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Dr. Urjit R. Patel: Good afternoon, everyone. Today, after two days of deliberations, the Monetary Policy Committee, by a 4 to 2 vote, decided to keep the policy repo rate unchanged and it decided to change the stance from neutral to calibrated tightening.

The MPC noted that global economic activity has held up so far but is becoming asynchronous across economies in a highly unsettled international environment and the outlook is overcast with downside risks. In particular, activity in emerging market economies is encountering headwinds from the oil price rise in response to robust demand in advanced economies amidst supply side disruptions**;** US dollar tightening in the wake of a late in the cycle fiscal stimulus in the United States; third, growth and supply chain uncertainties due to escalating tariff wars; and four, country specific emerging market events with attendant spillovers through portfolio rebalancing and repricing of risk channels. It is also important to recognize that close to a decade long extra ordinary accommodation by systemic central banks is finally tapering off. This inevitable normalization, coupled with the emergence of risks stated above, has resulted in several quantity and price adjustments in the global financial markets.

Global trade, according to the latest data from the World Trade Organisation (WTO), is losing pace, possibly on account of ongoing tariff wars. For Emerging Market Economies (EMEs) currency depreciations have imposed additional upside inflation risks, besides contagion risks of a technical nature from specific EME episodes and geopolitical developments.

Turning to the Indian economy, the Monetary Policy Committee observed that in a sequential acceleration that started in the second quarter of 2017-2018, real Gross Domestic Product growth had surged to a recent high of 8.2% in the first quarter of 2018-2019 on the back of strong expansion in private consumption, investment and exports.

On the supply side, there was double-digit growth in manufacturing activity and a pick-up in the pace of agricultural output, while services sector growth moderated from a high base. Kharif sowing has weathered initial monsoon setbacks and risen above last year's acreage. Early estimates have placed this year's kharif production higher than last year's record level. Industrial production accelerated in July 2018 and the seasonally adjusted capacity utilization in the manufacturing sector has risen in the first quarter of 2018-2019 to its long-term average.

Forward-looking surveys reflect continuing optimism on capacity utilization in the second quarter too, as also on production order books and exports. However, on the other hand, the performance of the services sector in the second quarter of the year appears to have been somewhat varied.

Retail inflation has eased in July and August, dragged down by a decline in food inflation and some moderation in other components, except in the fuel and light category, in which prices are closely tracking international product prices. Households reported a sharp uptick in inflation expectations three months ahead, although their inflation expectations a year ahead actually moderated. Manufacturing firms' expectations for both input prices and selling prices have risen in the second quarter of 2018-2019. In contrast, wage growth in both rural and organized sectors remained contained.

In the external sector, exports maintained double-digit growth in July and August, which was broad based. However, imports grew faster than exports, leading to a widening of the trade deficit over and above the expansion that had occurred in the first quarter. Higher net services earnings and private transfer receipts offset a part of the increase in the merchandize trade deficit. In the first quarter, they helped to contain the current account deficit to 2.4% of GDP from 2.5% a year ago.

On the financing side, net foreign direct investment flows improved in April to July 2018. By contrast, foreign portfolio investors have been net sellers of both equity and debt on a cumulative basis. Our foreign exchange reserves at $400.5 billion at the end of September are sufficient to finance 10 months of imports.

Notwithstanding the improvements in these fundamentals, the exchange rate of the Rupee has experienced bouts of volatility since the MPC last met in August. In particular, India has not been immune to global spillovers from external factors we set out in the introductory remarks.

The depreciation of the Rupee has, however, in some respects been moderate in comparison to several other EME peers. By end September, the Rupee had depreciated in Nominal Effective terms by 5.6% since end- March. In Real Effective terms, the Rupee's depreciation has been at 5%.

The RBI's response to these unsettled conditions has been to ensure that the foreign exchange market remains liquid with no undue volatility. There is no target or band around any particular level of the exchange rate, which is determined by market forces of demand and supply.

Coming to the outlook, the MPC noted that actual inflation outcomes in July and August were below the projections. Going forward, the outlook for food inflation is expected to remain benign, although the impact of the increase in Minimum Support Prices announced in July remains uncertain to some extent as yet. However, the price of the Indian basket of crude oil increased by $10 a barrel since the MPC met in August and remains vulnerable to further upside pressures from supply disruptions due to geopolitical tensions.

