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Minutes of the Monetary Policy Committee Meeting May 20 to 22, 2020 [Under Section 45ZL of the Reserve Bank of India Act, 1934]

The twenty third meeting of the Monetary Policy Committee (MPC), constituted under section 45ZB of the Reserve Bank of India Act, 1934, was held from May 20 to 22, 2020; the meeting was originally scheduled from June 3 to 5, 2020, but was advanced to May 20-22 in view of the ongoing COVID-19 pandemic.

2. The meeting was attended by all the members – Dr. Chetan Ghatе, 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. Janak Raj, 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 Ghatе, 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 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 (May 22, 2020) decided to:

- reduce the policy repo rate under the liquidity adjustment facility (LAF) by 40 bps to 4.0 per cent from 4.40 per cent with immediate effect;

- accordingly, the marginal standing facility (MSF) rate and the Bank Rate stand reduced to 4.25 per cent from 4.65 per cent; and
- the reverse repo rate under the LAF stands reduced to 3.35 per cent from 3.75 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.

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 March 2020, global economic activity has remained in standstill under COVID-19 related lockdowns and social distancing. Among the key advanced economies (AEs), economic activity contracted in the US, Euro area, Japan and the UK in Q1:2020. Among emerging market economies (EMEs), the Chinese economy went into a pronounced decline and data on high frequency indicators suggest that activity may have also shrunk in other EMEs such as Brazil and South Africa.

7. Global financial markets calmed after a turbulent period in March, and volatility ebbed as swift and large fiscal and monetary policy responses helped to soothe sentiment. Equity markets recovered some lost ground, while government bond yields remained range-bound, although somewhat elevated in some EMEs due to country-specific factors. Portfolio flows to EMEs revived in April and the rush to safe havens eased. With the US dollar weakening, major EME currencies, which had experienced persistent downward pressure, traded with an appreciating bias. Crude oil prices firmed up modestly as oil producing countries (OPEC plus) agreed to cut production, and prospects for revival in demand improved on expectations of imminent easing of lockdowns. Gold prices remained elevated on hedging demand. CPI inflation remained subdued across major AEs and EMEs primarily due to a collapse in oil prices and compression in demand amidst lockdowns, while food inflation picked up due to supply disruptions.

Domestic Economy

8. Domestic economic activity has been impacted severely by the lockdown which has extended over the past two months. High frequency indicators point to a collapse in demand beginning March 2020 across both urban and rural segments. Electricity consumption has plunged, while both investment activity and private consumption suffered precipitous declines, as reflected in the collapse in capital goods production and the large retrenchment in the output of consumer durables and non-durables in March. High frequency indicators of service sector activity such as passenger and commercial vehicle sales, domestic air passenger traffic and foreign tourist arrivals also experienced sizable contractions in March. The only silver lining was provided by agriculture, with the summer sowing of rice, pulses and oilseeds in the country

progressing well, with total area sown under the current *kharif* season up by 43.5 per cent so far, and the *rabi* harvest promising to be a bumper as reflected in record procurement.

9. Retail inflation, measured by the consumer price index, moderated for the second consecutive month in March 2020 to 5.8 per cent after peaking in January. This was mainly due to food inflation easing from double digits in December 2019 – January 2020. In April, however, supply disruptions took a toll and reversed the softening of food inflation, which surged to 8.6 per cent from 7.8 per cent in March. Prices of vegetables, cereals, milk, pulses and edible oils and sugar emerged as pressure points¹.

10. The Reserve Bank remained in pro-active liquidity management mode, expanding its array of measures, both conventional and unconventional, to augment system-level liquidity as also to channel liquidity to specific sectors facing funding constraints. Systemic liquidity remained in abundance, with average daily net absorptions under the liquidity adjustment facility (LAF) increasing to ₹5.66 lakh crore in May 2020 (up to May 20) from ₹4.75 lakh crore in April. During 2020-21 (up to May 20), ₹1,20,474 crore was injected through open market operation (OMO) purchases and ₹87,891 crore through three targeted long-term repo operation (TLTRO) auctions and one TLTRO 2.0 auction. In order to distribute liquidity more evenly across the yield curve, the Reserve Bank conducted one 'operation twist' auction involving the simultaneous sale and purchase of government securities for ₹10,000 crore each on April 27, 2020. Furthermore, the Reserve Bank has provided ₹22,334 crore as refinance to National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB) so far (as on May 21, 2020) and ₹2,430 crore to mutual funds through a special liquidity facility (SLF) with a view to easing liquidity constraints and de-stress financial markets. Since February 6, 2020 the Reserve Bank has announced liquidity augmenting measures of ₹9.42 lakh crore (4.6 per cent of GDP).

11. Reflecting the various liquidity management measures, domestic financial conditions have eased appreciably as reflected in the narrowing of liquidity premia in various market segments. Yields on government securities, commercial paper (CP), 91-day treasury bills, certificates of deposit (CDs) and corporate bonds have softened. The weighted average lending rates on fresh rupee loans of commercial banks declined by 43 bps in March 2020 alone. Though credit growth remains muted, scheduled commercial banks' investments in commercial paper, bonds, debentures and shares of corporate bodies in this year so far (up to May 8) increased sharply by ₹66,757 crore as against a decline of ₹8,822 crore during the same period last year. There were net inflows into various schemes of mutual funds in April in contrast to large outflows in March.

