

Edited Transcript of Reserve Bank of India's Post Policy  
Conference Call with Researchers and Analysts

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**PARTICIPANTS FROM RBI:**

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**SHRI H.R.KHAN – DEPUTY GOVERNOR**  
**DR. URJIT R. PATEL – DEPUTY GOVERNOR**  
**SHRI S.S. MUNDRA – DEPUTY GOVERNOR**  
**SHRI N.S. VISHWANATHAN – EXECUTIVE DIRECTOR**  
**DR. MICHAEL D. PATRA – EXECUTIVE DIRECTOR**  
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**MODERATOR:**

**MS. ALPANA KILLAWALA – PRINCIPAL ADVISER**

**Moderator:** Good Day, Ladies and Gentlemen. Welcome to the Second Bi-Monthly Monetary Policy Governor's Teleconference with Researchers and Analysts. 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 the conference call, please signal an operator by pressing '\*' and '0' on your touchtone phone. Please note that this conference is being recorded. Ladies and Gentlemen, I now hand the conference over to Ms. Alpana Killawala. Thank you and over to you, ma'am.

**Alpana Killawala:** Thanks, Karuna, and Welcome to this Post Policy Researchers and Analysts Conference. We will straightaway go to the questions. We have received some questions from the line.

**Amit Premchandani:**  
**UTI Asset Management**  
**M.B. Mahesh:**  
**Kotak Securities**

The first question is on MCLR, asked by Amit Premchandani, UTI Asset Management and a similar question from M.B. Mahesh, Kotak Securities, I am clubbing the two; the question is banks have not cut base rate for the last two quarters, while MCLR is not applicable for outstanding loans and banks charge a fee to move into the MCLR regime, all this means monetary transmission is low or absent for existing retail borrowers. Can you please share RBI's thoughts on how to make MCLR regime-led transmission applicable for existing borrowers?

**Dr. Raghuram G. Rajan:** I think the attempt in our efforts is to make sure that the cut in policy rates are transmitted into lending rates. The significant effect will come from competition. As banks find deposits building up and no good avenues to lend, they will compete to lend to viable clients at that point. That is yet to happen in a significant way. The transition to MCLR is a way to make sure that when this happens, banks are prepared to transmit quite rapidly, but it is a process. We are going to monitor what banks are doing in more detail, we have some preliminary analysis and we will push them to make the MCLR regime viable. On the transition from the base rate regime to the MCLR regime for existing borrowers, I think it would be unfair on us to enforce a change in contracts on the relationship between the banks and the existing borrowers. Of course, existing borrowers have the ability to transition, provided certain transaction cost and so on are paid, they also have the ability to borrow from other places if need be. Let me ask Mr. Mundra if he wants to add anything?

**Shri S.S. Mundra:** I would just like to add a couple of points; as already discussed in the morning monetary policy, that we shall be reviewing the MCLR framework, and if there are any valid concerns or points which needs to be relooked into, those will be reviewed at that point of time. The second, as Governor already mentioned about the competition, and it becomes even more relevant in respect of retail loans because we have already waived the prepayment charges in such loans and as such it would always be easier for the borrowers to make a right choice. As far as the third thing is concerned, I think these two questions are not the same, they are rather contradictory, because the question #1 is pushing for the MCLR transmission and the other question is rather telling that with MCLR, margins would come under pressure. So I think that question we would deal definitely when it comes to that.

**M.B. Mahesh:**  
**Kotak Securities**

Lending rates for banks have reduced because of high income de-recognition. Cutting lending rates at this stage is putting more pressure on earnings/capital ratios given the high provisioning requirements. Introduction of MCLR has increased the pressure on margins for banks. Second, there seems to be a fair bit of confusion on the eventual impact of AQR as asset classification appears to be quite divergent across banks. Your views on the same.

