Statement by Governor, February 7, 2019

Over the past two and a half days i.e., during February 5,6 and 7, 2019 the Monetary Policy Committee (MPC) reviewed macroeconomic and financial conditions and prospects and voted by a 4/2 majority to reduce the policy repo rate by 25 basis points. The MPC also voted unanimously to shift the monetary policy stance from calibrated tightening to neutral. I would like to take this opportunity to thank the MPC members for their extremely valuable contributions, and the richness and high quality of the discussions that took place. I also thank our teams in the Reserve Bank who provided inputs and support at various stages of policy formulation.

2. Let me begin by setting out key developments that the MPC considered while arriving at the policy decision. The MPC noted that global growth is slowing down across key advanced economies (AEs) and in some major emerging market economies (EMEs) as well. World trade is also losing momentum. While international commodity prices, especially of crude, have recovered from their December lows, they remain soft. In consonance, inflation has edged down in major AEs and many EMEs. Global financial markets have regained poise from heightened turbulence in December, with equity markets paring earlier losses, bond yields easing and EME currencies appreciating, aided by a weaker US dollar.

3. As regards domestic macroeconomic developments, the MPC noted that the CSO has placed India's real GDP growth at 7.2 per cent in 2018-19, with gross fixed capital formation (GFCF) accelerating, but consumption expenditure moderating and net exports improving. More recent high frequency indicators point to investment demand losing some pace in the third quarter of 2018-19, while credit flows to industry remain muted.

4. On the supply side, output from agriculture and allied activities and services is expected by the CSO to decelerate in 2018-19. *Rabi* sowing up to February 1, 2019 has been lower than in the previous year, but it could catch up as the season ends. The extended period of cold weather in this year's winter is also likely to boost wheat yields. In the industrial sector, activity measured by the index of industrial production (IIP) slowed down in November, even as capacity utilisation in the manufacturing sector increased above trend. Survey-based indicators point to weakening of demand conditions in the manufacturing sector. High-frequency indicators of the services sector suggest some moderation in the pace of activity.

5. In its assessment of inflation developments, the MPC noted that headline CPI inflation declined to 2.2 per cent in December, the lowest print in the last eighteen months. Continuing deflation in food items, a sharp fall in fuel inflation and some edging down of inflation, excluding food and fuel, contributed to the decline in headline inflation. Moreover, inflation expectations of households have softened by 80 basis points for the three-month ahead horizon and by 130 basis points for the twelve-month horizon. Producers assess that inflation in prices of farm inputs and industrial raw materials eased in Q3 while growth in rural wages moderated.

6. On the external front, export growth was almost flat while import growth slowed in November and turned negative in December 2018. Consequently, the merchandise trade deficit for April-December 2018 was a shade higher than its level a year ago, although higher services exports and low oil prices should have a salutary impact on the current account deficit in Q3. On the financing side, net FDI flows to India during April-November 2018 were higher than a year ago. Foreign portfolio flows turned negative in January 2019, after rebounding in November and December 2018. India's foreign exchange reserves were at US$ 400.2 billion on February 1, 2019.

7. Turning to the outlook, the MPC took into its consideration these developments and revised the path of CPI inflation downwards to 2.8 per cent in Q4:2018-19, 3.2-3.4 per cent in H1:2019-20 and 3.9 per cent in Q3:2019-20, with risks broadly balanced around the central trajectory. GDP growth for 2019-20 is projected at 7.4 per cent – in the range of 7.2-7.4 per cent in H1, and 7.5 per cent in Q3 – with risks evenly balanced.

8. It is noteworthy that the path of inflation has moved downwards significantly, and over the period of the next one year, headline inflation is expected to remain contained below or at the target of 4 per cent. This has opened up space for policy action. Meanwhile investment activity is recovering but supported mainly by public spending on infrastructure. The need is to strengthen private investment activity. Private consumption also needs to be buttressed. While bank credit flows have picked up and overall flows to the commercial sector have picked up, they are yet to become broad-based. The favourable macroeconomic configuration that is evolving underscores the need to act now when it is most opportune. In pursuance of the provisions of the RBI Act as amended in 2016, it is vital to act decisively and in a timely manner to address the objective of growth once the objective of price stability as defined in the Act is achieved. The shift in the stance of monetary policy from calibrated tightening to neutral also provides flexibility and the room to address challenges to sustained growth of the Indian economy over the coming months, as long as the inflation outlook remains benign. The decisions of the MPC in this regard will be data driven and in consonance with the primary objective of monetary policy to maintain price stability while keeping in mind the objective of growth.

