# "RBI Post-Policy Conference Call for the Media"

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**Participants from Reserve Bank of India:**

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**MODERATOR: MS ALPANA KILLAWALA – CHIEF GENERAL MANAGER, DEPARTMENT OF COMMUNICATION, RBI**

**Moderator** Ladies and gentlemen, good day and welcome to the Reserve Bank of India Post-Policy Conference Call for the media. As a reminder, for the duration of the conference, 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. Participants connected to the audio conference bridge may press '*' and '1' to ask a question. Should you need assistance during the conference call, you may signal for an operator by pressing '*' and then '0' on your touchtone telephone. Please note this conference is being recorded. I would now like to hand the conference over to Ms. Alpana Killawala from RBI. Thank you and over to you Ma'am.

**Alpana Killawala** Thank you Laveena, and welcome, good afternoon to all of you present here in this room and outside, at the teleconference. Governor will make a brief statement and then we move over to question-and-answers. Thank you. Governor, please.

**Dr. D. Subbarao** Thank you very much. Good afternoon. Good seeing all of you and welcome to this conference. I thought the world will end on 21st December as the Mayans said, and as the physicists say we are going into a big bang collapse and the RBI will disappear with high inflation record. That did not happen. So, we are into relentless pursuit of higher growth and lower inflation. And in that pursuit we reduced the repo rate this morning from 8% to 7.75% and also cut the CRR from 4.25% to 4% of NDTL. That is also, as many of you may have noted, historically the lowest number, indeed 4.25% is the lowest number. We did both actions, both the rate action as well as the CRR action in order to ensure that there is a transmission of monetary policy into lending rates.

As we explained in the policy document this was informed by three considerations. There was the consideration of inflation having moderated, both headline and core inflation. And also, the momentum of inflation, the three month seasonally adjusted moving average annualized inflation, that also shows that the momentum of inflation is coming down. Then, on growth, we have had deceleration of growth, not just of investment but also of net exports. Also, as we have been seeing for some time now of consumption demand.

The third consideration that weighed with us was liquidity. That was quite tight over the last few months. Those of you who have been keeping touch would have noted that because of the CRR cut in September and October we pumped in liquidity of Rs. 350 billion. And today's CRR cut will pump in another Rs. 180 billion, that is Rs. 530 billion.

We also did OMOs in November-December of Rs. 470 billion. So this adds to a neat Rs. 1 trillion. We didn't do it get a round number but that is how it happened. Rs.350 billion because of CRR cut from September and October, Rs. 180 billion because of today's cut and Rs. 470 billion because of the OMO operations. There were still net LAF borrowings during the month of January of Rs. 910 billion, on the average. That suggested that there was structural liquidity deficit and that prompted the CRR decision in addition to the rate action.

We of course discussed the global outlook and the domestic outlook. I will not go so much into the global outlook because it's quite clear but the only message on the global side is that the global economic prospects have improved modestly since our last review even though there are significant risks that persist.

On the domestic economy side, growth decelerated, the first quarter was 5.5%; second quarter was 5.3%. Taking into account the developments since the last quarterly policy review we revised our growth projection downwards from 5.8% to 5.5%. You will note that in the first half of the year growth was 5.4%. So in order to achieve 5.5% for the full year, in the second half the average growth has to be 5.6%. Our expectation is that growth has bottomed out, for a number of reasons that I could explain to you should there be a question.

Inflation also we scaled down the projected estimate for March 2013 from 7.5% to 6.8%. And I will get into that in slightly more detail very shortly.

There were five risk factors that we indicated. The first was the twin deficit risk arising from high current account deficit and large fiscal deficit. The second risk factor stems from the global outlook and the global risk perception, the implications of that for financing our current account deficit. The third risk factor relates to the inflation outlook and in particular we mentioned that even as demand pressures have ebbed, a sustained reduction in inflation will have to come from the vigorous supply response. The fourth risk factor is about investment which is very, very important because the key to stimulating growth is a vigorous and sustained revival in investment and achieving this will depend on a number of factors including bridging infrastructure gaps and resolute pursuit of structural reforms. Finally, we also mentioned about the bank asset quality. Indeed the Reserve Bank is quite understandably concerned about the high level of non-performing assets but we were also concerned that the high NPA level should not cut into flow of credit to productive sectors of the economy. That is as far as the policy document summary goes.

Your standard question has always been about the guidance. As I told you several times before, we agonise quite a bit about the English that goes into it and the communication value of that. This time has been no exception. But I thought I would voluntarily interpret the guidance for you before you ask me a question. One sentence there, which is that the decline in inflation provides space albeit limited for monetary policy to give greater emphasis to growth risks. So what does that imply? Our decision to cut the rate and cut CRR rate also, was informed, as I told you, by inflation coming down and growth moderating. Growth is actually below trend and there is a negative output gap. If we look at inflation, headline inflation has moderated, core inflation has come just above 4%, momentum indicators as I have told you, have come down. CPI inflation too which is high, but if we knock off food, that is left at 8%. So CPI inflation as much as it is a matter of concern, but if you try to disaggregate that and knock out food you find that it is at a certain level. So, slowing growth and inflation make a persuasive case for easing monetary policy. However, there are upside risks to inflation and I want to spend a couple of minutes giving you that.

