Governor's Post-Speech Question Answer Session at the Financial Express Modern BFSI Summit in Mumbai on June 17, 2022 (Edited excerpts)

Qn: Good morning, thank you, sir, for this encouraging address. It is so very encouraging to see the regulator talk about various forms of regulations. You talked about entity-based, activity-based and outcome-based regulation. There is another school of thought in terms of the ultimate user, i.e., the borrower segment-centric regulation. I say this, especially in the context of the pandemic and certain conditions. The small borrowers are the ones who get affected the most, especially in the context of the prudential regulations being the same across the board for small and big borrowers. Is there a case for having some special dispensation apart from the event-based but on an ongoing basis, if we can have some kind of borrower-centric regulation? Even technology today when the advent, it is the ultimate user who is at the focus, so your views on this.

Shaktikanta Das:
I must say that my address perhaps became a bit heavy on a very warm bright morning of monsoon season in Mumbai. Since this event is focused on modern BFSI, I thought that I should focus more on FinTech. As I mentioned, a copy of this speech will be uploaded on the RBI website. Those of you, who are interested, can look at it.

Addressing your question, in the case of NBFCs, we have already introduced scale-based regulation and in the case of MFIs, very recently, we have introduced activity-based regulation, which is neutral across entities. If it is a microfinance loan given by a bank or an MFI or another NBFC, the regulations are now uniform. It is targeting the size of the borrowing of the micro borrowers. We are already on that track. When we introduced activity regulation, activity is linked to outcomes. We want to see that eventually the microfinance borrowers are benefitted, and their interests are taken care of. The lenders, whether it is MFIs or banks, have also to take into account the customer requirement. We have made some changes with regard to assessing the income criteria of the microfinance borrowers. All these have been framed keeping in mind the requirement of the ultimate customer, so we are very much on that track. As and when any new or constructive suggestions come up, we will certainly look at them. As I said, the RBI will continuously strive to fine-tune its regulations because it is an ever-changing situation. We will respond proactively. We will try to be as proactive as possible. If there are new suggestions, new challenges or new trends and developments, the RBI will certainly respond to them.

Qn: Thank you, Governor. Your speech was just wonderful, where you spoke about the fine balance between fostering innovation and preventing systemic disruption but my questions are a little away from that. Firstly, on this easy liquidity, some time back you had said and I quote 'the day we announced that we will enter that Chakravyuh we planned an exit route also and we would come out smoothly'. Is exiting the Chakravyuh proving to be more difficult than you had imagined earlier?

Shaktikanta Das:

Certain developments, which took place after we announced certainly made the task more challenging. In the beginning of the COVID 19 pandemic, on March 27, 2020, we announced our first set of measures, thereafter on April 17 and then on May 22 and August 6, 2020. So, whenever we announced any liquidity infusion measures, there was a sunset date. The TLTRO was for one year or it was for three years. The reduction in the CRR was for one year and it ended at the end of one year. We, of course, gave a one-month extension, but it ended at the end of one year. Each injection of liquidity was accompanied by an end date when liquidity had to come back. But liquidity to the market also gets added from other sources, for example, when RBI intervenes in various markets, whether it is the G-sec market or the Forex market. This is part of our normal operation and generates a lot of liquidity. If you remember in January 2021, even before the first year of the COVID was completed, we announced VRRR (Variable Rate Reverse Repo) auctions. We tried to take out the liquidity, sequester it and keep it in the VRRR window. Then the process got interrupted by the Delta wave. Delta wave came around April, it subsided but our VRRR continued during that process. As we moved towards the end of 2021, we had the OMICRON and then on February 24, 2022, the war had started. So, our approach was that no injection of liquidity will be open-ended. The liquidity, which came into the system beyond our control, we had to deal with it; and VRRR and SDF have been able to deal with it.

Now, reasonably satisfactory credit offtake is also happening. The credit offtake growth is about 12 per cent (year on year) as per the latest data, and it was around 5-6 per cent a year ago. With credit offtake, a part of the liquidity will get absorbed. So, the process has taken a little longer, because of developments like the various waves of the pandemic and the onset of the war in Europe. During the pandemic time, total liquidity injected in the system was about ₹12.5 lakh crore, of which about ₹5.0-5.5 lakh crore have come back and there is ₹7.0 lakh crore sitting out there. That ₹7.0 lakh crore has also come down to about ₹5.0 lakh crore. Most of it is now getting absorbed in the SDF and the VRRR. We have to leave something in the system also, which the banks and the lenders must have to go on with their credit lending activities. So, I would say that the process of getting out of the Chakravyuh has taken a little longer because of things which happened beyond our control. Even at this point of time, we remain confident that we will come out of it very smoothly and we are targeting a soft lending.

