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

January 27, 2011

Alpana Killawala Thank you Melissa and welcome to this post policy conference of the Reserve Bank of India. We have Governor, Dr. D. Subbarao and four Deputy Governors as well as Mr. Deepak Mohanty, the Executive Director with us. Governor will make a short statement before we start question and answers and then we will go over to questions. Thank you. Governor...

Dr. D. Subbarao Thank you Alpana. This is actually a summary of the statement that I read out at the press conference 2 days ago, but I just thought I would give this so that we are all on the same page and we can refresh our memory.

On January 25, 2011, the Reserve Bank released its third quarter review of monetary policy for 2010-11. Based on an assessment of the current macroeconomic situation, we decided to increase the repo and reverse repo rates by 25 basis points each and we decided to retain the cash reserve ratio at 6% of net demand and time liabilities of banks. With these increases since mid March 2010, the Reserve Bank has cumulatively increased the repo rate by 175 basis points and the reverse repo rate by 225 basis points. Additionally, the CRR was increased by 100 basis points. In order to manage the current liquidity situation, we decided to extend the two special measures currently in operation that is the additional liquidity support to scheduled commercial banks under the LAF to the extent of 1% of NDTL and a daily second LAF up to April 8, 2011.

There were actually four considerations that guided our monetary policy. First and foremost, inflation is clearly the dominant concern. Second, there has been a sharp rise in global commodity prices which has heightened upside risks to domestic inflation. Third, growth has moved close to its pre-crisis trajectory even in the phase of an uncertain global recovery and fourth, the uncertainty with regard to global recovery has reduced. The 8.9% GDP growth in the first half of 2010-11 suggests that the economy is operating close to its trend growth rate. We have retained the baseline projection of real GDP growth at 8.5%, but with an upside bias.

Moving on to the inflation situation, headline inflation moderated between August and November 2010 as expected by the Reserve Bank. This trend, however, reversed when WPI inflation moved up from 7.4% in November 2010 to 8.4% in December due mainly to sharp increases in the prices of vegetables, mineral oils and minerals.

Going forward, the inflation outlook will be shaped by three factors; first on how the food price situation both domestic and global evolves, second how global commodity prices behave, and third the extent to which demand side pressures may manifest. We have raised the baseline projection of WPI inflation for March 2011 from 5.5% to 7%. While the Reserve Bank will endeavor to provide liquidity to meet the productive credit requirements of a growing economy, it is important that credit growth moderates to conform broadly to the indicative projections. This will prevent further build-up of demand side pressures. The Reserve Bank will constantly monitor credit growth and if necessary engage with banks which show an abnormal incremental credit-deposit ratio.

Current growth and inflation trends clearly warrant that we persist with the anti-inflationary monetary stance. Looking beyond 2010-11, the Reserve Bank expects the domestic growth momentum to stabilize. Inflation is expected to moderate from the first quarter of 2011-12, but several upside risks are already visible. The monetary stance will be determined by how these factors impact the overall inflationary scenario. Thank you very much.

Moderator Thank you. We have the first question from the line of Arun Khurana from UTI Mutual Fund, Mumbai. Please go ahead.

Arun Khurana Sir my question relates to the possibility of demarcation of credit towards production as well as towards the consumption needs and in case RBI wants to curtail the demand, is it not essential that we could have two lines of credit, two separate rates of interest in terms of the ones being used for the productive purposes to basically ease out the supply pressure as well as the one in terms of retail credits?

Dr. D. Subbarao Thank you for that question Arun, but we moved away from prescribing interest rates and also further segmenting the interest rate regime. So we do not think it is wise at this point of time to reverse what is considered as a reform move. I am not sure that is something that we are thinking about.

Arun Khurana And considering the fact that we have supply side constraints, is it not essential to basically focusing on ramping up the growth process rather than trying to control the money supply and curtail the growth process and this may actually further accentuate inflation because of lower availability of goods and services.

Dr. D. Subbarao That is true, but as Shyamala just mentioned to me that money is also fungible and it is difficult for us for indeed for banks to monitor the end use of credit. So we are not sure that is really the way forward.

Moderator We have the next question from the line of Vardha Pandey from Birla Mutual Fund, Mumbai. Please go ahead.

