Indian politics & policy

Urjit Patel: the yes-man who finally said no to Indian PM Modi

Central bank chief rejects government pressure over financial and economic policies

Urjit Patel, Reserve Bank of India governor, is reportedly on the brink of resigning © Reuters

Amy Kazmin in New Delhi NOVEMBER 1, 2018

When Prime Minister Narendra Modi abolished India's previous set of high-value banknotes two years ago, Urjit Patel, the newly appointed central bank governor, seemed little more than a pliant yes-man, who publicly defended one of the most unorthodox monetary experiments in Indian history.

But two years on, Mr Patel, a Yale-trained economist known for being both publicity-shy and strong-willed, is refusing to do New Delhi's bidding ahead of next year's general election.

Eager to boost the economy before Indians go to the polls within the next six months, Mr Modi's government is pushing the Reserve Bank of India to ease restrictions on lending by fragile state banks, to inject more liquidity into the financial system, and to hand over what New Delhi sees as the RBI's "excess reserves".

But Mr Patel has refused, leading to a bitter stand-off between the government and the semi-independent central bank, with reports in Indian media that the governor was on the brink of resigning.

"The government is very intensely in election mode and there is this huge pressure all around to be able to demonstrate lots of good things have gotten done and are getting done," said Alok Prasad, a former banker. "The conundrum is, how do you keep inflation in check; spend enough to show that things are getting done on the ground, and, at the same time, keep your fiscal deficit in check?"

"It's a hard game to play and there is this constant effort to really square the circle," he said.

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Although the RBI enjoys functional autonomy, New Delhi can order the central bank to do its bidding under Article 7 of the colonial-era RBI act, which permits the government to issue instructions that it "may consider necessary in the public interest".

Analysts said it was New Delhi's threat to invoke Article 7 — never used since India's independence — that led Viral Acharya, deputy governor of the RBI, to warn of the "potentially catastrophic" effect of the government's intensifying efforts to influence central bank policy.

Bankers and analysts said New Delhi utilising its powers under Article 7 would probably trigger Mr Patel's resignation.

"If you get to the point where Article 7 is invoked, the central bank has lost all and any autonomy it had," said Vivek Dehejia, an economics professor at Canada's Carleton University. "This would be a red line for any self-respecting governor."

Mr Patel was appointed in September 2016 after a previous, more discreet stand-off over policy between the government and his high-profile predecessor Raghuram Rajan, who unexpectedly returned to US academia after only one term in office.

Friction between Mr Patel and Arun Jaitley, the finance minister, spilled into the open after the alleged $2bn fraud at state-owned Punjab National Bank earlier this year. A big embarrassment for the Modi government, it led to public sparring between the two men over where blame for the fiasco lay.

The government seems to view the RBI as having grown too big and important for its britches

Eswar Prasad, Brookings Institution

Since then, tensions have mounted. Big business groups are complaining to New Delhi of being hurt by the RBI's overly stringent banking sector regulation — including its tough classification of bad loans, a policy aimed at cleaning up India's fragile state banks, but one which has also made it harder for them to lend.

Meanwhile, New Delhi is eyeing the RBI's billions of dollars worth of reserves as a potential source of funds to bolster public finances, and pay for a final wave of pre-election public spending. However, the RBI has rebuffed the government's requests for access to this money.

