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Matthews Asia Perspective: "Rexit" in Context

Over the weekend, the big news out of India was that Reserve Bank of India Governor Raghuram Rajan would not be seeking an extension to his term, which will expire in September. He said that he would be returning to his "ultimate home in the realm of ideas," at the University of Chicago. Rajan also said that he was open to seeing current developments through, but that upon due reflection and consultation with the government, has decided not to seek an extension. While change is always uncomfortable and creates uncertainty at times, our reaction to this event should consider the broader context.

Over the past three years, Rajan has been an influential and skilled central bank governor. He can be credited with enacting a few key policies, including the adoption of inflation targeting, using the consumer price index (CPI), instead of the wholesale price index (WPI). CPI holds a larger component of food, affecting the average citizen. Hence, to have accommodative monetary policies, the government has to make structural improvements to lower food inflation—which has been a historical pain-point for everybody. Rajan also pushed banks to recognize non-performing assets in the banking system. This cleansing of the banking system along with India's newly created Bankruptcy Law, should serve the country well over future credit cycles. Rajan, along with the government, also announced the formation of the new Monetary Policy Committee (MPC) to be a law. The formation of the MPC borrows best practices from other countries and further institutionalizes the mechanism for setting interest rates. Putting into motion a few of these changes, which perhaps will be part of Rajan's legacy, are already underway and should produce results even after his departure.

Rajan could have stayed to see these changes through by extending his term, but there are a number of factors outside his control and domain. During his tenure, commodity prices collapsed and India's trade/ current account benefited and helped the currency. That tailwind is less likely to exist going forward. Therefore, the next two years could potentially present a bit more difficult environment than the last three years.

Rajan will wrap up as the 23rd RBI governor since 1935. The average tenure of an RBI governor is only three and a half years, unlike longer tenures in U.S. Even with a term extension, Rajan would have served only for another two years. RBI as an institution, among others including the Supreme Court, has always been a pillar of strength in India. Previous RBI governors have also been reputed policy makers. There are a number of qualified individuals already being considered to fill the role. More broadly, terming Rajan's departure as "Rexit" sensationalizes the event. Such heavy "personalization" of the role of governor of an important institution also plays well to the media. However, given the RBIs strength as an institution over many decades, I believe even though the direct style of communication as embodied by Rajan may change, the substance of RBI's policies will endure.

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