Edited Transcript of Governor's Post-Policy Conference Call with Researchers and Analysts

"Reserve Bank of India Post Policy Researchers and Analysts Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Reserve Bank of India Post Policy Conference Call for Researchers and Analysts. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, you may signal for an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Alpana Killawala from RBI. Thank you and over to you Ma'am.

Alpana Killawala: Thank you Lavina and welcome once again from the Reserve Bank of India to this post policy conference. Governor will make a short statement and then it will be question answers. Governor.

Dr. D. Subbarao: Thank you very much and once again welcome to everyone who is tuned into this. Yesterday we released our second quarter policy where as you all know we reduced the CRR from 4.5% to 4.25%, reduced by 25 basis points. We also reduced our projection for growth for the current year from 6.5% to 5.8% based on an assessment of the investment demand which is weak, moderation in consumption spending and net exports which are sluggish. We raised our projection for inflation up from 7% to 7.5% and we have also indicated the upside and downside risks to the inflation situation in the country. You would have noted that the nominal GDP as a consequence of these revisions remain roughly the same. As per our July numbers, the nominal GDP was 13.5% is now come down marginally to 13.3%. We have indicated all the risk factors for the economy. There are 6 of them. I will just go through them quickly just so that we are all on the same page. First, the downside risk of the growth coming from the global macroeconomic environment now seems to be stronger than the earlier thought. Also at home here a revival in investment activity is key to stimulating growth and that depends particularly on the recent policy announcements by the government being translated into effective action. Second, there is the issue of suppressed inflation and there are under recoveries in domestic prices of administered petroleum products and they will need to be corrected. Those corrections are very much welcome from the view point of overall macroeconomic stability, but we will have to guard against the second round effects. Third, there is the behavior of food inflation which will depend on the supply response in respect to commodities where there are structural imbalances, particularly protein items.

Moving on, there is pressure coming from rural and urban wages which have gone up. Rural wages have gone up by about 22% in the year before and I believe about 18% last year and the concern is that the increase in wages has not been accompanied by any increase in productivity and my staff have told me that this is the first time that there is transmission of pressure from wages to prices rather than the other way round. Then there is the risk from the twin deficits, sizeable current account deficit and the fiscal deficit. Finally, there are liquidity pressures which pose a risk to credit availability for productive purposes.

There were questions about why we had gone for a CRR cut and not a rate cut. Let me briefly address that question. Our endeavor over the last several years has been to balance the growth

inflation dynamics which has always been a challenge, but a particularly complex challenge this time around. We have had to restrain demand even as ensuring flow of credit to productive sectors so as to ease supply constraints. So there are two factors which determine the market interest rate at a level of policy rate and the liquidity conditions. We determined that the policy rate should be left where it is at 8%, a little bit above the inflation rate, marginally positive in real terms now, but given the inflation trajectory it might become negative before becoming positive once again. On the other hand, there are liquidity constraints because of both structural and frictional factors. The wedge between deposit and credit growth, the buildup in government cash balances and currency demand on account of the festival season. It is our assessment that these constraints are likely to persist into the next few months. So given that risks to growth have increased, we did not want tight liquidity to push interest rates higher than there would be. It was our assessment that the CRR cut will ensure that even as the demand for credit, even at the current interest rate, the demand for credit should be met fully. To the extent that the CRR cut and the consequent comfort in liquidity position, allows idle capacity to be utilized, it will be noninflationary. So our overall aim was to keep the policy rate where it is, to signal our anti-inflation stance, to keep the liquidity slightly in deficit, but a deficit small enough not to restrict credit flow.

I will stop there and we look forward to your and we look forward to this session.

Moderator: Thank you Sir. Participants, we will begin the question and answer session. We will take our first question from the line of Varda Pandey from Yes Bank. Please go ahead.

Varda Pandey: My question is actually related to fan chart on WPI in inflation projection. This is on page number 8. If we compare this chart with what we had in the January 2012 policy, the band for inflation forecast for every confidence interval was much narrower. Can we understand this to be- and this band actually has now grown. So the 90% confidence interval which was plus minus 1% back in January has now become plus minus 2%. So can we understand this widening of the band to mean that there is more uncertainty in terms of inflation projections as well and if that holds true over the next 6 months when all of us expect, all of us meaning even after the media conference call yesterday, I believe as per our understanding, inflation can go above 8% in the December-January months. So we expect average inflation over the next 6 months to be well above 7.5%, will that be fair to assume that repo rate or the policy rate at that point in time would be kept higher than the inflation rate?

Dr. D. Subbarao: Thank you Varda for a very incisive question. I see that you have done a lot of analysis. I am going to turn to Subir to answer that question.

