Stance of RBI Monetary Policy

5 December 2019

Fifth Bi-monthly Monetary Policy Statement for 2019-20 (5 December2019)

RBI Repo Rate (5 December 2019 to 6 April 2017)

Sl No.	Date	Repo Rate	Increase/Decrease
1	**5 December 2019**	**5.15**	**No Change**
2	4 October 2019	5.15	25 basis point decrease↓
3	7 August 2019	5.40	35 basis point decrease↓
4	6 June 2019	5.75	25 basis point decrease↓
5	4 April 2019	6.00	25 basis point decrease↓
6	7 February 2019	6.25	25 basis point decrease↓
7	5 December 2018	6.50	No change
8	5 October 2018	6.50	No change
9	1 August 2018	6.50	25 basis point increase↑
10	6 June 2018	6.25	25 basis point increase↑
11	5 April 2018	6.00	No change
12	7 February 2018	6.00	No change
13	6 December 2017	6.00	No change
14	4 October 2017	6.00	No change
15	2 August 2017	6.00	25 basis point decrease↓
16	7 June 2017	6.25	No change
17	6 April 2017	6.25	No change

Note: Repo rate *increase* is highlighted in 'red'↑ and *decrease* in 'green'↓ colour.
Source: Compiled from previous Monetary Policy Statements.

Monetary Policy Committee (MPC) on 5 December 2019 decided to:

- Keep the policy repo rate unchanged at 5.15 per cent.
- To continue with the accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target.
- Consequently, the reverse repo rate remains unchanged at 4.90 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 5.40 per cent.

Reasons for the stance :

- The MPC notes that economic activity has weakened further and the output gap remains negative.
- Data on corporate finance and on projects sanctioned by banks and financial institution suggests some early signs of recovery in investment activity, though its sustainability needs to be watched closely.
- The need at this juncture is to address impediments, which are holding back investments.
- The introduction of external benchmarks is expected to strengthen monetary transmission. In this context, there is also a need for greater flexibility in the adjustment in interest rates on small saving schemes.
- In the judgment of MPC, inflation is rising in the near-term, but it is likely to moderate below target by Q2:2020-21. It is therefore, prudent to carefully monitor incoming data to gain clarity on the inflation outlook.
- The forthcoming Union Budget will provide better insight into further measures to be undertaken by the Government and their impact on growth.
- The MPC recognizes that there is monetary policy space for further action. However, given the evolving growth-inflation dynamics, the MPC felt it appropriate to take a pause at this juncture.
- Accordingly, the MPC decided to keep the policy repo rate unchanged and continue with accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target.

Outlook for Growth

- Growth in GDP in Q2:2019-20 slumped to 4.5%; which was 5.0 per cent in Q1:2019-20.
- Private Final Consumption Expenditure (PFCE) slowed down to an 18-quarter low.
- Gross Fixed Capital Formation (GFCF) declined sharply. The RBI December credit policy stated that the Government Final Consumption Expenditure (GFCE) has increased; if we exclude GFCE, GDP growth would have been at 3.1 per cent.

Overall Real GDP Growth Projections for 2019-20:

Monetary Policy date	**Overall Real GDP Growth Projections for 2019-20**	**Remarks on Risk Outlook**
5 December 2019	**5.0**	**While improved monetary transmission and a quick resolution of global trade tensions are possible upsides to growth projections; a delay in revival of domestic demand, a further slowdown in global economic activity and geo-political tensions are downside risks.**
4 October 2019	6.1	With risks evenly balanced
7 August 2019	6.9	With risks somewhat tilted to the downside
6 June 2019	7.0	With risks evenly balanced
4 April 2019	7.2	With risks evenly balanced

In 5 December, 2019 Monetary Policy, the RBI has revised its growth projections as follows:

Year/Quarter	**Projected Growth Rate(s)**
For the entire 2019-20	5.0
2019-20(H2)	4.9-5.5
2020-21(H1)	5.9-6.3

