"RBI Post Policy Conference Call for Researchers & Analysts"

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MODERATOR **MS. ALPANA KILLAWALA – CHIEF GENERAL MANAGER, DEPARTMENT OF COMMUNICATION**

Moderator Ladies and gentlemen, good day and welcome to the Reserve Bank of India Post Policy Conference Call for Researchers and Analysts…I would like to hand over the conference to Ms. Alpana Killawala from RBI. Thank you and over to you ma'am.

Alpana Killawala Thank you Shyma. Welcome to this post policy researchers teleconference. I will straight away hand it over to Governor.

Dr. D. Subbarao Thank you very much, thanks Alpana. You all heard the statement on Friday and over the weekend, I am sure you have read the statement several times over. And also may have seen some other dissemination in the print and electronic media. Regardless, I just wanted to take a few minutes to go little beyond the statement and give our perspective on the consideration that went into the policy on Friday.

We reduced the repo rate from 7.5% to 7.25% and you would have noted that this (is) cumulative reduction of 125 basis points since we started cutting the rate in April last year. There were two considerations that went into this policy action. First was growth. Growth as you would all recognise, declined from 9 plus percent in the pre-crisis years to 4.5% in the third quarter of last year. Our current assessment is that the activity will remain subdued during the first half of this year with a modest pick up in the second half. The second consideration that went into the policy decision was the inflation outlook. Although headline inflation had eased by March and came close to our tolerance threshold of 5%, it is important to note that food price pressures persist and there are endemic supply constraints. So our apprehension was that this could lead to generalisation of inflation and strains on the balance of payments.

We gave an assessment of the global and domestic economy; I will just make a few comments on our assessment of the Indian economy. For 2012-13 last year - the final growth number is not yet available - The last number available is growth for the third quarter which is 4.5%. For the first three quarters of last fiscal year, growth was 5.1%. So if we have to end last year with 5% growth, the last quarter we should have expanded at least by 4.7%. The CSO had put out advance estimate of GDP for last year which is 5% lower than our base line projection made in January of 5.5%. Looking ahead, our projection for growth during the current year is 5.7% with pick up in the second half of the year. That 5.7% growth during the current year is based on some conditions, in particular, about investment picking up. We spoke to corporates, industry associations, and the impression we got was that the pipeline is dry. Also our survey revealed that the capacity utilisation is quite low, and investor sentiment is quite subdued. Then the second condition is that supply constraints have to ease. Third we assume that monsoon will be normal as forecast and also it is important that the global situation does not throw up any event or process shocks.

On inflation - when I say inflation now I talk about WPI inflation - qverage WPI inflation last year was 7.8% which is a significant decline from the average WPI inflation in the year before last that is 2011-12 of 8.9%. During the current year, our projection for inflation is that it will be range-bound around 5.5% with some edging down in the first half and some edging up in the second half. This assessment, of course, factors in the domestic supply demand balance, the outlook for global commodity prices and expectation of a normal monsoon. We have also indicated the upside risks to inflation, which are actually four of them. First is the sectoral demand supply imbalances, which is quite easy to understand. The second is the ongoing and prospective correction of administered prices, in particular, the programmed adjustment of diesel prices and possible adjustment of coal and electricity prices. The third risk factor stems from food price pressures, both the MSP increases and wages; and finally, the current account deficit and its financing will transmit to our inflation through imported inflation and exchange rate.

On liquidity conditions as you all know we did not take any CRR action. The CRR remains at 4% but you also should note that since we started easing, we have got down CRR by a cumulative 200 basis points from 6% to 4%. Last year, we infused considerable amount of liquidity - through CRR Rs. 522 billion and through OMOs Rs. 1.5 trillion, actually Rs. 1503 billion; so CRR of 522, OMOs Rs. 1503 together injection of liquidity last year was Rs. 2025 billion. There must have been some reduction out of that number because of our forex operations. I also want you to note that there is quite a bit of liquidity buffer available with the banks at the moment. They are carrying excess SLR which itself should give them a buffer of Rs. 3.5 trillion. There is unutilised export credit refinance that is about Rs. 200 billion and by accessing the MSF they can get as much as Rs. 1.4 trillion. So together they have access to liquidity of about Rs. 5.2 trillion.

