Governor's Statement – May 22, 2020

"It is when the horizon is the darkest and human reason is beaten down to the ground that faith shines brightest and comes to our rescue."[1]

As a nation we must have faith in India's resilience and capacity to overcome all odds. COVID-19, a virus of the size of 0.12 microns, has crippled the global economy, with more than 300,000 dead and economic activity across the world stalled. Once again, central banks have to answer the call to the frontline in defence of the economy.

2. The recent release of macroeconomic data, that for the first time revealed the damage wrought by COVID-19, brought forward the need for an off-cycle meeting of the monetary policy committee (MPC) in lieu of the scheduled meeting during June 3 to 5, 2020. Over the last three days, *i.e.*, 20th, 21st and 22nd May 2020, the MPC reviewed domestic and global developments and their implications for the outlook. After extensive discussions, the MPC voted unanimously for a reduction in the policy repo rate and for maintaining the accommodative stance of monetary policy as long as necessary to revive growth, mitigate the impact of COVID-19, while ensuring that inflation remains within the target. On the quantum of reduction, the MPC voted with a 5-1 majority to reduce the policy rate by 40 basis points from 4.4 per cent to 4.0 per cent. Consequently, the Marginal Standing Facility (MSF) rate and the Bank rate stand reduced to 4.25% from 4.65%. The reverse repo rate stands reduced to 3.35% from 3.75%.

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[1] Mahatma Gandhi, Young India, March 21, 1929

3. Before I lay out the backdrop, the rationale and expected outcomes of the MPC's decision, I wish to thank the Committee members for their valuable contributions to the work of the Committee in the monetary policy decision taken today. I would also like to thank my colleagues in the RBI who have been working tirelessly in our fight against COVID-19. My gratitude goes out to our teams for their intellectual support, analytical work and logistical arrangements. A special word of praise for our team of over 200 officers, staff and service providers who are working unstinted 24X7 in isolation in order to keep essential RBI services available to the nation. I wish to express our admiration for doctors, healthcare and medical staff, police and law enforcement agencies, functionaries and personnel in the government, the private sector, banks and other financial institutions who have risen to the call of duty, day after day, through the pandemic to ensure continuity in the provision of all essential services. Our deepest gratitude to their families too.

I. Assessment

4. By all counts, the macroeconomic and financial conditions are austere. The global economy is inexorably headed into recession. The global manufacturing purchasing managers index (PMI) contracted to an 11-year low in April 2020. The global services PMI recorded its steepest decline in the history of the index. Among advanced economies (AEs) that have released GDP readings for Q1: 2020, contractions were in the range of 3.4 per cent to 14.2 per cent (q-o-q, annualised); for emerging market economies (EMEs), the growth rate ranged between 2.9 per cent and (-) 6.8 per cent (year on year basis). EMEs face additional pressures in the form of capital

outflows and asset price volatility from the bouts of turbulence afflicting financial markets. The plunge in crude prices has dried up budgetary revenues for oil exporters; on the other hand, oil importers have been denied terms of trade gains by the crushing blow to demand delivered by the pandemic. According to the United Nations Conference on Trade and Development (UNCTAD), the value of global trade contracted by 3.0 per cent in Q1:2020. The volume of world trade can shrink by 13-32 per cent in 2020, as projected by the World Trade Organisation (WTO). World services trade deteriorated in the first quarter of 2020 due to a broad-based loss of momentum in passenger air travel, container shipping, financial and ICT services. While commodity prices have eased on large demand shocks amidst widespread lockdowns, food price pressures are visible in inflation prints due to supply disruptions, especially in countries where food is a prominent item of households' consumption expenditure. Global financial markets have calmed after a turbulent period in March, and volatility has ebbed; but markets have generally been disconnected from real economy developments.

5. Relatively unsung, the global policy response by central banks and governments has been unprecedented.

6. Let me now turn to domestic developments. Domestic economic activity has been impacted severely by the 2 months lockdown. The top 6 industrialised states that account for about 60 per cent of industrial output are largely in red or orange zones. High frequency indicators point to a collapse in demand beginning in March 2020 across both urban and rural segments. Electricity and petroleum products consumption – indicators of

day to day demand – have plunged into steep declines. The double whammy in terms of losses of both demand and production has, in turn, taken its toll on fiscal revenues. Investment demand has been virtually halted by a decline of 36 per cent in the production of capital goods in March, which was coincident with a contraction of 27 per cent in imports of capital goods in March and 57.5 per cent in April. This is also evident in a fall of 91 per cent in finished steel consumption in April and a 25 per cent shrinkage in cement production in March. The biggest blow from COVID-19 has been to private consumption, which accounts for about 60 per cent of domestic demand. The production of consumer durables fell by 33 per cent in March 2020, accompanied by a 16 per cent decline in the output of non-durables. Similar indications are reflected in surveys of the fast moving consumer goods space.