**Dr. Raghuram G. Rajan:** First, this high income de-recognition seems to be a euphemism. If you are not collecting the income, you are not getting the income. Do not call it de-recognition, there is no income there. So, I think it is recognition that there is no real income rather than de-recognition of any existing income. Yes, there is pressure on bank margins and I think that speaks all the more to putting projects back on track so that they can start paying effectively real income as opposed to “De-recognised Income.” The MCLR as Mundrasa’b just pointed out, there is a contradiction between the first two questions. The first question is saying, there is no significant transmission through the MCLR, the second says there has been a lot and therefore margins are under pressure. I think it is too early to say margins are under pressure because of MCLR. As our answer to the first question suggested, as deposits build up and volumes in lending pick up, we will see more transmission and at that point bank margins would be offset by greater volumes and I think that it would be premature at this point to say that banks will be in a bad way as a result. On the AQR, let us be clear that there could be reasons why a borrower is termed an NPA in the books on one bank and not on the other. This has to do with the record of recovery of the banks on the loans that are made. So for example, if loans are of different kinds and one loan is being serviced while the other loan is not, one could be a working capital loan, the other is a project loan, there could be a different record of recovery and therefore different banks may treat that loan differently. Of course, we advise the banks that the fact that it is turning NPA in one bank’s books suggest weakness in the borrower which may result eventually in the loan turning NPA on the other bank’s books and therefore this is something we advise banks and we monitor this process. There are some reasons why an NPA would be common across banks. For example, if the project is not completed on time, the date of commercial operations is long delayed, and then it turns NPA on multiple banks’ books all at the same time. So, the uniformity that we maintain is on these kinds of classifications.

**Jayesh Kumar:**  
**Kotak Securities**

Next question on CPI projections. Please comment on the possible impact of 7<sup>th</sup> CPC on March CPI projections. Is 5% target absolute or would we look beyond transient factors like HRA side?

**Dr. Raghuram G. Rajan:** Let me ask Dr. Patel to comment. I will just pre-phrase it by saying that to some extent, HRA could be seen as partly transient, but there may be some permanent components also, we can look through the transient, but of course, we have to take the permanent component into account.

**Dr. Urjit R. Patel:** We are awaiting the details of the implementation of the Seventh Pay Commission Award. Monetary Policy Review that was published in April estimated the impact to be 100-150 basis points over a period of two years which with 100 basis points as the peak direct effect. Target of 5% for Q4 of 2016-17 has to be met. We have said then also that we may look through the first round statistical impact of the HRA effect but we will be watchful for second round and/or effects that are more than transient if they materialize.

**Nirmal Gandhi:**  
**SBI Life Insurance Company Limited**

You have reduced interest rates in line with the fall in the inflation, and now easy liquidity is being provided to the system. In the past, RBI governors have used liquidity as a tool to control spike in inflation. I would like to understand that if inflation starts to spike again beyond RBI's comfort, will RBI tighten the liquidity in the system?

**Dr. Raghuram G. Rajan:** I think this depends to what extent you believe that quantities as well as rates influence inflationary expectations. Of course, the ECB takes both quantities and rates into account, many other central banks just take policy rates into account as the biggest factor influencing inflation. We are certainly of the view that the quantities are not irrelevant, but at the same time, I think it would be a little premature to dub our policy as easy liquidity. We are moving to a more neutral stance on liquidity and we have said that the pace at which we will move, will depend to some extent on market conditions as well as external conditions. Even now we are still at somewhat of a liquidity deficit overall, but we are moving to a more neutral position over time and we will play it by ear as things go along.

**Amit Agarwal:**  
**Societe Generale**

On neutrality, how are we going to measure the liquidity neutrality since export refinancing is non-zero while the net repo is almost zero over last three to four days. If the liquidity is supposed to go to neutral, the 14-day repo amount should ideally go towards zero, and if it is the case, the 14-day repo market may not develop. Would you please share your views?

**Dr. Raghuram G. Rajan:** I do not think that is right. There are sustained periods over which there are frictional demands for liquidity. Our sense is taking out the frictional demand, we should be at close to zero demand on the windows. But that does not mean that you would not have demand on the windows over time. When we say neutral, we mean that taking the positives and the negatives, offsetting each other, the net demand should be zero over a period of time. Dr. Michael, would you like to elaborate a little more on that?

