Edited Transcript of Reserve Bank of India's Third Bi-Monthly Policy Press Conference

August 01, 2018

PARTICIPANTS FROM RBI:

DR. URJIT R. PATEL – GOVERNOR
MR. N. S. VISHWANATHAN – DEPUTY GOVERNOR
DR. VIRAL V. ACHARYA – DEPUTY GOVERNOR
MR. B. P. KANUNGO – DEPUTY GOVERNOR
MR. M. K. JAIN – DEPUTY GOVERNOR
DR. MICHAEL D. PATRA – EXECUTIVE DIRECTOR

Dr. Urjit R. Patel: Good afternoon everyone. Firstly, I would like to welcome Deputy Governor Mr. Jain. This will be his first post-monetary policy press conference.

In its assessment of current and evolving domestic and global macroeconomic and financial conditions, the Monetary Policy Committee observed that since its meeting in June, global growth has sustained pace, but it has become uneven. Risks to the outlook from volatile and elevated oil prices, mounting trade tensions and tightening of financial conditions have increased. Inflation has edged up in several major advanced and emerging economies driven by rising energy prices and the pass-through from respective currency volatility.

Financial markets remain unsettled and capital flows to emerging economies have declined with their currencies depreciating against the firming US Dollar. Instances of contagion have also occurred since April.

On the domestic front, the Monetary Policy Committee took note of the rise in retail CPI inflation for the third consecutive month in June. Even though food inflation remained muted, other components recorded moderate to sharp price increases. Households reported an uptick in inflation expectations while manufacturing and services firms indicated elevated input costs and wage growth in the organized sector remained firm. Even as inflation projections for Q2 have been revised marginally downwards vis-à-vis the June statement, to 4.6%, projections for the second half of this fiscal year remain broadly unchanged at 4.8% with risks evenly balanced. For the first time, the projection of inflation for Q1 for the next financial year, that is 2019-2020, has been given and it is placed at 5%. Excluding the HRA impact, CPI inflation is projected at 4.4% in quarter two of this fiscal year, 4.7% to 4.8% in the second half of this fiscal year and 5% in the first quarter of 2019-2020.

In the view of the MPC, there are several risks to this outlook - the high volatility characterizing crude oil prices, financial turbulence in global financial markets, hardening of households' inflation expectations and input pressures faced by corporations domestically. Moreover, any fiscal slippage at the center and/or state levels could have adverse implications for the inflation outlook and could crowd out private investment going forward. There is considerable uncertainty around the full impact of the Minimum Support Price (MSP) changes on inflation, which will only resolve in the next several months once the price support schemes are implemented and rolled out across the commodities. While the statistical impact of the HRA revision by state governments can be looked through, it is important to be watchful for any second-round impact on inflation. On the other hand, the MPC noted that the recent softening of commodity prices could contain input costs while the reduction in GST rates could moderate inflation if there is a pass-through to retail consumers.

In our assessment of the outlook for domestic economic activity, we observed that there is a gradual recovery of the southwest monsoon but the sown area of kharif crops is lagging in relation to a year ago. Industrial growth strengthened in April-May 2018 and the output of eight core industries accelerated in June. Non-food credit by banks is growing at about 13%. Capacity utilization in the manufacturing sector remains robust and there is optimism on the outlook. Services sector activity appears to be picking up in a broad-based manner. Double-digit import growth in May and June pushed up the trade deficit. Foreign direct investment flows improved significantly in the first two months of 2018-19 while recently, foreign portfolio investment outflows have been slowing.

Looking ahead, the Committee felt that the progress of the monsoon and a sharper than the usual increase in MSP of kharif crops could boost rural demand by raising farmers' income. Investment activity remains broadly firm and the pick-up in foreign direct investment amidst buoyant domestic capital market conditions bodes well for prospects.

Notwithstanding some tightening of financing conditions and rising trade tensions, GDP growth is projected at 7.4 percent for this fiscal year as in the June statement; 7.5-7.6 percent in the first half of 2018-19 and 7.3-7.4 percent in the second half, with risks evenly balanced. The projection of GDP growth for the first quarter of 2019-20 is placed at 7.5 percent.