Vardha Pandey My question is more related to the kind of debate we have seen so far on ahead of the curve and behind the curve. So there has been an effective hike of about 325 basis points as mentioned in the policy document as well, but the cost of funds of the banking system in the past 3 quarters has risen by only 40 to 50 basis points. So we have effectively moved from say a one trillion surplus kind of a situation around March to one trillion negative today which somewhat also sort of explains a 102% incremental credit-deposit ratio. So building up from a very low CASA and a very high liquidity situation for the banking system, do you think this has in anyway slowed down the pace of transmission and that still a big portion of whatever hikes have taken place that still a big portion of the transmission remains and I have another question. We have also heard of the government spending possibly being front-loaded in the first half of the next financial year. Does that additionally mean that we might not have liquidity coming back to comfortable levels before March of this year?

Subir Gokarn On the first question I think you are actually exactly pinpointing the whole transmission story which is that it took a few months from January of 2010 to about the end of May for liquidity move from surplus to deficit and during that period, we were basically focused on reducing the liquidity overhang and in the process also raising rates to deal with what we saw as a building inflationary situation, but clearly in that scenario liquid transmission was rather weak, but we had to do it gradually. We did not feel that the risk associated with very rapid withdrawal of liquidity could be borne by the system. But from the time that liquidity has moved into deficit, clearly the transmission has become a lot more visible, a lot stronger, and certainly quicker in terms of how the lag between our policy announcements and banks acting on the rates. So from that perspective, we have been making the point that the transmission mechanism is still very much in play and the impact of past actions is yet to be fully seen and this is something that will continue to manifest over the next few months. So that is essentially the lag effect that we expect to see in monetary policy and as we intensify the pressure in terms of raising rates further, if that is the way we go, then the transmission will simply consolidate because we are operating in a liquidity deficit situation and nobody has any doubts about that. On the second question, what is the source of this particular information?

Vardha Pandey No, given the government balances so far that they have been unusually high. Just wanted to understand what you would think on the government closing with a positive balance or a negative balance by the end of this financial year. If there are any thoughts there?

Subir Gokarn I think if the balance is carried forward into the next year's accounting, clearly that is a greater question on which expenditure scheduling can be done with a sort of a front loading, but that is a possibility. We do not have any particular information about it. It is simply one possibility given the fact that it is going into the next year with a relatively high cash balance. This is only going to be revealed when the budget is announced.

Shyamala Gopinath As Subir mentioned that we would know only when the budget is out, but usually what happens in the first half, the redemptions are quite a lot and usually the case that the first half, the borrowings are slightly higher than the second half where really credit rate picks up substantially. So that is not going to have really have any negative implication because it will depend on the other (Inaudible) that will happen.

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

Kumar Rajpuddy Just one question on the related lines, do you still see risks of LAF borrowing coming down from the current -2% levels of NDTL to +1% and in such a scenario, do you think it will pose a risk to transmission of monetary policy?

Subir Gokarn We have maintained in the November policy that we expect to see the LAF window in the deficit mode for some more months to come and that will be consistent with our anti-inflationary stance. So I do not see the possibility of it getting into a surplus, but certainly we wanted to be less in a deficit than it is now because the deficit now is about 2% of NDTL and we thought that the more appropriate level would be 1% and that is where we would like to see it.

Kumar Rajpuddy If I may ask one more question, also suggested that monetary policy might not impact inflation given that inflation is kind of supply side driven whereas it might impact growth if it is excessively tight. What indicators do you think we should be following to kind of understand the balance between growth and inflation in the current situation?

Dr. D. Subbarao I am not sure we can give you a list of indicators, but we monitor the drivers of growth and the drivers of inflation. On the inflation side, we look at the supply side factors on the food and other primary articles. On the non-food side, we have been looking at the non-food manufacturing inflation and we look at the credit growth about corporate sales, tax yields of the government. All the indicators that we mentioned actually in the review are the indicators that we will be monitoring.

Subir Gokarn And we also have as we cited in the document, the inputs from various surveys because of the time lag in collecting the information and processing it, it may be a little bit dated but it does give us a sense of what the mood is, what the sentiment is in both the corporate sector and in the household sector and that is another input into our assessment of whether the trend or tendency is positive or is it starting to reverse direction.

