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RESERVE BANK OF INDIA

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Azadi Ka Amrit Mahotsav

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RBI Bulletin – July 2022

The Reserve Bank of India today released the July 2022 issue of its monthly Bulletin. The Bulletin includes eight Speeches, six Articles and Current Statistics.

The six articles are: I. State of the Economy; II. Monetary Policy: Confronting Supply-driven inflation; III. Remote Sensing Applications for Policy: An Assessment of Agricultural Commodity Arrivals; IV. Fed Taper and Indian Financial Markets: This Time is Different; V. Headwinds of COVID-19 and India's Inward Remittances; and VI. Electronification of FX Markets in India.

I. State of the Economy

In a global landscape marred by fears of recession and war, the Indian economy shows resilience. The recent revival of the monsoon, the pick-up in manufacturing and services, stabilisation of inflation pressures and strong buffers in the form of adequate international reserves, sufficient foodgrain stocks and a well-capitalised financial system together brighten the outlook and strengthen the conditions for a sustainable high growth trajectory in the medium-term.

II. Monetary Policy: Confronting Supply-driven Inflation

The role of monetary policy in response to supply-driven inflation has attracted a lot of attention in the wake of current global inflationary episode. This article using simulations from the Quarterly Projection Model to an adverse supply shock characterized by an increase in crude oil price shows that monetary policy response is conditioned by a) the nature of the shock; b) aggregate demand conditions; c) monetary policy credibility; and d) the reaction of other agents in the economy to the shock.

Highlights:

- When a supply shock is transitory, inflation returns to the equilibrium without the need for any monetary policy action and that it can look through its initial impact as it lies outside its realm and remit. However, repeated supply shocks generate second round effects necessitating pre-emptive monetary policy action.
- When the economy is going through a contractionary phase, an adverse supply shock can worsen the monetary policy trade-off, as it can ill afford to weaken demand conditions further by responding to the inflationary impact of the supply shock.

- Under an adverse supply shock, by frontloading monetary policy actions, credibility is demonstrated by showing commitment to the inflation target. This will anchor inflation expectations, necessitating less aggressive policy increases in future and, therefore, a lower growth sacrifice.

III. Remote Sensing Applications for Policy: An Assessment of Agricultural Commodity Arrivals

The role of supply side factors in shaping the trajectory of food inflation and inflation in general has been well-recognised. Timely and reliable indicators of crop production are key to assessing inflationary trends in the near future. In this context, the study explores the utility of satellite imagery-based vegetation indicators for assessment of commodity arrivals in agricultural mandis, well in advance.

Highlights:

- Inter-dynamics of vegetation indicators with *mandi* arrivals suggest the strong influence of vegetation on arrivals, which strengthens with the progress of crop season.
- Geospatial modelling indicates presence of spatial heterogeneity in parameter estimates of vegetation growth across mandis.
- Availability of granular spatio-temporal remote sensing data at high-frequency provides an extra edge over traditional datasets as it helps in predicting supply conditions well in advance. The utility is further enhanced by the early availability of vegetation indicators.

IV. Fed Taper and Indian Financial Markets: This Time is Different

Taper of large scale asset purchase programmes initiated by the Fed in response to the adverse economic consequences associated with macroeconomic shocks has the potential to significantly impact the financial market variables in emerging market economies. This article compares the impact of the Fed’s two taper announcements (May 22, 2013 and November 3, 2021) on Indian financial markets.

Highlights:

- The event study results indicate that the 2021 Taper (Taper 2) announcement was less severe as compared to Taper Tantrum of 2013 (Taper 1) in terms of its impact on Indian bond yields and spreads.
- Empirical analysis using a GARCH framework suggests a muted impact of Taper 2 announcement on financial market volatilities which could be a result of India’s stronger external position in 2021 as compared to 2013.

V. Headwinds of COVID-19 and India's Inward Remittances

India’s inward remittances have proven to be a resilient source of current account receipts during the COVID-19 pandemic. This article identifies the factors determining the resilience of remittance inflows across countries and highlights the changes in the geographical and socio-economic composition of remittances, driven by the home and host country crisis dynamics and the severity of the impact across different working class.

Highlights:

- Cross-country remittances inflows are found to be driven by altruism motive, captured by the infection rate in the destination country and the stringency of the lockdown in the source countries.
- The fifth round of the remittances survey for 2020-21 finds that the share of Gulf countries in total remittances has declined, reflecting slower pace of migration and presence of Indian diaspora in informal sectors which was hit the most during the pandemic period.
- The proportion of small sized transactions increased, reflecting COVID-19 led stressed income conditions.
- The divergence was also reflected in the bank-group wise performances as public sector banks lost market share while private banks retained their dominance in the remittances business.

VI. Electronification of FX Markets in India

The electronification of global foreign exchange (FX) trading with the emergence of multi-bank platforms has transformed the execution of trade and price discovery. Some of these changes can be seen even in the onshore Indian Rupee (INR) market, *albeit* in a limited way. This article documents the recent changes in FX markets in India in terms of electronification and its broader implications.

Highlights:

- Electronification of global FX trading, in recent times, has been characterised by the emergence of new forms of trading venues, such as single-bank platforms (SBPs) and market-makers, including principal trading firms (PTFs).
- These developments have altered the market structure with growing market fragmentation *viz*., dispersion of FX trading across a wide range of trading venues, and internalisation *viz.*, dealers increasingly offsetting client trades with each other instead of covering the risk in the interdealer market.
- In recent years, SBPs are also becoming increasingly visible in the Indian FX market with trading volumes rising on such platforms.

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