Edited Transcript of Reserve Bank of India's
Fifth Bi-monthly Monetary Policy Press Conference

December 05, 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. Thank you for coming to the press conference for the Fifth Bi-monthly of this fiscal year. The Monetary Policy Committee evaluated current and evolving macroeconomic conditions and voted today to maintain status quo while reiterating its commitment to achieving the medium-term target for headline inflation of 4% on a durable basis. We noted that the global economy is likely slowing; the outlook is weighed down by decelerating global trade, ongoing trade tensions and expectations of slowing demand. Crude oil prices have declined by close to 30% since the peak in early October at about the time of the last policy, reflecting higher supplies and easing of geopolitical tensions. In many key Emerging Market Economies (EMEs), inflation has risen but the recent retreat in energy prices and stabilizing of currencies may have a salutary impact going forward. Global financial markets have been volatile. With the easing of the US Dollar, emerging market currencies in recent weeks have been trading with an appreciating bias.

Domestically, GDP growth slowed in Quarter 2 due to moderation in private consumption and net exports; however, the MPC noted that gross fixed capital formation (GFCF) expanded by double-digits for the third consecutive quarter and the growth of imports accelerated relative to exports, attesting to the underlying strength of domestic demand. Seasonally adjusted capacity utilization at 76.4% was above the long-term average of 74.9%.

The latest round of the Reserve Bank's Industrial Outlook Survey reflects stable business sentiment in Quarter 3 with sustained optimism about production and exports. This dovetails with the Purchasing Managers' Indices (PMI) for manufacturing and services that remained in expansion mode in November. In fact, the composite PMI Output Index touched a two year high of 54.5 in November. On a year-on-year basis, non-food bank credit grew at 15.3% as on the reporting Friday of November 23, 2018. This is faster than the growth of nominal GDP.

Moreover, the flow of bank credit has become increasingly broad-based with even credit to industry emerging out of contraction from November 2017 and posting positive growth thereafter. Inclusive of banks' investments in commercial papers, shares, bonds and debentures, the adjusted non-food bank credit increased by 15.6%. The total flow of resources to the commercial sector from banks and non-bank sources together has increased year-on-year by over 50% as on November 23rd.

Turning to inflation, the MPC observed that retail CPI inflation dipped to an intra-year low of 3.3% in October, cooled down by food prices plunging into deflation, whereas inflation relating to fuel remained elevated, and excluding food and fuel, CPI inflation accelerated to 6.1%. While near-term households' inflation expectations softened, they remained unchanged for the 12-months ahead horizon.

In our assessment of external factor developments, the MPC noted that India's merchandise exports rebounded in October but imports also grew at a faster pace and consequently, the trade deficit widened. On the financing side, net FDI flows moderated in relation to a year ago, while during the year up to November, there were net portfolio outflows. On the other hand, Non-Resident deposits increased markedly. Reflecting these developments, India's foreign exchange reserves were at about $394 billion as on November 30th. India and Japan have agreed to enter into a bilateral swap arrangement of $75 billion which will provide a partial backstop to foreign exchange reserves and enhance the capability of the Reserve Bank to stabilize the foreign exchange market in situations of heightened market volatility and sudden stops and/or reversals of capital flows.

On the outlook, the MPC was of the view that the broad-based weakening of food prices and the sharp decline in international crude oil prices imparts a downward bias to the headline inflation trajectory going forward. In contrast, there has been a broad-based increase in inflation in non-food groups. Accordingly, taking all these together, inflation is projected at 2.7% to 3.2% in the second half of 2018-19 and 3.8% to 4.2% in the first half of 2019-20, with risks tilted to the upside. Although recent food inflation prints have surprised on the downside and prices of petroleum products have softened considerably, it is important to monitor their evolution closely and allow heightened short-term uncertainties to be resolved by incoming data.

As regards growth projections, the MPC observed that going forward, lower Rabi sowing may adversely affect agriculture and hence rural demand. Financial market volatility, slowing global demand and rising trade tensions pose some downside risks to exports. On the other hand, the decline in crude oil prices is expected to boost corporate earnings and raise private consumption through higher disposable incomes. Increased capacity utilization in the manufacturing sector portents well for sustaining the acceleration in investment activity. As mentioned, bank credit growth has strengthened, and they should support productive sectors of the economy. Accordingly, GDP growth for 2018-19 has been retained at 7.4% which means 7.2-7.3% in the second half and for the first half of 2019-20 at 7.5% with risks somewhat to the downside.

