प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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June 08, 2023

Governor's Statement: June 8, 2023

As I make this monetary policy statement, we can derive satisfaction from the fact that the Indian economy and the financial sector stand out as strong and resilient in a world of unprecedented headwinds and swift cross currents. Unlike the previous three tumultuous years, the uncertainty on the horizon appears comparatively less and the path ahead somewhat clearer; but we have to be acutely aware that the geopolitical conflict continues unabated and policy normalisation globally is far from complete. Headline inflation across countries is on a downward trajectory, but is still high and above the targets. Labour markets are tight, and demand is rotating back from goods to services. Hence, central banks across the world remain on high alert and watchful of the evolving conditions, even though many of them have tempered their rate hikes or taken a pause. Financial stability concerns persist in advanced economies, although they appear to have been contained due to resolute actions. Retrenchment in trade, technology and capital flows caused by geopolitical fault lines and economic fragmentation further complicate the situation.

2. In these challenging times, the Reserve Bank of India has continued to focus on preserving price and financial stability, while ensuring adequate flow of financial resources to all productive sectors of the economy. As a result, domestic macroeconomic fundamentals are strengthening – economic activity is exhibiting resilience; inflation has moderated; the current account deficit has narrowed; and foreign exchange reserves are comfortable. Fiscal consolidation is also ongoing. The Indian banking system remains stable and resilient, credit growth is robust and domestic financial markets have evolved in an orderly manner.

Decisions and Deliberations of the Monetary Policy Committee (MPC)

3. The Monetary Policy Committee (MPC) met on 6th, 7th and 8th June 2023. Based on an assessment of the macroeconomic situation and the outlook, the MPC decided unanimously to keep the policy repo rate unchanged at 6.50 per cent. Consequently, the standing deposit facility (SDF) rate remains at 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 6.75 per cent. The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

4. Let me now explain the MPC's rationale for these decisions on the policy rate and the stance. The MPC recognised that the pace of global economic activity is expected to decelerate in 2023, dragged down by elevated inflation, tight financial conditions and geopolitical tensions. The pace of monetary tightening has slowed in recent months, but uncertainty remains on its future trajectory as inflation continues to rule above targets across the world.

5. In India, consumer price inflation eased during March-April 2023 and moved into the tolerance band, declining from 6.7 per cent in 2022-23. Headline inflation, however, is still above the target as per the latest data and is expected to remain so according to our projections for 2023-24. Therefore, close and continued vigil on the evolving inflation outlook is absolutely necessary, especially as the monsoon outlook and the impact of *El Nino* remain uncertain. Real GDP growth in 2022-23, on the other hand, turned out to be stronger than anticipated and is holding up well.

6. The policy repo rate has been increased by 250 basis points since May 2022 and is still working its way through the system. Its fuller effects will be seen in the coming months. Against this backdrop, the MPC decided to keep the policy repo rate unchanged at 6.50 per cent. The MPC will continue to remain vigilant on the evolving inflation and growth outlook. It will take further monetary actions promptly and appropriately as required to keep inflation expectations firmly anchored and bring down inflation to the target.

7. With the policy repo rate at 6.50 per cent and full year projected inflation for 2023-24 at just a little above 5 per cent, the real policy rate continues to be positive. The average system liquidity, however, is still in surplus mode and could increase as ₹2,000 banknotes get deposited in the banks. Headline inflation, as noted before, is easing but rules above the target, warranting close monitoring of the evolving price dynamics. Taking all of these factors into account, the MPC decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

Assessment of Growth and Inflation

Growth

8. India's real gross domestic product (GDP) recorded a growth of 7.2 per cent in 2022-23, stronger than the earlier estimate of 7.0 per cent. It has surpassed its pre-pandemic level by 10.1 per cent. Real GDP growth in Q4:2022-23 accelerated to 6.1 per cent (y-o-y) from 4.5 per cent in Q3, aided by fixed investment and higher net exports. On the supply side, real gross value added (GVA) accelerated from 4.7 per cent in Q3 to 6.5 per cent in Q4, driven by rebound in manufacturing activity which moved into expansion territory after two quarters of contraction.

9. Turning to 2023-24, domestic demand conditions remain supportive of growth on the back of improving household consumption and investment activity. Urban demand remains resilient, with indicators such as passenger vehicle sales, domestic air passenger traffic, and credit cards outstanding posting double-digit expansion on a year-on-year basis in April. Rural demand is also on a revival path – motorcycle and three-wheeler sales increased at a robust pace (y-o-y) in April, while tractor sales remained subdued.

