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

January 29, 2014

SPEAKERS FROM RBI:

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

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Reserve Bank of India Post Policy Conference Call for Researchers and Analysts. 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. Welcome to this Reserve Bank's Post Policy Researchers and Analysts Conference. Since we have started the new system of sending for the questions early on we already have received some questions, so we will straight away go to the questions and try and cover maximum number of questions.

Nandita Parker: Nandita Parker from Karma Capital Management. Governor, what is your estimate of MNREGA's role in leading to the current elevated CPI inflation? Given that large parts of the economy have slowed down, do you think it is important for the government to pause on the rate of increases of MNREGA wages?

Dr. Raghuram Rajan: The question for those who are not intimately familiar with the Indian situation. I presume there are very few of you but nevertheless, is this unemployment insurance program in rural areas basically offers 100 days of work to each family and there is some concern amongst some economists that that has led to a floor in rural wages and pushed up rural wages substantially over the last few years and that has been part of the hike in food prices and therefore overall CPI inflation. Of course, there is a very healthy debate about how much MNREGA is responsible for the rise in rural wages. I would say it is part of the explanation but far from the entire explanation. The sound econometric studies that I have seen that look at this say anywhere from 10% to 20% of the increase. And of course, it is hard to say over what period and what portion of the overall increase of last 4 or 5 years is due to this. One of the concerns more recently has been that these wages are indexed to inflation. So they tend to move up with inflation and create effective indexation of rural wages. That said, I think there are other factors which are also responsible for rural wage increases, including the price in Minimum Support Prices (MSP) which has increased the prices of food and therefore increased the subsistence wage, but also I would say the increasing construction and the rural prosperity generated by land sales has also been partly responsible, construction because that is a place where unskilled labor can be used. So all these factors play a part. Hard to point to just one factor and therefore I do not think it would be fair to say that is the central factor.

Jayesh Kumar: Jayesh Kumar from Kotak Securities. Food prices are dictated by the government through MSP, food subsidy, etc. and syndicate of traders decides prices of fruits and vegetables, as per one recent newspaper article, which accounts for nearly 50% of CPI. In fact, average CPI has been over 8% since 1970. In such a scenario how can RBI reduce inflation by raising rates?

Dr. Raghuram Rajan: This is a much asked question and I think first it is not just food prices which are going up, it is the price of services for example, which have been going up steadily over the last few years including services like education, healthcare and housing. So let us not just say its food prices and nothing else is moving, there are lots of other things that are moving. So at the very least if you cannot stop food prices increasing you can try and attenuate the second round effects the spill over into more general inflation which certainly is in the realm of monetary policy; that is no.1. No. 2 is that clearly you have to push on the government to both increase the supply side but also reduce the incentive or the pressures on food prices. For example, over the last year the government has become more moderate in its acceptance of agriculture support price increases, they have been quite moderate over the last year, going forward. Hopefully that moderation will continue, and that will take off some of the upward pressure on food prices. Also, if you look at some of the food commodities that have increased most in prices recently, you also see the supply response starting to kick in. So the idea that prices will go up without a supply response emerging. Remember, there is a lot of private activity in agriculture and that is responding to higher prices. So I think prices are doing what they are supposed to do, and to give up the fight on inflation saying food is beyond our control I think is understating the powers of the central bank.

Sanjeev Mohta: Sanjeev Mohta from Alchemy Investment Management. In December, you had said, "given the weak state of the economy, the inadvisability of over reactive policy action, as well as the long lags with which monetary policy works, there is merit in waiting for more data to reduce uncertainty". Today, (i.e. yesterday) you said, "the slowdown in the economy is getting increasingly worrisome". Also, the inflation data has improved. Despite this you still raised rates and also mentioned that the so-called trade-off between inflation and growth is a false trade-off in the long run. Are you thus clearly saying now that inflation is the key variable that you are going to focus on?

