Edited Transcript of Reserve Bank of India's Post Policy Conference Call with Researchers and Analysts

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MODERATOR:

MS. ALPANA KILLAWALA – PRINCIPAL CHIEF GENERAL MANAGER

Moderator: Good Day, Ladies and Gentlemen and Welcome to the Fifth Bi-Monthly Monetary Policy Governor's Teleconference with Research and Analyst. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now like to hand the conference over to Ms. Alpana Killawala. Thank you and over to you, Ma'am.

Alpana Killawala: Thank you, Malika and welcome to this post policy Researchers and Analysts conference. We will straight away go to the questions, as we have already received some.

Ankit Maheshwari:
ISEC PD

We see the direct impact of HRA update in Pay Commission leading to CPI impact of around 50 bps to 80 bps. Do you think the 5% inflation target is seriously under threat and does it require a rethink of the accommodative stance of RBI?

Dr. Raghuram G. Rajan: I think as Dr. Patel mentioned this morning, there are some aspects of Government HRA allowance increases which are somewhat mechanical, or technical I should say that is when we go out to find what is happening to house rents, the rent we impute to government housing is based on what the allowance is and so if the allowance has increased even through no money may actually change hands because this is Government owned housing there may be a sense that the rent is increasing and therefore the rentals will increase. Now, there is a case to be made which Dr. Patel made this morning of at least paying less weight to the direct impact because we know that is mechanical. Of course what we have to be careful about is the spill-over an increase in house rent allowance for Government employees to the larger rental market; there are some Government employees who rent housing elsewhere then from the government and so those are issues we will have to look at but the direct mechanical impact will have to we may pay less weight to and so to that extent I think the fear that is expressed here may be excessive. Let me also ask Dr. Patel to add.

Dr. Urjit R. Patel: No, I think Governor has covered both points.

Amit Agrawal:
Societe Generale

RBI plans to have medium-term target CPI 4% (+/- 2) range for FY17-18 and also talked about real rate as 1.5% to 2%. Question is, is long-term CPI target of 4% sustainable for India, since India's PPP ratio is lowest and CPI might pick-up faster.

Dr. Raghuram G. Rajan: When you say that India's PPP is low, I presume you have in mind something like the Balassa-Samuelson effect which is that as a country becomes richer the non-traded goods increase in price more because productivity is lower there, which then means that there is a certain amount of inflation which comes simply from that and that is something that is natural as a country gets richer. This is why our inflation objective is not 2% which is where the industrial countries are, in fact we have in a sense accounted for Balassa-Samuelson by saying 2% plus

2% productivity differential which means about a 4% inflation rate, if you think there is going to be that effect, which I think we will have. Of course we also we will take this into account going forward and unless the industrial countries change their inflation objective from 2% to something higher it seems that around 4% over the medium-term seems like a reasonable mid-point of the range. Of course we have a fairly wide range from 2% to 6% and that is precisely because as we get there we can allow this inflation process to take time rather than do it abruptly.

Moumita Samanta: Anand Rathi Securities

We know manufactured products are in deflation. Yesterday's GDP data showed that even the services component deflation for the third consecutive quarter. How do you reconcile this with the CPI numbers?

Dr. Raghuram G. Rajan: I am not sure that statement that services is in deflation is actually right. Certainly the large components of services that we see are not in deflation, whether it is education or health care spending. What you may be referring to is that the GDP deflator which combines services with manufacturing and so on is mildly in deflation. But that is really because it gives 60% or so weight to WPI and 30 odd per cent weight to CPI and therefore with WPI being in deflation that is going to take the entire index deflation. Now what the right weightage is and so on, one could debate. But I think the argument that services which is significantly non-traded goods is in deflation is not quite accurate.

Radhika Rao: DBS Bank Could you please share your take on the growth numbers released yesterday?

Dr. Raghuram G. Rajan: I will ask Dr. Patel to answer that.

