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

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**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 this conference call please signal an operator by pressing '*' and then '0' on your touchtone phone**.** 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 very much Shyma. Welcome to this Researchers and Analysts call after the policy announcement. I will straight away hand it over to the Governor.

**Dr. Raghuram G. Rajan:** I have no statement to make other than saying that in addition to making a statement about the economy and our expectations going forward, we took a number of actions on a variety of fronts, and I think it is useful to pay attention to some of that also because many of them I think are going to growth positive.

**Alpana Killawala:** We will go over to the questions we have received.

**Umesh Sharma: Franklin Templeton Mutual Fund** How serious, in your opinion as an economist, is the risk of global deflation? Have we borrowed too much from the future and with burden having been passed from the private sector to the governments to central banks now, do you feel that financial market risks are underappreciated or in other words, the easy liquidity being supplied by global central banks is suppressing risk? How do you think all this is going to unravel?

**Dr. Raghuram G. Rajan:** Well, I don't know. I think the hope that a number of central bankers have is that they are building a bridge to the future and that they walk off the bridge fairly easily because the deep ravine or chasm is bridged. My fear has always been that the bridge stops halfway and we have to exit it at a time that we have not reached the other side, and then we know that there is a deep fall. Time will tell, the muddle through solution is, economies start picking up somewhat, and the asset price inflation we have had subsides over time and there are no deep disruptions; that is sort of the best case scenario. Worst case is there are significant bouts of asset price volatility and we find out who has been playing the markets at that point and there are consequences. Best case, again within those, is if it is non-bank participants who can absorb the hit. The problem comes if it is levered participants who cannot. So we just have to prepare for volatility.

**Umesh Sharma:** With this background, how does an emerging market central banker navigate monetary policy? If he loosens too much, there are asset bubbles and if policy remains tight then the economy is at risk of stagnation.

**Dr. Raghuram G. Rajan:** Well we have a slightly different problem because we still have concerns about inflation. So given the deflationary environment elsewhere, it is actually easier for us because we not

fighting inflation in an environment where inflation is picking up elsewhere. So I think we are still in conventional monetary policy territory, and so it is easier.

**Jayesh Kumar: Kotak Securities** New CPI would have higher weight for services, which could indicate much slower disinflationary path than currently indicated. Would you still stay on easing path or if new CPI brings surprisingly higher inflation (slower disinflation) then could we be on hold for much longer period?

**Dr. Urjit R. Patel:** I think that you know it is not apposite to speculate on what the new CPI index number will be. We should wait and watch and analyse the recast. You know just as you have written here that it would have higher weight for services, I suspect that it could also have lower weight for food, and the methodology itself is being changed. So I don't think we should speculate on what would happen if the number is a bit larger or a bit lower. And we would do our best to look through these because it is the short to medium term perspective that is important rather than the immediate reading. So I think it is best not to speculate on this until the numbers come out.

**Edward Teather: UBS** How do you judge the level of capacity utilisation or output gap in the economy, especially in the light of the 2011-12 base year revisions to the national accounts?

**Dr. Raghuram G. Rajan:** Let me ask Michael Patra to speak on it.

**Dr. Michael D. Patra:** As in the case of the new CPI, it is best probably to wait for the release on February 9, on the new GDP data and then take a view on capacity. But on the existing data base, our survey suggests that there is spare capacity, it is a little above 70%. Also other indicators or rural demand and consumption demand indicate a slack in the economy.

**Bekxy Kuriakose: Principal MF** What is RBI's view on including trends in unemployment/jobs data for deciding monetary stance? At present we do not see any data on the same being included in the policy review documents.

**Dr. Raghuram G. Rajan:** Well, I think we would include them if we had a good series. We would include them explicitly. Right now what we do is we have a variety of indicators including some periodic surveys which we look at. We have some data from large corporations which we also look at. So it is not that it does not enter our calculations, it does; but it does not necessarily enter our policy statements because we don't have a very precise and frequent series going forward. Urjit, would you like to add anything?

