

India: Lower oil price a boon, politics a bane for the rupee

In yet another revision, we lower our USD/INR forecast for end-2018 to 71.5 from 74.0 and for end-2019 to 69.0 from 73.2. In the meantime, mounting political uncertainty in the run-up to general elections in May 2019 makes us think the rupee will weaken past the 73 level in the next three to six months

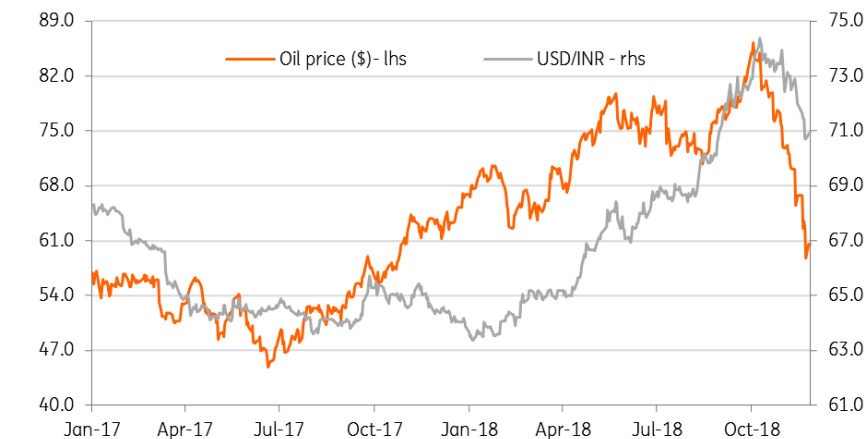


Lower oil price a boon for the rupee...

The Indian rupee's (INR) 4.4% month-to-date appreciation against the USD has it on track to be an outstanding Asian currency this month. At 70.9 the USD/INR has retraced a chunk of the 15% depreciation that drove the pair above 74.0 in the first 10 months of the year. The more than 30% collapse in the crude oil price since October explains the reversal of fortune for the currency (see figure).

The expectation of slower global growth amid an intensifying US-China trade war and increased supply are depressing the oil price ahead of the OPEC meeting in early December at which US - Saudi Arabia diplomacy will weigh heavily on future supplies.

Longest INR appreciation streak in two years



Source: Bloomberg, ING

... despite slowing growth, and

Aside from the falling oil price boon and the broader USD weakness, India's economic dynamics have hardly changed in favour of the INR. The GDP data for 2Q FY2019 (July-September quarter of 2018) due later this week (30 November) is expected to reinforce the fact that growth has peaked and the slowdown has begun. While the high base effect from the post-denomination bounce in growth from 2Q FY2018 is at work in depressing annual increase, weakening exports and private consumption, and increasing drag from net trade are also contributing to the slowdown. In addition to this are the persistently tight banking system liquidity and tough lending guidelines for public sector banks dragging investment demand.

Our view of a slowdown in India's GDP growth to 7.5% YoY in 2Q FY2019 from 8.2% in the previous quarter, which was the fastest rate of growth in two years, is consistent with the median consensus estimate of 7.4%. Anything weaker than consensus will be bearish for the local financial assets, including the INR.

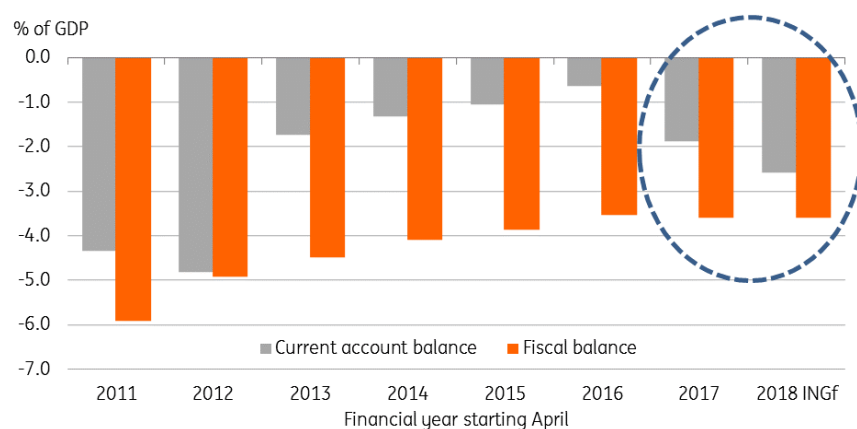
... widening twin-deficits

The key economic resistance for the INR appreciation, the twin-deficits (current account and government budget) remains intact and could even get worse. The cumulative budget deficit in the first half of FY2019 was 19% higher than a year ago and was 95% of the full-year target deficit. The pressure on public finances was obvious from recent pressure by the government on the central bank for more funds. Yes, the thawing of tensions between the Reserve Bank of India (RBI) and the government is another positive for now, though recent tensions will continue to lurk in the background and are not positive for the currency. And on the external front, the financial year-to-date trade deficit of \$111bn is 26% wider on the year, with more than half of the widening coming from oil trade.

The benign inflation backdrop, which is puzzling in view of INR's dismal performance, has allowed the RBI to hold the line on policy interest rates. But the wide fiscal deficit will eventually be inflationary while crowding out of private sector investment will also weigh on GDP growth. That said, we have recently scaled back our RBI view from a rate hike at the last meeting of the year in December to no more hikes this year. We do, however, expect the RBI to resume tightening once

the elections are out of the way by mid-2019.

Resurgent twin-deficit problem



Source: Bloomberg, CEIC, ING

Politics the key headwind to INR in 2019

Above all, politics is likely to decide the course for the INR in 2019. The political heat is already rising as the elections being held in five states currently will set the tone for the national elections scheduled in May 2019. Considering the public wrath following chaotic demonetisation in late 2016 and GST implementation in mid-2017, it will be a tough task for the incumbent Modi government to retain power for another term. We expect it to be a too close-to-call poll.

Snapping the longest appreciation streak in two years the USD/INR started trading this week on the weaker side. We aren't seeing the pair drifting far from the current level as the year draws to close, though the bias will be more on the weaker than stronger side depending on the outcomes of the state elections.

We revise our USD/INR forecast for end-2018 to 71.5 from 74.0 and that for end-2019 to 69.0 from 73.2. In the meantime, the mounting political uncertainty in the run-up to general elections leads us to a view of the INR weakening past the 73 level in the next three to six months. Once the political overhang lifts we anticipate a steady consolidation below the 70 level by the end of next year.

India: Economic forecast summary

India (FY April-March)	2017	1Q18	2Q18	3Q18F	4Q18F	2018F	2019F
Real GDP (% YoY)	6.7	7.7	8.2	7.5	6.8	7.2	7.0
CPI (% YoY)	3.6	4.6	4.8	3.9	3.5	4.0	5.0
RBI repo rate (% eop)	6.00	6.00	6.25	6.50	6.50	6.50	7.00
3M T-bill rate (% eop)	6.15	6.09	6.46	6.99	7.00	7.00	7.50
10Y govt. bond yield (% eop)	7.23	7.40	7.90	8.02	8.00	8.00	8.30
INR per USD (eop)	63.87	65.18	68.47	72.49	74.00	74.00	73.20
Note: Annual growth and inflation forecast on financial year basis, rest on calendar year basis.							
Sources: Bloomberg, CEIC, ING forecasts							
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Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michieltukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com