A key point the MPC discussed was that uncertainty around the projection remains rather large, as while recent downward surprises have been large, they have also been over a very short period of time. First, few more months of data are needed to ascertain the full impact of Minimum Support Prices on food inflation and the prices of several food items are at unusually low levels, there is a risk of sudden reversal, especially of volatile perishable items. Secondly and equally importantly, volatility indicators for crude oil prices and financial markets have not softened, suggesting that there remains considerable uncertainty in oil prices and international financial markets outlook, depending among other factors, on OPEC supply decision later this week and how the trade war truce or otherwise plays out. Finally, fiscal slippages, if any, at the center and/or state levels will influence the inflation outlook, heighten market volatility and crowd out private investment.

On balance, the MPC was of the view that incoming data will help ascertain the durable nature of recent inflation softening and allow better judgment on future policy action. Hence, given the assessment that growth will likely remain healthy for the rest of the year, the MPC retained its stance at calibrated tightening, so as to buy time to pause, reflect and undertake future policy action with more robust inflation signals. If the upside risks we have flagged do not materialise or are muted in their impact, as reflected in incoming data, there is a possibility of space opening up for commensurate policy actions by the MPC.

I will now request Dr. Acharya to say a few words.

Dr. Viral V. Acharya: Thank you, Governor. Good afternoon, everyone. I am going to mainly talk on various aspects of liquidity management by the Reserve Bank. Since the last MPC meeting, the Weighted Average Call Rate, at which money market participants transact in the unsecured funding market on an overnight basis, continues to remain soft and below the policy rate on average. This has been possible due to deployment of a variety of liquidity tools.

I will mention the three primary ones: RBI has injected durable liquidity through Open Market Operation purchases to the tune of now ₹ 1.36 trillion in the current financial year. The pace of our OMOs has stepped up with the injection of slightly over ₹ 1 trillion in the last three months. Second, the Reserve Bank has also provided liberal infusion of liquidity through Term Repos in addition to the usual provision via the LAF or the Liquidity Adjustment Facility. Third, as a supplementary measure, facility to avail liquidity for Liquidity Coverage Ratio or FALLCR as it is called, was increased with effect from October 1st to enhance the ability of individual banks to avail of liquidity if required from the repo markets.

Based on our assessment of durable liquidity needs, going forward, we have already announced an OMO purchase programme of ₹ 400 billion or ₹ 40,000 crores for this month of December. We expect that this increased frequency and quantum of OMO purchases may be required until end of March, but the exact calibration will depend on sustained changes in the behavior of currency in circulation and the magnitude of sterilisation operations for RBI's forex operations which of course keep evolving with external sector conditions. Second, we also plan to conduct additional long-term repo operations to meet transient liquidity demand that is likely to emerge later this month on account of the third tranche of advance tax outflows.

Two things in the supplementary Developmental and Regulatory Policies or Part-B that relate to liquidity: First is an operational change. It has been decided by the RBI that we will provide information on the daily CRR balance of the banking system to market participants on the very next day instead of two to three days at present so as to help individual banks improve their liquidity assessment. Second and more important - market liberalization. It was proposed in the Bi-monthly Monetary Policy Statement in April of this year that non-residents shall be given access to the Rupee interest rate derivatives markets in India. The draft directions in this regard will be issued after close of market today for public feedback. They propose allowing non-residents to hedge the Rupee interest rate risk flexibly by using any available interest rate derivative instrument in the Indian markets. Non-residents who are already permitted to participate in interest rate futures market will going forward also be permitted to participate in the Overnight Index Swap or the OIS market for non-hedging purposes, subject to a macro prudential limit on the collective exposure of all non-residents, in terms of the interest rate risk that is being undertaken. We think this is a pretty important reform in the interest rate risk sharing markets.

Just excuse my indulgence, I am going to now discuss in some detail the issue of funding liquidity for the NBFCs and the HFCs. The Reserve Bank has been watching the market developments on this front quite closely since end of August. We have been in regular touch with SEBI to assess the fallout in terms of mutual fund redemptions and the resulting rollover risk for NBFCs and HFCs. As I mentioned earlier, the Reserve Bank continues to provide system-wide liquidity at an augmented quantum and pace. In addition and specifically for NBFCs and HFCs, we have increased the liquidity that banks can raise against their G-Sec holdings as collateral, specifically also for on-lending to NBFCs and HFCs and we have also relaxed the concentration limits on banks for lending to individual NBFCs and HFCs. The concentration limit has been increased from 10% to 15%.

