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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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October 08, 2021

Governor's Statement: October 08, 2021

This is my twelfth statement since the onset of the pandemic. Of these, two statements were outside the Monetary Policy Committee (MPC) cycle – one in April 2020 at the outbreak of the COVID-19 crisis and the other in May 2021 at the peak of the second wave. Further, on two occasions – March and May 2020 – the MPC meeting had to be advanced to take pre-emptive action to safeguard the economy from the ravages of the pandemic. Over this period, the Reserve Bank has taken more than 100 measures to proactively and decisively respond to the unprecedented crisis. While doing so, we have not been a prisoner of any rulebook. We have not hesitated to take new and unconventional measures to keep the financial markets functioning and the market sentiments positive; provide liquidity to targeted sectors and institutions; and leverage on digital technologies to reach out to individuals and businesses. Thus, although the pandemic protocols do us part, technology ties us together.

2. In this backdrop, the MPC met on 6th, 7th and 8th October, 2021. Based on an assessment of the evolving macroeconomic and financial conditions and the outlook, the MPC voted unanimously to maintain status quo with regard to the policy repo rate and by a majority of 5 to 1 to retain the accommodative policy stance. Consequently, the policy repo rate remains unchanged at 4 per cent; and the stance remains accommodative as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward. The marginal standing facility (MSF) rate and the bank rate remain unchanged at 4.25 per cent. The reverse repo rate also remains unchanged at 3.35 per cent.

3. With the worst of the second wave behind us and substantial pick-up in COVID-19 vaccination giving greater confidence to open up and normalise economic activity, the recovery of the Indian economy is gaining traction. While vaccine reach is the real fault line in the current global recovery, India is in a much better place today than at the time of the last MPC meeting. Growth impulses seem to be strengthening and we derive comfort from the fact that the inflation trajectory is turning out to be more favourable than anticipated. In spite of global headwinds, we hope to emerge from the storm and sail towards normal times, steered by the underlying resilience of the macro-economic fundamentals of the Indian economy.

4. Let me now give a brief overview of the MPC's rationale for the pause on the policy rate and the accommodative stance. The MPC noted that economic activity over the past two months has broadly evolved in consonance with the MPC's August assessment and outlook; and CPI inflation during July-August has turned out to be lower than anticipated. The actual outturn of real GDP growth in Q1:2021-22 at 20.1 per cent was close to, *albeit* a little below the MPC's forecast of 21.4 per cent. High-

frequency indicators for Q2:2021-22 suggest that economic recovery has gained momentum, supported by ebbing of infections, the robust pace of vaccination, expected record kharif foodgrains production, government's focus on capital expenditure, benign monetary and financial conditions, and buoyant external demand.

5. Consumer price inflation softened during July-August, moving back into the tolerance band with an easing of food inflation, corroborating the MPC's assessment of the spike in inflation in May as transitory. Improvement in monsoon in September, the expected higher kharif production, adequate buffer stock of foodgrains and lower seasonal pickup in vegetable prices are likely to keep food price pressures muted. Core inflation, however, remains sticky. Elevated global crude oil and other commodity prices, combined with acute shortage of key industrial components and high logistics costs, are adding to input cost pressures. Pass-through to output prices has, however, been restrained by weak demand conditions. The evolving situation requires close vigilance.

6. Overall, aggregate demand is improving but slack still remains; output is still below pre-pandemic level and the recovery remains uneven and dependent upon continued policy support. Contact intensive services, which contribute about 40 per cent of economic activity in India, are still lagging. Supply side and cost push pressures are impinging upon inflation and these are expected to ameliorate with the ongoing normalisation of supply chains. Efforts to contain cost-push pressures through a calibrated reversal of the indirect taxes on fuel could contribute to a more sustained lowering of inflation and an anchoring of inflation expectations. Against this backdrop, the MPC decided to retain the prevailing repo rate at 4 per cent and continue with the accommodative stance, as stated in the last MPC statement.

Assessment of Growth and Inflation

Growth

7. According to the release of National Statistical Office on August 31, real GDP growth for Q1:2021-22 at 20.1 per cent exhibited resilience of the economy in the face of the destructive second wave of COVID-19. Almost all components of GDP registered y-o-y growth, despite a sharp loss of momentum due to the second wave.

