प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
ई-मेल/email: helpdoc@rbi.org.in

August 20, 2020

Minutes of the Monetary Policy Committee Meeting August 4 to 6, 2020
[Under Section 45ZL of the Reserve Bank of India Act, 1934]

The twenty fourth meeting of the Monetary Policy Committee (MPC), constituted under section 45ZB of the Reserve Bank of India Act, 1934, was held from August 4 to 6, 2020.

2. The meeting was attended by all the members – Dr. Chetan Ghate, Professor, Indian Statistical Institute; Dr. Pami Dua, former Director, Delhi School of Economics; Dr. Ravindra H. Dholakia, former Professor, Indian Institute of Management, Ahmedabad; Dr. Mridul K. Saggar, Executive Director (the officer of the Reserve Bank nominated by the Central Board under Section 45ZB(2)(c) of the Reserve Bank of India Act, 1934); Dr. Michael Debabrata Patra, Deputy Governor in charge of monetary policy – and was chaired by Shri Shaktikanta Das, Governor. Dr. Chetan Ghate, Dr. Pami Dua and Dr. Ravindra H. Dholakia joined the meeting through video conference.

3. According to Section 45ZL of the Reserve Bank of India Act, 1934, the Reserve Bank shall publish, on the fourteenth day after every meeting of the Monetary Policy Committee, the minutes of the proceedings of the meeting which shall include the following, namely:

(a) the resolution adopted at the meeting of the Monetary Policy Committee;
(b) the vote of each member of the Monetary Policy Committee, ascribed to such member, on the resolution adopted in the said meeting; and
(c) the statement of each member of the Monetary Policy Committee under sub-section (11) of section 45ZI on the resolution adopted in the said meeting.

4. The MPC reviewed the surveys conducted by the Reserve Bank to gauge consumer confidence, households' inflation expectations, corporate sector performance, credit conditions, the outlook for the industrial, services and infrastructure sectors, and the projections of professional forecasters. The MPC also reviewed in detail staff's macroeconomic projections, and alternative scenarios around various risks to the outlook. Drawing on the above and after extensive discussions on the stance of monetary policy, the MPC adopted the resolution that is set out below.

Resolution

5. On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (August 6, 2020) decided to:

- keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.0 per cent.

Consequently, the reverse repo rate under the LAF remains unchanged at 3.35 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 4.25 per cent.

- The MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The main considerations underlying the decision are set out in the statement below.

Assessment

Global Economy

6. Since the MPC met in May 2020, global economic activity has remained fragile and in retrenchment in several geographies. While the uneasy and differently-paced withdrawal of COVID-19 lockdown restrictions in some countries enabled a sequential improvement in high frequency indicators during May-July, a renewed surge in COVID-19 infections in major economies and threats of a second wave of infections appear to have weakened these early signs of revival. Contractions in economic activity have been more severe in Q2:2020 than in Q1, and the near-term outlook points to a slow, uneven and hesitant recovery pushed into the second half of the year, with risks steeply slanted to the downside. Among advanced economies (AEs), output in the US and the Euro area underwent a deeper contraction in Q2:2020 than in the preceding quarter. Emerging market economies (EMEs) are expected to shrink in Q2 as reflected in high frequency indicators.

7. Global financial markets have rebounded since end-March 2020 with intermittent pauses, shrugging off the volatility and sharp correction recorded in Q1:2020. Portfolio flows returned to EMEs in Q2 after a massive reversal, though there was moderation in July from the previous month's level. EME currencies have also appreciated in close co-movement, tracking weakening of the US dollar. Crude oil prices have remained supported on supply cuts by oil producing countries (OPEC plus) and improved demand prospects on the gradual easing of lockdown restrictions since May. Gold prices have rallied to an all-time high on August 5 on the back of safe haven demand. In AEs, benign fuel prices and soft aggregate demand have kept inflation subdued. In many EMEs, however, cost-push pressures arising from supply disruptions and demand revival have shown up in consumer prices in June 2020. Global food prices are elevated across the board.

Domestic Economy

8. On the domestic front, economic activity had started to recover from the lows of April-May following the uneven re-opening of some parts of the country in June; however, surges of fresh infections have forced re-clamping of lockdowns in several cities and states. Consequently, several high frequency indicators have levelled off.

9. The agricultural sector has emerged as a bright spot. Its prospects have strengthened on the back of good spatial and temporal progress of the south-west monsoon. The cumulative monsoon rainfall was 1 per cent below the long-period average (LPA) up to August 5, 2020. Spurred by the expanding precipitation, the total area sown under *kharif* crops on July 31 was 5.9 per cent higher than the normal area measured by the average over the period 2014-15 to 2018-19. As on July 30, 2020, the live storage in major reservoirs was 41 per cent of the full reservoir level (FRL), which bodes well for the *rabi* season. These developments have had a salutary effect on rural demand as reflected in fertiliser production and sales of tractors, motorcycles and fast-moving consumer goods.

10. The pace of contraction of industrial production, measured by the index of industrial production (IIP), moderated to (-) 34.7 per cent in May from (-) 57.6 per cent a month ago, with the easing of lockdowns in different parts of the country. All manufacturing sub-sectors, except pharmaceuticals, remained in negative territory. The output of core industries in June contracted for the fourth successive month though with a considerable moderation. The Reserve Bank's business assessment index (BAI) for Q1:2020-21 hit its lowest mark in the survey's history. The manufacturing PMI remained in contraction, shrinking further to 46.0 in July from 47.2 in the preceding month.

