Edited Transcript of Reserve Bank of India's Sixth Bi-Monthly Monetary Policy Tele-Conference with Researchers and Analysts

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Moderator: Ladies and gentlemen, good day and welcome to the Sixth Bi-Monthly Monetary Policy Conference with 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. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. Ladies and gentlemen, I now hand the conference over to Mr. Jose Kattoor. Thank you and over to you, sir.

Jose Kattoor: Thank you. We start off with the first question, this question is from Rahul Choksey, and the question is- for week ended 4th and 11th January center WMA was over 75% of WMA limit, but no cash management bills were announced, but two cash management bills are done so far in February when most likely Centre is again over the 75% threshold. Can RBI throw light on how these two scenarios are read differently where only in February CMBs were warranted and not in January?

Shaktikanta Das: I am Shaktikanta Das, Governor, RBI speaking. Now you see the government makes its cash flow projections in consultation with the Reserve Bank of India because RBI is the manager of government debt and government cash balances. So, normally, as long as there is visible space in Ways and Means Advances (WMA), resort to Cash Management Bills (CMBs) is usually not being undertaken by the government. So, that is one factor which has to be kept in mind. And the second point is that in January there was not enough space in the budget provision that was made for CMBs in the current year, but subsequently, the budget provision has now been made in the revised estimate and in the supplementary, so, that opens up opportunity for additional CMBs and that is how it has been undertaken in the current month.

Jose Kattoor: Thank you, governor. The next question is from Vivek Ramachandran. The question is- the FPI investment in debt has slowed down after notification of norms on concentration group limits last year. This was an important source of funds, particularly for lower-rated companies. Government had announced that norms will be relaxed, but no changes have been done so far. Can RBI indicate by when the norms will be amended?

Shaktikanta Das: We have announced, if you recall, I am sure all the participants would have seen the Part-B of the statement, which we released earlier today and also the press conference when this question also had come up to which I had replied. I am not going into the other remarks which we have made that something has slowed down only because of this- because there could be multiple factors for step up or slowdown of inflows, but having recognized the situation broadly and other factors, the 20% limit with regard to an FPI’s exposure to a single company or to the group companies, that 20% limit we have announced that it is being removed and the circular in this regard will be issued sometime next week.

Jose Kattoor: Thank you, governor. The next question is from Sandeep Yadav. The question is- in 2015 the then RBI governor had indicated that the preferred real interest rate target was 1.5% to 2% and the preferred manner to calculate real interest was spread between one year treasury rate and expected inflation one year down the line. In that context, he is asking two more questions –

One, has RBI continued to track real interest rates in the same manner? Two, in view of the global interest rates having decreased, has RBI changed its target for real interest rates?

Shaktikanta Das: Well, I will request Deputy Governor, Viral Acharya to reply.

Dr. Viral V. Acharya: Thank you, governor. You might want to see the press conference recording as well where I partly answered this question. In short, we do not target a specific real rate of interest, our mandated target is actually the realized headline inflation. Of course, real interest rate does play an important role in influencing economic activity and it is the factor that goes into our models. Real interest rates are more closely related theoretically to core inflation rather than actually to food and fuel inflation. So that also has to be kept in mind. Nevertheless, we do track real interest rates, there is no one standard accepted definition for it, the one that you referred to was introduced at some point by Governor Rajan; others- simply you look at repo rate and subtract last month's inflation from headline inflation, and some people take the repo rate and subtract the one year headline inflation from it. My sense is most of these measures over time should co-move and as I said we do take into account the impact of the real interest rate on headline inflation in our projections; however, it is not something whose specific level we target in particular.

Jose Kattoor: Thank you Dr. Acharya. The next question is from Dhaval Gada. Is there a timeline by when RBI intends to come up with the guidelines for holding company structure and non-banking operations which banks can undertake? This question will be taken by DG, N.S. Vishwanathan.

N.S. Vishwanathan: I want to clarify that there are already clear instructions on what non-banking activities banks can do, it is very clearly set out in the Act and various guidelines have been issued in this regard. With regard to guidelines on holding company structure, we are working on it and as and when ready, we will be able to give it out.

Jose Kattoor: Thank you, DG Mr. Vishwanathan. Next question is also from the same person- Dhaval Gada. Is RBI looking to tweak transaction fees on credit cards in line with the move undertaken for debit cards? This question will be taken by DG, Mr. BP Kanungo.

