Raghuram Rajan, India's departing central banker, has a new warning

By Geeta Anand
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Three years before the 2008 global financial crisis, an Indian economist named Raghuram G. Rajan presciently warned a skeptical audience of top economic thinkers that excessive risk threatened the entire global financial system.

As Mr. Rajan stepped down on Sunday as India's top central banker, following intense criticism at home, he offered a new warning: Low interest rates globally could distort markets and would be difficult to abandon.

Countries around the world, including the United States and Europe, have kept interest rates low as a way to encourage growth. But countries could become "trapped" by fear that when they eventually raised rates, they "would see growth slow down," he said.

Low interest rates should not be a substitute for "other instruments of policy" and "various kinds of reforms" that are needed to encourage growth, Mr. Rajan said in a recent interview with The New York Times. "Often when monetary policy is really easy, it becomes the residual policy of choice," he said, when deeper reforms are needed.

His warning comes at a time when the world's central banks appear to be at a loss about how to get global growth moving again. A growing number of voices say that low rates are not doing the job and that governments must take other, more politically difficult steps to reinvigorate growth.

The warning by Mr. Rajan, now 53, came as he stepped down from a position that had helped make him something of a rock star — albeit a controversial one — in India. He disputed the view that his tight monetary policies had cost him the support of the government, and he said that his departure was based on his inability to reach an agreement with the government on serving longer but not serving another full three-year term.

Mr. Rajan is a celebrity in a country where taxi drivers and vegetable sellers are as likely as business owners and bankers to be immersed in debate on the local economy. A blunt speaker who has laid out the case for tighter monetary policies in more than 30 public speeches over the last three years, he was called "the Ranbir Kapoor of banking," a reference to a Bollywood superstar, by one of the country's longest-running columnists.

Mr. Rajan, whose term expired on Sunday, is credited with helping stabilize the Indian economy. It was fighting double-digit inflation, a weakening of its currency and a plunging stock market when he took the job in 2013.

But he also leaves bruised after a barrage of public attacks from the political base of conservatives and small-business interests of India's governing Bharatiya Janata Party. They complained that he choked business by keeping interest rates high and requiring banks to clean up bad debts, which made credit expensive and hard to come by.

The attacks turned vicious and personal in the weeks before Mr. Rajan announced in June that he would not continue for a second term, with a B.J.P. lawmaker declaring that Mr. Rajan was "mentally not fully Indian," in part because he holds a United States green card, allowing him to work and live there. Narendra Modi, India's prime minister, later denounced the attacks, but only after Mr. Rajan said he was leaving the job.

With Mr. Modi preparing for contentious local elections, some observers have said the government did not want Mr. Rajan to stay because it needed a looser monetary policy to bolster growth. India has the fastest-growing large economy in the world, at an annual rate of 7.1 percent for the most recent quarter, but that is still far slower than the rate of a decade ago and not fast enough to create jobs for the more than one million people who enter the work force each month. Mr. Modi won election in 2014 promising economic growth and jobs.

Mr. Rajan, leaning back in his chair and laughing at times during the interview, disputed that claim.

"I don't think it's fair to say that it's because of tight policy that the government wanted to move on," he said.

He cited the government's move after he announced his departure to set a low inflation target of 4 percent for the next five years. He said his successor, Urjit Patel, a central bank deputy governor who takes over this week, played an important role in setting the country's tough inflation targets.

Mr. Modi has said little in public about Mr. Rajan's departure except to defend him as "someone who loves his country" and "will continue to serve it." Mr. Modi's spokesman declined in a telephone interview on Sunday to explain why Mr. Rajan was leaving, other than to say: "There is a tenure and the tenure has ended. Why should the prime minister of India even be brought into this discussion?"

Mr. Rajan said his tight monetary policy had helped bring India's rate of inflation — currently about 6 percent — down to the upper end of the government's target range. "I think we've done exactly what was needed," he said. Mr. Rajan said the central bank should continue to prioritize low inflation.

He said he hoped the country would finish "the process of bank cleanup which is underway." Under Mr. Rajan, India's banks, after decades of loose lending to corporations, had to own up to bad debts. The restriction was intended to shore up the long-term stability of banks, but in the short term it has reduced the pace of lending to businesses.

In discussing the Indian economy in the interview, Mr. Rajan offered a less-than-ringing endorsement of the government's emphasis on manufacturing in India — what the prime minister has called his Make in India campaign.

Mr. Rajan said he did not support the view of critics that it was too late in world economic history for India to become a manufacturing hub. But he also said that he would not focus exclusively on manufacturing as the solution to joblessness.

If India improves infrastructure and reduces government regulations, manufacturing might take off in a big way, but it "could also be services. It could be value-added agriculture also."

Although China's economy has overshadowed India's in recent decades, Mr. Rajan said he was still a believer in democracy as the better system to create long-term growth.

"India's strengths to some extent comes also from its democracy," he said. "Things can get bad in India, but not beyond a certain point, because the democratic process asserts itself. And we have a change in government."

Mr. Rajan, who served as chief economist of the International Monetary Fund from 2003 to 2006, will return to his longtime job as a professor at the University of Chicago's business school.

He grew momentarily wistful when comparing the job of central bank governor with his past positions, which were more advisory.

"So better to be a doer than an adviser. Of course being an adviser sometimes has effects, important effects, but you don't see it as much immediately. Here you can see what you're doing and in the years to come."