12. In the external sector, India's merchandise trade slumped in April 2020, with exports shrinking by 60.3 per cent and imports by 58.6 per cent (y-o-y), respectively. While imports contracted in all 30 commodity groups in April, exports contracted in 28 out of 30 groups. The trade deficit narrowed in April 2020 – both sequentially and on a year-on-year basis – to its lowest level in 47 months. On the financing side, net foreign direct investment inflows picked up in March 2020 to US\$ 2.9 billion from US\$ 0.8 billion a year ago. In 2020-21 so far (till May 18), net foreign portfolio investment (FPI) in equities increased to US\$ 1.2 billion from US\$ 0.8 billion a year ago. In the debt segment, however, there were portfolio outflows of US\$ 3.8 billion during the same period as compared with outflows of US\$ 1.4 billion a year ago. By contrast, net

¹All India headline CPI was not released for April 2020 in view of limited transactions in non-food items due to the lockdown; data were released only for the food and housing groups.

investment under the voluntary retention route increased by US\$ 0.7 billion during the same period. India's foreign exchange reserves have increased by US\$ 9.2 billion in 2020-21 so far (up to May 15) to US\$ 487.0 billion – equivalent to 12 months of imports.

Outlook

13. The inflation outlook is highly uncertain. As supply lines get restored in the coming months with gradual relaxations in the lockdown, the unusual spike in food inflation in April is expected to moderate. The forecast of a normal monsoon also portends well for food inflation. Given the current global demand-supply balance, international crude oil prices are likely to remain low although they may firm up from the recent depressed levels. Soft global prices of metals and other industrial raw materials are likely to keep input costs low for domestic firms. Deficient demand may hold down pressures on core inflation (excluding food and fuel), although persisting supply dislocations impart uncertainty to the near term outlook. However, volatility in financial markets could have a bearing on inflation. These factors, combined with favourable base effects, are expected to take effect and pull down headline inflation below target in Q3 and Q4 of 2020-21.

14. Turning to the growth outlook, economic activity other than agriculture is likely to remain depressed in Q1:2020-21 in view of the extended lockdown. Even though the lockdown may be lifted by end-May with some restrictions, economic activity even in Q2 may remain subdued due to social distancing measures and the temporary shortage of labour. Recovery in economic activity is expected to begin in Q3 and gain momentum in Q4 as supply lines are gradually restored to normalcy and demand gradually revives. For the year as a whole, there is still heightened uncertainty about the duration of the pandemic and how long social distancing measures are likely to remain in place and consequently, downside risks to domestic growth remain significant. On the other hand, upside impulses could be unleashed if the pandemic is contained, and social distancing measures are phased out faster.

15. The MPC is of the view that the macroeconomic impact of the pandemic is turning out to be more severe than initially anticipated, and various sectors of the economy are experiencing acute stress. The impact of the shock has been compounded by the interaction of supply disruptions and demand compression. Beyond the destruction of economic and financial activity, livelihood and health are severely affected. Even as various measures initiated by the Government and the Reserve Bank work to mitigate the adverse impact of the pandemic on the economy, it is necessary to ease financial conditions further. This will facilitate the flow of funds at affordable rates and revive animal spirits. With the inflation outlook remaining benign as lockdown-related supply disruptions are mended, the policy space to address growth concerns needs to be used now rather than later to support the economy, even while maintaining headroom to back up the revival of activity when it takes hold.

16. Accordingly, all members voted for a reduction in the policy repo rate and maintaining 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.

17. Dr. Pami Dua, Dr. Ravindra H. Dholakia, Dr. Janak Raj, Dr. Michael Debabrata Patra and Shri Shaktikanta Das voted for a reduction in the policy repo rate by 40 bps, while Dr. Chetan Ghate voted for a reduction by 25 bps.

18. The minutes of the MPC's meeting will be published by June 5, 2020.

Voting on the Resolution to reduce the policy repo rate

Member	Vote	Magnitude of policy repo rate reduction (basis points)
Dr. Chetan Ghate	Yes	25
Dr. Pami Dua	Yes	40
Dr. Ravindra H. Dholakia	Yes	40
Dr. Janak Raj	Yes	40
Dr. Michael Debabrata Patra	Yes	40
Shri Shaktikanta Das	Yes	40

Statement by Dr. Chetan Ghate

19. Since the last review, the outlook for the economy has deteriorated further.

20. Several high frequency indicators point to dire growth outcomes in the near term. On COVID-19, we haven't achieved the first goal, which is flattening of the curve. The "tug of war" between economic and health costs has led to some opening up of the economy. The economy needs to be opened up smartly. The risk of prematurely opening the economy is that there could be a surge in new cases. It takes time for local epidemics to grow. The main growth challenge is that the top six industrialized states produce 62% of India's GDP. These are also the worst affected states by COVID.

