Governor's Fire side Chat Session at the Banking Beyond Tomorrow: The Annual Banking Conclave of Bank of Baroda in Mumbai on July 22, 2022 (Edited excerpts)

Sanjiv Chadha, Managing Director, Bank of Baroda

Thank you very much, Governor once again for that tour de force. We are really reassured about the fact that in terms of the external sector, despite what is happening in the neighbouring countries, India is in a different and very strong place. Also, I think the areas you covered in terms of what banks need to focus on, I am sure that will define the agenda for not only this conference but also for the next few years. A few questions, Governor, first on the monetary environment, and then a few other areas that you also touched upon.

It seems to be the case that we may be moving now from an era of Great Moderation to a time of great uncertainty or even perhaps great volatility. Volatility in terms of commodity prices, supply chains, supply shocks, inflation, and interest rates. Inflation targeting has worked very well during the time of Great Moderation. However, the question is, is it an appropriate framework during great volatility, or do central banks need to have the advantage of a little more flexible framework?

Shaktikanta Das

I think the current framework that we have with regard to inflation targeting has worked very well over the years. We positioned this inflation-targeting framework in our country in 2016. The average CPI inflation (headline inflation) from 2016 to the onset of the pandemic (February 2020), if I remember correctly, was 3.90 per cent, thereafter, we had the huge shock coming from COVID. Since we have flexibility inbuilt into the target of 4.0 per cent plus/minus 2.0 per cent. So, the MPC decided to use that flexibility/space to tolerate slightly higher inflation that is higher than 4.0 per cent. It is that flexibility, which is built into the inflation targeting framework that allowed the MPC and the Reserve Bank to reduce the policy rates to inject a huge amount of liquidity and several other measures, which were taken by the Reserve Bank to fight the onslaught or the impact that the COVID was producing not only on the financial sector but also on the real economy. The entire framework has worked quite well. Inflation targeting is something, which is important at all times, as it is said and as it is well known, the common person suffers the most if there is high inflation. Inflation, without any price stability framework, may lead to other kinds of consequences, which will undermine the financial stability of the country.

Going forward, unless the central bank is mandated to control inflation and maintain price stability; unless the central bank as a follow-up to this mandate takes steps to adjust the policy rate accordingly from time to time, the negative interest rates will increase. It will act as a big disincentive to savers; it will be a big disincentive for financial savings. Less financial savings will have an impact on the investment outlook or the entire investment climate of any country. Now, there are other consequences also.

So, I feel that because we have gone through this kind of crisis, the COVID, and now the war in Europe, which has again produced a lot of consequences in the real sector. Having an inflation target and trying to achieve that ensures the aspect of financial stability. Not only in India but the world over that is maintained and is the key to maintaining financial stability. So far as India is concerned, the framework has worked well before the pandemic, during the pandemic. Even now, I would say that we are very much in line with the requirements of time in terms of the steps that need to be taken. I feel that the framework has worked well and needs to continue. My personal opinion and the opinion of all of us in the Reserve Bank is that let's not shift the goalpost to just suit our convenience because the larger requirement of the economy and the financial sector is to have such a framework.

Sanjiv Chadha
Thank you, Governor; just a connected question. While almost all central banks have moved to tighten policy almost in a coordinated manner. They are in very different situations. For the ECB, it seems to be all bad choices either control inflation or confront a potential sovereign debt crisis; where the Fed seems to be better placed with the underlying dynamism of the US economy likely to remain intact even if it were to engineer recession. How would you rate India in this context? Could rate hikes threaten slipping recovery or is growth momentum likely to continue to gather pace, despite what is the normalisation of interest rates possibly?

Shaktikanta Das
In the MPC statement, the minutes and the MPC resolution, it has been clearly stated and as I have also mentioned earlier in my statements, our decisions on rate hikes or decisions relating to liquidity, always take into consideration the aspect of growth. The law says that the Reserve Bank is responsible to maintain price stability, keeping in mind the objective of growth. So, the objective of growth has to be kept in mind at all times. We have now changed the sequence. Change in the sequence meaning sequence of priorities. Currently, our focus is on inflation followed by growth. So, any decision that we take with regard to liquidity, with regard to the policy rates always takes into consideration the kind of impact it is going to produce on the growth and the revival of economic activity. The high-frequency indicators in the first three months of this year and even in July so far, as India is concerned, they're looking very positive. Whether you look at GST collections or you look at E-way bills, there was a slight dip in between, but they have improved. The aggregate demand has also improved, and urban demand is fairly strong. The rural demand is now showing signs of picking up. The demand for work under Mahatma Gandhi NREGA has also moderated. So, there are several signs of high-frequency indicators, for example, the sale of passenger vehicles, and the sale of tractors, they are showing positive development. So, our approach is to deal with the problem of inflation squarely but keeping in mind the objective of growth. Ultimately, our target is and will continue to ensure that we have a soft landing for our economy. We had reached a kind of soft landing till the war broke out in Europe. The war has created new complexity of challenges, new issues, and new problems, which have come up and are not under our control. Commodity prices, crude prices, and the impact they are having on us; monetary policy tightening and their spillover; capital outflows; currency depreciation; we are dealing with all these

