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

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PARTICIPANTS FROM RBI:

DR. RAGHURAM G. RAJAN – GOVERNOR
SHRI HARUN R. KHAN – DEPUTY GOVERNOR
DR. URJIT R. PATEL – DEPUTY GOVERNOR
SHRI R. GANDHI – DEPUTY GOVERNOR
SHRI. S. S. MUNDRA – DEPUTY GOVERNOR

MODERATOR:

MS. ALPANA KILLAWALA – PRINCIPAL ADVISER, COMMUNICATIONS

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

Alpana Killawala: Thank you and welcome to the Post Policy Teleconference for Researchers and Analysts. I will straight away start reading the questions that we have received online.

Gautam Singh:
Spark Capital

The $32 billion FCNR deposits will come for redemption during November-December this year. While the RBI has built dollar position in the forward market to arrest the rupee volatility due to redemption of FCNR deposits, how it would impact the liquidity situation in the system? Will it impact the deposit growth of the banking system as the money goes out of the system?

Dr. Raghuram G. Rajan: Well, to the extent that these deposits have been raised and invested in India, presumably the investor will have to think about what they want to do with it. Many individual depositors may decide to leave the money at less favorable rates than in the past but certainly more favorable than they are getting elsewhere. To the extent however that these deposits represent levered positions where the depositors put in their money, borrowing from banks and so on because of the extremely good yields that were available, then they may not find that leverage still available in which case some of that money will have to be withdrawn and repaid. Now that will mean lower deposits in the banking system but I presume they will find other ways to make that up. What we are preparing for is certainly the outflows, we have forward positions which allow us to buy dollars and then pay for dollars that the banks will want when they take their money out. We are fully covered there; we do not see a problem there. There might be a possibility that banks that have sold forwards to us may then go out and try and buy those dollars in the market because they have not hedged themselves fully or the people they have lent the money to aren't repaying them dollars. So there might be some volatility at that point, we have plenty of reserves to ensure that there is no undue volatility.

Shri H.R. Khan: Only thing one can add, they should not expect that all deposits will go away because even now you see an attractive rate of interest plus it is protected.

Dr. Raghuram G. Rajan: Khan Saab makes a good point that is we are preparing for the worse but if some deposits stay that is all very good. Broadly we do not think this will have a significant impact on the system.

Rajeev Radhakrishnan:
SBI Mutual Fund

In view of the revised liquidity management framework and the current estimates on reserve money growth, what is the time frame that the RBI anticipates to bring the liquidity deficit to neutral? Also would the revised framework commit the RBI to entirely neutralize the currency leakage in the system on a durable basis?

Dr. Raghuram G. Rajan: First, to give you some numbers so that you can get a sense of what we are talking about that if you believe that the real money growth is broadly consistent with the needs of the economy, most estimates of how much we would need to grow the asset side of the RBI's balance sheet would be between 15,000 crores and 20,000 crores a month. So if you take that as what we would infuse in general through both foreign exchange purchases as well as through purchases of domestic bonds and say add to that another 10,000 crores a month as we try and reduce the liquidity deficit, depending on how much you think the liquidity deficit in the system is, you get a sense of how long it will take. Of course I am not giving you a forecast of exactly what we will do but a broad sense of the kinds of numbers we are talking about. And depending on the situation on the ground the extent of inflows that we get that we have to buy, that will determine the extent of our purchases of domestic bonds over time. If you think the deficit therefore is about 1% of NDTL which means about 80,000 crores, it will take us 8 months to cover this deficit up. If you think it is more it takes more, I mean just do the math and you will get a sense. The revised framework makes us forecast what the durable liquidity needs of the economy are. So if suddenly the demand for cash goes up then to that extent we will have to think about a higher durable liquidity need for the economy. I think it is too early now to say whether this recent pick up in cash demand that we have seen is durable or not. At least one school of thought is that this is just election time pickup in demand and it will come back or come down as we move away from the elections.

Amit Premchandani:
UTI AMC

What is the ideal liquidity environment (deficit or surplus) to ensure monetary transmission in the current accommodative phase? And how do you define surplus/deficit liquidity?

