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Governor's Statement, February 5, 2021

The Monetary Policy Committee (MPC) met on 3rd, 4th and 5th February, 2021 and deliberated on current and evolving macroeconomic and financial developments, both domestic and global. The MPC voted unanimously to leave the policy repo rate unchanged at 4 per cent. It also unanimously decided to continue with the accommodative stance of monetary policy as long as necessary – at least through the current financial year and into the next year – to revive growth on a durable basis and mitigate the impact of COVID-19, 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 stands unchanged at 3.35 per cent.

2. I would like to first set out briefly the broad contours of the MPC's decision making process and its underlying motivation. Inflation outturns in the last two months have turned out to be better than what was expected at the time of the December meeting. For the first time during the COVID-19 period, inflation has eased below the upper tolerance level of 6 per cent. Going ahead, factors that could shape the food inflation trajectory in coming months, including the likely bumper *kharif* harvest arrivals in markets, rising prospects of a good *rabi* crop, larger winter supplies of key vegetables and softer poultry demand on fears of avian flu are all indicative of a stable near-term outlook.

3. The preliminary estimate of GDP for 2020-21 released by the National Statistical Office (NSO) on January 7, 2021 has turned out to be very close to the MPC's December projection. The outlook on growth has improved significantly, with positive growth impulses becoming more broad-based, and the rollout of the vaccination programme in the country auguring well for the end of the pandemic. Given that inflation has returned within the tolerance band, the MPC judged that the

need of the hour is to continue to support growth, assuage the impact of COVID-19 and return the economy to a higher growth trajectory.

Assessment of Growth and Inflation

4. The new year 2021 has begun on a strong positive note with vaccination drives in major economies as well as in India. India's response to COVID-19 reminds us of an excerpt from Mahatma Gandhi's proclamation that "*determined spirits fired by an unquenchable faith in their mission can alter the course of history*¹." While the year 2020 tested our capabilities and endurance, 2021 is setting the stage for a new economic era in the course of our history.

Growth

5. Importantly, signs of recovery have strengthened further since the last meeting of the MPC. High frequency coincident and proximate indicators suggest that the list of normalising sectors is expanding. The RBI's survey points towards improvement in capacity utilisation in the manufacturing sector to 63.3 per cent in Q2:2020-21 from 47.3 per cent in the preceding quarter. Consumer confidence is reviving, and business expectations of manufacturing, services and infrastructure remain upbeat. The movement of goods and people and domestic trading activity are growing at a robust pace. Electricity and energy demand reflect a broader normalisation of economic activity than in December, even as fears of a second wave abate. Data for sales and new launches of residential units in major metropolitan centres reflect a renewed confidence in the real estate sector. Manufacturing, services and composite purchasing managers' indices (PMI) are in expansion zones – the manufacturing PMI rose to 57.7 in January 2021 from 56.4 in December 2020 and the services PMI rose to 52.8 in January 2021 from 52.3 in December 2020. Furthermore, the vaccination drive is expected to provide an impetus for the restoration of contact intensive sectors and a leading edge to the Indian pharma industry in the global market. Foreign Direct Investment and Foreign Portfolio Investment to India have surged in recent months, reposing faith in the impressive recovery in the Indian economy. Ahead of a broader infrastructure revival, the speed of daily national highways construction is rising and the pace of award of national highway projects in 2020-21 has doubled year-on-year.

¹ Gandhi, M. K. (1936). *Harijan*, November 19, 1936, pp. 341-2.

6. What is more, the flow of financial resources to the commercial sector has been improving, particularly in respect of non-food bank credit and *via* commercial paper (CPs), credit by housing finance companies, private placement of corporate bonds and foreign direct investment. The total flow of these resources is ₹8.85 lakh crore this year so far (up to January 15, 2021), compared with ₹7.97 lakh crore during the corresponding period of last year. The latest bank lending survey of the RBI suggests further sequential improvement in sentiment on loan demand across all sectors right up to Q2:2021-22. Taking these factors into consideration, real GDP growth is projected at 10.5 per cent in 2021-22 – in the range of 26.2 to 8.3 per cent in H1 and 6.0 per cent in Q3.

