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

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Dr. Urjit R. Patel: Good afternoon, everyone and thank you for coming to the Fifth Bi-Monthly Policy of this Fiscal Year. As you know, today, the Monetary Policy Committee decided to keep the policy repo rate under the liquidity adjustment facility unchanged, by a majority of 5:1.

It also decided to persevere with a neutral stance of Monetary Policy and reiterated its commitment to keeping consumer price index (CPI) inflation at the target of 4% while supporting growth.

In arriving at this decision, the MPC took note of the upside pressures from food and fuel prices on evolving cost of living conditions and inflation expectations. Our surveys indicate that corporates are also contending with rising input cost conditions and higher risks of pass-through to retail prices in the near term.

In addition, the Committee expressed concern about the implications for the inflation outlook of (a) possible fiscal slippage and (b) global financial instability, heightening asset price volatility. However, the MPC also expected the usual seasonal moderation in the prices of vegetables and fruits and the lowering of tax rates by the GST council to mitigate some of these pressures.

The MPC's decision was also conditioned by recent developments that augur well for growth prospects, going forward. In the primary capital market, resource mobilization has increased significantly, which will add to demand in the short run and boost the growth potential of the economy over the medium-term.

Recent reforms have contributed to an improvement in India's ease of doing business ranking which should help sustain foreign direct investment.

The MPC also took note that large distressed borrowers are being referenced to the insolvency and bankruptcy code (IBC) proceedings. Public sector banks are being recapitalised and this should enhance allocative efficiency.

In view of the MPC, all these factors should help to create conducive financial conditions for nurturing higher growth.

Turning to recapitalization of public sector banks, the Reserve Bank has been working closely with the Department of Financial Services, Government of India to finalize for each bank: one, the extent of funding to be raised by the bank; and two, the amount of recapitalisation bonds to be placed on the bank's balance sheet as Government's equity contribution.

As announced by the Government, the plan will be differentiated across banks. In particular, recapitalization bonds will be front-loaded for banks that have managed their balance sheet strength more prudently and can use injected capital to lend besides providing for legacy asset losses.

The other banks will receive Government contribution based on their resolve and progress towards reform in a significant and time bound manner; such as becoming slim and trim through adoption of simpler, better focused business strategies as also possibly non-core asset sales. Governance reforms for all Public Sector banks will also feature as part of the overall plan.

To summarise, this will be a reform and recap package and not just a recap package. So as to ensure that this money is used to strengthen public sector bank balance sheets and that we do not sow the seeds of the next boom and bust cycle of lending. Details will be released in the coming days by the Department of Financial Services.

I will now request Dr. Acharya to say a few words.

Dr. Viral V. Acharya: Thank You, Governor. Good afternoon, everyone. I will talk about the prevailing liquidity conditions. The liquidity conditions have continued to normalize gradually during the year. The overhang of liquidity surplus in the banking system post the withdrawal of specified banknotes or SBNs in November 2016, which had touched a peak of close to Rs. 7.96 trillion at the beginning of the year has since come down.

Banking system liquidity has in fact been moving towards neutrality as the currency in circulation has expanded by Rs. 7.6 trillion during the period January 6th of this year to November 24th.

During the year, surplus liquidity was high due to two reasons – one that is well appreciated, the overhang from withdrawal of SBNs; and second, which is somewhat less appreciated, the foreign exchange operations. The surplus liquidity was absorbed on a durable basis through a mix of open market operations or OMOs and issue of securities under the Market Stabilisation Scheme.

In addition, variable rate reverse repos of different tenors were used to absorb the short-term surplus. Going forward, it is expected that the liquidity conditions would be marginally still in surplus by end of fiscal year 2017 - 2018. Given the trends in currency in circulation, it is expected that system liquidity may reach neutrality in the first-half of 2018. Of course, these are projections and there are some uncertainties around these. But, this is what we see as the likely outcome based on data available.

The Reserve Bank will continue to manage the evolving liquidity conditions through a mix of variable rate repo and reverse repo operations of various maturities. These are for handling short-term liquidity fluctuations. We will also consider open market operations in case the liquidity is required to be injected or absorbed on a durable basis. Thank you.

N S Vishwanathan: I just want to draw your attention to one of the announcements in Part-2- the Statement on Developmental and Regulatory Policies. This is regarding implementation of the report of the working group on hedging of commodity price risk by residents. So as stated there, we have already placed the report on the bank's website on 16th November for comments and we intend to come out with our final guidelines on this by January 15, 2018.