Dr. Raghuram G. Rajan: So let us start with this definition, broadly we are talking about how much the banks who have access to our various windows have to borrow in order to meet the needs of the system and we see that extent of borrowing as what we have to infuse in order to keep the market rates, the weighted average call money rate at approximately equal to the repo rate. So if on net we are infusing money, that we are lending money to the system in a significant way over time we say the system is in deficit. On the other hand, if the system is depositing money at the RBI over time on average we say the system is in surplus. So what we would like to do is to ensure that over the years we are broadly neutral, that is the deficits outweigh our offset by the surpluses. In other words times when people have to borrow from us, the amounts they borrow are offset on average by the amounts they have to deposit with us and this borrowing and deposit will take place over time based on the frictional forces in the economy such as the buildup of government balances or the rundown of government balances. Right now we have some running down as the new year starts and payments are made and that is what we want to make sure, that on average these numbers are close to zero. I am not sure that there is a clear theoretical argument for staying in surplus during an accommodative phase and staying in deficit in a tightening phase. It certainly smells right but our first job is to get closer to neutral.

Ramkumar Krish: Reliance General Insurance Co. Ltd.

It is almost 4 years since savings interest rates are deregulated. Are savers adequately compensated for the introduction of transaction related charges and minimum balance insistence?

Dr. Raghuram G. Rajan: Let me ask Deputy Governor Shri Mundra to comment on this question of whether savings rates deposits after deregulation are compensating savers appropriately or not.

Shri S.S. Mundra: I think there are two-three aspects. One, of course after the deregulation there has been certain movement in industries and differential savings rate were introduced by some of the banks. Also the frequency of interest application has undergone a change which on a compounded basis makes a difference in the ultimate yields. But I think what is more important is number one, savings accounts are generally, I mean to say, more perceived as a vehicle of transaction where the ease of doing the transaction and the other operational conveniences are of paramount importance. The second point which we must look into it that in many of the banks there would also be the arrangement of sweeping in or sweep out of the balances and where the balances held above the threshold limit are automatically swept to the term deposit and which earns a higher rate of interest. So the point I am trying to make that from a savings bank account the total yield is to be looked into the broad perspective of these transactional facility, the other attached facility. And simply looking at the rate of interest and then trying to work out a formula that whether there is adequate compensation may not actually yield to right results.

Kaushik Das: Deutsche Bank Given the weakness in the economic cycle, can RBI consider working with 1% positive real interest rate, instead of 1.5% to 2% number that is being used currently?

Dr. Raghuram G. Rajan: I think we can always recalibrate as and when information comes in, we are not casting anything in stone. Our sense is, till we see some improvement in savings behaviors, some genuine improvements in savings behavior it would be premature to say that the savings rate is not appropriate. Of course we also have to consider the investment cycle and the reasons the investment cycle is not picking up and so on. I think these are things that we are keeping an eye on and when appropriate and if appropriate we will make adequate changes.

Kaushik Das: How concerned is the RBI about the prospect of deteriorating state finances?

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

Dr. Urjit R. Patel: We do monitor the states' budget both from the perspective of being a banker to them and their debt manager. From the budgets that we have received which is a for a fair number of states, the consolidated revenue account of the state governments is actually projected to be in surplus, which is indicative of their intent to adhere to fiscal consolidation. An improvement in the revenue account and a marginal decline in the capital outlay is expected to provide the necessary fiscal space for a reduction in the gross fiscal deficit to GDP ratio by 0.5% points which form the revised estimates of 2015-16 of 2.9% to 2.4% going forward. A reduction of 0.6% point in the primary deficit is envisaged and which is consistent with long run sustainability of state finances.

Abbas Keshvani
Dymon Asia

The RBI changed its monetary policy stance to accommodative in Jan 2015 when it started the rate cut cycle but continued to keep liquidity in deficit. However in today's meeting you have indicated a clear change of stance on liquidity by progressively lowering the average ex ante liquidity deficit in the system to a position closer to neutrality from a 1% of NDTL shortfall. Would it be right to look at this as a course correction in RBI's thinking on liquidity and how it drives transmission?

