"Reserve Bank of India Post Policy Conference Call for Researchers and Analysts"

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Melissa: 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 participant lines will be in the listen only mode and 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. 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. Welcome everyone and good afternoon. We have Governor Dr. Subba Rao, Dr. Gokarn, Mrs. Gopinath, Dr. Chakrabarty, and other senior executives of RBI here with us and we will start the researchers & analysts conference post policy. Governor will make a short statement and then we will open for questions.

D. Subbarao: Good afternoon. I am Subbarao, Governor. On behalf of the Reserve Bank I want to welcome all of you to this interaction session. This I think is the third session we are having and we found the past sessions to be quite value adding and I hope you are finding it to be useful as well. In the policy review announced yesterday, we increased the repo and reverse repo rates by 25 basis points each. In this action, we were guided by three considerations, first domestic road drivers are robust, second inflation inflationary expectations are quite high and finally liquidity deficits remains within a reasonable limit. On the global front there are concerns about the fragile and uneven nature of the recovery and also about the large unemployment in advanced economies. In fact as the IMF said global growth is fragile partly because it is uneven. The first indian economy is concerned we are operating close to the trend growth rate and that is driven mainly by domestic factors and therefore we have retained the growth projection for 2010-2011 the current year at 8.5%. Inflation has moderated somewhat in recent months, but headline inflation remains about the medium term trend, it is also about the Reserve Bank's comfort zone. Food inflation should have actually shown some post monsoon moderation, but that has not happened. At any rate it has not happened to the extent we had expected. On balance, the inflation projection we have retained it at 6% as per the old series which translates to 5.5% under the new series. The liquidity situation had been in the news over the last few weeks. Tight liquidity conditions of course are desirable from the viewpoint of inflation management but the tight situation has raised concerns about the deficit as the extent of injection through the last window had become too large. To address this concern, we said that we will take actions, in fact we have instituted some measures over the last weekend and yesterday we announced an OM of 12000 Crores to address the structural liquidity problem. In the policy document, we also listed the important risks to the growth inflation outlook, the main risk of course comes from the prospects of a long and slow recovery in advanced economies. On the inflation front the risk is that inflationary pressures may accentuate due to the structural component in food inflation, inflation pressures may also accentuate because of demand side pressures. The capacity constraints are emerging in many industries and global commodity prices are also under some upward pressure, then there is the issue of potentially large capital flows beyond our absorbing capacity and that could cause a major challenge for exchange rate and monetary management. Finally, there is the issue of current account deficit which we had said is going to widen this year as compared to last year and that raises concerns given the uncertainty associated with international capital flows. In yesterday's policy we also gave some forward guidance, specifically we set that base purely on current growth and inflation trends, the likelihood and probability of further rate actions is quite low, however we will need to act if there are unforeseen developments. Thank you.

Melissa: Ladies and gentlemen we will now begin with the question and answer session. Anyone who wishes to ask a question may press * and 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 handsets while asking a question. The first question is from the line of Vardha Pandey from Birla Sun Life Mutual Fund. Please go ahead.

Vardha Pandey: Hi, good afternoon every one. Couple of comments on the monetary policy before I ask the question. Liquidity management has actually been much more crucial than the rate hike expectations really, I mean, in a way rate hike expectations have also been reinforced by skewed liquidity conditions. My first question is with respect to that only. Sometimes back there was an RBI staff paper that laid out a money demand function and if we look at the RBI guidance on bank credit, money supply growth and the non-agri GDI growth the equation stands consistent. Are we also looking at any guidance in the reserve money multiplier so we get some sense on the reserve money growth as well, that is one and the second is on the debt capital inflows, how would the central bank look at the debt capital vis-à-vis the equity capital in terms of the nature of the flows and why is there a relative presence for equity capital source.

Deepak Mohanty: Yes, you would have noticed that from the numbers that the reserve money growth this year is higher than last year if we can adjust for the cash reserve ratio, but money supply has not increased commensurately, this is because the currency expansion has been higher, so in the process what has happened is the currency deposit ratio has increased which has pulled down the money supply growth, but we do see over last couple of fortnights of course the next fortnight will be different because of Diwali the currency demand would go up, but we are seeing some moderation in the currency growth, it is below 20% now, it is in the range of 17-18, so with that happening that we see that the multiplier should come back to the average which has been above 5% and it should reflect in the money supply growth. In fact the 22nd October, money supply number which we would be putting out in the public domain that indeed will show that money supply has gone back to 17% consistent with our projection for the year as a whole which is about 17%.

