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Azadi Ka Amrit Mahotsav

August 05, 2022

# Governor's Statement

We will celebrate 75 years of our Independence in another ten days. It is a great moment for all of us. I take this opportunity to convey my warm greetings to everyone on this historic occasion.

2. Successive shocks to the global economy are taking their toll in terms of globalised inflationary surges, tightening of financial conditions, sharp appreciation of the US dollar and lower growth across geographies. Multilateral institutions, including the International Monetary Fund (IMF), have revised global growth projections downwards and highlighted rising risks of recession. Disquietingly, globalisation of inflation is coinciding with deglobalisation of trade. The pandemic and the war have ignited tendencies towards greater fragmentation, reshoring of supply chains and retrenchment of capital flows, which will pose long-term challenges for both globalisation and the global economy.

3. For emerging market economies (EMEs), these risks are magnified as they have to contend with both domestic growth-inflation trade-offs and spillovers from the most synchronised tightening of monetary policy worldwide. EMEs are facing a rapid tightening of external financial conditions, capital outflows, currency depreciations and reserve losses simultaneously. Some of them are also facing mounting burdens of debt and default. Elevated food and energy prices and shortages are rendering their populations vulnerable to insecurity of livelihood.

4. The Indian economy has naturally been impacted by the global economic situation. We have been grappling with the problem of high inflation. Financial markets have remained uneasy despite intermittent corrections. We have witnessed large portfolio outflows to the tune of US$ 13.3 billion during the current financial year so far (up to August 3). Nevertheless, with strong and resilient fundamentals, India is expected to be amongst the fastest growing economies during 2022-23 according to the IMF, with signs of inflation moderating over the course of the year. Export of goods and services together with remittances are expected to keep the current account deficit within sustainable limits. The decline in external debt to GDP ratio, net international investment position to GDP ratio and debt service ratio during 2021-22 impart resilience against external shocks[1]. The financial sector is well capitalised and sound. India's foreign exchange reserves, supplemented by net forward assets, provide insurance against global spillovers. Our umbrella remains strong.

[1] External debt/GDP ratio fell from 21.2 per cent in March 2021 to 19.9 per cent in March 2022, while net international investment position/GDP ratio (*i.e.* net claims of non-residents) improved from (-) 13.2 per cent to (-) 11.6 per cent over the same period. Debt service ratio declined from 8.2 per cent in 2020-21 to 5.2 per cent in 2021-22.

## Decisions and Deliberations of the Monetary Policy Committee (MPC)

5. Against this background, the monetary policy committee (MPC) met on August 3 to 5 and reviewed the macroeconomic situation and its outlook. The MPC decided unanimously to increase the policy repo rate by 50 basis points to 5.4 per cent, with immediate effect. Consequently, the standing deposit facility (SDF) rate stands adjusted to 5.15 per cent; and the marginal standing facility (MSF) rate and the Bank Rate to 5.65 per cent. The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

6. Let me now dwell briefly on the MPC's rationale for its decisions on the policy rate and the stance. Against the prevailing adverse global environment, the MPC noted that domestic economic activity is resilient and progressing broadly along the lines of the June resolution of the MPC. Consumer price inflation has eased from its surge in April but remains uncomfortably high and above the upper threshold of the target. Inflationary pressures are broad-based and core inflation remains at elevated levels. The volatility in global financial markets is impinging upon domestic financial markets, including the currency market, thereby leading to imported inflation.

7. With inflation expected to remain above the upper threshold in Q2 and Q3, the MPC stressed that sustained high inflation could destabilise inflation expectations and harm growth in the medium term. The MPC, therefore, judged that further calibrated withdrawal of monetary accommodation is warranted to keep inflation expectations anchored and contain the second-round effects. Accordingly, the MPC decided to increase the policy repo rate by 50 basis points to 5.4 per cent. The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

