"RBI Post Policy Conference Call"

May 3, 2011

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Question and Answer Session:

Alpana Killawala: Governor will make a short statement and then we will open up for questions and answers.

Dr. D. Subbarao Thank you very much. I want to welcome all of you to this post policy Press Conference. All of you know that we changed the format in the processes surrounding the monetary policy review. Our people thought that (it) was a comfortable arrangement. So they thought that they'll push me out of the comfort zone. I read out a formal long statement in the morning so I do not intend to read out another statement but I just thought that I will make a few comments just to set the context for this conference.

As you all know by now, we have raised the repo rate by 50 basis points and that it stands at 7.25 %. We've changed the operating procedure for monetary policy. Consequently the reverse repo rate is no longer an independent variable. It stands adjusted 100 basis points below the repo rate and stands adjusted to 6.25%. We have introduced the MSF and that is calibrated 100 basis points above the repo rate so that rate gets adjusted to 8.25%. Our growth estimates for policy purposes for 2011-12, the current fiscal year, is 8% and WPI Inflation projection (end-March 2012, YOY) is 6% with an upward bias.

We have also said very clearly in our policy that the conditions surrounding this annual policy review are substantially different from what they were last year. The growth-inflation dynamics has significantly changed. Last year, if we go back to April 2010, domestic recovery was yet to get a foothold and there were lot of uncertainties on global recovery. Global recovery was still fragile and we were still talking about a double dip recession. And drivers of inflation last year around this time were largely food. So inflation was supply side driven. This year, 2011-12, recovery is on track, output gap is closed and our economy is operating at near full capacity. Importantly, drivers of inflation have changed from food to non-food and fuel items. Demand pressures have gotten progressively stronger as producers were able to pass on higher input prices to higher output prices and I believe there were also demand pressures coming from rising incomes in rural areas. On the global front this time round some short-term risks have abated but some new short-term and new medium -term risks have arisen. In short, the difference between last April and now is that the use of the phrase that is not quite common - the known-unknowns have increased, while the food prices…for example, there is lot of uncertainty about how the prices might behave over the course of this year, fuel prices too, both domestic and international. So all the risks to inflation are on the upside.

Last year in April 2010 our monetary policy strategy was aimed at supporting recovery while anchoring inflation expectations. You must remember that during the crisis the policy rates went historically low. So raising them necessarily had to take some time. The baby steps approach that is now popularly talked about was in fact necessary at that time. We needed to tighten only gradually. I also want to recall for you that we started tightening or talking about tightening when inflation was actually in the negative territory. The aim of our strategy this year, now, in April 2011, is to check inflation by restraining demand, navigate a soft landing and foster conditions for sustained growth in an environment of price stability. One comment about the growth-inflation tradeoff. I am sure that that there will be questions on this. I do not want to preempt any questions but I want to reiterate what we said in the statement which is that in the long-term, Inflation is inimical to growth. But even in the short-term, I don't want to go into an academic debate about the Philips curve and all that, but in our present circumstances given a high level of inflation, there is no trade off between growth and inflation. We need to bring inflation down in order to sustain medium-term growth even if that means sacrificing some growth in the short-term. So our strategy is to keep output at potential in the short-term and expand potential output in the medium-term.

One final comment that I want to make about guidance which we have said at two places in the statement - one under the guidance section and under the inflation section about the trajectory of inflation for the rest of this year- our baseline inflation projections, as per them, inflation rate will remain elevated in the first six months at roughly March 2011 levels. There are some forecasts, some projections about April 2011 inflation numbers, (I just saw Chief Economic Adviser say something on the TV). Regardless of short-term fluctuations, the trend will be to remain at the current levels for the next six months before coming down in the second half of this year. We have factored in this trajectory in our policy calculations and finally RBI will have to persevere with its anti-inflationary stance as we go forward. Thank you very much.

Ritesh (Zee Business) Governor**,** this is Ritesh from Zee Business. Sir, I want to know two things: Firstly, the rationale behind the increase in provisioning in respect of banks and the introduction of the MSF window provided to the banking system. Secondly, the kind of interest rate scenario that is prevailing makes it very evident that going forward, interest rates are going to increase. In such a scenario how challenging will it be to achieve the credit growth and deposit growth that RBI assumes at 19 and 17% respectively?

Dr. D. Subbarao The revised operating procedure which has been introduced has changed the LAF corridor and we have introduced the exceptional financing facility MSF. The purpose is twofold. One is to contain volatility in the liquidity system and second to improve monetary transmission. The rate is sufficiently high at 8.25%. We expect that banks will access the facility, only after they have played out in the market repo and the CBLO markets. So, the expectation is that this will remain an exceptional facility which banks could access only in exceptional circumstances.

Ritesh The other question is that on NPAs and credit business. In the high inflation and high interest rates scenario do you think the credit growth and deposit growth expectations of RBI at 19% and 17% respectively will be challenging for the banking system to achieve?

