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

December 2, 2014

PARTICIPANTS FROM RBI:

DR. RAGHURAM G. RAJAN – GOVERNOR,
SHRI H. R. KHAN – DEPUTY GOVERNOR
DR. URJIT R. PATEL – DEPUTY GOVERNOR
SHRI S. S. MUNDRA – DEPUTY GOVERNOR
DR. MICHAEL D. PATRA – EXECUTIVE DIRECTOR

MODERATOR: **MS. ALPANA KILLAWALA – PRINCIPAL CHIEF GENERAL MANAGER**

Moderator: Ladies and gentlemen, good day and welcome to the Reserve Bank of India Post Policy Conference Call for researchers and analysts. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Ms. Alpana Killawala. Thank you and over to you Ma'am.

Alpana Killawala: Thank you Inba. Without wasting much time I will straight away hand it over to the Governor. We will go to the questions?

Dr. Raghuram G. Rajan: Let's go to the questions.

Radhika Rao: Radhika Rao, DBS Bank. My question is to do with the likely changes to the new monetary policy framework after your consultation with the government. How are those progressing? By when do you expect a new framework to take effect? And do you anticipate any changes to the nominal CPI targets from what they are at present especially the ones which see CPI to settle around 4%, (+/-2%) longer out. To what extent would that alter your policy decision?

Dr. Raghuram G. Rajan: Well, thanks for asking that question. This question was obviously sent to us before the announcement today. We did say that those discussions with the government are going on. Our expectation from the progress of those discussions is the government is comfortable with the 4%, +/- 2% target and that is what will constitute the inflation objective as we go forward. Now, the precise timeframe by which the objective has to be achieved and the path, etc., will have to be spelt out as we discuss further. So what you should just keep in mind is post January 2016, we will gradually move into this structure. Does that mean that we have to achieve 4% on January 2016? No, I think we have to follow the glide path so that we are gliding into that framework and then I think we will be more specific about the timeframe in which we hope to get closer to the centre of that band.

Imran Syed: Imran Syed, AEGON Religare Life Insurance. The Urjit Patel Committee recommended an inflation target of 4% (+/-2%). However recent RBI communication has only focused on the 6% target by Jan 2016. This has led to market expectations that once inflation is seen as reaching 6% by Jan 2016, RBI will say "Mission Accomplished" and focus on reviving growth. Can RBI clarify its stance on the 4% target and by when it intends to glide CPI to the 4% level, if at all?

Dr. Urjit R. Patel: The glide path that we announced and implemented was of course in preparation for the initial conditions for adopting the new monetary policy framework around the 4%, (+/-2%) target. So the achievement of 6% or thereabouts in January 2016 should be seen as a milestone on the way to the 4%, (+/- 2%) band to which now the government has indicated that it is comfortable with. We have to recognise that by ensuring low and stable inflation and by anchoring expectations, monetary policy is already helping to stabilise the macro environment and create the conditions for a durable revival in growth.

Kaushik Das: Kaushik Das, Deutsche Bank. Does RBI focus more on real interest rates or nominal interest rates in its macro framework? What is the average annual real interest rate, (defined as repo rate minus CPI inflation) that RBI wants to maintain going forward? Will a rate cut of 20 to 50 bps help at this juncture to revise the investment cycle, given that the current slowdown in the Indian economy is mostly led by non-monetary factor?

Dr. Raghuram G. Rajan: This seems to be more of a statement than a question. Look, the reality is there are different kinds of real rates prevailing in the economy today, so when you say 'the real rate' it is not clear which one we should pick. For example if you talk to a variety of producers they will say that what the inflation they are seeing both on the output as well as the input side is much lower than say the inflation the consumer is facing. And obviously from the consumers' perspective the real rate they would like to see is the real rate they get on their financial savings which would be the nominal minus the inflation rate they experience. While from the producers side it would be similarly the kind of real interest cost that they pay which they might see as the nominal interest they pay minus the producer price inflation that they are seeing. So essentially our aim is to try and bring a more common real interest rate in the economy and the way we can do that is by, in a sense bringing inflation back on the consumer side more towards where the producer price inflation or the wholesale price inflation is, so to in a sense integrate the inflation rates across the system.