The first risk is about food inflation. For the WPI and CPI, food inflation have been high, and that can put upward pressure on inflation expectations and there will be pressure on monetary policy to respond and indeed there is obligation on monetary policy to respond to entrench inflationary expectations.

The second risk comes from the monthly diesel price increase which is a good thing for long-term inflation management but in the short-term it will put inflation pressures and thereby have implications for inflation expectations.

The third is global crude prices. They have plateaued in the last couple of months. Some people say that they should have come down even more. So the fact that they have plateaued at this level shows that there some upward pressures. Crude oil prices going forward will depend on both, economic, financial and geopolitical factors. And as far we are concerned the rupee prices also depend on the exchange rate movement.

The fourth risk factor in inflation is suppressed inflation. From last year if you recall, coal prices were adjusted in the month of January. So that gave us a benign base effect for the last quarter of this fiscal year or first quarter of the calendar year. We expect that coal prices will be adjusted later this year, perhaps in April, there will be a consequent adjustment in electricity prices. Some of the suppressed inflation must come out, it will come out and that will put inflation pressures.

Finally, there is the pressure from wages. In the MMD document released yesterday we indicated that the rural wages continue to be going up. They went up as high as 32% but last year inflation in rural wages was 18%. What is of concern is that, that increase in wages by 18% in nominal terms by about 7-8% in real terms is not accompanied by any productivity improvement. Therefore, there is inflation pressure.

By far the biggest risk for inflation and for macroeconomic management is the current account deficit. Not just high current account deficit but high current account deficit in the context of slowing growth and high fiscal deficit. For the first half, CAD was 4.7%, the third quarter trade numbers are quite disturbing and the current account deficit will also be quite higher for the third quarter. Why is that a problem? That is the problem because it has implications for financing the current account deficit; there are implications for our exchange rate stability. And especially because it is happening in the context of slowing growth, our ability to attract capital flows can get affected if growth slows down. And then the context of a large fiscal deficit, there is vicious cycle between large fiscal deficits leading to large current account deficit which go on and on.

There is also another concern about CAD which is not so much discussed, which is the quality of CAD. If we had a high current account deficit because we were importing capital goods, but if we are having a high current account deficit because we are importing a lot of diesel where demand is not price elastic and we are importing a lot of gold, that is a concern.

We had discussed about the implications of easing monetary policy when we expect CAD to be going up. The normal expectation of text book is that if you expect the CAD to be going up, you would want to tighten policy. Easing will lead to increase in aggregate demand, perhaps increase in exports, therefore worsen CAD. There is also a concern about how this might be interpreted by our external analysts, external interlocutors and external financiers, about how easing of monetary policy in the context of rising CAD might be interpreted. What indeed might it do for flows? Are our flows equity flows or debt flows and how interest sensitive they are?

We had taken into account all this, including the implication of easing policy at a time of rising CAD. But taking an overall picture, balancing all considerations we decided to ease the policy rate.

So what this mean for the monetary policy stance? I started from the guidance and interpreting the guidance. So what it means is that if inflation eases further, further I mean, more than we expect it to, and if the CAD moderates further, by further I mean more than we expect it to because in the fourth quarter, CAD might be less than in the third quarter, but it has to be significantly less, and we have to have low and sustainable CAD. So, if inflation moderates further, CAD moderates further, there will be more room for monetary policy easing but if they go along the currently expected lines, the space for monetary policy easing is quite limited.

I am taking a little longer than usual but please bear with me. I also want to tell you a few things about what we discussed with banks this morning. You interviewed the banks yourselves. As far as monetary policy transmission is concerned, banks were more forthcoming than before and that they were more assuring than before about transmission taking place through lending rates. On deposit rates, the signal was not uniform. Some banks thought that deposit rates might come down, some thought that there was not so much room for deposit rates to come down. They also expressed the concern that of late there is a flight of savings to the non-bank space and also substitution of savings in the banks by purchase of gold. Some banks also said that the margins will come under pressure but overall the message we got was that monetary policy transmission will take place. They were more assuring about transmission taking place because we have also cut CRR. We discussed quite a lot internally about whether we should also accompany the rate cut with the CRR cut and the decision after extensive consultations was that in order for monetary policy transmission to take place we must also do a CRR cut.

The liquidity constraint is not uniform across banks. Some banks have constraints; some banks are relatively more comfortable. So we gave a message to the banks that accepting the MSF is not a stigma. There were some apprehensions within the Reserve Bank that perhaps some banks think that the regulator will look askance at the banks accessing the MSF so we made it quite clear that will be a reasonable, appropriate and right thing to do if they have a liquidity constraint.

There was discussion on export performance and bank credit for exports. Those of you who have been following would have noticed that we did two things in the last six months we expanded the rupee exporting financial facility from 15% to 50%. Just two weeks ago we also introduced the dollar/rupee swap facility of $6.5 billion. I believe banks are mandated to extend up to 12% for exports, but the aggregate level of export finance is 5% or even lower.