10. Growth in steel consumption, cement output, and production and imports of capital goods suggest continued buoyancy in investment activity. On the back of double-digit growth of 15.6 per cent in non-food bank credit, the flow of resources to the commercial sector in 2023-24 (up to May 19, 2023) increased to ₹2.7 lakh crore

from ₹1.0 lakh crore during the same period last year. Fixed investment by manufacturing companies expanded in 2022-23, reversing the contraction seen in 2021-22. Our surveys also point towards higher investment intentions of manufacturing companies for 2023-24. The contraction in merchandise imports outpaced that of merchandise exports in April, resulting in a narrowing of the trade deficit. Coupled with the sustained and strong growth in services exports, the drag from net exports on growth is easing.

11. On the supply side, the eight core industries output expanded by 3.5 per cent y-o-y in April 2023 as compared with 3.6 per cent in March 2023. The purchasing managers' index (PMI) for manufacturing exhibited sustained expansion, rising to 58.7 in May, a 31-month high. Available high frequency indicators suggest that services sector activity has remained on an accelerating trajectory. PMI services maintained strong expansion at 61.2 in May on top of 62.0 in April.

12. Looking ahead, higher *rabi* crop production, expected normal monsoon, continued buoyancy in services and softening inflation should support household consumption. On the other hand, given the healthy twin balance sheets of banks and corporates, supply chain normalisation and declining uncertainty, conditions are favourable for the capex cycle to gain momentum. Robust government capital expenditure is also expected to nurture investment and manufacturing activity. Consumer and business outlook surveys display continued optimism. The headwinds from weak external demand, volatility in global financial markets, protracted geopolitical tensions and intensity of *El Nino* impact, however, pose risks to the outlook. Taking all these factors into consideration, real GDP growth for 2023-24 is projected at 6.5 per cent with Q1:2023-24 at 8.0 per cent; Q2 at 6.5 per cent; Q3 at 6.0 per cent; and Q4 at 5.7 per cent, with risks evenly balanced.

Inflation

13. Headline CPI inflation has come down during March-April 2023 to 4.7 per cent in April, the lowest reading since November 2021. Monetary policy tightening and supply side measures contributed to this process. The easing of inflation was observed across food, fuel and core (CPI excluding food and fuel) categories. Food inflation declined to 4.2 per cent in April, while core inflation moderated to 5.1 per cent. A durable disinflation in the core component would be critical for a sustained alignment of the headline inflation with the target.

14. Going forward, with the recent *rabi* harvest remaining largely immune to the adverse weather events, the near-term inflation outlook looks more favourable than at the time of the April MPC meeting. The forecast of a normal south-west monsoon by the India Meteorological Department (IMD) augurs well for the *kharif* crops. Uncertainties, however, remain on the spatial and temporal distribution of monsoon and on the interplay between *El Nino* and the Indian Ocean Dipole (IOD). Geopolitical tensions; uncertainties around the monsoon and international commodity prices, especially sugar, rice and crude oil; and volatility in global financial markets pose upside risks to inflation. Taking into account these factors and assuming a normal monsoon, CPI inflation is projected at 5.1 per cent for 2023-24, with Q1 at 4.6 per cent, Q2 at 5.2 per cent, Q3 at 5.4 per cent and Q4 at 5.2 per cent. The risks are evenly balanced.

15. As noted in the April statement, the decision to pause was based on the need to assess the cumulative impact of past monetary policy actions while charting out the future course. Subsequent incoming data suggest that while risks to near-term inflation have moderated somewhat, pressure remains during the second half of the year which needs to be watched and addressed at the appropriate time. According to our survey, inflation expectations of households for three months to one year ahead horizon have moderated by 60 to 70 basis points since September 2022. This would indicate that anchoring of expectations is underway and that our monetary policy actions are yielding the desired results. This also provides us the space to keep the policy rate unchanged in this meeting of the MPC. At the same time, given the uncertainties, we need to maintain Arjuna's eye[1] on the evolving inflation scenario. Let me re-emphasise that headline inflation still remains above the target and being within the tolerance band is not enough. Our goal is to achieve the target of 4.0 per cent, going forward. As Mahatma Gandhi had said "*The ideal must not be lowered*."[2] The continuation of the stance of withdrawal of accommodation should be seen from this perspective.