21. Despite the dire growth outcomes, why have I voted for a 25 bps cut, and not a larger amount?

22. *First*, it is not entirely clear to me that Covid-19 constitutes a large disinflationary shock. Inflationary pressures fall with economic slack (the output gap), but rise with expected future inflation and factors related to production costs.

23. Both 3-month ahead and 1-year ahead inflationary expectations have spiked sharply (by 190 bps and 120 bps respectively) in the latest round of RBI's survey. This spike reverses a relatively flat trajectory for inflationary expectations over the past six rounds of surveys. It also reflects a sharp rise in food inflation in recent months. In April, food inflation rose to 8.6% from 7.8% in March, and will likely remain elevated in the coming months. This is worrisome. I continue to be concerned about declining market arrivals of food commodities because of COVID related supply side bottlenecks and their inflationary impact.

24. When the economy turns to the upside, the recovery in demand will be swift. There has already been a severe dislocation in domestic and global supply chains. It will take some time to for these to get resolved, and it is therefore likely that demand will recover faster than supply.

25. Currently, core inflation (inflation excluding food and fuel) continues to remain moderate, with the April readings (not released by the CSO) likely to have been similar to the March readings, or around 4%. Lower oil prices have not been passed on to consumers at the pump because of a sharp hike in Central excise duties and increases in VAT rates on petrol and diesel across States, cancelling out any beneficial effects of lower oil prices on core inflation.

26. *Second*, as I mentioned in the last review, in a demand deficient economy, a large rate cut is akin to pushing on a string.

27. For rate cuts to work, banks have to lend. Despite the large number of steps taken to improve the liquidity and functioning of credit markets, as of April 24 (the most recent data available), non-food credit growth on a y-o-y basis was at 6.5% on May 8, 2020, lower than 7.2% on April 10, 2020.

28. *Third*, rate cuts should be seen as part other measures that have already been taken with respect to liquidity policy, social insurance policy, and fiscal policy in dealing with the crisis.

29. Since the last review, a comprehensive fiscal stimulus has been announced, amounting to about 10% of GDP. The “Keynesian component” of the stimulus, i.e., the part that increases discretionary spending via fiscal policy is however around 1% of GDP.

30. An ambitious Keynesian fiscal stimulus was always going to have to navigate between *Scylla* and *Charybdis*: if the government spent too much on the discretionary part of the stimulus, the yield curve would have gotten thrashed, banks would have booked losses, and our credit rating would have gotten a downgrade. It would have also signalled that the government is giving up on its commitment to controlling inflation. If it spent too little, it risked a worsening of growth.

31. To navigate the middle path, the government has focussed on much needed structural reforms. This is prudent. The measured approach to the stimulus recognizes the government cannot spend its way to prosperity without implications for financial instability.

32. Despite the small Keynesian component of the stimulus however, taking into account the relaxation in state government borrowing limits, the combined state-centre fiscal deficit is still likely to rise to around 10-12% of GDP in FY 21. I doubt if the bond markets will shrug this off. That means transmission to credit markets will suffer, making a large rate cut pointless. What compounds this is the rising risk aversion in the financial system will get exacerbated by a looming spike in NPAs because of the loan and mortgage holidays announced. This will hinder transmission even more.

33. *Fourth*, since the last review, a variety of high frequency indicators have declined sharply. There has been a broad based and deep contraction in the March IIP (Index of Industrial Production) which fell to -16.7% from 4.6% in March. Passenger vehicle sales have plummeted. Consumer non-durables have fallen by -16%. Indicators of fixed investment have tanked: finished steel consumption has declined by -90.9%, and IIP Capital goods (which proxy for machinery and equipment) have also fallen by -35.6%. PMI manufacturing declined to 27.4 in April from 51.8 in March due to a sharp contraction in output and new export orders. The services PMI dropped to 5.4 in April from 49.3 in March due to a sharp fall in business activity. Exports have also fallen drastically by -60.3%.

34. While these have no doubt resulted in a large negative output gap, it is also true that potential output has also fallen.

35. The only silver lining is the agriculture sector. The current Rabi crop has done well. And the current summer sowing of crops (for rice, pulses, coarse cereals, and oilseeds) is higher by 43.7% over last year.

36. The strongest argument for a big rate cut would therefore be the dire growth outcomes because of COVID. However, such rate cuts should be saved for when the economy starts reviving, and not when we are in a lock-down. Rate cuts, assuming that there is transmission and banks lend, works most effectively when the economy is on the upside. The MPC should keep some gunpowder dry.

37. *Fifth*, the reverse repo rate has been cut thrice in succession to 3.35%. The idea behind the asymmetric cuts is to use the LAF corridor as an instrument of monetary policy. For all practical purposes the reverse repo rate is now the effective policy rate. I worry that the current quantum of liquidity will be difficult to unwind when things return back to normal. RBI's liquidity policy has helped stabilize financial markets, but lender of last resort policies, as is widely recognised, are not useful outside a crisis, and thus should not be viewed as part of normal monetary policy.

