

Strengthening \$ is a global risk: RBI paper

MANOJIT SAHA

Mumbai, 19 October

The Reserve Bank of India's (RBI)'s 'State of the Economy' report has flagged the US dollar's continued strengthening as a global risk. This will further tighten financial conditions, according to the report, despite India adding more to its foreign exchange (forex) reserves than any other major country holding forex reserves.

"Even as energy importers reel from the impact of soaring crude oil prices that resurrect the spectre of inflation alongside external vulnerabilities, the US dollar gets ever stronger on the heft of surging treasury yields, creating a pernicious feedback loop," says the report, authored by RBI staff members, including Deputy Governor M D Patra, but not necessarily reflecting the RBI view.

During calendar year 2023, India's forex reserves have increased by \$22.0 billion — the highest among major forex reserve-holding countries according to the report — to \$584.7 billion as of the week ended October 6.

"The Indian rupee has also exhibited low volatility and orderly movements relative to peers, in spite of the elevated US treasury yields and a stronger dollar," the RBI report says.

Commenting on the October monetary policy review, the report says, with inflation ruling above the upper tolerance level for two months in a row, priority has been assigned to maintaining a disinflationary stance and the



The State of the Economy report says during CY23, India's forex reserves rose by \$22 billion, the highest among reserve holders this year

inflation outcomes' alignment with the target.

"Its [the Monetary Policy Committee's] resolution reflects the approach of an inflexion point in the conduct of monetary policy in India," the report adds.

On the Indian banking sector, the report points out that term deposit rates have surged to their highest in five years with banks rushing to meet a strong credit demand. "There is anecdotal evidence that funds are flowing from low-yielding current account savings account (Casa) to higher-interest-bearing term deposits. Competition among banks to garner deposits has intensified after a long hiatus." The structural liquidity mismatch in the banking system, according to the report, is also reflected in the highest certificate of deposit (CD) issuances this financial year in September.

The report observes that global growth might have lost steam in the September quarter of 2023, even as several emerg-

ing market economies (EMEs) — especially in Asia (and BRICS barring China) — have posted positive growth surprises. These countries are standing up to formidable global headwinds that keep stampeding capital flows out of their equity and debt markets and imposing relentless downward pressure on their currencies.

With the recent rally in crude oil prices undermining their overall prospects, these economies also appear increasingly vulnerable to selloffs and safe-haven flights, it adds. "The situation is compounded by rising food prices, a geopolitical fallout. Several EMEs — and even their advanced peers — are tapping into forex reserves to shore up currencies or engaging in open mouth operations," the report said.

High crude oil prices, which are forcing monetary policy authorities to remain on guard for a longer period, can take down the global economy by weakening its main engines, notably the US and India, the report adds.

On growth prospects in India amid broad-based gains for high-frequency indicators in August and September, the report sees the ongoing festival season lighting up e-commerce sales volumes. "Rural consumers also appear to be ready to join the party: There is a revival in demand for fast-moving consumer goods after the September showers, in spite of an uptick in freight and packaging costs. With kharif sowing acreage exceeding last year's coverage, joblessness in rural areas fell in September," the report explains.