

*Fifth Bi-monthly Monetary  
Policy Statement, 2019-20  
Resolution of the Monetary  
Policy Committee (MPC)  
Reserve Bank of India \**

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (December 5, 2019) decided to:

- keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 5.15 per cent.

Consequently, the reverse repo rate under the LAF remains unchanged at 4.90 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 5.40 per cent.

- The MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target.

These decisions are 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.

The main considerations underlying the decision are set out in the statement below.

### **Assessment**

#### Global Economy

2. Since the MPC's meeting in October 2019, global economic activity has remained subdued, though some signs of resilience are becoming visible. Among the advanced economies (AEs), GDP growth in the US picked up in Q3 on strong private investment and

personal consumption expenditure. More recent data, however, indicate that factory activity contracted for the fourth consecutive month in November, while retail sales and industrial production declined in October. In the Euro area, GDP growth remained stable in Q3 relative to the previous quarter on improved household consumption and government spending, although manufacturing activity continued to struggle with lingering geo-political uncertainties. With weak global demand pulling down exports, the Japanese economy lost momentum in Q3. Economic activity in the UK accelerated in Q3, primarily driven by the services sector and construction activity.

3. Among emerging market economies (EMEs), GDP growth in China decelerated further in Q3, reflecting weak industrial production and declining exports amidst trade tensions with the US. While retail sales edged lower in October, fiscal and monetary stimuli are expected to temper the slowdown. In Russia, GDP growth accelerated in Q3 on the back of an upturn in agricultural output and industrial activity. In South Africa, economic activity contracted in Q3, pulled down by slowing mining and manufacturing activity. In Brazil, GDP growth accelerated further in Q3, driven by agriculture, industry and business investment activity.

4. Crude oil prices have moved in a narrow range in both directions since the last meeting of the MPC, reflecting changing sentiments relating to progress in US-China trade talks. Gold prices traded sideways before falling in early November as a revival of risk appetite eased safe haven demand. Inflation remained benign in major AEs and EMEs in Q3, except in China where it firmed up to its highest level in eight years.

5. Global financial markets were buoyed in October by risk-on sentiment stemming from renewed optimism on a trade truce between the US and China and possibility of a Brexit deal. In the US, equity markets rallied in this environment, also supported by better than expected corporate earnings and strong jobs data. Stock markets in EMEs too registered gains

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in October before some selling pressure took hold in the second half of November on renewed fears of US-China trade talks stalling on the Hong Kong stand-off. Bond yields in the US firmed up from early October on risk-on sell-offs; however, they softened from mid-November on waning hopes of a near-term resolution of trade disputes. Bond yields in the Euro area remained negative, but expectations that a no-deal Brexit is less likely improved sentiment. In EMEs, bond yields showed mixed movements, driven initially by optimism on US-China trade talks and country-specific factors. In currency markets, the US dollar weakened against other major currencies, while EME currencies have been trading with an appreciating bias.

#### Domestic Economy

6. On the domestic front, gross domestic product (GDP) growth moderated to 4.5 per cent year-on-year (y-o-y) in Q2:2019-20, extending a sequential deceleration to the sixth consecutive quarter. Real GDP growth was weighed down by a sharp slowdown in gross fixed capital formation (GFCF), cushioned by a jump in government final consumption expenditure (GFCE). Excluding GFCE, GDP growth would have been at 3.1 per cent. Growth in real private final consumption expenditure (PFCE) recovered from an 18-quarter trough. The drag from net exports eased on account of a sharper contraction in imports than in exports.

7. On the supply side, gross value added (GVA) growth decelerated to 4.3 per cent in Q2:2019-20, pulled down by a contraction in manufacturing. The slowdown in manufacturing activity was also reflected in a decline in capacity utilisation (CU) to 68.9 per cent in Q2:2019-20 from 73.6 per cent in Q1 in the early results of the Reserve Bank's order books, inventories and capacity utilisation survey (OBICUS). Seasonally adjusted CU also fell to 69.8 per cent from 74.6 per cent during the same period. Growth in the services sector moderated, weighed down mainly by trade, hotels, transport, communication, broadcasting

services and construction activity. However, growth in public administration, defence and other services accelerated in line with the surge in government final consumption expenditure. Agricultural GVA growth increased marginally, despite contraction in kharif foodgrains production in the first advance estimates.

