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MODERATOR:

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Moderator: Good Day, Ladies and Gentlemen and Welcome to the Fifth Bi-Monthly Monetary Policy Governor's Teleconference with Media. As a remainder, 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 call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

Alpana Killawala: Thank you very much Malika. Good morning everybody and welcome to the post-policy conference. Governor?

Dr. Raghuram G. Rajan: Good morning. This is probably the most widely anticipated statement. Reserve Bank held rates today. Going forward we will follow developments on commodity prices, especially food and oil, even while tracking inflationary expectations and external developments. Of course the implementation of the Pay Commission proposals and its effects on wages and rents will also be a factor as we consider policy for the future. However, we believe its effect on aggregate demand will be offset by appropriate budgetary tightening as the Government stays on its fiscal consolidation path.

Now, we are focusing on transmission; thus far we have seen barely half the interest rate cuts since January pass through. We are working with the banks so that new methodology to determine the base rate, it will be based on marginal cost, and it should be put out sometime this week. The Government is considering the small savings rates and time them more to market interest rates and I think both these actions will help transmission. Also, banks are currently engaged in a process of cleaning up their balance sheets and as they clean them up they will have more room for fresh lending. We will use the space for further accommodation when available while keeping the economy anchored to the projected disinflation path that should take inflation down to 5% by March 2017.

So that is broadly the gist of the policy statement and I would be happy to take questions.

Nisha Poddar:
ETNow

Governor, you have paid a lot of emphasis on vigilance on CPI inflation and if I am not reading it incorrectly, you are being tentative about accommodation. You have especially mentioned "accommodation when available". I just wanted to understand your future stance because what will establish a turnaround? On whether it would depend a lot more on transmission, CPI which you have said will plateau out, and also are we already prepared to deal with an imminent Fed lift-off which is going to happen? So are we going to wait till February for any more measures to be taken or after the lift off really happens there could be something anticipated earlier?

Dr. Raghuram G. Rajan: First, we are still accommodative; I think that is very clear. We are always vigilant, so this is not anything new, we are vigilant. There are obviously both upside and downside risks to Consumer Price Inflation, we have highlighted some of the sources of risks going forward. One could imagine that there could be downside risks from say commodity prices, especially oil. But of course given where oil is produced there are also potentially upside risks if there are political events that constrain the supply of oil. So vigilance is always needed.

Now as far as you ask questions about when the next rate movement etc., what we have said is when times are warranted we are always prepared to move off-cycle. But when times normalise we prefer staying with the policy cycle rather than move off-cycle. Of course, when we use the words external developments, one of them is what happens to the Fed policy rate hike; that is probably even more widely anticipated than our statement today. Now of course there are some residual uncertainties about what the Fed will do. But my sense is, as I have said before, after an initial bout of volatility we probably should see Indian markets stabilise and come through. So it is not as I have said before again the central factor in our deliberations going forward.

Nisha Poddar: Tentative accommodation going forward?

Dr. Raghuram G. Rajan: I think I have said it. Clearly I will say it once again; we are in an accommodative stance.

Dr. Urjit R. Patel: I think the way to put this is that, because we do not reduce interest rate it does not mean we are not accommodative. I think the language in the policy statement suggests that if and when space opens up we will do what is required to ensure that both the inflation objective as well as promoting growth on a durable basis will be facilitated by the RBI.

Latha Venkatesh: CNBCTV18

You have just said 'when' but you have not said 'if and when' if accommodation opens. I want to know is something wrong?

Dr. Raghuram G. Rajan: One of the dangers of doing nothing is then you start parsing every word. I think the statement reflects a fair amount of deliberation and so that represents our stance.

Latha Venkatesh: Actually the previous policy said that RBI would look at the one year forward interest rate and subtract from it the one year forward inflation and you want that real rate to be between 1.5 and 2. Now today the one year forward rate is at 7.2 and your one year forward going by the fan chart is 5%. So actually you are hitting 0.2. Looks like you have a tough task to being accommodative. Now you said that you are looking at the 7th Pay Commission, I wanted to know whether you would only look at 3.5% fiscal deficit number or you would also ponder on the quality of fiscal consolidation. At any rate what is the RBI's assessment of the impact of the 7th Pay Commission on inflation?

