Comment on RBI Annual Monetary Policy 2013-14 (May 3, 2013)

The annual monetary policy of RBI for 2013-14 has been announced in the backdrop of:

- Uncertainty prevalent in the Advanced Economies on the economic activity front, which remains sluggish and often inconsistent. Inflation in advanced economies is expected to remain benign owing to low demand pressures;
- Weak external demand for major Emerging Economies including India. Indian growth registered at 4.5 per cent in Q3 of 2012-13, lowest in 15 quarters and amidst continued pressures on industrial output growth and depressed capital investment conditions;
- Bottlenecks in infrastructure creating supply bottlenecks and restricting investments;
- High inflation for major part of the past few years
- Sluggish growth, stemming from food inflation and increase in administered price mechanism; twin deficits continuing to be high, although fiscal deficit at 4.8 per cent remaining within sniffing distance from the GOI targeted level of 4.5 per cent.
- Likely improvement in domestic conditions during 2013-14 to be modest and largely conditional on normal monsoon with global growth unlikely to improve significantly.

RBI has attempted to balance the inflation target of 5 per cent on Wholesale Price Index level aimed to reversing the declining GDP growth rate trend i.e. to achieve a higher GDP growth rate of 5.7 per cent for 2013-14.

Parameter	**as announced in Annual Monetary Policy on 03/05/13**	**Changes, if any**	**Remarks**
Cash Reserve Ratio (CRR)	4%	Nil	
Statutory Liquidity ratio (SLR)	23%	Nil	
Repo Rate	7.25%	(-) 0.25%	
Reverse Repo Rate	6.25%	(-) 0.25%	
Marginal Standing facility	8.25%	(-) 0.25%	
Baseline projections for- GDP growth rate	5.7%		Modest recovery expected. CSO has estimated 5% GDP growth rate in 2012-13, lower than RBI's expected GDP growth rate of 5.5%
Headline inflation (WPI)	5.5%		Lower than the 6% (WPI) in March 2013, which was lower than RBI's expectation of 6.8%
Growth rate projected in Money Supply (M3)	13%		Down from 14% projected in Q3 2012-13
Non-food credit (credit for other than agriculture)	15%		Down from 16% projected in Q3 2012-13

RBI has shown a calibrated stance through the aforementioned measures by not directly infusing liquidity (no change in the CRR) but given the option it has through open market operations, it is likely to remain alert in managing the liquidity and reinforce monetary transmission, if required, consistent with the growth-inflation balance it strives to achieve. Similar steps were adopted by RBI wherein it infused Rs. 1012 billion under LAF in the second half of 2012-13 (up from Rs. 730 billion in the first half of 2012-13). RBI has recognised the existing risks on account of the Current Account Deficit and its financing, and with risks of inflation increasing beyond acceptable parameters, it would have to swiftly reverse its policy stance. Reserve Bank's own assessment of the growth-inflation dynamic, yields little space for further monetary easing.

<u>Announcements pertaining to the micro and small enterprises:</u>

Besides the monetary measures announced, RBI proposes to issue guidelines aimed at increasing the threshold limit for loans to micro and small enterprises involved as service enterprises, for classification purpose as 'priority sector advance', from the present level of Rs. 20 million to Rs. 50 million. The immediate effect of the same would get reflected as improvement in the priority sector lending figures to the micro and small segment for banks on account of this reclassification. It would however be more relevant, if banks also disclose increase in the number of additional enterprises provided credit as a result of the changed guidelines in this regard.

In addition to the aforementioned, RBI has decided that banks need to:

- Strengthen their existing systems of monitoring credit growth to the sector and put in place a system-driven comprehensive performance management information system (MIS) at every supervisory level (branch, region, zone, head office) which should be critically evaluated on a regular basis;
- Put in place a system of e-tracking of MSE loan applications and monitor the loan application disposal process in banks, giving branch-wise, region-wise, zone-wise and State-wise positions. RBI would be providing a format for the purpose and it would be expected that the position with regard to MSE applications be displayed by the banks on their websites; and
- Monitor timely rehabilitation of sick MSE units. RBI would be providing a format for the purpose. The progress in rehabilitation of sick MSE units would also be required to be made available on the website of banks.

<u>Announcements relevant for MSME sector:</u>

1. A Technical Committee on Services and Facilities for Exporters (Chairman – Shri G Padmanabhan) was set up in February 2013 to examine various **<u>issues relating to exports</u>** such as - availability of credit, transaction costs, insurance, factoring and other procedural aspects in the dealings of exporters with banks and financial institutions. The Committee has submitted its report in April 2013 and the same is being examined by RBI and would be shortly available on RBI's website for comments and dissemination.
2. **Import of Gold –** A Working Group on Gold (Chairman – Shri K U B Rao) recommended aligning gold import regulations with the rest of imports with a view to reducing gold imports by creating a level playing field between gold imports and other imports. Currently, banks authorised by the Reserve Bank are permitted to import gold on:
    a. Consignment basis;

b. Unfixed price basis; and
c. Loan basis

Gold can also be imported directly by export oriented units (EOUs) or units in Special Economic Zones (SEZs) in the gems and jewellery sector and nominated agencies or banks using letters of credit (LCs). The bulk of the gold currently being imported by nominated banks is, however, on consignment basis whereby the nominated banks do not have to fund these stocks. With a view to reducing the demand for gold for domestic use, RBI has **proposed to restrict the import of gold on consignment basis by banks only to meet the genuine needs of exporters of gold jewellery**. Detailed guidelines in this regard would be issued in May 2013.

3. **Unhedged Foreign Currency Exposure –** as per extant instructions, banks are required to put in place a proper mechanism to rigorously evaluate the risks arising out of unhedged foreign currency exposure of corporates and price them in the credit risk premium, while also considering stipulating a limit on the unhedged positions of corporates on the basis of banks' board-approved policy. RBI has reiterated need for utmost importance in adherence to the compliance of guidelines in this regard as unhedged forex exposures of borrowers, remains a source of risk not only to the borrowers but also to the financing banks and the financial system, especially in times of currency volatility. Corporates borrowing from banks or financial institutions are also expected to put in place a risk management policy for their unhedged forex exposures. RBI would be issuing guidelines in June 2013 on **banks requirement of higher risk weights and provisioning requirements on unhedged forex exposure positions**.