8. Looking beyond Q2, rabi sowing is catching up from the setback caused by delay in kharif harvesting and unseasonal rainfall in October and early November. By November 29, it was only 0.5 per cent lower than the acreage covered a year ago. North-east monsoon precipitation was 34 per cent above the long-period average up to December 4. Storage in major reservoirs, the main source of irrigation during the rabi season, was at 86 per cent of the full reservoir level as on November 28 as compared with 61 per cent in the same period a year ago.

9. Contraction in output of eight core industries – which constitute 40 per cent of the index of industrial production (IIP) – extended into the second consecutive month in October and became more pronounced, dragged down by coal, electricity, cement, natural gas and crude oil. However, output of fertilisers rose sharply, reflecting expectations of robust sowing activity in the rabi season. According to the early results of the Reserve Bank's industrial outlook survey, overall sentiment in the manufacturing sector remained in pessimism in Q3:2019-20 due to continuing downbeat sentiments on production, domestic and external demand, and the employment scenario. The purchasing managers' index (PMI) for manufacturing increased from 50.6 in October to 51.2 in November 2019, driven up by an increase in new orders and output.

10. High frequency indicators suggest that service sector activity generally remained weak in October. Tractors and motorcycles sales – indicators of rural demand – continued to contract but at a moderated pace; however, passenger vehicle sales – an indicator of urban demand – posted a slender positive growth in October after 11 months of decline, reflecting

festival season demand and promotional measures by auto companies. Commercial vehicle sales and railway freight traffic contracted. The PMI for services remained in negative zone in October (49.2) due to a decline in new export business and turning down of business expectations. However, it moved into expansion zone to 52.7 in November on a pick-up in new business.

11. Retail inflation, measured by y-o-y changes in the CPI, increased sharply to 4.6 per cent in October, propelled by a surge in food prices. Fuel group prices remained in deflation, while inflation in CPI excluding food and fuel moderated further from its level a month ago.

12. Turning to the drivers of CPI, food inflation spiked to 6.9 per cent in October – a 39-month high – pushed up by a sharp increase in prices of vegetables due to heavy unseasonal rains. Prices of onions, in particular, shot up by 45.3 per cent in September and further by 19.6 per cent in October. Inflation in several other food items such as fruits, milk, pulses and cereals also increased, reflecting diverse factors – the cost push of fodder prices in the case of milk; decline in production and sowing area of pulses; and minimum support price effects. Sugar and confectionery prices moved out of deflation in October as sugarcane output shrank on a y-o-y basis.

13. Fuel group prices remained weak for the fourth consecutive month in October due to deflation in prices of LPG, firewood and chips. Electricity prices, however, picked up in October following a rise in user charges by power distribution companies (DISCOMs) across 13 states as reflected in the CPI.

14. Inflation in CPI excluding food and fuel softened further from 4.2 per cent in September to 3.4 per cent in October, primarily due to favourable base effects. Price increases also moderated across several services as reflected in transportation fares, telephone charges, tuition fees and house rentals.

15. Households' inflation expectations, measured

by the Reserve Bank's November 2019 round of the survey, increased by 120 basis points over the 3-month ahead horizon and 180 basis points over the 1-year ahead horizon as they adapted to the spike in food prices in recent months. Based on the Reserve Bank's consumer confidence survey, spending on non-essential items of consumption has shrunk compared to a year ago; however, consumers expect their overall spending to remain unchanged going forward largely due to an increase in prices. Manufacturing firms polled in the industrial outlook survey of the Reserve Bank expect (i) weak demand conditions and reduced input price pressures in Q3:2019-20 and Q4; and (ii) muted output prices reflecting further weakening of pricing power.

16. Overall liquidity in the system remained in surplus in October and November 2019 despite an expansion of currency in circulation due to festival demand. Average daily net absorption under the LAF amounted to ₹1,98,566 crore in October. The Centre availed of ways and means advances (WMA) in the first week and the last three days of the month to fund its expenditure. In November, the average daily net absorption of surplus liquidity soared to ₹2,40,566 crore with more frequent and larger recourse to WMA by the Government. Consequently, the Reserve Bank decided to conduct longer-term variable rate reverse repo auctions with effect from November 4, 2019 in addition to overnight variable rate reverse repo auctions. So far, four longer term reverse repo auctions have been conducted – two auctions of 21 days tenor and one each of 35 days and 42 days tenor – absorbing ₹78,934 crore. Reflecting easy liquidity conditions, the weighted average call rate (WACR) traded below the policy repo rate (on an average) by 8 basis points (bps) in October and by 10 bps in November.

