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Governor's Statement: February 10, 2022

As I make this statement, the pandemic holds the global economy hostage once again. Despite signs of moderation, record numbers of daily infections in several countries and consequent containment measures are denting the pace of economic activity, especially in contact-intensive sectors, even as supply disruptions persist and restrained workforce participation tightens the labour markets. With inflation at multi-decadal highs in a number of countries, the evolving macroeconomic environment is being rendered highly uncertain by divergent monetary policy intentions and actions. Financial market volatility and geo-political tensions are adding layers of ambivalence to the outlook.

2. Notwithstanding a highly transmissible third wave driven by the Omicron variant of COVID-19, India is charting a different course of recovery from the rest of the world. India is poised to grow at the fastest pace year-on-year among major economies, according to projections made by the International Monetary Fund (IMF). This recovery is supported by large-scale vaccination and sustained fiscal and monetary support. Once again, our frontline warriors have admirably risen to the call of duty.

3. As we gain valuable experience from repeated waves of the pandemic, our responses are also becoming nuanced and calibrated. Protecting life is paramount; and protecting livelihood is rising in the hierarchy of priorities. The focus is on securing the economic and financial conditions of the vulnerable, the wage earners and all those who suffer the most. Accordingly, the emphasis is shifting to targeted containment strategies and a push towards universal vaccination and booster doses. This approach is being complemented by increased adoption of technology in our workplaces and in our day-to-day lives. The effort is to limit the extent of disruptions to economic activity.

Deliberations of the Monetary Policy Committee

4. The Monetary Policy Committee (MPC) met on 8th, 9th and 10th February 2022 and based on an assessment of the current macroeconomic situation and the outlook, it voted unanimously to keep the policy repo rate unchanged at 4 per cent. The MPC decided by a majority of 5 to 1 to continue with the accommodative stance 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.

5. The MPC flagged the potential downside risks to economic activity from the highly contagious Omicron variant. Reassuringly, the symptoms have remained relatively mild and the pace of infections is moderating as quickly as it surged. There is, however, some loss of momentum in economic activity as reflected in high frequency indicators such as purchasing managers' indices for both manufacturing and services, finished steel consumption and sales of tractors, two wheelers and passenger vehicles. The demand for contact-intensive services is still muted. Going forward, positive impulses for quickening the pace of recovery emanate from buoyant *Rabi* prospects, robust export demand, accommodative monetary and liquidity conditions, improving credit offtake, and the continued push on capital expenditure and infrastructure in the Union Budget 2022-23.

6. The MPC also noted that consumer price inflation has edged higher since its last meeting, but largely along anticipated lines. The increase in inflation in December was entirely due to unfavourable base effects despite month-on-month decline in prices. Large buffer stocks of cereals and effective supply side measures augur well for food inflation. Core inflation remains elevated, but demand-pull pressures are still muted. The renewed surge in international crude oil prices, however, needs close monitoring.

7. On balance, headline inflation is expected to peak in Q4:2021-22 within the tolerance band and then moderate closer to target in H2:2022-23, providing room for monetary policy to remain accommodative. At the same time, output is just barely above its pre-pandemic level, while private consumption is still lagging. Global headwinds are accentuating. Overall, taking into consideration the outlook for inflation and growth, in particular the comfort provided by the improving inflation

outlook, the uncertainties related to Omicron and global spillovers, the MPC was of the view that continued policy support is warranted for a durable and broad-based recovery.

Domestic Growth

8. In India, real GDP growth at 9.2 per cent for 2021-22 takes it modestly above the level of GDP in 2019-20. Private consumption, the mainstay of domestic demand, continues to trail its pre-pandemic level. The persistent increase in international commodity prices, surge in volatility of global financial markets and global supply bottlenecks can exacerbate risks to the outlook.

9. Going forward, government's thrust on capital expenditure and exports are expected to enhance productive capacity and strengthen aggregate demand. This would also crowd in private investment. The conducive financial conditions engendered by the RBI's policy actions will provide impetus to investment activity. The surveys done by the RBI reveal that capacity utilisation is rising, and the outlook on business and consumer confidence remain in optimistic territory, which should support investment as well as consumption demand. The prospects for agriculture have brightened on good progress of winter crop sowing.

10. Overall, there is some loss of the momentum of near-term growth while global factors are turning adverse. Looking ahead, domestic growth drivers are gradually improving. Considering all these factors, real GDP growth is projected at 7.8 per cent for 2022-23 with Q1:2022-23 at 17.2 per cent; Q2 at 7.0 per cent; Q3 at 4.3 per cent; and Q4 at 4.5 per cent.