BP Kanungo: Thank you, Mr. Gada. There is no question of tweaking because in the first place Reserve Bank does not fix the Merchant Discount Rate (MDR) for the credit cards at all and the rationale for that being, in case of the credit card, there is a credit risk that the bank who is issuing the card undertakes, which is not the case in case of debit cards. So we have been fixing the merchant discount rate in our effort to give a fillip to digitize and push and have no intention of going into other areas like credit cards, and for the same reason we do not interchange that changes hands between the acquiring bank and the other agencies also.

Jose Kattoor: Thank you DG Kanungo. The next question is from Chandan Thimmaiah. The question goes like this- as IMF gave cues of global economic down in next two financial years, how likely it will affect Indian market with respect to pre-supposed India's better growth than other

countries? According to budget estimates fiscal deficit will be 3.4% for current and next financial year, how this can affect private capital expenditure considering crowding out effect and its effects on employment generation?

A similar question is there from Arjun Nagarajan. The question is into FY20 with the Capex projections/ borrowing and the RBI's own FY20 growth projections, would the RBI be concerned about a scenario of crowding out of private sector activity? This question will be taken by our Governor.

Shaktikanta Das: If you look at the fiscal deficit figures for '18-19 and '19-20, now, both the years as you know are 3.4%. But for '18-19 actually if you go to the second decimal point, it is 3.37% and for '19-20 it is 3.35%. Now these numbers are broadly in alignment with the path of fiscal consolidation which was set out earlier by the government. Now with regard to crowding out effect in the market when the government's borrowing programme is implemented, again, I repeat, as a debt manager of government borrowing, before the beginning of every year and also before the beginning of every half year, Reserve Bank and the finance ministry, we have meetings where the borrowing programme is carefully discussed and the borrowing programme is announced in a manner that it goes through in a non-disruptive manner. So therefore, as in earlier years, this year also I think sometime next month the borrowing meeting will be held between RBI and the government and it will be our endeavor to ensure that the borrowing programme goes through without causing any disruption and minimizing, rather, eliminating the impact of any crowding out of private investment. I must also add that the composition of public expenditure in the budget is such that it is likely to crowd in private investment. On employment generation effect, I think this question is not for RBI to really reply and we do not have the data to base our reply on.

Jose Kattoor: The next question is from Abhijit Sakhare. Will the RBI consider harmonization of regulations among private banks with respect to licensing or shareholding norms? The question will be taken by DG Shri N.S. Vishwanathan.

N.S. Vishwanathan: Thank you, Mr. Sakhare. This matter is sub-judice in a court case, so we would not want to venture at this time.

Jose Kattoor: The next question is by Alpesh Mehta. His question is- media reports suggest holding company structure for financial institution. What is RBI's view on this? DG Shri N.S. Vishwanathan may like to reply.

N.S. Vishwanathan: I think I replied in response to the earlier question from Mr. Dhaval Gada where I said there is already clarity with regard to what non-banking activities banks can do and with regard to guidelines for holding company structure, we are working on it and we will come out with an update.

Jose Kattoor: Again, a question from Alpesh Mehta. This question is about NBFCs. In the light of current liquidity situation for NBFCs and episodic instances of liquidity issue for NBFC-NDSIs, could

any specific category be considered for NBFCs, especially with respect to accessing liability from retail segment? The question will be taken by DG, Shri N.S. Vishwanathan.

N.S. Vishwanathan: If I interpret your question, I think you are asking whether we will allow a category of NBFCs to accept public deposits. The current stance of not allowing NBFCs to accept public deposits is something that has been on for more than 15 to 20 years. At present, there is no thinking in terms of changing that.

Jose Kattoor: Shri Alpesh Mehta is asking one more question and this is also about NBFCs. The question is- there have been different regulations for the same product for different segments, example, (a) banks cannot lend more than INR 20 lakhs, (b) NBFCs have norm of 50% LTV, whereas (c) for mutual funds it is different. Would there be harmonization of regulations going forward? The question will be taken by DG, Shri N.S. Vishwanathan.

N.S. Vishwanathan: What we have tried to harmonize is regulations between various types of financial service institutions. I think given that they serve different purposes, we should not look at =across products harmonization between various segments in the financial services industry.

Jose Kattoor: The next question is from Abhishek Saraf. He has asked five questions again on NBFCs. The first one is exactly which kind of NBFCs would be affected by change in the risk weight guidelines by making it linked to credit rating?

