RBI THIRD BI-MONTHLY POLICY REPORT FY 23 - 24

10th August, 2023

Amid Ongoing Inflation Concern
MPC Holds Repo Rate Steady Once Again at 6.5%

During its meeting spanning from August 8 to August 10, 2023**, the Monetary Policy Committee (MPC) has chosen to maintain the Policy Repo Rate within the Liquidity Adjustment Facility (LAF) at a steady 6.50%.** This decision is based on the evaluation of the current and evolving macroeconomic conditions. The Standing Deposit Facility (SDF) Rate remains consistent at 6.25%, and both the Marginal Standing Facility (MSF) Rate and Bank Rate remain unwavering at 6.75%. With a 5:1 majority, the MPC has voted to gradually scale back accommodation, promoting a progressive alignment of inflation with the established target while simultaneously bolstering economic expansion. The committee has unanimously agreed to uphold the prevailing interest rates.

Looking at India's economic trajectory, the RBI has upheld a GDP growth projection of 6.5% for the Fiscal Year 2024. The GDP growth rate forecasts for FY24 have stayed consistent, with a projection of 6.6% for Q1FY25.

On the inflation front, the RBI has revised up its forecast for the Financial Year 2024, now pegging it at 5.4% instead of the prior estimate of 5.1%. The projection for the Q1FY25 stands at 5.2%.

RBI's primary objective revolves around attaining the medium-term goal of 4% CPI inflation, with an acceptable deviation band of +/- 2%, all while lending support to the drive for economic growth.

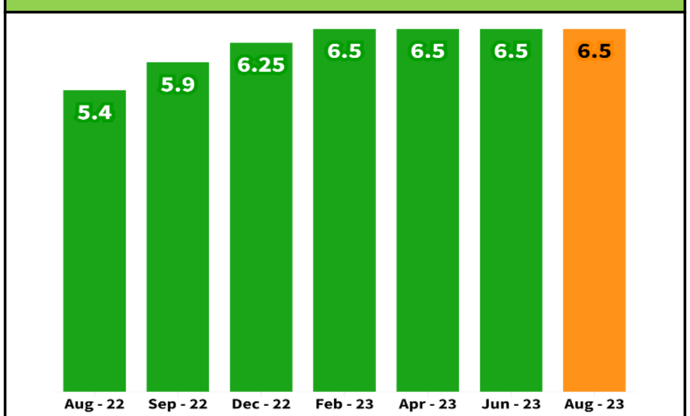
RBI's GDP GROWTH OUTLOOK

Period	Projection	Earlier
FY24	**6.5%**	**6.5%**
Q2 FY24	6.5%	6.5%
Q3 FY24	6.0%	6.0%
Q4 FY24	5.7%	5.7%
Q1 FY25	6.6%	-

RBI's CPI INFLATION OUTLOOK

Period	Projection	Earlier
FY24	**5.4%**	**5.1%**
Q2 FY24	6.2%	5.2%
Q3 FY24	5.7%	5.4%
Q4 FY24	5.2%	5.2%
Q1 FY25	5.2%	-

RBI REPO RATES (%)



MARKET's REACTION*

Nifty50	19,551.45 ▼81.10	▼0.41%
Nifty Bank	44,549.25 ▼331.45	▼0.74%

*DATA as on 3:30 PM – 10th August, 2023

Key Highlights:

- **Slowing Global Economy:** Amidst a slowing global economy, diverging growth paths across regions are evident due to inflation remaining above targets, financial constraints, up scaled geopolitical tensions, and economic fragmentation. The Sovereign Bond Yields have also increased. The US Dollar initially dropped but later recovered after expectations of an early end to tightening monetary policies. Equity markets globally rose due to predictions of a gentle global economic slowdown. Emerging economies are now facing amplified challenges due to weak external demand, high debt levels, and limited external funding impacting their growth prospects.

- **Resilient Domestic Economy:** The domestic economy is displaying resilience. Up until August 9, 2023, the cumulative south-west monsoon rainfall matched the longer term average, even after uneven distribution. The area sown under kharif crops increased by 0.4% YoY by August 4, 2023. Industrial production expanded with a 5.2% growth in May, and core industries output rose by 8.2% in June. High-frequency indicators like e-way bills, toll collections, rail freight, and port traffic exhibited strong growth in June - July. The composite Purchasing Managers' Index (PMI) reached a 13-year high in July.