In the assessment of the Committee, uncertainty around domestic inflation needs to be carefully monitored in the coming months. In addition, rising trade protectionism, geo-political tensions and elevated oil prices pose grave risks to near term and long-term global growth prospects by adversely impacting investment, disrupting global supply chains and hampering productivity. Against this backdrop, the Committee decided to increase the policy rate by 25 basis points while maintaining the neutral stance of monetary policy. The Committee reiterated its commitment to achieving the medium-term target for headline inflation of 4% on a durable basis while supporting growth.

I will now request each of the Deputy Governors to say a few words– Dr. Acharya.

Dr. Viral V. Acharya: Good afternoon, everyone. I will start off by saying a few words on the inflation projections.

The impact of MSP hike on the projections is a challenging task. What is known as of now is that the increase in MSP for kharif crops is much larger than the average increase that is seen in the past few years.

Now such an increase operates through multiple channels in affecting inflation. There is a direct impact on the prices of the targeted food items. There could be relative price adjustments within the food baskets. There could be impact on rural wages and then there could be generalization of all these through inflation expectations. It is important to note that a part of the announced MSP is already built into our baseline projections as of two months back because that is the average increase you are seeing year after year. So, it is only the incremental impact that needs to be factored in.

So, while there is considerable uncertainty, we have looked at all the available information and what we think is a reasonable estimated present that we have factored into the food projections. Now of course, as the implementation details become clearer, these projections will, therefore, necessarily have to undergo some revision. Second, I want to stress that the monetary policy transmission operates at several quarters of lags and as a result, the two rate hikes of June and this policy will play out only in due course in our immediate projections because they will take some time to bite on the inflation.

A few words on the liquidity conditions – we had indicated at the last policy that we expect the liquidity in the system to move into neutral zone in the first half of fiscal year 2018, and consistent with this indication, on most days in June and July, the system liquidity has remained in neutral zone. There are, of course, modulations related to tax outflows and changes in government cash balances. The system, however, is still in a small surplus on average and this is also reflected in the fact that the overnight lending rates and the weighted average call rate, which we monitor closely in determining our transient liquidity management, has remained on an average 10 basis points below the policy rate during the June and July period, though it has come down from 14 basis points during April and May. Besides the transient liquidity management, RBI also conducted three OMO auctions of Rs. 10,000 crores each so far in the fiscal year.

Last point on liquidity, though the growth in currency in circulation has moderated to some extent recently, its expansion remains above historical trend and as we have been telegraphing, reserve money growth is expected to pick up in the second half of fiscal year 2018, it is usually coincident with the start of the festive season. RBI will continue to actively 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 meeting economy's demand for reserve money growth. The evolving liquidity conditions will determine our choice of specific instruments for transient and durable liquidity management.

Finally, just two quick words on the developmental and regulatory policies. We are proposing to undertake a review of the various foreign exchange derivative facilities for residents. It is meant to reduce administrative and documentation requirements and making the present set of regulations more principle-based to incentivise hedging transactions while disincentivising sort of what might look like hedging transactions but are not. We are also hoping to encourage as a part of the review mechanisms through which Indian multinationals can hedge their global currency risks, and in non-rupee cross currency pairs, out of their treasury operations in India. Second, with increased global integration of domestic markets it is increasingly being discussed that market timings may be reviewed in order to facilitate better and quicker pricing of global developments. Of course, any changes to market timings have to be in sync with clearing and settlement arrangements and their efficiency. So, it is proposed to set up an internal working group that will comprehensively review timings of various markets that are under the purview of the RBI and assess the necessary payment and settlement infrastructure that can support coordinated timing across these markets. Thank you.

Dr. Urjit R. Patel: Mr. Vishwanathan.

