

India: No respite for the rupee

As if the global market turmoil isn't enough, domestic economic developments have been turning sour for the Indian rupee. This provides little hope for a break in the trend of the currency testing new lows against the US dollar. Prepare for more aggressive central bank policy tightening ahead



Source: Shutterstock

The Indian rupee (INR) exchange rate per US dollar surged to a record high of 70 when the Turkish financial crisis hit emerging market currencies hard earlier this week. As if the external drags on the INR aren't enough, the domestic economic data -- a multi-year high trade deficit, elevated inflation, and signs of slowing GDP growth -- haven't been any friendlier.

With an apparently shallow central bank (RBI) tightening cycle ahead, the current INR depreciation trend looks to be a prolonged one. The next challenge will be a string of state elections in the remainder of this year and general elections in 2019, which should see investors starting to add a political risk premium into local financial assets. As such, we don't rule out an aggressive central bank (RBI) policy tightening at the October meeting. Yet we see no threat to our 71.5 forecast for the USD/INR by end-2018.

\$18bn Trade deficit in July

Five-year high

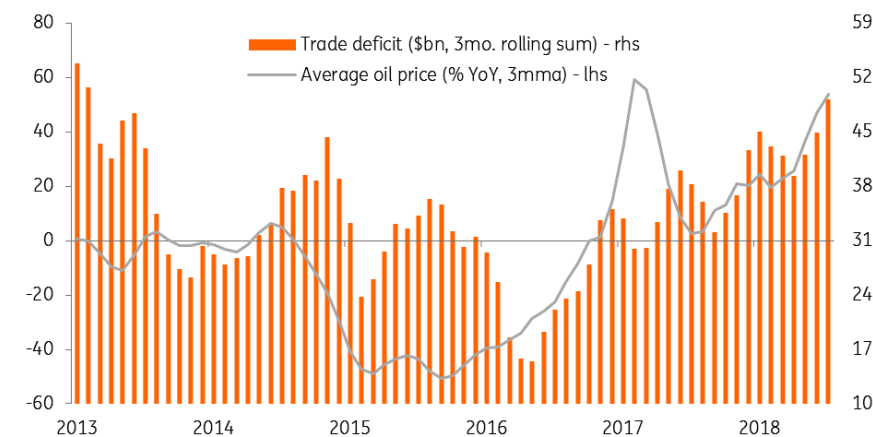
Trade deficit at five-year high in July

India's external trade deficit jumped to the highest level in five years, to \$18 billion in July from \$15.6 billion in the previous month. This was far above our forecast of a \$15.9 billion deficit, while the consensus was centred on an even lower figure of \$15.7 billion. The high trade deficit was due to import growth outweighing export growth for the second consecutive month. Imports grew by 29% year-on-year in July, beating our 26% forecast, while export growth of 14% YoY was in line with expectations.

Oil imports, with a 58% YoY surge in July, remained the main driver of total imports. Even as global oil prices stabilised around \$75/barrel in the three months through July, year-over-year oil price inflation remained on an upward trend, 52% YoY in July, causing the oil import bill to balloon. Therefore, oil has been mainly responsible for the higher trade deficit as is clear from the chart below.

The cumulative deficit in the first four months of FY2018-19 (starting April) was \$63 billion, up from \$51.5 billion a year ago. Nearly all of the widening over the year was due to oil trade. The trade balance drives the current account balance. We expect the current deficit to rise to 2.6% of GDP in the current financial year from 1.9% in the last year.

High oil price inflation is fuelling trade deficit



6.3% Core CPI inflation in July

A four-year high

Rising core inflation, slower GDP growth

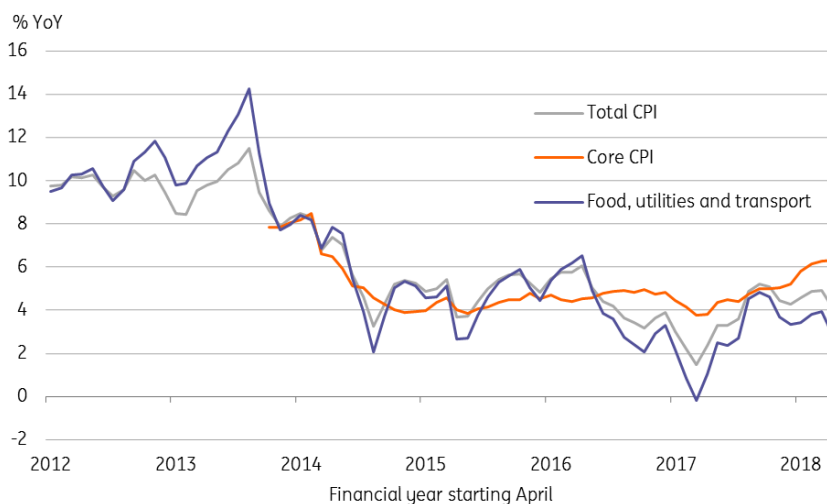
Consumer price inflation surprised on the downside in July, coming in at 4.2% YoY, while June's figure was revised down to 4.9% from 5.0%. But the headline overshadowed a steady increase in the core measure to a four-year high of 6.3%. While central bank (RBI) policymakers aren't letting their guard down against inflation, which will remain elevated due to several administrative factors apart from the high oil price, the ongoing currency weakness and higher trade tariffs will pressure inflation going forward.

