Sailing Through Turbulence: India's Tryst with Financial Stability

Keynote Address by Shri Shaktikanta Das, Governor, Reserve Bank of India

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I am happy to be here at the Global Leadership Summit which marks the 25th anniversary of CNBC TV18. I would like to congratulate Team CNBC TV18 for its successful journey over the years. It is indeed an honour for me to join this occasion to felicitate three distinguished former Governors of the Reserve Bank of India – Dr. C. Rangarajan, Dr. Bimal Jalan and Dr. Y.V Reddy. With their exceptional performance in economic and financial sector policy making, they occupy the pole position in the art and science of central banking. As stewards of a full-service central bank, they initiated fundamental shifts in monetary frameworks as well as in the financial, exchange rate and external sector policies of the country. I humbly bow to the rich tradition and legacies left behind by Dr Rangarajan, Dr Jalan and Dr Reddy in shaping what the Reserve Bank of India is today. Drawing inspiration from their contributions, I have chosen to speak today on the topic, 'Sailing through Turbulence: India's Tryst with Financial Stability'.

2. In recent years, the global economy has gone through a period of continual and unprecedented shocks. This was a period of "Great Volatility"[1] as distinct from the earlier era of "Great Moderation".[2] Complex and varied shocks of a global pandemic, supply chain disruptions, wars, geopolitical conflicts and climate change hit the global economy very hard. These were not typical shocks dealt with in textbooks or having standard policy responses. Sailing through this turbulent period has, therefore, been a daunting challenge for every country including India.

[1] Governor's Statement: December 8, 2023;

[2] The 'Great Moderation' is the name given to the period of decreased macroeconomic volatility experienced in the United States in the mid-1980s,1990s and early 2000s.

Current Global Context

3. After almost a synchronous adoption of expansionary policies following the pandemic, central banks across the world resorted to an equally synchronous monetary policy tightening when high inflation bounced back in the face of supply chain disruptions and the war in Ukraine. Overall, these policies across the globe appear to have worked well.[3] Soft landing has been ensured, but risks of inflation coming back and growth slowing down do remain. The headwinds from geopolitical conflicts, geo-economic fragmentation, commodity price volatility and climate change continue to blow.

4. During this entire period of great volatility, maintaining price and financial stability have posed difficult trade-offs, as evident – among others –from the banking sector turmoil in certain advanced economies in 2023. The challenge is always between doing too little or too late on the one hand; and doing

[3] Chapter 2, World Economic Outlook, IMF, October 2024.

too much or too early on the other. Reading the interplay between monetary policy actions and the developments in the financial sector as well as the evolving situation correctly, and timing the decisions are always challenging. Central Banks have by and large performed well this time around.

5. In this challenging global environment, let me highlight certain contradictions globally which we observe at the current juncture. First, government bond yields are rising even as many advanced economies have embarked on an easing path through rate cuts, underscoring the fact that treasury markets are influenced by a host of global and domestic factors that are much beyond mere policy adjustments. Incidentally, even the US dollar is appreciating although the FED is cutting rates. Second, undeterred by the strong US dollar and higher bond yields, prices of gold and oil - the two commodities that typically move in tandem - are showing sharp divergence. Third, an interesting contrast is also emerging between rising geopolitical risks and financial market volatility. While geopolitical tensions have

escalated steadily in recent years, financial markets have shown considerable resilience in the face of mounting uncertainties. Fourth, global trade is projected to remain higher than the previous year[4] notwithstanding the sanctions, tariffs, import duties, rising cross-border restrictions and supply chain disruptions. Fifth, the emerging market economies (EMEs) have shown greater resilience than advanced economies (AEs) in the current phase.

Indian Context

6. Amidst these headwinds and contradictions, the Indian economy is sailing through smoothly, powered by buffers like strong macro-economic fundamentals, stable financial system and resilient external sector. Our endeavour has been to seize every opportunity to further strengthen our fundamentals through prudent and proactive policy approach. Our prime focus has

[4] World merchandise trade volume is projected to grow by 2.7 per cent in 2024 and 3 per cent in 2025 as per Global Trade Outlook and Statistics, WTO, October 2024. The IMF has projected world trade volume to increase by 3.1 and 3.4 per cent in 2024 and 2025 respectively (World Economic Outlook, October 2024).

been to maintain financial stability, which breeds growth and prosperity.