Dr. Raghuram G. Rajan: First, as far as those differentials go we are not looking at it on a day-to-day basis, it is a rough indicator of where we would like to be. As far as the fiscal deficit goes, clearly the quantum as well as the quality matters and that is an issue which the government is fully seized of. I am hopeful that while maintaining the fiscal consolidation path, the Government can also maintain the quality or enhance the quality of the budget. So it is clearly an issue that they and us will both be looking at.

Latha Venkatesh: The impact of the 7th Pay Commission on inflation?

Dr. Raghuram G. Rajan: Let me also ask Urjit to chip in but in the broad sense, I mean, yes, there is going to be additional expenditure. But it will be offset presumably by either additional revenue-raising or cuts elsewhere so that the fiscal consolidation path is maintained. So in that sense we do not feel there will be a significant effect on aggregate demand provided of course you maintain the fiscal path. Of course investment in some ways maybe higher quality than certain kinds of spending and therefore one would hope that you would uncover space elsewhere for the public investment which we really need. And I think the Government has taken a number of these into account while anticipating the consequences of the Pay Commission. So let us wait and see what happens.

Dr. Urjit R. Patel: Just to say that in the medium term fiscal policy of the Government some of this was already anticipated. So the base line has some of this already pegged in. One impact that will be felt through the CPI index would be via the house rental allowance. But that is a one-time level change and unless there are wider externalities we will most likely look through that. But you will feel it in the index through the housing sub-component of the CPI combined index because they do sample, a fair bit of Government housing in the sampling frame that is used and that impact will be felt from April onwards for six to eight months and you will see an index change there. But that is likely to be looked through by the RBI.

Dinesh Unnikrishnan:
FirstPost

Sir, I wanted to understand what is RBI's assessment about the current growth scenario? The latest GDP print is at 7.4%. But as we have seen some of the key indicators, they do not really percolate to these kinds of numbers. Turning the bank credit growth, auto sales, generally. So do you believe that the growth has taken firm hold in the economy or feel is there a disconnect between GDP and the economy?

Dr. Raghuram G. Rajan: No, I think it is very clear that we are in the process of a recovery; we are in the midst of a recovery. Now there are areas of weakness, there are places of course where, agriculture for example, agriculture is growing relatively weakly because of the monsoons' allied activities, dairy etc. are growing more strongly. But as a result rural demand is somewhat weak and you see non-durable consumption, for example, relatively weak. Set against that, capital goods have grown fairly strongly; public investment seems to be growing quite strongly. So I think what we have is an economy which is well and truly in recovery but with areas of weakness and hopefully as we go forward some of the areas of weakness will turn around. For example, with the kind of investment that is contemplated, construction may start picking up more strongly and that would be very helpful. Perhaps, with the kinds of measures that the Government is taking as well as for example on low income housing, the capital requirement measures that the RBI has announced will have some boost to housing.

Bijoy:
Cogencis

Sir, this is on marginal cost funding and base rate. Do you think banks are ready to handle ALA management with no liquid OIS market, plus there will be a direct impact on NIMs. Do you think Indian banks are ready for that? The other question is slightly old in that sense, because for last four years savings bank deposit rates have been deregulated and somehow all the banks are at 4%. Clearly that cannot be a coincidence, so as at any point of time has the RBI wondered about why this is so? Also on ARCs, there were some discussions happening on change in promoter norms for ARCs to enable international players to come in.

Dr. Raghuram G. Rajan: The first question was on the marginal cost pricing. Yes, as we move towards marginal cost and eventually market benchmark, both of which will be enabled, they will have to pay more attention to asset liability management, clearly they have the capabilities. The question you asked is, are there the instruments? But demand creates its supply, when there is no demand there is obviously no supply. Obviously as they start looking for these kinds of instruments, others will start creating them. So I have no doubt that the markets will become more vibrant as a result of what the banks will need to do to manage their liabilities' mismatches.

As far as second question goes, you asked savings rates at 4%. I do not want to conjecture why they have been stuck at that rate for so long. Of course as you know perfect competition will also get you the constant rate across the system. I am not saying there is perfect competition but we have to, I mean it is something that perhaps in the future we could also look at. But I do not think we should presume, which you seem to be hinting at, that there is some misbehaviour right off the back, but it is something that we can look at.

