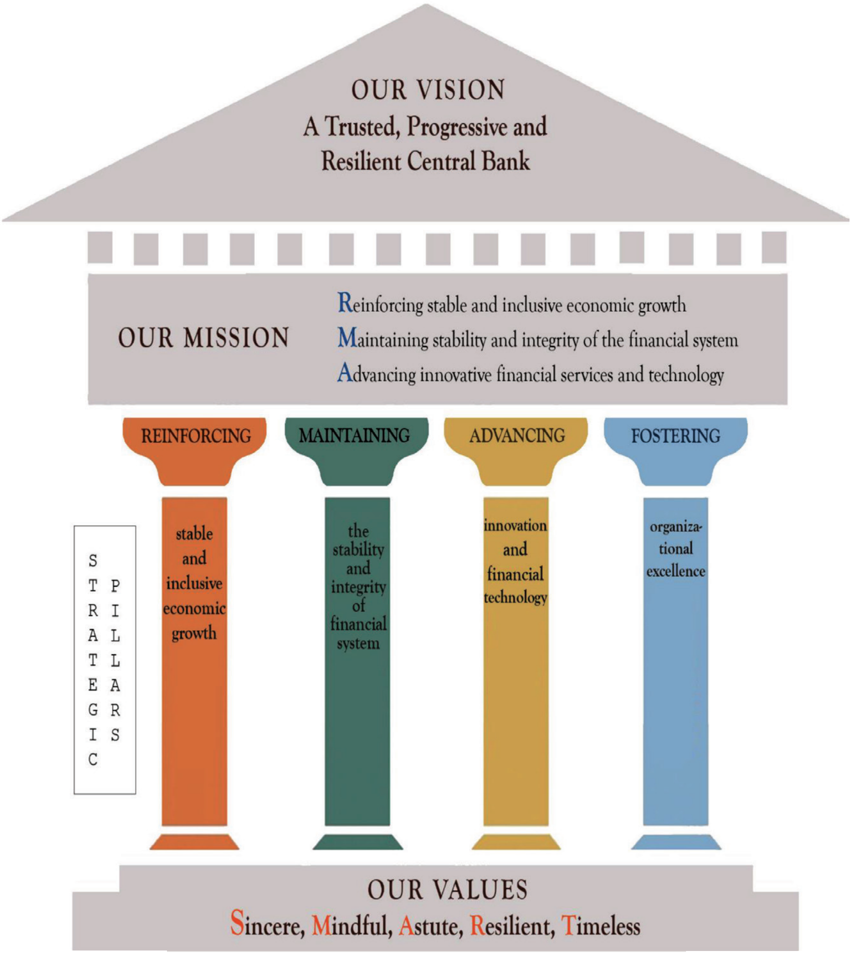
MONETARY POLICY STATEMENT

July 2018

Royal Monetary Authority of Bhutan

Vision, Mission and Values



Monetary Policy Statement

In accordance with Chapter II, Section 7 of the Royal Monetary Authority Act of Bhutan 2010, the Royal Monetary Authority is assigned with the primary objective "to formulate and implement monetary policy with a view to achieving and maintaining price stability".

In that context, the Monetary Policy Statement of the Royal Monetary Authority of Bhutan is issued in accordance with Chapter II, Section 10 of the Royal Monetary Authority Act of Bhutan 2010. The Monetary Policy Statement is issued annually in July, coinciding with the first month of the new fiscal year.

Macroeconomic statistics presented in this statement are based on multi-sector Macroeconomic Framework Coordination Technical Committee (MFCTC) projections, endorsed by the policy-level Macroeconomic Framework Coordination Committee.

Contents

Acronyms

BEFIT	Bhutan Economic Forum for Innovative Transformation
CPI	Consumer Price Index
CSI	Cottage and Small Industry
CEFL	Consumer Empowerment and Financial Literacy
FI	Financial Institution
FY	Fiscal Year (July 1 – June 30)
FYP	Five Year Plan
FIS	Financial Inclusion Secretariat
GDP	Gross Domestic Product
GST	Goods and Services Tax
IMF	International Monetary Fund
INR	Indian Rupees
M2	Broad Money
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MFI	Microfinance Institution
MoF	Ministry of Finance
NFIS	National Financial Inclusion Strategy
NFLS	National Financial Literacy Strategy
NFA	Net Foreign Assets
RBI	Reserve Bank of India
RGoB	Royal Government of Bhutan
RMA	Royal Monetary Authority of Bhutan
USD	US Dollars