EME currencies have depreciated significantly and the outlook is uncertain. Moreover, as pricing power returns, there is a risk of high input costs being passed through into retail inflation. Accordingly, the trajectory for inflation is set to rise from the current level, from Q4 2018-2019. Excluding the HRA impact, CPI inflation is projected at 3.7% in Q2 of this financial year, 3.8% to 4.5% in the second half of 2018-2019 and 4.8% in Q1 of 2019-2020, with risks tilted to the upside. Should there be a fiscal slippage at the Center and / or State levels, it will have a bearing on the inflation outlook, besides heightening market volatility and crowding out private sector investment.

On the outlook for growth, the MPC noted that the print for the first quarter of 2018 – 2019 was significantly higher than what was projected. Looking ahead, it was of the view that private consumption will likely be sustained in spite of the recent rise in oil prices.

Improving capacity utilization, larger FDI inflows and increased financial resources to the corporate sector is projected to augur well for investment activity. The key risks to the outlook emanate from the tightening of global and domestic financial conditions, which could depress investment activity and the prospects for exports. Accordingly, the projection for GDP growth for 2018-2019 was retained at 7.4% as in the August resolution, which means 7.4% in Q2 and 7.1% to 7.3% in the second half of 2018-2019, with risks evenly balanced around this 7.4%.

Reiterating its commitment to achieving the medium-term target for headline inflation of 4% on a durable basis, the Committee called for a close vigil on the inflation outlook to ensure that expectations remain anchored. With global headwinds posing major risks to the growth and inflation outlook, the MPC believes the highest priority is further strengthening of the domestic macroeconomic fundamentals. It is prudent for the Indian economy to continue to recalibrate the macroeconomic stance and direction to further buttress our resilience against global headwinds.

The primary responses in these areas include maintaining steadfastly inflation creditability of monetary policy; sticking to the fiscal policy targets at the general government level, which means Centre and States combined; allowing flexible exchange rate adjustment without undue volatility to help reorient Current Account balance given the revised terms of trade; retaining adequate capital and liquidity buffers in the financial sector, so as to maintain financial stability, especially when retail credit growth is in excess of the nominal GDP growth; fifth, undertaking further structural reforms to propel the domestic growth engine and liberalizing capital flows, including Foreign Direct Investment, subject to macro prudential constraints, while also increasing the attractiveness of domestic economy to such flows.

The strong growth tailwinds of the Indian economy and the Reserve Bank of India's balance sheet preparation should help smooth the short-term fluctuations while the medium to long-term policy response, which are already being actively considered and also being pursued, take shape to buttress the economy.

Finally, the well-structured institutional measures, taken by the Central Government in the IL&FS case, have been timely and appropriate. These have helped to stabilize the situation. The Reserve Bank will engage with the new management, if necessary, on assistance in its efforts, going forward.

I will now request Deputy Governor, Acharya.

Dr. Viral V. Acharya: Good afternoon, everyone. I will first summarize the evolution of system liquidity over the first half of this fiscal year 2018 – 2019. As you know, post demonetization, the system liquidity remained in surplus mode till March 2018. And as I have been telegraphing in the prior post-monetary policy press conferences, system liquidity has largely remained neutral for most of the first half of this fiscal. The weighted average call rate, the rate at which banks and primary dealers borrow and lend in the unsecured money market, has been 10 basis points below the policy rate, reflecting this comfortable liquidity position.

Turning now to system liquidity over the past two months, system liquidity again remained largely neutral in August and entered into deficit zone since mid-September as was anticipated. There was a small daily average liquidity injection by the Reserve Bank in the months of August and September. Prior to that in June and July, Reserve Bank was, on average, absorbing liquidity. Nevertheless, you could see that the weighted average call rate was still about nine basis points below the policy rate even in August and September.