As far as ARCs go, we are very open to entities who want to set up as ARCs, there is a process of licensing, and they have to apply. But if entities want to put more capital to existing ARCs, get licenses to become new ARCs, we are very open to it especially if there are foreign entities that want to bring in more capital into this business its most welcome.

Anupriya Nair: Bloomberg TV

I want to focus on upside risk to inflation coming from services sector and the impact the GST implementation could have on inflation in the coming. And secondly, are there any concerns on for the currency not so much just from Fed lift off but the cross of ECB QE and normalisation by the Fed? Could we possibly see some regulation on sale pricing of loans to ARCs as questions are being raised on the big write-downs as well as the sudden surge for 5/25? Is there any relook on ARC sale norms?

Dr. Raghuram G. Rajan: First as far as services inflation goes, services inflation is obviously a source of concern. I think it largely reflects the supply constraints in our economy that high quality education, high quality healthcare or reasonable quality healthcare and reasonable quality are education are relatively in short supply, which is why you see higher inflation. And that is one reason why we keep saying this is not just about food, it is about other elements. Now that has been coming down over the last year or so but obviously it gets impacted by things like taxes. Now as far as taxes go that is not wage or price push inflation and we will have to figure out a way as and when GST comes in for example and there is a big change, how we account for that going forward. So it is something that we will have to adjust for.

The second question was currency, dollar and ECB moving in opposite direction, it does create problems for countries like us because partly people are not aware of the concept of real effective or nominal effective exchange rate; the one exchange rate that always matters is the dollar-rupee. So at the same time as they are saying dollar-rupee weakest in the history of the rupee, it turns out that we are pretty strong because we have appreciated versus the Euro, versus the Yen, versus may Asian currencies. So it does make a dialogue a little more difficult. The other aspect is of course there are these volatile flows because you may see outflows from the Euro area but flows back into the dollar area. Now we will have to manage it; unfortunately this is how the global monetary system is and we have to live with the way it is. My hope is down the line the Euro area also strengthens enough that the Euro area contemplates a monetary normalization.

Third question was ARCs and the price at which assets are sold to ARCs. Well the truth is, this is a problem around the world. Banks are reluctant to sell at the prices that come, companies that deal with distress are willing to buy. And so there is always a wedge between them, at some point they both come to an agreement and assets sold, typically these assets are sold at prices that are lower than what the banks would like to have. Now we are in dialogue with the banks on a number of issues including the assets on their balance sheet and we are talking to them about what is being done on the 5/25 etc., etc. We have given a number of facilities to the banks to improve their asset quality, we are very concerned and we insist that they be used in the right way and hopefully going forward these additional parts as well as the additional recognition that banks will now be doing will clean up the balance sheets in a significant way so that banks will be in a position to grow and lend going forward, that is something that we are fully engaged in right now and we hope that the outcomes will be visible in the next year or so.

Shobhana:
Financial Express

So Piyush Goyal has put out the SEB restructuring plan Uday. Once the loans are converted into bonds, he is talking about roughly an 8% interest rate, whereas the current loan rate is about 12%, 12.5%, 13%. So that is an immediate hit for the banks if they subscribe to the bonds. So how does the RBI see that because these are very large quantum of loans, we are talking 20000, 40000, lakhs and crores would be converted. And if they do not buy the bonds, then are they writing off the loans or are they going to be subscribing to the bonds?

Dr. Raghuram G. Rajan: This is all still being discussed. The banks will take a view on what they do with their loans, ultimately the loan is from the bank to the discoms. The banks do not have to buy the bonds, the bonds can be used to repay the loans. Now what we have to see is what the final sort of structure emerges, this is still I think the ‘i’s’ are being dotted and ‘t’s’ are being crossed.

Shobhana: Sir, who do you envisage are going to buy the bonds?

Dr. Raghuram G. Rajan: Well, let us see. I mean banks have their boards, they have to make decisions and they will have to make decisions based on their capacity.

Shobhana: Is RBI advising them?

Dr. Raghuram G. Rajan: No, as I said this is still being discussed.

