Edited Transcript of Reserve Bank of India's Post Policy Conference Call with Media

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MODERATOR:

MS. ALPANA KILLAWALA – PRINCIPAL CHIEF GENERAL MANAGER

Moderator: Ladies and Gentlemen, good day and welcome to the Third Bi-monthly Monetary Policy Governor's Teleconference with Media. As a reminder, all participants' line will be in the listen-only mode and 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. I now hand the conference over to Ms. Alpana Killawala. Thank you and over to you, ma'am.

Alpana Killawala: Thank you very much, Mallika, and welcome once again for joining this press conference. Governor please!

Dr. Raghuram G. Rajan: Thank you. As you know by now, we held the policy rate at 7.25 per cent while we await data on whether recent increases in inflation, including in non-food items, are temporary, and whether the monsoon will continue to be near-normal. We note the recent fall in oil prices, which will be very beneficial for India. As we await greater transmission of our frontloaded past actions, we will monitor developments for emerging room for more accommodation.

A couple of other points I want to make separate from the policy.

Framework for FPI Limits in Debt Securities

The Reserve Bank is talking to the Government about a Medium Term Framework for FPI limits in debt securities. This will include: (i) A target for what fraction of the sovereign bond market would be constituted by FPIs in the medium-term; (ii) An announcement of staggered changes in limits every six months and these being released on a monthly or quarterly basis; we have to determine that yet; (iii) Limits to be specified in Rupees so that they do not vary with exchange rate movements; (iv) The Framework will create space for participation of different kinds of investors, which include long term investors, such as, Pension Funds and Sovereign Wealth Funds as well as medium term investors and those coming through International Central Security Depositories, such as, Euroclear and Clearstream; (v) The overall goal of this medium term framework will be to enlist FPIs in market development within prudential limits that we set, even as they are attracted by rates available on Indian bonds. Once the Framework is decided, we will wait for suitable market conditions, including possibly greater certainty about Federal Reserve actions and appropriate liquidity conditions in Indian markets, before making a public announcement.

Payment/ Small Finance Banks

The Reserve Bank has received recommendations from the External Advisory Committees on Payment Banks chaired by Dr. Nachiket Mor and on Small Finance Banks chaired by Ms. Usha Thorat. Now an internal committee of the Reserve Bank, composed of its Deputy Governors and the Governor, is going through each of these applications again. Finally, a set of recommendations will be presented to the Reserve Bank Board, which will decide the final list of successful applicants. As I said before, I hope to announce at least one set of bank licences before the end of this month.

Report on Urban Cooperative Banks

I have received the report of the High Powered Committee on Urban Cooperative Banks. Much as we did with the Urjit Patel Committee report, the P.J.Nayak Committee report and the Nachiket Mor Committee report, I believe this report will inform our actions in the months to come on Urban Cooperative Banks. It will be put out for public comments shortly.

Monetary Policy Committee

Let me end by talking something about which there has been a lot of commentary in the press. There has been a lot of commentary about the composition of the Monetary Policy Committee. Let me start by saying that the Reserve Bank believes institutionalising the process of monetary policy formulation is vital, given that the Government has given the Reserve Bank a clear inflation objective.

We have already done a lot internally in the past in my term and before to institutionalise the process, including having scheduled meetings with different constituencies before the policy decision, having serious discussions with internal staff based on incoming economic data and based on our model analysis, and speaking with the Government to obtain its viewpoint. The final policy is usually a consensus arrived at by the Governor, the Deputy Governor in charge of Monetary Policy, and the Executive Director in charge of Monetary Policy, but ultimately the responsibility is that of the Governor's.

Going forward, there are at least three virtues of taking the decision away from the Governor and giving it to a committee. First, a committee can represent different viewpoints, and studies show that its decisions are typically better than an individual's; Second, spreading the responsibility for the decision can reduce the internal and external pressure that falls on an individual; and Third, a committee will ensure broad monetary policy continuity when any single member, including the Governor, changes.