Vardha Pandey: Do we have a money multiplier guidance of about 5?

Deepak Mohanty: No, as I was mentioning that one is from the policy which is the cash reserve ratio, the reserve deposit ratio that remains fixed, so the other one would be behavioral because it depends on the preference of public how much currency they want to hold, so then that impacts the money multiplier, so we do not have a number there, that what we are hoping to achieve.

D. Subbarao: On the question on capital flows, of course our stated policy and our hope is that we get long-term flows as of course the short-term flows, we will get flows as opposed to cycle or volatile flows, but you know, but actualizing that in the real world is actually a challenge because as long as you open some doors certain flows come in and it is difficult to distinguish, that is what is the lesson of our experience, but as between debt and equity flow the specific question that you raised, we have been quite open on equity flows and all our controls and calibration of the policy has been on the debt side and we found that to be quite effective during 2007-2008 when there was flood flows or during the crisis time when we had to augment flows we found it effective and efficient to tweak the controls on the debt side in order to calibrate the flows but I must admit that our ability to calibrate flows in the short term is but limited.

Melissa: The next question is from Rajeev Malik from CLSA, please go ahead.

Rajeev Malik: Good afternoon governor and everyone else. At the outset once again thanks for making the time, I know you have a busy schedule but this forum does really help us a lot in getting more insights in to the broader thinking behind policy. I have two questions. One is really in terms of the big picture signal that you wanted to send and there, it seems to be a bit of a contradiction if I can use that word. On the one hand, lot of the details in the policy and the run up to the policy were really very, very hawkish, inflation and all kinds of superlatives we are beginning to get used and then while the rate hike has been pretty much priced in there was not just an indication of a pause, but a very fairly precise three-month pause. If inflation is such an issue, what gives you so much comfort that within the next three months you will not have to hike or is that decision already being made, the second aspect related to that is the whole issue about impact of inflation on the structural rise in food prices, how should one think about that from a policy perspective given the fact that you have used it as one of the reasons for hiking the policy rate? You know this is a government who is about to embark on a food security program and most of the input for that is still not assured, so we are just going to see multiple levels of those issues come back, once again related to that this only came up less than a month ago in one of speeches, after hiking once do you really think that has been sorted out so that nothing gets done over the next three months, there is just a bit of hawkish on one side but dovish on the other, if you could just help us think through that more clearly please.

D. Subbarao: Thank you very much, I will answer the first question and defer to Subir to answer the question on the structural dimensions of food inflation. On the first question about sounding hawkish on inflation and not walking the talk in terms of policy action or in terms of guidance all the background or interpretation or appreciation of inflation that we had given was actually to justify our action in this round and unless we had given that it would have been difficult to communicate rationale of where we were coming from. Having done that we also believe that we must give some overt guidance. We are trying to adopt what is not turning out to be the best practice among central banks among the world. Of course you are quite right in criticizing that it is only for three months, what sort of predictability are you giving in three months, but given the indian situation and the amount of speculation that goes on it, it was quite important for us to manage expectations about what the Reserve Bank might do, so we have said that barring unforeseen circumstances we are on track to growth of 5.5% WPI inflation by March end but should there be unforeseen developments we will need to act and then of course beyond January it will depend on the evolving situation.

Subir Gokarn: I think the first question you raised about the implications of the food security act and when it is to be implemented, we have been focusing and you referred to my speech made last week, in fact, you referred to some other speech, but the one I made last week on protein prices, we have been focusing on the dynamics of protein prices as a source of structural inflation and the analysis that underlies that speech essentially refers to changes in consumption patterns and points of inflection that are emerging in the income distribution where people shift decisively towards a protein-based diet. The Food Security Act actually is very focused on cereals, from my understanding of it, it guarantees access to certain quantities of cereals at certain prices. It does not again, to my understanding refer to protein sources, so in a sense there may be some spillover and substitution effects and some going on but the two are actually referring to different components, different commodities, now the question of why and how we are incorporating these structural factors in to our policy making, even from a textbook perspective structural imbalance between demand and supply is something that monetary policy should take in to account because it drives expectations, it could drive cost through and we are also hearing not necessarily directly an outcome of food prices but the evidence on wages is quite significant, that wages at the bottom of the income hierarchy are also rising which is having its own impact on inflation. So our objective is to take this into account and not ignore it and not sort of underestimate its power to drive inflation and inflationary expectations by assuming that the post monsoon trend will be very, very favorable which it has not been so far. So that is the way in which we are looking at it and I think in terms of the forward guidance it fits into that three month cycle where the guidance essentially says that we do not feel that there is a high likelihood of an action in December and that is really what the guidance is saying. This has to be seen in the context of the fact that we have been hiking mid quarter at every opportunity during the course of this year to count in and now we are saying well maybe we do not need to maintain that frequency, that is what the guidance is and from the food perspective this is keeping the possibility open that food prices will actually follow the expected post monsoon pattern and start to come down fairly sharply, it is now that the harvest is coming in certainly things like pulses have seen quite sharp declines in prices. Some of these products are not monsoon dependent but then they also quite heavily substitutable so these are the kinds of dynamics that will shape prices over next month or two months and that is something we will be keeping track of.

