“Reserve Bank of India Post-Policy Conference Call

for Researchers and Analysts ”

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Moderator: Ladies and gentlemen, good day and welcome to the Reserve Bank of India Post-Policy Conference Call for Researchers and Analysts. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. To ask a question you may press '*' and '1' at any time during the conference call. Should you need assistance during the conference call please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Alpana Killawala from RBI. Thank you and over to you.

Alpana Killawala: Thank you Melissa. We have the Governor, Deputy Governor and Executive Directors here. Welcome to the conference. Governor will say a few words before we throw it open to the question and answers. I hand it over to the Governor. Governor?

Dr. D. Subbarao: Thank you, Melissa and thank you, Alpana. On behalf of all of us here I want to welcome all of you once again for this teleconference with the researchers and analysts. Just for your recall, yesterday we took some actions. The repo rate was raised by 50 basis points from 6.75% to 7.25%. Consequently, the reverse repo rate stood adjusted upwards at 6.25%. We revised upwards the interest rate on savings bank deposit from 3.5% to 4%.

We revised the operating procedure for LAF. There will be only one independently varying policy rate henceforth and that will be the repo rate. The reverse repo rate will be pegged 100 basis points below the repo rate and that will no longer be an independent variable.

A new marginal standing facility, MSF is being created with an interest rate 100 basis points above the repo rate. So the new corridor is 200 basis points right with the repo rate in the middle and the upper bound being the MSF rate and the lower bound being the reverse repo rate.

A lot of people have asked us if it actually widened the corridor. That is not true because we have actually fixed the width of the corridor between the repo rate and the reverse repo rate at 100 basis points and there is a new corridor above the repo rate but that is a separate matter, it is not as if we widened the corridor.

The motivation for this is to more accurately signal the monetary policy stance of the Reserve Bank and to contain the volatility in the overnight interbank rate.

The MSF is expected to be an exceptional facility. Indeed, initially we wanted to call it the EMSF with 'E' standing for 'Exceptional'. But just for brevity we eliminated that but I do want to say that we expect that this will be an 'Exceptional Facility,' used only after other avenues have been exhausted, that is the repo market and the CBLO. We do not expect banks to routinely come here.

And indeed if you look at the situation when they come they will now have on average about 4 to 5% points of SLR above the requirements so they have to exhaust all that. They have to play in the repo market and the CBLO and then only come here. And in spite of that banks are repeatedly coming here that should signal to us that there is a problem on the liquidity side. So we believe that it will remain an 'Exceptional Facility.'

I just want to make one other comment on this shift from 25 basis points to 50 basis points hike in the repo rate that we effected yesterday. There were a lot of questions about the rationale for this whether this means that inflation is a much greater concern now whether we are sacrificing growth, I do not intend to address all of them but I do want to say that between last year and this year growth inflation dynamics have changed. Early last year in 2010-11 the conditions were significantly different from what they are today. Domestic recovery was yet to get a foot hold, there was uncertainty about the monsoon. On the global front, recovery was still fragile. And importantly, drivers of inflation were mainly from the food side so it was a supply pressured inflation to start with. Many of you will note that the non-food manufactured inflation rate was actually moderating between June and September of last year.

Now if you move forward to current year on the month of May 2011 recovery is on track, output gap has closed and the economy is operating at near full capacity. On the global front some risks have abated but some other risks have arisen. But most importantly, the drivers of inflation have changed from food to non-food and fuel.

The surge in international commodity prices firmed up more than we had anticipated, thereby increasing the uncertainty. Also on the non-food primary products there was more pressure on prices than we had expected and producers were able to pass on these higher input prices to consumers signifying that there are demand pressures. So the known unknowns have increased.

And as Subir was telling us in the morning, for this year, the risks to growth are abounding all the risks to inflation are on the upside and essentially unbounded. So this change in situation, change in conditions between April 2010 and early May 2011 is the motivating factor for the change in our strategy whereby we had to hike policy rates by 50 basis points. It was essential last year, for example, our focus was on supporting growth and anchoring inflation expectations and you will recall that rates went historically low during the crisis; it took us some time to move them up to normal levels and move them up to levels sufficient to combat inflation. But now the emphasis is on checking inflation by restraining demand and anchoring inflation expectations and to navigate to a soft landing. Thank you.

Alpana Killawala: And with that we will start with the questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. At this time anyone who wishes to ask a question may press '*' and then '1' on their touchtone telephone. If you wish to remove yourself from the question queue you may press '*' and '2.' Participants are requested to use only handsets while asking a question. We have the first question from the line of Srinivas Varadarajan from Credit Suisse, Singapore. Please go ahead.

Srinivas Varadarajan: Hello, Governor and distinguished panel, thank you for doing this call. My question is really on the new LAF framework and it is as follows. Is it not the Reserve Bank of India actually constricting its degrees of freedom by essentially just targeting one rate which is the repo rate which really means that the banking system is essentially short of reserves and the reserves are actually supplied by the Reserve Bank of India at its targeted rate? It is all very well that we need to see better transmission during times of inflation, but what happens in times when you have capital flows and you have a different set of problems. As I understand it in advanced countries and especially in Europe targeting one rate and keeping the system short on reserves works because the external sector and the capital account is not controlled which is not the case in developing countries like India. So the question is, isn't it kind of constricting your degrees of freedom? And related question here is do you envisage the possibility of actually targeting the policy rates overnight repos and having variable rates for longer tenure repos that you would do, to kind of fine-tune liquidity something that is again being done by the ECB? And these are really the questions. And the second question really is actually coming from Page 10 of the policy where you said financing the CAD could be a challenge in the future if basically developed countries exit their accommodative monetary policy. If that happens and it kind of gets in tune with growth slowdown in India I mean obviously you see a challenge in terms of financing the current account deficit and capital outflows, what would really be the implication, it is going to have a bearing on the currency and on government finances and government cost of borrowing, is there a possibility that actually government bond rates, sovereign bond rates could actually hit double-digits something that you have not seen in the last decade?

