Interview with Cogencis on April 27, 2020 – Shri Shaktikanta Das, Governor, Reserve Bank of India

Interviewers: **T. Bijoy Idicheriah and Kalyan Ram from Cogencis.**

RBI has emerged as the first line of defence against the impact of COVID-19, and some may say, the only line of defence. Do you think more fiscal measures are needed for the relief package to be effective? Also, what is your advice to the government? Should they suspend FRBM or monetise deficit?

Fiscal measures are important and the government is working on a package of measures. The finance minister has gone on record on this. I expect that the government will take a judicious and balanced call on the question of fiscal deficit, while addressing the challenges arising from the COVID-19 pandemic. The government has taken measures to contain expenditure, like freeze on its employees' dearness allowance; at the same time, the government has announced a relief package to support the vulnerable and disadvantaged sections.

Through measures like in-kind support (food grains), cash support, DBT (direct benefit transfer) support or depositing money in PMJDY (PM Jan Dhan Yojana) accounts, government has committed to spend 0.8% of GDP. So, therefore, meeting the fiscal deficit target of 3.5% this year is going to be very challenging, and going beyond it becomes unavoidable. Also, because of the lockdown, GST (goods and services tax) collections are going to be significantly impacted, and impact on direct taxes cannot be ruled out. While deciding on the size of the fiscal package, it would be very important to prioritise the support measures and interventions. All measures should be well targeted to optimise the outcome.

Equally important is to have an exit strategy of fiscal interventions. In other words, fiscal measures under the COVID-19 package should contain specific sunset provisions. This would be in line with the recommendations of the FRBM Committee. In terms of exceeding the fiscal deficit, two straight replies, one is the 3.5% fiscal deficit target for this year will be very challenging to meet. As regards, how much it will exceed and how much the government will spend, that will depend on the view taken by the government, with regard to how much they can exceed the deficit number, and what kind of support measures can be taken that produce maximum impact. In other words, it has to be a judicious and balanced call keeping in mind the need to support the economy on one hand and the sustainable level of fiscal deficit that is consistent with macroeconomic and financial stability.

Will the RBI monetise the government deficit and will you look at private placement of gilts on your books, given that everybody realises that the only solution is to expand the central bank's balance sheet? Some of the former RBI governors have also said this may not be a bad thing to do.

There is an animated public discourse around this subject. Within the RBI, the debate is not new, and governors before me have had to contend with it. In fact, dealing with this issue has produced some landmark reforms like the phasing out of ad hoc treasury bills, the enactment of FRBM Act, the monetary policy framework, to name a few. For

every governor who has confronted with the situation, the solutions have been based on prevailing operating conditions. To illustrate, ad hoc treasury bills were phased out over a three-year timeframe to facilitate a smooth transition to market borrowing. On the current situation, we haven't taken a view on it. We will deal with it keeping in view the operational realities, the need to preserve the strength of the RBI's balance sheet, and most importantly, the goal of macroeconomic stability, our primary mandate. In the process, we also evaluate various alternative sources of funding too.

You are not ruling out private placements?

(Laughs) I will not give a specific reply to your specific question. My generalised response to all such questions is that all instruments, both conventional and unconventional, are on the table. I have said this before. RBI will take a judicious and balanced judgement call, depending on how the evolving situation plays out.

There is talk of the RBI indirectly or directly participating in the T-bill and bond auctions in the last two weeks. Could you explain what the advantage of RBI's participation in these auctions was?

Let me say very clearly, we have not participated in any primary auction so far. Our financial market operations as well as debt management activities warrant participating in the secondary market from time to time for a variety of reasons such as elongation of debt maturity, filling up gaps in the maturity spectrum of our holdings and the like.

Could COVID-19 bonds, which may be long maturity bonds that the government places with RBI, be an option?