Dr. Raghuram G. Rajan: Well, I think you can consider it any which way you want. I think I would rather think of this as a continuing development of how we are approaching liquidity. The reason I say this is that key to today’s move was a move away from using the windows to determine the operating rate in the economy, moving from that to using market repo transactions and auctions. This was critical because now we can essentially set the rate in the market close to the policy rate without relying on the windows. That means we do not have to keep the system in deficit anymore because we can get close to neutral and still keep the rate at the policy rate without it plunging to the reverse repo rate which used to be the case earlier when borrowing was only at the repo or the reverse repo windows. So think of this as a development as a result of the very sensible recommendations of the Urjit Patel Committee Report which we implemented. Now that market repos are working excellently we can move to actually using them for the purpose which was then move the system from liquidity deficit to liquidity neutral which is where we are going. So think of this as development rather than waking up.

Vinothharish GS
Wealth Advisors Does the RBI have a defined framework in choosing the tenors of the securities for open market operations?

Dr. Raghuram G. Rajan: Let me ask Khan Saab to offer his views on this.

Shri H.R. Khan: Well, the idea of open market operation is that we should be able to mop up securities and inject liquidity; that is the overarching objective. So we have to give a combination of liquid and semi-liquid securities and normally we keep a track what is the option, so people do not play one against the other. So keeping those parameters in view we chose securities. Our maximum intention is to mop up maximum amount; that is the intention.

Dr. Raghuram G. Rajan: While I have the analyst on the line, I would like to point to the fact that this a pretty thick monetary policy document and once we pay attention to all the elements in it, of course liquidity framework is important but there are some structural reforms that are suggested. As also, within liquidity, for example, the substitution of securities in market repo transactions will help us do longer term market repo transactions because now the securities do not get locked up once they are repoed. So I would advise looking at the entire document, as also looking at the fact that what is important here is that the pace of transmission is the focus. Earlier we cut rates but there was not much transmission, my belief is both with the MCLR and its effects which we are already seeing in the market, as I said this morning, we are already seeing a 25 basis points median rate reduction and a 50 basis points overnight reduction even before the policy rate cut. But going forward there will be more transmission because of all these moves. So I think it is important not to fixate on was it 25 basis points or 50 basis points or whatever number one thought was possible, but to focus on the process by which lower rates are being transmitted into the market which would be extremely helpful. And of course we still are open looking for possible room while recognizing there are risks on both sides to the inflation process.

Jayesh Kumar:
Kotak Securities

Within two years of adopting Dr. Patel's committee recommendation of 100 bps spread (repo / reverse repo) and 1% of NDTL deficit, we are cutting the spread to 50 bps and liquidity deficit to neutral. What changed?

Dr. Raghuram G. Rajan: Let me ask the Patel Committee author to respond.

Dr. Urjit R. Patel: What changed is improved marksmanship, the call rates staying closely aligned, usually plus or minus 25 basis points with the repo rate, the significant decline in volatility in the call rate and the introduction of new instruments for liquidity management. In summary, nothing changed, the process that was set in motion by the Committee’s recommendations is following its course.

Saket Kapoor
Kapoor & Company

Sir, in your earlier statement you stressed on the point that factoring all negative news in the system a cut of 0.25 basis points was decided. So what according to the RBI is a key negative factor that may affect the economy going forward other than the monsoon?

Dr. Raghuram G. Rajan: No, I think we decided the rate cut based on the outlook that we had thus far. Of course there are uncertainties to the outlook. On the negative side which is what you asked about, there is obviously the monsoon, there is the fact that we have to see the inflation process play out both in terms of headline inflation. Remember we have had one reading of lower inflation, we are of the view that this should continue but it is something that we need to see born out in the data. And also the core inflation that is taking out food and fuel has remained somewhat sticky perhaps because of services prices. So we need to look at that and understand better what its long-term prospects are. And finally, this is not negative but this is more something we have to look at is transmission. On the positive side is that world growth, in fact the IMF again today said things are weaker than they look, world growth is still weak which suggests any upturn in inflation is still some way away in terms of world prices. And also we have seen some weakening in commodities prices, especially crude in recent days. These will be helpful to our own disinflationary process and we have to set off the positives against the negatives, that is what we did in determining the rate today. But going forward we will see how they play out and certainly use whatever room emerges.

