Interview with Business Standard on July 8, 2021 - Shri Shaktikanta Das, Governor, Reserve Bank of India

Reserves remove doubt on ability to act: RBI Governor Shaktikanta Das

Economic activities are expected to improve further going into July or into the second half, says Governor Das

The Reserve Bank of India (RBI) is mindful of the entire yield curve and is not just focused on the 10-year bond. However, the 10-year bond has a larger impact on other rates. Hence, the central bank's intervention in it was greater than in other papers, said **RBI Governor Shaktikanta Das** in an interview with Anup Roy and Vishal Chhabria. India's monetary policy will be driven by domestic considerations, notwithstanding the stance taken by the US Federal Reserve. Any volatility in the currency can be addressed with the vast foreign exchange reserve of $609 billion, the governor said. **Edited excerpts:**

You have said the impact of the second wave of Covid-19 could be limited to the first quarter, but your survey in the Financial Stability Report (FSR) says business expectations are down; the job scenario, wages, and productivity are unlikely to improve in the short term...

Activities had revived in the fourth quarter (Q4) of last year, and in the second half the economy had emerged out of contraction and had entered positive territory. Then we had the interruption of the second wave, which peaked in May. If you look at the high speed indicators, sequentially there are growing signs of improvement in certain indicators. For example, data on freight traffic, GST e-way bills, import and export, electricity consumption, volume of transactions in the payment and settlement systems are showing sequential improvement. The lockdowns were localised this time and economic activities, including manufacturing, continued. Individuals and businesses have better adapted to Covid protocols. So, we feel that the worst of the second wave is behind us. Economic activities are expected to improve further going into July or into the second half. Further, congenial financial conditions continue to prevail and vaccination is gathering pace. We made our detailed assessment on that basis, and we feel our projection of 9.5 per cent is quite realistic.

The numbers probably capture the formal economy. How do we gauge the informal economy, where the impact could have been much more?

In the rural areas there was good agricultural production last year, and there are expectations of a good monsoon this year. Both of them provide strong support to the rural sector and going forward that should support rural demand and also incomes. We do our own internal assessments and surveys to gauge informal economy data.

RBI's resolution framework 2.0 was specifically targeted at the micro, small and medium enterprises (MSMEs) and small businesses. We have also provided targeted liquidity support through the banks, including the small finance banks and through them to the smaller non-banking financial companies (NBFCs) and the microfinance institutions.

The FSR says the true state of bank balance sheets will be revealed once the effects of regulatory forbearance fully plays out, but your worst case estimate this year is better than the best case estimate of last year, in terms of non-performing assets...

When we came out with the last FSR in January, the regulatory forbearances were still in operation. The Supreme Court had ordered asset classification standstill immediately after the six months moratorium was over and our resolution framework 1.0 was still under implementation. So, therefore, asset quality recognition was camouflaged because of these dispensations. So, the FSR had relied upon the figures of December 2019 as the base because it was not contaminated by the Covid numbers.

In the July 2021 FSR, we have a clearer picture of bad debts. The base of March 31, 2021, numbers are, therefore, far more realistic. The second wave's impact is something that we'll see over the coming months. But having said that, I would like to add that Indian banks are far more resilient today than they were earlier. Today, the gross non-performing assets (GNPAs) are about 7.5 per cent. The provision coverage ratio is close to 69 per cent, capital adequacy ratio is about 16 per cent. So, therefore, in terms of resilience, the banks are in a better place today. Having said that, there is also a necessity to continuously monitor and augment the capital adequacy of banks, given the overall uncertain outlook on the Covid front.

If there is an unexpected rise in bad debts, will RBI extend a helping hand to banks in terms of regulatory dispensation?

I would not like to comment on what we would do in future, but let me make one thing clear: RBI, as an institution, would not like to delay or postpone any asset quality recognition. It is always better that the asset quality is recognised in time and addressed and resolved in time.

RBI has decided to look past inflation for now. But, inflation is sticky and the real interest rate is negative. Are you worried?