We have also given guidance for the way forward and that is quite clear. Nevertheless I want to just add a couple of sentences on that. This guidance is based on our assessment of the macroeconomic outlook and in particular the growth inflation outlook. What we figured was that there has been a significant decline in the average levels of inflation. We have come down significantly from the levels that we saw in 2010-2011 and indeed in 2012 and after a long time, we are within striking distance of our threshold inflation of 5%. So what we indicated was that our baseline position is that we need to consolidate on these gains on inflation and be alert to the upside risk factors and our baseline position is that if the growth inflation scenario unfolds as we expect it to, the room for further rate action is little. However, there could be action either way. If inflation pressures re-emerge or if CAD deteriorates more than we have factored in, we need to take action, we will need to respond to that and take action. On the other side, should inflation recede further and faster, current account deficit moderate more than we have factored in, or if the upside risk factors become more benign, then space would open up for easing policy and further supporting growth revival. So the sum and substance of this is that our base line projection is that, there is little space for further monetary policy easing. But in the next few months, if the situation changes it could go either way. I will stop there, thank you very much.

Alpana Killawala Thank you sir. May I request the participants to be brief in their questions and ask one question at a time? Will you please announce Shyma?

Moderator Sure ma'am. We have the first question from the line of Mahruk Adajania from Standard Chartered. Please go ahead.

Mahruk Adajania Good Afternoon. Thank you. I have two questions, I will ask one and if you have time for one more then we can take that as well. The first question is that, is RBI happy with the transmission of monetary policy by banks because as the Governor pointed out the total reduction in repo has been 125 basis point since you started easing. Base rates have come off but not by an equal amount. The second question really is that on the Cobrapost allegations. The policy does mention that there will be guidelines on wealth management and other stuff, but the press also mentions and probably they picked it up from the media call that RBI is likely to issue show cause notices to the banks which were alleged in the April expose. So is that correct?

Dr. D. Subbarao On the first question Mahrukh, you are right that the base rates have come down. They have not come down one to one, even as we cut rates by 125 basis points including on Friday. What we reported in the document is that the base rate, the model base rates had come down by about 50 basis points. So it has not been a one-to-one correspondence. But as we noted, as I had said in the media dissemination after that, the yields in the money market have come down as a consequence of this, yields on G-Secs have; so to the extent that corporate bonds are priced off the G-Sec yield curve that would have softened and made money cheaper for corporates. Even bank borrowing would become cheaper first because of the lower rate in the LAF window and lower rate that they would get in the money market. Also I have been told that a lot of projects which have been found to be unviable because of the internal rate of return being above the hurdle rate, they might become viable because the hurdle rate will go down has a result of this. So some transmission will take place through other routes and we expect also that base rates will come down in the months ahead even if in the immediate, next few weeks, there may not be any action. Anything else Deepak? On the second question about Cobrapost…

Dr. K C Chakrabarty You see, look, our reaction is not based on Cobrapost.com. You see actually whatever they have been reported we have verified those branches, we have not found anything irregular there. But during this period we are otherwise also looking into how the anti-money laundering guidelines, how the KYC guidelines, how they are implemented by the branches and how the people are looking, because we cannot remain insensitive to what comes in the media. So we have done a special inspection of first 3 banks then we are doing for other banks. Based on that we see that there are certain deficiencies, irregularities in the matter of KYC compliance, in the matter of reporting of suspicious transactions, in the matter of selling of third party products specially gold and other things. There are also other areas. Based on that we have to issue a show cause notice. Whenever we do that thing, we will take the explanation from the bank, based on that appropriate action will be taken. That is at the individual bank level. But system as a whole we feel that there is a need to strengthen our guidelines and that is a process being taken and it has been mentioned in the Governor's annual policy statement. Respective departments will follow up and will try to strengthen the system. This is the position as of today.

Mahruk Adajania Okay sir, so it does not necessarily mean that there will be show cause notices to the banks alleged, it can be to any bank where some systems may not be in place.

Dr. K C Chakrabarty Today all other banks have also been given the same under same allegation. So that is why we do not go by what the media says but we are sensitive to them. You see we definitely look into that we cannot ignore that thing and based on that we do our own investigation, we take our own decision and we take our own action.

Moderator Thank you. We have the next question from the line of Shishir Shindekar from BYK College of Commerce. Please go ahead.

Shishir Shindekar Respected Dr. Governor and Deputy Governors. Sir thanks for providing this opportunity. You have done a great job since January beyond expectations with courage and believing in the strengths of Indian economy. Sir I am Shishir Sindekar from Nasik. Sir if you are the chairman of FED would you like to continue with quantitative easing programs or austerity programs? And regarding Indian economy, what will be the satisfactory level of fiscal deficit as well as current account deficit as a percentage of GDP for India, and what exactly you are expecting it in the year 2013-14? Thank you sir.

Dr. D. Subbarao Thank you Shishir, what are you studying?

Shishir Shindekar I am actually a Ph.D. student.

Dr. D. Subbarao What is the topic of your dissertation?