issues. Our target is and our endeavour shall be to ensure a soft landing for our economy, where inflation is brought down closer to the target of 4.0 per cent over a period of time. At the same time, the growth sacrifice is also within manageable limits.

Sanjiv Chadha
Thank you, Governor. Soft landing of course means that it's how monetary policy plays out over a period of time. So, the question, I have, is why the short-term trajectory of interest rates is apparent, there remains some ambiguity as to where we are in the interest rate cycle. Is it an accelerated normalisation of rates, which then translates into rate stability or is it a response aimed at anchoring inflationary expectations, and managing the external environment?

Shaktikanta Das
Our approach, as we have said earlier in the last MPC, is the withdrawal of accommodation. The policy rate is still lower than where we were before the pandemic. Before the pandemic, our policy rate was 5.15 per cent. Now the policy rate is 4.90 per cent. In terms of liquidity, we are still below the pre-pandemic level. But the liquidity has been brought down substantially over the past several months and we had initiated action already through the VRRR and the other measures, so the liquidity has come down. Nonetheless, it is still higher than where we were at the time of the onset of the pandemic. Of course, you have a new challenge and new issues arising out of the war in Europe. We are still in the mode of withdrawal of accommodation. Our objective is to anchor inflation expectations and that is how we are proceeding forward. What was the other part of your question?

Sanjiv Chadha
Whether demand management is also part of it or again because it is largely a temporary factor in terms of the external environment, there is a possibility of retracing the steps that we are taking now?

Shaktikanta Das
Our objective as I said, let me just summarise; firstly, withdrawal of accommodation; secondly, taking steps and ensure anchoring of inflation expectations; and thirdly, through monetary policy action to ensure a balance between demand and supply that is something which we are targeting. So, it's not a question of compressing the demand unduly. It is basically finding a balance; the monetary policy rates should ensure that there is a balance between demand and supply conditions.

Sanjiv Chadha
Just a small follow-up on the last part of what you said, Governor. To the extent that predictability is a desirable goal of communication and the policy tool; would a dot plot like the ones provided by the FOMC members be a good idea for the RBI.

Shaktikanta Das
The situation, today and it has been earlier also, is extremely volatile and extremely uncertain. In such uncertain times, giving a dot plot may create unnecessary expectations on either side. It will create expectations which you may or may not be able to fulfil through your actions. In the first week of February, when we presented

the monetary policy; nobody, even around the 19th or 20th of February, expected a war of this magnitude and the impact that it has created. So, supposing you had given a dot plot kind of thing and you had been very specific that this is how we are going to move that is representing each member's thinking then the situation completely undergoes a change. So, you create unnecessary expectations, which you may or may not be able to meet. Therefore, in such uncertain and volatile times, I think having a dot plot approach is a problem because you have to change your stance every time and there should be some amount of consistency in communication. I agree the situation is volatile; and when facts change, I also changed my actions, but the point is – broadly, there has to be some kind of consistency in our approach. What the dot plot is achieving in the US, I feel will create expectations, which you may or may not be able to live upto. In any case, forward guidance is provided through the monetary policy statement that we are making and the thinking of each of the individual members is given out when the minutes are released exactly two weeks after the MPC. So, we are already doing it, but a dot plot and binding yourself to specific points will not work in the current time when the situation is so uncertain and volatile.

Sanjiv Chadha
Thank you, Governor. Let me just now touch on a few areas that you have covered in your speech. Central banks ensure the stability of the financial system by regulating the major entities and activities. How much of a challenge is it to deliver on this mandate when important financial activities, payments, lending, and quasi lending is migrating to unregulated institutions?