1. Executive Summary

Bhutanese economy continued to gain momentum, averaging at 7.4 percent growth in the FY 2016/17, largely driven by hydropower projects. Domestic consumer inflation continued on a downward path, with headline inflation moderating to 3.2 percent in March 2018 from 5.1 percent from the previous year. The slowdown in the consumer inflation was mainly contributed by fall in non-food prices, particularly the fuel prices. Prices for vegetables and cereals, the principal drivers of food inflation, also continued to remain constant. The headline inflation excluding food and fuel prices, fell significantly to 0.6 percent from 3.9 percent as compared to the same period last year

As of March 2018, the overall soundness of the financial sector remained largely favorable. The capital adequacy ratio has increased to 14.5 percent, maintaining well above a minimum regulatory requirement of 12.5 percent. The asset base of the banking sector has expanded by 9.5 percent, owing to 13.5 percent growth in loans. Similarly, the deposit liabilities also witnessed a growth of 19.1 percent in March 2018, contributed largely by increase in current, savings and time deposits. On the credit front, the overall financial sectors' total loans to the economy have increased by 15.6 percent from almost 92 billion in March 2017 to over Nu. 106 billion in March 2018. Of the total loans, the share of loan to medium enterprises constituted 22.4 percent followed by micro, cottage and small industries by 17.2 percent and large enterprises by 14.8 percent. While, a 45.6 percent of loans were attributed to loans to non-enterprise sector. With increase in overall loan size, the NPLs to loan ratio has also remained relatively higher at 14.6 percent in March 2018.

Fiscal deficit for FY 2017/18 is expected to fall almost at 1 percent of GDP due to upward revision in total resources by 6.34 percent and outlay by 1.2 percent. The increase in outlay is attributed to increase in current expenditure by 0.16 percent and capital expenditure by 2.2 percent in the revised outlay.

On the external front, with high level of dependence on imports, the current account deficit continues to remain at an elevated level. In FY 2017/18, export is projected to increase by 4.2 percent while import by 1.8 percent, the current account deficit is anticipated to improve slightly from 22.8 percent in 2016/17 to 21.8 percent of GDP. Gross international reserves during the FY 2017/18 increased to USD 1,243 million from 1,106.7 million in FY 2016/17. As of March 2018, total international reserves were USD 1,032.5 million, of which USD 823.2 million were convertible currency reserves and remaining ₹ 13.6 billion in Indian Rupees, sufficient to finance 11.5 months of merchandise imports.

Moving forward, the global economy continues to improve owing to investment recovery in advanced economies and strong growth in emerging Asia. Indian economy is expected to grow at a higher level, propelled by a revival of investment and manufacturing sectors. Given the close economic relationship with India, the domestic economy is expected to experience a higher growth trends over the medium term, driven by commissioning of Mangdechhu Hydro Project by the end of 2018. On an average, the real GDP is expected to accelerate at 8.2 percent. With the expected growth in electricity exports, trade deficit is anticipated to improve and consequently, the current account deficit to remain lower at an average of 12 percent of GDP over the medium term. Gross international reserves over the medium term is anticipated at USD 1,650.9 million on average sufficient to finance 18.6 months of merchandise imports.

As in the past, the pro-cyclicality in growth trend over the medium term, owing to commissioning of hydropower project will continue to put pressure on domestic consumption demand resulting into imports.

Credit to private sector is expected to grow on an average of 11.7 percent and broad money supply at around 13 percent over the medium term. The softening of interest rate and increased focus on promoting access to finance in the priority sector are likely to influence the domestic credit growth. Rising global commodity prices, particularly the fuel prices and inflation developments in India will continue to have a strong pass-through effect on the headline inflation in Bhutan.

To address inherent domestic structural challenges, particularly the challenges associated with the supply side bottleneck, the RMA's monetary policy stance over the medium term will remain supportive to economic growth and employment generation- by channeling credit to productive sectors of the economy, whilst keeping vigil on consumption credit through necessary policy interventions. The RMA will also continue to monitor developments that will influence the movements of domestic inflation. Monetary policy will be formulated and implemented with a view to achieving and maintaining price stability, as stipulated in the RMA Act 2010. In particular, to manage domestic inflation at a desired level, the RMA will be committed to make necessary interventions through the new market-based monetary policy operating framework which will be implemented within the third quarter of 2018.

