

Edited Transcript of Reserve Bank of India's First Bi-Monthly
Post Policy Press Conference

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PARTICIPANTS FROM RBI:

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Dr. Urjit R. Patel:

Good afternoon, everyone. Thank you for coming to the First Bi-Monthly of the new fiscal year. We take this opportunity to welcome Mr. B P Kanungo to his first post monetary policy press conference.

Let me start with the Monetary Policy Committees' decision today. The MPC made a detailed assessment of macroeconomic and financial conditions, both domestically and globally on the basis of its judgment on the evolving outlook and the MPC decided unanimously to keep the policy rate unchanged in this review. The MPC also decided to persevere with a neutral stance of Monetary Policy. It noted that inflation is set to undershoot the target of 5% for Q4 for 2016-2017. For 2017-2018 inflation is projected to average 4.5% in the first half of the year and 5% in the second half with the risks balanced around the inflation trajectory. The MPC also noted that GVA growth could strengthen to 7.4% in the current fiscal year from 6.7% in the last fiscal year with risks balanced.

The MPC saw the path of inflation in 2017-2018 as challenged by upside risks and unfavorable base effects towards the second half of the year. Accordingly, inflation developments have to be closely and continuously monitored with food price pressures kept in check so that inflation expectations can be re-anchored. Accordingly, the future course of Monetary Policy will largely depend on incoming data on how macroeconomic conditions are evolving.

The Committee took note of the reduction in bank lending rates, but saw further scope for a more complete transmission, including for small savings and administered rates. In its opinion, along with rebalancing liquidity conditions, the Reserve Bank should endeavor to put the resolution of banks' stressed assets on a firm footing and create congenial conditions for bank credit to revive and flow to productive sectors of the economy.

I will touch on a couple of other issues first before I request the other Deputy Governors to speak. Regarding the guidance on liquidity, we have provided greater clarity on how we see liquidity conditions evolving and the manner in which we propose to manage them with ongoing refinements of the LAF as recommended by the Expert Committee to revise and strengthen the Monetary Policy framework. The objective is to more finely align the operating target, the weighted average call rate and money markets with the stance of Monetary Policy.

You may recall that post demonetization there was a surge of liquidity in the system which the RBI had to absorb to preserve financial stability and ensure unclogged channels of monetary transmission. At its peak, liquidity absorption was close to ₹ 8 trillion. The RBI employed a mix of conventional and unconventional instruments, the first line of defense were variable reverse rate repos of varying tenors. The incremental CRR functioned as a placeholder till the enhancement of the ceiling on securities under the Market Stabilization Scheme to ₹ 6 trillion by the Government.

This enabled the withdrawal of the incremental CRR within a fortnight of its institution. From the latter half of February, the situation was well under control, greatly facilitated by the wartime pace of re-monetization. This allowed:

- a) Progressive removal of withdrawal restrictions to completely lift off by mid-March.
- b) Increasing use of our own instruments by vacating the use of MSS securities.

By the end of March, liquidity absorption was down to ₹ 3.1 trillion, all of which was held in Reverse Repos.

Looking ahead, and there are details in part B, our endeavor will be to:

- 1). Drain out the remaining liquidity overhang.
- 2). Manage the new drivers of liquidity in 2017-2018.
- 3). Ensure that the normal requirements of liquidity consistent with the needs of a growing economy are met.

The first step, though not necessarily in chronological order, is the narrowing of the corridor to (+ and -25) basis points. This is a continuation of the reform initiated in April 2016 when we narrowed the corridor to (+/-50) basis points in consonance with the recommendations of the Expert Committee. The objective is to more finely align the money market rates with the policy rate, bring down volatility and create conditions for improved transmission of Monetary Policy across the whole spectrum of interest rates. A collateral benefit that market participant should note is that when liquidity conditions flip to a tighter mode, the cost of funds through the Marginal Standing Facility will be lower by 25 basis points.

The second step is the assignment of appropriate instruments to the sources of liquidity. Over the first half of the year we expect government spending to increase significantly, including due to large redemptions. Mismatches between the Government's cash flows, balances and recourse to bridge funding, Ways and Means overdrafts will be managed by the use of Cash Management Bills as envisaged under the arrangement with the Government put in place in 2009. Liquidity associated with forex flows will be managed with securities under the MSS, although the budgetary provision of capping them to gross issuance is of ₹ 1,00,000 crores will be an operational constraint that circumscribes the effective use of the MSS as an instrument of liquidity management, and increases the burden on the RBI's own instrument mix, but we will endeavor to manage.