Dr. D. Subbarao We have taken that in to account, you would note that both the credit growth, deposit growth this year are one percentage point below last year's numbers and they correlate with our growth and inflation projections of 8% and 6%. We believe that these are realistic numbers at this point of time, but we will have to see as we go forward.

Lata Venkateash May I refer to your guidance referred to in paragraph 68 of the Monetary Policy Statement saying that the Bank's baseline data projection as indicated in chart 2 will remain close to the March 2011 level. These projections factored in the upward revision of petrol and diesel prices but the crucial part is the next question. While the persistence of inflation over the next two months has been incorporated in this policy, the Reserve Bank would continue to persevere with anti-inflationary targets. How should we understand this that you have factored in price rise and therefore for now you do not have to hike rates or do you think you are sending another message. How should we understand it? Your work on anti-inflation or inflation attack is not over?

Dr. D. Subbarao I would prefer not to interpret that any further. There is a lot of thought behind that and I would leave it to you people to analyze that. But we have factored in the inflation trajectory over the course of the year and I want to say that we will not be surprised if inflation trajectory is as we had projected.

Ira from NDTV Sir the other side of this growth dynamics now. What is the reaction in the markets today. I know it is impossible to please the market but they are worried that cumulative risk factor of policy actions taken so far plus 50 basis points hike, plus coming at a time the oil prices could have their own impact on growth could actually mean that this softlanding may not end up being that soft and the hit to growth could be a lot larger than the 8% which the RBI is forecasting. What is the risk, the probability that you could see a relatively more significant hit to growth, keeping in mind oil prices and of course the large impact of monetary action?

Dr. D. Subbarao Okay, I will answer that question and request Subir to jump in. We have thought out the growth number and given around 8%, which means that it could be below or above and a number of risk factors are still there. On agriculture last year we had a rebound from a bad agriculture season and this time round, agriculture will revert to its trend growth rate. Industrial growth will take a hit because of monetary tightening as also because of higher input prices. From the expenditure side private consumption will hold out but investment will probably be slow. Government consumption will slow if fiscal deficit is contained. On the net exports, there is uncertainty, exports is more or less has registered a 36.7% increase over the last year. Because of global uncertainty it is not clear that we can maintain that pace of the export growth. I have explained all these just to let you know what went into our calculations. There are, of course, downside risks to growth in terms of oil prices, in terms of the monsoon situation, in terms of other commodity prices, in terms of international food prices and we have taken our best estimates of those risk factors at this time.

Subir Gokarn In our outlook for growth we have given this probability range distribution at 90% confidence interval downside of the floor is 7.4%. Now that is an outer limit in a sense and that will only materialize as far as calculation is all of the risk the downside risk s will come together. Now, I mean what is the reference point for that, keep in mind that in the year 2008-2009, when we had a situation that was not anticipated both domestic and global combine and we went to about 6 to 6.7. So, in a sense just from a comparison basis provides us some sense of what the floor might be in the worst of all possible circumstances. We may not have stated that. So, in that sense we felt that although there was a growth risk including the factor that we mentioned, it is not a risk. It is a reality. That is one reason why we have moderated our growth forecast and also are looking at inflation coming down over the second half which is the cumulative impact of past IP. But having factored that in, the risks of inflation rising in an unbound fashion is really materializing here and that is what has sort of prompted our calculation the comparison between inflation risk and growth risk.

Participant When we talk about trend output levels, what is the levels that the Reserve Bank would be comfortable with before you start providing, once you get those, so 7.4 is the down sort of the lower limit on the probability distribution that you gave, this should be understand even 7.5% kind of growth the RBI is comfortable with and an inflation at current levels remain a priority in that sense, unless it goes below that level. How do we sort of look at the trend level that RBI is comfortable with?

Subir Gokarn Well, I think the baseline is really the reference point. We said 8 because not all these risks are likely to materialized and not all of them together. So given that, what is more likely than not is the fact that cumulative actions will start to moderate growth. That is given, that is not the risk. The risk that come in are, as Governor mentioned the monsoon. We do not know that what is happening on the global front, both in terms of overall demand which will in fact export either positively or negatively and in terms of oil or commodity prices, which again if they harden, there will be an impact both on growth and inflation and domestically it is essentially how to pursue situation. So, these are the known unknowns that we try to take a view on in arriving at our base line.

Ragini This is Ragini from Bloomberg UTV. Sir over the past year we have been seeing revised inflation projections three times, not only it has missed that it has also lost out on creditability in that sense, anyone you talk to range it from fund manager to the common man everybody is beginning to doubt Central Bank ability to bring inflation to comfortable levels. In this document also you do accept that you under predicted inflation and also going forward at least for six months period it will be above comfort level. So my question is how sure is the RBI of controlling inflation in bringing it to a comfort level effectively and are you sure of your inflation numbers?