Dr. Subir Gokarn: I think the band is a reflection of our current assessment of risks. In January, I don't have the January document in front of me, but at that time we perhaps had a somewhat different assessment of the range of movement over which this risk might operate and now I think when we look ahead, this is of course post-monsoon, we have some risks coming from food prices. Keeping mind that we have had adjustments to administered prices and there may be more. So we are looking at headline inflation, to some extent the band reflects the range of assumptions as

to what extent these adjustments might happen over the course of the year and of course we have had a lot of movement in the rupee which adds to uncertainty to as to what the eventual impact on headline will be. So I think the assessment is correct, that the range of uncertainty has increased somewhat which reflects in a wider band. In terms of what might be, obviously our guidance is based on our baseline scenario and it is always caveated by saying that if the risks materialize, then the actions that are presumed in the baseline scenario or **the** trajectory as presumed in the baseline scenario may not be. So that is the nature of guidance, that is what we try and do and the baseline suggests that despite an escalation in inflation over the next three months, after that the directionality will emerge and although in the chart we have only gone up to March, the underlying sort of assessment suggests that this directionality will persist for sometime. So that is the basis on which we have given our guidance. Now of course if the risks materialize, the qualification of the guidance is that the actions will obviously have to take account of those risks.

Varda Pandey: So historically speaking, every time if we look at the WPI and the repo spread, every time that uncertainty has persisted, the repo has only been higher than the inflation rate, is that correct understanding?

Dr. Subir Gokarn: I am not sure what the implications of that statement are. I think certainly the chart, the band of the fan chart should give you a sense of the level of confidence with which we approach our forecast, but the baseline really becomes the benchmark and it is important to keep the guidance or when you evaluating the guidance to keep the baseline scenario in mind.

Varda Pandey: Sure, Sir I had another question please if I may?

Dr. D. Subbarao: Before that Varda, your understanding that the repo rate has always been above the inflation rate is not correct. Indeed in recent past before, repo rate has been below the inflation rate and the real rate has been negative. I would also like to turn to Deepak to supplement the answer Subir has given.

Shri Deepak Mohanty: Just to supplement, I think what is important that if you see the distribution, I think it is symmetric around the baseline. So essentially which would indicate that more or less, it shouldn’t stray too much, though the risks remain, so that is one. And second thing, from here there are no presumption that the policy rate could be kept higher than the inflation rate from here.

Varda Pandey: Can I also ask another question please. This is on CRR. So I mean if we look at the overall system's liquidity, the banking system liquidity plus what the government has in terms of the cash balances. I mean we all know that the government is sitting on a good amount of cash. So if we add that to the liquidity, deficit is really not as much as what just the banking system number tells us. Now a preference for CRR versus OMO, because the systemic liquidity, meaning government plus banks is not all that high. The CRR has been used instead of the OMO because the systemic liquidity is not as high and only when the system as a whole reaches to possibly unavoidably stressful levels, will the OMOs be used?

Dr. D. Subbarao: I don't think that assessment is accurate. We believe that the constraints that are operating on the liquidity system will persist for few more months. You mentioned about government cash balances which might persist in surplus for sometime. There are other factors as well such as the wedge between the deposit and credit growth and even the demand for currency might persist beyond the festival season because the opportunity cost of holding currency is quite low. So we expect that the constraints on liquidity will persist for some more months and we thought the CRR action would be more appropriate to respond to that rather than OMO.

Moderator: Our next question is from the line of Sonal Varma from Nomura. Please go ahead.

Sonal Varma: My question is on your guidance. In your post policy interviews, you are not ruling out a rate cut at the January meeting. When your baseline trajectory shows 8% inflation in December, second quarter current account deficit will be high, budget will be still a month away. Why are we even entertaining the possibility of a rate cut in January or will you be looking at other variables and not just the headline inflation?

Dr. D. Subbarao: Part of the answer is contained in your question which is that we will be looking at not just the headline inflation, but the disaggregation of those inflation numbers, the other inflation indices, we will be looking at growth. So our action in January and our guidance for that action in January are based on an overall assessment of the growth inflation situation. Now drilling down to the inflation trajectory that you referred to, yes we ourselves have said that inflation will trend up during this quarter and will trend down in the fourth quarter of the current fiscal. At the inflection point, it might go a tad above 8%. So in January, we will be responding not just to the point inflation number, but also to our projected trajectory and if the growth and inflation trajectories play out as we assess now, we believe that there will be scope for further easing in the January policy review.

Sonal Varma: Thanks Governor. Just one more question on policy transmission. Since April when repo has come down by 50 basis points, bank base rates have only come down by 20 basis points. So policy transmission with tight liquidity work during the hiking cycle, but during the easing cycle do you see any challenges? Since you have mentioned that scope for rate cut is limited. Isn't there a risk that transmission will be very muted in a tight liquidity scenario then?