Now where do we see real interest rates go? I mean it obviously depends on the stage of the cycle and the stage of development also to some extent. Today, world real interest rates are about between 1.5% and 2% depending on the country that you go to; I am talking about long-term real interest rates. So my guess is that would be approximately where we would go in the normal phase of the cycle.

Rajeev Radhakrishnan: Rajeev Radhakrishnan, SBI Mutual Fund. The RBI has conducted OMO sales of Rs.50,000 crore in the current fiscal. OMO sales have also been conducted when overnight rates have been aligned with the repo rate and liquidity condition broadly in

balance. Can frequent OMO sales be construed as part of the central bank's balance sheet realignment or as a yield signal in the current context apart from the stated liquidity management intent?

Dr. Raghuram G. Rajan: Let me ask Michael Patra to answer.

Dr. Michael D. Patra: OMOs are conducted essentially to align liquidity conditions with a programmed expansion of primary money that the RBI plans on the basis of its expectations on growth and inflation. I want to say here that RBI does not conduct OMO to influence yields or to achieve a desirable rate of yield. It is only to ensure that liquidity that is of a permanent nature is withdrawn or injected into system as the case may be and other instruments are used to deal with frictional liquidity.

Siddhesh Satvase: Siddhesh Satvase, SCMHRD. If RBI reduces the policy rate in let us say next one year and US Fed decides to hike the rate, then what will be the central bank's stand on expected rupee depreciation? Is RBI comfortable with it looking from the exporters' point of view or will it intervene with its reserves?

Dr. Urjit R. Patel: Monetary policy in India as in most other countries is solely conducted with domestic objectives in mind and our decision to change the policy repo rate if and when taken will be on the basis of growth-inflation dynamics in our country. That said, we are conscious of the spill overs that the US Fed action can involve and how they could impact our domestic goals including through the exchange rate. It is for this reason that for the last year and a half or so we have equipped ourselves with buffers while correcting the micro imbalances and strengthening the health of the financial sector. Our stance on the exchange rate is what it has always been and that is to ensure smooth functioning of the market with a view to eschewing undue volatility that can impact all stakeholders including exporters adversely and I think we will continue to pursue that policy stance in the future also.

Vinothharish: Vinothharish, Wealth Advisors. Could you elaborate the thought process behind dismantling the 80-20 scheme for gold imports despite the trend of rising gold imports?

Dr. Raghuram G. Rajan: Well, this 80-20 scheme whereby gold had to be exported to the extent of 20% in order to import more is a scheme that was running into some distortions. Let me ask Mr. Khan to perhaps throw some light on the arguments for and against and at the end of it how this decision was made.

Shri H. R. Khan: As Governor was mentioning in the post policy conference, this has created some distortions. We had additional players who came into force, trading houses also

created some uneven playing field and there are reports of smuggling and other infrastructure being created. So the argument was the distortions should be cleaned up. The other argument which Governor alluded to in the press conference was that broadly our demand is around 1100 to 1150 tonnes, out of that 350 to 400 tonnes are investment demand and around 650 to 700 tons are jewellery consumption demand. If the gold prices are going down there might not be an investment demand for this plus the real rates are turning positive, so people are turning towards financial savings. So there might not be real cause for worry that this will shoot up too much. Of course we saw some amount going up partly because of distortion, and partly because of seasonal demand plus the comfort which was brought by oil prices going down so there is a level of comfort in terms of CAD. So because we are comfortable in terms of oil price going down drastically and to clean up this distortion this decision has been taken. Of course we will be very watchful and going forward we see whether it should be smoothened further. If necessary whether we can do some other activity to see that it is moderated if warranted.