## Assessment of Growth and Inflation

### Growth

8. Domestic economic activity is exhibiting signs of broadening. The south-west monsoon rainfall and reservoir levels are above normal; *kharif* sowing is progressing well, although it is marginally below last year's level due to uneven rainfall distribution[2]. On the demand side, indicators such as production of consumer durables, domestic air passenger traffic and sale of passenger vehicles suggest improvement in urban demand. Rural demand indicators, however, exhibited mixed signals – while two-wheeler sales increased, tractor sales contracted in June over a high base though. High frequency indicators of the services sector like railway freight traffic, port freight traffic, e-way bills, toll collections and commercial vehicle sales remained robust in June and July. Investment activity is also picking up – the production of capital goods recorded double-digit growth for the second month in a row in May and import of capital goods also witnessed robust growth in June. PMI manufacturing rose to an 8-month high in July. PMI services indicated continued expansion in July, although it fell from an over 11-year high of June. Capacity

[2] The cumulative seasonal rainfall was 6 per cent above the long period average (LPA) as on August 4, 2022, with 30 out of the 36 sub-divisions receiving normal or above normal rainfall as against 28 sub-divisions last year. As of July 29, 2022, the total area sown under *kharif* crops was 2.2 per cent lower than a year ago. The storage in major reservoirs as on July 28 was 119 per cent of that in the corresponding period of last year and 139 per cent of the average during the last ten years.

utilisation in the manufacturing sector is now above its long-run average[3], signalling the need for fresh investment activity in additional capacity creation. Bank credit growth has accelerated to 14.0 per cent (y-o-y) as on July 15, 2022 from 5.4 per cent a year ago. Incoming data of corporates for Q1 indicate that sales and demand conditions and profitability of manufacturing sector remained buoyant.

9. Looking ahead, a good progress of the southwest monsoon and *kharif* sowing would support rural consumption. Urban consumption is expected to benefit from the demand for contact-intensive services, better performance of corporates and improving consumer optimism. The increase in capacity utilisation, government's capex push and large expansion in bank credit should support investment activity. According to our survey, manufacturing firms expect sustained improvement in production volumes and new orders in Q2:2022-23, which is likely to sustain through Q4. At the same time, the domestic economy faces headwinds from global forces - protracted geopolitical tensions; rising global financial market volatility; tightening global financial conditions; and global recession risks. Taking all these factors into consideration, the real GDP growth projection for 2022-23 is retained at 7.2 per cent, with Q1 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, with risks broadly balanced. Real GDP growth for Q1:2023-24 is projected at 6.7 per cent.

**Inflation**

10. June 2022 was the sixth consecutive month when headline CPI inflation remained at or above the upper tolerance level of 6 per cent. Looking ahead, the inflation trajectory continues to be heavily contingent upon the evolving geopolitical developments, international commodity market dynamics, global financial market developments and the spatial and temporal distribution of the south-west monsoon. Since the last MPC meeting, however, there has been some let-up in global commodity prices – particularly in prices of industrial metals – and some softening in global food prices. Domestic edible oil prices are expected to soften further on the back of improving supplies from key producing countries and Government's supply-side interventions. The resumption of wheat supply from the Black Sea region, if it sustains, could help to temper international prices. Supply chain pressures, though elevated, are on an easing trajectory. Further, the advance of the south west monsoon is by and large on track and *kharif* sowing has picked up in recent weeks. The shortfall in *kharif* sowing of paddy, however, needs to be watched closely, although buffer stocks are quite large. Household inflation expectations have eased, but they still remain elevated.

11. Incidence of unseasonal and excessive rainfall, if any, can impact food prices, especially vegetable prices. Greater transmission of input cost pressures to selling prices across manufacturing and services sectors may also create fresh price pressures. Moreover, persistently elevated cost of living conditions could translate to higher wages and further price increases, especially if pricing power of firms strengthen. Taking into account these factors, and on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel, inflation is projected at 6.7 per cent in 2022-23, with Q2 at 7.1 per cent; Q3 at 6.4 per cent; and Q4 at 5.8 per cent, with risks evenly balanced. CPI inflation for Q1:2023-24 is projected at 5.0 per cent.

[3] According to RBI survey, capacity utilisation in the manufacturing sector in Q4:2021-22 was 75.3 per cent relative to its long-term average of 73.7 per cent.

