"Reserve Bank of India Post Policy Conference Call for Researchers and Analysts"

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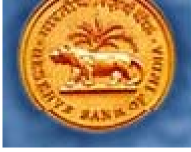


Moderator: Ladies and gentlemen good morning, good afternoon, good evening and welcome to the Reserve Bank of India's Post Policy Conference Call for researchers and analysts. As a reminder for the duration of this conference all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. To ask a question you may press * and 1. If you should need assistance during the conference call please signal an operator by pressing * and then 0 on your touch-tone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Alpana Killawala from RBI. Thank you and over to you.

Alpana Killawala: Thank you Melissa. Welcome to this Reserve Bank of India's conference call with the researchers and analysts. We have here Governor Dr. D. Subbarao, Deputy Governor, Mrs. Gopinath, Dr. Chakrabarty and Dr. Gokarn. We are expecting Mrs. Thorat, the fourth Deputy Governor to join in through the telephone very soon.

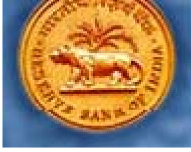
In the meanwhile I will request Governor to read out a brief statement on yesterday's policy and then we will begin the questions and answers. Governor.

Dr. D. Subbarao: Thank you. Hi I am Governor Subbarao, I want to say hello and good afternoon to everyone including all our listeners. This is the second conference call we are doing with researchers and analysts. The one we did after our January policy review was very rewarding and useful for us so we look forward to this conference and we really look forward to what you have to say on the nuances of the policy.

After the policy announcement yesterday we issued a press release and I want to take this opportunity just as a curtain raiser to summarize what we said in that statement. In India economic recovery, which began around the 2nd Quarter of 2009/2010 has since shown sustained improvement. Industrial recovery has become more broad based, exports & imports have been expanding since October and November 2009. Flow of resources to the commercial sector from both bank and non-bank sources have picked up and business optimism has improved. On balance, under the assumption of a normal monsoon and sustained good performance of the industry and service sectors for policy purposes we have projected real GDP growth for the current year 2010/2011 at 8% with an upside bias.

The developments on the inflation front of course are worrisome as we have said repeatedly in the press conference yesterday. Headline WPI inflation accelerated from 1.5% in October 2009 to 9.9% in March 2010, that is last month. What was initially a process driven by food prices has now become more generalized with non-food inflation contributing more than 50% of the WPI inflation. Non-food manufacturing inflation accelerated from (-0.4%) in November to 4.3% in February and further on to 4.7% in March. Going forward 3 major uncertainties cloud the outlook for inflation 1) The prospects for monsoon in 2010/2011 are not yet clear. 2) Crude prices continue to be volatile. 3) There is evidence of demand surge pressures building up. On balance keeping in view domestic demand-supply balance and the global trends in commodity prices the baseline projection for WPI inflation for March 2011 is placed at 5.5%.

As far as the risk factors go, we have listed them and discussed them extensively in our documents, but just for ready reference, I)



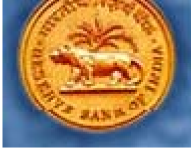
There is the uncertainty persisting in global macro economic environment. II) If the global recovery does gain momentum commodity and energy prices may harden further which could add to inflationary pressures. III) Any unfavorable monsoon rainfall pattern could exacerbate food inflation and dampen rural consumer and investment demand. IV) Large capital flows will pose a challenge for exchange rate and monetary management.

We had extensive media interviews yesterday and today and we read what's come out in the media this morning in the print media and the commentary on the electronic media. One strong, one dominant view, the big question that has been asked of us has been that our action should have been stronger than it actually was, because of potential inflationary pressures. Of course there are a few people, minority who have said that action should have been softer than it actually was because growth is not firmly established. What people have said depends really on where they are coming from on their judgment of the growth-inflation dynamics. In the Reserve Bank we calibrated our policy obviously in accordance with our understanding of this dynamics but we looked forward to really what you have to say on the growth inflation dynamics going forward and whether we are actually behind the curve as some commentators have said. Many thanks, over to you.

Alpana Killawala: Thank you Governor. Melissa can we have questions now.

Moderator: Thank you. Ladies and gentlemen we will now begin with the question and answer session. The first question is from the line of Srinivasan Varadharajan from JP Morgan, Mumbai. Please go ahead.

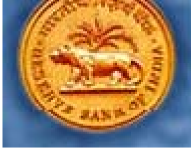
Srinivasan Varadharajan: Hello to the distinguished panelists, I have the following questions for you, first one is as follows, it was indicated in the



policy that the real policy rate is negative, to the extent that the Rupee has appreciated by close to 5% in nominal terms and more so in real terms. Would you agree that at the margin this has actually tightened monetary conditions and therefore a stronger interest rate response might have not been warranted? Was this is a factor in the deliberations that you had? The second question that I have is that in the policy it was indicated that the market will have to face up to issuances of 36% this year. Obviously this is predicated on a lower headroom from MSB desequestering as well as OMO purchases for this year. My question is in the event as we progress in the year we do not see strong capital inflows, would that mean that the Reserve Bank could be open to OMO purchases to augment reserve money to meet its M3 objectives? And how would you balance this, if this scenario folds out, kind of comes up with inflation. And the last question is on inflation. Steel and cement prices have moved up pretty significantly since November and the same is not getting reflected in the WPI. What is your response to this and has this been taken into account while calibrating policy? Thank you.

