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

October 30, 2013

SPEAKERS FROM RBI:

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Moderator: Ladies and Gentlemen, Good Day and welcome to the Reserve Bank of India Post-Policy Conference Call for Researchers and Analysts. As a reminder, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' followed by '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Ms. Alpana Killawala from RBI. Thank you. And over to you, ma'am.

Alpana Killawala: Thank you very much. Welcome to this Post Policy Researchers and Analysts Conference. We can start right away. Governor.

Dr. Raghuram Rajan: Let me say that well, thanks for anybody who is joining at this point. We announced our monetary policy yesterday. The aim of the policy as we said yesterday is to bring inflation under control, recognising that both Wholesale Price Index as well as the Consumer Price Index inflation are higher than we would want them to be at this point and there are inflationary pressures from a variety of sources in the system. Having said that we also recognise that the economy's growth at this point is weak and probably below potential, the output gap is probably negative and therefore we have to keep in mind that there are disinflationary forces also in place from the state of the economy. The interest rate structure that we have in place, we think at this point is consistent with the condition of the economy and is at a level which will help us fight inflationary pressures. Of course, we will watch for incoming data and take action as necessary to the extent that data are stronger than what we anticipate both in terms of growth or in terms of higher inflation we will have to take action vice versa if it is weaker but at this point we think that our interest rate policy is consistent with what we project outcomes to be.

Let me also say that we took a number of other measures that was stated in the policy, some small, some larger, some statements of intent. I am sure if you get a chance you will read through the policy. And with that as preamble perhaps we can move to questions.

Moderator: Thank you very much sir. Participants, we will now begin with the question-and-answer session. We have the first question from the line of Deepali Bhargav from Espirito Santo. Please go ahead.

Deepali Bhargav: I have two questions. What in your view would govern the shift from MSF to repo rate on a sustainable basis? Term repos would help, but on a sustainable basis, is it a pick-up in deposit growth or the moderation inflation or the mix of factors? And my second question is on the risks that you have seen to the current macro outlook. And in this context, are we any better placed to contain the volatility that maybe associated with the Fed tapering?

Dr. Raghuram Rajan: To your first question, when would be repo rate become the operational rate. I think as you correctly surmise it is a question of there being adequate liquidity in the system. Because clearly once there is adequate liquidity, the price of money in some sense will move down from the MSF to the repo very quickly. Now, at this point, the system is still borrowing from the MSF window which means that the term repos are priced close to the MSF window rate and therefore the rate is still higher than the repo rate. Now, the timeframe we have for that coming down is not determined as much by monetary policy as by the concerns about the external sector and making sure that the external sector is fully in balance as we bring down that rate finally to the repo rate. So, I would not say the timeframe is of the order of quarters which would be that consistent with monetary policy, but it is shorter than that. There are a variety of instruments we have. But there are a variety of market forces that can also add liquidity to the system. I mean, just one example, government spending if that picks up, that would certainly add liquidity to system, but of course, other instruments like OMOs and deposit growth would also help. But, let me not give you a precise timeframe. We are watching the exchange market. As I said, we will feel fully confident that the exchange market is working as normal when we have brought back both the oil demand on to that market but also any flows we should direct into the market rather than away from the market into a corpus and the pace of normalization will be steady but my sense is we will be fully comfortable when all that is back in the market.

Let me just address the second question which is “Are we in a better position?” Yes, I think we are in a better position to face tapering as and when it occurs for two reasons. One, the current account deficit. both the RBI and the government have spent a fair amount of time trying to narrow it. I think we will be in a more comfortable position. As you know the government said the current account deficit would be 70 billion in August, now a number of analysts are saying it could be even smaller than that, of the order of the low 3s in terms of percentage of GDP for the current account deficit. So that I think will help us. But also I think we have shown the capacity of the system to raise money if need be. As of yesterday the FCNR(B) deposits plus capital raising by the banks had reached 12 billion but the point more generally is that international markets are open to borrowers in India and I think we have shown that whatever current account deficit is we can finance it if necessary from outside money. We have also had substantial equity inflows. Again, I do not want to be too complacent about any kind of flows because what comes in can go out, but nevertheless I think that the picture has changed little from what it was in May when our current account deficit was blowing out and there was a lot of concern about it.