Apart from the cost of financing for exports there are a number of other non-cash issues such as transaction costs, accounting norms, documentation required, procedural difficulties etc. After consulting the banks this morning we decided to constitute a technical working group and Mr. Padmanabhan, our Executive Director to go into these issues. This working group will involve apart from the RBI, EXIM Bank, ECGC, FIEO, FIMMDA and IBA**.**

We also talked about transition to risk based supervision with banks. Some of you, if not all of you may have seen the Chakrabarty Committee report which said that consequent to our transiting into Basel III banks must also improve their risk management systems and practices. There were several things that were identified as needing to be done like capacity building, like better quality data, introduction of systems and processes within the Reserve Bank and within the banks. The impression or the message we got was that different banks are at different levels of preparedness for transiting to risk-based supervision. There is not much of a difference between private banks and public sector banks but there is difference across banks altogether.

There were some questions about whether the Reserve Bank is going to be very prescriptive on what risk based supervision is but what Mr. Chakrabarty told them was that it will be principle-based, not very prescriptive, but we need to disseminate much more information. For that purpose there will be a major conference in the next one month with the CEOs on risk based supervision.

The final thing we talked about with banks was about inflation-indexed bonds. We introduced that some years ago and that didn't take off because of some design flaws. Since then based on the lessons that we have learnt we have tried to redesign it, this time most importantly, indexing both the principle and the coupon to inflation rate. We consulted banks about whether this might be successful. There were several questions apart from the design about which inflation index do we peg it to - the CPI, WPI and if we peg it to CPI which is about 10% what interest rate will you offer? Whether that will attract retail investors, indeed even bulk investors? Then about timing, can we do it at a time when inflation is rising. See the government will want to do it when inflation is falling, but customers will want it when inflation is rising so there is an inherent conflict there. They have also said that we must introduce it at a time when there are no tax free bonds in the market so that there is no rivalry for this. One question that haunts us all the time is whether this will disrupt the G-Sec market, because there will be a wedge between the yield on this and the yield on the regular G-Sec market. But Deputy Governor Khan and his team who have done research tell me that, no, if we educate investors they will see that this is pegged to inflation over a cycle not at a point in time. So people will understand and will invest in this. From our side, the attraction for IIBs at

this point of time was as before is to wean people away from gold. So if you have to provide them an asset that yields inflation indexed returns, the most straight forward asset to give is an inflation-indexed bond. But we have to engage both the government and the banks in taking this forward. Thank you very much.

**George**: The macroeconomic review that you put up yesterday was very strongly worded where you went about saying that in an environment where risk from high inflation, current account and fisc still remain, the scope for the supportive monetary policy action is constrained. In today's document the wording is a lot softer. Is there some sort of a disconnect in the message that you are sending out to the stakeholders? That's my first question. And the second one is, how concerned are you about the wedge between credit growth and deposit growth?

**Dr. D. Subbarao** On the first question George, at least I read them quite consistently. What we said in the MMD yesterday and what we said in the policy document today, on top of my extended and somewhat tedious explanation to you on the guidance, because we said the space for monetary policy is there. There is some space, but it is quite limited, and I had explained at length that there is limited space. So if you read any inconsistency there that was not deliberate and maybe you should may be look at it again with the benefit of what I have said. Regardless, the message that we are trying to give is that as much as there is some space that it is going to be quite limited and we are going to use it with a lot of judgment on both the timing and the quantum. On the wedge between deposit and credit growth, credit growth is 16.2% and deposit growth is 13.3% I think in January. There is quite a lot of wedge, I have not really looked at whether this is the largest or, wider gaps in the past and that is one of the structural reasons for the liquidity deficit. And that also explains the reluctance of banks or their inability to reduce deposit rates, which is just as well, because even as we want lending rates to come down for investment purposes, we want deposit rates to stay as high as possible to garner savings. So, I would worry about the wedge from a liquidity management point of view, but I would not worry about deposit rates being too low.

**Lata**: Actually, I share what George said in terms of the disconnect between the two documents. My question was more directly on what you said just now that your next action will depend on whether inflation moves lower than what you have forecast and current account deficit moves less or in accordance with what you have forecast. We have some idea of what you expect on inflation to be on March 31st, so we can get the trajectory and you are expecting it will remain in sync with these levels in FY14, but on current account we don't have any such guidance. On March 19, 2013 when you meet next you will not even have an additional current account deficit number and almost if you do a dip stick survey, expectation in the market is at a minimum 6% for the December quarter and there are some like JP Morgan who go to even north of 6.5%, how will you interpret that on May 3rd, when you meet thereafter you will have only that number with you. So what is your expectation of current account deficit for third quarter and indeed for fourth quarter that will make you believe you have room?

