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

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MODERATOR: **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 and good morning to everyone in this Post Policy Teleconference for Researchers and Analysts. The Governor along with all the Deputy Governors and Executive Directors is here. I will straightaway go to the questions. We have received these in advance on the net.

Kaushik Das: Kaushik Das, Deutsche Bank. How many months does it take for a 25 bps cut to transmit into the real economy, in RBI's view?

Dr. Urjit R. Patel: Our work indicates that the transmission lags are of the order of 3 to 4 quarters, and it is a bit faster on the inflation side and possibly a bit slower on the real side depending on where we are in the interest rate cycle, but these things need not be constant all the time but as reported in our work a fair number of times, this is of the order of three to four quarters, give or take.

Kaushik Das: Does RBI consider unsterilised FX intervention as a tool to improve domestic liquidity?"

Dr. Raghuram Rajan: I do not think so, I do not think we manage liquidity through the foreign exchange markets, sometimes there may be situations where we can temporarily take advantage of any interventions we have undertaken to alter the liquidity position take delivery or postpone delivery given the liquidity situation but it is not a long-term or a tool which we rely on, it is more an opportunistic tool that sometimes comes into play.

Naveen Sharma: Naveen Sharma, HDFC Life Insurance Company. Governor in July 2013, while assuming the office you mentioned that RBI would look to find new buyers for Indian sovereign bonds so that it can reduce banks' SLR. However, RBI seems reluctant to increase FII limits in G-Sec and it seems talks on pushing Indian bonds' inclusion in benchmark indices have not moved forward. There is some contradiction, request you to please help us understand this.

Dr. Raghuram Rajan: No, I think the assumption in the question is that only new buyers will be foreign institutions or investors. We have other sources of buying for government bonds, and I think as the Indian markets develop more domestic institutionary investors – pension funds, insurance companies – will start looking at redeploying more of their funds in Indian bond markets. We have to facilitate the way for Indian retail investors also to get in. Furthermore, I think when we look at some of the actions we have taken such as these SLR cuts, people assume automatically that when we cut SLR, banks will no longer be clients for government bonds, and that is not necessarily true. It essentially gives them the flexibility of choice when that choice has to be made. But I think for the foreseeable future we will probably see some excess investment in SLR. So whatever we are doing is in a measured way, we are interested in foreign institutional investors coming into the markets. I had for example, discussions with long-term investors, government investment companies over the last few days who are starting to see some interest in government bond markets, and we are open to an increased presence. But when we are talking about external debt, we have to be careful about the pace at which we do it and what maturities and so on. We I think at this point are fairly comfortable with the fact that there is room in the G-Sec market for more investment from foreign investors, we are also comfortable with the maturity at which they are coming in incrementally, it is at the 3-year plus range and that is a pretty decent level for us to be at. And going forward if those limits fill up, we will certainly examine the possibility of increasing it. We are not in any way against changing it; we just are doing it at a better pace. Finally, we are exploring the possibility of trying to get various systems like Euroclear or Clearstream engaged in India. The important issue we have to consider is whether liquidity stays in India or goes somewhere else, and in order to facilitate the deepening of the bond markets in India, we are looking for finding ways that trading occurs in India rather than elsewhere.

Gautam Singh: Gautam Singh, Spark Capital. The expectations that Fed could raise interest rates sooner than expected led to around 2% depreciation in the rupee in last one month. Assuming inflationary pressures continue to ease more than the RBI's expectations what would be your stance on the monetary policy when the Fed actually starts raising the rates? How would the Fed's rates tightening cycle impact the RBI's monetary policy decisions?