17. Monetary transmission has been full and reasonably swift across various money market segments and the private corporate bond market. As against the cumulative reduction in the policy

repo rate by 135 bps during February-October 2019, transmission to various money and corporate debt market segments ranged from 137 bps (overnight call money market) to 218 bps (3-month CPs of non-banking finance companies). Transmission to the government securities market, however, has been partial at 113 bps (5-year government securities) and 89 bps (10-year government securities). Credit market transmission remains delayed but is picking up. The 1-year median marginal cost of funds-based lending rate (MCLR) has declined by 49 basis points. The weighted average lending rate (WALR) on fresh rupee loans sanctioned by banks declined by 44 basis points, while the WALR on outstanding rupee loans increased by 2 basis points during this period. However, transmission is expected to improve going forward as (i) the share of base rate loans, interest rates on which have remained sticky, declines; and (ii) MCLR-based floating rate loans, which typically have annual resets, become due for renewal.

18. After the introduction of the external benchmark system, most banks have linked their lending rates to the policy repo rate of the Reserve Bank. The median term deposit rate has declined by 47 bps during February-November 2019. The weighted average term deposit rate declined by 9 bps in October as against a decline of just 7 bps in eight months during February-September. This augurs well for transmission to lending rates, going forward.

19. Exports contracted in September-October 2019, reflecting the persisting weakness in global trade. Excluding petroleum products, however, the decline in exports was less pronounced and, in fact, non-oil export growth returned to positive territory in October after a hiatus of two months. Imports contracted faster than exports, with lower international crude oil prices resulting in a decline in the oil import bill. A sharp contraction in the volume of gold imports kept outgoes on this account in check. Non-oil non-gold imports also contracted, pulled down by electronics, coal and pearls and

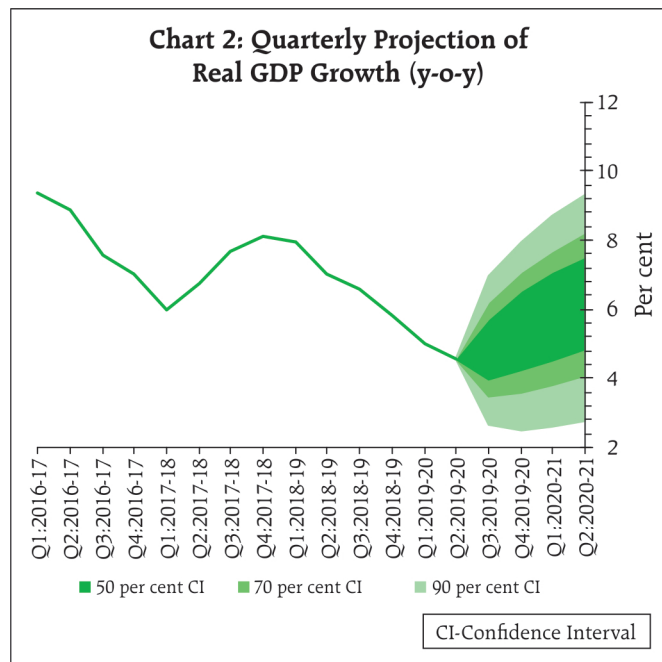
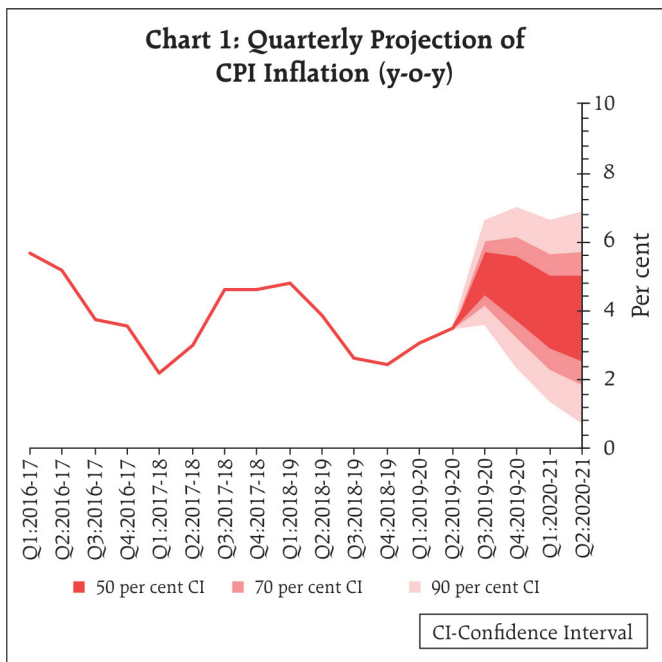
precious stones. Reflecting these developments, the trade deficit narrowed in September-October. On the financing side, net foreign direct investment rose to US\$ 20.9 billion in H1:2019-20 from US\$ 17.0 billion a year ago. Net foreign portfolio investment was of the order of US\$ 8.8 billion in April-November 2019 as against net outflows of US\$ 14.9 billion in the same period of last year. In addition, net investment by FPIs under the voluntary retention route have amounted to US\$ 6.3 billion since March 11, 2019. Net disbursements of external commercial borrowings rose to US\$ 11.5 billion during April-October 2019 as against US\$ 1.2 billion during the same period a year ago. India's foreign exchange reserves were at US\$ 451.7 billion on December 3, 2019 – an increase of US\$ 38.8 billion over end-March 2019.