11. High frequency indicators of services sector activity for May-June indicate signs of a modest resumption of economic activity, especially in rural areas, although at levels lower than a year ago. Notably, the decline in passenger vehicle sales moderated to (-) 49.6 per cent in June from (-) 85.3 per cent in May, indicative of tentative urban demand, and faster recovery of sales in rural areas. On the other hand, domestic air passenger traffic and cargo traffic continued to post sharp contraction. Construction activity remained tepid – cement production fell and finished steel consumption moderated sharply in June. Imports of capital goods – a key indicator of investment activity – declined further in June. The services PMI continued in contractionary zone in July to 34.2, although the downturn eased relative to the May and June readings**.**

12. The National Statistical Office (NSO) released data on headline CPI for the month of June 2020 on July 13, 2020, along with imputed back prints of the index for April and May 2020. This resulted in a sharp upward revision of food inflation for the month of April and May. During Q1:2020-21 food inflation moderated from 10.5 per cent in April to 7.3 per cent in June 2020. Meanwhile, fuel inflation edged up as international kerosene and LPG prices firmed up. Inflation excluding food and fuel was at 5.4 per cent in June, reflecting a spike in prices across most sub-groups. Inflation in transport and communication, personal care and effects, pan-tobacco and education registered significant increases in June. Headline CPI inflation, which was at 5.8 per cent in March 2020 was placed at 6.1 per cent in the provisional estimates for June 2020.

13. For the second successive round, households' three months ahead expectations remained above their one year ahead expectations, indicating their anticipation of lower inflation over the longer horizon. Producers' sentiments on input prices remained muted as their salary outgoes fell. Their selling prices contracted in Q1 in the April-June round of the Reserve Bank's industrial outlook survey. The contraction in output prices is also corroborated by firms participating in the manufacturing PMI survey.

14. Domestic financial conditions have eased substantially and systemic liquidity remains in large surplus, due to the conventional and unconventional measures by the Reserve Bank since February 2020. Cumulatively, these measures assured liquidity of the order of ₹9.57 lakh crore or 4.7 per cent of GDP. Reflecting these developments, reserve money (RM) increased by 15.4 per cent on a year-on-year basis (as on July 31, 2020), driven by a surge in currency demand (23.1 per cent). Growth in money supply (M3), however, was contained at 12.4 per cent as on July 17, 2020. Average daily net absorptions under the liquidity adjustment facility (LAF) moderated from ₹5.3 lakh crore in May 2020 to ₹4.1 lakh crore in June as government spending slowed. In July, average daily net absorptions under the LAF moderated further to ₹4.0 lakh crore, as government spending remained subdued. During 2020-21 (up to July 31), ₹1,24,154 crore was injected through open market operation (OMO) purchases. In order to distribute liquidity more evenly across the term structure and improve transmission, the Reserve Bank conducted 'operation twist' auctions involving the simultaneous sale and purchase of government securities for ₹10,000 crore on July 2, 2020. Furthermore, the utilisation of refinance provided by the Reserve Bank to the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and the National Housing Bank (NHB) increased to ₹34,566 crore on July 31, 2020 from ₹22,334 crore during the May policy.

15. The transmission to bank lending rates has improved further, with the weighted average lending rate (WALR) on fresh rupee loans declining by 91 bps during March-June 2020. The spreads of 3-year AAA rated corporate bonds over G-Secs of similar maturity declined from 276 bps on March 26, 2020 to 50 bps by end-July 2020. Even for the lowest investment grade bonds (BBB-), spreads have come down by 125 bps by end-July 2020. Lower borrowing costs have led to record primary issuance of corporate bonds of ₹2.1 lakh crore in the first quarter of 2020-21.

16. India's merchandise exports contracted for the fourth successive month in June 2020, although the pace of fall moderated on improving shipments of agriculture and pharmaceutical products. Imports fell sharply in June in a broad-based manner, reflecting weak domestic demand and low international crude oil prices. The merchandise trade balance recorded a surplus in June (US$ 0.8 billion), after a gap of over 18 years. The current account balance turned into a marginal surplus of 0.1 per cent of GDP in Q4 of 2019-20 as against a deficit of 0.7 per cent a year ago. On the financing side, net foreign direct investment moderated to US$ 4.4 billion in April-May 2020 from US$ 7.2 billion a year ago. In 2020-21 (till July 31), net foreign portfolio investment (FPI) in equities at US$ 5.3 billion was higher than US$ 1.2 billion a year ago. In the debt segment, however, there were outflows of US$ 4.4 billion during the same period as against inflows of US$ 2.0 billion a year ago. Net investment under the voluntary retention route increased by US$ 0.9 billion during the same period. India's foreign exchange reserves have increased by US$ 56.8 billion in 2020-21 so far (up to July 31) to US$ 534.6 billion – equivalent to 13.4 months of imports.

Outlook

17. Supply chain disruptions on account of COVID-19 persist, with implications for both food and non-food prices. A more favourable food inflation outlook may emerge as the bumper *rabi* harvest eases prices of cereals, especially if open market sales and public distribution offtake are expanded on the back of significantly higher procurement. The relatively moderate increases in minimum support prices (MSP) for the *kharif* crops and monsoon are also supportive of benign inflation prospects. Nonetheless, upside risks to food prices remain. The abatement of price pressure in key vegetables is delayed and remains contingent upon normalisation of supplies. Protein based food items could also emerge as a pressure point, given the tight demand-supply balance in the case of pulses. The inflation outlook of non-food categories is, however, fraught with uncertainty. Higher domestic taxes on petroleum products have resulted in elevated domestic pump prices and will impart broad-based cost-push pressures going forward. Volatility in financial markets and rising asset prices also pose upside risks to the outlook. Taking into consideration all these factors, headline inflation may remain elevated in Q2:2020-21, but may moderate in H2:2020-21 aided by large favourable base effects.

18. Turning to the growth outlook, the recovery in the rural economy is expected to be robust, buoyed by the progress in *kharif* sowing. Manufacturing firms responding to the Reserve Bank's industrial outlook survey expect domestic demand to recover gradually from Q2 and to sustain through Q1:2021-22. On the other hand, consumer confidence turned more pessimistic in July relative to the preceding round of the Reserve Bank's survey. External demand is expected to remain anaemic under the weight of the global recession and contraction in global trade. Taking into consideration the above factors, real GDP growth in Q2-Q4 is expected to evolve along the lines noted in the May resolution. For the year 2020-21, as a whole, real GDP growth is expected to be negative. An early containment of the COVID-19 pandemic may impart an upside to the outlook. A more protracted spread of the pandemic, deviations from the forecast of a normal monsoon and global financial market volatility are the key downside risks.