Importantly, the Reserve Bank has also taken measures to facilitate asset and risk transfers within the financial system. This can be considered as re-intermediation across financial players of risks. We believe this is healthy for financial stability, overall. Just to give an example, when banking sector was getting recapitalised in the wake of corporate NPA recognition, NBFCs and HFCs picked up their market share. So to this end, so to facilitate re-intermediation of this type, the Reserve Bank has taken two measures; first, it has allowed banks to provide partial credit enhancement on bonds issued by NBFCs/HFCs. This will help raise the credit quality of these bonds and thereby attract mutual funds to provide greater rollover funding to NBFCs and HFCs. And second, we have also relaxed the rules for securitization by NBFCs and HFCs, which should allow the risks to transfer to better funded bank balance sheets.

I want to stress that these measures have been carefully chosen from the full set of available options based on our analysis of the reasons behind the funding stress for NBFCs and HFCs. Our assessment is that these measures have collectively eased the funding stress in a steady manner over the past two months. They have given NBFCs and HFCs time and the opportunity to make their own balance sheet adjustments on both asset and liability side, in particular, improve the duration structure of their liabilities.

Let me conclude, the Reserve Bank is guided by and large by the principle of addressing system wide liquidity. The Reserve Bank also stands ready to be the lender of last resort, but that is provided conditions warrant that sort of an extreme measure. In our assessment there is no such necessity at the present, given the sound health of our economy. And as Governor explained in detail, we are at a level of aggregate credit growth, which remains comfortably in excess of nominal GDP growth with a fairly robust distribution across various sectors. Thank you.

N. S. Vishwanathan: I want to highlight a few policies from Part B. We have been moving towards enhancing transparency in interest rates on loans. As a part of this, we moved from Base Rate to MCLR, which is more transparent than Base Rate. But in furtherance of this objective, now we are making it mandatory for banks that loans after 1st April, 2019 for personal retail segment and MSE (Micro and Small Enterprises) will be linked to an external benchmark. So, we have listed a few benchmarks and also allowed them to use any other benchmark that FBIL will come with. And the actual interest rate will be a spread over the base rate or the benchmark rate, which the banks can determine on their own. But that spread is variable only if there is a change in the credit rating of the borrower as per the conditions of the loan agreement. So, this will bring lot more transparency in interest rate and the borrower will know the terms at which he has been lent.

Second, we had announced in April policy that we want to bring in a mandatory loan component in respect of the cash credit limits that large borrowers enjoy. So, we are now coming out with final guidelines. We had issued draft guidelines. Response had come. And based on that, we are issuing final guidelines that take effect from April 1, 2019 that gives all the stakeholders enough time to plan and transition in a smooth manner. Of course, as I said, we will clarify as how much percentage of the cash credit will have to be treated as loan component.

The third is on aligning the LCR with SLR. The Liquidity Coverage Ratio is one of the important liquidity measures under the Basel III as part of the post global crisis reforms. It requires that banks maintain high quality liquid assets (HQLA) equal to the stressed demand on their liabilities for 30 days. This was phased in starting from 2015. At present it is 90%. From 1st January 2019, it will become 100%. So, what we are saying is that, as a part of this move, we are also reducing the SLR, which is currently 19.5% over a six quarter period to 18% at the rate of 25 basis points in each quarter. Currently the banks are allowed to use a part of SLR to be treated as HQLA for LCR. That will of course continue even after this.

On the Urban Co-operative Banks front, governance, given that Co-operative banks work under dual control of the state government and the RBI is something that we have been working on. So, right from the Malegam Committee that was set up in 2010, there was a suggestion that the banks should have what is called as a Board of Management, which will work under the control of the Reserve Bank of India. And this was reiterated by High Powered Committee under Mr. R. Gandhi on Urban Cooperative Banks. So, we have issued a draft guidelines on this. Based on the response that we have received, we are going to issue final guidelines, which requires such banks to have a Board of Management. What we are saying is that, the banks should actually have in their by-laws, a provision for Board of Management. And the incentive is that, unless they have a Board of Management, we will not allow them to expand their business, increase branches, etc. So, the banks which want to expand will have to put in place this arrangement.

I want to also mention one thing that is not part of this policy but something that we had announced earlier. In the October 2017 Policy, we had announced that the banks should have special facilities for the senior citizen customers, and we had followed it up with a detailed circular which requires them to have special counters, there must be doorstep services provided to them, etc. We had also made it clear that non-compliance with these instructions will be treated as a case of deficiency in services, which can be taken up for redressal with the Banking Ombudsman. I just want to use this forum to reiterate that these are very serious instructions that we have put in place. And, we would request the banks to implement these instructions in toto and grievances, if any, which we receive from the senior citizens will be viewed seriously. Thank you.