Earlier, in 4 October 2019 Monetary Policy, the RBI growth projections were as follows:

The quarter-wise growth rates are projected as follows:

Year/Quarter	**Projected Growth Rate(s)**
2019-20(Q2)	5.3
2019-20(H2)	6.6-7.2
2020-21(Q1)	7.2

Inflation Outlook

- Retail inflation, measured by Year-on-Year changes in the CPI, increased sharply to 4.6 per cent in October 2019 propelled by a surge in food prices. Fuel group prices remained in deflation, while inflation in CPI (excluding food and fuel) moderated further.
- Food inflation increased in October 2019 to 6.9 per cent; pushed up by a sharp increase in vegetable prices due to heavy unseasonal rains.
- Onion prices increased by 45.3 per cent in September 2019 and further by 19.6 per cent in October 2019.
- Milk price increase due to increase in fodder prices.
- Pulse increased due to decline in production and sowing area of pulses.
- Sugar and confectionary prices moved out of deflation in October 2019 as sugarcane output shrank on a Y-o-Y basis.
- Electricity prices increased in October 2019 following a rise in user charges by power distribution companies (DISCOMs) across 13 states as reflected in the CPI.
- Household inflation expectations increased by 120 basis points over the 3-month ahead horizon and 180 basis points over the 1-year ahead horizon as they adopted to the spike in food prices in recent months.
- Going forward, the inflation outlook is revised upwards with risks broadly balanced. **The risk factors are as follows**:
- Upsurge in vegetable prices is likely to continue in immediate months.[1]
- Incipient price pressures seen in other food items such as milk, pulses and sugar are likely to be sustained.
- Both the 3-month and 1-year ahead inflation expectations of households have risen.
- Domestic financial markets have shown volatility.
- Domestic demand has slowed down.
- Crude oil prices are expected to remain range bound barring any supply disruptions due to geo-political tensions.

CPI projection in December 2019 Monetary Policy

Sl No.	Quarter/Half and Year	CPI Inflation Projections (in per Cent)
1	H2:2019-20	5.1-4.7
2	H1:2020-21	4.0-3.8

[1] However, it is expected that a pick-up in arrivals from the late kharif season along with measures taken by the government to augment supply through imports should help soften vegetable prices by early February 2020.

CPI projection in October 2019 Monetary Policy

Sl No.	Quarter/Half and Year	CPI Inflation Projections (in per Cent)
1	Q2:2019-20	3.4
2	H2:2019-20	3.5-3.7
3	Q1:2020-21	3.6

CPI projection in August 2019 Monetary Policy

Sl No.	Quarter/Half and Year	CPI Inflation Projections (in per Cent)
1	Q2:2019-20	3.1
2	H2:2019-20	3.5-3.7
3	Q1:2020-21	3.6

Global Economy

- Though GDP Growth in US shows an increase due to improvement in private investment and personal consumption expenditure, factory activity contracted.
- Economic activity in the UK accelerated driven by the services sector and construction activity.
- In the Euro area household consumption and government spending increased which maintains a stable GDP growth, but manufacturing activity remained subdued along with lingering geo-political uncertainties.
- In Japan, the loss of momentum in Q2 spilled over into Q3, due to weak global demand pulling down exports.
- In China, GDP growth decelerated reflecting weak industrial production and declining exports amidst trade tensions with the US. However, rising inflation is posing a challenge, as CPI increased to 3.8 per cent in October 2019 from 3 per cent in September 2019 primarily due to increase in pork prices.
- In Russia, GDP growth accelerated on the back of an upturn in agricultural output and industrial activity.
- In South Africa, economic activity contracted pulled down by slowing mining and manufacturing activity.
- In Brazil, GDP growth accelerated driven by agriculture, industry and business investment activity.

Crude Oil and Gold Price Trends

- Crude oil prices have moved in a narrow range reflecting changing sentiments to progress in US-China trade talks.
- Gold prices falls in November as a revival of risk appetite eased safe haven demand.