9. Now let me turn to some developmental and regulatory policies that have been announced, which complement the monetary policy stance and action. Several measures are being proposed in areas spanning financial markets, regulation of banks and non-banking financial companies (NBFCs), regulation

of payment and settlement systems and financial inclusion in the Statement on Developmental and Regulatory Polices (Part B) of the Monetary Policy Statement. These policy actions will be anchored by the goal of financial stability, so that the soundness and efficiency of the financial system in intermediating the economy's needs of financial resources for productive purposes is preserved at all costs. With regard to financial markets,

- the Reserve Bank proposes to modify the foreign exchange derivative regulations (Regulation FEMA-25) in order to improve access and participation by promoting operational ease and removing regulatory differentiation based on residence, product and type of transaction;
- a task force on offshore rupee markets will assess the causes underlying the growth of this market and recommend measures to encourage non-residents to access the domestic market;
- interest rate derivative directions would be rationalised with the objective of simplifying regulations and reducing prescriptive stipulations to promote liquidity by encouraging participation, product innovation and by easing access norms;
- a draft regulation of financial benchmarks is proposed, which is based on the practices recommended by international standard setting bodies and lays down governance, quality and accountability standards for administrators of 'significant' benchmarks in markets regulated by the Reserve Bank;
- the provision that no foreign portfolio investor (FPI) shall have an exposure of more than 20 per cent of its corporate bond portfolio to a single corporate is being withdrawn to encourage a wider spectrum of investors to access the Indian debt market; and
- resolution applicants under IBC will be permitted to avail external commercial borrowings under the approval route to lower their cost of

funding for repaying outstanding rupee loans availed by companies undergoing the Corporate Insolvency Resolution Process(CIRP) – this is expected to improve the overall effectiveness of the CIRP

10. Proposals relating to regulation of banks and NBFCs include

- revising the definition of 'bulk deposit'' as a single rupee deposit of '₹2 crore and above' instead of the earlier threshold of '₹1 crore and above' in order to provide greater operational flexibility to banks in raising such deposits;
- establishment of an Umbrella Organisation for urban co-operative banks (UCBs) that can provide several services so as to enhance public confidence in the UCB sector, provide regulatory comfort and promote financial stability in an inter-connected financial system;
- harmonisation of the three separate categories of NBFCs *viz.*, Asset Finance Companies, Loan Companies and Investment Companies (which together constitute almost 99 per cent of NBFCs in terms of numbers) by creating a merged category called NBFC - Investment and Credit Company (NBFC-ICC), in order to address the complexities associated with multiple categories of NBFCs and to provide the NBFCs greater flexibility in their operations which would result in diversified product offerings, and better access to NBFI services;
- alignment of risk weights for bank exposures to all categories of NBFCs, other than CICs, with their credit ratings, with a view to facilitating credit flow to better rated NBFCs, lowering the cost of bank borrowings for the NBFCs and in turn, for end consumers, particularly borrowers of MFIs.

11. Proposals related to enhancing financial inclusion include

- enhancing the limit of collateral free agriculture loans from ₹1 lakh to ₹1.6 lakh, keeping in view the overall increase in inflation and rise in agriculture input costs – this is expected to enhance coverage of farmers in getting access to formal credit;
- setting up of an internal working group to examine and recommend measures to address issues pertaining to the policy framework and delivery of agricultural credit in the country.

12. On the payment systems, the feasibility of bringing payment related activities of Payment Gateway Service Providers and Payment Aggregators under the direct regulatory ambit of the Reserve Bank will be examined, given their increasing importance in the evolving structure of payment systems in the country and the fact that at present, they are essentially regulated indirectly through the banks with whom they have a tie-up.