### Outlook

20. In the fourth bi-monthly resolution of October 2019, CPI inflation was projected at 3.4 per cent for Q2:2019-20, 3.5-3.7 per cent for H2:2019-20 and 3.6 per cent for Q1:2020-21 with risks evenly balanced. The actual inflation outcome for Q2 evolved broadly in line with projections – averaging 3.5 per cent. The inflation print for October, however, was much higher than expected.

21. Going forward, the inflation outlook is likely to be influenced by several factors. First, the upsurge in prices of vegetables is likely to continue in immediate months; however, a pick-up in arrivals from the late kharif season along with measures taken by the Government to augment supply through imports should help soften vegetables prices by early February 2020. Second, incipient price pressures seen in other food items such as milk, pulses, and sugar are likely to be sustained, with implications for the trajectory of food inflation. Third, both the 3-month and 1-year ahead inflation expectations of households polled by the Reserve Bank have risen and these latent sentiment upsides are being reflected in other surveys as well. Fourth, domestic financial markets have exhibited volatility. Fifth, domestic demand





has slowed down, which is being reflected in the softening of inflation excluding food and fuel. Sixth, crude oil prices are expected to remain range bound, barring any supply disruptions due to geo-political tensions. Taking into consideration these factors, the CPI inflation projection is revised upwards to 5.1-4.7 per cent for H2:2019-20 and 4.0-3.8 per cent for H1:2020-21, with risks broadly balanced (Chart 1).

22. Turning to the growth outlook, real GDP growth for 2019-20 in the October policy was projected at 6.1 per cent – 5.3 per cent in Q2:2019-20 and in the range of 6.6-7.2 per cent for H2:2019-20 – with risks evenly balanced; and 7.2 per cent for Q1:2020-21. GDP growth for Q2:2019-20 turned out to be significantly lower than projected. Various high frequency indicators suggest that domestic and external demand conditions have remained weak. Based on the early results, the business expectations index of the Reserve Bank’s industrial outlook survey indicates a marginal pickup in business sentiments in Q4. On the positive side, however, monetary policy easing since February 2019 and the measures initiated by the Government over the last few months are expected to revive sentiment and spur domestic demand. Taking into consideration these factors, real

GDP growth for 2019-20 is revised downwards from 6.1 per cent in the October policy to 5.0 per cent – 4.9-5.5 per cent in H2 and 5.9-6.3 per cent for H1:2020-21 (Chart 2). While improved monetary transmission and a quick resolution of global trade tensions are possible upsides to growth projections, a delay in revival of domestic demand, a further slowdown in global economic activity and geo-political tensions are downside risks.

