INDIA'S ROCK STAR ECONOMIST ASSUMES CENTRAL BANK LEADERSHIP

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Dr. Raghuram Rajan took office as the new Governor of the Reserve Bank of India (RBI) on September 4, 2013, and his appointment appears highly welcome. He certainly brings strong credentials, as most recently Dr. Rajan was the Chief Economic Advisor for the Indian Ministry of Finance. He previously spent time as a finance professor at the University of Chicago's Booth School and as Chief Economist and Director of Research at the International Monetary Fund (IMF). In January 2003, he was awarded the Fischer Black Prize for the "best finance researcher under the age of 40" by the American Finance Association.[1] In a number of articles discussing his appointment, Dr. Rajan is being referred to as India's rock-star economist.[2] He is well known for warning about the build-up of financial sector risks at a meeting of central bankers in 2005. In typical rock-star fashion, he came out with a bang at his first press conference. Currency strategists have expressed concern that the RBI lacks credibility and that this contributed to rupee volatility. It will be Dr. Rajan's job to re-establish the RBI's credibility—and the reaction in both the currency and equity markets, at least initially, was a positive sign. Dr. Rajan underscored the importance of predictable monetary policy, inclusive growth and development, and improving India's financial infrastructure. Key highlights of new initiatives and his research: • **Monetary Policy Framework Review:** Dr. Rajan wants to establish a panel to review and strengthen the RBI's monetary policy framework. This may be a tacit acknowledgement that the RBI must establish more predictable policies to fix its credibility problem. • **Inclusive Development** o Dr. Rajan mentioned that rural areas, as well as small and medium-size industries across the country, have been important engines of growth for India. However, access to finance is still difficult for them. He argued that faster, broad-based, inclusive growth would lead to a rapid drop in poverty. o He made the case that the Indian public would benefit from more competition among banks and that banks would benefit from more freedom in their decision making. • **Speeding Up Approvals of New Branches:** The RBI intends to make it easier for commercial banks to open new bank branches in every part of the country. A well-run domestic commercial bank will no longer have to approach the RBI for permission to open a branch. Regulations are often thought of as one of India's challenges. The RBI's cutting back red tape could prove a useful model for other parts of the economy. • **Opening Market to Foreigners:** India has a number of foreign-owned banks that have helped fuel India's growth in the past years. The RBI wants them to participate more in India's growth but states that it would like "more regulatory and supervisory control over local operations so that the RBI is not blindsided by international developments." Raising long-term foreign capital is key for the rupee's future, and additional support for allowing those who receive rupees to reinvest them in India could also be very supportive of financing needs. • **RBI's Mandate to Ensure the Flow of Credit to the Productive Sectors of the Economy:** Dr. Rajan thus wants to reduce the requirement for banks to invest in government securities in a calibrated way so bank credit shifts toward businesses and consumers and away from the government. This should encourage investment activity and fuel local consumption in the years ahead. • **Providing Discounted Loans to Banks:** The RBI is providing discounted rates for banks to borrow from the RBI, which can help alleviate the interest rate pressures the banks are facing. Dr. Rajan also lowered the rate for banks to exchange (swap) foreign currency deposits for the local currency to 3.5% per year from the prevailing market rate of 7%.[3] The markets reacted extremely positively to this initial announcement. Many of these initiatives came from Dr. Rajan's years of research. It is great to see he's taking deliberate actions to cut down red tape and speed bank branch openings, as regulations are often cited as a primary concern for India. Encouraging more foreign direct investment (FDI) is critical for funding investment needs, so Dr. Rajan's calls to open access to foreign banks and open corporate and government bond investments to foreigners is helpful. Furthermore, Dr. Rajan last year advocated for a new wave of privatization of state-owned enterprises, which control about three-quarters of the banking sector but also substantial parts of other sectors, including natural resources and energy. He stated, "State ownership in many areas no longer serves the public interest, and the only reason it continues is because it serves the many vested interests that benefit from the status quo … public sector workers who have cushy undemanding safe jobs ... the occasional corrupt executive who rakes in bribes, and the minister who enjoys the patronage." These are serious thoughts and very much in line with India's needs. Dr. Rajan brings high expectations. We have been living in a world dominated by central bank activity in recent years, with the U.S. Federal Reserve, bold new policies from the Bank of Japan, the European Central Bank, which will do "whatever it takes" to preserve the euro, and Mark Carney taking the helm at the Bank of England. Dr. Rajan has the potential to enter the discussions as one of the most influential global central bankers. His first press conference certainly had an immediate positive impact on the financial markets. Let's hope he can continue the momentum at his first policy meeting on September 20. [1]Source: European Corporate Governance Institute, May 2009. [2]See, for instance www.reuters.com/article/2013/09/03/us-india-economy-rajan-idUSBRE9820HP20130903 [3]Source: Bloomberg.

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Monetary easing policies : Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

Swap : A swap is an agreement between two parties to exchange payments based on a reference asset, which may be a currency or interest rate but also may be a single asset, a pool of assets or an index of assets.

Foreign direct investment (FDI) : An investment made by a company or entity based in one country into a company or entity based in another country.