Dr. D. Subbarao: I am going to request Subir to answer the first question.

Subir Gokarn: I think the context for the new corridor is essentially the experience we had in 2008 when call rates became extremely volatile and spiked up to 17%, 18%, 20% in a period of intense liquidity pressure. Obviously, that was not a normal situation and we should not expect such situations to happen very often, but what it did point out to us was that the corridor as a mechanism was not proving to be very effective. In the sense that when you are tight on liquidity the call rates were unbounded on the upside, and when you add surplus liquidity, it just moves to the bottom of the corridor and there wasn't any corridor such as an upper bound and lower bound. Since we are looking at call rate as sort of the market indicator of our policy stance, we felt that we needed to bound it and look at the factors that cause that volatility, it was essentially absence of kind of back-stop facility which meant that if banks were short of liquidity all they had was the call market. So, yes, the MSF, the Marginal Standing Facility is essentially a back-stop. And what we have done with it is to simply formalize an existing ad hoc measure which is the ability for banks to borrow against SLR securities from 24% of

NDTL to 23% of NDTL. Right now, they can do that at the repo rate what we have done is to introduce a premium and that is the rate at which they can access the MSF should they need to. As the Governor said this is essentially seen as something that will become operative only in situations of extreme stress. The average holding for the system in terms of SLR securities is around 28% and from 28% to 24% is they have the capacity to access the repo. It is only if they reach that, or individual bank reaches that level that they would actually have to go to the marginal facility. But it is a backstop. It is something that they have should the need arise . The stability of the call rate was the big motivator here. Now, are we losing out anything in terms of degrees of freedom? Not really, because firstly, 100 basis points corridor existed in any case, so in that sense, the earlier system has been simply been embedded into the new one. If liquidity starts to become abundant, the rate will move towards the reverse repo which it did in any case with or without the system. And if we are dealing with situations of excess liquidity, keep in mind that we do not target the exchange rate but if we find ourselves in a situation of having to absorb the excess capital inflows, we have the CRR, we have the MSF, we have other quantitative instruments to do that. So it is not as though we are only operating in an environment of rate instruments, there are also quantity instruments that we can bring together which is how we have managed the processes on previous occasions.

Dr. D. Subbarao: Deepak, do you want to add something, you are the author of the report?

Deepak Mohanty: Just to supplement what DG was just mentioning, I think technically, any operating procedure of monetary policy, would have two objectives. One is signaling, other thing is transmission. As you know signaling is much better in a single objective function if it is there. So that is why the single rates should be there. And in terms of transmission what you have seen globally is our case. Also in the recent experience, one, the system is in deficit so then the transmission is much better. But now the question that how much the liquidity adjustment facility can really tolerate in terms of liquidity. So it is designed to tolerate the frictional liquidity. And if liquidity indeed is structural as we have seen, so clearly, the LAF is not designed to handle that. So as DG mentioned if there is structural liquidity and it is coming from somewhere else for example, in terms of excess capital flow, so there are other instruments which should be used that is CRR or MSS. And if indeed, there is liquidity surplus is coming from elsewhere, so there are other instruments which can be utilized. Thank you.

Dr. D. Subbarao: Shyamala do you want to quickly add to that?

Shyamala Gopinath: Yes, I will just respond to the latter part of the question on the current account deficit and maybe how we operate the liquidity facility in the context of reversal of flows and when there is an outflow. See, one thing we should remember is that even if financing is a challenge, we have policies in place which clearly cushion us against such vulnerability. For instance, you were mentioning about the bond yield going up if there are huge outflows. As far as the government bond market is concerned the debt market in general and we do have a capital account framework where we have a kind of a quantitative limit on the amount of investments that foreigners can make, and therefore, even in terms of financing the fiscal deficit through the market, the dependence on foreigners is far lower in India, we do have a large domestic investor base. It is true that probably if monetary conditions and liquidity conditions overseas change, there may be some impact on in terms of getting the ECBs, particularly, debt flows, but this will not have such a major impact because of our policy framework. And in any event, if there is a liquidity issue, then we do have instruments to inject liquidity into the market in the event of outflows.

Srinivas Varadarajan: Just one suggestion. A lot of the volatility that you are seeing in liquidity is because the government cash balances in WMA. Is it possible to kind of publish government WMA on a more frequent basis, may be on a daily basis or a one-day lag basis? The second point which I thought I should make and I will close after that is obviously OMOs are going to be an important tool in managing liquidity. I was wondering whether you could comment on the possibility of lot of bonds are actually trapped in the HTM books of banks. If you try and release some of that so that the OMOs themselves become more effective both in terms of conducting policy as well as operating the window. Just your comments on that?

Shyamala Gopinath: Yes, on the publication that WMA or in general, I mean, I would say government balances as such, whether it is surplus or deficit, more frequently we are examining that issue in consultation with the government. In any event, in our weekly statistical supplement it does come but I agree with you that since it is with a lag, the information is lagged. We are in consultation with government. There are technical issues in doing it on a daily basis because it is a pool and all flows need to be reflected in that account on a daily basis, end of the day, and therefore, daily could be an issue but we look at seriously we are examining this issue of making this information, more frequent, if not, daily. On the other issue of HTM and release for OMO operations, through that to the extent that the bonds are held in HTM and if any OMO involved a loss, the banks maybe reluctant to sell these bonds but this is an overall definitely an issue for us and in any event once the IFRS is adopted by us these investments would be held in accordance with IFRS principle which also permits amortization of cost. But maybe it probably would change the behavior of banks.

Srinivas Varadarajan: Thank you very much.

Moderator: Thank you. The next question is from the line of Rajeev Malik from CLSA, Singapore. Please go ahead.

