

India: Patel throws in the towel

Governor Patel's sudden exit from the Reserve Bank of India intensifies market uncertainty and is negative for the Indian rupee (INR). The USD/INR is just shy of our end-year 71.50 forecast (spot 71.3). We continue to see the pair re-testing the 73 level within the next three-to-six months



Source: shutterstock

RBI governor Patel throws in the towel

We noted in our ['Asia week ahead' note last Friday](#) that investors would stay clear of Indian markets ahead of polling results for the five state elections to be announced today. And we have more reasons to think so now, following the news yesterday about Reserve Bank of India's governor resigning ahead of the forthcoming RBI board meeting later this week (14 December).

Urjit Patel's resignation for 'personal reasons', well before the expiry of his term in September 2019, in fact, goes to reinforce the widened rift between the central bank and the government. Clearly, central bank independence is compromised, and the government indeed now has greater control of the central bank and its reserves, which are required to plug the widening fiscal deficit in the election year.

What's next?

Whoever replaces Patel, most likely the most senior deputy governor, or a hand-pick of the government, the next central bank chief will be under intense pressure from the government to concede to the latter's demands for more growth-friendly policies ahead of general elections in early 2019. The news is clearly a significant negative for the markets; even Moody's deplored it as being credit negative.

The opinion polls for state elections are neck-and-neck between Modi's Bharatiya Janata Party and its main rival Congress Party, and the outcome will be crucial for the incumbent retaining power in the general elections. We aren't expecting today, or probably during the rest of the week, any positive news for the local markets. The politics will continue to overshadow the economy as most of India's monthly economic data (consumer and wholesale prices, industrial production, and trade) will likely be pushed into the background.

Going forward, the focus will remain the way the RBI conducts its monetary policy. And based on the current economic dynamic, and the political pressure to ease, the RBI leaving policy on hold through mid-2019 remains our baseline. Any policy easing on grounds of lower inflation is unlikely to do enough to boost growth in time to enhance political odds in favour of Modi.

The USD/INR is just shy of our end-year 71.50 forecast (spot 71.3). We continue to see the pair re-testing the 73 level within the next three-to-six months.