“Reserve Bank of India Conference Call”

Interaction with Press

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RESERVE BANK OF INDIA PANEL:

`` DR. D. SUBBARAO,GOVERNOR

````SMT. SHYAMALA GOPINATH, DEPUTY GOVERNOR

````SMT. USHA THORAT, DEPUTY GOVERNOR

````DR. K.C. CHAKRABARTY, DEPUTY GOVERNOR

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

Start Time: 11:13

Participant Sir, how confident are you about inflation getting subdued by March'10 would you want to give that number an upward bias. Would you say 6 is challenging? How worried are you about the demand pressure?

D. Subbarao No, I do not think we will want to give that an upward bias because we did take that into consideration and this is our best judgment for inflation. At the moment we are fairly confident about that number. I do realize that the Prime Minister had indicated a number of 6% for December in his recent speech where the Prime Minister gets inputs from a number of other sources. But on the upside of inflation, let me give you some of the factors. First is the southwest monsoon for the remaining two months of this monsoon season. The rainfall has been 86% of the long period average. That has been fairly well distributed across the country except I believe in parts of central India, Madhya Pradesh where it is important for pulses and soyabean but otherwise we believe that sowing has been good and we should expect some dampening impact on agriculture and food prices, particularly. Second, is deregulation of petroleum prices. If more petroleum products are deregulated and how soon that happens, that will have an impact on inflation. Third, about demand side factors, capacity utilization is not at its cyclical peak but very close to that. So as much as a policy is calibrated to contain demand pressures, it is important to continue to keep an eye on demands side pressures. On the downside, there is the global growth prospects and if global growth is subdued as is currently the situation, the sunny side of that is that there will be a downward pressure on commodity prices, particularly, oil. Also I have been told that if there is a spare capacity around the world and because we are fast growing and our import requirement is higher, as I said in the statement, there could be some softening of prices of imports as well as import substitutes. And finally, on the downside, I hope that monetary policy actions since January 2010 will start playing in now because that has been about six months so we expect that they will start having an impact.

Question: In terms of the transmission of the monetary policy now we heard all the bankers today I am not sure what they told you but they told us that they do not intend to raise rates in the immediate future to now 100 basis point that the RBI has already done. Is that issue of monetary transmission bothering you because you addressed this from a liquidity picture, tightness of liquidity in the policy as well. Is that the feedback you got from the bankers and if so, is that a little bit worrying and does it put pressure on the RBI to sort of have come in with a stronger measure or stronger words?

D. Subbarao Yes. Transmission of monetary policy is something that we worry about all the time. I would not say it is disturbing me, but something that we have been talking about in this conference for the last two years and we are talking about it today. It is important that the signals that we send transmit through the monetary policy but there are good reasons why that has not happened so far because of the liquidity being in surplus because bankers have also said that the demand for credit has been sluggish and I would say there was some concern in the bank support to this transition from the BPLR system to the base rate. Now, some of those factors are behind us. As credit demand picks up, as liquidity becomes tighter, and as other monetary policy actions start playing up, we expect the deposit rates, and lending rates to go up and I heard the bankers tell you that the deposit rates will go up and lending rates and that is what they told us.

Dr. Gokarn I think the message was similar to what we got in the April review which is that they do expect credit to start picking up more firmly in the second half of the year and as that happens the incentive to start to raise rate is going to be stronger. Until now I have to say that there has been a liquidity surplus situation so that has eased the pressure and in the last month or so even as liquidity has been tightening the growth in credit that we have seen according to the bankers is not as broad-based as it needs to be to start to pass on prices. So we do see the transmission kicking in a little more strongly now, one, because of the liquidity situation, two, because the credit growth pattern itself is going to become a little more broad-based and this is not inconsistent with the view that bankers had requested earlier in the year when they said that its going to be a second half phenomenon where, credit growth is going to be strong. It is going to be more broad-based and strong.

Lata Venkatesh If you are sanguine about the targets for growth and inflation that you have set out, sir, would you say that your policy rates are normalized at this point in time for the targets that you have set?