Melissa: Thank you. The next question is from Nilesh Shah from ICICI Prudential. Please go ahead.

Nilesh Shah: Good afternoon governor and other senior members of RBI. Congratulations on the credit policy which brings us current issues facing Indian economy quite well. Sir I have two questions, one that the income effect coming in Indian economy and also the wealth effect of higher lend prices, higher gold prices and equities do you feel that the economy is getting bit over heated especially when we have very limited excess capacity and second what will be Plan B of RBI to manage current account deficit if capital flows close down in an uncertain global environment and god forbid if oil prices puts prices on current account deficit?

D. Subbarao: First question on income effect, wealth effect and whether the economy is getting overheated. In fact we did warn in our July policy documents as well as in the September statement about demand pressures getting building up. We looked at non food manufactured inflation not only the headline number but also the underlying momentum.

Over the last two months that has somewhat leveled at 5% but it is also considerably above the long term average which is about 3.6%. If we look at the real world there is capacity constraints in several sectors, so as much as demand pressures are easing somewhat we are not completely free of demand-side pressures and there has to be both action in terms of containing demand as well as building up the supply and that would take time, so you are right that because of the income effect, wealth effect there is a demand side pressures that is moderated somewhat in the last few months because of the action taken by us but going forward we need to expand supply and to meet the expanding demand.

Subir Gokarn: Well, I would also like to address the overheating question. When you look back at the period say 2006-2008 when we were growing between 9-9.5% the rest of the world was also growing at very close to perhaps its potential even exceeding it in some cases. That was the situation were overheating was very tangible because global capacity was also being stretched and commodity prices were being driven by very buoyant global demand. Today we are growing at 8.5 as is the forecast that we put out and basically seems to be a pretty widespread consensus in a situation where the global economy is growing far below its potential, so there is idle capacity, commodity prices are being driven by liquidity which is one factor but in many instances the existence of idle capacity is providing opportunities to import and so in a sense that provides a safety valve as far as managing the overheating situation, domestic capacity constraints which you are referring to, so the pressure are not the same, I think the situation in which we would see over heating becoming a serious problem is when global capacities are also being stretched and we are not in that situation now. On Plan B would you like to say something.

Shyamala Gopinath: Of course, I think one needs to look at our overall framework for capital account as well as our exchange rate policies even if in this uncertain capital world where it is too high of capital flows we really need to look at the track record in the sense even in the past, even after the Lehmann's crisis, we did have some reversal of capital flows and that was perhaps a big sum but you know we did not really impact, it impacted of course because that was kind of the part of several other factors that were influencing domestic recovery, but in general we feel that we have resilience to manage capital flows, we can manage the capital account in terms of our policy both on the debt side and equity side and the very fact that we are not so much dependent on external demand but then at the same time we have a strong domestic industry so my feeling is that we will be able to manage any reversal which will be shortlived according to us even if it is there.

D. Subbarao: I should think so, because if your concern was from the other side about whether we will be able to finance the current account deficit, just to give you a picture, this calendar year itself we have had varying perceptions on this. Early in the year, there were concerns about possibility of too much was coming in, then in the spring there was concerns about outflows because of the sovereign debt crisis in Greece in Europe and subsequently again in the wake of further loosing of monetary policy of quantitative easing, there is concern about too much flows coming in, so this year I do not think we will have any problem about financing capital flows, financing the current account deficit, but as we stated in the policy, we have a challenge, the challenge is really to finance the deficit in the short term and reduce the deficit in the medium and that is what we should be working towards.

Nilesh Shah: If I have the liberty of asking one more question, a substantial portion of Indian savings is stored in the form of gold, it is probably more than banking deposit, can RBI take steps to monetize gold to fund the deficits so that the reliance on current account deficit can come down?

