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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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October 29, 2013

Second Quarter Review of Monetary Policy 2013-14

Statement by Dr. Raghuram G. Rajan, Governor, Reserve Bank of India

"Good Morning and welcome to the Reserve Bank.

Today, continuing the process begun in September, we have announced the following policy measures:

- we have reduced the marginal standing facility (MSF) rate by 25 basis points from 9.0 per cent to 8.75 per cent with immediate effect;
- we have also increased the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 7.5 per cent to 7.75 per cent with immediate effect; and
- the liquidity provided through term repos of 7-day and 14-day tenor has been increased from 0.25 per cent of net demand and time liabilities (NDTL) of the banking system to 0.5 per cent with immediate effect.

Assessment

Our policy decisions are based on a detailed assessment of the global and domestic macroeconomic situation. The outlook for global growth has improved modestly and the prospect of delay in the taper of the Federal Reserve's bond purchases has brought calm to financial markets.

Domestically, while industrial activity has weakened, strengthening export growth, signs of revival in some services along with the expected pick-up in agriculture could increase the real GDP growth from 4.4 per cent in Q1 to a central estimate of 5.0 per cent for the year as a whole. The revival of large stalled projects and the pipeline cleared by the Cabinet Committee on Investment may buoy investment and overall activity towards the close of the year.

On inflation, both wholesale and consumer price inflation are likely to remain elevated in the months ahead, warranting anappropriate policy response.

We have calibrated liquidity management to the system's requirements. We are providing liquidity through overnight LAF repos, through export credit refinance and through 7-day and 14-day term repos. We have also given greater flexibility in managing reserve requirements. Going forward, however, the more durable strategy for mitigating mismatches between the supply of, and demand for, funds is for banks to step up efforts to mobilise deposits.

On the external sector, a perceptible narrowing of the trade deficit coupled with policy interventions have brought some calm to the foreign exchange market, but normalcy will be restored only when the demand for dollars from public sector oil marketing companies is fully returned to the market.

Policy Stance and Rationale

We began a calibrated change in the exceptional liquidity measures since September. As steps to contain the current account deficit started taking effect in an improving external environment and as volatility in the foreign exchange market ebbed, it became possible for us to unwind the exceptional liquidity tightening measures. With the reduction of the MSF rate and the increase in the repo rate in this review, the process of re-aligning the interest rate corridor to normal monetary policy operations is now complete.

However, it is important to break the spiral of rising price pressures in order to curb the erosion of financial saving and strengthen the foundations of growth. It is in this context that the LAF repo rate has been increased by 25 basis points. Curbing mounting inflationary pressures and managing inflation expectations will help strengthen the environment for growth by fostering macroeconomic and financial stability. The Reserve Bank will closely monitor inflation risk while being mindful of the evolving growth dynamics.

Developmental and Regulatory Policies

We plan to build the Reserve Bank's developmental measures over the next few quarters on five pillars. These are:

a. Clarifying and strengthening the monetary policy framework.

b. Strengthening banking structure through new entry, branch expansion, encouraging new varieties of banks, and moving foreign banks into better regulated organizational forms.

c. Broadening and deepening financial markets and increasing their liquidity and resilience so that they can help absorb the risks entailed in financing India's growth.

d. Expanding access to finance to small and medium enterprises, the unorganized sector, the poor, and remote and underserved areas of the country through measures to foster financial inclusion.

e. Improving the system's ability to deal with corporate distress and financial institution distress by strengthening real and financial restructuring as well as debt recovery.

Action on the monetary policy framework will follow the submission of the Dr. Urjit Patel Committee report. A number of measures to strengthen bank structures and financial markets have already been announced, and more will follow as they are worked out. The strategy to expand financial inclusion will be informed by the Dr. Nachiket Mor Committee report, though significant efforts to explore the use of technology are already under way.

I invite you all to go through Part B of the Policy Statement which lays out developmental and regulatory initiatives. I will only list a few important ones. We are discussing other measures and the fact that I do not mention them does not mean that they are not on the table, only that more work is needed to get them to the point where they can be announced.

In formulating these measures, we have listened to concerns that have been expressed to us. For instance, a number of banks have expressed concerns about the difficulty of settling electronic funds transfers when the markets have closed. Keeping this in mind, we have revised the timing of MSF operations. With effect from November 5, 2013 they will be conducted between 7.00 pm and 7.30 pm instead of between 4.45 pm and 5.15 pm. I believe this new timing will help the banks greatly in their reserve management and help free up liquidity for the economy. Turning to other measures

- The report of the Group to operationalise the countercyclical capital buffer framework in India (Chairman: Shri B. Mahapatra) will be placed on our website by end-November for comments.

- The draft of the proposed framework for dealing with Domestic Systemically Important Banks in India will be placed on our website by end-November.

- The scheme of subsidiarisation of foreign banks in India in order to reduce the risks they pose to the system while giving them the near national treatment promised in the past will be placed on our website within two weeks. It will be guided by the two cardinal principles of reciprocity and single mode of presence.

- Inflation Indexed National Saving Securities (IINSSs) will be launched for retail investors in November/December 2013.

- Guidelines on cash settled 10-year interest rate futures contracts will be issued by mid-November so that the product can be launched by the exchanges by end-December.

- A number of suggestions from the FSLRC report to improve the interaction between the RBI and its regulated entities are being implemented.

I thank you for your attention and on behalf of the Reserve Bank, my best wishes to everyone for a Happy Diwali."

Alpana Killawala
Principal Chief General Manager

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