"Reserve Bank of India Post-Policy Conference Call"

January 25, 2012

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

Alpana Killawala: Thank you, Lavina, and welcome to this teleconference. We have the Governor and the Deputy Governors. I request the Governor to make a short statement.

Dr. D. Subbarao: Thank you. Thank you, Alpana and good afternoon to all our listeners. Once again, a very hearty welcome to this Post-Policy teleconference with analysts. I just want to say that we attach a lot of value to this interaction over the last one year. We found that this has been very useful for clarifying our thinking and also to enable us to focus on some dimensions of policy issues that we might have missed in our internal deliberations. So, once again, we cut the CRR by 50 basis points yesterday, bringing it down from 6% to 5.5% of NDTL, thereby injecting Rs. 320 billion of additional primary liquidity into the system effective the fortnight starting January 28. But the policy repo rate has been left unchanged at 8.5%. Now, three major considerations that inform this policy. First, that growth is decelerating and this you will note if you see from the sectoral side the sharp deceleration in industry and if you see from the demand side the sharp deceleration in gross fixed capital formation (GFCF) . In fact, **GFCF** has come down from 10.7% in the first half of last year to 3.5% in the first half of this year. Once again, I want to emphasise that this is a result of, of course, the external situation but also a lot of domestic circumstances, such as the unhealthy fiscal situation, the high interest rates and a lot of policy and administrative uncertainty. The second consideration that informed our policy was the inflation situation. The WPI inflation has been coming down; it averaged 9.7% between April and October, came down to 9.1% in November and further down to 7.5% in December. But if you disaggregate the numbers you will find that much of the moderation has from come food inflation and much of the moderation in food inflation has come from vegetable prices. In fact, if you look at food inflation including vegetables that has come down from 8.5% in November to 0.7% in December. But if you take out vegetables the decline is quite modest from 8% to 7.1%. And non-food manufactured inflation is still high at 7.6%. You must contrast that the average of non-food manufactured inflation that we had of 4 to 4.5% in the years before the crisis. Then the momentum indicators we have noticed that the momentum indicator of inflation, of the non-food manufactured product inflation, has been different as its come from different analysts and we have our own number in the Reserve Bank which we put out. The way we have done is to do it on a three-month moving average basis. We put out our analysis in the document that came out day before yesterday, the "Macro & Money Analysis"**.**

The third consideration that informed our policy is the liquidity deficit. The average drawal from the LAF window in the month of January has been of the order of 1.2 trillion. We had injected some money through the OMOs, about 700 billion. But we had also taken out some money as a result of our forex intervention, consequently, there has been a net drain out of the system and we felt that we have to replenish that in a structural way , given the limitations of OMOs beyond a point.

And we have also given guidance. I do not want to go into the details of that but one question that we were asked several times yesterday in our interaction was about the future rate action. As we had emphasised the interest rates will come down from hereon but when and at what pace will depend on a number of factors including the downward trajectory of core inflation, credit growth, the rupee exchange rate and the fiscal deficit. That is all I want to say at this time. So thank you very much. We look forward to your questions.

Moderator: Thank you very much sir. We will now begin the question-and-answer session. Our first question is from the line of Subhada Rao from Yes Bank. Please go ahead.

Subhada Rao: I have just a small question. Quite critical for future rate direction and rate cuts would be the fiscal consolidation. What kind of specifics would you look for in terms of the quality of fiscal deficit? Whether be it on the expenditure side or subsidies or any specific that you would be very keen to watch out for, within the budget arithmetic, which would provide a guidance for the central bank in terms of taking the rates lower?

Dr. D. Subbarao: That is not a small question at all. That is a very big question- the fiscal consolidation. First, the number as a proportion of GDP has to come down, that is very important as you recognise but within that we will look for the quality of fiscal adjustment that is being made. First, we have depended , I believe, quite heavily on the tax side and neglected the expenditure compression element of this over the years. So I believe that in reducing the fiscal deficit we have to focus as much on the tax increase as on expenditure compression. Second, within expenditure compression, recognising that a lot of large items are non-discretionary. We will have to see where there is discretion and that discretion is largely on the subsidy side. That is the only place where sizeable reduction in expenditure can take place. Then we also said we will look at the quality of fiscal adjustment how expenditure is shifting from current expenditure to capital and from public investment to private investment, that the fiscal deficit has to see that investment increasingly shifts , that fiscal deficit comes down so that private investment can go up. So, we will look at the headline number. We will see what strategy is being followed to bring that down and we will look at the quality of fiscal adjustment.