Moderator Thank you. The next question is from the line of Shubada Rao from YES Bank, Mumbai. Please go ahead.

Shubada Rao I have one observation and two questions. I shall start with my observation that in the monetary policy statement, the underlying flavor is essentially that inflation is likely to be sticky and further intensification of inflation pressures going ahead and when we come to guidance part, there is one statement which appears quite out of sync suddenly which says inflation is likely to resume its moderating trend in the first quarter of 2011-12. So this sort of comes out of nowhere and it is a question mark as to what exactly do we expect in terms of the pressure points, especially when we read it in conjunction with the macro-monetary development report of the previous day where once again inflation pressures have been headlined and highlighted. This particular line seems slightly out of place-- that iss my personal opinion. Coming to the two questions that I have. One is very clearly that we are going to and expect to see fiscal expansionary measures to support growth from the consumption side which would probably exert a demand led inflationary pressures whereas monetary policy is going to strive to contain the demand side pressures on inflation; somewhere I see contradictory forces coming into play. The second question is do you see with the tightening cycle that now we see going ahead as well investment cycle coming under some serious threat.

Subir Gokarn Let me address the first observation. If you read that sentence fully, it is moderation but with upside risks already visible. So in the sense the outlook for moderation is coming from the fact that when we analyzed and, as reported in the document, the reversal of inflation that we saw in December that there was a significant transitory component in it which reversed in this one month the trend that had become visible from about mid year where all of the drivers of inflation were starting to turn down, particularly nonfood manufacturing inflation which we now see as having become sticky and has contributed to this November to December surge. So our assessment based on resumption of that trend as the transitory elements start to weaken and we are already seeing some signs of that, although it may not be out in the numbers yet, but I think over the course of this month, we will start to see that and also the continuing impact of our policy actions because there has obviously been very substantial tightening over the last one year and the guidance, but as I mentioned that this view is not unconditional, it is not categorical. We pointed in different context both in the policy statement and in the MMD to the various risks that we see going ahead into 2011-12. So I think that is the way to look at it that it is a very qualified outlook on moderation and that is really what also in a sense if that the base of our guidance that based on this combination of trend and risk that the persistence of the stance is the most likely outcome. I am not sure I got the second question because did you…

Shyamala Gopinath I'll take that question.. Whether the investment cycle is facing some threat because of this as you are aware the investments decisions are taken based on several factors and interest rate is only one of them and in any event interest rates as they are now or even as they evolve may not be such a major factor in investing decisions as other factors as you know very well should be on financial factors as well as the global recovery, the global demand those factors are going to affect the decisions even more than just the interest rates.

Shubada Rao There was another question actually which I had asked it was regarding the some contract actually pauses here fiscal expansion is likely to continue to support growth on consumption side ,which would lead to some demand led pressures on inflation whereas the monetary policy would strive to contain those demand side led pressures on inflation I think on contradictions and challenges coming forth in the management of inflation expectations thereby?

Dr. D. Subbarao Actually it was not our intention to evade that question--iit slipped through the crack so I did remember as you asked that question. We did point this out in the document about the inflation pressures that could possibly arise from the fiscal side that fiscal consolidation is not along the lines that we are expecting so there has to be fiscal adjustment in line with monetary tightening for the anti-inflationary stance to work through all of the economists no doubt and we thought it appropriate to highlight that we did in fact do that. However, we went a little further to even explain the governments dilemma about how fiscal consolidation could come about in the face of rising commodity prices because we tried to absorb that in the fisc there will be higher fiscal deficit and there will be inflationary pressures from that dimension. On the other hand if they try to pass it on to the consumers there will be more direct inflationary impact.

Shubada Rao Is it possible to have from RBI when we see the inflation numbers accompanying the policy document to have seasonally adjusted month over month momentum because from now on I think everyone would want to know well RBI does publish the adjustment factors but if in the policy document we could also see a kind of inflation numbers, seasonally adjusted month-over-month or quarter-over-quarter I think it would help.

Dr. D. Subbarao It certainly would help but we have not done that so far, so we will have to think through whether to do that because suddenly we cannot introduce seasonally adjusted numbers because people compare them with earlier numbers.