Keeping with the pace of development of financial technologies and modernization, as in the past, the RMA will continue to make renewed efforts in strengthening the payment and settlement system, promoting financial inclusion and further deepening of the financial sector in the larger national interest.

2. Monetary Policy Implementation Landscape

As stipulated in Chapter II, Section 7 of the RMA Act 2010, the primary mandate of the RMA is to formulate and implement monetary policy with a view to achieving and maintaining price stability. The RMA conducts monetary policy in the context of peg arrangement with Indian Rupee, while keeping close track of macroeconomic developments in India. With over 80 percent of imports sourced from India, price movements in India is an important driver of inflation in Bhutan. About 52 percent in the domestic consumer basket constitutes the imported items from India. The RMA's monetary policy operation is pursued through (i) cash reserve ratio and interest rate policy to influence credit and monetary aggregates (ii) prudent management of international reserves to support the peg. Currently, the RMA maintains one to one peg exchange arrangement with the Indian Rupee. The peg has served as a nominal anchor for achieving and maintaining price stability. The price stability refers to maintaining long term stability in the general prices of goods and services in the economy.

To further strengthen the existing monetary policy operation system, the RMA will be introducing a new market based monetary policy operation framework. The main objectives and expected benefits of the new framework are to (i) facilitate monetary policy signaling (ii) maintain an optimal level of liquidity in the banking system (iii) allow banks to enhance their treasury function, leading to reduced liquidity costs and settlement risks, and (iv) support development of the domestic money market. In addition to the current cash reserve ratio, the new monetary policy framework will allow the RMA to manage overall liquidity conditions in the economy through reliance on broad range of market-based instruments (such as open market operation in the form of collection of fixed-term deposits, issuance of Treasury bills and collateralized loans), as well as standing facilities including both marginal lending and deposit facilities

3. Recent Macroeconomic Developments

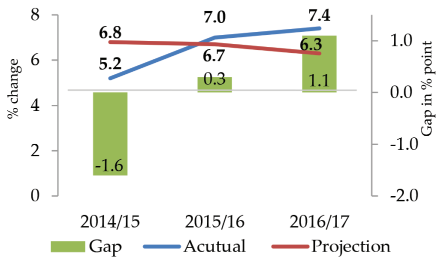
I. Macroeconomic Review[1]

Amidst international financial market volatility and trade protectionism, the global economic growth continued to expand at 3.8 percent in 2017 driven mainly by investment recovery in advanced economies and continued growth in emerging Asia. China and India have recorded a robust growth, supported by growing exports and strong private consumption *(World Economic Outlook, April 2018).*

The Indian economy is estimated to have grown by 6.7 percent during 2017/18, propelled by a revival of investment and manufacturing sectors. The growth momentum is also supported by tailwinds from re-monetization and improvement in implementation of Goods and Services Tax (GST). Driven by revision in house rent allowance for central government employees, combined with rising food prices, consumer price inflation in India peaked to 4.6 percent during the third quarter of 2017/18. Rise in international commodity prices, particularly the oil prices contributed to higher inflation in India. Given the upside risk of inflation, the RBI made an upward revision of policy rate by 25 basis points from 6.0 percent to 6.25 percent in June 2018.

On the domestic front, real GDP growth was estimated at 7.4 percent in FY 2016/17, with 1.1 percentage point higher than projected growth of 6.3 percent. The initial projection assumed a slower growth in the secondary and tertiary sectors. In the revised estimate, the growth in construction sector

Chart 1 : Real GDP Projection Vs Actual



was estimated at 10.6 percent higher than the initial projected figure of 6.0 percent.

In the service sector, the growth in transport and finance was projected at 9.3 percent and 5.7 percent, lower than the revised estimate of 10.2 percent and

[1]Comparisons between initial projections and revised estimates/projections are based on the April 2017 and April 2018 projection results of the MFCC/MFCTC, respectively. The April 2017 projections were featured in the 2017 Monetary Policy Statement of the RMA. All ratios to the GDP use fiscal year GDP, which are derived by averaging two calendar year GDPs. In contrast, other publications of the RMA use calendar year GDP in all ratios; and therefore figures may vary slightly.