Shishir Shindekar Standard of living and monetary policy.

Dr. D. Subbarao Very good. Do send it to us after you have done the dissertation, we would like to look at that, the link between quality of life or standard of living and Monetary Policy. Okay, now about your questions. We are not doing any quantitative easing. Quantitative easing is being done by advanced economy central banks who hit the zero low upon and there is the whole big debate on the advisability of that. So from an Indian perspective, we need to study that for our own understanding and also because it has implications for us through capital flows. So what advanced economy central banks are doing by way of quantitative easing is important for us, but we ourselves are not doing any quantitative easing. Second about fiscal and current account deficit etc, what we are learning from the recent debate on Reinhart and Rogoff, etc., is that even as we try to put some numbers on this, we have got to understand those numbers with reference to the assumptions we make and the economic context in which we make them. I hope you are following that debate that is coming in the media about the Reinhart and Rogoff that 90% debt GDP limit being sharp inflection point where growth accelerates rapidly. Okay, so our fiscal deficit numbers they are quite large now, if you take the Center and States together, fiscal deficit is of the order of close to 9%, must be brought down. And the FRBM as well as the Kelkar committee said that the Central Government must bring fiscal deficit down to 3% of GDP. As much as that quantitative indicator is important, it is also important to focus on the quality of fiscal adjustment. Okay? Current account deficit, the Reserve Bank's estimate given some assumptions about macroeconomic variables is that a sustainable current account deficit for India is 2.5% of GDP. So you would note that at close to 5% of GDP current account deficit last year, we are way above the sustainable limit. Thank you.

Shishir Shindekar Sir the housing price index is continuously growing, so do you feel any problem regarding the housing price bubble or like that?

Dr. D. Subbarao No there is no bubble. Housing price index is showing an increase and we have reported that in our document that came out on Thursday. The monetary and macroeconomic development document which shows the housing price index, I think in 9 cities of the country and there is no bubble building up there. Okay, thank you let us move on.

Moderator Thank you. We have the next question from the line of Kumar Rachapuddi from ANZ Bank. Please go ahead.

Kumar Rachapuddi Thank you sir for the opportunity. Couple of questions please. First one while the RBI was in the hiking cycle you have felt that it is important for monetary transmission that the liquidity deficit be around -1% of NDTL. Do you think the same holds true even in the cutting cycle as well or would you think that the liquidity conditions should ease from those levels? The second one is on the current account deficit which has just been answered but within that I would like to know, your expectations of oil and gold prices going forward as well as your comfort zone for current account deficit as a percentage of GDP in the next few quarters as opposed to the medium term goal of 2.5%. Thank you.

Dr. D. Subbarao Thank you very much Kumar. On the liquidity situation, we still maintain that our objective is to maintain liquidity within plus minus 1% of NDTL. And some people have asked us when you are actually easing the policy rate, why do you want to still keep liquidity in a slightly deficit mode? That is because we believe that is consistent with our overall stance. However we recognise that over the last few months it has gone above that 1% NDTL limit because of frictional and structural factors; in particular the cost of the large government cash balances with the Reserve Bank and the wedge between deposit and credit growth for much of last year, although there was convergence towards the end of last year. We hope both these factors to unwind in the course of the next few months and the liquidity situation should be less uncomfortable than it was in the past few months. We have also indicated that we will actively manage liquidity and consistent with that we announced OMO of Rs.100 billion on Friday evening after market hours. On your question about oil and gold prices, I do not think we want to really indicate our understanding or assessment of gold and oil prices. We hope that they remain soft and they will keep coming down, for our economy, for our monetary management but we have no control over them. Oil prices are subject to number of supply and demand side uncertainties and gold prices too are subject to demand supply balances and are subject to how people assess inflation in this country. We are hoping that with inflation coming down and with expectation that it might remain at that level more or less, the demand for gold in India will come down. Okay, thank you.

Moderator Thank you. We have the next question from the line of Shubhada Rao from Yes Bank. Please go ahead.

Shubhada Rao Good afternoon everyone. Just one question regarding the guidance, particularly around CAD concerns. Our observation tells us that the interest sensitive non-oil, non-gold trade account is in surplus particularly since February and outlook is more benign than ever before, so are we overlooking some risks probably, specially when the guidance says that any swift reversal can take place if the risks play out, so your thoughts on this one please.

Dr. D. Subbarao Can you be more specific?