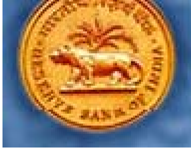
Dr. D. Subbarao: I am going to request Subir to answer the first question.

Dr. Subir Gokarn: Thank you, well the short answer is clearly the appreciation did enter our calculations in terms of what the growth-inflation dynamics are going to be. We have stated in the policy document that our policy on exchange rate is essentially to control volatility but also to be watchful of potential macro economic impact. But as you yourself observed, there has been a steady appreciation of the Rupee over the last few well last couple of years, back and forth. And this clearly has some impact on the cost of imports. Domestic producers are raising concerns about this, but from an inflation management perspective it is a factor. But we also need to keep in mind that since a lot of the inflation and we are saying roughly 50%



of inflation is still being driven by food prices. Imported food is not a particularly viable option in today's conditions, for some products because there are not enough global supplies to make very much difference, for others because there are also inflation pressures in global markets. So in that sense the anti-inflation/deflation if you will component of the exchange rate, impact of the exchange rate is really restricted to the manufacturing sector. So it was a factor in our calculation but I would not say it was a dominant one.

Dr. D. Subbarao: On the second question that you have asked about government borrowing program and the impact it might have or the impact capital flows might have on that, I thought the answer was embedded in your question itself, which is that yes government borrowing program this year in net term is lower by the measures of fresh supply of paper is 36% higher, the numbers are all out there. There are more challenging circumstances surrounding the management of the government borrowing program this year. We have mentioned them in our policy document. The capital flow is an additional dimension. Yes if capital flows come in and depending on the exchange rate and depending on other conditions in the macro economy, we may have to intervene at the appropriate level and that I cannot say anything at this point of time. But we have assured yesterday and I want to assure once again that we will have adequate liquidity in the system both for government borrowing and for private borrowing that needs to be met. Your specific question was whether we will resort to OMO. That possibly will be the last option, because we cannot be sucking up liquidity through CRR and all that and in parallel infuse liquidity through OMO. I do not foresee such a contingency at this time. There was a third question on steel and cement prices and whether they might accentuate demand side pressure. Indeed they will and we have taken that into account to forward projections on demand side inflation, but the



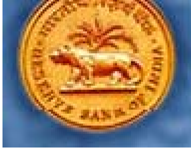
expectation is that our monetary policy is also supportive of growth and investment will pick up and supply will come in, in order to meet the growing demand. Thank you.

Srinivasan Varadharajan: Thank you very much.

Moderator: The next question is from the line of Sujan Hajra from Anand Rathi Financial Services, Mumbai.

Sujan Hajra: Hello sir, thank you for taking this session once more this time after the policy. My question is in the context of infrastructure funding by banks. If I may point out three relevant points here. First of all, what we are seeing recently that the CASA share at the systemic level for the banks is something to the tune of 35%. The share of Fixed Deposits up to 2 year maturity, that is, 2 years and less, is almost 70% in overall current deposit of the banks. And so basically on the liability side, banks have a very huge share of short term liabilities but on the asset side, we are seeing the share of infrastructure increasing very fast in the last 3 years as a percentage of outstanding bank credit. It has jumped from less than 8% to 13%. So do you see a possibility of asset liability mismatch especially in the fact that RBI has given certain dispensations in the current policy to induce banks towards more infra funding. Thank you sir.

Shyamala Gopinath: As you mentioned that banks have a very high CASA, around 35%, and that itself provides a lot of support for the infrastructure funding. And even though duration of short term deposits is around 2 years, like what you mentioned, at least in the case of a large number of banks which depend on retail deposits, these deposits are pretty sticky and they keep rolling over and they get renewed. So in that sense a sizable portion of the deposits could be a part of a core deposit base or a stable deposit base. But we do recognize that banks could run into ALM mismatch and in fact in yesterday's



discussions with the bankers this was actually taken up as a single issue for discussion. Banks are conscious of ALM mismatches and what we think could really happen in these markets is that securitization and take-out financing would be really products that can deal with the ALM mismatches of the banks. Because the initial project risk has to be taken by the banks and then the markets can take over these risks. Thank you.

Sujan Hajra: Thank you very much Ma'am.

Moderator: The next question is from the line of Ramya Suryanarayanan from DBS.