Durable and semi-durable liquidity will be managed with a combination of longer tenor Reverse Repos and Open Market Operations. Fine tuning operations will continue to be used to manage day to day mismatches in liquidity demand and supply. We will continue to provide assured liquidity through our regular operations under the LAF.

The learning experience through demonetization period and the constraints circumscribing instruments such as the MSS underscores the priority warranted for strengthening the instrument tool kit of the RBI. It is in this context that RBI has proposed the institution of the

Standing Deposit Facility, drawing upon international best practices and the recommendation of the Expert Committee.

We have been engaging with the government on this subject for some time and will continue to pursue the matter with them. When the deposit facility is instituted, market participants have agreed that it will significantly improve the robustness of the liquidity management framework of the RBI.

I will now turn to the issues regarding banks. An important, perhaps the most important prerequisite for efficient transmission of Monetary Policy is a well capitalised banking sector that is able and willing to provide credit at reasonable terms to productive parts of the economy. The capital can come from either the market or the principle owner for the PSBs, which is the Government. Having completed the Asset Quality Review of our banks and with several other critical ingredients in place, viz., the insolvency and bankruptcy code and the Oversight Committee, the Reserve Bank of India has been preparing actively for the next steps in an orderly resolution of the bank stressed assets. This will be undertaken concomitantly with resolution of the weakest bank balance sheets under the aegis of a revised Prompt Corrective Action framework (PCA), and our new Enforcement Department that has started its work this week.

We reiterate that further creeping forbearance in the treatment of bank losses is untenable and costly for the rest of the economy. The measures that will be announced soon to deal with banks stressed assets and weak balance sheets along with the institutional strengthening that we just alluded to, should help enjoy confidence in our banking system, restore corporate demand and put us on the virtuous path of healthy bank credit and industrial growth. Thank you.

I will now request Deputy Governor, Viral Acharya, to say a few things.

Dr. Viral V. Acharya:

Just a few quick remarks on the management of surplus liquidity. I want to stress that with the rapid pace of re-monetization and increase in the currency in circulation as we have been seeing, we do expect the quantum of durable surplus liquidity to come down over the next few quarters. However, in the meantime over the next several quarters, perhaps three to four quarters we do need to manage the quantum of the liquidity that remains. And as the Governor alluded to, we will employ the whole toolkit that we have at our disposal within whatever constraints we face, in particular the MSS, longer tenor variable Reverse Repos, variable rate Reverse Repos, Open Market Operations if necessary, however in a well calibrated and nimble manner, so as not to have a large price impact on the G-secs. And in addition, we will keep dealing with the short-term liquidity needs through overnight and shorter tenor and Repo and Reverse Repo operations.

We are awaiting decision on our preferred facility which is the Standing Deposit Facility, beyond that we may deploy other tools if our tool kit remains constraint and contingencies that arise so demand. Thank you.

S. S. Mundra:

I will little bit elaborate on what Governor has already mentioned about the issue of asset quality. We have yet to get the final results of Q4 which has just ended, but based on the figures which were available for December quarter, the various indicators of the stressed assets they have further deteriorated during this period, though there had been some positive signals in the sense that the pace of acceleration of new NPAs, formation of new NPAs had relatively come down. The Provision Coverage Ratio had moreover remained stable, so resultantly the cost of credit in Q3 had come down. The overall capital adequacy, particularly of Public Sector Banks in Q3 was meeting the regulatory requirement, but quite clearly there would be more demand on the banks' capital as we have completed the Q4 and going forward also the capital would be needed for supporting the growth. So, having taken stock of all this, there had been an active engagement by the RBI as well as with the Government of India and all the tools which are required, all the options would be open and they would be employed. I think that there is a clear acknowledgement and recognition that the asset quality situation in which we are, there is no one size which fits all. There would be case specific instruments which would be required to be deployed and a number of them were introduced by the RBI from time to time. So, how to bring the faster implementation of JLF decision, how to enhance the number or role of Oversight Committees or whether to look at the sectoral or size specific approaches in achieving these resolutions these are all the options which are being considered and which are under active discussion.