Dr. D. Subbarao Since you have raised this issue, let me first of all talk about our inflation forecast last year and why we have consistently under predicted inflation. Last year story of inflation was a series of supply shocks on escalating demand pressures and that happened for a number of reasons. Actually the divergence between our forecast and the actual outcomes started in December 2010 if you look at the charts that are there in the document. First as we just said the known and unknown had increased the prices of crude and the minerals, metals and domestically cotton, coal. Producers were able to pass on these prices to consumers because there was lot of demand pressures. I understand what my people tell me is that the numbers for December 2010 to February 2011 had not completely projected the underlying demand pressures, therefore in projecting the March numbers we had gone off track. Then you must also realize that there was totally unanticipated hike to inflation because of vegetable prices, which nobody could anticipate. The upward adjustment in coal prices and also I do not know how much of an impact it has had, but I understand that some of the upward adjustment in non-food, non-metal manufacturing that normally occurs in April this time got advanced to March 2011. So, for number of reasons, number of variables got us off track on inflation projection. You are quite right to say that there is therefore some question about the reliability of our projection and the ability of RBI to control inflation to bring it down to that level. The second question first, we certainly will try. RBI's current priority is inflation as we have said and over the year we expect the to be preoccupied with inflation concerns and that we will try to ensure that the inflation comes down to that level and in the process regain our credibility.

Participant Do you admit that RBI was behind the curve in checking inflation at least at this year of course?

Dr. D. Subbarao I do not think that would be the correct inference. As I explained in my opening remarks, the approach last year was good for last year's growth-inflation dynamics and now the growth-inflation dynamics have changed and we hiked more than we had done so far.

Pradeep Sir, this is Pradeep from CNBC Awaaz. So, this time the upgradation you have done have you changed anything in your model and the range which you are predict 3.5 to 9.5 so is there any variation in that because of that you think that such big variation could be there in the final figure for March which you will have and what assumption is there in your base line?

Subir Gokarn Well the range is quite wide as you pointed out from the fan chart in the document. The concentration of probability if you look at the color is 6 to 6.5 so while for the growth projection the risks are somewhat symmetric, up and down between 8% being a sort of a mid point, for inflation the risks are concentrated on the upside which is why we have indicated that our base line forecast projection is 6% with an upside bias. Now, this is what is going to shape our policy making. The base line scenario is what we use as we think about the steps that we have to take, which is why we pointed out that we expect the number to remain fairly stable at current level till about the middle of the year, after which a number of things will happen particularly the cumulative impact of fast action that will take it down, so that is our projection. If things change if commodity prices are to move in a very different trajectory, if the food prices are to respond to a weak monsoon, all of these unknowns now will become evident as we go along and that will of course have an impact on both our outlook and our action.

Pradeep Okay, so in your best case what assumption are there, how much will the petrol prices go down or have you done any assumption regarding the monsoon?

Subir Gokarn The best case for monsoon is always based on the advance forecast which this year has been in the past with a normal forecast so that will then give us an input into what are agricultural growth and food inflation will be. Keep in mind that over the last year food inflation has not been entirely conditioned or sensitive to the monsoon. A number of products, number of items were prices not only remain firm but continue to increase milk, for example, even though the monsoons were good, so we have taken that factor into consideration but there are now important food items, whose prices are not going to be driven down even by a good monsoon. And we have assumed some pass through of higher oil prices, our crude oil estimate is 110 average which is what the IMF has assumed for its global growth forecast and we have assumed some pass through into petrol and diesel in the first half of that period that is first half of the current year. So those are the assumptions broadly we have made.

Anirudh This is Anirudh here from ET Now. You have mentioned about global commodity prices in the policy statement and you said that they would at best remain firm if not go up further, but there is a lot of indications in the West that QE-2 could be winding down soon and that might have its impact on commodity prices as well, how long do you expect global commodity prices to remain at elevated levels and how long do you expect international commodity prices to really have a significant impact on Indian inflation?

Dr. D. Subbarao Commodity prices are a function of a number of variables. By definition they are variables and therefore we have no firm fix on them. First as you mentioned the liquidity in the global system there is conflicting evidence about what impact that has but some studies we have looked at say that the excessive global liquidity is having an impact on driving up oil prices. Then there is the question of how fast advanced economies recover, what demand they will put on oil, they will move in opposite directions obviously. There is also the question of China, what China's growth performance is and impact it might have on demand for commodities, then there is the uncertainty about substitution for nuclear energy in Japan and probably I would say so in the short term at least if there is a shortage of nuclear energy in Japan there might be higher demand of oil and there is the possible supply shocks from MENA (Middle East and North Africa). So, there are so many variables that will influence oil prices and many of these variables will also influence other commodity prices. As, Subir just said there is a lot of uncertainty about risks we have taken for our purposes, crude price of $110 per barrel. I hope it will be lower but that is the price we have taken.

Shobhana Sir, how much you of transmission are you expecting after this hike and how much you banks to raise loan risk, how soon are we expecting this and will it be more at the shorter or long term, how much of an effective hike in loan growth are you expecting?