Shymala Gopinath: Nilesh, you know very well, much of the gold that is held by the residents is not something that can be monitized and we did try the gold deposit scheme, we allowed the banks to open gold deposit accounts for residents and government had also given incentives in terms of income tax, gift tax, wealth tax, actually this scheme was really meant to monetize the gold that is with the residents. Not much was received and actually using this gold to finance current account deficit, you are really saying this gold needs to be converted to foreign exchange, since much of the gold is held in private hands, it is not really something that we can depend on to finance our current account deficits, it is left to the persons who hold the gold, whether they want to declare it, when they want to keep in banks and whether they want to monetize this gold, but true there is always a suggestion coming to us every time that there is so much of gold, we need to put this gold to productive use and that we should monetize but we tried to monetize physical gold, it has not been very successful but definitely the ETF have done well, but that does not really help us in monetizing the gold that is held in the hand of the residents.

Moderator: The next question is from Indraneel Sen Gupta from Merrill Lynch. Please go ahead.

Indraneel Sen Gupta: There is a question on how to bridge the growing gap between deposit growth around 15% and loan growth that is running around 20%, clearly at some stage you need to push in more reserves money either by OMO or effect intervention, so any thoughts on this.

Deepak Mohanty: As I was responding to earlier question that if you would see Indraneel that this year so far the reserve money adjusted for reserve changes is higher than last year, but certainly the money supply had not gone up, up to last fortnight because the multiplier was lower because of the currency demand was higher. In fact the latest fortnight the number that we would be putting out so that shows there has been a sharp increase in deposits, it was partly because of the IPO now but it will take the deposit growth to about 17% and money supply to about 17% which is again the kind of projection that we have put out in the policy.

Indraneel Sen Gupta: But Sir, once the IPO money goes away, again money supply will return 15%.

Deepak Mohanty: That we need to see because it is again the rupee liquidity which is in the system, so it will go from one bank to the other bank but we need to see, but there is kind of change, so as you know that we are getting in to the second half of the year, and when the credit demand really picks up and if that were indeed to happen and what is the expectation, so obviously multiplier is also better, the credit creates deposit, so deposit growth should be good and the other aspect that has happened is that the banks also earlier raised deposit rate, so we see inflow coming in to the term deposits, so overall on balance that we expect that our projection would be met.

Melissa: The next question is from Subramanian PS from Sundaram Mutual Fund. Please go ahead.

Subramanian PS: Hi, thanks for taking my question. My question was more on the regulatory aspect. You had the Basel III guidelines which describe that equity, core equity should be part of tier 1 capital, but at the same time we have seen that a lot of PSU banks capital is being infused by the government by way of cumulative non-redeemable preference share capital. Any thoughts by the RBI or any communication by the RBI with the government in terms of converting this to equity or ensuring that further capital infusion in to these banks is by way of equity so that once we come closer to the Basel III implementation dates Indian banks are compliant with these norms.

Shyamala Gopinath: On the subject I do not know whether you are aware but even today the core equity that is the equity, the real equity of Indian banks is quite high, and in fact if you consider what Basel III is proposing in terms of core tier 1 equity Indian banks already meet those standards and even those standards will kick in a couple of years later, it does not come in now, so it was like 3.5 and 4.5 and then you go to 7, so the Basel III in fact has given a very good time road map for actually converging to these norms for all the banks and in fact Indian banks even today is quite high. Even if one were to consider such tier 2 as not qualifying as for equity capital I think Indian banks even today comply with the Basel III guidelines, but I just want to say one more thing, the cumulative non-redeemable preference shares, I mean they are really non-redeemable, so to that extent they are kind of long-term capital that the banks can have, the only issue is that it is cumulative, but even so we need to recognize that there will be some amount of such capital also recognized for the purpose of Basel III, you get balance 2.5, so I do not think this should be a problem at all.

Subramanian PS: One more question this is more on the recent happenings in the microfinance segment, what is it that prompted RBI to set up a committee in terms of looking at the regulatory framework for microfinancing institutions or was it something to do with the rates or was it the practices that they adopted and is it likely that the other NBFC also might actually come within this kind of a framework?

D. Subbarao: In the wake of the ordinance by Andhra Pradesh Government, there were several issues relating to the microfinance sector that had come up, as you had said the first was the rate of interest charged by them, second is relating to the lending practices whether they were impinging on the borrowers interest in particular about the debt sustainability at the household level and the third category of grievances or complaints was about the coercive practices being used for recovery. You know that only one segment of the MFI sector comes within the RBI's regulatory jurisdiction which is the NBFC which I believe are about 36 in number, so even though only a small portion of the MFIs come within RBI jurisdiction admittedly they account for a large segment of the overall business. As much as part of the microfinance sector is within RBI jurisdiction and because these issues had come up to the forefront we thought we must examine to what extent these issues needs to be revisited, what changes in policy or changes in regulatory practices might be required and of course the motivation behind appointing this committee.

