David Shipley for Bloomberg
Investors pulling back from emerging markets have lately thought India a relatively safe bet. That's partly because they've been impressed with Raghuram Rajan, the governor of the Reserve Bank of India. If the global financial turbulence persists, confidence in the central bank's new boss may not be enough.

Like many other emerging-market economies, India badly needs reform. Rajan has called for a big change in the way the central bank does its job, but that's just the start. The list of other vital reforms is long. Completing it won't be easy, especially with an approaching general election (which will be contentious even by Indian standards).

Last summer, India took a beating as investors weighed the likely effects of tighter U.S. monetary policy. Global appetite for risk fell and capital fled to the advanced economies. India's rupee dropped more than 20 percent, making it one of the world's worst-performing currencies. After Rajan became governor last September, the Reserve Bank of India began to draw investors back through means both conventional (raising interest rates) and unconventional (encouraging deposits from Indians living abroad). The rupee recovered.

In recent days, investors' anxiety has rattled the rupee again -- though nothing yet to compare with last summer. India looks stronger, but it can't relax. Economic growth (less than 5 percent) is still low, and inflation (about 10 percent) is high. India's external deficit is too big, its fiscal discipline too lax and its investment climate too unfriendly. And don't forget that election, which has to be held by May. Unless global markets stabilize, all this could be more than enough to induce an abrupt change of mood, and India could find itself back on the firing line.

Rajan is doing what he can. He lifted interest rates another notch last week because inflation hadn't fallen as much as he'd hoped. Last month an expert committee he set up recommended a thorough overhaul of monetary policy, including a formal inflation target of 4 percent and a new central-bank committee to set interest rates. That's all to the good: The existing arrangements are opaque and unpredictable.

But a modernized central bank can't do everything -- and lately it has seemed that the rest of the government can't do anything. The ruling United Progressive Alliance is mired in corruption scandals, with a leadership divided between an ineffective prime minister and an unaccountable Congress Party president.

Heightening the uncertainty is the rise of Narendra Modi, the charismatic leader of the main opposition -- the pro-business, Hindu-nationalist, right-of-center Bharatiya Janata Party. Modi, chief minister of Gujarat (one of India's most successful states), is an electrifying speaker and a hero to many business leaders. His followers can be fanatical -- in both senses of the term. In the past, Modi has sided with anti-Muslim extremists. At the very least, he failed to prevent riots in 2002 that claimed more than 1,000 lives. The U.S. has revoked his visa as a result.

From a purely technocratic standpoint, a Modi-led government might be just what India needs. His record in Gujarat has been impressive, with cleaner government, new infrastructure, fiscal discipline, inward investment from India and abroad. Gujarat has consistently grown much faster than India, and the state's poor have shared in the gains.

For a program like that to succeed nationally, political stability is essential. In India, this can't be taken for granted. Modi has been trying to broaden his popularity beyond his Hindu-nationalist base: He has called on Hindus and Muslims to make common cause in defeating poverty. That's fine, but his outreach to a Muslim community that still views him with justified suspicion needs to be more forthright.

India's economic potential is staggering. Realizing that potential will require better leadership than the country currently has. Over the coming months, India will test investors' nerves.