**Dr. D. Subbarao** Thank you, Lata. First question on the inflation trajectory, we said inflation will remain around the current levels at 6.8% for March 2013 and thereafter it might go up a little bit. It is not

certain that it will secularly trend downwards, because of all the factors that I mentioned including suppressed inflation and there will be base effects later in the year. Two messages, one is that we come off in the peaks in double digits and second there might be movement around this number going up and down, that's the trajectory of inflation, and that is the projection on the basis of which we have given the guidance, on the basis of which we will conduct monetary policy going forward. On the current account deficit, I have seen numbers floating around; those numbers are based on the trade data for the third quarter and I don't want to rule them out, because there is going to be a large current account deficit in the third quarter. But your question about our assessment of the current account deficit in the mid-quarter in March and the next quarter on the 3rd of May, you would know that we have some more data than the market has, we have data from the banks about export proceeds and we correlate them with the customs data. So we have some information, not very much more, but certainly more than what the market has, to assess the current account deficit. But this is not a perfect world we have to conduct policy in a world of imperfect information.

**Lata**

So exactly, since you will already know more than we know on the December 30th number, what is your comfort zone? Will 6 be your comfort zone? How do we interpret or expect RBI to behave?

**Dr. D. Subbarao**

I wish I could give a precise answer to that question. I cannot say what the comfort zone is, we said the sustainable current account deficit is 2.5%. Dr. Rangarajan has come out with a similar number. So anything like 5%, 5.5%, 6% is way above that level, and we have expressed concern. But if you want me to quantify what is an acceptable level I cannot really get locked into a number. 5%, 6%, even 4.2% of last year was certainly beyond the comfort zone. And mind you as I said earlier, it is not just the current account deficit, but the quality of the current account deficit, the situation, macroeconomic context in which it is happening and the type of flows that are financing the current account deficit. So all of these are attendant to the fact.

**Ira**

Governor, you articulated your position on current account and on inflation. On growth, in the policy stance- not the guidance but the policy stance, you talk about the fact that it was critical to arrest the loss of growth momentum, yet on the other hand we were all assuming and you seem to agree that growth has sort of bottomed out at some level. But then what does it come to? Was it a fear that if this cut doesn't happen or that if the monetary easing does not continue that growth may not have bottomed out or the consumption could weaken further and growth could further be sacrificed. Was that the fear in this action, because on the other two levers, that is from CAD or the inflation presumably, the RBI could have waited for more comfort?

**Dr. D. Subbarao**

Yes, more certainly. I can only reiterate what you said in your question, which is that we were trying to balance growth and inflation considerations. And growth has decelerated, 5.5% to 5.3%, all that we have written, about that being the lowest in the last nine years, etc. And it's just not what is holding our growth, the last bastion of growth was consumption, even that has started decelerating. So there were concerns about how monetary policy can support growth. And we believe that it has bottomed out in a sense that from here onwards growth will pick up, there are some early indications that we have hit the bottom and we will be moving up because

of manufacturing and services PMI which show that the three months in a row that they have gone up; the index of industrial production indices and we certainly can take off a festival related demand, that also shows a positive trend, there is inventory restocking, there is also the hope and expect some positive sentiment, because of inflation coming down and almost friendly and more agreeable investment climate, together with what the government is doing for measures and repeated commitment to fiscal consolidation by the Finance Minister and his team. So all these factors I believe will play with the potential investors, and take growth up. So the answer to your question is, yes, the main consideration for us to ease today was that growth had decelerated.

**Ira** I mean in a reducing interest rate scenario, do you not think there will be the consumption part of the economy which would come up and if investment does not keep pace then isn't there a risk it will drive core inflation rather quite quickly? You said it is in fact core inflation to remain benign. So how do you balance on that?

**Dr. D. Subbarao** And that is a difficult question to answer, because in my explanation itself I had admitted that easing might lead to higher imports and therefore deteriorate CAD, but you have to remember that we have one instrument - the interest rate . With the same instrument we have to encourage the investment by reducing lending rates, we have to discourage consumption, we have to improve savings, and we have to reduce the CAD. So that is almost an impossible task, so it is a matter of judgment and balancing risk. I was told when I discussed this with my own staff was that the marginal propensity to consume out of a reduction in interest rate is lower than the margin propensity to consume out of an increase in income. So the question is if interest rates come down, does it lead to higher consumption or higher investment? In the first order we believe that it will inspire and spur more investment and consumption will go up only when people see their incomes going up but not so much because interest rates come down. That is at a broad brush response, but that is the judgment on which we have gone forward. What Mr. Mohanty just told me to tell you all is that there is also excess capacity in the economy, capacity utilization is 70% to 74%. So if interest rates come down it will help working capital and we first utilize the existing capacity, which is clearly non-inflationary and supportive of growth. Thank you.

**Participant**: Just as an extension to what Ira said probably just put it little more bluntly, considering the trajectory that you have indicated for inflation that includes the probable rise in FY14 would not cutting today have meant missing the bus and missing that opportunity to do so and second question within the MMD and in today's document, you have spoken about liquidity as a concern, but although you had cut the M3 growth target indicative projection rather, you have not mentioned anything on deposit growth or the indicative projection for deposits in this document. I just wanted to clarify on that.

