Statement by Governor - Third Bi-monthly Monetary Policy, 2019-20, August 7, 2019

The Monetary Policy Committee (MPC) met on 5th, 6th and 7th August, 2019 and deliberated over the evolving macroeconomic outlook, against the backdrop of recent developments and incoming data. Today, the MPC voted unanimously to reduce the policy repo rate and to maintain the accommodative stance of monetary policy. As set out in the MPC's resolution, four members voted for a reduction in the policy repo rate by 35 basis points, while two members voted to reduce the policy repo rate by 25 basis points.

2. I take this opportunity to express my gratitude to the MPC members for valuable and insightful discussions that culminated in the policy decision.

3. I also wish to thank our teams in the Reserve Bank and express my appreciation for their hard work and dedication with which they supported the MPC's work.

4. In reviewing global developments, the MPC noted that global economic activity has slowed down since its meeting in June in an environment rendered hostile by elevated trade tensions and geo-political uncertainty. Reflecting subdued demand conditions, crude oil prices have fallen sharply since mid-May. On the other hand, gold prices have risen, propelled by increased safe haven demand. These developments exemplify the high uncertainty weighing on the outlook, amidst rising downside risks to growth. Increasingly, central banks across the world are easing monetary policy, including through 'insurance' rate reductions, and are committing to maintaining accommodation in their policy stances.

Meanwhile, inflation remained benign across major advanced and emerging market economies. Financial markets have turned volatile on the back of the monetary policy stances of major central banks and the uncertainty generated by trade and geopolitical tensions.

5. On domestic developments, the MPC observed that the south-west monsoon is rapidly catching up, with the cumulative rainfall being 6 per cent below the long-period average (LPA) and 25 of the 36 sub-divisions having received normal or excess rainfall as on August 6, 2019. The India Meteorological Department has forecast normal rainfall in August and September. Catch-up is also underway in the area sown under *kharif* crops, which is only 6.6 per cent lower as on August 2 than a year ago. Industrial growth, measured by the index of industrial production (IIP), moderated in May 2019, pulled down by manufacturing and mining. Electricity generation picked up on strong demand. The manufacturing PMI rose to 52.5 in July from 52.1 in June, underpinned by a pick-up in production, higher new orders and optimism on future demand conditions. High frequency indicators of services sector activity for May-June present a mixed picture. Indicators of rural and urban demand as well as construction activity weakened, whereas domestic air passenger traffic growth turned positive in June after three consecutive months of contraction. The services PMI expanded to 53.8 in July from 49.6 in June, on increase in new business activity, new export orders and employment.

6. Retail inflation, measured by y-o-y change in the CPI, edged up to 3.2 per cent in June from 3.0 per cent in April-May. Food inflation rose to 2.4 per cent in June from 2.0 per cent in May and 1.4 per cent in April, while inflation in the fuel and light group moderated. Excluding food and fuel, inflation remained unchanged after having fallen by 50 basis points to 4.1 per cent in May from 4.6 per cent in April. The softness in inflation

in this category was broad-based. Inflation expectations of households moderated by 20 basis points for the one year ahead horizon.

7. Merchandise exports contracted in June 2019. Imports also contracted and as the fall in imports was larger than that of exports, the trade deficit declined modestly during May-June on a y-o-y basis. On the financing side, net foreign direct investment flows moderated to US$ 6.8 billion in April-May 2019 from US$ 7.9 billion a year ago. Net foreign portfolio investment (FPI) flows in the domestic capital market amounted to US$ 2.3 billion during the current financial year so far (up to August 5, 2019) as against net outflows of US$ 8.5 billion in the same period last year. India's foreign exchange reserves were at US$ 429.0 billion on August 2, 2019 – an increase of US$ 16.1 billion over end-March 2019.

8. In view of these developments and considering that inflation for the first quarter of 2019-20 was in alignment with its June projections, the MPC has retained its inflation projection at 3.1 per cent for Q2:2019-20 and revised the projection for H2:2019-20 to 3.5-3.7 per cent, with risks evenly balanced, from 3.4-3.7 per cent projected in June. CPI inflation for Q1:2020-21 has been projected at 3.6 per cent.

9. The MPC has revised downwards the projection of real GDP growth to 6.9 per cent for 2019-20 - 5.8-6.6 per cent for H1:2019-20 and 7.3-7.5 per cent for H2 - with risks somewhat tilted to the downside, against 7.0 per cent in its June resolution - 6.4-6.7 per cent for H1:2019-20 and 7.2-7.5 per cent for H2 – with risks evenly balanced. The downward adjustment in the GDP growth projection was warranted by various high frequency indicators pointing to weakening of both domestic and external demand conditions. On the other hand, the MPC was of the view that the

impact of monetary policy easing since February 2019 is expected to support economic activity, going forward.

10. The MPC has voted for a policy rate reduction of 35 basis points instead of the conventional 25 basis points. Let me explain the rationale underlying this action. Considering the evolving macro-economic outlook, the Reserve Bank has been pre-emptive in its monetary policy actions and stance. Since February 2019, it has reduced the policy repo rate by a cumulative 75 basis points. In addition, it has changed the stance of policy from neutral to accommodative, which is effectively a further reduction in the policy rate since it takes rate increases off the table, while committing to either rate reductions or *status quo*, going forward. Furthermore, sufficient liquidity has been provided to the system, resulting in overnight money market rates trading below the policy rate throughout July and August so far. In today's meeting, the MPC judged that with inflation projected to remain within the target, addressing growth concerns by boosting aggregate demand, especially private investment, assumes the highest priority at this juncture. Against the backdrop of policy actions taken so far, the MPC felt that it is prudent to remain accommodative. While remaining consistent with the inflation mandate, the MPC considered it necessary to calibrate the size of the policy rate cut to the dynamics of the situation. Accordingly, the MPC was of the view that the standard 25 basis points might prove to be inadequate in view of the evolving global and domestic macroeconomic developments. On the other hand, reducing the policy repo rate by, say, 50 basis points might be excessive, especially after taking into account the actions already undertaken. Reducing the policy repo rate by 35 basis points was, therefore, viewed as a balanced level of cut under the circumstances.

