GOVERNOR'S STATEMENT

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Shaktikanta Das

Kautilya in his *Arthashastra* more than two thousand years ago, had said: *"stability enables a state not only to share its wealth equitably but also augment it"*.[1] These words are relevant even today. In fact, they have eternal validity. Macroeconomic stability and inclusive growth are the fundamental principles underlying a country's progress. The policy mix that we have pursued during the recent years of multiple and unparalleled shocks has fostered macroeconomic and financial stability. The external sector also remains eminently manageable. The twin balance sheet stress that was encountered a decade ago has now been replaced by a twin balance sheet advantage with healthier balance sheets of both banks and corporates. India is poised to become the new growth engine of the world.

The need of the hour is to remain vigilant and not give room to complacency. Lessons from the past one and a half decades and from living through the global financial crisis and the *taper tantrum* tell us that risks and vulnerabilities can grow even in good times. All stakeholders in the economy, be it lenders, corporates, businesses – small and big – and even policymakers should continue to reinforce their buffers and fundamentals in the fast changing world that we live in. So far as the Reserve Bank is concerned, we have identified high inflation as a major risk to macroeconomic stability and sustainable growth. Accordingly, our monetary policy remains resolutely focused on aligning inflation to the 4 per cent target on a durable basis.

* Governor's Statement - October 6, 2023.

[1] Source: Kautilya – The Arthashastra by L. N. Rangarajan, Penguin, 1992. Although Kautilya had said this in a different context, an analogy has been drawn here to state this in the macroeconomic context.

Decisions and Deliberation of the Monetary Policy Committee (MPC)

The Monetary Policy Committee (MPC) met on 4th, 5th and 6th October 2023. After a detailed assessment of the evolving macroeconomic and financial developments and the outlook, it decided unanimously to keep the policy repo rate unchanged at 6.50 per cent. Consequently, the standing deposit facility (SDF) rate remains at 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 6.75 per cent. The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth.

I shall now briefly set out the MPC's rationale for these decisions on the policy rate and the stance. Headline inflation had surged in July driven by tomato and other vegetable prices. It corrected partly in August and is expected to see further easing in September on the back of moderation in these prices. A silver lining amidst all these is declining core inflation (*i.e.*, CPI excluding food and fuel). The overall inflation outlook, however, is clouded by uncertainties from the fall in *kharif* sowing for key crops like pulses and oilseeds, low reservoir levels, and volatile global food and energy prices. The MPC observed that the recurring incidence of large and overlapping food price shocks can impart generalisation and persistence to headline inflation. Economic activity, on the other hand, has remained resilient. Taking into account the evolving inflation-growth dynamics and the cumulative policy repo rate hike of 250 basis points which is still working through the economy, the MPC decided to keep the policy repo rate unchanged at 6.50 per cent in this meeting. The transmission of the 250 basis points (bps) increase in the policy repo rate to bank lending and deposit rates is still incomplete and hence the MPC decided to remain focused on withdrawal of

accommodation.[2] The MPC remains highly alert and prepared to undertake timely policy measures, as may be necessary, in order to align inflation to the target and anchor inflation expectations.

Assessment of Growth and Inflation

Global Growth

Let me turn to a detailed assessment of the growth and inflation dynamics, starting with the external environment. The global economy is slowing under the impact of tight financial conditions, protracted geopolitical tensions and increasing geoeconomic fragmentation. Global trade is contracting.[3] Headline inflation is easing but rules above the target in major economies. While major central banks are signalling a peaking of their rate hike cycle, there are indications that the tight monetary policy stance could persist for longer than anticipated earlier. Sovereign bond yields have firmed up, the US dollar has appreciated, and global equity markets have corrected.

Domestic Growth

In contrast to global trends, domestic economic activity exhibits resilience on the back of strong domestic demand.[4]

The momentum in agricultural activity in Q2:2023-24 has been sustained, although the monsoon has been uneven.[5] The acreage under *kharif* crops as on September 29, 2023 was 0.2 per cent above last year's level.