Moderator: Thank you. The next question is from the line of Simon Flint from Dymon Asia. Please go ahead.

Simon Flint: If I may ask Dr. Rajan, I wanted to know your opinion of interest rates moving in general, I mean, in a sense used by Woodford, Goodhart and others in central banking literature. And how might one apply the intuition of this interest rates smoothing literature to the current Indian situation?

Dr. Raghuram Rajan: You need to be more explicit, what do you have in mind, what do you mean by interest rates smoothing?

Simon Flint: I suppose if there was a model which told you interest rates should be at an X per cent. And that X per cent could be 100 or 200 basis points above the current or below the current interest rate. You might want to move less than that the model told you to move, maybe for two or three reasons. First of all, there is some uncertainty in your forecast; maybe you think there is something inherently good about having a kind of predictable path on the interest rates. And thirdly and finally, maybe you want to minimize financial market volatility that might be inherent in having interest rate which responds relatively strictly to model. That was the kind of thing I was driving at.

Dr. Raghuram Rajan: I think that is a reasonable question. I think another way of asking the question is whether we have a path of interest rates in mind having started on a process. And the answer to that is no, that it is not that we are trying to take baby steps towards some longer-term interest rate goal we have in mind. I would say a better way of describing what we are doing is Brainard, saying that when there is a lot of uncertainty, you may move a little less than what everybody thinks maybe necessary while you see what is happening and also because there are forces that you cannot quite estimate which may come in and help or hinder your efforts. So to point to some of the forces that might be disinflationary. By most counts we have a negative output gap now and we can see for example, the rural wage growth has come down substantially. Rural wage growth coming down substantially could be an example of disinflationary process underway. And so, with some of the effects of the monsoon coming in and hopefully certain food prices not all, coming down, we would rather wait and see how these forces play out, especially given the weak state of the economy before deciding on further steps. So as I said we have a sense that some of this will help and it will help achieve our inflation goals and obviously, given the state of the economy we think these disinflationary forces are underway. But we are in wait and watch mode. So I would not say that we have a set of rate hikes in mind and we are taking small steps towards that goal. I would say more that we think we have done enough given what we know about the economy to wait and watch and see what happens.

Moderator: Thank you. The next question is from the line of Badri Nivas from Citibank. Please go ahead.

Badri Nivas: I have to ask two questions; one is on the repo as the operating rate. But you have now mentioned in the current policy that normalcy is restored. So based on yesterday’s action, is it your expectation that repo will become the operational run rate very shortly? And as the term LAF rate comes much higher than repo for whatever reasons and short tenor rates get anchored to the higher term LAF rate, would that belie your expectations? A related question is on the system liquidity deficit. Earlier, RBI had mentioned their comfort level is (-1%) of NDTL, and if the deficit persists beyond that level, RBI used OMOs. Now, the deficit is about 1.5% which you are financing equally through LAF, refinance, term LAF, etc. Where would you define as a new RBI threshold on liquidity deficit and if the deficit is above that comfort level would you prefer infusing liquidity through term LAF or use OMOs?

Dr. Raghuram Rajan: I think at this point given where we are, we are looking more at the prevailing interest rate rather than the quantity of liquidity out there. Because a new channel has opened up, as you recognise the export refinance channel as a source of liquidity. So natural fact we are giving about 1% at the LAF rate through both the LAF window as well as the export refinance and it is the additional that is being kicked over into the term repo and eventually into the MSF. There is a whole lot of liquidity that the RBI is providing now. What we would like to see over time and we talked before this about the horizon what we would like to see is the operational rate come down to the LAF rate, and at that point we will take a call on how much liquidity we feel comfortable with in the system. There is I would say a definite view in the RBI that we should be careful about letting the system rely too much on borrowing from the RBI to fund activities. These windows should be not permanent windows at any permanent level, but rather temporary windows for emergency liquidity. By setting a level and having people borrow that much for long periods of time we are encouraging reliance on the central bank rather than going out and raising liquidity directly from the markets, and that to my mind is not a situation which is long-term tenable. In the short run we are not worrying that much about that. We are really focused on getting interest rates back to normal but as I said there is a process by which we will get it back to normal.