Dr. Urjit R. Patel: I think the growth numbers indicate that while there are coincident indicators that go both ways broadly we are on a recovery path which looks to be sustainable and should pick up pace going forward as more of the capital expenditure that the Government has programmed in the budget for this year comes into play. And in fact after the policy a multi-year road program expenditure target has been established by the Government. So I think that we are on track for 7.4%-7.5% growth rate for this year with may be a slight downward bias but broadly about the numbers that both the Government and RBI have been talking about. So I think yesterday's GDP growth numbers were good news and it establishes certain confidence in the way the macro economy is evolving this year and likely so also in the next year.

Radhika Rao: If capital expenditure is compressed to accommodate the wage commission proposals but keep within targets, would you consider this as a prudent fiscal rationalisation path?

Dr. Raghuram G. Rajan: I think there are two components that we have always been talking about. One is the quantity of the deficit which is what the Government tries to keep within in its fiscal consolidation path and the second is the quality which typically would mean that if we spend we would try to emphasis the capital investment part of spending rather than the current expense part of spending. So by those metrics I think it would be not quite complete if what one did was to accommodate wages by cutting capital expenditure; you would certainly meet the fiscal deficit target but you would not assure the quality of the spending. And I think the Government is quite intent on trying to protect the capital spending that has been taken up. It is a difficult task that the Government has ahead of it, but it is by no means impossible.

Amanjot Singh:
Punjab University

How we can relate FED lift-off with reducing interest rates in Indian economy? Can we not consider this as an opportunity for the Indian economy?

Dr. Raghuram G. Rajan: Not really, opportunity to do what? I mean the FED is going to lift off because there is diversion in monetary policies between the Fed and likely what the ECB will do. That will mean exchange rates will move a little bit, to the extent they have not already done so. There will maybe some volatility around that event. But really from our perspective we have to focus on making space in the domestic economy for investment to grow and doing all the things that are necessary. So, I think that is only slightly affected by the actions of the FED at this point.

Promit Sengupta:
AIWMI

Most of the commercial banks have cut their deposit rates but the other way round they are very reluctant to cut on the lending front. Do you think a standardised base rate calculation linked to policy rates will help the end user in a great way?

Dr. Raghuram G. Rajan: I think we go back and forth in this discussion. The banks will tell you that their deposit rates adjust slowly so they cannot pass through changes fast. Of course there are market based participants who pass through changes quite quickly because their short-term players can borrow quickly in the market and can lend also. Commercial paper rates for example have come down quite shortly since policy rates were cut. The answer in the longer-term because the banks compete in say working capital loans with commercial paper, has to be that banks find ways to manage their assets and liabilities in such way that they are able to pass on policy rate cuts, so as to be able to compete with commercial paper markets, for example, in lending to firms. We are moving towards a marginal cost pricing structure so that the way that is determined does not stand in the way of banks passing on rate cuts. Longer-term I sense a number of banks will move towards pricing loans of market benchmarks and that will also help quicker transmission. But this is an evolutionary path, it does not happen overnight and I think we will all try to do a bit.

Rajesh Agrawal:
Bank of America

In para 13 under policy stance you have highlighted multiple risks to inflation, viz., El Nino, likely shortfall in Rabi crop, uptick in CPI inflation excluding food and fuel in the last two months. Also in November we have seen on the ground prices of some food items move higher which is likely to get reflected in the CPI numbers to be released later. Based on this it seems that the risks to inflation path should be on the upside and not on the downside as highlighted in the policy.

Dr. Raghuram G. Rajan: Well some information came in in-between which caused us to revise down our inflation projections and of course there are risks which could revise it up. So I think taking the sum of both the information that has come in as well as potential risks, some of which have grown and some of which have diminished, our sense is that there is some slight downward bias towards, downward possibilities to our projections. We are taking small numbers here not large downward bias.