Subir Gokarn There is a chart on #Page 46 of MMD, also chart number 6.6, which is indicating some of this momentum. We are doing it where we think it's appropriate to support the overall conclusion.

Moderator The next question is from the line of Ravi Ratan Pal from JP Morgan Asset Management Mumbai please go ahead.

Ravi Ratan Pal My question is related to fiscal deficit. Last year in February 2010, during the budget the government said that the fiscal deficit for FY12 will be 4.8. Based on the assumption that the nominal GDP will be somewhere around 13% but FY12 because of high inflation and the nominal GDP might be higher than 13% and because of which we may end up seeing a higher fiscal borrowing, so wanted to understand your take on that?

Dr. D. Subbarao Actually we can't speculate on this now because it's entirely hypothetical. But we are waiting for the budget just as all of you are to know the fiscal deficit and to know the GDP estimate that goes into the budget making.

Moderator Thank you, the next question is from the line of Indraneel Sengupta from DSP Merrill Lynch Mumbai, please go ahead

Indraneel Sengupta Do you worry that monetary tightening is actually beginning to progress at a speed that's higher than what is warranted given that a lot of the inflationary pressures are really supply side. In the sense if you see lending rates has now gone up 100 basis points since end-August and may be if they go up 100 basis points from here on historically you will see that is where the cycle has always tumbled when the SBI PLR hits around 14%. Would you think that it would be more appropriate to start injecting liquidity through OMO? Because if you ask banks to hike deposit rates, all that they are going to do is side over a smaller money supply if you don't inject liquidity. Deposit rates hikes are not really going to lead to deposit growth unless the RBI injects liquidity and overall money supply to begin with? So would you think that a money supply of 16% is somewhat too tight in the scenario where you have growth at 8% odd?

Dr. D. Subbarao Okay, there are several questions there. First about the stance of a monetary tightening whether we worry about it I think our monetary tightening we believe has been quite measured and calibrated through the growth inflation dynamics and that's where we let it rest. On the liquidity situation we did make a statement in the policy document about the current situation and about how it is consistent with our anti-inflationary stance. We also said that if at 2% and perhaps it should come down more appropriately to plus/minus 1% of NDTL. About whether we should do further OMO or any other measure to ease liquidity, we have said that we are not contemplating any of those measures now. If indeed we were contemplating we would have said that in the policy review. The reason we are not doing that is because we believe that we have done all that RBI could reasonably do to ease the liquidity situation and that the frictional and the structural components of the liquidity situation must unwind in the months ahead. The frictional component through government either spending or adjusting their cash balances by taking it forward into the budget and the structural component by banks bringing their credit growth in line with their deposit growth and that's what we have said in the statement, that's what we told bankers in the meeting, and that's what we have said in the post policy conference and I believe that message has gone through.

Moderator Thank you, the next question is from the line of Praful Kumar from Principal Mutual Fund Mumbai please go ahead.

Praful Kumar Just two questions, one is on the incremental CD ratio that we all are worried about so what exactly one can do here? Are we talking about a slowdown in advances or are we expecting banks to hike deposit rates further from hereon and if we do that are we seeing any risk to slowdown in growth for FY12?

Dr. D. Subbarao I am going to request Anand Sinha to answer this question.

Anand Sinha See the fact is that as far as the credit growth is concerned, two concerns have been expressed. One is over the indicative rate ,which is 20% as indicated in the monetary policy. Now if the growth is much above this rate then it has implication from our macroeconomic perspective. From a supervisory and regulatory perspective, the risk comes if there is so much of imbalance in the balance sheet. And what has happened is that on one hand the maturity of the deposits has decreased substantially-- more than 70 per cent of these are of around two years. While on the lending side, if you consider infrastructure, it needs financing for a longer term. Why infrastructure financing is very important--this imbalance which is building up needs to be controlled otherwise this will result into systemic risk and that systemic risks in turn will feedback into macroeconomic risk. That's why we have to strike a balance between the need of growth and ensuring that unnecessary risk does not build up and it is in this context that we have given this guidance to the banks.

Praful Kumar Correct, so basically we are looking at a slowdown in advances for the fiscal end maybe next year?