Dr. Raghuram Rajan: Note the word 'long run'. I think the short run clearly there are some trade-offs. In fact, we try and exploit those trade-offs. But the broader point that was trying to be made in December I think was that in an environment where the economy is weak we should wait and look for data which clarifies the noise so to speak before we act. One piece of data was headline inflation. Is headline inflation as rampant as we saw in December? And our thought was 'no' because we already had data coming in suggesting that vegetable inflation was coming down, and, in fact, our stance there was vindicated. However, we also said we are looking at the second round effects, we are looking at the feed through into services and so on, and we want to see whether the weak economy, the disinflation that has happened that will feed through into the lower core inflation and that was the second aspect of our guidance which was given in December. And unfortunately, there is a lot of debate I can see on the net about how you calculate core inflation, but the fact is it did not come down in a significant way. So, in that sense even though we had given another one and half months to see some effects, it had not materialised as strongly as we would have liked. Of course, there has been some reduction, but perhaps we would have liked to see a stronger reduction in core. So given that we thought that a certain increase in rates would be appropriate. Of course, we want to wait and see how these things play out and that is why yesterday we said we are going to wait for more data before we decide on further moves.

Sonal Varma: Sonal Varma of Nomura Securities. Keeping aside the owl analogy, hike with a dovish guidance or pause with a hawkish guidance (as in December) is confusing. The takeaway for many yesterday was that this could perhaps be the end of the rate hiking cycle. Most banks are unlikely to change their lending/deposit rates. So how will transmission happen? Does not this run counter to the objective of getting inflation and inflation expectations down?

Dr. Raghuram Rajan: I think the point that I made yesterday in the press conference and I will make again is, yes, that at this point deposit rates are being tuned to the high levels of inflation. My hope is as the disinflationary process plays out, the policy rate will become once more central to the rate setting process, at which point it will start gaining traction. We have to wait and see if that plays out. Again, this is part of our assumption. So even though now we are still somewhat infra-marginal, my hope is that as the disinflationary process plays out we will become more marginal and that is really what we are waiting for. Now on the hawk with dove and dove with hawk and all that, the whole point is that we are trying to craft a path in an environment where the economy is relatively weak and we have to be careful that people- I am not talking about analysts, I am talking about the mass of people in the country- understand. We have to operate in such a way that people understand that inflation is the important sort of target but at the same time that inflation control is in the wider interest of the population. I think thus far we have managed that, but to some extent this is a continuous process and so we cannot talk only to the analysts who are steeped in inflation targeting and speak their language so to speak, we have a broader audience also that we have to take along. Which is why in every conversation we have to also talk about growth, which we are concerned about. We are in an environment where we have got high inflation with low growth, and so navigating in those circumstances has to be done with more care than in a situation where you have got high inflation and high growth when it is clear what needs to be done and there is complete consensus on that.

Rajesh Raman: Rajesh Raman of Dymon Asia. The 8% CPI for January 2015 that you are targeting using the glide path recommendation of the Urjit Patel Committee Report. Is it a point target or do you have a band around that, and if so what is the tolerance band?

Dr. Raghuram Rajan: Michael, you want to say something?

Dr. Michael D. Patra: In the “Macroeconomic and Monetary Developments Report” we have indicated a band of 7.5% to 8.5%, and the probabilities around it are captured in a fan chart which shows that with unchanged policy there would be an upside risk to the central forecast of 8%, and that is why this policy measure.

Dr. Raghuram Rajan: Obviously, as we get closer to dates we will have to calibrate accordingly based on developments. But as of now we do not say that current policy will hit 8% on the nose, there is some volatility around that, but the central expectation or the central tendency will be 8%.

Headley Albuquerque: Hedley Albuquerque from Banhem Securities Pvt. Ltd. Governor Sir, although the policy outlook suggests tightening cycle is behind us in the near term, if inflation moves as per the baseline projection, that is, headline CPI at 8% by January 2015. The document mentions core CPI to be sticky on account of wage increases and second round effect. I would like to understand one, is the RBI more focused on core CPI or headline CPI and two, if core CPI, the core CPI has remained sticky at

8%, and given the aforementioned drivers remaining in the system in the near term, what provides visibility to suggest rate hikes in near term are over?

Dr. Raghuram Rajan: Look, I think you have to be very careful about looking at the language; the language is basically saying, given the rate hikes we have done we believe that we would be in a position to achieve the disinflationary objectives that have been suggested by the Urjit Patel Committee Report over the next year and that is exactly what we have said that, that is where we are. Of course, if there are shocks that move much either way or the disinflationary process does not follow the path that we have laid out or assumed we will have to take calibrated action down the line. We want to, and this is what I said earlier today, allow some time for that disinflationary process to play out and so we will wait for data and that is basically where we are.