Ramya Suryanarayanan: Good afternoon everybody. My question is about inflation. I wanted to understand better how the RBI looks at the inflation data and clarity on the forecast for 2010/2011. The year-on-year inflation whether it is for headlines or some measure of underlying inflation will fall due to basis effects anyway. So I mean one does not worry about inflation when it is rising due to base effect. I mean we adjust for it when we estimate where exactly inflation is. So likewise now that inflation is expected to ease in year-on-year terms, will the RBI pay attention to that while estimating underlying inflation? In other words, it is good that the RBI is looking at underlying inflation rather than just headline inflation but will the focus also be on what the sequential rate of inflation is as opposed to year-on-year that is influenced by base effect? That is one part of the question. The other is, will the RBI consider announcing annual average inflation forecast instead of end period. As end period forecast does not reflect the average level of inflation through the year. I mean specifically for example the inflation forecast of 5.5% at end March 2011, I am not sure what is the path there because it seems to imply

an annual average inflation for 7.8% which is pretty high. That is all. Thank you.

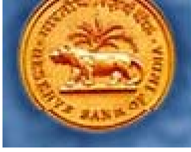
Dr. Subir Gokarn: Well to answer your first question, yes we do consider a bunch of underlying parameters, underlying components. The projection that we put out in the document is for headline inflation in March 2011 which is 5.5%. But in our consideration of inflationary dynamics we are looking at the aggregate; we are looking at various components; we are looking at how the distribution across components is changing over time and that is why we have been talking about non-food manufacturing inflation. And the number that we have, its contribution to inflation has risen from virtually nothing to around 50% in the last 4 to 5 months. We also look at the seasonally adjusted month-on-month numbers when we are doing our internal discussions. And of course the CPIs and what is driving them is also brought into consideration. Actually it is a bit messy if you have to report forecasts on all of these things. So given that most of the focus in the public disposal is on the headline rate, that is something we have chosen to put out a projection on. But our decisions and our actions are based as much on the underlying drivers. I would press more on the underlying drivers. And in the current context we are focused on what we would consider representative of demand side pressures which is the non-food manufacture inflation which, as we pointed out, has started to rise and that has been a factor in our decision and we will of course continue to track this both on a year-on-year basis and on a month-on-month basis to get a sense of where it is headed and further considerations will be driven by this. Now in terms of reporting, it is an ongoing discussion we are having in terms of what is the best measure to report. We have a number of alternative core measures internally which we bring into the discussion. But again there is a trade off between clarity and detail here. Maybe there is room for improvement in the way we disclose

our projections and we will take into account, you are not the first person, to suggest this average reporting. We will take that suggestion into the account. But as it stands, if you look at Chart #2 in the policy document, you do have an implied trajectory there. So I guess that is what you are using to calculate the 7.8% and that is essentially what we are going out with. We will look at ways to improve our communication on our inflation projection.

Ramya Suryanarayanan: Okay thank you very much.

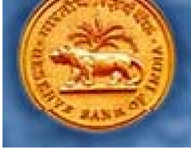
Moderator: The next question is from the line of Rajeev Malik from Macquarie, Singapore.

Rajeev Malik: Thanks a lot Governor. Thanks again for this opportunity and my compliments on this effort, because I do know you and your team, both would have many other things. I would only warn you. Be prepared to hear from other central banks in the region who might be writing to you for forcing them to follow your footsteps on this. I have three simple questions. One, which I think was, to some extent, alluded to in the answer to the last question. You know, given the fact that in its communication RBI is stressing non-food manufacturing inflation a lot more, also with the realization that there was very little it can do on the food front. Why not actually announce a forecast for that rather than just the headline WPI. Secondly, in the policy statement as a reference to neutral rate being negative, I just want to understand - and I would not ask you what that neutral rate is, because I know you would not tell me - but more in terms of that we understand exactly that do you mean it is the non-inflationary trend GDP growth rate for India or is there some other matrix or definition that is being implied. And finally, we have seen two rate hikes come through and the width of the last rate corridor has been unchanged; should we assume that that is going to



be a standard practice or it could change as and when things warranted. Thanks very much sir.

Dr. D. Subbarao: Okay Rajeev, many thanks for those very searching questions. On whether we should announce non-food manufacturing inflation as we have for the headline inflation, I would revert to Subir for that. On your second question about neutral rate, in fact we picked it up from you analysts who have been talking about our need to reach the neutral rate as soon as possible and I have enquired with our staff here, our economists here. They told me that neutral rate is the rate that is consistent with potential output and low and stable inflation. But again, I understand that this is a textbook concept, more applicable to mature economies and not to an economy like that of India which has huge growth potential, huge room for improvement on productivity, on efficiency and the demographic dynamics. And that it is not an observable construct in India. Having said that, I believe there is an IMF study of January 2010 perhaps (done) as part of their Article IV, I do not know, where they have said that the neutral rate is or the effective rate - which at that time was the reverse repo rate - that is 200 basis points below the neutral rate. So if you take that calculation, the neutral rate should have been about 5.25% and if you take the 75 basis points corridor on either side the rate could be 6% on the upside 4.5% on the reverse repo side. I am also told that if you take the range that our rate succeed during the time when the economy was set to have been overheating the repo rate was 9% and during the depth of the crisis the repo rate was 4.75%. So the neutral rate would be approximately somewhere in between there and I believe that is what everybody, I think that tallies with the estimates of most. Now over to Subir for the first question.