So we have been enthusiastic supporters of the idea of a committee. Since the Finance Minister's budget announcement that such a Monetary Policy Committee would be formed, we have been engaged in dialogue with the Government. From the Reserve Bank's side, we wanted to that the structure should ensure continuity in policy as the market attempts to understand the voting patterns of new MPC members.

I can reiterate the Finance Secretary's comment yesterday that the Government and the Reserve Bank have reached a broad consensus on what such a committee should look like and what the powers of the Governor should be. While the details have to be ironed out, there are no differences between the Government and the Reserve Bank in this matter.

Happy to take questions.

Latha Venkatesh: CNBC TV18

Since you just say that a committee is better and that you are an enthusiastic supporter of a committee, should we therefore understand that you was okay with not having a casting vote or veto power in that committee? Secondly, coming to the policy itself, you have lowered the Jan-March inflation trajectory by 0.2 basis points, however the Jan 2016 inflation stands at 6%. Is there even a downward bias to that 6% forecast? Finally, on the NPAs, do you really believe the numbers put out by banks or do you think the situation is a lot worse?

Dr. Raghuram G. Rajan: Let us start with the monetary policy committee. The details will be made public when the government feels comfortable and I think we should await that process rather than talk about the details. I will only talk about the veto issue which has gained some public discussion. Currently, the situation is the Governor has the veto, i.e., effectively all advice is only advice; ultimately, the decision is the Governor's. So if we continue to retain a veto, it does not change the current situation, it maintains the status quo. So that is something to keep in mind. But, on the rest of the issues I think why not we await the formal announcement of the committee proposal. After all this will have to eventually go into a change in the RBI Act which requires legislative changes so it requires Parliamentary approval, etc., On the second question of the forecast, can I ask Urjit to speak about it?

Dr. Urjit Patel: The forecast for early next year and indeed the time between now and then has been updated as we always do given that we had two data points that came in after the June policy and the reasons for making the central estimate projection lower are well-known and therefore that is what it reflects. We have always said that these things are data-dependent and this is an example that it is data-dependent.

Latha Venkatesh: But the fall can come in a little earlier, like the January 2016 forecast?

Dr. Urjit Patel: At the moment the risks are balanced but as you know the fan chart is a confidence interval, so you would find in that broad funnel, numbers which would be below 6.

Dr. Raghuram G. Rajan: On your third question on NPAs, there are a number of checks and balances on trying to ensure that the NPAs that are announced are the true and fair picture. We also supervise banks and go into their portfolios to see whether they have declared all the NPAs they should and we examine divergences and bank management is hauled up if there are divergences. Now going forward, I think the key question is how does stress in the banking system play out. There are some important areas that are stressed; the power sector is one, the steel sector is another. We are certainly monitoring that process and trying to urge that restructuring if and when done is deep, is appropriate, that projects are put back on track. I think that is what we need for the continuing health of not just the banking system but the economy.

Bijoy:
Cogencis A couple of questions: You mentioned the rupee-linked debt limits; will this mean that the rupee will be mark-to-market for the limit? On the liquidity front, the Reserve Bank has indicated that it believes liquidity is comfortable, but at this point of time, did you consider SLR or HTM cuts for meeting the LCR requirement? Domestic-systemically important banks are to be named this month, but with banks in a stressed position, do you think it is a good time to introduce it?

Dr. Raghuram G. Rajan: On the SLR liquidity issue, I think right now we still have some way to go before the HTM and SLR balance. Once that happens we can take a further view as to when the future SLR cuts would come. Undoubtedly, SLR will keep coming down over time till it reaches a more comfortable level, but when is something we have to determine. To your first question, limits are going to be set in terms of as I said a progression eventually to that target, where we think we are comfortable with the fraction of FPIs of the bond market. That limit will change from dollars to rupees now, but obviously it will bear some relationship to the current rupee investment that already is there and it will be incremental based on that. So I think it will move up from there on a reasonable basis as I have announced.

Bijoy: Will it be left open or will it be pegged to the dollar level?