Rahul Chokshi: Rahul Chokshi from Altius Fincap Markets Limited. As per the last call the net amount of outstanding or oil swaps for USD 7 billion. What is the latest number as at the end of January, and if you can give broad percentage distribution of maturity over next 3 months?

Dr. Raghuram Rajan: I can give you the percentage distribution, the precise numbers I think I cannot give you offhand. Mahalingam would it be fair to say equally distributed over the 3 months?

Shri G. Mahalingam: Up till March it is 50%, April and May is the remaining 50%.

Dr. Raghuram Rajan: So between the end of February and the end of March about 50% of the oil swaps will come due, and beyond that another 50%. I have to look at the data but I remember the earlier data that at least the repayments for March already well covered and I do not know the precise number beyond that.

Alpana Killawala: Sir, I am taking this next question from the same person because it is a different question and not covered so far.

Rahul Chokshi: RBI in the past 10 days has done OMO as well as longer maturity term repo. My question is, can you give out some broad numerical range for key liquidity indicator beyond which you would start considering term repo and OMO?

Dr. Raghuram Rajan: You are asking for more transparency here. The problem to some extent is that the key variable in liquidity tightness in the market is being driven by government balances and we are not at liberty to disclose those for a variety of reasons beyond our control. But given that those fluctuate, as the government is trying to meet its fiscal targets, we are trying to offset that by liquidity infusion. Where the liquidity tightness is temporary we do term repos, where we need to accommodate more permanent liquidity needs also to meet the overall credit growth needs of the economy which have to be met by expanding the central bank balance sheet we do OMOs. Clearly, we are trying to keep the permanent liquidity accommodation consistent with both our inflation control as well as the need to accommodate the legitimate credit expansion in the economy, and so we calibrate that accordingly. Of course, some expansion in the balance sheet has taken place as a result of the FCNR(B) deposits which were brought in, so our net foreign assets went up as a result. So we are trying to make sure that the combination of the expansion of net foreign assets and net domestic assets is consistent with what we want the overall balance sheet to expand with at over the year. But the key aspect that makes it hard for us to predict what we will do is really the fluctuating government balance.

A. Prasanna: A. Prasanna from ICICI Securities Primary Dealership. Core inflation figured prominently in your guidance in the December policy and its role was implicit in yesterday's policy action. This time around you have spoken in general about disinflation in your guidance. To the extent that core CPI may determine the durability of the disinflationary process, how do you see it evolving in the near term? Also, in terms of the glide path for inflation, once CPI inflation falls below 8%, would it not be logical to tolerate a rise in real policy rate so as to achieve the 6% inflation target at the earliest?

Dr. Raghuram Rajan: Let me give it to Dr. Urjit Patel to give you a different view around this, I have already given my view a few times.

Dr. Urjit Patel: I think my view would not be that different. I think in some ways what you are suggesting is jumping the gun. We first have to see what will happen by the end of this year on the CPI headline number and whether we reach there early or not I do not know, we may, and if so that is a good thing. But, as my colleague Michael Parker pointed out a few minutes back that we have a projection around 8% with a band of 7.5% to 8.5%. So there is a fair bit of uncertainty and we feel that the central estimate is likely to be achievable all things being equal with the policy action that has been taken over the last few months and not just yesterday. Regarding core we have not made projections explicitly, we have some internal working numbers, but thus far the glide path is based on CPI headline.

Bijay Kumar: Bijay Kumar from J.P. Morgan. Inflation is a real economy problem. Government's different subsidies, expenditures, policies have different implications on inflation. Do you think there is scope of RBI advisory to government on specific measures that could help solve inflation problem? Should there be more specific suggestions and a plan of action for the government which RBI can track? After all inflation control is RBI's objective.