Vinothharish: Second question is what is the RBI’s framework for doing announced open market sales of government securities in addition to the regular sales through the secondary market?

Dr. Michael D. Patra: As you know for the direct open market operations we follow a framework in which we preannounce these auctions, we conduct auctions, announce cut offs and then settlement is on a T+1 basis.

Kumar Rachapudi: Kumar Rachapudi, ANZ Bank. During the rate hike cycle, the RBI viewed that tight liquidly is a necessary condition for better pass through of policy rates into the real economy. Is the converse true, that is, is easy liquidity a necessary condition for better pass through of rate cuts whenever they happen?

Dr. Raghuram G. Rajan: I don’t think there is a one-to-one correspondence and to some extent our liquidity framework intends to try and manage liquidity in the market so that the weighted average call money rate is close to the policy rate. So given that the objective is to try and maintain a price for liquidity it’s hard for us to at the same time manage a quantity for liquidity that is easy liquidity as suggested here. Going forward I think that will continue to be our policy. I think as banks find that short-term money is available at or around the policy rate, it slowly filters into other decisions especially if they have a sense of how this plays out over the medium term and it filters into their lending rates and so on. So that is why a certain predictability about the path of policy is also useful so that the transmission takes place, which is why we have attempted to be quite clear on our communication on this aspect.

Achala Jethmalani: Achala Jethmalani, Nirmal Bang. A question on inflation expectation and its role in formulating monetary policy at the RBI. One-year ahead inflation expectations have remained elevated for previous five quarters at around 15.0% or 16.0% level. How do you consider or rather factor in the inflation expectations data points while formulating monetary policy? Is there a level that the RBI is looking at on inflation expectations?

Dr. Raghuram G. Rajan: I think if you look at market based inflation expectations there is no way that any market participant today expects 15% to 16% over the medium term. Otherwise we simply would not have government bond yields at 8%. So I think you have to distinguish the information that one can obtain about widespread market based inflation expectations from the inflationary expectations we obtain in the service which are more close to the kind of expectations that the public holds. Now of course the public's expectations are also important in that they eventually influence things like wage setting behaviour and perhaps even price setting behaviour, so we have to be careful that we don't focus only on market expectations. The surveys have indicated 14-15% expectations at that level, even though historically headline inflation over the past few years has not been anywhere near those levels. And I think part of the reason is sometimes these expectations are driven by the things that households buy. And often the things that are closest to them are commodities like vegetables and so movements in vegetable prices influence their expectations of inflation considerably. It has done that on the up and I presume it will do that as we come down also, the approximate things that they buy will be important in the inflationary expectations. My sense is that the information that is most valuable from these expectations is the change, not so much the level. So as these changes emerge I think we will get more comfort that the broader public is internalising the disinflationary process and therefore we should expect it to filter into other decisions the broader public makes.

Bekxy Kuriakose: Bekxy Kuriakose, Principal Mutual Fund. Recently there has been some news in the market that FPIs may be taking exposure to government securities through the mutual fund route which gets counted under corporate bond limits for exposure. Would RBI be concerned about this and therefore look to enhance the limit for GSecs which is currently almost full?

Shri H. R. Khan: We have seen some FPI investment through mutual fund route, both debt mutual fund as well as liquid and balanced mutual fund. Some of the investments through this mutual fund have happened in GSecs and some happened at CP, CD and treasury bills and as we have put some restrictions in FPI investment in short-term paper for less than three years and CD, CP are not allowed, this is in a way of indirectly investing in

that. But as of now the limit which had been utilised by FPIs for the short-term papers through this mutual fund route is not very significant. In any case we are keeping a watch on how this moves forward and going forward if we see that this becomes significant and substantial maybe we will be taking action.

