प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
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December 07, 2022

Governor's Statement: December 7, 2022

As we come to the end of yet another turbulent year, the global economy is still marred by profound shocks and unprecedented uncertainty. Mixed signals are emanating from the geopolitical situation and financial market volatility. In the beginning of this year (2022), just as the COVID-19 pandemic was receding, the war in Ukraine overwhelmed the world in a black swan moment and fundamentally altered the global economic outlook. Surges in food and energy prices and shortages in key staples have severely affected the poorer sections across the world. Though international food, energy and other commodity prices have eased moderately in recent times, inflation remains high and broad-based. The IMF has projected that more than one-third of the global economy will contract this year or next year. While no country is spared the ill-effects of such large shocks, emerging market economies (EMEs), especially the ones dependent on food, energy and commodity imports, have been the worst affected.

2. Looking beyond the pandemic and the war, fragmentation in trade, finance and technology is also adding to the forces of deglobalisation. Supply chains are being redrawn on considerations of geopolitical security, leading to 'reshoring' and 'friend-shoring'. Food and energy security, together with climate change, have become the biggest challenges to the world.

3. In this hostile international environment, the Indian economy remains resilient, drawing strength from its macroeconomic fundamentals. Our financial system remains robust and stable. Banks and corporates are healthier than before the crisis. Bank credit is growing in double digits for 8 months now. India is widely seen as a bright spot in an otherwise gloomy world. Yet, our inflation remains elevated, as in most parts of the world. Global spillovers continue to impart high volatility and uncertainty.

Decisions and Deliberations of the Monetary Policy Committee (MPC)

4. The Monetary Policy Committee (MPC) met on 5th, 6th and 7th December 2022. Based on an assessment of the macroeconomic situation and its outlook, the MPC decided by a majority of 5 members out of 6 to increase the policy repo rate by 35 basis points to 6.25 per cent, with immediate effect. Consequently, the standing deposit facility (SDF) rate stands adjusted to 6.00 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 6.50 per cent. The MPC also decided by a majority of 4 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

5. Let me now elaborate on the MPC's rationale behind these decisions on the policy rate and the stance. Growth prospects across the world are dampening. Financial markets remain nervous and are characterised by high volatility and price swings.

6. For the Indian economy, the outlook is supported by good progress of *rabi* sowing, sustained urban demand, improving rural demand, a pick-up in manufacturing, rebound in services and robust credit expansion. Consumer price inflation moderated to 6.8 per cent (y-o-y) in October as expected, but it still remains above the upper tolerance band of the target. Core inflation is exhibiting stickiness. While headline inflation may ease through the rest of the year and Q1:2023-24, it is expected to rule above the target. The medium-term inflation outlook is exposed to heightened uncertainties from geopolitical tensions, financial market volatility and the rising incidence of weather-related disruptions.

7. On balance, the MPC was of the view that further calibrated monetary policy action is warranted to keep inflation expectations anchored, break core inflation persistence and contain second round effects. These actions will strengthen the medium-term growth prospects of the Indian economy. Accordingly, the MPC decided to increase the policy repo rate by 35 basis points to 6.25 per cent and to remain focused on withdrawal of accommodation, while supporting growth.

8. As regards the stance of monetary policy, the MPC took a holistic view of the policy rate and liquidity conditions relative to inflation. Adjusted for inflation, the policy rate still remains accommodative. Over the next 12 months, inflation is expected to remain higher than the 4 per cent target. System liquidity remains in surplus with an average daily absorption under the liquidity adjustment facility (LAF) of ₹1.6 lakh crore in November 2022. Since then, it has gone up to ₹2.6 lakh crore as on 5th December. The overall monetary and liquidity conditions remain accommodative and hence, the MPC decided to remain focused on withdrawal of accommodation.

Assessment of Growth and Inflation Growth

9. According to the latest data released by National Statistical Office (NSO), real gross domestic product (GDP) posted a growth of 6.3 per cent year-on-year (y-o-y) in Q2:2022-23, driven primarily by private consumption and investment. This is in line with our expectations.