**Dr. Urjit R. Patel:** Just to say that from what I understand that we may have a series on quarterly unemployment beginning the second half of this calendar year. And we would look at those numbers and hopefully they would satisfy standards of methodology coverage and quality for them to enter our policy statements explicitly and indeed in our calculations. However, one data series that

we do look at fairly closely is the wage growth data which is an indirect measure of pressure in the labour market.

**Samiran Chakraborty:**
**Standard Chartered Bank** Do you think that repeated inter-meeting rate decisions undermine the importance of scheduled policy meetings or are you comfortable with frequent inter-meeting policy decisions?

**Dr. Raghuram G. Rajan:** Well, I don't know where repeated came from, we have done it once, so we still have to repeat. Look we clearly respect the importance of the dates, the monetary policy dates. They are set in advance, and we would like to adhere to them as far as possible. There are sometimes reasons to move in between policy dates, if nothing else, because of past commitments. That was the reason last time when we committed to move as soon as the data permitted us to move given that there was in some quarters, a public perception that the RBI was tardy. We wanted to say that we understood the need for action as and when we had the information and we were prepared to act even outside policy dates. So I think it was useful to signal that and there might be other occasions when because of large changes, we feel a need to act. So I don't want to straightjacket us by saying we will never act outside policy dates. But I think the idea behind the question that it is reasonable to act on those dates and not to keep doing things outside is a reasonable one and it is certainly is something that we also believe in.

**Rajeev Radhakrishnan:**
**SBI Mutual Fund** Why has the RBI abruptly stopped issuance of Inflation Linked Gilts? Wouldn't it be desirable to revive the issuance and also make suitable revisions such as rebasing to CPI? A reasonably liquid IIB issuance can also provide market based measures of inflation expectations that could be a vital signal for monetary policy measures apart from providing financial assets offering a real rate of return.

**Dr. Raghuram G. Rajan:** Let me ask DG Khan to speak on this.

**Shri H. R. Khan:** You have said we had 6 or 7 tranches of institutional IIBs and we mopped up around 6,000 to 7,000 and after that we stopped, then we had three to four months of retail IIB linked to CPI inflation, we mopped up around 95 crore. After that it has stopped and we have been in dialogue with government to improve its features, but it make it more attractive for the retail investors; that is work in process. As far as the institutional investors also are concerned, we have also suggested to the government to link it with retail inflation. So we are awaiting the response and the discussions thereon.

**Arvind Chari:**
**Quantum Advisors** Given that CPI is now the nominal anchor; shouldn't the targeted real rate be the deposit rate for the investor, instead of the overnight repo rate?

Second question, in the Taylor rule, western economists assume the short term real rate to be zero. Is that ever likely in India?

**Nirav Dalal:**

**YES Bank** Did you refer to the repo rate when you spoke about the "real risk free policy rate" yesterday? If yes, request RB'Is views on the relevance of real policy rate (repo) versus real rate (1 year bank deposit) in the context of conducting monetary policy in India?

**Dr. Urjit R. Patel:** I will combine the answer to the question from Arvind Chari and the one by Nirav Dalal from Yes Bank. The targeted real rate is usually the risk policy rate. And one reason why that is the case is that is what the Central Bank can specify and control. And the other is that it is relevant for the entire economy, and not just for depositors, investors, lenders etc. In that sense the repo rate fulfils this requirement on these two grounds and the entire economy is covered, then as this is the base, and premia of various sources including credit, tenure, term, will be then be priced off this. So it is not possible and indeed it would be incomplete to target real rate for specific sections of the economy. The risk free policy rate is the one that should be used and that is what we do. On the Taylor rule, your question is incorrect. Actually Taylor himself assumed a 2% real rate for the US. In India where full capacity potential growth or steady state has not yet been reached as also the fact that productivity differentials exist, that real interest accordingly maybe somewhat higher given the circumstances or indeed a little lower, and so 1.5 to 2% that the Governor has spoken seems to be a reasonable number to go by.