Dr. Subir Gokarn: I think my answer is the same as it was for the previous question which is that yes we are looking at ways to improve our communication on our inflation outlook particularly with respect to the components of the index that we have some influence over. And so the headline number tends to mask that influence, it tends to suggest that we have influence over the whole index. But when you bring the food component into the equation really we do not. So it is something that is under consideration. We will look at the best way to do it without raising further or creating more or more confusion we want to be very clear as to the effectiveness of our communication when we decide to do it.

Dr. D. Subbarao: Can you please repeat your third question, I have not got it.

Rajeev Malik: The third was just in terms of the width of the LAF rate corridor that we have seen two rate hikes and both rates have been moved which is the way I will think it should be but in the past that is not necessarily been the case. Is it fair to assume that that discipline will be maintained or it could once again be one or the other depending on how things evolve?

Dr. Subir Gokarn: I think the safe answer to that Rajeev is the second which is everything depends on how things evolve so make assumptions that your own peril, I would say.

Rajeev Malik: Sure, okay, thank you very much.

Moderator: The next question is from the line of Mridul Saggar from Kotak Securities, Mumbai.

Mridul Saggar: Thank you everybody for giving us this opportunity. In essence my question is an extension from where Rajeev Malik was saying in terms of the neutral rate. In terms if the neutral rate is anywhere

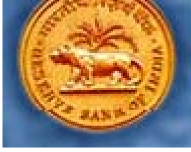
between 5.25% or 5.5% apparently there is a catch up and in that sense what could be the path for that catch up given that the estimate of growth put out in the policy is 8% with an upside bias. So if we do a Hodrick-Prescott calculation, the potential output growth comes to more like 7.5% and so in some sense you are just about potential now. So apparently would that mean that through the baby steps that we are talking about, we would be catching up with the curve over a period of a year or two? And meanwhile if real interest rate stay negative and they do seem a bit too negative in terms of the policy rate being negative by almost like -11% or a 10-year G-sec being negative by -7%, then what are the risks attendant to this?

Dr. D. Subbarao: On the question where you asked that how long will it take to catch up with the curve and what is the path for catching up will be, it is not even clear that we are behind the curve. But what is certainly clear is that we have to reverse further from our expansionary stance and we will do it over the course of the next few months. May be, I cannot really say whether that number of months will be 12 or more than 12 or less than 12. But again it will be inappropriate and difficult for us to speculate on the path of reversal of the expansionary stance, but we will do it consistent with the macro economic situation.

Mridul Saggar: Thank you very much.

Moderator: The next question is from the line of Indranil Pan from Kotak Mahindra, Mumbai.

Indranil Pan: Good afternoon and thanks for giving us the opportunity to interact with your team. The question is not directly related to yesterday's policy action, but what I intend to ask is the communication in the policy about the inflation, medium term inflation target. Now given



the fact that globally food supply chains are becoming quite weak and demand on the other hand is becoming strong. And especially in India we have a policy perspective like the NREGA operating to boost up the demand. Would it not be the correct stance from the Reserve Bank of India to sort of look at the medium term inflation higher than what it generally had been looking at; may be at around 5% to 5.5% rather than a 3% to 4% corridor that has been mentioned in the policy. And in this sense what in the Reserve Bank's opinion is the definition of the medium term? Thank you.

Dr. Subir Gokarn: I think you are really raising the issue of relative price changes. It is possible that there is going to be a structural increase in global food prices as a result of changing demand patterns and some slowdown in productivity growth, which itself could possibly be reversed if conditions were right. But on the other side of the index, clearly we must also allow for productivity changes, positive productivity growth in many other sectors. So when you average out the two, I think it is not entirely right to say that food price will go up while everything else remains constant. So I think it is quite reasonable to accommodate medium term target. I would not call it a target of course, it is more of an aspiration. It is sort of a medium term scenario, trend growth and low inflation that we are trying to describe. But even though relative prices may have changed, the average rate of inflation may still remain the same. So I think that is the reason, the context in which we are looking at the medium term and we are looking at this from an historical perspective as a steady decline in the average inflation rate, we have cited in the document the trajectory of inflation from the 1990s into the 2000s and that's how if you average out the short-term fluctuations there is indicative steady decline and that is the sort of path along which we would like to move. But let us not underestimate the benefits that the economy will get from continuing and very large productivity

improvement in a variety of sectors which could well offset the food part. So since it is not a target, this is not a mechanical exercise, but it is something that we think the trajectory will move forward even if relative prices within the baskets change.