**Dr. Michael D. Patra:** There will be frictional factors at play and there will be seasonal and festival effects which will keep demand for 14-day repos alive. And to the extent that these repos contribute to market development, markets will grow around.

**Alpana Killawala:** That also answers question from Rajesh Agrawal, Bank of America. ....

**Promit Sengupta:**  
AIWMI

Despite poor monsoon in last two years; earlier years with good monsoon, the food inflation remained elevated, this year coupled with Seventh Pay Commission as well as upward bias towards oil prices, how inflation is going to shape?

**Dr. Raghuram G. Rajan:** As we said in the monetary policy statement and the press conference that followed, there are some potential upward risks but there are also downward risks. We really need to see how these uncertainties play out. I think it would be incorrect to say that there is absolutely no relationship between a good monsoon and food inflation. Some people find a conditional relationship, depends on the level of reservoirs, other people find relationship in downturns and not in upturns, in bad years and not in good years. These things really are probably very conditional and we need to see how it plays out this year. It would be hard to imagine that a good monsoon would result in significantly elevated food prices. If anything, the pressure should be downwards, let us see how much and how it plays out. Similarly, without knowing the contours of the Seventh Pay Commission and what exactly is going to be proposed, it would be difficult to estimate what the effects of it on inflation will be, how much is mechanical, how much is more persistent, as the earlier answer by Dr. Patel suggested, we have to take all these things into account. Finally, on oil prices, we do believe some factors are pushing up oil prices. It probably had gone to low, typical overshooting in an asset price. It has come back some way. What the equilibrium level is, given the potential for shale to start producing once it reaches higher levels, is something that a lot of people have opined on. We think that current levels are manageable. Let us see.

**Merryl Morley:**  
FactSet Research Systems

What, in your opinion, would be the potential impact of Brexit on the Indian economy and what are the actions being considered by the RBI to reduce the potential negative impact of such a development?

**Dr. Raghuram G. Rajan:** Certainly, over the medium term, if people in Britain vote for exit, it will create turbulence in Britain's trade relations and investment in Britain, and in the short run could have effects on financial markets as people revalue both their opinion of the UK economy as well as what will happen in the Euro areas, some peripheral countries may explore exiting. But we sort of think that if the primary effects are through financial market volatility in the short term, it looks like other sources of financial market volatility. To that extent the three-tier defense, good policies, both by the government as well as the central bank here, the fact that we are trying to push out maturities of our liabilities so that there is not a rapid exit and the fact that we have significant reserves to handle turbulence. All these factors would shield us as they would shield us from other shocks. We do not rule out the fact there will be short-term volatility but I think we are prepared to handle and look beyond it, at which point, people as well as investors will look for the policies of country and we think we should look better at that point.

**Bekxy Kuriakose:**  
**Principal Mutual Fund**

At present trades done in primary CP market are not reported on FTRAC platform unlike secondary market trades. Given the large primary market CP issuance in recent times, reliable information dissemination has become crucial to understand pricing of credits. Can it be made mandatory for issuers to report primary market trades?

**Dr. Raghuram G. Rajan:** Let me ask Mr. Khan to address this.

**Shri H.R.Khan:** We are doing two things here: One is we have in the last Policy said that we will authorise some of the trading platforms. That work is on. Second thing about aggregation of information and dissemination. We have received few proposals including one from NSDL and one from another service provider, and particularly NSDL becomes natural choice because they are already maintaining the demat accounts and they are providing the ISN numbers. We are working with them and we will shortly come out with concept paper on how we aggregate and disseminate the information. This is something which is that we are also looking at very seriously.

**Gautam Singh:**  
**Spark Capital**

From 10% year-on-year growth in August 2015, currency in circulation is now growing at 15% which is the fastest pace since June 2011. Given that state elections are over now, what explains the sharp Rs.2.4 trillion jump in currency in circulation? Does the RBI still expect some of the money coming back into the system? If yes, how much and by when?

