Interview with The Times of India (as published on June 24, 2022) – Shri Shaktikanta Das, Governor, Reserve Bank of India

Q: What are the risks and opportunities for the Indian economy?

The revival of economic activity continues to be steady and is gaining traction. GDP has exceeded 2019-20 levels, and from April 2022 onwards, many high-frequency indicators that we monitor are showing steady improvement. The economy is back on track. In terms of business activities or investment, the opportunities are larger in pharma, technology, and renewables, etc. The other opportunity for India is to get into the global supply chain – in manufacturing, services and agricultural products in a bigger way.

As far as challenges are concerned, inflation is definitely the biggest challenge confronting most countries. Almost all market economies are confronted with mounting inflation, which is a problem that worries governments and central banks worldwide. The current surge in our inflation is primarily because of global factors. From April onwards we have been taking rate actions to effectively deal with rising inflation

Q: Why did the RBI not hike interest rates earlier?

Unfortunately, quiet steps do not make headlines. Before we increased the repo rate in May and June and the cash reserve ratio in May, we had been taking measures to rebalance liquidity through VRRRs, roll back the expansion of our balance sheet and the liquidity infusion related to the pandemic. In our April 2022 policy, we sent out a clear message by prioritising inflation over growth. We introduced the Standing Deposit Facility at a rate that was 40 basis points (100bps = 1 percentage point) higher than the reverse repo rate. Consequently, the overnight call rate – which is the operating target of monetary policy – moved up in tandem.

In January 2021, we resumed our liquidity management framework, which was kept in abeyance because of the pandemic. We had announced government security acquisition programmes (GSAP and GSAP 2.0) during the pandemic, which we discontinued from October 2021. Advanced economies are still tapering their asset purchase programmes.

The idea behind these steps was to take out liquidity from the system in a very gradual and orderly manner. Unless you take out excess liquidity, overnight call rates will not respond to rate hikes and will remain lower. So, you have to deal with the problem of excess liquidity first.

We are well on track to bring down inflation and inflation expectations. Until December, CPI inflation is expected to remain higher than the upper tolerance level; thereafter it is expected to go below 6% as per our current projections. there will be inflationary pressures, and only in the fourth quarter, we have projected it to go below 6%.

Q: Many people think that inflation is up because of supply side factors and the government should be taking steps to cool prices and RBI's rate hikes will not address the problem.

Supply side factors have driven the current inflation; nonetheless, monetary policy plays an important role when inflation rises. Household inflation expectations are backward-looking. They go by the current state of affairs and look at what it was two or three months earlier and their expectations are accordingly conditioned about future inflation. Inflation expectations influence not only households but also businesses and drive up pricing of food, manufactured goods and services. If they expect inflation to be high, even companies will defer their investment plans.

When the central bank communicates that it is focused on inflation and takes steps in that direction, it gives confidence and a clear message to households and businesses. This will anchor inflation expectations and contain second round effects of supply shocks. Eventually, the core and headline inflation can moderate.

Also, let us not forget the depositors with whose savings the banks function. In an environment of high inflation, if interest rates are kept artificially low, then the real rate of return for the depositors would become that much more negative and if that happens, depositors may turn to other assets like gold. This will impact financial savings and have an immediate impact on investment.

Q: How worried are you that inflation could get entrenched?

When you start worrying, then it affects your actions. Policymakers should always be concerned. And we are keeping a strict vigil. Inflation has now become broad-based and that is the issue which we are now addressing through our actions.

Q: Is there a need to have some sort of flexibility in the band given that the current situation is unprecedented in a way given the inflation levels in developed economies?

The current framework also allows flexibility up to 6%. High inflation hurts people the most, especially the lower segment of society is hit the hardest by inflation. It is desirable that we have a framework and operate within that. RBI's analysis shows that when consumer inflation exceeds 6%, it is negative for growth.

Q: How do you respond to this noise around the rupee that it has collapsed, and the economy is badly hit?

