

PARTING HOTS

CHAITANYA KALBAG

*As he leaves India's central bank,
Rajan takes aim at his critics
and points out the challenges
awaiting his successor*

NEW DELHI Although his three-year term as governor of the Reserve Bank of India was one of the shortest in the last 25 years, Raghuram Rajan will leave a pair of very large shoes to fill after his departure on Sept. 4.

The government of Prime Minister Narendra Modi is taking its time in announcing Rajan's successor. Despite intense speculation, Modi and Finance Minister Arun Jaitley are playing their cards very close to their chests.

Asked who he thought would be a likely candidate, Rajan told the Nikkei Asian Review in an exclusive interview on Aug. 11 that there is no single formula for choosing a central banker.

"Sometimes what is needed is somebody who's going to maintain the system and stabilize the system and build on it, and sometimes who you need is somebody who will shake up the system," he said. "So I think that those things can vary depending on the time."

Past RBI governors have come from within the central bank's own ranks or from the country's financial bureaucracy. Rajan was a former chief economist at the International Monetary Fund who acquired "star" status in 2008 when his predictions of a global financial crisis, initially considered controversial, proved accurate.

IMAGE CORRECTION There is little doubt that Rajan, a prolific speaker, has been one of India's most outspoken and controversial central bankers, and his forthright views have drawn considerable flak. His outsider status drove some of his more pointed comments on touchy subjects, such as crony capitalism, once rampant but now much subdued, or even about tolerance under a government seen as right-wing and hewing to a Hindu majoritarianism.

In his interview with NAR, however,

PHOTO: Reserve Bank of India Gov.

Raghuram Rajan wraps up a news conference following a monetary policy announcement on Dec. 1, 2015.

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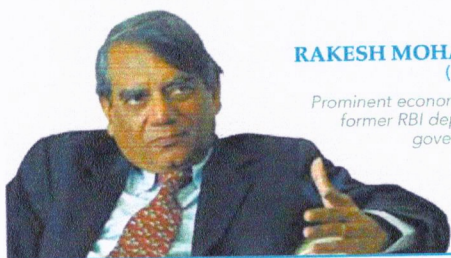
POTENTIAL CANDIDATES TO
SUCCEED RAGHURAM RAJAN

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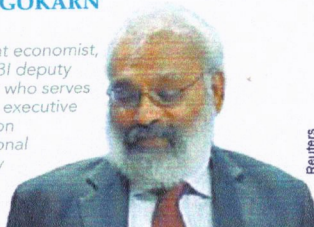
**URJIT PATEL**
(52)RBI deputy governor,
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PANAGARIYA**
(63)Vice chairman of
National Institute for
Transforming India,
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(68)Prominent economist,
former RBI deputy
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governor who serves
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International
Monetary
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board

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Rajan attempted to dispel the impression that he has been a relentless critic of the Modi government. "I would say first that I haven't been a firm critic of the government as has been sometimes portrayed. I have been somebody who has warned or cajoled about the direction of economic policy, absolutely. I think that has been done with the broader intent of macro [economic] stability that the RBI has firmly a mandate [for]," he said.

Rajan implied that a headline-hungry press with a tendency to take his comments out of context was to blame. "That is a hard standard for anybody's commentary to meet, especially if you have a press which is continuously looking for what they think are slights to the government," he said as he sought to correct claims that his governorship had gone "off the reservation."

"I don't make political comments, I make economic comments. Economic comments can be taken politically based on who's reading it and how they report it. What I have said is any suggestions I have given to the government on the path of government actions have all been private. I have never publicly said 'you should do this' and 'you should do that.' So in that sense, sometimes these speeches [of mine] are reported as 'he's been a vocal critic of the government.' Show me a place where I have criticized the government in any of my speeches," Rajan said.

STAYING THE COURSE Rajan's tenure, which began in September 2013 under the previous Congress government when the rupee was at record lows and confidence in the economy was ebbing, has been a steadying factor for Modi and his economic team. But the prime minister is known to brook no dissent within his cabinet and will likely look for a new governor who is less of a celebrity and more attuned to the ruling Bharatiya Janata Party.

A number of factors may help Modi and Jaitley steer the economy through the shoals of Rajan's departure. One of the most significant would be the introduction of a national goods and services tax, which

recently received parliamentary approval and could herald the creation of a common market for India.

There are plenty of other tailwinds, too. Millions of government employees are about to receive sizeable salary increases, which should fuel consumer spending as India's festival season begins, and the first good monsoon in three years promises a revival in rural demand. Meanwhile industrial output is starting to wake from a long slumber and persistently low global oil prices have helped reduce India's current-account deficit. The rupee and stock markets have also shrugged off the impact of "Brexit," Britain's shock decision to leave the European Union.

Along with the passage of the GST legislation, the Modi government is liberalizing foreign direct investment rules and bringing the country's poor and unbanked population into the financial system by transferring subsidy payments directly to them. Midway through his five-year term and facing elections in several key states early next year, Modi appears to be successfully walking a socialist-populist tightrope.