  The Urban demand remains robust, as seen through double-digit growth in domestic air passenger traffic and household credit. However, passenger vehicle sales growth has slowed. Rural demand improved in tractor sales but decreased in two-wheeler sales. Cement production and steel consumption have grown significantly, suggesting a strong revival of the Construction Sector. Capital goods import and production continued expanding. Merchandise exports and non-oil non-gold imports remained in contraction in June due to subdued external demand.

  The Liquidity Adjustment Facility (LAF) absorbed an average of Rs. 1.8 lakh Crore in liquidity during June - July, up from Rs. 1.7 lakh Crore in April - May. Money supply (M3) grew by 10.6% YoY as of July 28, 2023, compared to 10.1% on May 19, 2023. Bank credit increased by 14.7% YoY as of July 28, 2023, compared to 15.4% on May 19, 2023. India's Foreign Exchange reserves reached US$ 601.5 billion as of August 4, 2023.

- **CPI Inflation**: Inflation trends in Q1 of 2023-24 were consistent with projections from the June MPC meeting, with headline inflation at 4.6%. A subsequent rise to 4.8% in June was attributed to increased food inflation, while core inflation decreased by over 100 basis points from its January peak. July saw elevated food inflation due to higher vegetable, mainly tomatoes, cereal, and pulse prices. While expected corrections in vegetable prices and improved monsoon prospects provide some optimism, uncertainties linger due to El-Nino weather events and global geopolitical tensions affecting food prices.

- **Liquidity and Financial Market Conditions:** Surplus liquidity in the economy has increased due to factors such as the return of Rs. 2000 banknotes, RBI's surplus transfer, government spending, and capital inflows. Despite this, the market response to RBI's Variable Rate Reverse Repo Auctions has been tepid, with banks preferring the Standing Deposit Facility (SDF) due to risk aversion. Recognizing the importance of liquidity management, a temporary measure, the Incremental Cash Reserve Ratio (I-CRR) has been introduced, effective from August 12, 2023. Banks will have to maintain a 10% I-CRR on the increase in their net demand and time liabilities between May 19, 2023, and July 28, 2023, to absorb excess liquidity. This move aims to ensure adequate liquidity while curbing excessive liquidity's impact on price and financial stability. The I-CRR will be reviewed by September 8, 2023, or earlier, with the intention of returning the impounded funds before the festive season. The existing cash reserve ratio (CRR) remains unchanged at 4.5%.

- **Financial Stability and External Sector:** The Indian financial sector remains stable and resilient, with steady credit growth and manageable non-performing assets. Despite this, caution is advised against complacency, as vulnerabilities can emerge during tranquil periods. The Reserve Bank and regulated entities share the responsibility of upholding financial stability. India's current account deficit stood at 2.0% of GDP in 2022-23, and foreign portfolio investment has been robust in 2023-24. Foreign exchange reserves have surpassed US$ 600 billion, contributing to the stability of the Indian rupee. Overall, India's financial and external sectors are displaying promising performance.

Additional Measures

- **Comprehensive Benchmark Administration Framework:**

  The existing regulations for financial benchmark administrators will be revised to establish a risk-based framework encompassing benchmarks related to forex, interest rates, money markets, and government securities. This aims to enhance accuracy and integrity in financial benchmarks.

- **Revised Framework for Infrastructure Debt Fund - NBFCs (IDF-NBFCs):**

  Infrastructure Debt Funds (IDFs) are set to undergo regulatory changes, including the withdrawal of the sponsor requirement, enabling direct lending for Toll-Operate-Transfer (ToT) projects, permission to raise funds through External Commercial Borrowings (ECBs), and making Tri-Partite agreements optional for Public-Private Partnership (PPP) projects. These changes will boost infrastructure financing capacity.

- **Enhanced Transparency in Floating Interest Loan Resets:**

  A transparent framework will be established for resetting interest rates on floating interest loans. Regulated entities will be required to communicate tenor and/or EMI resets to borrowers, offer options for fixed-rate loans or loan foreclosure, disclose related charges, and ensure proper communication of key information, enhancing consumer protection.

- **Consolidation of Supervisory Data Submission Guidelines:**

  To reduce compliance burden and enhance ease of business, multiple guidelines on supervisory data submission will be consolidated into a single Master Direction for supervised entities.

- **Innovative Digital Payment Enhancements:**

  New digital payment initiatives include "Conversational Payments" on UPI, enabling users to make payments through AI-powered conversations, offline UPI payments using NFC technology via the *"UPI Lite"* platform, and increasing transaction limits for small-value offline digital payments, encouraging broader digital payment adoption.