Dr. D. Subbarao: You are right, that transmission will take place when liquidity situation is compatible for transmission and one of the factors that weighed with us yesterday in reducing the CRR was indeed to improve the transmission from the policy rate to the lending rates. Subir will like to add?

Dr. Subir Gokarn: I think one of the issues we have been dealing with and we have indicated that we have a committee working on this chaired by Mr. Sinha on pricing. And in that consideration, the role of the base rate, the role of spreads, how pricing is actually transmitted, whether visibly or not so visibly, these are issues we are looking at in that committee and the feeling is that while the base rate may not be reflecting a very high degree of transmission because of the institutional features that are built into its calculation. So less visible transmission through spreads is taking place and

we have to resolve what is the best way of bringing this into visibility is that is one of the issues the committee is focused on. But when we look at weighted average lending rates, I think certainly we don't have enough data to make any inferences about the easing cycle because it has just started, but there seems to be much stronger correlation between the policy rates and the weighted average lending rates, certainly in tightening cycle that was visible, we will obviously have to wait for sometime to see whether that symmetry exists on the easing of cycle as well.

Shri Deepak Mohanty: If I could just supplement, I think that observation is not correct that liquidity has been tight because as we have put in the policy, that you will see in first half of this year, it has been well within that 1% deficit and compared to the system has been operating at 150,000-200,000 crore kind of a deficit. So that is not very high and transmission did happen in terms of if you look at the base rate, the 25 basis point change and then added to that you know many banks have also changed selectively the spreads and things like that. No, we don't have firm data, so it could suggest some transmission has taken place on that side.

Sonal Varma: Sir I mean previously we have seen the policy rates itself transmit from repo rate to reverse repo, reverse repo to repo. So the extent of actual transmission has been much more. If we are going to stay at repo as the operative rate, then that flexibility to change the corridor is not available this time.

Dr. Subir Gokarn: Yes because since repo is the operative rate even in the transmission process also, one would expect that the interest rate should be around that, I am saying the overnight and money market rates and the presumption is not that it should go to reverse repo rate.

Moderator: Thank you. Our next question is from the line of Mr. Bhaskar Chatterjee from L&T. Please go ahead.

Bhaskar Chatterjee: I have two questions. In fact the first one is regarding the pumping in of liquidity. In India, we have pumped in around 1.7 as your macro monetary says, 1.7 trillion through CRR cuts, OMO operations this January. Now as just opposed to that, liquidity remains comfortable, bank credit growth as in rest of the world has not picked up and on the other hand, deposit growth also remains below your trajectory while corporates raise more money through CPs. If we look on the other side, banks SLR Holdings have gone up, real estate markets are still booming, your RBI index would indicate that. Gold prices are still high and government has got around Rs. 4 trillion at a lower average yield. What I want to point out is whether this CRR cut over the sustained period of time is helping growth or does it have any feedback on inflation?

Dr. Subir Gokarn: I think the concept of liquidity has to be seen in a binary fashion. If we go back to the analytics that went into the restructured LAF and so on a couple of years ago; it emerged from that we needed to look at liquidity differently when it is in deficit and when it is in surplus and the key is that when it is in surplus, it feeds into inflationary expectation, it feeds into accelerating credit growth which then may also exert inflationary pressures.While it is in deficit, it tends not to. So that is the base on which we arrived at this comfort zone concept of 1% and our approach over the last three quarters has essentially been, we certainly say that the interest rates are high, we are

not challenging that proposition. Policy rate is high, lending rates are high as a result of that. But that can be aggravated by liquidity conditions becoming tight and so the idea is to keep the policy rate as a reflection of the policy stance, of the anti-inflationary stance, but not let it be further aggravated in terms of credit flows, in terms of willingness of banks to lend by liquidity conditions and so that is the benchmark. Every time liquidity has shown signs of staying outside the comfort zone, we have taken steps to bring it back; when that deviation is seen to be persistent we have used the CRR which has the more long lasting effect. When it has been seen to be transitory, we have tended to use the OMOs which can be done very quickly and will have also one-off effect on liquidity. So keeping liquidity within that comfort zone as close as possible is really the objective and as long as it remains in deficit, as long as the call rate remains close to repo rate, I don't think it compromises the anti-inflationary stance.

Shri Anand Sinha: Just to supplement on your observation on the credit side, you are right, as you would have also noticed from the policy that we have scaled down the money supply, deposit, and credit growth by a percentage point and why that is happening because the growth itself has come down from our earlier projection of 6.5 to 5.8%. And if you see at a disaggregated level and so that is the main concern that the investment is not happening that, so through that process credit to investment related activity particularly on the infrastructure side has slowed down and that you rightly observed, because the credit to retail sector and housing continues to be normal.

