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Moderator: Good Day, Ladies and Gentlemen, Welcome to the Second Bi-Monthly Monetary Policy Governor's Teleconference with Media. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. Over to you Ms. Alpana Killawala. Thank you. You are connected to the call.

Alpana Killawala: Good morning, everybody. We are here as usual for the policy press conference. Straightaway to the questions, Sir?

Dr. Raghuram G. Rajan: I would like to make a statement first. Just a quick review - in our monetary policy statement of April 2016, we said we would watch macroeconomic and financial developments in the months ahead with a view to responding as pace opens up. Now incoming data since then show a sharper than anticipated upsurge in inflationary pressures emanating from a number of food items as well as a rise in commodity prices. Now we expect that a strong monsoon continues as astute food management as well as steady expansion in supply capacity especially in services could help offset these upward pressures. But given the uncertainties, the Reserve Bank will stay on hold. However, the stance of monetary policy remains accommodative and we will monitor macroeconomic and financial developments for any further scope for policy action. We also noted that the transmission of policy into bank lending rates still remains work in progress. We will shortly review the operation of the marginal cost lending rate framework to iron out any issues and we also believe that timely capital infusion into constrained public sector banks will also aid credit flows.

Now I want to talk about a few other concerns that have been left out in the policy statement. On liquidity there have been two big concerns, first on the maturing FCNR(B) deposits, our sense is that the leveraged portion of those deposits people have borrowed to invest in FCNR(B) deposits, that leveraged portion will not be renewed. Therefore, there could be outflows possibly of the order of $20 billion or so. Now we have covered these outflows in the forward markets and before the maturation of the deposits we will take some advance deliveries in the lead up to the maturity. Now some counter parties that we have contracts with are apprehensive that they may not be able to deliver easily on the dollars we are owed and hence there may be some episodes of dollar shortage in the market going forward. This is something we will monitor. We may supply dollars in case of extreme volatility but no one should take this for granted. But for sure, we have plenty of dollars that we can supply if necessary. We are also committed to supply short-term rupee liquidity to the extent needed to support our monetary stance.

The second concern on liquidity has been a question about how long we propose to take to move from a situation of systemic liquidity deficit to one of close to neutrality. Now this is something that depends on the market and external conditions. As you know, we have already infused a fair amount of durable liquidity into the market. In addition, we are seeing some reduction in outstanding cash balances. We will not commit to a timeframe by which we will move to a neutral position but we will be opportunistic in moving this system towards that goal.

Finally, on the bank clean up, we are working together with the government on facilitating the process. There are discussions going on- on mechanisms that will leave projects with the right capital structures as well as access to credit, with also some incentives for promoters to earn their way out of difficulty. SEBI is also being consulted on these issues. There is also some talk of a variety of funds to invest in stress situations. However, and let me emphasize this, there is no intent to go back to the days of forbearance or reverse the move towards transparent bank balance sheets.

Let me stop there, and we can take questions now.

Supriya:
ETNow

The question that I want to ask you is, is a take away from the policy. It seems to me that you are being a little hawkish on inflation. So is that reading correct? Because a lot of what has been said in the policy as far as the April forecast is concerned, you have said there is an upside bias to it now, you have said there is inflationary pressure emanating from food and commodity prices. The question that one would want to ask you at this stage is, is there a probability of the 5% target being revised upwards? That is the point number one. And point number two, a lot of the heavy lifting is expected to be done by the monsoon? So are we expecting a pause in the August and October policy as well? That is one part of the question. And the second part of the question is, the commodity prices that you spoke about, how has that changed the dynamics of both monetary and fiscal policies?

Dr. Raghuram G. Rajan: Look, those are a lot of questions. All we are saying is that relative to our April stance, the data that came in surprised on the upside. I do not think there is any news about that, the inflation reading in April was higher than anybody in the markets or we expected. Now going forward we have to see how it pans out, it is one month's readings. We have to see how, as you said, the monsoon plays out, how that effects food prices, we have to look at supply management by the government. So a variety of factors will come into play. So I would not term, I hate these bird analogies like hawkish, dovish, etc, I would just say it is a realistic assessment of the data that have come in. There are potential disinflationary pressures, there are also potential inflationary pressures. The net effect is, we have put a little more weight on upside risk to inflation but we have to wait and see. The target is obviously 5% by March 2017, that target is there for us to attain and we have to figure out how to attain it.