Dr. D. Subbarao Okay so this policy has the hike in the repo rate of 50 basis points. There is also tightening of some provisioning norms and there is also 0.5% increase in the interest rate on saving deposits. We have some internal calculations about what this could be and you had just interviewed all the banks and they have told you about this and when we had a meeting with banks this morning our numbers roughly tallied I do not have the exact numbers now but the numbers tallied about what cost it might impose. I believe the savings bank the estimate was that the tightening could be in the range of about 12 to 13 points. How soon this will impact I really cannot say but it depends on what banks do. We hope that it will be soon enough. I just want to say that the monetary transmission has been improving and there has been quite a bit of transmission for cumulative policy action so far all that has still not played out completely. I am sorry, I cannot be more specific on this because I cannot really say which bank will raise when.

Kavita Sir, Kavita from CNBC Awaaz. Sir, savings rate you have increased and already on deregulation of saving rate you have published a discussion paper. So basically what is your thought process. Did you want to put pressure on banks and there were news that many banks were against the deregulation of savings rate. So, was this some of kind of moral suation?

Dr. Subbarao No, it is nothing like that. We have put all the discussion paper, we have been talking to not just banks even to analysts, even to economists about this. We have been talking over the last few many months. You can see that 8-9 months ago there some editorials were coming. Again two weeks before when we had a meeting with economists then we had discuss this issue and this is not to pressurize bank, this is just to understand the dynamics of what might happen because this is uncertain but what the implications could be both in the short term and the long term. We do not want to destabilize the market. On the other hand we want to be sure that it contributes to financial inclusion. So, that it does not militate against financial inclusion. So, the thing is that today we had taken a decision to raise it by half a percentage point but this is no indication, please do not read into this any indication of a final decision and I would urge all of you to please candidate some debate on that so that all of us collectively have a better understanding of this. One minute, I just need to read what this is.

Subir Gokarn Also keep in mind that this rate has been at 3.5% since 2003 all other rates have been deregulated, rates have moved up and down for the course of the last 8 years but this one has not and so as part of the overall adjustment, deregulation is still a debated proposition whether we should let it go or not. But given the differential that had emerged between this rate and all of the other rates particularly in this upward cycle, we thought that an adjustment was necessary. So this is not a signal about deregulation because that is not an issue that has been decided upon, the debate has started hopefully by the discussion paper.

Joel from Mint So, it is linked to the savings rate. I just want to understand why this increase now and what is the timing about. Is it an understanding that inflation is here to stay and probably food price inflation in a way it is not going away too quickly so you know this in ....?

Dr. D. Subbarao I believe not, I do not think that would be a correct inference.

Participant Why not, I mean what is the question – take into decision upward?

Dr. D. Subbarao Well that if you look at that in isolation you cannot ask that question why now, but you please understand that we have been trying to generate a debate about this for the last several months. Okay, even in the last conference I believe we talked about this. So, I do not want you to get an impression that we suddenly sprung this on the world and that is for some link with our anti-inflationary stance or poor inflationary stance or whatever, it is nothing like that. Incidentally, it might have a monetary impact but that is entirely incidental. As Subir just said all the other interest rates have gone up and this has remained frozen since April 2003. And in favor of deregulation, just the one thing that has not come out very well in the discussion paper but I want to say which is that we moved away from regulation. Almost all interest rates except the one on savings bank rate and NRI interest rates, those are the only ones which are administered as of now. So, we believe that that is the way to move forward but again I want to say that we are open-minded and we would certainly respect and are being open to all the feedback that we get, OK. thank you.

Parinika Hi sir this is Parinika from Business Standard. Sir, my question is that the working group on the monetary policy, operating procedure of the monetary policy, it has also recommended the revival of Ban k Rate. So, any specific reason for why the bank rate has been left as irrelevant as it is?

Dr. D. Subbarao Yes, see the bank rate linking up to the interest rates on MSF we had some legal and operational problems, okay and we had to sort them out. See, some of the other interest rates in the economy are actually linked to the bank rate, they have nothing to do with the bank rate as such but that is the index, so we have to take a stock of all that and see what implications it might have and there are also some legal issues that is why we had to. One option for us was to wait and resolve all the issues before we took a decision on the revised operating procedure but we thought that this is something to be done right away, so we delinked the bank rate from the revised procedure.

Nupur from Dow Jones Does that implies sir that going forward you would no longer have the bank rate and second related question of MSF just want to clarify, the MSF facility is without the collateral?

Dr. D. Subbarao The bank rate will be there, it is there for now and will be there until we announce or we link it to something else. And the MSF will be with collateral.

Anoop Anoop from Bloomberg. What is the impact do you think of the rate increases and subsequent increase in lending rates to the bank, sensitive sectors like real estate which is already going under downturn and the power sector which is facing some sort of funding issues. I mean is there not a risk default coming up in either specially the real estate sector?