Shymala Gopinath: One aspect is that the loans that the banks give through the MFI are part of the priority sector lending, so that is the only other point I want to mention because to the extent that banks fund the MFI, RBI does have an interest in terms of being packed on banks balance sheet although I must again say here that it is not a systemic problem, it is not that banks will have a huge problem even if the MFI do not repay quickly and the loans have to be restructured, that is not the issue, it is just that we do treat loans to MFI as priority sector, of course we do have some interest.

Subramanian PS: Any likeliness of these same being applied for other NBFC as well?

Shyamala Gopinath: It is just meeting and looking at the terms of reference and what you are really saying in case we come up with some norms for the MFI will it apply to all microfinancial owners, are you saying that?

Subramanian PS: Because if interest rates were a concern there are other NBFC as well for certain products the interest rates are pretty high, so would that be applicable for other NBFC as well?

D. Subbarao: It is actually too early to say whether we are going to take a view on interest rates, so your question is jumping really several possibilities, so it depends on what the committee recommends and what view we might take on that.

Melissa: The next question is from Matthew Wickens from Moore Capital. Please go ahead.

Matthew Wickens: I have three questions back to structural inflation. The question is what do you think is more effective in reduce structural inflation, higher rates or more infrastructure CapEx and supply and a related question that is, is there an issue here we are too high with our interest rates including supply CapEx and supply growth could actually make structural inflation worse and the second question is about neutral rates given the old growth and inflation profile what do you think the current neutral rate is?

Subir Gokarn: Well, on the first question yes the sort of robust enduring solution to structural inflation is more supply and that means both investment in the production of capacity that will produce these products, the food items and also huge increase in productivity, now obviously you could say that interest rates are one factor that could determine whether that investment takes place but we do not think it is going to be a decisive factor and when you are trading off the short-term versus the long term impact of rising interest rates, I think the weight as far as monetary policy is concerned is always towards managing the short term impact on expectations and letting other factors, the certainty of demand, the business environment dictate investment. Now, obviously we are in a sector where a lot depends on pubic investment both directly and indirectly and so it is not going to be driven strictly by commercial considerations, food production as you presumably know it is very largely in the unorganized sector and the typical determinants of investment do not organize well (ph), but I think a broad based pubic-private supply risk cons is really the long-term solution and that is something that obviously will come out of this recognition that this is structural inflation. On our part what we are trying to do is to reinforce the point that it is structural, it cannot be handled by a good monsoon here or there and that something more long-term needs to be done, so I think that is the message we also want to send out. The second question on neutral rate, well we do not really have a number explicitly, but just to give you sort of back of the envelope reasoning that is useful if you look at our peak growth period before the crisis in a situation where we were overheating the repo rate was at 9%. If you look at the trough when we were trying to deal with the crisis it was 4.75%. So in a sense these two numbers establish some sort of boundary condition and if the sort of stable, sustainable trend growth is somewhere between the two then, you know, that provides us some indication of where the neutral might lie and what we have signaled in our previous policy i.e., September mid quarter review was that we think we are sort of approaching the end of normalization, which is retreat or an exit from the crisis management phase and from this point on the predominant driver of reduction is going to be what the current and expected inflation dynamics are. So, in that sense you could say we seem to be entering that zone but we do not really have a number.

Moderator: Thank you. The next question is from Suresh Ganpathy from Macquarie, please go ahead.

Suresh Ganpathy: I have some questions on the provisioning requirements on the teaser loans. First of all it is applicable from a prospective or a retrospective basis, I mean basically on the outstanding loans is it applicable or only for new loans it is applicable the provisioning requirement?

Shyamala Gopinath: It will apply even to the existing book.

Suresh Ganpathy: Why it has been only restricted to banks, I mean lot of NBFCs and HFCs are also involved in this teaser loan products, so is there a possibility that even they would be brought under this purview, the NBFCs as well as HFCs?

Shyamala Gopinath: Yes, as soon as the actual guidelines to the circulatory banks are issued it will be made applicable to the housing finance companies also and you are saying that even NBFCs are doing this?

Suresh Ganpathy: Yes, indeed, lot of NBFCs are into teaser?

Shyamala Gopinath: Not predominantly into housing finance.

Suresh Ganpathy: Some NBFCs who are involved in housing finance, there are lot of NBFCs who are involved in housing finance?

Shyamala Gopinath: But not registered as housing finance company?