7. In the production sectors, industrial production shrank by close to 17 per cent in March 2020, with manufacturing activity down by 21 per cent. The output of core industries, which constitutes about 40 per cent of overall industrial production, contracted by 6.5 per cent. The manufacturing PMI for April recorded its sharpest deterioration to 27.4, spread across all sectors. The services PMI plunged to an all all-time low of 5.4 in April 2020.

8. Amidst this encircling gloom, agriculture and allied activities have provided a beacon of hope on the back of an increase of 3.7 per cent in foodgrains production to a new record (as per the third advance estimates of the Ministry of Agriculture released on May 15, 2020). A ray of hope also comes from the forecast of a normal southwest monsoon in 2020 by the India Meteorological Department (IMD). By May 10, 2020 up to which latest information is

available, *kharif* sowing was higher by 44 per cent over last year's acreage. *Rabi* procurement is in full flow in respect of oilseeds, pulses and wheat, benefiting from the bumper harvest. These developments will support farm incomes, improve the terms of trade facing the farm sector and strengthen food security for the country. Going forward, these would also have a salutary effect on food price pressures.

9. The inflation outlook has become complicated by the release of partial information on the consumer price index (CPI) by the National Statistical Office(NSO), obscuring a comprehensive assessment of the price situation. From the incomplete data that have been made available, food inflation, which had eased from its January 2020 peak for the second successive month in March, suddenly reversed and surged to 8.6 per cent in April as supply disruptions took their toll, immune to the ongoing demand compression. Prices of vegetables, pulses, edible oils, milk and cereals emerged as pressure points.[2]

10. In the external sector, India's merchandise exports and imports suffered their worst slump in the last 30 years as COVID-19 paralysed world production and demand. India's merchandise exports plunged by 60.3 per cent in April 2020 while imports contracted by 58.6 per cent. The trade deficit narrowed to US$ 6.8 billion in April 2020, lowest since June 2016. On the financing side, net foreign direct investment inflows picked up in March 2020

[2]All 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.

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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 has also 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 against outflows of US$ 1.4 billion a year ago. By contrast, net 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 a year's imports.

II. Outlook

11. Against this backdrop, the MPC assessed that the inflation outlook is highly uncertain. The supply shock to food prices in April may show persistence over the next few months, depending upon the state of lockdown and the time taken to restore supply chains after relaxation. Among the pressure points, the elevated level of pulses inflation is worrisome, and warrants timely and swift supply management interventions, including a reappraisal of import duties. Immediate step-up of open market sales/PDS-offtake by the FCI to offload some part of excess stocks can cool down cereal prices and also create room for *rabi* procurement. Given the current global demand-supply balance, international crude oil prices, metals and industrial raw material prices are likely to remain soft. This would ease input costs for domestic firms. Deficient demand may hold down pressures on core inflation, although persisting supply dislocations impart uncertainty to the near term outlook. Much will depend on the shape of the recovery after COVID. Accordingly, the MPC is of the view that headline inflation may remain firm

in the first half of 2020-21, but should ease in the second half, aided also by favourable base effects. By Q3 and Q4 of FY20-21, it is expected to fall below target. Thus, the MPC's forward guidance on inflation is directional rather than in terms of levels. Going forward, as and when more data are available, it should be possible to estimate the path of inflation with greater certainty.