Srinivas Varadarajan:
Deutsche Bank

The September Monetary Policy Report discusses the use of Forecasting and Policy Analysis System (FPAS). Could you please provide us with some intuition on this the way the FPAS works?

Dr. Raghuram G. Rajan: Let me ask Michael to take this.

Dr. Michael D. Patra: The FPAS as it is known is founded on the theoretical New Keynesian framework. Essentially it has three blocks. It has one block which links aggregate demand to the interest rate, the real lending rate. It has another block which links inflation to cost conditions in the economy including those that emerge from the exchange rate and then it has a policy block which links the policy interest rate to inflation and growth or rather the difference of the inflation from target and the difference of growth from its potential. Three things are important in this: it is written entirely in gaps, i.e., aggregate demand is measured as output minus its potential, inflation is measured as actual inflation minus its target. It is very flexible in that it allows for variety of shocks to be imposed on the policy rate. It allows for lag structure and also it allows the RBI to approach targets in a very gradual fashion.

Jayesh Kumar:
Kotak Securities

RBI intends to make bank base rates market determined. Should it be linked with yields or inflation?

Dr. Raghuram G. Rajan: I think yields capture to a large extent inflationary prospects, especially market determinant yields. Of course, there is a liquidity component there also. But to a large extent I think they do capture inflation expectations. So I think it is a reasonable thing to go with yields.

Devika Mehndiratta:
ANZ

In your forward guidance you said that RBI will accommodate further 'when' the space is available. So is it fair to say that it is a question of only 'when' and not 'if'"?

Dr. Raghuram G. Rajan: We are getting into semantics now. I have not thought deeply about the words 'if' and 'when'. Maybe we should use them both 'if and when'. Look, all we are trying to say is as and when room opens up we will be able to do more. But right now we have done what we can and we are on a wait and watch mode with the general sense that we continue to be in an accommodative stance.

Alpana Killawala: The received questions are over. Shall we open the line for questions?

Dr. Raghuram G. Rajan: Sure.

Sonal Varma:
Nomura

Two questions actually, one is if you could throw some light on the view beyond March 2016. So, in the previous Monetary Policy Report it was indicated CPI expected to be around 4.8% in the first quarter of 2017. Just update on what is the view beyond March 2016? And second, if we look at the underlying CPI in terms of the core CPI, it was at 5.3% when we started cutting rates in early 2015. And it is currently around the same level. So my question is why do you think there has not been a sharper disinflation? And what is your expectation in terms of what drives this disinflation into 2016?

Dr. Michael D. Patra: In 2016-2017, we are seeing some base effects in play until October, both ways. And we hope to end the year, March 2017 by around 5.4% a little above 5. Although I have to caveat this by saying that the output gap in our assessment is closing very slowly and it will still have a disinflationary pull into inflation in the next year.

Dr. Raghuram G. Rajan: Urjit, would you like to answer the second question?

Dr. Urjit R. Patel: I think that there is first the obvious one that commodity prices continue to be soft and yesterday in fact the petrol and diesel prices were reduced further. Secondly, I would like to think that as these levels of inflation, both the headline and the core take hold, the inflationary expectations should come down and this is likely to then permeate and percolate into wages salaries and therefore the services side. Of course these are based on assumptions, but it is precisely why if this kind of disinflation persists that you are likely to then get in fact a higher benefit going forward by anchoring the expectations. So, that is the way we look at the disinflationary process.

Shubhada Rao:
Yes Bank

I had just one small question regarding core inflation that non-food inflation, non-fuel inflation edging up and likely to edge up from here on in the coming months. Will it at any point in time prompt a change in monetary policy stance from the RBI?

Dr. Raghuram G. Rajan: You are asking, are we saying we will never change our stance? No, of course not, we will, if the data does require. As of now we think this stance is appropriate and it is obviously a forward looking statement. It is based on what we think will happen going forward. But if the data show otherwise, there are surprises, there are changes, of course we will have to change our stance.