As you might be aware, the current regulation is based on reports submitted in 1997 by the R V Gupta Committee and a lot of changes have happened. So several recommendations have been made by this group and we hope that we will put in place set of regulations that are most suited to the current frame work in place. Thank you very much.

Dr. Urjit R. Patel: Mr Kanungo, please.

B. P. Kanungo: Thank You, Governor. If you take a look at the Part-II – Statement on Developmental and Regulatory Policies, there are two significant announcements that are being made.

The first is pertaining to the merchant discount rate (MDR). As you would have noticed, the retail payments in the recent times has gained significant growth and within that, the card payments have also increased manifold and again, out of those card payments the use of debit cards in the POS that is the Point of Sales that has significantly increased.

To give you a flavor of the kind of increase that has taken place in 2016 – 2017, the percentage usage of debit cards at the Point of Sales, in volume terms was 21.9% and that is now almost at that stage. So we thought that it is about time that a further push is given to that and one of the ways which we thought we will achieve that objective is the rationalisation of the merchant discount rate. This is especially intended to widen the network of merchant establishments, which will accept this, i.e., the Point of Sales. We have been guided by twin objectives in this. The first is that the acceptance infrastructure will accept it more happily and it should also leave money on the table for the stakeholder, so that they are interested in the game to invest in technology and other things.

It has many salient features that the previous system of ad valorem rate continues, but the slab system has been done away with, we have gone by the merchant category, which will be very simple to administer. There is also a limit on the card transaction and the third aspect is that a differentiated MDR for asset light infrastructure has been put in place which will be slightly less. So with this, we believe that the debit card usage at POS terminals, especially for the small merchants will gain further boost.

There is also another policy announcement relating to the External Commercial Borrowings (ECB). As you would be aware, when it comes to refinancing, the bank branches or the wholly owned subsidiaries (WOS) of the Indian bank branches abroad were not allowed to re-finance the ECBs. Normally what happens is, when the ECB is contracted, it is for an average period of five to six years. At that time maybe it is not a viable unit, or it is as the nascent stage and the foreign investor does not have an appetite also to take a very long-term risk. So, they prefer to give it for five to seven years. When the cash flow starts coming, the Indian borrower is in a position to access ECB or refinance it at a lower rate. And the current instruction is, if the all-in-cost has come down, in that case their ECB can be refinanced. But the Indian banks were kept out of the purview of this for some reason which was very relevant at that point of time.

So now in order to give a level playing field, we have said that along with the foreign banks, the WOS of the Indian banks and their branches overseas will also be allowed to extend refinancing facility to the Indian corporates which is a very significant step. Thank you.

Dr. Urjit R. Patel: We will a few questions. We start with Financial Express.

Bhavik Nair: Financial Express Yes, Good afternoon, Governor. So the inflation estimates have been nudged a bit higher to 4.3% - 4.7% in the second-half of the year. Now, at the same time you have mentioned that the second quarter growth has been lower than what was projected. We have seen that after bottoming out for five consecutive quarters, the growth started picking up in the second quarter. Now, let us say if the growth does not pick-up further and it continues to lag at the same time when inflationary pressures remain, what will have more prominence here for RBI's policy decisions, going ahead?

Dr. Urjit R. Patel: You know, we have a neutral stance which means that depending on the data flow in the coming months and quarters, we will determine what we do regarding the policy, so the neutral stance is there for a reason that all possibilities are on the table and we would look carefully with both the inflation data and the growth data that comes in the coming months. The change is that our inflation projection is at the end of the day very small. It is 10 basis points compared to the October policy and we are still retaining the growth out turn for the full year at what it was in the October policy.

Anup Roy:
Business Standard Thank You, Governor. Sir, because of drying up of liquidity, banks have already started raising their bulk deposit rates. So, you still expect transmission? Bond rates are rising.

Dr. Urjit R. Patel: You should look at the existing rate of the bulk deposit and where it has been increased to. It is more of a qualitative assessment rather than the quantitative. To the best of my knowledge the wholesale deposit rate was very low in the first place. Secondly, I do not know what you mean by liquidity drying up because our Weighted Average Call Rate continues to be below the policy repo rate. So to me, it is not at all clear and we are still undertaking a fair bit of reverse repo operations. So liquidity drying up, I think is just a wrong definition of what you are saying. You want to add something, Dr. Acharya?

