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When will cryptocurrencies become mainstream?

Watch video

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz
Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebre@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 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.schroder@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

Article | 23 September 2019 Think Forward Initiative

The costs of holding cash

Coins are a pain to hold on to and consumers are often eager to get rid of them, according to Jay Zenkic, Kobe Millet and Nicole Mead in a recent TFI report. This has important implications for spending and saving

Despite the ease of credit and debit cards, cash is still king and many people worldwide still rely on it every day. Even in The Netherlands, the least cash-reliant country in Europe, almost half of the transactions occur in cash.

Parting with cash can sometimes be difficult. Studies have shown that paying with credit cards actually dulls the pain of paying, even though the cost is the same. But new TFI research shows that holding on to some forms of cash can be painful, too.

While paper banknotes are light and easy to carry, coins are heavy and cumbersome. In both developed and developing countries, people see coins as an inconvenience and something to be rid of, which in turn affects spending habits.

In India, poor consumers spent the equivalent of 10% of their daily income more when they had coins instead of notes. In a different study- this time hypothetical- European and American consumers donated more of their money but also gambled more with coins than with notes.

This spending behaviour could have detrimental effects on consumer finances. After all, the more we spend the less we can save. So what can be done? One innovative and pragmatic solution could be to have organisations return change from cash transactions onto debit cards, credit cards, or other forms of digital wallets.

Read the full report here.

Author

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

US & China trade: Who is "winning?"

US – China trade tensions are an obvious threat to supply chains and corporate profitability. Businesses are trying to adapt to the new environment with third party countries seemingly benefiting from the impasse at the expense of both China and the US

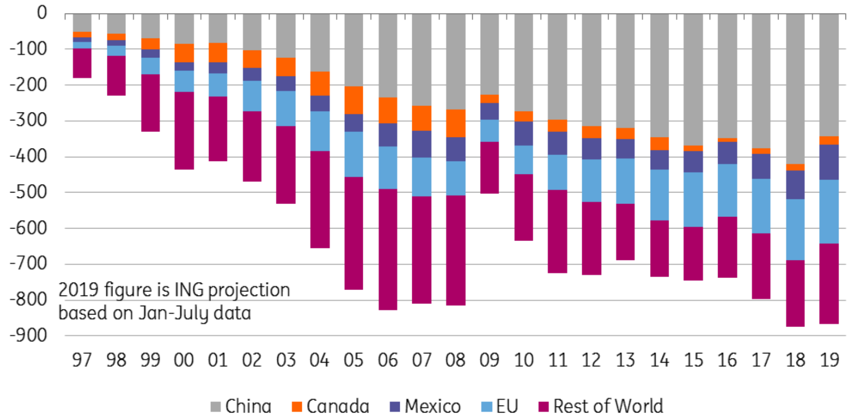
Source: Shutterstock

President Donald Trump shakes hands with Chinese President Xi Jinping during a meeting on the sidelines of the G-20 summit in Osaka, Japan

So far so good for the US?

One of President Trump's election campaign promises was to get better trade deals for the US. China has been the focus of his attention as he seeks improved access for America companies while protecting intellectual property rights. On the face of it the policy appears to have been a success for the US. The US goods deficit with China has shrunk 11% for January-July 2019 versus the same period in 2018. This means the US is on track to experience its smallest goods trade balance with China since 2012.

US goods trade balance breakdown (USD bn)



Source: Macrobond, ING

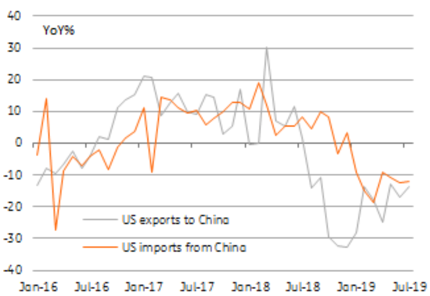
In reality both sides are losing...

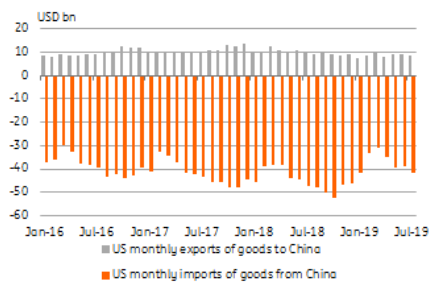
However, the chart above shows that the US goods deficit overall is not narrowing to anywhere near the same extent. Instead, the US deficits with Mexico and the EU look likely to hit new highs in 2019 while the deficits with Canada and the "rest of the world" are on course to widen out versus 2018. This hints at some substitution of Chinese goods imports for imports from other countries.