Supriya: Have the disinflationary pressures gone down?

Dr. Raghuram G. Rajan: I would not say that, I mean again the monsoon could be a source of disinflationary pressure. If some salient prices come down rapidly that could also bring down expectations; expectations are moving about little bit, so we have to see.

Shobhana:
Financial Express

Sir you said transmission is work in progress, so could you give us a sense of how much more you are expecting now that the marginal cost of funding rate is in place?

Dr. Raghuram G. Rajan: Well, it is early days yet, I mean this has been in place for about a month. We have to see how it transmits into lending rates. There is an MCLR and then the banks have to add a spread to it and we have to see how that moves. So I think it is going to take a little while before we can assess fully whether it has the affect intended.

Latha Venkatesh: CNBC TV18 Governor, you began that statement how long we take to neutrality. If you can flesh out that statement a little more? In July because of the redemptions we may anyway reach neutrality. Will you continue with OMOs to make up for the backlog of the deficit, so do we reach neutrality early? And more importantly, the market is terribly worried about passing on rates or even yields because of the coming FCNR(B) deposits that will leg it out in September, October. The bigger worry is about rupee liquidity, you will give the dollars to the bank but then you will suck out rupee liquidity. So if you can detail the game plan of the Reserve Bank so that the market's worries are lessened. And pardon me this is not to embarrass you at all but if you can tell us anything about whether you will be there during those tense months in September and October. Have you been offered and have you refused?

Dr. Raghuram G. Rajan: So let me take questions one at a time. You asked for liquidity, I said something about liquidity I think when you were outside the room. So we will monitor both dollar and rupee liquidity and act appropriately. I think as far as our ability to act, there should be no question. At the same time we do not want to encourage complacency on the part of people who sold us dollars assuming we will come in when they cannot provide the dollars to us and bail them out, that is not the intent at all.

Latha Venkatesh: Not dollar Sir, rupee liquidity.

Dr. Raghuram G. Rajan: Rupee liquidity we can always provide what the market requires, that we are committed to. Now as far as this separation between long-term liquidity and short-term liquidity goes, and the idea to move long-term liquidity to a neutral position, that will take some time. I think we may find periods when the market is not borrowing from us. But that does not necessarily mean the long-term liquidity is in balance at that point because it could be a period of surplus. So we will have to achieve that over a period of time. It is something that we will work on. I cannot give you a date by which we will achieve that. I have said we will be opportunistic in getting there.

Latha Venkatesh: CNBC TV18 Even a ballpark, like is it 2016, is it FY17, is it first half of FY16?

Dr. Raghuram G. Rajan: Look, last time this question was asked I said here is a way we could do it in eight months, but I do not know, it depends on how the market conditions evolve, so let's see.

Latha: Sir, September?

Dr. Raghuram G. Rajan: I have a prepared statement on that. As far as the question of my continuing in this position after September 4th goes, it would be cruel of me to spoil the fun the press is having with all its speculation**.** I am personally intrigued by all the letters I am supposed to have written. Seriously, in all such cases a decision is reached after discussion between the government and the incumbent. I am sure you will know when there is news. I cannot do better than point you to the statements of the Finance Minister and the Prime Minister on this. That's all I have to say.

Aparna:
Mint

My question is on the stressed asset resolution that the RBI is working with the government. Previously when the stressed assets were discussed, you had reservations of a bad bank kind of structure. Is the Stressed Asset Fund which is proposed by the government different from the bad bank? Are you okay with what the government is proposing and are there any contours or would you like to share some more details on how this would come about?.

Dr. Raghuram G. Rajan: No, there are variety of stressed asset funds one could think of. For example, one would be a lending fund; that is not going to take assets off the banks, it is going to lend into stressed situations. Or take a project which has already got loans from the banks but which needs more funding, you could lend into that. And then there are situations where you want to buy the assets, that looks more like a bad bank and there the key questions is at what price? I think there are lots of ideas floating around as to how price will be determined as well as how the banks may feel confident in selling at that price. We have to see if in fact it works out.