**Devika Mehndiratta:**

**ANZ Bank** Could you give some examples of what you consider as steps towards high quality fiscal consolidation? The month on month pace of rise in 'core' CPI (ex- transport) component has indeed softened, how long do you think that can continue?

**Dr. Raghuram G. Rajan:** Let me take the first one, and give Michael the second one. On high quality fiscal consolidation, I think movement of spending for example from subsidies towards more capital investment, from mis-targeted subsidies I should say. We do need some subsidies; from mis-targeted or poorly targeted subsidies to capital investment would be a good move. And good move even from the inflationary perspective which is the primary reason for us looking at the fiscal. Because it will move from current spending without an appropriate supply response to something current spending which creates an eventual supply response because of the capital investment being put in the ground. So that would be an example of high quality fiscal consolidation. I think, more broadly the entire package is what we are looking at, and let me give the next question to Michael.

**Dr. Michael D. Patra:** Just in the line what we said earlier, I think it is useful not to speculate and to look at the data that come out in the days ahead, and then take a view on momentum. Essentially we communicate in terms of headline inflation and we watch the momentum headline inflation very carefully. But to reiterate it would be a better idea to look at the data when they come and analyse them.

**Nirav Dalal:**

**YES Bank** All future investment by FPIs in the debt market will be required to be made with a minimum residual maturity of three years. Does residual maturity mean the door to door maturity or the

maturity up to the call or put option dates prior to the final maturity? For example, can an FPI invest in a 5-year bond with a call/put option at the end of 15 months? The RBI and SEBI guidelines issued yesterday are silent on this.

**Dr. Raghuram G. Rajan:** Let me ask ED Padmanabhan to opine on this.

**Shri G. Padmanabhan:** When the intention is to move the FPI investment 3-year category, any kind of product structure which actually negates this, by way of an optionality is something which is not within the ambit of this scheme. So the specific question whether a 5-year bond with a 15-month put option or call option is acceptable, is not acceptable.

**Vinothharish GS:**
**Wealth Advisors** What is the RBI's thought process behind limiting the FPI flows in corporate bonds to residual maturities of 3 years and above?

**Dr. Raghuram G. Rajan:** The question is why did we limit the residual maturity to three years and above. Well remember we have already done this for government securities, and to some extent this is just evening the playing field for the corporate bonds. Initially we were reluctant because we thought there would be some benefit to development of corporate bonds if people took more positions in corporate bonds, we could afford to be a little more open. But our sense was there were a number of fairly short term investors coming in to corporate bonds especially quasi-government corporate bonds treating it as near government, and effectively vitiating the reason we put the three year limit for government bonds in place in the first place. Now what we are trying to do here, we are not in any way trying to limit exit, because you can sell your three year bond or your five year bond and move. What we are trying to do is do a little bit of filtering in who comes in. Some investors are much more reluctant to invest for any term because they fear some price adjustments if in case there is volatility and these are typically investors who were not particularly invested in the country but are taking fairly short term positions. We believe that those who come in at the longer end are taking a more careful view of the country or spending more time analysing before they come in and therefore are likely to stay longer. This certainly was our experience within investors in the turmoil in summer of 2013, and taking the lessons from that, we are basically saying we love to have you, just stay a little longer.

**Jyotinder Kaur:**
**HDFC Bank** In yesterday's conference with the media the Governor had mentioned that he is comfortable with a real policy rate of 1.5-2.0% given where we are in the business cycle. In previous interactions, he had also referred to this level of the real policy rate as the "neutral" real policy rate for India. Now the recommended real policy rate for a central bank is a function of the neutral rate, degree of deviation of inflation from the target and the output slack in the economy. Given that the RBI expects inflation to be close to its target of 6.0% and the existence of a negative output gap, how would you explain the fact that the RBI wants to limit easing to the neutral rate (i.e. 1.5-2.0%) and not below it?