Suresh Ganpathy: Yes, not registered as HFCs.

Shyamala Gopinath: We do regulate both NBFCs and HFCs.

Suresh Ganpathy: The definition of teaser loan rates; the problem here is that some of the banks are arguing that their loans are special home loan rate schemes and not teaser loan rate schemes, so how do you define what is teaser and what is non-teaser?

Dr. Chakravarthi: Which is neither fixed nor floating is called teaser loan.

Suresh Ganpathy: Okay, so any combination of fixed cum floating is called as teaser. Thanks a lot for your time.

Moderator: Thank you. The next question is from Nidhi Sharmafrom ING Investment Management, please go ahead.

Himanshu: This is Himanshu, thanks for taking my question. If we look at the reverse repo rate and the repo rate and the inflation, the headline inflation number in the last few years we have seen that the difference is positive i.e., repo rate, reverse repo rate has been really higher than inflation whereas since last October-November that number is negative, so we are in negative real interest rate so to say. If we are looking at a structural issue in food price inflation do you see this kind of a situation persisting for may be beyond March also?

Dr. Subir Gokarn: No, actually if you look at our forecast for headline inflation as that is what we are using as an indication then our expectation clearly in March even if we do not change (ph) the repo rate further we will be in positive territory in real terms and slightly negative on the reverse repo if we do not make any changes, so in that sense our outlook for inflation and the rate action so far are broadly consistent with achieving a non-negative real rate by the end of March. Now, reason for this transition and the reason why it has persisted for so long is because we were beginning October 2000 (ph) and exiting from a very extreme price response situation so the choice between an instantaneous adjustment to a non-negative real rate and a more gradual calibrated adjustment was what we made in the context of a recovery that was in its early stages and was always vulnerable to some threat or the other that our calibrated response was more appropriate and it would take us some time to reach this sort of non-negative real rate so that is where we stand, so if you look at March forecast we are sort of headed towards that outcome but you bring the final structural inflation and that is where we keep saying that ultimately our actions are going to be driven by the current and expected inflation trajectory and maintaining a non-zero rate clearly becomes one consideration in our decision on rate action.

Moderator: Thank you. The next question is from Aashish Sharma from Enam Asset Management, please go ahead.

Aashish Sharma: Just wanted to get a sense on this whole MFI controversy, I guess this had your remarks to the earlier question raised. Now, there was one media report, which mentioned that RBI is happy with NABARD being the regulator for all the MFI including which are registered and CMFI (ph) as of now with RBI. Can you first throw some light on that sir?

D. Subbarao: I do not think that is the correct assessment of RBI projection. As of now as you have heard it just says that we are regulators for that part of the MFI segment, which is NBFCs. There is of course a view that the MFI sector must come under greater regulation under one body and if NABARD takes on that responsibility that is fine with us, but that NBFC segment of the MFI sector should continue to be with the reserve bank.

Aashish Sharma: But what currently is the current stance of RBI on the whole controversy of overcharging of interest rate correction method being used because they have not just got on any indication what stance RBI has, I mean the NBFC, which are already under coverage or governed by RBI. Was there any such issues where they were misreporting this information regarding interest rate, I mean we have not got a stance from RBI as of now and we just heard that there would be a malegam committee, which will be looking into the matter, I mean what is exact stance as of now from RBI and secondly on this whole regulatory aspect I mean we heard regarding this business correspondence guidance where we have not kept MFIs under the structure and any way we can introduce a sort of a saving structure into the current regulatory structure of MFI?

D. Subbarao: See, over the years we have moved away from regulating interest rate. We have to move towards regulating an interest rate for MFI sector, NBFC segment of that, that will lead very strong justification, so one of the plans of reference of the malegam committee is indeed the regulatory jurisdiction, what sort of regulation they must be and I am sure that they will hold this question but I do not want to raise this expectation that this might become some additional imposition of regulation on the interest rate, we will need very strong reasons for doing that. On the other hand there are legitimate concerns about transparency about disclosure, about justification for the interest rates for how much must go as return on equity and how much must go as softened interest rate for the borrowers, so all those are questions that the committee will go into.

Aashish Sharma: On this whole savings structure for the MFI I mean is it sort of a thought process, will that be under purview of the malegam committee?

D. Subbarao: No, it would not be. I do not think there is the issue of mobilization of savings by MFIs, that is not an issue on any ones datastream (ph).

Aashish Sharma: On the whole saving bank's deregulation, I mean you mentioned that the working paper will be out in December. What exactly is the thought process behind this whole saving bank's rate deregulation because I guess that will make this whole rate sort of competitive, I mean every bank will be buying for higher rate, I mean what exactly is the thought process behind the deregulation of saving banks?