7. In 2019, we faced severe stress in the non-banking financial company (NBFC) sector. Liquidity had dried up and there was a crisis of confidence in the financial markets. There were also certain instances of bank stress, both in commercial and cooperative banking sectors, in recent years. In all these exigent situations, the Reserve Bank took effective measures to stem the crisis from snowballing and restore stability and confidence in the markets. In parallel, we strengthened our regulatory architecture and supervisory vigil to proactively identify weaknesses and be future ready. It is, therefore, appropriate to reflect on our experience during this period, not just – if I may say so – as a success story but, more importantly, to draw lessons for the future.

8. When the COVID-19 pandemic hit us, our response was swift and decisive. We put in place business continuity measures

even before the nation-wide lock down was announced. We set up a special quarantine facility, with about 200 officers, staff and service providers, to ensure continuity in financial market operations and payment systems. All regulated entities were advised to take immediate contingency measures to ensure business continuity and manage their risks.

Monetary Policy and Liquidity Operations

9. Monetary policy has completed a full cycle in the last six years – an easing cycle during 2019-22 and a tightening cycle of equal magnitude thereafter. We have used the flexibility embedded in flexible inflation targeting (FIT) to prioritise growth or inflation depending upon the prevailing conditions and the outlook. For instance, when economic activity came under severe stress during the COVID-19 pandemic, we prioritised growth over inflation and cut policy rates and infused huge liquidity into the system. These measures were nuanced, keeping in mind the price and financial stability challenges that

may arise in future. In addition, forward guidance during the easing phase complemented and reinforced monetary policy and liquidity measures. In parallel, appropriate regulatory measures, consisting of moratorium on repayment of loans and resolution frameworks for stressed loans were also announced.

10. Later, when the Russia-Ukraine war caused massive supply disruptions in key commodities and threatened inflation to get out of control, we shifted our focus from growth to controlling inflation. We frontloaded our monetary policy actions and changed our stance to withdrawal of accommodation. We remained nimble and agile in our liquidity management operations. Further, fiscal-monetary coordination – Reserve Bank's rate hikes along with proactive supply side measures by the Government – helped in controlling inflation and anchoring inflation expectations.

11. Coming to a more recent period, the MPC in its meeting on October 7-9, 2024 took note of the prevailing and expected

inflation-growth dynamics and decided to change the monetary policy stance from withdrawal of accommodation to 'neutral'. It also decided to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth. The change in stance provides greater flexibility and optionality to act in sync with the evolving conditions and the outlook.

12. Overall, while average growth during 2021-24 remained buoyant at above 8.0 per cent, the receding of headline inflation in 2023-24 and 2024-25 (up to September) to within the tolerance band bears testimony to the success of the Reserve Bank's policies. What is equally important is that all these actions did not undermine financial stability. Our rate hikes were preceded or accompanied by prudent risk management practices in the form of greater flexibility to banks in holding government securities under the held to maturity (HTM) category that minimised marked-to-market losses. It is evident that while designing our responses to both the pandemic and the inflation upsurge, our policies were nimble, flexible and balanced. We

remained consistent with our mandate of "price stability while keeping in mind the objective of growth". The underlying mandate of maintaining financial stability was also adhered to.

Central Bank Communication

13. During this entire period, communication became an important tool to complement our policy actions. During the pandemic, our endeavour was to give confidence to the wider economy, financial markets and the public at large. In the monetary policy statement on April 17, 2020 in the early part of the lockdown, I had said "*Although social distancing separates us, we stand united and resolute. Eventually, we shall cure; and we shall endure*". We began using quotes from Mahatma Gandhi like "….in the midst of death life persists….in the midst of darkness light persists" (April 17, 2020); "*It is when the horizon is the darkest and human reason is beaten down to the ground that faith shines brightest and comes to our rescue*" (May 22, 2020) ; and similar other quotes.