Several measures have been taken, especially in the second half of September, to provide adequate system liquidity, in particular, two open market operations- OMO purchases - were undertaken of ₹ 10,000 crores each in the second fortnight and ₹ 36,000 crores of OMOs have been announced for this month. Reserve Bank also provided liberal infusion of liquidity through term repos in addition to what it usually provides through the frictional liquidity adjustment facilities. And there was also an increase in the facility to avail liquidity for liquidity coverage ratio, which also freed up the liquidity that banks could access, given that the collateral became eligible now for raising liquidity. And, this would in-turn help transmit liquidity to other sectors in the financial system and economy.

The Reserve Bank will continue to proactively manage the system liquidity so as to achieve the monetary policy objective of aligning the overnight weighted average call rate with the policy rate, while also meeting economy's demand for reserve money growth. The evolving liquidity conditions will however continue to determine our specific choice of instruments for liquidity management.

A word on events of the past few weeks in the short-term debt markets is in order. The Reserve Bank, along with the Government of India and the Securities & Exchange Board of India, have been closely monitoring the situation. I would like to encourage, in fact, urge all financial firms to place greater reliance on equity and other modes of long-term finance for funding of long-term assets rather than relying excessively on short-term wholesale paper. Chasing lower marginal costs of funding, in order to retain or acquire market share in lending, is a myopic strategy. It is associated with significant rollover risks in the medium-term and this practice appears to have led to a form of maturity rat race in the financing of the financial sector. Increasing asset liability mismatch in this manner can be a particularly imprudent policy in a time of global and domestic tightening conditions. It is best to avoid this in order to safeguard financial firms' own balance sheets as well as for overall financial stability.

I will hand it over to Deputy Governor Vishwanathan who will further speak on financial stability and NBFC sector in particular.

Shri N. S. Vishwanathan: Thank you, Dr. Acharya. Thank you, Governor. In the wake of anxiety about the NBFC sector, let me mention that RBI is closely monitoring the NBFC sector. The regulatory and supervisory framework for the sector hinges on three principles of protection of depositors' interest when they are deposit accepting companies, healthy customer interface and avoiding systemic risk. The NBFC sector plays a critical role in meeting the credit needs of different segments of the economy, more so of the informal sector. The NBFC sector overall is quite strong and the regulatory and supervisory framework is robust.

We have moved towards harmonizing the regulations and have fully synchronized the NPA recognition norms for the NBFCs with the banking system now. Early this year, we had initiated the process of weeding out many of the non-compliant small NBFCs that would have been noticed.

The NBFCs have a CRAR of 15% and there were high density of 100% risk-weighted assets because we have not allowed the differentiated risk weights for them, so most of the assets are risk-weighted at 100%. The core investment companies, that is a separate class of NBFCs, they are for the purpose of making investments in the groups. So, the regulatory framework for them is that 90% of their exposure should be to group entity of which at least 60% should be in equity. The framework for them is that they must work on a debt-equity ratio of 2.5. And this is at the entity level, not at the group level.

Last couple of years saw rapid growth of the NBFC sector, NBFCs used diverse sources of funds for this expansion. They have also tapped the market. And in the process, in order to manage the marginal costs, as Dr. Acharya said, some of them have resorted to increased market borrowings in the form of Commercial Paper (CP) and that could result in asset liability mismatch, more so for companies which are financing long-term assets like infrastructure. There is an ALM guideline for them, but we are looking at strengthening them so that we can avoid this rollover risk, going forward.

As Governor said, the measures taken by the Central Government in the IL&FS case are timely and appropriate. These have helped to stabilize the situation. We also believe that the isolated events should not be seen as having any system wide implications. Thank you.

Dr. Urjit R. Patel: Thank you, DG Acharya and DG Vishwanathan. I will take a few questions.

Manojit Saha:
The Hindu Sir, since we are in an election year and yesterday we have seen some populist measure, do you think there is a risk to fiscal deficit if such measures continue? And if there is a risk for overall financial stability since current account deficit and inflation is going to rise six months down the line?

Dr. Urjit R. Patel: The Central Government recently committed to the fiscal deficit target and moved some of its borrowing from the market to the National Small Savings Fund (NSSF) and other small savings instruments. However, it is important that the fiscal deficit target is maintained and not only for the reasons that you mentioned but also to mitigate the risk of further crowding out, because when the Centre and States' borrowing programme is taken together, it is of a large quantum. And therefore, I assume, given that these two decisions were taken over only a few days in between, this was possibly internalized when the government made its commitment to the fiscal deficit target and reduced its market borrowing. So, so far, we have to take that at face value.

