

## The Indian Rupee's plight is far from over

Expect the rupee's depreciation to nudge the central bank closer to a rate hike but for now, we see USD/INR ending the year at 68.3, higher than our previous forecast of 66.6



Source: Shutterstock

The Indian rupee's plight has been underway since mid-2017 but intensified this month after the publication of the US Treasury Currency report.

Since then, the rupee (INR) has seen a steep fall losing 2.5% of its value against the US dollar to a 13-month low of 66.9, at the time of writing this. We believe its troubles are far from over, as several external and internal factors will continue to expose it to considerable weakness in 2018 and beyond.

This is why we revise our USD/INR forecast for end-2018 to 68.3 from 66.6.

**68.3** ING's USD/INR forecast for end-2018  
Revised up

## ➔ Move to currency manipulator list

The latest US Treasury report placed India under the monitoring list of countries possibly tempering their currency exchange rates. Other countries under the scope are China, Japan, Korea, Germany and Switzerland. This wasn't a complete surprise for the markets as the previous US Treasury report had already flagged such a possibility.

Of the three criteria, Indian ticked two. A significant bi-lateral trade surplus with the US of at least \$20bn and persistent one-sided intervention with net foreign exchange purchases of at least 2% of GDP. It dodged the bullet on the third criteria of a material current account surplus of at least 3% of GDP.

In the fiscal year 2017-18, the trade surplus with the US amounted to \$22bn, and foreign reserve accumulation was 2.4% of GDP, whereas current account deficit was around 2% of GDP, from 0.7% the previous year.

## ➔ More hawkish central bank

The Reserve Bank of India (RBI) has also turned more hawkish.

In what we consider a premature move, the RBI downgraded its inflation forecast for the first half of fiscal 2018-19 to a range of 4.7-5.1% from 5.1-5.6%, while the forecast for the second half was also cut to 4.4% from 4.5-4.6% at the bi-monthly monetary policy meeting held on 5 April.

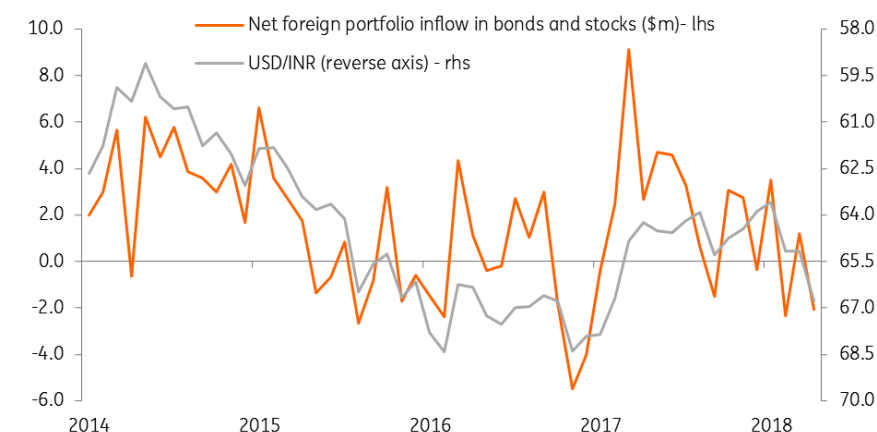
Contrary to an inflation forecast downgrade, minutes of the same meeting released on 19 April tipped the scale of monetary policy risk towards tightening from the current neutral bias, as Deputy Governor Dr Viral Acharya signalled his "decisive" vote for "withdrawal of accommodation" at the next meeting in June.

**\$2.1bn** Net portfolio investment outflow in April

## ➔ Increased capital outflows

According to Bloomberg, foreigners sold \$2.1bn of Indian stocks and bonds month-to-date in April, more than reversing \$1.2bn of inflows in March. We anticipate no near-term respite from the outflow of confidence sensitive capital from India even if the central bank, which reportedly defied the US Treasury's warning, comes to the rescue of the rupee.

## Foreign portfolio flows vs. USD/INR exchange rate



Source: Bloomberg, ING

Moreover, we have also entered a seasonally weak period (April-June) for the currency, the period when the typical surge in demand for gold demand for the wedding season contributes to INR weakness.

Add to this rising oil prices which accounts for almost half of India's trade deficit, which surged 44% YoY to \$157bn, \$70bn was oil-related.

Both gold and oil prices have been on an upward trend and, based on ING's house view of a weak USD for the rest of the year, the trend will persist.

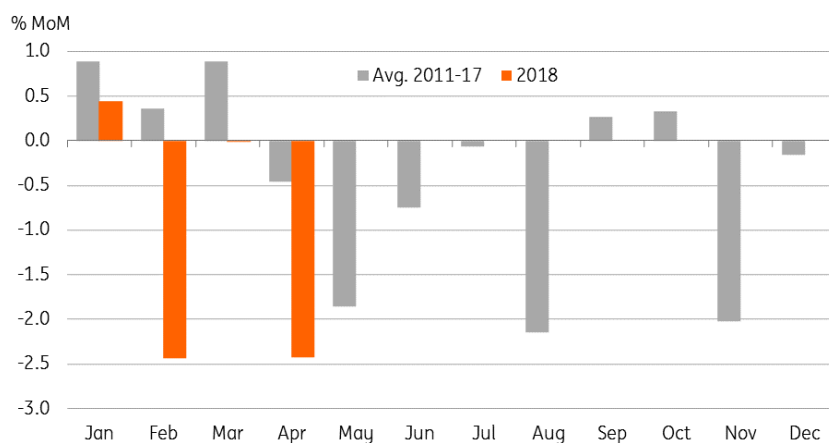
### ➔ Other headwinds

External and internal headwinds to the rupee remain. These include a potential global trade war, rising crude oil price and tightening monetary policies in developed markets. The domestic headwinds which include twin-deficits, a scandalous banking system further aggravating policy bottlenecks, and above all rising political risks before the general elections in 2019 are not insignificant. All these factors undermine the prospects of growth.

### ➔ Sell in May and go away?

The rupee's predicament will be put to the test next month in May, one of the three weakest months of the year for the currency. As the chart shows, the other two are August and November.

## Indian rupee seasonality



Source: Bloomberg, ING

An exacerbated INR depreciation will move the central bank closer to a rate hike. But for now, we maintain our view of a 25bp rate hike in August, followed by another hike next year, in February 2019.

This is why we revise our USD/INR forecast to end the year at 68.3, higher than our previous forecast of 66.6.