Shubhada Rao Yes. We have observed that since February non-oil, non-gold trade account is in surplus, it is not in deficit, i.e., at 57% of the trade account and the outlook particularly look at the growth and the pricing power and so on looks more benign, particularly for that turning into deficit in the immediate term. Are some risks that we have overlooked, particularly when we see your risks coming as pointing towards any likelihood of a swift reversal if the CAD turns on the negative side or worsening side? So there was some disconnect between our expectations and what came out in the guidance, so just wanted some highlighting from your side.

Dr. D. Subbarao Thank you Shubhada. On oil prices as I said in answer to one earlier question, even as they have softened and modestly firmed up in the last few weeks, we cannot be certain about what the behavior will be because this is subject to both economic and political uncertainty around the world; on the supply side both political and economic considerations, on the demand side by economic considerations. So we had a number for, that went into our model, I am somewhat uncomfortable about giving that number but we should be alive to the risk of oil prices going up. Second on gold itself, yes as I said again if with inflation coming down, gold demands should come down but how much it will come down, is not certain. Now the risk that we highlighted or we took into account in the guidance or in enumerating the risk factors was about first the large current account deficit, the second the financing of the current account deficit. We were able to finance CAD of as high as 6.7% in the third quarter of last year because capital flow had come in and we were conscious of the fact that as much as pull factors were in play there, there were also push factors, the enormous amount of global liquidity. And that liquidity could reverse quite swiftly. Even if there is no reversal of quantitative easing if there is some process shocker either in the Euro zone or in the US, let us say like if Cyprus had extended for a few more days, there would have been a reversal of capital flows out of emerging economies including India. So we did not want to rule off the risk factors like that and that is what we tried to reflect in the risk factors as well as in our guidance.

Shubhada Rao In that case sir would it be right to ask you and request you for a ball park CAD estimate that RBI may be working with for FY-'14?

Dr. D. Subbarao It will be lower than last year. Last year it might be about 5%, close to 5%. All expectations including that of the Reserve Bank are that it will be lower. We have looked at the numbers for the last quarter of last year. It is too early to get numbers for this year, but we are hoping that exports will pick up and imports will soften or will not pick up that fast. So we expect it to be lower but I do not think there is a number that we want to disclose.

Moderator Thank you. We have the next question from the line of Sonal Verma from Nomura. Please go ahead.

Sonal Verma Hi Sir on this liquidity issue, I wanted to ask you at some point in time, would the RBI be comfortable with shifting the overnight trade from repo to between the corridor or to reverse repo and under what conditions?

Dr. D. Subbarao At some point of time, yes when we said plus/minus 1% NDTL that will go to minus 1% NDTL some time. But at the moment you recognise that we are still maintaining an anti-inflation stance. And as we have indicated, inflation threat is still very much there. There are a number of upside risk factors that could potentially come into play, so the expectation should be that liquidity will be in deficit for the next few months at least.

Sonal Verma Sir post that if inflation does moderate then you would look at shifting the corridor?

Dr. D. Subbarao Well, yes but how much is an open question. How much it comes down and whether we assess that decline in inflation to be pure sustained and durable, it will depend on that judgment.

Sonal Verma Okay. Sir another thing is, if WPI, you know we are not talking about this 5, 5.5 and a half and GDP at 5.7 when we are still talking about potential at 7% then why is there only a little space for policy easing? Does the RBI have CPI in mind while we talk about WPI or do you think potential growth is lower?

Dr. D. Subbarao Well potential growth is lower, we have given out our number of potential growth, which is 7% but even when we are growing at 5% we are having inflation pressures. And if you have read the report of the Economic Advisory Council, Sonal, you would have seen that they talked about this in more than one paragraph, they talked about productivity levels going down, ICOR going up. Because if you are having savings rate of 32% and we are growing only at 5%, that means that the ICOR has gone up. And so there are lot to be concerned about the mismatches, the sectoral imbalances in the economy and in the supply constrains especially in the infrastructure sectors which are adding costs eroding competitiveness and eroding ICOR.

Sonal Verma Just one final small question, you said you will be actively managing liquidity, will there be a greater reliance on open market operations rather than cash reserve ratio and is FX intervention a possible tool?

Dr. D. Subbarao No, on relative choice between CRR and OMO it depends on whether we assesses the liquidity deficit to be structural or frictional or transient. We will also assess whether the liquidity shortage is across all the banks or it is confined to a few banks only. What was the second question?

Sonal Verma FX intervention is that a possible tool?

Dr. D. Subbarao We don't use forex intervention as a liquidity tool. If a forex intervention changes liquidity either way that is an incidental by product, but liquidity infusion or liquidity removal is not an objective of forex intervention.

Moderator We have the next question from the line of Samiran Chakravarty from Standard Chartered. Please go ahead.