12. The inflation trajectory is now poised at a decisive point. While there are incipient signs of a confluence of factors that could lead to further softening of domestic inflationary pressures, there remain significant uncertainties. In such a milieu, with growth momentum expected to be resilient despite headwinds from the external sector, monetary policy should persevere further in its stance of withdrawal of accommodation to ensure that inflation moves close to the target of 4.0 per cent over the medium term, while supporting growth. A calibrated approach would provide sufficient flexibility to monetary policy in the current uncertain environment.

**Liquidity and Financial Market Conditions**

13. The introduction of the standing deposit facility (SDF) in April 2022, which raised the floor of the liquidity adjustment facility (LAF) corridor by 40 basis points (bps), along with the policy repo rate hikes of May and June, have effectively resulted in withdrawal of accommodation by 130 bps. Consequently, the weighted average call rate (WACR) – the operating target of monetary policy – has commensurately firmed up. At the longer end of the money market, interest rates on 91-day treasury bills, commercial paper (CPs) and certificates of deposit (CDs) have also moved higher since April. The rate hikes also triggered an upward adjustment in the benchmark lending rates by the banks. Term deposit rates are also increasing which should bode well for availability of funds with the banks in the context of sustained buoyancy in credit demand.

14. Surplus liquidity in the banking system, as reflected in average daily absorptions under the LAF (both SDF and variable rate reverse repo auctions), moderated to ₹3.8 lakh crore during June-July 2022 from ₹6.7 lakh crore during April-May. The sharp moderation in surplus liquidity from July 20, mainly on account of tax and capital outflows, resulted in money market rates firming up above the repo rate. To alleviate the liquidity stress, the RBI conducted a variable rate repo auction of ₹50,000 crore of 3 days maturity on July 26, 2022. Going forward, and as indicated in my February 2022 statement, the RBI will remain vigilant on the liquidity front and conduct two-way fine-tuning operations as and when warranted – both variable rate repo (VRR) and variable rate reverse repo (VRRR) operations of different tenors, depending on the evolving liquidity and financial conditions.

15. During the current financial year (up to August 4), the US dollar index (DXY) has appreciated by 8.0 per cent against a basket of major currencies. In this milieu, the Indian Rupee has moved in a relatively orderly fashion depreciating by 4.7 per cent against the US dollar during the same period – faring much better than several reserve currencies as well as many of its EME and Asian peers. The depreciation of the Indian rupee is more on account of the appreciation of US dollar rather than weakness in macroeconomic fundamentals of the Indian economy. Market interventions by the RBI have helped in containing volatility and ensuring orderly movement of the rupee. We remain watchful and focused on maintaining stability of the Indian rupee.

16. The Indian financial system remains resilient. This will help the economy in emerging out of the shadows of the pandemic and the impact of the war in Europe. While the banking system remains well capitalised and profitable, a deleveraged corporate sector augurs well for sustaining the recovery.

**External Sector**

17. India's external sector has weathered the storm while navigating through the recent global spillovers. Merchandise exports grew in April-July 2022 while merchandise imports surged to record high on the back of elevated global commodity prices. Consequently, the merchandise trade deficit expanded to US$ 100.0 billion in April-July 2022. Provisional data indicate that demand for services exports, especially IT services, remained buoyant in Q1 despite global uncertainty. Exports of travel and transport services also improved in Q1:2022-23 on a year-on-year basis.

18. From the external financing perspective, net foreign direct investment (FDI) at US$ 13.6 billion in Q1:2022-23 was robust as compared to US$ 11.6 billion in Q1:2021-22. Foreign portfolio investment, after remaining in exit mode during Q1:2022-23, turned positive in July 2022. Along with several other measures undertaken in July, the Reserve Bank has also used its foreign exchange reserves accumulated over the years to curb volatility in the exchange rate. Despite the resultant drawdown, India's foreign exchange reserves remain the fourth largest globally.

**Additional Measures**

19. I shall now announce certain additional measures, the details of which are set out in the statement on developmental and regulatory policies (Part B) of the Monetary Policy Statement. The additional measures are as follows.