Qn: Governor, over the last two days, central banks like US Fed, Bank of England and many other central banks in Europe, have become more aggressive in hiking rates, while at the same time, some of them acknowledge the risk of the recession still remains uncomfortably high. i) Did RBI delay the rate hike cycle because it felt that the economy is too weak to handle that kind of situation and ii) now that the rate hike cycle has started, do we see more aggressive RBI going beyond the pre-pandemic level of 5.15 per cent?

Shaktikanta Das:
I truly and sincerely believe that the RBI is in sync with the trend of economic developments and the process of recovery; we are very much in sync with the requirements of the economy. I will take a little longer to reply to this question.

We had started to take out the liquidity as early as the beginning of 2021 and then we faced the Delta wave and other challenges. During Q1:2020-21, our GDP contracted by a historic high of 24.4 per cent and the economy witnessed a contraction of 6.6 per cent in 2020-21. Our primary focus then was to support growth and to see the financial markets remain functional. Let me remind that after the global financial crisis there was no activity in the financial markets for the first 15 days. This time, when COVID started followed by a nationwide lockdown from March 25, 2020, we announced our measures on March 27; the financial markets and all financial market infrastructures remained fully functional. We ensured that liquidity, which is the lifeline of a financial system, was provided adequately. So, our focus was to maintain financial stability, to see that the financial markets function normally and to support the process of economic revival. This approach continued through 2020-21 and 2021-22. During this period, there were situations where inflation crossed 6.0 per cent, but we decided to look through them because we realised that this inflation was transitory, and it will come down. In August 2021, we stopped describing inflation as transitory, because core inflation was becoming persistent and in several other areas, we realised that inflation was becoming persistent. Thereafter, we focused on liquidity withdrawal.

The GSAP, which we had announced around April 4, 2021, ended on October 30, 2021, and thereafter, we did not announce any fresh GSAP. We focused more on Operation Twist so that additional liquidity is not injected into the market. Right after September-October 2021 onwards, we focused on the withdrawal of liquidity, and we were watching the revival of economic activity and the revival of growth. In fact, in one of my monetary policy statements, where I had said that when the shore is visible, why to rock the boat, let us first reach the shore safely. So, our focus was to ensure that the economy reaches a stage, where we can pull out the support in terms of liquidity and the support in terms of lower interest rates, which we had given to deal with the fallout of the pandemic. So, we wanted growth to reach a particular level, where we were comfortable that it was stable.

Questions have been asked that our projection of inflation in February 2022 was very optimistic. We projected 4.5 per cent for the whole year. I will tell you why it was not optimistic. The Professional Forecasters' conclusion was that it was going to be 5.0 per cent. We had done our internal analysis. At that time, we had assumed the crude oil prices to be US$80 per barrel. Internally, we did an analysis, if the crude oil was to touch US$90, US$95 or US$100 per barrel, even then we found that the inflation will be about 5.0 per cent or 5.2 per cent. So, we took a conscious call that let us tolerate for a little more time till year-end, i.e., 2021-22. Let us see what has been the outcome of two years of support? We will get sense from it by the end of March, and then we will act. So, reaching the end of March, we concluded that activities and GDP size and growth had exceeded the 2019-20 level, the pre-pandemic level. We, then, decided it was now time to focus more on inflation.

In the April policy, we introduced SDF at a higher rate, it was higher by 40 basis points compared to the reverse repo rate. We changed our inflation projections. We came out very clearly with the policy statement that from now on in the sequence of our priorities, inflation takes priority over growth.

From April 2022 inflation number, we got a sense that it is much more than expected. In the meantime, the war started, which came without any forward guidance or advanced notice. Nobody knew that the war would start. Even as late as 20th and 21st February, everybody was saying that it will be a geopolitical conflict. Nobody expected a full-fledged war and its consequences. In April 2022, we knew that this war is going to cause damage. We came out with about five or six measures. We introduced SDF at a higher rate of 3.75 per cent, which had the effect of pushing up the overnight call rates, which is the primary instrument of monetary policy. We changed our focus to inflation. We revised our inflation projections. In April 2022 policy, there was, indeed, a rate hike of 40 basis points because the SDF at 3.75 per cent ensured that the call money rates went up by an equivalent amount. On top of a 40 basis point rate hike through the SDF, we did not want to add another 50 or 40 basis points of the rate hike, because the shock would have been too much. The shock that the war gave had to be dealt with in a calibrated manner, just as the shock, which COVID gave to our economy. Our financial markets had to be dealt with in a calibrated manner so that the shock is well absorbed by the players, the businesses, the financial sector and the lenders. So, we had a calibrated path. Therefore, we did the off-cycle meeting in May 2022. Now the growth numbers for last year are about one and a half per cent higher than the 2019-20 level. I feel that we are very much in line with the requirements of the time and the RBI has acted proactively.