Badri Nivas: And on the point about if the deficit is above your comfort level, would you prefer term LAF or OMOs?

Dr. Raghuram Rajan: As of now I am not focusing on a level for the deficit that is comfortable. I think that is a decision we will take beyond when we get interest rates back to normal.

Moderator: Thank you. The next question is from the line of Srinivas Varadarajan from Mount Nathan Capital Management. Please go ahead.

Srinivas Varadarajan: I have just two questions. The first one is you really talk about the state of the economy as a source of disinflation, which actually was an input in your rate calibration of 25 basis points instead of 50 basis points. As I feel one of the state of the economy is also very high inflation expectations. As per your own September survey three-month and one-year forward inflation expectations have gone to 13% handle from 12%. And embedded in this is also the fact that potential output is somewhere in the region of 6-6.5% and rightly so given that you have a saving rate of 30%, acceptable CAD of 2% and ICOR of 5%. So while there is a negative output gap right now we could actually very soon be steering into overheating risks. Over the medium again if one considers, takes into account the impact of surplus income on the beneficiaries of the Food Security Act what kind of impact it would have on inflation? Then the worry really for an external investor is that with inflation expectation of 13%, what is the probability that this ratchets up much higher to around 20% and the economy might actually see a Volcker-like policy? That is the first question. And the second one is was it really an optimal strategy in normalizing monetary policy without bringing oil demand back into the market?

Dr. Raghuram Rajan: First on whether we will have to go into a Volcker-like policy at some point, I hope we do not have to go there where we certainly have to ratchet up to 18-20% interest rates. But if there is a necessity given inflation is blowing out, the Indian public has a very low tolerance for high sustained levels of inflation and so we will have to act at that point. But our estimate at this point is that we are some distance away from any such situation. You mentioned the Food Security Bill. It does sound like an awful lot of food is going to be given away at relatively low prices, but if you look at the Food Security Bill when it is rolled out fully most reasonable estimates of how much it will cost will be in the order of Rs. 1.5 lakh crores and translating that it is 1.5% of GDP and currently, the spending on food is approximately 1% of GDP. So when the Food Security bill is fully rolled out, that will be a 0.5 percentage point of GDP addition. And if sensible economics plays out the spending on fuel subsidies would be reduced by that much by the time the Food Security Bill is fully rolled out. As you know there are baby steps being taken every month on diesel and I am hopeful that a bigger step will be taken when the political opportunity arises. But every rupee that diesel prices are increased saves slightly less than 0.1% of GDP, and therefore if diesel prices are brought fully to the market it would compensate for the increase in food subsidies. That said I do not want to sound complacent. Again I think we have taken steps. The problem in India to some extent is that the manufacturing sector is seeing very low price increases and so the effective real interest rate that they face given the levels to which we have increased rates are quite high while the consumer sector of course is experiencing high consumer price inflation in which services play a bigger role and therefore the real rates that they see are relatively low. And to some extent we have to work with this kind of dual economy in bringing down inflation. I think as I said before disinflationary processes are underway and there is a possibility of greater food production which will tackle one of the biggest causes of inflation. So I do not think we are at the 18-20% possibility, I do not think there is a high probability, but nevertheless if it does happen we will have to deal with it. On the oil demand, I have said repeatedly that we will normalize fully when we have brought oil demand back on market and clearly we have that in mind. Yes, we are seized of the matter.

Moderator: The next question from the line of Jayesh Kumar from Kotak Securities. Please go ahead.

Jayesh Kumar: The question is you mentioned that RBI is not very comfortable with giving regular liquidity through LAF window to the banks. So if suppose in future, banks have less reliance on LAF, then how would the market per se actually act?

Dr. Raghuram Rajan: You are assuming that they will have no resort to the LAF at all. I think that is unlikely. But let me ask Dr. Urjit Patel to give you a fuller answer on that.

Dr. Urjit Patel: The issue is that LAF is a facility that the banks should be using as a resort to moderating their daily fluctuations of liquidity requirements rather than a window where they should be borrowing every day in large amounts. The chances of no one resorting to the LAF window when at present if you combine the three; the term, the overnight and the ECR is of the order of Rs. 1,20,000-1,30,000 crores, 1.5% of NDTL is unlikely, and I think we would have a different set of problems if people stop resorting to the LAF. And that would probably mean that there is a time to reduce interest rates if you are saying that at a certain interest rate people are unlikely to come to the LAF. So that would send us a signal to retune our monetary and liquidity position.