Shaktikanta Das
That is an issue, we are dealing with. There are a large number of unregulated and unlicensed entities, which are now doing various kinds of lending. There are licensed entities also, which are entering into activities which they are not supposed to undertake. So, we are dealing with these issues, and we have formed a committee. We have examined the committee's recommendations and we will be issuing the relevant guidelines in this regard very shortly. It has taken more time than we had initially in our mind. But the situation is very complex and we are being cautious. On the one hand, you have to support innovation, a new product or a new approach which is coming. On the other hand, you have to maintain financial stability and see that undue leverage or risks are not built up. So, you have to find a very delicate balance and, we are, therefore, dealing with the issue very carefully. We are expecting it shortly, we have taken more time because the entire dynamics is very complex, and we are being very cautious. We are trying our best to take a very balanced call that supports innovation and at the same time does not, in any manner, compromise financial stability or lead to over-leveraging or create unnecessary financial risks.

Sanjiv Chadha
Thank you, Governor. I think you almost answered my next question when you talked about the balanced call. But let me ask it anyway. RBI itself has recently launched an innovation hub which the Governor inaugurated. What role do you envisage for the central bank in terms of promoting innovation and technology?

Shaktikanta Das
It is twofold. One is that we have certain thoughts and ideas in our minds, especially relating to the payments space, and other kinds of FinTech initiatives. We have a regulatory sandbox and a number of products, which were part of the regulatory sandbox. The trials have been completed and we have said that we are okay with it. Now, it is for those players to take it forward.

On one hand, we have certain priorities. We feel that there are certain areas, particularly in payment systems in ensuring that without internet or in what best way, we can improve the entire payment ecosystem in our country. On the other hand, there are lots of new innovations, new initiatives, start-ups, which are coming up with new and fantastic ideas. The Innovation Hub: number one will focus on our priority areas; number two, they will also suggest ideas to the RBI. So, the first is to try and work on those areas. Second is to work and partner with the private sector initiatives and all that is happening in the start-up ecosystem and in the innovation ecosystem, to work with them and try to provide incubation facilities so that the start-up companies or start-up entrepreneur is able to commercialise their product and take it forward.

The Bank of International Settlements (the BIS) has set up innovation hubs in multiple places. We had the option of trying and getting one of their centres in India, but we decided to go on our own because if we are on our own, we have two advantages. Number one, we have flexibility, we can do whatever we want. Number two, we can always leverage on what the BIS is doing because there is constant dialogue with the BIS innovation hub. That is something which we have launched as an RBI institution and already the board is functional. I have been tracking what is happening. I think the developments are looking very promising.

Sanjiv Chadha
Thank you, Governor. My last question would really cover what you have covered in the last part of your address in terms of banking and banks beyond tomorrow. Banks have emerged from the pandemic in reasonable shape, what might be the residual concerns of the Reserve Bank and what are the key enhancements that the RBI might have on its agenda for the next few years.

Shaktikanta Das
There is room for constant improvement. During the last three years, notwithstanding the pandemic, the lockdown etc., we came out with certain guidelines for relating to governance in scheduled commercial banks, we have come out with a new regulatory architecture for microfinance lending, a new regulatory framework for NBFCs, new regulatory framework relating to the urban cooperative banks. So, constantly we are endeavouring to see that the banks in terms of risk management, in terms of governance, in terms of responding to the changing needs of the time, are in a position to move forward. But our intention is not to interfere at all in any commercial activities. The banks and their technology teams, their commercial teams, and their risk management teams are sufficiently capable of dealing with all these issues. As a regulator and supervisor, we have to ensure that overall, financial stability is maintained. There are new challenges coming up with regard to financial stability from

time to time. So, we have to keep close track of developments in individual banking entities, as well as what is happening in the entire ecosystem and work closely with the banks and in partnership with the banks to see that they remain robust at all times. During the pandemic, we were having regular interactions with the banks. Even during the lockdown, we were having these video meetings with both public and private sector banks. One point which we were constantly emphasising was to raise capital because we knew that going forward, there can be stress to the balance sheet of the banks. I am very happy to say that almost every bank responded very positively, and most of the banks raised capital. Today, we have a strong financial sector and strong capital adequacy in the banks. So, the idea is that to work constantly with the banks, with regard to the challenges that we have currently, one is this whole digital and this technology space, where the banks also need to move in tandem with the requirements of time, banks are also facing a challenge from new entities. Whether we should try and regulate the new entities or if we decide to regulate how we regulate them. What remains to be done depends on how the situation evolves, and how we read the evolving situation. It's a constant exercise that goes on; the challenges of today will undergo change and the challenges of tomorrow will be completely different. The challenges of beyond tomorrow will also be far more different. So, we have to be in tune with the times.

