

# New RBI Governor - Way Forward

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## Appointment of Dr. Urjit Patel as the new RBI Governor

The government announced on 20th August that Dr. Urjit Patel will be taking over on 4th September as the new RBI Governor from Dr. Raghuram Rajan who completes his 3 year term in September. The selection of Dr Patel is a positive for 2 key reasons. Firstly as a core member of Dr. Rajan's team since 2013, he represents continuity in terms of policy direction. Further, as a respected economist with long standing policy and consultation experience, he brings strong intellectual capability to the role.

Both the above aspects will be crucial in continuing the multi-pronged structural reforms initiated by Dr. Rajan over the last 3 years. Indeed, Dr. Patel was the author of the report on reforming monetary policy that led to the 2 signature changes of the Rajan era - adoption of a formal inflation target and setting up of a monetary policy committee.

We perceive Dr. Urjit Patel as a firm believer in the role of stable inflation in achieving medium term economic growth and development. He has on many occasions communicated his view that sustained high food inflation does percolate into increased rural wage growth which has secondary and tertiary effects on overall inflation and hence it is important to control food inflation for sustainable growth.

He considers RBI governor's role as an "owl", who does not have a pre-defined "Dovish" or "Hawkish" stance and hence we feel that future monetary policy actions will be more data dependent after assessment of Macro Economic data. His other contributions include the targeting of a positive real rate.

He has also been the key driver behind the RBI's new thinking on liquidity management, which has seen it target a neutral system liquidity after many years in which it was systematically kept in deficit.

It is to be noted that the recommendation of a 4% +/- 2% target laid out by the RBI committee headed by Dr. Patel was recently affirmed by the government. Thus there seems to be consensus across both the government and the RBI on the medium term inflation target and this should bring down potential for any dissonance as Dr. Patel takes over as the new Governor.

Further, with the Monetary Policy Committee close to being set up, rate actions will be determined by the MPC going forward. However the Governor will have a large say in the MPC and in that sense having Dr Patel will be helpful.

As he takes over, his impact on other key issues such as bank NPA recognition and clean-up, foreign currency movements and external account management will become clearer over time. In this context it is to be noted that the core RBI team remains unchanged, and Dr. Patel is likely to share some of his predecessor's views on having a strong external balance sheet and pushing the government to adopt a prudent fiscal policy.

The bond markets had rallied in last few months anticipating a more dovish replacement at the RBI that would initiate near term rate cuts. With the announcement of Dr. Patel, we do not expect these hopes to be realized and as such there is potential for some short term knee jerk reaction.

While the latest CPI inflation print came over 6%, we believe that inflation broadly remains in the 5-6% range targeted by the RBI this year. Unless inflation demonstrably and sustainably trends lower from this range (sub.5%), there is little elbow room for policy rate cuts in the near future. There is no change in our medium term outlook as we expect 1-2 cuts over the next year.

The continuing commitment to a 4% inflation target should help set a solid foundation for the Indian bond markets that helps us avoid the kind of dramatic macro imbalances and consequent interest rate volatility that we have seen over the last couple of cycles. We also expect this announcement to be treated positively by foreign investors and should help support FII inflows into the debt markets.

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