Dr. D. Subbarao I thought you were asking the omnibus question about monetary transmission? Is that so? Those details are in the document about how much banks have raised their lending and deposit rates at aggregate level. At the sub-sector level, real estate and power sector, in the all infrastructure sectors we had asked banks and that they have said that in certain cities adjustments have taken place in real estate and in certain cities adjustment is yet to take place. And that also the demand for real estate credit has flattened that is what the banks have told us. So, there is some connection that has taken is place and we are monitoring it.

Anand Sinha No, I do not have the data right now on that specific sector, but NPAs levels are there in more or less stable in percentage terms, stocks of course has been growing up.

Participant Sir, just related to that provisioning has been increased on the NPAs as well as the restructure account, so what sort of concerns the RBI is foreseeing that they have made these norms more prudent.

Anand Sinha The interest rates have gone up in the last year and then today we had 50 basis point increase. So in the current scenario, it is possible that in all probability may increase and therefore we wanted banks to have more provision to put more ammunition in their hands to deal with the situation in case that happens. As far as restructured accounts are concerned, from what we have understand by talking to bankers and otherwise that the default probability in restructured accounts particularly those which were done during that period is a multiple of normal slippage for bankers and that is why we upped provision requirements by four or five multiples.

Participant Can I just continue the question to that when the RBI prescribes provisioning norms of 70%, the provision coverage ratio of 70% for loans up to September last year, the most of this is little unscientific and ad hoc. Now you have come up with this change in the provisioning, it looks more logical. Does it mean that there will be more changes in provisioning coming forward because there was a committee which was working on? So are there more changes expected in terms of provisioning and for that some???

Anand Sinha When the 70% was instituted, it was logical. When it was PCR it was logical and what we have done now is also logical**.** I will explain to you why. In the immediate aftermath of the crisis, we did not know how the situation will pan out, therefore we did something as an intermediate step that was that 70% PCR and that was to be achieved by 30th September, 2010. That is countercyclical. If you see our circular carefully, it was a countercyclical provisioning requirement which is basically a stock to build up and you use them when there is a downturn. So we did that. We had the other alternative available at that stage of increasing specific provision but we went that way. Now the expectation was that that will be replaced by some methodology on which Basel Committee is working. Unfortunately, it has not yet fructified. Then we started working on our own methodology which has not yet come into a shape. Now in a normal countercyclical provisioning policy which operates in certain countries, that dynamic provisioning you must have heard of, there the stock of countercyclical capital automatically gets transformed into specific provision and too unforced because it is a calibration. Now if you have that calibration, you cannot allow the use of countercyclical category in a very free manner because that amounts to smoothing of profits which is not what would be accepted. So we had a situation where some stock has been built up. We will address about that stock but going forward, we wanted something more easily available to bank in their hands and that is why specific provision has been raised because this is something which we can use freely.

Latha Venkatesh Have you all done some industry-wise calculation? Generally because this spread becomes 15% to 20% to 40% more provisioning at the industry will be needed and the second question is to the governor, I am coming back like a bad record. Sir even after this 7.25 repo rate, your projection of inflation is close to the March 31, 2011 level, 9% for the next 6 months or so, you are still at negative real interest rate. We understand that you will be unhappy with this?

Dr. D. Subbarao How you assess the negativeness or positiveness of policy, the policy rates is, depends on what your expected inflation rate is, and our people do calculations for me because I keep asking them the same question. So I don't want to contest this but at 7.25% and average inflation for the year may be 7%, slightly positive, right? So it is on the borderline I admit but future action I really cannot comment just now except what we said in the guidance, given our understanding of the trajectory and for this policy action today we have taken that it will count. Let me revert to that question about housing prices. There is in this document that we released yesterday, the money market document that has paragraph on asset price concerns remain as housing prices remain firm. So that is the message and it also has the movement of price indices in the service cities and I find that except in Mumbai, this movement has been not very much positive.

Latha Venkatesh At an industry level, will the banks have to provide for more.

Anand Sinha Yes, because the housing loans have gone up.

Latha Venkatesh So the 70 does not...

Anand Sinha As I mentioned to you, 70 was something to be achieved as on a particular day. So that gives you a stock of provision. Now that will be allowed to be used as I explained earlier. That we have to work out the calibration. Once the calibration works out, then it can be used for specific provision.

Latha Venkatesh Most of the bankers said they, well, we just asked a handful of them. So at an industry level, they have more….

Anand Sinha **See,** whatever has been built up as on 30th September that remains that is one stock and out of today's, whatever we have raised something more will be coming what will come now will be freely available to the banks and what has already been built up will be only available to banks after we work out our calibration from hereon.

Moderator We have the next question from the line of Sunera Vasudev from Business Standard. Please go ahead.

Sunera Vasudev Good afternoon. Just one question really, can you explain your stance on the priority sector classifications with microfinance institutions and really the implication for other NBFCs who operate in the area?