Bhaskar Chatterjee: Interest rates affecting the corporates, you have rightly said in your policy that interest rates, in the macro monetary, that interest rates are eating away a lot of our PBIT on the aggregate. This is more for the infrastructure companies and the companies in the capital goods space. In some cases, the nominal interest rates eat away most of their PBIT, in some cases more than 100%. My point is, if infrastructure development mainly through PPP holds the key to real sector growth, many companies, many big corporates couldn't be able to bear this over a long time. So do we have any timeline for implementation of the Deepak Parekh committee report or any other steps Reserve Bank envisages?

Dr. Subir Gokarn: While the Reserve Bank is represented on Deepak Parekh committee report that is not a process that has been run out of the Reserve bank. So we are contributing in some way since it focuses on expanding financial channels**,** but I don't think this is the right forum. The report will be submitted I believe in March of 2013 and whatever actions are taken, based on those recommendations, yes we will follow up from that.

Moderator: Thank you. Our next question is from the line of Rajeev Malik from CLSA Singapore. Please go ahead.

Rajeev Malik: I think after each quarterly policy you guys go out of your way to spend a lot of time with us and entertain our questions. I have two small questions. The first is really seeking a clarification because given what was in the policy statement and some of the media comments- was the repo rate not cut because of concerns on inflation or because at the current level of liquidity the cut in the repo rate would not have had the desired impact? That is the first question, I will ask the follow up question after the answer.

Dr. D. Subbarao: Well, Rajeev, we did not cut the repo rate to signal our continuing anti-inflationary stance. As we indicated yesterday, we believe that inflation pressures are still strong, momentum is still firm and inflation is going to go up before it is coming down. So the objective behind not touching the repo rate is to signal the anti-inflationary stance, while at the same time ensuring that the demand for credit at the prevailing interest rate regime is fully met and for that reason we wanted to maintain comfortable liquidity.

Rajeev Malik: Thanks, that takes me to the subsequent question which is that to the extent repo rate was not cut because of inflation concerns, injecting liquidity or easing liquidity, cutting CRR and having an explicit outcome desire that it should actually boost credit growth, which automatically also means demand is not perceived as a contradiction?

Dr. D. Subbarao: I don't think so because our expectation is that as there is comfortable liquidity in the system, credit will flow to those sectors which can use the existing capacity which will be non-inflationary. As you will note, if the potential growth rate is 7% and the projected growth rate is 5.8%, there is negative output gap. So it is our expectation that credit should flow to those sectors to improve capacity utilization and in the process investment should get into the pipeline. So, largely we expect that it will be non-inflationary. Of course you are right that there will be some inflation pressures coming from there but not as much as you imply in your question.

Rajeev Malik: Sir would it be fair to then conclude that based on the feedback you are getting both from industry and from banks that there are segments who are indicating that liquidity availability is itself a problem rather than the level of the interest rates?

Dr. D. Subbarao: Well our conversation with banks leading to the policy review has indicated to us that or has at least given us the inference that if we make liquidity comfortable, transmission will improve. So it was on that basis that we taken the action, you know when we talk to industry, we talk to business people, they did not base their assessment or their advice or their recommendations based on liquidity, liquidity is not on their policy radar screen.

Moderator: Thank you. Our next question is from the line of Pranav Tendulkar from Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: I have just one question. In your press release you have written that there is a continuous increase in the wages, real wages of rural and urban. Whereas, whatever I have seen that from 2003-2008 whatever real income wages, especially in urban areas whichever has increased have actually slowed down in last two three years. So could you please correct me if I am wrong there and what I think is that even the rural wages are increasing in last two years. So, I am okay with that rural but urban real wages are decreasing, not increasing that much. So am I correct?

Dr. D. Subbarao: Pranav, can you please give us the cross reference to the page number in our document?

Pranav Tendulkar: In your press release, you have mentioned- fourth point, that is the persistent increase in the rural and urban wages, accompanied by commensurate productivity increases has been and will continue to source the inflationary pressure.

Dr. Subir Gokarn: On rural wages, we would refer you to page 42 of the macro monetary developments document, chart 6.9 and 6.10 and that is giving us sort of now systematic source of data on rural wage strengths and when you look at chart 6.9 if you have it in front of you, you will see that there is a very sharp acceleration in around 2007 in rural wages and that has really persisted, the blue line there nominal wages really persisted at high teens, growth rate for the last four years. Now urban wages, we don't have such systematic data which creates some difficulty in putting together a comparable chart but based on our consultation with number of sectors, particularly construction, where doing a consultation, we also get the sense that this rural pressure is transmitting through to workers in urban labor markets also. So that is the overall judgment we have made. Now if you have specific data that you are referring to, you could certainly send it to us and we will take a look at it.

Moderator: Thank you. Our next question from the line of Abhishek Panda from JP Morgan. Please go ahead.