19. The June release of headline inflation after a gap of two months and imputed prints of the CPI for April-May have added uncertainty to the inflation outlook. The NSO has adopted best practices in producing these imputations for the purpose of business continuity in the face of challenges to data collection due to the nation-wide lockdown. The NSO has, however, not provided inflation rates for April and May. For the purpose of monetary formulation and conduct, therefore, the MPC is of the view that CPI prints for April and May can be regarded as a break in the CPI series.

20. The MPC noted that the economy is experiencing unprecedented stress in an austere global environment. Extreme uncertainty characterises the outlook, which is heavily contingent upon the intensity, spread and duration of the pandemic – particularly the heightened risks associated with a second wave of infections – and the discovery of the vaccine. In these conditions, supporting the recovery of the economy assumes primacy in the conduct of monetary policy. In pursuit of this objective, the stance of monetary policy remains accommodative as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy. While space for further monetary policy action in support of this stance is available, it is important to use it judiciously and opportunistically to maximise the beneficial effects for underlying economic activity.

21. At the same time, the MPC is conscious that its primary mandate is to achieve the medium-term target for CPI inflation of 4 per cent within a band of +/- 2 per cent. It also recognises that the headline CPI prints of April-May, 2020 require more clarity. At the current juncture, the inflation objective itself is further obscured by (a) the spike in food prices because of floods in eastern India and ongoing lockdown related disruptions; and (b) cost-push pressures in the form of high taxes on petroleum products, hikes in telecom charges, rising raw material costs reflected in upward revisions in steel prices and rise in gold prices on safe haven demand. Given the uncertainty surrounding the inflation outlook and taking into consideration the extremely weak state of the economy in the midst of an unprecedented shock from the ongoing pandemic, it is prudent to pause and remain watchful of incoming data as to how the outlook unravels.

22. Meanwhile, the cumulative reduction of 250 basis points since February 2019 is working its way through the economy, lowering interest rates in money, bond and credit markets, and narrowing down spreads. Financing conditions have eased considerably, enabling financial flows *via* financial markets, especially at a time when banks remain highly risk averse. Accordingly, the MPC decides to stay on hold with regard to the policy rate and remain watchful for a durable reduction in inflation to use the available space to support the revival of the economy.

23. All members of the MPC – Dr. Chetan Ghate, Dr. Pami Dua, Dr. Ravindra H. Dholakia, Dr. Mridul K. Saggar, Dr. Michael Debabrata Patra and Shri Shaktikanta Das – unanimously voted for keeping the policy repo rate unchanged and continue with the accommodative stance as long as necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

24. The minutes of the MPC's meeting will be published by August 20, 2020.

Voting on the Resolution to keep the policy repo rate unchanged at 4.0 per cent

Member	Vote
Dr. Chetan Ghate	Yes
Dr. Pami Dua	Yes
Dr. Ravindra H. Dholakia	Yes
Dr. Mridul K. Saggar	Yes
Dr. Michael Debabrata Patra	Yes
Shri Shaktikanta Das	Yes

Statement by Dr. Chetan Ghate

25. Since the last review, the economy has seen a gradual rebound in economic activity. This is largely mechanical, as much of the lockdown in the economy is being undone as policy constraints on the supply side are removed.

26. Average CPI headline inflation has been above the target range's upper bound (6 per cent) for the last 6 months (6.7 per cent between January – March 2020, 6.5 per cent between April-June 2020). While the NSO's imputed estimates for April-May 2020 inflation require more clarity, it is clear that just looking at CPI headline inflation in March 2020 (5.8 per cent) and June (6.1 per cent) means that the trend is upwards. Inflation excluding food and fuel (*i.e.*, core inflation) also rose to 5.4 per cent in June. Higher price momentum in most sub-groups of core inflation saw some increase in May and June suggesting that core inflation remains high and sticky.

27. On the other hand, after the April peak, food price momentum has subsided, which has largely been driven by the decline in cumulative momentum in vegetables. This however needs to be carefully watched. Both 3-month and 1-year ahead inflationary expectations increased marginally by 10 basis points to 10.4 per cent and 10.5 per cent respectively. The "levelling-off" of inflationary expectations from a steady increase since March 2020 is comforting.

28. The prospect of an "inflation whipsaw", a phrase used by Markus Brunnermeir at Princeton, is probably the right way to look at inflation going forward, *i.e.*, there are different inflation/deflation pressures that need to be watched carefully. On the upside, a perfect storm of cost push pressures, accommodative monetary policy, and adverse food supply shocks could lead to a pickup in inflation. On the downside, the paradox of thrift, *i.e.*, forced saving pressure induced by a "de-facto" lock-down, could be a potent disinflationary force.

29. In terms of output losses, my assessment is that the worst is almost surely behind us (notwithstanding second waves of the pandemic etc.).

30. Economic crosscurrents however make it difficult to diagnose precisely the underlying damage because of the virus over the next year.

31. Real GDP growth in Q4 FY 20 based on provisional estimates produced by the NSO is now pegged at 3.1 per cent. This is the weakest print in the new data series that started in 2012-2013. The complete year FY20 real GDP growth is 4.2 per cent, which is also the weakest in the series. Netting out government expenditure's contribution in Q4 FY20, private demand growth remains anaemic. Consumption growth, for instance, in FY 20 was 5.3 per cent compared to 7.2 per cent in FY 18-19 and 8.1 per cent in FY 16-17. In FY 21, these numbers will be compounded by idiosyncratic shocks to particular sectors because of Covid (aviation, tourism) where the policy response has not been adequate.

32. Credit growth continues to remain muted despite large rate cuts. I worry that a negative credit supply shock to the MSME sector may lead to a "credit-gap", *i.e.*, a reduction in the supply of credit to small firms, leading to small businesses to shift towards higher cost providers of credit. This will have a bearing on growth. Some of these issues have begun to be addressed in amendments to the recently announced ECLGS scheme by the government. I worry though that if credit continues to be expensive, these firms will become less capital intensive over time, leading to a lower marginal product of labour. The long run equilibrium for the economy will involve a negative impact on wages, and therefore demand.