38. Given the above reasons, I vote to cut the policy rate by 25 bps this time.

39. I will continue to watch the incoming growth-inflation data carefully, and remain data dependent.

40. I also vote to retain the stance as accommodative.

Statement by Dr. Pami Dua

41. The nationwide lockdown over the past two months due to the COVID-19 pandemic has severely impacted domestic economic activity, yielding a grim prognosis for the economy. This unprecedented and extraordinary economic and health crisis has also gravely affected the global economy with acute intensity and spread.

42. On the domestic inflation front, headline CPI inflation fell from 6.6 per cent in February 2020 to 5.8 per cent in March. For the month of April, only partial information has been released, providing the numbers for food inflation, which rose from 7.8 per cent in March to 8.6 per cent in April, with prices of vegetables, pulses, edible oils, milk and cereals being the prime drivers. However, low crude oil prices, soft global prices of metals and other industrial raw materials, and weakening aggregate demand are expected to soften inflation, although supply disruptions may impact inflation adversely. Overall, headline inflation is expected to ease in the second half of FY:2020-21 and fall below target. This also conforms with the May 2020 round of the Inflation Expectations Survey of Households conducted by the Reserve Bank of India that shows higher inflation expectations for the three-months-ahead forecasts compared to forecasts for the one-year-ahead horizon.

43. On the domestic output front, the evolving pandemic has had serious ramifications for domestic growth, which is crippled by a near-standstill in economic activity due to the lockdown and social distancing, leading to demand compression as well as supply disruptions. High frequency indicators of urban consumption demand – passenger vehicle sales, domestic passenger air traffic and consumer durables – fell dramatically in March 2020. A similar dismal picture emerges in indicators of rural demand – tractors sales, motorcycle sales and consumer non-durables – that plunged sharply in the same period. Indicators of fixed investment also fell, with a sharp drop in finished steel consumption in April and cement production in March, reflecting a slowdown in construction activity. Moreover, capital goods production (as per the use-based classification of IIP) declined by 36 per cent in March, along with a significant drop in capital goods imports during March and April. While the data for the March print of IIP has been compiled with limited sample due to the institution of the lockdown from March 25, the preliminary data indicates a drop in IIP by almost 17 per cent, with manufacturing falling by more than 20 per cent, infrastructure/construction goods by almost 24 per cent and electricity by 6.8 per cent.

44. The Purchasing Managers' Index (PMI) for manufacturing declined sharply to its lowest level of 27.4 in April from 51.8 in March, partly due to contraction in output and new exports orders. The PMI for services dropped dramatically to an unprecedented level of 5.4 in April from 49.3 in March, due mainly to a drop in business

activity, new business orders and new export business. High frequency indicators of the services sector, in addition to those mentioned above (passenger vehicle sales, domestic passenger air traffic), and including foreign tourist arrival, railway freight traffic, and commercial vehicle sales, contracted in March/April.

45. Fortunately, growth in agriculture has held up, with the total area under summer crops including rice, pulses, coarse cereals and oilseeds up by 43.7 per cent as on May 10, 2020 over the corresponding period of last year. Further, as per the third advance estimates of crop production for 2019-20, production of foodgrains (*kharif* and *rabi*) in 2019-20 is 3.7 per cent higher than the final estimates of the previous year.

46. The Consumer Confidence Survey conducted by RBI in May 2020 also paints a grim picture, showing that the overall Current Situation Index is at a historic low, while the Future Expectations Index reflects high pessimism for the year ahead. Thus, consumer sentiment has plunged to abysmally low levels.

47. At the global level, the global manufacturing PMI plunged to an eleven year low in April 2020, while the global services PMI sharply declined to a record low. Accordingly, India's merchandise exports and imports witnessed record contractions, with exports falling by 60.3 per cent in April 2020, while imports dropped by 58.6 per cent.

48. The economic situation is thus extremely gloomy. While the COVID-19 pandemic is a humanitarian and health crisis, the related lockdown has precipitated a collapse in economic activity, which has come to a near standstill. Other than in the agriculture sector, economic activity may continue to remain sluggish even after the lifting of the lockdown, due to social distancing and shortage of labour as a result of the migration of workers to their native places. In fact, GDP growth in FY:2020-21 is expected to remain in negative territory, with some respite in the second half of the fiscal year. The way forward in terms of restoration of economic activity thus depends on the speed with which the pandemic is contained, how quickly the Indian economy opens up, and how soon supply disruptions are repaired and demand revives. It will also depend on the impact of the combined stimulus from fiscal, monetary, social and administrative measures that have been implemented to create conditions conducive to survival in the crisis, as well as for revival in growth. Over time, some reprioritisation in government expenditure towards health infrastructure and capital expenditure may also be desirable for promoting economic revival.

49. The Government has outlined a comprehensive package in five tranches covering, amongst other measures, rural employment creation, infrastructure creation, focus on MSME sector and creation of an enabling business environment. The package also includes relief measures for poorer sections of society and for resource constrained state governments by increasing their borrowing limits. The measures also encompass a number of major structural reforms, which are more long-term in nature.

