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Governor's Statement

In my statement of [April 8, 2022](#) I had referred to the tectonic shifts caused by the conflict in Europe which had created fresh challenges for global growth and the conduct of monetary policy. As the war draws on and sanctions and retaliatory actions intensify, shortages, volatility in commodity and financial markets, supply dislocations and, most alarmingly, persistent and spreading inflationary pressures are becoming more acute with every passing day. Debt distress is rising in the developing world amidst capital outflows and currency depreciations. Recent GDP releases suggest that the global economic recovery is losing pace.

2. Amidst these challenges, which I termed as humongous in my April statement, the Indian economy has shown resilience, drawing upon the innate strength of its underlying fundamentals and supported by a prudent and favourable policy mix. In the conduct of monetary policy, we have demonstrated our resolve not to be bound by any rulebook and our preparedness to decisively deploy the full range of tools – conventional and unconventional. By remaining accommodative, monetary policy continues to foster congenial financial conditions to support growth and mitigate the adverse effects of the geopolitical crisis. As a result, the Indian economy has managed to weather the shock so far. Reassuringly, we have also been able to preserve macro-financial stability, despite the synchronised shocks of commodity prices, supply disruptions and higher inflation unleashed by the war. Confronted by elevated inflationary pressures that have shifted the future trajectory of inflation upwards, we have announced our intention to engage in withdrawal of accommodation to ensure that inflation remains aligned to the target. As I had stated in the April monetary policy statement, our actions will be calibrated to the rapidly evolving situation so that the impulses of growth are preserved and strengthened. Our journey is best reflected in the words of the famous Greek philosopher Epictetus: *“The trials you encounter will introduce you to your strengths. Remain steadfast...and one day you will build something that endures.”*¹

3. As we navigate through this difficult period, it is necessary to be sensitive to the new realities and incorporate them into our thinking. In its World Economic Outlook of April 2022, the International Monetary Fund (IMF) has noted: *“The economic effects of the war are spreading far and wide – like seismic waves that emanate from the epicentre of an earthquake – mainly through commodity markets, trade, and financial linkages.”*² It is, however, important to recognise that, despite our strengths and our buffers, India is not an island in this globally connected world. There was a spike in the headline CPI inflation in March, 2022 as anticipated in the April policy statement. The print for April is also expected to be elevated. There is the collateral risk that if inflation remains elevated at these levels for too long, it can de-anchor inflation expectations which, in turn, can become self-fulfilling and detrimental to growth and financial stability. Hence, we must remain in readiness to use all policy levers to

¹ Source: Epictetus, Greek Philosopher 55-135 AD [The Art of Living]

² World Economic Outlook, April 2022, International Monetary Fund.

preserve macroeconomic and financial stability while enhancing the economy's resilience. I reiterate that the situation is dynamic and fast changing and our actions have to be tailored accordingly.

Decisions and Deliberations of the Monetary Policy Committee

4. Against this backdrop, the Monetary Policy Committee (MPC) decided to hold an off-cycle meeting on 2nd and 4th May, 2022 to reassess the evolving inflation-growth dynamics and the impact of the developments after the MPC meeting of April 6-8, 2022. Based on this assessment of the macroeconomic situation and the outlook, the MPC voted unanimously to increase the policy repo rate by 40 basis points to 4.40 per cent, with immediate effect. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.15 per cent; and the marginal standing facility (MSF) rate and the Bank Rate to 4.65 per cent. The MPC also decided unanimously to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

5. I would now like to set out the rationale behind the MPC's decision and stance. Globally, inflation is rising alarmingly and spreading fast. Geopolitical tensions are ratcheting up inflation to their highest levels in the last 3 to 4 decades in major economies while moderating external demand. Global crude oil prices are ruling above US\$ 100 per barrel and remain volatile. Global food prices touched a new record in March and have firmed up even further since then. Inflation sensitive items relevant to India such as edible oils are facing shortages due to the conflict in Europe and export bans by key producers. The jump in fertiliser prices and other input costs has a direct impact on food prices in India. Further, the normalisation of monetary policy in major advanced economies is now expected to gain pace significantly – both in terms of rate increases and unwinding of quantitative easing as well as rollout of quantitative tightening. These developments would have ominous implications for emerging economies, including India. Meanwhile, COVID-19 infections and lockdowns in major global production hubs are likely to accentuate global supply chain bottlenecks while depressing growth. In fact, global growth projections have been revised downwards by up to 100 basis points for this calendar year. These dynamics pose upside risks to India's inflation trajectory set out in the MPC resolution of April 2022.