Ashish Goyal:
Bluecrest Capital

For this year you have spoken a lot about the 1.5% to 2% real rate that is appropriate for this economic cycle that India is going through. I was wondering what sort of economic cycle would desire a slightly lower, slightly higher real rate band basically. I would appreciate some comments on that.

Dr. Raghuram G. Rajan: Well, I mean if you take our growth that around say between 7% and 8%, that is pretty strong growth. So given that strong growth I think real rates, even though we are an emerging economy and not developed, real rates are in the band that we have been talking about for some time that should be a reasonable real rate. Of course if growth plummets for a variety of reasons that we do not foresee right now clearly real rates, appropriate real rates could be lower. And on the other hand if growth picks up very-very strongly it maybe the reverse. So I cannot calibrate that for you and tell you what growth rate corresponds to what real rate but that is the directional way we see it.

Naveen:
HDFC Standard Life

My question is slightly on the longer horizon. I am looking at September 2016 when FCNR(B) money will move out of the country and that will lead to two situations. One is the liquidity on the domestic front and second is the demand supply of the Government bond. I know that on the Forex side we are very well-covered on that side. So what is RBI's thought process on that?

Dr. Raghuram G. Rajan: Let me ask Mr. Khan to just respond. In general there will be no effect.

Shri H. R. Khan: You are talking about the yield on the G-Sec?

Naveen: Yes and the liquidity front as well because that is a huge amount of money which will leave the country.

Shri H. R. Khan: No, we are well balanced in terms of meeting the liabilities with matching assets so that should not be a problem. As and when there are liquidity drops, we will take care through our liquidity management process, so that process will continue.

Dr. Raghuram G. Rajan: In other words, we have long forwards to balance the short forwards and so they just effectively cancel out, it has no effect on the underlying liquidity here. And since we bought enough to match the out flows I think we do not foresee any real problem.

Vibha Batra:
ICRA

I have two questions; first question is on Tier-I capital of banks. There was a Guideline from RBI which said that banks should proactively shore up their Tier-I capital. But we have not seen any issuances of additional Tier-I and obviously equity market conditions have not been very conducive. So how satisfied or dissatisfied you are with core Tier-I capital of banks, especially some of the banks who are also reeling under phenomenal asset quality pressures?

Dr. Raghuram G. Rajan: Well, I think the statement or some version of that statement still holds. We would like to see banks with more capital but we also have to appreciate the conditions in the capital markets. What we are trying to do is create more conditions for additional Tier-I bonds and Tier-II bonds, by trying to see what kinds of requirements we will need to get some of our long-term investors to buy some of that. That will help boost non-equity capital. But clearly wherever there is opportunity, the banks that are closer to the capital requirement may see that as an occasion to raise more.

Vibha Batra: But do you see that there are very limited spreads that banks as issuers are willing to pay for an instrument which is very risky. And do you think that is more of a deterrent or it is investors' appetite in general that is the deterrent? So what is holding back the issuances there?

Dr. Raghuram G. Rajan: Look, I do not want to comment on a specific reason. Of course if the yields are lower, banks will be more prepared to issue. On the other hand the investors will be less prepared to buy. So there is some meeting point, that is, the risk bearing capacity of our buyers, our investors, is sufficient is a bigger question. In general, we do not have enough appetite for risk capital in this country to the extent that is needed for financing whole a lot of issues, including our investments going forward, which is why we have been open to foreign investment, especially in riskier assets. But what we will have to do is to make sure that there are no impediments, regulatory or otherwise to entities buying these assets and after that the market has to play out and yields have to be attractive enough for investors to buy as well as the people issuing to be willing to issue.

Vibha Batra: Sure, Governor, that is helpful. I have another question. You had given a lot of leeway or strengthened banks' ability to recover through SDR and 5/25 Refinancing Scheme. So if we were to see the loans which have got restructured or refinanced under these schemes and purely from the point of recoverability and the kind of provisioning that has been done or not done on these accounts, how satisfied are you on these accounts?