50. The Reserve Bank of India has used conventional monetary policy measures as well as unconventional monetary policy tools that supplement the conventional measures in order to ease financial conditions and stimulate growth in the economy. It has also undertaken several measures to improve liquidity, monetary transmission and credit flows to the economy, and provide relief on debt servicing.

51. Before the COVID-19 pandemic hit the Indian economy, the policy repo rate had already been reduced by 135 basis points between February and October 2019 in response to the slowdown in economic activity. Since the advent of the pandemic, the repo rate was further cut by 75 basis points in the March MPC meeting, amounting to a total cut of 210 basis points between February 2019 and March 2020. The monetary policy transmission to lending rates of banks has improved with a 90 basis

points decline in the one-year median marginal cost of funds-based lending rate (MCLR) between February 2019 and May 15, 2020. The weighted average lending rate (WALR) on fresh rupee loans declined by 114 basis points between February 2019 and March 2020 with a fall of 43 basis points in March itself.

52. Given the severity and depth of the crisis, the macroeconomic impact of the pandemic is turning out to be more severe than initially anticipated. Thus, in order to revive growth and mitigate the economic impact of COVID-19, it is important to ease financial conditions further. Accordingly, I vote for cutting the policy rate by 40 basis points. This brings the total reduction in the policy rate since the start of the spread of the COVID-19 pandemic to 115 basis points with the magnitude of cut in the easing cycle that started in February 2019, (up to May 2020) being 250 basis points. In the current scenario, with heightened uncertainty and a near-standstill in economic activity, this may not necessarily lead to an immediate increase in borrowing, but should raise consumer confidence and investor sentiment, going forward. I also vote to maintain the accommodative stance as long as necessary to revive growth, while ensuring that inflation remains within the target.

Statement by Dr. Ravindra H. Dholakia

53. Continuing lockdown in the geographical areas that contribute a major share in the Indian economy and worsening global economic situation due to COVID-19 has now created a distinct possibility of the real GDP growth in India during 2020-21 to be in the negative zone for the first time in the last 40 years. Even the nominal GDP growth may slip into the negative zone. There are all symptoms of a recession – fall in aggregate demand, negative real growth and high unemployment. The government has provided a major fiscal boost through a series of announcements. The role of the monetary policy under such circumstances should be to supplement and support the fiscal efforts to bring the economy out of the unprecedented crisis. Without exhausting all the space for policy rate cuts, in this meeting I, therefore, vote for a 40 bps cut in the policy Repo Rate and maintaining the accommodative stance. More specific reasons for my vote are as follows –

- i) Under the lockdown, measurement of consumer inflation and a survey of household inflationary expectations are likely to quite problematic. The samples would be truncated and undesirable biases may enter the estimates making them unreliable and non-representative. Under such circumstances, I feel, the model based forecasts provide a better guide. A very carefully carried out forecasting exercise provides an estimate of headline CPI inflation around 2.8 percent for Q4 2020-21. Even accounting for uncertainties, a very conservative estimate may be taken as 3.1-3.2 percent. Thus, inflation rising above the target of 4 percent does not seem to be any concern for the policy right now.
- ii) Although the real policy rate in most other comparator countries is zero or negative, in India it is not only positive but relatively very high at around 1.2 to 1.6 percent. I believe that the real policy rate needs to be kept positive but not so high under the present conditions.
- iii) The fiscal boost given by the Central government in several instalments is likely to result in further slippage of the fiscal deficit to GDP ratio of only 150 bps. Similarly, all states together may raise their fiscal deficit to GDP ratio by about 150 bps. Thus, the impact on the combined fiscal deficit to GDP ratio may be confined to about 300 bps, which in my opinion is quite prudent under such extreme conditions. It may not be inflationary and may result in growth recovery.

iv) Once the situation returns back to normal and the fiscal and monetary boost measures start generating impacts, the recovering economy in my opinion may require some further boost. It is prudent to preserve some space for the future.

54. Considering all these factors, I vote for a 40 bps reduction in the policy repo rate and maintaining the accommodative stance.

Statement by Dr. Janak Raj

55. The impact of COVID-19 on economic activity has turned out to be much more acute than initially expected with the nation-wide lockdown having been extended from initial 3 weeks to 9 weeks. There is still uncertainty as to when the epidemiological curve will flatten and this will continue to cloud the macroeconomic outlook for some more time. Be that as it may, we are staring at a huge negative growth in the current quarter and overall negative growth for the year as a whole. Both demand and supply sides of the economy have collapsed. However, I believe that supplies would recover much faster than demand. This is because capacity to produce goods and services by and large remains intact, though non-availability of labour may temporarily hamper production for a few months. On the other hand, however, there has been a substantial loss of demand. A large number of daily labourers/wage earners have been rendered jobless because of lockdown. Though a part of the unemployed work force will get back to work, still there are some sectors which have been hit hard and many people working in these sectors may have lost their jobs permanently. This will adversely affect private consumption. Otherwise also, consumer confidence has been dented and consumers are likely to cut down on discretionary spending.