**Dr. Raghuram G. Rajan:** I guess this is a difference between statics and dynamics. Is the output gap narrowing because of forces in play already, and to that extent do we need to add additional momentum to it. Our sense is it is narrowing our estimate for next year is 6.5% growth with only moderate help from monetary easing. So my sense is that the output gap is closing for a variety of reasons including the alleviation of supply constraints that were in place, that the government is taking actions on, and so to that extent it is more of a dynamic issue rather than a static issue.

**Jyotinder Kaur:** The RBI, like many other central banks across the world, has conditioned its guidance on incoming data. However, given the backward looking nature of this data and the lags associated with monetary policy transmission does the central bank not run the risk of falling behind the monetary policy reaction curve? If so, is this risk more than offset by the reassurance provided by this data?

**Dr. Raghuram G. Rajan:** Let me ask Dr. Urjit Patel to speak on this.

**Dr. Urjit R. Patel:** Incoming data is immediately passed and analysed and they become inputs for our forecasts and the forecasts are forward-looking taking into account a variety of internal technical models and judgments. And only subsequently are these used as intermediate targets to conduct forward looking monetary policy. And therefore I think the work that we put behind this in terms of analysis and segmentation, momentum indicators, and internal models which have forward-looking variables built into them gives us some reassurance that they are not backward-looking. And also we do take the input of our forward-looking inflationary expectations surveys from the household and the professional forecasters, etc. So I think we have a reasonably good balance in terms of the data that we look at when making these decisions.

**Alok Sahoo:**
**Baroda Pioneer Mutual Fund** How do you see the impact of revised GDP number in Monetary Policy action with the new number suggesting a strong recovery in the economy?

**Dr. Raghuram G. Rajan:** Well as I said yesterday, we are still trying to understand it. So we need to see the February 9th releases as well as the end February releases and the details before we come to strong conclusions about this. I would say something I have said in a different interview today, that is, we may be reaching the outskirts of the woods but we are not out of the woods yet. So I don't think any data that suggests we are out of the woods at this point, we would put too much weight on it.

**Ravikant Rathore:**
**Tata Asset Management Ltd** With regards to the large scale quantitative easing by both ECB and BOJ, can we expect there is room for depreciation of Rupee going ahead?

**Dr. Urjit R. Patel:** If there is large scale easing by systemic central banks, in fact the pressure on emerging market currencies is opposite to what you have postulated. And as you know we don't directly

comment on which way the rupee is going to move except that we don’t like volatility and we intervene accordingly and only for that reason rather than any target in mind regardless of what other central banks do.

**Amit Agrawal:**
**Societe Generale** What would be RBI's preferred liquidity management tool, if the foreign flows continue to pour in India, given a stable current account profile? Please elaborate in terms of OMO buyback, CRR, sterilization bonds, short term repos.

**Dr. Raghuram G. Rajan:** Let me ask Urjit again to answer that question.

**Dr. Urjit R. Patel:** Sort of soft rule of thumb that we use and it is not ingrained in stone, is that in terms of what we perceive to be permanent injection, we use sterilization instruments that are permanent in nature for example OMO is preferred. But eventually if we make a judgment call and we use a variety of instruments suitable for the time. But broadly permanent is addressed through OMOs and for short term issues we use the other instrument. Except I would not say the CRR would be used. I mean, that is an extremely rare instrument for this purpose, and sterilization bonds only enter the picture when we don’t have enough instruments on our balance sheet.

**Dr. Raghuram G. Rajan:** Let me add something to what Urjit said which is that the world has become friendlier to countercyclical prudential policy when it comes to flows. And one of the actions we took yesterday should be seen as part of that, which is we liberalised outflows, the LRs which is Liberalised Remittance Scheme, we took up from 125 to 250, beyond where it is was when we curtailed it in August/September of 2013. Remember at that time there was a hue and cry about us curtailing an existing outflow but that was a macro prudential measure. This is again a macro prudential measure and while we don’t expect this to be high frequency, so that people have time to make considered investment decisions, we retain the right to get more liberal or get less liberal over time depending on the macro prudential needs of the economy.