The industrial sector extended recovery in Q2.[6] Manufacturing sector gained ground in July-August 2023, supported by key sectors such as pharmaceuticals, basic metals, cement, motor vehicles, and food products and beverages. The purchasing managers' index (PMI) for manufacturing remained robust in September.

Services sector activity is maintaining buoyancy as indicated by healthy expansion in high frequency indicators in August-September.[7] PMI Services exhibited strong expansion in September. Construction activity continues to be strong.[8]

Investment activity maintained its momentum with good support from government capex. Private sector capex is gaining ground as suggested by expansion in production and imports of capital goods and new projects sanctioned by banks.[9] Capacity utilisation (CU) in the manufacturing sector, on a seasonally adjusted basis, continued to trend up, which augurs well for investment activity.[10] The total flow of resources to the commercial sector from banks and other sources taken together at ₹10.6 lakh crore during the current financial year so far is higher

[2] The weighted average domestic term deposit rate (WADTDR) on fresh deposits of scheduled commercial banks and the weighted average lending rate (WALR) on fresh loans have increased by 233 bps and 196 bps, respectively in the current tightening cycle. The corresponding increase in outstanding term deposit rates and outstanding lending rates is even lower at 157 bps and 112 bps, respectively.

[3] Global merchandise trade volume fell by 3.2 per cent (y-o-y) in July 2023 according to CPB Netherlands Bureau for Economic Policy Analysis.

[4] Real gross domestic product (GDP) posted a growth of 7.8 per cent year-on-year (y-o-y) in Q1:2023-24.Gross fixed capital formation rose by 8.0 per cent and private consumption by 6.0 per cent in Q1. On the supply side, real gross value added (GVA) also rose by 7.8 per cent in Q1:2023-24, powered by a 10.0 per cent increase in services sector.

[5] According to India Meteorological Department, the cumulative south-west monsoon rainfall was 94 per cent of the long period average (LPA). Rainfall over the monsoon core zone, consisting of most of the rainfed agriculture regions in the country was normal at 101 per cent of LPA.

[6] The index of industrial production rose by 5.7 per cent in July and core industries output expanded by 12.1 per cent in August.

[7] In September 2023, e-way bills, toll collections and railway freight traffic expanded (y-o-y) by 9.5 per cent, 15.4 per cent and 6.7 per cent, respectively. In August, port traffic and diesel consumption increased by 4.4 per cent and 5.2 per cent, respectively.

[8] Indicators like cement production and steel consumption increased by 18.9 per cent (y-o-y) and 21.5 per cent (y-o-y), respectively, in August 2023.

[9] Production of capital goods increased by 4.6 per cent (y-o-y) in July, while imports of capital good expanded by 13.3 per cent (y-o-y) in August 2023. As per latest available information, banks have sanctioned new projects in roads, bridges, inland waterways, railways, electricity, ports, airports, chemical and fertilisers.

[10] On a seasonally adjusted basis, CU improved from 74.1 per cent in Q4:2022-23 to 75.4 per cent in Q1:2023-24. Unadjusted CU recorded a seasonal decline from 76.3 per cent in Q4:2022-23 to 73.6 per cent in Q1: 2023-24. The long-term average is 73.7 per cent which pertains to the period Q1:2008-09 to Q1:2023-24 excluding Q1:2020-21.

than that of last year (₹10.4 lakh crore). Merchandise exports and non-oil non-gold imports, however, contracted though at a moderated pace in August. Services exports expanded at a healthy pace.

On the demand front, steady expansion is seen in urban consumption while rural demand is showing signs of revival.[11] Looking ahead, domestic demand conditions are likely to benefit from sustained buoyancy in services, consumer and business optimism, government's continued thrust on capex, healthy balance sheets of banks and corporates, and supply chain normalisation. Headwinds from geopolitical tensions and geoeconomic fragmentation, volatility in global financial markets, global economic slowdown, and uneven monsoon, however, pose risks to the outlook. Taking all these factors into consideration, real GDP growth for 2023-24 is projected at 6.5 per cent with Q2 at 6.5 per cent; Q3 at 6.0 per cent; and Q4 at 5.7 per cent. The risks are evenly balanced. Real GDP growth for Q1:2024-25 is projected at 6.6 per cent.