B.P. Kanungo: Just wish to highlight two paragraphs in Part-B. The first one refers to the foreign exchange transactions. As you would recall, the Foreign Exchange Management Act 1999, when it was enacted to govern the cross border financial transactions flows, it started with 25 original regulations. But whenever we carried out an amendment or changed the rules, an amendment regulation had to be brought out, and over a period of time this had ballooned to more than 350 amendment regulations along with the 25 regulations. So, we undertook an exercise to consolidate them. Actually, the objectives were four-fold – one is, consolidating them into the primary regulations- 25 of them; then align it with an evolving business practices and the needs of the economy; then iron out the definitional differences that exist across various statutes; and also, to soft-code it so as to obviate the need of further amendments whenever you change the rules. You would have noticed that over a period of last one year or two years, we have consolidated 18 original regulations that archives 195 amendment regulations so far out of the 350. In continuation of that effort, we will be amending or rationalizing the borrowing regulations between the residents and non-residents and bring out a new framework for the borrowing regulations which will be announced by the end of the month. There are two to three majors, in the Part- B regarding consumer protection for digital transactions. You would recall that in the recent times we have issued guidelines to protect the interest of the customers of the commercial banks, non-banking financial companies who are in the business of issuing cards and co-operative banks, so far as the consumer protection limiting the liability of the customers for unauthorized electronic transactions. However, such protection is not available when the electronic transaction is originated by PPI issuers who are non-banks. So, it has been decided that as a measure of providing the consumer protection to all the customers of all the segments, all the issuers, and bring them to the same level; we will issue the guidelines limiting the consumers' liability for unauthorized PPI transactions where PPIs are issued by non-banks. The framework would prescribe the limits after which the customer may bear the liability against the contributory frauds, negligence or deficiency on the part of the issuer, third party breach where the deficiency lies with neither the issuer nor the customer, and the maximum loss due to negligence of customer, etc. And, we propose to issue the guidelines by the end of this month as well. Thank you.

Dr. Urjit R. Patel: Thank you Mr. Kanungo. Mr. Jain.

M. K. Jain: A very good afternoon friends. I will give a brief perspective on two policy announcements, one on Ombudsman scheme for digital transactions. The Reserve Bank's endeavor to build a less-cash society has facilitated a significant rise in the volumes, value and channels for conducting digital transactions. For promoting the level of trust and customer confidence in this powerful channel that has wide and deep reach, a dedicated and empowered grievance redressal mechanism is a prerequisite. Accordingly, an Ombudsman Scheme for digital transactions is being formulated by the Reserve Bank to provide a cost-free and expeditious avenue for handling the rising number and growing complexity of such complaints. The Ombudsman Scheme for digital transactions will be administered and funded by the Reserve Bank and will cover entities falling under the Reserve Bank's regulatory jurisdiction, it means beyond banking as well, providing related services.

The next is setting up an expert committee on Micro, Small, and Medium enterprises (MSMEs). Micro, Small and Medium enterprises are one among the most important sectors forming the backbone of the Indian economy. Despite contributing significantly to the economy, large number of MSME units exist in informal space and face difficulty in accessing credit. Reserve Bank has recently taken several steps, such as, setting up of Trade Receivables Discounting System, which is called TReDS, operationalization of national mission for capacity building of bankers for financing MSME sector, allowing banks to co-originate loans with non-banking financial companies, etc., to facilitate flow of credit to the sector. In order to enable MSMEs tide over the impact of demonetization and GST, Reserve Bank also undertook regulatory forbearance in prudential norms. However, the increasing stress in the sector is a matter of concern. A comprehensive approach needs to be adopted to understand the problems of the MSMEs and the challenges faced by them for a holistic development of the sector. Keeping this in view, an expert committee would be constituted by the Reserve Bank of India to identify causes and propose long-term solutions for the economic and financial sustainability of MSME sector. The composition of the committee and its terms of reference will be finalized by the end of December 2018, and report will be due by end-June 2019. Thank you.

Dr. Urjit R. Patel: Thank you very much, Mr. Jain. We will take a few questions. Economic Times?

Govardhan Rangan:
Economic Times

Thank you, Governor. You have given some hope of reversing the rate cycle if the upside risks do not materialize. So, when the reversal happens, will it depend on your first half, second half forecast of inflation in the next fiscal? On the other hand, is it that so many months of undershooting of inflation target is required for you to change the course of the interest rate cycle?