7. The Union Budget 2021-22 has provided a strong impetus for revival of sectors such as health and well-being, infrastructure, innovation and research, among others. This will have a cascading multiplier effect going forward, particularly in improving the investment climate and reinvigorating domestic demand, income and employment. The investment-oriented stimulus under AatmaNirbhar 2.0 and 3.0 (given during the peak of the pandemic) has started working its way through and is improving the spending momentum along with the quality of public investment. Both will facilitate regaining India's growth potential over the medium-term. The projected increase in capital expenditure augurs well for capacity creation and crowding in private investment, thereby improving the prospects for growth and building credibility around the quality of expenditure.

Inflation

8. After breaching the upper tolerance threshold continuously since June 2020, CPI inflation moved below 6 per cent in December for the first time in the post-lockdown period, supported by favourable base effects and a sharp fall in key vegetable prices, the latter accounting for around 90 per cent of the decline in headline inflation during November and December. Both higher fresh arrivals and active supply side interventions contributed to this favourable development. It is expected that vegetable prices will remain soft in the near-term, while pressures may continue to persist in certain key food items. The outlook for core inflation is influenced by the escalation in cost-push pressures seen in recent months. Petroleum product prices have reached historic highs as international crude prices surged in recent months and the high indirect taxes remain, both in the Centre and States. These, along with the sharp increase in industrial raw material prices have

resulted in a broad-based increase in prices of services and manufacturing products in recent months. Going forward, concerted policy action by both Centre and States, is critical to ensure that the ongoing cost build-up does not escalate further. Taking into consideration all these factors, the projection for CPI inflation has been revised to 5.2 per cent for Q4:2020-21, 5.2 per cent to 5.0 per cent in H1:2021-22 and 4.3 per cent for Q3:2021-22, with risks broadly balanced.

9. By March 2021, the Government would be reviewing the inflation target for the next five years. The experience with successfully maintaining price stability and the gains in credibility for monetary policy since the institution of the inflation targeting framework, barring the COVID-19 period, needs to be reinforced in the coming years even as we exit the pandemic and seek to exploit the opportunities of the post-COVID world. Price stability is the foundation on which the economy can strive to reach its potential in a virtuous cycle of higher financial savings and investment; reduced uncertainties for firms in investment and wage decisions; reduced term and risk premia in financial markets; and increased external competitiveness.

Liquidity Guidance

10. The Reserve Bank and the markets evolved a shared understanding towards cooperative solutions during the pandemic period. A large government borrowing programme was managed seamlessly. The issuance of corporate bonds reached a record level (₹5.8 lakh crore during April-December 2020 as compared with ₹4.6 lakh crore during April-December 2019). Explicit forward guidance was an innovative feature in the conduct of monetary policy during 2020-21. In addressing the discomfort of markets regarding persistently higher inflation prints and the large supply of government paper, the maintenance of financial stability and the orderly evolution of the yield curve were explicitly regarded as public goods as the benefits accrue to all stakeholders in the economy. The RBI's market operations dispelled illiquidity fears and bolstered financial market sentiment. Convinced by the RBI's communication and actions, market participants also responded synchronously and cooperatively, which bears testimony to the effectiveness of the forward guidance.

11. The measures taken by the RBI through a combination of policy rate cuts, proactive liquidity management and regulatory forbearance against the backdrop of global spillovers and the nation-wide lockdown ensured smooth transmission of policy rate cuts across the market spectrum, narrowing of risk spreads and a

rekindling of the corporate bond market. In the G-sec market in which risk-free benchmarks evolve, a record low weighted average cost of 5.78 per cent and an elongated weighted average maturity of 14.9 years testify to the credibility of monetary and liquidity management operations of RBI.