Inflation

The heightened inflation levels in July and August at 7.4 per cent and 6.8 per cent respectively, were largely driven by food price pressures.[12] Vegetables, with a weight of around 6 per cent in the CPI basket, contributed to about one third of CPI headline inflation in July and to around one fourth of overall inflation in August. Sustained inflationary pressures in cereals, pulses, and spices added to the overall food inflation.

On the positive side, core inflation softened to 4.9 per cent during July-August 2023.[13] It has eased by around 140 basis points from its recent peak in January 2023. Further disinflation of the core component is critical for price stability. As evident from our survey, there is further progress on anchoring of inflation expectations which entered single digit zone for the first time since the COVID-19 pandemic.[14]

While near-term inflation is expected to soften on the back of vegetable price correction, especially in tomatoes, and the reduction in LPG prices, the future trajectory will be conditioned by a number of factors. For *kharif* crops, the area sown under pulses is below the level a year ago. *Kharif* onion production needs to be watched closely. Demand supply mismatches in spices are likely to keep these prices at elevated levels. The inflation trajectory will also be shaped by *El Niño* conditions and global food and energy prices. Together with global financial market volatility, these factors pose risks to the outlook. Taking into account these factors, CPI inflation is projected at 5.4 per cent for 2023-24, with Q2 at 6.4 per cent, Q3 at 5.6 per cent and Q4 at 5.2 per cent. The risks are evenly balanced. CPI inflation for Q1:2024-25 is projected at 5.2 per cent.

What do these Inflation and Growth Conditions mean for Monetary Policy?

Over the last one and half years, monetary policy actions broadly included compression of excess liquidity in the system, increase in policy repo rate by 250 basis points and change in policy stance to withdrawal of accommodation to keep inflation expectations anchored and break the stickiness of

[11] Expansion in urban demand is reflected in solid domestic air passenger traffic, passenger vehicle sales and household credit in August-September 2023. In indicators of rural demand, two-wheeler sales turned positive in August, tractor sales continued to expand while consumer non-durable goods posted a healthy growth in July.

[12] Food inflation rose from 4.7 per cent in June to 10.6 per cent in July and 9.2 per cent in August as vegetable prices moved out of deflation (-0.7 per cent, y-o-y) in June and jumped by 37.4 per cent (y-o-y) in July and 26.1 per cent (y-o-y) in August.

[13] Core inflation decreased with easing of inflationary pressures in sub-groups of clothing and footwear, housing, household goods and services, education and personal care and effects.

[14] Mooring of household inflation expectations has been underway since September 2022. Inflation expectations for three months ahead fell by 90 bps from 10.0 per cent (July 2023 round) to 9.1 per cent (September 2023 round) and by 40 bps for one year ahead from 10.3 per cent (July 2023 round) to 9.9 per cent (September 2023 round).

core inflation. Complementing these measures were proactive supply side interventions by the Government to improve domestic availability of key food items and reduce input costs.[15] Consequently, headline inflation moderated to 4.6 per cent in Q1:2023-24 as compared to 7.3 per cent in Q1:2022-23. A significant easing of inflation pressures from its exceptionally high level in July and August is expected to materialise in September as the impact of fleeting food price shocks wane. Further, underlying inflation pressures[16] are moderating while the impact of past monetary policy actions is still unfolding. Even so, indications are that throughout much of Q3:2023-24, food inflation pressures may not see a sustained easing. External factors like energy prices and financial market conditions continue to be volatile. All these call for careful monitoring of incoming data and the outlook to clearly delineate the durable components of price shocks from its transitory elements. Monetary policy has to be in absolute readiness to take appropriate and timely action to prevent any spillovers from food and fuel price shocks to underlying inflation trends and risks to anchoring of inflation expectations. These are non-negotiable necessities.