Rajeev Malik: Thanks very much, Governor and team and at the very outset, much appreciated the time you guys spent taking our questions and bearing with us. I will keep this really short because I know there are others would want their question in. Two part question. One, rather simple, something that is not really new, I have talked about and brought it up before. Since the RBI puts so much emphasis on non-food manufactured growth inflation why does it not announce a forecast for it? Do you not think that would actually help in anchoring inflation expectations much more than the headline WPI where many of the things, whether it is the monsoon impact or the governments, local fuel price hike, uncertainty pretty much put it off course for the last several years the official forecast has been off course partly because of that and then there were other factors. The second question is really on demand dynamics. You are forecasting nominal credit growth of 19% which is only a tad slower. Given the kind of hawkishness and a 50 basis points increase and almost an all-out war, is that sufficient especially when you look at it on an inflation adjusted basis, your own numbers actually real credit growth in FY12 is going to be a touch higher than what it was in FY11. And finally, the policy statement or even the macro review that came out, did not really give much clarity on what was unique December onwards that the pass-through of a variety of higher input prices increased. It certainly was not that companies were sitting on much fatter margins, demand was actually slowing. So that piece of the puzzle still persists. Thanks very much.

Subir Gokarn: On the first question yes, Rajeev that is certainly an objective that we want public forecast of whatever components, whatever measure of inflation that is sort of critical or significant in our policy calculation. Of course, the risk with publishing forecast is that if you are wrong then it creates further complications but it is something we are working towards. On the second question of credit growth, Deepak, perhaps you want to address that?

Deepak Mohanty: Rajeev, in terms of the credit growth because we have a projection of inflation, projection of growth and so this is consistent that. So, added on to that that we also would have to see the government's budgeted market borrowing program through. So the balance of resources which should be there should adequately finance this. And in terms of credit, again, that one really would have to see that apart from bank credit because there are also external sources of funds which is quite sizable and we also put out that number in the Money and Macro you would have noticed. So in terms of aggregate demand that one really would have to see what is happening to overall credit in the system.

Subir Gokarn: On the third part of your question on what changed in December we have tried to articulate our sense that it was really the turnaround in commodity prices which I think is just a factual statement but how it pass-through into producer prices or wholesale prices across the board I think is the question you are asking. Margins, they have not obviously exploded which is not the indicator here. I think the indicator is essentially that they softened considerably or they did remain relatively robust. Now, of course, the corporate numbers for Q3 are delayed this quarter because we have a two months window for reporting but certainly in our discussions with industry and we do that a lot, do that to number of consultations we did put a lot of emphasis on the question of whether fourth quarter margins were shrinking dramatically or not, some people said they were under severe pressure but many people said, no, they were certainly not looking as healthy as they did during the first three quarters but there was no appreciable shrinkage. So that gave us some sense of validation of the pass-through. And so that is really the judgment that we have gone with. But you will of course see this as the larger body of companies declared results through the course of May obviously there will be some validation for this, but the sense is that the compression has not been very significant and that reflects and that there may not be an escalation but there certainly is significant pass-through.

Rajeev Malik: Many thanks.

Moderator: Thank you. The next question is from the line of Kumar Rajapodi from Barclays Capital, Singapore. Please go ahead.

Kumar Rajapodi: Good afternoon, sir. I have a question on the credit growth projections actually. Given the way the RBI is actually saying that it would want to maintain tight liquidity condition going forward and given that the deposits growth projections are only 17%, do you think that the incremental deposit growth will actually result or will give enough money for banks to have a 19% credit growth or do you see some kind of downside risks to that?

Deepak Mohanty: As I have clarified, given our inflation projection and the growth and the implicit government borrowing program, so this number is consistent with that. And so I do not know going forward how the demand would evolve and things like that. Indeed, if the government market borrowing program is higher then there could be pressure on the resources.

Kumar Rajapodi: Okay, thank you.

Moderator: Thank you. The next question is from the line of Mahrukh Adajania from Standard Chartered, Mumbai. Please go ahead.

Mahrukh Adajania: Sir, just wanted one clarification on some guidelines relating to NBFC. Is there a guideline now that bank lending to NBFCs cannot be classified as priority sector?

Dr. D. Subbarao: Yes, by implication. Because what we said is that banks lend to NBFCs and NBFCs in turn lend to MFIs that will be classified as priority sector. Banks lend to NBFCs and NBFCs will lend for other priority sector purposes not MFI, then that will not be priority sector.

Mahrukh Adajania: Okay. Thank you so much.

Moderator: Thank you. The next question is from the line of Deepali Parker from ING, Mumbai. Please go ahead.

Deepali Parker: Good afternoon, sir. I have two questions. The first one being what amount or rather extent of pass-through of higher crude oil prices to administered mineral oil prices as RBI expecting in the March 2012 inflation projection by RBI? And the second question being there is an emphasis on reduced volatility and increased monetary policy transmission in the new operating procedure of monetary policy. Will the intent also apply to short-term money market rates? Because currently, if you look at the correlation and the spreads between call and the CP-CD rates they are volatile and much higher than what you have seen globally on an average. Thank you.

Dr. D. Subbarao: Deepali, there were some assumptions we made about the pass-through. We do not want to put them in the public domain because we are not privy to what might eventually happen but we assume that the price is $110 per barrel on the average for the year and that there will be some adjustment done in the first half year, indeed in the first quarter on the prices of both petrol and diesel. Can you please repeat the second question of yours?

Deepali Parker: Sir, I wanted to understand that since there is a lot of emphasis now on a better monetary policy transmission and reduced volatility in call, does the same also apply to the money market rates, the short-term for example, three months CP-CD rates? So if you look at the spreads between call and three months CD, there have been very volatile and rather much larger than what you would see globally and also versus our Asian peers? So are you also looking at the volatility of the spreads?