12. It is in the growth outlook that the MPC judged the risks to be gravest. The combined impact of demand compression and supply disruption will depress economic activity in the first half of the year. Assuming that economic activity gets restored in a phased manner, especially in the second half of this year, and taking into consideration favourable base effects, it is expected that the combination of fiscal, monetary and administrative measures being currently undertaken would create conditions for a gradual revival in activity in the second half of 2020-21. Nonetheless, downside risks to this assessment are significant and contingent upon the containment of the pandemic and quick phasing out of social distancing/lockdowns. Given all these uncertainties, GDP growth in 2020-21 is estimated to remain in negative territory, with some pick-up in growth impulses from H2: 2020-21 onwards. The end-May 2020 release of NSO on national income should provide greater clarity, enabling more specific projections of GDP growth in terms of both magnitude and direction. Much will depend on how quickly the COVID curve flattens and begins to moderate. As the nation prepares for this

future, the words of Mahatma Gandhi should inspire us to fight on: “We may stumble and fall, but shall rise again…….”[3]

13. The MPC is of the view that that the macroeconomic impact of the pandemic is turning out to be more severe than initially anticipated. Beyond the destruction of economic and financial activity, livelihood and health are severely affected. Judging that the risks to growth are acute, while the risks to inflation are likely to be short-lived, the MPC believes that it is essential now to instil confidence and ease financial conditions further. This will facilitate the flow of funds at affordable rates and rekindle investment impulses. It is in this context that the MPC voted to reduce the policy repo rate by 40 basis points from 4.4 per cent to 4.0 per cent. If the inflation trajectory evolves as expected, more space will open up to address the risks to growth.

III. Regulatory and Developmental Measures

14. I now turn to the various regulatory and developmental measures being announced today to complement and amplify the reduction in the policy rate decided by the MPC. While doing so, let me spend a little time on the policy actions already taken by the RBI, their rationale and their likely impact. In my statement at the time of the MPC’s meeting in February 2020, I had pointed out the increasing downside risks to global growth in the context of the outbreak of the coronavirus, the full effects of which were still uncertain and unfolding. Since then, the RBI has pro-actively managed liquidity conditions,

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[3] Mahatma Gandhi, “*Our Aim*”, Navjivan, September 7, 1919, Collected Works of Mahatma Gandhi (CWMG), Vol. XVI, p.93

expanding its array of measures, both conventional and unconventional – to augment system-level liquidity, both in rupees and forex, as also to channel liquidity to specific sectors facing funding constraints. These liquidity measures are intended to keep the financial system and financial markets functioning as normally as possible under the circumstances so that financial conditions do not freeze up.

15. In the meantime, monetary policy transmission to banks' lending rates has continued to improve. The 1 year median marginal cost of funds-based lending rate (MCLR) declined by 90 bps (February 2019-May 15, 2020). The weighted average lending rate (WALR) on fresh rupee loans has cumulatively declined by 114 bps since February 2019, of which 43 bps decline occurred in March 2020 alone. The WALR on outstanding rupee loans declined by 29 bps during October 2019-March 2020. Domestic financial conditions have also eased as reflected in the narrowing of liquidity premia in various market segments. After April 17th when I last spoke to you, interest rates on 3-month CPs, 3-month CDs, 5-year AAA corporate bonds, 91-day Treasury Bills, 5-year and benchmark 10-year government paper have softened by 220 bps, 108 bps, 48 bps, 71 bps, 59 bps and 66 bps, respectively, by May 15, 2020.

16. The decision of the MPC to reduce the policy repo rate and maintain the accommodative stance of monetary policy provides the opportunity for the RBI to announce certain additional measures against the backdrop of a deteriorating outlook for economic activity. These policy actions complement and strengthen each other in intent and reach. The measures being announced today can be broadly delineated under four categories:

(A) measures to improve the functioning of markets and market participants;

(B) measures to support exports and imports;

(C) efforts to further ease financial stress caused by COVID-19 disruptions by providing relief on debt servicing and improving access to working capital; and

(D) steps to ease financial constraints faced by state governments.

(A) Measures to Improve the Functioning of Markets

Refinancing Facility for Small Industries Development Bank of India (SIDBI)

17. The RBI had earlier announced a special refinance facility of ₹15,000 crore to SIDBI at RBI's policy repo rate for a period of 90 days for on-lending/refinancing. In order to provide greater flexibility to SIDBI, it has been decided to roll over the facility at the end of the 90th day for another period of 90 days.

Investments by Foreign Portfolio Investors (FPIs) under the Voluntary Retention Route (VRR)

18. Since its introduction, the VRR scheme has evinced strong investor participation, with investments exceeding 90 per cent of the limits allotted under the scheme. In view of difficulties expressed by FPIs and their custodians on account of COVID-19 related disruptions in adhering to the condition that at least 75 per cent of allotted limits be invested within three months, it has been decided that an additional three months time will be allowed to FPIs to fulfil this requirement.