Samiran Chakravarty Good afternoon sir. My question is about the inflation guidance, I can pick out that you have commented 3 things on the forward looking trajectory of inflation. One is you have mentioned that the average inflation is going to be around 5.5%. You have said that second half inflation is likely to be higher than the first half and you have said that you expect the margined inflation to be about 5%. I am having difficulty in understanding what kind of trajectory would ensure that all three of these assumptions will hold?

Dr. D. Subbarao You saw the Fan chart Samiran, and that is right. We showed inflation March 2014 at 6% with I think quite a lot have read around the 6% that is the most probable estimate. But then we said in a paragraph following that that we will endeavor to bring inflation down to 5%. So you are quite right to be a bit confused between our statements in the two consecutive paragraphs. So if we do nothing, we expect inflation to be around 6% edging up in the second half, but we will assess the situation or take action as may be necessary including communication, including macro-prudential tools to try and bring inflation down and inflation expectations down. I think it will be difficult for me to say anything beyond this because my English will then fail me.

Moderator We have the next question from the line of Soumya Kanti Ghosh from ICRIER. Please go ahead.

Soumya Kanti Ghosh I have a couple of questions. The first question regarding this growth inflation trade off. I believe that RBI had done in the past some study regarding the sacrifice ratio during the period 1975 till 2000 where it was found out to be around 2. Has there been any recent study regarding that growth inflation trade off because empirical evidence suggests that sacrifice ratios tend to increase significantly in a period of declining inflation? And the second point is that the RBI document has been also consciously talking about CPI inflation being at relatively higher levels with the WPI inflation and the wide divergence between the two. Notwithstanding the fact that a new CPI being of a recent origin. Is there any CPI target which the Reserve Bank is currently looking at?

Dr. D. Subbarao Are you working on this growth inflation trade off?

Soumya Kanti Ghosh Yes sir, I have been working.

Dr. D. Subbarao I am going to ask Deepak Mohanty, our Executive Director, who actually did this work to answer your question.

Deepak Mohanty In terms of your question on the sacrifice ratio, the observation is right. We have seen the average relationship of about 2, but again it is asymmetric at different intervals of growth and inflation, it becomes different. The latest study on that is by the IMF, they did a paper, but I am not too sure whether they have put in the public domain. So that again kind of confirms the finding that we had earlier that 2 is the kind of average sacrifice ratio.

Dr. D. Subbarao On to your second question, we have no CPI target, nevertheless I want to emphasise once again that we look at CPI, we look at all the three CPI as well as the new composite CPI and we try like everyone else including perhaps yourself to study why there is a divergence or convergence between WPI and CPI. But we do not have a CPI inflation objective.

Moderator We have the next question from the line of Prashant Shah from Vantage Securities. Please go ahead.

Prashant Shah Good afternoon sir. Just wanted to ask you, you mentioned in your outlook that you are projecting base line GDP growth projections at 5.7%. Now you have mentioned that you see the economy activity to be modest in the first half with a pick up expected in the second half based upon our normal monsoon, which should boost agricultural growth, but other sector lines, you seem to be not being very bullish on that. With the GDP expected to grow at about 5%, how do you reconcile this with that 0.7% extra growth in 2014?

Dr. D. Subbarao Good question. You are right that agriculture, we expect agriculture to return trend growth which is of the order of 3.5% on the expectation of a normal monsoon as has been forecast. As far as the industry is concerned, there is considerable excess capacity. So the first order of economic activity will be for that excess capacity to be utilised, and then new capacity will have to come in to play. Also as I said at the beginning of this conference, there is unutilised capacity and pipeline is dry. So as for the pipeline to be built up will take time for investors to reappraise the projects and make the applications to financial institutions and banks. So we are expecting and hoping that in the first half of this year that process will take place so that by the time we come into the second half, industry and services will pick up. On the services side, as industry picks up, as agriculture picks up there will be some corresponding pick up in services sector activity and services sector activity might also pick up if global situation improves.

Dr. Urijit Patel I think that one boost to growth even without new investment is the existing standard investment especially in the energy sector. If that comes into play, you would get a boost in industrial production and therefore one doesn't necessarily need a sharp pickup in investment for more output growth. There is a fair number of investments which are waiting to come into line.

Prashant Shah I just wanted to make one more observation I have. In the last cycle in terms of the transmission from food inflation to manufactured inflation when the inflation spiked up, we had sufficient room to at least cut our monetary policy, because we growing in excess of 8%. But if a similar situation occurs in this cycle around, food inflation is still close to 10% and core manufacturing is close to 4%, but we are also growing at less than 5%. So what action would we be having in that case, in case, food inflation transfers to manufacturing inflation?