33. Some high frequency indicators however have begun to turn in June. To name a few, the Index of Industrial Production (IIP), PMI services, PMI manufacturing, electricity output, some rural demand indicators like tractor sales, and GST collections have retreated from their earlier lows in April-May. A tentative global recovery is also happening. The distribution of rainfall has overall been positive. Monetary transmission has also improved. This is crucial

given the close connection between sovereign yields and funding conditions in the economy. For instance, between March-July 2020, the policy repo rate was cut by 115 bps. The WALR for fresh rupee loans during this period declined by 91 bps. Despite this I worry though that given that there is a lot of uncertainty on the investment side, the option value of waiting will be big, which will delay the onset of investment spending.

34. There are other risks due to Covid that pose downside risks to growth in the medium run.

35. For instance, Covid is simultaneously a negative demand and a negative supply shock. Macro policy broadly must ensure that a temporary Covid type shock to the Indian economy does not become permanent. Economists call this hysteresis. In a post-Covid world, as Olivier Blanchard notes, hysteresis will be driven by human behaviour. Despite the economy opening up, people will still hesitate to go out and spend. This will limit the effects of unlocking the economy.

36. I continue to maintain that the major brunt of future fiscal stimuli should be tilted towards social insurance payments and on the taxation side, where the multipliers are larger. It is important to recognize that fiscal multipliers depend on country characteristics. They are smaller in countries with flexible exchange rate regimes, open to trade, and with high levels of public debt. India has all three. Fiscal multipliers may be larger at the zero lower bound, but India is not there yet. Prices are also more flexible in developing countries like India because of the presence of a large informal sector. This weakens the transmission of fiscal policy from financial markets to the real economy. Fiscal stimulus design will have to keep these factors in mind, and will have a strong bearing on the type of cyclical recovery that the economy experiences. Economic policy is a potent tool for equilibrium selection at the current juncture.

37. This should be a crisis that is not wasted. The government must continue to focus on much needed structural reforms. Some fiscal space should be reserved for later outbreaks.

38. Given the above reasons, it would be opportune to wait and watch to see how the growth-inflation numbers pan out over the next few months. I therefore vote to pause. I also vote to retain the stance as accommodative.

39. I should mention that I have been advocating a more cautious path for policy rate reductions since February 2019. However, I have been in a minority in the MPC. Inflation has now been above the upper band of 6 per cent for a number of months. Notwithstanding large rate cuts to spur growth over the last year and a half, growth has steadily declined despite 250 bps in cuts since February 2019. Future MPCs should not go soft on inflation. Going forward, monetary (and fiscal) policy will be needed to be used wisely with a clear understanding of what and what not they can achieve in terms of controlling inflation, smoothening out the business cycle, and limiting spurious economic volatility.

40. I have been contributing to the setting of monetary policy since February 2013 (first on the TAC, and now on the MPC). I want to thank the Reserve Bank of India and the Government of India for giving me this opportunity.

Statement by Dr. Pami Dua

41. Since the last policy meeting, CPI headline inflation prints have been released for three months – April, May and June – of which the numbers for April and May are imputed. The provisional data for June shows headline inflation of 6.1 per cent compared to 5.8 per cent in March. Food inflation moderated somewhat from 7.8 per cent in March to 7.3 per cent in June, while rising in the interim to 10.5 per cent and 8.4 per cent in April and May, respectively. Fuel inflation rose slightly from 1.6 per cent in May to 2.7 per cent in June, reflecting the increase in international LPG and kerosene prices, although it was lower than the March level of 6.6 per cent. CPI inflation excluding food and fuel rose from 3.9 per cent

in March to 5.4 per cent in June, portraying the increase in inflation in transport and communication, personal care and effects, pan-tobacco and education.

42. Going forward, a bumper *rabi* (winter) crop and a moderate increase in minimum support prices for the *kharif* crops, along with overall demand compression augur well for inflation. At the same time, however, upside risks to inflation include pressure on vegetable prices, continued supply chain disruptions, high taxes on petroleum products resulting in cost-push pressures, uncertainty regarding price changes in non-food categories, rising asset prices and volatility in financial markets. The headline print is expected to remain elevated in Q2:2020-21 and then moderate in the second half of FY: 2020-21 due to favourable base effects. This conforms with both the May and July 2020 rounds of the Inflation Expectations Survey of Households conducted by the Reserve Bank of India that show higher inflation expectations for the three-months-ahead forecasts compared to forecasts for the one-year-ahead horizon.

43. On the domestic output front, some signs of recovery were visible in June following the partial unlocking of some parts of the country. The ensuing increase in the number of new cases of COVID-19, however, forced the restitution of localised lockdowns, restraining growth in some high frequency indicators. Some indicators of urban consumption demand – passenger vehicle sales, domestic passenger air traffic and consumer durables – picked up slightly but continued to remain in deep contraction. On the other hand, some signs of recovery were evident in high frequency indicators of rural demand – tractor sales, motorcycle sales and production of consumer non-durables. High frequency indicators of investment demand remained weak, including consumption of finished steel, import of capital goods and capital goods production (as per the use-based classification of IIP), although the year-on-year contraction in cement production eased considerably in June. Contraction in IIP, year-on-year, moderated to (-) 34.7 per cent in May 2020 from (-) 57.6 per cent in the previous month due to the easing of lockdowns. Within manufacturing, only pharmaceuticals witnessed positive growth.

44. The Purchasing Managers' Index (PMI) for manufacturing continued in the contraction zone, dropping to 46.0 in July from 47.2 in the preceding month. The PMI for services also continued in the contractionary zone while edging up to 34.2 in July, although contracting much less than in April and May. High frequency indicators of the services sector under construction and trade, hotels and transport – steel consumption, cement production, passenger vehicle sales, domestic passenger air traffic, railway freight traffic and commercial vehicle sales – contracted in June. Within financial and professional services, non-food credit growth remained muted.