Dr. Viral V. Acharya: Yes, I think that perhaps the market is adjusting to the fact that we have been in remarkably surplus conditions for a while. But I think, we are nowhere close to having reached neutrality, if you were neural some days you would pump in liquidity, some days you would absorb liquidity, we are still essentially absorbing liquidity as Governor said, to the tune of Rs. 20,000 crores to Rs. 70,000 - Rs. 80,000 crores on a pretty persistent basis. And I want to stress one thing, which I mentioned in my remarks as well, which is that the FX operations in terms of buying dollars in the earlier part of the year were substantial. They injected close to Rs. 100,000 crores liquidity from RBI on top of the demonetisation induced liquidity. In a text book operation, as soon as you inject liquidity you would actually sterilise it with an Open Market Operations because otherwise you lose control of your monetary policy. We have done this time with a lag because we were waiting for the liquidity conditions post-demonetization to normalize and see where the currency in circulation stabilizes. But a lot of the open market operations that we did, in fact I would say the quantum was essentially in line with the FX operations that we undertook and when we cancelled the last OMO, it was effectively around the right number and so we could have gone slightly above or slightly below and we chose to end slightly below.

Manojit Saha:
The Hindu Good Afternoon, sir. What is the percentage of bank accounts where an Aadhaar seeding has been done? We have to do it by 31st December, so what is the status now?

N S Vishwanathan: We do not have that number as such. We do not have the number. That has not been collected yet.

Manojit Saha: How difficult is the task going to be? That is the question. By 31st December, we have to do Aadhar seeding, how banks are prepared, basically, that is the question?

N S Vishwanathan: If you look at the way the seeding has to happen, initially we have said that on the basis of demographics they can complete the seeding. So that can be done for a large number of people in one go, so that we do not see as a problem. Ultimately of course, they will actually have to do the biometrics, so that will take some time, but I think, going by the demographics, I think that is possible to be done.

Govardhan Rangan
Economic Times: Thank you, sir. Sir, the Para 17, you mentioned about keeping in the mind the output gap dynamics, MPC decided to continue with the neutral stance, does that mean the MPC considered shifting of stance and it is only the consideration of the output gap that made you keep neutral and if there is going to be a kind of acceleration growth- what happened in the last quarter continues, then the next move could be shifting stance, probably as early as February?

Dr. Urjit R. Patel: You know, we did not consider shifting the stance because nothing between October to now was significant enough in terms of the macro outcomes to warrant that and as I said in the first question that was asked that we will look at the data in the coming months and the coming quarter or two and decide on the policy based on that, which is exactly what the neutral stance enjoins us to do.

Sunitha Natti
New Indian Express: Thank You, Governor. You mentioned about the bank recapitalisation plan as a reform and recap package. When do you see the next cycle of lending to kick start, as such?

Dr. Urjit R. Patel: Actually, the latest data on bank credit, adjusted bank credit and total financial resources flows suggest that we are already on the uptick in terms of the credit growth. So credit is already flowing in, more than what it was the case in October and as the economy picks up the demand for credit should go up and there is enough supply to ensure that lack of credit is not in the way of supporting higher growth. So, the uptick in credit growth has already happened.

Ira Dugal
Bloomberg Quint: Sir, banks have continued to report fairly material divergences in bad loan reporting for FY 2017, there is a bit of confusion on what exactly is going on, is there another round of an AQR? Is it that restructuring schemes are being looked at because in private conversations bankers tend to say that the RBI is moving the goal post and hence, these divergences are coming. Can you please help us understand, sir?

N S Vishwanathan: I think, I must clarify two things. One, divergences on the basis of inspection used to happen in the past as well. What has changed is the transparency that we have brought in, in the form of disclosure or divergences when they are more than a certain percentage. So that has actually changed the narrative in terms of that. So this divergence is to happen even prior to AQR and it is happening now. Second is, I want to make it very clear there has no change in goal posts, the rules are as they are, we have assessed the banks' asset classifications based on the rules as they are today, and we found that in some of the cases they have not applied the rules correctly.

Dr. Urjit R. Patel: we can take one last question. ET Now?

Supriya Srinate
ET Now: Thank you very much, sir. You said, you have retained the GVA at 6.7%. Given that, what would your projection be for Q3 and Q4?

Dr. M D Patra: They are going to be 7% and 7.8%, so we are on an up-trend from now.

Dr. Urjit R. Patel: Thank you.