Vishnu Sawant:
National Stock Exchange

This is with regards to the financial market, one of the points is that the broadening market participation in electronic trading platform. The framework covers the FOREX platform to facilitate hedging by small end retailers. Sir just wanted to have some small clarity with regards to like which all type of target audience will be falling under this particular framework. Is it corporates also or who else would be there for this particular framework?

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

Shri H.R. Khan: Right now we are in the OTC market, it is the telephone based to broker driven and in some cases we have got the electronic platform but what we are trying to suggest is to expand this platform and these platforms will have a pipeline with the clearing and settlement system. So once you have the platforms the accessibility increases. So it will basically facilitate small and retail enterprises because large corporates in any case have their way of doing things. So basically the focus will be on the small and retail enterprises to access.

Badri:
Citibank

One of the key recommendations of the Urjit Patel Committee was to target the 14-day repo rate as the key targeted policy rate and we thought that that was the reason why so far you had not looked at bringing the system liquidity to a neutral or even a small surplus mode. Now that you are saying that you will keep it to neutral how would you achieve the objective of keeping the 14-day repo rate as the targeted policy rate?

Dr. Urjit R. Patel: The steps that we have undertaken today and the changes that have been made in the liquidity framework are towards the evolution of ensuring that the 14-day repo becomes the operating target. At this point we are still in Phase-I of what the Committee had recommended and the steps taken today were a transition towards the 14-day repo as the operating target.

Dr. Raghuram G. Rajan: Put differently, one of the things to remember is that this does not mean that at any point in time the system will not be in liquidity deficit or liquidity surplus and we will have to use the appropriate instruments to that moment to suck out additional liquidity or to infuse additional liquidity. The point however is that the rate that will prevail regardless of whether we suck out or infuse using 14-day term repo as well as reverse repos will be close to the policy rate and that is really the objective. I mean I am less wedded to a particular instrument as to the idea that the short-term call money rates broadly are what we are focusing on and we have enough instruments to achieve that whether it is through the overnight repo or reverse repo or the term reverse repo or even the medium term reverse repo.

Parul Mittal Sinha: Deutsche Bank

In the inflation targeting framework where headline CPI is the anchor, what will be the implications for monetary easing if the headline CPI moves lower than core in case we see a huge drop in food inflation?

Dr. Raghuram G. Rajan: I think the Urjit Patel Committee's view was broadly in agreement that this was the measure to focus on. To some extent we will have to figure out which aspects of this are transient. The whole point about excluding food inflation in other countries was a sense that this was a volatile component which was extremely transient; in India it has not been so which was the rationale for including it in our targeting framework. To the extent that elements of it are deemed as totally transient we probably will put less weight on it in determining policy but our focus still remains on the headline inflation.

Anjali Verma: PhillipCapital India Pvt. Ltd

In today's statement RBI has stated that adverse impact of pay commission on inflation can be to the extent of 100 to 150 basis points and excluding that RBI is expecting inflation to hover at around 5%. Now of course you have continued to highlight that we do not know when the Pay Commission will get implemented but we somewhere know that in a staggered way it will get implemented in this financial year. So that would mean that from CPI target of 5% there is at least a risk of about 50 to 70 basis points. So should that mean that the RBI is mostly done with the accommodation assuming everything else remains constant?