Moderator: We have the next question from the line of Abhishek Gupta from Bank of America Merrill Lynch. Please go ahead.

Abhishek Gupta: I would like to follow up on the earlier questions regarding the anchoring of call money market rates to the repo rate or the MSF rate. If you look at the liquidity deficit in the money market right now, it stands close to 1.1 trillion and you are currently offering about 80,000 crores at the repo rate and yesterday you increased the cap on variable term repo to 40,000 crores. So this adds up to that 1.2 trillion of liquidity. So does this basically imply that going forward the call money market rate should be anchored within a week's time to the repo rate, and if again the liquidity deficit increases beyond 1.2 trillion, then that would mean that the call money rates would actually increase? So are you comfortable with this fluctuation in the call money market rates between the repo rate and the MSF rate? Could you throw some light on this?

Dr. Raghuram Rajan: I am not sure, we have to see how this works. But I am not sure that as soon as the liquidity is enough that nobody resorts to the MSF window, that immediately the rate will fall to the LAF rate. There is 100 basis points between the two, and there is 40,000 crores of term repo which is bridging the gap between the two. So my sense is that when people bid for the term repo, they will bid something in between the LAF and the MSF rate, but the closer the liquidity demand in the system is to 40,000 crores of term repo, the closer will the term repo rate get to the MSF rate and vice versa. It may be more sort of volatile than that, it may not be as smooth and it may be a very competitive market in which as soon as you have enough liquidity that you do not have to resort to the MSF window, it drops sharply to the LAF window. We have to wait and see how this works, but let us see once we get to a situation of excess liquidity. It is not entirely out of the realm of possibility, but it is not entirely also something that would be very problematic if in fact there is a sharper movement downwards. The point however is this 40,000 crores gap between one and the other and so I do not expect things to fluctuate that much on a daily basis or the interest rate to fluctuate that much because the interest rate will fall within that gap.

Abhishek Gupta: A related question, in case you see the interest rates fluctuating and the liquidity moving around 1.2 trillion which is in a border line scenario, in that case would you want to move in and provide permanent liquidity through an OMO so that to anchor the rate either to the repo or to the MSF?

Dr. Raghuram Rajan: This is a hypothetical question, and it really depends on a) the liquidity reaching that border exactly; and b) that condition of reaching the border rates fluctuate a huge amount, both of which we have to wait and see when that happens. When it does reach that depending on conditions in the market, we may decide that LAF is the appropriate rate at that point and then try and anchor closer to LAF. So I cannot give you a conditional statement right now. We have to wait and see. Of course open market operations are a way for us to inject liquidity into the system, but at this point I do not want to predict what we will do.

Moderator: We have the next question from the line of Kanika Pasricha from ICICI Bank. Please go ahead.

Kanika Pasricha: My question is that RBI in its macro report has indicated that sustained wage increases have fed into generalized inflation levels in the economy. Also in the policy statement the RBI asserted about the need to break the spiral of price pressure in the economy. So wanted your perspective on how interest rates hikes will be able to break this wage price spiral prevailing in the economy?

Dr. Raghuram Rajan: I hope you are not asking me for an entire discourse on how interest rates can affect activity and how activity feeds into expectations. But I think your question is about what channels are working at this point and how we think it could feed into activity. And to some extent this reflects the kind of situation we are in. Clearly, we have fairly slow growth and we are trying in this environment of fairly slow growth to bring down inflation and so there will be a certain amount of damage that interest rates do to activity including whether it is borrowing to buy or borrowing to invest. So interest rates work through that channel as you well know, and there will be a little bit of that going on. But also to the extent that savings look more attractive with higher interest rates, there will be a certain amount of willingness to postpone consumption in case savings rates are higher. And so those would be two channels in which activity or demand would be affected and that would help slow down inflation. And of course to the extent that we can convince market participants that we are serious about fighting inflation, that over time will help quell inflationary expectations. Of course, the key question that you, I, everybody has is, how well do these interest rates hike feed into expectations? What are the channels through which they feed into expectations in India and that is something we have to watch and see. Clearly, across the world there are channels through which this happens and I do not think India is unique in that these channels are not at work. But we have to wait and see how fast and how much it feeds into inflationary expectations. But the demand channel would surely be part of what happens.

