ease of use, but without compromising on security.
- UPI Mandate with Blocking of Funds: This permits the registration of a debit mandate for repetitive/periodic payments automatically and would be akin to standing instructions in a manual account-based operational scenario.
- UPI for Overdraft Account: This facilitates transactions on such loan accounts that hitherto were not provided for, thus making UPI even more ubiquitous.
- Another noteworthy feature is the increase of the "Per-Transaction" cap from the existing level of ₹1.0 lakh to ₹ 2.0 lakh. This will support large-value real-time transactions on a mobile phone.

In all of the above, it is worthy of mention that the enhanced capabilities will ride on the safe backbone of UPI which has not only stabilised well but has also become the trusted channel of choice, he stated and added that "UPI has the potential for further facilitations". Some of the possibilities include integration with newer payment systems of the future in view of its standardised formats and structures; capability to integrate with many home-grown e-commerce applications that hold substantial potential; emerging innovative delivery channels using the digital mode; and so on, thus underscoring its (relatively low cost) versatility.

Speaking on NPCI gaining status of being a Systemically Important Payment Infrastructure (SIPI) in a span of about a decade of its existence, the Governor said that such a status brings with it added responsibility and NPCI will certainly continue to excel in its role of a pioneer payment system provider. He also believed that as a designated SIPI, NPCI will continue to pursue the highest levels of good governance, sustenance, innovation, reliability, and resilience. It should also continually assess the performance of its systems and products by benchmarking expected performance metrics in respect of technical declines, business declines, processing speed & capacity, and others, he stated.

The Governor in his concluding remarks highlighted that India has been enjoying a very healthy evolution of payment systems as a result of the calibrated approach adopted by the Reserve Bank – in the initial years as a developer, and in later years as a catalyst and facilitator. "Today our systems are not only comparable to systems anywhere in the world, but they also set standards and good practices for others to emulate", he stressed and further added, "Going forward, we will ensure that regulation will foster competition and innovation in the payment space." The Governor concluded with expressing his confidence on products like UPI that will continue to serve the nation's aim of bringing all its citizens to the fold of safe digital payments.(https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1060)

[1] Address at the Launch of UPI Version 2 by Dr Urjit R. Patel on August 16, 2018 in Mumbai.

RBI releases its Annual Report 2017-2018

The Reserve Bank of India, on August 29, 2018, released its Annual Report for 2017-18, a statutory report of its Central Board of Directors. A summary is given below:

Economic Review

The Indian economy exhibited resilience during 2017-18, with upturns in investment and construction. Inflation eased on a year-on-year basis in an environment characterised by high variability. In the evolution of monetary aggregates, currency in circulation surpassed its pre-demonetisation level while credit growth revived to double digits from a historic low in the previous year. Domestic financial markets were broadly stable, with rallies in equity markets and intermittent corrections, hardening bond yields, the rupee trading with a generally appreciating bias except towards the close of the year and ample liquidity in money markets. The implementation of GST achieved another important milestone towards an efficient indirect tax structure. On the external front, the current account deficit was comfortably financed with accretions to foreign exchange reserves.

Monetary Policy Operations

The policy stance remained neutral from February 2017 onwards. Surplus liquidity in the system generated in the wake of demonetisation was gradually drained away by the Reserve Bank's liquidity management operations. Transmission of policy impulses to deposit and lending rates improved further during the year, albeit with large variations across sectors and bank groups.

Credit Delivery and Financial Inclusion

The Reserve Bank undertook several new initiatives that include revised guidelines on priority sector lending, launch of Certified Credit Counsellors (CCCs) Scheme for MSMEs, conduct of survey for assessing the challenges faced by the MSME sector, revamp of Lead Bank Scheme (LBS), implementation of some of the key recommendations of the Committee on Medium-Term Path on Financial Inclusion and also innovative approaches for financial literacy. The work is also underway for the formulation of a National Strategy for Financial Inclusion. In order to ascertain efficacies, the Reserve Bank would undertake the impact assessments of some of the projects under credit delivery and financial inclusion during 2018-19.