56. Within aggregate demand, while private consumption is likely to slowdown from the pre-COVID-19 levels, what worries me more is investment demand, which is likely to be impacted severely for a variety of reasons. First, given the collapse in demand, excess capacity is likely to be created in many sectors. This, combined with huge uncertainty about future demand, both domestic and external, is likely to hamper new investments in the private sector. Second, financing of investment activity – from own sources due to a decline in profitability or by borrowing due to weak balance sheets – will also be a challenge. Third, the focus of government spending, both by the Centre and the States, will also be on revenue expenditure than on capital expenditure. For all these reasons, investment activity, which contracted in last two quarters, is expected to be severely hit, going forward.

57. Moving on to inflation, the NSO has released data only on the food and housing groups for April 2020. Food inflation rose to 8.6 per cent in April from 7.8 per cent in March. However, these numbers need to be interpreted with a caution as the rise in food prices in April was caused by a disruption in supply lines and is transitory. The wedge between CPI inflation and WPI inflation for food in April widened sharply by more than 500 bps. While CPI food inflation increased by close to 80 bps in April, WPI inflation declined by 190 bps from 5.5 per cent to 3.6 per cent, suggesting an increase in margins at a retail level due to supply bottlenecks. Should monsoon be normal, as it has been forecast, it should also have a salutary effect on food inflation. I, therefore, feel that risks to food inflation, other than in pulses, are minimal at this stage and overall food inflation is expected to resume its downward trajectory from May/June.

58. Though the print of CPI fuel inflation was not available for April, data from oil market companies suggest that domestic LPG and kerosene plunged in April in line with a decline in global prices.

59. Finally, we also do not have core inflation (excluding food and fuel) print for April. The fall in international crude oil prices has not been passed on to domestic

pump prices of petrol and diesel. Though this makes domestic pump prices vulnerable to any rise in international prices, on the current demand supply balance, oil prices are likely to remain soft. Given the collapse in domestic demand, core inflation should soften significantly from the current levels over the medium term. Input cost pressures are also likely to ease due to a sharp decline in global commodity prices. Housing inflation at less than 4 per cent during March-April was the lowest in the series. Gold prices are expected to remain firm due to a flight to safety. On the whole, however, core inflation is expected to remain benign over the next few quarters. Even though there is expected to be a V shaped recovery, the economy will still be left with a considerable slack, which will keep core inflation under check.

60. To sum up, economic activity is expected to contract in 2020-21. While supply lines are likely to be restored as lockdown is relaxed, demand would take far longer to revive to pre-COVID levels. Even as some support will be provided by government expenditure, overall consumption is likely to slow down due to a slump in private consumption. More than private consumption, however, it is investment demand which is expected to be hit hard in this uncertain environment and may be a huge drag on economic activity in the near future with attendant implications for potential growth. Therefore, concerted efforts need to be made to revive investment demand. Overall, inflation over the medium term is expected to be benign. Monetary policy has been eased significantly since February 2019 and the Government has also taken several measures, which will help mitigate deleterious impact of COVID-19 on aggregate demand. However, an unprecedented collapse in demand calls for further easing of financing conditions. With the likely contraction in economic activity and the inflation outlook remaining soft, the policy space has opened up. I, therefore, vote for reducing the policy repo rate by 40 basis points and keeping the stance accommodative as long as it is necessary to revive growth, while ensuring that inflation remains within the target. Given the long transmission lags with which monetary policy operates, it is important to create enabling financing conditions so that economic activity takes off swiftly as soon as normalcy is restored. Should the inflation trajectory turn out as expected, some more policy space may open up, going forward. For monetary policy actions to transmit fully to the credit market, it is important that banks remain well capitalised. Only banks with strong balance sheets could be expected to support lending activity as and when credit demand picks up.

Statement by Dr. Michael Debabrata Patra

61. In my view, the destruction of economic activity by COVID-19 and ensuing lockdowns is much more deleterious in terms of loss of basic livelihood, economic security, health and confidence than the range of estimates/projections of GDP and other macroeconomic aggregates suggest. In India, as in the rest of the world, external trade, investment, manufacturing, services involving people – hospitality, tourism, aviation and construction – and investment have been the worst hit. Private consumption is tenuously holding on to positive territory, but spending patterns have altered drastically away from the discretionary and to the essential. The large monetary stimulus and fiscal effort are striving to put a floor under the aggregate demand. At the current juncture, the all-out effort is to maintain and sustain, with the hope that when life is secure, resources, energy and time can be marshalled to rebuild and revive.

62. In fact, my view is that the damage is so deep and extensive that India's potential output has been pushed down, and it will take years to repair.

63. In the deliberations of the MPC, my view is that the threats to growth have to be addressed frontally and aggressively, or risk a more dire outlook.

64. Meanwhile, the prolonged lockdown has thrown supply into disarray and interrupted the easing of inflation that had gotten underway after the January 2020 peaking. Contemporaneous information suggests that the momentum in the prices of several food items, especially perishables, may be ebbing, with favourable implications for the evolution of headline inflation going forward. This suggests that the food price spike has very little persistence and dispersion (except in April 2020 when the lockdown started producing wider effects), and can be looked through for policy purposes. The sustained loss of momentum of seasonally adjusted GDP growth over eight consecutive quarters is depressing the underlying momentum of core inflation, and this is likely to continue in the near term, as aggregate demand would take time to return to pre-COVID levels.