8.1 percent, respectively in FY 2016/17. Similarly, in the revised estimate, the agriculture sector grew by 1 percentage point higher than the initial projected figure of 3.2 percent in FY 2016/17.

On the demand side, the investment and consumption combined, grew by 8.2 percent in 2016/17 compared to 4.3 percent as projected earlier. Growth was largely driven by government investment (22.8 %) and consumption (7.3 %). Although the public sector continues to drive the economy, the private consumption also increased by 3.4 percent during the period.

Headline inflation was recorded at 4.9 percent compared to initial forecast of 6.1 percent in FY 2016/17. The lower inflation was mainly attributed by a fall in non-food prices, particularly the fuel prices.

In March 2018, the headline inflation further moderated at 3.2 percent due to continuous fall in the non-food prices.

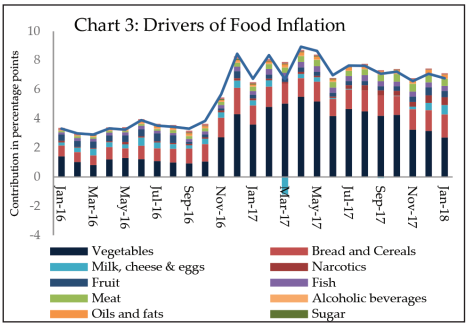


Chart 3: Drivers of Food Inflation

Prices for vegetables and cereals, the principal drivers of food inflation, continued to remain constant. The headline inflation excluding food and fuel prices, fell significantly to 0.6 percent from 3.9 percent as compared to the same period last year.

Domestic inflation, which constitutes 48 percent in the overall CPI basket, slowed down to 3. 1 percent in March 2018, compared to 5.6 percent in the previous year, due to fall in the inflation in transport and education sectors. However, it was observed that the domestic food inflation remained constant during the period.

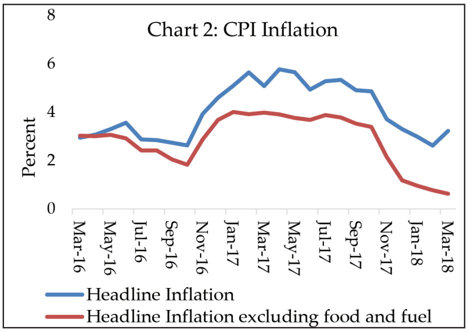


Chart 2: CPI Inflation

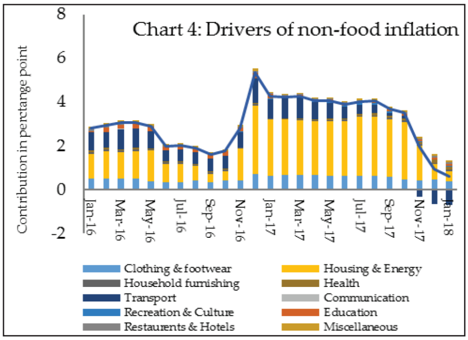
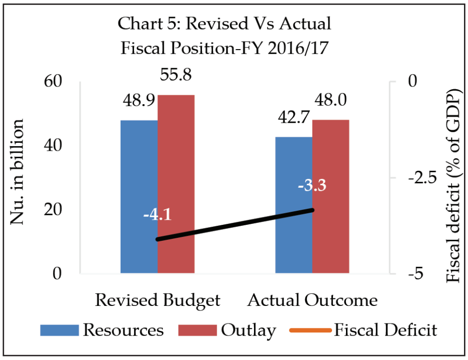


Chart 4: Drivers of non-food inflation

On the other hand, the imported inflation which constitutes 52 percent in the overall CPI basket, declined from 4.5 percent to 3.3 percent in March 2018. Slowdown in the imported inflation was owing to drop in the inflation in the transport sector.

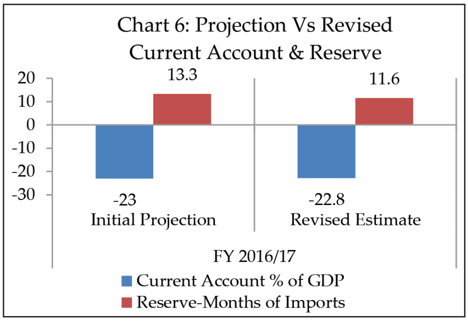
On the fiscal front, the deficit was reduced to 3.3 percent of GDP in FY 2016/17, against the revised target of 4.1 percent of GDP, as a result of higher decrease in the outlay as compared to total resources.