The economy is stable. The macro fundamentals are stable. You have raised the question of the rupee depreciation and capital outflows. We are also dealing with it. But look at why it is happening. Internationally, inflation is rising. In the US CPI inflation is at a four decade high at 8.6%. Even in Europe, inflation is very high in countries like Germany and UK. All over the world, all major economies, particularly the advanced economies, are on a monetary policy tightening mode. They are increasing their rates. In such a situation, there will be outflow of capital from emerging market economies. It is happening across emerging market economies. This is nothing but the spillover of the monetary policy actions in the advanced economies.

I just want to point to two things. First, our forex reserves are quite strong. Our forex reserves are almost two-and-a-half times that of our short-term foreign debt in terms of residual maturity. Second, our macro fundamentals are far better, and India is in a better place than many other economies. Further, India is witnessing revival of growth, which is also steady.

Q: The credit numbers are going up but loans to corporates have shrunk. Are banks becoming too risk averse?

Risk aversion was perhaps seen and felt 6 to 7 years ago, immediately after the NPA numbers soared. After the asset quality review, there was credit aversion because banks had to first focus on improving their balance sheet and on correcting the NPA problem. Over the last five to six years, things have improved and NPAs are at low levels. Banks have taken steps to bring down NPAs and IBC has helped resolve some big-ticket cases. Banks have also raised capital over the last two years. Banks are lending to segments where there is greater demand. Corporate balance sheets are deleveraged, which is a positive for the overall investment prospects. Banks are also doing their due diligence on which sectors they should lend to. There should not be concentration of credit in certain sectors, which can be a potential risk. Compared to the level a year ago, credit growth has picked up and it has now reached about 12%.

Q: Automatic reset of loans is still a concern. How is the RBI going to force banks to do it for the sake of consumers?

Interest rates are deregulated. So, banks decide their deposit and lending rates. What the RBI has done is that we already introduced this external benchmarking for loans, through which monetary policy transmission has been satisfactory. Against a reduction of 250 basis points, starting February 2019, our analysis shows that 232 basis points were transmitted. Now we are increasing the policy rates and banks are also adjusting their lending rates suitably. But it’s not as if the lending rates will all change overnight, because most of the floating rate loans have a fixed reset date. Similarly, on the deposit side also, if you look at May and June, a number of banks have increased their deposit rates. The process has started and with credit offtake now picking up, banks will require deposit flows to carry on with lending activities.

Q: You have set up a new committee on consumer related issues, there have been changes to the ombudsman scheme but there are several instances of mis-selling and other problems with banks. How is the RBI trying to become more consumer-centric in its approach?

We have introduced the integrated ombudsman scheme and from time to time, during our supervision or even otherwise, whenever we find cases of mis-selling going against RBI guidelines, we have been taking action. One thing that has happened over the last 2-3 years is that our supervision has now become much more intense. We have also sensitised banks and advised them to resolve the complaints within 30 days. I have been emphasising a lot on the need for consumer protection. We also felt that time has come to look at some of the systemic issues. Therefore, we formed this committee, which will give us recommendations based on which we will take further steps.

Q: Is it time to look at higher penalties because in a lot of cases we find that the penalty imposed is Rs. 2 lakh, even for things like KYC violation?

The committee will look at such issues. But more than the penalty amount, whether it is a few lakhs or in crores, there is a reputational risk for the banks, NBFCs and the other regulated entities. Second, we are also taking supervisory action, which could be through restriction on their business. That is something which we have started only in the last few years.

Q: On corporate NBFCs, how do you see the evolution path for them for obtaining bank license?

Even now they are eligible, provided they meet the fit-and-proper criteria.

Q: Do you see the current phase and the next few months as the most challenging part of your tenure since you came to Mumbai?

Every day is a new day. Every challenge is important. COVID was definitely a big challenge for every central bank, including the RBI. And, then there is this war in Europe, coming close on the heels of COVID. I can't say whether it's a big challenge or the biggest. Like in cricket, every ball can be different.

Q: Is this a test match or a T20? How will you approach it?

RBI is a continuing organisation. So it can be T20, 50 overs game or a test match. The challenges we face can be short, medium or long term. We will play it as per match requirement. Our endeavour is to remain prepared for all forms of the game.