



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi

Website : www.rbi.org.in

ई-मेल/email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

Department of Communication, Central Office, S.B.S.Marg, Mumbai-400001

फोन/Phone: 022- 22660502

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RBI Bulletin - January 2021

The Reserve Bank of India today released the [January 2021](#) issue of its monthly Bulletin. The Bulletin includes one Speech, four Articles and Current Statistics.

The four articles are: [I. State of the Economy](#); [II. Effective Exchange Rate Indices of the Indian Rupee](#); [III. Small Finance Banks: Balancing Financial Inclusion and Viability](#); [IV. Green Finance in India: Progress and Challenges](#).

I. State of the Economy

- 2020 turned out to be a year in which everything changed. The year 2021 has commenced with countries across the world in a massive vaccination drive.
- In India, recent shifts in the macroeconomic landscape have brightened the outlook, with GDP in striking distance of attaining positive territory and inflation easing closer to the target.
- Financial markets remain ebullient with EMEs receiving strong portfolio inflows and India on track for receiving record annual inflows of foreign direct investment.

II. Effective Exchange Rate Indices of the Indian Rupee

Structural changes in the Indian economy and shifts in pattern of India's foreign trade warrant updates to the broad (existing 36-currency-based) indices of nominal/real effective exchange rate (NEER/REER) of the Indian rupee. This article presents the updated series, with two important innovations: the base year is shifted from 2004-05 to 2015-16; and the existing basket is expanded from 36 to 40 currencies, with the inclusion of eight new currencies and exclusion of four currencies.

Highlights:

- The new REER indices have remained around the benchmark (*i.e.*, base year value of 100) for most part of the sample period from 2004-05 to 2019-20, reflecting India's external competitiveness better than the old series.
- Inflation differentials between India and its major trading partners have declined and stabilised since the adoption of flexible inflation targeting (FIT) framework, boding well for India's external competitiveness.
- The new REER, on average, was 0.8 per cent above its base year level during 2016-17 to 2019-20, reflecting moderate inflation observed under FIT regime.

III. Small Finance Banks: Balancing Financial Inclusion and Viability

Small Finance Banks (SFBs) are a new entrant into the Indian banking system. This article analyses the performance of SFBs with specific reference to their objective of financial inclusion, while also highlighting salient aspects about their financial viability. The key observations from this analysis are the following:

- SFBs are making their presence felt in certain under-banked states, including Madhya Pradesh and Rajasthan. There is, however, a concentration of their branches in the relatively well-banked states, including Tamil Nadu, Maharashtra and Karnataka. Their branches also display a concentration at semi-urban and urban centers.
- SFBs have been reasonably successful in reaching out to under-served sectors, such as Micro, Small and Medium Enterprises (MSMEs) and agriculture. MSMEs accounted for about 41 per cent of the total SFB credit in March 2020. Furthermore, the loan portfolio of SFBs is geared towards small-sized loans.
- The return on assets, an indicator of financial viability, has been high for SFBs. Their cost of funds has also been high explained by a lower percentage of current and savings accounts (CASA) in their deposit base. However, a high spread has enabled them to earn a high return on funds.
- The NPA ratio, another important indicator of financial viability, has remained moderate for SFBs since their inception, in part reflecting the better management of credit risks by these institutions.

IV. Green Finance in India: Progress and Challenges

Green finance plays a pivotal role in resource allocations towards sustainable economic growth. This article highlights the recent developments and challenges relating to green finance in India.

Highlights:

- World over, green finance has emerged as a priority for public policy. The Government of India, the Reserve Bank of India and the Security and Exchange Board of India have taken several initiatives to promote green finance in India, including, *inter alia*, implementation of mandatory sustainability disclosure and bringing the production of renewable energy under priority sector lending scheme, measures that incentivise the production and usage of unconventional energy by firms and households.
- Our findings based on variety of data sources indicate that there have been improvements in public awareness and financing options for green finance in India.
- Some of the major challenges could be high borrowing costs, false claims of environmental compliances, plurality of green loan definitions, and maturity mismatches. In this vein, a reduction in asymmetric information through better information management and increased coordination among the stakeholders could pave the way towards greener and sustainable long-term economic growth.