Abhishek Panda: Sir, we have noticed that liquidity outflow from the system has now almost become structural with currency in circulation tending to increase by at least 1 lakh crore or more every fiscal year. However, at the same time, there are no significant structural inflows into liquidity and RBI's options of injecting liquidity are now restricted only to OMO and CRR, with FX intervention also not an option as of now with the current level of rupee, etc. As such, Sir you said that CRR is the main option to counteract structural liquidity outflows. So is there a minimum level that CRR can be; is there some regulation or something that let us say provides a lower limit for the CRR that RBI wants to keep?

Dr. Subir Gokarn: No, there is no statutory limit. There was a convention and this was articulated I think in 2003 or 2004 that we wanted to take it down to 3% and so keep it there, but subsequently it has obviously come back into toolkit and has played quite an active role since 2006. Now the issue is, are these the only two channels and when you look at, even if CRR becomes a constraint, the mandatory SLR is 23%, the actual holding of SLR security is about 29-30%. So, theoretically that gives you a very large cushion. If the system needs significant infusion of liquidity, then that can be used. I am not saying that that scenario is on us but let us not forget that the whole point of SLR is essentially that, it is the liquidity ratio and it is something that represents the capacity of system to generate liquidity when the need arises.

Abhishek Panda: Sir, but if I may ask a follow-up question regarding the SLR point, I think you referred to that yesterday that it is a liquidity buffer in extraordinary circumstances. But Sir, at the time of liquidity stress or everything, it is likely that banks may rather be holding onto government bonds both for getting liquidity in the LAFs as well as because of risk aversion that might result in a situation like that. So it is still a subjective decision whether a bank would be selling a government bond at that time in order to get liquidity?

Dr. Subir Gokarn: If a bank is running short of liquidity, then I do not think it has much of a choice and if it needs liquidity to manage its liabilities, then it will look at obviously some hierarchy of preferences in terms of what is going to liquidate in order to generate that liquidity. So the SLR is the capacity, and OMOs are market processes. They are auctions. So there is some pricing flexibility that banks have been deciding whether to offer securities for sale or not. So I think there are enough built-in cushions and flexibilities in the system that it does not cause us a great deal of concern.

Moderator: Our next question from the line of Indranil Sen Gupta from DSP Merrill Lynch. Please go ahead.

Indranil Sen Gupta: Sir, on FX reserves. I am sure we agree that there is a need to augment FX reserves. Given that the import cover has gone down to late '90s levels. Would you consider RBI FX intervention both ways, that is you buy the moment there is some inflow and may be you sell if there is an outflow. I think in a sense we are getting into a chicken and egg problem where the RBI probably waiting for the rupee to stabilize and the market does not venture beyond a point because it thinks that the RBI will start buying. So if at some stage the RBI is able to indicate a level where it thinks that it can now start to accumulate FX reserves. That would add to the stability of the rupee. And secondly, is it possible to publish the data on FX intervention and forwards at may be a one week lag or two week lag because by the time the data comes in, it is really of not much use.

Dr. D. Subbarao: Thank you for those two questions. On the first question about whether we will intervene to increase our foreign exchange reserves, the answer is no. As we have always maintained, we believe that the exchange rate should be largely market driven and our intervention should only be to manage volatility; volatility as we all understand. So, we do not believe that we should intervene in the market just to build up reserves as self insurance. If reserves get built up as a consequence of intervention for exchange rate volatility management that is an incidental by-product. I hope that is clear and on the second question, I believe we now publish data with a lag of one month, by the 10th of the next month. In fact just this morning we were discussing in a meeting about how soon or how quickly we can publish this data. We will keep your request in view, but I believe that there is no scope for reducing the lag at this point of time.

Moderator: Our next question from the line of Mr. Gopal Tripathi from RBS. Please go ahead.

Gopal Tripathi: The question which I would like to ask is that we have seen in 2010 and 2011 that the growth rates were significantly robust despite RBI has been very slow on raising the rates and now the growth has dipped quite significantly although the inflation has not followed the growth. The reluctance to cut the rate is quite significant. So has anything significantly changed on the growth prospect of the country from RBI side?

Dr. D. Subbarao: No, we have put in the public domain our assessment of the growth inflation dynamics. Your interpretation is that we had acted quite swiftly when growth rates were high, when inflation was on the rise. Now you are saying that are we reluctant to act quickly enough to spur growth. I want to say once again it is our endeavour to balance both growth and inflation. You must also note that potential output of economy has come down from our number of 8.5% before the crisis

to 7.5% after the crisis and the latest estimate is 7%. So our projection of growth for the current year is 5.8% that yields quite a bit of output gap. We are concerned about growth, but we believe that inflation must be low and stable in order for securing growth in the medium term. We want to increase growth and we want higher growth, sustained growth at that level. For that purpose, we need to manage a low and stable inflation regime so that consumers and more importantly investors can make informed decisions.

