

*Governor's Statement**

Shaktikanta Das

As I make this statement, I look back at the traumatising experience with two waves of an existence-defining pandemic. Virtually every aspect of human life has been drastically altered. Yet, what has been achieved on this troubled journey has been no less extraordinary. We are now better prepared to deal with the invisible enemy, COVID-19, which keeps threatening the entire world from time to time and even more recently.

The Indian economy has literally hauled itself out of one of the deepest contractions in the first quarter of 2020-21 to a position in which the GDP has expanded by 13.7 per cent in the first half of 2021-22, in alignment with our projection. In several sectors of the economy, pre-pandemic levels of output have been crossed. Inflation is broadly aligned with the target of 4 per cent, barring short-lived spikes. External financing requirements are very modest and strong buffers should withstand any global spillovers. Public finances have been strengthened by buoyant tax revenues. The Central and State Governments and the Reserve Bank of India (RBI) mobilised policy actions on an unprecedented scale and scope to bring about this outcome. Equally, the selfless and tireless efforts of our unsung warriors among municipal and local bodies; healthcare, police and administrative personnel; philanthropic entities; and civil society are praiseworthy. They remind us of a quote from Mahatma Gandhi: "The best way to find yourself is to lose yourself in the service of others"¹. I think this pandemic truly brought India together and could just be the moment of India's arrival as a global growth driver.

* Governor's Statement - December 8, 2021.

¹ Leider, R. (2015). The power of purpose: Find meaning, live longer, better, p. 35.

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

I would now like to dwell briefly on the MPC's rationale for maintaining status quo on the policy rate and the stance. Noting that economic activity is broadly evolving in line with its assessment in October, the MPC was of the view that the sharp and sustained reduction in new COVID-19 infections and the rise in vaccination coverage are contributing to consumer confidence and business optimism. The prospects for economic activity are steadily improving, including for contact-intensive services that were hit hard by the pandemic. The MPC noted the supply side measures taken by the government to contain food prices as also the calibrated reductions in central excise duties and state VAT (value added taxes) on petrol and diesel. Crude oil prices have also softened since end-November. These would alleviate, to an extent, the domestic cost-push build-up.

The recovery of aggregate demand hinges on private investment, which is still lagging. The MPC regarded the accentuation of headwinds emanating from global developments as the main risk to the domestic outlook, which is now somewhat clouded by the Omicron variant of COVID-19. Moreover, given the slack in the economy and the ongoing catching-up

of activity, especially of private consumption, which is still below its pre-pandemic levels, continued policy support is warranted for a durable and broad-based recovery. Against this backdrop, the MPC decided to retain the prevailing repo rate at 4 per cent and continue with the accommodative stance.

Assessment of Growth and Inflation

Growth

The NSO's release on November 30, 2021 confirmed that the recovery of the Indian economy is gaining traction, with real GDP growth at 8.4 per cent, year-on-year (y-o-y), for Q2:2021-22 subsequent to 20.1 per cent in the preceding quarter. All components of GDP registered y-o-y growth, with exports and imports strongly surpassing their pre-COVID levels.

Incoming information indicates that consumption demand has been improving, with pent-up demand getting reinforced by the festive season. Rural demand is exhibiting resilience and farm employment is picking up with the robust performance of agriculture and allied activities, supported by a strong start to rabi sowing, continuing direct transfers under the PM-Kisan scheme and extension of free foodgrains under the Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) till March 2022. Urban demand has also shown signs of strengthening, with spending on travel and tourism surging in the last few months. Other indicators like railway freight traffic, port cargo, GST receipts, toll collections, petroleum consumption and air passenger traffic have also picked up in October/November. The recent reductions in excise duty and state VAT on petrol and diesel should support consumption demand by increasing purchasing power. Government consumption is also picking up from August, providing support to aggregate demand.

Enabling conditions for a revival of investment activity are also falling into place. The production of capital goods remained above the pre-pandemic level for the third month in a row during September, while

imports of capital goods increased by double digits during October for the eighth consecutive month. The Central Government's relaxation of additional market borrowings by states equivalent to 0.5 per cent of gross state domestic product (GSDP) subject to certain capex related milestones and the decision to front-load tax devolution are likely to bolster capital outlays of the states. The government's focus on capex should crowd in private investment, which has remained in a prolonged state of muted activity. Further, there has been significant deleveraging of corporate balance sheets amidst congenial monetary and financial conditions engendered by the Reserve Bank's liquidity measures.