Moderator: Thank you. Our next question is from the line of Indranil Sen Gupta from DSP. Please go ahead.

Indranil Sen Gupta: Sir, two questions from my side; first, given that the RBI needs to put in about Rs. 2,000 billion of reserve money every year, how would you propose to fund that this year especially given the FX outflows that we have seen? And secondly, it is quite likely that in the coming months we face a situation where growth continues to slow and inflation rebounds with Power, Oil and Coal price hikes. So what would you think the monetary policy reaction would be to that?

Dr. D. Subbarao: I am going to request Subir to answer that.

Subir Gokarn: I pass on the reserve money mathematics to the person and then I will come in

D K Mohanty : Indranil, as you know, reserve money has been expanded because if you see overall money supply, that remains close to our trajectory. But as you rightly said from where it is coming. So that is the issue that what we have seen that bulk of it is again getting financed through the LAF window because that amount has become quite large. Apart from that we had done open market operation of 700 billion so that is also adding to reserve money. And now this CRR cut of 50 basis points what has been done that will also go to alleviate the structural constraint to the liquidity side which is there. Of course, on the forex side it remains uncertain, how things would evolve. So all put together the RBI would try to maintain reserve money at a level which is in consistent with our trajectory of the broad money.

Subir Gokarn: On the issue of administered price increases and pass-through, I think from the overall sense of macroeconomic desirability we have argued that even with the potential inflationary consequences that price correction is important particularly from the fiscal view point. Now, if we look at a particular situation that we are visualising which you articulated which is growth slowing down and these administered prices being revised upwards, clearly, there is an issue of pricing power and how much of this increases can be passed through to final goods. I think in that context the experience we have had over the last few months with the rupee depreciation is illustrative. Because although that was an immediate cost shock when you look at how it has translated inflation, clearly, there have been some muting, some absorption of that cost shock by producers because of weakening of pricing power. So I think when we try and see the impact or try and project the impact of these administered price increases on inflation, the fact that growth is slowing down, the fact that prices are itself easing and that is quite visible from all of the corporate analysis that we have done, would suggest that the impact on headline may not be that great and I think that is something that we will factor into our overall growth inflation assessment.

Moderator: Thank you. We will take our next question from the line of Vivek Singh from PIMB Principal from Singapore. Please go ahead.

Vivek Singh: RBI was signaling before the rate cut that it will use probably OMOs as your preferred mechanism for maintaining liquidity in the system. Just wanted to clarify, you mention that you wanted to structurally add liquidity to the system, going forward would you still be using OMOs or what is your thinking regarding maintaining liquidity in the system. Is CRR, the more preferred way going forward?

Dr. D. Subbarao: It is difficult to say how this will roll out going forward. We have done OMOs over the last two months for 700 billion and that there are inherent limitations to OMOs including the bank's appetite for OMOs. They may not want to give up securities that are liquid and they may also want to retain some flexibility by way of additional SLR so that they can take money on a daily basis, not give up that flexibility by selling the securities to us. So, recognising those rigidities in OMO and recognising that we have to give some structural injection of liquidity into the system we have gone for CRR yesterday. Going forward we will have to assess how the liquidity is behaving in the system and depending on that take a view. The OMO and CRR you have recognised are both liquidity injection mechanisms but there are inherent differences in the sense that CRR reduces the cost for banks whereas OMOs does not do that. So, my long answer to your question is that we will assess the situation and decide whether we have to do further OMOs, how much of that is necessary. Subir?

Subir Gokarn: Just want to reinforce that message which is that an impression was apparently created that OMOs will no longer be carried out and that is really not the impression or the message we want to send. Liquidity is going to be the driver. If liquidity conditions so warrant then OMOs remain on the table as an instrument to deal with them.

Moderator: Our next question is from the line of Kumar Rachapudi from Barclays Capital. Please go ahead.

Kumar Rachapudi: I have a couple of questions regarding the CRR. Is there any comfort level for the RBI with regards to the CRR level given the sharp need for injection of liquidity going forward? And a follow-up question to this is if the RBI feels the need to inject liquidity before the next policy, out of CRR and OMOs which one would be the preferred choice?

