

RBI's Prudent Management of its Balance Sheet

12th June, 2023

Highlights:

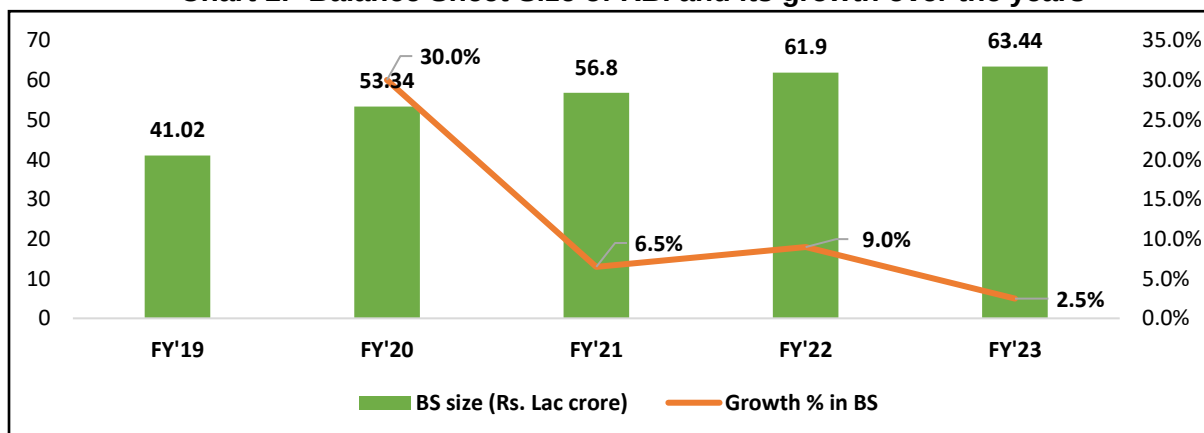
- ☞ Size of the Reserve Bank's balance sheet increased by 2.5% for FY 2022-23.
- ☞ Central Bank's balance sheet is not merely a statement of accounts, it is central to the money supply process.
- ☞ The steepest rise in balance sheet is seen in USA and Euro area that led to excess money supply in the economies and thus decadal levels of inflation in these countries.
- ☞ Since, RBI expanded its balance sheet prudently, the inflation levels in India remained manageable.

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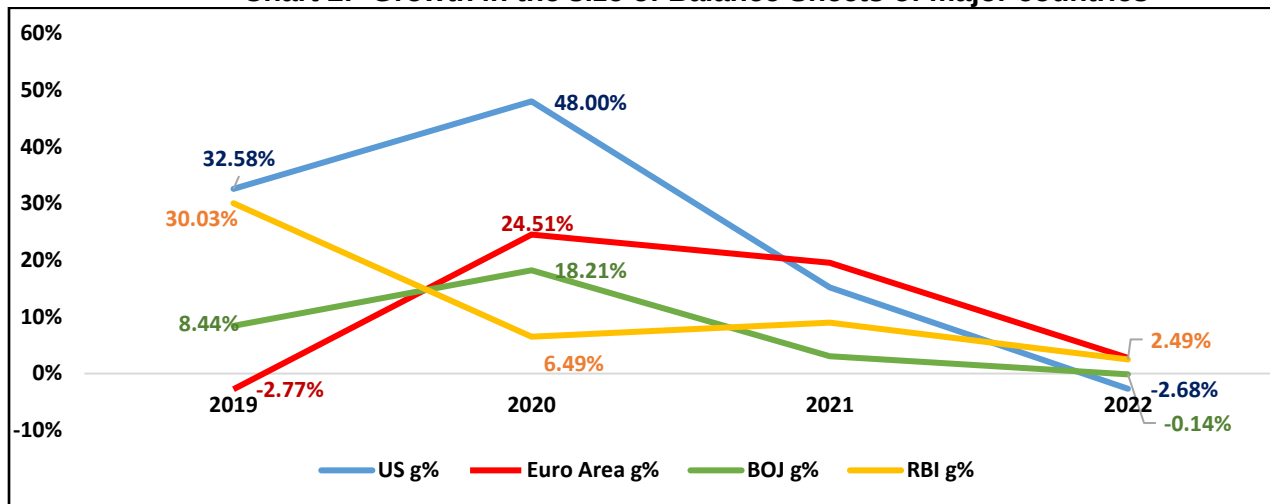
- The size of the Reserve Bank's balance sheet increased by 2.5% for FY 2022-23 to about ₹63.45 lakh crore on higher income.
- The balance sheet of the RBI plays a critical role in the functioning of the country's economy, largely reflecting the activities carried out in pursuance of its currency issue function as well as monetary policy and reserve management objectives.
- The increase on the asset side was due to rise in foreign investments, gold, and loans and advances by 2.31%, 15.30% and 38.33%, respectively
- On the liability side, the expansion was due to increase in notes issued, revaluation accounts and other liabilities by 7.81%, 20.50% and 79.07%, respectively.
- A central bank's balance sheet is not merely a statement of accounts, it is central to the money supply process.