**Dr. D. Subbarao** Yes, not cutting the rate today or earlier, every time we discuss this somebody or the other tells me that you are missing the bus. So maybe I have missed a lot of busses, but the point is whenever you do it there is always a question of what you should or should not have done and there was a point of view, both within the Reserve Bank and from the stakeholders whom we

have consulted, not so much in the stakeholders this time, but from the analysts, that perhaps we could have paused. But then as I said we have taken to account all the considerations and decided to cut. On why we did not indicate our revised number for deposit growth, because it's the same as before.

**Deepak Mohanty** Yeah, 13% would be 14%; the thumb rule is that if the money supply is 13% the deposit growth is 14%.

**Dr. D. Subbarao** Okay. But in an effort to keep the document to 12 pages...

**Participant** If you could see, the deposit rate forecast is perhaps reduced?

**Deepak Mohanty** Yes, because the recollection is that, earlier we have not given that, so deposit was not given.

**Dr. D. Subbarao** Oh, it was given maybe we have given that, but we have given M3 and the non-food credit growth projections.

**Shobhna** What do you make of large scale restructuring of all these corporate accounts like Rs.50,000 crores-60,000 crore, there seems to be no end to it?

**KC Chakrabarty** No, that is a matter of concern, but you see we are not too worried. The issue is that what do we do when a large number of people are sick, we have to give them some time. If they are not well we cannot ask them that you all die, is it? It is a financial instrument which has to be used judiciously. We can issue the guidelines to the bank.

**Shobhna** One statement you said that the manner in which this restructuring is happening is not always transparent. You have also highlighted that it is only the larger companies that is getting the bulk of the restructuring and you have put out data to show that the larger corporates are the one who are the bigger beneficiaries.

**KC Chakrabarty** I have used the same logic that the small people are not getting credit but I cannot say that big people should not be getting credit. The issue is that we assume that banks are doing it judiciously. Our guidelines are that bank must do it judiciously. Now all these concerns which has been raised, for that a committee has worked, they had prescribed certain proposals but the only issue is that this is not the time where we can go whole hog for implementing those guidelines and last part is that, look, you have to make a judgment, we are making the data available to you every quarter after quarter and we believe that if the people have chance to survive we must give them the chance to survive, but this assessment has to be done by the banks. In our own assessment that, yes, it is a situation which does not give us a lot of comfort. But we are only engaging in a dialogue with the bank and our own view is that banks are saying it is now slowing down. Other concerns remains that smaller accounts should be restructured, there has to be a system that has to be looked into. Beyond that you see that data is available to everybody and you have to take a call on that.

**Shobhna** Sir, don't you think that lending in terms of a 15% for a company and 40% of the net worth of a group should be relooked and don't you think that is very high?

**KC Chakrabarty** But it was low. It has been increased, now again the issue is that you see our entire investment model is bank led model and credit led model. Now if we have to meet the huge requirement to infrastructure industry and we don't have large number of banks. The banks are limited for the last 30 years. So there is no other way. We have to look into within the system, that is a compromise you have to make. What Mr. Sinha says, when you study across the globe what is the group exposure limit, what is the individual exposure limit, he says that there is not much difference, even Basel Committee is studying this. I think you can give more on this thing. This is not that bad in our case.

**Anand Sinha** Yes. Everybody says we have a large exposure limit. To go by the laid down norms it is. But then partly this is due to the compulsions of development. We have few industries or few industrial houses which are into several things, so it is now the compulsion of economic development. Basel Committee as a part of the reforms has appointed a committee in which we are also members for looking into this. When the work starts the first item is stock taking and the stock taking is an eye opener. Many countries have a disorder. Apart from that, many countries adjust for collaterals; we do not, so it is not as disastrous as it is laid out to be. In any case once the norms are finalized, we will have a relook on the exposure norms.

**Gopika:** If I could just follow up, you mentioned that in the policy there is a risk aversion in the banking sector that you are seeing, which has constrained credit flow. Is there any rationale why you are saying this? Any particular sector or any particular borrower who are being deprived of credit flow because of risk aversion, because bankers seem to believe that this is a conflict of perception between the RBI and the bankers, so what is the rationale behind this?

**KC Chakrabarty** This is something on which the customers give us the feedback . We go and meet the people at various places. Truth is that at lower level it is a credit starved economy, there is absolutely no doubt about that. Banks are not able to respond -first thing may be they don't have the ability. We are engaging into dialogue with the bank that they must also improve their ability to meet this requirement. People in the SME, they require credit, their exclusion is very high, in agriculture people are not getting credit and we have to see in the context that banks are the only suppliers of credit. They have no other source of money except the banks or go to the moneylender or some NBFCs and that also they are getting money. So it is a credit starved economy. If banks say that there is no demand for credit at least this statement we do not agree and I do not think any bank is saying that. What they are saying is that that we are not having ability to meet that credit and because their credit is delivered through the branch unit and that is the issue. We are engaging into a dialogue with the bank, how you can improve your ability to meet this requirement, our entire financial inclusion program is only to meet the ability of the bank to meet the credit needs of this segment. But there is definitely credit starvation at least from this set of people, the corporate have no requirement of credit today.

**Dr. D. Subbarao** Gopika I suggest you call some small and medium industries panel and talk to them and this will give a sense of exclusion in the SME sector.