Dr. Raghuram G. Rajan: Well, as I said in the press conference this morning, we are engaged in a continuous dialogue with banks in terms of pushing them to do what is right, both in terms of putting the asset back on track, exercising the powers we have given them but also ensuring that they recognise and reflect the true nature of the assets in their balance sheet. This is an ongoing process, but I am fairly confident that over time with the attention that we are giving, the Government is giving and the banks themselves are giving, this problem will get sorted out.

Astha Gudwani:
Birla Sun Life AM

Two quick questions. The first one is while services core CPI miscellaneous is hinting at inflation, the GVA deflator for services is actually turning out to be a (-)2.5% if we do not take construction into services. Now, if that is the case and CPI is actually positive, does this mean that we are overstating real GVA growth in the country?

Dr. Raghuram G. Rajan: Michael, would you like to respond to that?

Dr. Michael D. Patra: As Governor answered a little while ago and Dr. Patel too, the GVA services deflator is largely WPI which reflects internationally traded commodities and has no services in it. So when you deflate by the WPI you add a little up to the volume number.

Astha Gudwani: But actually the industry's GVA deflator is even lower then services GVA deflator, which would imply that an even larger component of industry is being captured in services GVA?

Dr. Michael D. Patra: No, there is a lot of WPI used in the industrial component too, apart from parts which are measured in terms of volumes. So that accounts for industrial deflator being lower.

Astha Gudwani: Okay. And the second one is on while you clarify that whatever one-off spike comes up in CPI housing because of the rental allowance going up whenever it is implemented, you will overlook it, the MPFA that was signed in February asks you to basically make sure that the CPI combined headline is kept in the 4% (+/-2) band FY18 onwards every time. So if there is spike which could be then the case how would you gel it with the MPFA's clauses?

Dr. Raghuram G. Rajan: Well, it is not so much spike as a steady addition to inflation because an additional component of Government housing will be taken into account every time. So it would not be a one-off spike because of this rental adjustment, but more a steady addition to inflation. Now our target over the next year is to go down to 5% and then beyond that to go down to 4%. So there is some play between what our target is and what the technical requirement of the Monetary Policy Agreement is. There is some room in between and that can accommodate the differences between what we are going towards in this temporary push up in inflation.

Astha Gudwani: Sir, if I may, just quoting from the last two incidents of the 5th and 6th Pay Commission, there was jump in two months only, from 5% housing CPI going up to 22% in the 5th Pay Commission and roughly something similar in the 6th Pay Commission as well. Now if suddenly whenever this implementation happens and we see some sort of an 18% increase which takes the headline say a percentage point higher then what the trajectory of the fan chart is, it will be overlooked from a monetary policy action standpoint but it is justifiable under whatever clause of MPFA is, is it?

Dr. Raghuram G. Rajan: Well, we have to overshoot the target for three successive quarters before we have to write a letter to the Government explaining why. So if there is one month or two months, in which it exceeds the target it is not a total disaster. In fact, it may not even require writing a letter to the Government because that blip will get evened out as we go forward into the next quarters.

Shyam Dwarkani:
ICICI Bank

This is regarding the liquidity management operations. In the first half of this financial year what we saw was RBI actively providing liquidity against whatever outflows are happening on account of currency in circulation. In the last two months, what we have seen is while the currency in circulation has gone up by about 1 lakh crore which has tightened the liquidity significantly in the market, RBI has not provided any sort of long-term structural liquidity into the market in the form of Forex market intervention or by way of G-Sec purchases. So you could just throw some light on any change in the way liquidity is being managed or you want the liquidity to remain continuously in deficit to this extent?

Dr. Raghuram G. Rajan: No, I think if you look at the extent which there is a liquidity deficit, it is at this point approximately 1% of NDTL. It is not in any way out of line with what it has been in the past.