Dr. D. Subbarao Yes, that of course there is a continuing concern, Prashant. That is why we keep saying that even if monetary policy does not have much to do with food inflation as such, the food inflation or any inflation that is triggered by supply shocks persists, it will have impact on inflation expectations and inflation might get generalised. Therefore we continue to be concerned about inflation stemming from supply shocks. You are right that the headroom for monetary policy action is much less than we had in the pre-crisis years or in the immediate post crisis period and that we have to be watchful about that.

Moderator The next question is from the line of Bhaskar Chatterjee from L&T. Please go ahead.

Bhaskar Chatterjee Good afternoon sir. I have two questions. My first question relates to the transmission mechanism, now the credit channel transmission has been weak in India. It all boils down to the issues relating to rising cost of funds, even low deposit growth and the load of the deteriorating asset quality across banks. This brings us to the paradox of low credit growth to industries when RBI had taken a relatively accommodative stance in 2012-13. Given a stance of limited policy space for 2013-14, how do you support your target for overall credit growth of around 15% and credit availability to crucial sectors like infrastructure? Secondly, with around 5% GDP growth we are expected to end up with a CAD of around 5% in 2012-13. Now if growth revives in India in H2 2013-14, some forecasters project a CAD of around (+6%). Now like inflation, is CAD also on a new-normal, should we look at a higher sustainable CAD level?

Dr. D. Subbarao Our Deputy Governor, Urjit Patel will answer this question.

Dr. Urjit Patel Let me take the last question first. You made several points. I don't think they were necessarily coherent in terms of the logic, but if I would comment on the current account deficit, the issue is how much the current account deficit is sustainable depends on the extent to which we can rely on stable, predictable flows from the rest of the world coming into India. Given that I don't think that the RBI needs to revisit its long-standing sustainable CAD of about 2.5%. On the issue of credit growth, the important thing to remember is that we are predicting credit growth slightly above last year and you find that to be difficult to understand. But we are also predicting output growth to be a little larger than last year. Therefore I don't see that as much of a disconnect that credit growth is about 1 percentage point higher than what it was last year because output is supposed to be about well at least 0.7% of a percentage point higher. So I don't think there is a disconnect there. Also remember that on the deposit side, one of the changes that is likely to take place is that as inflation moderates, you are going to get re-intermediation into the financial and banking system savings that were going outside the financial and banking system. So I think there is consistency there between deposit growth, credit growth, and our output projection.

Bhaskar Chatterjee What you mean to say is that deposit growth would be much more vibrant than last year and a lot of money will flow from commodities like gold back into banks?

Dr. Urjit Patel Yes, that is a possibility because the real rate of return as inflation comes down on the financial products would rise.

Moderator We have the next question from the line of Shyam Poddar from Forex Capital. Please go ahead.

Shyam Poddar Good afternoon everybody. First question is that if you look at the sharp decline of the FIIs inflow from January 2013, particularly from February when it was over $5 billion, which has come down to hardly $1.9 billion. Secondly as Governor rightly said that in spite of the 1.25% decline in the interest rate, the real benefit is not being passed to MSME sectors either by way of export finance or even in the real finance. So in that scenario, what measures can be taken where the real effect, as you have also agreed sir, that only 50%, 0.50 basis points has been passed on the base rate, which is a very selective basis. But you have declined the rates from 1.25. Is it not possible like last time also I suggested having some sort of a mechanism where the uniform benchmark rates should be decided for the MSME sector particularly, so they should avail the export finance at a similar rate as per their credit worthiness?

Dr. D. Subbarao Thank you Shyam, we appreciate your concern and I want you to know that the Reserve Bank is sensitive to the need for flow of credit to the MSME sector, which we recognise is disadvantaged. Especially in situation like this now when many of them are not getting payments for what they have supplied. Two points, first in the Reserve Bank, we have moved away from sectoral regulation, micro management, we leave it largely to banks and signal a monetary policy stance through the policy repo rate. Even as regulator of banks or as the supervisor of banks, we do not get into the interest rate structures of banks unless we see that there are gross irregularities or some mistaken priorities. The first MSME sector is concerned; we did one thing in the last policy which is to say raise the limits of credit to them which will be eligible for priority sector. Every time we meet banks both on a bilateral basis and as a group, we do talk about the distress that the MSME sector is under and about the need for banks to be more sensitive to giving credit to that sector. But I think it will be improper and regressive for the Reserve Bank to now get back into the business of setting rates for specific sectors. I am going to refer to the Deputy Governor – Mr. Khan, who will extend my answer to your question. You are happy with my answer, but we want to make you happier.