Dr. D. Subbarao Thank you very much Sunera. On the priority sector classification, first of all after the followup on the Malegam committee recommendation, they said that this classification has done now several years ago and there is a need to review this and we said today that we are going to appoint a committee for that purpose. That comes into context of what qualifies as a priority sector lending by banks to NBFCs. In accordance with the Malegam committee recommendations what which we have accepted, what this means is that only bank lending to NBFCs which is on-lend to MFIs who confirm to our regulations and that will qualify as priority sector lending. By implication, bank lending through NBFCs which is for purposes other than microfinance. Or for microfinance which does not confirm to the regulations will not be reckoned as priority sector. So the repeat again, only bank finance to NBFC-MFIs which is lent as per the regulation will be treated as priority sector lending..

Sunera Vasudev Does it also impact portfolio securitization which happens by other NBFCs in this segment?

K C Chakrabarty Yes, this also includes the portfolios securitization. Also the same condition will apply to them. Only thing that what will be treated as portfolio securitization we will be issuing a separate set of guidelines, but finance by NBFCs or microfinance sectors has to satisfy the same set of condition and for other NBFCs, they will be not treated for the time being as priority sector.

Sunera Vasudev So would you be able to just give me a sense of how much of cumulative portfolio will be affected on the priority sector which is classified as priority sector?

Dr. KC Chakrabarty It is very difficult. We have the total finance to NBFC about 1 lakh 75,000 crore. Out of that, microfinance segment is about 20,000 crores, but other finance to housing finance is about 75,000 crores. Now other remaining how much is the priority sector, how much is non-priority sector. Out of that, how much non-priority sector is reported as priority sector. Our contention is very clear that banks when we are saying must go for financial inclusion and if banks are the financial intermediaries if they should direct finance and if there is a priority sector obligation on them, why it should go through another financial intermediary. For microfinance, the problem was that they are very vulnerable six monthly striking and banks do not have adequate capacity to meet their requirements of this type of borrowers. So this is an intermediate arrangement. If we say that if banks lend to microfinance institution and they have to satisfy all these conditions and then only it will be classified as priority sector and if the banks are lending to any other NBFCs and they have not to satisfy any condition, they need creation of arbitrage situation. For the time being this has been stopped. Now, as

Governor has indicated, anyhow we are appointing a committee. If we feel at a later stage then other NBFCs have a case and if we feel that something has to done, so we will examine at that particular space. For the time being, this is what is the position. We cannot allow arbitrage position in respect to financing through the NBFC sector.

Sunera Vasudev Thank you so much.

Moderator Thank you. We have the next question from Lola Nair from Outlook Magazine. Please go ahead.

Lola Nair RBI has tried to balance inflationary concerns with growth moderation, we have been witnessing a slowing down investment. How long do you see this moderate growth trend lasting?

Dr. D. Subbarao I hope not but for this year for example, we said 8% which is lower than last year's 8.6%. I cannot really look beyond that at this point of time, but if the inflation comes down to 6% by March 2012 and even lower beyond that, then we can of course get on to a higher growth trajectory. I want to reiterate at this point of time that our effort is really to restrain demand in the short-term see that output is at the potential level, but also make sure at the same time that supply responses play out so that potential output expands in the medium term.

Alpana Killawala Thank you Melissa.

James, Financial Times Governor, we have been speaking to some of the manufacturers around the country, we think they are very concerned by the bank, kind of bias towards fixing inflation and battling inflation over growth it's a topic lot of our colleagues are talking about, but my issue is like some domestic companies will be facing tough times because they would not be able to complete those infrastructure project because borrowing costs are going high, do you think we are entering tough time and if not then what are you words of reassurance to manufactures and business companies?

Dr. D. Subbarao Thank you very much. First of all as I said a short while ago, persistent high inflation undermines growth. So if we want to sustain growth in the medium term, we need to bring down inflation. There is, like you sacrifice a little now for much more later. So that is how balanced on the growth inflation dynamics. I also want to say because you asked for some reassurance, I want to say that high inflation is not inevitable, we can bring down inflation. We have the policy tools to bring down inflation and we will try our best to bring down inflation. So that we have noninflationary, stable growth and our aspiration to reach double digit growth will be attained.

Ram Kumar Is it that with this 50 basis points hike, you have abandoned the calibrated and baby steps approach actually?

Dr. D. Subbarao In a manner of speaking, yes. If you define baby steps as 25 basis points taking a 50 basis point is a large step. So in fact someone in the bankers meeting this morning suggested that why did you not make the quantum at 10 points so that you can make many more steps so you can calibrate it further, but yes, it is no longer a baby step.

Vaidyanathan Basically I think at a broad philosophical level, in the finance ministry there seems to be a greater tolerance towards slightly higher inflation level because even in the economic survey this year, chief economic advisor seems to suggest that with this high growth rate will come high inflation? The last year like baby steps of monetary action of 25 basis points, there was some sense that whether this was guided by this awakening within the policy makers that we can live with slightly higher inflation, but we should not compromise too much on growth. So were you guided by this thought and second is like do you think that we can live with slightly higher inflation norm with a higher growth?