**Ritesh** Three questions, firstly you have mentioned in your document also and in your speech also that the government actions have given some comfort on the other hand current account deficit is a concern, but from the government's recent actions including the railway fare hike and the partial diesel pass through, how much that had given comfort on the fiscal deficit and how comfortable are you at the current fiscal deficit number which you are targeting for the fiscal year end? Second question on the liquidity front on one hand we are seeing these LAF borrowing are on an average of Rs. 90,000 crore in January month, but on the other side there is an excess SLR which all banks are holding and it averaged to about 27 to 28% over the requirement of 24%. So does not it seem contrary and the third question on the new bank licenses.

**Dr. D. Subbarao** First on government actions, a very short reply. Apart from specific actions and announcements, we have gone by the road map that the Finance Minister has indicated and what he said both here in India and in his meetings with investors outside of India and we have gone by that fiscal road map. On liquidity management, there are some banks which have excess SLR, there are some banks which have SLR just about the minimum. In assessing the liquidity constraint we do a detailed assessment. We see whether it is structural or temporary. We see the tax payment schedule of the government, we look at the spending program of the government, and then we see only some banks or all banks have the liquidity deficit as the point you mentioned. Then we also look at our own Forex operation, not deviation from the policy, but there are some obligations that we might have like the forward shares, etc., which we may have to deliver. So we look at all that in assessing the liquidity requirement. One of the things that our people tell me is that if the liquidity deficit is uniform across all banks cut CRR, if it is only specific banks then you do OMO with or without an SLR cut because then it will only go to those banks which are willing to pay the cost that is how we assess the situation and decide on our policy. Regarding the new bank guidelines it is in the final stage, we have consulted the government, they have made certain points to which we have responded and I do not know how many iterations it might go through. But now we are awaiting the governments' response to that. Both the government and the Reserve Bank will want to launch this as soon as possible.

**Participant** What is the change in the guidelines because the government had asked for inclusion of real estate?

**Dr. D. Subbarao** You will have to wait till the final guidelines come.

**Lokesh** My question is the CRR cut seem opposed to OMOs?

**Dr. D. Subbarao** No and yes, because the answer is that as I just explained to Ritesh's question we will look at the liquidity situation, the causes for that liquidity situation and decide whether to do a CRR

or an OMO. So you should not read one way or the other from the CRR action about our decision on the OMOs.

**Alpana Killawala** Laveena, can you please check if there is a question with you there?

**Moderator** We have a question from the line of Manju from Financial Chronicle. Please go ahead.

**Manju** I wanted to ask you, you said in your policy that there is a limited scope for this monetary easing that you started today, I wanted to know like how long this limited means how many months, what is the room available?

**Dr. D. Subbarao** Manju I cannot be more specific than what I have said because if you are talking about when we say anything further on this, you have to wait for our next policy, this is when we give guidance thereafter so you have to live with this guidance over the next 3 months.

**Manju** Over the last one year, banks have been selectively reducing rates especially on retail loans. Now you are talking about, for growth and to revive investment, you need lending rates to come down further. Is there any commitment from banks that they would reduce rates by revising the base rate now?

**Dr. D. Subbarao** Not commitment but an assurance.

**Manju** That monetary transmission would be through the base rate and not through selective interest rate cuts?

**Dr. D. Subbarao** Yes that is the indication that we got.

**Manju** I just have one last question, in the policy statement, you said banks should see that credit flow should be there for productive sectors. I wanted to know if banks are jamming credit to any particular sector?

**Dr. D. Subbarao** Yes, you have been listening, Dr. Chakrabarty just answered, there are some sectors which are have not getting credit that they should be getting like the SME sector in parts of the country, the agriculture sector, etc.

**Moderator** Our next question from the line of Gautam Chakravarty from Ticker Plant. Please go ahead.

**Gautam Chakravarty** I have two questions, one relates to the CRR, you seem to have now almost reached to a place where, do you think you have any more room or leeway for more CRR cuts given the liquidity tightness as you have mentioned earlier? And the second question pertains to a broader issue of financial stability from capitalization of banks. Twenty years back, public sector banks were recapitalizing because it was the government's mandate and they are government owned and they were following certain policies they needed to be capitalized, so we saw a huge amount of book entry being done and capitalized. But the theme seems to be continuing even 20 years

later. Whereas private sector banks have to go to the market to raise money and funds and other things, so is it a cost for concern in terms of financial stability?

**Dr. D. Subbarao** On the first question, yes, CRR is 4% now and 0% is the theoretical limit, some central banks have tested those limits, but as far as we are concerned we have quite a lot of cushion there. I am not suggesting that we will bring it down to 0 or even below 4% but the question was about the room available to us that is 4% there. On financial stability considerations of bank, the capitalization what exactly was the question?

**K C Chakrabarty** It is the job of the owners, the equity holders, to provide the capital. So long as government is the owner of the public sector banks, its responsibility is to provide the capital and if the government says that it will provide the capital, we should be happy, that we have no problem in that, the other banks are going because their owner is raising the capital from the market, now this is an issue which has been settled at a policy level. Now Parliament of this country has decided that more than 50% stake in the banks will be held by the government and we cannot question that. We are not worried, so long as government is able to give the capital, we are happy, banks will remain stable.

