

Topic: 'Rexit' and 'Wrecks It'

Topic  
Introduction

The sudden decision to step down by the man deemed by many to be the **world's best central banker** has raised doubts over the Indian government's commitment to structural reforms, as well as India's position as a harbor of safety amid troubles in other emerging markets. Reserve Bank of India (RBI) chief Raghuram Rajan announced that he would not seek a second term when his **three-year reign ended in September**, and would **return to academia instead**. Rajan, a former chief economist at the International Monetary Fund, has earned rockstar status in the financial industry for his achievements, which include lowering runaway consumer prices and stabilizing the exchange rate. "When Rajan took the helm in September 2013, the economy was **declining** at an annualized rate of **2 percent** on quarter, consumer prices were soaring **9.8 percent**, the rupee was **down 16.6 percent** from the year earlier, and the current account deficit was estimated **at 4 percent of GDP**," independent analyst and CNBC columnist Michael Ivanovitch said. "He is now leaving an economy growing at a rate of **9.6 percent**, inflation is **down to 5.8 percent**, the rupee lost only **4.7 percent** from its year-earlier level, and the estimated current account deficit is about **1 percent of GDP**." Famously gloomy investor Marc Faber has reportedly called Rajan "**the only central banker I trust**," while another high-profile investor, Jim Rogers, has described him as "**probably the best central banker in the world**." Despite tangible success and external plaudits, Rajan has faced mounting criticism from conservative members of **Prime Minister Narendra Modi's ruling Bharatiya Janata Party (BJP)**.

Here, we explain his **disagreements with certain BJP officials** and what his departure means for a country aspiring to become a driver of the global economy.

### **BJP vs. Rajan**

During his first two years, **Rajan's aggressive bet on high interest rates amid double-digit consumer price inflation (CPI)** sparked anger from politicians, who wanted lower rates to pull the country out of a deep economic slowdown. The BJP party rode to power in 2014 on the promise of bolstering growth, attracting foreign investment and providing jobs as annual GDP growth **sank below 5 percent** in the 2012-2013 and 2013-2014 financial years. Tighter monetary policy as well as a decline in commodity prices helped tame inflation, leading the central bank to cut interest rates **by more than 150 basis points since the start of 2015**. But the issue wasn't just rates. The 53-year old Rajan asked banks, where lending decisions have been partly influenced by politics, to clean up their books. He has also been an outspoken critic of the government's management of social issues, particularly **crony capitalism, corrupt police, and religious violence**. "Perhaps the system tolerates corruption because the street smart politician is better at making the wheels of the bureaucracy creak, however slowly, in favor of his constituents," he said in a 2014 speech.

Resentment has boiled among BJP hardliners over the years, particularly parliament member **Subramanian Swamy**. In May, Swamy urged Modi to sack Rajan, stating that high rates had resulted in a "**collapse of industry and rise of unemployment** in the economy." Rajan's **foreign-educated background** also became an issue. "He is in this country on a Green Card provided by the U.S. government and **therefore mentally not fully Indian**," Swamy said in May. **Modi's administration** has stayed **quiet** on the attacks. Despite the political noise, many market participants expected Rajan to continue for another term. **He'll be the first RBI governor since the early 90s to only serve a three-year term**.

## Major implications

One of the most unnerving consequences of Rajan's decision is the **growing influence of government over monetary policy**, an area meant to be **independent from political pressure, according to strategists**. Moreover, Rajan's exit comes at a time foreign investor confidence in New Delhi has been eroded amid a lack of substantial progress on key structural challenges in the two years since Modi assumed power. Injecting liquidity into distressed public banks, implementing a goods-and-service (GST) tax and land acquisition are some of the biggest issues that remain unresolved. Then there's also the question of the reforms initiated under Rajan. Can they continue without the charismatic chief? He has to a great extent institutionalized enough change to ensure smooth continuity under his successor, particularly his 2015 decision to adopt **inflation targeting** as a guide to monetary policy and the ongoing **clean-up of bad loans** among Indian banks. The problem isn't so much the new successor, but the fractured state of Indian politics.

## Who will be his successor?

The decision to pick Reserve Bank of India Deputy Governor Urjit Patel as the successor to outgoing Governor Raghuram Rajan is a clear affirmation of the Centre's commitment to ensure **policy continuity at the central bank**. That the man chosen for the top job at the RBI is a person, **who helped formulate crucial changes** in the monetary framework, including the decision to **target a specified inflation level** as the primary remit of the bank, reflects the administration's focus on making price stability central to its economic agenda. Prime Minister Narendra Modi recently reiterated his backing for the **4 per cent retail inflation target**, at a time when the **Consumer Price Index-based measure had accelerated to 6.07 per cent**. The Centre's choice of the Yale economist, who has earned a reputation as a "**fiscal conservative**" with a "**hardliner stance**" on inflation, is in line with that thinking. Dr. Patel will need little time to settle in, given his insider credentials and experience in working with officials at the Finance Ministry. But as in all such transitions, there will also be substantive change. Known at the RBI headquarters as someone who largely keeps his own counsel and prefers a low-profile and discreet working style, Dr. Patel is unlikely to grab headlines as frequently as his plain-speaking predecessor has done. And that is another factor that must have weighed in his favour.

## Challenges before Urjit Patel

The first among many challenges that the new Governor will face will be the changed **circumstances of monetary policy formulation**. When Dr. Patel chairs the first meetings of the Monetary Policy Committee — the six-member panel that is expected to start deciding interest rates from the October 4 policy announcement onwards — it will be interesting and instructive to see how he helms the committee approach to rate-setting. As the head of the banking regulator, Dr. Patel also inherits the ongoing **clean-up of bank balance sheets**. Unclogging the credit pipeline by helping resolve the build-up of stressed assets with the country's lenders and thereby improving monetary transmission are tasks that Dr. Rajan will now leave unfinished. Investors and markets alike will be keenly watching his successor's approach to expediting the process, especially given Dr. Patel's past stress on fiscal restraint. His **wide-ranging experience** — he has played roles at **multilateral lending institutions** and diverse industries, including a stint in advising on **business development strategy at Reliance Industries** — ought to stand him in good stead while dealing with the complexities of regulating the markets, the financial services industry and payments systems at a time of rapid technological change and disruption. Dr. Patel will also have his task cut out in managing and future-proofing key cadres at the central bank itself.

### Read further:

<http://www.firstpost.com/business/raghuram-rajan-exit-targeted-campaign-led-to-rbi-governors-decision-2842880.html>

<http://www.livemint.com/Opinion/gmrbNBXnSD0l1jvnP6nKNM/Why-does-Raghuram-Rajan-have-to-go.html>

<http://blogs.wsj.com/indiarealtime/2016/06/20/rexit-and-wrecks-it-how-india-reacted-to-rbi-gov-raghuram-rajans-exit/>

<http://qz.com/710881/did-indias-dirty-politics-kill-raghuram-rajans-appetite-for-a-second-term/>