10. Going into Q3:2022-23, economic activity continued to gain strength in October. Urban consumption firmed up further, driven by sustained recovery in discretionary spending, especially on services such as travel, tourism and hospitality. Passenger vehicle sales and domestic air passenger traffic posted robust y-o-y growth. Rural demand is recovering as reflected in the pace of tractor and retail two-wheeler sales, with rising farm activity. Investment activity is also gaining traction. Non-food bank credit rose by ₹10.6 lakh crore during April-November 2022 as compared with an increase of ₹1.9 lakh crore last year. The total flow of resources to the commercial sector expanded by ₹14.7 lakh crore during 2022-23 (up to November 2022) as compared with ₹6.8 lakh crore in the same period of 2021-22. On the other hand, the drag from net external demand further accentuated in October as merchandise exports contracted by 12.1 per cent (y-o-y) after expanding during the previous 19 months. Merchandise imports expanded by 10.0 per cent in October.

11. On the supply side, the agricultural sector remains resilient. *Rabi* sowing got off to a strong start. The area sown so far is 6.8 per cent higher than the normal sown area (as on December 2, 2022). The manufacturing PMI rose from 55.3 in October to 55.7 in November. The PMI for the services sector expanded from 55.1 in October to 56.4 in November. Incidentally, the manufacturing and services PMIs for India in November are among the highest in the world. Construction activity is picking up after the end of the south-west monsoon, as indicated by high growth of steel consumption in October.

12. Going ahead, investment activity will get support from government capex. A pick-up in the share of fixed assets in total assets of manufacturing companies was visible in H1[1]. According to our surveys, consumer confidence has improved further. Manufacturing and infrastructure sector firms are optimistic about the business outlook[2]. Services sector firms also expect activity to expand. In an interconnected world, we cannot remain entirely decoupled from adverse spillovers from the global slowdown and its negative impact on our net exports and overall economic activity. The biggest risks to the outlook continue to be the headwinds emanating from protracted geopolitical tensions, global slowdown and tightening of global financial conditions. Taking all these factors into consideration, real GDP growth for 2022-23 is projected at 6.8 per cent, with Q3 at 4.4 per cent and Q4 at 4.2 per cent. The risks are evenly balanced. Real GDP growth is projected at 7.1 per cent for Q1:2023-24 and at 5.9 per cent for Q2. Even after this revision in our growth projection for 2022-23, India will still be among the fastest growing major economies in the world.

Inflation

13. The inflation trajectory has largely evolved in line with the outlook given by us in June 2022. Going forward, food inflation is likely to moderate with the usual winter softening and the likelihood of a bountiful *rabi* harvest, but pressure points remain in the form of prices of cereals, milk and spices in the near-term. The main risk is that core inflation (CPI excluding food and fuel) remains sticky and elevated. Overall, the CPI price momentum remains high. Risks from adverse weather events add to uncertainty in the outlook.

14. Global commodity prices, including crude oil, have undergone some downward correction, but uncertainty continues to surround the near-term outlook in view of the prolonging geo-political hostilities. The outlook for the US dollar and hence imported inflation also remains uncertain. Moreover, the resurgence in domestic services sector activity could also lead to price increases, especially as firms pass on input costs. Taking into account these factors and assuming an average crude oil price (Indian basket) of US$ 100 per barrel, headline inflation is projected at 6.7 per cent in 2022-23, with Q3 at 6.6 per cent and Q4 at 5.9 per cent. The risks are evenly balanced. CPI inflation for Q1:2023-24 is projected at 5.0 per cent and for Q2 at 5.4 per cent, on the assumption of a normal monsoon.

15. What do these growth and inflation scenarios convey? Let me summarise. GDP growth in India remains resilient and inflation is expected to moderate; but the battle against inflation is not over. Pressure points from high and sticky core inflation and exposure of food inflation to international factors and weather-related events do remain. While being watchful of the impact of our earlier monetary policy actions, we

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[1] The share of funds used for fixed assets in total incremental funds of 1575 manufacturing companies rose from 0.1 per cent in H1:2021-22 to 19.4 per cent in H1:2022-23.

[2] The expectations of manufacturing, infrastructure and services firms are based on early results of the RBI's enterprise surveys.

will keep Arjuna's eye[3] on the evolving inflation dynamics and be ready to act as may be necessary. Our actions will be nimble and in the best interest of the economy. The aspect of growth will obviously be kept in mind.

Liquidity and Financial Market Conditions

16. Overall system liquidity remains in surplus. During October-November, the average total absorption under the liquidity adjustment facility (LAF) was ₹1.4 lakh crore, down from the average of ₹2.2 lakh crore during August-September.