Kanika Pasricha: Sir, just an additional perspective that I wanted from you, is it that in India the wage price spiral that we are witnessing and it is getting difficult to break is partly contributed by the fact that wages, especially for NREGA are linked to CPI-agricultural labourers, there is the dearness allowance of public sector employees linked to CPI industrial workers and there is a pay commission every 5 years. So all these measures are linked to inflation measures which have a very high rate of food and hence are prone to price shocks and concomitantly resulting in a wage-price spiral which is being difficult to break through interest rate hikes?

Dr. Raghuram Rajan: There is some of that, but not all wages are indexed in India, a lot of private sector wages are not necessarily indexed to inflation. Of course, there are clearly minimum wages and so on but the privately contracted wages may differ from them. So to that extent some of the wages will respond to inflation and not simply be indexed upwards to it. There is a lot of worry about NREGA, the rural employment generation program as being one of the most important drivers in rural wage growth. And it clearly plays some role, but careful studies that I have seen say it probably accounts for 0.1% or 0.2%. I should say 10 or 20% of rural wage growth, it is too small a program to be a credible factor in explaining all of rural wage growth and rural prosperity, the high minimum support prices, but also the enormous amount of rural construction or construction across the country which relies on rural labour migrating, and also the rural prosperity coming from land sales and so on, all these I think help account for strong rural wage growth. But as I said, even rural wage growth is now just keeping pace with inflation, and there is hope that it will come down further at least the path, the momentum is downwards, and that should help contain some of the inflation we see.

Kanika Pasricha: And just one last question, one more perspective on the fact that in India, after the shock in 2009, inflationary expectations have turned sticky, and they have not responded to any interest rate changes. So how do you think interest rate hikes at this juncture will be able to feed in the form of a decline in inflationary expectations?

Dr. Raghuram Rajan: It is harder, but remember that post-2009 we had very strong growth, but we also had substantial increases in minimum support prices in rural areas, we had the strengthening of NREGA which you pointed out to. So a whole bunch of forces have been there to hold up food prices and broadly to support inflation over this time. So, when people say interest rates had no effect on inflation, it is not clear what the counterfactual is. If you had lower interest rates would inflation have been the same or would it have been higher still. So in an environment when there are forces that are inflationary, I do not think it is fair to say just looking at the graph that the interest rates had no effect on inflation. So, again I mentioned early on in my opening that because the economy has weakened considerably since then, there are likely disinflationary forces, people are losing jobs, there are people without work, this is having an impact on private sector wages, and this is starting at this point and will spread. So to some extent there will be disinflationary forces, but we have to be careful at the same time we do not overdo it. Let me end with this very quickly, the part of what we have to ensure is the supply side also starts kicking in, in a number of areas and expands the productive capacity of the economy. We cannot entirely eliminate demand and expect supply to come up autonomously. You need to preserve enough demand for supply to also start showing up, and therefore it is a very, very balanced path that we have to follow.

Moderator: Thank you. We have the next question from the line of Samir Lodha from QuantArt. Please go ahead.

Samir Lodha: I have two questions; one is, where do you think is the fair value of dollar/rupee, which can balance the current account deficit, the inflation, and the capital flow at this stage? And second question is inspite of the direct FX to oil companies and no tapering talk for some time, we are still at 61 level. What if the tapering talk comes back in three months' time and so what would be the RBI's preferred method of combating? Will it be further hike in interest rate or use of FX reserves, or swaps? As you rightly noted that the concern of growth is showing everywhere, and will you be comfortable with further rate hike?

Dr. Raghuram Rajan: Let me just quickly say that we do not have a value of the rupee in mind. I think there are so many forces at play that it would be very hard for me to say this is the value and stick to it. But that said, let me ask Mr. Deepak Mohanty to perhaps answer the rest of your question.