Mr. N. S. Vishwanathan I want to draw your attention to two policy announcements and both these relate to cooperative banks this time. Firstly, we have decided to extend the access to Marginal Standing Facility (MSF) to Scheduled Urban Co-operative Banks and Liquidity Adjustment Facility (LAF) and MSF to the State Co-operative Banks. This will provide them additional tools to manage their liquidity and broaden and deepen the financial markets, which will in turn facilitate better transmission of monetary policy to the money market rates. The list of eligible banks will be reviewed on an ongoing basis, because, there are eligibility conditions and that will be announced on an ongoing basis with the concerned department, which is the Department of Co-operative Bank Regulation.

The second again relates to cooperative banks. Currently, the Urban Cooperative Banks are allowed to trade in the non-SLR investments only with the Commercial Banks and the Primary Dealers. We want to provide them a larger avenue with whom they can trade, and we are therefore including mutual funds, insurance companies, pension funds, etc., so that they will have a wider choice of counter parties and enable them to get better price discovery for their non-SLR investments.

Dr. Urjit R. Patel: Mr. Kanungo.

Mr. B. P. Kanungo I will talk about the G-Sec market, one of the important announcements that is there in the Part-B. As you know, over several years, Reserve Bank has been consistently trying to widen and deepen the G-Sec market. In line with these developments, RBI has been operating a state-of-the-art central electronic depository with SGL account and CSGL account in our Public Debt Office in Reserve Bank for holding the securities of the market participants.

Several market participants have been demanding and they have been requesting us to take a relook at this. As you know, the guidelines were last reviewed in the year 2012 and has not been reviewed since then. So, in order to improve the operational ease and give them more flexibility, we are taking a relook at these guidelines. A comprehensive review till be undertaken. The kind of thing that they have been requesting is- whether the opening of the account or the closure of the account, does it necessarily require a no-objection certification from the respective regulatory department of the Reserve Bank. Secondly, they have been demanding whether there can be multiple accounts – we allow only one account. So, these kinds of requests have been coming and we will take a look at this and review the guidelines comprehensively and by October we will issue the guidelines.

Dr. Urjit R. Patel: Mr. Jain.

Mr. M. K. Jain Let me touch upon two policy announcements in today's policy – one on the co-origination of loans by banks and NBFCs for lending to priority sectors. In our continuous efforts to bring the financially excluded segment of the society into the fold of formal financial sector and to increase priority sector lending, the co-origination model between banks and NBFCs has been conceived.

This convergence, between banks on one hand and the NBFCs on the other, can bring the strength of the two sectors together. Accordingly, a framework for co-origination of loans by banks and the NBFC ND-SIs (Non-Deposit taking- Systemically Important NBFCs) with risk participation is being introduced. While it would ensure skin in the game for both the parties, it would benefit the priority sector beneficiaries, in terms of cost of credit, which on account of blending could be substantially lower. To begin with, the scheme will be allowed only to Scheduled Commercial Banks (excluding RRBs and Small Finance Banks) and NBFC ND-SI on risk sharing basis. We will issue basic principles to be adopted by both the institutions in their formal arrangements.

The second policy announcement is with regard to strengthening Internal Ombudsman (IO) mechanism in banks. The Internal Ombudsman mechanism was set up with a view to strengthen the internal grievance redressal system of banks to minimize the need for the customers to approach other fora for redressal. As part of customer centric approach, a review of the IO mechanism was undertaken, and it has been decided to extend the IO scheme to all Scheduled Commercial Banks excluding RRBs with 10 or more banking outlets. Earlier it was confined only to the Scheduled Commercial Banks and few banks.

The revised IO scheme seeks to enhance the independence of the IOs and reinforce the oversight on the implementation of the IO scheme for further improving the quality of customer service in banks. Keeping in view the rising customer base and the fast-paced growth of the digital transactions, the banks would have the option to appoint more than one Internal Ombudsman depending upon their assessment of the volume and nature of complaints. Thank you.

Dr. Urjit R. Patel: Thank you. We will now take a few questions. We will start with Bloomberg Quint.

Ira Dugal
Bloomberg Quint: Governor, we have now two rate hikes behind us. We also have inflation projections up to Q1 of FY20, which say that it will remain above the 4% mark. Against that backdrop, sir, can you explain a bit more about why a neutral stance is consistent right now or is appropriate right now?