- **Frictionless Credit Delivery through Public Tech Platform:**

  The RBI, in collaboration with the RBI Innovation Hub, is developing a Public Tech Platform for Frictionless Credit delivery. Building on the pilot project for Kisan Credit Card loans and recently added dairy loans, this platform will simplify and expand digital lending processes, fostering financial inclusion in underserved regions.

The Way Ahead:

In the upcoming period, there are expectations of increased inflation, particularly driven by rising vegetable prices, mainly tomatoes. However, this is likely to be temporary as fresh supplies enter the market. The monsoon progress and crop planting have improved, though irregular rainfall needs careful monitoring. Crude oil prices have risen due to production cuts. Various sectors anticipate lower input costs but higher output prices. Assuming normal monsoon conditions, the projected CPI inflation for 2023-24 is 5.4%, with quarterly projections at 6.2%, 5.7%, 5.2%, and 5.2% for Q2 to Q4 respectively.

Looking ahead, factors such as improved rural incomes, growing services sector, and positive consumer sentiment are expected to support household consumption. Healthy financial positions of banks and companies, along with normalized supply chains, contribute to a potential revival in capital expenditure. There are potential risks from weak global demand, financial market volatility, geopolitical tensions, and economic fragmentation. Considering all these factors, the projected real GDP growth for 2023-24 is 6.5%, with Q1 at 8.0%, Q2 at 6.5%, Q3 at 6.0%, and Q4 at 5.7%. The projection for Q1FY25 is 6.6% growth.

Chart 1: Quarterly Projection of CPI Inflation (y-o-y)

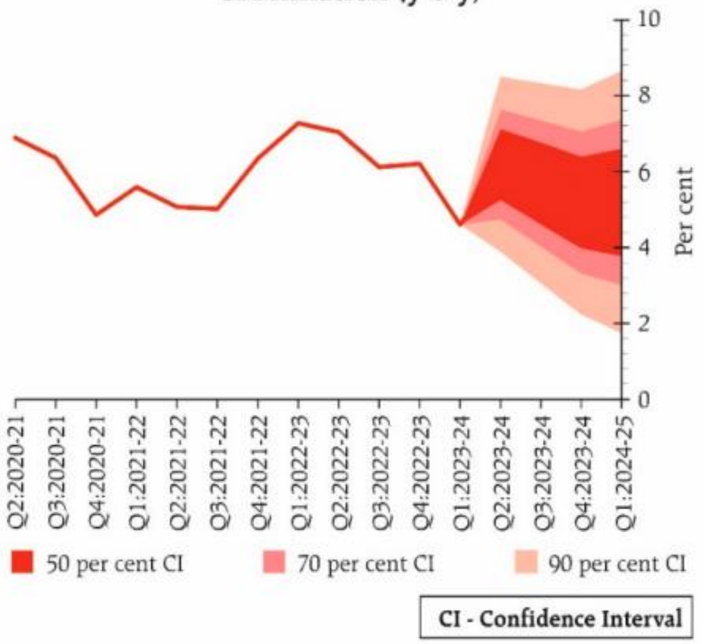
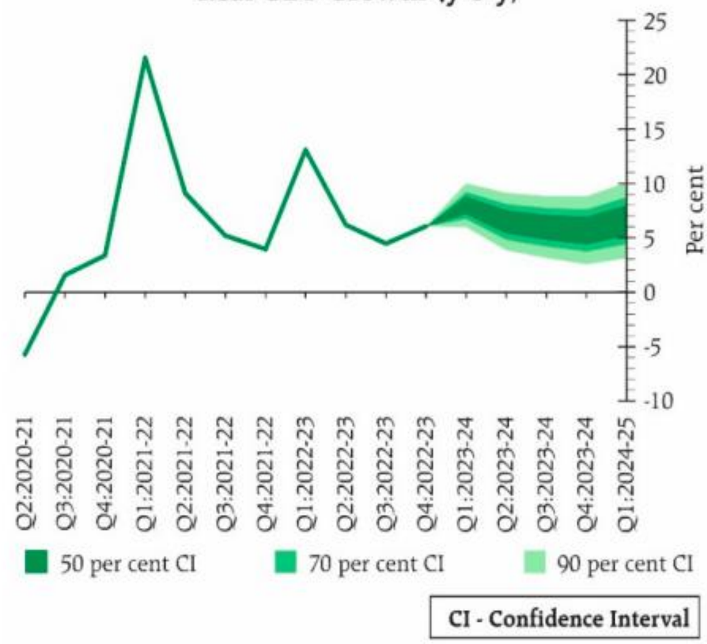


Chart 2: Quarterly Projection of Real GDP Growth (y-o-y)



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