Hedley Albuquerque: Hedley Albuquerque, Banhem Securities. Is the RBI planning to permit banks to convert more than 10% into equity for restructured loans? Are we asking banks to take additional risk and reducing the importance of higher promoter's "skin in the game?" Would it be prudent to let banks focus on core competence in credit assessment and monitoring and let promoters take efforts to be bailed out by risk capital providers such as private equity in genuinely troubled loan cases?

Shri S. S. Mundra: I think the point to consider here is what we are talking here about the additional equity exposure in the cases of the restructuring process. When a restructuring process is happening, in any case the exposure is coming to banks in various shapes and sizes. I think we have to differentiate between this. It is not we are not talking about new project where the banks are *ab initio* providing debt capital as well as equity capital. Now in a whole restructuring process if enterprise is viable and banks are putting a package and if they are taking higher haircut or a higher write off in shape of debt, I think there are merits that they can for the time being at this point of time it can be converted into equity. It also has another advantage that in such cases if there is a turnaround then the entire upside is going to promoters only. But when there is a higher component of equity, some of these upsides can spill over to the banks. So I think that is the whole thinking behind it.

Brinda Jagirdar: Dr. Brinda Jagirdar, independent economist and former chief economist SBI. You have often expressed concern about rising corporate defaults and deteriorating asset quality of banks. Of course we need banks to expand productive lending, but latest data shows bulk of incremental credit going to personal loans. How can you help/nudge banks look beyond retail and working capital and also expedite transmission?

Dr. Raghuram G. Rajan: See, we can only set conditions. I think it would be beyond our remit to guide banks into specific areas. That said, I think Mr. Mundra in certain fora and I have expressed some caution to banks about jumping all into retail at this point given that there has been a fair amount of credit going to retail, it should not be seen as a new panacea. And I think the banks are taking cognizance of that kind of caution also. So going forward as credit demand from the corporates pick up and now I think there is healthy competition between the money markets and the banks for their business as large corporates credit demand picks up and then overtime the small corporates also,

banks will move towards lending to them. Our role is really to create the underlying frameworks such as the debt recovery mechanisms, the credit rating mechanisms those kinds of things so that lending becomes easier. But I think it would be wrong for us to push too hard in a particular direction so long as there is no risk aspect involved.

Alpana Killawala: We will take some questions from the live call. Inba, can you announce please?

Moderator: Sure ma'am. Our first question is from Ankit Baweja of DBS Bank.

Ankit Baweja: I want to know that over the last almost one year the change of limits for FIIs have not been done for the debt segment, as in they have not been expanded for the government debt securities, while the limits are freely available for corporate bonds even now. So that to some extent has led to some sort of an imbalance on the credit spread in the market, at least that's what people here feel. To give you an example of a corporate bond got placed almost 3 basis points above government securities last week on a big amount. Do you think that these spreads are reasonable and do you think that RBI should look to increase FII limits in G-Sec so that the spreads become realistic again?

Dr. Raghuram G. Rajan: So I suspect you are referring to the MTNL bond?

Ankit Baweja: Yes sir.

Dr. Raghuram G. Rajan: And the reason the spreads are narrow admittedly is because they are being treated as quasi sovereigns and that suggests there is an unfulfilled demand for sovereign bonds out there. We over time expand the limits for sovereign bonds and we have in mind a schedule of expansion so that it's consistent with our ability to absorb that kind of capital also. So I would say don't despair, we will expand the limits but it has to be not at the pace that the market wants to absorb but our ability to absorb the kind of flows that are coming in.

Nikunj Doshi: Nikunj Doshi, Bay Capital. Just wanted to understand RBI's stance on interest rate is it mainly to compensate financial investors for the real interest rate point of view or is it RBI's belief that interest rate can control inflation?

Dr. Raghuram G. Rajan: You know interest rate does many, many things. It is a price for capital but it does many things. Obviously one way we expect the transmission of higher rates into slower activity and therefore lower inflation is by controlling demand, whether it is investment demand or it's demand for consumption as the citizen prefers saving rather than consuming. So it acts both on investment as well as savings and I don't

know which one you want to pick at any particular point in time, I presume it works on both sides.