Overall, the recovery that had been interrupted by the second wave of the pandemic is regaining traction, but it is not yet strong enough to be self-sustaining and durable. This underscores the vital importance of continued policy support.

Downside risks to the outlook have risen with the emergence of Omicron and renewed surges of COVID-19 infections in a number of countries. Besides, notwithstanding some recent corrections, headwinds continue to be posed by elevated international energy and commodity prices, potential volatility in global financial markets due to a faster normalisation of monetary policy in advanced economies, and prolonged global supply bottlenecks. Considering all these factors, the projection for real GDP growth is retained at 9.5 per cent in 2021-22 consisting of 6.6 per cent in Q3 and 6.0 per cent in Q4 of 2021-22. Real GDP growth is projected at 17.2 per cent for Q1:2022-23 and at 7.8 per cent for Q2:2022-23.

Inflation

Headline CPI inflation ticked up in October to 4.5 per cent from 4.3 per cent in September, after falling sharply between June and September. This uptick mainly reflected a spike in vegetable prices due to unseasonal rains in some parts of the country.

Hardening international energy prices have kept domestic LPG and kerosene prices elevated for nearly three quarters, edging up fuel inflation to 14.3 per cent in October. The persistence of high core inflation (*i.e.*, CPI inflation excluding food and fuel) since June 2020 is an area of policy concern in view of input cost pressures that could rapidly be transmitted to retail inflation as demand strengthens. In this context, the reduction of excise duty and VAT on petrol and diesel will bring about a durable reduction in inflation by way of direct effects as well as indirect effects operating through fuel and transportation costs.

The inflation trajectory is, therefore, likely to be in line with our earlier projections, and price pressures may persist in the immediate term. Vegetable prices are expected to see a seasonal correction with winter arrivals in view of bright prospects for the rabi crop. Supply side interventions by the Government have limited the fallout of continuing high international edible oil prices on domestic prices. Though crude oil prices have seen some correction in the recent period, a durable containment of price pressures would hinge on strong global supply responses to match the pick-up in demand as pandemic restrictions ease. Cost-push pressures continue to impinge on core inflation, though their pass-through may remain muted due to the slack in the economy. Over the rest of the year, inflation prints are likely to be somewhat higher as base effects turn adverse; however, it is expected that headline inflation will peak in Q4:2021-22 and soften thereafter. Taking into consideration all these factors, CPI inflation is projected at 5.3 per cent for 2021-22; 5.1 per cent in Q3; 5.7 per cent in Q4 of 2021-22, with risks broadly balanced. CPI inflation is then expected to ease to 5.0 per cent in Q1:2022-23 and stay at 5.0 per cent in Q2:2022-23.

Our monetary policy stance is primarily attuned to the evolving domestic inflation and growth dynamics. Yet, imminent shifts in monetary policy settings by systemically important global central

banks are bringing about fresh challenges for domestic macro-financial stability in the form of spillovers. In such a scenario, domestic macro-fundamentals need to be resilient, with appropriate policy stances and actions, and strong buffers. In this context, a well-entrenched nominal anchor provided by the flexible inflation targeting framework has imparted credibility and flexibility to monetary policy to effectively address growth concerns during the pandemic. In the current situation, it is important to keep inflation aligned with the target while focusing on a robust growth recovery. Simultaneously, the Reserve Bank remains cognisant of the need to ensure that financial conditions are rebalanced in a systematic, calibrated and well-telegraphed manner while preventing build-up of financial stability risks. Price stability remains the cardinal principle for monetary policy as it fosters growth and stability. Our motto is to ensure a soft landing that is well timed.

Liquidity and Financial Market Conditions

The global context is evolving rapidly. Appearance of the Omicron variant has added to the complexity of the situation even as several economies are still battling the virus while others continue to deal with the lingering scars of COVID-19. As economies reopened, the spurt in catch-up demand has met with choked supply chains, shortage of key inputs and tightening labour markets. Combined with high energy and commodity prices, this has ignited long-dormant inflation in a number of countries, even before output has returned to pre-pandemic levels. Several central banks in both advanced and emerging market economies have begun unwinding from crisis-time policies as warranted by their own growth-inflation dynamics. Now, with fears of further restrictions on travel and activity, there is considerable uncertainty at this moment on how the growth-inflation dynamics will pan out in the immediate months. The financial conditions are turning increasingly volatile as a consequence.