Liquidity and Financial Market Conditions

As I have reiterated several times in my previous policy statements, excessive liquidity[17] can pose risks to both price and financial stability. To ensure that liquidity conditions evolve in sync with the monetary policy stance, the Reserve Bank – as a temporary measure – had imposed an incremental cash reserve ratio (I-CRR) of 10 per cent which impounded about ₹1.1 lakh crore from the banking system. The I-CRR was reviewed on September 8 and is being discontinued in a phased manner, ending October 7, 2023.

Moderation in excess liquidity conditions as a result of the combined impact of I-CRR and advance tax outflows in September has resulted in greater recourse to the marginal standing facility (MSF) by banks.[18] Elevated levels of MSF borrowings amidst substantial funds parked under the standing deposit facility (SDF)[19] is symptomatic of skewed liquidity distribution in the banking system. This got reflected in the firming up of the weighted average call rate (WACR) – the operating target of monetary policy.[20] Despite such hardening at the short-end of the term structure, the average term spread in the G-sec market (10-year *minus* 91-day Treasury Bills) remained at around 40 basis points in August-September suggesting stable financial conditions.

In recent months, banks have preferred to place funds under the overnight SDF instead of offering them in the main 14-day variable rate reverse repo (VRRR) operations. It is imperative that banks assess their actual liquidity requirements over the reserve maintenance cycle and bid accordingly in the auctions under main 14-day VRRR operations. It is desirable that banks having surplus funds explore lending opportunities in the inter-bank call market rather than passively parking funds in the SDF at relatively less attractive rates. Greater volume of call money transactions would not only help in deepening the inter-bank money market but also lower the recourse of deficit banks to the MSF.

[15] These included restrictions on wheat and rice exports; exempting imports of pulses (*tur* and *urad*) from import duties; release of pulses *(chana dal)* at a discount to states and union territories; stock limits for wheat and pulses; reduction in import duties on various edible oils; additional procurement and discounted sale of tomatoes and onions; restricting sugar exports; and cut in excise duties for petrol and diesel.

[16] In terms of core inflation; other exclusion based and trimmed mean measures.

[17] Liquidity overhang was engendered by (i) the return of ₹2000 banknotes to the banking system; (ii) RBI's surplus transfer to the government; (iii) pick up in government spending; and (iv) capital inflows.

[18] Average borrowings under the MSF, which was ₹6,702 crore in July increased to ₹34,735 crore in August and further to ₹94,605 crore in September. Daily MSF borrowings peaked at ₹1.99 lakh crore on September 21, 2023.

[19] Average fund parked under SDF was at ₹1.06 lakh crore, ₹1.10 lakh crore and ₹0.76 lakh crore in July, August and September, respectively.

[20] On an average, the WACR hardened from 6.48 per cent in July to 6.58 per cent in August and further to 6.65 per cent in September.

The release of the remaining impounded I-CRR funds tomorrow along with pick-up in government spending are expected to ease liquidity conditions. Festival time increase in currency demand may, of course, act as a counterbalancing factor. It is a turning pitch and we will play our shots carefully. Going forward, while remaining nimble, we may have to consider OMO-sales (Open Market Operation sales) to manage liquidity, consistent with the stance of monetary policy. The timing and quantum of such operations will depend on the evolving liquidity conditions.

Financial Stability

The Indian banking system continues to be resilient, backed by improved asset quality, stable credit growth and robust earnings growth.[21] The credit growth is broad-based and backed by the strong fundamentals of financial institutions. The financial indicators of non-banking financial companies are also in line with that of the banking system as per the latest available data for June 2023. Certain components of personal loans are, however, recording very high growth. These are being closely monitored by the Reserve Bank for any signs of incipient stress. Banks and NBFCs would be well advised to strengthen their internal surveillance mechanisms, address the build-up of risks, if any, and institute suitable safeguards in their own interest. The need of the hour is robust risk management and stronger underwriting standards.

