The National

Modi government may still pressure the new RBI governor

The ruling BJP party's desire to clinch next year's general elections is threatening the central bank's independence

A supporter holds up a cut-out of a lotus, the election symbol of India's ruling Bharatiya Janata party, with an image of Prime Minister Narendra Modi. The government is piling pressure on India's central bank to change its policies to help it win next year's general elections. Reuters

Rebecca Bundhun
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Shaktikanta Das was overwhelmed by the frenzy of camera flashes as he appeared for a press conference on his first day as the new governor of India's central bank last week.

“It's blinding ... I can't see,” he said.

Mr Das has been the subject of major interest and come under great scrutiny since he took over from Urjit Patel, who abruptly resigned as the governor of the Reserve Bank of India two weeks ago. The departure comes following an unprecedented public dispute between the RBI and the Indian government concerning the autonomy of the central bank.

Questions have been raised about whether Mr Das, a bureaucrat and former economic affairs secretary seen as an ally of India's Prime Minister Narendra Modi, will give into the government's demands and sacrifice the independence of the RBI.

“If you have a situation where a position of the governor of the RBI is filled within 24 hours of the resignation, that will raise eyebrows,” says Ajay Jain, the chairman and managing director of Monal Capital, an investment banking firm based in Mumbai. “The incoming governor will have to work hard to prove that he has his own independent mind despite his background and history with the government."

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On Thursday, the government revealed that it was boosting its capital infusion plan for public sector banks by providing 830 billion rupees (Dh43.4bn) over the next few months.

This is seen as part of a broader election strategy. Ahead of a general election due to be held in May, the government is eager to spur lending by banks in an effort to help stimulate economic growth. It is one of the matters that New Delhi came to blows with the RBI over in recent months. The government wants the central bank to ease restrictions on a group of public sector lenders that have been placed under its "prompt corrective action" framework – a system to control some Indian banks that have struggled with soaring levels of bad debt.

Other areas of disagreement between the two sides include pressure on the RBI to release more reserves to the government. The central bank's reserves currently stand at 9.6 trillion rupees.

On his part, Mr Das stresses that he wants "to uphold the credibility and the autonomy" of the RBI, he said speaking at the press conference in Mumbai following his appointment.

Some analysts believe that Mr Das' background in the government will help to mend relations between the two sides.

"The first positive outcome of this appointment is that there will be no personal opinion conflict between the government and the RBI, and decision-making will get smoother," says Abhishek Bansal, the chairman and managing director of ABans Group, a financial services company based in Mumbai.

He says that the government's expectations of the RBI are reasonable given the economic situation.

India's gross domestic product growth slipped to 7.1 per cent in the quarter to the end of September, compared with 8.2 per cent in the previous quarter, show official figures.

"The government needs the RBI's help in infusing liquidity into the banking system and also to sort out debt defaults and bad loans," says Mr Bansal.

Mr Das has made it clear that addressing the challenges in the banking sector is a priority for him. Last week, he met with public sector banks, which account for 86 per cent of the industry's bad loans and zero per cent of total banking assets. He tweeted that next week he plans to meet representatives of private banks.

Mr Das has said that inflation targeting is important for the RBI, but that economic growth is also part of its mandate.

There have long been tensions between the government and the central bank over interest rates. With one of RBI's main functions being to keep inflation in check, it has opted to keep rates on the higher side to rein in inflation. But the government is eager to cut interest rates to make borrowing cheaper to help stimulate economic growth. Analysts say the government would want to see at least a 25 basis points cut in the next monetary policy committee meeting which will be held in February.

“A change in RBI’s policy stance from hawkish (pro-rate hike) to neutral is a much awaited decision as growth is slowing and inflation is flattening,” says Mr Bansal.

Retail inflation in India for November came in at a 17-month low of 2.33 per cent, helped by a decline in food and fuel prices.

This is comfortably below the RBI's medium-term inflation target of 4 per cent, strengthening the case for an interest rate cut.

“At present it can be seen the RBI has been consistently overestimating inflation and adhering to tighter monetary policy. We think at this stage the RBI should look at cutting rates, as in our opinion the inflationary headwinds are behind us,” says Rahul Agarwal, the director at Wealth Discovery, a financial services company headquartered in New Delhi

But the fact that the general election is looming could add to the pressure on the central bank to cut rates.

“A key demand that can come from the government would be in terms of lowering the interest rates as an immediate relief to the middle class and as a tool towards boosting growth,” says Mr Agarwal.

Lower interest rates would bring some respite to businesses that depend heavily on borrowing capital to expand and sectors that rely on consumers taking out loans.

“Given the low inflation levels, we hope to see an increase in liquidity and a reduction in interest rates to spur the real estate sector, which is facing headwinds on account of various factors,” says Rohit Gera, the managing director of Gera Developments, a property developer in India.

But there are concerns among investors about the sudden resignation of Mr Patel, which was immediately followed by the ruling BJP party losing power in three key states in assembly elections, adding pressure on the government to come up with populist measures to win votes.

“Investors are worried that the government will use the central bank to do its short-term bidding to boost the economy for political reasons, with a general election due by May, without fully considering the long-term consequences for inflation and financial stability,” says Mr Jain.

The demand from the government for more cash is also likely to continue.

“The biggest pressure that we think the RBI governor would come under would be to part ways with some of the excess reserves that are sitting on the RBI’s balance sheet,” says Mr Agarwal. The RBI is well capitalised as per global norms and the government to an extent has a fair demand in getting some of those reserves that can be used more productively.”

During his time spent working for the government, Mr Das is perhaps best-known as the public face of Mr Modi's controversial demonetisation initiative, when the two highest value banknotes were banned in 2016. Mr Das addressed press conferences related to the programme and defended the move.

“Being a bureaucrat, Mr Das has had many political bosses in the past, so we can be sure about him handling the government in a better way [but] this may also include getting influenced by it,” says Raghvendra Nath, the managing director at Ladderup Wealth Management.

Analysts agree that only time will tell whether Mr Das will give in to the demands of the government or manage to uphold the RBI's independence.

“Since Mr Das previously was working directly with the government his thought process had to be in line with the government, he may have disagreed on certain things but all of it was behind closed doors,” says Mr Agarwal.

“In this current role, he is in a position where he does not have to agree on everything that the government says or does. The RBI is an independent body and it appears that Mr Das would be able to assert his independence but at the same time would be able to work with a less confrontational approach.”

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