N.S. Vishwanathan: One, as you would have seen in the past policy announcements, we have said that the certain categories of NBFCs are already having risk weight linked to the rating. All those which were not linked to the ratings will now get linked to rating. So across the board, all NBFCs will be linked to rating, the exception being Core Investment Companies (CICs). I think there is a clarity on whom this will apply and whom this will not apply as far as the changes in regard to credit rating.

Jose Kattoor: I will continue with his questions. The next question is- it seems that this change in risk weighting guidelines will not apply to housing finance NBFCs, infra NBFCs and deposit taking NBFCs. Is this assessment correct?

N.S. Vishwanathan: As I said, only the differential is that wherever there was 100% risk weight for an NBFC, all those NBFCs will now have their exposure linked to rating.

Jose Kattoor: (c) If yes, will the current risk weighting stay for NBFCs?

N.S. Vishwanathan: I have given answer to that in the previous answer.

Jose Kattoor: (d) What is the current risk weight mechanism for these NBFCs?

N.S. Vishwanathan: As I said, for the NBFCs other than asset finance companies, infrastructure development funds, infrastructure finance companies, risk weight was not linked to rating, now they are all getting linked to rating. I think my response to the first question answers the question.

Jose Kattoor: One last part of his question is how will the risk weight change from 100% especially for higher rated NBFCs post the operationalization of the new guidelines?

N.S. Vishwanathan: Under the Basel guidelines as we have issued to banks, AAA-rated exposure to a corporate will be risk weighted at 20%, AA-rated will be 30%. Same system will apply for these NBFCs as well.

Jose Kattoor: The next question is from Alpesh Mehta. Two parts to his questions; one, would the deadline for IND AS implementation for banks, i.e., from 1st April 2019, remain intact or are there any plans to reconsider that? The second part is- what is your assessment for NBFCs IND AS implementation? Our Governor will be responding to this.

Shaktikanta Das: I will reply to the first part. The operationalization of the IND AS guidelines require certain legislative amendments. So as and when the law is amended by the parliament, then it will be followed up by action in RBI to operationalize and implement the system. With regard to assessment for NBFCs, it is something which is on the table, the banks have already been sensitized to prepare themselves to implement it and as and when the legislative process is through, this should be getting operationalized and many banks have already taken steps to comply with the requirement.

N.S. Vishwanathan: On the NBFCs, one, we have made it very clear in the past that implementation of IND AS is as per the schedule given by MCA and therefore IND AS is applicable to them from the financial year '18-19. We are looking at what the NBFCs are doing and as we have mentioned earlier also, if we find there is too much of divergence in the way the standards are being applied, then we will think in terms of bringing in some change in regulation.

Jose Kattoor: A couple of questions both on core inflation, so I will take these two questions together. This is from Ishan Daga. The monetary policy committee has turned its focus now on growth from inflation, citing the relative stability in the latter. However, as the core inflation still remain at higher levels, how this factor will attribute to the committee's future policy decisions? This is the first of the questions. The second one is- how does the RBI explain the fact that output gap is negative yet core inflation (excluding housing) is very persistent at close to 6%. Isn't higher core inflation reflection of better pricing for corporates and better aggregate demand situation? These two questions will be taken by Dr. Michael Patra.

Dr. Michael Patra: Analysis of core inflation and its evolution with the risks around it are already incorporated in our projections. So, when the path of headline inflation is set out for the next 12-months, we have also taken into account the analytics relating to core and its dynamics including its elevated level and its stickiness.

Jose Kattoor: The next question is from Shantanu Mudgal. We have seen that in currency in circulation increased by ₹74,000 crore in April 2018. This year too the trend may continue, further compounded by currency leakage due to general elections. RBI has currently indicated that

they expect to inject liquidity via OMOs till March. If the currency in circulation continues to increase in April, would RBI consider extending the OMOs into FY19-20?

Shaktikanta Das: This question I had replied during the press conference earlier today. Two aspects: One is there are several factors which impact the demand for currency in circulation and consequently on the liquidity situation. Secondly, the liquidity situation as I said earlier today, we are constantly monitoring it very closely, and as and when steps are required to be taken by the RBI using various policy instruments, you have referred to OMO; the quantum of future OMOs or for that matter measures for dealing with the liquidity, this will depend on the evolving liquidity situation in the market.