D. Subbarao Those are not targets those are projections and for policy purposes they are indicative projection yes, and also we are quite sanguine about that. About that our policy rates are neutral, even in the April policy statement we talked about whether we have reached there. One thing is we have not reached there, there is still work cut out for us and how quickly that is in what steps we reach there is a question that will be determined by the macroeconomic situation. In fact we have said in the statement that our current policy is not consistent with the current macroeconomic situation, we are getting there. About neutral rate issue itself, it is difficult to say that this is the neutral rate because the way economists define neutral rate is price rate consistent with the potential growth rate and low and stable inflation. And in the economy that is growing very fast, there is no stable neutral rate, neutral rate itself is a dynamic concept but if we take the movement of rates that have been the highest point before the crisis 9% for the repo rate, and the lowest point it went to 4.75% that is repo rate, the neutral rate is somewhere in between them. But with a big plus/minus around that.

George Governor in the policy documents you have retained M3 growth projections and again credit growth projections at 17% and 20%, the document however remains silent on deposit growth, so should we assume that 18% is what it will grow by in the financial year base economy, April number, you put out?

D. Subbarao I should think so, 18%, although I realized that deposits at the moment are lower. 15.2% is the number that we put out in the document but, after we sent it to the press, yesterday's numbers are slightly lower actually. I understand and banks also spoke to us about this, deposits have declined because of public sector enterprises, particularly oil companies, withdrawing deposits, mutual funds withdrawing deposits and also public holding more currency that they can pull money in the bank because of the high inflation situation. We expect that to reverse and that deposits will pick up because the 20% deposits growth is important for the other monetary variables there as I take it.

George So is it 20% or 18%?

D. Subbarao 18%.

Lata One of the many things happened is that there is so much of money that one lakh crore goes into Government coffers because of the Spectrum, that also has some sort of impact on deposits and maybe when that comes, deposits will mobilize. Is that the relationship between the two?

Shyamala Gopinath They will multiply

Lata Government balances go up

Shyamala Gopinath There are deposits, there are other liabilities on the basis of which the companies have paid the Government. They would have borrowed or used the line from banks or from market or raised through bonds or whatever: the money is already there in the system and the one lakh crore paid to the Government was there in the system has been withdrawn from the system. If the money is back in the system, there is a multiplier, that adds to deposits.

Alpana Killawala Mrs. Gopinath, our Deputy Governor, has answered Lata's question, Pradeep from CNBC Awaaz?

Pradeep Sir you said that you will manage liquidity actively so that there is transmission of monetary policy and the effectiveness of policy in action. It means you are saying that your open market operations or through the other measures, you will ensure that repo rate remains the operative rate?

D. Subbarao I wouldn't be as specific as your question has been not necessarily OMO, we accept the one-time liquidity situation on the realizing because of the 3G auction payments and if the advance tax payment are released that will substantially ease the situation further by the end of this month. However, the injection mode of this or the absorption mode of this over the last two years when we kept abundant liquidity that will change from, as the statement said, a unidirectional motto bi-directional mode, we expect that the operative rate will be repo rate and that the system will remain in the injection mode because that way the monetary transmission works better. And I cannot commit to OMO whatever but we expect that depending on the liquidity movements in the market itself, it will be more of that rate.

Participant What is balance liquidity is it minus 50, 000 plus 50,000, minus 10,000 plus 10,000 what would constitute that?

D. Subbarao I would say anything about less than 1% of NDTL.

Question Sir two three questions. First your assessment of the international conditions now I mean you are pretty confident about the Indian recovery but what is your assessment on the international front; second have you heard anything lately from the government on the changing in the borrowing program; and third sir there is bill that has been placed in the parliament today where you have been selected as the Vice Chairman so your reaction to that sir?

D. Subbarao Let me answer the second question, this s borrowing program we have not heard anything from the government so borrowing program now stands as it is. So whenever government gives some indication you would probably know. On the global situation, we have said something in the policy document that the IMF raised the forecast for global growth from 4.2% to 4.6% But IMF sunny outlook is not broadly shared. There is somewhat disappointing news coming from around the world, sovereign debt crisis in Europe. You read about Bernanke saying that conditions are unusually uncertain rather than just being certain but its debate that's going on about the stimulus versus austerity, the unemployment rates. The uncertainty in the financial sector particularly banks, because of this Basel III discussions what implications it might have for them. Consumer confidence is low that's the global situation and it is all there in the public domain. What is of greater concern in the last few weeks is that, that subdued outlook is also transmitting to EMEs, now know three months ago we were talking about capital flows and sentiments were very positive, **,** that has changed, the sentiment has changed and that if this uncertainty prolongs it will have implications for emerging markets, economy and exports. And on the third issue I just saw as I came into the press conference on the ticker that the ULIP Bill has been introduced.

Question Some countries have done stress tests of banks, are you also trying similar kind of stress testss on our banks?