12. On January 11, money market rates and G-sec yields firmed up on perceived market misconceptions about the RBI reversing its accommodative policy stance. In this context, it is useful to remember that variable rate reverse repo auctions are already a part of our menu of instruments as the main tool under the revised liquidity management framework and were in active use before the pandemic. They are voluntary and, in any case, the recourse to the overnight fixed rate reverse repo remains available on a daily basis. Variable reverse repo rate auctions offer a higher remuneration than the fixed rate reverse repo in view of the longer tenor (14-days). The stance of liquidity management continues to be accommodative and completely in consonance with the stance of monetary policy. The RBI stands committed to ensure the availability of ample liquidity in the system and thereby foster congenial financial conditions for the recovery to gain traction. It would be worthwhile to note here that reserve money rose by 14.5 per cent y-o-y (on January 29, 2021), led by currency demand. Money supply (M_3), on the other hand, grew by only 12.5 per cent as on January 15, 2021.

13. Since early November 2020, international crude oil prices have risen, following optimism on the back of vaccination and news on additional policy stimulus. These factors have engendered a return of risk appetite and an intensified search for returns, resulting in surges of capital flows into EMEs like India and consequent increase in volatility in the financial markets. The RBI has, however, proactively taken steps to insulate domestic financial markets from global spillovers and consequent volatility while ensuring comfortable domestic liquidity conditions.

14. A two phase normalisation of the cash reserve ratio (CRR) – which I am going to announce – needs to be seen in this context. Systemic liquidity would, however, continue to remain comfortable over the ensuing year. In fact, the CRR normalisation opens up space for a variety of market operations to inject additional liquidity. The underlying theme of our endeavour in these areas would be to flexibly use all instruments in our arsenal appropriately without jeopardising financial stability, which is at the core of RBI's policy objectives.

15. Gross market borrowing of the Centre for 2021-22 is budgeted at ₹12 lakh crore. As the government's debt manager and banker, the Reserve Bank will ensure the orderly completion of the market borrowing programme in a non-disruptive manner. In this context, we look forward to the continuance of the common understanding and cooperative approach between market players and the RBI during 2021-22 also.

Additional Measures

16. Against this backdrop, the RBI will persevere with its paramount objective of reviving the economy with measures relating to (i) enhancing liquidity support to targeted sectors and liquidity management; (ii) regulation and supervision; (iii) deepening financial markets; (iv) upgrading payment and settlement systems; and (v) strengthening consumer protection. The details of the measures are set out in the statement on developmental and regulatory policies (Part-B) of the Monetary Policy Statement.

(i) Liquidity Measures

TLTRO on Tap Scheme – Inclusion of NBFCs

17. With a view to support revival of activity in specific stressed sectors that have both backward and forward linkages and have multiplier effects on growth, the RBI had announced the TLTRO on Tap Scheme for banks on October 9, 2020. Given that NBFCs are well recognised conduits in reaching out to the last mile in various sectors, it is now proposed to provide funds from banks under the TLTRO on Tap scheme to NBFCs for incremental lending to the specified stressed sectors.

Restoration of CRR in two phases beginning March 2021

18. To tide over the disruption caused by COVID-19, the Cash Reserve Ratio (CRR) of all banks was reduced by 100 basis points to 3.0 per cent for a period of one year ending on March 26, 2021. On a review of monetary and liquidity conditions, it has been decided to gradually restore the CRR in two phases in a non-disruptive manner to 3.5 per cent effective from March 27, 2021 and 4.0 per cent effective from May 22, 2021. As mentioned earlier, the CRR normalisation opens up space for variety of market operations of the RBI to inject additional liquidity.

Marginal Standing Facility (MSF) - Extension of Relaxation

19. On March 27, 2020 banks were allowed to avail of funds under the marginal standing facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional one per cent of net demand and time liabilities (NDTL), i.e., cumulatively up to 3 per cent of NDTL. This facility, which was extended in phases up to March 31, 2021, will now be available for a further period of another six months, i.e. up to September 30, 2021 to provide comfort to banks on their liquidity requirements. This dispensation provides increased access to funds to the extent of ₹1.53 lakh crore.