(B) Measures to Support Exports and Imports

19. The deepening of the contraction in global activity and trade, accentuated by the rapid spread of COVID-19, has crippled external demand. In turn, this has impacted India's exports and imports, both of which have contracted sharply in recent months. In view of the importance of exports and imports to the economy certain measures are being taken to support the foreign trade sector.

Export Credit

20. In order to alleviate genuine difficulties being faced by exporters in their production and realisation cycles, it has been decided to increase the maximum permissible period of pre-shipment and post-shipment export credit sanctioned by banks from the existing one year to 15 months, for disbursements made up to July 31, 2020.

Liquidity Facility for Exim Bank of India

21. In order to enable EXIM bank to meet its foreign currency resource requirements, it has been decided to extend a line of credit of ₹ 15,000 crore to the EXIM Bank for a period of 90 days (with rollover up to one year) so as to enable it to avail a US dollar swap facility.

Extension of Time for Payment for Imports

22. With a view to providing greater flexibility to importers in managing their operating cycles in a COVID-19 environment, it has been decided to extend the time period for completion of outward remittances against normal imports (*i.e.* excluding import of gold/diamonds and precious stones/jewellery) into

India from six months to twelve months from the date of shipment for such imports made on or before July 31, 2020.

(C) Measures to Ease Financial Stress

23. The RBI had earlier, on two separate occasions (March 27 and April 17, 2020), announced certain regulatory measures pertaining to (a) granting of 3 months moratorium on term loan installments; (b) deferment of interest for 3 months on working capital facilities; (c) easing of working capital financing requirements by reducing margins or reassessment of working capital cycle; (d) exemption from being classified as 'defaulter' in supervisory reporting and reporting to credit information companies; (e) extension of resolution timelines for stressed assets; and (f) asset classification standstill by excluding the moratorium period of 3 months, etc. by lending institutions.

24. In view of the extension of the lockdown and continuing disruptions on account of COVID-19, the above measures are being extended by another three months from June 1, 2020 till August 31, 2020 taking the total period of applicability of the measures to six months (i.e. from March 1, 2020 to August 31, 2020). The lending institutions are being permitted to restore the margins for working capital to their original levels by March 31, 2021. Similarly, the measures pertaining to reassessment of working capital cycle are being extended up to March 31, 2021.

25. Additionally, it has been decided to permit lending institutions to convert the accumulated interest on working capital facilities over the total deferment period of 6 months (i.e. March 1, 2020 up to August 31, 2020) into a funded interest term loan which shall be fully repaid during the course of the current financial year, ending March 31, 2021.

26. In view of the current difficulty in raising resources from capital markets, the group exposure limit of banks is being increased from 25 per cent to 30 per cent of eligible capital base, for enabling corporates to meet their funding requirements from banks. The increased limit will be applicable up to June 30, 2021.

(D) Measures to ease financial constraints faced by State Governments

Consolidated Sinking Fund (CSF) of State Governments - Relaxation of Guidelines

27. In order to ease the bond redemption pressure on states, it has been decided to relax the rules governing withdrawal from the CSF, while at the same time ensuring that depletion of the Fund balance is done prudently. Together with the normally permissible withdrawal, this measure will enable the states to meet about 45 per cent of the redemptions of their market borrowings, due in 2020-21. This change in withdrawal norms will come into force with immediate effect and will remain valid till March 31, 2021.

28. Detailed guidelines for all the above announcements will be issued separately.

Concluding Remarks

29. Central banks are typically seen as conservative institutions. Yet when the tides turn and all the chips are down, it is to them that the world turns for support. As I have stated earlier, the RBI will continue to remain vigilant and in battle readiness to use all its instruments and even fashion new ones, as the recent experience has demonstrated, to address the dynamics of the unknown future. The goals, as I have enunciated earlier, are (i) to keep the financial system and financial markets sound, liquid and smoothly

functioning; (ii) to ensure access to finance to all, especially those that tend to get excluded by financial markets; and (iii) to preserve financial stability. It shall be our endeavour that RBI's actions and stance contribute to laying the foundations of a better tomorrow. Today's trials may be traumatic, but together we shall triumph. Thank you.

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