THE WEEK
JOURNALISM WITH A HUMAN TOUCH

Conflict of interest

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Few appointments of the United Progressive Alliance government met with as much fanfare as that of Raghuram Rajan as the Reserve Bank governor last September. The stock markets surged, foreign investors rejoiced and the economy-astute populace hailed the man as the saviour of the slumping economy. Though the economy is not yet out of the woods, Rajan, a former chief economist at the International Monetary Fund, has managed to initiate a turnaround in his eight months at the helm.
However, the BJP, which is the frontrunner in most pre-poll surveys to make the next government, has found no reason to cheer Rajan. Party treasurer Piyush Goyal recently expressed the BJP's unhappiness about Rajan consistently increasing interest rates in a bid to keep the inflation checked. The RBI governor's tight monetary policy had been at odds with the interests of the BJP's influential vote-bank of traders, who have been pressing for a rate cut to boost growth. Goyal, however, later said the BJP did not have an agenda to remove Rajan just because he was appointed by the UPA.
While there is no precedence of a new government replacing the RBI governor, two governors had resigned before completing their terms. "Rajan is easily identified with the UPA government and the BJP may want to bring in one of their own. Right now, though, it seems unlikely that they would do that. But there could be disagreements between the RBI and the government if Narendra Modi becomes prime minister," said a banker, requesting anonymity.
BJP leaders' opinion on Rajan ranges from neutral to hostile. While Subramanian Swamy went to the extent of saying that they could make it worthwhile for Rajan to leave, Arun Jaitley, who is in the running for the post of finance minister if Modi makes a government, had told THE WEEK that he did not think Rajan would be asked to leave. "I don't know him personally," said Jaitley. "He has impeccable credentials both as an economist and as an academic."
Jaitley, however, added that the BJP was committed to growth. "The kind of social sector and developmental spending that we have committed ourselves to can only be supplemented by a 9 per cent growth rate over a period of a decade. So any growth, which is less than 5 per cent, can hardly cater to our national requirements," he said.
Some BJP leaders say the repeated hiking of interest rates has stifled growth. Rajan, however, did not have many options here. "He did what he thought was right and many of us think that he should have hiked [the interest rates] earlier and even more aggressively. Given that you have an inflation rate of 8 per cent, I think he hasn't tightened enough," said Jahangir Aziz, head of Asian emerging markets research at JP Morgan Chase.
Rajan had started on a sticky wicket. "He took over as RBI governor when the economy was going through challenging times across all frontiers. The US Federal Reserve's tapering had created issues on currency, interest rates, growth and, to a certain extent, inflation," said D.R. Dogra, managing director and CEO, Credit Analysis and Research Ltd. Forex reserves were dropping and investor sentiment was down. The RBI had to impose several measures to stop the outflow of dollars, such as curbing gold imports and checking the outflow of investments and remittances.
Thrust into the challenging environment, Rajan concentrated on increasing dollar inflow, which came in through the swap facility kept open for Foreign Currency Non-Resident (FCNR) deposits. Forex reserves grew from $275 billion in September 2013 to $304 billion by March 2014. To deal with the stubborn core inflation, the RBI hiked repo rate (the rate at which the RBI lends money to commercial banks) to 8 per cent from 7.25 per cent, which led to growth in deposits from 6.3 per cent in August 2013 to 14.6 per cent in March 2014.
The rupee, which went for a free fall in September 2013, stabilised under Rajan's aegis around 60

against the dollar. "This was done by controlling the current account deficit internally; while foreign institutional investments have turned positive, a part of which can be attributed to the reaffirmation in India and its policy stance," said Dogra.

The economy is bouncing back, albeit slowly. With tapering fears turning out to be unfounded, capital is finding its way back into India. And there are the expectations of a new growth-oriented government.

The RBI has also taken forward the ideas conceived during Rajan's predecessor D. Subbarao's tenure. There are now papers on inclusive banking and monetary policy, and the RBI has acted on the non-performing assets of public sector banks, created an exchange for receivables of micro, small and medium enterprises, introduced interest rate futures and issued new banking licences.

Rajan, however, is still grappling with inflation. Though it is yet to be announced formally, he seems to be batting for inflation targeting. "I would have to give him full credit for stemming the rupee crisis in September 2013," said Jim Walker, founder and managing director of Hong Kong-based Asianomics Ltd, an economic research and consultancy company. "His actions and market smoothing words were exactly what were required at the time. But I would equally have to give him an 'F' on his proposed inflation targeting approach to monetary policy. I would have preferred to see him return the RBI to a credit and money supply watching central bank."

Rajan is unlikely to change his methods even if a new government comes to power. However, the straight-talking RBI governor, who is not known to crumble under pressure, might have to brace up to stand his ground.

Rajan's moves

* *Increased dollar inflow through swap facility kept open for FCNR deposits. This played an important role in increasing forex reserves from $275 billion in September 2013 to $304 billion in March 2014*
* *Repo rate increased from 7.25 per cent to 8 per cent. This revived growth in deposits from 6.3 per cent in August 2013 to 14.6 per cent in March 2014*
* *Managed to stabilise the rupee around Rs60*
* *Took action on NPAs of the public sector banks*
* *Introduced interest rate futures*
* *Issued new banking licences*

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