17. In the period ahead, liquidity conditions are likely to improve due to several factors which would include moderation in currency in circulation in the post-festival period, pick up in government expenditure in the last few months of the financial year and higher forex inflows due to the return of portfolio investors. Tax outflows and currency demand do produce transient episodes of tight liquidity, but a holistic view needs to be taken. I reiterate that the Reserve Bank remains nimble and flexible in its liquidity management operations to meet the requirements of the productive sectors of the economy. Therefore, although the Reserve Bank remains in absorption mode, we are ready to conduct LAF operations that inject liquidity as may be needed through our main operations. In doing so, however, we will look for a durable sign of a turn in the liquidity cycle when banks draw down large part of their standing deposit facility (SDF) and variable rate reverse repo (VRRR) balances. The Reserve Bank remains committed to flexibility and two-sidedness in liquidity operations, but market participants must wean themselves away from the overhang of liquidity surpluses.

18. As part of our gradual move towards normal liquidity operations, we have decided to restore market hours - from 9.00 am to 5.00 pm - in respect of call/notice/term money, commercial paper, certificates of deposit and repo in corporate bond segments of the money market as well as for rupee interest rate derivatives.

19. The pace of transmission of monetary policy actions to lending and deposit rates has quickened in the current tightening phase, beginning May 2022. The weighted average lending rates (WALRs) on fresh and outstanding rupee loans have increased by 117 bps and 63 bps, respectively, during the period May to October 2022. On the deposit side, the weighted average domestic term deposit rate on fresh and outstanding deposits increased by 150 bps and 46 bps, respectively, during the same period. We are keeping a close watch on this process of transmission.

20. The appreciation of the US dollar this year, which precipitated large scale depreciation of all major global currencies including the Indian rupee (INR), has drawn wide attention. It is important to make an objective assessment of the movement of the INR in the context of global and domestic macroeconomic and financial market developments. Through this episode of US dollar appreciation, the INR's movements have been the least disruptive, relative to peers. In fact, the INR has appreciated against all other major currencies except a few[4]. Cross-country comparisons of exchange rate movements are often made on an inflation-adjusted basis or what is called in real effective terms. On a financial year basis (i.e., from April 2022 to October 2022), the INR has appreciated by 3.2 per cent in real terms[5], even as several major currencies have depreciated. The story of the INR has been one of India's resilience and stability.

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[3] Das, Shaktikanta (2022), "India: A Story of Resilience"; Inaugural Address at the Annual FIBAC 2022 Conference Organised Jointly by FICCI and IBA, Mumbai on November 02, 2022.
[4] Barring the Swiss franc, the Canadian dollar, the Singapore dollar, the Russian ruble etc.
[5] Based on BIS real effective exchange rates.

21. As stated by me in a recent speech[6], the terminal interest rate for the US Fed is anybody's guess, but it cannot be the case that their monetary policy will be tightened endlessly. When the tightening is over, the tide will surely turn. Capital flows to India will improve and external financing conditions will ease. In this complex world with both push and pull factors at play, the INR - which is market-determined - should be allowed to find its level and that is what we have been striving to ensure. We must deal with the current global hurricane with confidence and endurance.

External Sector

22. The external sector has been affected by strong global headwinds. Slowing global demand is weighing on our merchandise exports. The growth of merchandise imports is also decelerating. At the same time, the impact of the terms of trade shock due to the war in Ukraine is getting gradually normalized. It is also important to take cognizance of India's innate buffers. The growth of services exports, mainly contributed by software, business and travel services remained robust at 29.1 per cent in April-October 2022. Remittances are scaling new heights and the outlook is optimistic with pick-up in activity in the middle east. According to the latest update of the World Bank, India's remittances are estimated to grow by around 12 per cent to US$ 100 billion in 2022 from US$ 89.4 billion in 2021. In Q1:2022-23, remittances to India rose by 22.6 per cent year-on-year. The net balance under services and remittances remains in large surplus, partly offsetting the trade deficit. Consequently, even if the current account deficit is higher than 2021-22, it is eminently manageable and within the parameters of viability.