Mayur Shetty:
The Times of India There were many forecasters who were expecting that the Reserve Bank of India would be taking some action to stabilize the Rupee, because they are talking about Rupee coming under further pressure because of difference with US Fed rates, oil prices going up and current account deficit widening. The fact that you have chosen to retain the rate, is it indicative of your comfort on the exchange rate front?

Dr. Urjit R. Patel: Let me say a few words and then I will request Dr. Acharya to also say something on this. The mandate of the Monetary Policy Committee is a legislated one and it is a flexible inflation targeting mandate at 4% with a band of +/-2%. To the extent that domestic and international financial conditions including commodity prices affect the inflation outlook and the projections that is internalized in the projections with the fan charts; and in that respect, the risks that you mentioned are already baked in with respect to the forecasts, and therefore, the decision that we took today. Please do recall that prior to this, we had two rate hikes in the space of literally two months, and today's stance of calibrated tightening essentially means that, in this rate cycle, rate cut is off the table and that we are not bound to increase rates at every meeting because that is not required, given our inflation outlook and forecasts at this point in time. As new data comes in, we would look into changing our policies accordingly. But the calibrated tightening is the appropriate stance at this point in time, given the forecasts and the financial conditions.

Dr. Viral V. Acharya: I would just add one or two things to what Governor has just said. I think the exchange rate is a price, Rupee-Dollar is a fairly deep market, it gets determined by supply and demand forces. The Reserve Bank of India's stated policy has always been to manage undue volatility rather than a very specific level. And as Governor already articulated earlier in his initial remarks, exchange rate adjustment is an important part of how your economy adjusts to terms of trade shocks. The second is the managed float which is what roughly the RBI stated policy is, it is essentially what the Reserve Bank of India's foreign exchange operations pursue. And as far as interest rate is concerned, it is primarily focused, I would say exclusively focused, on its mandate of flexible inflation targeting.

Govardhan Rangan:
The Economic Times: Sir, when it comes to inflation outlook, the kind of upside risks have been here for quite long; from emerging market currencies, to oil prices, to fiscal and everything, but at the same time, you have cut inflation forecast. What was the trigger that actually made you cut the inflation forecast and keep rates where they are and change the stance?

Dr. Urjit R. Patel: That is a good question. In a way, the long list of risks that we have enunciated, is the reason that we have said that the risks are tilted to the upside. So that, in a way, is taken into account. There are one or two risks which could move in the other direction, and even the commodity prices risk is a two-way going forward, not necessarily just oil but other commodities. The forecasts are based on data so far and our projections using our models. And given that it is an outcome of what has taken place so far, it indicates to us that there has been a 20 basis points reduction in our projection in Q1 for 2019-2020. So, that is something that is an outcome from the trajectory so far and based on assumptions and the forecasts that we make from our models. And therefore, the stance, for that reason, has been changed because the risks are tilted to the upside. And we are focused on inflation being at 4% level on a durable basis.

Shritama Bose:
The Financial Express: So you have kept the rate unchanged but changed the stance, so would you call this a deferred action on the part of the Central Bank? Also the currency as well as stocks have crashed after the action, so your comment on that.

Dr. Urjit R. Patel: Well, the stance is not necessarily a deferred action. That could be said even with a neutral stance. What this stance indicates very clearly is that going forward, there are only two options in this particular rate cycle, either we increase rates or we keep them steady. With the neutral stance, a cut was also on the table. So, I think it is very clear that we are focused on the 4% inflation target on a durable basis as RBI's long-standing policy underscored by both Dr. Acharya and I, that the monetary policy is exclusively focused on inflation targeting and that is the legislated mandate.

Dr. Urjit R. Patel: A clarification, on the status quo on rates, it is 5:1 vote.

Dr. Viral Acharya: It was also 5:1 on the stance, but it is two different people who voted. So, on the overall decision, it is 4:2 vote.

Dr. Urjit R. Patel: Thank you.

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