Dr. Raghuram G. Rajan: As I said it will be pegged to a rupee level, so, for example, just if I say today it is Rs.2 lakh crore it can be Rs.2 lakh 20 tomorrow and that Rs.2 lakh 20 will be independent of the rupee-dollar level. So it will be how much do you invest in rupees, which is the more sensible way of doing it because after all they are investing in rupee instruments. On the third issue, DG Gandhi will answer.

Shri R. Gandhi: Basic framework we have announced and before the month end we have to declare the names. Work is going on and we will come back on that.

Anupriya Nair: Bloomberg TV Two questions: first, you have mentioned that near-term inflation expectations of households have gone back to double digits and that is a problem. On the other hand WPI has been in negative territory for 8 months. What is that divergence signaling to you right now? Because there have been some papers indicating that maybe all price indicators should be looked at. Secondly, we have a lot of different growth indicators. We have the IIP, we have core sector, we have GDP, the skepticism continues. What are the growth parameters the RBI is looking at? What in your assessment gives you the indication that economic recovery is progressing, is work in progress? What are the indicators that the RBI is looking at?

Dr. Raghuram G. Rajan: On the first issue of inflationary expectations, inflationary expectations do get altered considerably by certain salient items such as food, milk; various components of foods are more salient than others, vegetables for example. So given that, yes it is a concern but one should keep it in that perspective, it is one of the factors we are looking at. When you look at WPI inflation, a significant part of WPI inflation is the commodity disinflation that has happened, in some cases it is commodity deflation, this is more globally determined. Now, one of the problems with focusing on WPI alone was it left out the large parts of the service sector and focused largely on traded goods which is primarily beyond our control except by the exchange rate and neglected non-traded goods in India. So it is very convenient to look at WPI because then you can do all your inflation management based on the work of others outside and only a very small part of it is because of your own efforts. If we really want to manage inflation, we have to look at the sum total of inflation, especially the inflation that confronts consumers because that is what determines things like household savings behavior, it determines the wage pressures that will come and therefore CPI inflation seems to us much better. We cannot keep shifting from one index to another depending on what is more comfortable. There are people who make the argument that WPI being so low, they look at real rate that they face they have to in a sense add the WPI deflation to the nominal interest rate to get the real rate that they face. That is not right. When you look at firms you are seeing even though their top line is not growing that strongly, a number of firms are reporting bottom line growth. Why is that? Because even while they lose out in the ability of pricing on the output side, their input costs are also falling. So as a result profitability may in fact be increasing. It is the rate of inflation of profitability rather than the rate of inflation of the output prices which is more important to understand what is the appropriate rate that the firms are facing. Regardless, we have said again and again, what we really need to do is bring inflation down so that both the producer as well as the consumer, the saver and the investor all of them feel comfortable. That is what we are engaged in.

Anupriya Nair: For growth what are the parameters that you are looking at while assessing the economy?

Dr. Urjit Patel: We look at a variety of both low frequency and high frequency indicators since we have to make the statement every two months and some of them are listed. We do look at the PMI which gives a slightly forward-looking diagnosis of the situation, car sales, freight traffic, etc., because they are important indicators of ultimate and down-the-stream activity. So those are the indicators that we use including the national ones like the IIP, core and the quarterly GDP numbers, nominal credit growth as well.

Pradeep Pandya: CNBC Awaaz Sir you have stated in Para 16 that your future actions depend on four points: inflationary expectations, the full monsoon outturn, possible Federal Reserve actions and other issues. It is apparent that it may not take two months to get clarity on these. If there is some clarity mid-way on these points, do you see a mid-policy action? And my next question relates is that you have indicated that the decline in exports is in part a result of weak global demand and in part due to significant depreciation of currencies of some major trading partners against the rupee. So is that the reason why you are lowering the comfort band of the rupee, because we are observing a gradual depreciation?