Dr. D. Subbarao The economic survey did certainly raise this debate about growth inflation trade off and my recall is that they said that because we do not have reliable unemployment numbers in the country we tend to miss out on the inflation unemployment trade off, the Philips Curve argument that there is a trade off to be exploited there. The survey also talked about some high inflation coming from financial inclusion that is increasing demand for currency and it also talked about inflation coming from increased integration of India into the world, the Samuelson-Balassa effect. I do not want to go into discussion of all those issues now, but certainly in course of time at an appropriate forum, Subir or I or someone else from the RBI will speak to those issues at an academic level and at a policy level. The more practical question you asked which I want to answer now is whether we want to settle for a high level of inflation. I believe not. We have said in the statement that the objective or the endeavor of RBI will be to condition an environment to bring inflation down to 4-4.5% and to bring an environment in the medium term of 3% inflation consistent with the global inflation scenario. So there is no trade off between growth and inflation. There could be at some point of time above or below a certain threshold level of inflation, but at the levels of inflation we are now 9% coming down to 6% gradually, there is no trade off between growth and inflation. If you have low levels of inflation below a certain threshold, expectations will not work, wage pressures will not be there, but at our levels of inflation, there is no trade off. There is no output gap. Economy is operating at near capacity. So I do not believe that we can exploit higher growth by sacrificing inflation.

Gautam Question is that the monetary policy talks of government being the operating target from here on, where would you like the target to be, within be somewhere close to the repo rate?

Dr. D. Subbarao I believe so, yes, close to the repo rate because we said last time, we said it in this policy also that we were slightly in the deficit mode so closer to the repo rate than to the reverse repo rate because that way the monetary transmission works better.

Aparna Two questions. In your previous policy statement your mid quarter review and the quarterly review in January, you have been expressing concerns your concerns over inflations with recognized demand pressures, generalized inflation, but you are stuck to 25 basis calibrated approach until today. The language in your previous policy statement and that you made today are not that different. So what is the reason for 50 basis. Should we take 50 basis and the new challenges from here on? And my second question is the marginal standing facility which you are referring to as other liquidity management tool. You have several other inflation management tools like MSS and OMOs going on. So ample of those. You using these tools will it come down because of the MSS?

Dr. D. Subbarao First on Aparna on your reading of the document, on your understanding, I have a slight different perception possibly because I had a hand in drafting it. But I believe that the message and the language is slightly different, qualitatively different from last time around - about our anti-inflationary stance and about the relative prioritization between growth and inflation. I also explained that earlier on in my comments about the conditions that are changed between the last year and this year how the drivers of inflation have changed which have actually been the motive force to change our approach from a baby step to a large step. The second part of that question whether this will be the size of the step here onwards. I will not comment on that, but this you have to interpret from the guidance or whatever we do in the future. The MSF question, I will refer to Shyamala whether they will still access MSF.

Subir Gokarn (But before that) I would like to refer you to page 40 of MMD which traces the changing drivers of inflation over the course of last year. Now as we were looking at the progression, what was driving inflation over the course of 2010-11, it is only in the last quarter that we saw very sharp reversal in what we have been communicating as core inflation which is non-food manufacturing. From the period of July to December, this was coming down and that was consistent with what we felt it was still high, but it was not rising and so that was the motivation for our approach which is sort of calibrated the growth inflation balance that we were talking about. From January onwards, this number will start to go up, February number roughly 6.1, the March number was 7 and that is I think one of the most sort of significant changes in the way that we perceived inflation and also corresponding in the way in which our policy stance has changed.

Shyamala Gopinath The MSF facility is basically intended to be an overnight facility to reduce volatility in liquidity as well as in overnight rates. So as we have said in the framework it is exceptional it has a penal rate. So it is 100 basis points above the repo rate. So we do expect banks to use that not as a regular facility, but exceptional depending on their own liquidity requirement. So it will provide some kind of stability in liquidity management as well as in the call rate. Now if you were to use OMO and MSS, that is not an overnight facility. It is for a longer period and OMO really is for longer period injection of liquidity or longer period withdrawal of liquidity. So really these instruments are different and there will be a role for these instruments whenever the conditions require.

Participant Ma'am we already have a LAF. This is an exceptional facility which you just said so are you forseeing it or was there a demand from the banking sector that you need a standing facility again?

Shyamala Gopinath In a way, we had this ad hoc facility for sometime because there was a liquidity deficit in the system since May 2010 and we had this Ad hoc facility to draw being able to use 1% below the SLR for meeting that total requirement which we were giving at repo rate. Now we did not want to like continue that facility to be at the repo rate. So through banks, they need a facility which will enable them to access our window. In case of banks individual requirements, not as a systemic liquidity requirement and that of course we said, okay we can give only at the rate higher than the repo rate. So in a way, yes that the banks will have some assurance of liquidity, but not at the same rate as repo rate at the higher rate and limited to 1%.