Pradeep Pandya:
CNBC Awaaz

Sir, two questions, first question is, in your last paragraph you have said that the Government is examining linking small savings interest rates to market interest rates. Has the Government had any discussions with the RBI as to how this can be made market linked? Have you given any suggestions?

Dr. Raghuram G. Rajan: We have given our suggestions; let us see what the Government comes out with.

Shri H.R.Khan: The Government had asked for data we have given. Suggestions will vary whether it can be reset quarterly or half yearly or annually. We will like it to be reset as frequently as possible, then they have to collect data and see what the benchmark is. There is already benchmark suggested by the Gopinath Committee. So how much spread they will allow and what frequency they will do, the discussions are going on. I think the Government is working on that.

Pradeep Pandya: My second question is that the decision that the IMF has taken yesterday of including Chinese Yuan in the international reserve currency. There have been a lot of developments on the rupee front as well, rupee linked overseas bond have been issued. Yesterday in the guidelines on ECBs that you have issued, there are separate provisions that have been made for rupee bonds. But from the point of view of internationalisation of rupee, how far behind do you think are we behind China?

Dr. Raghuram G. Rajan: See, how far are we behind China? On some dimensions we are ahead of China. I think in terms of the degree of competitiveness within the banking system, some of the markets we have taken some steps which put us ahead. But in terms of the size of the economy, in terms of the extent of external trade, in terms of denominating trade in Renminbi I think they are much ahead of us. So my sense is this is a process, we are taking steps, we are steadily moving towards being a much more open economy while keeping some of the concerns about stability, making sure that we have things broadly under control, keeping that in mind also. So we are taking steps, as you can see the steps are regular, they are all in one direction, the announcement for example of FPI limits now is over a medium-term, the ECB policy announced yesterday, the masala bond as you say which number of companies are issuing. All these are in direction to broaden and open up a little more, but at the same time it is not a big bang where we lose control over the whole process, it is a steady process.

Radhika Merwin:
Business Line

With regard to the transmission that we have been mentioning, in the past the transmission has happened only partially, in fact it has been less than 40% or 50% of the rate action by the RBI. So considering that banks have repriced 50% to 60% of what they can in terms of deposits, where do we expect the additional transmission to come from. Is it only because the banks will move to the marginal cost of fund or as we have been discussing earlier of talking about market linked benchmark which will kind of help every other segment to follow that particular yield curve, and hence there will be a transmission across different products?

Dr. Raghuram G. Rajan: I think that if you look at say one to three year deposits, banks have already cut significantly more than has been transmitted through the base rate. So in that sense there is room building up for the banks to transmit more; I think it is a matter of time as these costs flow through. What the marginal cost pricing does is make the cost flow through into lending rates faster. So the intent is that at least for a time banks will be able to make incremental loans on the marginal cost pricing while their historical or the legacy loans will be on the base rate, that is the intent as we going forward.

Amol:
Zee Business

Sir my question is also related to transmission, you have said again and again about transmission and also about small savings interest rate, market linked interest rates and talked about the need to clean the balance sheet of the banks. So first I would like to know that after a reduction of up to 125 basis points banks have not reduced the rates to that extent, so what you would do about this going forward? And what you are saying of cleaning balance sheet of banks time and again, exactly what is the problem there and is this only for PSU banks or also for private banks as well. What are the aspects that you think that are necessary to be cleaned? And second Sir, a lot has been spoken about 7th Pay Commission, boosting consumption. Will this have an impact on your inflation target for March 2016?

Dr. Raghuram G. Rajan: So I think I have already answered the transmission question twice, so let me skip the transmission question. On the question of bad loans, I think our approach to this has been very systematic. The first part of the process was to give bank more powers and more flexibility to deal with it and the idea is to put the real asset back on track with whatever needs to be done. So that was the first step with things like the SDR, with the 5/25, with the bringing in new promoters and so on, a whole range of steps had been taken there. Now given that banks have more powers we can now be a little more careful about recognition and the first step of that was to do away with forbearance starting April 1st, but next step is to make sure that what should be classified as A is classified as A and not B. And there we are in constant dialogue with the banks and also looking at how some of these existing facilities are being used to make sure as somebody said we are not kicking the can down the road. So this process is ongoing and my hope is as the banks recognize more of what needs to be recognized and they deal with the stressed assets, remember stressed assets NPAs plus restructured is an important part of banks' balance sheet, that they will be able to bring that down and not just by provisioning but also by putting some of these assets back on track so that they can be elevated back to performing assets over time. So this is what is underway and it is both for public sector banks and private sector banks, but as you well know more of the problem is in public sector banks because they went more into infrastructure investment where many of the difficulties lie. So this is underway and we hope that over the span of the next year, I want to put something like March 2017 on the table as when we hope that the clean-up will have been done.