Deepak Mohanty: See, it is one thing that if you have a look only at the money market. So basically what one should be looking at the call money and the collateralized segment which again would be in market repo and CBLO. So there the correlation is very good between the call rate the way transmission happens and also with the other collateralized segment. And also the transmission is quite good to other money market instrument that is important. And some bit of volatility as you mentioned has come about because given the imbalance in resources in the system depending on the corporates' preference for CP and similarly, since the banks were short of funds in terms of which was again reflected in lower deposit growth, so there was a demand for CD. So that is kind of transitory that one would think but generally the transmission is quite good from the policy rate to the collateralized segment and then going on to the other money market instrument.

Deepali Parker: Thank you very much.

Moderator: Thank you. The next question is from the line of Subhra Mittal from Kotak Mahindra Bank, Mumbai. Please go ahead.

Subhra Mittal: Good afternoon, sir. I have two questions, the first was related to the report on the working group on the operating procedure of monetary policy. Sir, in its report the Committee had recommended that the upper bound of the corridor should be 50 basis points above the repo rate. However, you have decided to keep that upper bound at 100 basis points above the repo rate. Could you elaborate on any reasons for deviating from the recommendations of the Committee? My second question relates to the inflation projection of the Reserve Bank. According to the Reserve Bank, WPI is likely to be close to around 9% in H1 and then moderate towards 6% by March end. Could you explain some of the assumptions behind the moderation to 6%? Thank you.

Dr. D. Subbarao: Okay. Subhra, I will answer the first question about raising the upper bound by 100 basis points or rather than 50 as recommended by the Committee because the Committee of course was headed by our Executive Director but also had both the internal and external members. But when we examine that within the management of RBI we thought that this rate must be penal, as we were discussing a short while ago, banks must access this facility only after they have exhausted all other avenues and with considerable thought. And that will happen only if the rate of interest is stiff, and that is the reason we pegged it at 100 basis points rather than 50 as recommended by the Committee. I will defer to Subir or Deepak for their assumptions on the inflation part.

Subir Gokarn: The main driver of that pattern is the fully realized impact of past tightening. We typically see about a four quarter lag between the beginning of the transmission and the full impact on inflation rate. So our scenario suggests that the 350 basis points tightening we have done over a year now, now it is year plus 50 so it is 400 basis points over a year. But the previous actions we do expect to see them impacting on inflation in the second half of '11-12. So that is the main driver of the moderation inflation. But as you pointed out that this in itself is based on certain assumptions about oil prices and commodity prices and also some pass-through from there. And which is why we have highlighted the fact that the risk to inflation are predominantly on the upside now because we do not really see very realistic scenarios of significant decline in commodity prices. It may happen but the probability is at this point we think they will either remain firm or rise further. But the cumulative impact of interest rates will have an impact on inflation in the second half. So putting these two factors together we have come out with that moderating inflation scenario but also as I said emphasize that risks are more on the upside.

Subhra Mittal: Thank you.

Moderator: The next question is from the line of Aniruddh Godbole, an individual investor from Bangalore. Please go ahead.

Aniruddh Godbole: Good afternoon to the distinguished panel. My first question is regarding some of the recommendations made by Deepak Mohanty Committee. There is specific recommendation on which I would want to know whether the recommendations have been accepted. One is about auctioning of government cash balances and second is about the occasional liquidity support that maybe provided using variable rate auctions. My second question is does the Reserve Bank in its analysis, has it identified any reasons why the export growth may have been so strong in Q4 to be around 46%? My third question is I understand that in future lending to MFIs may be classified as priority sector. If there is a minimum of 75% lending that happens for income generation activities. Now, in the previous conference call, taken by the distinguished panel, there was a clear reference that it is difficult to distinguish between income generating activities and non-income generating activities. But that may be for the larger banking sector. If you could just throw some light on why it is different for micro finance?

Dr. D. Subbarao: Shyamala, on the first question about government cash balances.

Shyamala Gopinath: Thank you sir. On auctioning of government cash balances, yes, this Committee had recommended that. In fact, we have been in discussions with government for sometime now since the 3G revenues were credited to the government account, the government cash balance has been in surplus continuously. So the possibility of auctioning these cash balances was being discussed with the government. And of course, this was also supported by the Mohanty Committee. So as we were still in discussions, meanwhile, the situations changed and the government expenditure during April was high that the cash balances from surplus turned to negative, and actually the government got into WMA. So for the time being, immediately it is not an issue that we need to grapple with, but in case if the situation arises we have already had discussions with the government and some kind of a framework we will have so we could always use that. But as of now it is not an issue.

Dr. D. Subbarao: As of now it is not an issue but I do want to say that this is a framework that we want to put in place in consultation with the government because that gives predictability to the government, it gives us better option for management and it gives greater transparency to market participants. On your second question about export growth we were also very pleasantly surprised by the buoyancy in exports in the last quarter of last year. And that has come about as news in the media because of diversification of export destinations and diversification of products, value-added products. But it is not very clear that that hypothesis stands to empirical scrutiny because some initial research done in the Reserve Bank shows that the impact of that diversification is actually quite small. So there is something else that played there and we need to investigate that. On the third question about MFIs I will request Dr. Chakrabarty.

Dr. K. C. Chakrabarty: You see, you are asking the question of priority sector classification, and thats why we are saying that loans to NBFCs will be not considered and for MFI it will be considered.

Aniruddh Godbole: No, no.

Dr. D. Subbarao: First, repeat your question.

Aniruddh Godbole: My understanding is, from the reading of the document put out yesterday, is that minimum 75% of the loans given out need to be for income generating activities and only then the credit given to NBFCs can be considered for priority sector, is my understanding correct?