Aparna: Are you comfortable? You had issues.

Dr. Raghuram G. Rajan: No, the issue is not for me to be comfortable, the issue is for banks to be comfortable and selling at that price and for the stressed asset fund to pay a price which it thinks is appropriate. That meeting of the two is a big issue which needs to be resolved. Banks want to sell at a price which typically ARCs do not want to buy at, now how do we bridge that gap is something we have to wait and see.

Pradeep Pandya:
CNBCAwaaz

Sir, two statements that you have made on account of which I think that there will be a lot of pressure on the rupee. One you said that some counterparties many not be able to supply dollars.

Dr. Raghuram G. Rajan: There is an apprehension that some counter parties have expressed that others may not be able to supply dollars or they may not find that they can raise dollars in time.

Pradeep Pandya: So this means that there is a possibility of demand for the dollars to increase and rupee can come under a pressure? Second thing you said that we will provide dollar but it should not be taken for granted. So again I think you are giving a signal towards depreciation in rupee.

Dr. Raghuram G. Rajan: We have no desire to move the rupee in any direction. At the same time if people have contracted to supply us dollars, all we are saying is they should not rely on us bailing them out and us supplying them the dollars that they are going to supply us. So they should be a little careful, they should perhaps enter into appropriate contracts.

Pradeep: So are you giving a signal to the market participants towards hedging?

Dr. Raghuram G. Rajan: No, all I am saying that… maybe Mr. Khan has a better way of saying it than me.

Shri H. R. Khan: Just as Governor has stated, we are fully committed to take care of **rupee** liquidity and dollar liquidity in the market and we are committed to contain the volatility in the market. There is a lot of speculation about this in press and media. Some problems may arise with some banks as Governor said, but system wide from what we have calculated, it would not have a big impact because we have forward match. Small problems may occur, but we have enough tools to take care of these small problems.

Anoop:
Business Standard

This is related to; you said that some of the counterparties have said they may not able to supply dollars. But what kind of counter parties are these? If they have entered into a contract, they have to oblige you.

Dr. Raghuram G. Rajan: So let me give you some of the possibilities that people have outlined to us. Now again, let me emphasize, these are hypothetical possibilities and we are just taking extreme precautions that we understand all the possibilities and are prepared for it. The hypothetical possibility is an exporter who has committed to pay dollars to the bank which has then committed to giving to us through the forward contract it has supplied to us. Suddenly the exporter finds he wants to rollover the contract. If he rolls over the contract the bank does not get the dollars, then the bank has to go out and buy the dollars in the market. So the bank is hedged but it just does not have dollars at that point in time. So the bank says, look we need to buy dollars, it goes into the market to buy dollars. Because all these deposits are maturing at the same time we may find that there is a lot of demand for dollars at that point. All we are saying is we are going to monitor that process, we have enough dollars to supply if need be, but we also urge those who have committed to supply us dollars to take cognizance of that position that we are not going to make sure that they make no losses in the process, we do not want to create moral hazard in this system.

Anoop: You have already sold the dollars to them?

Dr. Raghuram G. Rajan: We bought the dollars from them, they have to supply us dollars and they may find that their counterparty does not supply them dollars, there is a chain here.

Anoop: Will you contemplate penalizing them if they don't adhere to the contract?

Dr. Raghuram G. Rajan: No, this is not about penalties, penalty already exists, they have to buy dollars at high cost in the market. So we are just telling them be aware of what you owe as well as the liquidity of your counter parties and we have three, four months. This thing is spread over time and we will certainly monitor to make sure there are not extremes; we will intervene to reduce extreme volatility. But we would urge people not to believe that we have bailed them out of their responsibilities.

Govardhan:
Economic Times

You have mentioned that RBI will stay being on hold but the stance remains accommodative. The choice of words sends a conflicting message. So it is accommodative or on hold? Can you explain? Again the statement is full of possibilities of inflation spiking so does it mean that there is more weightage on hold rather than accommodative?