Shyamala Gopinath In the last financial stability report we had indicated the outcome of some of the stress that we get both on the quality of assets, the NPAs, we did baseline scenario, the adverse scenario, similarly on liquidity and what would be the impact on the capital adequacy ratio perhaps. In addition, we have told the banks to do such stress testing internally also, that is at the micro level, in fact one of the objective is also financial stability, before that we are going to do it periodically, idea is to dissiminate information on what would be the consequences of these stress tests and just try to give information on what are the triggers or what are the indicators of that analysis.

Participant In every Financial Stability Report, are you conducting a stress test?

D. Subbarao I must also add that we are trying to make our stress testing process more vigorous, we are learning on the job because I must admit that our stress testing is not as vigorous as was done by the US or Europe and we should get there but just now its somewhat less sophisticated.

Participant What's the periodicity?

Shyamala Gopinath Twice in a year we have been publishing the reports and, as the Governor has said, it is a single-factor stress test which is not really a very complex model but we are learning on the job.

D. Subbarao At some international press conference someone asked Bernanke whether they were going to do the a stress test every six months, he said that the stress test that they did which results were then published, there they took help of the people in several institutions,they worked on that for about three months day and night so that sort of a thing requires a lot of intellectual effort and we need to pick up on that.

Moderator: The first question is from the line of Neha Arora from Newswire18 please go ahead.

Participant Yeah, my question is for the Governor, sir do you think that banks have been caught on the wrong foot as far as deposit growth is concerned and that it will take sometime for it to revive and has it been one of your major concerns. Also sir, second question do you think that the reverse repo rate will become the operative rate going forward?

D. Subbarao On banks being caught on the wrong foot on the deposit growth, I don't think so. We have discussed it in the past also that there is some lag between their raising the rates and the response to that in the sense that what the banks have told us that even if they raise the deposit rates today, the average cost of deposit would not go up immediately because there is a lot of historical deposit that they carry, so it will take some time for the adjustment to take place, I don't think they may be caught on the wrong foot, Second going forward to expect the reverse repo rate to be the operative rate, No. This thing is just opposite, going forward we expect the repo rate to be operative rate.

Subir Gorkarn Can I just say something on that, I think we have got to recognize the fact that the system is coming out of surplus liquidity situation after a long time, its been two years, the reverse repo has been the operative rate and in that scenario, banks are not terribly keen on expanding their deposit base because there is lot of liquidity in system that supports their credit growth, its now only in the last two months, in fact two months that we have seen a transition and so when we look ahead at the financial system as a whole, and the banking system in particular they will be operating in a different regime and that in a sense addresses both the questions. We have moved from reverse repo operating to repo operating point and that in a sense reflected an autonomous tightening in the policy rate and we expect that to be the prevailing position there is always some possibility that things will swing back particularly in event of large capital inflow which is one reason why we are starting to tighten the corridor because this the range we concentrate trying to keep the operating rate as close as possible to where it is now. And also in that scenario banks have to start looking for deposits, because if they want to earn their credit growth, it can only come now from new deposits, if they do not have enough liquidity which they can use finance this growth. So I think we want to see both scenarios emerge that is banks will move from a situation where they do not have much pressure to raise deposits to one where they have to raise deposit in order to finance growth and two, that the liquidity situation will keep the operating rate closer to the repo, more likely at the repo end than on the reverse repo end.

Alpana Killawala Our next question from Joyeeta Dey from PTI.

Joyeeta Dey Sir the government today introduced the ULIP bill in the parliament making you the Vice Chairman. Has this laid fears of RBI and second question is that by increasing the repo and the reverse repo rate what is the indication that you are giving to the bank?

D. Subbarao On the first question on the ULIP bill I have no comments to make at this stage, you have all read about it written about it and that’s what it is, and I am sure that as the parliament debates the bill you will get more information on this. On raising the reverse repo and the repo rate we have indicated that in policy statement itself. What we expect it to do is to make credit dearer, contain demand pressures and also reduce the LAF corridor and make liquidity tighter than its been for the last several years.

Participant Okay, Aruna here.

Alpana Killawala Let me comeback who is that, okay, okay, yeah, Gopika. (The next question is from Gopika)

Gopika My question is, you said the monetary policy is expected to reduce the volatility of the short term rates in a narrower corridor is there a comfortable corridor that you are looking for?

