

Reserve Bank of India**Indian central bank to rethink policies amid government pressure**

Expert committee to examine RBI's management of reserves



© Getty

Simon Mundy in Mumbai NOVEMBER 19, 2018

India's central bank has given ground to government pressure and agreed to reassess its management of reserves and treatment of troubled banks, as prime minister Narendra Modi seeks to reinvigorate the economy ahead of a general election.

The moves were announced by the Reserve Bank of India following a nine-hour meeting of its board of directors, the first since differences between the RBI and the government [burst into the open last month](#).

The administration has been pushing the central bank to pay out more of its annual surplus to the government, and to do more to ease a recent [liquidity squeeze](#) in the debt market.

In a statement late on Monday evening, the RBI said it would work with the government to set up an expert committee to examine its reserve management. It also promised a review of its "Prompt Corrective Action" framework, which has been applied to 11 state-controlled banks badly hit by non-performing loans, restricting them from lending until their balance sheets are strengthened.

Government officials had voiced concern that the PCA measures were damaging market liquidity.

Recommended

"The government is pretty much getting everything it wanted," said Vivek Dehejia, a fellow at the IDFC

Institute. “It looks like the government is really turning the screws and they’ll get their way one way or the other.”

The RBI’s board also said the institution would consider a scheme to restructure stressed loans to small businesses, and would extend by a year the deadline for banks to meet a risk-weighted capital adequacy ratio of 9 per cent.

However, there was no mention of a new credit facility for non-bank lenders struggling with tougher funding conditions — something the government had been strongly pushing the RBI to set up, according to one person with direct knowledge of the matter.

Tensions between the central bank and the government have been the subject of intense public debate since last month, when deputy governor Viral Acharya made a thinly veiled attack on the government’s recent treatment of the RBI.

“Governments that do not respect central bank independence will . . . come to rue the day they undermined an important regulatory institution,” he said.

Government pressure on the RBI followed a liquidity squeeze in September triggered by defaults within the IL&FS group, a major issuer on the Indian corporate debt market. This particularly affected non-bank lenders who have driven credit growth in the past two years, raising concerns about a hit to the broader economy — ahead of a general election that must be held no later than next May.

Recommended

In a speech last week, S Gurusamy, an economic commentator close to Mr Modi who was appointed to the RBI board in August, criticised the RBI’s stance of focusing on bank capital strength at the expense of faster lending growth, which he said reflected a lack of “original thinking”.

“This should be looked upon as a bank-driven economy,” he said. “A new thinking is needed. An India-centric thinking is needed.”

Since the IL&FS defaults began to disrupt credit markets in September, the RBI has moved to boost liquidity through a Rs560bn (\$7.8bn) sovereign bond purchase programme, while announcing that banks would be permitted to partially guarantee the bonds of non-bank lenders.

These measures have already led to a substantial recovery in India’s corporate debt market, said Mahendra Jajoo, head of Indian fixed income investment for Mirae Asset Global Investments.

“The situation has improved dramatically — the RBI has been very strong in terms of injecting liquidity,”

It's not uncommon that a government and central bank take different views on what the priorities should be . . . The difference here is that the government is being much more aggressive

Eswar Prasad, senior fellow at the Brookings Institution

government is being much more aggressive.”

he said.

The government's continued pressure for further RBI action reflects its focus on growth and its more relaxed view about the risk of liquidity leading to inflation. The government has a “more sanguine reading of inflationary risks”, said Eswar Prasad, a senior fellow at the Brookings Institution.

“It's not uncommon that a government and central bank take different views on what the priorities should be, especially in the lead-up to an election season,” he said. “The difference here is that the

Get alerts on Reserve Bank of India when a new story is published

Get alerts

[Copyright](#) The Financial Times Limited 2018. All rights reserved.

Latest on Reserve Bank of India

Follow the topics in this article

Central banks

Indian economy

Indian politics & policy

Reserve Bank of India

India

How easy or hard was it to use FT.com today?

Leave feedback