Jose Kattoor: The next question is from Arjun Nagarajan. He says- Thank you for taking my question. Firstly, I'd like to take this opportunity to congratulate Mr. Das and his team for making it a point to answer as many questions in the press conference as possible. This increase in communication is greatly appreciated and putting to ease market concerns. The RBI has made a note of some opening up of the output gap. However, its growth trajectory for FY20 has seen an upward revision. Would it be right to read this as a near-term discrepancy then? The question will be taken by Dr. Michael Patra.

Michael D. Patra: The RBI has estimated the output gap for the period right up to the second quarter of 2018-19 for which we have data from the CSO. This estimate suggests that the output gap is modestly negative and is set to close over the coming quarters and this has been factored into our growth projections. Also, I need to correct you on your comment that the growth trajectory for financial year ending March '20 has seen an upward revision. If you will refer to the latest monetary policy report of October 2018, GDP growth has been projected at 7.6% for 2019-20. So the current projection of 7.4% is a downward revision.

Jose Kattoor: The next question is from Vikas Kotha. You have assumed normal monsoon for 2019 for the food inflation projections. How reliable are these monsoon forecasts historically and in the case of deficit monsoon, how much upside risk to the food inflation do you see?

Michael D Patra: We have assumed the normal monsoon in our projections and this creeps into a base line forecast. Should the monsoon be in deficit, there will be an upside risk to inflation. And this will be factored into the balance of risks, which is reflected in our fan chart.

Jose Kattoor: We will now take questions, Aman, from the line.

Moderator: Sure, thank you very much. Ladies and gentlemen, we will now begin the questions for the audio participants. The first question is from the line of Nilanjan Karfa from Jefferies. Please go ahead.

Nilanjan Karfa: Two simple questions: First is on the real estate sector. We do hear from people that the sector is extremely distressed, could be because of multiple reasons, lower sales or lack of liquidity. Any thoughts from RBI? How do you look at the sector and what can be done from RBI's

perspective? The second question is- recently we took three banks out of the Prompt Corrective Action (PCA). Any thoughts on what was the urgency in doing that specifically given when the policy was formulated, the plan was to look at the audited financials and not to be done in the middle of the year?

Shaktikanta Das: I will answer the second part first, thereafter I will request my colleague, Deputy Governor, M.K. Jain to supplement. The decision with regard to the three banks which have been taken out of the PCA framework that is based on the quarterly results, which have been published by the banks. And as you know the quarterly results are also subject to audit and once the Board approved the quarterly results, then only on that basis action was taken. In respect of one bank, after the Board had approved the third quarter results, the very next day there was capital infusion by the government which the bank brought to our notice that this has been done and that was also taken into consideration to take out these three PCA banks from the list of PCAs. Any decision on the PCA banks will be taken on the basis of data and obviously it goes without saying it is not a matter of discretion but it is basically data driven. I think Mr. Jain may like to supplement some points.

M.K. Jain: I would like to clarify couple of things that first, the banks are brought under PCA framework the moment they breach any parameter under the framework. The banks which were taken out of the PCA, they were not in breach of the parameters of PCA framework except Return on Assets, which is reflected in the capital adequacy. So that is very important and we have seen the quarterly audited numbers as well and we have seen the qualitative improvement in these banks and that is the reason we have taken these banks out of PCA.

Shaktikanta Das: With regard to the real estate sector, the current status of this sector, in fact, all sectors including the real estate sector- they are factored into our inflation and growth projections.

Moderator: Thank you. The next question is from the line of Shubhada Rao from Yes Bank. Please go ahead.

Shubhada Rao: I have this question regarding the RBI's further rate action scenario. Inflation trajectory has been significantly revised lower, particularly for the first half of fiscal '20. For future rate action or change in stance, which of the following two factors is likely to drive RBI's action? First, the breach of this newly revised inflation trajectory, either upside or downside breach, or, a broader comfort that despite this breach the inflation is likely to hover close to 4%. So would the rate actions be on the horizon of 4% inflation trajectory or basis the newly revised inflation trajectory?

Shaktikanta Das: Any answer to your question at this point of time would be, may I say to some extent, it would be somewhat speculative. Now, in my statement which I made during the press conference there is a paragraph that I read out twice. I will just check out the paragraph number and tell you, where I said clearly that the decisions of MPC in this regard will have to be data-driven and in consonance with the primary objective of monetary policy to maintain price stability while keeping in mind the objective of growth. Just prior to this statement I had said in my

statement today that the shift in stance of monetary policy from calibrated tightening to neutral also provides flexibility and the room to address challenges to sustain growth of Indian economy over the coming months as long as the inflation outlook remains benign. So that would give you a broad sense of the thinking, but let me also mention that all decisions as I said will be data-driven and within the ambit of the Reserve Bank of India Act and based on available data and as the data flows in, two months down the road we will have the next MPC meeting and then to be fair to the other members of MPC, this needs to be deliberated and then the decision of the MPC will be made known.