**Dr. Raghuram G. Rajan:** Let me ask Dr. Patra to address this question.

**Dr. Michael D. Patra:** We have gone over the factors that influence the expansion in demand for currency at quite some length. Now that currency is returning to the system, I think we need to look at those effects. After the week ended May 27<sup>th</sup>, Rs.16,500 crores of currency has come back to the system. These moments are very dynamic and cannot be pinned down to specific dates and events.

**Srinivas Varadarajan:**  
**Deutsche Bank**

A question on money multiplier. There has been an appreciable fall in the money multiplier over the last year. What further steps can be undertaken to arrest the fall in the money multiplier given its wider implications?

**Dr. Michael D. Patra:** The money multiplier has two components – one is the currency deposit ratio and one is the reserve deposit ratio. The reserve deposit ratio remains very stable except for margin spikes when banks maintain excess reserves. The reason why the money multiplier is falling is because the currency deposit ratio has been rising on a sustained basis. But now that currency is returning to the system, we expect the currency deposit ratio to fall and that will bring the money multiplier back to its normal level.

**Kaushik Das:**  
**Deutsche Bank AG**

Is the output gap still negative post the GDP data that was released recently? Second question is, how concerned is RBI about the likely trajectory of core CPI inflation (excluding food, fuel and transportation) going forward?

**Dr. Raghuram G. Rajan:** Let me ask Dr. Patel to respond.

**Dr. Urjit R. Patel:** Yes, the output gap is still negative by our models and estimates, and if you overlay that with the capacity survey results that we bring out every quarter, which suggests that though capacity utilization has increased, it still remains comfortably below the point where pricing pressure moves in. We have expressed concerns about inflation, excluding food and fuel, which has been sticky and relatively elevated, and we will be watchful that it does not set a lower bound to the disinflation process; however, if you look at the services component of it, there are a couple of good things happening – rural wage pressures which if you think of as a surplus labor set up, from which labor comes to the services sector, the wage increases there remain fairly low. Also the staff cost of the corporate that we survey as part of our quarterly process suggest that they have become relatively benign though I wouldn't say they are low.

**Sudhir Agarwal:**  
**UTI AMC Limited**

The recent inflation reading has surprised on higher side with RBI highlighting the upside bias to the inflation projection. If the upside risk to the RBI's inflation target for Jan 2017 is to materialize, what may be the possible sequence of tools to be used by RBI?

**Dr. Raghuram G. Rajan:** I think this is a repeat of the earlier question which is how do we see liquidity versus the interest rate as tools to tackle inflation. Firstly, we do not sort of predetermine what our response will be, but let us see, this is a hypothetical question on what we will do if the upside risk materialize. Let it materialize, then we will see what we can do.

**Radhika Rao:**  
**DBS Bank**

A question on FCNR B redemption. Can you please share how the central bank plans to tackle the potential liquidity squeeze from FCNR B redemption, particularly since the RBI has shifted to neutral stance for systemic liquidity. Will this count as durable demand?

**Dr. Raghuram G. Rajan:** First, we have not reached neutral. That is the issue that some people keep asking, when we will reach neutral. So, this is the process, we are on that way. Clearly, issues like how much of FCNR B is re-deposited, how much of it goes out, what effect this has on liquidity of the system, will be part of the calculations we will make as we move towards neutrality. Mr. Mahalingam, would you like to add something on this?

**Shri G. Mahalingam:** As Governor has mentioned earlier, a good part of the FCNR redemption is already covered by the way forward assets. So we will not match, say its a liquidity deficit or liquidity shortfall

because more or less the forward assets and the forward liabilities in the RBI side is matched. Wherever there is going to be a tenure mismatch, these tenor mismatch will be taken care of by variable rate repos and reverse repos.

**Alpana Killawala:** That is for the received questions. Can we open it to the house, Karuna?

**Moderator:** Sure. Thank you very much, ma'am. Ladies and Gentlemen, we will now begin the Question-and-Answer Session.