Inflation

11. The CPI inflation trajectory has moved in close alignment with our projections. In particular, the softening of food prices is providing welcome relief. The improving prospects for foodgrains production and the expected easing of vegetable prices on fresh winter crop arrivals are adding further optimism. Moreover, the softening of pulses and edible oil prices is likely to continue in response to strong supply side interventions by the Government and increase in domestic production.

12. The hardening of crude oil prices, however, presents a major upside risk to the inflation outlook. Core inflation remains elevated at tolerance testing levels, although the continuing pass through of tax cuts relating to petrol and diesel last November

would help to moderate input cost pressures to some extent. The transmission of input cost pressures to selling prices remains muted in view of the continuing slack in demand. Further, as risks from Omicron wane and supply chain pressures moderate, there could be some softening of core inflation. On balance, the inflation projection for 2021-22 is retained at 5.3 per cent, with Q4 at 5.7 per cent on account of unfavourable base effects that ease subsequently. In particular, the CPI reading for January 2022 is expected to move closer to the upper tolerance band, largely due to adverse base effects. Taking all these factors into consideration and on the assumption of a normal monsoon, CPI inflation for 2022-23 is projected at 4.5 per cent with Q1:2022-23 at 4.9 per cent; Q2 at 5.0 per cent; Q3 at 4.0 per cent; and Q4 at 4.2 per cent, with risks broadly balanced.

13. At the current juncture, the conduct of domestic monetary policy is primarily attuned to the evolving inflation and growth dynamics even as we remain watchful of spillovers from the uncertain global developments and divergent monetary policy responses. Our monetary policy would continue to be guided by its primary mandate of price stability over the medium term, while also ensuring a strong and sustained economic recovery. As stated by me earlier, our actions will be calibrated and well-telegraphed.

Financial Stability

14. A strong and well-functioning financial sector fortifies the foundations of growth and development. The Reserve Bank has accorded the highest priority to preserving financial stability by taking quick and decisive steps to ease liquidity constraints, restore market confidence and prevent contagion to other segments of the financial market. We have been also strengthening the regulatory and supervisory framework for both banking and non-bank financial sectors to proactively identify, assess and deal with vulnerabilities.

15. Thus, despite the pandemic induced bouts of volatility, the Indian financial system has remained resilient and is now in a better position to meet the credit demands as recovery takes hold and investment activity picks up. The balance sheets of Scheduled Commercial Banks (SCBs) are relatively stronger with higher capital adequacy, reduced NPA, higher provisioning cover and improved profitability than in the previous years.

16. We have to be, however, watchful of the impact of the pandemic on the banking and NBFC sectors when the effects of regulatory reliefs and resolutions fully work their way through. Banks and other financial entities would be well advised to further strengthen their corporate governance and risk management strategies to build resilience in an increasingly dynamic and uncertain economic environment. They also need to continue the process of capital augmentation and building up of appropriate buffers.

Liquidity and Financial Market Conditions

17. The pandemic has delivered a once in a century crisis, with a health shock morphing into a macroeconomic and financial shock. The RBI undertook a slew of measures to deal with such an exceptional situation. As a consequence, borrowing costs fell to their lowest levels in decades and spreads narrowed across rating cohorts. Record levels of government securities, corporate bonds and debentures were issued. Corporate entities have been able to deleverage seamlessly and reduce high-cost debt while improving profitability and retained earnings for future capex. Overall, the financial sector has remained fully functional and has anchored the process of recovery. In our assessment, the policy actions of the RBI have yielded the desired results in a smooth and orderly manner.

18. With these objectives being achieved on an ongoing basis, the Reserve Bank has turned to rebalancing liquidity on a dynamic basis, while maintaining adequate liquidity in support of its accommodative stance. This rebalancing has involved two-sided operations: first, rebalancing liquidity from the overnight fixed rate reverse repo towards the 14-day variable rate reverse repo (VRRR) auction as the main operation, supported by fine-tuning auctions of varying tenors as envisaged in the Revised Liquidity Management Framework of February 2020; and second, conducting repo auctions of 1-3 day maturities to meet transient liquidity mismatches and shortages, as for instance in the recent case of more than expected GST outflows during the third week of January 2022. The key to effective liquidity management is the 'timing' and having a nuanced and nimble footed approach that responds swiftly to the manner in which liquidity tilts.