Dr. Raghuram Rajan: This is what one would call a really hypothetical question because I think Fed raising rates is still someway off and the Fed keeps insisting every time when the question is directly put- that its further off than you think. Nevertheless, it is a legitimate question in the sense that would we be driven by interest differentials with other countries in determining the domestic interest rate. My sense is that for the most part we would be driven by domestic conditions rather than external conditions in determining the interest rate. Which is precisely why we are fighting very hard to build inflation credibility, because I think once you get some inflation credibility it gives you a certain amount of flexibility in focusing on domestic conditions rather than trying to act kneejerk towards external developments. So a combination of macro-stabilisation of which inflation credibility is an important component, I think will give us much more room as and when the Fed tightening happens. You want to add to something, Urjit?

Dr. Urjit R. Patel: Only to paraphrase what the Governor said yesterday, that it is very difficult to predict the outcomes of what the Fed actions will be. If you recall that when taper talk first started, US rates were 30 to 40 basis points higher than what they are now and they continue to be at the rates that they are now which is 30 to 40 basis points lower even after the talk on the interest rate hike has gathered some momentum. So it is difficult to predict how much of what has been said by the Fed and what the data says, has already been brought into the information set of the players on the bond markets. And therefore I think it is not very constructive to speculate on what we would do if and when these things happen.

Bekxy Kuriakose: Bekxy Kuriakose, Principal Mutual Fund. What is the RBI's thought process in announcing multiple price led G-Sec auctions recently? Does this indicate discomfort with current rates of on-the-run securities?

Dr. Raghuram Rajan: I think this is one situation where too much is being read into a move. Let me explain what happened. Before the volatility we experienced last year, the RBI was on a multiple price auction system, and there was a feeling here when the volatility occurred that perhaps investors may be more comfortable with the uniform price even though that may lead to perhaps more muted participation and it may also allow to some extent a less efficient, from our perspective, auction outcome. So we moved to that. Now, there is a lot of debate on which system is better multiple price or uniform price. And across the world you have some central banks on the uniform price, some central banks on the multiple price. The feeling here was that we could go to uniform price while the volatility was on, and as the volatility has come down we have been moving back to many of the pre-volatility measures we had. So, for example on the foreign outflows we took a step to move back towards what we had earlier, which is allowing households to send out more money than they could in a period of volatility. So we have been reversing many of these measures and this was one of the measures we reversed. There has been a lot read into this, because it accompanied the new bonds that came in - the 10-year bonds. So I do not think you should read too much into it. We are just going back to a system we had before the volatility; that was a system that was preferred here. Of course, the legitimate question is which system is really better, which helps us create a more liquid market, which helps investors invest more effectively? And as I said the world is split on this, we have to do is more research domestically to look at which system is better and that research is ongoing. So next time we make a shift we will make sure if it occurs, and I am not saying it is going to occur, but if our research indicates some great advantage to one system or the other, we will make sure that we communicate it much more widely before any such shift happens.

Bekxy Kuriakose: The credit-deposit data as per the Reserve Bank's Weekly Statistical Supplement released for the period ended July 11, 2014 shows a significant pick-up in deposits and fall in outstanding credit. Given this, isn't the SLR cut again within a span of two months premature?"

Dr. Raghuram Rajan: Let me take the piece on the SLR cut and then ask Urjit to take the question on pick up in deposits and the fall in outstanding credits. First, people say on the one hand your SLR cut is not going to have much effect because credit pick up is still very dormant, banks are not going to use the space to make loans and that is certainly true given the stage we are at. On the other hand, they say "Oh! The SLR cut will large effects in the bond markets." The two statements do not go together. If banks are not going to increase credit they are going to stay with their current allocations to the bond markets and this will have limited effect. In fact that is our belief that at this time when credit is relatively muted we are not creating too much volatility in any market, either in the credit market or in the bond markets by doing some of these SLR cuts. And that gives banks the ability to anticipate, gives the bond markets the ability to anticipate as and when credit picks up, and therefore price movements would be somewhat smoother than they would be if we did this in the middle of heavy credit season. Now that said I do not think the implication you should take away from this is its going to be 50 basis points every monetary policy meeting. These were two cuts we made because we thought there was room, going forward we will investigate the conditions in both, the credit markets as well as the bond markets and make appropriate decisions at that point. The broader longer term and by long term I am talking about 5-year program, is that we should reduce the amount of preemptions we have in the system including SLR and make a more effective priority sector lending process. We have a committee looking at priority sector lending to make it more effective, but these are necessary changes in the system and should not be seen as tied to the monetary cycle. Urjit.