The outlay for FY 2016/17 decreased by 14.0 percent (from Nu. 55,812.1 million) due to fall in capital expenditure by 21 percent and current expenditure by 4 percent. The total resources also decreased by 12.8 percent (from Nu. 48,941.7 million to Nu. 42,673.1 million) mainly due to decline in grant by 33.7 percent as the domestic revenue grew by about 2.0 percent.



Consequently, the actual resources gap for the FY 2016/17 improved at Nu. 4,820.5 million from the revised budget of Nu. 5,648.8 million, which was fully financed through domestic borrowings.

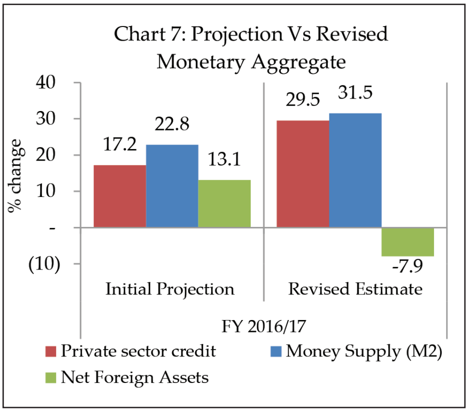
On the external front, the current account deficit continues to remain elevated. However, the current account deficit for FY 2016/17 was slightly lower at 22.8 percent compared to the initial projection of 23.0 percent of GDP. This was mainly due to lower trade deficit driven by higher electricity exports to India and export of mineral and base metals to countries other than India.



Capital and financial account decreased to Nu. 36.6 billion, compared to the initial projection of Nu. 43.5 billion, mainly due to decrease in the Indian Rupee denominated hydropower disbursements. Gross international reserves during the FY 2016/17 decreased slightly to USD 1,106.7 million from USD 1,118.8 million in FY 2015/16. As of March 2018, total international reserves were USD 1,032.5 million, of which USD 823.2 million were convertible currency reserves and remaining ₹ 13.6 billion in Indian Rupees, sufficient to finance 11.5 months of merchandise imports.

On the monetary front, growth in money supply was initially projected at 22.8 percent in FY 2016/17, lower than the actual growth of 31.5 percent. Growth of money supply was higher since the initial projection assumed a moderate growth in domestic credit at 17.2 percent and inflows of net foreign assets at 17.1 percent. However, the actual figure shows that the domestic credit was recorded at 29.6 percent, mainly due to an increase in credit to the government.

As of March 2018, money supply growth slowed down to 24.1 percent, due to fall in the growth of transferrable deposits and lower domestic credit. Net Foreign Assets (NFA) continued to be a major source of liquidity built-up in the banking sector. As in the past, the spillover impact of NFA is transmitted directly in the banking sector's balance sheet.



4. Updates on RMA's Key Policy Interventions

The RMA continues to give high priority to promoting inclusive economic growth through financial inclusion and supporting modern digital financial services. The FY 2017/18 was a new milestone for the RMA in implementing several policy initiatives in the financial sector. The key highlights of the RMA's policy initiatives are summarized below:

1. Gaining momentum of priority sector lending policy: As per the first quarter report 2018, 92 CSI related project proposals were reviewed. Of which, 67 project proposals were approved and 52 proposals were related to agricultural and the remaining 15 were non-agricultural activities. The first PSL loan was sanctioned by the Bhutan National Bank Limited (BNBL) on March 8, 2018 for commercial potato cultivation. A total PSL loan amounting to Nu. 4.9 million has been disbursed during the first quarter and additional Nu.15.3 million was disbursed in April 2018 by the financial institutions.

2. Financial inclusion drive takes to a newer height of development: The National Financial Literacy Strategy (NFLS) 2018-2023 is the first initiative taken by the Authority to enhance RMA's strategic priority in reinforcing stable and economic growth for promoting financial inclusion and literacy. The NFLS, as a subset to National Financial Inclusion Strategy (NFIS) 2018-2023 is aligned to meet the NFIS objective of promoting consumer protection and financial literacy.