19. As a result of RBI's rebalancing operations, the daily average absorption under the fixed rate reverse repo has moderated sharply since August 2021 when rebalancing started. Overall system liquidity, however, remains in large surplus,

though it has moderated over the same period. Reflecting the migration of surplus liquidity from the overnight window to longer tenors, the effective reverse repo rate - the weighted average rate of the fixed rate reverse repo and the VRRRs of longer maturity - increased from 3.37 per cent as at end-August 2021 to 3.87 percent as on February 4, 2022.

20. It may be recalled that while instituting the revised liquidity management framework on February 6, 2020, the daily fixed rate repo and the four 14-day term repos within a reporting fortnight were withdrawn. In view of the pandemic and related work from home and social distancing protocols, the MSF and the fixed rate reverse repo windows were made operational throughout the day, instead of only at end of the day under normal circumstances. This passive mode of liquidity management worked well through pandemic conditions in ensuring adequate provision/absorption of liquidity as warranted by the evolving market conditions.

21. With the progressive return of normalcy, including transient demand for liquidity from the RBI, it is logical to restore the revised liquidity management framework in order to make it more flexible and agile. Accordingly, four decisions have been taken. First, variable rate repo operations of varying tenors will henceforth be conducted as and when warranted by the evolving liquidity and financial conditions within the cash reserve ratio (CRR) maintenance cycle. Second, variable rate repos (VRRs) and variable rate reverse repos (VRRRs) of 14-day tenor will operate as the main liquidity management tool based on liquidity conditions and will be conducted to coincide with the CRR maintenance cycle. Third, these main operations will be supported by fine-tuning operations to tide over any unanticipated liquidity changes during the reserve maintenance period. Auctions of longer maturity will also be conducted as warranted. Fourth, with effect from March 1, 2022, the Fixed Rate Reverse Repo and the MSF operations will be available only during 17.30-23.59 hours on all days and not during 09.00-23.59 hours, as instituted from March 30, 2020 to deal with the pandemic situation. Market participants are advised to shift balances out of the fixed rate reverse repo into VRRR auctions and avail the automated sweep-in and sweep-out (ASISO) facility in the e-Kuber portal for operational convenience[1].

[1] To provide greater flexibility to banks in managing their day-end CRR balances, the RBI has provided an optional automated sweep-in and sweep-out (ASISO) facility in August 2020 under which banks are able to pre-set a specific (or range) amount that they wish to maintain at the end of the day. Any shortfall or excess balances maintained by banks will automatically trigger marginal standing facility (MSF) or reverse repo bids, as the case may be, under the ASISO facility.

22. In the forex market, the Indian rupee (INR) has shown resilience in the face of global spillovers, even relative to EME peers. India's external sector sustainability is anchored by high foreign exchange reserve buffers and a modest level of the current account deficit (CAD). In H1:2021-22, the CAD was 0.2 per cent of GDP, underpinned by robust exports of goods and services. The merchandise trade deficit has widened in recent months partly due to elevated crude oil prices and rise in non-oil imports in line with the domestic economic recovery. Buoyant services exports led by IT services with strong prospects going forward are, however, likely to keep the CAD contained well below 2.0 per cent of GDP during 2021-22. Moreover, foreign direct investment inflows remain strong, which along with other forms of capital inflows, are expected to comfortably finance this modest level of the CAD.

23. In a global environment rendered highly volatile and uncertain by diverging monetary policy stances, geo-political tensions, elevated crude oil prices and persistent supply bottlenecks, emerging economies are vulnerable to destabilising global spillovers on an ongoing basis. Thus, policymakers face daunting challenges even as recovery from the pandemic remains incomplete. On its part, the Reserve Bank has been and will continue to insulate the domestic economy and financial markets from these spillovers. Further, while the RBI will continue to focus on smooth completion of the government borrowing programme, market participants also have a stake in the orderly evolution of financial conditions and the yield curve. It is expected that market participants will engage responsibly and contribute to cooperative outcomes that benefit all.

Additional Measures

24. Based on our continuing assessment, 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:

Extension of On-tap Liquidity Facilities for Emergency Health Services and Contact-intensive Sectors

25. On-tap liquidity facilities of ₹50,000 crore and ₹15,000 crore for emergency health services and contact-intensive sectors, respectively, were announced in May

and June 2021 during the second wave of the Pandemic. Banks were given certain incentives for lending under the two schemes. On account of the continued uncertainties brought on by the third wave, the two schemes are being extended from March 31, 2022 to June 30, 2022.

