*Governor's Statement**

Shaktikanta Das

In my statement of May 4, 2022, I had mentioned that as we navigate through this difficult period, it is necessary to be sensitive to the new realities and incorporate them into our thinking. The war in Europe is lingering and we are facing newer challenges each passing day which is accentuating the existing supply chain disruptions. As a result, food, energy and commodity prices remain elevated. Countries across the world are facing inflation at decadal highs and persistent demand-supply imbalances. The war has led to globalisation of inflation. Not surprisingly, central banks are reorienting and recalibrating their monetary policies. Emerging market economies (EMEs) are facing bigger challenges from increased market turbulence, monetary policy shifts in advanced economies (AEs) and their spillovers. The process of economic recovery in EMEs is also getting affected.

During these difficult and challenging times, the Indian economy has remained resilient, supported by strong macroeconomic fundamentals and buffers. The recovery has gained momentum despite the pandemic and the war. On the other hand, inflation has steeply increased much beyond the upper tolerance level. A large part of the rise in inflation is primarily attributed to a series of supply shocks linked to the war. In these circumstances, we have started a gradual and orderly withdrawal of extraordinary accommodation instituted during the pandemic.

Similar to our resolute and timely actions to limit the economic damage emanating from the COVID-19 pandemic, the Reserve Bank will continue to be proactive and decisive in mitigating the fallout of the ongoing geopolitical crisis on our economy. We have already reprioritised our policies to control inflation, without losing sight of the growth requirements. Our approach underscores a commitment to move towards normal monetary conditions in a calibrated manner. We will remain focused on bringing down inflation closer to the target and fostering macroeconomic stability.

Decisions and Deliberations of the Monetary Policy Committee

Against this background, the Monetary Policy Committee (MPC) met on 6th, 7th and 8th June 2022. Based on an assessment of the macroeconomic situation and the outlook, the MPC voted unanimously to increase the policy repo rate by 50 basis points to 4.90 per cent, with immediate effect. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.65 per cent; and the marginal standing facility (MSF) rate and the Bank Rate to 5.15 per cent. The MPC also decided unanimously to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Let me now explain the MPC's rationale for its decisions on the policy rate and the stance. The protracted war in Europe and the accompanying sanctions have kept global commodity prices elevated across the board. This is exerting sustained upward pressure on consumer price inflation, well beyond the targets in many economies. The ongoing war is also turning out to be a dampener for global trade and growth. The faster pace of monetary policy normalisation undertaken by systemic advanced economies (AEs) is leading to heightened volatility in global financial markets. This is reflected in sharp corrections in major equity markets, sizeable swings in sovereign bond yields, US dollar appreciation, capital outflows from EMEs and even from some AEs. The EMEs are also witnessing depreciation of their currencies. Globally, stagflation concerns are growing and are amplifying the volatility in global financial

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markets. This is feeding back into the real economy and further clouding the outlook.

The MPC noted that, in such a challenging global environment, domestic economic activity is gaining traction, while inflation pressures have intensified further. The upside risks to inflation as highlighted in the April and May 2022 policies have materialised earlier than anticipated – both in terms of timing and magnitude. Inflationary pressures have become broad-based and remain largely driven by adverse supply shocks. There are growing signs of a higher pass-through of input costs to selling prices. The MPC noted that inflation is likely to remain above the upper tolerance band of 6 per cent through the first three quarters of 2022-23.

In this context, supply side measures taken by the government in reducing excise duties on petrol and diesel, along with the other measures would help in mitigating the inflationary pressures to some extent. The MPC also recognised that sustained high inflation could unhinge inflation expectations and trigger second round effects. It, therefore, judged that further monetary policy measures are necessary to anchor the inflation expectations. Accordingly, the MPC decided to increase the policy repo rate by 50 basis points to 4.90 per cent. The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. It may be noted in this context that the repo rate still remains below its pre-pandemic level.

Assessment of Growth and Inflation

Growth

According to the provisional estimates released by the National Statistical Office (NSO) on May 31, 2022, India's real gross domestic product (GDP) growth in 2021-22 is estimated at 8.7 per cent. The level of real GDP in 2021-22 has exceeded the pre-pandemic (2019-20) level. On the supply side, major categories also surpassed the 2019-20 levels.