The Financial Inclusion and Literacy Division at the RMA shall act as a Financial Inclusion Secretariat (FIS) which is supported by the NFIS steering Committee and multi-sectoral Consumer Empowerment and Financial Literacy (CEFL) Working Group. The FIS will be responsible to implement both the NFIS and NFLS 2018-2023 through multi stakeholder's collaboration.

The NFLS 2018-2023 is targeted to strengthen the financial capability and empower all citizens towards attaining a greater financial inclusion. Educating and promoting entrepreneurship, financial products and services, financial management, responsible finance, leveraging digital technologies and consumer empowerment are the key focus areas of the strategy. It provides a key platform of support for the CEFL Working Group to develop initiatives, targets and interventions, aligning the NFLS Action Plan Framework 2018-2023 under Phase I Implementation Plan. Some of the core activities expected over the medium term are the development of the national school curriculum, stakeholder intermediaries' programs for target groups and impartial tools and resources for the vulnerable segments of the society. The FIS shall also guide in the formulation of relevant financial inclusion policy reforms and in promoting research and development.

The strategy shall be effective from July 2018, with immediate plans of re-structuring FIS and setting up of the NFIS development budget, formation of NFIS Governance Groups, sensitization of strategy to various stakeholders and development of NFLS Action Plan Framework 2018-2023.

3. Promotion of payment system and digitization becomes a vehicle for promoting economic development: Currently, the pace of development of financial technologies and modernization in the financial sector is growing at a remarkable speed, ranging from deployment of ATMs, electronic fund transfers, mobile banking and payments, cashless solutions and national e-payment gateways. To commemorate the 50th anniversary of Indo-Bhutan Friendship in 2018, the RMA will be connecting the Bhutan Financial Switch with the National Financial Switch of India. Interconnection of these two switches would not only enable safe and convenient banking but would also help in cost-effective and cashless transactions, formalizing the flows into mainstream banking system in both countries and further promoting trade and financial flows through a digitally integrated system.

4. Promotion of MFIs and CSI banks marks the new beginning of financial deepening efforts in the country: With the lessons learnt from 2017 BEFIT Summit, the RMA makes a renewed commitment to further deepen the financial sector through promotion of MFIs and CSI banks across the country. The RMA also formulated the CSI Bank Regulation which is at the final stage of implementation. As of March 2018, the RMA has issued registration certificates to three microfinance institutions, focusing on different targeted groups such as RENEW Microfinance, Bhutan Association of Women Entrepreneurs and Rural Enterprise Development Corporation Limited with primary focus on women empowerment and promotion of non-formal rural activities. As of March 2018, MFIs have catered credit to 4,498 clients with the total sanctioned loan amounting to Nu. 362.8 million. To support the MFIs and CSI banks, the RMA developed and provided the Druk MicroFin to the MFIs and the CSI banks. The Druk MicroFin is an integrated core banking solution that enables users to make effective financial service delivery across the country.

5. RemitBhutan continues to promote financial inclusiveness and nurture saving habits among the Non-Resident Bhutanese: As of May 2018, a total of USD 3.5 million was remitted by the Non-Resident Bhutanese through RemitBhutan channel. Of the total remittances, about 43 percent was sourced from Australia followed by Africa at 21 percent and North America by 12 percent. A total of 1,327 numbers of accounts were opened with the banks and 17 new applications are under review. In currency composition, out of the total number of accounts opened, about 71 percent of accounts were in USD, 17 percent in Australian dollar and 12 percent in Euro.

II. Medium-term Outlook[2]

Real GDP growth is projected at 6.7 percent in FY 2017/18, slightly lower than 7.4 percent in 2016/17. Despite the slowdown in the construction sector due to the near completion of ongoing major hydropower projects, the growth in manufacturing sector is expected to stimulate the overall economic growth. Over the medium term, with full commissioning of Mangdechhu Hydropower Project in FY 2018/19, growth is expected to accelerate to an average of 8.2 percent. The sectors including agriculture, manufacturing and services are also expected to grow moderately.

According to the Interim Budget Report for the FY 2018/19, a fiscal deficit of 1.0 percent of GDP is expected in FY 2017/18. For the FY 2018/19, a fiscal surplus of 0.4 percent of GDP is projected. With the completion of tenure of the present government, FY 2018/19 budget has been approved as an interim budget. Capital budget has been only allocated for continuing and completing the spillover activities of the 11th FYP and critical regular activities to ensure public service delivery. However, with implementation of 12th FY plan, the fiscal deficit is expected to revert at 4.3 percent of GDP in FY 2019/20 and during the entire plan period the fiscal deficit is projected to be 2.1 percent of GDP.