6. Further, the MPC noted that domestic economic activity is progressing broadly on the lines anticipated in April. Contact-intensive services are benefitting from pent-up demand and investment activity is showing some signs of gaining traction. At the same time, the MPC judged that the inflation outlook warrants an appropriate and timely response through resolute and calibrated steps to ensure that the second-round effects of supply side shocks on the economy are contained and long-term inflation expectations are kept firmly anchored. In the MPC's view, monetary policy response at this juncture would help to preserve macro-financial stability amidst increasing volatility in financial markets. Accordingly, the MPC decided to increase the policy repo rate by 40 basis points in its meeting today; it also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Outlook for Growth and Inflation

Growth

7. In this high-voltage global environment, it is useful to take stock of the domestic macroeconomic and financial conditions. The rebound in domestic economic activity that took hold with the ebbing of the Omicron wave is turning out to be increasingly broad-based. Private consumption is regaining traction on the back of recuperating contact-intensive services and rising discretionary spending. The forecast of a normal southwest monsoon in 2022 for the fourth successive year has brightened agricultural prospects and this should support rural consumption. There are also signs of an incipient revival taking place in the investment cycle. This is reflected in high-frequency indicators like imports and production of capital goods; rising capacity utilisation supported by conducive financial conditions; and stronger corporate balance sheets. Export growth has remained buoyant while persisting high growth in non-oil non-gold imports reflects a durable revival in domestic demand.

8. Even as the drivers of domestic economic activity are getting stronger, they face headwinds from global spillovers in the form of protracted and intensifying geopolitical tensions; elevated commodity prices; COVID-19 related lockdowns or restrictions in some major economies; slowing external demand; and tightening global financial conditions on the back of monetary policy normalisation in advanced economies. These risks are evolving on the lines anticipated in the April 2022 statement and appear to be lingering.

Inflation

9. The sharp acceleration in headline CPI inflation in March 2022 to 7 per cent was propelled, in particular, by food inflation due to the impact of adverse spillovers from unprecedented high global food prices. Nine out of the twelve food sub-groups registered an increase in inflation in March. High frequency price indicators for April indicate the persistence of food price pressures. Simultaneously, the direct impact of the increases in domestic pump prices of petroleum products – beginning the second fortnight of March – is feeding into core inflation prints and is expected to have intensified in April.

10. Looking ahead, food inflation pressures are likely to continue. Food price indices of the Food and Agriculture Organisation (FAO) and the World Bank touched historical highs in March and remain elevated. Spillovers from global wheat shortages are impacting domestic prices, even though domestic supply remains comfortable. Prices of edible oils may firm up further due to export restrictions by key producing countries and the loss of sunflower oil output due to the war. Elevated feed costs are translating into escalation in poultry, milk and dairy product prices. International crude oil prices continue to hover above US\$ 100 per barrel and this is prompting pass-through to domestic pump prices. The risks of unprecedented input cost pressures translating into yet another round of price increases for processed food, non-food manufactured products and services are now more potent than before. This could strengthen corporate pricing power if margins get squeezed inordinately. To sum up, the strengthening of inflationary impulses in sync with the persistence of adverse global price shocks poses upward risks to the inflation trajectory presented in the April MPC resolution.

11. In these circumstances, it is necessary for monetary policy to focus on the withdrawal of accommodation. It may be recalled that in response to the pandemic, monetary policy had shifted gears to an ultra-accommodative mode, with a large reduction of 75 basis points in the policy repo rate on March 27, 2020 followed by another reduction of 40 basis points on May 22, 2020. Accordingly, the decision of the MPC today to raise the policy repo rate by 40 bps to 4.40 per cent may be seen as a reversal of the rate action of May 22, 2020 in keeping with the announced stance of withdrawal of accommodation set out in April 2022.

Liquidity and Financial Market Conditions

12. In April, several liquidity management measures were taken in alignment with the shift in the monetary policy stance, including restoration of a symmetric LAF corridor around the policy repo rate and the introduction of the standing deposit facility (SDF). These measures operationalise the primacy accorded to maintaining price stability, while keeping in mind the objective of growth. Monetary policy has to engender an environment in which inflation persistence is broken and inflation expectations are re-anchored. Headroom for this reordering of priorities is becoming available with the receding of the pandemic and the steady broad basing of growth as economic activity regains and surpasses pre-pandemic levels.