Available information for April and May 2022 indicates that the recovery in domestic economic activity remains firm, with growth impulses getting increasingly broad based. Manufacturing and services purchasing managers' indices (PMIs) for May point towards further expansion of activity. This is also corroborated by movements in railway freight and port traffic, domestic air traffic, GST collections, steel consumption, cement production and bank credit. While urban demand is recovering, rural demand is gradually improving. The contact-intensive services related to trade, hotels and transport have recovered in Q4:2021-22. Going by the early results of our surveys, capacity utilisation (CU) in the manufacturing sector increased further to 74.5 per cent in Q4:2021-22 from 72.4 per cent in Q3:2021-22. Capacity utilisation is also likely to increase further in 2022-23. Investment activity is thus expected to strengthen, driven by rising capacity utilisation, government's capex push and deleveraged corporate balance sheets. Improvement in investment activity is also reflected in pick-up in demand for bank credit and persisting growth in imports of capital goods. Merchandise exports have remained buoyant with double digit growth for the fifteenth successive month in May, while high growth of non-oil non-gold imports is indicative of recovery in domestic demand conditions.

Looking ahead, real GDP is expected to broadly evolve on the lines of the April 2022 MPC resolution. The forecast of normal south-west monsoon should boost kharif sowing and agricultural output. This will support rural consumption. The rebound in contact-intensive services is expected to sustain urban consumption. Our surveys suggest further improvement in consumer confidence and households' optimism for the outlook a year ahead. Business sentiment remains upbeat according to early results of our surveys. Nevertheless, the negative spillovers from geopolitical tensions; elevated international commodity prices; rising input costs; tightening of global financial conditions; and slowdown in world economy continue to weigh on the outlook. Taking all these factors into consideration, the real GDP growth for 2022-23 is retained at 7.2 per cent, with Q1 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, with risks broadly balanced.

Inflation

The CPI headline inflation in April registered a further sharp increase to 7.8 per cent. It was the fourth consecutive month when inflation touched or was above the upper tolerance level of 6 per cent. The surge in headline inflation was seen across all major categories.

The global geopolitical situation remains fluid and commodity markets remain on the edge, rendering heightened uncertainty to the domestic inflation outlook. Certain positive developments on the prices front in recent weeks may help to ease the acute price pressures to some extent. These would include expectations of a normal south-west monsoon and kharif agricultural season; the recent supply side measures taken by the government and the unfolding of their impact; lifting of the palm oil export ban by Indonesia; and signs of moderation in global industrial metal price indices. Our quick survey of urban households undertaken after the excise duty cuts on petrol and diesel on May 21, 2022 shows a significant moderation in their inflation expectations: declines of 190 basis points in their three months ahead expectations and 90 basis points in one year ahead expectations. In such a scenario, further reduction of State VATs on petrol and diesel across the country can certainly contribute to softening of the inflationary pressures as well as expectations.

Notwithstanding these positive developments, upside risks to inflation do persist. These risks emanate from elevated commodity prices; revisions in electricity tariffs across many states; high domestic poultry and animal feed costs; continuing trade and supply chain bottlenecks; rising pass-through of input costs to selling prices in the manufacturing and services sectors; the recent spike in tomato prices which are adding to food inflation; and most important of all, the elevated international crude oil prices. With the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel, inflation is now projected at 6.7 per cent in 2022-23, with Q1 at 7.5 per cent; Q2 at 7.4 per cent; Q3 at 6.2 per cent; and Q4 at 5.8 per cent, with risks evenly balanced. It may be noted that around 75 per cent of the increase in inflation projections can be attributed to the food group. Further, the baseline inflation projection of 6.7 per cent for 2022-23 does not take into account the impact of monetary policy actions taken today.

Between February and April, headline inflation has increased by about 170 basis points. With no resolution of the war in sight and the upside risks to inflation, prudent monetary policy measures would ensure that the second-round effects of supply side shocks on the economy are contained and long-term inflation expectations remain firmly anchored and inflation gradually aligns close to the target. The monetary policy actions including withdrawal of accommodation will be calibrated keeping in mind the requirements of the ongoing economic recovery.