23. The MPC notes that economic activity has weakened further and the output gap remains negative. However, several measures already initiated by the Government and the monetary easing undertaken by the Reserve Bank since February 2019 are gradually expected to further feed into the real economy. Data on corporate finance and on projects sanctioned by banks and financial institutions suggest some early signs of recovery in investment activity, though its sustainability needs to be watched closely. The need at this juncture is to address impediments, which are holding back investments. The introduction of external benchmarks is expected to strengthen monetary transmission. In this context, there is also a need for greater flexibility in the adjustment in interest rates on small saving schemes. In the

judgement of the MPC, inflation is rising in the near-term, but it is likely to moderate below target by Q2:2020-21. It is, therefore, prudent to carefully monitor incoming data to gain clarity on the inflation outlook. Similarly, the forthcoming union budget will provide better insight into further measures to be undertaken by the Government and their impact on growth.

24. The MPC recognises that there is monetary policy space for future action. However, given the evolving growth-inflation dynamics, the MPC felt it appropriate to take a pause at this juncture. Accordingly, the MPC

decided to keep the policy repo rate unchanged and continue with the accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target.

25. All members of the MPC – Dr. Chetan Ghate, Dr. Pami Dua, Dr. Ravindra H. Dholakia, Dr. Michael Debabrata Patra, Shri Bibhu Prasad Kanungo and Shri Shaktikanta Das – voted in favour of the decision.

26. The minutes of the MPC's meeting will be published by December 19, 2019.

27. The next meeting of the MPC is scheduled during February 4-6, 2020.

## **Statement on Developmental and Regulatory Policies**

This Statement sets out various developmental and regulatory policy measures for strengthening regulation and supervision; broadening and deepening of financial markets; and improving payment and settlement systems.

### **I. Regulation and Supervision**

#### **1. Primary (Urban) Co-operative Banks – Exposure Limits and Priority Sector Lending**

With a view to reducing concentration risk in the exposures of primary (urban) co-operative banks (UCBs) and to further strengthen the role of UCBs in promoting financial inclusion, it is proposed to amend certain regulatory guidelines relating to UCBs. The guidelines would primarily relate to exposure norms for single and group/interconnected borrowers, promotion of financial inclusion, priority sector lending, etc. These measures are expected to strengthen the resilience and sustainability of UCBs and protect the interest of depositors. An appropriate timeframe will be provided for compliance with the revised norms. A draft circular proposing the above changes for eliciting stakeholder comments will be issued shortly.

#### **2. Primary (Urban) Co-operative Banks - Reporting to Central Repository of Information on Large Credits (CRILC)**

The Reserve Bank has created a Central Repository of Information on Large Credits (CRILC) of scheduled commercial banks, all India financial institutions and certain non-banking financial companies with multiple objectives, which, among others, include strengthening offsite supervision and early recognition of financial distress. With a view to building a similar database of large credits extended by primary (urban) co-operative banks (UCBs), it has been decided to bring UCBs with assets of ₹500 crores and above under the CRILC reporting framework. Detailed instructions in this regard will be issued by December 31, 2019.

#### **3. Comprehensive Cyber Security Framework for Primary (Urban) Co-operative Banks (UCBs) – A Graded Approach**

The Reserve Bank had prescribed a set of baseline cyber security controls for primary (Urban) cooperative banks (UCBs) in October 2018. On further examination, it has been decided to prescribe a comprehensive cyber security framework for the UCBs, as a graded approach, based on their digital depth and interconnectedness with the payment systems landscape, digital products offered by them and assessment of cyber security risk. The framework would mandate implementation of progressively stronger security measures based on the nature, variety and scale of digital product offerings of banks. Such measures would, among others, include implementation of bank specific email domain; periodic security assessment of public facing websites/applications; strengthening the cybersecurity incident reporting mechanism; strengthening of governance framework; and setting up of Security Operations Center (SOC). This would bolster cyber security preparedness and ensure that the UCBs offering a range of payment services and higher Information Technology penetration are brought at par with commercial banks in addressing cyber security threats.

Detailed guidelines in this regard will be issued by December 31, 2019.

#### **4. Development of Secondary Market for Corporate Loans – setting up of Self-Regulatory Body**

As recommended by the Task Force on Development of Secondary Market for Corporate Loans, the Reserve Bank will facilitate the setting up of a self-regulatory body (SRB) as a first step towards the development of the secondary market for corporate loans. The SRB will be responsible, inter-alia, for standardising documents, covenants and practices related to secondary market transactions in corporate loans and promoting the growth of the secondary market in line with regulatory objectives.