Dr. Raghuram G. Rajan: First question, we are waiting information. There was more need to move fast in the early stages of the turnaround. We will take all the information into account and decide whether at times it warrants moving in between policy cycle or it does not. Generally, early stages of the turnaround in monetary policy, there is probably more need to do that than at later stages. There have already been monetary policy announcements for some time. So it is more reasonable to go back to a pattern during such times. But nobody ever rules out any actions that a Central Bank can take and it is one of the options that we always have. On the second question of the exchange rate, we do not really have a target band at any point in time. The exchange rate moves because of a variety of factors including news about what the likely current account deficit is going to be. One of the reasons for the strength of the rupee in recent times vis-à-vis the emerging markets is because of the falling price of oil and therefore the shrinking current account deficit. We do monitor factors like the competitiveness of Indian industry which is not just a function of the exchange rate but a variety of other factors. We look at relative rates, relative to some of the other regions and so on. But put all that together our intervention in markets is again primarily to reduce volatility rather than to try and target a particular level. So I would not say we have target bands.

Arpana Tripathi: Nikkei What is your view on independence of the Reserve Bank on backdrop of IFC draft released recently and is there any concern about it?

Dr. Raghuram G. Rajan: I think you had an article by the former Finance Minister in the newspapers a couple of days ago and he has been Finance Minister for long time and given that he is out of government now he feels comfortable in talking about it. I think there has been healthy respect between the government and the Central Bank and the Central Bank ultimately decides what the course of monetary policy will be. Of course it seeks out and gets information from the government on how the government sees the situation and that factors into monetary policy decisions. Now, there are various attributes of independence that academic economists have used, and to some extent, I would argue those attributes are probably not as present in India as elsewhere. For example, fixed terms of Central Bank Governors and Deputy Governors, existence of a monetary policy committee, things like that. But I would say *de facto* independence including in the kinds of people that historically the government has appointed as Reserve Bank of India Governors as well as the space it gives them. The Government in India has the right to give direction to the Reserve Bank of India and tell it what it should do, there is a clause in the Reserve Bank of India Act. That direction had never been given in the history of the RBI. So you have to distinguish what is *de jure* from what is *de facto* and I think *de facto* the RBI is independent.

Gayatri Nayak: Economic Times You have talked about comfortable level of SLR, could you elaborate what would be the comfortable level of SLR that you have in mind and what is the timeframe that you would want to have it by?

Dr. Raghuram G. Rajan: This is an evolving issue. What is clear is that government bonds should find an open market and not have a captive market which is forced to invest in them. There will be a level of government securities that banks will want to hold because of liquidity, because of safety, because of protection, etc. You can see across the world, banks generally even when there are no constraints do hold some level of government securities. So we have to move towards that level, partly, because it is important that the government bond market be sort of freed up, but partly also banks need to be freed up to do what is most important, for example, credit to the non-government sector. So I think this is an evolving picture and we will know as time goes on. Most people would argue it is significantly below where we are right now. But the timeframe over which we reach that we have to be careful because we have to ensure we do not disrupt the government bond market as we go towards that point.

Gayatri Nayak: This is regarding the cost of funds and transmission. Not all banks have reduced lending rates over the period since you have reduced policy rates. One such segment of borrower through NBFCs they are not directly benefited out of rate cut. So, how would you help them get a better price?

Dr. Raghuram G. Rajan: The good thing about monetary policy as Governor Stein of the Federal Reserve said is it gets into every crack. In fact what we see today is transmission is not happening as much through the banks as through money market rates. Money market rates had come down significantly because of the Reserve Bank action. Those money market rates feed into the rates at which the NBFCs borrow, at the rates at which they issue commercial paper. So I think that rates eventually feed into everybody. They all get the benefit of low rates and therefore have to pass it on.

Gabriele Parussini: Wall Street Journal Is the low credit growth in the economy due to lack of demand or lack of supply? How much more capital do state-owned banks need by the end of 2019 and how do you see the unfolding of the NPA issue in the coming 2/3 years.