Financial Markets and Foreign Exchange Management

During 2017-18, the Reserve Bank used a variety of instruments to absorb the persisting surplus liquidity in the system for ensuring better alignment of money market rates with the policy rate in order to achieve efficient transmission of monetary policy signals. The Reserve Bank operated in both Over-The-Counter (OTC) and Exchange-Traded Currency Derivatives(ETCD) segments. Further rationalisation of regulations were carried out during the year for facilitating cross-border flow of funds.

Regulation, Supervision and Financial Stability

In order to align the resolution process with the Insolvency and Bankruptcy Code (IBC), 2016, the framework for the resolution of stressed assets was revised and the previous schemes were withdrawn. Customer rights were strengthened by limiting the liability of customers in unauthorised electronic banking transactions. Data protection and cybersecurity norms were strengthened. An Ombudsman Scheme for deposit-taking NBFCs was initiated. Regulatory policies for cooperative banks were further harmonised with those of scheduled commercial banks (SCBs). In order to bring about ownership-neutral regulations, government-owned NBFCs will be required to adhere to the Reserve Bank's prudential regulations in a phased manner.

Public Debt Management

Notwithstanding the multiple challenges emanating from the glide path for reduction in Held to Maturity (HTM) category of banks' investment portfolio and Statutory Liquidity Ratio (SLR), the Reserve Bank managed the borrowing requirements of the central and the state governments for 2017-18 within the overall contours of the debt management strategy of low cost, risk mitigation and market development while factoring in domestic and global economic and financial conditions. On the macroeconomic front, the tilting risks to inflation, pressure emanating from the fiscal slippages, event-specific announcements, namely, farm loan waivers coupled with global factors, such as the increasing crude oil prices and the monetary policy normalisation in major economies were the major factors that impacted the yields.

Currency Management

Currency management during 2017-18 was geared towards managing the process of remonetisation and processing and reconciliation of specified banknotes (SBNs). The year was marked by the issuance of banknotes of ₹10 and ₹50 under the new series and introduction of ₹200, a new denomination. New banknotes under the Mahatma Gandhi (New) Series highlighting the cultural heritage and scientific achievements of the country were issued.

Payment and Settlement Systems and Information Technology

The Reserve Bank's endeavour to build a less-cash society continued with the large-scale adoption of digital modes of payments in the country. In an era of rising means of electronic payment systems, the Reserve Bank focused it's efforts on safety and security of digital transactions.

Communication, International Relations, Research and Statistics

The Reserve Bank, adopting various measures, strengthened its communication efforts further during the year which was also marked by the successful completion of the Financial Sector Assessment Programme (FSAP). Efforts were sustained towards improving research and statistics as also for providing better banking services to governments. Foreign exchange reserves were managed and guided by the consideration of safety, liquidity and returns. To ensure a robust legal framework for the banking and financial sector, several financial laws/bills were introduced/amended during the year.

Governance, Human Resources and Organisational Management

The year 2017-18 was marked by several initiatives in the arena of, inter alia, human resource development, Enterprise-wide Risk Management (ERM), audit management, and promotion of Rajbhasha. As part of the drive to spread knowledge among staff, structured e-learning courses were introduced. The third edition of the RBI Policy Challenge, a national level competition targeting under/post–graduate students, was successfully conducted during the year. A rule-based Staggered Surplus Distribution Policy (SSDP) was introduced for transfer of surplus to government. A web-enabled audit management, risk assessment and analysis platform, namely, Audit Management and Risk Monitoring System (AMRMS), is under development. Alongside, the regional offices have strived to implement the policies to achieve the enshrined goals of the Reserve Bank.

The Reserve Bank's Accounts for 2017-18

The balance sheet size of the Reserve Bank increased by 9.49 per cent for the year ended June 30, 2018. While income for the year 2017-18 increased by 26.63 per cent, the expenditure decreased by 9.24 per cent. The year ended with an overall surplus of ₹500 billion as against ₹306.59 billion in the previous year, representing an increase of 63.08 per cent.

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