Dr. D. Subbarao: On the first question there is no threshold limit for CRR. We will move it as deemed necessary and you would recognise that it has gone as low as 3%. So it has gone up as high as 9%. So we are somewhere in the middle of that range. And about whether we will do OMOs or CRR cut before the next mid-quarter review I cannot really speculate. But as I said in answer to the earlier question we will assess the liquidity situation and take a view on that.

Kumar Rachapudi: In the policy document and the document released the day before, the RBI has mentioned that core inflation will be one of the inputs which will be taken into the policy stance going forward. Like the RBI has a indicative level for headline inflation, is there any threshold level for core inflation which the RBI is looking at?

Dr. D. Subbarao: The only reference number we have is the rate which core inflation had come down by average in the years before the crisis which is 4 to 4.5%. It is not to suggest that we will not act until it comes down to that level. But reaching 4 to 4.5% is within the realm of possibility and that is where we would like to get eventually.

Subir Gokarn: In this connection we should remember that in the last few months of 2010, that is, August to November or thereabouts, this number, the non-food manufacturing inflation was just around 5% maybe 5.1% or so. In November it accelerated again to about 7% and it has stayed about that number since then. The approximate cause of that was a very sharp increase in oil prices around the end of October but even in recent times that 5% number has been achievable.

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

Sonal Verma: On inflation wanted to ask the factors you have mentioned in the policy yesterday that are keeping inflation, high like high fiscal deficit and structural nature of food prices, these factors are unlikely to go away in any near-term. So, would it mean that inflation is unlikely to ease below 6% unless we see a crash in global commodity prices? Wanted to understand what is the RBI's tolerance on inflation given these persistent factors?

Subir Gokarn: I do not think these are sort of written in stone. We have had some initiatives in the last budget on addressing shortages in certain food categories and we think that that initiative would be taken forward in the coming budget. So typically, these have fairly short payback periods and if these schemes are well conceived, we should not expect the pressure to persist so very long. Of course, it can happen that the schemes are not well conceived and not well implemented but that is a risk that we will have to live with. On the fiscal side again the question is of the direction of adjustment, the commitment to the path that perhaps was earlier laid out in the FRBM and perhaps a new version of that with a clear statement or clear description of the path. So, all of these may not have an immediate impact on inflation but they will certainly determine the direction. And that is really the basis on which we are looking ahead. So, the direction of movement, the change, the tendency to start easing off is really what we need to see quite visibly before we start thinking of action. But that does not mean that we have to wait until a particular number is achieved.

Sonal Verma:: Also wanted to ask you what is your assessment on how long it takes for the multiplier effect to play out?

Subir Gokarn: The multiplier of CRR?

Sonal Verma:: Yeah.

Subir Gokarn: I think it is really situational. We are in a situation where credit flows to the private sector are relatively sluggish, growth rates that we have seen, have actually fallen below the growth rate of deposits. So, a lot of the incremental deposits have been deployed in government securities or other investments. That would tend to reduce the multiplier. So we are in a situation the multiplier of the CRR cut, at least given current conditions, not going to be to its maximum limit which is 5.16.

Moderator: Thank you. Our next question is from the line of Ashish Kumar from Elara Capital. Please go ahead.

Ashish Kumar: A couple of questions; first question is RBI has suggested that diesel prices would be completely deregulated. So I do agree that it is a good step towards fiscal consolidation in a medium-term but is the Indian economy actually ready to bear the short-term implications of this move on the inflationary pressures in the economy? So, that is the first question. And second question is actually I have been observing RBI talking about seasonally adjusted WPI. So in my previous assessment at an IPFDA research program -- it was with the Ministry of Finance -- we used to do a lot of work, some significant work on a seasonal adjustment on some major macro series using the X12 ARIMA of the US Census Bureau and actually we have found no seasonality in the overall WPI series. It was based on some diagnostic checks of spectral decomposition. So, could you throw some light on the same? And the third is- it was just observation. So at present intervention data on the currency market which was released, I think it is around one month back. So I think it will help a lot to us as an analyst on the thinking of RBI's forex policy and you can kill lot of speculation in the currency market if the said data is released say with a reduced lag on a weekly basis or so.