D. Subbarao Yeah, that’s a good question. You know, we have not determined what would be the comfortable corridor in an equal grip situation but that’s something that we need to look at and the LAF study group that we are going to set up will in fact look at this as well, we know, when we started I think that lap system , we started with 100 basis points in 2005 and then we expanded 300 basis points that’s what I inherited when I came in two years ago and during the crisis that got narrowed not because we deliberately narrowed it but because we reduced rates asymmetrically. There had also been a sense that when you are more uncertain the corridor should be wider because you can tinker the call rate quicklybut as we get to a more certain situation and we want to stay on monetary conditions more firmly I think it helps to have a narrow corridor for the monetary policy transmission.

Participant Can you elaborate on that working group sir, what will be the terms of reference of that group and will it also look at not having a corridor at all like it is in the United States, will it look at the narrower corridor like the ECB?

Subir Gokarn I think we have not yet set up the terms of reference, so this is the question that will be answered as and when the terms of reference are set up. If you have suggestions on the terms of reference then please feel free to say.

D Subbarao But you know some people do keep telling me that it will not collapse. Now the eventual thing if you should have a corridor at all. These sort of discussions keep taking place whenever the issue comes up. And some people say that the corridor should be so wide we must actually have the inner bridge. That makes it so costly for banks either to borrow from you or to give money to you. This is the issue that we need to go into but yes of course in a theoretical sense and in limited case a zero corridor width is a distinct possibility.

Anup I am Anup from MINT. Can you just explain a bit more on this review the current operating procedure of monetary policy in practice and also the working group that you are proposing and also on making repo rates operative rate for most of the time because your preference will the mechanism be such that it will make repo rate as the operating rate.

Subir Gokarn To address the second part of the question first, the repo rate is the desired operating rate when the policies are on a tightening side because you are getting the full range, the full benefit of the quick corridor and the reverse repo rate is the desired rate when the policy is in a loosening type. So that literally that defines the role of the corridor in different phases of the business cycle so its not correct to say that the repo rate is the desired rate in any situation. It is the desired rate in a specific phase of the business cycle. Now the problem we are having with the corridor as a sort of range within which the short term rates move is that when it is very wide, the fact that the call rates can vary in that entire range in a surplus liquidity, it goes all the way down to the floor and when liquidity is tight it goes all the way after the ceiling. Actually, it tends to dilute the objectives of the policy so in a situation where we are raising rates and there is surplus liquidity as we had for some time, the full impact of raising those rates is not being passed on to the short term money market because the rate increase can be offset or diluted by the fact that there is liquidity. So this is the kind of operating situation which we are trying to address how do we ensure that whatever we want to the desired rate of it how do we ensure that there is the high probability that we can keep it there, what are the instruments that we need, what are the mechanism we need. What do we need to do? So that is really going to be the broad scope of the working group and within that specific question that we spend, what is the optimal width of corridor, is there are constant optimal width or is it a variable width either no corridor at all that the situation those are the kind of specific questions that we will address.

Alpana Killawala We have a question from Banglore Arun Iyer Melissa.

Moderator Mr. Arun Iyer from Bennett Coleman. Please go ahead.

Arun Iyer You made mention of the real estate prices and there has been some concern of the rising price being witnessed is in the real estate sector. Just wanted to check out in the policy announcement that you have done today, there is no mention about that sector. And is your worry that possibly that could be adding to inflation and the possibility of informal modes of financing coming into real estate sector and thereby leading to an inflationary spiral. Is that likely to happen?

D Subbarao It's true that we have not made an explicit statement about asset prices in statement but that is something that we had taken into account and among asset prices the inverted equity prices have gone up last year and within this year too. Gold is at an all time high and real estate is what you referred to and information that is coming to us is that, in the cities of Mumbai and Delhi, prices have reached or over shot the peak prices and in another cities they are inching up and they have not yet reached pre-crisis level. So asset price is something that has always been a part of the inflation calculus of the Reserve Bank unlike other central banks who have kept asset price situation outside their perks and you know that historically we have taken action and we are keeping a watch on that as well.

Participant Sir the statement mentions that there are indications of a softening in inflation by mid-year 2010-11 level. Could you tell us what is value in mid-year and also it probably means coming at below the double-digit numbers, and also you are saying that the liquidity is expected to stay in deficit mode. So when the liquidity goes into surplus situation, could we see some actions from the Reserve Bank like a hike?