23. On the financing side, net foreign direct investment (FDI) flows have remained robust and rose to US $ 22.7 billion during April-October 2022 from US$ 21.3 billion in the corresponding period last year. Foreign portfolio flows have resumed in recent months and were positive at US$ 11.8 billion during July to 5th December 2022, led by equity flows. As a result of the measures announced by the RBI on July 6, 2022 to enhance forex inflows, new external commercial borrowing (ECB) agreements have been concluded for US$ 8.6 billion. This includes US$ 5.1 billion which exceed the earlier threshold of US$ 750 million under the automatic route. The size of forex reserves is comfortable and has also increased. It has gone up from US$ 524.5 billion on October 21, 2022 to US$ 561.2 billion as on December 2, 2022 covering around nine months of projected imports for 2022-23. Further, India's external debt ratios are low by international standards[7].

Additional Measures

24. I shall now announce certain additional measures.

SLR Holdings in Held to Maturity (HTM) category

25. To provide further flexibility to banks in managing their investment portfolios, it has been decided to extend the dispensation of enhanced HTM limit of 23 per cent up to March 31, 2024. Banks will now be allowed to include securities acquired between September 1, 2020 and March 31, 2024 in the enhanced HTM limit. The HTM limits would be restored from 23 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2024.

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[6] Same as footnote 3.

[7] The ratio of reserves to total external debt has increased to 95.5 per cent in June 2022 from 71.3 per cent in 2012-13. The debt service ratio (principal repayments and interest payments as a ratio of current earnings) at 4.9 per cent in June 2022 was lower than 5.9 per cent in 2012-13. Currently, it is one of the lowest among emerging market peers.

Enhancing the Mandates of Unified Payments Interface (UPI)

26. The UPI has emerged as the most popular retail payments system in India. It currently includes functionality to process payment mandates for recurring as well as single-block-and-single-debit transactions. The capabilities in UPI will be further enhanced by introducing single-block-and-multiple-debits functionality. This facility will enable a customer to block funds in his/her account for specific purposes, which can be debited whenever needed. This will significantly enhance the ease of making payments for investments in securities including through the Retail Direct platform as well as e-commerce transactions.

Expanding the Scope of Bharat Bill Payment System (BBPS)

27. The BBPS has been steadily expanding since its launch in 2017. At present, it handles recurring bill payments for merchants and utilities and does not cater to non-recurring bills. It also does not cater to bill payments or collections such as payment of fees for professional services, education fees, tax payments, rent collections, etc. for individuals even if those are recurring in nature. Therefore, the scope of BBPS is being enhanced to include all categories of payments and collections, both recurring and non-recurring, and for all category of billers (businesses and individuals). This will make the BBPS platform accessible to a wider set of individuals and businesses who can benefit from the transparent payments experience, faster access to funds and improved efficiency.

Hedging of Gold in the International Financial Services Centre (IFSC)

28. Resident entities in India are currently not permitted to hedge their exposure to gold price risk in overseas markets. With a view to providing greater flexibility to these entities to hedge the price risk of their gold exposures, resident entities will now be permitted to hedge their gold price risk on recognised exchanges in the IFSC. This measure will benefit importers/exporters of gold such as jewellers and industries which use gold as an intermediate or raw material.

Conclusion

29. The last three years have been unusually challenging as we encountered multiple shocks. The buffers we built in the years leading to COVID-19 in terms of accumulating reserves and inflation averaging close to the target came good to deal with these repeated shocks. In this arduous period, our constant endeavour has been to take timely and effective measures. It is gratifying to see that our policies have yielded positive results.

30. The course of our future policy will duly consider new data releases and the evolving outlook of the economy as well as the effect of our past actions.

31. In meeting the challenges thrust upon us by a hostile global environment, we should not lose sight of the task of improving the long-term potential of our country. Green transition, reconfiguration of supply chains and logistics, production-linked incentive schemes, digital banking and financial services, and innovative technologies offer immense opportunities for the Indian economy.

32. As we enter 2023, India's G20 presidency provides us a historic opportunity to play a bigger role in the international arena. The theme of our Presidency "*Vasudhaiva Kutumbakam*" – the world is one family – reflects our vision of global cooperation for universal welfare. We must remain optimistic and derive inspiration from the words of Gandhiji: "*Let no one think that it is impossible because it is difficult. It is the highest goal, and it is no wonder that the highest effort should be necessary to attain it*."[8] As the current year ends and a new one awaits, I wish you all a happy new year in advance.

Thank you. Namaskar.

(Yogesh Dayal)
Chief General Manager

Press Release: 2022-2023/1319

[8] The Story of My Experiments with Truth: M.K. Gandhi translated from Gujarati by Mahadev Desai; Navajivan Publishing House, Ahmedabad.