**Alpana Killawala:** Can we take a few questions from live, Shyma, can you announce?

**Moderator:** We have the first question from the line of Shreeram Ramanathan from L&T Mutual Fund.

**Shreeram Ramanathan:**
**L&T Mutual Fund** Basically just two quick questions, first is, if there is any update in terms of the inflation targeting framework that is being discussed with the government and whether any kind of progress has been made on that. The second one, I think it has been covered, but just a particular aspect of that, given this whole easing of financial conditions across the world by almost every other country to the extent possible, both on the interest rates to the maximum extent possible and on the currency side, once again to the maximum extent possible. Over here we are kind of constrained on the currency side given limited weakness that is possible. So is there an additional element that gets introduced on the interest rate side, more in terms of cyclicality of the real interest rate as well, because this 1.5 to 2% clearly is a big issue, so is there an element of cyclicality that comes in for real interest rates in this context because that is a limited extent that we can do over here on the financial condition side.

**Dr. Raghuram G. Rajan:** On the framework it is currently being discussed, yes there has been progress, but I don't want to give repeated bulletins on the state of the discussions. My hope is that when they conclude, we can put out the entire framework at that point but progress has been made. On the second issue, which I guess is a question about the real interest rate over the cycle, and our judgment of 1.5 to 2% is given that we are closer to the bottom of the cycle in India than the top, this is the kind of rate which might energize investment. Of course to those who say it should be zero, well that is peculiar to the industrial countries at this point given where they are. Remember we have to also incentivize savings, and we cannot run the risk of another bout of large current account deficits and instability as a result. So keeping that in mind, I think we are comfortable with a 1.5 to 2% range at this stage of the cycle, which means that as the cycle progresses and gets stronger, maybe the equilibrium real rate might increase a little from that. But certainly at this point of nearer the bottom of the cycle, keeping in view the need to incentivize inflation it would be 1.5 to 2, and I think it will stay this way for some time.

**Moderator:** The next question is from the line of Nikhil Gupta from Emkay Global.

**Nikhil Gupta:**
**Emkay Global** My question is related to a subject which for some reasons I believe is not widely debated, at least publicly. This is about savings in India, which you just spoke about Governor, but I would like to continue. To start with some data first – household savings in India have fallen from almost 25% in FY10, 23% in FY12, to 18% last year according to new data released. And we cannot expect to increase investment in a sustainable manner unless we have it financed domestically through savings. Now considering the cuts that commercial banks have done in the deposit rate, what do you think needs to be done in order to boost savings? I mean do you think we have reached the bottom on this front or if not then what can the monetary authority and the government do to have savings.

**Dr. Raghuram G. Rajan:** I think we have crossed the first hurdle, which is moved away from negative real interest rates to positive real interest rates. That is important, to reward the saver, and I welcome your question because too many people focus only on the producer side and not on the saving side. And we need to keep that in mind. But the other aspect is whether there could be some tax benefits to savings. Remember the government increased the limits for tax benefited savings by about Rs 50,000 in the last budget. And the question is, is there room for more, primarily because the real tax benefit has fallen over time because that limit was at Rs. 1 lakh for a long, long time. So maybe what we have to do is increase that. Final point, that one should not diminish the role played by lower inflation in increasing real disposable incomes and thereby giving people more of an ability to spend but also to save and I think that could also play a part in savings. Finally the shift between real assets and financial assets will also play a part as financial assets become more attractive.

**Nikhil Gupta:** My second question is, according to Dr. Urjit Patel Report, medium term inflation target is 4% (+/-2%). Now currently we are at 5% to 5.5% target. I mean we have had an average inflation of almost 9.5% in the past 7 years. So if we go by the inflation index, we have had huge inflation in the past few years. So would not it be nice to have a lower than target inflation for

some time before trying to boost the demand. I mean, in simple terms what I am trying to say is, would not it be wise if we see an inflation of lower than 4%, somewhere around 2% to 3% to be sure that okay we have reached sure short disinflationary trend, and probably 4% is within our reach?