The global financial landscape is rapidly changing and potential stress may emerge from unanticipated corners. The Reserve Bank is closely monitoring the evolving situation and will act proactively to maintain financial stability.

External Sector

India's merchandise exports and imports have remained in the contractionary zone so far during 2023-24, although at a decelerated pace during July and August. Services exports grew at a healthy pace in Q1:2023-24 and remained strong during July and August 2023 driven by software and business services.[22] Inward remittances have risen by 5.8 per cent (y-o-y). The current account deficit (CAD) for Q1:2023-24 declined to 1.1 per cent of GDP from a year ago.[23] There was an accretion of US$ 24.4 billion to foreign exchange reserves on balance of payments (BOP) basis during Q1:2023-24.

On external financing, foreign portfolio investment (FPI) flows have seen a significant turnaround in 2023-24 with net FPI inflows at US$ 20.3 billion up to September 2023 as against net outflows in the preceding two years.[24] Net foreign direct investment (FDI), on the other hand, moderated to US$ 5.8 billion in April-July 2023 from US$ 17.3 billion a year ago. The inflows under external commercial borrowings (ECBs) witnessed a turnaround, with net inflows of US$ 4.5 billion during April-August 2023 as against net outflows of US$ 3.2 billion a year ago. The number and total amount of ECB agreements grew markedly during April-August 2023 with about 60 per cent of the total amount being raised for capital

[21] All key indicators of asset quality of scheduled commercial banks (SCBs) continue to improve on a sustained basis. Provisional data as of June 2023 indicate that gross non-performing assets (GNPA) and net non-performing assets (NNPA) ratios declined to a decadal low of 3.6 per cent and 0.9 per cent, respectively. Capital adequacy ratio (CRAR) of SCBs increased to 16.9 per cent in June 2023 from 16.2 per cent in June 2022. The slippage ratio, a primary indicator for standard assets turning NPAs during the quarter dipped to 1.6 per cent, the lowest after the COVID-19 outbreak. The return on asset (RoA) of SCBs increased to 1.3 per cent as of June 2023 from 0.9 per cent in June 2022, while the net interest margin (NIM) of SCBs improved to 3.8 per cent from 3.3 per cent over the same period. SCBs have enough high-quality liquid assets as the liquidity coverage ratio (LCR) of SCBs stood at 141.9 per cent as at the end of June 2023.

[22] Services exports grew by 5.9 per cent (Y-o-Y) in Q1. As per provisional data, services exports rose by 8.1 per cent and 8.4 per cent in July and August 2023, respectively.

[23] The CAD was 2.1 per cent of GDP in Q1:2022-23. On a sequential basis, however, CAD rose from 0.2 per cent of GDP in Q4:2022-23 as the trade deficit widened.

[24] Net outflows of US$ 14.1 billion in 2021-22 and US$ 4.8 billion in 2022-23.

expenditure. External vulnerability indicators[25] also indicate lower vulnerability in comparison with EME peers. India's foreign exchange reserves stood at US$ 586.9 billion as on September 29, 2023. We remain confident of meeting our external financing requirements comfortably.

Additional Measures

I shall now announce certain additional measures.

Prudential Framework for Income Recognition, Asset Classification and Provisioning pertaining to Advances - Projects Under Implementation

With a view to strengthen the extant regulatory framework governing project finance and to harmonise the instructions across all regulated entities, the extant prudential norms for projects under implementation have been reviewed. A comprehensive regulatory framework applicable for all regulated entities is now proposed to be issued. Detailed draft guidelines will be released for public comments.

Credit Concentration Norms – Credit Risk Transfer

At present, under the Large Exposures Framework, NBFCs in the Upper Layer are permitted to use Credit Risk Mitigation (CRM) instruments for reducing their exposures to a counterparty. With a view to harmonise the credit concentration norms among NBFCs, it has been decided to also permit NBFCs in the Middle and Base Layers to use CRM instruments for reducing their counterparty exposure under the credit concentration norms.