Dr. Raghuram G. Rajan: I do not think you should read anything. First, we need to see that the recommendations of the Pay Commission, how the Committee the government has set up comes back and it is quite possible that some of the recommendations may be pushed in to the future and as a result may not have that much of an impact this fiscal year. Of course I have no superior information what the committee is going to recommend, we have to wait and see. Second, even when the recommendations are implemented perhaps the most important recommendation given that the government is largely going to stick to the fiscal deficit target is going to be the one on HRA which has almost a mechanical influence on house rents because that is the way house rents are computed in the CPI headline inflation measure. So as the government rolls it out house rents will go up not because any actual money is changing hands but because the notional value of government rentals goes up. So what we have to judge is how much of that is truly going to have a sustained impact on inflation and how much of that is going to increase the headline numbers temporarily while it is feeding out but not have a sustained impact. And our sense is the sustained impact is not going to be zero but it is not going to be a 100% either. So we will have to make that judgment once we know what is being rolled out, at what pace, when, etc. So the point is, even if it feeds into headline inflation there is a possibility that some of it could be overlooked. Now until we know how much, when, we do not want to make a clear judgment on that but it is something that we certainly have looked at for some of our own internal studies and will make some judgments as we go along.

Devika Mendiratta:
ANZ Bank

You mentioned that it is a good thing that credit growth is picking up. What is really driving this pick up in the way you look at it? Is it purely a shift to lending in CP market, to bank lending maybe because commercial paper rates have gone up. Or do you think this is new demand for loans. And when you see this loan pick up with the bounce up in the PMI- the most recent print, and core industries reduction. Do you think that there would be a scope for positive surprises on growth?

Dr. Raghuram G. Rajan: Well, actually for sure because of higher rates in the CP market there may have been some migration back to banks during this period. But I think if you look at private banks' credit growth over the year it has been fairly strong, north of 20%. The problem has been more with the public sector banks where growth has been more of the order of 6.0%-6.5% and that yield accounts for the relatively tepid credit growth. Now of course looking forward, it is too early still to say that the big projects are back on track, though road projects there has been some borrowing for. But as investment starts picking up partly as a result of government public investment I think we might see that element start to pick up more strongly and public sector banks presumably will be part of that process. Retail credit, both from private banks and public sector banks has been fairly strong, public sector banks are moving more into it. So that is an aspect, especially as rate cuts get transmitted and EMIs come down, that retail demand may be impact the first leg of a more virtuous circle as retail demand picks up more broadly and investment then picks up.

Arvind Chari:
Quantum Advisors

My question is on the T+2 settlement for FPIs. We have noticed that a lot of domestic counter parties do not trade T+2 and some foreign investors are there at the mercy of few foreign banks and few PDs who quote T+2. This goes against the desire to trade in local currency and get the entire local domestic market liquidity. Can the RBI look at offering both T+1 and T+2 for FPIs?

Dr. Raghuram G. Rajan: If I recollect it was because FPIs demanded it that we moved from T+1 to T+2. So this constant back and forth, I mean you have to make up your mind what you want.

Arvind Chari: It could be driven by real money clients and funds that are operating as against proprietary foreign FPI accounts. So they might be able to easily get an account open in trade because of a proprietary nature. But for clients who have desires of having domestic market liquidity, I think if you ask for a general broad consensus there would be consensus from funds and from non-props that they are facing difficulty in executing transactions.

Dr. Raghuram G. Rajan: I think we allow choice, right?

Arvind Chari: No, it is only T+2 now, compulsorily.

Shri H.R. Khan: So then we are not sure which market, they straddle from one market to another.

Dr. Raghuram G. Rajan: See, the problem is we had a very strong demand from the people who represent it to move towards T+2. Well, please do send us a letter and we will see whether there is more demand. But really this back and forth is something that we would like to avoid, but certainly like to hear what your views are.

Vikas Agarwal: Prokens

So as of now in proactive response to recognize the stress many of the good accounts or otherwise who have fallen into NPA category. So my concern is their working capitals also get blocked because no bank would like to lend them because the time you lend them they are in NPA so you have to keep provisions at 25%. So how do we overcome this stress with these companies and what is the way out?