Shri Deepak Mohanty: As was earlier mentioned by Governor, because the current account itself is also coming down to more sustainable levels, the way that we see it, and with the outlook on the economy also improving, that we can see that capital flows could also hold on. Because we see that other component of capital flow except the debt flows are normal or near normal, only the pressure is coming more on the debt side. But we have taken steps on that side, because in terms of the NRI deposits that we have a swap window open and we are getting substantial flows. So as long as the current account can be financed with the normal capital flows, so there should be more stability in the exchange rate, but at the same time as Governor mentioned that we do not have a value for exchange rate, that what is the number that one is really targeting at.

Dr. Raghuram Rajan: As far as tapering goes, we will figure out what we need to do based on the events at that point. Let me just say that as I remarked on a previous question, we are in a much better position to face up to tapering and I would hope that the volatility would be lower, but we are prepared for any eventuality.

Moderator: We have the next question from the line of Prasanna Ananthasubramanian from ICICI Securities. Please go ahead.

P. Ananthasubramanian: My question is about, I think there has been a lot of reference to real rates and boosting financial saving both in the MMD and in your policy. I just wanted a clarification whether you are possibly referring to real rates offered by bank deposits, are you implying that a real policy rate would also have to turn positive? And on a related note, if the government is able to borrow at negative real rates in the bond market, do you think that is part of the problem, that perhaps banks and insurance firms should demand higher real rates from government in order to provide positive real rates to depositors?

Dr. Raghuram Rajan: Let me just say that the inflation expectations we have are not really long-term inflation expectations, so we cannot really say the real rates are negative until you have expectation over very long terms commensurate with the security, but let me turn it over to Dr. Michael Patra.

Dr. M. D. Patra: As Governor mentioned, the inflation expectations are partly adaptive, so you must factor in that while assessing the level of the interest rate. Yes, we do need to increase financial savings in the economy, and that will provide resources for investment. Yes, we are looking at real interest rates for savers, and for other instruments of financial savings.

Moderator: We have the next question from the line of Sonal Varma from Nomura. Please go ahead.

Sonal Varma: I am just trying to understand the objective of the rate hikes that the RBI has done in September and yesterday. If the objective is positive real rate of return for savers then deposit rate is 8.5 and CPI is at 10. So there is actually a significant gap that has to be bridged. Earlier on you mentioned that the RBI thinks they have done enough to wait and watch. So why are we sounding so neutral on rates?

Dr. Raghuram Rajan: I think you had a pretty good commentary on what we were trying to do. I think to some extent as I just said, you do not have to look at the instantaneous inflation and what the deposit rate is today. I mean today we can get 9% for any money over one year and some banks it is 9.5, there are tax-free bonds which are selling at 8.9. Variety of interest rates out there, and if you look, you can get interest rates which would take you into the low-9s, and of course inflation is 9.8 according to the latest combined, but we expect that that would probably fall a little bit with the policy measures that we have taken. And this is what I said about Brainard and so on, we have to see what the extent of the disinflationary forces are, and how they play out. So what I said yesterday, I will say again today, let us watch the data and see how they come in. We expect some fall in inflation over the next few months as the monsoon and its effects kick in. If that does not happen, then we have to take a fresh call.

Sonal Varma: Sir, also on inflation expectations, they have been sticky and we know supply side shocks and the constraints are a reality in India. So, without a growth sacrifice how does the RBI expect inflationary expectations to actually come down in this environment?

Dr. Raghuram Rajan: There is some growth sacrifice already, right, and there may be more of a growth sacrifice, we are getting calls from left, front, and center about the damage we are doing to growth. So, I do not think it is fair to say there is no growth sacrifice even now and as a result of the rate hikes there will be no additional growth sacrifice. But, what I think we are saying is that given the potential growth and depends on what you think potential growth is, as you know typical estimates out there are very much influenced by what recent growth has been rather than any bottom up view of what potential growth is. If the supply bottlenecks are solved, for example, could potential growth be higher than what is currently estimated. So, the hope is that these disinflationary forces from lower growth relative to potential and the negative output gap basically help in reducing inflation; second, that reduction in food prices or a softening in food price inflation given the importance of food in consumer baskets and given the salience of food could help dislodge inflationary expectations from the high level and these two I think could help significantly over the next few months and that is why given that some of these events may be near-term, I think we are saying let us wait and watch. If we tighten significantly more now given the long lead times in monetary policy acting, we may find ourselves having overtightened and we do not want to go there with a weak economy. So let us see, some of the forces I have talked about should be playing out over the next few months. We will take a view as soon as we see data coming in.