Dr. Raghuram G. Rajan: I will ask Mr. Gandhi to respond on the amount of capital that is required and perhaps Mr. Mundra also. On the issue of demand versus supply, you are asking a question of the ages, right? There is always a question that is asked, "Is it the banks that are proving too tight or is it the borrowers who are not coming to ask?" If you ask the banks they will say no borrowers are coming. If you ask the borrowers they will say the banks are too tight. In any beginning phase of the recovery this discussion always goes on. I think what happens is that over time as the opportunities that are brought to banks look more attractive and as deposit growth picks up and the banks have funds that they need to invest, you will see both factors happening — the opportunities will look more attractive and the terms will get a little less onerous. I would say today it is hard to argue that the healthy large firms have difficulty in accessing credit. They certainly can go to the commercial paper markets but the banks too are looking for good credits to lend to. Small and medium size enterprises always have difficulty and the difficulty because of liquidity constraints in the recent past may impact the higher because they have not received their payments from people who owe them money and so on. That is an issue we need to continue looking at and see how we can resolve it. But I would say that for now I am not overly perturbed about tightness in credit flow. My sense is that as the projects come up they will find financing especially given that the capital situation of the banks has improved somewhat. But, on the capital issue let me ask Mr. Gandhi and Mr. Mundra.

Shri R. Gandhi: On the capital required, it depends on the assumptions that we make. Two years before when we gave guidance to banks and the government also, at that time the banking sector was growing very fast. So now the growth has slowed down to 13-14% credit growth. So depending upon the current level of growth we have indicated that about Rs.1,40,000 crore capital may be needed. So government had announced its intention to support the public sector banks with Rs. 70,000 crore. In any case it will be constantly looked at, because it is a long process, up to 2018. So every year we have to relook at the figure based on the conditions prevailing at that point in time. As of now it looks good.

Shri S.S. Mundra: Just to add as you must have seen that while increasing the capital, the calculation which is done by the government is something like Rs.1,80,000 crore. The assumption is 12% credit growth for the current year and 15% credit growth for the rest of the part. But as Governor and Mr. Gandhi also mentioned, these are moving targets. How the growth in economy picks up, also the profitability and the ability of banks to retain profit, I think all these factors would need to be factored in as we move further. But range must be visible to you, something like Rs.1,50,000 crore to Rs.2,50,000 crore over a period of the implementation that is what looks to be the range at this point of time.

Radhika:
Hindu Business Line Historically, if we see there has always been a gap between the Reserve Bank’s rate actions and the banks’ lending rates. Even if we take a period between 2008 to 2009 or 2012 to 2013, the reduction in lending rates has always been far lower than the reduction in the policy rates. So when you say that any future action will be contingent on a full transmission this time around, what do you think has changed or is different this time that will allow banks to really cut the full 75 basis points on the lending rates?

Dr. Raghuram G. Rajan: I think that is a misunderstanding, we did not say full transmission, further transmission is what we said and transmission takes place over time. What is important to remember is monetary policy is not like the lever that you press immediately and immediately you get action. There is about three to four quarters lag between when rates are cut and when the effects are seen in the economy. So we started cutting rates in January, I would start seeing the effects of that rate cut only in September, October, November. This is something people have to remember when they look at rate cuts, we have to forecast what is going to happen in the economy three to four quarters down the line, not what is happening currently in the economy in order to gauge the impact of any rate action that we take. So we are fully sort of cognizant of the fact that transmission takes place slowly through the banks but that further beyond that into real activity takes a little more time. What the rate cut does is gives a signal which is why the market gets optimistic or pessimistic depending on the rate cut or the lack of it. But that signal then starts plans, the plans then fructify down the line, when those investment plans fructify you get more activity at that point. So there is a lag, three to four quarters. What we should be looking for now is the effects of the rate cut that started in January. They should start coming as we go forward and that is what we will be seeing soon.

Joel Rebello: Mint According to an analysis we have done, more than 50% of the NPAs from industries are from metals, power, infrastructure and commodities. Is RBI worried about this so called concentration of NPAs from a particular area or particular services? I also want to ask a question about the NPAs, do you really believe the banks' numbers or could we see more skeletons out of the cupboard? Also are you under pressure to not call NPAs NPAs?