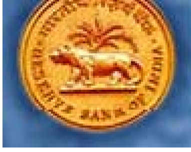
Indranil Pan: Thank you very much Sir.

Moderator: The next question is from the line of Sonal Verma from Nomura, Mumbai.

Sonal Verma: Hi, good afternoon, I have a question on liquidity. Can we expect reverse repo rate to remain the operating rate throughout fiscal 2011 and under what circumstances would the RBI move the systemic liquidity into a deficit such that the repo rate becomes the binding rate corridor? Thank you.

Dr. D. Subbarao: Okay. That is a very succinct question. No, we cannot assure that the reverse repo rate will be the operative rate. We will of course manage liquidity. Ideally we would like the operative rate to be in the middle of the LAF corridor. But that is difficult to maintain at that level. So we would ensure that the call rate is within the LAF corridor but it is not clear that we will definitely maintain it at the reverse repo level. And the second part of your question about liquidity, yes we will monitor liquidity to make sure that there is enough there both for the government and for the private sector. There could be variations on the day-to-day basis, on a week-to-week basis but I note that over time our ability to monitor liquidity has improved and that should improve our management of liquidity in the system. Thank you.

Sonal Verma: Thank you.



Moderator: The next question is from the line of Nilesh Shah from ICICI Prudential, Mumbai.

Nilesh Shah: Good afternoon sir, it is pleasure listening to you. The market probably is viewing inflation in a different context and could we take a view that probably RBI is taking a slightly different part of tackling inflation compared to its previous stance of raising rates, curbing liquidity and curbing demand. On the other hand now probably it is trying to keep liquidity, keep rates low and trying to create supply side mechanism to control inflation?

Dr. D. Subbarao: Yes that is one way of paraphrasing our policy stance because I recall that I have said in answer to an earlier question that there are concerns from some analysts that the action should have been stronger, that demand pressures will be so overwhelming that we could have a hard landing. We are sensitive to the possibility of a hard landing and we will do everything possible to prevent it. And the way we have calibrated our action yesterday and we will calibrate down the line, we will wait to see that there is sufficient liquidity to meet both, private sector and government credit demands. Thank you.

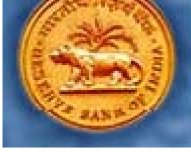
Nilesh Shah: Thank you sir.

Moderator: The next question is from the line of Shishir Shindekar, an individual from Nasik.

Shishir Shindekar: Hello, good afternoon sir. Governor thanks for arranging such programs and such calibrated exit or slowly tightening policy. I am Shishir Shindekar calling from Nasik. My question is on the backdrop of rising government borrowing programs, rising foreign capital flows, rising gross fiscal deficit in interest rates and expected

rise in oil prices, how you will address the inflation and crowding out in future?

Dr. Subir Gokarn: All of these are expected, not all of them are facts in front of us, so we have a scenario where some or all of these things may happen. But it is difficult often to act in anticipation of something because if that outcome does not materialize and the action you have taken tends to be the wrong action, it could do damage. Now our concern here is threefold. We want to sustain the recovery, and we want to give it as much support as possible. At the same time we do not want an accelerating growth rate to start putting inflationary pressure, start creating inflation pressure in the system. And we do have a government borrowing program which cannot be allowed to disrupt financial market. So in trying to find a balance between the three broad objectives we have come to conclusion that moderate action on rates and liquidity provides us the best prospect of meeting all of these obligations. There is a further problem or possibility of high capital inflows that has not materialized yet. As I said, if and when that happens - a lot of people are telling us that it will certainly happen but it has not happen yet. And so I do not think we can take preemptive action in anticipation of that happening. Let us wait to see whether the trend is firming up before we act. And on oil prices again it is a risk. We have pointed it out in our policy statement that one possible downside from faster than expected global recoveries is that oil prices will firm up and that may not only provoke or simulate inflationary pressures in the economy but also may have a fiscal implication because the subsidy bill may go up, if the government chooses not to pass on this increase to consumers. So there are number of unknowns in the environment and we cannot take all of them into account. We are aware of them, we are keeping watch on them but we act on the basis of what we know.



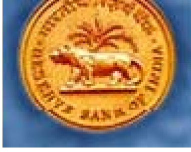
Shishir Shindekar: Thank you very much sir.

Dr. D. Subbarao: I just want to revert to the earlier question, I think there was some transmission failure. The question of Nilesh Shah about what our strategy is to avert an overheating of the economy, I was saying that we are alive to the possibility of overheating and we will do everything possible to prevent that. And our approach to preventing that is to act from the supply side to make sure that investment is supported. So as demand is increasing supply catches up or is indeed ahead of demand so that we do not have overheating. Sorry that we lost transmission at a point of time, thank you.

Shishir Shindekar: Thank you sir.