This is the same question as the one you asked on private placement. What you are perhaps suggesting is that COVID bonds could be among the instruments of private placement. As I said earlier, we have not taken any view on the subject. When the time comes, we will take a judicious and balanced view, keeping in mind the parameters I set out earlier.

Were you surprised that banks did not participate in the TLTRO 2.0? The RBI has been proactive but banks just didn't come to the table.

We had a sense that the response may not be as good as TLTRO, despite the additional incentives such as exemption from being reckoned as adjusted net bank credit. The auction results convey a telling message, which is that the banks are not willing to take on credit risk in their balance sheets beyond a point. We are reviewing the whole situation and based on that, we would decide on our approach.

Would that mean a move to more general liquidity tools like LTROs or TLTROs?

That I cannot say, but the underlying challenge of ensuring flows to the mid-sized and small-sized NBFCs and microfinance institutions, that underlying challenge still remains. That is an issue that is very much on our table. We will take further measures as necessary to address that challenge. The RBI remains in battle-ready mode.

There are many parallels drawn between 2008 and 2020. While 2008 was more a financial sector problem spilling over to the real sector, this time it is a real sector problem which is being addressed through financial sector. This may be a necessary condition but not a sufficient one to bring the economy back on track. To that extent would you acknowledge that the role the central bank can play is limited?

The central bank's role should not be underestimated. Monetary policy, liquidity management, financial regulation and supervision are very powerful tools and are known to have lasting effects on economic and financial conditions. That said, we are dealing with a pandemic superimposed on a slowdown. The response has to be a coordinated one, with all arms of public policy as well as other stakeholders in the economy pulling together and working in close cooperation. Obviously, the government has a very important role in the response to the crisis.

You mentioned the exit from stimulus measures earlier. Even in 2008-09, it was easy to enter the 'chakravyuh' but difficult to get out of it. How do you ensure we don't cause new problems with our crisis response?

This is a pertinent question you have asked, as there has to be a very well calibrated and well thought out roadmap for entry and exit. The mantra of coming out of the 'chakravyuh' has to also be thought through very carefully and be factored in when entering the 'chakravyuh'. So, both have to be done simultaneously. Whether it relates to fiscal deficit or liquidity or any other extraordinary measure, it has to be applied in time, and the exit also has to be made in time. To ensure the markets don't read me differently and think that RBI is going on a tightening mode, let me make it very clear: the exit has to be well-timed, when you are confident that things are working and near normal. It should not be premature. At the same time, it should not be delayed beyond a point, in the interest of all.

Will the exit decision be more difficult than the entry at this point?

(Laughs) In the current juncture, all decision-making is very tough. It is an extraordinarily challenging situation, but both decisions on entering and exiting from the 'chakravyuh' are important.

You have taken the decision to widen the policy corridor by cutting reverse repo. What is the rationale there as markets are treating reverse repo as the operative rate thanks to abundant liquidity? Would the corridor stay wide, even in future if the MPC acts on repo?

Please note that the single policy rate is the repo rate, as decided by the MPC - and it alone conveys the stance of monetary policy. Reverse repo rate, on the other hand is essentially a liquidity management tool. With regard to the corridor being wider and having a lower reverse repo, this issue has been discussed in MPC earlier. The reverse repo decision is very much in the domain of the RBI; but having said that, let me reiterate that having a wider corridor and lowering of reverse repo has been discussed several times earlier in the MPC. Even in the last MPC (meeting), when we reduced the repo rate by 75 basis points, we reduced the reverse repo by 90 bps. The MPC was fully briefed about the rationale for our decision on reverse repo. The MPC

was very much taken into confidence, so far as the RBI thought process was concerned. On widening or narrowing of the corridor, even in April 2017, the corridor was narrowed to 25 bps, and it was not an MPC decision, it was an RBI decision. Even this time, it was an RBI decision, but the RBI thought process had been shared with MPC members even during earlier meetings. Through a lower reverse repo, we are offering an adverse rate in our liquidity absorptions and thereby seeking to incentivise banks to stop passively depositing funds with the RBI and instead lend to the productive sectors of the economy.