Dr. D. Subbarao: I will answer your first question about diesel price deregulation. In saying it for quite sometime now that adjustment has to take place in petroleum product prices which are subsidised and subsidies are not only costing the government in terms of money but they also cause inefficiencies. So, there is a strong case for deregulation. It will have inflationary impact in the short-term, that were recognised and in fact, acknowledged in our statement yesterday. But current inflationary impact will run out over time and once adjustment has taken place and we have smoothened out the temporary transient inflation I think we will get into a macroeconomic situation where fiscal deficit will be lower, inflation will be steady and growth will accelerate. On seasonal adjustment of inflation momentum indicators –

D K Mohanty: No, since you have worked on that as you see that there is no unique method of really doing deseasonalisation because a lot of assumption is also involved in that. So, X12 ARIMA becomes standard. So there could be differences in terms of making assumption about the outliers in the series. So, internally, we have debated that issue on various things. And the one we thought that would be more appropriate under the circumstances that three months moving average kind of number that we have put out. But I do agree that there is no unique way really to represent that there could differences from method to method.

Dr. D. Subbarao: Ashish, on your third comment about release of intervention data, you said you worked in the Ministry of Finance on this?

Ashish Kumar: I was working with the seasonal adjustment on macro series and all.

Dr. D. Subbarao: Okay. On intervention figures I do not know how many countries release with what lag but if you can do some research on that and send it to us that will be useful.

Moderator: Thank you. Our next question is from the line of Dr. Manvinder Singh from Devi Ahliya University, Indore. Please go ahead.

Dr. Manvinder Singh: My question is that as you might be observing that rupee-dollar rate has appreciated from 54 to 50, that has also injected money into the system and looking at the measures that Government of India and RBI have taken, in order to inject new capital flows into the country, gives the probability that more dollars will come into the country and more of the liquidity will come into the system. Now, while planning out the rate of CRR cut, had RBI have some projection in mind regarding how much money supply will be infused through forex inflow in the coming months? And what impact that may have on the liquidity situation in the country?

Dr. D. Subbarao: No, Dr. Manvinder, it is difficult to say because the external situation is quite uncertain. We do not know how much money will come, what sort of money will come and at what pace it will come. So, whether we intervene or not and how much we intervene will depend on the rupee exchange rate and the state of capital. So it is very difficult to make a calculation about that.

Dr. Manvinder Singh: Like the rupee appreciation that we are seeing into the system, that might have brought some money into the system, some rupee into the system. So while making the policy has that been encountered?

Subir Gokarn: To clarify your point, inflows translate into liquidity only if the dollars are bought by the central bank. They are coming into the market and the currency market is reflecting the increased supplies through rupee appreciation. But unless the central bank ,in this case RBI, buys dollars, there is no liquidity infusion, because it is only when the central bank buys the dollars that more or new rupees are put into the system and until that happens there is no liquidity infusion. So you should not read the inflow as a direct or an automatic increase in the liquidity in the system.

Dr. Manvinder Singh: And my next question is that like your policy document has mentioned that gross capital formation on quarterly basis as well as private consumption has come down. Secondly, you are also highlighting that inflation has come down only because of the vegetables apart from that still there is high inflation. On the liquidity front, yes, the CRR cut move is welcome but can RBI give some projection in terms of basis points that the CRR cut how much impact that will have on the growth prospects in the near future term?

Dr. D. Subbarao: Do you have any studies linking CRR to growth?

D K Mohanty: Not really.

Dr. D. Subbarao: Why do you not get one of your students to do this?

Dr. Manvinder Singh: Purchasing power increase you might be targeting private consumption through this liquidity infusion. Has RBI something in mind regarding that.

D K Mohanty: Not linking so much into CRR. Ultimately, it gets translated into money supply and credit. So, credit again would help in terms of growth. And so that is what we have indicated because as you would have seen that our earlier projection was 18%. The latest indicative projection is 16% and as Governor also mentioned in the press conference that with the CRR cut perhaps banks would be encouraged to put more money into credit which would have a positive impact on growth. But quantifying directly from the CRR to growth is a difficult task.

Moderator: Thank you. Our next question is from the line of Praful Kumar from Principal Mutual Fund. Please go ahead.

Praful Kumar: I just wanted to check on one thing; how comfortable are you with banks providing just 2% on the restructured book given the fact that we have seen high slippages already from the restructuring that was done two years back and now we are looking at banks talking about a lot of restructuring coming in Textiles and Iron and Steel and bigger infra projects?

Anand Sinha: See the normal provision requirement is 0.4% and on restructured assets it is 2%. So, we think it is sufficient.