Manish Bhatia: Manish Bhatia, ICICI Prudential. My question is about inflation index bonds, these bonds were introduced around more than a year back, and since then RBI has shifted its focus from WPI to CPI. So we have an outstanding amount in these bonds which have been invested by us as well. So we want to know the fate of these bonds. Whether RBI will reissue more with WPI bonds or come up with CPI bonds in the future, what do we expect from RBI on this?

Shri H. R. Khan: We had been in dialogue with government for both institutional inflation indexed bond as well as the retail inflation indexed bond and both pegged to CPI and some design changes also have been contemplated and this is we are in active dialog as I mentioned and as and when we reach some consensus institutional IIBs are most likely to be reissued with some revised features. And on the retail IIB, we have to take a call because government has in the meantime come out with Kisan Vikas Patra for small savings. But we still feel there is a case for retail IIB with revised more customer friendly features, it think that is being considered.

Manish Bhatia: Sir, any plan for the current inflation index bonds which are there in the market?

Shri H. R. Khan: As I told we are in dialogue with government, let’s see how we take it forward.

Ashish Kumar: Ashish Kumar, Elara Capital. There are two parts to my question. One, this is on growth, so is growth revival a given in 2015. So given the somewhat weak set of arguments that I find in monetary policy statement I was wondering if the government, the RBI and all the analysts including me are being utopian in projecting for the real economic activity further down in 2015? And secondly, if the growth is so given, will it necessarily be non-inflationary especially in absence of durable revival in the investment cycle? I have a third part, a related part, how are you viewing the output gap scenario in 2015?

Dr. Urjit R. Patel: I think some of the more recent high frequency indicators suggest that there are good reasons to expect growth to pick up except maybe in the third quarter for agriculture for the obvious reason of inadequate rains in the past. I think that one of the main reasons for optimism are the structural reforms or the decisions pertaining to specific sectors like energy, the GST, the fuel supply, etc., which is likely to given an impetus to growth and given the systemic nature of some of this sectors, I think multiplier effects should take hold. Yesterday, I know this can be a one-off, but it seems that

some of the auto sales segments have perked up, clearances for mining have been liberalised, and one of the main reasons why commercial vehicles were weak in the last couple of years was because of that; the trucks were lying idle. So I think there are many good reasons to expect growth to perk up going forward and some of this growth can actually take place at current capacity levels, once those capacities get exhausted then obviously investments will have to lead the way. I think we still have a fair bit of gap between where we are and the potential output. So I am not too worried about both growth picking up and inflation coming down.

Ashish Kumar: And what exactly are you looking out in terms of output gap, I mean we are moving in the positive territory in 2015, is that possible?

Dr. Urjit R. Patel: You know there are three measures of this metric and the capacity utilisation is something that we follow in our Surveys very closely and it would suggest that there is a fair bit of headroom for this in 2015.

Shubhada Rao: Shubhada Rao, Yes Bank. I just wanted to ask the rational for the "googly" phrase being used in paragraph 18 that says "including outside the policy review cycle".

Dr. Raghuram G. Rajan: So, it is a very good question. I think the intention was to signal that we were looking basically for new information and that once enough information came in we were sufficiently attuned to the broader concerns about interest rates remaining higher longer than necessary. We have said in many fora that we won't hold it a second long than necessary, to say that if the information came in at a time outside the policy decision we would make the change. And let me emphasise, it is about the change in the policy stance that could take place and after that we will go back to the normal policy decision making date. Of course we always retain the ability to react to extra ordinary events outside the policy dates. This was an attempt to say we felt the change in the monetary policy stance was to some extent an important signalling event and that we also wanted to say that we would not hold it a second longer than necessary in our view. So it was a message to say we are sort of attuned to broader concerns but I don't think you should read more into it than that.