Chart 1:- Balance Sheet Size of RBI and its growth over the years



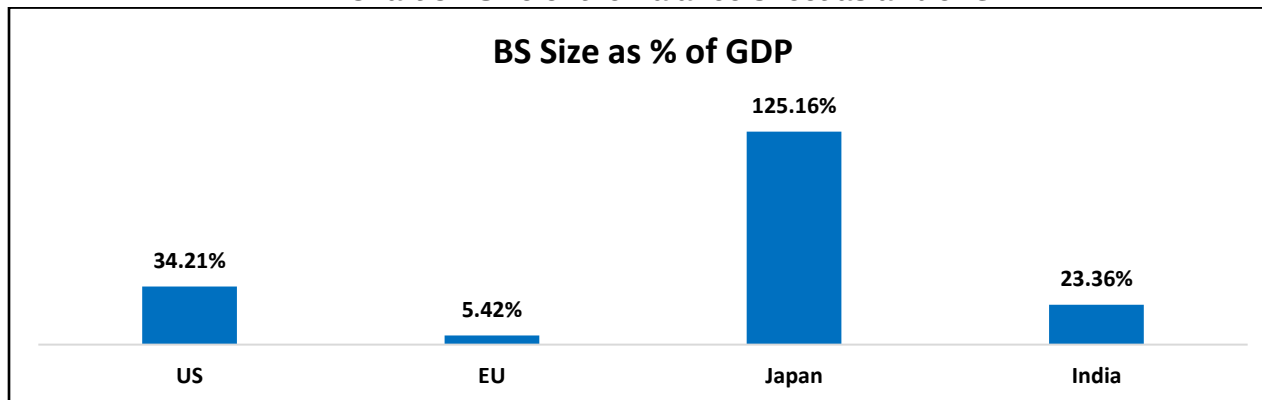
- RBI's Balance sheet grew the most in FY'20 at the rate of 30%. This increase can be attributed to the pandemic. RBI provided surplus liquidity in the system to support the economy and thus its balance sheet expanded.
- As the economy has normalized, the RBI has expanded its balance sheet marginally. In FY'23 balance sheet expanded by 2.5%.

Chart 2:- Growth in the size of Balance Sheets of major countries



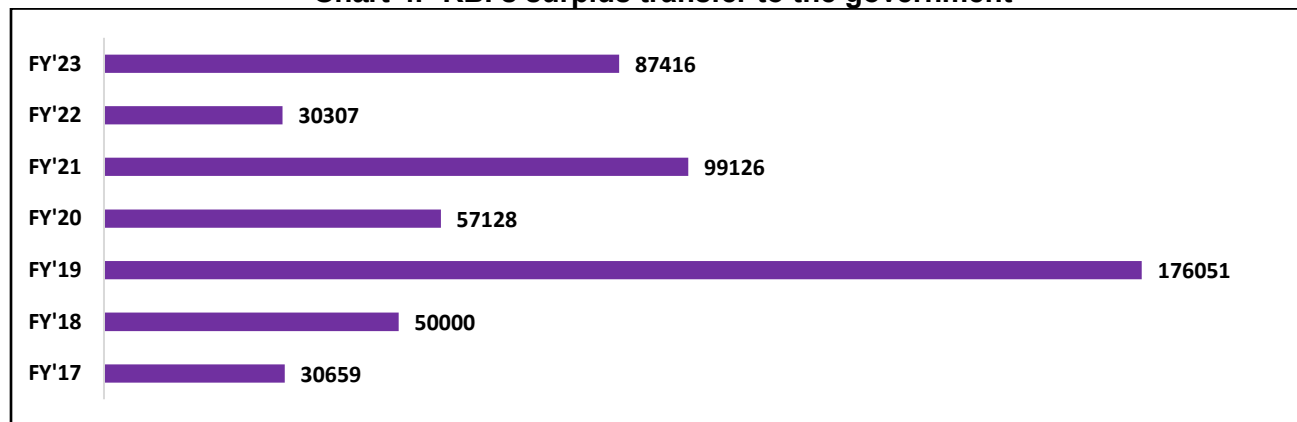
- As can be seen from the above graph, all the major economies i.e. USA, Europe, Japan and India expanded their balance sheets in response to the pandemic, as central banks tried to avert an economic meltdown by pumping money into the system by buying bonds and supplying out money.
- The steepest rise is seen in USA and Euro Area.
- This expansion in balance sheet led to expansion in the money supply in the economy and in turn led to rising inflation scenario. Thus, we have witnessed record level inflation in US and Euro Area in 2022.
- Financial crises are more likely to occur after periods when the balance sheets of central banks have massively expanded. This is evident in the recessionary fears that are looming in US and Euro Area.
- In response to high inflationary pressures, the economies are now shrinking their balance sheets by tightening the money supply.
- Economies have now reduced the pace of buying the bonds, thereby reducing the pace of expansion of the balance sheet, a process known as tapering, a gradual reduction such that it does not shock the recovery process.
- RBI's expansion in the balance sheet has remained flat since 2020. RBI remained vigilant and provided the monetary policy support adequately.
- Therefore, while the major economies in the globe are battling with high inflation levels, inflation in India was at comfortable levels.

Chart 3:- Size of the Balance sheet as a % of GDP



- RBI's balance sheet is 23.4% of its GDP.
- The assets of central banks in America, Britain, the Euro area and Japan rose during the pandemic by more than \$10trn.
- Japan's Central Bank Balance sheet size is 125% of its GDP. Japan has relied heavily on its monetary policy to boost the economy.
- Central banks with weak balance sheets are less credible bastions of a fiat currency.

Chart 4:- RBI's surplus transfer to the government



- The latest surplus transfer of Rs.87,416 crore from RBI to government is higher than the Rs.48,000 crore that the government had budgeted as dividend income from the RBI and public sector banks.
- From a fiscal perspective the dividend represents additional revenue of 0.2% of Gross Domestic Product.
- This will aid government spending on rural and other schemes while maintaining capex spending without pressuring the fiscal deficit.

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