First Bi-monthly Monetary Policy Statement, 2014-15 Press Statement by the Governor

"Good morning and welcome to the Reserve Bank.

On the basis of an assessment of the current and evolving macroeconomic situation, we have decided today to keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 8.0 per cent. We have also decided to increase the liquidity provided under 7-day and 14-day term repos from 0.5 per cent of net demand and time liabilities (NDTL) of the banking system to 0.75 per cent, and decrease the liquidity provided under overnight repos under the LAF from 0.5 per cent of bank-wise NDTL to 0.25 per cent with immediate effect.

Let me turn to the rationale. Real GDP growth is projected to pick up from a little below 5 per cent in 2013-14 to a range of 5 to 6 per cent in 2014-15 *albeit* with downside risks to the central estimate of 5.5 per cent. Easing of domestic supply bottlenecks and progress on the implementation of stalled projects already cleared should contribute to growth, as will stronger anticipated export growth as the world economy picks up.

For the year as a whole, the CAD is expected to be about 2.0 per cent of GDP. Sustained inflows, augmented by repayments by public sector oil marketing companies of their foreign currency obligations to the Reserve Bank during March, have led to an increase in reserves.

Looking ahead, vegetable prices have entered their seasonal trough and further softening is unlikely. There are also risks to our central forecast of 8 per cent CPI inflation by January 2015. These include a less-than-normal monsoon due to possible *el nino*effects; uncertainty on the setting of minimum support prices for agricultural commodities and the setting of other administered prices, especially of fuel, fertilizer and electricity; the outlook for fiscal policy; geo-political developments and their impact on international commodity prices. There will also be a downward statistical pull on CPI inflation later this year, due to base effects from high inflation during June-November 2013. It is critical to look through any transient effects, including these base effects, which could temporarily soften or harden headline inflation during 2014.

Our policy stance is firmly focused on keeping the economy on a disinflationary glide path that is intended to hit 8 per cent CPI inflation by January 2015 and 6 per cent by January 2016. At the current juncture, it is appropriate to hold the policy rate, while allowing the rate increases undertaken during September 2013 through January 2014 to work their way through the economy. Furthermore, if inflation continues along the intended glide path, further policy tightening in the near term is not anticipated at this juncture.

In pursuance of the Dr. Urjit R. Patel Committee's recommendation to de-emphasise overnight "guaranteed-access" windows for liquidity management and progressively conduct liquidity management through term repos, we have decided to further reduce access to overnight repos under the LAF while compensating fully with a commensurate expansion of the market's access to term repos from the Reserve Bank. The primary objective is to improve the transmission of policy impulses across the interest rate spectrum.

Developmental and Regulatory Policies

We have set out a five-pillar framework to guide the developmental and regulatory policies of the Reserve Bank. I invite you all to go through Part B of the Policy Statement which lays out the developmental and regulatory measures, the progress made and some new initiatives that are being undertaken. Let me highlight a few.

- Some recommendations of Dr. Urjit R. Patel Committee report have been implemented including adoption of the new CPI (combined) as the key measure of inflation, explicit recognition of the glide path for disinflation, transition to a bi-monthly monetary policy cycle, progressive reduction in access to overnight liquidity under the LAF at the fixed repo rate and a corresponding increase in access to liquidity through term repos, and introduction of longer tenor term repos as well as, going forward, term reverse repos.

- Following on the recommendations of the High Level Advisory Committee chaired by Dr. Bimal Jalan, and after consulting the Election Commission, the RBI will announce in-principle approval for new bank licenses. Immediately after, and using the learning from the licensing exercise as well as building on its previously-released discussion paper on banking structure, the Reserve Bank will work to giving licenses more regularly, that is virtually "on-tap". It will also set out categories of differentiated bank licenses that will allow a wider pool of entrants into banking.

Turning to markets

- To expand investor demand for Inflation Indexed Bonds, design changes improving their attractiveness to the general public are being worked out.
- In order to expand the market for corporate bonds, banks will be allowed to offer partial credit enhancements to them.
- The feasibility of limited re-repo/re-hypothecation of "repoed" government securities is being explored.

As regards foreign investors, the Reserve Bank welcomes them and will continue to work to ease entry costs while reducing risk for investors and the volatility of flows. Towards this end

- Modalities allowing Foreign Portfolio Investors to hedge their currency risks through exchange traded currency futures are being worked out in consultation with SEBI.
- FPIs will be allowed to hedge their coupon receipts falling due during next 12 months.
- KYC norms are being simplified for Foreign Portfolio Investors.
- To encourage longer-term flows and reduce volatility, FPI investments in G-Secs will henceforth be permitted only in dated securities of maturity one year and above, and existing investment in T-bills will be allowed to taper off on maturity/sale. Any investment limits vacated at the shorter end will be available at longer maturities, so overall FPI limits will not be diminished.

Turning to inclusion and customer protection,

- To enlarge the Banking Correspondent (BC) base, the inclusion of new entities, as well as a relaxation of existing distance restrictions, is being considered.

A number of measures to protect consumers are being envisaged. For example,

- Banks should not levy penal charges for non-maintenance of minimum balance in ordinary savings bank account and inoperative accounts, but instead curtail the services accorded those accounts until the balance is restored.

Finally, to tackle distress in the system

- The comprehensive framework to help banks reduce their NPAs even while putting distressed projects back on track will be effective from today. We will monitor progress and make any needed adjustments to ensure it operates smoothly.

Finally, I hope the only thing that was surprising about monetary policy today was the lack of surprise. I am glad financial markets and analysts have started understanding what we are doing. Thank you for your attention".