On the external front, export is projected to grow by 4.2 percent in 2017/18, while the current account deficit is anticipated to improve at 21.8 percent of GDP from 22.8 percent in 2016/17. With full commissioning of Mangdechhu Hydropower Project in 2018/19, the export is projected to increase by 29.6 percent and subsequent fall in the hydro related imports.

As a result, the trade deficit is expected to improve at 7.9 percent of GDP, leading to softening of current account deficit from 21.8 percent in FY 2017/18 to 14.3 percent in FY 2018/19. On an average, the current account deficit is projected to remain around 12.4 percent of GDP over the medium-term. Official inflows in the form of capital transfers and external loans of the Government are expected to continue to finance the current account deficit. However, the net surplus in the capital and financial account are anticipated to be slightly larger than the current account deficit, resulting in a gradual built up of reserves over the medium-term.

[2] *Medium-term outlook has been revised, based on the outturn of the FY 2016/17 and new developments. Medium term refers to FY 2018/19 to FY 2019/20.*

On the monetary sector, broad money supply is projected at 14.2 percent in FY 2017/18. The broad money supply growth will be largely influenced by the domestic credit. Softening of interest rates combined with increasing dependency on bank financing for meeting fiscal deficit is likely to impact the domestic credit growth.

Although, there is ongoing efforts to promote access to finance in priority sectors, the credit to private sector is expected to remain at a moderate level, averaging about 44 percent of GDP over the medium term.

Particulars	2016/17	2017/18	2018/19	2019/20
	Actual	Projections		
Output and Prices				
Nominal GDP at market prices (mn. of Nu, fiscal year)	159,742.6	183,502.3	211,857.2	238,972.8
Real GDP (annual % change)	7.4	6.7	8.6	7.8
Agriculture & Allied	4.0	4.5	3.7	2.8
Industry	6.1	7.4	12.6	8.8
Manufacturing	6.4	10.3	10.3	10.3
Electricity & water	0.9	11.1	28.2	16.3
Construction	10.6	1.1	-3.5	-4.5
Services	9.1	9.0	9.0	8.8
Balance of Payments and Reserves (mn. of Nu)				
Current account balance	(36,341.5)	(40,093.6)	(30,226.8)	(23,026.7)
(in % of FY GDP)	-22.8	-21.8	-14.3	-9.6
Merchandise exports	36,872.0	38,406.7	49,783.4	58,149.5
(growth in %)	12.5	4.2	29.6	16.8
Merchandise imports (c.i.f.)	68,008.4	69,263.3	66,442.0	69,383.6
(growth in %)	-3.2	1.8	-4.1	4.4
Trade balance (% of FY GDP)	-19.5	-16.8	-7.9	-4.7
Current and capital grants	18,807.4	3,990.8	11,247.2	21,755.9
of which, Budgetary Grants	9,948.2	16,778.3	4,161.2	15,500.0
Financial account balance	(24,236.8)	(19,705.8)	(34,639.0)	(28,777.2)
Overall balance (mn. of Nu)	(1,565.3)	1,925.2	15,243.3	25,956.4
International Reserves (mn. of USD)	1,106.7	1,243.0	1,461.1	1,840.6
(months of essential imports)	22.4	20.6	22.0	25.2
(months of merchandise imports)	12.5	13.6	16.8	20.4

Particulars	2016/17	2017/18	2018/19	2019/20
	Actual	Projections		
National Budget (mn. of Nu)				
Total Resources	42,673.1	54,666.4	40,743.1	59,104.0
(in % of FY GDP)	26.7	29.8	19.2	24.7
Domestic revenue	29,713.6	36,178.4	35,855.0	44,424.9
(in % of FY GDP)	18.6	19.7	16.9	18.6
Grants	12,986.8	17,433.1	4,610.3	14,401.6
Total expenditure	49,966.6	58,607.3	39,847.5	69,058.0
Current	24,129.6	28,616.6	29,075.2	39,802.0
Capital	25,837.0	29,990.6	10,772.3	29,255.0
Fiscal balance	(5,344.9)	(1,847.1)	895.6	(9,957.0)
(in % of FY GDP)	-3.3	-1.0	0.4	-4.3
Money and Credit (mn. of Nu)				
Money Supply (M2)	104,113.6	118,866.2	136,173.1	152,631.1
(annual % change)	31.5	14.2	14.6	12.1
(in % of FY GDP)	65.2	64.8	64.3	63.9
(Income velocity)	1.5	1.5	1.6	1.6
Credit to private sector	72,552.6	87,695.9	101,048.2	109,222.8
(in % of FY GDP)	45.4	47.8	47.7	45.5

