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RBI Bulletin – March 2023

Today, the Reserve Bank released the March 2023 issue of its monthly Bulletin. The Bulletin includes five speeches, five articles and current statistics.

The five articles are: I. State of the Economy; II. Consumer Price Index: Aggregation Method Matters; III. Financial Stocks and Flow of Funds of the Indian Economy 2020-21; IV. Application of Growth-at-Risk (GaR) Framework for Indian GDP; and V. Subnational Borrowings in India – Volatilities and Determinants of State Government Securities (SGS) Spread.

I. State of the Economy

Even as global growth is set to slow down or even enter a recession in 2023 as global financial markets wager, India has emerged from the pandemic years stronger than initially thought, with a steady gathering of momentum since the second quarter of the current financial year. On the supply side, agriculture is into a seasonal uptick, industry is emerging out of contraction and services have maintained momentum. Consumer price inflation remains high and core inflation continues to defy the distinct softening of input costs.

II. Consumer Price Index: Aggregation Method Matters

By Praggya Das and Asish Thomas George

The present method of consumer price index (CPI) compilation involves an aggregation of indices across States/UTs and sectors to arrive at the all-India overall index. The national sub-group and group level indices are also arrived at by following a similar horizontal method of aggregation. As a result, any attempt to derive the all-India indices (sub-group/group/overall) through item-level aggregation may diverge from the published indices, especially when there are instances of missing prices or provision of subsidised items for which price quotes may be zero, as was the case in January-February 2023. The article, in this context, presents a discussion on the aggregation methodology followed in the compilation of CPI, the extent of divergence seen between published and user derived CPI inflation and sets out feasible ways to minimise such divergences in inflation measurement.

Highlights:

- The extent of divergence in inflation between the published indices and the user derived indices before 2021 was small and bidirectional. Since 2021, however, this divergence has become large and recurrent, emanating primarily from the fuel group and recently from the cereals sub-group.

- Alternate aggregation methods, which can reconcile the horizontal and vertical aggregated price indices and are in conformity with the international standards, may be considered by the Technical Advisory Committee on Statistics of Prices and Cost of Living (TAC on SPCL).
- At present, there is no guidance on proper treatment of price levels that may be zero. Drawing from international best practices, such rare cases may have to be considered as zero price quotes and not missing prices.
- The current CPI base of 2012 is derived from the consumption expenditure survey (CES) conducted during 2011-2012 and the market survey to identify shops for collecting prices is even older. Efforts to conduct new CES for rebasing CPI to a recent period may be expedited to make the CPI consumption basket relevant to the present consumption behaviour.

III. Financial Stocks and Flow of Funds of the Indian Economy 2020-21

By Anupam Prakash, Kaustav K Sarkar, Ishu Thakur and Sapna Goel

The article provides insights on instrument-wise financial stocks and flow of funds (FSF) for the institutional sectors, *i.e.*, financial corporations; non-financial corporations; general government; households including non-profit institutions serving households; and rest of the world, on a 'from-whom-to-whom' (FWTW) basis for the year 2020-21.

Highlights:

- The overall domestic financial resource balance – measured by the net acquisition of financial assets less net increase in liabilities – continued to improve, turning marginally positive at 0.3 per cent of GDP in 2020-21.
- The household financial savings spiked significantly during 2020-21 from its long-term trend reflecting an elevated stock of both currency and deposits and increased savings in insurance products.
- The balance sheet of the Reserve Bank expanded in 2020-21 with a rise in financial assets reflecting unconventional monetary measures to mitigate the impact of the pandemic and to ensure adequate liquidity for smooth functioning of the economy. Other financial corporations with excess inflows from households, and in view of reduced demand for bank credit in the pandemic year, increased investment in government securities.
- The non-financial corporations deleveraged their balance sheets in 2020-21; as a result, their net financial wealth improved after years of successive deterioration.
- With a relatively reduced dependence on external financing, particularly by the Indian corporates, the growth in both financial assets and liabilities of rest of the world decelerated in 2020-21.

IV. Application of Growth-at-Risk (GaR) Framework for Indian GDP

By Saurabh Ghosh, Vidya Kamate and Ria Sonpatki

This article analyses the role of domestic and international macro-financial conditions in influencing the future distribution of GDP growth for India using a Growth-at-Risk (GaR) framework. It helps to shed light on low probability extreme events and in quantifying the likelihood of tail risk scenarios. It is important to note that GaR relates to the lower quantiles of GDP growth rather than the baseline mean growth forecast.

Highlights:

- GaR estimates indicate that in the short-term, domestic financial conditions, global conditions, and domestic credit assume importance, while in the medium-term domestic credit conditions tend to be a significant determinant of lower tails of future GDP growth.
- The GaR framework allows for modelling potential non-linearities between macro-financial conditions and GDP growth rate. Therefore, GaR analysis could complement baseline GDP forecasts in shaping policies.

V. Subnational Borrowings in India –Volatilities and Determinants of State Government Securities (SGS) Spread

By Suraj.S, Amit Pawar and Subrat Kumar Seet

The article outlines the impact of the pandemic and policy measures undertaken by the Reserve Bank on the primary and secondary markets for State Government Securities (SGS). It studies the linkages between G-Sec and SGS yields and factors driving the pricing of SGS in primary markets.

Highlights:

- The Reserve Bank's special Open Market Operations (OMO) in SGS during the pandemic was effective in stabilizing the yields.
- Developments that have a bearing on the benchmark G-sec yield eventually weigh on SGS yields. Prevailing growth and liquidity conditions explain the variation in SGS spreads over G-sec across States.
- Higher yield spreads with larger cash balances accompany significant negative carry costs, which is the interest rate differential between the high borrowing costs and low investment returns of States. It highlights the need for improved fiscal marksmanship in cash management by States.

The views expressed in the Bulletin articles are of the authors and do not represent the views of the Reserve Bank of India.

(Yogesh Dayal)
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