Sanjiv Chadha
Thank you, Governor, you have been very kind, very frank and forthright as always. With your permission, since we have a bit of time, we might take a few questions from the audience.

Y. Pitalwalla, Business India
Governor, you talked about the issue of commodity price inflation and the resulting impact with respect to the war that we are experiencing. The Indian GDP, as well as exports, also have a very high import intensity. To what extent do you see the exchange rate contributing to these inflationary expectations? Because that too will play in terms of how you go about anchoring those inflation expectations.

Shaktikanta Das
We are major importers of crude oil. When the price of crude oil goes up from US$80-85 per barrel to US$120 – in fact, it touched US$130 per barrel; today, it is about US$106 per barrel – naturally, we are paying more for that barrel of crude oil. So, when you pay more for importing for two factors, number one, the prices have gone up number two the currencies are facing depreciation. That is called imported inflation. Monetary policy action also looks at the imported component of inflation. In all our assessments, we have given a projection for the current year the 6.70 per cent as the average inflation for the current financial year. We will be reviewing it as a part of the next MPC. I would not like to comment on that, because our research teams are already working on it, and we will discuss it during the MPC meeting and we will decide. Obviously, it is a component which impacts our inflation and our action. Monetary policy action will naturally factor that in, and it factors that in. The rise of commodity prices, as well as the further rise due to currency depreciation, are definitely important factors. Imported inflation is a challenge. Today, even food inflation

as we had stated in the last policy meeting. We are surplus in wheat, but the wheat prices went up because international prices of wheat went up, that naturally impacts our local inflation. All these factors are analysed as a part of our inflation calculation and projections.

Y. Pitalwalla, Business India
You talked about the issue of negative interest rates and the impact that it will have on savings and investments and therefore growth. You also pointed out that pre-COVID and post-COVID we had this. To what extent, given the volatile situation that you see, do we continue to forecast the Indian economy will have negative real interest rates for savers because historically we have always been a savings-intensive economy particularly when you look at the household sector?

Shaktikanta Das
The savings are picking up with the growth of credit. Credit growth has now touched 14 per cent. Our official figures, which we have given out the latest number is about 13.5 or 13.4 per cent, but it has already touched 14 per cent. When there is credit offtake, there will be draining out of liquidity and there is always leakage of liquidity through an increase in currency in circulation. We are also increasing our policy rates. So, going forward, the banks have already started adjusting their asset prices. On the liability side also, some banks have started increasing the deposit rates. Going forward, when there is a requirement for liquidity the banks will steadily and slowly increase the deposit rates. When we increase the policy rates that also impact the deposit rates in the system on the liability side. There is transmission time but eventually, it will transmit to deposit rates also.

VML Interior Private Limited
Recently, RBI has decided to allow the settlement of international trade in rupees. So, what is the impact of the same on the overall economy of India, whether India will have a dependency on USD or how it will affect the Indian economy?

Shaktikanta Das
It is too early to say. It is an additional facility that we have given to the importers and exporters. So far, all the international trade as India is concerned has been by and large dollar-denominated. This is a new facility we have opened up. There was a demand from the industry for quite some time. This idea was under discussion and was under assessment in the Reserve Bank. We have been working on this idea. The idea was to give a new avenue, a new option to the importers and exporters to do their trade in rupees. It is too early to assess its impact. But I think over a period of time, it should pick up, but we have to wait and see. It's too early to say how it will shape up in the future. But the potential is good.

Arundhati Bhattacharya
Good morning, sir. First of all, thank you for your very reassuring and erudite speech. It is very reassuring to hear the kinds of things that you said from this podium. What I really wanted to ask is about climate change, you mentioned that as one of those events that are definitely going to impact us. India has on the whole overall as a country given a net zero goal for itself, which is way out. You control a very large sector

of the economy. You are the regulator for the BFSI sector. The BFSI sector, in turn, leads to many industries that are very far from achieving net zero status. We also know that in India mandates work best. Do you as the regulator have in mind any mandate for the BFSI sector to achieve net zero status?