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

**Dr. Urjit R. Patel:** Firstly you know, I think sort of inter-temporal substitution of inflation rates is not a valid economic policy making metric. But on a more serious note – I think given where we are in the development cycle, if we were to try to get inflation below 4%, firstly the basis of anything below 4% needs to be established. Assuming that there is, we run a risk of deflation actually, and given our development needs and the need for further growth, and 4% has been recommended. The advanced economies are at about 2% and we have a productivity differential of about 2% on average. And that is one of the primary basis on which the 4% has been reached. So I think that is defensible target with a range of + or -2% and I don't think we need to revisit that because we have had higher inflation in the past few years.

**Dr. Raghuram G. Rajan:** I think the thrust of your question seems to be coming from some kind of a price level targeting, and given that we have exceeded sort of notional targets before, we should adjust now on the downside. But I think Urjit makes a very good point - when the world is in deflation flirting with zero or close to zero on our side, we may enter complications we don't want to deal with. But also I think the extent of disinflation we may need to engender from where we are, given the current growth scenario, I am not sure that the economy is prepared for that. We have to bear in mind that as an emerging economy disinflationary paths have to be more smooth rather than abrupt, because the ability of our institutions, our corporations, etc., to handle abrupt disinflation with substantial growth changes may be more limited as also our people. People who are unemployed don't have the kind of safety network that people elsewhere have and therefore we should avoid abrupt changes in economic growth.

**Alpana Killawala:** We will take the last question, Shyma.

**Moderator:** The next question is from the line of Indranil Sengupta from DSP Merrill Lynch.

**Indranil Sengupta:**
**DSP Merrill Lynch** I had two questions, number one, when we talk about real rate, we get a fairly different answer if you look at the real lending rate in terms of let us say the WPI inflation which really reflects the pricing power of corporates. So how do you marry that with the real policy rate, which is based on CPI? Second question, given that the optimal threshold CPI largely works out to 6.2 to 6.7%, should we be targeting anything lower than that for now, given that we are at this kind of a stage in the cycle?

**Dr. Raghuram G. Rajan:** I don't know what you mean by optimal threshold CPI?

**Indranil Sengupta**: What the Patel Committee has as threshold CPI inflation.

**Dr. Urjit R. Patel:** I think this issue of real interest rate and what index to use, from the RBI side we are fairly settled that headline CPI is what we would use for policy and for calculating the real interest rate and this would be of the nominal policy rate. So we are not going to confuse matters by talking about WPI in this context. On the second bit, what we have in the report is work carried out by the RBI over a number of years, that beyond 6% inflation growth actually suffers and that is the threshold. But that does not mean that the optimal level of inflation for growth is 6%. So I don't think that the reading of the threshold analysis that we have done is consistent with your interpretation.

**Dr. Raghuram G. Rajan:** Let me add something there, which is that in a sense if you think about traded goods companies, you may argue that WPI containing more traded goods is the appropriate measure of inflation for the kind of prices they will receive. And so for those it may seem that the real rate is much higher, and for savers, CPI may be the appropriate inflation rate. So there is a differential between these. CPI includes services, so service companies may prefer CPI. So the point is different parts of the economy may see different inflation rates. The solution is not to keep altering what we look at in terms of inflation rate, but to try and converge the inflation rates at a low and sustainable level. And that is one of the reasons why I have been saying we need to bring down inflation because the saver is not going to save if you try and target policy rates at what the corporations want. But if you keep it at what the savers want, then the corporations may not have adequate incentive to invest, and the real way to bring them both much closer is to bring down inflation which is what we are engaged in.

**Alpana Killawala:** That would be it from our side, Shyma. Thank you very much for joining in.

**Moderator:** Ladies and Gentlemen, with that we conclude this conference call. Thank you for joining us. You may now disconnect your lines.