Liquidity and Financial Market Guidance

I would now like to touch upon liquidity and financial market conditions. It may be recalled that in April we introduced the Standing Deposit Facility (SDF) as the floor of the liquidity adjustment facility (LAF) corridor at an interest rate of 3.75 per cent. This was effectively a rate hike of 40 basis points over the fixed rate reverse repo of 3.35 per cent. As a result, the weighted average call money rate (WACR) – the operating target of monetary policy – moved from an average of 3.32 per cent in March 2022 to 3.54 per cent during April 8-30. Following the repo rate hike of 40 bps on May 4, the WACR has further increased, averaging 4.07 per cent during May 5-31.

In line with the emphasis on gradual withdrawal of accommodation articulated in the April and May MPC resolutions, systemic liquidity has moderated in the recent period. Surplus liquidity, as reflected in average daily absorption under the liquidity adjustment facility (LAF) – that is, the absorption under SDF and variable rate reverse repo (VRRR) of 14 days and 28 days – at ₹5.5 lakh crore during May 4-May 31 was lower than ₹7.4 lakh crore during April 8-May 3, 2022. Nevertheless, the overhang of excess liquidity has resulted in overnight money market rates, on an average, trading below the policy repo rate. At the longer end of the money market term structure, interest rates on 91-day treasury bills, commercial papers (CPs) and certificates of deposit (CDs) firmed up post the rate hike in May. Yields on AAA rated 5-year corporate bonds have also increased. The rate hike also triggered an upward adjustment in the benchmark lending rates by banks. The term deposit rates of banks have increased and will augment stable funding resources amidst increasing credit demand.

Going ahead, while normalising the pandemic related extraordinary liquidity accommodation over a multi-year time frame, the Reserve bank will ensure availability of adequate liquidity to meet the productive requirements of the economy. The Reserve Bank will also remain focussed on orderly completion of the government's borrowing programme.

A direct fallout of the geopolitical tensions and the rapid pace of policy normalisation by AEs is the exodus of portfolio capital flows from most of the EMEs. Several EME currencies have thus faced depreciation pressures. Safe haven demand for the US dollar has increased. Amidst all these, the Indian Rupee has moved in an orderly fashion and has depreciated by 2.5 per cent against the US dollar during the current financial year so far – faring much better than many of its EME peers.

The Indian banking system also remains strong and its health has improved in recent years as reflected in key indicators – capital adequacy, asset quality, provisioning coverage and profitability. Bank credit offtake has gradually improved in the recent months, supported by both resilience of the banking system and progressive normalisation of economic activity. The strength of the banking sector and deleveraged corporate balance sheets will help us in sustaining the economic recovery.

External Sector

India's exports have performed exceptionally well despite weakening recovery across major trading partners. The impact of rising crude oil prices on petroleum, oil and lubricants (POL) import bill has been partly offset by export of petroleum products, which also benefitted from better price realisations in recent months. Optimism on exports of both goods and services and remittances should help contain the current account deficit (CAD) at a sustainable level, which can be financed by normal capital flows. As on June 3, 2022, India's foreign exchange reserves were of the order of US$ 601.1 billion, which are further supplemented by a healthy level of net forward assets of the RBI.

Additional Measures

I shall now announce certain additional measures, the details of which are set out in the statement on developmental and regulatory policies (Part-B) of the Monetary Policy Statement. The additional measures are as follows.

Regulatory Measures – Cooperative banks

Considering the importance of cooperative banks in promoting inclusive growth, three measures are being announced for the cooperative banking sector:

i. The limits for individual housing loans being extended by Urban Cooperative Banks (UCBs) and Rural Cooperative Banks (RCBs-

State Cooperative Banks and District Central Cooperative Banks) which were last fixed in 2011 and 2009 respectively are being revised upwards by over 100 per cent taking into account increase in house prices. This will facilitate better flow of credit to the housing sector.

ii. In line with the dispensation available to Scheduled Commercial Banks (SCBs) and UCBs, it is now proposed to permit Rural Cooperative Banks (RCBs- State Cooperative Banks and District Central Cooperative Banks) to extend finance to 'commercial real estate – residential housing' (i.e. loans for residential housing projects), within the existing aggregate housing finance limit of 5% of their total assets. This measure will further augment credit flows from the cooperative banks to the housing sector.

iii. It has also been decided to permit UCBs to extend doorstep banking services to their customers. This will enable UCBs to meet the needs of their customers, especially senior citizens and differently abled.