D Subbarao Mid-year 2010-2011 I recall it because even when I was reading the statement it struck me, mid-year 2010-2011 will be around of September-October, six months or so. About the inflation trajectory, its difficult to say that we have peaked but probably we are at the peak and next month it might go up, or go down marginally we do not know; but beyond next month we should see a trajectory coming down, its only because of the base effect and also because of the food prices softening that we expect to see. And on liquidity, yes, as we have said and as you Subir has mentioned in his answer, we expect to shift additionaly from the injection mode to the absorption mode when for a marginal day or two, the reverse repo might be effective rate but it does not mean that at the first instance or first sight of the rate moving we will act. After all we will not act on a spurt like that so we will have to see a trend. I cannot really speculate in a press conference whether we will have a CRR or OMO whatever is appropriate at that point of time

Subir Gokarn Just to respond to the first question, there is chart 2 in the statement on page 8 gives you the month-by-month trajectory of inflation rate that is our base line forecast and then the error around it. But that suggests that mid-year which is in October, it is some sort of plateau over the next few months and then it will start to come down. So in that sense you could say it will peakon a monthly basis or that it will persist but not go any higher.

Participant I want to draw your comments on the global outlook, especially the fall off in foreign capital flows to emerging markets. I want you to give an idea about how India has been affected from this fall off.. The other question I just wanted to ask you about the stress test and how many stress test you have conducted if you have done about two a year how many you have already done

D Subbarao On a first question about capital flows, I want to say that even three months ago we were talking about possible frlood of capital flows and then after, just before the policy review and the Washington Spring meetings of the IMF and World Bank, this was the dominant concern among all EMEs that there would be a flood of capital, because its not if there is a flood of capital flows, it is when there is a flood of capital flows how do we do it, how do we manage that. Thus we have clearly shifted through will there be capital flows that we will see excess or will we see a deficit, we will we see enough for our current account deficit but I want to say that even in a crisis year 2008-09 we had net positive capital flows. It wasn't sufficient to cover the current account deficit but it was there. And last year we have capital flows slightly in excess in the current account deficit. This year 2010-2011 we have some internal estimates that show that capital flows will be adequate to cover a current account deficit but really it depends upon the external situation. If we keep raising rates and if advanced economies are at low rates over an extended period that interest rate differential must be the push factor to the capital because the pull factors are already there as internal drivers of the growth; so both the push and pull factors should normally be working towards leaving enough factors for us. On the stress test may I delve it to Shyamala.….

Shyamala Gopinath **Anand will take.**

D.Subbarao **Anand, Yes.**

Anand Sinha The new stress test has been done at the time of the first financial stability report and since we plan to bring two reports so definitely there will be two sets of stress tests but apart from that sector specific or some particular issues specific stress tests continue to be carried out almost very regularly.

Alpana Killawala That was Mr. Anand Sinha Executive Director, Melissa anymore questions from regional centre.

Moderator Participants who have a question may press * and 1 on their touchtone telephone.

Alpana Killawala Okay in the meanwhile we will take a question from Bombay, Anup.

Anup Having reached a point where there is only so much the RBI can do, when the government needs to act on what sort of inflation is concern?

D Subbarao I don't think we can say that. What both the government and RBI need to do is to continue to act. The government has acted RBI has acted, the government has shown efforts towards fiscal consolidation but as some people have said the fiscal stance now is getting to be more pro-cyclical. rather than counter-cyclical. So that I think the effort done on fiscal consolidation shows that at the RBI too as we have said at that beginning of this conference. Our job is not done and there is still work ahead of us.

Anup Sir last question we have had four interest rate increases this year, doesn't it increase the risk of getting more flows than desired?

D.Subbarao Yes we had interest rate hikes and interest rate differential is one of the variables, not the only variable that determines the flow of capital. As it has operated last year, we will operate this year too and we expect that is not totally out of line. Capital flows so far have been consistent with current stock deficit.

Participant This is regarding the Statement where you have mentioned the word calibrated with reference to last actions since October 2009. However, unlike in the previous policies you have not mentioned this word "calibrated", for going ahead s stance that is the stance for going ahead. Does it mean that you have been more aggressive in forthcoming policies?

D. Subbarao No. It doesn't mean that. We will remain calibrated but calibrated to what is the question, calibrated to the macroeconomic situation and our growth inflation dynamics.