65. Relative prices tend to adjust within the budget constraint. For setting monetary policy, however, it is the absolute level of prices and its prospective movements that matter. This warrants a careful assessment of aggregate demand. Apart from the unidirectional loss of speed in real GDP growth, monetary conditions are also reflecting the fragile state of demand. While reserve money adjusted for the first round CRR effects is expanding substantially in relation to its pace a year ago, this essentially reflects the large monetary stimulus and the public's flight to cash – currency in circulation expanded year-on-year by 18.4 per cent up to May 22, 2020 as against 14.9 per cent a year ago. In the current milieu in which banks are depositing sizeable balances with the Reserve Bank rather than lending/investing, the money multiplier at which this reserve money expansion translates into money supply, has to be adjusted to include LAF reverse repos, which are essentially (remunerated) excess reserves. With this adjustment, the money multiplier would have effectively declined from its normal level of 5.5 to about 4.5. This is showing up in the rate of money supply which has slowed below its secular trend; in fact, the negative money gap (actual rate of money supply minus its trend rate) has widened since 2019-20, especially from the second half. Both bank credit and investments are decelerating to multi-year lows, pointing to badly dented demand and risk aversion. On the other hand, bank deposits are growing faster than a year ago, driven by a precautionary savings instinct in these times of heightened uncertainty. It is important to break this recessionary loop, shore up the erosion in confidence, incentivise banks to invest and lend, and people to spend.

66. It is this context that should condition monetary policy actions and stance. The MPC has decided to remain accommodative as long as it is necessary to revive growth and mitigate the fallout of COVID-19. In keeping with this stance, the policy rate has been reduced by 75 basis points since February 2020 when the virus outbreak assumed pandemic proportions. In the evolving configuration of growth and inflation, monetary policy can inspire confidence among households and businesses to break the vortex of public preference for deposits over spending and banks' aversion to lend and invest. Ahead of turning to mend broken areas of activity, it is important to nurture the green shoots that have become visible – as in agriculture and allied activities – so that they take root and grow. These considerations warrant backing up past actions and stance with another decisive reduction in the policy rate while persevering with the accommodative stance. The experience of central banks has been that monetary policy acts best when it is reinforced by policy actions and stance in the same direction repetitively till the desired objectives are achieved.

67. The size of the rate reduction needs to be calibrated to the space opened up by the inflation outlook, after allowing for margins of error in these fluid and uncertain times, while keeping in mind the ramifications of the size of the rate reduction for financial stability.

68. Accordingly, I vote for a reduction in the policy rate by 40 basis points while maintaining the accommodative stance of monetary policy that has been reflected in the resolutions of the MPC in the recent period.

Statement by Shri Shaktikanta Das

69. The impact of COVID-19 on the domestic economy has turned out to be far more severe than initially anticipated. Lockdowns across major economies have also severely impacted economic activity across the globe. In the April WEO, the IMF projected the global economy to contract sharply by 3.0 per cent in 2020. GDP data for Q1:2020 and more recent high frequency indicators emanating from major advanced and emerging market economies, however, suggest that the contraction in global growth could be even deeper.

70. Domestic economic activity has been impacted severely by two months of lockdown which was imposed to contain the spread of the COVID-19 pandemic and save human lives. High frequency indicators for March-April 2020 suggest a collapse of demand. Industrial output, measured by the index of industrial production (IIP) for March, which included only seven days of the nation-wide lockdown, contracted by 16.7 per cent. The contraction was spread across sectors, with manufacturing shrinking by 20.6 per cent and capital goods production by 35.6 per cent. Private consumption, which has been the bedrock of domestic demand, also plummeted with the production of consumer durables falling by 33.1 per cent in March 2020 and that of non-durables by 16.2 per cent.

71. Limited data that are available for April suggest a further shrinkage in demand. India's merchandise trade slumped in April 2020, with exports contracting by 60.3 per cent and imports by 58.6 per cent. While railway freight traffic shrank by 35.3 per cent in April, steel consumption declined by 90.9 per cent. PMI manufacturing and PMI services in April slipped to unprecedented levels of 27.4 and 5.4 respectively.

72. Bank credit growth continues to be tepid, suggesting weak demand. Non-food credit of scheduled commercial banks (SCBs) grew by 6.5 per cent (y-o-y) as on May 8, 2020 as compared with 13.0 per cent a year ago. During 2020-21 so far (up to May 8, 2020), however, banks' investment in commercial paper, shares, bonds and debentures increased by ₹66,757 crore as against a decline of ₹8,822 crore during the same period last year, reflecting the impact of targeted long term repo operations (TLTROs) of the Reserve Bank.

73. The only silver lining has been the agriculture sector – the summer sowing is progressing well. As on May 10, 2020, summer sowing of all crops in the country was much higher by 43.7 per cent (37.9 per cent for rice, 74.8 per cent for pulses and 29.3 per cent for oilseeds) over last year's acreage. The harvest of *rabi* crop is almost complete. The forecast of normal monsoon by the India Meteorological Department (IMD) augurs well for agriculture output and farm incomes.