Dr. Raghuram Rajan: I think it would be presumptuous of us to advise the government. I think the government has plenty of good people who tell the government what to do and I think what needs to be done is fairly well known from the government's side. On the relationship between the government and the RBI it is a cooperative relationship. In our projections we do have embedded in them the fiscal tightening that the government has suggested to do. Whether it is on the nose or not is not as relevant as the fact that there is a fiscal tightening on the cards not just this year but a fiscal consolidation following the plan that the government has laid out and I think that will help inflation control. The precise details of course are up to the government. I also want to emphasise that if government policies in aggregate prove too expansionary we will have to adjust policies ourselves to meet the overall disinflationary process. So we cannot throw up our hands in some sense and say there is nothing we can do because of fiscal dominance. Countries across the world, the monetary authorities and the fiscal authorities cooperate as far as possible but one has to adjust for the other.

Ashish Kumar: Ashish Kumar of Elara Capital. I heard your observation in yesterday's press meet that inflation has made a comeback politically. I broadly agree to this thesis. Where I want to have your view is whether you see a greater political consensus building up on need for inflation control in light of the recent rout of the incumbents and then public acknowledgment that price rise was an issue behind the defeat. So can we have a sense in Delhi on your observation that there is really no tradeoff between inflation and growth especially in the context that Central Bank would need to have ministry onboard for adopting several recommendations of Dr. Urjit Patel Committee Report? If and when this realisation happens, do you see more and easy room for monetary tightening in case inflation does not behave according to Central Bank's forecasted trajectory?

Dr. Raghuram Rajan: I think there are four questions there. Let me turn to our resident political expert Mr. Deepak Mohanty to answer that question.

Shri Deepak Mohanty: Of course, as you know that India is a moderate inflation country, because if you look at our history of more than 50 years that we see, the average inflation whether WPI, CPI around 6.5% and 7%. And the issue that the inflation has really veered from this path post-Lehman, post crisis 2008, is an aberration. Though as a Central Bank we do not have in our statute kind of a de jure mandate if we may say so, if you look at the statute of the modern inflation targeting countries, but there is obviously a de facto mandate for inflation. And that obviously comes from the public and also reflected in the political process. So as historically the inflation has been low, so tolerance for inflation is also low, and obviously, I am not surprised that people are agitated about it. So that lends necessary moral support for this fight against inflation.

Dr. Raghuram Rajan: Again, let me emphasise that we are trying to take the public along in this fight against inflation and I feel confident that we are succeeding. Ultimately, inflation is both a monetary, and pardon Milton Friedman, but also a political issue. We need the political establishment to understand the importance and I am confident that it will and it is actually.

Soumyakanti Ghosh: Soumyakanti Ghosh of State Bank of India. Is inflation targeting the clear recognition of the fact that "Brainard Principle" of attenuation and gradualism may not be the universal policy prescription in an uncertain world? Is there now a clear policy synchronisation across emerging economies in raising interest rates to ward off contagion risk?

Dr. Raghuram Rajan: First, we are not at this point in inflation targeting. At this point what we have said is, we want to bring inflation down and the Urjit Patel Committee gives us a glide path to bring inflation down, and as we examine the details of the Urjit Patel Committee Report we will take up more issues. And as I said some issues will have to be taken up with the government, some we can do on our own. That said, we are trying to give you as much clarity as we can about the process and the time path and so on. Many of you have asked me in previous conferences for more clarity and I think we have tried to do as much as possible in this particular monetary policy statement. Was the rate hike yesterday taken with view of tackle contagion because other central banks were raising rates and so on? No, I think for some time we have been saying very clearly that we are focused on preserving the value of the rupee. Preserving the value of the rupee in a domestic context will preserve it in the international context; preserving it in the domestic context means bringing inflation under control. So once we do that we believe investor confidence naturally follows. So it was a decision that would have been taken whether or not there was financial market turmoil in the last few days. On the specifics of the financial market turmoil we believe that this at least as far as it affects India is relatively temporary, there is some buildup of short term flows over the month of January. Some of that is exiting, and we do not think this is a longer term situation unlike what we saw in July and August. So I think we are much better prepared for any outflows this time, and to the extent that it happens I am not overly worried. I think we have to continue focusing on getting our domestic house in order. Something that government is focused on, something the Reserve Bank is focused on. I think that itself will create the conditions for financing of the current account deficit (CAD). So I think that is what we should focus on.

