

India Macro Flash

Governor's First Speech Hints at Changes in Monetary Policy Framework

- **No Time for Niceties, Acts with Urgency** — New RBI Governor Raghuram Rajan acted with a sense of urgency on his first day at the job. Many of the measures he announced yesterday were in the works before but, with precise timelines, they appeared as a refreshing change, e.g. Issue of new banking licenses by Jan 2014. The currency received immediate attention with targeted market measures to encourage NRI deposits, e.g. concessions on FX swaps. But more importantly, we see hints of a broader shift in the RBI's operating style on monetary policy in his speech. Note that the RBI will announce its monetary policy statement on 20 September.
- **Committee set up to revisit Monetary Policy Framework** — RBI has set up a committee under Deputy governor Urjit Patel which will submit its recommendations on revision and strengthening of the monetary policy framework in the next three months. Earlier a similar committee was set up in 2011, whose recommendations to make the repo rate as the single policy rate and keeping system liquidity in deficit were largely accepted. The committee will also consider FSLRC recommendations, e.g. setting up a seven-member monetary policy committee and putting quantitative objectives to the RBI.
- **Governor says headline inflation is priority** — Not only did Dr Rajan cite the RBI act of 1934 to emphasize the primary role of the Central Bank as inflation control, but he also interpreted it further as safeguarding the value of Rupee, irrespective of sources of inflation. This significantly dents the importance of core inflation (which strips out the volatile food and fuel component) in the policy formulation exercise.
- **CPI could gain prominence under new governor** — Governor has proposed to issue CPI-linked bonds even though a past RBI technical report (Dec 2010) found the CPI index "impractical to be used in indexation of IIBs". It is not clear if the purpose of CPI linked bonds will be limited to wane away demand from gold and physical assets in the short term, or if it indicates a calibrated push towards increasing focus on this index going forward. Note that, unlike global Central Banks, RBI continues to base its policy largely on WPI. But current CPI has data issues, so it is difficult to envisage an overhaul of the monetary policy's benchmark without an overhaul of the index itself.
- **Summary & Macro Implications** — The first speech had several growth-supportive measures, especially on banking sector reforms, but in no way dilutes RBI's stance on inflation. Even though core inflation has eased considerably to 2.4% and growth remains sub-par, we now expect rate cuts to get delayed further due to (1) diminishing significance of core inflation amid elevated headline inflation (WPI 5.8%, CPI 9.6%), (2) continued pressure on fuel inflation from global oil prices and impending diesel hike and (3) weak INR. We thus do not expect any reduction in repo rates in FY14 as headwinds remain on the exchange rate and inflation fronts.

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With thanks to

Abha Agarwal

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Announced Measures

Figure 1. RBI's List of Measures Announced (Please See Our Banking Team's Report, [A New Mindset](#), for more details)

S. No.	Measure Announced		Previous Status	Timeline	Caveat/ Comment
BIG & NOW					
1	Bank Branch Licensing	Completely freed (with inclusion goals)	Restrictive - RBI approval had to be sought	Immediate	More flexible financial inclusion
2	New Bank Licenses	Committee has been formed under Bimal Jalan	Sluggish - 2 yrs from draft to potential candidates	Jan 2014	Defined, accelerated
3	Further New Bank Licenses	Possible on-tap; conversion of urban cooperative banks; differentiated licenses	Just a policy paper	None	Could substantially expand the banking sector - limit the current premia on new Bank licenses
4	Foreign Owned Banks	Near national treatment for wholly-owned subsidiary structure	Discussion paper	Only few pending issues	Could significantly expand the presence/competition from foreign banks - hitherto constrained
5	SLR Norm	Reduce G-Sec requirement for banks	SLR at 23%; has been declining but very gradually	None	Will be calibrated as Govt. finances improve; would free up BS's but unlikely near term
6	Priority Sector Lending	Adjust to needs of economy - review committee under Nachiket Mor formed	Fairly rigidly defined; consistently missed by several banks	None	More flexibility - less onerous, and potentially more productive
7	Financial Markets	Enhanced exporters re-book limit on FX to 50% of cancelled contracts and introduced up to 25% for Importers	Exporters re-book limit on FX at 25% of cancelled contracts; None for Importers	Immediate	Very positive - Recognizing market players/willingness to open up , benefit from market liquidity
8	Rupee Internationalization & Capital Inflows	Special concession to swap FCNR \$ deposits with min tenor 3 yrs at 3.5% fixed rate; Increased overseas borrowing limit to 100% of Tier I by banks	No dispensation on FCNR Dollar Deposits; Overseas borrowing limit at 50% of Tier I by banks	Till Nov, 2013	Seeking \$ inflows for currency support - with currency hedge and liquidity for raising banks
BIG, BUT OVER TIME					
9	Financial Infrastructure	Use Aadhaar to build credit history; build factoring exchanges for SME/MME; Improving debt recovery systems (DRTs, ARCs)	On-going but slower progress	None	Directionally strong - but execution some while away
10	NPA & Restructured Monitoring	Deputy Gov. Dr. Chakrabarty to examine rising trend; create a central shared repository of large exposures	No shared database of exposures	Shortly (not defined)	Greater focus - but it is an asset cycle
11	Households	Issue Inflation Indexed Savings Certificated linked to CPI for retail investors	Earlier inflation index bond offer aimed at institutions, WPI-linked	By Nov, 2013	Widening financial markets and savings avenues
12	Payments	Online Bill Payment System; White label POS and ATMs; Mobile Banking:			Financial inclusion reach - large potential

; Source: Citi Research, RBI

Appendix A-1

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