8. Recovery in aggregate demand gathered pace in August-September. This is reflected in high-frequency indicators – railway freight traffic; port cargo; cement production; electricity demand; e-way bills; GST and toll collections. The ebbing of infections, together with improving consumer confidence, has been supporting private consumption. The pent-up demand and the festival season should give further fillip to urban demand in the second half of the financial year. Rural demand is expected to get impetus from continued resilience of the agricultural sector and record production of kharif foodgrains in 2021-22 as per the first advance estimates. The improved level in reservoirs and early announcement of the minimum support prices for rabi crops boost the prospects for rabi production. The support to aggregate demand from government consumption is also gathering pace.

9. Improvement in government capex, together with congenial financial conditions, could bring about an upturn in the much-awaited virtuous investment cycle. Pick up in import of capital goods and cement production point towards some revival in investment activity. According to our survey results, capacity utilisation (CU) in the manufacturing sector, which declined sharply in Q1:2021-22 under the second wave, is assessed to have recovered in Q2 and further improvement is expected in the ensuing quarters.

10. Critical support to aggregate demand also came from exports, which remained in excess of US$ 30 billion for the seventh consecutive month in September 2021 reflecting strong global demand and policy support. This augurs well for meeting our export target of US$ 400 billion during 2021-22.

11. Recovery in the services sector is also gaining traction. Gradual pickup in contact-intensive services, together with strong performance of technology driven sectors, are likely to support the momentum.

12. Impact of elevated input costs on profit margins, potential global financial and commodity markets volatility and a resurgence in COVID-19 infections, however, impart downside risks to the growth outlook. Taking all these factors into consideration, the projection for real GDP growth is retained at 9.5 per cent in 2021-22 consisting of 7.9 per cent in Q2; 6.8 per cent in Q3; and 6.1 per cent in Q4 of 2021-22. Real GDP growth for Q1:2022-23 is projected at 17.2 per cent.

Inflation

13. Headline CPI inflation at 5.3 per cent in August registered a moderation for the second consecutive month and a decline of one percentage point from its level in June 2021. The key driver of the disinflation has been the moderation in food inflation even as fuel inflation edged up and CPI inflation excluding food and fuel inflation (core inflation) remained elevated. Headline inflation continues to be significantly influenced by very high inflation in select items such as edible oils, petrol and diesel, LPG and medicines. On the other hand, a very low seasonal build-up in vegetable prices, declining cereal prices, a sharp deflation in gold prices and muted housing inflation have helped to contain inflationary pressures.

14. Going forward, several evolving factors provide comfort on the food price front. Its momentum is expected to remain muted in the near term. Cereal prices are expected to remain soft due to likely record kharif foodgrains production and adequate buffer stocks. Vegetable prices, a major source of inflation volatility, have remained contained in the year so far with record production and supply side measures by the Government. Unseasonal rains and adverse weather-related events – if any, in the coming months – are, however, upside risks to vegetable prices. Supply side measure by the Government for edible oils and pulses are helping to temper price pressures; however, an uptick in prices of edible oils is seen in the recent period.

15. Overall, the CPI headline momentum is moderating which, combined with favourable base effects in the coming months, could bring about a substantial softening in inflation in the near-term. Taking into consideration all these factors, CPI inflation is projected at 5.3 per cent for 2021-22: 5.1 per cent in Q2, 4.5 per cent in Q3; 5.8 per cent in Q4 of 2021-22, with risks broadly balanced. CPI inflation for Q1:2022-23 is projected at 5.2 per cent. We are watchful of the evolving inflation situation and remain committed to bring it closer to the target in a gradual and non-disruptive manner.

Liquidity and Financial Market Conditions

16. At the current juncture, central banks across the world find themselves at crossroads. Diverging monetary policy stances are not being dictated by country groupings but by country circumstances. Among EMEs, some are tightening monetary policy, others are undertaking further monetary stimulus, while a few are on a resolute pause. The countries that are tightening monetary policy are those which are facing inflation much above their upper tolerance bands and are also registering a strong rebound in growth above pre-pandemic levels, boosted mainly by commodity export earnings and positive spillovers from improvement in macroeconomic conditions in some advanced economies. Countries that are easing monetary policy through non-rate actions are the rare few which have low consumer price inflation. And finally, countries which are on a resolute pause have inflation in the elevated zone but poor growth prospects or nascent recoveries that need nurturing. In India, the MPC has maintained a pause and given time and state contingent forward guidance from time to time on maintaining accommodation. The conduct of monetary policy in India will continue to be oriented to our domestic circumstances and our assessment.