(ii) Regulation and Supervision

SLR Holdings in Held to Maturity (HTM) category

20. On September 1, 2020, the Reserve Bank increased the limits under Held to Maturity (HTM) category from 19.5 per cent to 22 per cent of net demand and time liabilities (NDTL) in respect of statutory liquidity ratio (SLR) eligible securities acquired on or after September 1, 2020, up to March 31, 2021. This dispensation was made available up to March 31, 2022. In order to provide certainty to the market participants in the context of the borrowing programme of the centre and states for 2021-22, it has now been decided to extend the dispensation of enhanced HTM of 22 per cent up to March 31, 2023 to include securities acquired between April 1, 2021 and March 31, 2022. The HTM limits would be restored from 22 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2023. It is expected that banks will be able to plan their investments in SLR securities in an optimal manner with a clear glide path for restoration of HTM limits.

Credit to MSME Entrepreneurs

21. In order to incentivise new credit flow to the micro, small, and medium enterprise (MSME) borrowers, Scheduled Commercial Banks will be allowed to deduct credit disbursed to 'New MSME borrowers' from their net demand and time liabilities (NDTL) for calculation of CRR. For the purpose of this exemption, 'New MSME borrowers' would be those who have not availed any credit facilities from the banking system as on January 1, 2021. This exemption will be available for exposures up to ₹25 lakh per borrower for credit extended up to the fortnight ending October 1, 2021. Details of the scheme would be spelt out in the circular.

Capital Conservation Buffer and Net Stable Funding Ratio

22. The emphasis of regulatory interventions by the Reserve Bank has veered towards supporting and nurturing the recovery. While some of the regulatory measures taken in the immediate aftermath of the pandemic are being gradually phased out, it is necessary to enable banks to continue providing the necessary support to the process of recovery. It has, therefore, been decided to defer the implementation of last tranche of the Capital Conservation Buffer (CCB) of 0.625 per cent and also defer the implementation of Net Stable Funding Ratio (NSFR) by another six months from April 1 to October 1, 2021.

Review of the Regulatory Framework for Microfinance

23. Microfinance sector plays an important role in last mile delivery of credit to needy segments. In view of the evolving role of the sector and the need for a robust framework for enhanced delivery of last mile credit and strengthening consumer protection, the Reserve Bank will come out with a consultative document harmonising the regulatory frameworks applicable to various regulated lenders (NBFC-Micro Finance Institutions, Scheduled Commercial Banks, Small Finance Banks and NBFC–Investment and Credit Companies) in the microfinance space.

Expert Committee on Primary (Urban) Co-operative Banks

24. The Primary (Urban) Co-operative Banks are an important segment of the credit structure. The Reserve Bank has undertaken several measures in the recent past to strengthen the Urban Co-operative Banking sector and deepen financial inclusion. The recent amendments to the Banking Regulation Act, 1949 have brought near parity in regulatory and supervisory powers between Primary (Urban) Co-operative Banks and commercial banks, including those related to governance, audit and resolution. An Expert Committee (EC) will be constituted to provide a medium-term road map for strengthening the sector leveraging on the legislative amendments. Constitution of the EC and its terms of reference will be announced shortly.

Remittances to IFSCs under the Liberalised Remittance Scheme

25. Currently, resident individuals are not allowed to make remittances under the Liberalised Remittance Scheme (LRS) to International Financial Service Centres (IFSCs). To further develop IFSCs and bring them at par with other international financial centres, it is proposed to permit resident individuals to make remittances to

IFSCs for investment in securities issued by non-resident entities in IFSCs. For this specific purpose, resident individuals would be allowed to open a non-interest bearing Foreign Currency Account (FCA) in IFSCs.