Praful Kumar: But given the fact that a lot of power projects are very huge and chunky in nature do you not think that will cause a systemic risk in terms of any projects going unviable?

Anand Sinha: We do not think that we are into a situation where we see systemic risk.

Moderator: Thank you. Our next question is from the line of Prithviraj Shrinivas from HSBC. Please go ahead.

Prithviraj Shrinivas: My question is how much of the INR 1.2 trillion liquidity deficit is due to structural factor? I understand from the analysis in your quarterly review that the current phase of liquidity deficit is due to FX intervention and advance tax payment. Now, the former can be alleviated if there is sterilisation and the latter once the government starts to spend. I appreciate if you could throw some light on it?

Subir Gokarn: The three factors that are contributing to this and if you look at the graph IV.2 that we have in the macroeconomic and monetary development, the view, one is transitory which is the peaking of the Advance Tax bunching in mid-December. But other two which one is this deposit growth and we just increased CRR requirement to support that and the forex intervention which have taken rupees out of the system are more persistent now. Obviously, the pressure that they continue to exert on the system will depend on the trends in these two variables. But they have contributed to a more persistent state of the liquidity deficit and you could roughly take that combination, that amount as a measure of structural or the more persistent deficit.

Moderator: Thank you. Our next question is from the line of Abhishek Panda from JP Morgan. Please go ahead.

Abhishek Panda: Is there a constraint on using FX forward to address the INR liquidity situation? We have seen RBI using the forward book in November but given that near-term forward premia is still quite high and dollar liquidity situation is comfortable. Do you think this can be used more actively by central banks?

H.R. Khan: When we do intervention we do a combination of both on the cash basis as well as forward basis but there is a limit up to which you can do forward, because then the premium should disturb the other way. So we have a policy of doing it both but how much to do depends on the market conditions and how much disruption it will create to the forward premium markets. So we have to take a balanced view and we keep that very much on our radar when we decide over intervention.

Abhishek Panda: If I might ask a follow-up question in policy, because recently we have seen that the forward premia really shortened like February, March and April go up quite high like 9, 9.5% even above the call rate, so is that something that you have taken into account or that changed your effective decision-making?

H.R. Khan: As you know the forward premium will largely depend in fact on overnight rate, so once you have seen that overnight rates will soften because we have now taken some action, the forward premium will reflect that to some extent.

Moderator: Thank you. Our next question is from the line of Rahul Jain from Goldman Sachs. Please go ahead.

Rahul Jain: Just moving slightly away from the monetary policy, if I can ask two questions pertaining to first one on the SPV model suggested by Shunglu Committee, just wanted to know how comfortable would RBI be in becoming de facto lender to this SPV?

Dr. D. Subbarao: Which SPV are you talking about? Power? Shunglu Committee. Can you please clarify that?

Rahul Jain: Basically, Shunglu Committee has proposed an idea of creating a Special Purpose Vehicle which will sort of buy the loan portfolio from, SEB Discoms from the banks and basically, RBI will hold the majority stake in SPV and will be providing the liquidity to this SPV to buyout the portfolios. So just wanted to get a clarity how this whole structure would work out and how comfortable would RBI be in becoming a de facto lender and if you can share your thoughts?

Dr. D. Subbarao: Rahul, all of us on this are completely blanked out, because this did not come to us, we have not applied our mind to it, thank you for telling about this but we have not applied our mind, it has not been referred to us.

Rahul Jain: And if I can ask you another question on the restructuring of loans for the likes of Air India and all, how do you view the significant hit that the banks might be required to take? Because the amount which we are reading in the newspapers is pretty large and we believe that the matter is still pending and no restructuring has been cleared by the SBI Caps or maybe RBI for that matter?

Anand Sinha: Yes, the amounts are large, there is no doubt about it, but then what is the purpose of provisioning? That is to strengthen the balance sheet of banks, is it not? And therefore, whatever provisioning is required, generally, we do not compromise on that. The only thing we can do is that if the amount is very large we spread it over a period of time.

Rahul Jain: So basically, in that respect I think in yesterday's press conference somebody has raised this question that would RBI contemplate upon giving this a SLR status. So would you clarify further on this point please if you do not mind?

Anand Sinha: Governor has already indicated yesterday in the press conference that RBI will not be comfortable with that.