The headline inflation, and inflationary expectations were well anchored at 4 per cent before the onset of the pandemic. We would like to consolidate and preserve those gains. Stable inflation has its advantages in terms of reducing uncertainty for investors, for businesses, for everybody, and eventually it supports growth. But then we had an extraordinary situation arising because of the pandemic. The flexible inflation targeting framework allows us to target within a range of 2-6 per cent. The Monetary Policy Committee, therefore, focused on keeping headline inflation within this range. The consumer inflation narrative comes from other emerging economies' central banks, some of them have increased their rates, of course, but the narrative is that it is a transitory phenomenon. The current inflation spike appears to be transitory, driven largely by supply side factors and going forward, it is expected to moderate in the third quarter. We are very watchful of the emerging inflation trends and momentum. Any hasty withdrawal of monetary policy support will negate the nascent or incipient recovery that is taking place. So, therefore, RBI will remain watchful. And the MPC will take appropriate decisions depending on the evolving situation.

You have shifted your guidance to state based, from time based. Why so?

As I said, any hasty withdrawal can undo the gains in the face of economic revival. In 2020, the CPI inflation exceeded 6 per cent in July-August and 7 per cent in September-October. But the MPC believed that inflation would moderate in December and January. So, the MPC decided to continue with the accommodative stance with the belief that inflation was transitory. The MPC focussed on assuaging market expectations of an inflation spike. Sure enough, inflation came down to little above 4 per cent during December 2020-March 2021. In hindsight, the time-based guidance provided by the MPC was the right call to take because it anchored market expectations. We are monitoring the inflation situation closely and we now feel that the state based guidance is appropriate in the current context.

Are you not building up expectations in the market? The bond market seems to be assured that whatever happens to inflation, bond yields will remain stable.

We are very watchful about inflation and growth. But the main challenge is economic revival and growth. Let us not forget that 2020-21 witnessed a severe contraction of 7.3 per cent and the 9.5 per cent growth projection for the current year is built on that.

The economy needs to reach and exceed the pre-pandemic level of growth. We are acutely conscious and sensitive to the fact that a hasty reversal of monetary policy stance or monetary policy approach can have serious consequences for the economic recovery. But we also want to anchor inflation expectations within the tolerance band and closer to the inflation target in the medium term. The current inflection in inflation is also largely impacted by supply side issues. International commodities and crude prices have also risen. The government has taken certain supply side measures in recent weeks but more supply side measures are necessary and we are actually looking forward to more such measures, especially on taxes from both Central and state governments.

Is the RBI policy hostage to the huge borrowing programmes of the government?

It is a fact that the borrowing programmes of both the Centre and states are huge. The pandemic crashed government revenues last year. This year it looks better so far. But on the expenditure side also there are pressures on the government to spend more. The net result is that the borrowing had to be higher, both for the Centre and the states. RBI as the debt manager of the government is committed to ensuring non-disruptive implementation of the borrowing programme at the lowest possible cost and our efforts are in that direction.

The Reserve Bank will continue to deploy various instruments at its command. Interestingly, over the last one year, the debt management function of the RBI has actually facilitated better monetary policy transmission.

The various conventional, unconventional and the new kinds of measures which RBI has undertaken, such as G-SAP, TLTRO, etc. together with appropriate communication and signals have ensured the lowest borrowing cost for the government in the last 16 years in 2020-21.

The G-Sec yields act as a benchmark for the private sector borrowing.

Corporates and businesses were able to raise cheaper funds by way of corporate bonds. This has helped them to have adequate liquidity and undertake deleveraging, etc. The debt management exercise of RBI throughout the pandemic has indeed ensured better interest rates for the entire economy. All conventional and unconventional actions of RBI as a debt manager, and also the central bank are basically in that direction.

Why did you buy most of the 10-year bonds from the market?

The 10-year benchmark has a bigger influence on the yield curve as a whole. But it is wrong to assume that we are focusing only on 10-year bonds. We are focused on the entire maturity curve. If you look at our last G-SAP announcement, we are targeting six- to 12-year maturity G-Secs.

Why have you accumulated so much reserves? Is it to address volatility, or are you building a sort of permanent reserve for other purposes as well?

Internationally, capital flows involve a lot of volatility. Especially, in the current context when all the advanced economies have adopted ultra-accommodative monetary policies, there is naturally a lot of liquidity floating around. But capital flows are also very volatile. The emerging market economies, in this kind of a scenario, have to build their own buffers, their own safety nets.