The Reserve Bank has maintained ample surplus liquidity in the banking system to nurture the nascent growth impulses and support a durable economic recovery. This has facilitated swifter and more complete monetary policy transmission and the orderly conduct of the market borrowing programme of the Government. The Reserve Bank will continue to manage liquidity in a manner that is conducive to entrenching the recovery and fostering macroeconomic and financial stability.

In our endeavour to restore the revised liquidity management framework instituted in February 2020, the Reserve Bank has been rebalancing the liquidity surplus by shifting it out of the fixed rate overnight reverse repo window into the variable rate reverse repo (VRRR) auctions of longer maturity. The objective is to re-establish the 14-day VRRR auction as the main liquidity management operation. This rebalancing followed a pre-announced glide path whereby VRRR auction amount was progressively enhanced to ₹6.0 lakh crore by December 3. In response to this increase, overnight collateralised money market rates have mildly firmed up in recent times. By and large, the rebalancing of liquidity has proceeded in a timely and non-disruptive manner as planned. It is also fulfilling its objective of strengthening the Reserve Bank's control over the liquidity overhang which, in turn, reinforces the ability of the Reserve Bank to normalise liquidity conditions when warranted.

The Reserve Bank will continue to rebalance liquidity conditions in a non-disruptive manner while maintaining adequate liquidity to meet the needs of the productive sectors of the economy. With this objective, it is now proposed to enhance the 14-day VRRR auction amounts on a fortnightly basis in the following manner: ₹6.5 lakh crore on December 17; and further to ₹7.5 lakh crore on December 31. Consequently, from January 2022 onwards, liquidity absorption will be undertaken mainly through the auction route.

As announced earlier, the RBI has been conducting fine-tuning operations from time to time to manage unanticipated and one-off liquidity flows so that systemic liquidity conditions evolve in a balanced and evenly distributed manner. The RBI has also been conducting 28-day VRRR auctions. Going forward, the main operation of 14-day VRRRs will continue to be complemented by longer term VRRRs, the size and maturities of which will be decided on the basis of continuous assessment of the evolving liquidity conditions. The Reserve Bank also retains the flexibility to conduct fine-tuning operations of varying amounts/maturities as and when required. As I have repeatedly stressed in my statements and speeches, the endeavour of the Reserve Bank is to put in place an effective liquidity management framework that is consistent with an economy emerging out of the pandemic and having a nascent but strengthening recovery. The Reserve Bank also stands committed to undertake Operation Twists (OT) and regular open market operations (OMOs) as may be required for effective monetary transmission and anchoring of interest rate expectations in line with the evolving macroeconomic and financial conditions.

As a step towards rebalancing the liquidity surplus, it has now been decided to provide one more option to banks to prepay the outstanding amount of funds availed under the Targeted Long-Term Repo Operations (TLTRO 1.0 and 2.0) announced on 27th March and 17th April, 2020. It may be noted that banks have already prepaid ₹37,348 crore in November 2020, which constituted about one-third of ₹1,12,900 crore availed under the scheme.

The on-tap liquidity windows of ₹50,000 crore for ramping up COVID-related healthcare infrastructure and services and ₹15,000 crore for certain contact-intensive sectors will continue till their terminal date *i.e.*, March 31, 2022.

Further, given that the usage of the MSF window has been rare due to surplus liquidity conditions, we propose to return to the normal dispensation under the MSF. Consequently, banks will be able to dip up to 2 per cent of net demand and time liabilities (NDTL) instead of 3 per cent for overnight borrowing under the MSF from January 1, 2022. This dispensation which was provided at the beginning of the pandemic had boosted market confidence at a crucial time.

Let me reiterate that we remain committed to our stance in support of our overarching priority at this juncture to broaden the growth impulses while preserving monetary and financial stability. We will also continue to encourage adequate flow of credit to all productive sectors of the economy.