D. Subbarao: The thought process as you put it is that we move towards deregulation, the interest rate of savings bank or interest rate on NRI deposits are the two remaining segments where interest rate is still regulated, so off and on this issue keeps coming up that we must move towards deregulating the interest rate because that is also in the interest of the depositors and savers. Now it is an unknown territory because we do not know what might happen, there are concerns, there are arguments in support of the regulation and arguments against. There are some arguments, which says that if we liberalize the interest rate there is a competition among banks and they might offer higher interest rate on saving deposits, which is good for small savers. There is also an argument that it will promote innovation and products that are needed by small savers. On the other hand there are concerns that if we liberalize the interest rate it might actually go down and it will militate against small savers particularly pensioners, old age people, middle class people. There are also concern that it will militate against the objective of financial infusion, there is also concern that if we deregulate the interest rate public sector banks, which are now largely catering to this account even in spite of the transaction cost being high they might not show the same social obligation, so there are all these concerns both in support and against liberalizing the interest rate and that is why we said we will put out a discussion paper. So that is a long description of the thought process and advantage to this discussion paper.

Aashish Sharma: If at all we are deregulating it would it be a partial deregulation with a certain floor being there or will it be a full deregulation?

D. Subbarao: I do not want to comment on that at this stage, we will wait for the discussion paper and our responses of people.

Moderator: Thank you. The next question is from Shubhada Rao from Yes Bank, please go ahead.

Shubhada Rao: I just had one small question regarding, you know, the outlook of the demand side pressure likely to emanate and intensify further in the second half. A lot will depend on the capacity utilization domestic. We have not in recent times seen, you know, tables on the domestic actual capacity utilization being released by the RBI, what we do have is indeed a survey but it would be of great help if we could also get some kind of, you know, the actual capacity utilization number being release by the Reserve Bank?

Dr. K C Chakrabarty: It all again depends on the methodology that one is using, if the peak production method 1 uses it gives a different measure of capacity utilization, but what we have now is mostly survey list, we do not have a complete comprehensive estimate of capacity, again the industrial outlook survey gives the particular measure of capacity utilization and we have the other survey for capacity utilization, which are again put in the public domain but as of now we do not have a comprehensive measure as you mentioned.

Shubhada Rao: Because I thought this annual report did not have that capacity utilization table, may be I overlooked (ph). In addition, if I could add would you think that the OMO along with the policy tightening in some sense is dilute as an impact?

D. Subbarao: No, I do not believe so because as we have said we have looked at liquidity as distinct from the policy tightening, liquidity has been over tight and we have given some guidance on that dimension that it should be within plus/minus 1% of NDTS, so we are going to ease it up in the endeavor over the next few weeks to try and bring within the upper limit and I do not see that actually diluting our resolve to bring down inflation or indeed our patenting of monetary policy.

Dr. K C Chakrabarty: Just to reinforce that point we have clearly said that a deficit liquidity situation is consistent with the monetary stance but at the same time an excessive deficit could be disruptive, so that is why we went out with the band plus or minus 1% and on that basis assess the current situation as being an excessive deficit for both very short-term factor and perhaps some more persistent factor. It is really something that is addressing both the relaxation of the SLR, which we did last week, so these are ways in which we will handle the situation, also when you look back at May-June when the auction realizations also had an impact on liquidity, so that is the balance assigned to-we would like a deficit liquidity situation that is consistent with the monetary stance, we would not like it to get two-point ways actually causing some disruption.

Shubhada Rao: This is more a corrective to get a preferred band of deficits?

Dr. K C Chakrabarty: Yes.

Moderator: Thank you. The next question is from Devendra Nevgi from Delta Global Partners, please go ahead.

Devendra Nevgi: Congratulations to your teaching for enhancing the communication strategy of RBI over the last few quarters. I have two small questions to the team. There has been lot of talk about the structural and frictional aspect of some of the macroeconomic indicators and friction includes the cyclical part also, the inflation, the liquidity also is back now in band of plus/minus 1% of the NDTS, the current account deficit has got a 3% upper band, there is a trend growth ring (ph). Is it possible that there are some numbers, which would give a future guidance that is one, and secondly in India do you really see negative interest rates have direct correlation with the asset prices?