**Gautam Chakravarty** The only problem is from the fiscal deficit route that is all basically because it adds to some kind of government.

**KC Chakrabarty** We agree, we are talking about fiscal deficit, but that is a decision which is not at our level. So long as banks are having capital, banks have to be adequately capitalized. Now fiscal deficit is not good and so as long as government is meeting these expenses, we cannot question that because it is a much broader policy and beyond our mandate.

**Neha** Two questions, one is the issue of bringing down fiscal deficit substantially, its implications on growth and the second question is what are your views on banking licenses in terms of giving it to corporates or real estates?

**Dr. D. Subbarao** On the first question about fiscal deficit, yes, of course you know to the extent the government retrenches, there will be an impact on growth but consequently as Urjit just told me there would be shifting of expenditure, so government will be vacating space for the private sector, therefore I do not see fiscal deficit reduction as necessarily contractionary; indeed it might be growth enhancing. On the second question, about what my view on giving banking licenses to the categories of applicants that you mentioned, you will have to wait till the final guidelines come out. We have put out the draft guidelines, we have received feedback that also we have put out in the public domain now we are in the final lap and then we will take a view shortly.

**Govardhan** Are you are still stressing on the consumer price index and food prices vis-à-vis headline WPI. Sir last time the RBI had to reverse its stance, how is it different this time?

**Dr. D. Subbarao** No certainly that is a concern as I just mentioned in my explanation. Even as the core inflation has come down and fuel inflation has remained level. Food inflation has gone up both in WPI

and much more in CPI and some people argue that the monetary policy need not respond to supply constraints or cyclical shocks such as food inflation, if food inflation persists for long enough it will engender inflationary expectations and there would then be cause for action for monetary policy to respond. So that is certainly a concern and we will keep track of that. You will see that we have noted that very clearly both in the document yesterday and in the policy document this morning.

**Govardhan** One more question to that about fiscal deficit. Last quarter review you were quite skeptical about the government's ability to meet its target and now you said that after the Finance Minister Statement here and overseas meeting that you are convinced, so what is the difference?

**Dr. D. Subbarao** It is not a question of me being convinced or otherwise. The question is what do we go by, so we are going by our Finance Minister statement on the roadmap that is laid down.

**Parnika** In terms of liquidity, one of the reasons for tight liquidity condition you have mentioned in the MMD is the high government cash balances with RBI. So when you think those will be released into the system and should we assume that still would it not help the condition because you have gone ahead with the CRR cut and the second question is in the MMD you said that in terms of policy concession to lending rates there is some structural rigidity, so can you explain us what this is?

**Dr. D. Subbarao** First on the government cash balances, they have been higher than their historical regime and as I said longer they have on the average in the past. We have requested the government that we want to disclose the government cash balances so that everyone is on the same page. So we have some idea, our people keep discussing with the budget division of the Ministry of Finance who tell us about the spending program. So we have some idea about what the spending program is and we have taken that into account in cutting the CRR. Then, about the policy obstacles to transmission. There are several ways to doing it, but I look upon this as what I have just explained, which is that consumption is more than 50% of our GDP and how that will behave with reference to interest rate is not very clear and I have just explained the marginal propensity to consume because of lower interest rates is quite low. So investment which is about 35% to GDP, that has to respond. So that is the component of GDP that we are trying to move because of our interest rate change. That will respond to a number of factors including interest rate that we maintained several time in the past that interest rate is only one of the factors, there are a number of other factors that must come into play in order for investment to take off.

**Aparna** There is a statement in the policy that talks about containing the perception of inflation in the range of 4.5% to 5% in line with the medium term of 3%. I just want to understand what is the perception of medium-term, is it for 2 years, 3 years, 5 years? In that context is it relevant because we have not seen inflation anywhere near those levels for the last 2-3 years? Second question is, in your policy statement you say that the likelihood that the CAD may exceed 4% of the GDP for the second successive year in 2012 and 2013, is this 4% which we were

watching in terms of qualitative policy measure going ahead and do you have an internal measure for CAD ready for the next year?

**Dr. D. Subbarao** Thank you for those very difficult questions. First on the perception of inflation, 4 to 4.5%, your question was what is the medium term? Given the inflation trend and given the global trends I would think that we are looking at about 5 years and I am saying this without the advice from my colleagues but I am just reacting on my feet as it were**.** I think it is 4 to 4.5% over the medium term. To your second question which is much more loaded, much more difficult about whether we should be hanging on to this 4% or 3% to 3.5%, the answer is yes. There is no argument for the Reserve Bank to bring down what it believes is the medium term inflation target. There are a number of arguments and we have heard in the IGIDR debate about why we should accept a higher normal for inflation because of both domestic and external considerations. I will actually speak on that issue in the next one month or so. At this time I only want to say that we believe that this is a target that we will continue to pursue. On the second question about current account deficits, what is the number we are working on internally? You know, we have no number, we have admitted to in answer to Lata's question, we have a little more information that you do because we get the financial source, on that basis we want to project what CAD might be. But I am not in a position nor am I obligated to disclose a CAD number, on March 30th or whenever it is due, it will come out.