45. Fortunately, growth in agriculture has held up, with the total area under summer crops (*kharif*) including rice, pulses, coarse cereals, oilseeds, cotton and sugarcane, up by 13.9 per cent as on July 31, 2020 over the corresponding period of last year and by 5.9 per cent over the normal area (5 years average).

46. The Consumer Confidence Survey conducted by RBI in July 2020 shows that the overall Current Situation Index is at a historic low, while the Future Expectations Index reflects some optimism for the year ahead.

47. On the external front, the pace of contraction of India's exports growth slowed down in June to (-) 12.4 per cent from (-) 43 per cent during March to May. Imports growth, however, dropped by (-) 47.6 per cent in June.

48. At the global level, the global manufacturing PMI and the global services PMI increased to 50.3 and 50.5, respectively, in July, and moved back to the expansion zone.

49. The prognosis for the economic situation is thus highly uncertain. There are some signs of revival, but the restoration of economic activity depends on how soon supply disruptions are repaired and demand revives. This depends, amongst other factors, on the

severity of the evolving pandemic in terms of its depth, duration and diffusion and the control of infections, as well as the development of a vaccine.

50. Clearly, it is important to revive the economy and mitigate the impact of the COVID-19 pandemic, in line with the objective of monetary policy – to maintain price stability while keeping in mind the objective of growth. It is thus prudent to continue with the accommodative stance of monetary policy. At the same time, the mandate of the MPC is to achieve the target of CPI inflation (combined) of 4 per cent with the upper tolerance limit of 6 per cent and the lower tolerance bound of 2 per cent.

51. In its attempts to revive the economy, the MPC has already front loaded cuts in the policy rate. In fact, before the COVID-19 pandemic hit the Indian economy, the policy repo rate was reduced by 135 basis points between February and October 2019 in response to the slowdown in economic activity. Since the outbreak of the pandemic, the repo rate was further cut by 75 basis points in the March MPC meeting and 40 basis points in the May meeting, amounting to a total cut of 250 basis points between February 2019 and May 2020 and 115 basis points between March and May 2020. The monetary policy transmission to lending rates of banks has also improved, with a 91 basis points decline in the weighted average lending rate (WALR) on fresh rupee loans between March and June 2020. However, at the present juncture, the outlook for inflation is also uncertain, with risks more on the upside. Some clarity is also required with respect to the imputation of the April and May prints. In this context, CPI inflation data for at least two or three more months will be crucial for clearly gauging the impact of supply side disruptions and demand conditions on prices.

52. Considering the above factors, at this juncture, it is best to adopt a wait and watch strategy and look forward to incoming data to assess the evolving macroeconomic situation. I therefore vote to keep the policy rate unchanged and to continue with an accommodative stance as long as necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target, going forward.

Statement by Dr. Ravindra H. Dholakia

53. After the last MPC meeting in May 2020, changes in the economic environment were along the expected lines except the official announcement about the headline CPI and implicit inflation numbers during April, May and June. These high inflation prints coupled with the apprehensions about GDP growth likely to be negative both in real terms and nominal terms would imply that the economy is not caught up in recession with deflation but in a deep stagflation, which occurs when the adverse supply shock is more severe than the demand shock. Under such circumstances, expansionary aggregate demand policies – both monetary and fiscal – would result first in fueling inflation further rather than output and employment expansion and growth recovery, which is expected under recession with deflation. I have strong reservations in accepting the implicit inflation numbers for April and May announced by the NSO. I would, therefore, like to wait and watch for more reliable and realistic estimates of the headline inflation before taking any decision on the policy rate. I vote for status quo both on the policy repo rate and the stance. More specific reasons for my vote are as follows –

i) Price quotations collected for various items from the designated shops by NSO to measure inflation could not be collected during April and May because of the nation-wide lockdown. Even for June, the sample was not satisfactory to prepare the estimates for different states. Instead of leaving the gap in the CPI series, the NSO decided to impute the CPI values for April and May as suggested by the business continuity guidelines issued by a group of six international agencies that resulted in the implicit headline inflation of 7.2 percent for April and 6.3 percent for May from 5.8 percent for March. On the other hand, inflation based on the CPI for Industrial Workers released by the Labour Bureau (that has a very high degree of correlation with CPI-C prepared by NSO) for the months of March, April and May are respectively 5.50, 5.45 and 5.10

percent. Similarly, WPI – the index used to measure inflation in India till 2014 – based inflation rates for March, April and May are respectively 0.42, (-)1.57 and (-)3.21 percent. Thus, the imputed CPI and inflation rates implied by them do not seem to be consistent with the alternative measures not only in terms of the magnitude but also in the direction of change.

ii) Moreover, I have been expressing serious concerns over the mismeasurement of inflation in our country (see The Report of the Sixth Central Pay Commission, 2008; and my article in Economic and Political Weekly, Nov.17, 2018) by the fixed base-weighted index with limited number of consumption items instead of the chain-base weighted index method followed in the developed countries. In an extreme situation created by the nation-wide lockdown for months, the consumption pattern in the country has significantly and substantially changed. This would simply not be reflected in the measurement of our headline inflation based on the fixed base-weighted index even if all price quotations were available; and would provide an unrealistic measurement of inflation.

iii) Imputation of the headline inflation numbers ignoring all such limitations when used in forecasting models and policy simulation exercises may misrepresent and provide misleading signals. It is, therefore, prudent to ignore them and wait for more reliable measurements and estimates.

iv) The household survey rounds for inflationary expectations carried out in May and July 2020 provide very interesting results. When the standard errors are considered, there was no statistically significant difference between May and July rounds of the survey in the three months ahead and one year ahead inflationary expectation of households. Similarly, in the July round of the survey, there is no statistically significant difference between the current perception of inflation and one year ahead inflationary expectations of the households, though the difference between three months ahead inflationary expectations and the current perception of inflation is statistically significant. This suggests that the (urban) households expect faster recovery of aggregate demand over the aggregate supply in the short run, but expect the supply to recover faster in the long run reducing the inflationary pressures.

v) On the other hand, the RBI's industrial outlook survey shows that manufacturing firms expect domestic demand to recover gradually from Q2:2020-21 and sustain through Q1:2021-22. Producers expected their input prices and costs to remain low and their selling prices actually contracted during April-June 2020. Similarly, the consumer confidence survey conducted by RBI also does not paint any optimistic picture.