Dr. Raghuram G. Rajan: See, that is something you have to keep guessing. Really what we are saying is that we have not shifted stance to either a neutral stance or a tightening stance, we are still accommodative. That means we are looking for room to ease, if that room opens up we will be able to ease. Now I cannot tell you because I told you there is lot of uncertainty around this depending on all the factors I have laid out. But broadly we are still in easing mode.

Govardhan: A broader question, when you took charge in September 2013 you read out a short term plan for the RBI, what you wanted to do. So if you have to assess on all that has been delivered on and the unfinished agenda for you?

Dr. Raghuram G. Rajan: I think if you look at what was listed in that initial plan, you would find that most of it has been delivered on. But if you ask me what we need to going forward, one is of course move inflation towards what the Urjit Patel Committee report suggested and what is in our framework with the requisite government more to a comfort level in the band, we are already in the band but to a greater comfort level. Second is cleaning up the bank balance sheets so that they can fund growth, that is extremely important. I think those are the big parts of the agenda but on the reform side, those are the short-term part of the agenda. On the reform side, clearly market development, especially for string of corporate bond market and this is something SEBI Chairman and I had a discussion just this weekend and we intend to move as fast as we can to try and remove impediments in this process. But also, other markets to increase participation Mr. Khan is working on many of those issues. And finally financial inclusion, I think it is an unfinished agenda, we need to do a lot including work on the base of Pradhan Mantri Jan Dhan Yojna accounts to build that last mile so that they can be used more effectively, make lending to small enterprises and medium enterprises more effective. Perhaps through these small finance banks which are being setup but through other kinds of institutional reforms such as collateral registries, such as SME loan data base and things like that.

Gabriele Parusinni:
Wall Street Journal

Governor, you talk about oil and oil prices quite a bit in your statement. Another reflection of relatively lower oil prices from those we saw a couple of years ago is that the ongoing crisis in the Gulf countries and that reverberates upon India through the form of remittances which have started falling. Do you have any thoughts on that and how do you see the dynamic remittances going forward

Dr. Urjit R. Patel: On the oil price, at the levels at which we are, one does not expect remittances to be affected adversely going forward, they have fallen but by a relatively small amount and about half of the remittances come from the Middle East, the five oil exporting countries but the other half does not. So I do not think the impact is universal. In many ways I think an oil price of between 40 and 50 is a sweet spot, it is something that we can absorb a bit with relatively low current account deficit, the remittances are protected to some extent. So at the moment it is not a cause for worry. Just one more point, some of the spike that we have seen recently in the oil price is because of some short-term issues like the Canada fires and some disruptions which are considered temporary but it is mug's game predicting oil prices, but I do not think it is a cause for concerns at these levels.

Bijoy:
Cogencis

My question is on LCR, one is as the LCR regime, we have already moved to 70%. Will there be further carve outs that will need to be done, will there be a mid-term review of further carve outs within the SLR to accommodate that? Also, a connected question is that, Basel has a differing view on state development loans. What is the RBI's stance on treatment of state development loans within the LCR framework? And additionally one question on the asset quality review, you had mentioned March 2017, do you expect banks to increase the provisioning that they are doing as they move forward because they have only done the 15% provisioning at this point of time. Do you expect to accelerate their provisioning, may be improve their provision coverage ratio as we go forward?

Dr. Raghuram G. Rajan: Let me ask Mr. Mundra to respond to the provisioning question. On the issue of LCR, I mean clearly it depends on the pace at which SLR is brought down and what we do not want is to impose a double burden on the banks, that is, they maintain SLR as well as have LCR. So when appropriate, we will make adjustments so that they are not subject to two different standards. Essentially if SLR is enough to fulfill the LCR requirement we do not want to impose double requirements on them, so we will look at that. On state development loans, our stance at Basel has been that these have not defaulted and should be treated as risk free sovereigns. Now of course it is important that that continues and that no state thinks about defaulting on the SDLs, I do not think there is any prospect of that. But also we have to fight that case, it still is a case that we have to make at Basel.