(iii) Deepening Financial Markets

Allowing Retail Investors to Open Gilt Accounts with RBI

26. The Central Government and the Reserve Bank have taken several measures to encourage retail investment in Government Securities. These include introduction of non-competitive bidding in primary auctions, permitting stock exchanges to route primary purchases and allowing a specific retail segment in the secondary market. In continuation of these efforts, it is proposed to provide retail investors with online access to the government securities market – both primary and secondary – directly through the Reserve Bank ('Retail Direct'). This will broaden the investor base and provide retail investors with enhanced access to participate in the government securities market. This is a major structural reform placing India among select few countries which have similar facilities. This measure together with HTM relaxation, will facilitate smooth completion of the Government borrowing programme in 2021-22.

Foreign Portfolio Investors (FPIs) Investment in Defaulted Bonds

27. In order to further promote investment by foreign portfolio investors (FPI) in corporate bonds, FPI investment in defaulted corporate bonds will be exempted from the short-term limit and the minimum residual maturity requirement under the Medium-Term Framework.

(iv) Payment and Settlement Systems

Setting up of 24x7 Helpline for Digital Payment Services

28. With enhanced penetration and efficiency of digital payments, major payment system operators would be required to facilitate setting-up of a centralised industry-wide 24x7 helpline for addressing customer queries in respect of various digital payment products and give information on available grievance redress mechanisms. Going forward, the facility of redress of customer grievances through the helpline shall be considered. This is envisaged to enhance consumer trust and confidence in the digital payments ecosystem.

Guidelines on Outsourcing for Operators and Participants of Authorised Payment Systems

29. The resilience of the of the digital payments ecosystem to operational risks needs to be constantly upgraded. A potential area of operational risk is associated with outsourcing by payment system operators (PSOs) and participants of authorised payment systems. To manage the attendant risks in outsourcing and ensure that a code of conduct is adhered to while outsourcing payment and settlement related services, the Reserve Bank shall issue guidelines on outsourcing of such services by these entities.

Cheque Truncation System (CTS) Clearing across all Bank Branches

30. The coverage of the Cheque Truncation System (CTS) has been extended to all legacy clearing houses by September 2020. It is, however, noticed that about 18,000 bank branches are still outside any formal clearing arrangement. It is now proposed to bring all these branches under CTS clearing by September 2021. With this measure, all bank branches in the country would be covered under the CTS. This will enhance customer convenience and bring in operational efficiency to paper based clearing system.

(v) Consumer Protection

Integrated Ombudsman Scheme

31. At present, the framework for alternate dispute resolution consists of three separate Ombudsman schemes for banks, NBFCs and non-bank prepaid payment issuers (PPIs). These three schemes are operated by the RBI from twenty-two Ombudsman offices located across the country. To make the Ombudsman mechanism simpler, efficient and more responsive, it has been decided to integrate the three Ombudsman schemes and introduce centralised processing of grievances following a 'One Nation One Ombudsman' approach. This is intended to make the process of redress of grievances easier by enabling the customers to register their complaints under the integrated scheme, with one centralised reference point. *The Integrated Ombudsman Scheme will be rolled out in June 2021.*

Conclusion

32. In conclusion, I would like to say that, going forward, the Indian economy is poised to move in only one direction and that is upwards. It is our strong conviction, backed by forecasts, that in 2021-22, we would undo the damage that COVID-19 has inflicted on the economy. After the chaos and despair of the year gone by, through which we have sailed together and shall continue to sail ahead, the overall situation can be best described in the words of Mahatma Gandhi, "*We are daily witnessing the phenomenon of the impossible of yesterday becoming the possible of today ...*"².

Thank you. Stay safe. Stay well. *Namaskar*.

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(Yogesh Dayal)
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² Mahatma Gandhi; XXVI-68 Epigrams From Gandhiji - Compiled by: S.R. Tikekar First Edition: 1971 Published by: Publications Division Ministry of Information & Broadcasting