And surprisingly strong industrial production data for June, with 7% YoY growth (although this is back-dated data), provides little solace. The average April-June IP growth is still slower at 5.2% from the 6.5% average in the previous three months. This foreshadows a slowdown in GDP growth in 1Q FY2018-19, not a good start to the year, the rest of which will remain exposed to greater global economic uncertainty and rising domestic political risk.

In the 2018 Article IV Consultation released last week, the IMF warned about sustained upward inflation requiring gradual monetary tightening. The Fund also warned about slower growth ahead resulting from adverse terms of trade and loss of real income to households and firms, while tighter monetary policy will hinder the recovery of credit growth and investments.

A month ago, we downgraded our GDP growth forecast for FY2018-19 from 7.2% to 6.7% ([see 'India: Downgrade of growth forecast'](#)). We now increase our inflation forecast for the year from 4.7% to 5.0%.

Rising core inflation



Source: Bloomberg, CEIC, ING

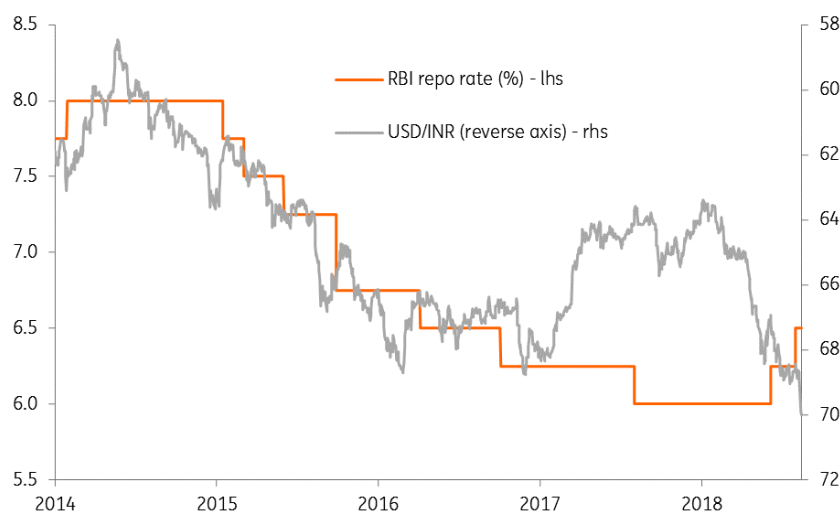
Authorities accommodating INR weakness

The INR's 8.6% year-to-date depreciation is the steepest among Asian currencies, of which 7% has occurred since April. A \$20 billion fall in foreign exchange reserves in the last four months to \$404 billion through July is a testament to the RBI's presence in the market to support the currency. This is still a sufficiently large stock of reserves, though the authorities concede that any intervention will not do much to stabilise the currency when it's due to global factors.

Even if the rupee falls to 80, it will not be a concern provided all other currencies depreciate. – Subhash Chandra Garg, secretary of India's Economic Affairs Department

And with local factors also kicking in now, it might take a more aggressive policy response to rein in INR weakness. Just as in other Asian countries (Indonesia and Philippines), a weak currency was the principal force behind two 25 basis point RBI policy rate hikes in June and August. Will the RBI follow central banks in Indonesia and the Philippines in pursuing aggressive policy tightening? Or, on the contrary, will the central bank take the currency weakness in stride as a factor required to curb imports and the trade deficit, even though this would also be inflationary. This poses a significant policy challenge for the RBI going forward.

Prepare for an entrenched RBI tightening cycle



Source: Bloomberg, ING

Likelihood of more aggressive RBI policy tightening

An apparently shallow RBI tightening cycle based on current domestic economic conditions could become entrenched in the event that global currency turbulence intensifies, which remains a risk if the US delivers on its planned \$200 billion worth of tariffs on China.

While we maintain our forecast of one more 25 basis point RBI policy rate hike at the next meeting on 3-5 October, we don't rule out the RBI doubling it up. Not only that, we now add to our policy forecast a further 50 basis points of rate hikes in 2019.

Will this stem the INR weakness? Besides external and domestic economic factors, politics will be an added overhang on the currency as a string of state elections in the remainder of the year culminates in general elections by mid-2019. With investors starting to add a political risk premium into local financial assets, any relief to the currency from higher interest rates will be transitory. This should keep the USD/INR rate on the path towards our 71.5 forecast for the end of 2018.

Economic Forecast Summary

India (FY April-March)	2017	1Q18F	2Q18F	3Q18F	4Q18F	2018F	2019F
Real GDP (% YoY)	6.7	7.7	7.0	6.7	6.5	6.7	7.2
CPI (% YoY)	3.6	4.6	4.8	5.0	4.8	5.0	4.8
RBI repo rate (% eop)	6.00	6.00	6.25	6.50	6.75	6.75	7.25
3M T-bill rate (% eop)	6.15	6.09	6.46	6.80	7.05	7.05	7.50
10Y govt. bond yield (% eop)	7.23	7.40	7.90	8.10	8.30	8.30	8.60
INR per USD (eop)	63.87	65.18	68.47	70.10	71.50	71.50	69.80

Note: Annual growth and inflation forecast on financial year basis, rest on calendar year basis.

Source: Bloomberg, CEIC, ING

Author

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