Anand Sinha If you don't have the resources, yes. And also be close to the indicative guidance**.**

Moderator Thank you the next question is from the line of Umesh Sharma from Franklin Templeton Mutual Fund Mumbai, please go ahead.

Umesh Sharma There are two questions. The first was actually a bit theoretical. Over the last few quarters we have seen tight liquidity and the key reasons for that is the Government of India's balance with RBI. While RBI had taken a few options like OMO and reduction in SLR, did cancellation of T-bills as an option thought over and if not or if you can comment on the implications of that if you could have done that? The second question was regarding another risk mentioned in the policy which mentioned reversal of FII flows if the global growth picks up. This year we could have a typical situation because the FII exposure to fixed income is also quite high and knowing the illiquid nature of the fixed income market I think the reversal of FII flow on the fixed income side could put some additional risk in the system, so if you can just comment on this?

Dr. D. Subbarao I will request Shyamala to respond to them

Shyamala Gopinath I think your question was whether the government could have cancelled the Treasury bill option are you referring the government buying back treasury bills?

Umesh Sharma Cancellation of the bills.

Shyamala Gopinath T-bills issuances of government are primarily based on the intra-year mismatches in receipts and payments. So mainly these are short-term instruments just to deal with the mismatches in receipts and payments, so really speaking it's not something that can be done easily. In fact, these instruments provide investment opportunities for those who have short term funds and generally government has not had problems in raising funds by way of T-bills. On the FII investment or exposure to fixed income instruments, what we find is that all short-term mostly short term. The exposures are in mostly less than two year instruments and since we will have a cap on the amount they can invest and we find that it hasn't really reached the particular ceiling that we have, in fact for that very reason that we have a cap we don't see too much vulnerability coming from that end.

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

Sonal Verma I have two questions, one on liquidity and the other one on growth. In the call actually you have already reiterated 1% of NDTL as your comfort zone and you have also said that you have done whatever you could on liquidity. I just wanted to understand how the RBI is thinking on liquidity has evolved? I mean is the comfort zone on liquidity itself a function of government balances? If the government balances are at 2% of NDTL then the RBI is comfortable with the last deficit of 2% of NDTL? Second on growth, in the document the RBI has mentioned that GDP growth rate will decline next year due to mathematical reasons related to agriculture but won't there also be a demand slowdown because of policy tightening? I mean if you look at a lot of the anecdotal indicators, IIP numbers have been very weak, imports have contracted, and there have been a lot of delays on the CapEx cycle. So while services sectors may be doing well can they really sustain if industry is as weak as it is currently. So I just wanted to understand if there are risks of a much sharper growth slowdown next year?

Dr. D. Subbarao Thank you for those questions Sonal. On the first question about liquidity--what's an appropriate acceptable comfort level this plus-minus 1% of NDTL, I think that's quite independent of the extent of government cash balances at any point of time. I think this should be read in an absolute sense irrespective of the frictional and structural factors at play. If you are following this you would have noticed that our thinking on this is has evolved in response to questions of the type you asked. Earlier we did not say anything like this, now we have said that our comfort level is plus-minus 1% of NDTL and I believe that should be interpreted in an absolute sense. On the second question about growth rate in 2011-12 and what could be the factors underlying the moderation that we are expecting, we actually said that mathematical reasons and agriculture because its rebounding this year in 2010-11, next year it will be on a stronger base. That was the mathematical thing that I talked about. But you are right that there are other factors at work. The margins of corporates will be hit because of higher input prices to the extent that they cannot pass on that it in the output prices. You are also right that the tightening that we had done through monetary policy will tighten demand. So all these factor and commodity prices and how much pressure domestic prices might come under as a result of international prices. All these factors will be at play and they will all be responsible for the expected moderation.

Subir Gokarn I think also Sonal the risk factors do address some of these issues. So we have to keep just imposing the baseline scenario with the risk factors, whether we are looking at growth or inflation.

Moderator Thank you, the next question is from the line of Avinash Vijayaraj from Tata Securities Limited, Mumbai, please go ahead

Avinash Vijayaraj Sir, this is Shri Shankar Jha from Tata Securities. One quick question, the CD ratios of the bank have already reached 75% which will leave very little room for further credit growth if this should the incremental credit growth be higher than the deficit growth and do you believe that if the interest rates moves up further, it is going to increase the delinquency in the system in the banking system itself that's one and second should the interest rate remain at this high levels and move up do you also think that the growth is going to slowdown much below what you have anticipated?