Industrial Growth Trend

- Contraction in output of eight core industries which constitute 40 per cent of the Index of Industrial Production (IIP) contributed by contraction of coal, electricity, cement, natural gas and crude oil.
- However, output of fertilser increased, reflecting expectations of robust sowing activity in the rabi season.
- According to the early results of the RBI's industrial outlook survey, overalls sentiment in the manufacturing sector remained in pessimism in Q3:2019-20 due to continued downbeat sentiments on production, domestic and external demand, and the employment scenario.
- The slowdown in manufacturing activity was also reflected in a decline in capacity utilization (CU) to 68.9 per cent in Q2:2019-20 from 73.6 per cent in Q1 in the early results of the RBI's order books, inventories and capacity utilization surveys.

Financial Market Trend

- In the US, the equity market rallied amid strong jobs data and better than expected corporate earnings.
- Stock markets in EMEs too remains buoyant before some selling pressure took hold in the second-half of November 2019 on renewed fears of US-China trade talks stalling on the Hong Kong stand-off.
- Bond yields in the US firmed up from early October 2019, however they softened from mid-November 2019 on waning hopes of a near-term resolution of trade disputes.
- In the Euro area, bond yields remained negative, but expectations that a no-deal Brexit is less likely improved sentiment.
- In EMEs, bond yields exhibited mixed movements, driven initially by optimism on US-China trade talks and country-specific factors.
- In currency markets, the US dollar weakened against other major currencies, while EME currencies have been trading with an appreciating bias.

Mansoon Trend

- Rabi sowing is catching up from the setback caused by delay in kharif harvesting and unseasonal rainfall in October and early November 2019.

- By 29 November 2019, it was only 0.5 per cent lower than the average covered a year ago. North-East mansoon precipitation was 34 per cent above the long-period average up to 4 December 2019.
- Storage in major reservoirs, the main source of irrigation during the rabi season, was at 86 per cent of the full reservoir level as on 28 November 2019 as compared with 61 per cent in the same period a year ago.

Indicators of Urban and Rural Demand

- Tractors and motorcycles sales- indicators of rural demand; continued to contract but at a moderated pace.
- Passenger vehicle sales- an indicator of urban demand posted a slight positive growth in October 2019 after 11 months of decline, reflecting festival season demand and promotional measures by auto companies.
- Commercial vehicle sales and railway freight traffic contracted.
- The PMI for services expanded to 52.7 in November 2019 from 49.2 in October 2019.

Liquidity Trend

- Overall liquidity remained surplus in October and November 2019 despite an expansion of currency in circulation due to festival demand.
- Average daily net absorption under the LAF amounted to INR 1, 98,566 crore in October 2019.
- In November 2019, the average daily net absorption of surplus liquidity soared to INR 2,40,566 crore with more frequent and larger recourse to Ways and Means Advances (WMA) by the Government.
- The RBI decided to conduct longer-term variable rate reverse repo auctions. So far, four longer term reverse repo auctions have been conducted: two auctions of 21 days tenor and one each of 35 days and 42 days tenor –absorbing INR 78,934 crore.
- According to RBI, the credit market transmission remains delayed but it shows an uptick. The 1 year median marginal cost of funds-based lending rate (MCLR) has declined by 49 basis points. Transmission is expected to improve going forward as (i) the share of base rate loans, interest rates on which have remained sticky, declines (ii) MCLR-based floating rate loans, which typically have annual resets, become due for renewal.
- The RBI further stated that, after the introduction of the external benchmark system, most banks have linked their lending rates to the policy repo rate of the Reserve Bank. The median term deposit rate has declined by 47 basis points during February-November 2019. The weighted average term deposit rate declined by 9 bps in October 2019 as against a decline of just 7 bps in 8 months during February-September 2019. This augurs well for transmission to lending rates, going forward- as stated by RBI in 5 December 2019 credit policy.