**Lata** I am just adding this what clarification you said that you asked the government about the food balance situation and that was one of the inputs for the CRR cut. I just wanted to know the current deficit is largely because of cash balances, then why is the CRR cut? Are you assuming that all these promises that plan expenditure will be cut seriously implies that you are going to be stuck with a lot of cash balances and therefore this liquidity deficit is a thing which we possess. Is that one of the reasons why you cut the CRR and the second question, this is only prompted by what you answered, this is what bankers were telling us earlier that in a move to restructure state electricity board loans, they have been asked to give bonds which are guaranteed by their state government. Apparently Reserve Bank gave them to understand that if state government does not pay up when the DISCOM defaulted, RBI will withdraw the money from the state government account, in a sense RBI will be the backstop if the DISCOM does not get guaranteed money from the state government. Is that a backdrop, if it is then there is a lot of comfort.

**Lata** On the first question, cash balances of the government we know, there is no need to discuss that. What we are discussing with the government is the spending program, so that will give us an idea of how quickly the cash balances might be spent or be further augmented. When we decided to do the CRR cut, it was not informed just by the government's cash balances, it is informed by the host of other considerations that I indicated earlier, so we believe that there was a structural deficit, which will persist despite the government or even after the government cash balances come down to uneven levels. That was the consideration to find the CRR cut. On restructuring of SEB loans, Anand will you please answer?

**Anand Sinha** What you are telling at least we have not committed anything like that. Now because there is a lot of apprehension about restructuring, so even though this question has not been asked let me reply, on my own as to why we have allowed asset classification benefit. The SEB restructuring first time it took place was very recent. Even the ink was not dried on that and then Government of India has come out with a much more comprehensive program which is more beneficial to the bankers so while vis-a vis the second restructuring what we mean is that first restructuring was not proper and has failed which is not the case over here and second one or whatever it has been put in place is more comprehensive and more beneficial to the banks so that is why we have not treated it as a second restructuring.

**Lata** Last question that you have not given them any comfort?

**Anand Sinha** We have not given them any comfort.

**Participant** You have been saying banks have to lend more to the productive sector. I want some clarification, if the education loan comes under priority sector.

**Dr. D. Subbarao** I have not thought of it that way, but education loan is certainly a priority loan, I do not mean priority sector, it is something that the Reserve Bank urges banks to take more seriously.

**Participant** Why I am asking this question is one PSU bank last year issued a loan to an engineering graduate. The loan had been sanctioned and even the first year fees has been dispersed but for the second year, now they have suddenly made a new clause that he has to come out with an Aadhar card. My point is that while the loan has already been sanctioned and part dispersal is also over how can you insert a new clause?

**Dr. D. Subbarao** I am unable to answer that question. We will certainly check on that. In fact I thought you might say that in the second year, they did not give the loan because they did not get the 62%, but this is a more solvable problem, otherwise we will have to offer tuition.

**Dr. KC Chaktrabary** I do not think it is not necessary, it is branch manager behave in their own view, we are having one lakh branches. Bring to the notice of the higher authorities in the bank and the work will be done. Aadhar card is not mandatory for a bank account and because he has a loan account, bank must have completed KYC and that is why there is no need of Adhar card, but you see we have 100,000 branches, different people, large number of customers, such things will happen, deal it separately. Make a complaint to the banking ombudsman. It is has nothing to do with the policy of the Reserve Bank of India or policy of the bank.

**Kavita** You spoke at length on gold today, just wanted to know how much does gold contribute to the current account deficit and also you did speak about inflation indexed bonds as a product to kind of wean away investors from gold. What are the other products that you are all looking at introducing and what is the timeframe in which we can see them coming into the market?

**Dr. D. Subbarao** As far as gold as a proportion of current account deficits is concerned, you can look at the numbers. My recall is last year net import of gold was about $47 billion for the full year, net

import which is import minus export, and the current account deficit was about $80 billion, you can work out, it is slightly less than that. In fact at one point of time, last year we said gold imports were actually equivalent to the current account deficit. If we had no gold imports, we would have been in current account balance, but over the course of year we improved a little bit. We talked about inflation indexed bonds this morning. We did not talk about other instruments in lieu of gold but the KUB Rao Committee, has spoken about a number of alternatives, we are still examining how many are feasible. But meanwhile the government has already implemented one of the recommendations which is that this fractional reserve which is that ETF should be allowed to lend gold to the banks which in turn will lend to customers so that it generates some return instead of lying idle. We are shortly going to also consider that whether we should allow banks to buy back gold. Now they sell gold, but I believe there are some regulatory restrictions which imply not directly but which imply that banks cannot buy back gold that also we are examining Thank you very much, it has been very good conference for us. We had to confront a number of challenging questions, but it has been very rewarding. Thank you very much.

**Moderator** Thank you, on behalf of Reserve Bank of India that concludes this conference, thank you for joining us, you may now disconnect your lines.