UNFINISHED BUSINESS At his final bimonthly policy review on Aug. 9, Rajan chose to leave key interest rates unchanged. But consumer price inflation, which is forecast to have risen to 5.9% in July from 5.77% in June, is already approaching the upper limit of Rajan's comfort zone of 6%, which he had expected by March 2017. Worryingly, food price inflation has been climbing inexorably.

Nevertheless, Rajan said inflation can be beaten. "Why are we an exception in terms of beating inflation? If you look at emerging markets around the world — Malaysia, Thailand, Indonesia, the Philippines — they seem to have relatively low levels of inflation. So if these countries can do it, why can't we? What is so different about us? A country like Vietnam has a pretty high proportion of food in its consumer price index, so we are not the only country to have a high proportion of food in our CPI," he said.

Chaitanya Kalbag is a former Reuters Asia editor and editor-in-chief of the Hindustan Times.

Significantly, his last monetary policy review will also be the final one led independently by an RBI governor. One of Rajan's key bequests to his successor is a Monetary Policy Committee, which he hammered out after months of closed-door negotiations with the government. The six-member MPC will have three government nominees, and although the governor will have the casting vote in the event of a deadlock, the committee is widely seen as curbing the central bank's independence.

Rajan, however, disputed that interpretation. "The governor is independent, and the MPC enhances the RBI's independence on monetary policy. The governor can still persuade the members of the MPC to his or her way of thinking, so I'm not sure that the MPC implies the RBI governor has no influence. What it does mean, however, is that basically the RBI does not determine policy alone but on the basis of a consensus within a committee. So to that extent, yes, they've given up a little bit of power, but they gain some because committees

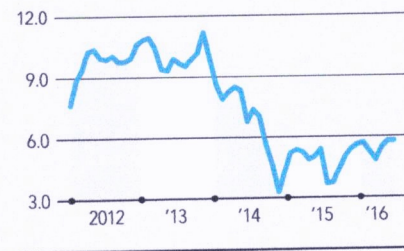
are more immune to pressure."

The uncompleted Asset Quality Review Rajan launched brought into the open the banking system's mountain of non-performing assets. The government has pledged to inject fresh capital into tottering state-owned banks, but is a financial crisis imminent?

"I think that is too pessimistic a view," Rajan said. "I think the process is under way, that the culture of forbearance has turned, that the problems are coming out into the open and therefore the solutions are now discussed more openly."

He said dozens of key infrastructure projects paralyzed by bad debts could be revived. "There is discussion now about how we [can] bring in good strong management if the project has been mismanaged. Should we bring in turnaround specialists, should those specialists come from retired people in the industry? So, creative solutions are emerging. If you see asset sales are now happening, [that means] firms are doing the restructuring."

Year-on-year change in India's consumer price index (in percent)



Rajan laughed off suggestions he might be in the running to succeed International Monetary Fund Managing Director Christine Lagarde if she should step down due to the financial ethics case she is facing in France. "I am heading towards academia," he said. "I think I've done enough administration for a little while, and while I like it in reasonable doses, I also want to submerge myself in ideas for a little while." **N**

ROSEMARY MARANDI and KIRAN SHARMA Nikkei staff writers

TO THE BITTER END

India's Rajan sticks to his guns on inflation

MUMBAI/NEW DELHI When the "rock star" governor steps down on Sept. 4 he might not be leaving legions of adoring fans, but will certainly be hailed for his steady hand in managing inflation. While some have criticized him for being too rigid and anti-growth, few can argue with his overall record.

When Raghuram Rajan took over as RBI governor, the key interest rate was at 7.25% and inflation at around 10%. The rate was raised to 8% and kept there throughout 2014, with the governor citing inflation concerns. His stance softened in January 2015 as inflation eased and the rate was brought down to the current 6.5%.

During his three-year tenure, he also

paved the way for a cleanup of the banking system by asking banks to reveal the burden of bad debts on their books.

Rajan leaves in the hope that his initiatives on inflation and the herculean cleanup task will be taken forward by whoever takes over.

Though he had no specific words of advice for his successor, the governor sounded confident that the formation of the Monetary Policy Committee ensures future steps on policy rates will be balanced and independent.

The six-member panel will consist of three government-appointed nominees and three representatives from the RBI, with the governor as the head.

Prime Minister Narendra Modi's government has yet to announce a replacement governor. It has been widely reported that Modi will make the call in consultation with Finance Minister Arun Jaitley.

According to sources, the delay is down to a desire to find a candidate of similar caliber as an economist, but who will be more flexible in his approach to taming inflation.

The more pressing matter of rolling out a universal goods and services tax across the whole country has also held up the process. With the government managing to push through the necessary constitutional amendment, an announcement is expected soon.

A source said a consensus has already been reached between Modi and Jaitley on the candidates. The bigger question is how independent the new governor will be, given the circumstances surrounding Rajan's exit. **N**

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