54. Thus, there are high uncertainties and some contradictory evidences about the characterization of the current and future macroeconomic environment. I am sceptical about the deep stagflationary conditions prevailing in the country. Although the present circumstances are truly exceptional, the primary mandate given to MPC for inflation targeting at 4 percent with the upper tolerance limit of 6 percent has to be respected. In fact, the confusion and uncertainty created by the imputed CPI-C and implied inflation estimates needs to be cleared by more of regular readings on inflation rates. Since the transmission of the policy rate cuts to the money, bond and credit markets has been commendable but not complete, there is no harm in taking a pause at this juncture. In my view, the available space for policy rate should now be used prudently and opportunistically to optimize the impact on the economic recovery. Hence, I vote for a status quo on the policy stance and rate.

Statement by Dr. Mridul K. Saggar

55. For purposes of transparent communication, it will be useful to explicitly recognise that monetary policy is being framed under considerable uncertainty at the current juncture. The depth of the gorge created by the unprecedentedly deep pandemic shock is difficult to measure. The underlying data is populated from incomplete and less reliable information due to missing data, larger sampling and non-sampling errors. Unusual revisions are likely down the line. Forecast uncertainty is compounded by the future course the pandemic might take. With medical solutions yet to be found, it is difficult to anticipate the output loss that might occur from further waves of infections even as path to normalisation has begun.

56. Growth estimates for 2020-21 are difficult to arrive at the current juncture, but there could be a downward bias to the present consensus estimates when the final data becomes available. Inflation, on the other hand, may have an upward bias. The recovery path is inextricably linked to the course the pandemic might take and complete normalisation will be difficult till pandemic is overcome. High frequency indicators of real activity show that contractions have turned smaller in May and still smaller in June as activity recovers from the severe lockdown in April. Recovery in GST, including through E-way bills, railway freight, port cargo, cement production and petroleum consumption has been particularly encouraging. However, with the notable exceptions of electricity and tractors, all other indicators remained in red in June with levels at least 15 per cent below that in February. Vehicle registrations, railway and airline passenger traffic remain abysmally low in face of travel restrictions. Anecdotal evidence from industry sources suggest that activity levels might improve only marginally in July. This signals that it may be hard to recover the last 10 per cent of the production given that the Covid-19 curve has not flattened yet. The disruption caused by it will leave hysteresis, implying some permanent damage to potential output even after pandemic recedes, although speedy policy action has contained this impairment. In these circumstances, the MPC has been rightfully mindful of growth as well within the flexible inflation targeting framework. It has taken actions with a view to prevent output collapse that could otherwise have had lasting impact.

57. Inflation statistics in the pandemic period have elements of fuzziness. Statistical authorities had to resort to imputation method in face of lockdown and had not released the headline inflation for the month of April and May. Item-level data is also not available for March-June. However, the June data shows that inflation is above the upper tolerance level when the markets coverage in price statistics had improved to 88 per cent of the usual coverage, up from 52 per cent in April. Quotations coverage could be relatively lower. It is not clear if the full coverage would have made a difference to the headline number. However, the best judgment that I can exercise with available information is that non-monetary factors may have led the headline inflation persisting above the acceptable band for most of the months since December, but monetary factors may also be contributing to the elevated inflation. Ex-food and fuel, inflation was at 5.4 per cent in June. However, this core component itself has been driven high by certain elements that may not be contributing to true inflation. For instance, gold that enters into personal care and effects segment may have contributed about 34 bps to the headline inflation if one were to proximate it by gold prices in the market. Ex-food, fuel and estimated gold, inflation was likely in the vicinity of 5.1 per cent. Consumption of gold had dropped but the CPI index is driven by Laspeyres or base-year consumption weights and not Paasche or current consumption weights. The bias on this count, however, could be non-material as high food inflation may have been accompanied by higher current consumption of food in the overall basket.

58. The question relevant for the policy is how long food inflation might stay high and are we seeing signs of generalisation. Food inflation should soften as food stock levels are well above norms, monsoon is shaping normal, reservoir levels are reasonable and *kharif* sowing has been brisk. However, the drivers of food inflation include protein-rich food sub-groups and as is evident from retail price data from the Department of Consumer Affairs, also tomatoes and potato. Price rise in protein-rich items has significant demand component.

Moreover, rise in food prices, even though predominantly caused by supply disruption, runs the risks of generalisation to keep headline inflation higher than is being anticipated. The incipient signs of generalisation have also been aided by higher excise and VAT on petro-products. Higher diesel prices have implications for transportation costs. Risks to inflation arise from price stickiness and supply chain disruptions, high costs of rebuilding or modifying supply chains and less than competitive markets under lockdowns, translating into higher retail margins. As such, it remains to be seen how much inflation falls later in the year due to demand destruction, base effects and improved agriculture supplies.

59. In my view, with considerable policy rate reduction effected since February 2019 and liquidity and credit easing getting frontloaded since March 2020, a breather is necessary awaiting greater clarity. The transmission of rate cuts has picked up in the preceding quarter. Liquidity infusions have reduced financial market spreads on corporate paper of various tenors and credit quality, especially of corporate bonds whose issuance has risen. During July, the All-India financial institutions and Housing Finance Companies have been able to raise money through Commercial Papers at a weighted average rate below the reverse repo rate and corporates and NBFCs at below repo rate. Further rate reductions may come in the way of smoothening of interest rate movements unless durable reduction in path of inflation materialises. While markets and fundamentals seldom do a tango, a disconnect between the two carry the risks of disruptive market corrections. Policy needs to be mindful of the space that may be needed to deal with possibility of increased stress that may resurface later with loan defaults and recognition of bad loans. Impact of fiscal actions and space also need to be closely observed for demand management. Growth is at risk over the medium term if we sacrifice macro-financial stability for short-run expediency. Moreover, there is sound rationale that monetary policymakers should do less under uncertainty. While pausing, it is best to retain the accommodative stance as long as the baseline suggests that inflation will soften to well within the tolerance band keeping in view the need to avoid frequent directional changes even as policy remains data dependent. Also, confidence levels are currently fragile and monetary transmission of earlier rate reduction is still in pipeline.