Dr. D. Subbarao Anand is going to respond to those questions.

Anand Sinha Can you repeat the first part of the question?

Avinash Vijayaraj Sir the CD ratio from the banking system itself is around 75% moved up and reached a level which leaves very little room for liquidity with the system itself, the banking system I am talking about. In this environment if the interest rate moves up further, you are going to see further increase from the banks in terms of lending rates and will in your estimate lead to an increased delinquency from the system itself?

Anand Sinha See as far as the increase in interest rate is concerned, it has got to be a result of the transmission of the monetary policy intention. Therefore some increase in the interest rates is definitely envisaged. Now as far as the delinquency is concerned it is for the banks to take care that advances that they are making at these interest rates are viable and if they do that then delinquency should not increase; but if a lot of advances are on floating rate then your apprehension could be correct, because its not possible to envisage particularly for long term loans total repayment capacity over the entire lifetime if they are least reported that right. That there could be a possibility but the basic intention of the monetary policy right now is higher interest rate and bank has to take care about the viability of the advances that they are giving.

Dr. D. Subbarao Dr. Chakrabarty, you have anything to add?

Dr. KC Chakrabarty See one thing is that if the interest rates goes up delinquency should not increase per se if the corporates and borrower's ability to absorb that cost. Now if you see the small loans, I do not think by another 1% in the small loan interest goes out that delinquency there are a corporate. Yes, risk is there. It all depends on corporate, absorption of the cost increase in the interest rate. And second thing banks have also to improve, as Mr. Sinha says, that if they improve their risk management, they improve their due diligence, but that risk always remains. You cannot say that risk is not there, but it all depends how the system absorbs that risk from both the side, from the borrowers point of view, from bankers point of view.

Shyamala Gopinath Also I wanted to add, that while assessing the viability of long terms projects, the banks also stress the cash flows to ensure that any interest rate changes particularly if it is a floating rates, will not impact the viability.

Subir Gokarn Can I just address the growth issue? Now we are not at this point making any formal projection about the growth next year that we will do in the next review, which will actually be the annual policy on May 3rd. But when you look at our survey of forecasters which has information that is very much in the public domain, most people are looking at growth rate in the 8.8-8.5% range aggregate, on the assumption of monetary tightening. So in a sense whatever projection you have or that is out there in the public domain is essentially looking at a growth momentum stabilizing, taking into account the possibility of further interest rates hikes. So there is not a surprise or an unanticipated element built into this projection. But that is the base line scenario and I think it is important to recognize that there are many risks to the base line, some of which we addressed in the previous question and which we have pointed out in our document, I think not just pointed out but also highlighted that there are significant risks in the macro-economic environment.

Moderator Thank you. The next question is from the line of Abhishekh Panda from J P Morgan Mumbai. Please go ahead.

Abhishekh Panda See given all the upside risks that you have pointed out in the monetary policy to inflation, the guidance on inflation is more moderate. It says inflation is going to be moderate in Q2, could you share some of the assumptions that lead to inflation moderating in the April to June quarter? And sir the second question I have is the 1% of NDTL target for liquidity, is that a fixed target or does it have some relationship with the SLR in the system, because an excessive SLR is, say, 6% do you think that the 1% of NDTL remains similar or does it change with respect to that?

Subir Gokarn On the first question in a sense, we already answered it because the sentence should not read "inflation is expected to moderate" it should read "inflation expected to moderate but there are significant upside risks already visible". So let us put the two together. But where we see the possibility of crisis starting to come down is essentially the transitory components that we have already identified in the discussion, which is that the surge in vegetable price in particular will moderate and we have the prospect based on our assessment of the Rabi crop that this is going to be a good crop. We have a bunch of leading indicators to suggest that and this then will also add to moderation of some food items. So it is not across the board necessary but some food items. And together this should then take a little bit of the food pressure off. Plus what we saw is the moderating trend in non-food manufacturing inflation. We expect that given our stance that that is likely to continue. So these are the two factors that we think will bring this moderation back into play. But the risks are there. The global commodity prices, energy prices, and the structural component of food inflation in domestic markets.