Moderator: The next question is from the line of Devika Mehndiratta from Credit Suisse, Singapore.

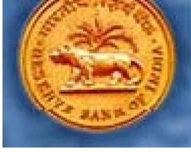
Devika Mehndiratta: Good afternoon Dr. Subbarao and Deputy Governors, thank you so much for taking the time to speak with us. I have two questions. The first one is, you mentioned and a lot of analysts say that real policy interest rates are very negative. And that is true. And so the argument is made there is as a result we need to hike policy rates quite a bit. But sometimes I wonder do not you think that there is a danger of over exaggerating the extent of looseness of monetary policy by looking at the short-term policy rates? Should we be looking actual bank lending rates, lending rates for corporates especially did not come down much and if I were to look at those I think it is likely that banks credit is anyway picking up and with RBI hiking policy rates could we end up with bank lending rates say in a year's time that a back to levels or even higher than what we had seen in the so-called overheating phase of FY2008. Just more generally how do you judge, how expansionary or contractionary policy rates are. My second question is that on banking liquidity



recently we have seen the reverse repo rates come down. Specially yesterday. Is the extent of decline in line with what you were expecting and in your view is this primarily driven by say pick up in bank credit and do you think it's good if on its own, that is, even without RBI's taking any action, could liquidity on it's own tighten significantly? Thank you so much.

Dr. D. Subbarao: I am going to request Dr. Chakrabarty, one of our Deputy Governors to please respond to these questions.

Dr. Chakrabarty: When we are talking about policy rates and the bank lending rate, transmission mechanism is generally weak. And more so in a country where the market is not well developed. In fact even if the policy rates are high, it will give the savers a lower rate then banks can have a lending rates low. Also in our country the savers are not having any other opportunity that is one reason. So theoretically lending rates still can remain low. Now, I do not know how is the lending rate here. Lending rates are definitely lower than the market related rate, if you have seen the informal market what the rate is. But there is lot of cross subsidization. When we are saying that corporates are getting lower rate, even agriculturists are getting the lower rate. May be through the monetary resources. So it is very difficult at this stage. But we feel that our base rate system and which you must have seen we have mentioned in the policy, if this is introduced, it will respond to the changing in the policy rates more appropriately and may be sometimes volatility in the lending rates will be less. Lending rates also is a function of the liquidity. How much is the liquidity is available. So long as, as Governor has already indicated and we are indicating in our policy, that we will ensure that there is enough liquidity in the system, I do not see a lending rate going beyond a particular limit. Banks have already given enough indication, immediately they are not going to increase



the rate, but yes there will be some hardening of the rates. But this will be within the manageable limit and the OVER subsidization of the corporates will definitely be less and we will see that it will be more homogenous rate across the smaller borrowers.

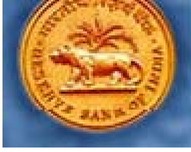
Moderator: Thank you. The next question is from the line of Kumar Rachapudi from Barclays Capital, Singapore.

Kumar Rachapudi: Thank you sir for the opportunity. I just wanted to ask you about, does RBI have in mind any incremental credit deposit ratio to monitor given the fact that credit growth and government borrowing compete with each other for liquidity. Does RBI have any C-D ratio in mind to kind of be aware of?

Dr. D. Subbarao: Shyamala.

Shyamala Gopinath: Yes, thank you sir. We always say that the RBI does not just look at one indicator. We do follow a multiple indicators approach. And the C-D ratio and the incremental C-D ratios are always within our range, in terms of assessing the credit expansion, the extent of reliance on wholesale funds for expanding credit and these two indicators have always been important indicators and we invariably comment on them in our discussions with the bank as well as in our inspection reports. And it is a very important indicator in our assessment of the ALM mismatches in the banks and assessment of overheating or excessive credit to particular sectors. So these are important indicators but we do not have any targets as such. It depends on individual bank's asset liability profile as to what type of incremental credit ratio can be risky for that bank. So it is really a bank level discussion that we have, I mean we use these ratios at that time.

Kumar Rachapudi: Thank you.



Shyamala Gopinath: I hope you are satisfied.

Kumar Rachapudi: Yes, thank you.

K C Chakrabarty: See it is available in the policy. If our deposits are growing by 18% and non-food credit is increasing by 20%, mathematically you can work out what will be the incremental C-D ratio and that is already inbuilt in the policy. And it should be around say 70% if you approximately work out. So we take this for the system as a whole. What Madam is saying, individual bank wise we don't plan but system as whole we definitely plan for that.

Kumar Rachapudi: Okay. But then the follow-up question for that would be if the C-D ratio is as high as let us say 90% or 100% then will RBI kind of be worried?

Shyamala Gopinath: Actually the C-D ratio cannot be 90% or 100% given that we do have CRR and SLR. But certainly if the incremental credit deposit ratio is 90% and 100%, the Reserve Bank does get worried and you will recall that in our earlier policy statement we have highlighted that the banks' incremental C-D ratio is high and it is a matter of concern and we had told the banks I mean even for the system as a whole that they should concentrate on mobilization of retail deposits rather than relying on interbank resources or other wholesale funds.