Dr. Raghuram G. Rajan: Certain sectors are going to be hit. There are two sources of at least current stress — one is the global overcapacity and certainly you can see that in ferrous but also non-ferrous metals, that global overcapacity especially the huge discrepancies in China are affecting countries across the world including India. So that is one source of stress. Second source of stress is power. In fact power is probably the more important stress and that is less external factors more domestic factors. A central factor in the power stress is these power distribution companies. If they get resolved in a more permanent way then that would alleviate some sources of stress in the power sector. So our focus is how can we resolve the distribution company's stress in a proper way so that we can get power purchases going in a more effective way.

You asked whether we believe the bank numbers. We inspect the banks and we ferret out situations where there is something that is standard is not an NPA. These are called divergences. Some banks that are more divergences than others, in which case they have a pretty strong discussion with Mr. Mundra here in which he hauls them over the coals for what doing what they did, and increasingly, we are turning towards actually taking action on such divergences. So it is not that these things get done with impunity. There are of course in a stressed environment situations where sometimes projects are lent to when in fact they are better either closed or restructured in a significant way. Our recent actions, our attempts to get all players on the same platform to discuss how to put the project back on track in a significant way. This requires effort by both the banker, the promoter, state governments, central government, regulators, electricity, tariff, etc., for it to really work. And that is why we have been much less keen on forbearance going forward and saying "Face up to the reality you need to do what you need to do, take the medicine. Pushing it into the future is going to just create bigger problems in the future." There is always a discussion of these issues, because there is a thin line between forbearance and flexibility. We have said we are for flexibility. For example, sometimes, there is only little more to develop in a project and then it can start producing revenues. In that situation, should a bank lend into that project even if the project is NPA in order to complete it and put it back on track. We have said no problem in lending to a project which is an NPA, so long as it is meant not to evergreen, but to put the project back on track and get it going. Similarly, 5:25 rule, that sometimes is derided, we are actually examining 5:25 cases to make sure it is used for the right purpose. The point is not so much again to postpone problems into the future to postpone repayment way into the future, in fact, we are insisting that there should not be significant moratorium on repayment in the 5:25 rule. The point however is to ensure that what was structured as repayment in the short while for a long project can be extended. So, where there is genuine reason to believe it is a long project, extend it. So that kind of debate always takes place. Industry will say, please extend, please this thing. And we have to take a decision on whether this is forbearance which we do not want to do or flexibility which may be warranted in order to get the project back on track. Again, the primary force is getting it back on track rather than postponing the problem to the future.

Ushang: Zee Business What is your stand in terms of the common KYC for all financial products? What is your stand on increasing the limits for e-wallets which is presently capped at Rs.10,000? Finally, the status of small and payments bank licenses?

Shri R. Gandhi: Common KYC is a work-in progress. We have identified a common set of information for a common application. Already work is going on, some tests are also going on. Afterwards we will finalise.

Shri H.R.Khan: E-wallet is something which is catching up very fast and we are constantly reviewing that and that will get a push once payment bank comes. But certainly we will review the limits based on how things are evolving. We already have three categories where we have up to Rs. 50,000 with full KYC.

Suvashree: Reuters This is Suvashree from Reuters. Wanted to understand whether RBI is trying to maintain the liquidity deficit at below the previously stated one percent deficit target. Also, under what circumstance will you use OMO sales as an instrument to drain liquidity?

Dr. Urjit Patel: We have modulated liquidity to be as close to the policy rate as possible and we have explained in the statement itself that over May, June and July, different actions using the full gamut of instruments that are available to us have been used. We have ensured that there are comfortable liquidity conditions so that it helps the transmission and going forward we will be trying to keep the call money and the broader money market as close to the policy rate as possible.

Alpana Killawala: Thank you very much to all of you for joining. Thank you, Sir.

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.