Dr. Urjit R. Patel: Many of the risks that we have sighted, which informed our projections are on both sides and that is why we have said that these projections are against the backdrop of balanced risks. Secondly, there is a fair bit of uncertainty around CPI prints, going forward, and therefore it was important that we kept our options open depending on the prints coming over the next few months, given the volatility of the prints that seem to be coming most of the time. So, that is why we emphasize that we would need to monitor the domestic inflation outlook in the coming months very carefully. For these two reasons, the stance is retained at neutral and the risks around their projections are balanced.

Nikkei.

Takehiko Koyanagi
Nikkei Actually, I am with these numbers coming from Japan where inflation rate is always de-facto minus and interest rates are always minus these days. Well, anyway, I wonder, in medium-term, what is your diagnosis of cause of rising inflationary pressures, especially in the core inflation, and how does that diagnosis affect the judgment today?

Dr. Urjit R. Patel: I will request Dr. Michael Patra to address that.

Dr. Michael D. Patra It is difficult to set out exact projections for the items in the core inflation for the medium-term but currently we have seen pressures getting generalized across services particularly, especially health and education and a large number of miscellaneous services, which enter the basket of the common person.

Takehiko Koyanagi
Nikkei What is the cause of that?

Dr. Michael D. Patra: There are several causes. Some of them are cost push, like Governor indicated, there are input costs feeding through. There are also some staff costs in the organized sector which are passing through. Also, there might be demand pressures starting up.

Dr. Urjit Patel: Economic Times.

Atmadip Ray
Economic Times As the geopolitical risks and uncertainties that are looming large and trade war happening, so what are the possible outcomes or fallout on the Indian economy and how is RBI preparing to trade with that, to maintain stability in the money and currency market?

Dr. Urjit R. Patel: We have already had a few months of turbulence behind us and it looks like that this is likely to continue for how long I do not know, but you know, the trade skirmishes evolved into tariff wars and now we are possibly at the beginning of currency wars. Given this, we have to ensure that we run a tight ship on the risks that we control to maximize the chances of ensuring macroeconomic stability and continuing with a growth profile of 7 to7.5%, going forward. We do have things that are in our favor, which you are aware of and if we continue along that path we ensure that we do not add to the global risk profile that would adversely affect us.

The Hindu

Manojit Saha
The Hindu In India we have three banks which are 'too big to fail'. One of them is in the middle of a huge controversy following allegations of conflict of interest, among others. There are regulators like the SEBI and SEC that are engaging with the bank. Is there any engagement from RBI also and if there is a bigger issue of governance in the private sector banks?

Mr. N. S. Vishwanathan: I think it is not appropriate for us to discuss any specific bank, but I must tell you that we are alive to what is happening in the banking system and we are dealing with those situations as they are emerging, but I cannot mention what we are doing with the specific bank. As far as 'too big to fail' is concerned, there are global standards of BCBS, under which additional capital is being maintained, and all those principles are being adopted in India.

Ben Jose
PTI The policy gives a lot of reasons for what you did today by hiking the rate but at the same time the risks are evenly balanced, even to the inflation. So, what was the main drive for hiking the rate today? Is it the non-inflationary factors, especially the trade wars or something else?

Dr. Urjit R. Patel: The main reason for changing the policy rate is to ensure that, on the durable basis, we come to and maintain the 4% target and we have been away from the 4% number for several months now, and we took two steps, once is June and once in August, to maximize our chances that we do not drift away from 4% and in fact we move towards 4% on a durable basis. So, it is based on the objective that has been given, the data prints and our projections going forward.

Anup Roy

Business Standard Sir, even as our inflation is below 5% but the core inflation is touching 6% or may have crossed it already, so what is your fear around that core inflation part? How much is core inflation a concern for you, especially after MSP has come, so it is already touching 6%?

Dr. Urjit R. Patel: Our mandate is to target the headline and therefore, while we look at the components that make up the headline, our focus in terms of the policy choices, is to get the headline to 4% or thereabouts. So, while it gives us information- you know it is not just core, there is core- core and many others- as many as people want. The legislated target is on CPI headline and our policy is oriented to keep that at 4%. Thank you.