Gopal Tripathi: Sir one follow up question I would like to ask, one more thing that we have seen that the core inflation has gone down significantly to 5.5% and the non-core inflation has, most part of it is cost push. So is it not high rate of inflation is pushing that inflation as well and preventing the overall inflation to come down?

Dr. Subir Gokarn: The share of interest or the proportion of interest is in terms of total cost of production or take interest to sales ratio is not very high. So as a cost factor, interest rates themselves I do not think are significant. So we are really approaching it from the demand side which is that when headline inflation is high, even if it is cost push, its tendency to spillover into inflation expectations is then influencing the behavior of all kinds, pricing behavior, investment behavior, consumption behavior, starts to have an impact on the long-term inflation trends. So managing expectations even if the inflation is coming from the supply side is now treated as mainstream objective of monetary policy and in that sense that is a challenge somewhat different from directly controlling inflation through demand management. So we keep emphasizing in our guidance or our stance that the objective is to both contain inflation and to contain inflationary expectations. So these are seen as two interrelated, but still distinct objectives.

Moderator: Our next question from the line of Shubhada Rao from Yes Bank. Please go ahead.

Shubhada Rao: I have one question related to the guidance on future course of monetary policy action. Quite clearly, the indicator would be some amongst the inflation indicators. Just wanted your thought whether it would be core inflation, the sequential momentum or because headline inflation is likely to come in lower given the suppressed component coming into open and therefore inflation would likely average in our estimate around 8% in the current fiscal year. So as a guidance for easing policy rate, are you seeing some comfort on core sequential momentum because our rupee may have some beneficial impact on the sequential momentum on core. Are you thinking along these lines or are other inflation indicators also going to be closely monitored, be the core CPI or headline CPI or just the core non-food manufactured inflation?

Dr. D. Subbarao: The short answer is we look at all indicators of inflation, all those that you have mentioned; headline WPI, core WPI, the CPI inflation under the three separate CPI indicators that there are. We look at the momentum of those indicators and we ourselves have said that the headline WPI inflation will go up in this quarter before coming down in the fourth quarter. So our guidance was based on an assessment of the direction of movement of inflation. So even at this point inflation reading might be high, above 8%. If in January we see that the direction of inflation is on the downward trend, we will respond to that in our policy action.

Moderator: Our next question from the line of Manoj Swain from Morgan Stanley. Please go ahead.

Manoj Swain: I have two questions. One fundamental and one technical and the fundamental question is on potential growth rate. The GDP growth rate has been around 5 to 6% for the last few quarters against the popularly believed potential growth rate of 7%. However, some of the indicators such as current account deficit has been at all time high, fiscal deficit in the upper quartile, inflation continues to be high and sticky in spite of in a situation wherein commodity prices globally has been in our range for the last 4 years. These are signs generally associated with an overheating kind of situation, but clearly 5% growth does not show we are in that situation. Is it possible that the assessment of potential growth rate at 7% is not right, may be it has come down to may be around 5% or 5 to 6% range, due to structural issues in the economy or due to issues associated with non action or not sufficient action from government and my second question is a technical one. SLR has been cut from 25% to 23% during last 2 years; however, HTM continues to be at 25%. Is there any linkage or logic between these two numbers and are there any plans to realign them together?

Dr. Subir Gokarn: On the potential growth side, clearly you can define potential growth as the rate at which inflation starts to become a problem and so by process of elimination, bringing it down to 5.5 or 6% and inflation is still a problem, therefore potential growth has come down that much. But there are other ways of looking at it, both bottom up and statistical and we have done a number of different estimates based on both time series analysis and production function and so this 7-7.5% number is to us a reasonably robust one. Now the question is, if growth has come down below that, how come inflation still persists? I think the adjustment takes place with a lag that is fairly obvious, but what has happened in the last couple of quarters that has perhaps slowed down the adjustment of core inflation to the output gap. One is that rupee has depreciated, so even though commodity prices globally may have stabilized or softened, the rupee prices of these have actually not come down and the impact of the rupee depreciation is really going to be felt up to about now to November or so when it really started to depreciate last year. So that if the currency stabilizes, then we should see the normal transmission from the output gap to core inflation picking up over the next quarter and that is one reason why our projection also suggests that there is some declining momentum in inflation. The other factor which I think we have to keep in mind is the supply side. Regardless of whatever else is happening globally, our domestic food price pressures have been very high and the monsoon performance has aggravated price pressures in some commodities and referring to the response to an earlier question that the rate of increase in wages has been very sustained since 2007. So there is clearly some sort of a pressure building up from the labor markets as well. Both of which are unrelated to global developments directly. So when you have the supply side pressures remaining unabated, the adjustment of core to output gap also tends to be a little slower and that is the scenario that we are looking at now. On the current account deficit, let us not forget the role of gold which does not directly have to do with the absorption capacity in imports. We have also seen some substitution of domestic capital goods by imported capital goods. When you break down the import data, we have seen pretty significant growth in some categories of capital goods. So the other thing is going on there that perhaps we need to take into account when analyzing the overall trends in the balance of payment.