17. Since the onset of the pandemic, the Reserve Bank has maintained ample surplus liquidity to support a speedy and durable economic recovery. The level of surplus liquidity in the banking system increased further during September 2021, with absorption under fixed rate reverse repo, variable rate reverse repo (VRRR) of 14 days and fine-tuning operations under the liquidity adjustment facility (LAF) averaging ₹9.0 lakh crore per day as against ₹7.0 lakh crore during June to August 2021. The surplus liquidity rose even further to a daily average of ₹9.5 lakh crore in October so far (up to October 6). The potential liquidity overhang amounts to more than ₹13.0 lakh crore.

18. As the economy shows signs of emerging from the COVID-19 inflicted ravages, a near consensus view emerging among market participants and policy makers is that the liquidity conditions emanating from the exceptional measures instituted during the crisis would need to evolve in sync with the macroeconomic developments to preserve financial stability. This process has to be gradual, calibrated and non-disruptive, while remaining supportive of the economic recovery.

19. The Reserve Bank's secondary market G-Sec Acquisition Programme (G-SAP) has been successful in addressing market concerns and anchoring yield expectations in the context of the large borrowing programme of the Government. Coupled with other liquidity measures, it facilitated congenial and orderly financing conditions and a conducive environment for the recovery. The total liquidity injected into the system during the first six months of the current financial year through open market operations (OMOs), including G-SAP, was ₹2.37 lakh crore, as against an injection of ₹3.1 lakh crore over the full financial year 2020-21. Given the existing liquidity overhang, the absence of a need for additional borrowing for GST compensation and the expected expansion of liquidity in the system as Government spending increases in line with budget estimates, the need for undertaking further G-SAP operations at this juncture does not arise. The Reserve Bank, however, would remain in readiness to undertake G-SAP as and when warranted by liquidity conditions and also continue to flexibly conduct other liquidity management operations including Operation Twist (OT) and regular open market operations (OMOs).

20. With the resumption of normal liquidity operations since mid-January 2021, 14-day variable rate reverse repo (VRRR) auctions have been deployed as the main instrument under the liquidity management framework. Market appetite for VRRRs has been enthusiastic. Moreover, the higher remuneration which VRRR offers *vis-à-vis* the fixed rate reverse repo is also rendering the former relatively attractive. Keeping in view the market feedback, it is proposed to undertake the 14-day VRRR auctions on a fortnightly basis in the following manner: ₹4.0 lakh crore today as already notified; ₹4.5 lakh crore on October 22; ₹5.0 lakh crore on November 3; ₹5.5 lakh crore on November 18; and ₹6.0 lakh crore on December 3. Further, depending upon the evolving liquidity conditions – especially the quantum of capital flows, pace of government expenditure and credit offtake – the RBI may also consider complementing the 14-day VRRR auctions with 28-day VRRR auctions in a similar calibrated fashion. The RBI also retains the flexibility to conduct fine-tuning operations of varying amounts as and when required. Even with all these operations, the liquidity absorbed under the fixed rate reverse repo would still be around ₹2 to 3 lakh crore in the first week of December 2021.

21. Let me reiterate and reemphasise that the VRRR auctions are primarily a tool for rebalancing liquidity as part of our liquidity management operations and should not be interpreted as a reversal of the accommodative policy stance. The RBI will ensure that there is adequate liquidity to support the process of economic recovery. The Reserve Bank will continue to support the market in ensuring an orderly completion of the borrowing programme of the Government. Further, our focus on orderly evolution of the yield curve as a public good also continues.

Additional Measures

22. Against this backdrop and based on our continuing assessment of the macroeconomic situation and financial market conditions, certain additional measures are also being announced today. The details of these measures are set out in the statement on developmental and regulatory policies (Part-B) of the Monetary Policy Statement. The additional measures are as follows.

