



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi

Website : www.rbi.org.in

ई-मेल/email : helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस. मार्ग, फोर्ट, मुंबई - 400 001

Department of Communication, Central Office, S.B.S. Marg, Fort, Mumbai - 400 001

फोन/Phone: 022 - 2266 0502

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Governor's Statement: April 8, 2022

Two years ago in March 2020, we began a journey to fight the onslaught of COVID-19 on our economy with courage and determination. During the period thereafter, the Reserve Bank has successfully navigated its course through turbulent waters. While the pandemic has scarred our psyche and tested our resilience, we have responded with bold, unconventional and resolute measures to stabilise the economy through three waves of the pandemic. As the situation normalised, we have taken measures towards rebalancing liquidity conditions while ensuring that our actions are nimble and proactive but well-timed.

2. Now two years later, as we were emerging out of the pandemic situation, the global economy has seen tectonic shifts beginning 24th February, with the commencement of the war in Europe, followed by sanctions and escalating geopolitical tensions. We are confronted with new but humungous challenges – shortages in key commodities; fractures in the international financial architecture; and fears of deglobalisation. Extreme volatility characterises commodity and financial markets. While the pandemic quickly morphed from a health crisis to one of life and livelihood, the conflict in Europe has the potential to derail the global economy. Caught in the cross-current of multiple headwinds, our approach needs to be cautious but proactive in mitigating the adverse impact on India's growth, inflation and financial conditions. We are, however, reassured by the strong buffers that we have built over the past few years, including large foreign exchange reserves, significant improvement in external sector indicators and substantial strengthening of the financial sector, all of which would help us to weather this storm. Once again, we in the RBI stand resolute and in readiness to defend the economy and navigate out of the current storm.

Decisions and Deliberations of the Monetary Policy Committee

3. Against this backdrop, the Monetary Policy Committee (MPC) met on 6th, 7th and 8th April 2022 and, based on an assessment of the macroeconomic situation and the outlook, voted unanimously to keep the policy repo rate unchanged at 4 per cent. The MPC also decided unanimously to remain accommodative while focussing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. The marginal standing facility (MSF) rate and the Bank rate remain unchanged at 4.25 per cent. Further, it has been decided by the Reserve Bank to restore the width of the Liquidity Adjustment Facility (LAF) corridor to 50 basis points, the position that prevailed before the pandemic. The floor of the corridor will now be provided by the newly instituted standing deposit facility (SDF), which will be placed 25 basis points below the repo rate, i.e., at 3.75 per cent. I shall explain the details in this regard later in my statement.

4. Let me first dwell upon the MPC's rationale for its decision on the policy rate and the stance. Since the MPC's last meeting in early February 2022, the expected positive benefits from the ebbing Omicron wave have been offset by the sharp escalation in geopolitical tensions. This has significantly changed the external and domestic landscape. Concerns over protracted supply disruptions have rattled global commodity and financial markets, given the significant share of the two economies engaged in war in global production and exports of key commodities like oil and natural gas; wheat and corn; palladium, aluminium and nickel; edible oils; and fertilisers. Global crude oil prices briefly crossed US\$ 130 per barrel, touching their highest level since 2008 and remain volatile at elevated levels, despite some correction. Global food prices along with metal and other commodity prices have also hardened significantly. Risk aversion towards assets of emerging market economies (EMEs) has increased, leading to large capital outflows and a depreciating bias in their currencies. These developments have, first, ratcheted up the projections of global inflation, which was already running well above targets in major countries; and second, will produce sizeable adverse impact on output across geographies.

5. The geopolitical tensions have exacerbated at a time when the global economy was grappling with a sharp rise in inflation and consequent monetary policy normalisation in major advanced economies. Global supply chain disruptions and input cost pressures are now expected to linger even longer. The resurgence of COVID-19

infections in some major economies in March and the associated lockdowns run the risk of further aggravating the global supply bottlenecks and input cost pressures. World trade and output and hence external demand are likely to be weaker than envisaged two months ago. Overall, the external developments during the past two months have led to the materialisation of downside risks to the domestic growth outlook and upside risks to inflation projections presented in the February MPC resolution. Inflation is now projected to be higher and growth lower than the assessment in February. Economic activity, although recovering, is barely above its pre-pandemic level. Against this backdrop, the MPC decided to retain the repo rate at 4 per cent. It also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Assessment of Growth and Inflation

Growth

6. According to the second advance estimates released by the National Statistical Office (NSO) on February 28, 2022, real GDP rose by 8.9 per cent in 2021-22. Private consumption and fixed investment – key drivers of domestic demand – however, remain subdued, with these two components being only 1.2 per cent and 2.6 per cent respectively, above their pre-pandemic levels. On the supply side, contact-intensive services still trail the 2019-20 level. Nevertheless, the Indian economy is steadily reviving from its pandemic induced contraction.

