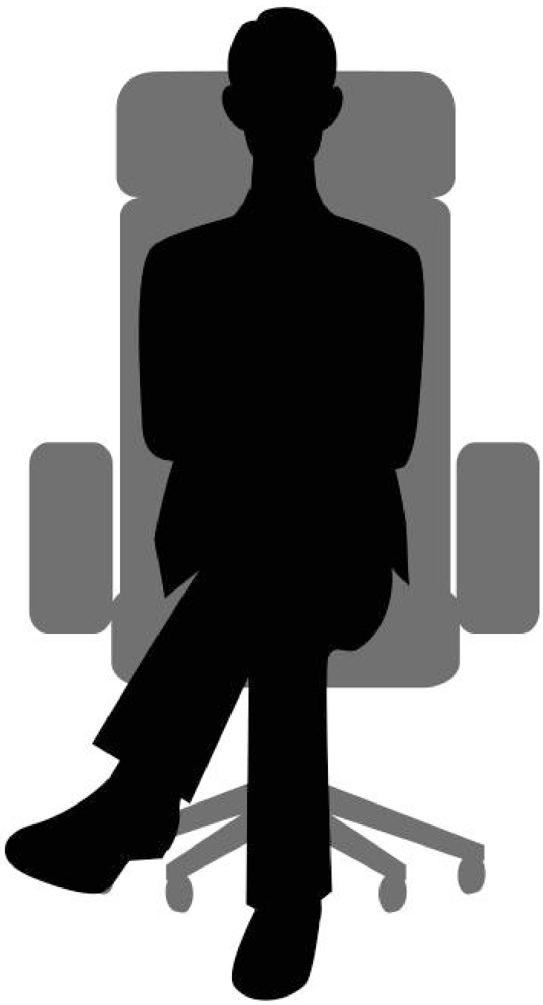
# In the hot seat

## RBI's new Governor has his task cut out



Sanjay Malhotra, who takes over as Governor of the Reserve Bank of India (RBI) today, will inherit a relatively comfortable state of affairs, thanks to the work done by his predecessor Shaktikanta Das. The banking system looks robust, with gross NPA ratios of under 3 per cent; the battle against inflation is in its terminal stages and the after-effects of the pandemic have been left behind. Yet, helming the central bank will not be easy. The new Governor will likely face a trifecta of challenges.

The trickiest of these will be steering the Monetary Policy Committee (MPC) to strike the right growth-inflation balance. In the past two policy meetings, the MPC has adopted a hard stance on rates while taking a sanguine view of growth. But with real GDP growth rates in the last two quarters undershooting RBI projections by 60 and 160 basis points respectively, the MPC's line is beginning to wear thin. Climate change is leading to erratic rainfall patterns, making it difficult for the RBI to take a forward-looking view on inflation to calibrate rates and liquidity. The Governor is likely to face his second big challenge in monitoring foreign capital flows and their impact on the rupee in the Trump era. Conflicting policy signals from the Trump camp on the need to quell US inflation while also erecting high tariff barriers against cheap imports, have confused markets, with US bond yields, stock markets and the dollar displaying sharp two-way moves. This is hurting capital flows into emerging markets.

India, which attracted a steady stream of Foreign Portfolio Investment (FPI) flows amounting to over $30 billion between January and September 2024, has seen outflows of $14 billion over just October and November, with weakening growth adding to the worries. The resulting volatility in the rupee and the central bank's attempts to arrest it, have seen India's foreign exchange reserves dip from over $704 billion in end-September to $658 billion by end-November. With the inclusion of Indian gilts in global bond indices since June 2024, domestic bond markets are now as vulnerable to FPI actions and global volatility as stock markets. This calls for yet another trade-off — between easing rates to support growth and keeping them high enough to avoid an exodus of FPI flows in favour of US bonds.

A third challenge is about how far the RBI, as banking regulator, should go to further tech-enabled financial inclusion. Having allowed new-age digital lenders to stretch the boundaries on retail lending, the RBI has had to pull back recently, after unearthing a host of dubious practices that could lead to a renewed spike in NPAs. The phenomenal growth in the digital banking and payments ecosystem and the rising incidence of cyber-fraud that goes with it are new areas for the central bank to contend with. However, with his technocrat background, Governor Malhotra may well be at home in dealing with this challenge.