Manoj Swain: And my second question was on SLR and HTM.

Shri Anand Sinha: It is 25%, but HTM has certain other components also, we will have a look on that.

Moderator: Thank you. Our next question from the line of Vibha Batra from ICRA. Please go ahead.

Vibha Batra: Sir my question is on restructured advances, the provisioning on the restructured advances has been increased. But if we look at the profile of restructured advances and possibly the way they are going to move this year in light of the package that has been announced for DISCOMs. Now the vulnerability of these advances pre the restructuring was possibly very high because these advances which are estimated or given in the note are close to Rs. 1.2 lakh crore and post the restructuring, these will be either guaranteed by state governments or will be taken over by state governments. So the vulnerability goes down, but if we go by the guidelines, the provisioning goes up. So would there be special dispensation from RBI on nature of such advances which are quite substantial?

Dr. D. Subbarao: Vibha, I am going to turn to Anand Sinha, Deputy Governor, for a response to you.

Shri Anand Sinha: As far as the raise in provisioning for restructured accounts are concerned, that is across the board. So DISCOM is a particular segment and our decision is not necessarily based on that. Apart from that, DISCOM restructuring has not yet taken place. So we will have to have a look and these provisioning decisions are taken on portfolio basis not on individual account basis. So we will see it later on, but as of now the recommendation of the Mahapatra Committee report is to raise it from 2 to 5% and that is actually based on an anticipation of higher defaults in the restructured account. Today the provisioning is based on some kind of notion that the descend to NPA category out of restructured standard accounts is roughly about 15%. So the jacking up to 5% is basically a linear arithmetic equation. If you assume that the delinquency might increase to 30% and that is the reasoning behind it.

Vibha Batra: Possibly this does not gel with RBI's philosophy of almost negligible risk weight on a state government guaranteed advances. So on one hand we have negligible risk weights there and on the other hand if there are restructured advances which are backed by state government guarantees, we are saying that there has to be additional provisioning requirement.

Shri Anand Sinha: No, there is no disconnect, because risk weight is different from provisioning. Provisioning is to take care of the expected loses and risk weight is to take care of the unexpected loses. Now, what has been guaranteed by state government for that we are giving a due weightage in risk weight, that is whatever risk weight state government guarantee carries, that portion will carry that lower risk weight but provisioning is a different issue, that is unexpected loss so that will be treated on a different footing.

Dr. D. Subbarao: Just in this context, Anand did you say yesterday that we will finalize our views on the Mahapatra Committee by end January?

Shri Anand Sinha: Yes we have said in the policy also.

Shri B. Mahapatra: Sir, draft guidelines.

Dr. D. Subbarao: Draft guidelines on the Mahapatra Committee recommendations by end January 2013.

Vibha Batra: Sir I have another question, RBI share in G-Sec is close to 17% now. Is there an upper limit that possibly is going up because of OMOs, but would there be an internal limit to what RBI can go up to?

Dr. D. Subbarao: No, I believe there is no limit. It will be based on our understanding of how to manage the liquidity situation, but we are not constrained by any limit.

Moderator: Our next question from the line of Indranil Pan from Kotak Mahindra Bank. Please go ahead.

Indranil Pan: I think what my real point is that in the macro and monetary statement that was released to the previous evening you have clearly indicated that future scope of monetary easing would depend on both an inflation containment and correction on the rates of the CAD and fiscal deficit. Now while I realize that the two may be interlinked on a macro basis, I just wanted to understand what is the relative importance that an RBI would place on these two variables given the fact that most of the inflation subside that we are expecting in January to a larger degree is also a base effect issue, that is number one. Number two in terms of fiscal deficit consolidation, would the RBI be viewing a consolidation out of revenue issue such has meeting or exceeding 2G revenues or a PSU disinvestment revenue as a fiscal consolidation rather than the capping of 2% subsidies as a proportion of GDP. So whether the expenditure side containment is what the RBI would be more keen on or a general consolidation in terms of the fiscal deficit/ GDP numbers coming down even though it might be from the revenue side?

Dr. D. Subbarao: Thank you Indranil for those very thoughtful questions. First on the weights that we give to the variable that might influence the inflation projection. You asked as If I understood you right, you asked for weights on fiscal and current account deficit, right?

Indranil Pan: Right.

Dr. D. Subbarao: We would of course look at the overall inflation trajectory and also the variables that are influencing the trajectory. Our assessment will depend on both on the headline number and what variables are driving it because trajectory will be a function of the variables which are driving it. So the answer to your question is although we do not have precise weights, we certainly look at the trajectory of inflation and the factors that are driving the trajectory in making our assessment. On the second question about the…

Indranil Pan: The nature of consolidation of the fiscal, expenditure versus the revenue aspects?