Shridhar Shivram: Shridhar Shivram, Morgan Stanley. Sir just wanted some clarity; at the outset you mentioned that the inflation expectation for FY15 is being reduced from 8% to 6% which seems fairly significant, which suggests that you have enough data to suggest that the inflation trajectory is quite good. Yet you have not cut the interest rates and you have mentioned that you are waiting to see more data before you could take any action. Also in some of your interviews you mentioned that on the fiscal side you are reasonably confident that the government may achieve the fiscal deficit target. When

I put all of this together and the growth has not really picked up as much as most people are anticipating, when I put all this together it seems like you had the ingredients to cut the rates this time around yet you haven't done. So I am just a bit confused as to what data is it that you are going to get in the next two three months which will give you more confidence to go ahead with the policy stance?

Dr. Michael D. Patra: All the information that we have seems to suggest that we are moving in the right direction, that inflation is softening although not at a pace at which we would like it to. But all analysis also suggests that there is a time in the months ahead when the favourable base effects that are driving down inflation now may wane or it may even reverse. We want to see what kind of upturn we are going to look at in these months. If for instance this upturn is a lower one, we would be emboldened to act faster but if it is a durable one we would like to wait and see how this pans out before taking any action.

Dr. Raghuram G. Rajan: So basically we have mentioned the three or four things that we are looking for, I would modify Michael's statement a little bit to say that to some extent we have been surprised by the extent of the fall in inflation rather than worried about the pace. It has actually been quite good and perhaps beyond what we anticipated. But I think on the three or four things we want more reassurance on. And when I say reassurance we are really talking about reducing the bands of uncertainty around our forecast rather than that we need more assurance on the level of the forecast. So it would be on first the pace of disinflation going forward, something Michael talked about, the second would be that inflationary expectations which we already have some early signs are coming down continue coming down. And of course as we go into the early part of next year we will have more confidence that the government is achieving its fiscal targets, we can be confident in expectation but then we will be confident in realisation when we actually see that happen. So given that we have said again and again that the change when it comes will hopefully be a set of actions over time that is consistent with one another. Let us be confident that we see inflation with very tight bands around the target next year and that would give us lot more confidence to act.

Shridhar Shivram: Sir, the 6% inflation for FY15 I am assuming RBI has enough data to support that but it seems like a very aggressive target, I mean if we reach that that will be a great number to reach. But why the aggressive change to 6% and not say a comfortable level like say 7% or just leave it at 8%. 6% suggests that the trajectory for the next three four months is looking very good.

Dr. Raghuram G. Rajan: Well, you want us to change the prediction of our models or build in a lot of room for error?

Shridhar Shivram: No but given that you said 6% which is why I was a bit confused that 6% suggests that the trajectory is going to be very good. Yes you are awaiting for some more data so I am wondering whether do you want the inflation number to be even lower than 6% because that's the data which will give you more comfort or are you happy if we come in and around 6%.

Dr. Raghuram G. Rajan: No, see I think what we are looking for is we are going to go into the details of the numbers that come, to understand whether the processes driving inflation, we are comfortable with them. So it is not that we are going to look at the overall number and say, "yay, we are done!" We are going to look at the details, look at the components, see how the components are moving, and that will give us more confidence that this is to stay. So remember the big moves we have seen, so we have seen a series of moves since November of last year but the big moves we have seen have been in the last couple of months and so we want to see how durable some of these moves are especially outside of food. So once we get more confidence then we can project out for the whole year in a much better way because remember it is not just a transitory factor, it is not just the base effects but the underlying inflation as reflected in a number of services for example that we have to be comfortable about.

Alpana Killawala: That would it for this time friends. We will close here. Thank you very much for joining this conference.

Moderator: Thank you. Ladies and Gentlemen, on behalf of RBI that concludes this conference. Thank you for joining us and you may now disconnect your lines.