Additional Measures

Based on our continuing assessment, certain additional measures are also being announced today. The details of these measures are set out in the statement on developmental and regulatory policies (Part-B) of the Monetary Policy Statement. The additional measures are as follows:

Infusion of Capital in Overseas Branches and Subsidiaries of Banks and Retention/Repatriation/Transfer of Profits by these entities

At present, banks incorporated in India can infuse capital in their overseas branches and subsidiaries; retain profits in these centres; and repatriate/ transfer profits therefrom with prior approval of the RBI. With a view to providing operational flexibility to banks, it has been decided that banks need not seek prior approval of the RBI if they meet the regulatory capital requirements.

Discussion Paper on Review of Prudential Norms for Investment Portfolio of Banks

The extant prudential norms on classification and valuation of investment portfolio by scheduled commercial banks are largely based on a framework introduced in October 2000. In view of the significant

developments since then in domestic financial markets and global standards/best practices in this area, a need has been felt to review and update these norms following a consultative process. In this direction, a Discussion Paper will be placed shortly on the RBI's website for comments.

Discussion Paper on Charges in Payment Systems

Concerted efforts by all stakeholders have led to a significant increase in digital payments in recent years. There have, however, been some concerns on the reasonableness of various charges incurred by customers for digital payments through credit cards, debit cards, prepaid payment instruments (cards and wallets), Unified Payments Interface (UPI) and the like. It is proposed to release a discussion paper on various charges in the payment system to have a holistic view of the issues involved and possible approaches to mitigating the concerns so as to make digital transactions more affordable.

UPI: Simplification, Deepening and Enhancement of Limits

UPI is the single largest retail payment system in the country in terms of volume of transactions, indicating its wide acceptance, particularly for small value payments. In order to further deepen digital payments and make them more inclusive, ease transactions for consumers, facilitate greater participation of retail customers in various segments of financial markets and enhance the capacity of service providers, it is proposed to (i) launch UPI-based payment products for feature phone users, leveraging on innovative products from the RBI's Regulatory Sandbox on Retail Payments; (ii) make the process flow for small value transactions simpler through a mechanism of 'on-device' wallet in UPI applications; and (iii) enhance the transaction limit for payments through UPI for the Retail Direct Scheme for investment in G-secs and Initial Public Offering (IPO) applications from ₹2 lakh to ₹5 lakh.

External Commercial Borrowing (ECB)/Trade Credit (TC) – Transition from LIBOR to Alternative Reference Rate (ARR)

At present, interest rates on ECB and trade credits are benchmarked to LIBOR or any other interbank rate applicable to the currency of borrowing. As we transition away from LIBOR, guidelines enabling use of any widely accepted interbank rate or alternative reference rate (ARR) for such transactions are being issued separately.

Concluding Remarks

Globally, economies are opening up and activity levels are reaching pre-pandemic levels. At the same time, the recurrence of COVID-19 waves in many parts of the world including the appearance of the Omicron variant, stubborn inflation and headwinds from continuing supply bottlenecks cast a shadow on the outlook. Given the evolving growth-inflation dynamics across countries, monetary policy is also reaching an inflection point, keeping financial markets edgy.

The Indian economy is relatively well-positioned on the path of recovery, but it cannot be immune to global spillovers or to possible surges of infections

from new mutations including the Omicron variant. Hence, fortifying our macroeconomic fundamentals, making our financial markets and institutions resilient and sound, and putting in place credible and consistent policies will assume the highest priority in these uncertain times.

Managing a durable, strong and inclusive recovery is our mission. We need to be persevering, patient and persistent in our efforts. We also need to be aware, alert and agile to the new realities confronting us. Our efforts over the past one year and nine months have given us the confidence and a head start to face the challenges that lie ahead. To quote Nelson Mandela, "Part of being optimistic is keeping one's head pointed toward the sun, one's feet moving forward"². Our journey ahead is clearer now and our mission is cut out. Let us work together towards a strong, stable and vibrant economy, inspired by the words of Mahatma Gandhi: "My success lies in my continuous, humble, truthful striving. I know the path. It is straight and narrow. It is like the edge of a sword. I rejoice to walk on it. he who strives never perishes. I have implicit faith in that promise...."³.

Thank you. Stay safe. Stay well. Namaskar.

² Mandela, N. (1995). Long walk to freedom: the autobiography of Nelson Mandela.

³ The Collected Works of Mahatma Gandhi (CWMG), Vol. 35, p. 374-375.