Moderator: Thank you. Our next question is from the line of Richa Sharma from L&T Mutual Fund. Please go ahead.

Richa Sharma: I would like to ask one question that the CRR which has been cut by 50 basis points it would infuse liquidity in the system as you have rightly pointed out. My question is would it not add to the inflationary pressure which is already to a certain extent driven by demand? There is OMOs which were done to the extent of 70,000 crores. Since the money was circulating within the bank and the central bank it was not adding to the system in terms of anything in inflation. So, if I may just understand that why this step is more receptive?

D K Mohanty: As has been explained in a few other questions before response to this question, what we see that the deficit which is there, which is reflected in our LAF window is in the range of something like 2 to 2.5% of NDTL. So there is a structural deficit to the tune of 1, 1.5% of

NDTL. And once you cut CRR then it becomes a substitution because to that extent they would be coming less to the LAF window. So it would redress a little bit of structural imbalance. So it does not really add excess liquidity, primary liquidity from what it is there in the system now.

Moderator: Thank you. Our next question is from the line of Ayan Chaudhary from Morgan Stanley. Please go ahead.

Ayan Chaudhary: I had a couple of questions or concerns; the first one being this current deficit in the system which is 2, 2.5% of the NDTL. Now, obviously, you are taking all steps to reduce it by like cutting CRR. I was just wondering in a rate cutting cycle when let us say the cost of capital needs to be reduced and liquidity needs to be infused in the system, how effective will a repo rate or a reverse repo rate cut be in this current liquidity strained environment? So let us say three months from now, if RBI has to resort to rate cuts do you think that is going to be effective?

Subir Gokarn: If you are in a liquidity deficit situation the reverse repo is clearly not operational, it will simply adjust and we have now moved to a regime where the reverse repo is fixed at a 100 basis points below the repo. But as long as the system is in deficit a rate cut will automatically lower the rate at which the banks are accessing overnight liquidity and that should translate, other things remaining the same, into lower overall cost of funds. That is how the translation would work.

Ayan Chaudhary: And my second question is in the current scenario if I can project what is going on, so let us say over the course of the next year we still have the Europe situation, INR remains under pressure and RBI has to resort to selling Dollars in the market and hence withdrawing liquidity from the system. On the other hand we also have the currency in circulation going out to the tune of let us say 1.1, 1.2 lakh crores. In this scenario do you not see the structural deficit only worsening? There is obviously a certain extent to which CRR cuts can be done and I am also assuming that OMOs are not going to continue forever. Do you have any projections on that, how for example this can be reversed if the current scenario continues?

Subir Gokarn: At the end of the day the deficit is being financed by LAF borrowings. So, distinction between a structural deficit and temporary deficit essentially reflects the concern that you cannot fund any sustainable process of credit growth predominantly by overnight borrowings. So we want to provide a little more predictable source of liquidity to the system and that is the rationale for using instruments like the CRR. But if the need arises, it is really a question of how much capacity the banking system has to accept the repo window. And at this point that cushion is about 5%, actually 6% if you take the MSF. The banking system has about 29% of NDTL in SLR securities. So that cushion is there. It is not something that has been taken away or in any way being affected by anything else that we do. It is just a question of composition of liquidity that is a lot of it coming from this overnight channel, the rest coming from more predictable and more sort of stable channels. So in a situation where liquidity is under extreme pressure because of all other factors you mentioned, ultimately, then SLR comes to the rescue.

Moderator: Thank you. Our next question is from the line of Nikhil Gupta from First Global Securities Ltd. Please go ahead.

Nikhil Gupta: In 2009 the entire world was in the grips of deflation, there was negative growth in prices, everywhere in the world, but post that since the beginning of 2010 and for the entire 2011, Indian economy's inflation has been much higher than the inflation witnessed in almost other Asian economies and developed markets as well. Now, if we look at YoY growth in inflation we might feel some comfort that has come down below 7.5% from 9% a month ago, but if we look at the index we do not feel that comfortable. If we look at the central bankers in the developed markets they are talking about targeting index rather than the YoY growth. So I want to understand if the RBI is also thinking something on that line to look at index or to target index rather than YoY growth.