74. On inflation, the headline consumer price index (CPI) for April 2020 was not available on account of nationwide lockdown. Among the major groups, for which indices were released, food group inflation edged up in April 2020 (to 8.6 per cent from 7.8 per cent in the previous month) due to a broad-based increase in inflation across the food sub-groups.

75. The Reserve Bank has been proactively managing liquidity. Since the MPC statement of February 6, 2020 the Reserve Bank has announced liquidity augmenting measures of ₹9.42 lakh crore (4.6 per cent of GDP). Monetary transmission has continued to improve with the weighted average lending rate (WALR) on fresh rupee

loans declining by 43 bps in March; the decrease since February 2019, when the current cycle of rate cut began, being 114 bps.

76. Looking ahead, the growth outlook has deteriorated sharply. There is still uncertainty as to when the COVID curve will flatten. Even as the supply side is expected to ease gradually as the lockdown related restrictions are phased out, it is the demand side, which will continue to weigh heavily on economic activity for some time to come. The impact of the fiscal and contingent liability measures announced by the government on demand creation needs to be carefully watched. Quick implementation of various reform measures can also inject growth impulses into the Indian economy in the medium to long term. Economic activity, however, is expected to contract in the first half of the year before recovering gradually in the second half of 2020-21 on the back of various fiscal, monetary and liquidity measures undertaken in the recent period. Overall, the GDP growth in 2020-21 is estimated to remain in negative territory. The pace of recovery will be contingent upon the containment of the pandemic and how quickly social distancing/lockdown measures are phased out.

77. It has become challenging to assess the inflation outlook in the absence of complete information on CPI. Food inflation is expected to moderate in the coming months as transport impediments and supply lines get eased. This is also corroborated by data on 22 essential commodities released by the Department of Consumer Affairs, which show that prices of several food items have declined in this month so far from the April levels. The meltdown in demand is also likely to result in a significant easing of price pressures in core goods and services. Weak demand conditions in the presence of strong favourable base effects could result in headline inflation falling below the target rate during Q3 and Q4 of 2020-21.

78. Since the last off-cycle MPC meeting on March 27, 2020 macro-financial conditions have deteriorated rapidly. The fast evolving trade-offs between growth and inflation have underscored the need for intensifying the assessment of the macroeconomic outlook, and the preparedness to act pre-emptively to address the swiftly shifting underlying economic and financial conditions and what they portend for the path going forward. Delaying timely monetary policy response by two weeks, waiting for the bi-monthly MPC meeting schedule, could be costly and irreversible. In fact, such a delay in monetary policy action could potentially become a source of risk itself to the deteriorating growth outlook. Monetary policy is a rapid deployment instrument of public policy, and monetary authorities, forewarned by prescient assessment of the prevailing macroeconomic conditions, have to be nimble. It is in this context that the scheduled second bi-monthly meeting of the MPC was advanced from June 3 to 5, 2020 to May 20 to 22, 2020.

79. As pointed out in the foregoing paragraphs, the risks to growth have become far more severe than in our assessment at the end of March 2020. It is expected that this diagnosis will be validated by hard data over the next few months, even as the overall outlook continues to be highly uncertain. The key challenge for monetary policy at this stage is to resuscitate domestic demand to avoid any harmful effect on income and employment in the short run and potential growth over the medium term. For strengthening domestic demand, it is important to revive consumer and business confidence. The Government has already announced a variety of measures to provide economic support to various sectors of the economy and protect the interests of vulnerable sections of society. The Reserve Bank has also been proactively managing liquidity to ensure that funds flow to all productive sectors of the economy. RBI has also been easing monetary policy to reduce the cost of funds/capital to revive domestic demand. While all these measures should help support demand as and when the nation-wide lockdown is lifted, but given the enormity of a collapse in demand, the need is to move ahead full throttle to ease financing conditions further so as to revive

consumption and revitalize investment. Since banks are the key players in financing consumption and investment, it is also imperative that they remain adequately capitalised. The benign inflation outlook that is expected for the second half of 2020-21, coupled with the rising probability of a sharper loss of growth momentum in the near-term, has provided us with more policy space to ease financial conditions further and stimulate growth. Since the outbreak of COVID-19, the MPC has voted for front-loading its actions. In view of the deteriorating outlook, it is critical to reinforce these actions in sync with the space provided by the underlying conditions.

80. In assessing the magnitude of policy space, it is important to take into account the weak growth momentum, the need for prioritising growth in view of the less risky inflation outlook, and the need to assure benign financial conditions ahead of the recovery taking hold so that confidence is sustained. Considering all these factors, a reduction in the policy rate by 40 basis points would be appropriate. Accordingly, I vote for reducing the policy repo rate by 40 basis points from 4.4 per cent to 4.0 per cent. I also vote for persevering with the accommodative stance of monetary policy. The RBI remains watchful and shall not hesitate to use any conventional and unconventional tool in its toolkit to revive the macro economy and preserve financial stability while adhering to the inflation target.

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