

India: Never underestimate central banks

The key question for markets ahead of the central bank meeting this Friday is whether it will overlook the rupee's weakness? We won't be surprised by more than a 25 basis point hike, but still, we revise our end-year forecast for USD/INR to 75 from 73.5



Source: Shutterstock

A confounding consensus on RBI policy

The [recent media headline about the Reserve Bank of India](#) possibly abandoning the rupee was eye-catching but was based on the increased stress in India's financial system due to a beleaguered non-bank finance company going bust and the resulting tighter liquidity conditions.

The fact that higher interest rates will compound the liquidity problem was a setback for the consensus view on the RBI policy. Until the troubles surfaced to batter local markets around two weeks ago, the consensus was biased towards a 25 basis point hike at the next meeting. However, since then, things have become pretty indecisive with almost half of the analysts expecting a 25bp hike and the remaining expecting no hike at all.

We have been in the rate hike camp all along.

6.75% ING forecast
RBI repurchase rate

Will the RBI overlook the weak rupee?

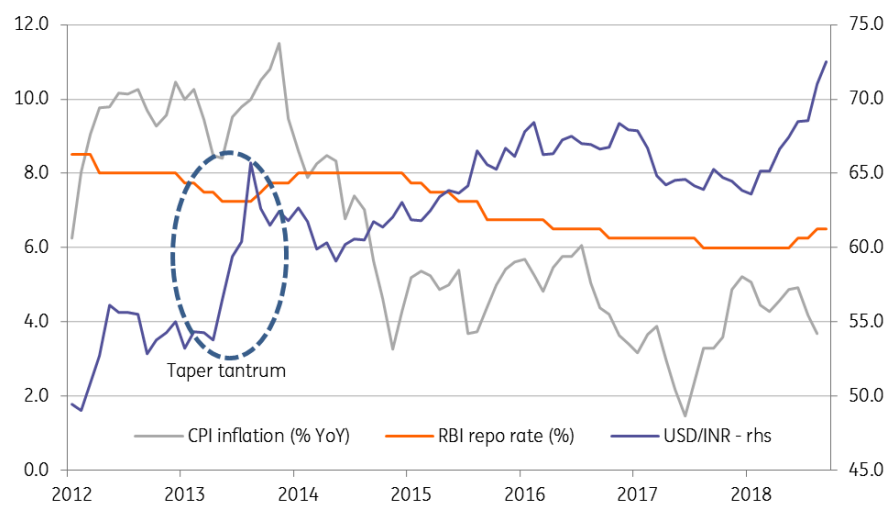
The usual central bank response to a weak currency is aggressive policy tightening, like Indonesia and the Philippines, who have had 150 bp rate hikes recently. But the odds of the RBI following their footsteps seems to be constrained by the central bank's 4% (+/- 2%) inflation mandate, a potential slowdown in growth due to the ongoing trade war, and troubles in the financial system.

We won't be surprised if the central bank hikes more than 25bp, though for now, our base case remains only a 25bp hike and another move in December

The latest rupee sell-off is a mirror image of the sell-off in 2013 and the RBI's response back then was just as lacklustre as it is today. Despite domestic inflation running in double-digits in 2013, they only lifted the policy rate twice by 25bp in September and October 2013.

If history is any guide, then the RBI upping its ante on tightening measures may be a remote possibility, just as the consensus view for the upcoming policy meeting stands.

A lacklustre response to currency turmoils



Source: Bloomberg, CEIC, ING

As other support measures have been failing

Other currency support measures, including import tariffs, relaxation of foreign borrowing limits for manufacturing companies, removal of withholdings on masala bonds have all failed to do much.

The RBI has allowed commercial banks to dig into their statutory reserves to ease the liquidity crunch. There have been some traces of the central bank intervening in the foreign exchange market to support the currency, but not a lot. The \$22.6bn fall in the country's foreign reserves since the onset of currency market turmoil in April represents the largest capital flight from any Asian economy.

Even as the government has moved to bail the troubled infrastructure finance company out, the uncertainty surrounding restructuring of the company continues to be an overhang on financial markets.

Never underestimate central banks

However, we also find it hard to believe that the central bank will turn a blind eye to the currency problem. Although inflation has been anchored within the RBI's target, it certainly is more of a transitory phase, especially when global oil price are rising and the hit from this on the country's current account deficit is already being compounded by depreciating the currency.

The USD/INR rate has almost hit our 73.50 end-year forecast, which is why we now revise our forecast upward to 75.0 (spot 73.3)

Any central bank in the world will want to be pre-emptive rather than reactive to future inflation expectations and in India's case expectations remain elevated.

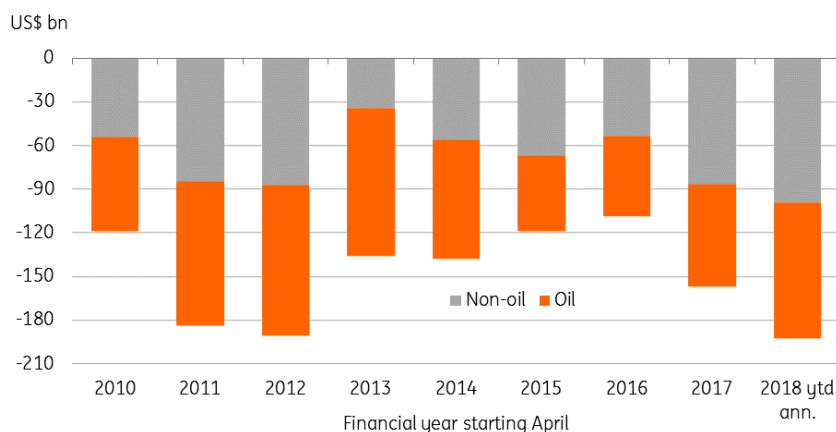
Never underestimate central banks, when it comes to preventing a crisis from eroding investor confidence in the economy and the currency. Indeed the currency and the financial sector troubles will top the agenda for the RBI policy committee this week and an extra policy thrust can't be completely ruled out. This is why we won't be surprised if the RBI does hike more than 25bp this Friday, though our baseline remains only a 25bp now and another like move in the next meeting in December.

Another downgrade of INR forecast

Whether the aggressive policy move (if we get one at all) will eventually keep the rupee from losing further ground remains a perennial question given the lingering risks of a wider trade deficit from high oil imports and elevated inflation expectations. Add to this the political risks becoming a more prominent sentiment driver for markets going into the election year and any additional policy thrust may still prove to be inadequate in an environment of a strong US dollar.

The USD/INR rate has almost hit our 73.50 end-year forecast, which is why we now revise our forecast upward to 75.0 (spot 73.3).

Oil is swelling the trade deficit



Source: Bloomberg, CEIC, ING

Author

Alissa Lefebre

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

michiel.tukker@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 Klokk

Senior Economist, Netherlands
marcel.klokk@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