Govardhan:
Economic Times

Sir, how do you maintain inflation forecast next year when the 7th Pay Commission implementation could induce demand and the base effect of lower commodity prices also goes away? Last time the inflation cycle was mostly because of NREGA as well as the Pay Commission implementation. Is this going to be different this time?

Dr. Raghuram G. Rajan: See, throughout the year there are base affects because it depends on what happened the last year when inflation picked up and when it went down. So if you look at the chart you will see base effects starting to show up towards the middle of next year and in a sense they also reflect seasonality in vegetable prices, in pulse prices and so on. Broadly what one should be looking at is the momentum of inflation over time to see that that is well contained. We have already talked about a number of factors that go into that momentum. Let us see, I mean our sense, which is why we cut interest rates last time was that the balance of risks, how much we wanted to do for energizing growth versus how much we had to be worried about the inflation allowed us to reach the policy stance that we did last time, which we have maintained this time. Now going forward, if room opens up we will be able to do more as we have said.

Govardhan: You had said market has been efficient in transmitting through lower CP rates. If so why whip banks on base rates. Why not just leave it to markets.

Dr. Raghuram G. Rajan: Well, that is a good question, I was confusing your base rate question with base affects in inflation was what I was talking about. Yes, there will be competition but the base rate, there is a particular way to calculate it and our worry is that that should not come in the way of banks passing through lower lending rates to customer. So that is why we took a relook at the base rate and that is why we are coming to this marginal cost pricing which we will announce later this week. That will give the bank the flexibility to move more quickly while the base rate would not allow them to move, if they followed the average cost, would not allow them to move quickly. The marginal cost will allow them to move much more quickly and react to the kind of competition that you talked about in the market. Today for example newspaper are reporting a commercial paper issuance which essentially means corporations are going there rather than going to the banks. So at some point when the banks want to recapture that market the way they calculate that lending rates not stand in the way of their competing, that is why this is important.

Govardhan: Why not scrap base rate itself?

Dr. Raghuram G. Rajan: Well, the base rate forms the basis for your EMIs right? So we cannot scrap it, what is then going to take its place? There has to be something. Ideally we would have a market base measure which is sound, which is credible. LIBOR used to do it in the West but LIBOR has come under some cloud recently. We need a market based benchmark which does not have those kinds of problems. We are in the process of creating one; there is a company which is collecting those rates. As we get some experience we will get a market based benchmark, but till then we need some way of calculating and because people rely on this. They have to have a sense of how this is going to move, contracts are written on this basis that is why we need to actually regulate this.

Aparna:
Mint

Sir, I have two questions. My first question is regarding small finance banks, the share of foreign holdings. A lot of these players already have a really high share of foreign holding -75% to 80%. So will the RBI give them enough time to comply with the norms that you have set out? IS there a rethink on the time given to meet the norms? My second question is, you had said in September that transmission has taken place very quickly in the bond market and the money market compared with that to base rates. But the benchmark 10-year bond yield has hardened and this is considered proxy for pricing other debt by a lot of people. Do you think the RBI should provide liquidity to the bond markets to aid transmission?

Dr. Raghuram G. Rajan: See, we do not determine liquidity to help the bond market, it is an incidental effect. I mean it is good if the bond market is helped but we primarily provide liquidity because the system needs liquidity. A good measure of whether there is enough liquidity in the system is how much various entities are borrowing from the various windows and they have not been borrowing excessive amount which suggests that there is plenty of liquidity and if you look at short-term rates they are pretty close to our policy rate. So we are providing the liquidity that the market needs and I think it is fairly well balanced there. Now you are asking should we be directly targeting the bond yield through some kind of a quantitative easing measure, I think we are in a very different situation from the other industrial countries. Now what is driving the government bond rate, the 10 year rate, clearly a variety of factors including the tightening that is going on or the anticipated tightening that is likely to go on in industrial countries, that you see some co-movement between the 10 year treasury rate, the US treasury rate as well as government bond rates in a number of emerging markets. So that is part of what is going on. So there was some supply that came on to the market from the government in October that is easing off now but it is another factor that comes into the determination of long-term yields. So the point is long-term yields are a complicated phenomenon where many factors include not just monetary policy. So it is something that hopefully over time will stabilize and come down as anticipation of lower inflation as well as our reaching our inflation target over time, as that sets in, it should come down, so let’s see.