60. Considering all of above, I vote for leaving the policy rate unchanged and maintaining accommodative stance as communicated in the resolution, that emphasises need for continued support to growth, while remaining watchful for a durable reduction in inflation to use the available space so as to ensure that inflation remains within the target going forward.

Statement by Dr. Michael Debabrata Patra

61. From the time of the outbreak of the pandemic, the setting of monetary policy by the monetary policy committee (MPC) has involved the assignment of a more than proportionate weight to growth relative to inflation. The severe contractions in various sectors of the economy in the first half of 2020-21 so far vindicate this weighting scheme.

62. Disappointingly, however, inflation surprises of recent months are undermining the MPC's actions and stymieing its resolve to do what it takes to revive growth and mitigate the impact of COVID-19 on the economy. The unanticipated concoction of imputations of the consumer price index (CPI) for April and May 2020, supply disruptions and unrelenting cost push interventions in price formation that have reared up outside the ambit of monetary policy has complicated its conduct, especially as the inflation levitation seems to show persistence.

63. Amidst the high uncertainty characterising the near-term outlook, two outcomes are possible, drawing from precedents alone. There can be a good outcome based on the 2016-17 experience when a combination of delayed market arrivals and risk-minimising supply management caused food inflation – which had risen to 8.0 per cent in July of that year – to fall off a cliff in the next month (August) itself. For the year as a whole, headline inflation averaged 4.5 per cent in spite of some hysteresis in core inflation. There can also be a bad outcome as in 2009-10 when, awash with stimulus, a build-up of domestic inflationary

pressures and inflation expectations occurred on the back of surging food prices in the backdrop of a failed monsoon, and it spilled over into other components. Monetary policy action was delayed on the ground of nurturing nascent growth impulses; inflation became generalised and 13 consecutive policy rate increases could not excoriate inflation's pernicious hold. The 2009 experience has striking similarities with what confronts us today. There is one important difference though – in 2009-10, India rebounded out of the global financial crisis and its real GDP growth was strong at close to 8 per cent. In 2020-21, India's real GDP is widely expected to record its deepest contraction in history. There is also an important lesson from the 2009-10 experience – in India, food prices are the 'true core' of inflation dynamics. They can and do get persistent and generalised into wider macroeconomic instability.

64. At the current juncture, with inflation prints above the upper tolerance band, technical considerations under the monetary policy framework warrant a pre-occupation with dealing with the conditions of failure. All this, after a period of four years of uninterrupted success in keeping inflation well within the tolerance band and in fact, closely aligned with the target, which has earned the country credibility in monetary policy conduct, investor confidence and the anchoring of expectations! Consequently, monetary policy is forced into a standstill even when there is space available to persevere with its commitment to reinvigorate growth momentum and alleviate the effects of COVID-19. In fact, if inflation persists above the upper tolerance band for one more quarter, monetary policy will be constrained by mandate to undertake remedial action, including an immediate and more than proportionate response to head off the build-up of inflation pressures and prevent it from getting generalised. The question is: can the economy withstand it in this virus-ravaged, debilitated state? The MPC has already signalled its concern in its stance by resolving to ensure that inflation remains within the target *going forward*. It has also expressed the unanimous view that for the purpose of monetary formulation and conduct, CPI prints for April and May can be regarded as a break in the CPI series.

65. The outlook is grim; even when it improves, the expectation is one of slow, hesitant recovery, with the situation likely to worsen before it gets better. The upticks that easing of lockdowns yield are likely to be ephemeral and vulnerable to flattening out due to lack of underlying vigour. A durable revival of the economy depends on sustained policy support to resuscitate activity in various sectors, restore employment and livelihood to the displaced and dispossessed, continue to assure health support and pursuit of the vaccine, ease financial stresses facing households, businesses and financial intermediaries, instil confidence and anchor financial stability before it slips away. This underscores the urgency of unshackling monetary policy from extraneous non-pandemic constraints, emerging out of inadequate and lagged reactions in terms of supply management. In the absence of this coordinated strategy, monetary policy will be left with no option but to adhere to its primary mandate of the MPC, which is after all, achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

66. At this juncture, therefore, I vote for *status quo* on the policy rate. I reiterate that, abstracting from the exogenous shocks to inflation mentioned earlier, the state of the economy warrants that the MPC should continue to maintain its accommodative stance, while ensuring that inflation returns to the target.

Statement by Shri Shaktikanta Das

67. The outlook for the domestic economy remains extremely uncertain as the impact of COVID-19 is more severe than initial assessments and the global economy remains vulnerable to renewed surge in community infections and fears of a second wave. While the US and the Euro area registered record-setting contraction in output in Q2:2020, the emerging market economies (EMEs) also look set to see large declines in output. Even as high frequency indicators suggest some momentum in July, the near-term outlook remains uninspiring with large downside risks. In this backdrop, relatively buoyant global financial

markets demonstrate not just a disconnect with underlying economic fundamentals, but also portend financial stability risks, particularly for EMEs.

68. Recent data releases on sale of automobiles (wholesale), electricity generation and issuance of e-way bills indicated that a moderate recovery was taking place in the domestic economy. Indicators relating to investment like cement and steel production saw some moderation in the pace of contraction to 6.9 percent and 33.8 percent, respectively, in June as compared to the previous two months (cement contracted by 21.4 per cent in May and 85.3 per cent in April, while steel contracted by 43.1 per cent in May and 78.7 per cent in April). Lately, however, it is seen that the nascent signs of recovery in June following the gradual resumption of activity in the country, have again slumped after a renewed spate of infections forced re-imposition of lockdowns in several states and cities. The agriculture sector remains a beacon of hope. The progress of the south-west monsoon in terms of wider coverage and intensity along with the significant increase in the total area sown under kharif crops augur well for the rural economy as reflected in fertiliser production and sales of tractors, motorcycles and fast-moving consumer goods. Robust agricultural production would not only have a salutary impact on rural demand but also should help easing of the inflationary pressure from food prices, going ahead.