On Tap Special Long-Term Repo Operations (SLTRO) for Small Finance Banks (SFBs)

23. A special three-year long-term repo operation (SLTRO) of ₹10,000 crore at the repo rate was introduced for Small Finance Banks (SFBs) in May 2021. This facility is currently available till October 31, 2021. Recognising the need for continued support to small business units, micro and small industries, and other unorganised sector entities, it has been decided to extend this facility till December 31, 2021 and make it available On Tap.

Introduction of Retail Digital Payment Solutions in Offline Mode

24. A scheme to test technologies that enable digital payments even in remote places where internet connectivity is either absent or barely available was announced in August 2020. Given the encouraging experience gained from the pilot tests, it is proposed to introduce a framework for retail digital payments in offline mode across the country. This will further expand the reach of digital payments and open up new opportunities for individuals and businesses.

Enhancing Transaction Limit in IMPS to ₹5 lakh

25. Immediate Payment Service (IMPS) offers instant domestic funds transfer facility 24x7 through various channels. In view of the importance of the IMPS system and for enhanced consumer convenience, it is proposed to increase the per-transaction limit from ₹2 lakh to ₹5 lakh.

Geo-Tagging of Payment System Touch Points

26. Ensuring wider availability of payments acceptance (PA) infrastructure throughout the country has been one of the priority areas for financial inclusion. To target areas with deficient PA infrastructure, it is proposed to introduce a framework for leveraging geo-tagging technology for capturing exact location information on all existing and new PA infrastructure *viz.*, Point of Sale (PoS) terminals, Quick Response (QR) Codes, etc. This would complement the Payment Infrastructure Development Fund (PIDF) framework of the Reserve Bank in ensuring wider geographical deployment of PA infrastructure.

Regulatory Sandbox – Announcement of the Theme for a New Cohort and On Tap Application for Earlier Themes

27. The Reserve Bank's Regulatory Sandbox (RS) has so far introduced three cohorts on 'Retail Payments'; 'Cross Border Payments'; and 'MSME Lending'. With a view to provide further impetus to the fintech eco-system, a fourth cohort on 'Prevention and Mitigation of financial frauds' is being announced. In addition, based on the experience gained and the feedback received from stakeholders, it is proposed to facilitate 'On Tap' application for earlier themes for participating in the Regulatory Sandbox. This measure is expected to ensure continuous innovation in the fintech ecosystem of our country.

Review of Ways and Means Advances (WMA) Limits and Relaxation in Overdraft (OD) Facility for the State Governments / UTs

28. To help States/UTs to manage their cash flows amidst continued uncertainties on account of the pandemic, it has been decided to continue with the interim enhanced WMA limits of ₹51,560 crore for States/UTs for a further period of six months up to March 31, 2022. It has also been decided to continue with the liberalised measures, *viz*, enhancement of maximum number of days of overdraft (OD) in a quarter from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days, up to March 31, 2022.

Priority Sector Lending - Permitting Banks to On-lend through NBFCs - Continuation of Facility

29. Considering the increased traction observed in delivery of credit by NBFCs to the underserved/unserved segments of the economy, bank lending to registered NBFCs (other than MFIs) for on-lending to Agriculture, MSME and Housing was permitted to be classified as Priority Sector lending (PSL). This facility, which was available from August 13, 2019 till September 30, 2021 is being further extended for another six months up to March 31, 2022.

Internal Ombudsman for NBFCs

30. The increased strength and reach of NBFCs across the country has necessitated various measures by the Reserve Bank for protection of customers of NBFCs. With a view to further strengthening the internal grievance redress mechanism of NBFCs, it has been decided to introduce the Internal Ombudsman Scheme (IOS) for certain categories of NBFCs having higher customer interface.

Concluding Remarks

31. If there is anything that the most trying and difficult past eighteen months have taught us, it is to never doubt the indomitable human spirit which always rises to face mighty challenges. With our resilience and resolute commitment, we have learnt to adapt, innovate and turn challenges into opportunities. As we further accelerate the pace of economic recovery, it is important not to rest in the glory of what has been achieved but work tirelessly on what remains to be done. As Mahatma Gandhi, whose birth anniversary we celebrated last week, had said: "*to lose patience is to lose the battle*"[1].

Thank you. Stay safe. Stay well. Namaskar.

(Yogesh Dayal)
Chief General Manager

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[1] *Source: Book "Mahatma" by D.G. Tendulkar Volume 2 – Mahatma Gandhi*