Dr. D. Subbarao The other question that you asked about whether the plus-minus 1% comfort zone is in any way linked to the SLR limit. No, actually you would have seen that we reduced the SLR from 25% to 24% of NDTL and we did not change this. So you should treat this as a comfort zone quite independent of the transient factors in the liquidity system.

Moderator Thank you. The next question is from the line of Sameeran Chakraborthy from Standard Chartered Mumbai. Please go ahead.

Sameeran Chakraborthy My question is that we have now seen about 325 basis points of effective rate tightening over a nine month period. Are you seeing any signs of demand side inflation pressures moderating on the back of that? In that context, are we to believe if that is not the case then it is only the counter factual that we are looking at, if RBI had not hiked where demand side pressures could have been and if you can tell us little bit about whether interest rates sensitivity of inflation in India is coming down over the years or not?

Dr. D. Subbarao Okay I will try and answer your questions and I will ask Subir to chip in also. First of all you have answered part of the question yourself which is that the counter factual is not known and perhaps the non-food manufacturing inflation in the absence of monetary policy tightening would have been higher, it would be a fair conjuncture. But there has been some leveling off in the absolute headline number of non-food manufacturing inflation which came down from 5.4% or 5.3%. But it is still above the long term average. However, there are underlying pressures and I am not sure we said that in the document, but we have said that in the press conference, which is that the deseasonalized, annualized inflation momentum is strong. So the answer to your question is, yes, demand side pressures are abating because of our monetary policy tightening and perhaps they have to be stronger in the absence of our policy.

Subir Gokarn I think when you look at the structure of demand and break it up into components which are now financed by borrowing, there are grounds to expect that the interest sensitivity of demand, which then translates into inflation dynamics is probably increasing. But of course, you have to control for various other factors and it is not the only factor driving demand. There is a whole long term expectation of growth and so on which is also kicking in. So if you have to control for those, I think the interest sensitivity will probably look a little higher but in the real world you are not controlling for those, they are also there. There are in play and they may be in a sense offsetting the pure impact of interest rates. So I think we do have to keep that counter factual picture in mind. But overall I would say that just on the basis of a sort of a balance sheet approach that interest rate sensitivity, I think, would have gone up. But we probably have some empirical work going on this.

Deepak Mohanty Again it depends as you know, on the various components. For example, like consumption component in expenditure would be more interest sensitive rather than the investment component in the scenario where we see the capacity utilization is increasing and new capacity would have to be added. In that case investment cycle could continue but there could be some moderation on the consumption side. I think overall with opening up and more competition we see that the interest rate has an overall influence. It also works through the expectation side also.

Subir Gokarn On manifestation of this a few years ago there was this debate on the EMI factor. That is the fact that households are locking into EMIs was actually reducing their spending on other discretionary elements. So that is one example of what I am talking about.

Moderator Thank you. The next question is from the line of Devika Mehandiratha from Credit Suisse Singapore. Please go ahead.

Devika Mehandiratha My question is that would it be fair to-, this is how I understand it, that one of the key reasons that Central Bank would like to see credit growth move lower, is more really because you are worried more about the liquidity tightness situation and the fact that if credit growth were not too slow from here on that could lead to a pretty large rise in lending rates by banks, is that one way of looking at it? Because if you really just see it the credit growth pace right now which is 24% it does not necessarily look too strong given that in the past we have seen credit growing for quite a while at even close to a 30% pace. So is it in fact that we are worried that there might be down the line too sharp a rise in lending rates by banks if this credit growth does not ….?

Subir Gokarn I think the concern about credit growth is coming from both angles and Mr. Sinha had actually addressed this issue in an earlier response which is that there is a macro dimension to it. In the sense that if we expect credit growth to get a particular rate consistent with the overall macroeconomic environment, then anything that is above or significantly above that because there will always be some margin for error there, but if it is significantly above that then we have to worry about the fact that it is aggravating or pushing demand pressures. So that is one aspect of it. The other aspect is, as you said, the liquidity which is that the wedge between credit growth rates and deposit growth rates is very high. Its 24% to 16.5% and that is clearly contributing to the liquidity scenarios. So from that perspective there is a systemic or a banking element to it. So we have actually highlighted both dimensions.