7. During 2021-22, weakness in economic activity resurfaced in Q3 and got exacerbated by the emergence of the Omicron variant in January 2022. A gradual turnaround has been noticed during February, although in March 2022 a mixed picture was seen. Some contact-intensive activities have regained traction amidst declining infections and removal of restrictions. Several high frequency indicators – railway freight; GST collections; toll collections; electricity demand; fuel consumption; and imports of capital goods posted robust year-on-year expansion during February-March. With the easing of restrictions, domestic air passenger traffic rebounded in March. According to our surveys, consumer confidence is improving and households' optimism in outlook for the year ahead has strengthened with an uptick in sentiments. Business confidence is in optimistic territory and supportive of revival in economic activity. On the other hand, passenger vehicle sales and registrations continue to

contract, though at a moderating pace. Both manufacturing and services PMIs remain in the zone of expansion; while manufacturing PMI moderated slightly in March, services and composite showed improvement.

8. Going forward, robust *Rabi* output should support recovery in rural demand, while a pick-up in contact-intensive services should help in further strengthening urban demand. Investment activity may gain traction with improving business confidence, pick up in bank credit, continuing support from government capex and congenial financial conditions. Capacity utilisation (CU) in the manufacturing sector recovered further to 72.4 per cent in Q3:2021-22 from 68.3 per cent in the previous quarter, surpassing the pre-pandemic level of 69.9 per cent in Q4:2019-20.

9. As the horizon was brightening up, escalating geopolitical tensions have cast a shadow on our economic outlook. Although India's direct trade exposure to countries at the epicentre of the conflict is limited, the war could potentially impede the economic recovery through elevated commodity prices and global spillover channels. Further, financial market volatility induced by monetary policy normalisation in advanced economies, renewed COVID-19 infections in some major countries with augmented supply-side disruptions and protracted shortages of critical inputs, such as semi-conductors and chips, pose downside risks to the outlook. Taking all these factors into consideration, real GDP growth for 2022-23 is now projected at 7.2 per cent with Q1:2022-23 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, assuming crude oil (Indian basket) at US\$ 100 per barrel during 2022-23.

Inflation

10. The February 2022 meeting of the MPC had projected a moderating path for inflation during 2022-23. Heightened geopolitical tensions since end-February have, however, upended the earlier narrative and considerably clouded the inflation outlook for the year. On the food price front, a likely record *Rabi* harvest would help to keep domestic prices of cereals and pulses in check. Global factors such as the loss of wheat supply from the Black Sea region and the unprecedented high international prices of wheat could, however, put a floor under domestic wheat prices. Edible oil price pressures are likely to remain elevated in the near-term due to export restrictions by key producers as well as loss of supply from the Black Sea region. Feed cost pressures could continue due to global supply shortages, which could also have a spillover impact on poultry, milk and dairy product prices.

11. Coming to non-food items, the spike in international crude oil prices since end-February poses substantial upside risk to inflation through both direct and indirect effects. Sharp increase in domestic pump prices could trigger broad-based second round price pressures. A combination of high international commodity prices and elevated logistic disruptions could aggravate input costs across agriculture, manufacturing and services sectors. Their pass-through to retail prices, therefore, warrants continuous monitoring and pro-active supply management. Financial markets are likely to remain volatile on rising risk premia, dislocations in trade and capital flows and divergent monetary policy responses across central banks. Taking into account these factors and on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US \$ 100 per barrel, inflation is now projected at 5.7 per cent in 2022-23, with Q1 at 6.3 per cent; Q2 at 5.8 per cent; Q3 at 5.4 per cent; and Q4 at 5.1 per cent.

12. It may, however, be noted that given the excessive volatility in global crude oil prices since late February and the extreme uncertainty over the evolving geopolitical tensions, any projection of growth and inflation is fraught with risk, and is largely contingent upon future oil and commodity price developments.

13. In this context, continuation and deepening of supply side measures may alleviate food price pressures and also mitigate cost-push pressures across manufacturing and services. On our part, let me assure all stakeholders that as in the past, the Reserve Bank will use all its policy levers to preserve macroeconomic stability and enhance the resilience of our economy. The situation is dynamic and fast changing and our actions have to be tailored accordingly.