Dr. K. C. Chakrabarty: No, it is only MFIs sector. This is what I am saying. That if it is MFI, MFIs must satisfy the condition of qualifying asset as well as pricing guidelines. And if they satisfy these two conditions then only funding to them will the entire amount be considered as priority sector. We do want to go to individual scrutiny so that implementation of this scheme is better. So 75% qualifying asset is only for MFI, that income generating activity for MFI. At present, finance to other NBFCs we have not considered as priority sector.

Aniruddh Godbole: I understand. My question here is why this classification of 75% for income generation? Because my understanding from the last conference call that was held a few months ago, was that at least as far as regular banking is concerned, this kind of classification is not deemed as feasible.

Dr. K. C. Chakrabarty: Look that is what Malegam Committee recommendation. This has been deliberated at length because credit has to be for the income generating activity, you cannot eat credit. Now, we understand that whoever has some other requirement, emergency requirement, and that is why some part it will be utilized for consumption but we cannot give that credit that I will give him the credit, and he will use it for consumption, then how will he repay back. And that is why the Malegam Committee has recommended that you cannot give, it is the definition of micro finance, the Committee has first decided what is the definition of microfinance. The entire framework is if that definition of micro finance is acceptable to you. The entire framework is based on that. The one short answer is that you cannot give credit for the non-income generating activity but then whoever has some emergency requirement, some provision has to be there and that is why it is 25%, the option has been kept.

Aniruddh Godbole: Okay. My first question had two parts. The second part was about liquidity support, about the monetary policy operating procedures. There was a recommendation in the Deepak Mohanty Committee report that the occasional liquidity support maybe provided for longer tenors and a variable rate auction. Is that also been contemplated?

Deepak Mohanty: That is one of the recommendation. I think because that is more of operational issue because Reserve Bank has rights to do the auction both at fixed basis or floating on the variable auction basis or even change the corridor also. So because the fixed rate auction is the overnight rate is the signaling rate. So that is why the fixed auction option was given. But if it is a long-term, then there is a price discovery process, so it could be better with variable rate auction. But it is clearly up to the bank to do that. And this is very much within the tool kit. Even within the existing operating framework of the LAF we have had these auctions, in the past also we have done longer term repo auction.

Moderator: Thank you. The next question is from Ganesh Jairaman from Spark Capital, Chennai. Please go ahead.

Ganesh Jairaman: Good afternoon. Thanks for taking my question. The first question is on your reluctance to use CRR as a tool for inflation control. Given that the current levels of CRR are lower than what we have seen even in a benign inflation environment of say 2005 to 2007 when it was around 7% and I know your comfort zone of plus or minus 1% of NDTL but, if you look at the current levels of currency in circulations that is more than 9 lakh crores and growing faster than deposits and that is stoking inflation and do we need to use CRR as a tool to suck that surplus money out to control inflation, that is question number one. Second is on home loans which banks tend to give and when rates go up by, see, banks do not increase the EMI of the home loan but increase the tenor of home loan rather than increasing the EMI and is it not in some form of a restructured asset as a result and we have seen given the pace of interest rate hikes the tenor go up even beyond the working life of most borrowers. So is it not the systemic risk given the quantity of the home loans that the system has to be classified as a restructured asset given the increase in the tenor? Thank you.

Dr. D. Subbarao: On your first question about CRR, certainly, some people ask me whether we consider that as an option. I want to say that every time we do a policy review we do consider all the tools available to us in our tool kit. The reason we did not think that CRR adjustment was appropriate this time around was even as you say even as the liquidity situation just now is comfortable and according to you too comfortable. We believe that for the next three, four months, we need to be watching this especially because the movement in government cash balances even as they may not be as much uncertainty as there was last year, we still need to watch this, that is why we thought it appropriate not to make any adjustment on the CRR. In any case, I just want to say that we do consider all the options available to us. On the question of currency in circulations stoking inflation, I am somewhat puzzled that you say that because within the Reserve Bank people tell me that the causation is the other way around that in fact inflation is high, therefore there is demand for currency, not that higher currency in circulation is stoking inflation. And I am also told by economists within the RBI that having higher currency circulation and lower deposit growth is actually anti-inflationary. That money supply growth actually comes down because money multiplier comes down but these are issues we need to understand further if there are dynamics that are quite different from the way we understand. On the second question, Shyamala?

Dr. K.C. Chakrabarty See, when you are increasing the tenure and the rate goes up, so long as repayment we see that installments are utilized only for repaying the interest it increases the risk but in my view if it is also partly diminishing the principal part the risk comes down because he is already paying the principal and principal is coming from his loan balance. So I do not think but this is the standard practice. Whenever interest rate goes up, because borrower has income capacity and if he is not able to pay we increase the tenure, so long as the part of this is going towards the payment of the principal it does not increase the risk in the home loan because the home remains intact and his loan value comes down and that is why we do not see. it is contrary. Maybe some thing problematic to the customer of the fairness from the customer point of view, other point of view there maybe other issues. But I do not think it generates high risk. If the payment is not reducing his installment burden then definitely it increases the risk. I do not think banks are doing that way. The part of this is definitely utilized further reducing the principal.

Shyamala Gopinath: During our inspections, we do look at the policies of the banks.

Dr. D. Subbarao: Anand, do you want to say something?

Anand Sinha: When we talk of restructuring, each and every restructuring should not be treated as a credit demand. Because the basic definition is if a borrower is not in a position to pay because of credit difficulty, in the normal course, banks reduce margins, banks reduce interest rates for their various customers but that is not treated as restructuring if there is no credit difficulty involved in that. In the case of home loan, we have given some dispensation, what Dr. Chakrabarty stated. I do not remember the full particulars but within certain parameters we have treated it not as a restructuring from asset classification point of view.

Ganesh Jairaman: Thank you.

Moderator: Thank you. The next question is from the line of Indranil Sen Gupta from DSP Merrill Lynch, Mumbai. Please go ahead.