Data as of the FY ending June, including GDP which is also on FY basis. Source: MFCTC, Ministry of Finance (projections as of April 2017) and IMF. 1) Fiscal projection source: Ministry of Finance. 2) BOP data source: RMA. 3) GDP data source: National Statistics Bureau. 4) Calendar year essential imports have been projected using an inflation of 6% (upper band of India's inflation target).

6. Risk and Challenges

1. Despite positive growth prospects, the current account deficit continues to pose challenges for the economy over the medium term. Given the domestic supply constraints and import dependency, the rising per-capita income and consumption demand is likely to deteriorate trade imbalances, exerting pressure on international reserves and exchange rate arrangement in the long run.

2. Pass-through impact on domestic inflation arising from global commodity prices uncertainty, especially in sectors such as the transport, construction and trade and commerce are anticipated-since these sectors are highly exposed to external price shocks. Monetary policy combined with the fiscal policy becomes critically important for mitigating the impact. Particularly, managing the demand side factors through use of monetary policy and prudential tool becomes critical as large portion of credit translate directly into imports. Thus, re-directing domestic credit for investment in productive sectors has become a priority and challenging task for the RMA.

3. Lower rigidities in the wages and subsequent hike in the recurrent expenditure of the Government is likely to further put upward inflationary pressure. In absence of matching resource mobilization effort with expenditure control measures, maintaining a desired level of fiscal deficit will be a challenging task over the medium term. Prudent fiscal management through tax reforms such as broadening of tax base, implementation of GST and calibrating an appropriate current and capital expenditures with the matching resources would be critical in order to keep pace with the GDP growth trend.

4. Given the current structural challenges faced by the economy, addressing the supply side constraints continues to remain at the top agenda of the government. Success of addressing these challenges depends on the degree of cross sectoral interventions and concerted efforts made by the key sectors of the economy. The small market size, low economies of scale, technological constraints and relatively lower productivity of factors of production are some of the challenges that requires close attention. Harnessing the potential comparative advantage of domestic niche market and natural endowment with the focus on the CSI sector remains as an

alternative choice for promoting development of the real economy. In this context, the focus towards economic diversification will pave a way forward in addressing the major structural challenges faced by the economy.

5. From a market infrastructure point of view, developing a well-functioning collateral market to support the RMA's monetary policy interventions becomes critical in the context of the RMA's new market-based monetary policy operating framework. It will demand well-coordinated and balancing efforts from both the government and the private sector.

7. Monetary Policy Stance for FY 2018/19

Based on the economic outlook, the monetary policy stance for the FY 2018/19 remains supportive of the RMA's legal mandate to achieve and maintain price stability, while also supportive of economic growth and employment generation. Persistent credit growth in consumption sector continues to pose challenges in the financial sector. The RMA will be vigilant and monitor credit growth and make necessary interventions to mitigate potential risks through targeted monetary policy and macro-prudential measures.

To manage domestic inflation at a desired level, the RMA will be committed to make necessary interventions, in particular through the new market based monetary policy operating framework which will be implemented within the third quarter of 2018. At the same time, to safeguard the peg exchange arrangement, the RMA will continue to maintain adequate level of international reserves to meet import needs. The RMA will continue to keep track of price and exchange rate developments in India.

With the implementation of new monetary policy operation framework, the RMA will be committed to influence the domestic market in ways better aligned with best practices, by facilitating policy signaling, supporting domestic money market, and also allowing banks to enhance their treasury function, leading to reduced liquidity costs. The new monetary policy framework is expected to guide the market and facilitate RMA management of short term liquidity more effectively.

It is also imperative that the RMA and the Government make joint efforts to consistently promote the capital market, including the primary as well as secondary markets for Government securities. It is also necessary to further strengthen the monetary and fiscal policy coordination to bring greater synergy and dynamism in the financial sector.

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