H R Khan As the Governor had mentioned in the policy, we had set up a committee under the Chairmanship of Mr. Padmanabhan, technical committee for facilities to the export sector. So quite a few recommendations which will also include MSME sector are being finalised by this committee and the committee's report is coming out today evening, so please have a look.

Dr. D. Subbarao So please watch for that Shyam. This evening the report will come and that report as you may not recall immediately that report is to look at non-finance facilities for export as much as we are concerned about finance. But we have also talked that we should let into the interface of exporters with banks and other financial institutions. Lot of exporters complain about frustrating procedures, length of time it takes to get clearances, the harassment that they have to go through because of repeated visits, etc. So we have appointed a committee under our Executive Director, Mr. Padmanabhan, they have studied all this issue including talking to some banks and talking to MSME associations and that report will come out this afternoon. Now, we wait for your next question.

Shyam Poddar My next question is, there is a lot of talk to control the volatility in the Indian market, which is being influenced by the global volatility even the Singapore and the Chicago Mercantile Exchange, they have opened up the rupee-dollar options and the rupee-dollar future contracts. Why don't we, to curb that activity, is it not possible to extend the trading hour in the Indian market so that participants, particularly the gold and silver importers, they participate in the offshore market, they can hedge their risk in India itself rather going to the offshore exchanges?

Dr. D. Subbarao Our Deputy Governor Khan, will answer that question.

H R Khan We had received representation from some of these quarters for extending market hours. Extending market hours have other implications because forex market will not function independent of itself, it has linkage with the market liquidity and other conditions. So we have to examine that proposal very carefully just opening the forex market for the sake of one particular segment. So far as Indian hedging going to other markets are concerned, you will remember that we had said that we are trying to liberalise so that more and more people come to the onshore market and in this policy we have indicated that for the FIIs even the currency futures market subject to certain conditions we will permit them. We are also considering some other measures possibly for simplification of documentation so that people more and more hedge and come to the onshore market. The second thing which has been mentioned very clearly in the policy about unhedged portions of the corporates, that is why we are now creating a structure, an incentive or disincentive structure so that corporate come for more and more hedging so that volatility on their balance sheet is minimised and in the process volatility in the market also is minimised.

Moderator We have the next question from the line of Raghvan Munjurpattu from SBI Life Insurance. Please go ahead.

Raghvan Munjurpattu Good afternoon to all. My question is sir that the macroeconomic group that generally gets released one day before, just wanted to know whether the department that prepares the monetary policy and the technical committee that sits on and decides the monetary policy, is it the same that goes through and prepares this report or the views could be completely different. Why I am asking this is specifically because once we had a look at the monetary policy, the macroeconomic report, one got the feeling that the hawkishness was very clear and words like 'very limited' were being used in terms of monetary policy space. So if that was the case, why did this 25 bps rate cut have to be done if the space was already less and there is only a small amount of time that we had seen gold and other positive improvements happening in terms of

CAD? That is one question. The second question being that a few months before when we were following the monetary policy review and the pre-policy reports, QE was looked at from a perspective of creating higher inflation expectations and higher inflation domestically in India, so higher the QE, more would be the inflation, but now we see that QE is being looked at from a perspective that if QE reduces maybe globally than that would be causing further outflows or at least a stoppage of inflows. So one aspect is a negative and here we look at QE as being positive as far as flows are happening. Has the position of RBI changed in terms of looking at QE or how should we interpret it right now?

Dr. D. Subbarao Thank you Raghvan. On the first question, of course different people, different departments initiate these reports. The money macro document as we informally call it that comes a day before the policy and the policy statement that comes on the day of the policy, but there is convergence that takes place at the senior management level. So as far as external stakeholders are concerned, both these documents should be seen as institutional products of the Reserve Bank irrespective of our internal processes of who is preparing what and at what level the convergence takes place. In the monetary and macro developments report that come out a day before the policy, we try to make an objective assessment of the macroeconomic situation and there is no overt intention to communicate a particular stance. It is an objective assessment. It is analysts such as yourself, you draw your own conclusions, of course that is fair, but it is quite possible that different people reading the same document get different perceptions. In the policy document, we of course try to nuance our understanding of the situation and give an indication and an explanation; an indication of our assessment of the macroeconomic situation and an explanation for our policy including the guidance. Several times analysts such as yourself have told us that there is a disconnect between these two documents and particularly in last week, more people have said that there is a disconnect. It could well be, I am not trying to affirm or deny a disconnect. But that itself is not going to be something that we are going to worry over because we try to be objective in both the documents. Anything else that I need to say in answer to this question? You are satisfied, but I think we want to satisfy ourselves.