Now in the early part of the year of course we were possibly in excess liquidity because of our foreign exchange purchases last year and that had carried over into this financial year. Now over time the excess has been eroded as the economy grows and now we probably are more or less in balance. But a true measure of the liquidly needs, either quantity of liquidity the market is absorbing which is not at this point extraordinary, suggesting there is no serious shortage, or the price, and we find that there are intra-day movements, but in general, the short-term money market rates are pretty close to the policy rate. And in the current period where some people, again, very rare complaint that there is a shortage of liquidity, we find that people are putting money into reverse repos at the end of the day. So there does seem to be excess at least on some dimensions. So broadly, we have provided the liquidity the market needs. If we find on a sustained basis that there is liquidity being absorbed by the market, of course we will provide long-term forms of liquidity. Just to mention in the Monetary Policy Statement, that average net liquidly absorption of about Rs. 10,000 crore in Q2 gave away to net injection of Rs. 37,000 crore in October and up to Rs. 85,000 crore in November. That is an example of what I am saying, from excess liquidly we went to some more normal liquidly over this period.

Shyam Dwarkani: Sir, just to follow on, this period of the financial year now from here onwards till March also we are likely to see continuous build-up of Government balance as well as further leakage in currency in Q4 also.

Dr. Raghuram G. Rajan: As I said we will be monitoring the liquidly situation and we have no ideological bias against providing the liquidity the market needs. So as and when there is a shortage indicated and there are requirements later this month, for example, we will provide them and we will keep the market plentifully supplied with liquidity.

Anjali Verma:
PhillipCapital

I have got a couple of questions, one is just wanted to understand is the inflation trajectory that RBI is suggesting is inclusive of the impact of the 7^{th} Pay Commission and GST, because irrespective of when GST is implemented, service tax rates will continue to raise.

Dr. Raghuram G. Rajan: Let me ask Dr. Patel to comment.

Dr. Urjit R. Patel: The Pay Commission impact has not been taken into account in part because of one assumption that the Government’s medium-term fiscal consolidation path will be maintained and secondly, on the sectoral basis we have provided commentary that there will be an impact through the house rental allowance which we will take on board as an when it comes about. On GST, well I think firstly that depends on a variety of factors: a) what the new unified rate will be? It could very well be that it will not be inflationary if the unified rate is less than the sum of the States and the Centre rates at the moment. The coverage of the GST as well so, I think it is a too early to take that into account. We have incorporated the last half a percentage point increase in the services tax on account of the cess, so that is in our projections.

Anjali Verma: And second question was I heard the commentary on the impact of 7^{th} Pay Commission, as you are saying that, largely RBI is of the view that fiscal consolidation path will be retained by the Government. However, I mean it definitely will have an adverse impact on the capital spending because there is no other way, there is no other saving that Government will have. So what I am asking is that instead should RBI be not comfortable if some slippage is allowed on the fiscal front, however, the capital spending continues?

Dr. Raghuram G. Rajan: I think this is a hypothetical question, let the Government do its job and then we will see what we need to do. But obviously, the Government is fully aware of these issues and has reiterated that it wants to both maintain the fiscal consolidation path as well as do what is necessary for the growth of the economy, which implies capital spending. So let us see what happens. I think it is too early to judge the Government's actions.

Alpana Killawala: Let us have the last question, Malika.

Rohan Maru:
ICICI Prudential My question is about inflation indexed bonds, any update on this?

Dr. Raghuram G. Rajan: Let me ask Mr. Khan.

Shri H. R. Khan: This we have taken up with the Government and I think they are working on that. We hope to announce something shortly.

Alpana Killawala: That is it from our side for today. Thank you very much for joining. Thank you, Governor.

Dr. Raghuram G. Rajan: Thank you.

Moderator: Thank you very much. Ladies and gentlemen with this we conclude the conference call. Thank you for joining us and you may now disconnect your lines.