Liquidity and Financial Market Conditions

16. Surplus liquidity, as reflected in average daily absorptions under the LAF[3] at ₹1.7 lakh crore during April-May, was lower than ₹2.9 lakh crore during the full year 2022-23. The shrinkage in surplus liquidity during April-May was, among other things, due to the maturing of TLTROs.[4] The seasonal expansion in currency in circulation and build-up of government cash balances during this period also moderated surplus liquidity. Since the third week of May, however, the decline in currency in circulation and pick-up in government spending have expanded the system liquidity. This has got further augmented due to the Reserve Bank's market operations and the deposit of ₹2,000 banknotes in banks.

17. The prevalence of surplus liquidity amidst higher recourse to the marginal standing facility (MSF) by some banks suggests skewed liquidity distribution within the banking system.[5] To address this situation, the Reserve Bank conducted a 14-day variable rate repo (VRR) auction amounting to ₹50,000 crore as part of its main operation on May 19, 2023, similar to two such auctions conducted earlier in February and March 2023. Reflecting swiftness in its liquidity action, the Reserve Bank conducted a 14-day variable rate reverse repo (VRRR) auction of ₹2.0 lakh crore on June 2; 4-day VRRR of ₹1.0 lakh crore on June 5; 3-day VRRR of ₹75,000 crore on June 6; and 2-day VRRR of ₹75,000 crore on June 7, considering the overall build-up of surplus liquidity. The response has been cautious in these auctions. Going forward, the Reserve Bank will remain nimble in its liquidity management, while ensuring that adequate resources are available for the productive requirements of the economy. The Reserve Bank will also ensure the orderly completion of the government's market borrowing programme.

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[1] "India: A Story of Resilience" Inaugural Address by Governor, RBI at the Annual FIBAC 2022 Conference Organised Jointly by FICCI and IBA, Mumbai on November 2, 2022 (Paragraph 4).
[2] Brewer D. (Edited); Quotes of Mahatma Gandhi, 2020.
[3] Including absorptions under the standing deposit facility (SDF) and the variable rate reverse repo (VRRR) window.
[4] Targeted long-term repo operations (TLTROs) amounting to about ₹61,000 crore.
[5] The daily average MSF borrowing increased to ₹13,654 crore in April-May 2023 from an average of ₹5,716 crore in February-March 2023.

18. The moderation in system liquidity along with its skewed distribution was reflected in firming up of money market rates even beyond the repo rate on a few occasions before they came down from May 18 to sub-repo rate levels. Long term rates have, however, remained broadly stable. This has led to sharp compression of term spreads in the recent period. The relative stability of long-term yields augurs well for the economy and suggests effective anchoring of market-based long-term inflation expectations.

External Sector

19. In recent months, the trade deficit has narrowed on the back of sharper decline in imports *vis-à-vis* exports. India is making resolute strides to achieve the US$1 trillion merchandise export target by 2030 by focusing on diversification of markets and products; leveraging free trade agreements; strengthening manufacturing capacity and competitiveness by participating in value chains; and through schemes such as Production Linked Incentive (PLI) across sectors. Service exports and remittances have provided valuable support to India's external sector viability. During 2022-23, services exports grew faster (27.9 per cent) than merchandise exports (6.9 per cent). The current account deficit (CAD) is expected to have moderated further in Q4:2022-23 and should remain eminently manageable in 2023-24 also.

20. On the financing side, foreign portfolio investment (FPI) flows have seen a significant turnaround in 2023-24 led by equity flows. The net FPI inflows stand at US$ 8.4 billion during the current financial year (up to June 6, 2023) as against net outflows in the preceding two years - US$ 14.1 billion in 2021-22 and US$ 5.9 billion in 2022-23. Net FDI flows to India were US$ 28.0 billion in 2022-23 compared to US$ 38.6 billion in the previous year. Preliminary data for April 2023 suggest that FDI flows have improved. Net inflows under non-resident deposits increased to US$ 8.0 billion during 2022-23 from US$ 3.2 billion in the previous year. The Indian rupee has remained stable since January 2023. Overall, India's external sector remains resilient as key indicators, such as CAD to GDP, external debt to GDP and international investment position (IIP) to GDP ratios continue to improve. Foreign exchange reserves stood at a comfortable level of US$ 595.1 billion (as on June 2, 2023). Inclusive of net forward assets, foreign exchange reserves are well above US$ 600 billion.

Additional Measures

21. I shall now announce certain additional measures.

Borrowing in Call and Notice Money Markets by Scheduled Commercial Banks

22. The extant regulatory guidelines prescribe prudential limits for outstanding borrowing in Call and Notice Money Markets for Scheduled Commercial Banks (SCBs). With a view to providing greater flexibility for managing their liquidity, it has been decided that SCBs (excluding Small Finance Banks) can set their own limits for borrowing in Call and Notice Money Markets within the prescribed prudential limits for inter-bank liabilities.