I would not agree with any perception or any sort of description that the RBI has fallen behind the curve. Just imagine, if we had started increasing the rates early, what would have happened to growth. This is all hindsight knowledge. If we had started increasing the rates a little earlier, what would have happened to growth in 2021-22? Could it have prevented the spike in inflation, which has now been caused by the war? No, inflation would still be at seven per cent. So, the assumption that RBI should have increased the rates another three or four months early, let us look at the economic cost that it would have caused to the economy. It would be fair to reach a conclusion only thereafter, I'm sorry, I've taken a very long time, but this question is being asked by in several quarters. So, I thought I will address this question in a detailed manner.

Qn: So, what is the neutral rate after the pandemic?

Shaktikanta Das:
It will depend on the evolving situation. In the last MPC press conference, I explained from the point of view of liquidity when the overnight rates are at the level of the repo rate, but that is more from the point of view of liquidity. It all depends on the inflation dynamics. It will depend on the inflation scenario, and how it is panning out. Every day, there are new developments taking place. Yesterday, the US Fed has increased its rates by 75 basis points and the earlier expectation was 50 bps. So, it will depend on the evolving situation. The RBI is very watchful of the evolving dynamics of inflation, and we will respond to it appropriately. It's very difficult and not possible for me to pinpoint a specific level. Even now, we are having a negative interest rate. But our negative interest rates, incidentally, are far better off compared to some of the advanced economies where the negative interest rates are even much higher.

Qn. I'm referring to a recent article by a former chief economic adviser in Indian Express our sister publication, wherein he made one comment, the mistake, I am quoting, that the RBI was treating the ceiling as a floor, that 6.0 per cent ceiling became its floor target. How do you respond to that?

Shaktikanta Das:
Sorry, I have not seen that article. I don't want to enter into any sort of debate with anyone. We have a regime of flexible inflation targeting, where the target is 4.0 per cent and there is a band around it plus/minus 2.0 per cent. The range of 2.0-6.0 per cent, is the range available to the regulator to deal with extraordinarily challenging situations as it came out during the time of the COVID. During the time of the COVID, the Monetary Policy Committee consciously decided to tolerate inflation which was higher than 4.0 per cent up to 6.0 per cent. Because the situation required that. If we had been very firm in maintaining at 4.0 per cent and kept the rates unduly high, I'm sorry, the consequences of that approach would have been disastrous for the economy. We decided to use that band, the flexibility available to us is around 4.0 per cent to support growth and we are very open about it. The cost and the damage to the economy, you analyse two scenarios; i) we maintain 4.0 per cent inflation and ii) we focus on growth when the economy was facing extraordinary challenges. If we had attempted to keep our monetary policy tighter at that time, the economic damage that it would have caused to our economy and our financial markets would have been enormous. It would have taken years for India to come back. We are a country of 130 crore people. We have to give priority to growth also. The way the law is defined, it was not MPC’s discretion to tolerate inflation up to 6.0 per cent. It was not MPCs unilateral decision. Look at the provision in the RBI Act. The provision in the RBI Act says that the RBI shall maintain price stability, defined in terms of 4.0 per cent plus/minus 2.0 per cent while keeping in mind the objectives of growth. So, we are required, under the law, to keep in mind the requirements of growth. The economy contracted by 6.6 per cent. If we had adopted a tighter policy, then it would have been sort of disastrous for the economy.

Another area, which I must point out that going by past experience, our response this time around was very calibrated. The injection of liquidity was not open-ended. There were in-built withdrawal clauses. Even the COVID resolution package, which we offered on August 6, 2020, for restructuring of bank and NBFC loans etc., we had set out parameters with regard to what kind of debt-equity ratio it should have, what kind of financial parameters and operational parameters should be, sort of the borderline beyond which it should not be done. We were very careful and calibrated even while loosening monetary policy. But tolerance of higher inflation during the pandemic was on necessity. We still stand by our decision. It was MPCs decision to tolerate higher inflation, which definitely, among other factors, contributed to the revival of the economy and put our economy where we are today. As our bulletin article has said, yesterday, India is much better placed than many other economies to face the fallout of the war.