Aparna Aparna from Newswire 18 here. Sir two questions. Your mid-quarter review which you are conducting from here on, the incremental data collected between mid-quarter not that significant as the end of quarter so is this the decision of mid quarter review is it just to kind of legitimize that intermediary policy that you announced. And second question is on the LAF corridor, Sir this para a little contradictory because you're saying that the corridor should not be broad enough the unduly intensify interest rate band but you've hiked the reverse repo rate by 50 basis and the repo rate by 25; and you are saying that it will not be broad as to givescope for relative volatility. So can we change the current 125 basis point corridor width as it is given?

D Subbarao First question about the six-weekly review, that is, mid-quarter review. No, the intention is not to legitimize anything but as we were getting into the crisis and as we have been exiting over the last nine months we found that action every six weeks have been called for and even if there was no action communication every six weeks is called for because I noticed that there is a lot of intellectual activity in the media about what the Reserve bank might do , what the Reserve bank should do and that's educated us that's informed our policymaking. But I thought it's important also to contain expectations and being more predictable. It's not necessary that in every mid-quarter review we will be taking some policy actions. So don't go away from this room with that impression. You're right the data will be much more limited but over time we hope to standardize that so that you and I and the country get to understand what we're trying to do. Just to an insight, every time we do this action we do not tell you before hand obviously; and then I realize that my god this people have gone home and are there in market or with children; and when we're doing this and they will be call back to the studio (laughter) , It gives a stressful life. I do have a concern for you. I hope this predictability will help you.

Subir Gokarn Let me add to that before you ask the next question. Firstly the issue of the mid-cycle there are three very significant data points that come out, the two monthly inflation numbers,, monthly inflation, the IIP number and there will also be the quarterly GDP number. This is not insignificant information, new information. The difference between quarterly **cycle** and the mid quarter that we are exposing is that in the quarterly cycle we have our own analytical and consultation inputs, that is very difficult to replicate at a higher frequency. In fact even doing it quarterly it's quite difficult but it's very elaborate. But we have the whole modeling forecasting process, we have a series of quarterly surveys that we do which has just come in. And we have a stakeholder's meeting. So that is the process which we feel is absolutely critical to our decision making and we intend to continue on that rigour at the quarterly cycle. But new data that comes in domestically as is indicated that I mentioned. but global indicator data from every country and, as you have been observing over the last few months, this data is extremely volatile: month-to-month consumer confidence, unemployment or any other housing sales, they are fluctuating a lot. That is new information coming to us in the term of assessing the global scenario. So this is something we have been doing internally for ever since I have been here. We have been doing it internally on six weeks cycles and we feel that it makes sense to, since we are going through this exercise internally, that it's just one step further to sort of communicate this assessment and actions there are in policy statement. On the second question very important, when you move from the reverse repo to the repo as the operating rate then raising the reverse repo is not incentivising because there is no surplus to be invested. So it is not an incentive it is not a contradictory signal. It is attempt to try and push the operating rate closer on the top and vice versa; so let us say this year we are in expansionary mode, we would look at going the offset. We want the system to come back to reverse repo, we want to put more liquidity in the system . So that's the way it works.

Alpana Killawala Mellissa any question from your side?

Moderator Participants who have a question may press * and 1 on the touchtone telephone.

Alpana Killawala Okay we will take question from Bombay in the meanwhile.

Anirudh RBI was supposed to come out with licenses, guidelines for new licenses for banks, some time at the end of this month so just wanted get a sense from you, is this on the track and what could we expect from it if at all?

D Subbarao Yes the discussion paper is on track. We expect to put it on at the end of this month or shortly thereafter in the first week of August. And there have been a number of issues that have come out about what should be the entry level capital, what should be the promoters capital, what should be the dilution norms? Whether we should allow corporates to come in? Whether we should allowed NBFCs to come in automatically? So on all these issues we will marshal international experience. We will marshal our own experience and that discussion paper will contain all of that and thereafter we will ask for the feedback.

Jitesh Just a follow up question that…Jitesh here. There is a follow up question on that. There are already some corporates or some NBFCs or institutions kind of shown interest for the banking license to RBI.

D. Subbarao Yes Jitesh there are some people who have come and talked to us but that is very-very informal and that does not matter at all for the formal process that we will initiate.

Jitesh So this paper will be put on the website for a discussion of the comments and then the final guidelines will be adopted right?

D. Subbarao That is correct.

Jitesh So what will be the timeline when the final guidelines will get?

D. Subbarao It is difficult to say at this point of time. It depends on what sort of feedback we get, how complex the issues are and how much disagreement there might be. In most of the big issues if there is an agreement and there is not much of a difference of opinion, it is easier then and the process might be faster.