Widening of the Scope of the Framework for Resolution of Stressed Assets

23. Compromise settlement is recognised as a resolution mechanism in respect of non-performing assets (NPA) under the Prudential Framework, which is currently applicable to SCBs and select NBFCs. It is proposed to issue comprehensive guidelines on compromise settlements and technical write-offs which will now be applicable to all regulated entities including co-operative banks. Further, it is also proposed to rationalise the extant prudential norms on restructuring of borrower accounts affected by natural calamities.

Default Loss Guarantee Arrangement in Digital Lending

24. The Reserve Bank had issued the regulatory framework for Digital Lending in August/September 2022. With a view to further promoting responsible innovation and prudent risk management, it has been decided to issue guidelines on Default Loss Guarantee arrangements in Digital Lending. This will further facilitate orderly development of the digital lending ecosystem and enhance credit penetration in the economy.

Priority Sector Lending (PSL) Targets for Primary (Urban) Cooperative Banks (UCBs)

25. The Reserve Bank has undertaken several initiatives in recent years to strengthen the UCB sector as well as to deepen financial inclusion. Such initiatives include revision of the priority sector lending targets for UCBs in 2020. While revising the PSL targets, a glide path up to March 2024 was provided for a non-disruptive transition to achieve the revised targets. While a number of UCBs have met the required milestones as of March 2023, a need has arisen to ease the implementation challenges faced by other UCBs. It has, therefore, been decided to extend the timelines for achieving the targets by two more years up to March 2026. Further, UCBs which have met the targets as on March 31, 2023 shall be suitably incentivised.

Rationalisation of Licensing Framework for Authorised Persons (APs) under Foreign Exchange Management Act (FEMA), 1999

26. The licensing framework for Authorised Persons (APs) issued under FEMA was last reviewed in March 2006. Keeping in view the developments, including progressive liberalisation under FEMA, over the last several years and to effectively meet the emerging requirements of the rapidly growing Indian economy, it has been decided to rationalise and simplify the licensing framework for APs. This is expected to improve the efficiency in the delivery of foreign exchange facilities to various segments of users including common persons, tourists and businesses.

Expanding the Scope and Reach of e-RUPI Vouchers

27. At present, purpose-specific e-RUPI digital vouchers are issued by banks. It is now proposed to expand the scope and reach of e-RUPI vouchers by (i) permitting non-bank prepaid payment instruments (PPI) issuers to issue e-RUPI vouchers; (ii) enabling issuance of e-RUPI vouchers on behalf of individuals; and (iii) simplifying the process of issuance, redemption, etc. These measures will make the benefits of e-RUPI digital voucher accessible to a wider set of users and further deepen the penetration of digital payments in the country.

Streamlining the Bharat Bill Payment System (BBPS) Processes and Membership Criteria

28. The Bharat Bill Payment System (BBPS) is operational since August 2017. The scope of BBPS was further expanded in December 2022. To further enhance the efficiency of the BBPS system and to encourage greater participation, it is proposed to streamline the process flow of transactions and membership criteria for operating units.

Internationalising Issuance and Acceptance of RuPay Cards

29. RuPay Debit and Credit cards issued by banks in India are gaining increased acceptance abroad. It has now been decided to permit issuance of RuPay Prepaid Forex cards by banks. This will expand the payment options for Indians travelling abroad. Further, RuPay cards will be enabled for issuance in foreign jurisdictions. These measures will expand the reach and acceptance of RuPay cards globally.

Conclusion

30. We have made good progress in containing inflation, supporting growth and maintaining financial and external sector stability. Despite three years of global turmoil, India's growth has bounced back and headline CPI inflation is easing. This confluence of factors gives us the confidence that our policies are on the right track. Nevertheless, we need to move towards our primary target of 4 per cent inflation. It is always the last leg of the journey which is the toughest. I wish to emphasise that we will do whatever is necessary to ensure that long-term inflation expectations remain firmly anchored. The best contribution of monetary policy to the economy's ability to realise its potential is by ensuring price stability. The Reserve Bank will remain watchful and proactive in dealing with emerging risks to price and financial stability. Let me end by recalling the inspiring words of Mahatma Gandhi *"... If we are determined, we shall find the way that leads us to our goal*."[6]

Thank you. Namaskar.

(Yogesh Dayal)
Chief General Manager

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[6] Young India, January 15, 1925.