Indranil Sen Gupta: Good afternoon, sir. I had a question on how you plan to increase reserve money to fund the 16% money growth that you are speaking of. That probably requires about Rs. 2,000 billion. So would you share with us your plans for either OMO or such intervention, etc.? The reason why I am asking this question is that lending rates have already gone up, almost 200 basis points since August and is likely to go up more. So at some stage, there clearly, begin to hurt growth and as we have seen in the past as when growth is high it is difficult to imagine that growth will fall below trend. But as we saw in 97, as we saw in 2008, growth did slip quite a bit.

Deepak Mohanty: Indranil, as you could see now, because we have data for April 22 that year-on-year money supply growth is about 17.6%, still above the Reserve Bank's projection. And so Reserve Bank needs to provide primary liquidity, certainly can be done because there are various instruments which can do that. But to give you the details at this stage is difficult because these are again operational issues. As it comes and then we would also provide liquidity through different ways if there is a need for it.

Indranil Sen Gupta: Okay. Thanks.

Moderator: Thank you. The next question is from the line of Jatindra Agarwal from RBS, Mumbai. Please go ahead.

Jatindra Agarwal: Good afternoon, sir. Two questions. One is what is RBI's assessment in terms of asset quality, generally across the sector? Within that if you could be specifically with respect to the power sector exposure where exposure has been rising over the last couple of years. My second question is related to NBFC loan growth. We have seen something like 50, 55% year-on-year growth in NBFC outstanding. Could we have some qualitative aspect in terms of who are these NBFCs who have taken loans from banks and what is the onward purpose for which this money has been utilized? Thank you.

Dr. D. Subbarao: Assessment of asset quality.

Dr. K. C. Chakrabarty: You see, we do not think the asset, whenever the interest and this high interest rate is high, definitely the asset quality comes under pressure. But in our view, so long as growth is around 8% or even 7.5%, and corporate default is none. We cannot think of corporate default. That is not going to happen. There maybe small loans here and there which banks are in a position to absorb. So we do not see much concern. What we are saying banks asset quality that deterioration is coming, more on the part of their inability to manage the NPAs, to follow-up and other aspects, and partly, it is that because of the technology adoption it is becoming more transparent. And that is why in the intermediate period some provisioning requirement has been increased. But we do not see a major concern on the asset quality as a the systemic point of view and by the time banks will improve their risks management ability even deterioration in the overall environment will be taken care of. So in nutshell we do not see asset quality immediately as a problem, but there are certain frictional issues because of more NPAs are coming to surface because of better transparency. Now, coming to NBFC, it is really difficult for us to understand how the NBFCs are utilizing the money. They give a purpose. It depends on the chartered accountant certificate rather. And that is one of the reasons where we are trying to say that the priority sector data will not be available to the total flow of finance to the NBFCs other than MFI is only 1,73,000 crores, out of that, 33,000 crores is already taken over in the bank books and we hope that banks have done enough due diligence before taking these advances in their books. So total amount is only 1,39,000 crores. So if you see the total credit portfolio of the banks is about 39 lakhs crores it is not that significant amount and we do not see that immediately it is going to pose a major risk factor.

Dr. D. Subbarao: Just to give a perspective, can you give the number for amount going to MFIs from NBFCs?

Dr. K. C. Chakrabarty: MFIs it is only 17,800 crores.

Dr. D. Subbarao: 17,800 crores as against….

Dr. K. C. Chakrabarty: 1,73,000 crores, out of the 33,000 crores is the purchase portfolio, 1,38,962 crores of that finance. But sir, it is 39 lakh crores.

Dr. D. Subbarao: Shyamala, do you have anything to add to that?

Shyamala Gopinath: True, if you look at the year-on-year growth of credit to NBFC by the bank it has grown. And probably this is one of the sectors where credit growth has been rapid. Reserve Bank does not allow banks to finance NBFCs for certain kinds of activities like for capital market activities or for financing the share purchases and things like that. But a lot of these financing last year has also gone to auto sector, commercial vehicles. As you know, there was tremendous demand for cars and commercial vehicles. Part of this demand has also been met by the NBFCs and banks have given loans to NBFCs to fund these sectors also and also SMEs and others, housing finance, probably, some of the funding could also have gone to commercial real estate, but yes, we are looking at this segregated thing, but as Dr. Chakrabarty said, very often banks rely on the auditor certificate and we need to really look at the ground level realities.

Jatindra Agarwal: Is the commercial real estate exposure which is the direct exposure and something which would have increased indirectly for NBFCs a cause of concern?

Shyamala Gopinath: I mean precisely we are looking at the data. It is not a concern as such because if you look at the overall percentage of credit to NBFC sector the total credit of the banking sector it is not alarming. It is just that year-on-year it has grown and therefore we are looking at this data. That is all.

Dr. K. C. Chakrabarty: Even real estate default has not yet started. That is what we are saying. So long as the growth is 8% we do not see major problem in this segment. There may be restructuring, there maybe something but as of now we do not see major problem here. If the growth slows down considerably then it may create a problem.

Shyamala Gopinath: But I can tell you that it is not much going to real estate indirectly because banks would rather do it directly. If the other sectors, like particularly, road transport operators, commercial vehicles, personal loans for cars and housing finance to some extent.

Jatindra Agarwal: Perfect, that is useful, thank you.

Moderator: Thank you. The next question is from the line of Sonal Verma from Nomura, Mumbai. Please go ahead.