**Sarvesh Shetye:  
Trivantage Capital**

My question is regarding the bank capital bonds that have been issued by the state owned banks. So we see a lot of these issuances coming out in the market but there is a distinct coupon discretion condition in these bonds. So, as per your view, what is the possibility of state-owned bank actually exercising this coupon discretion – is the Indian bond market actually ready for that?

**Dr. Raghuram G. Rajan:** Are you talking about some kind of a contingent capital bond where the coupon falls in case capital falls below a certain ratio, is that what you have in mind?

**Sarvesh Shetye:  
Trivantage Capital**

Yes, sir, it is the additional Tier-I capital bonds issued by the state owned banks.

**Dr. Raghuram G. Rajan:** My sense is that any bank management is fairly careful to ensure that it stays well away from the triggers for those bonds. I am not going to say that can never on any circumstance happen but I think most managements pay very careful attention to the possibility that they may trip the wire so to speak and try and stay away from that by raising equity well in time.

**Astha Gudwani:  
Birla Sun Life Asset Management**

Two quick questions: The first one is with respect to the supply response that you are expecting is one of the methods or the measures going ahead. What kind of supply response particularly in the services side in terms of capacity are you looking at and these are usually long-term in nature -- does this in effect means that we are going to wait longer for the next policy move? Second is from the press conference that was conducted in the morning, wherein you said that the movement of inflation is broadly in line with Urjit Patel Committee Report and you have greater comfort because you are already in that band; however, from what we understand is January 2018 4% target is what the UPCC highlighted. So are we now in the band and does that offer you greater comfort?

**Dr. Raghuram G. Rajan:** First on supply response, it is not that we are looking for a certain number of hospitals and a certain number of schools to be set up over this period and clearly as you point out it is a longer-term process, but we are hopeful that as the demand for these kinds of services express themselves, there is an appropriate response from entities that are already underway from expansion of the existing entities and so on. So we are not looking for sort of measures of



investment but more we are looking at the prices of these things and expecting that supply will rise to meet demand there. On the second issue, as far as the agreement with the government goes, we have to stay within the 2% to 6% band and so long as we stay within that we are clearly sort of meeting the requirements; however, prudence dictates as well as our past commitment in terms of the path dictates that we move from 6% to 5% to 4%. The first sign post along the way is 5% which is intended for March of 2017 and so we intend to meet that target of 5% and monetary policy is geared towards that. Thus far we have been sort of focusing on the immediate target and then figuring out the next step beyond that. Clearly, at some point, as we get closer to March 2017, the next step beyond that will start figuring. For now, what is primarily in our mind is meeting the 5%.

**Astha Gudwani:**  
**Birla Sun Life Asset Management**

For now, does any number between 2% to 6% during March '18 or on March '18 is okay with RBI's comfort zone?

**Dr. Raghuram G. Rajan:** No-no, I did not say that, I said as far as the agreement with the government goes anything between 2% and 6% meets the requirement of that agreement, the monetary policy committee has to write a letter explaining its failure only when inflation falls outside these parameters; however, the Reserve Bank has said that it is moving towards the center of the band which is typically what central banks do once they have a range, they try and stay nearabouts the center of the band.

**Vikas Agarwal:**  
**Proken Financial**

My question is related to the provisioning what these banks are holding for NPA. So as we see many of these bad loans are from stress sector or concentrated loans, so in case going forward, when banks start taking the write-off or write-down on some of these bad loans, do you really feel comfortable about the provisioning that they have because the numerator and denominator impact, if they just take a 25% haircut on the loan or write-down on the loan, it starts looking like a very-very low provisioning coverage available?

**Shri S.S. Mundra:** Of course, at the system level also, provisioning coverage ratio is something like (52%+) as per the primary estimation which are there now. You would appreciate the provisioning is a dynamic situation when the bank start with a certain percentage of provisioning, once they classify the loan account into a particular category, then the provisioning keeps on progressing. So, I think on a overall portfolio basis and at the individual cases and the progress, we feel that with the current trajectory of provisioning, banks should be able to deal with the individual cases without bringing any significant impact on their current financials.