Gold Loan – Bullet Repayment Scheme – UCBs

It has been decided to increase the existing limit for Gold Loans under the Bullet Repayment scheme from ₹2 lakh to ₹4 lakh in respect of Urban Co-operative Banks (UCBs) who have met the overall target and sub-targets under the Priority Sector Lending (PSL) as on March 31, 2023. This measure is in pursuance of our earlier announcement that suitable incentives shall be provided to UCBs that have met the prescribed PSL targets as on March 31, 2023.

Framework for Recognition of SROs for Regulated Entities (REs) of Reserve Bank

Self-Regulatory Organisations (SROs) can play an important role in strengthening compliance culture among their members and also provide a consultative platform with the Reserve Bank for policy making. Therefore, it has been decided to issue a draft omnibus framework for recognising SROs for various categories of Regulated Entities (REs) of the Reserve Bank for stakeholder comments. Additional sector specific conditions may also be prescribed at the time of calling for applications.

Payments Infrastructure Development Fund – Extension of Scheme and Inclusion of PM *Vishwakarma* Scheme Beneficiaries

Since its launch in January 2021, the Payments Infrastructure Development Fund (PIDF) Scheme has enabled over 2.66 crore new payment touch points across the country. It has been decided to extend the scheme by two years, *i.e.*, up to December 31, 2025. The coverage of PIDF scheme is also being expanded (i) to include the beneficiaries of PM *Vishwakarma* Scheme; and (ii) to deploy emerging modes of payment acceptance, such as soundbox and *Aadhaar*-enabled biometric payment acceptance devices. These measures will further accelerate the Reserve Bank's efforts to promote digital payments at the grass root level.

Introduction of New Channels for Card-on-File Tokenisation (CoFT)

Given the growing acceptance and benefits of tokenisation of card data, it is now proposed to introduce Card-on-File Tokenisation (CoFT) creation

[25] External debt to GDP ratio was placed at 18.6 per cent at end-June 2023 and reserves to external debt ratio was 94.6 per cent. The reserve cover of imports are over 10 months.

facilities directly at the issuer bank level. This measure will enhance convenience for cardholders to get tokens created and linked to their existing accounts with various e-commerce applications.

Master Direction on Internal Ombudsman Mechanism in Regulated Entities

At present, the Internal Ombudsman (IO) framework in regulated entities comprises of separate guidelines for select Scheduled Commercial Banks (SCBs), Non-Bank issuers of Prepaid Payment Instruments (PPIs), NBFCs; and all Credit Information Companies (CICs). These guidelines have similar design features but vary in certain operational aspects. It has been decided to effect certain changes and also consolidate and harmonise the IO guidelines into a single master direction. This will further strengthen the customer grievance redress system of the regulated entities.

Conclusion

The Indian economy is forging ahead in a challenging global environment, drawing strength from its underlying macroeconomic fundamentals and buffers. While growth remains on track, the declining trend in inflation was interrupted in July-August 2023 due to price shocks in certain food items. Volatile energy and food prices in the wake of lingering geopolitical tensions and adverse weather conditions render uncertainty to the inflation outlook. We remain vigilant of the evolving inflation dynamics. I would like to emphatically reiterate that our inflation target is 4 per cent and not 2 to 6 per cent. Our aim is to align inflation to the target on a durable basis, while supporting growth. Our commitment to ensure financial stability reinforces our emphasis on price stability and anchoring of inflation expectations. This would keep inflation risk premium low and improve our competitiveness, productivity and growth potential. As we continue our journey ahead, we take inspiration from Mahatma Gandhi's profound words, *"If we keep that as our goal, we shall never despond, we shall never weaken; we shall ever go forward…"*[26]

Thank you. Namaskar.

[26] Mahatma Gandhi, Collected Works, Volume 12.