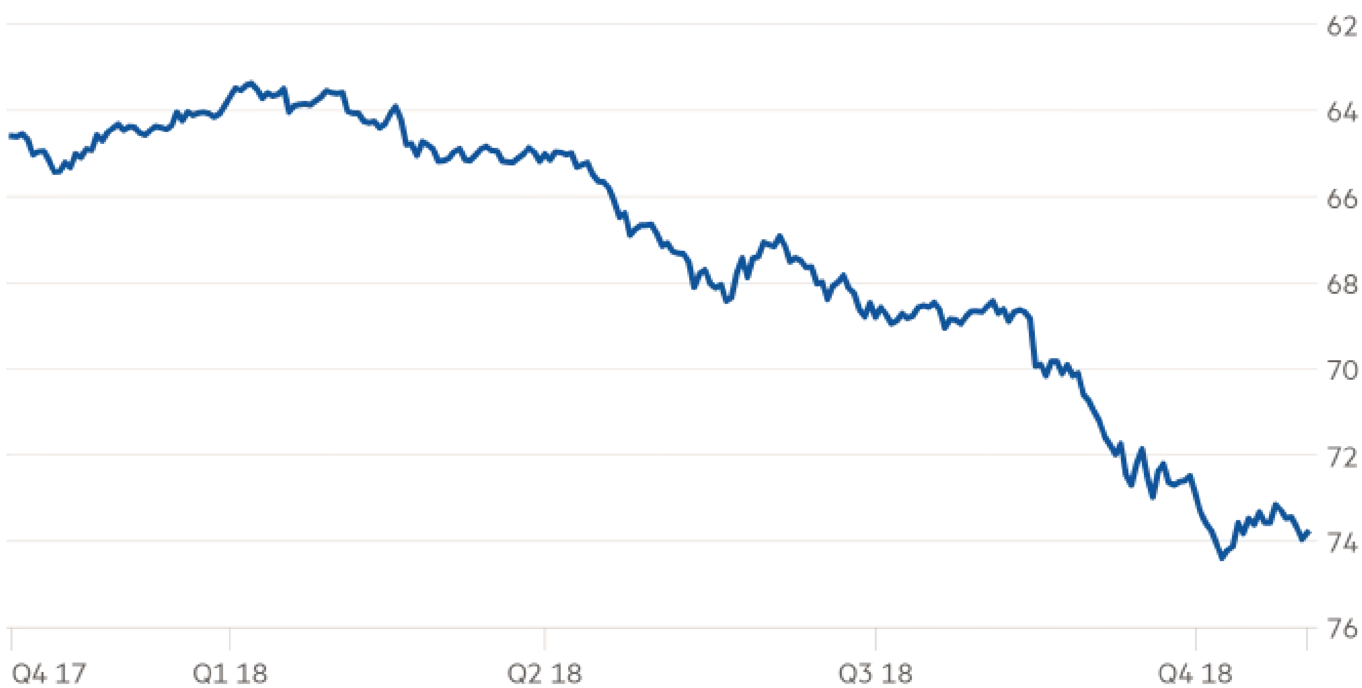
What has pushed strained relations to breaking point has been the woes of the non-bank finance companies — India's "shadow banks", which have been pumping consumer credit into the economy but have been roiled by the default of IL&FS, a large infrastructure-focused non-banking financial company.

According to Saurabh Mukherjea, founder of Marcellus Investment Managers, NBFCs have an estimated $15bn in one-year corporate debt instruments coming due in the coming weeks. While such commercial paper was previously rolled over almost automatically, investors now want to reduce their exposure to the sector, causing a liquidity squeeze.

In light of the funds crunch, Mr Mukherjea said that New Delhi wants the RBI to ease rules to allow state banks to lend more to struggling NBFCs. But the central bank has refused, concerned that these loans would eventually sour, adding to state banks' already high bad debt burden.

Indian rupee weakens

Against the US dollar (Rs per $)



Source: Bloomberg
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"The better quality NBFCs have got bank loans — it's the weaker NBFCs that have a challenge," he said. "It's a high-wire balancing act that the RBI has to play."

Market analysts have expressed dismay at the government's overt pressure on the RBI to ease prudential norms, even as the finance minister criticises the central bank for presiding over a reckless lending spree from 2008 to 2014.

"Mr Patel and his lieutenants have helped steer the RBI through treacherous waters . . . but the government seems to view the RBI as having grown too big and important for its britches," said Eswar Prasad, a senior fellow at the Brookings Institution.

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He added that "such concerted and persistent attacks from the government on different fronts" will undercut the RBI "to the long-term detriment of the Indian economy".

But many market analysts are hoping the two sides will find ways to defuse the damaging crisis before it escalates further.

All eyes are now on an RBI governing board meeting that Mr Patel has called for November 19.

"I don't see the governor resigning," said Sharmila Whelan, deputy chief economist at Aletheia Capital. "Investor sentiment is fragile. The governor resigning would be interpreted as the RBI no longer being independent . . . It would hit investor sentiment, and risks a further correction in the stock market and rupee depreciation. That's the last thing Indian policymakers need right now."

Additional reporting by Emma Dunkley in Hong Kong

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