Dr. Urjit R. Patel: Just to add one bit on the SLR cut I think that we concentrate a fair bit on the aggregate SLR holding by the banking system. But the changes in the SLR also help or help the banks that are at 23% much more, and therefore if those banks need the elbow room to lend more, then they have that all elbow room. While your observation on the SLR holdings at the aggregate level is correct, so actually it is not a policy cut that effects the entire banking system in the same way. The banks that have the elbow room and have the demand for credit will obviously benefit, that is part of the motivation. Credit depends on demand and the fortnightly numbers are fairly volatile, the year-on-year is still lower, and what we are doing is creating the enabling conditions so that supply is not a constraint when credit picks up as we envisage. Firstly, as we move towards the busier end of the fiscal year in this regard and secondly as some of the supply constraints and the government conditionalities and clearances come through for the larger projects, we are hopeful that credit will pick up then.

A. Prasanna: A. Prasanna, ICICI Securities. My question is on RBI's balance sheet and G-Sec holdings. Does the RBI have a policy regarding the reinvestment of maturing G-Secs in its portfolio, and will such policy be placed in the public domain? More generally, is the RBI contemplating providing more information about the composition of its G-Sec holdings?

Dr. Raghuram Rajan: Let me ask Mr. Khan to answer this.

Shri H. R. Khan: Policy of reinvesting the maturing G-Sec per se, the G-Secs we are holding, whenever we do OMO operations, and the OMO operations are linked with our liquidity assessment. So there is no such policy as I mentioned. On the second question, we do publish how much is the G-Sec and how is the oil bond so that composition is available in our balance sheet, so that breakup is available.

A. Prasanna: My second question is on the HTM classification; currently the HTM limit is higher than SLR by 2%. Over the medium-term does the RBI intend to bridge this gap or is there a preference for maintaining higher ceiling on HTM compared to SLR requirements?

Shri H. R. Khan: As we mentioned we had laid out a roadmap last time of reducing the HTM proportion in a phased manner. But immediately after that last year we had huge volatility in the market so we had to put a pause to that. So again since we have found some stability and we need to further improve the liquidity in the market, we have started moving the process. But in what exact measured pace we will do, will depend on how things pan out.

Dr. Raghuram Rajan: Absolutely, I think the message to take away from these moves is not that it is part of a steady every policy meeting measure. It is more that when there are opportunities to reduce some of these constraints, I would emphasise on the banking system and allow for a freer market, we will take them, but there is no predetermined path in any which way.

M. J. Raghavan: M. J. Raghavan, SBI Life Insurance. Why did the RBI leave out the words of June policy document, "On the other hand if disinflation, adjusting for base effects, is faster than currently anticipated, it will provide headroom for easing of policy stance" from the August policy statement? So is it that the RBI will react to a faster than expected disinflation in a different way now as compared to what it felt in June 2014?"

Dr. Raghuram Rajan: No, I do not think so, I think the reason we left it out is the statement seems to have been misinterpreted by the market. Let me read out the first part of that statement in June, "If the economy stays on this course further policy tightening will not be warranted." That is if it stays on the course we would not tighten, but if it does not stay on the course we will tighten. I think that is how you read that first sentence. Second sentence is if it disinflates faster we will be more accommodative, if it does not disinflate faster we will not be more accommodative. I think it was a two-way statement which was conditional on developments on inflation. The market seems to have misinterpreted it first as an unbalanced statement because it thought the second phrase was more pointed than the first phrase. And I can see how that misunderstanding and I have to emphasise, it was some players in the market rather than the market uniformly because a number of players understood what we were saying. But some players seem to think that it meant a bias, and there was no intent of bias, it was a conditional statement and conditionalities can happen on both sides. We thought that we were on the path which we still reiterate. So in that sense the policy statement has not and the policy actions that are intended conditional on developments have not changed since June. I think what is different in this policy statement is that we are closer to the end of the year and therefore we have also emphasised that we have to be thinking about the next phase of the target which is reaching 6%. But in our willingness to be acting on either side depending on developments- that has not changed.