Liquidity and Financial Market Conditions

14. As stated earlier, the macroeconomic outlook is undergoing tectonic shifts and our policy response has to be pre-emptive and re-calibrated dynamically to the evolving outlook. The Reserve Bank will continue to adopt a nuanced and nimble footed approach to liquidity management while maintaining adequate liquidity in the system. At present, liquidity management is characterised by two-way operations: through variable rate reverse repo (VRRR) auctions of varying maturities to absorb liquidity; and variable rate repo (VRR) auctions to meet transient liquidity shortages and offset mismatches. This approach will be continued.

15. It may be noted that the interest rate for around 80 per cent of the total liquidity absorbed under the LAF during Q4:2021-22 has firmed up close to the policy repo rate due to the rebalancing of liquidity through VRRR auctions. Accordingly, financial market participants have been prepared for the eventual normalisation of the LAF corridor.

16. Further, it has now been decided to fully restore the liquidity management framework instituted in February 2020, *albeit* with some refinements to enhance its effectiveness. Accordingly, the following measures are being instituted:

- (i) The amendment to Section 17 of the RBI Act in 2018 empowered the Reserve Bank to introduce the Standing Deposit Facility (SDF). By removing the binding collateral constraint on the central bank, the SDF strengthens the operating framework of monetary policy. Accordingly, it has now been decided to introduce the SDF as the floor of the LAF corridor. This would provide symmetry to the operating framework of monetary policy by introducing a standing absorption facility at the bottom of the LAF corridor, similar to the standing injection tool at the upper end of the corridor, namely the marginal standing facility (MSF). Thus, at both ends of the LAF corridor, there will be standing facilities – one to absorb and the other to inject liquidity. Accordingly, access to SDF and MSF will be at the discretion of banks, unlike repo/reverse repo, OMO and CRR which are available at the discretion of the Reserve Bank. Notably, the SDF is also a financial stability tool in addition to its role in liquidity management.
- (ii) The SDF rate will be 25 bps below the policy rate, and it will be applicable to overnight deposits at this stage. It would, however, retain the flexibility to absorb liquidity of longer tenors as and when the need arises, with appropriate pricing. The MSF rate will continue to be 25 bps above the policy repo rate. Thus, the width of the LAF corridor is restored to the pre-pandemic configuration of 50 bps, symmetrically around the policy repo rate, which will be at the centre of the corridor.
- (iii) The fixed rate reverse repo (FRRR) rate is retained at 3.35 per cent. It will remain as part of RBI's toolkit and its operation will be at the discretion of the RBI for purposes specified from time to time. The FRRR along with the SDF will impart flexibility to the RBI's liquidity management framework.
- (iv) Both MSF and SDF will be available on all days of the week, throughout the year.

(v) It has also been decided to restore the opening time for financial markets regulated by the RBI to the pre-pandemic timing of 9:00 am with effect from April 18, 2022, without any change in their closing time prevailing at present.

17. During the pandemic, the RBI offered liquidity facilities of the order ₹17.2 lakh crore of which ₹11.9 lakh crore was utilised. So far ₹5.0 lakh crore has been returned or withdrawn on the lapse of various facilities on their due dates. The extraordinary liquidity measures undertaken in the wake of the pandemic, combined with the liquidity injected through various other operations of the RBI have left a liquidity overhang of the order of ₹8.5 lakh crore in the system. The RBI will engage in a gradual and calibrated withdrawal of this liquidity over a multi-year time frame in a non-disruptive manner beginning this year. The objective is to restore the size of the liquidity surplus in the system to a level consistent with the prevailing stance of monetary policy. While doing so, I would like to reiterate our commitment to ensure the availability of adequate liquidity to meet the productive requirements of the economy. We also remain focussed on completion of the borrowing programme of the Government and towards this end the RBI will deploy various instruments as warranted.

External Sector

18. Despite the worsening global supply shocks slowing the recovery in the world economy, India's merchandise exports grew robustly in 2021-22, overshooting the target of US\$ 400 billion. A sharp escalation in international commodity prices in conjunction with domestic demand recovery has also led to a strong rebound in imports and a widening of trade and current account deficits. The sustained and robust growth in services exports and in-bound remittances continue to keep our invisible account balance in large surplus, which helps to offset partly the merchandise trade deficit. Despite the sharp jump in crude oil and other commodity prices, we expect the current account deficit to remain at sustainable levels which can be financed with normal capital flows.