Shri S. S. Mundra: Under provisioning there are two aspects, one you mentioned that they have just made 15%, yes fine 15%. But even in existing framework there is a natural progression over a period of time. So it does not move quarter-to-quarter, not expected to move quarter-to-quarter and this is the dynamic situation. As we have mentioned that large part of this there were to recognize in the quarter of December and March, this they have done. This year we have suggested them to utilize to address the potential weaknesses which would of course entail making some provision. So I think the additional provisioning requirement during the year would come from identifying and addressing those situations, whereas the cases where the provisioning has already been done would move forward. Now moving forward, as I mentioned is a dynamic situation. It would be reasonable to expect that some of the cases where banks are able to move towards resolution, that they would also be able to free some of these provisioning. But having said all this, though at this point of time we have not prescribed any benchmark of provision used to be but we would certainly encourage the banks on their own volition to keep on improving their PCR as their financial position permits them to do so.

Ritu:
CNBC

My question is on NPA management and provisioning levels, additional capital funds are going up, capital is scarce with banks. So when you are talking about setting up of stressed asset funds, how much capital contribution are you expecting from the banks or will the bulk of it comes from NIIF. Could you throw some more clarity on that?

Dr. Raghuram G. Rajan: First, we are not setting up any stressed asset funds, all we have been asked is, do you think this structure is reasonable, what structure are you okay with and what kinds of ownership etc. are you comfortable with. So we have given our views on those, ultimately it is the government as well as the other investors who will be coming together along with the banks to setup such funds. In our view, majority ownership by the banks of any such fund is probably not wise or warranted and perhaps some form of minority ownership with a number of other players coming in in addition to the government to provide capacity, especially in management of stressed assets would be appropriate.

Ritu: Sir could you give us any sense on the size of the fund that banks would set up?

Dr. Raghuram G. Rajan: I think that question you should ask the government. It is more their discussions which will have relevance here.

Ritu: Governor if I may take one more question on the MCLR rates, what are the impediments you see to banks transmitting the rate cuts at this point of time, after you have introduced the MCLR, after the government’s small savings rate cuts? You have also said that you are looking to review the MCLR framework. What specifically are you looking to tweak that will enable banks to transmit faster?

Dr. Raghuram G. Rajan: Well, review would suggest that we need to assess what are the aspects that are working, where are the aspects where there are rigidities that we have to take further action on. So I cannot prejudge what we will find. In general, I think there is a paucity to some extent of credit demand from the usual sources which is why the banks are not in a great hurry to reduce rates, either. They seem to be suggesting we are not going to attract a whole lot of new credit if we reduce rates, so why not stay with the existing borrowers and so on. That was why we moved from the base rate to the MCLR because that would mean a more automatic reduction in rates when deposit rates came down. Now what we have seen in April-May is that while credit growth has not been very strong in those two months, deposit growth has been fairly strong. So my hope is that as deposits keep building up on the liability side, banks then find more of a need to make those deposits go to work, other than through investment in government securities. They actually start making more loans and they look for borrowers and therefore start reducing rates more. This is why to an earlier question about MCLR review etc, we need to give it a little bit of time which is why I do not want to pronounce judgment immediately but we will see as we get a little bit of experience, is it working as advertised and are the banks then passing through rates into lower rates for customers.

Bijoy: Sir why don’t you have sunset clause there?

Dr. Raghuram G. Rajan: We do not want to interfere in a contractual process in the interim. That will create all sorts of difficulties. The base rate, a number of contracts have been written on the base rate at some point in time. For us to say the base rate is going to end today would not be appropriate. What we have said is, incrementally loans should be made on marginal cost. Mundra Saab, would you like to say something?

Shri S. S. Mundra: And while there might not be a sunset but a hat is provided so that people can shield themselves. So there is enabling clause for the customers to move from one regime to other regime, from BPLR to base rate and base rate to MCLR and there is a whole framework for that. So that enabling is there, while maintaining the sanctity of the contract which has already been entered into.

Bijoy: But there is very a high cost for the switch.

Shri S .S Mundra: Not necessarily, yes there is an element of negotiation involved. But ultimately it is the product of competition and I think that works better than anything else.