Sonal Verma: Hi, sir, good afternoon. Actually I had three questions. On growth yesterday, the reason for the moderation on the expenditure side, you mentioned that government consumption will slow, investments will slow, but private consumption will hold on. What I wanted to understand is why the optimism on private consumption and if rate hikes really continue to hurt investments which is already weak and not private consumption, would not it just widen the demand/supply gap and add to the inflation problem? Second, you mentioned next six months inflation is around 9% and that this has already been factored in your trajectory. Does it mean that the future policy decisions will be determined only by the deviation of inflation from this base line expectation? And any broad expectation on non-food will be very helpful? And finally, on non-food manufacturing inflation is this really the right measure for core inflation? Because it appears to capture not just finished goods but also a lot of intermediate goods in it. So it seems to be partly capturing input cost inflation rather than consumer price inflation. So I would love to hear your comments on that. Thank you.

Dr. D. Subbarao: Thank you, Sonal. Since my staff has to defend what I have said I am going to request Deepak to answer this question. On the first one about how private consumption might behave?

Deepak Mohanty: As you would have seen that both were picking up the private consumption and the investment demand but obviously if the fiscal consolidation goes through that we would expect that the government consumption demand to really come down and the overall investment demand perhaps would slow. And also supporting consumption demand that we see that consumer durables that is increasing, that is apart from the industrial production side. And previous year you would have noticed on the demand side on the housing and other things and personal consumption loans and all that was lapsed. But on the credit indicator that we have seen that has actually picked up in 10-11, and we expect that trend to continue in '11-12 and indeed if households really expect that inflation to come down, so that should also have a positive impact on the consumption pattern.

Subir Gokarn: I think the other aspect to consumption is what we have been talking about with respect to food which is thresholds. With GDP growth at whatever it is, even 8%, there is a strong threshold effect from many commodities. We have been seeing that for many years, we have been using that as the basis to justify very optimistic growth rate forecast for many commodities and that continues. So even by our own standards relatively moderate growth you will have a threshold effect for consumption spending which is going to drive consumption in a structural fashion and that has been the concerns we have been expressing about food that the supply response is simply not keeping pace with this. And clearly then the way to deal with it is to try and get the supply response in place as quickly as possible. On the inflation I think that is going to be one factor clearly that we have in contrast with last year when we were doing sort of end point projections of inflation the fact that we have decided to at least indicate a trajectory, would suggest that as long as the trajectory is fanning out as we expected, there will be no significant inflation shock feeding into our decision, but that does not mean that that is the only factor. And we have also said that the inflation risks are very much on the upside including in the first half when the commodity prices expect to do either remain firm at best or go up. On the last question of non-food manufacturing, it is a compromise. Every segment in that aggregate has a mix of intermediate and final goods. And so if you were to strip out only the final goods from that it would reduce the representativeness very significantly. But bear in mind that we are also keeping track of CPI with all its limitations, that number is still around 8-8.5%, so it is not as though consumer indices are giving us a very fundamentally different picture from the producer indices, which is quite the case in many countries, in the US, the producer price index is 9%, 10% because of this intermediate issue. But the consumer price is only 1, 1.5. We do not have that situation. So the reading of inflation numbers I do not think is being terribly compromised in this situation by using the WPI as opposed to CPI.

Dr. D. Subbarao: I just want to supplement what Subir said on the guidance. I just want all of you to know that we agonized a lot about what to say in this paragraph and how to say it. And in effect, what we wanted to say was that if inflation remains at an elevated level, for the first six months we will not be surprised but that should give no indication one way or the other about a possible action.

Sonal Verma: Thank you.

Moderator: Thank you, the next question is from the line of Suresh Ganapathy from Macquarie Mumbai, please go ahead.

Suresh Ganapathy: Just a quick question on the recommendations which have been adopted by RBI on the Malegam Committee I think for MFI. The issue here is that there seems to be some conflict of regulations with respect to what the Andhra Pradesh Ordinance is suggesting currently. Because if you look at it there they strictly allow only monthly payments whereas RBI has said even weekly payments is fine. So is there any dialogue or conversation that RBI is carrying out with the respective state governments because this seems to be infringing on RBI's regulatory power. Does this mean the RBI regulations are the final binding and will override whatever Andhra Pradesh regulations are stating with respect to MFI?

Dr. D. Subbarao: See the Malegam Committee I have requested them to interact with the government of Andhra Pradesh, they have. The Government of Andhra Pradesh has had their say in the formulation of the Malegam Committee recommendations. After the Committee recommendations have come I requested the Deputy Governor, Chakrabarty to consult with all stakeholders including all the state governments. Having said that I must also say that it is the sovereign right of the state government to enact a law. You are right that once there is regulatory framework in place from the Reserve Bank, ideally, we should apply that uniformly across the country without fragmented legislations in different states. So as the Malegam Committee said in its report that once this regulation comes into place, indeed, there will be no need for separate state legislation, we have spoken to Government of Andhra Pradesh, we will continue to dialogue with them but I expect that it will take sometime before everything falls into place because thereare considerable loose ends still to be tied up, for example, what is the regulatory framework for that segment of the MFI which are not incorporated. A large number of small MFIs which have to be regulated or some framework has to be there, which has to be done, which has to be formulated by the government. So we are coordinating with the government. Hopefully, sooner rather than later there will be a complete framework in place with no gaps and then perhaps the Government of Andhra Pradesh will be encouraged to withdraw the legislation.

Suresh Ganapathy: Okay, thanks and just one last question on savings rate which has been increased by 50 basis points. I mean if the eventual motive of RBI is to move towards deregulation. Why have you done a 50 basis points hike? Is it that you want banks to be prepared for higher savings rate eventually when the deregulation happens is that the thinking in RBI that once savings rate deregulation happens the rates are going to stabilize at higher level contrary to some of the banks indicating that rates will go down. So what is the thought process behind hiking the rate by 50 basis points when you eventually want to deregulate it?