Deepak Mohanty Macroeconomic and Monetary Development document apart from the stance I think the essence of that is again more factual. Lot of information is being put out there; analysis, forward-looking information, so it has value in that sense. Those stance it is again subject to judgement whether it is differing from the way policy is coming up.

Dr. Urijit Patel On the first question, you know it is interesting that after the MMDR was released, people said it had a hawkish tone. Actually after the monetary policy itself, people said there was no hawkish tone. So I think there was a fair amount of congruence in terms of what we were trying to say.

Dr. D. Subbarao On your second question about the quantitative easing, you are right to observe that when we were growing vigorously in the pre-crisis years and there was capital coming in, we had one type of problem, which is that of capital flow beyond our requirement which was leading to appreciation of the currency quite unrelated to fundamentals. Then the problem was of how to cope with that excess capital flows and with the appreciation of the currency which was unrelated to our fundamentals. Now, we have a current account deficit, the flows coming in, so we are in somewhat of a sweet spot as it were because we have a large current account deficit that is being financed, but that is not a place we want to be in. We want to have a lower current account deficit which is financed by non-debt, stable flows. So even as the current global liquidity situation is made our challenge less of a challenge, it is still a big problem. So you are right that both the problems whether currency is appreciating because of too much of capital flow or currency is depreciating because of too little capital flow, both are problems for external sector management and by implication for monetary policy management. So we have no value judgment on one being good or bad. We would like ideally a low current account deficit which is financed by stable and non-debt creating flows.

Raghvan Munjurpattu With regard to the first question, I just asked if then there was very limited space in either of the reports if they both sounded the same, then what was the major factor that incited a rate cut at this point of time?

Dr. D. Subbarao We indicated that in the policy, the major factor that informed the policy decision was that the growth has moderated and inflation has moderated.

Moderator We have the last question from the line of Manish Wadhawan from HSBC. Please go ahead.

Manish Wadhawan Sir good afternoon. This question is regarding OMOs as a tool for managing liquidity. I think you made a comment on Friday that if liquidity is a problem OMOs are as good as CRR if not better and an indication from the MPD Advisor- in-charge two days back that CRR is at 40-year low and further scope of CRR cut is considered quite low. In view of these statements and with the persistent liquidity deficit, is it reasonable to presume that going further OMOs will remain the preferred tool to calibrate liquidity? And secondly if that is true, is it not possible for RBI to announce the overall indicative quantum of OMO it plans to do in the financial year as it would help the market participants in planning the liquidity planning and investment strategy. And such guidance would also be consistent with the efforts made by RBI to be more predictable through its guidance and policy rates.

Dr. D. Subbarao Thank you for both those questions, very clear. On the first question, the assumption that OMO will be the preferred tool is wrong. Don't go with that assumption. We will use all options available to us depending on how we assess the liquidity situation to be. It could be OMO, it could be CRR, and it could be something else. On the second question, as much as we would like to be predictable and give guidance to the market for long term planning, it is difficult to give a plan for the entire year or even for a few months on the OMO because the liquidity situation is rapidly evolving. There are a lot of uncertainties including about the government's spending pattern, about deposit mobilization, about the rate of credit growth. So we don't want to give a plan and then change it and confuse stakeholders even more. So given the level of uncertainty, I think we are somewhat constrained to go with the present plan of managing liquidity actively and announcing OMOs as and when necessary, but I will certainly keep your advice in view.

Manish Wadhawan One final question, there has been a talk in the press regarding auctioning these government balances with the banks. Has there been any decision or what is your view on that if that is something in the near future?

Dr. D. Subbarao That is in discussion with the government, auctioning of cash balances to the banks, but I want you to know and I am sure you know that by auctioning this we are not going to change the overall liquidity situation. Banks instead of borrowing it from us from the LAF window, they will be getting these securities through some other window. They will be getting money through some other window, so overall it should not change the liquidity situation. What it will change is the costs to the government. So we will of course come out with a decision when we have concluded our discussions with the government and then let all of you know.

Dr. D. Subbarao Thank you very much, I wanted to thank all the analysts who asked questions and several many others who silently listened to this interaction. We attach a lot of value as I said on previous occasions. In fact not only at this conference, but even when I met some of you interlocutors on a one-on-one basis, I asked you people whether this is adding any value to you and every one of you said that it is adding value. I want you know that we learn a lot from talking to you little 24 or 48 hours after the policy. So thank you very much. We hope to keep this going in future policy reviews.

Moderator Thank you. Ladies and gentlemen on behalf of Reserve Bank of India that concludes this conference call. Thank you for joining us and you may now disconnect your lines.