Siddhartha Bhotika: Siddhartha Bhotika from Aviva Life Insurance. When we talk about upside risk, the 6% CPI target for Jan 2016, would it not be fair to construe that policy rates need to be higher (at current assessment, that is) to ensure those risks are roughly balanced? Is the repo rate endogenous or exogenous when we make these fan chart projections?

Dr. Raghuram Rajan: Let me ask Urjit to answer.

Dr. Urjit R. Patel: If you look at the 6% CPI target rate, at the moment we feel that where we are is in line with the glide path that has been guiding our policy since January. But of course as the policy also makes clear, that the incoming data over the next few months, correcting for base effects and other seasonalities will inform the policies going forward. And that is why both the previous policy statement and this one has emphasised the balance of risks on both sides of that number.

Samiran Chakraborty: Samiran Chakraborty, Standard Chartered Bank. Are you comfortable with the flat/inverted yield curve continuing for a prolonged period? If not, how do you plan to normalise it?

Dr. Raghuram Rajan: Our ability to act on the long end of the market is very, very limited. All we can do is ensure that there is adequate liquidity, adequate demand/supply or whatever. But really we cannot really move prices at the long end. What we can do of course is at the short end through the policy rate. So the yield curve is going to be what it is and I do not think we are going to act actively on creating a yield curve. It does of course reflect a variety of issues including demand and supply, including the path of developments in the economy and the anticipated policy reaction that will happen when that path evolves. So I think we are not going to try and affect that. Of course central banks in western countries where there is a certain amount of inflation credibility have tried to guide that through forward guidance and perhaps quantitative easing. I suspect that the effect is more limited than most people conclude.

Saugata Bhattacharya: Saugata Bhattacharya, Axis Bank. India is hopefully entering into a growth upcycle. Rarely has monetary policy been eased, particularly rates cut, during such a phase. What combination of inflation, growth, currency, and financial savings might allow policy easing in the month ahead, if indications are that CPI inflation might sustain around 6%? Will there even be a need for easing?

Dr. Raghuram Rajan: Our first objective is to ensure that the economy disinflates according to the path that we have laid out. If we believe that the path of disinflation will be faster than what we have laid out, certainly, there is a room for easing. We laid out this path because we thought it is something that we can achieve and consistent with reasonable rates of growth. If the economy shows signs of doing it faster, there is no reason why we should not be in a position to cut rates in order to may be have somewhat faster growth, again consistent with the targets we have laid out. On the other hand, if things look much tougher on the inflationary front, we are prepared to raise rates, if need be. Now, as I said again, it is a two-way statement. Our sense is the risks are balanced, but we have to see because it depends on a number of issues which are uncertain at this point, for example, the monsoon, for example, the government actions, a number of which have been promised, some have been undertaken. So a number of things have to happen. And of course every economy is a complex animal, and we have to see how it behaves.

Kumar Rachapudi: Kumar Rachapudi, ANZ Bank. To help us estimate the total systematic liquidity deficit, would it be possible to give an estimate of government cash balances with the RBI?

Shri H. R. Khan: On Government cash balances we have been in discussion with government whether they can release the figure. But as of now they have some reservations about releasing the figures, so that is the constraint. But we are in discussion with government about auctioning their balances. So if and when that happens that will give an indication how much balance they are giving. But the other important point here is that we are in dialogue with government to see that there is some information available to RBI on a real-time basis about how the balances are fluctuating so that we can modulate our liquidity management.