Dr. D. Subbarao: I will answer this. Maybe some of my colleagues will add to that. I have read some reports in some papers on targeting the index and as you say it is a topic for research, topic for discussion, but I do not think any central bank is actively considering targeting an index because that has its own problems. And year-on-year measurement of inflation is now standardised not notwithstanding the fact that what you highlighted which is that prices might still be going up but inflation will seem to come down which is a wrong way of assessing the situation according to you. The other thing that you mentioned as a preface to your question about how when the whole world is still in a disinflationary situation, India is facing high inflation that is partly a reflection of growing incomes in this country and especially rising incomes in the rural areas where because of rising incomes, there is demand going up and supplies have to catch up and that is the reason we are having this demand pressure inflation. We pointed out perhaps not in yesterday's statement but in some other statement that wages have gone up. Last year wages have gone up by 20% whereas average CPI was about 10%. So, real wages had actually gone up by about 10%. All this is causing pressures on demand and leading to inflation and there are structural factors fueling inflation and we need to take care of the structural factors. Anything else on targeting the index?

D K Mohanty: What you have said that just remains at the stage of discussion, I do not think any central bank is targeting the price level.

Moderator: Thank you. The next question is from the line of Indraneel Pan from Kotak Bank. Please go ahead.

Indraneel Pan: My question is that we have already cut the CRR and going ahead we may continue to face liquidity shortages in the system given the fact that we are not really looking too robust in terms of the forex inflows also. What is the scope that or what are the pros and cons that the

RBI thinks is there in terms of slightly a longer-term liquidity operation in terms of the type that maybe the ECB is undertaking. Definitely, not a three-year type but whether the RBI could be open to a future date in terms of say, a 30-day or a 45-day the long-term operations through the LAF? Thank you.

Subir Gokarn: I think it is an important point because in response to an earlier question I was making the point that overnight borrowing as a basis for supporting credit growth is little tenuous. We have been discussing the merits of a longer-term repo, not reset three years but 7 days, 14 days and we have had these in the past. But they have not worked for a variety of reasons which we have tried to analyse and build into the new design that we are looking at. This is still in the design and discussion phases. It has not yet moved to a concrete scheme. But I think the basic point that moving from the overnight liquidity window to a slightly more elongated framework, I think is something that we are really looking at. I think we will have to draw on the experience that when we did this in the past it did not work we are trying to understand why that was the case.

Dr. D. Subbarao: Do you have any views on this why it did not work?

Indraneel Pan: I thought it could be important because –

Dr. D. Subbarao: No, it is certainly important but do you have any view on why it did not work? During the crisis for example, we opened a 14-day window and there was no takers for that.

Indraneel Pan: No, I am sorry, I would not have a view on that.

Dr. D. Subbarao: Okay, but you analysts please work on this and see if you can understand why there was no appetite for this.

Indraneel Pan: Okay.

Moderator: Thank you. The next question is from the line of Kaushik Das from Deutsche Bank. Please go ahead.

Kaushik Das: I just had two questions; first question is somewhat similar to what one gentleman asked, now during a rate hike cycle RBI kept liquidity tight to ensure that the monetary policy transmission is effective and the call rate hovered at the upper end of the corridor. Now at some point during the rate cut cycle can we expect the call rate to kind of come to the lower end of the corridor that is reverse repo? Why I am asking this is because according to the Mohanty Committee recommendation last year it seems that now the repo rate is the only policy rate and the RBI wants to target overnight call rate around the repo rate. So there is a little bit of confusion that is it a permanent feature in the monetary policy procedure or during a rate cut cycle this can change depending on how slow the growth momentum is and how inflation is panning out?

Dr. D. Subbarao: We have said that we would like the LAF window to operate within the band of (+/-1%) NDTL. Your question is whether the call rate can come to the lower end of that band. We have also said that we would like the LAF window to be in moderate deficit. That is our preferred option. So it might come down to the lower end but the ideal is that it is in that band and in a modest deficit.

Moderator: Thank you. Our next question is from Ganesh Jayraman from Spark Capital. Please go ahead.

Ganesh Jayraman: I was just trying to understand looking at liquidity do you look only at LAF borrowings as a parameter to judge the systemic liquidity? The reason I am asking that is the incremental CD ratio for the banking system as a whole is only about 73% and when you speak to the treasury desk banks tend to look at borrowing from the LAF window to take advantage of arbitrage opportunities also. So, is this the only criteria to look at or do you look at anything else?