13. Liquidity conditions need to be modulated in line with the policy action and stance to ensure their full and efficient transmission to the rest of the economy. Since the April policy announcement, banking system liquidity has remained comfortable. Average surplus liquidity in the banking system – reflected in total absorption through SDF and variable rate reverse repo (VRRR) auctions – amounted to ₹7.5 lakh crore during April 8-29, 2022. The large liquidity overhang in the form of daily surplus funds parked under the SDF (average of ₹2.0 lakh crore during April 8-29, 2022) has resulted in the weighted average call money rate (WACR) – the operating target of monetary policy – dipping below the SDF rate. The favourable response of banks as evident in bid-cover ratios of 14-day and 28-day VRRR auctions as well as the USD/INR sell-buy swap auction conducted on April 26 also suggest that system-level liquidity remains ample. Therefore, in keeping with the stance of withdrawal of accommodation and in line with the earlier announcement of gradual withdrawal of liquidity over a multi-year time frame, it has been decided to increase the cash reserve ratio (CRR) by 50 basis points to 4.5 per cent of net demand and time liabilities (NDTL), effective from the fortnight beginning May 21, 2022. The withdrawal of liquidity through this increase in the CRR would be of the order of ₹87,000 crore.

14. Sustained high inflation inevitably hurts savings, investment, competitiveness and output growth. It has pronounced adverse effects on the poorer segments of the population by eroding their purchasing power. I would, therefore, like to emphasise that our monetary policy actions today – aimed at lowering inflation and anchoring inflation expectations – will strengthen and consolidate the medium-term growth prospects of the economy. We remain mindful of the possible near-term impact of higher interest rates on output. Our actions will, therefore, be calibrated. I would like to further stress that monetary policy remains accommodative and our approach will be to focus on a careful and calibrated withdrawal of pandemic-related extraordinary accommodation, keeping in mind the inflation-growth dynamics. It is reiterated that the RBI will ensure adequate liquidity in the system to meet the productive requirements of the economy in support of credit offtake and growth.

External Sector

15. India's external sector has remained resilient amidst formidable global headwinds. Provisional data suggest that India's merchandise exports remained strong in April 2022 and services exports reached a new high in March 2022. Potential market opportunities have opened up due to geopolitical conditions and the recent trade agreements. Strong revenue guidance by major information technology (IT) companies also bodes well for the overall external sector outlook in 2022-23. The worsening of terms of trade, driven by higher commodity prices could have implications for the current account deficit in 2022-23, but it is expected to be comfortably financed. Net foreign direct investment flows have remained robust, despite some recent moderation. Long term flows such as external commercial borrowings also remain stable. India's foreign exchange reserves are sizeable with net forward assets providing a strong back-up. The external debt to GDP ratio remains low at 20 per cent.

Concluding Remarks

16. The last two years are a saga of our determined fight against the daunting challenges posed by the pandemic and now the war. We rose to these challenges to safeguard the economy and the financial system from a maelstrom of shocks. We now stand at a crucial juncture once again. We, in the RBI, remain steadfast in our commitment to contain inflation and support growth. Inflation must be tamed in order to keep the Indian economy resolute on its course to sustained and inclusive growth. The biggest contribution to overall macroeconomic and financial stability as well as sustainable growth would come from our effort to maintain price stability.

17. As several storms hit together, our actions today are important steps to steady the ship. We remain watchful of incoming data and information to constantly reassess the situation and the outlook. We will be proactive and flexible in our approach. Despite challenges, it is comforting to note that the fundamentals of our economy remain strong and we are well placed to deal with the situation emanating from the global developments. The IMF has also recently pointed out that the macroeconomic management of the pandemic in India has resulted in a strong recovery and the country is in a good position to face the current external shock.³ Let me repeat what I have said earlier – I am an eternal optimist. My colleagues in the RBI and I strongly believe that our chosen path will guide us to a better and brighter tomorrow. As Mahatma Gandhi said: "*I have had my share of disappointments, uttermost darkness, but I am able to say that my faith...has ultimately conquered every one of these difficulties.*"⁴

Thank you. Stay safe. Stay well. Namaskar.

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Chief General Manager

³ <https://www.thehindu.com/news/national/india-in-much-better-place-to-face-ukrainian-crisis-imf-official/article65340653.ece>

⁴ Young India, 20-12-1928, p. 420