11. Now, I shall turn to some developmental and regulatory policy measures that we have announced today in the areas of financial markets; payment and settlement systems; banking regulation, financial inclusion and credit flows to NBFCs.

12. As regards financial markets, the Reserve Bank has been making continuous efforts to develop the market for State Development Loans (SDLs) in both primary and secondary segments. In continuation of these efforts, it has been decided to introduce the stripping/reconstitution facility for SDLs in consultation with State governments.

13. In order to enhance the efficiency and soundness of the payment and settlement systems, several measures are proposed. First, the National Electronic Funds Transfer (NEFT) payment system operated by the Reserve Bank as a retail payment system will be made available on a 24x7 basis from December 2019. This is expected to revolutionise the retail payments system of the country. Second, all categories of billers (except prepaid recharges) who provide for recurring bill payments will be permitted to participate in the Bharat Bill Payment System (BBPS), an interoperable platform for repetitive bill payments, on a voluntary basis. Apart from digitisation of cash-based bill payments, these segments would also benefit from the standardised bill payment experience for customers, centralised customer grievance redressal mechanism, prescribed customer convenience fee and the like. Third, it has been decided to enable diversification of risk and encourage innovation and competition by offering 'on tap' authorisation to entities desirous to function/operate/provide platforms for (i) Bharat Bill Payment Operating Unit (BBPOU); (ii) Trade Receivables Discounting System (TReDS); and (iii) White Label ATMs (WLAs). Fourth, the Reserve Bank will also facilitate the creation of a Central Payment Fraud Registry for tracking

payment system frauds. Participants in payment systems will be provided access to this registry for near-real time fraud monitoring. The aggregated fraud data will be published to disseminate information on emerging risks.

14. In the area of banking regulation, it has been decided to reduce the risk weight for consumer credit including personal loans, but excluding credit card receivables, to 100 per cent from 125 per cent or higher.

15. Over the last one year, the Reserve Bank has taken several measures to enhance credit flow to the non-banking financial companies (NBFC) sector (which are detailed in the statement on developmental and regulatory policies). In continuation of these efforts, two more measures are now being announced. First, it has been decided to raise a bank's exposure to a single NBFC to 20 per cent of Tier-I capital of the bank, as a step towards harmonisation of the counterparty exposure limit to a single NBFC with that of the general limit. Second, in order to augment the flow of credit to priority sectors that contribute significantly to exports and employment, it has been decided to allow bank lending to registered NBFCs (other than MFIs) for on-lending to (i) agriculture (investment credit) up to ₹10 lakhs; (ii) Micro and Small Enterprises up to ₹20 lakhs; and (iii) housing up to ₹20 lakhs per borrower (up from ₹10 lakhs at present), to be classified as priority sector lending.

16. It will be remiss of me not to address issues relating to monetary policy transmission and liquidity management, which have been flagged for prioritized focus in previous statements on developmental and regulatory policies. I also appreciate that market participants and analysts will be looking forward to developments in these spheres.

17. With regard to monetary policy transmission, it may be recalled that an easing cycle of monetary policy commenced in February 2019, with a

cumulative reduction in the policy rate by 75 basis points during February-June. The stance of policy was changed from neutral to accommodative in June. These policy impulses have been transmitted through financial markets fully. The weighted average call money rate (WACR) has declined by 78 bps, market repo rate by 73 bps and 10-year benchmark g-sec yield by 102 bps. Banks, on the other hand, have reduced their interest rates on fresh rupee loans by 29 basis points so far (February-June 2019). Our interactions with various stakeholders, including both public sector and private sector banks, indicate that steps are being taken by them on an ongoing basis to progressively lower their interest rates so that the benefits of the policy rate reductions are passed on to the economy. Accordingly, we expect higher transmission of monetary policy actions and stance by the banks in the weeks and months ahead.

18. On liquidity management, the system has experienced large surplus conditions since June. The Reserve Bank absorbed liquidity of ₹51,710 crore in June, ₹1,30,931 crore in July and ₹2,11,140 crore in August (up to August 5) on a daily net average basis under the LAF. Two OMO purchase auctions amounting to ₹27,500 crore were conducted in June, thereby injecting durable liquidity into the system. The weighted average call money rate (WACR) – the operating target of monetary policy – was aligned with the policy repo rate in June, but it traded below the policy repo rate on a daily average basis by 14 bps in July and 17 bps in August so far. As announced in the Statement of Developmental and Regulatory Policies of June 6, 2019 the Reserve Bank constituted an internal working group to comprehensively review the existing liquidity management framework. The group has reached an advanced stage in its deliberations and its recommendations will be available shortly for public comments. Meanwhile, the Reserve Bank has injected a substantial amount of

liquidity into the system through a combination of instruments, including the LAF, open market operations and forex swaps. There is an abundance of liquidity in the system currently, warranting absorptions of surpluses by the Reserve Bank. Surplus liquidity parked in the reverse repo window of the Reserve Bank was almost ₹2.0 lakh crore on August 6. The Reserve Bank is committed to ensuring that sufficient liquidity is available so that the needs of all productive sectors of the economy are met. Towards this objective, the Reserve Bank will use its liquidity management instruments to ensure that the system's requirements of both day-to-day liquidity and durable liquidity are adequately provided.