Sonal Varma: Dr. Rajan, just wanted to confirm that the intention is still to make repo the operative rate and that overnight ranging between repo and MSF is not a new regime?

Dr. Raghuram Rajan: I think the answer is yes, the intention is to make the repo the operational rate. Now the overnight may be a little above that, but the idea is pretty close to the repo.

Moderator: All right, we will take the last question from the line of Samiran Chakraborty from Standard Chartered. Please go ahead.

Samiran Chakraborty: My question is on the global bond index inclusion. One of the considerations that we have heard is about the limit increase for FIIs. I would like to know your thoughts on what you think could be the challenges in increasing that limit?

Dr. Raghuram Rajan: Let me ask Deputy Governor Khan to speak on that.

Shri H. R. Khan: Governor has also said this in press conference yesterday, that there has to be matching of our comfort level with bond index comfort level and we still have to take a calibrated call because in the recent past we have seen when we have opened up more towards the debt segment maximum heat has come from debt segment, outflows have been very large, and a lot of volatility has been caused because of this debt segment. So we have to take a call how do we move and if we can strike a balance between their requirement of unlimited access and some sense of opening in a calibrated manner with a bias towards long term real money investors, who remain invested on a long term basis rather than getting investor tourists who come and go, I think we could possibly strike a balance. But the discussions are on, and we have to see how do we strike the balance.

Dr. Raghuram Rajan: So, as Mr. Khan said, we not only have to reach our comfort level, but we also have to be able to persuade the broader Indian public that this makes sense, and of course as Mr. Khan said, I think there are rationales which would suggest that the index investor is more stable in a more longer term and we like that. But at the same time we have to find a way to sort of calibrate the opening so we can get more of a stable investor rather than as Mr. Khan said the tourists. We like tourists, but we like real tourists who spend money here, not so much the bond tourists. You asked about costs and benefits, benefits are longer term investors, more liquidity in the bond markets. Costs, I think there are some short term costs, and some longer term issues we have to worry about. Short term costs are that the transition may be a little volatile and we have to anticipate how that happens. Supposing we do get on to the index, the index flows will take some time coming, but there will be pre-positioning before those index flows and how that plays out is something we have to consider. There is also the longer term which I am firmly convinced that we need to have a bond market which is fully open to the world, so that it is determined, it is deep and liquid, but in the process of getting there, you may have a moderately liquid market which may be more exposed to global forces than you intend. So with a lot of volatility in the world, tapering in the US, eventual tapering in Japan, whether the extent of world volatility will get significantly augmented in markets that are not that liquid. We have already seen a number of emerging markets bond market yields change dramatically as a result of capital outflows. I do not think India was as affected because foreign bond holders are a small portion of the overall market, but we could have been. Now I think that is the price you pay for going towards a more liquid market and we have to get there, but we have to find ways in which we can limit some of those costs while expanding the benefits, that is what the talks are all about, and I am hopeful we would get some resolution at some point.

Samiran Chakraborty: Sir, if I may just ask, are you concerned also about the independence of monetary policy that you might lose because of index inclusion?

Dr. Raghuram Rajan: You are right in one sense that it goes to the point I made earlier that some action in the US will affect bond yields in India considerably because of outflows. But I think we already see some of that effect through the exchange rate because we are totally open on equity. But we do see some equity outflows when those actions take place. So, we are not immune to global capital flows, it is a question of degree rather than whether we are exposed or not. So monetary policy even today has to take into account the effects on global flows and the influences of global flows on monetary policy so that is not the primary concern. I think it is more tactics rather than strategy, if you will.

Dr. Raghuram Rajan: Okay, well, thank you very much everybody. Thank you very much for listening in, and I hope some of your questions have been answered.

Moderator: Thank you Sir. Ladies and gentlemen, on behalf of Reserve Bank of India that concludes this conference call. Thank you for joining us, you may now disconnect your lines.