Dr. Urjit R. Patel: Well, as we have mentioned very clearly, including in the Resolution and in my opening remarks, is that we need few more data points to ascertain the durability of the decline in inflation that has taken place in a very short period of time, especially with respect to oil, the implied volatility now is actually higher than in October, although the price of oil has come down. So, with incoming data, our projections will change and we will take a call as and when required.

Nivrita Ganguly:
BTVI

This is a follow-up really on that question. There has been a sharp downward revision that we have seen for the inflation forecast. In fact, the mid-point of the second half projection is below the target of 4%. Why then has the stance been retained at calibrated tightening? And in that case if this remains the stance, should we expect going ahead, as long as inflation is below that target, we will see a hold on rates?

Dr. Viral V. Acharya: It is a good question and in some sense, the volatility of data make the decision somewhat difficult. But, I think I would like to stress two things. One, we have to look for inflation staying at our target rate at medium-term horizon. So, I think in some sense at Q2 of 2019-20, the number is 4.2%, which is basically implying that as of now we are still slightly above the target at a 12-month horizon. So, what has really happened is that the two surprises in food and oil in a very short period of time have of course brought the projections down quite significantly. Nevertheless, the medium-term target actually remains above the headline target. So, I think we need to observe the data for a couple more months, first, to see if these recent prints are durable or not. The recent prints have also created massive uncertainty, as Governor said, actually surprisingly when oil prices rise; that is typically when the implied volatility in options market for crude oil rises. But what we are observing is exactly the reverse. And it is not surprising because the collapse has been so dramatic in just less than four-five weeks. So, I think what we are saying is that we really need some time in order to assess the inflation outlook better and then we will be able to take a further policy action if necessary.

Pradeep Pandya:
CNBC Awaaz

Governor, you said in your statement that you are seeing an upward bias in non-food inflation, but the food inflation is expected to fall. In non-food inflation, what are your assumptions and what level of crude are you considering for this forecast?

Dr. Urjit R. Patel: Actually, the forecast that is there in resolution is for non-food and non-fuel. So it is not just a non-food projection, it is a non-food non-fuel. So, the oil component has also been deleted in making the projection for that particular category of CPI inflation. And as is usually the case, you can get a better idea on the assumptions, if you look at the Monetary Policy Report (MPR), which shows how we make adjustments with respect to inflation projections as the oil price and exchange rate changes. So, on oil we generally look at the futures curve, which you also have access to. And on the exchange rate, we maintain an exchange rate which is basically the same as what is prevailing now.

Pradeep Pandya: What is the rate of crude in your inflation forecast?

Dr. Urjit R. Patel: It is the same as the futures curve, which actually changes every day. But we would fix it on the day that we are making the projection, which was yesterday.

Somesh Jha:
Business Standard

Recently analysts have talked about cut in the CRR as a way to provide liquidity in the system. So, was this discussed by the MPC? And if yes, why there was a decision to keep it unchanged? Secondly, about the recent developments, do you see the usage of Section 7 of the RBI Act as an attack on the autonomy of the RBI? And the call for governance reform by RBI, how do you see that?

Dr. Urjit R. Patel: I will only answer the first question. With respect to the CRR, the CRR is not in the ambit of MPC. And secondly, we see no reason to use the CRR when we have so many other instruments at our disposal, which Dr. Acharya and Mr. Vishwanathan enunciated, and which we have implemented over the last two months for liquidity management, which are broadly market based with some incentives, CRR is not counted.

Bijoy Idicheriah:
Cogencis

Just a follow-up to the point you just made, instead of doing OMOs which also have the yield impact, even though you are balancing out with forex interventions at the same time; have you considered longer-term repos as a better option to do that because it will have much lesser impact on the actual yields in the market? Because as soon as your comments have gone out, the markets have already started reacting.

Dr. Urjit R. Patel: Actually, the OMOs address durable liquidity and longer-term repos- we have used 28-day, 56 day- at the end of the day, helps to smoothen the relatively short-term and the more frequent liquidity shortages and surpluses. So, that is for frictional liquidity; so the two instruments are quite different.

Vivek Wankhede:
All India Radio

Can you just elaborate more on the relationship between RBI and the Government?

Dr. Urjit R. Patel: Well, I already said that I would avoid those questions because we are here discussing the Monetary Policy Committee Resolution. Thank you.

Subhash Shirke:

News Nation

Sir, Dr. Viral Acharya has said some things in the public domain, do you agree to that? And has any decision been made with respect to surplus funds being handed over to the Central government?

Dr. Urjit R. Patel: Is this related to the Monetary Policy Committee resolution? I don't think so. We are here to discuss the Monetary Policy Committee resolution and the macro economy.

Thank you.