Margin Requirements for Non-Centrally Cleared Derivatives (NCCDs)

With the objective of strengthening the resilience of OTC derivative market and in line with G20 reforms, the Reserve Bank is putting in place margin requirements for non-centrally cleared OTC derivatives. In the first phase, the Directions on the Exchange of Variation Margin (VM) for NCCDs were issued on June 1, 2022, after consultation with stakeholders. In the second phase, it is now proposed to mandate the requirements for exchange of Initial Margin (IM) for such derivatives. To garner feedback from stakeholders on these requirements, Draft Directions on Exchange of Initial Margin for NCCDs will be issued shortly.

e-Mandates on Cards for Recurring Payments – Limit Enhancement

The framework for processing of e-mandate based recurring payments was introduced by the Reserve Bank, keeping in mind the benefits of convenience, safety and security to the users. Under this framework, over 6.25 crore mandates have been registered in favour of a large number of domestic and over 3,400 international merchants. To further facilitate recurring payments like subscriptions, insurance premia, education fee, etc. of larger value under the framework, the limit is being enhanced from ₹5,000 to ₹15,000 per transaction. This will further leverage the benefits available under the framework and augment customer convenience.

Unified Payments Interface (UPI) – Linking of RuPay Credit Cards

UPI has become the most inclusive mode of payment in India with over 26 crore unique users and 5 crore merchants on the platform. In May 2022 alone, about 594 crore transactions amounting to ₹10.4 lakh crore were processed through UPI. At present, UPI facilitates transactions by linking savings/current accounts through users' debit cards. It is now proposed to allow linking of credit cards on the UPI platform. To begin with, the Rupay credit cards will be linked to the UPI platform. This will provide additional convenience to users and enhance the scope of digital payments.

Review of Payments Infrastructure Development Fund Scheme

The Payments Infrastructure Development Fund (PIDF) Scheme was operationalised by the Reserve Bank in January 2021 to incentivise the deployment of payment acceptance infrastructure such as physical Point of Sale (PoS), mPoS (mobile PoS), Quick Response (QR) codes in Tier-3 to 6 centres and North Eastern States. Beneficiaries of PM SVANidhi Scheme in Tier-1 and 2 centres were included in August 2021. As at end-April 2022, over 1.18 crore new touch points have been deployed under the Scheme against a target of 90 lakh touch points to be deployed over three years (till end-2023). It is now proposed to make modifications to the PIDF scheme by enhancing the subsidy amount, simplifying the subsidy claim process and other steps. This will further accelerate and augment the deployment of payment acceptance infrastructure in the targeted geographies.

Concluding Remarks

Experience teaches us that preserving price stability is the best guarantee to ensure lasting growth and prosperity. Our actions today will impart further credibility to our medium-term inflation target, which is the central tenet of a flexible inflation targeting framework. India's recovery is proceeding apace, offering us space for an orderly policy shift. While we will continuously assess the evolving situation to tailor our responses, our actions must demonstrate the commitment to keep inflation and inflationary expectations under check. Therefore, monitoring and assessing inflation pressures and balancing risks to growth will be crucial for judging the appropriate policy path as we move ahead.

The road we have travelled during the recent past has indeed been very arduous, but we gathered faith, focus and fortitude along the way. Our actions today are in continuation of several measures that have been taken recently to achieve price stability. Given the elevated uncertainties of the current period, we have remained dynamic and pragmatic rather than being bound by stereotypes and conventions. As the Reserve Bank works tirelessly in its pursuit of macro-financial stability, I am reminded of what Mahatma Gandhi said long ago: "If we want to overtake the storm that is about to burst, we must make the boldest effort to sail full steam ahead".[1]

Thank you. Stay safe. Stay well. Namaskar.

[1] Source: The Collected Works of Mahatma Gandhi (Electronic Book), New Delhi, Publications Division, Government of India, 1927, Volume 40.