External Sector Outlook

- Exports contracted in September-October 2019, reflecting the persisting weakness in global trade.
- Import contracted faster than exports, with lower international crude oil prices resulting in a decline in the oil import bill.
- Non-oil non-gold imports also contracted pulled down by electronics, coal and pearls and precious stones.
- The trade deficit narrowed in September-October 2019.
- Net Foreign Direct Investment (FDI) rose to USD 20.9 billion in first-half of 2019-20 from USD 17.0 billion a year ago.
- Net Foreign Portfolio Investment (FPI) was of the order of USD 8.8 billion in April-November 2019 as against net outflows of USD 14.9 billion in the same period last year.
- Net FPI investment by FPIs under the voluntary retention route has amounted to USD 6.3 billion since 11 March 2019.
- Net disbursals of External Commercial Borrowings (ECBs) rose to USD 11.5 billion during April-October 2019 as against USD 1.2 billion during the same period a year ago.
- India's foreign exchange reserves were at USD 451.7 billion on 3 December 2019- an increase of USD 38.8 billion over end-March 2019.

Developmental and Regulatory Policies

1. Regulation and Supervision

(a) Primary (Urban) Co-operative Banks – Exposure Limits and Priority Sector Lending: With a view to reducing concentration risk in the exposures of primary (urban) co-operative banks (UCBs) and to further strengthen the role of UCBs in promoting financial inclusion, it is proposed to amend certain regulatory guidelines relating to UCBs.

The guidelines would primarily relate to exposure norms for single and group/interconnected borrowers, promotion of financial inclusion, priority sector lending, etc. These measures are expected to strengthen the resilience and sustainability of UCBs and protect the interest of depositors. An appropriate timeframe will be provided for compliance with the revised norms.

A draft circular proposing the above changes for eliciting stakeholder comments will be issued shortly.

(b) Primary (Urban) Co-operative Banks – Reporting to Central Repository of Information on Large Credits (CRILC): The Reserve Bank has created a Central Repository of Information on Large Credits (CRILC) of scheduled commercial banks, all India financial institutions and certain non-banking financial companies with multiple objectives, which, among others, include strengthening offsite supervision and early recognition of financial distress.

With a view to building a similar database of large credits extended by primary (urban) co-operative banks (UCBs), it has been decided to bring UCBs with assets of INR 500 crores and above under the CRILC reporting framework. Detailed instructions in this regard will be issued by December 31, 2019.

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(c) Comprehensive Cyber Security Framework for Primary (Urban) Cooperative Banks (UCBs) – A Graded Approach: Reserve Bank had prescribed a set of baseline cyber security controls for primary (Urban) cooperative banks (UCBs) in October 2018. On further examination, it has been decided to prescribe a comprehensive cyber security framework for the UCBs, as a graded approach, based on their digital depth and interconnectedness with the payment systems landscape, digital products offered by them and assessment of cyber security risk.

The framework would mandate implementation of progressively stronger security measures based on the nature, variety and scale of digital product offerings of banks. Such measures would, among others, include implementation of bank specific email domain; periodic security assessment of public facing websites/applications; strengthening the cybersecurity incident reporting mechanism; strengthening of governance framework; and setting up of Security Operations Center (SOC). This would bolster cyber security preparedness and ensure that the UCBs offering a range of payment services and higher Information Technology penetration are brought at par with commercial banks in addressing cyber security threats.

Detailed guidelines in this regard will be issued by December 31, 2019.

(d) Development of Secondary Market for Corporate Loans – setting up of Self-Regulatory Body: As recommended by the Task Force on Development of Secondary Market for Corporate Loans, the Reserve Bank will facilitate the setting up of a self-regulatory body (SRB) as a first step towards the development of the secondary market for corporate loans. The SRB will be responsible, *inter-alia*, for standardising documents, covenants and practices related to secondary market transactions in corporate loans and promoting the growth of the secondary market in line with regulatory objectives.