Kumar Rachapudi: Thank you.

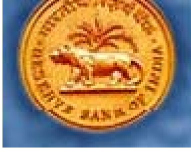
Moderator: The next question is from the line of Jeetu Punjabi from Capital Group, Singapore.

Jeetu Punjabi: Thank you Governor and the team for this opportunity. I have two questions. The first one is around your FX policy and as you have highlighted it as well, we have not seen the central bank really intervening in the FX markets on a net basis over the last 9 months.

But my assumption is, this probably is coming to an end in the context of one, the Renminbi peg to the Dollar, being the relative prices hit a point where you cannot just do nothing and the second, the MSS coming into play. So you probably expect some intervention going forward. Is that a fair framework? The second question broadly is if you were to build the scenario where the capital flows in the scale of 2007 multiplied by 2, which is about $200 billion, coming to the country, how should we expect policy response to that?

Dr. D. Subbarao: You know Jeetu I wish I could give specific answer to your question as specific as your questions have been. But that is not possible. On the first question about what our foreign exchange intervention policy might be, I only want to say that we will continue our policy as in the past. We have intervened in order to manage volatility and in order to prevent disruptions to the macroeconomic situation and we will follow the same policy. In fact because a number of people have raised this question we have restated the policy in our document. Similarly on capital flows, you have said what if $200 billion come. First of all in the Reserve Bank we get widely varying estimates about what the size of the capital flows might be, what the nature might be and when they might come. If indeed they are going to be $200 billion and given that GDP and current account deficit, GDP has not grown so much in the last few years. And given that current account deficit will not be able to absorb $200 billion of inflows, we may have to intervene at that point of time depending on the macroeconomic situation. I cannot at this time comment on that. Thank you.

Jeetu Punjabi: Thank you very much.



Moderator: The next question is from the line of Rajeev Malik from Macquarie, Singapore.

Rajeev Malik: Thanks. Sir, I just wanted to build on that particular question a bit. One of the interesting things where India stands out compared to many other countries in the region is really in terms of the absorptive capacity. And I think unlike the last episode when there was a surge in capital inflows, this time around there seems to have been, at the margin, a bit of an improvement. Is it something that RBI, along with the government or the government more so, is trying to do more or is it the sense that the pace of that improvement is really still not as much as it should be?

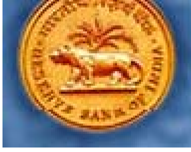
Dr. D. Subbarao: You mean in terms of widening the current account deficit?

Rajeev Malik: No, just in terms of enhancing the absorptive capacity. I mean the current account size would be a very crude measure of that, but not necessarily the case that you could have a wider current account deficit. But that could still be a reflection of things going far faster than underlying supply side might dictate?

Dr. D. Subbarao: Yeah, there is no doubt about it. There was a conference on infrastructure last month in Delhi. I could not attend that but one of the big issues that was talked about in that conference was how to actually improve, accelerate project implementation. First of all we need accelerated improvement in implementation of infrastructure projects, but that also helps in absorption of this pool of investable resources that are coming our way. So that is certainly on the top of the priority list of the government.

Rajeev Malik: Thank you very much.

Dr. D. Subbarao: Does that answer your question?



Rajeev Malik: Yes, thank you very much.

Moderator: The next question is from the line of Jatinder Agarwal from RBS, Mumbai.

Jatinder Agarwal: Good afternoon sir. Just one question on the corporate loan segment. As a part of the normal procedure that RBI does in terms of its audit, do you also look at lending terms that banks follow in general, say, in this period compared to probably what it was six months back. By lending terms I would mean by debt covenants, much more relaxed debt covenants compared to what it was probably six months back?

Shyamala Gopinath: I do not know why you are referring to the six months period because the banks too follow an appropriate credit appraisal methodology for all corporate loans. Probably your question really relates to the liquidity and the short-term lending that the banks are doing. Is not it because otherwise, I mean they have, they always looked at their credit appraisal systems, in all our annual financial inspections. In fact, how the banks lend? What are the covenants? What is the kind of due-diligence they do? It is very important part of our inspection and we do discuss with the banks if we find any relaxation or any kind of tendency to not to be very rigorous in their underwriting standards. So certainly we monitor the corporate loans including short-term corporate loans given by the banks and we do emphasize that the banks should actually know what the corporates are doing with these short term funds.

Jatinder Agarwal: That is extremely useful, just that we are outsider we do not really get those finer details.

Shyamala Gopinath: Okay it is alright, that is fine.

Dr. D. Subbarao: Thank you for saying that. Alpana, time management. How are we doing and what do we do now?