14. In particular, I would like to refer to my December 2023 statement following the macro prudential measures undertaken on November 16, 2023: "*Financial stability is a public good* [5]*…….we do not wait for the house to catch fire and then act. Prudence at all times is our guiding philosophy*." The spirit behind these statements are key to withstanding a period of multiple crises. Our communication was backed up by appropriate policy actions. Evidently, communication played a critical role in maintaining stability in the turbulent times of recent past.

Robust Regulation and Supervision for Stability

15. It goes without saying that a sound regulatory framework for the regulated entities (REs), together with a robust supervisory and monitoring mechanism, are key enablers for ensuring financial stability. From a prudential perspective, so far

[5] Financial stability was also described as a public good in Nani Palkhivala Memorial Lecture (Das, Shaktikanta), January 16, 2021

as the Reserve Bank is concerned, measures like the revised norms on classification and valuation of investments; the scale-based regulation for NBFCs; revised regulations for micro finance loans; four-tiered regulatory approach for urban cooperative banks (UCBs); and steps to contain potential credit exuberance in unsecured loans are some illustrations of prudential design of regulations in the interest of maintaining financial stability.

16. Looking ahead, the financial system will continue to face newer challenges. There is a continuing need for financial sector entities to strengthen their levels and quality of capital, while further sharpening the risk management standards. The Reserve Bank is now working on issues like adoption of revised Basel III standards in a phased manner; issuance of guidelines for Expected Credit Loss (ECL); liquidity coverage ratio (LCR); and prudential framework for financing of project loans. Our overall approach is consultative. For instance, with regard to the ECL framework, even after issuing a discussion paper and receiving

stakeholder comments which we got examined by an external working group, we now propose to issue a draft circular for implementation of ECL. The idea is to get stakeholder comments on certain specifics of the framework considering its significance for the banking sector. Our endeavour is to maintain a balance between banking sector stability and economic growth, both of which are necessary and are complementary to each other. We are also working on climate risks and their impact on the financial sector. The final guidelines for Disclosure Framework on Climate related Financial Risks will be issued shortly.

17. The process of supervision of banks, NBFCs and other financial entities has also been unified and substantially strengthened with pro-active on-site and off-site supervisory mechanisms. The focus is now on early detection and pre-emptive correction. The enhanced off-site assessment framework is more analytical and forward looking with introduction of macro-stress tests, early warning indicators (EWIs), fraud vulnerability index (FVI), micro-data analysis

(MDA), and use of artificial intelligence and machine learning techniques. The onsite supervision now goes into greater depths. Direct engagement with the Supervised entities is enabled through discussions and also through the Daksh portal – a SupTech initiative with end-to-end workflow solution to streamline and strengthen various supervisory processes.[6] The College of Supervisors, which was set up by the Reserve Bank in May 2020, is now helping our supervisors to sharpen their skills and remain up to date with the new and complex developments in the financial sector.

18. The financial sector has indeed become more complex, with the development of multiple digital products, common market infrastructure and common service providers for IT services. These developments have elevated both the micro-prudential and macro-prudential risks. The Reserve Bank has been proactive in addressing the growing cybersecurity

[6] Daksh provides secured, anytime-anywhere role-based access to the users. It is envisioned as the single interface for all the supervisory functions. The supervisory processes covered in Daksh include inspection planning and execution, scoping and resource allocation, report finalisation and availability of inspection reports to the entities.

challenges in the financial sector by issuing regulations related to basic Cyber hygiene in Regulated Entities, Digital Payments Security Controls, IT Outsourcing and IT Governance. Recognising the critical importance of data and its future potential, an Enterprise Computing and Cybersecurity Training Institute is being set up in Bhubaneshwar. Along with this, a Data Centre is also being set up. Work on setting up the financial sector cloud facility by the Reserve Bank is also gathering pace.

19. Overall, the financial sector in India is now more robust and resilient than at the beginning of the recent period of turmoil. There is, however, no room for complacency. The Regulator and the Regulated Entities must remain alert and future ready for the emerging challenges.