(e) On Tap Licensing of Small Finance Banks: In the Second Bi-monthly Monetary Policy Statement, 2019-20 of June 06, 2019, it was announced that the Draft Guidelines for 'On tap' Licensing of Small Finance Banks will be issued by the end of August 2019. Accordingly, the Draft Guidelines were placed on the RBI's website on September 13, 2019 inviting comments from the stakeholders and members of the public. After examining the responses received, the

'On tap' Licensing Guidelines for Small Finance Banks have now been finalised and are being issued today.

(f) International Financial Service Centre Banking Unit (IBU): With a view to facilitating ease of operations for IBUs and having regard to the Liquidity Coverage Ratio being maintained by them, it has been decided to allow IBUs to:

i. Open foreign currency current accounts of their corporate borrowers subject to the provisions of FEMA 1999 and regulations issued thereunder, wherever applicable;
ii. Accept fixed deposits in foreign currency of tenor less than one year from non-bank entities and consequently remove the current restriction on premature withdrawal of deposits.

However, the current prohibition on acceptance of retail deposits including from high net worth individuals (HNIs) will continue. Necessary instructions are being issued shortly.

(g) Review of NBFC-P2P Directions- Aggregate Lender Limit and escrow accounts: The Reserve Bank had issued directions for Non-Banking Financial Company-Peer to Peer Lending platform (NBFC-P2P) on October 4, 2017. At present, the aggregate limits for both borrowers and lenders across all P2P platforms stand at INR 10 lakh, whereas exposure of a single lender to a single borrower is capped at INR 50,000 across all NBFC-P2P platforms.

A review of the functioning of the lending platforms and lending limit was carried out and it has been decided that in order to give the next push to the lending platforms, the aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, shall be subject to a cap of INR 50 lakh. Further, it is also proposed to do away with the current requirement of escrow accounts to be operated by bank promoted trustee for transfer of funds having to be necessarily opened with the concerned bank. This will help provide more flexibility in operations. Necessary instructions in this regard will be issued shortly.

(h) Baseline Cyber Security Controls for ATM Switch application service providers of RBI regulated entities: A number of commercial banks, urban cooperative banks and other regulated entities are dependent upon third party application service providers for shared services for ATM Switch applications.

Since these service providers also have exposure to the payment system landscape and are, therefore, exposed to the associated cyber threats, it has been decided that certain baseline cyber security controls shall be mandated by the regulated entities in their contractual agreements with these service providers.

The guidelines would require implementation of several measures to strengthen the process of deployment and changes in application softwares in the ecosystem; continuous surveillance; implementation of controls on storage, processing and transmission of sensitive data; building capacity for forensic examination; and making the incident response mechanism more robust. Detailed guidelines in this regard will be issued by December 31, 2019.

2. Financial Markets:

(a) Hedging of foreign exchange risk by residents and non-residents – Issue of final guidelines: An announcement regarding the review of foreign exchange hedging facilities was made in February 2019, followed by issue of draft regulations for public comments on February 15, 2019. The Task Force on Offshore Rupee markets (Chairperson: Smt. Usha Thorat) also suggested some changes based on its review. The draft regulations have been modified based on the feedback and the recommendations of the Task Force. The important changes are as follows:

- Users may undertake over the counter (OTC) currency derivative transactions up to USD 10 million, without the need to evidence underlying exposure.
- Banks shall be provided with the discretion, in exceptional circumstances, to pass on net gains on hedge transactions booked on anticipated exposures.
- Strengthening of the safeguards to ensure, that complex derivatives are sold only to users that are capable of managing the risks.

The final directions will be issued after notification of the changes to Foreign Exchange Management Act (FEMA) Regulations.

3. Payment and Settlement System:

(a) New Pre-Paid Payment Instruments (PPI): Prepaid Payment Instruments (PPIs) have been playing an important role in promoting digital payments. To further facilitate its usage, it is proposed to introduce a new type of PPI which can be used only for purchase of goods and services up to a limit of INR 10,000. The loading / reloading of such PPI will be only from a bank account and used for making only digital payments such as bill payments, merchant payments, etc. Such PPIs can be issued on the basis of essential minimum details sourced from the customer. Instructions in this regard will be issued by December 31, 2019.