Moderator: Thank you. The next question is from the line of Jayasree Ram from Karvy Stock Broking. Please go ahead.

Jayasree Ram: The difference between CPI and WPI is about 160 bps and our interest rate decisions are more aligned towards CPI. So would you be also considering WPI?

Dr. Michael D. Patra: RBI Act which was amended in 2016 clearly specifies the target for inflation in terms of the headline CPI and we are bound by the Act.

Moderator: Thank you. The next question is from the line of Hardik Shah from Reliance Mutual Fund. Please go ahead.

Hardik Shah: Wanted to understand that the change in the NBFC categories linked to rating, now same will be applicable for the calculation of LCR for the banks and earlier the banks were not allowed to consider the NBFC exposure for the calculation of LCR, now with revised risk weight capital, whether it will be considered for LCR calculation or not?

N.S. Vishwanathan: LCR as you know is the requirement to have high quality liquid assets to meet 30-days stress liquidity outgoes. I am not very clear what your question is.

Moderator: Thank you. The next question is from the line of Nikhil Gupta from Motilal Oswal. Please go ahead.

Nikhil Gupta: I have two quick questions: Firstly, CSO released revised data for FY'17 and '18 and we learn that GDP growth was much better than previously estimated and in particular construction sector grew at 6-year highest pace in FY'17. I would want to know if RBI has any view on them? Secondly, as the debt manager of the government, we know that states and Centre both have plan for record borrowings in Feb and March, Centre is also planning to borrow ₹480 billion in March. So I just wanted to know when will tentatively RBI look at the need for liquidity support in the market if required?

Dr. Viral Acharya: We do not have any view on the CSO. We need CSO data release, we need more details. On the second question, I think as governor replied at the press conference, our liquidity decisions are reviewed certainly at every weekly or fortnightly horizon, in fact, internally even at a higher frequency than that. What exactly we plan to do will depend on a variety of factors that

drive the durable liquidity needs such as currency in circulation, for example. So, the exact decision on liquidity support and the instrument we choose will depend on those evolving conditions. We have already telegraphed the plan for the three OMOs for week two, three, four of February for ₹12,500 crore each.

Moderator: Thank you. The next question is from the line of Vibha Patra from Fair Connect. Please go ahead.

Vibha Patra: My question is on some of the large NBFCs, HFCs, their disbursements have actually declined by over 90% and these are the companies which are also funding to self-employed and SMEs and without really resorting to taxpayers money which is what public sector banks are doing and they were doing this business quite sustainably but because of liquidity conditions, their funding is really dried out. So there is the strong case by RBI to define the qualifying assets, say, ticket size, delinquency and open some kind of window. So right now what is happening is what we see is banks are okay with liquidity, but they are not really lending to NBFCs because no one is really confident which one is solvent or which one is not. My question is that larger NBFCs and HFCs who are lending to SMEs are in dire need of liquidity whereas RBI measures liquidity only for banks. So it is really disrupting the economy. So is there a case for RBI to open a special window where you kind of define qualifying assets and these NBFCs can borrow from the central bank against these assets because banks, mutual funds, insurance companies are all very shaky and there is no confidence there.

Dr. Viral Acharya: I think this issue has come up quite a bit over the last six months I would say starting with the default of IL&FS. We have looked quite carefully at the data and our assessment is that since the peak of the stress in the short-term commercial paper markets in September and October, things have eased quite comfortably, they have eased especially for the better quality NBFCs and HFCs. So I think what is happening is that the liquidity conditions that had been extremely in surplus mode post-demonetisation have finally reached some normal level so that mutual funds and others who are providing capital to these entities are finally doing quality sorting themselves. I think that needs to be allowed to happen but nevertheless we remain watchful and if we think that there are extremely healthy borrowers who are also struggling with the funding, then we would consider that.

Jose Kattoor: Thank you, Dr. Acharya. We conclude the session here.

Moderator: Thank you. Ladies and gentlemen, with this we conclude today’s conference call. Thank you all for joining us and you may now disconnect your lines.