### 5. On Tap Licensing of Small Finance Banks

In the Second Bi-monthly Monetary Policy Statement, 2019-20 of June 06, 2019, it was announced that the Draft Guidelines for 'On tap' Licensing of Small Finance Banks will be issued by the end of August 2019. Accordingly, the Draft Guidelines were placed on the RBI's website on September 13, 2019 inviting comments from the stakeholders and members of the public. After examining the responses received, the 'On tap' Licensing Guidelines for Small Finance Banks have now been finalised and are being issued today.

### 6. International Financial Service Centre Banking Unit (IBU)

With a view to facilitating ease of operations for IBUs and having regard to the Liquidity Coverage Ratio being maintained by them, it has been decided to allow IBUs to:

- i. open foreign currency current accounts of their corporate borrowers subject to the provisions of FEMA 1999 and regulations issued thereunder, wherever applicable; and
- ii. accept fixed deposits in foreign currency of tenor less than one year from non-bank entities and consequently remove the current restriction on premature withdrawal of deposits.

However, the current prohibition on acceptance of retail deposits including from high net worth individuals (HNIs) will continue. Necessary instructions are being issued shortly.

### 7. Review of NBFC-P2P Directions- Aggregate Lender Limit and escrow accounts

The Reserve Bank had issued directions for Non-Banking Financial Company-Peer to Peer Lending platform (NBFC-P2P) on October 4, 2017. At present, the aggregate limits for both borrowers and lenders across all P2P platforms stand at ₹10 lakh, whereas exposure of a single lender to a single borrower is capped at ₹50,000 across all NBFC-P2P platforms. A review of the functioning of the lending platforms

and lending limit was carried out and it has been decided that in order to give the next push to the lending platforms, the aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, shall be subject to a cap of ₹50 lakh. Further, it is also proposed to do away with the current requirement of escrow accounts to be operated by bank promoted trustee for transfer of funds having to be necessarily opened with the concerned bank. This will help provide more flexibility in operations. Necessary instructions in this regard will be issued shortly.

### 8. Baseline Cyber Security Controls for ATM Switch application service providers of RBI regulated entities

A number of commercial banks, urban cooperative banks and other regulated entities are dependent upon third party application service providers for shared services for ATM Switch applications. Since these service providers also have exposure to the payment system landscape and are, therefore, exposed to the associated cyber threats, it has been decided that certain baseline cyber security controls shall be mandated by the regulated entities in their contractual agreements with these service providers. The guidelines would require implementation of several measures to strengthen the process of deployment and changes in application softwares in the ecosystem; continuous surveillance; implementation of controls on storage, processing and transmission of sensitive data; building capacity for forensic examination; and making the incident response mechanism more robust. Detailed guidelines in this regard will be issued by December 31, 2019.

## II. Financial Markets

### 9. Hedging of foreign exchange risk by residents and non-residents – Issue of final guidelines

An announcement regarding the review of foreign exchange hedging facilities was made in February 2019, followed by issue of draft regulations for public



comments on February 15, 2019. The Task Force on Offshore Rupee markets (Chairperson: Smt. Usha Thorat) also suggested some changes based on its review. The draft regulations have been modified based on the feedback and the recommendations of the Task Force. The important changes are as follows:-

- Users may undertake over the counter (OTC) currency derivative transactions up to USD 10 million, without the need to evidence underlying exposure.
- Banks shall be provided with the discretion, in exceptional circumstances, to pass on net gains on hedge transactions booked on anticipated exposures.
- Strengthening of the safeguards to ensure, that complex derivatives are sold only to users that are capable of managing the risks.

The final directions will be issued after notification of the changes to Foreign Exchange Management Act (FEMA) Regulations.

### **III. Payment and Settlement System**

#### **10. New Pre-Paid Payment Instruments (PPI)**

Prepaid Payment Instruments (PPIs) have been playing an important role in promoting digital payments. To further facilitate its usage, it is proposed to introduce a new type of PPI which can be used only for purchase of goods and services up to a limit of ₹10,000. The loading / reloading of such PPI will be only from a bank account and used for making only digital payments such as bill payments, merchant payments, etc. Such PPIs can be issued on the basis of essential minimum details sourced from the customer. Instructions in this regard will be issued by December 31, 2019.