Nidhi Sharma: Nidhi Sharma of ING Investment. Some statements and comments have been seen in public domain on the 50,000 crore debt swap. Is there any possibility of the switch happening in this quarter, and could you please throw some light on how this would be conducted?

Dr. Raghuram Rajan: Let me ask Mr. Gandhi to offer some thoughts on that.

Shri R. Gandhi: In the budget it has been announced for Rs.50,000 crore of switching and buyback. We have been assessing the right moment, at which it can be done without disturbing the market. So if the market timing and preparedness is there, then it will be done. Otherwise we will be continuously reviewing and monitoring when we can do.

Dr. Raghuram Rajan: It will be done conditional on stability in the market and therefore it is a very contingent policy.

Jatinder Agarwal: Jatinder Agarwal of CIMB. Can we get a status update on the central repository - on common exposure of banks are there any preliminary indicators which you can share? Have you started sharing the database with banks?

Dr. Raghuram Rajan: We are certainly collecting the data and we are examining the quality of the data and seeing whether that quality is of the quality that we desire. The idea is by April 1st to go fully public with that depository. But the data is already coming in to us and we are just checking quality. By the way when I said, 'fully public,' it is not going to go to all the public, it is going to go to the banks.

Indranil Pan: Indranil Pan of Kotak Mahindra Bank. How worried would be the RBI at this point in time of any contagion effect that face India from the EM side, such as the recent Argentine Peso movement, in this context what is your probabilistic model on a Turkey-like policy action (not new to India though) at any time in the future?

Dr. Raghuram Rajan: Turkey-like policy action is hypothetical, I would not venture there. On the concerns, you have to always be concerned, you cannot be complacent and say we are immune. And of course, there are a number of investors who do not understand the details of India, who treat the emerging markets as a basket. Sometimes, because India is doing better, because India has more liquidity in certain markets, take that as a signal to sell in the Indian markets when other markets are doing badly. So, even standing out sometimes you can be punished for that. So, I think what we have to do is just remain vigilant, not overreact to short term events, but keep in mind that longer-term we want to keep the fundamentals and the progress towards better fundamentals going and that if there is undue volatility we will act to reduce that undue volatility. But I think we should just keep a cool head during this process. At this point am I overly worried? No. But am I complacent? No.

Bansi Madhwani: The last question from Bansi Madhwani from STCI Primary Dealer. The Dr. Urjit Patel Committee Report laid secular emphasis on headline CPI inflation for monetary policy targeting. When one looks at RBI's policy action, the RBI chose to stay on hold when headline CPI inflation was 11%, but acted when it decelerated significantly. How does one draw consistencies from these stances? Also, what is the RBI's assessment of core CPI trajectory based on disinflationary forces estimated at play?

Dr. Raghuram Rajan: I think this is a version of a previous question, but I will ask Dr. Urjit Patel to give yet another answer.

Dr. Urjit Patel: Firstly, in December, actually the report had not been done. So, the forward guidance that was given in December has been followed through in January in spirit. You may recall there were two conditions that had to be met and one of them did not and that was with core. So what has been done yesterday is completely consistent with what was done in December. The fact of the matter is that whether the headline was 11.2% in December and it is 1.5 percentage points less now, they are both at double-digit level. So, in terms of the glide path of reaching 8% within 12 months and 6% within 24 months, that action that was taken yesterday is perfectly consistent with what has been written in the report. And as I said earlier, that we have not made projections on core for this year or next.

Dr. Raghuram Rajan: Let me just add that obviously, different inflationary indicators give us different pieces of information. Our belief is that as we bring down headline inflation, core will come down accordingly. But the reason we have talked about core CPI for sometime is precisely to demonstrate that it is not just food inflation, there are other aspects of inflation that have been picking up. So, in a sense it is to build support for the idea that there is a monetary aspect, if you will, to the inflation process. So that is to some extent why it is important, in the current context, with high headline inflation to not dismiss it as only food, but to see even if you strip it of the food aspects, there is inflation in it.

Alpana Killawala: Before we close, a small clarification. We have deliberately not taken questions directly alluding to Dr. Patel Committee Report because we wanted primary focus on the monetary policy. Thank you very much for participating all of you. Thank you, Inba.

Dr. Raghuram Rajan: Thank you.

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