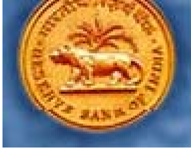
Alpana Killawala: We have about 40 people to ask questions in the queue and we have just 5 minutes left. So may be we can take two more questions and close? And the others who did not get an opportunity, can send an e-mails to us. Yes Melissa, we will two questions more.

Moderator: Sure. The next question is from the line of Sutapa Roy from Microsec Capital, Kolkata.

Sutapa Roy: Good afternoon sir. My question is in case of measuring inflation why we do not consider GDP deflator as a measure?

Dr. Subir Gokarn: Well as I said in response to an earlier question, we consider every measure that we have, whether it is wholesale price index or financial aid components, CPI and its various disaggregations as well as the GDP deflator. But from an operational perspective it is the one that comes last. So as an indicator of policy action or a guide to policy action it suffers the disadvantage that it comes two months and there is also then subject to revisions and so on. So the whole point of having an indicator that to even look at, is the one that comes out with the shortest lag and it is really where the WPI scores because it is the one that comes out at the shortest lag with all its disadvantages. But then it is for us to use analytical techniques to be able to infer broader patterns of, underlying patterns as somebody referred to it, from this one index which actually reflects the kind of dynamics that are going on in other indices as well.

Sutapa Roy: Thank you sir.



Moderator: The next question is from the line of Mahrukh Adajania from Nomura, Mumbai.

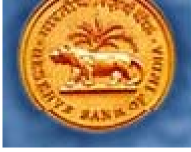
Mahrukh Adajania: Good afternoon everyone and sir thank you very much for sparing the time to talk to us. I just had one question. Wanted clarity on some provision in the policy and this is about the sop given on infrabonds, that is, banks' investments in infrabonds can be classified as HTM. Now would this be bonds only of infrastructure companies or that would also include investment of banks in bonds of infrastructure finance company. Say a bank investing in an IDFC bond or something like that?

Shyamala Gopinath: Yes you are right. I mean we would not actually consider investment in the bonds of infrastructure finance companies as eligible for being held to maturity. It is really the subscription to the bonds of infrastructure companies, that is, companies that are actually executing infrastructure projects that we had given this benefit.

Mahrukh Adajania: Okay, that helps a lot. And sir I just needed clarity on one more issue which may not exactly be referred to in the credit policy document. But banks need to have a provisioning cover of 70%, that is loan loss provisioning cover of 70%, by September 2010. Now, is there a chance of certain banks getting a case by case exemption depending on their progress?

Shyamala Gopinath: Yes, you are right that the banks have different levels of provisioning coverage and in certain cases it might take them a little longer. We are looking at a few cases of these type.

Mahrukh Adajania: Okay. And about the holding company saying this is going to be a long drawn discussion, right? As in terms of the financial holding company. This revival of discussion on those that is mentioned in



the credit policy. It would involve detailed discussions between various regulators. So, any timeframe?

Shyamala Gopinath: Yes of course. I mean as you rightly pointed out that it is not simple issue. It is a complex issue. It does involve discussion with other regulators. That is why we have suggested formation of a group with other regulators too. And there are legal issues and there are several issues and we have to look at the international experience particularly in the US with reference to the holding company. So yes, at this point I think giving a timeframe is a little difficult.

Mahrukh Adajania: Okay, thank you so much, thanks a lot.

Dr. D. Subbarao: We come to the conclusion of this conference. This is Subbarao, Governor. Thank you very much. It has been very useful for us. And I hope you have found it useful. We look forward to continuing this interaction after our every quarterly policy review. And I also want to get your feedback on how we should better structure this. It will be useful for us if some of you, instead of just asking questions, also give some commentary from your perspective on some of the important issues keeping in view of course that they have got to be very brief. Then I also would request your comments on the policy document. We had tried to reduce the size over the last several months. But we need to improve the content and messaging. If you have any views on that, please do feel free to revert to us. Many thanks.

Alpana Killawala: Thank you Governor and the Deputy Governors and other senior officials. The Governor said you can send us comments and suggestions. Please send them to email and we will certainly take them on board. Thank you very much. Thank you Melissa.

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

Questions received through email

Arvind Chari **1. What was the key rationale for the CRR hike? Is the RBI comfortable with around 50k (my estimate) of surplus banking system liquidity? &**

2. Given the 8 per cent GDP growth, 20-24 per cent credit growth, won't this surplus liquidity dry out sooner than expected? &

3. Given that in this year, apart from un sterilized interventions, there isn't much scope for liquidity creation.

RBI The system has been awash with surplus liquidity since September 2008 when the Reserve Bank eased the monetary policy aggressively. Despite absorption of liquidity by 75 basis points increase in the CRR announced in the Third Quarter Review in January 2010, there was still surplus liquidity left. Even after the increase in the CRR by 25 bps, there will still be surplus liquidity in the system. The Reserve Bank continuously monitors the liquidity situation in the system and will take such action as warranted by the evolving condition.