Dr. Raghuram G. Rajan: I think we should emphasize that last point that ultimately it will be competition which forces the banks into this. Of course some banks have stressed balance sheets, they are focused on that rather than on new loans etc, but overtime the healthy banks will generate the lending which I think it is very important and that is one reason why we want to get all the banks back to health.

Radhika Mervin:
Hindu Business Line

My question is on the issue of transmission as we have been discussing, time and again we have seen that there has been a disparity in terms of how lending rate cuts or increases have been passed to old borrowers as well as new borrowers. So even under the MCLR regime you see that the new borrowers were incrementally benefitting from a reduction in MCLR rather than the older ones. So is there any way that this divergence can be ironed going ahead in the new system.

Dr. Raghuram G. Rajan: I do not know that it is for the RBI to iron out the divergence. If somebody is locked into a loan they did that at the beginning. So for us to suddenly break contracts it would not be appropriate. But if the loan allows them to move onto something else, clearly they can do that. Mr. Mundra, would you like to add?

Shri S. S. Mundra: I will just add one dimension to is, see there are two situations, one, where the existing borrowers who are under base rate regime and then the MCLR was introduced. And second, within MCLR the borrowers come in and as the MCLR moves further the borrowers earlier contracted whether they remained discriminated. Within MCLR framework there is already a provision, so there is a dynamic review of prices and window at the best can be one year where between the two set of borrowers a kind of differentiation can exist but not after that. So in the new framework this has already been taken care of. As far as the issue between the base rate and MCLR is concerned, I think we have already dealt with while replying to previous questions.

Sajeet:
BloombergQuint

You spoke in the policy about global growth which is uneven and not able to get traction and now with Brexit also coming in, do you expect any volatility because of that? And secondly, the payment bank licenses have been given and since then three players have withdrawn from that. I wanted your view on the entire model of payment banks and what is hampering the players to get into it?

Dr. Raghuram G. Rajan: First on potential risks, I do not think you can rule out Brexit as a source of volatility. If in fact it happens, people in Britain vote for exiting, there will be a lot of turmoil in markets, a lot of financial institutions have headquarters in the UK, there could possibly be some turmoil in financial markets and we cannot rule that out. That said, as I have said repeatedly we have three defenses, good policy, we have longer term liabilities in this country, we have not contracted too many short-term liabilities and we have a reasonable amount of reserves, all of which should help us weather volatility in financial market. So yes we are watching what happens, we are not being complacent about it, at the same time I think we should be able to weather any volatility that emerges. And the second question was payment banks, now I think one has to be careful about this because we gave out licenses to anybody we thought had the appropriate qualifications to run a payment bank. Now we presume they also analyzed potential business prospects. Now after doing further analysis and seeing the other players who are coming in, some of them have decided to back out. My sense is that the payment bank works particularly well for those who already have a base of operations and many contact points and therefore can build upon that and the classic example is somebody affiliated with a mobile company, with many kiosks through which you can do cash in cash out. So the first license is already with Airtel and I would presume other mobile operators would also go the full length. We are not overly perturbed that some people decided after analysis that they would not go forward, in fact it suggests that the licensing has been adequately liberal and that we have a variety of players coming in. I think that is as it should be, people will decide whether they should come in or not. Now I think Mundra Saab has made this point that people should also acknowledge the fact that it imposes some cost on the assessee or the assessor I should say to go through these applications. We ask for a lot of information from a variety of government agencies. So going forward we have to find some way that people devote adequate time to understanding whether in fact they should apply or not. The days where licenses were rationed and therefore you had to get in the license, because otherwise you would not get it down the line, we hope is in the past. Therefore when you go forward do a proper assessment, do not just go for a license because it is a valuable property to have but instead do the due diligence on your own and when you apply it should be with the intent of fully carrying out. Again that said, we are not overly perturbed that some people decided to back out.

Alpana Killawala: So that’s it from our side.

Dr. Raghuram G. Rajan: Well, thank you very much.

Moderator: Thank you. Ladies and Gentlemen, with this we conclude today's conference call. Thank you for joining us. You may now disconnect your lines.