Dr. Raghuram G. Rajan: See, let me first say that we have not changed the rules on recognition, the rules are always what they have been. What we have asked the banks to do is to recognize the rules and apply them appropriately. So sometimes people say the RBI is forcing the banks. No, no we are not forcing any banks we are just suggesting the rules be applied. Second, we are very well aware of this problem that some times when projects get declared NPA people are worried about lending and therefore we have reiterated on a number of occasions that loans to projects that have turned NPA are not necessarily NPA themselves; certainly depends on the record of recovery of those particular loans and we have reiterated this in a number of circulars. Third, and this is the interesting development that in some of these restructuring, reorganizations we have also allowed for the possibility of new lending under the JLF process to have effectively super priority, i.e., it gets paid first out of the cash flows that are generated by the project when it consists of new loans made by the joint lending forum. That to some extent can take care of worries about getting paid when the project needs to be completed, but you are worried about your priority relative to the other lenders who have made loans. So in a variety of ways we are trying to work with this in the system. But what is important and this is why even in the press conference today I made it very clear that we have to be extremely careful about this process, not to brand default as necessarily a thing driven by the promoter and driven by bad behavior. Default is a process that happens across the world after a period of extreme optimism followed by a sudden slowdown in growth. Across the world you have defaults happening. So we should not say this is a bad thing and therefore people should be named and shamed. Sometimes it happens for good reason and we have to find ways primarily of putting the project back on track which is worth this whole asset quality reviews about.

Mahindra Bhatia
Vadilal Forex

Sir, you said that for our swaps on the FCNR deposits you have forward purchases. Another question that worries is the Iran payments. It is reported that there are $6.5 billion of Iran payments slated in the system. Have any forward purchases made on that account as well?

Dr. Raghuram G. Rajan: So we are discussing with them the way they want to be paid and certainly we will work with them on when and how we pay them. I do not think it will happen as a lump-sum but is going to be staggered. And we have $355 billion worth of foreign exchange, assets and gold, so movement up or down by some will not be necessarily problematic.

Nikhil Kabra:
ICICI Mutual Fund

My question concerns the currency in circulation, I mean we have seen a sudden spurt in currency in circulation over the last six months, normally I would assign relationship between nominal growth of the country and currency in circulation. While the nominal growth has come down over the last one year, currency in circulation has remained very high. Is there any particular reason which RBI thinks the reason why it has been going up? And is it also a reason why deposits are low because currency in circulation is increasing?

Dr. Raghuram G. Rajan: So first you have to look at the magnitude of this number, it is about 50,000 crores to 60,000 crores above what we would have expected. So I have seen some wild numbers floating around, it is about 50,000 crores to 60,000 crores. What has happened is after the festival demand when typically currency in circulation increases it has not abated post the festival demand, it has not really come back to the extent that we would have anticipated. Now there are various stories, I am sure you are aware of the various explanations, some people in act are arguing that nominal growth is higher than what we are measuring because we are not picking up some of the rural demand and currency is being used for a rural economy which is picking up, that is one view. Another view is that there are elections being fought in a number of states and this money has remained out as it goes to fund the election activity. We do know that whenever elections take place we do see an increase in currency demand, so that could also be an explanation. There could be others. I doubt that there is a structural change in the economy which suddenly requires more currency. So at least till I see the data, till the data persuades me otherwise I think this is temporary rather than permanent. But let us see.

Depojal Saha
Antique Stock Broking

Sir you have said that you will consult with the government on how to moderate the cash balances. So what could be the key recommendations in this aspect?

Dr. Raghuram G. Rajan: See consultations are going on, I cannot preview what exactly we are talking to them about. But there are various suggestions that have been made by market participants. Some of them require a change in the legislation to actually implement them. So we will see what is possible and talk about it. There has been over the last year greater build up of government balances, we are already in the process of auctioning excess government balances, so that is not the change and we are doing buybacks and so on. But we have to see what more can be done to alleviate this frictional fluctuation in liquidity. But it is something that we will talk to the government about and government has always been very responsive on measures. Let us see.

Alpana Killawala: So that is about it from our side. Thank you very much for joining. Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, with this we conclude today's conference call. Thank you for joining us. You may now disconnect your line.