Shaktikanta Das
In this area, whatever we want to do, we would like to do it in a collaborative manner. Precisely with this objective, we are coming out with a discussion paper on climate change and climate-related risks. The discussion paper should be coming out sometime next week. It is a discussion paper, so, we would like to get suggestions, and ideas from all stakeholders, and after getting the ideas and inputs, we will examine them internally and we will move forward. So far as the climate change targets are concerned, India has done very well. All the goals and milestones for India, under COP-26 have been achieved. Quite a number of developed countries have not done that, but India has achieved all the targets under COP-26. Having been a Sherpa for G-20, I keep track of what's happening in these areas. We have achieved all our mandates and India has a target net zero which you have mentioned. We have to move in a very calibrated manner. There is the aspect of not sacrificing too much of growth, and there is the aspect of looking at the cost. At the same time, there is the requirement to give due and sufficient priority to climate-related risks. A balanced approach always needs to be taken. I would look forward to very valued comments from, senior bankers and other stakeholders, academicians and finance professionals and others on our discussion paper when it comes out. We do not want to be too prescriptive without having a proper consultation. Our approach has been consultative, we will consult and then move forward.

Arundhati Bhattacharya
The IT industry can definitely contribute. We will look forward to doing that.

Shaktikanta Das
Sure, definitely.

Mohit Degan, MasterCard
Good morning, Governor sir. I ask you a question of a student of cyber security. I am doing a course on cybersecurity. I have been reading about the challenges that banks across the world have been facing. As we say with challenges, there are opportunities. So, it works vice versa as well with the opportunities, especially in digital. The explosion in digital that we've seen because of COVID and other technology, that banks have adopted. My question is, do cybersecurity threats give you sleepless nights? And if so, what would be your recommendation to banks on the whole.

Shaktikanta Das
I never have a sleepless night, whatever be the situation. Because what is happening all around, you cannot control everything, but you have to deal with it. So, you have to sleep well, so that you go out to do your batting and you bat well. A good night sleep is very essential for doing very well on the cricket pitch. Since I'm a cricket fan, I always use the cricketing analogy.

Now, cybersecurity is a real problem, it is a real threat. When the COVID pandemic started; Mr. Chadha and other senior bankers present here would recall; around 28th of February in 2020; internally, we heightened our cyber alertness. We sensitised all the banks not just by writing a letter to all the banks, but we had interaction with the IT heads of all the banks. We also had a meeting with the CEOs of banks because that was a time when we expected the number of cyberattacks to go up because those guys on the other side will think that now people are focused on COVID, and this is the best time to attack. Therefore, everybody was sensitised. This is a challenge, and this is one area, where I think, the IT systems of every bank, every financial institution, including the Reserve Bank, will have to be one step ahead of the attackers. The kind of cyberattacks or any problem/threats that may come requires knowledge acquisition, requires being constantly alert. People have been talking of ethical hacking, that is up to institutions to decide because ethical hacking also has its downsides and risks. Basically, the idea is to constantly upgrade knowledge, constantly know what is happening all around and keep on investing more in IT systems and internal skills of banks and financial institutions. In days to come, the problem is going to become bigger and bigger. We have to be very alert to deal with it. We just cannot afford to compromise our financial system and the huge data that we carry in any manner.

Dipanwita Mazumdar, Bank of Baroda
Sir, the system level liquidity has gone down, and liquidity normalisation has happened, but durable liquidity is still at an elevated level and going forward in the second half when currency demand picks up and RBIs FX intervention pans out. So, how would that impact the level of liquidity and what will be the impact on rates?

Shaktikanta Das
Impact on rates, I cannot say. You will have to wait for the Monetary Policy Committee meetings. The rates will depend on the evolving inflation growth dynamics. So far as liquidity is concerned today if you put together the VRRR 14 days, the VRRR 28 days, and the liquidity which comes back to us through the SDF that works out to about Rs.2.8-2.9 lakh crore. There is a government cash balance also. Putting together, we have about Rs.5.0-6.0 lakh crore of liquidity in the system. So, liquidity still is very comfortable. Yes, you are right; going forward, as credit offtake takes place, as government spending picks up from the second quarter onwards and after the monsoon; and you mentioned the Forex intervention also which the Reserve Bank does from time to time; the level of liquidity will come down. But as I have said earlier, we will ensure that there is always adequate liquidity in the system to meet the credit requirements of the economy. Beyond that, I will not be able to say how much liquidity, we are comfortable with. We will ensure that credit offtake is not sacrificed, and credit offtake is not affected due to problems of liquidity. So, it will depend on how the situation evolves.

Sanjiv Chadha
Thank you very much, Governor, for patiently asking so many questions.