Thank you, Governor, we can have a couple of questions from the audience.

Qn: Thank you Governor for taking the questions. In the context of FinTech as you were telling us, how do you envisage the existing banks setting up separate digital banks as distinct entities? how do you see that and how would the RBI view that because it would help them in terms of branding, putting in brand new technology? So, have you already received applications?

Shaktikanta Das:
We don't have a separate regulatory framework for what is called as digital banks. Two things are happening; i) we have come out with regulatory guidelines for digital banking units, DBUs, you are familiar with that, and ii) the banks themselves are also adopting technology in a big way. I feel there is no need for any bank to set up a separate digital bank to have a parallel entity in the same business. What they can achieve by having a parallel entity, they can very well achieve as a part of their own organisation. The idea of a separate digital bank, there were some suggestions which came, but we felt that that carries certain risks with it. We have, therefore, not accepted that at the moment, but the banks are free to change their business model to focus more on harnessing technology for the delivery of various banking services.

Qn: Just a follow-up question on neo banks, where does RBI stand on this and could we expect some regulations soon?

Shaktikanta Das:
At the moment, there is no proposal as such, because we feel that the existing banks and the NBFCs can adopt more and more of technology to achieve the outcomes in order to exploit and capitalise on the opportunities that digital transactions or new technology are offering them. At the moment, we have no idea of setting up what may be called neo banks or digital banks, because we feel that the existing architecture is sufficient to enable the existing players to leverage technology and innovations.

Qn: How soon can we expect the regulations for BigTech participating in our financial system?

Shaktikanta Das:
BigTechs are already participating in this financial system. By way of a partnership with banks, we are trying to see the kind of terms and conditions of the agreement between the bank or the NBFCs and the BigTech company because there are only certain things which the banks can outsource and there are certain things which the banks cannot outsource. That is one aspect, which we are looking at. So far as BigTechs are concerned, there are various forms of lending which have now started. For example, 'buy now pay later'. Which is now offered by several e-commerce companies that are also involved in a kind of lending activity. But we have to be very careful and calibrated in our approach, we should not suddenly start interfering everywhere. For example, if an e-commerce player is giving an opportunity of 'buy now and pay later'; let him carry on with their business. What is our responsibility as a regulator is that we keep assessing what kind of leverage is building up in the total system, and is it going to pose a challenge at the systemic level. So, we watch very clearly the major players, what kind of buy now pay later they are offering, and what kind of leveraging they are doing. Because if a real sector business fails, it impacts the banking sector also. We are studying all these details very carefully to the best of our capacity. As and when required, we will come out with guidelines. But to begin with, we should not, at every incipient stage, unnecessarily before it reaches a place where it would cause worry, interfere and kill some new business methods or models. We have to allow new business practices and methods to grow. We step in only when we feel that well, it's now time for the regulator to intervene.

Qn: On the NUE guidelines, how soon can we expect that? Or if you have any views on the applications?

Shaktikanta Das:
Not at the moment, you will hear about it. The matter is under consideration, and we will come out with some decisions.

Qn: We have also the chief economic adviser here and this is an era of coordinated approach which is happening. Do you both always agree?

Shaktikanta Das:
No. But let me mention, that we do not agree always. But, we also agree on many points. Wherever there are disagreements, which is quite normal between any fiscal and monetary authority. Wherever there are differences of opinion, we engage internally and resolve them.

Do not carry the headline tomorrow, that the CEA and the Governor do not agree. We do agree on most of the points, wherever there are differences, they are sorted out,

Qn: Shri Das, you're actually very sure-footed in uncertain times. And one former governor once told me that it's better to be vague and accurate than be precise and wrong. And you're never wrong as well and never vague.

Given the current scenario, when do you think we could be touching 4.0 per cent inflation? I know, it's very difficult to say, but in the current environment, given your understanding of how things are, what's the sense you get?

Shaktikanta Das:
We have given our inflation projections. I cannot say anything beyond that. We have now given our inflation projection for the current year i.e., 6.7 per cent. We keep on internally analysing it, there are so many uncertainties. It all depends on how quickly the war ends, and how quickly the COVID ends. We are looking at it totally uncertain future. But from our side, we have made our assessment on one-year horizon. We also have our internal analysis about what lies beyond and our decisions and monetary policy actions are suitably calibrated to respond to that and bring back inflation to the target level.

We have to do it in a manner so that the process of economic recovery is not jeopardized; that also has to be kept in mind. But the priority obviously at the moment is inflation.

Thank you, Governor