Deepak Mohanty: One thing is that the structural deficit the way that we have explained because ultimately what is happening on the central bank book in terms of the liquidity deficit. And as you recall the last year we had focused on this difference ways between the deposit growth rate and the lending growth rate. So some structural deficit can emanate from the Banking sector itself. So that is also another very important indicator.

Subir Gokarn: I think the issue of arbitraging from LAF borrowings has been clarified in the last few months. You can only borrow from the LAF if you have surplus SLR securities and to the extent that you have that cushion your borrowings from the LAF and using that in whatever way that you think is appropriate there is nothing in the system that stops you from doing it.

Ganesh Jayraman: Secondly, if you could give us an update on the Usha Thorat Committee recommendations or you have formed some another Committee to look at the global practices on restructuring of loans, if you could give us an update on some of those?

Anand Sinha: The Committee to look into restructuring will be operational very soon. And as far as Usha Thorat Committee is concerned we have received the responses. We have analysed them. And now we are in the process of discussing and linking decisions on them. It will take a little time.

Ganesh Jayraman: Lastly, a small, if you have seen some banks, not all, looking at the non-food credit as a way of building their advance book because the demand is for non-base rate linked loans, so you have CPs or bonds which are cheaper than base rate, that line of lending is gaining prominence. How do you view it basically? Because they tend to be outside the prudential norms or priority sector or tend to even be lower than base rate on pricing. So how do you look at that?

D K Mohanty: That is not a correct observation. If you look at the banks book, the banks can give loan or subscribe to CP. So banks direct subscription to CP, it has not gone up substantially. Of course, at the same time the CP issuances has increased but that is again coming from the non-bank sources not from the banking sources.

Moderator: The next question is from Sachin Desai from Franklin Templeton. Please go ahead.

Sachin Desai: There was a statement in the macroeconomic and monetary developments which was pertaining to the composition of capital inflows. So, there essentially what was mentioned was that going forward there is a need to reduce dependence on debt flows, encouraging renewed equity flows. At the same time what we have seen in the last one, one-and-a-half years is that the FII limits on debt have been substantially increased. So just wanted to understand what is RBI stance on the increased FII debt limit? Do you see that as a source of concern or do you think that given the current backdrop of our BoP it is a necessary evil?

Dr. D. Subbarao: First, you are right that we have a preference for non-debt flows over debt flows and that preference persists. And we would like more of a non-debt flows come. And within non-debt flows more of FDI come which that builds a stake into our economic prospects. We have expanded the limit for FIIs both in corporate debt and in government debt, but that is very marginal. If you see in proportional terms it is quite small. That is just to test how much of appetite there is and whether there is any benefit for us by way of allowing them access. You should not read into this as a further gradual increase of FII limit that could well happen but it is not automatic.

Sachin Desai: One related question was would the RBI in consultation with the Ministry consider issuing sovereign debt in non-rupee currencies, maybe the G3 currencies?

H R Khan: Sovereign debt issuances in fact the years back we had gone into that and, we had broadly come to the conclusion that India should not be one for a sovereign debt issuance.

Dr. D. Subbarao: We will stay with rupees.

Moderator: We will take the last question from the line of Ravi Ratan Pal from JP Morgan Asset Management. Please go ahead.

Ravi Ratan Pal: In the next one year we have around short-term debt maturing to the extent of 137 billion, out of which commercial borrowing is 20 billion and short-term debt is around 68 billion. I have got two questions pertaining to that. The first is does RBI see this as a risk to the system? And the second, is RBI worried how the repayment will happen given the pressure on INR?

Dr. D. Subbarao: Yes, as we said in the press conference yesterday we are monitoring this. It is true that there is, together with the ECB and FCCB in calendar 2012, about $20 billion will come for repayment and that will have to be rolled over. And we will have to see how the external situation, particularly, the European situation unfolds in this regard. As far as short-term debt is concerned, yes, it is about $60 billion or $65 billion overall and much of that is usually rolled over. So we do not anticipate a problem but should there be pressures in Europe they will have to find alternate sources including onshore sources. There is really no cause for alarm but there is certainly a cause for heightened sensitivity to these numbers.

Moderator: Participants that was the last question. I would now like to hand the conference over to Ms. Alpana Killawala for her closing comments.

Alpana Killawala: Just wanted to thank everybody for participating. Thank you very much.

Moderator: On behalf of Reserve Bank of India that concludes this conference. Thank you for joining us. You may now disconnect your lines.