**Regulatory Measures - Standalone Primary Dealers (SPDs)**

20. Standalone Primary Dealers (SPDs) have played an important role in the development of financial markets in India. Considering their potential in further facilitating financial market development, the following two measures are being announced for the SPDs.

(i) It is proposed to enable Standalone Primary Dealers (SPDs) to offer all foreign exchange market-making facilities as currently permitted to Category-I Authorised Dealers, subject to prudential guidelines. This measure will provide customers with a wider set of market makers to manage their foreign currency risk. This will also increase the breadth of the forex market in India.

(ii) Standalone Primary Dealers (SPDs) will be permitted to undertake transactions in the offshore Rupee Overnight Indexed Swap (OIS) market with non-residents and other market makers. This measure will supplement a similar measure announced in February this year for the banks. These measures are expected to remove the segmentation between onshore and offshore OIS markets and improve price discovery.

**Managing Risks and Code of Conduct in Outsourcing of Financial Services**

21. The RBI has, from time to time, issued guidelines on managing risks in outsourcing of certain activities by the Regulated Entities (REs). In view of the increasing trend of outsourcing, the framework for REs to manage the associated risks needs to be suitably strengthened. Therefore, to harmonise and consolidate the extant guidelines, a draft Master Direction on Managing Risks and Code of Conduct in Outsourcing of Financial Services will be issued shortly for comments from stakeholders.

**Enabling Bharat Bill Payment System (BBPS) to Process Cross-Border Inbound Bill Payments**

22. The Bharat Bill Payment System (BBPS) is an interoperable platform for standardised bill payments. This has transformed the bill payment experience for users in India. Over 20,000 billers are part of the system, and more than 8 crore transactions are processed on a monthly basis. It is now proposed to enable BBPS to accept cross-border inward bill payments. This will enable Non-Resident Indians (NRIs) to undertake bill payments for utility, education and other such payments on behalf of their families in India. This will greatly benefit the senior citizens in particular.

**Inclusion of Credit Information Companies (CICs) under the Reserve Bank-Integrated Ombudsman Scheme (RB-IOS) 2021 and Introduction of the Internal Ombudsman (IO) Mechanism**

23. The Reserve Bank - Integrated Ombudsman Scheme (RB-IOS) has improved the customer grievance redress mechanism. The turnaround time of grievance redress under RB-IOS has declined considerably. In order to make the RB-IOS more broad based, it has been decided to include Credit Information Companies (CICs) under the RB-IOS framework. This will provide a cost-free alternative redress mechanism for grievances against CICs. Further, with a view to strengthen the internal grievance redress by CICs themselves, it has been decided to mandate the CICs to have their own internal Ombudsman (IO) framework.

**Committee on MIBOR Benchmark**

24. The Reserve Bank has been taking measures, from time to time, to develop the interest rate derivatives (IRD) market in India. Such measures have led to diversification of the participant base and increased use of IRD instruments, such as the Mumbai Interbank Outright Rate (MIBOR) overnight indexed swap (OIS) contracts. In view of the recent international efforts to develop alternative benchmark rates, it is proposed to set up a committee to undertake an in-depth examination of the issues, including the need for transition to an alternative benchmark for MIBOR, and suggest the way forward.

**Concluding Observations**

25. The Indian economy is holding steady and progressing in an ocean of turbulence and uncertainty. As we celebrate *Azadi ka Amrit Mahotsav*, this is a moment of reckoning, reflection and renewed resolve to work for the betterment of our economy. We, in the RBI, reiterate our commitment to maintain price and financial stability to place our economy on a sustainable path of growth. Our actions have helped the economy to tide over a series of shocks in the last two and half years. We are seized of our role at this critical juncture and will persevere in our efforts to ensure a safe and soft landing. This is a moment to recall a quote from Mahatma Gandhi: "*For me the road to salvation lies through incessant toil in the service of my country and there through of humanity*"[4].
Thank you. Namaskar.

**(Yogesh Dayal)**
Chief General Manager

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[4] Source: Young India, 3-4-1924, p.114