Dr. D. Subbarao: All of us, not just the Reserve Bank, but all stakeholders in the macroeconomic management are concerned about the quantum of fiscal adjustment, we are also concerned about the quality of fiscal adjustment. And international experience shows that fiscal adjustment that comes from expenditure compression is more sustainable than one that comes from tax increases. So every

country has to attempt its fiscal consolidation map depending on its country context and giving due weightage to these two variables. In our own country, we have achieved fiscal consolidation in the pre-crisis period largely because of tax increases. It will be worth a while to focus on expenditure compression to manage credible, sustainable fiscal consolidation on the way forward and if I got the Finance Minister's statement on Monday, well he was focusing indeed on expenditure compression. I think that is the right way to go.

Moderator: Our next question from the line of Manish Wadhawan from HSBC. Please go ahead.

Manish Wadhawan: Given that the GDP growth projection for the current year has been revised downwards from 7.3% in April to 5.8%. I would request your comments, which is actually lower than the worst case projection in April policy and yet RBI has chosen to keep policy rates unchanged because of inflation reasons. What would be the threshold level or the inflection point of growth at which RBI will have to be providing monetary stimulus to the growth and second part to my question is before the mid-quarterly review in December, we will have the quarter two GDP data, two industrial production data and two inflation numbers, will it be fair to assume that these data points will not have any bearing or you have already considered them in stating that there is a zero possibility of any rate action in December and the earliest monetary action could happen only by January?

Dr. D. Subbarao: First on the threshold growth level, I wish I could give you a precise answer. We did not have a threshold growth level, but we will certainly respond should growth moderate much more than we now expect, but that is unlikely according to our current assessment. You would note that the GDP growth projection for the full year is 5.8%. In the first quarter, we printed 5.5%. So on average, the growth in the remaining three quarters has to be higher than 5.5%. So we expect growth to edge up from here onwards and we do not have a precise threshold number, but I do want to reassure you and everyone else who is listening in that where we are very sensitive to the growth projection and growth performance and we will pay attention to that. Then you asked about the policy stance and the variables that will influence the policy stance for our mid-quarter policy review in December. Yes, the data points will come. The guidance that we gave was based on our assessment of the trajectory of growth and inflation up to the end of the current fiscal year. It shows that inflation will edge up in December when we will have the November number, will still be high. So that is the reason, we indicated that further policy easing can be expected in the January quarter, but should there be substantial deviation from this trajectory, we will certainly respond to that.

Moderator: Thank you. We will take our last question from the line of A Prasanna from ICICI Securities. Please go ahead.

A Prasanna: Thank you. I just wanted to ask two questions. One is a follow up on the HTM question. Basically I am looking at it from the efficacy of SLR as a tool. In July policy, you cut SLR and one of the reasons was to release resources for the private sector, but if you look at the bank's SLR holding, it has not changed much. So I am just wondering because of the wedge which has developed between SLR and HTM, banks are not incentivized to cut SLR holdings and of course

there is a working committee of RBI itself which has talked about cutting HTM in order to improve market liquidity. So, from this perspective both from the perspective of market liquidity as well as efficacy of SLR as a tool, would you be looking at HTM limit that is the first question and second question is in terms of your hierarchy of tools for managing liquidity, since you said you use CRR because you expect liquidity to remain tight for a few months. By the time of December review also it is likely that liquidity will remain tight and the forecast will be tighter for a few months. So should be assume that again CRR would be the preferred tool in December also?

Shri Anand Sinha: On HTM, yes, that as you are aware there is a committee report which has recommended cutting down on HTM in order to improve market liquidity, but it is a fact that HTM is rather on higher side and we will certainly be looking at it in the context of the recommendation of that committee to improve market liquidity.

A Prasanna: Is there a timeline for that?

Shri Anand Sinha: Timeline, the committee has given its report. It will be difficult to commit a definite timeline, but we are certainly looking into it.

Dr. D. Subbarao: And on your second question Prasanna, there can be no presumption that CRR would be the preferred tool to deal with the liquidity situation should it arise in December. First of all, I want to say that our action yesterday should ensure that the liquidity is within the range that we indicated through December, but should there be a liquidity shortage, our response will depend on how we assess that shortage, whether it is temporary, permanent or whether it calls for any action and if so what sort of action. So the short answer is that there can be no presumption. The CRR would be the preferred tool.

So I want to thank everyone who has tuned in for your very thoughtful questions. I also want to say that your questions keep us on our toes. We give you answers, but in trying to answer your questions we also learn quite a lot. So I am thankful to all of you and Happy Diwali.

Moderator: Thank you very much. Participants on behalf of Reserve Bank of India that concludes this conference. Thank you for joining us. You may now disconnect your lines.