

Rajan's exit from RBI — what will become of Islamic finance in India?

The shocking announcement by Raghuram Rajan, the governor of the Reserve Bank of India (RBI), earlier in June that he will be stepping down from his post when his term ends in September after a three-year stint shocked market observers and was a negative surprise for India, given his central role in reforming the country's monetary policy. DANIAL IDRABI asks what this means for the future growth of Islamic finance in India, given that Rajan has played such an instrumental role in introducing interest-free banking in the country, as well as being a strong proponent of Islamic finance.

Rajan, a former chief economist at the IMF, has made some notable strides during his tenure and took office when the rupee was at a record low and India was battling double-digit inflation. According to data by the World Bank, the economy is now growing at an average of 7%. Inflation, meanwhile, is down to 5.9%, with the RBI having a target to further lower the figure to 4% over the medium term.

"A new inflation-focused framework is in place that has helped halve inflation and allowed savers to earn positive real interest rates on deposits after a long time," Rajan noted in his letter to fellow colleagues at the RBI. He further highlighted that the currency stabilized as a result of the RBI's actions, and its foreign exchange reserves stood at a record high of US\$363 billion as at the end of the first week of June 2016, according to the RBI's data. It is also under his watchful eye and skilled maneuvering of monetary policy reforms that Islamic finance took off in India, with RBI officials paying closer attention to the need of interest-free banking to ensure the financial inclusion of approximately 200 million Muslims in the country.

In the 'Report of the Committee on Medium-term Path on Financial Inclusion' released by the RBI in December 2015, it was recommended that commercial banks in India be enabled to operate interest-free windows with simple products. This follows the findings by the Financial Sector Reforms Committee chaired by

Rajan in 2008, which stated that the non-availability of interest-free banking products results in some Indians, including those in the economically disadvantaged strata of society, not being able to access banking products and services due to reasons of faith. This also denies India access to substantial sources of savings from other countries in the region.

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Saif Ahmed, the managing director of Zayd Chit Funds, explained to IFN that Rajan's decision to not seek a second term is a negative development for Islamic finance in India, as he was a central banker who had an international outlook and appreciated the potential and scope of Islamic banking. "In terms of continuity of [the] RBI's internal processes on the topic [interest-free banking], yes there will be continuity in my view, but the push could be lacking unless the next RBI governor is also a visionary such as Rajan and possesses a global outlook with a familiarity and appreciation for the potential of Islamic banking," said Saif.

Although Saif reckons that there will be continuity of Rajan's policies and recommendations on interest-free banking by the next candidate to fill his shoes, his departure will nevertheless be a setback for the future growth of Islamic finance in India. His resignation comes on the back of a member of Narendra Modi's ruling party, Subramanian Swamy, calling for Rajan's dismissal, accusing him for keeping interest rates unnecessarily high and stifling growth. Swamy has also been against the introduction of Islamic banking in the country, deeming it "normal banking in disguise, and using Islamic terms to camouflage interest as profit or profit-sharing".

"Previously, not all governors were keen on Islamic finance, but now, the system can accommodate interest-free banking window[s] within the country's current regulations," Abdur Raqeeb, the general secretary of the Indian Center for Islamic Finance, commented to IFN. Abdur Raqeeb further noted that Rajan's presence at the RBI was a great time for Islamic finance in the country, as the topic was never at the top of the government's agenda.

The recent agreement signed between the Modi administration and the Islamic Corporation for the Development of the Private Sector to set up India's second Islamic non-banking financial company (NBFC) in the state of Gujarat remains a highlight under Rajan's tenure. The first such Islamic NBFC in India, Cheraman Financial Services, started operations in Kerala in 2013. "Though opening an Islamic bank appears challenging given the political ground realities and regulatory roadblocks, several Islamic NBFCs are already in operation and more are springing up as the demand and awareness for Islamic finance and investments grows in India," Saif noted.

The markets will be highly anticipating the Modi administration's appointment of the next RBI governor to replace Rajan, and the Islamic finance industry will be hoping that the candidate will be a strong proponent of interest-free banking in India, as his or her predecessor was.☺