Dr. Raghuram Rajan: Let me also add at this point that on liquidity management, we have said in the policy that we would review liquidity management, and the idea is that we will examine some of the reasons for volatility, and our intention is not to foster more volatility. Some of it is unavoidable, because of fluctuations in balances and demand for cash, but we have to try and smooth that process. Our intent is to keep the call money rate close to the policy rate, and we will come out very shortly with any measures that we think might be necessary to further this process, we are examining what is required.

Dr. Urjit R. Patel: Something that we had mentioned at the press conference yesterday also, that call market volumes have actually come down by about 40% and therefore when you have a thin market you are going to have some volatility. Therefore, I think if you look at some of the other attributes that affect this market. For example, if we have a weighted average call rate or we look at the term repo auction spread, the utilisation of LAF and ECR to required reserves, the number of banks that are participating in this- I think that whole gamut needs to be looked at to determine the condition of liquidity in this market, where volumes are now lower by Rs.16,000 to Rs.10,000 crore.

Alpana Killawala: Would you like to take some direct questions Sir?

Dr. Raghuram Rajan: We can take a couple of questions if anybody has questions after these that we have answered.

Moderator: Ladies and Gentlemen, if you wish to ask a question at this time you may press '*' and '1' on your touchtone telephone. Our first question is from Srinivas Varadarajan of Deutsche Bank. Please go ahead.

Srinivas Varadarajan: Sir, just two questions. In your inflation targeting framework what element of the central bank's reaction function is driven by a monetary policy rule like a Taylor rule and what proportion of it would actually be discretionary? The second question really relates to the household inflation expectations survey that you released yesterday. If one looks at these numbers, the 3-month forward expectations have actually gone up to about 14% and the 1-year is at about 15%. Now if the economy actually begins to disinflate as you envisage but if inflation expectations continue to be sticky, and they have been sticky and rising for the last 4-years, and if they continue to exhibit that behavior in the back drop of labile food and primary article prices, how would the reaction function actually change?

Dr. Raghuram Rajan: The first, while we have a glide path in mind, I would not say we are currently in an inflation targeting framework, but we have many of the elements in place. That said, I think we do look at what kind of policy would be consistent with a Taylor rule. But remember, Taylor rule is just an empirical statement based on behaviour of some other central banks, and we cannot be guided solely by that at this point. There are structural forces changing in the Indian economy, there are shocks which would not exist in other economies. So while it is a mistake often to say that the Indian economy is so generous on this, we have to be a little careful that we do not simply take experiences elsewhere and translate immediately. But, we are working with models. We are trying to see what would be appropriate interest rates given the kind of sensitivity of the economy to interest rates in the past, of course the economy itself is changing. So this is not - here is what the model says, here is where we have to go kind of process at this point. Over time, we hope to move towards a more analytical model-driven process, but we are not there yet. The economy has disinflated considerably if you look at headline inflation since November. Too early to claim victory by any means, we are not claiming any kind of victory, but there is a process of disinflation. That has not shown up as yet in inflationary expectations in a significant way.And of course, one could argue that people still believe expectations are really high or we could say that maybe we have to be a little careful about what the surveys tell us. I would say that perhaps being careful about what the surveys tell us is perhaps where we should be. When we look at the surveys we find a significant number of people expect inflation to be above 16%, we do not even tally…there are some which is 30, 40, there are people who are talking about hyperinflation in India, when you look at this survey. I would guess that many of them are not really looking at the overall experience, but looking at salient products – tomatoes go up by 40-50-60% in the current season, and they extrapolate that to all the goods that they buy. So we have to be a little careful about looking at the level of these surveys. I would feel more comfortable with the change in the surveys as an indication that we are having some effect. There is some minor reduction, but not enough to feel confident about. So, I think there is some way to go for the disinflationary process to go into these expectations. But, I think our policy would be more driven by actual inflation than by these survey inflationary expectations. Of course, expectations as evidenced or embedded in bond yields might be something that we would also pay attention to, but I would not take the level of these surveys as Gospel truth.