PCA, already Governor has mentioned, we expect to put the revised PCA framework by mid-April and then it will become operative. There is another mention in Part B which is, of course, away from the usual question which always remains in your mind, but as you know that RBI also does a lot of developmental work, so in the area of financial literacy you will find that pilot project is being launched. And post pilot, I think there is an ambitious project of nationwide financial literacy campaign to be carried forward. Thank you.

N. S. Vishwanathan:

Among the measures that we announced in Part B, I want to highlight couple of them. One of course, is the decision to allow banks to invest and participate in REITS and invITS within 20 percent limit of their capital allowed for equity and equity type instruments. But I think the more important announcement that we are making is with regard to the branch authorization scheme where we are moving away from emphasis on a brick and mortar branch to a fixed location where banking service is available and the idea is that this will enable banks to provide cost efficient service. Cost efficiency is important to facilitate financial inclusion. We believe that this is going to result in further propping up of the financial inclusion measures by the banking industry in general and this might even facilitate for example the small finance banks which have come on the scene to do their job even better.

B. P. Kanungo:

I will refer to just one most important development that has been, a reference has been made to that in the policy, this is relating to the payment and settlement system, relating to NEFT actually and this is consistent with the vision document that we have announced, Payment System Vision Document 2018, and this is the introduction of the additional settlement batches in the NEFT system. As you know, presently it is on hourly basis and the batches start from 8am in the morning till 7pm in the afternoon. While the window of time will remain the same,

now we will bring down the periodicity from one hourly interval to half hourly interval. Consequently 11 more batches will be introduced which will significantly improve the customer service and increase the efficiency of the NEFT system. Thank you.

Dr. Urjit R. Patel:

We will take a few questions. May I request Mint.

Participants:

Gopika Gopakumar

Mint:

Basically the question is, do you see any sort of impact coming from excess liquidity on inflation going forward?

Dr. Viral V. Acharya:

I think the important thing to keep in mind is that while there is surplus liquidity in the system it is actually getting drained out through the large quantum of variable rate reverse repos that we are doing. So, as of now we do not have a reason to believe that there is sort of leakage happening through that in to the inflation numbers that we expect. I think the main symptom that we are seeing is the softness of money market rates at the short end, other than the weighted average call rate if you look at the CBLO rate, in some cases sometimes market repo Treasury Bill rates, these are softer and they have been at the lower end of the LAF corridor. And a part of the intension of the narrowing of the corridor is to anchor these rates closer to our target policy rate. And as Governor explained, of course this means that even when we are in a tight liquidity situation, the upper end of the corridor would now be lower at 25 basis points above the policy rate.

Shayan Ghosh
Financial Express:

What do you think are the implications of the farm loan waiver schemes and is it a cause of concern for the RBI?

Dr. Urjit R. Patel:

There are several conceptual issues, if one were to put one's hat as an economist on. I think it undermines an honest credit culture, it impacts credit discipline, it blunts incentives for future borrowers to repay, in other words, waivers engender moral hazard. It also entails at the end of the day transfer from tax payers to borrowers. If on account of this, overall Government borrowing goes up, yields on Government bonds also are impacted. Thereafter it can also lead to the crowding out of private borrowers as higher government borrowing can lead to an increase in cost of borrowing for others. I think we need to create a consensus such that loan waiver promises are eschewed, otherwise sub-sovereign fiscal challenges in this context could eventually affect the national balance sheet. Thank you.

**Govardhan
Economic Times:**

Governor, you mentioned that forbearance is no more tenable and that MPC is looking for resolving the bad loans issue. What are the specific things that the RBI proposes to do to clean up the banking system, the bad loans?

Dr. Urjit R. Patel:

I think there are a variety of things that have been put into place and more will be put into place, going forward. As Mr. Mundra mentioned and as has been enunciated in Part B of the Policy that a revised PCA framework will now be put in public domain mid-April which will trigger actions by the RBI vis-à-vis specific banks going forward. The IBC is now in place, the RBI's Enforcement Department has started its work and the fact of the matter is that there seems to be a renewed commitment from all sides, including the Government that we now need to address this in even a more forceful manner than we have in the past. Mr. Mundra, do you want to add anything?