Participant Governor, there has been the demand in the banking industry for the recast of the aviation loans . They have been saying that the sector is particularly facing stress . So just want to get the RBI stand on considering that sort of sector specific exemption for banks to be able to recast these loans.

D. Subbarao Yes I will say something and then I will request Usha to see what she has to add to that. See, there is one airline which approached us for some adjustments and we said that it is not RBI's policy to address issues on company to company basis or indeed what you said sector by sector basis. However, then we realized and banks have told us and airlines have told us that this is a sector issue. And that there is a problem of maintaining the payment schedules for the entire industry. We have also been told that this is the world wide phenomena and not unique to India and that unless there is some forebearence given by the Reserve bank, we will make our airline industry competitive vis a vis rest of the world so there are all these kind of issues that is why Deputy Governor Usha had a meeting with the banks and then she will tell you about that.

Usha Thorat Basically, since the time this consortium arrangements **evolved and dissipated**, there have been multiple banking. In the airline industry too, there have been a number of bankers which are really lend to the airline sector. So when the bankers met us to look at the way which this airlines sector could be supported firstly we said that the individual companies you cannot look at specifically. Given if at all we have to look at the sector even that we will not inclined as Governor explained first. But soon we rectified that as there are several issues that affected this particular sector. We said you could look at the problem as long as the bankers sort of came together as a consortium and took a long term view and took a holistic view. Because there was no point in doing any kind of piece-meal thing. This will have to be something that is sustainable and with the correct governance and other conditions put in to it. So, so far we yet to get from them.

Participant Are they supposed to put it in a proposal?

Usha Thorat Yes, they are supposed to come to us.

Participant And if you consider sector specific demand do you fear that another sector that has strained by big-time losses…

Usha Thorat Well it depends on the specific issues which have led to this problem. In the airlines industry as it stated world over there is number of issues it is not just one issue. There were the ATF entities, there was traffic going down. There were a lot of issues which came in simultaneously.

Participant So if the banks will come back to you with the revival package are you open to…

Usha Thorat Yes, when they come to us then we will look at what is the exactly the package they have come up with and then we will take a view on that.

Participant So basically ask you for extension and rescheduling**.**

Usha Thorat Let us see. Let them come together as a the consortium. When they will come certainly we would like to see that all interest are protected not the case that whatever would need to be done we will definitely do that.

Participant What is the government stand on this?

Usha Thorat No this is a really a regulatory norm so we have to decide.

Participant So government has currently approach the….

Usha Thorat See government because of the one of the companies is the government company so whatever is the principles and norms that we draw; it will have to be adhere to by the owner whichever they are.

Participant So if you can package is viable for the banks, you will.

Usha Thorat If the package is viable for the bank and if it is something that is in **consonance with the prudence** and in the interest of the banking system definitely we would like to pay attention to it. Basically we told them that you come together, form a consortium that is very important.

Participant Sir you mentioned in the report that some of these sectors are facing capacity constraint or they are close to that peak. So could we get some details as in which are those sectors or which are the sectors seeing this more and could it actually require another CAPEX Cycle in the coming period.

Subir Gokarn This is not a very sort of firm picture. It is based on anecdotes discussions we have with industry representatives and also what we are reading in the media but clearly auto is one where you have a significant capacity constraint and some of the engineering industries. Now whether it is a beginning of a new CAPEX cycle, I think you have to look at it from two perspectives, one is the strongest driver of the IIP has been the captive goods segments so that will reflect that a lot of the CAPEX program that were in the pipeline before the slow down started seemed to be back on the track and people are expanding. This is actually a good news from inflation management perspective because you are essentially saying that new capacities are coming in even as these old capacities are seeing some constraints. The other part of it is the global capacity. Now many of these products and not cars specifically but the inputs are good such as much metals or plastics or rubber there is a global capacity and if there is global excess capacities and that is going to shape the thinking on optimal capacity installation, new investments by Indian producers. So I think we have to balance out these four factors and the fact that we have global excess capacities in the light of apparent sort of sluggishness of the global recovery is actually good from an inflation management perspective. It could have risk on the other side but from the point of keeping prices on the check, it is helpful.

Speaker We can have last two questions one from Neha Arora, Delhi and then Gopika last. Yes Melissa.

Moderator Neha Arora from News Wire 18, please go ahead.

Neha Arora This question is for the governor. I would like to know what the RBI position is on raising the FII limits in corporate bond and gilts given the uncertain outlook on the capital flows sir?