Is reverse repo effectively the operative rate, as that's not the intention of the MPC?

No. I want to repeat for the benefit of your readers: the repo rate is the single policy rate and it alone conveys the stance of monetary policy. Market participants are well advised not to be complacent about these transient arrangements which are necessitated by the imperatives of liquidity management, specifically, a huge overhang of liquidity. We live in extraordinary times and our policy responses have to be out of the ordinary. But do bear in mind that our critical active operations such as LTRO, TLTROs, lines of credit and the like are all at the policy repo rate or closely aligned to it.

Is it time to bring in Standing Deposit Facility as approvals are already in place? Has an SDF rate been decided?

That instrument is always available with RBI and it can be activated at any moment. We have not taken a final view on the rate yet.

Any concern that the wider LAF corridor can accentuate some outflows, when capital outflows emerge driven by risk aversion towards emerging markets?

As regards foreign exchange markets, if you compare India with other emerging markets, I think the depreciation of the Indian rupee has been orderly and much less than other comparable emerging markets. I am talking about the trends during the pandemic situation of the last one-and-a-half months. I won't rule out the possibility of inflows picking up. That can also happen with so much of liquidity in the advanced economies, it will naturally spill over to economies like India which have strong macroeconomic fundamentals. As far as the Indian economy is concerned, even compared to the aftermath of the global financial crisis, we are better placed in a comparative sense. In any case, the RBI has enough forex reserves. They are robust and we will be able to deal with any eventuality.

Has the US Federal Reserve committed to provide dollar support to RBI, if needed?

Federal Reserve has come out with a general policy and opened up a dollar repo window for central banks. That option is available for a large number of countries. We also have a bilateral swap arrangement with Bank of Japan.

Although India's debt-to-GDP ratio is deteriorating, many former central bankers have said that policymakers like RBI should not fear these rating agencies and be shackled by them...

Irrespective of rating upgrade or downgrade, so far as India is concerned, we have seen that India has continued to enjoy the trust of foreign investors, both in terms of foreign portfolio investment and foreign direct investment. It is the policies which a country follows, macroeconomic fundamentals and the outlook that foreign investors have on an economy that matters. Today, with the information explosion, thanks to the internet and electronic media, investors abroad, are much better informed about what is actually happening in India, than they were, say, 20 years ago. I am not saying rating agencies are totally irrelevant. Rating agencies do influence some foreign investors who follow their own methods of indexation where there is application of ratings for investment. But, by and large, foreign investors in the last several years have exhibited their trust on the Indian economy irrespective of the rating upgrade or downgrade.

Most commentators believe that we have the best person in the top job at the RBI, given your experience across the bureaucracy and government. How helpful has this been, given there is a fair bit of coordination that you have to do with the government and at the same time, protect the autonomy of the central bank?

The RBI's autonomy is never in doubt. All decisions are independently taken by the RBI. We take our own decisions but we do engage with various stakeholders, including the private sector and markets. Stakeholder consultation is an essential part of the approach at the RBI and the government is much more than a stakeholder. Obviously, we do consult with them and they also consult us. Consultation flows both ways between the government and the RBI. My experience of working in the government does help me to take a balanced call on all issues, without in any manner compromising the core principles of central banking. Let me also say that even when I was in the North Block, my effort was always to take a balanced call taking into account the requirements on the government and the viewpoint of the RBI. During my tenure in the finance ministry, it was always my endeavour to take a balanced call between the expectations of the government and the central bank viewpoint. The same approach continues even now.

You have delivered some very strong messages from the RBI in recent times such as 'don't discount the RBI' and 'we shall endure'. In a crisis period, as the monetary authority of the country, what is your message to the financial sector and the common man on the streets?

This is a time of trial; an endurance test. We must remain resilient and believe in our capacity to come back stronger.