Dr. D. Subbarao: I don't think it is correct to infer that we eventually want to deregulate it. Because we put out a discussion paper that assess both the pros and cons of deregulation. Some people have told me that there is an implied bias in this but I want to let everyone know that we are quite openminded, we are quite respectful of the feedback that we might get, we will consider all that, we have heard the banks but we also want to hear millions of other stakeholders who have a stake in this process, we want to listen to all of them, consider the feedback, and take a decision on that. So any impression that the RBI eventually wants to deregulate is incorrect. The reason we have adjusted the rate is just assume that we had not come out with the discussion paper. On a standalone basis there were sufficient justification for an upward adjustment of the savings bank rate because there is inflation which is high, there is all other interest rates have gone up on other deposits and that Subir had just passed on a paper to me which shows the trajectory of rate adjustment in '77 July it was 5%, in '78 it was 4.5%, in '92 it was 6%, in 2000 it was 4%, in 2003 it was 3.5%. So you would see that over time it had actually come down. So we thought that we must compensate not compensate but that millions of households who use this facility must get a fairer share, a fairer deal that is the motivation behind this adjustment.

Suresh Ganapathy: Okay, thanks, thanks so much.

Moderator: Thank you. The next question is from the line of Ajitesh Nair from UBS, Mumbai. Please go ahead.

Ajitesh Nair: Sir, one just last clarification on the NBFC guidelines. This applies to the securitization transactions as well?

Dr. K. C. Chakrabarty: You see, yes, so far as MFI is concerned it will be for securitization asset also. Others, you see, we are saying that no guideline will come because those securitized assets banks are taking on their books, so they must do their due diligence, that means this has all become the bank loans and if they satisfy the criteria of priority sector loans we may look into that but that is still not finalized. For MFI they have to definitely follow the same set of guidelines.

Ajitesh Nair: Okay sir, just so that I have understood it clearly that the statement that you have made that bank financing to other NBFCs will not be classified as priority sector funding, that is on direct bank giving loans to NBFCs. That does not imply that NBFC securitizing loans to banks will fall, the statement is correct

Dr. K. C. Chakrabarty: Yeah.

Ajitesh Nair: Okay, sir, the second thing again on this guideline is on the housing finance companies, because they also borrow from banks to on lend into mortgages below 2 million will that be covered under the statement?

Dr. K. C. Chakrabarty: As of now, no, it is only a committee will be appointed, we will examine, as of now it is no.

Ajitesh Nair: Much appreciate sir, thanks for taking my questions.

Moderator: Thank you. The next question is from the line of Deepankar Patnaik from Religare, Mumbai please go ahead.

Deepankar Patnaik: Thanks sir, this is Deepankar Patnaik. What I wanted to ask was you mentioned the economy is at full capacity at this point and I was just wondering with the current tightening in policy how much would you expect corporate CapEx revival to be pushed back?

Subir Gokarn: I do not think I have a firm estimate on the number but I think in terms of growth projections if you look at the fine chart in the policy statement we have roughly indicated a range of 7.4 to 8.5 as 90% so essentially we are saying implicitly that in our base line scenario of 8% that we could see if assumptions change if underlying drivers change that we could see growth go down to 7.4% but that is a sort of almost an outer limit you could say. Now obviously that implies then a different composition of activity and clearly in that scenario perhaps investment will be somewhat lower than it otherwise would be. But I do not think we have gone to the extent of breaking that scenario into demand components.

Deepankar Patnaik: All right and my second question was you are also looking at some appreciation in auto fuels going forward, I mean there would be at least some partial pass-through probably after the elections are done. What level of appreciation are we looking at for the current inflation scenario?

Subir Gokarn: I think it is the best to wait for that to happen, we don't want to sort of put out a public view, we have made some assumptions which we have indicated but I think to put a number on to this point would lead to some cross signal, so we rather not comment on that.

Deepankar Patnaik: Many thanks, sir.

Moderator: Thank you. Ladies and gentlemen we will now take one last question from the line of Deepu Awasthe from Sahara, Mumbai, please go ahead.

Deepu Awasthe: Good afternoon sir. My question is related to Para No. 19, you have mentioned that entry load of 59.9% suggest that money supply growth was not a contributing factor to inflation. Sir in that case in the current year also when we are expecting 16% monetary growth, how do you expect that this current rise of interest rates 200 basis points already and going forward also will actually be able to control inflation? And my second question is sir do you have anything in mind regarding the real interest rate which is inflation minus say one year or any benchmark interest rate? Thank you.

Deepak Mohanty: Yeah, on the money supply growth that you would have noticed that our projection was 17%. So it was consistent with the GDP growth of 8.5. But we ended the year with 15.9%. So suddenly money supply did not contribute to inflation. As you know that money supply inflation relationship is more on the medium term. So one cannot really make immediate inference on looking at the money supply. And going forward the next year that we have projected 16% which is again consistent with the growth and inflation number that we have.

Dr. D. Subbarao: On the real interest rate?

Deepak Mohanty: The real interest rate as you know that is very difficult to do that because it is again should be the nominal interest rate and expected inflation. So there could be a various measure of expected inflation. And if it is backward looking, one is looking at the past information and exports so there are different ways of calculation, so that can be done. And if you can expect because our expectation of inflation by the end of the year is about 6%, so then it is up to you, your judgment to derive, really what should be the real interest rate and what is the interest rate for what tenor we are looking at whether we are looking at overall short-term or we are looking at the medium term. It is really complex exercise and some bit of judgment involved in that.

Dr. D. Subbarao: That brings this conference to a close from our side. I want to thank all the analysts and researchers who have switched in. I want to say that we started this in January 2010 since then we have been holding this analysts teleconference after every quarterly policy review and we found this to be an enormously value adding experience especially because you people ask such searching questions and we find the amount of research that you do to be quite impressive and it pushes us to probe further into many other questions that we must be thinking through. So thanks very much and we look forward to connecting with you after our next policy. Thank you.

Moderator: Thank you. Ladies and gentleman on behalf of RBI that concludes this conference call. Thank you for joining us and you may now disconnect your lines.