Dr. Urjit R. Patel: Just that short-term fluctuations in long-term rates are difficult to attribute to any single source or driver and if at the margin our bond markets are open to the outside world then we are likely to be affected by that a fair bit. And if you look at the covered parity calculations we are more or less in line, taking away issues of risk premia and term premia.

Aparna: Sir on the small finance banks?

Dr. Raghuram G. Rajan: On the small finance banks they have 18 months. So I think that is a fair amount of time to do what they need to do in terms of raising or altering their capital holdings, so it is a fair amount of time.

Anup Roy:
Business Standard

You mentioned that your OBICUS survey is showing robust growth in manufacturing and pockets of the economy. So how much credit goes to Reserve Bank of India policy cut for this. Because when the economy was not very good you were criticised for not cutting rates. Second question, with the FED and Europe's quantitative easing it looks like China's devaluation or adjustment of its currency peg affects the Indian rupee more. So do you think it is a good way to let the rupee depreciate when China devalues to maintain India's competitiveness?

Dr. Raghuram G. Rajan: The first question is about news on manufacturing, again this is early. When we use the word early there because it is based on a small sample in our OBICUS surveys, not the entire sample. But nevertheless I think what causes growth is actually a whole mix of factors, so I would be far from claiming credit for monetary policy, lots of other factors including the feel-good factor introduced by the Government, the public investments and lots of other things go into this. So I think it is not a useful question to answer that how much are we responsible? I have no idea.

Anup: But Sir you were being criticized when the growth was tepid.

Dr. Raghuram G. Rajan: Yes, but that does not mean I should take credit when the growth takes place. Look, we are all working together to ensure that growth takes place, I think it is in our collective interest and I kept emphasizing and I will emphasize again, the RBI is not against growth, we need sustainable growth, we will ensure there is sustainable growth and will ensure the maximum sustainable growth we can get. Now sustainable means within the bounce of whatever inflation we are willing to accept and that is what the Government says for us, this is what inflation we are willing to accept and what our job is to create the maximum growth consistent with that.

Chinese devalued initially but then stopped and in fact it came up a little since then, and perhaps with the Chinese inclusion in the SDR basket you may see a little more of that. But we do not see the exchange rate as something that we can manipulate in a significant way to attain whatever macro objectives we have. We have said repeatedly that our intent is to minimize volatility in the exchange rate rather than target a particular level. Now the market as it moves the exchange rate determines what is reasonable given the various market forces that are underway. As I said, if you look at our exchange rate, over the course of this year, the nominal effective exchange rate is approximately flat.

Manojit Saha:
The Hindu

Are you satisfied with the pace of banking sector reforms? The PJ Nayak committee submitted its report about last year but we have only seen some sporadic reforms. How crucial are the banking sector reforms in order to achieve the March 2017 target that you have set to clean up banks' balance sheet?

Dr. Raghuram G. Rajan: A number of actions have taken place including splitting the Chairman and the CEO of the banks, appointing some private sector players as CEOs. There is a process of appointing new board members, typically more professional. The bank board bureau is being set up. So a number of actions have taken place. My sense is these have all been quite positive and of course these things play out over time but let us see how it moves.

It is absolutely crucial because I think if you take the broader process that we are trying to do together with the government. First take the governance process of the banks, move towards cleaning up the banks' balance sheets and appropriate recapitalisation and then they will be in a position to do the kind of lending that the economy will need as the recovery picks up steam. So that is the process that is being followed and I think it is well under way.

Alpana Killawala: So that is finally it. Thank you very much. Thank you Malika.

Dr. Raghuram G. Rajan: Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, with this we conclude the conference call. Thank you for joining us and you may now disconnect your lines.