Voluntary Retention Route (VRR) - Enhancement of Limits

26. The Voluntary Retention Route (VRR) scheme was introduced in March 2019 to facilitate long-term investment by Foreign Portfolio Investors (FPIs) in debt securities issued by the government and the corporates. The response to the scheme has been very encouraging. It is, therefore, proposed to enhance the limit for investments under the scheme by ₹1.0 lakh crore from ₹1.5 lakh crore at present to ₹2.5 lakh crore with effect from April 1, 2022. This will provide access to additional sources of capital for the domestic debt market including g-secs.

Review of Credit Default Swaps (CDS) Guidelines

27. The guidelines for Credit Default Swaps (CDS) initially issued in 2013 were reviewed and draft guidelines were issued in February 2021 for public comments. Taking into account the feedback received, the final CDS Directions are being issued today. These guidelines will facilitate the development of a credit derivatives market and deepen the corporate bond market in India.

Permission for Banks to deal in Foreign Currency Settled - Rupee Derivatives Market

28. Banks in India have already been permitted to offer Rupee interest rate derivatives such as overnight indexed swaps (OIS) to non-residents. Now it has been decided to allow banks in India to undertake transactions in the offshore Foreign Currency Settled-Overnight Indexed Swap (FCS-OIS) market with non-residents and other market makers. This will reduce the segmentation between the onshore and offshore markets, enable more efficient price discovery and further deepen the interest rate derivatives market in India.

Enhancement of the Cap under e-RUPI (Prepaid Digital Vouchers using UPI)

29. The e-RUPI pre-paid digital voucher developed by the NPCI was launched in August 2021. The single use cashless payment voucher has a cap of ₹10,000. It is now proposed to increase the cap of e-RUPI vouchers issued by the Central government and State governments from ₹10,000 to ₹1,00,000 per voucher and

permit such e-RUPI vouchers to be used more than once (until the amount of the voucher is completely redeemed). This will further facilitate the delivery of various government schemes to the beneficiaries more efficiently.

Enabling Better Infrastructure for MSME Receivables Financing – Increasing NACH Mandate Limit for TReDS Settlements

30. The Trade Receivables Discounting System (TReDS) facilitates the financing of trade receivables of Micro, Small and Medium Enterprises (MSMEs). Transactions in TReDS are settled through the National Automated Clearing House (NACH) system. Keeping in view the requests received from stakeholders and to further enhance the ease of financing the growing liquidity requirements of MSMEs, it is proposed to increase the NACH mandate limit from ₹1 crore at present to ₹3 crore for TReDS related settlements.

Master Direction (MD) on IT Outsourcing and Master Direction (MD) on Information Technology Governance, Risk, Controls and Assurance Practices

31. Extensive outsourcing of critical IT services, leveraging of technology by the Regulated Entities of RBI and increasing use of digital channels by customers expose the Regulated Entities to significant financial, operational and reputational risks. A need was, therefore, felt to review and consolidate the extant guidelines. Accordingly, two draft directions will be issued for comments of stakeholders and members of the public: (i) Reserve Bank of India (IT Outsourcing) Directions, 2022; and (ii) Reserve Bank of India (Information Technology Governance, Risk, Controls and Assurance Practices) Directions, 2022.

Concluding Remarks

32. We are living in a world of Knightian uncertainty[2] in the absence of determinate knowledge about the next mutation of COVID-19. The ability to forecast the future course of the economy is so contingent on the evolution of the virus that one prognosis is as good or as bad as the other and as ephemeral. If the last two years of living with the virus have taught us anything, it is to remain humble, but

[2] In economics, Knightian uncertainty is a lack of any quantifiable knowledge about some possible occurrence, as opposed to quantifiable risk. It is an acknowledgement of imperfect knowledge that makes future events essentially unpredictable. The phenomenon is named after Frank Knight (1885-1972), an economist from the University of Chicago, whose seminal work Risk, Uncertainty, and Profit was published in 1921.

grounded in self-belief, never losing confidence and optimism. As the great Lata Mangeshkar – whom we lost recently – sang in her immortal voice: "*aaj phir jeene ki tamanna hai*". Together with the spirit behind the next line of this beautiful song, she has conveyed an eternal message of optimism.

33. We, in the Reserve Bank, have remained steadfast in our commitment to safeguard trust and confidence in the domestic financial system as we rebuild the foundations of strong and sustainable growth with macroeconomic stability. This has been our anchor in the ocean of uncertainty. We are inspired by Mahatma Gandhi's spirit of constant striving amidst challenges: "*Satisfaction lies in the effort, …… Full effort is full victory*."[3]

Thank you. Stay safe. Stay well. Namaskar.

(Yogesh Dayal)
Chief General Manager

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[3] The Collected Works of Mahatma Gandhi (CWMG), Vol. 26, p. 293