19. Overall, our external sector indicators remain healthy and have improved significantly in recent years. Our foreign exchange reserves stand at US\$ 606.5 billion as on April 1, 2022 which are further bolstered by the net forward assets of the RBI. The Reserve Bank remains committed to maintain orderly conditions in the domestic

financial markets and will take appropriate steps, as needed, on an ongoing basis to contain the adverse spillovers from the global developments.

Additional Measures

20. I now propose to announce certain additional measures, the details of which are set out in the [statement on developmental and regulatory policies \(Part-B\)](#) of the Monetary Policy Statement. These measures are as follows:

Individual Housing Loans – Rationalisation of Risk Weights

21. The risk weights for individual housing loans were rationalised in [October 2020](#) by linking them only with loan to value (LTV) ratios for all new housing loans sanctioned up to March 31, 2022. Recognising the importance of the housing sector and its multiplier effects, it has been decided to extend the applicability of these guidelines till March 31, 2023. This will facilitate higher credit flow for individual housing loans.

SLR holdings in HTM category

22. With a view to enable banks to better manage their investment portfolio during 2022-23, it has been decided to enhance the present limit under Held to Maturity (HTM) category from 22 percent to 23 per cent of NDTL till March 31, 2023. It has also been decided to allow banks to include eligible SLR securities acquired between April 1, 2022 and March 31, 2023 under this enhanced limit. The HTM limits would be restored from 23 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2023.

Discussion Paper on Climate Risk and Sustainable Finance

23. Climate change poses certain risks that could have implications for the safety and soundness of financial institutions and as well as financial stability. To facilitate better understanding and assessment of the potential impact of climate-related financial risks by Regulated Entities, a Discussion Paper on Climate Risk and Sustainable Finance will be published shortly for feedback.

Committee for review of Customer Service Standards in RBI Regulated Entities

24. The Reserve Bank has over the years taken a number of measures to enhance consumer protection. These measures include laying down regulatory frameworks on customer service, internal grievance redress and the Ombudsman mechanisms. In view of the transformation underway in the financial landscape due to innovations in products and services, deepening of digital penetration and emergence of various service providers, it is proposed to set up a committee to examine and review the current state of customer service in the RBI Regulated Entities, adequacy of customer service regulations and suggest measure to improve the same.

Interoperable Card-less Cash Withdrawal at ATMs

25. At present, the facility of card-less cash withdrawal through ATMs is limited only to a few banks. It is now proposed to make card-less cash withdrawal facility available across all banks and ATM networks using the UPI. In addition to enhancing ease of transactions, the absence of the need for physical card for such transactions would help prevent frauds such as card skimming, card cloning, etc.

Bharat Bill Payment System – Rationalisation of Net-worth Requirement for Operating Units

26. Bharat Bill Payment System (BBPS), an interoperable platform for bill payments, has seen an increase in the volume of bill payments and billers over the years. To further facilitate greater penetration of bill payments through the BBPS and to encourage participation of a greater number of non-bank Bharat Bill Payment Operating Units in the BBPS, it is proposed to reduce the net worth requirement of such entities from ₹100 crore to ₹25 crore.

Cyber Resilience and Payment Security Controls of Payment System Operators (PSOs)

27. Payment systems play a catalytic role in facilitating financial inclusion and promoting financial stability. To ensure that our payment systems remain resilient to conventional and emerging risks, specifically those relating to cyber security, it is proposed to issue guidelines on Cyber Resilience and Payment Security Controls for Payment System Operators.

Concluding Remarks

28. The last two years have seen turbulence and uncertainty of epic proportions. At the Reserve Bank, we have worked unrelentingly to mitigate their impact on our economy. When I look back, I see that we have traversed an arduous path with candour, courage and the conviction that a brighter future lies ahead.

29. The conflict in Europe now poses a new and overwhelming challenge, complicating an already uncertain global outlook. As the daunting headwinds of the geopolitical situation challenge us, the RBI is braced up and prepared to defend the Indian economy with all instruments at its command. As we have demonstrated over the last two years, we are not hostage to any rulebook and no action is off the table when the need of the hour is to safeguard the economy. Our goals of price stability, sustained growth and financial stability are mutually reinforcing and we continue to be guided by this approach.

30. The sky today may be overcast with clouds, but we will use all our energies, resolve and resources to let the sunlight illuminate India's future. Let me end by recalling what the Father of our nation, Mahatma Gandhi said long ago: "*It is faith that steers us through stormy seas, faith that moves mountains and faith that jumps across the ocean.*"¹

Thank you. Stay safe. Stay well. Namaskar.

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(Yogesh Dayal)
Chief General Manager

¹ Young India, 24-9-1925, p. 331