D. Subbarao: On the first question about frictional and structural factors and our given numbers. Actually we have gone out of our way to be as predictable or as definite responsible on guidance that is why we said current account deficit 3% is a cause for concern, if it is sustained on year-on-year basis. On liquidity, yes, we have admitted to structural and frictional factors. On inflation of costs there is more recently this structural food inflation dimension, but we have given many numbers or tried to be as definitive as possible on that and now that you have commented this we will try and move on this direction. On negative real interest rates and their impact on asset prices, yes, they would certainly be that, so part of the effort towards tightening the policy rates and tightening monetary policy in general has been towards reigning in inflation including reigning in asset prices because as far as the Reserve Bank is concerned asset prices have been very much within the ambit of our monetary policy or regulatory policy.

Devendra Nevgi: Is that the inclusion of liquidity management in the core monetary policy stance as realized asset prices, will those two be the most critical inputs going ahead in the monetary policy?

D. Subbarao: No, I do not think we can characterize it like that because it is not necessarily monetary policy whenever liquidity situation has to be treated as apart from policy rate tightening and as far as asset prices are concerned to the extent that they are driven by any credit increase to any particular sector it becomes part of monetary policy calculation, otherwise too it is within the realm of out macroeconomic calculation but we may or may not use monetary policy, we might use regulatory policy for that purpose.

Moderator: Thank you. Ladies and gentlemen, due to time constraints we will now take the last two questions. The next question is from Vibha Batra from ICRA Limited, please go ahead.

Vibha Batra: My question is on microfinance institutions, I think part of it got addressed; I have a second thought-as you said some of these microfinance institutions are non-banking finance companies and most of them are systemically important companies, RBI's regulations apply to them, so AP ordinance is inferencing upon RBI's regulatory policy, we cannot have ordinance spreading all over the states for MSI (ph) organizations and second is because of these uncertainties and the signals that various banks are getting from government from state sector lot of them are adopting wait and watch policy especially for lending to these MSIs. So I take the point that they are specifically important (ph) 22,000 Crore portfolio is not very big as far as the system is concerned but if you look at the borrowers they are very large, there would be in lakhs, so if there is a disruption in their activity, which is right now happening to some extent because the collection efficiency has really dropped because they cannot hold and also banks do not seem to be lending to them, there is no fallback option, this was during September-October liquidity crisis. For housing finance companies and NHP window was quite effective but for NBFC the rate window will be from RBI, so is there a thought to kind of avoid disruption in activities at least from the liquidity point of view especially where these entities are regulated by Reserve Bank of India.

D. Subbarao: Just to give you a perspective, we do not have anything called an NBFC MFI, there is no categorization like that but after this has become a high profile issue we tried to take some census and what it turns out is that across the country there are about 36 or 37 NBFC MFIs and none of them is deposit making and out of those 36 about 13 I believe are systemically important, so those 13 are subject to most stringent regulation than the remaining 23. Now the specific question was about whether the AP ordinance infringes on the RBI's regulatory jurisdiction. You must note that if the ordinance has not done anything on the interest rate and has not done anything contrary to RBI's regulation. So to that extent I think there is no overlap but really the implications of Andhra Pradesh government's ordinance and the implication so far regulatory jurisdiction this has to be studied further and we will do that. As the malegam committee moves forward we will also be taking into account the implications of AP legislation or anything similar to that other governments or the state governments might undertake. On the second question about wait and watch about the resource lines to MFIs being cut if that is the problem that is happening because of the uncertainty created by all the issues that have come up as far as the Reserve Bank is concerned we are looking into the issue of whether we must continue the priority sector lending facility for banks to lend MFI and do not take a final view on that and banks are taking up business decision whether to continue funding the MFIs in the interim (ph), but the larger issue of maintaining lines of query, the line of flow of resources, the MFIs is something beyond RBI.

Vibha Batra: Again, you know, there is actually something on interest rates in the ordinance although ti is quite redundant because interest should not exceed principle so technically you are talking about filling of IRR in excess of 100%, I guess this is quite superfluous. With the way the lender functions, you know, they conduct center meetings, you know, there are restrictions in the ordinance on that…

D. Subbarao: You are right, there is some restriction that the repayment cannot exceed twice the principle etc., but I am not sure whether that can be interpreted strictly as regulation of interest rate, even the money lending has some stipulations about what interest rates can be charged and you know this whole issue of what regulation that the state government applies to banks, to non-banks, money lending regulation, the usurious interest rate regulation etc., some answers have been thrown up by this AP ordinance and we have to study this further.

D. Subbarao: Thank you very much I want to say that these questions have been very searching, very involved, and you have not seen us but if you have seen us you would have noted that you have challenged us. Thank you very much and we look forward to the next session. Thank you.

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