Moderator Thank you. The next question is from the line of Vibha Batra from ICRA Gurgaon. Please go ahead.

Vibha Batra Sir my question is on implementation schedule for Malegam Committee report that is one part. And second is in the past we have seen that Andhra Pradesh MFI's collection efficiency dropping to 15-20%. But for non-Andhra Pradesh MFI the collection efficiencies are close to 99%, but disbursements were severely hampered because there were no funding lines from banks, understandably so because of the uncertainty. So is there a thinking at RBI to provide some liquidity support at least for continuity of operations for the entities which seem important from financial inclusion point of view?

Dr. D. Subbarao On the first question about the implementation schedule of the Malegam Committee, we just got the report last Wednesday and we are going to study it internally within the Reserve Bank. We are also going to consult some of the stake holders such as banks, the state governments, Government of India and indeed some of the MFIs before we take a view on this. But we are also going to invite some feedback from the public and the expectation is that we should be able to take some decision by early April. On the second question, we have already given some concession to MFIs operating in Andhra Pradesh or in the rest of the country about the restructuring and we are not contemplating any further measures at this point of time.

Moderator Thank you. The next question is from the line of Mangala Pruthi from HSBC Mumbai. Please go ahead.

Mangala Pruthi My question comes from this point that we have been seeing monetary tightening over the past nine months. Have you considered monetary tightening from the line of increasing the provisioning for banks, etc., is that line also being considered? You have done something like this for real estate in the November review. So is that another possibility going ahead?

Dr. D. Subbarao If it is a possibility we will let you know because every time there is a policy review we look at the traditional monetary policy instruments such as interest rates and CRR and we also look at monetary policy of the prudential instruments. But as much as we have not said anything in the last policy statement we are not contemplating any but when we do contemplate, we will put it out in our policy document.

Moderator Thank you. The next question is from the line of Gautam Singh from Anand Rathi Financial Services Mumbai.

Gautam Singh Sir we all know that inflation is one of the key indicators to determine the policy rates. Now if we see the last 12 months, there has been 12 upward revisions in the inflation and the extent has been to the tune of 164 bps which happened in the April 2010. Now my question is, do you look at some other indicators or parameters to look at inflation apart from WPI Index or CPI Index, like when the mid quarter policy review on December 16th what inflation rate we had in front of us was 7.5% for November and if we look at October 2010 data now it has been revised from 8.58 to 9.12%. So do we have some other indicators to look at which can actually tell us the actual inflation scenario in the country?

Subir Gokarn I think obviously the data is the data. Whatever we get is what you get. But we try and filter it in various ways looking at components which will be more stable and trying to filter out the more volatile components, which are some filtering techniques which everybody has access to and nothing terribly sophisticated or rocket scientific about it. But I think the main point is to be able to extract the right kind of signal from whatever data we are getting and obviously revision volatility is a bit of a problem. But I think beyond processing the individual numbers, the micro foundations of the index into categories which we think are a better reflection of the underlying trend; I think that is really the way we make our judgment. But of course, because the projection is for the head line, getting into more detailed projections can also be quite complicated. So we then come up with a projection for the headline number.

Dr. D. Subbarao Okay I also want to add something to what Subir said which is not directly a response to your question but this probably a good a point to say it, which is that increasingly we are operating on the principle that there should be no information asymmetries between the Reserve Bank and the analysts outside of the Reserve Bank. So we trying to put out as much of the information that we have into the public domain, including the inflation expectation survey that we are now putting out. So I want to emphasize that we have the same information that all of you are having and we also are influenced or we also study the analysis that you people make of the inflation numbers.

Deepak Mohanty I wanted to add in terms of statistical construct, as you know, that many of the prices get repeated if inflation is rising what we have seen that the revision becomes positive, once you see that inflation is coming down we see there is less scope for upward revision. So that could be fairly assessed because once you look at the past revisions it may be a percentage point or 1.1, but there is a broad idea that what extent the final numbers will come out compared to the post numbers.

Alpana Killawala We need to close. Thank you all very much for joining us.