69. The July 13, 2020 NSO press release on CPI, which published the imputed headline CPI index for April and May along with the provisional headline inflation number for June, brought about a significant change in assessment of the inflation trajectory for Q1:2020-21 and added uncertainty to the inflation outlook. Though the NSO has adopted best practices in imputing CPI for the months of April and May, the CPI prints for April and May obscure a realistic assessment of the inflationary momentum and can be regarded as a break in the CPI series for monetary policy formulation.

70. Imputed food inflation for April-May 2020 showed a sharp upward revision compared to earlier releases. The June 2020 CPI showed food inflation remaining at an elevated level. While vegetables inflation moderated, inflationary pressures in protein-based food items and cereals got entrenched. Further, price inflation in spices and oils and fats which was already elevated pre-lockdown, remained in double digits. Moreover, imputed CPI excluding food and fuel inflation during April-May surged by 90-100 bps from March readings. They were seen to accentuate further in June due to inflationary pressures in pan, tobacco and intoxicants, transportation and communication and personal care and effects sub-groups, among others. Consequently, headline inflation remained above 6 per cent in June. Inflation expectation of households, as polled in the Reserve Bank's July 2020 round of survey, rose marginally by 10 bps for 3-month and 1-year ahead horizons. One year ahead expectations were, however, lower than the 3-month ahead expectations, suggesting lower inflation expectations over the longer horizon.

71. In the recent months, the major drivers of inflation have been supply-chain disruptions resulting from localised lockdown; increase in excise duty and VAT on petroleum products; price pressures in protein rich items and vegetables; and impact of statistical imputations. Looking ahead, headline inflation is expected to remain elevated in Q2:2020-21 due to inflationary pressures in both food as well as core inflation. Near-term price pressures in CPI excluding food and fuel continue due to cost-push factors and lock-down related production and supply-chain disruptions, even as aggregate demand conditions register sharp contraction in the post COVID-19 scenario.

72. The generalised inflationary pressures across food and CPI excluding food and fuel, in a situation where growth is expected to contract sharply, is a matter of serious concern. The survey-based measures of slack in the economy testify that there is little risk to inflation from demand side. Given that supply disruptions and bottlenecks in the post-COVID environment are key factors in engendering these inflationary impulses, the containment of it calls for proactive sector-specific supply-side measures. In case of edible oils this would entail augmenting imports to meet domestic shortfall and rationalisation of import duties. For pulses

also, imports may have to be continued to the extent of domestic supply shortfall. Further, if open market sales and public distribution offtake of cereals are expanded on the back of significantly higher procurement, it would help in easing of cereal price pressures during the latter part of the year. As the economy recovers, some rebalancing of the duty structure on petroleum products can ease some of the cost-push pressures on the economy. Such timely policy intervention to ameliorate supply side concerns along with prospects of a normal monsoon and large favourable base effects could result in moderation in inflation during H2:2020-21.

73. Regarding growth outlook, the rural economy is expected to be robust while industrial and services activity may recover gradually. The recovery out of current slowdown, which is mainly conditioned by supply disruptions and compression of consumption demand especially on non-essential goods and services, would depend on the containment of Covid pandemic and unlocking of economic activities. Rural indicators led by good monsoon, higher kharif sowing and Government-led initiatives to provide employment in the rural areas have shown sharp revival which, if sustained, can provide support to demand going forward. High frequency indicators, however, suggest that private consumption which is the mainstay of aggregate demand remains subdued. Certain crucial sectors such as tourism, hospitality and entertainment will take some time to recover. Consumer confidence, as captured from the Reserve Bank's July 2020 survey, is low; however, one year ahead expectations have improved and indicate some optimism. External demand is expected to remain frail. Manufacturing firms responding to the Reserve Bank's industrial outlook survey, however, expect domestic demand to recover gradually from Q2:2020-21 and to sustain through Q1:2021-22. Low capacity utilisation amid subdued domestic and external demand is likely to delay early revival of investment demand. In view of the above, real GDP is likely to shrink in the first half of the year, and growth for the full year 2020-21 is estimated to be negative.

74. In an environment of extreme stress and uncertain outlook, the Reserve Bank's proactive management of liquidity through both conventional and unconventional measures undertaken since February 2020 have cumulatively infused liquidity to the extent of ₹9.57 lakh crore (4.7 per cent of GDP) and have alleviated stress on the domestic financial conditions. Comfortable liquidity conditions, in turn, have helped improve monetary transmission in consonance with the MPC's accommodative stance and actions and borrowing costs in financial markets have plummeted to their lowest levels in a decade. The weighted average lending rate (WALR) on fresh rupee loans sanctioned by banks declined by 162 basis points during February 2019-June 2020, of which 91 basis points transmission was witnessed during March-June 2020.

75. As I have been reiterating since October 2019, monetary policy is geared towards supporting the economic recovery process. Although there is headroom for further monetary policy action, at this juncture it is important to keep our arsenal dry and use it judiciously. I also feel that we should wait for some more time for the cumulative 250 basis points reduction in policy rate since February 2019 to seep into the financial system and further reduce interest rates and spreads. Given the uncertain inflation outlook, we have to remain watchful to see that the momentum in inflation does not get entrenched, which is also dependent on effective supply-side measures. As the economy continues to be in a fragile state, recovery in growth assumes primacy. It would be prudent at this stage to wait for a firmer assessment of the outlook for growth and inflation as the staggered opening of the economy progresses, supply bottlenecks ease and the price reporting pattern stabilises. Considering all these aspects, I vote for a pause on the policy rate at this moment while continuing with the accommodative stance.

(Yogesh Dayal)
Chief General Manager

Press Release: 2020-2021/214