A strong foreign exchange reserve is the best safety net against global spillovers. Also, it renders a considerable amount of stability to the exchange rate. It also eliminates doubts in the market about a country's capacity to deal with a situation of outflows. Today, India is much better placed at $609 billion forex reserves. It covers about 15 months of projected imports for 2021-22. It covers more than our overall external debt.

Are you taking private help for managing reserves?

These are all options. There is no plan to outsource the forex reserve management functions of RBI. The reserve management will be done by RBI, and while doing so, we are always considering various options of how to improve our internal skills by harnessing external expertise.

The reserve management works on three principles — safety, liquidity and return — in that order. RBI is not chasing any return as such, it is our last priority. So, utilisation of external expertise would augment our own capabilities.

Can the reserve be used for other purposes as well?

The reserves are not our own money. It is not that we have built it up by way of trade surplus. If we have reserves, we also have liabilities against them. Capital flows are a strong contributor to our reserves. We have to be watchful. Our current level of reserves gives us confidence, but we cannot be complacent.

How concerned are you now that the Fed has indicated raising rates?

The monetary policy action of the US Fed will impact all economies across the globe, particularly emerging market economies, and India will also be affected. But the principal focus of our monetary policy will be the domestic macroeconomic situation and the domestic growth inflation dynamics. Our policy will be more governed by domestic factors.

Do you get a feeling that the currency market is getting out of hand for the RBI because of the non-deliverable forward (NDF) size? By bringing it onshore, are you legitimising NDF?

NDF is a fact of life. The volumes are much more than the onshore transactions. It is bound to happen in a country, as long as there are capital controls. Our current endeavour is to address market segmentation between offshore and onshore markets. We have given access to non-residents to the onshore market. We have enabled Indian banks to participate in the offshore market 24 hours and five days a week. The segmentation between onshore and offshore markets is steadily getting eliminated. This will improve pricing and efficiency.

How happy are you with the way IBC is progressing? There are delays, and the haircuts are steep.

The main concern around the IBC resolution is that it is taking too much time — more than a year. It happens because of litigation and counter-litigation. The average time for resolution under IBC needs to be compressed. That is something we expect should happen because this is a new law, which was enacted and implemented in 2016. The jurisprudence around the new law is also getting established. The average resolution time taken under IBC needs to be quicker.

If we look at the numbers for the comparable period (2014-15 to 2019-20), the average recovery in the case of Lok Adalat was 5 per cent. In the case of DRT, it was 6 per cent; in the case of SARFAESI, it was 20 per cent. In the case of IBC, the average is still 40 per cent. If you exclude 2020-21 — the pandemic year — the average recovery under IBC was 45 per cent.

We should judge the success of IBC, not just from the point of view of percentage of recovery. There are other parameters to judge its success. IBC has spurred banks to recognise their bad debts in time. It has also instilled a strong credit and repayment culture by both banks and borrowers.

You have been a bold governor. Can a country like India afford to adopt a whatever-it-takes policy?

Covid-19 was a shocker of extraordinary proportions. India, after several decades, witnessed a contraction of 7.3 per cent. The loss of lives and livelihoods was unprecedented. It was a global shock and central banks the world over came to the forefront to battle economic crises. For central banks, it was a whatever-it-takes moment, and the RBI was no exception. We adopted conventional, unconventional, and new measures. Some of them were similar to what the advanced economies were undertaking, some designed to deal with local challenges.

For example, the resolution framework factored in the prudent principles of resolution and the need to support businesses. We adopted measures such as bond purchase programmes, reduced interest rates, and adopted an accommodative stance. At the same time, we undertook other measures like targeted liquidity for smaller NBFCs and mutual funds. The RBI's whatever-it-takes approach has helped insulate the economy and the financial markets from a possible crisis and ensured financial stability.

What is the status of India's inclusion in the global bond indices and the central bank's digital currency?

They are both works in progress. As far as our inclusion in the global bond index is concerned, we are working closely with three or four agencies. In fact, one of the bond index providers has placed India on the watchlist, perhaps as a prelude to our inclusion in the bond index. We are in active dialogue with them, as also with the other bond index providers. We hope to see this effort gain more traction in the days to come. With regard to the central bank's digital currency, we are discussing the technology/cybersecurity aspects. I cannot give a timeline. This is something that has got other implications on monetary policy and on overall savings.