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RESERVE BANK OF INDIA

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RBI Bulletin - October 2021

The Reserve Bank of India today released the [October 2021](#) issue of its monthly Bulletin. The Bulletin includes [Governor's Statement](#), [Monetary Policy Statement, 2021-22 Resolution of the Monetary Policy Committee \(MPC\) October 6-8, 2021](#), [Monetary Policy Report – October 2021](#), five Speeches, five Articles and Current Statistics.

The five articles are: [I. State of the Economy](#); [II. Should Financial Stability be a Monetary Policy Goal? Evidence from India](#); [III. Return on Physical Capital: Lessons from Firm Level Data](#); [IV. Renewable Energy – The Silent Revolution](#); and [V. The low yield environment and Forex Reserves management](#).

I. State of the Economy

Amidst an accentuation of global risks, the Indian economy is picking up steam, although the recovery is uneven and trudging through soft patches. The step up in vaccination, slump in new cases/mortality rates and normalising mobility has rebuilt confidence. Domestic demand is gaining strength while aggregate supply conditions are recouping, powered by the robust performance of kharif agricultural production and revival in manufacturing and services. Softer than expected food prices have eased headline inflation into a closer alignment with the target.

II. Should Financial Stability be a Monetary Policy Goal? Evidence from India

Literature is divided on whether financial stability should be adopted by an inflation targeting central bank as an 'explicit' policy objective. The present article empirically evaluates the question in the Indian context where financial stability is not an 'explicit' goal of monetary policy, but macroprudential policies and interest rate decisions are coordinated for simultaneous pursuit of both goals. Major highlights of the article are presented below:

Highlights

- In this article, an aggregate macroprudential policy (MPP) index has been constructed using risk weights and provisioning for standard assets in housing, commercial real estate (CRE), consumer loans and capital market exposure; loan-to-value (LTV) ratio and cash reserve ratio (CRR).
- An empirical analysis using macroeconomic variables for the period June 1997 to March 2020 suggests that monetary policy does exert influence over inflation and business cycles, but, at the same time, does not intensely influence financial cycles. Financial cycles are influenced by credit cycles, which in turn are impacted by macroprudential policies. Juxtaposing the MPP

index with the repo rate shows that macroprudential policies in India have generally evolved in sync with the monetary policy.

- The article concludes that the approach of using monetary and macroprudential policies in a coordinated manner has served the economy well, even after the adoption of flexible inflation targeting (FIT).

III. Return on Physical Capital: Insights from Firm Level Data

Return on physical capital (RoPC) is an important metric to gauge value creation in manufacturing due to the predominant role of physical capital in production. This study explores the variation in RoPC in the formal manufacturing sector across various firm characteristics such as age, location, size, type of ownership, capital intensity and type of activity using the firm level Annual Survey of Industries (ASI) data for the year 2017-18.

Highlights

- The aggregate RoPC of the Indian formal manufacturing sector estimated at 19.5 per cent stands comparable to the returns observed in other developing countries.
- In MSMEs category, RoPC increases with size of the firms. For large firms, it decreased owing to its high capital-intensity.
- The RoPC of Government (public) companies is slightly higher than that of Non-Government (public) companies. Nevertheless, the average return of Non-Government (private) firms is significantly higher than that of Government (private) firms.
- RoPC holds an inverted U-shape relationship with firms' age and labour employed, while it decreases monotonically with capital intensity.
- Region wise, the north-east outperformed others due to very high returns of Pharma industry in Sikkim and Petroleum industry in Assam. These two industries pulled up the aggregate RoPC of the entire region.

IV. Renewable Energy – The Silent Revolution

Renewable Energy (RE) has played a pivotal role in India's transition to a power surplus country. This article examines India's current electricity market structure and the role of RE in electricity inflation. Empirical analysis suggests that sustained fall in generation costs for RE sources are exerting downward pressures on electricity tariffs in the whole sale and short-term markets. It argues that realizing the potential of the progress made in RE development of the promises of RE for a greener and low-cost economy warrants strategic policy changes, focusing on curbing cross-subsidisation, speedier resolution of financial stress facing DISCOMs, promotion of decentralised production and distribution and creating an environment for innovations and faster adoption of green technology.

Highlights

- The share of REs in overall installed capacity has more than tripled from 11.8 per cent at end-March 2015 to 37.9 per cent at end-August 2021. The Government of India (GoI) has set a target of 175 GW installed capacity by 2022 for renewable electricity generation.
- Empirical analysis shows significant positive relation between producer price of electricity (WPI electricity) and auction prices for conventional power, RE energy and spot price of energy exchange.

- As regards CPI electricity, no meaningful relation was observed with the same set of regressors. The methodology for calculation of retail power tariffs, inter-sectoral cross subsidisation and the exclusion of other segments of electricity consumption barring household consumption in CPI electricity may have bearing on this result.
- India's per capita electricity consumption at 804.5 kwh in 2014 is much lower than the world average of 3132.8 kwh. RE by providing low-cost electricity can meet the increased demand in coming years.
- Deregulation of the tariff structure and success in minimising transmission and distribution losses and cross-subsidisation could promote efficient price discovery and attract higher RE investment.

V. The Low Yield Environment and Forex Reserves Management

This article highlights the prominent drivers of the declining trend in nominal yields and the scope for looking beyond traditional ways to manage foreign exchange reserves in order to augment portfolio returns without undermining the goals of safety and liquidity.

Highlights

- The short term and long-term interest rates in advanced economies have been witnessing a trend decline since the early 1980s. This ultra-low interest rate environment is a reflection of structural changes in the advanced economies and global financial markets, in particular well anchored low inflation/expected inflation, and trend decline in equilibrium real interest rates over the last 3 to 4 decades.
- This low yield environment has made it an arduous task for the asset managers in general and reserve managers in particular, to generate reasonable returns. In light of the likely persistence of various structural reasons for low yields, it is imperative that reserve managers look beyond the traditional approaches for the management of reserves to maintain and enhance returns.
- Some alternate ways to enhance returns on forex reserves could be increasing duration of portfolio, investment in new products/asset classes, active management of gold and investment in new markets. The choice of strategy, however, would require to be tailored to suit the risk appetite, investment priorities, skill sets and operational capabilities of individual institutions.