External Sector Stability

20. India's external sector has also exhibited strength and stability in the recent period. The current account deficit (CAD) has remained within the manageable limit and stood at 1.1 per

cent of GDP in Q1:2024-25 (0.7 per cent in FY 2023-24 and 2.0 per cent in FY 2022-23). During the first half of 2024-25, India's merchandise exports recovered from a contractionary zone in 2023-24. Services exports have remained buoyant and rose by 11.0 per cent during H1:2024-25 (4.8 per cent in FY 2023-24). The robust growth in services exports, coupled with buoyant private remittances, are helping to contain the current account deficit.

21. On the financing side, net capital inflows have been generally exceeding the CAD and contributing to accretion in foreign exchange reserves. India has the fourth largest foreign exchange reserves in the world at US$ 682 billion as on October 31, 2024, sufficient to cover the entire external debt[7] and about 12 months of merchandise imports.[8] In terms of other key external sector indicators such as external debt to GDP, net

[7] At end-June 2024.

[8] Annualised merchandise imports on Balance of Payments basis.

international investment position (IIP) and short-term debt to external debt, India’s position remains resilient.

22. Our exchange rate policy is well-articulated and has remained consistent over the years. India’s exchange rate regime is market-determined, and the Reserve Bank does not target a level or band of the exchange rate. The forex interventions are carried out to ensure an orderly movement of the exchange rate and to curb undue volatility, anchor market expectations and ensure overall financial stability.

23. It is important to note that the exchange rate is also a barometer of an economy’s inherent strength. If the Indian Rupee (INR) has remained relatively stable despite severe external shocks including the largest and steepest tightening by the Fed in 2022 and 2023, it speaks volumes about the sea change in our macro fundamentals from the Taper Tantrum days.

24. In fact, if we look at the other major segments of the financial markets regulated by the Reserve Bank – money market and government securities market – they have also remained stable despite large swings and spillovers from global markets. The weighted average call money rate has remained rangebound within the liquidity adjustment facility (LAF) corridor and closely aligned to the policy repo rate. The 10-year G-sec yield has also moved in a narrow range of 6.72 to 7.61 per cent[9] during the tightening cycle amidst global policy pivot, fluctuations in US treasury yields and global crude prices. The Reserve Bank has undertaken several regulatory measures in recent years to ensure resilience and stability of the financial markets. These include: putting in place regulatory frameworks for benchmark administrators and electronic trading platforms; robust governance requirements for market makers in OTC derivative markets; and margin requirements for non-centrally cleared derivative reforms.

[9] As on June 16, 2022, the 10-year G-sec yield touched 7.61 per cent. The 10-year G-sec yield softened to a minimum of 6.72 per cent as on September 26, 2024.

25. As I proceed to conclude, let me add that the Reserve Bank has played a crucial role in creating an enabling eco-system for innovations in the payment systems. This has enhanced the efficiency and stability of the Indian financial system. Introduction of 24x7 NEFT and RTGS;[10] the success of the Unified Payments Interface (UPI); and implementation of the central bank digital currency (CBDC) pilot project (e₹) are transforming the wider financial system. Digitalisation of banking services has received a further boost from Reserve Bank's pilot, the Unified Lending Interface (ULI), which has been designed and developed by the Reserve Bank innovation Hub (RBIH), Bengaluru. A few other initiatives of RBIH are also in the pipeline.

Concluding Observations

26. The Reserve Bank's mandate spans multiple dimensions. Our consistent effort is to take a holistic view of stability which

[10] National Electronic Funds Transfer (NEFT) was made round the clock 24/7 including weekends and holidays from December 16, 2019. The Real Time Gross Settlement (RTGS) was made round the clock 24/7 including weekends and holidays from December 14, 2020.

encompasses price stability, financial stability and sustained growth. We deploy multiple policy instruments to serve these multiple objectives.

27. Today, India's economic growth remains resilient; inflation is expected to moderate despite periodic humps; and the external sector is robust. Without being complacent, let me end by saying that the Indian economy has sailed well through the prolonged period of turbulence and exhibits resilience in the face of constantly emerging new challenges.

Thank you. Namaskar.