Ritesh You mentioned for the next 6 months, you expect the inflation to be at the current levels since the crude oil price and the commodity prices remain whether they are right now and after that you see somewhat downward trend in that inflation, but first question is do you expect a double digit inflation before that and second question you mentioned about the real estate prices in Mumbai, do you think there is a asset bubble in the real estate prices here?

Dr. D. Subbarao First about double digit inflation, the March number was 9% and a lot of analysts have said that when the revised number comes, it might be 10% and in double digits, but what I said earlier on this stage what happened was that there were some December-February numbers were under projected. So March number is more realistic. I expect that the correction in the final number may not be as much as we have been used so far, but that is just an expectation at this point in time, but we said around the March level and the March level was 9%, it could be some up and down around that level. We are not very far from double digit when we are at 9. So I cannot really say that it will breach that 10 line. But I hope not. On the second question of our asset bubble, there is no asset bubble. There have some pressure in some sectors, we have taken action as you know about revising the loan to value ratio, provisioning norms, risk weights etc. and there is no asset bubble there.

Participant Are you concerned on real estate prices?

Dr. D. Subbarao We are monitoring them. I do not think I can say, we are concerned in the sense, using the word concerned.

Participant The new bank license framework the finance ministry had said it would come somewhere at end of March, so when is the latest that we expect the new bank guidelines?

Dr. D. Subbarao That is what the Finance Minister said in its Budget statement and we are discussing with the government. We thought that we must serially agree and any difference of opinion, we must resolve that. So the legislation for amendment to the Banking Regulation Act which is the precondition for the new bank license framework. We were hoping that will go through the budget session but the budget session got curtailed. So there is some uncertainty about the timeframe of that. So there are some loose ends, I cannot at this time really say, but I am hoping that sooner rather than later

Participant Coming back to the MFI sector, the Andhra Pradesh government ordinance, sir does this now true to be that does that law the AP government ordinance will wound now.

Dr. D. Subbarao Our regulation does not supersede the Andhra Pradesh government Act because the government of Andhra Pradesh has the sovereign right to enact and no regulation by RBI can really supersede that. There is a recommendation in the Malegam committee that if the regulation is implemented as suggested by them, there will be no need for individual state governments to have their own respective laws and I believe that is right. Andhra Pradesh government quite understandably has misgivings because of the developments in the microfinance sector there. We have spoken to them. We have to continue the dialogue with government of Andhra Pradesh and I am hoping that once the regulatory architecture for the entire microfinance sector, not just that regulated by RBI, but that which is outside the RBI also once the government of India and RBI together have well understood, well articulated regulatory framework for the entire microfinance sector, I am hoping that state governments will pursue it to withdraw their own individual legislation.

Participant Sir in that case could be probably looking something at the central government act which perhaps would give this space for their role to play which also would be talked about?

Dr. D. Subbarao I think that is the issue we need to debate because there was a microfinance bill and the government I think withdrew that because they want to redraft it. I am hoping that all the debate in the public domain will inform the redrafting of that and also the Malegam committee.

Participant How much will the banks need to withdraw after the liquid debt schemes cap that you have introduced?

Participant My question is also related to this. What was the reason you all have to introduce this cap first of all and were banks above the cap so far?

Shyamala Gopinath Why we needed to introduce this cap is because of systemic concerns. The banks used to invest in the mutual funds and then withdraw whenever they could because it is like a demand deposit like a current account with interest on the amount they have with the mutual funds and that causes systemic risk because mutual funds again use these funds to keep deposit as CDs. Quite a bit of the funds again come back to the banking system as in way of certificates of deposits with different banks. So that is really opened up vulnerability and this systemic risk we saw in 2008. Now these amounts do not remain static as if they are always invested at a particular level, in fact every quarter they withdraw for purpose of booking profit and so they used to vary like from 2% to 50%. Now we capped it at 10% comes to 50,000 crores at 10% of net worth. We have time to phase with this and we do not think that there will be any disruption at all. Banks investment in the mutual funds smetimes it is at 2%, sometimes it is 3%, sometime it is 50,000 crores. Sometime it could be more because as I said it is not same, static. The amount it keeps ranging from 2% of net worth.

Participant But as we speak ma'am, are banks higher than their limit?

Shyamala Gopinath They are higher as of now, but as I said we do not see any problem and there is time for them to manage.

Participant How much time do they have?

Shyamala Gopinath What I am saying is at times, they would even there, investment used to be like, as low as 2 or as low as 1%. We saw it really reduce and then it depends on the liquidity situation.

Dr. D. Subbarao Thank you very much. We are not taking any more questions, but please do not go away. Since all of you are part of the quarterly policy review process and your stakeholders in part of this larger family which runs this policy review. I want to say that Shyamala, she will be leaving the Reserve Bank upon superannuation towards the end of June, so this will be her last policy press conference. I was asking her for coming here this morning and then she has done over 25 of these and she is veteran of this. I personally, and the Reserve Bank as an institution, will miss her very much. She has been of invaluable help and of very-very knowledgeable and valued person. So we will miss her very much. I want to acknowledge that at this forum.

Thank you.