**Vikas Agarwal:**  
**Proken Financial**

Do you think last two-three years was the time that was taken just to recognize the NPA, it may have taken two-three years' time just to make the required provisioning and deal with this stress, so are we targeting that type of timeframe here?

**Shri S.S. Mundra:**

I think these are very-very general kind of assumption. One thing it has not taken really two-three years, I mean to say, it will be wrong to believe that it was an NPA sitting three years back and it has taken three years to recognize. The overall condition in economy, the particular development in a sector are the cases with individual account. They have moved in a different variety of fashions in regions and accordingly the accounts have been classified from time-to-time. The process may look accelerated in last couple of quarters, because as we explained in the morning also, that the portfolio at the entire banking level where look at one point of time under the AQR exercise may have brought out some additional quantum, but otherwise it was a process which was going on very well. So going by the same assumption that it has taken two-three years or it will take two-three years for matching the provision would not be a right assumption. There are two possibilities – next two-three years it is also possible that the provision already being held in many of these accounts may get released if there are positive developments; in other cases, while the provision would increase in normal course but in between if individual cases come for resolution and banks are required to put in extra provisions in some of the cases, I think they would be able to do so.

**Dr. Soumya Kanti Ghosh:**  
**State Bank of India**

Currently, the RBI requirement on provisioning is gross of realizable value of collaterals of the borrower. This is not in sync with global IFRS norms that allows provisioning on the path of banks net of realizable value of collateral. Do you think it may be worthwhile to relook at these provisioning requirements in the Indian context given the huge provisions Indian banks are making?

**Shri N.S. Vishwanathan:**

Our requirements are based on our assessment of how long it takes to realize the value of securities which is why beyond a point of time when the account is sub-standard, we require the banks to provide over a period of three-years for the entire secured portion as well, that is taking into consideration the current time it takes to realize value of security, of course, we are moving towards IFRS even otherwise anything there, the provision requirements will get attuned to actually move towards there in the next two years.

**Bharat Parekh:**  
**Reliance Industries**

Do you think that if we discontinue the term 'Reverse Repo' we will have a better impact on the rates and in turn will help in better transmission, because currently banks are not making the transmission effective because of the window available to lend the money at repo rate?

**Dr. Raghuram G. Rajan:**

I do not know, I mean, if we suddenly say that you have to reinvest that 100 basis points below where they were used ...

**Bharat Parekh:**  
**Reliance Industries**

In last policy you have reduced the corridor to 50...?

**Dr. Raghuram G. Rajan:**

No-no, I know, I was trying to readjust for that and trying to figure out in real-time, so 50 basis points below where you are asking them to invest. Whether that will move them to lend immediately or to find other instruments to invest in it? It is unclear. I am not sure, moving a

window or adding a window is necessarily the way to go. I do think... and this is something that Mundra Saab and I have said repeatedly today that one more competition will help transmission and everything else we are doing is in attempt to make sure there are no impediments but ultimately transmission will happen when there is more competition to lend and that will happen when the pressure from the deposit inflows into the banks, force the bank to look for new outlets. It will also happen when banks feel a little more confident about the health of the balance sheets. Some of these conditions are changing as we speak and so I am hopeful that the transmission will happen, but in the meantime all the efforts we are making is to remove any impediments to the transmission, for example, because of the way that they calculate the lending cost.

**Priyank Chouksey:**  
**Wealth First Portfolio Managers**

I wanted to say that in overall global economy, bankers are reducing interest rate below 90 bps, even in India we have to go to an MCLR regime from the base rate regime, so that the transmission of interest rate gets to the market. So do you think if the monetary policies are getting ineffective around the world?

**Dr. Raghuram G. Rajan:** I do not think monetary policy is ineffective when the policy rate is 6.5%. I think if it is zero, then I think you can make that case. There is still tremendous room for Indian monetary policy to have effect. I think the reason why transmission is not happening is for different reasons in India today than is experienced in the west because of the zero lower bound. So my hope and belief is that transmission will indeed take place in India and hopefully sooner rather than later.

**Alpana Killawala:** That is about it from our side. Thank you very much for joining. Thank you, Karuna.

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