D. Subbarao The limit at the moment is 5 billion for G-Secs and 15 billion for corporate debt. I do not have the latest numbers but there is still some gap left there and not so far utilized. Raising this limit will always on the card sometime but it is not the case that we are considering an immediate raise and have to manage the external sector because getting FIIs in sovereign debt has both cost and benefits and has financial stability is an issue. So we will study all of them and I want to say that that will not something that is on our immediate policy agenda.

Gopika My question is actually directed to Dr. Chakraborty and Madam Thorat. This is a three part question. Has Reserve Bank done a review of the base rate implementation and secondly have we taken a view on the sunset clause when will it be introduced and finally is effective monitory transmission actually possible under the base rate regime considering that most bankers are of the view that they are not going to the increase the lending rate soon we are looking at the lag even under the base rate regime?

Usha Thorat **On** implementation what we have said is there is a fair conversions the way banks have announced it. Everybody is still finding their way in this so I think implementation is something today nobody is wearing the base rate so to that extent that will be implemented and the implementation issue are really each bank trying to see whether the benchmark that they have chosen and the really in which they have raised an issue that is working out going forward so I think it will take a little bit of time to see for each matter I said for itself whether they have got it right. It will take time. Second the sunset clause. There was a discussion about the sunset clause in the meeting with bankers. It is a question of, a resolve the issue of floating rates which is based on the BPLR and you have to give that for a fairly long time but when he has a 15 years loan and keep announcing a BPLR and he also simultaneously announce the base rate. What we have said is that because this are all based on existing contracts we have said that it will be decided. But there was a feeling that when the regulator came with some kind of an equivalence measure or to say that this could be subsume into the base rate then this is something that would be considered. Our response was that legally whatever you do, whenever you alter a contract it is something that should not be to the detriment of the customer. So it is written their parameters that there is something that we can legally can explore and it is something that we will do and are examining it. As far as effective threat of the transmission is concerned this again is something that banks did mention and as Governor himself said currently banks are taking the average cost of deposits so if you take the average cost of deposits and they have not increased deposit rates but even if they do for a marginal impact and the average will expand so there would be a lag. But there could be banks which are using a different kind of a benchmark. So definitely, the transmission mechanism using the kind of transparent benchmark will be more but how quick the transmission mechanism will work will again depend on how banks start actually responding to the changes. Also we have moved from very statistical rule to a different thing. I think this will also be getting the banks for being on there in near term.

Subir Gokarn Yes I think the idea of the base rate from a transmission perspective was to bring some transparency into the process so that we know that banks are, and we can see banks responding to changes in the policy rate whether up or down because if they cannot lend below the base rate then they have to adjust the base rate to reflect the underlying cost of funds that was the only division. Now when you say that the banks are telling you that they are not going to raise rate it is really a reflection of what I said in response to the earlier question which is so far we are in the process of moving from a surplus liquidity scenario in which the cost of funds is not terribly sensitive to policy action to now up a more constrainted liquidity scenario and along with that we are also moving from a regime at which the credit has been growing somewhat selectively to a regime in which credit was start to grow on a more broader base. When you put the two together it highly unlikely that bankers will not raise rate as their cost of funds are going up because it would just be bad business to do that. So I think the statement by bankers in terms of their unwillingness or their willingness not to raise rates has to be seen in the context of this gap that this is the closing gap right now. Liquidity is becoming tighter and credit is starting to grow faster. Both of these will bring pressure on banks to raise rates and that is the expectation that we have as we go into the next quarter.

Speaker The very last question from Ulga.

Ulga Sir you had mentioned that as a young boy the monsoon played a factor in your life what percentage of the monsoon would affect inflation today. I mean on what percentage would you based your hope on inflation coming down?

D. Subbarao Now food inflation has come down from about 21% to the highest of about 10.4% now but as I said non-food contribution to inflation is say over 70% so 30% of inflation is still driven by food prices and to the extent that monsoon is good, that the rising agriculture prospects will have an impact on industry and service sectors we should see that in fact more than 30% impact on inflation.

Ulga Even you raised your rates to 75 basis points and yet manufacturing cost have been going up so what is the problem?

D. Subbarao That is what we have been discussing you know in our meeting with banks in a meeting today that because of the easy liquidity situation, because of there has not been enough credit demands banks have not been able to raise their lending rates. But going forward I think the transmission is going to take place and it is going to be more effective. It is not that as of now transmission is taking place, it has but it will be more effective on the way forward. So with that question thank you very much for your attention.