S.S. Mundra:

I think I did mention in my opening statement, one thing is very clear, a number of instruments which were already introduced, if there is a need, there could be relook even at the existing instruments but the message which we are trying to give is that all these instruments are meant for resolution in a serious sense and not for postponement of a problem. And I think that would be the basic focus, going forward.

**Ira Dugal
Bloomberg Quint:**

Just on the inflation target side, your statement says we try and move towards 4% in a durable and calibrated manner. This year we are saying 4.5% in first half and 5% in the second half, and in the Monetary Policy Report there are some staff projections for the following fiscal we are saying we could come to around 4.6% by the fourth quarter of the following fiscal. Should one understand then that the RBI is comfortable with staying above that 4% mark for the next couple of years? I mean, there is no time guidance obviously but if the projections are suggesting that we are maintaining a neutral stance should we read into it if we are okay with this?

Dr. M. D. Patra:

So, as you rightly read into the MPR and other places, what RBI is signaling is that the move to 4% is going to be challenging, there are no lucky disinflationary forces in the horizon that were there in the past. And therefore if it is in this context that they move the stance from accommodative to neutral so that there is no one way bets on the way the RBI moves. So, the evolving outlook will decide how the RBI will move, but it is cautioning you that inflation is elevated relative to where we wanted to be.

Pradeep Pandya:
CNBC Awaaz

The Federal Reserve has taken this decision of unwinding their balance sheet. Earlier when there were talks of removing QE, it had impacted the rupee hugely. At this time how are you assessing this and in coming days what preparation would you do for the same?

Dr. Viral V. Acharya:

There was a sudden shock in 2013, this time they have been talking of this since last two to three years, so we are all gradually prepared for it. And I think emerging markets, including us, we are in much better shape overall. And I would actually stress that on many dimensions we are macro-economically very stable- something that the Government has taken actions towards, something that RBI has actually taken lot of steps forward. So, the 'Fed' has a very large balance sheet and it does create significant capital movements in the global economy. But we are vigilant and I think we are prepared to deal with them with various tools we have available.

Shishir Mehta
Vyapar:

Some cooperative banks have complained that whenever administrator is appointed to conduct the affairs they are not very open to the shareholders and depositors. Do you have any take on that? I am talking about a specific bank.

N. S. Vishwanathan:

See, it is not correct to speak about a specific bank in this context. But, please understand, whenever administrator is appointed by superseding the Board, it means that there are problems in the bank and the administrator has a new set of responsibilities to discharge and obviously if the Board and the shareholders were responsible enough, the need for an administrator in the first place would not have arisen. It is not fair for the shareholders to complain against the administrators in that sense.

S. S. Mundra:

I would like to just add here, as the structure of cooperative banks stands today, the shareholders and depositors are not the same thing, basically the shareholders are the borrowers in a cooperative bank. And to some extent may be not quoting individual bank, but they might have reached to a present situation because of some of those actions only. So I think if administrator is working towards safeguarding the interest of the depositors, it may appear little bit difficult to the others.

Mayur Shetty
Times of India:

Governor, the spread between the yields on long-term bonds, 15-year bonds and home loans has narrowed considerably, probably less than 100 basis points. I just wanted to know whether you are comfortable with this kind of narrow spread or you expect some kind of correction going forward?

Dr. Urjit R. Patel:

I mean, I do not think that at this juncture we are particularly concerned about the narrowing spread, it reflects a variety of factors, including a possibly slightly late transmission, so that is why it becomes evident. It could also reflect that the credit score and the credit culture in this

particular sector continues to be good. So, there are no reasons at the moment why we should be concerned about the spread coming down, it is a fairly secured asset which, you know, there is a long history of dealing with delinquencies in the sector. So, I think it broadly reflects market forces and the fact that housing has become an activity where there is a fair bit of Government support also which has made it affordable, going forward.

Latha Venkatesh
CNBC TV 18:

To continue with what Ira asked you Governor, you are speaking about upside risks to inflation. So, should we assume that even this movement to neutral cannot remain for long that if you have to get to 4% you will have to even go beyond neutral and get too hawkish?

Dr. Urjit R. Patel:

The Committee has also pointed out a couple of downside risks and we have also said that the economic content of the incoming data will determine our future course. We are of course aware of the risks on inflation and we have a medium-term target to achieve. So we will do that, but we feel that at this juncture the shift from accommodative to neutral is adequate. Thank you.