Moderator: Thank you. The next question is from Chintan Mehta of Pramerica Mutual Fund. Please go ahead.

Chintan Mehta: In one of your recent policies, you had talked about making available that export refinance money partially between export refinance and productive sectors. But, since then there has been only one special 28-day term repo**.** So sir, just wanted the outlook on that particular parameter?

Dr. Raghuram Rajan: We did the 28-day term repo, and then when that matured there was a huge amount of liquidity being released into the economy, because of government spending. So we worried about renewing that amount once again for a similar period and seeing the economy overly flooded with liquidity and then the next day having to do reverse repos. So, this goes back to the point I made earlier that perhaps we have to look into the maturity of these repos, the frequency with which we do them and ensure that we manage that auctioned liquidity a little better in streamlining that process. Keeping in mind as Dr. Patel said that if you look at more measures things are not as badly off as if you just look at fluctuations in the call rate. But that said, I think there is scope for improvement, we are looking at these things, let us see what we can do. The idea of course of the Urjit Patel Committee Report was to move away from windows where you have assured access to auction liquidity. I think we are going to make sure that the auction liquidity is available in a smooth way.

Moderator: Thank you. The next question is from Sriram Ramanathan of L&T Mutual Fund. Please go ahead.

Sriram Ramanathan: One or two things related to the Urjit Patel Committee Report and how a lot of things have been implemented. A couple of things that seem still to be in the pipeline; one of the things that was mentioned is the move towards using the 14-day term repo as the overnight policy rate given its superiority. So just wanted to understand where we stand on the transition? Second thing is in terms of just a real rate part of it and how that is linked to financial savings, and how much of a factor that is going to become from a medium-term perspective to determine where the appropriate policy stands? Third and a very quick one was in terms of the GBI-EM index inclusion which has been talked about a lot. Anything at all that the market can take in terms of any fresh thoughts on that front?

Dr. Raghuram Rajan: Let me start with the first question when will the term repo what we are looking at in terms of the effectiveness of policy. I think we need more frequent term auction than we have right now, because the 14-day is driven by a whole lot of factors including fluctuations in liquidity during that period. So we have to be careful about taking a one 14-day auction as evidenced over the whole period. I think if we go towards more frequent term repos, then we will be able to make a call, especially that market becomes more liquid than the call money market as a measure of the conditions in the money market. Real rate, if you take the deposit rate as around 9%, and you take year-on-year inflation at about 7.5% , 7.3% was last month, we are into positive real rates and these real rates are certainly on par if not better with deposit real rates across the world. So, we are getting there in terms of real rates. We should see stronger deposit growth on a sustained basis. Let us see. I think we are getting to that point. On the inclusion in the emerging market index, we are still in talks, those have not been abandoned. But I think the indices want for the most part a complete elimination of limits on government securities holdings by international investors, and I think until we see through the process of unwinding of this quantitative easing as well as the beginning of the interest rate tightening cycle, it would be premature for us to completely abandon all limits. We have said repeatedly, we will expand the limits as and when they get filled. We did this again just recently, and we are prepared to look at them as and when they get near being filled. But to completely abandon them at this stage I think would be irresponsible. If there are indices that want to include us with the promise that we will expand as and when necessary we are happy to have a discussion. We are still in discussion with some, but this is the main stumbling block. In the meantime, however, we are also discussing with Euroclear for example. And this is a statement made by the Finance Minister in his budget speech, and to the extent that we can open up access to foreign institutional investors and through these mechanisms, I think that maybe more immediate step, given the limitations that indices have or given the requirements that indices have.

Alpana Killawala: So that is it, Inba from our side. Thank you, Governor and the Deputy Governors and Executives, and thank you all participants for joining us. Good day.

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