

# Raghuram Rajan's Announced Departure from RBI

June 2016

Raghuram Rajan the Governor of the Reserve Bank of India (RBI) has announced he is going to leave the bank early this September. The announcement surprised the markets, despite the fact that there had been a fair amount of disagreement between him and a number of senior politicians. The disagreements were largely around the interest rates that the Rajan-led RBI could have cut, but held up to control inflation, even while price and demand pressures were subdued due to lower oil prices and cuts in agricultural subsidies (lowered rural demand). We viewed Rajan as a competent and independent-minded central banker who has done good work:

- keeping inflation under control,
- working to address the troubled loan books at state controlled banks as well as consolidating a number of these banks,
- bringing clear communication to domestic and international markets, which has helped keep the Rupee stable.

However, he was an economist first and a politician not so much, and this appears to have been a problem for his superiors. Inflation is close to 10-year lows, while 1-year interest rates are closer to mid-range. We believe Rajan understood that inflation in India is easy to stoke given the poor level of infrastructure, especially around food. And, house prices in India have risen strongly over the past decade. Encouraging a credit bubble on top of its current strong growth does not seem prudent.

To assess the potential changes, we feel there are three issues to consider:

1. Track record at the RBI - the RBI has been run well for many years. Rajan benefited from the hard work done by his predecessor Duvvuri Subbarao. Rajan has maintained the independence of the central bank, as can be seen by the interest rates, but has not made significant structural changes to an already well-run institution.
2. Replacement choices – the RBI has a deep management bench with a number of well-qualified potential future bankers. Beyond this, there are a number of well-regarded bankers we feel could fill the role competently.
3. Independence – this is the big question. Will the government select an independent-minded central banker or one that will tow the party line, lower interest rates and run money supply on the looser side? This we cannot guess in the near term.

From a portfolio standpoint, we do not believe there will likely be any negative risk to our Indian holdings or to the near term economic prospects for India.

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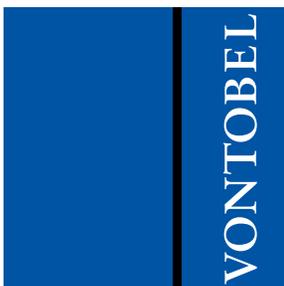
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