President Trump has suggested that unless China agrees to US demands "China's supply chain will crumble and businesses, jobs and money will be gone!" Unfortunately for the US, the charts below suggest that American companies are feeling pain too. There has been a reduction in goods imports from China, but there has been an even bigger percentage decline in US exports of goods to China (as measured in US dollars). This will be due in part to the tariffs China has placed on some US imports, but also the general slowing of the Chinese economy with possibly some currency effect too.

This may seem a confusing outcome given the narrowing of the trade deficit. It is because the value of US imports from China dwarf the value of US exports to China - the smaller percentage change still yields a much bigger dollar outcome. The net effect of the trade war is that both sides have been hurt.

US-China trade YoY% and monthly flows in USD bn



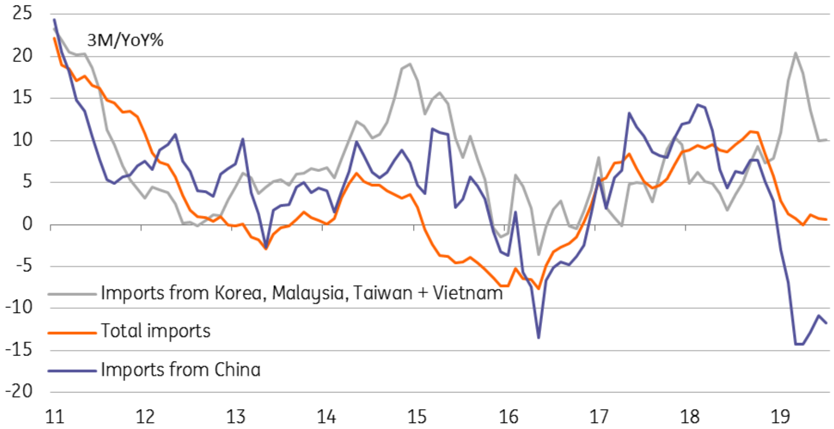


Source: Macrobond, ING

US businesses are looking for solutions

Given the scale of demand for Chinese intermediate goods within US supply chains there are clearly going to be challenges for US companies domestically too. Higher tariffs put up costs of Chinese products imported into the US, some of which is likely passed onto consumers, but the net overall result is still likely to be a hit to US corporate profitability. Businesses are looking for ways to limit the financial impact and this typically involves trying to find alternative suppliers, either domestically or from abroad. This takes time, but there is clear evidence that US firms have increasingly been sourcing alternatives from other Asian countries.

US import growth from China versus other Asia & World



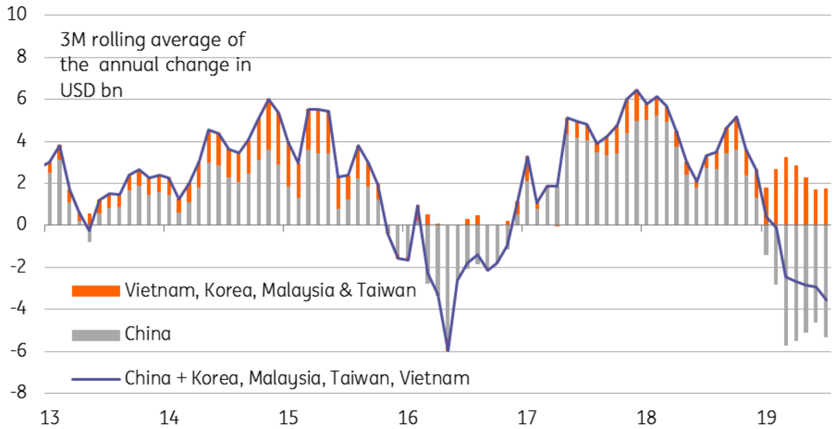
Source: Macrobond, ING

Looking for alternative supplies…

The chart above shows that US imports from Korea, Malaysia, Taiwan and Vietnam have accelerated sharply over the past year, which coincides with the steep drop in imports from China, supporting the substitution effect hypothesis.

We have to remember that the US historically has imported far more from China than other Asian countries so we need to also look at the 12M change in USD levels (chart below). The substitution effect since late 2018 is again clearly evident, but it shows us that the dollar value drop in imports from China has not been fully offset by higher dollar value imports from Korea, Malaysia Vietnam and Taiwan. Currency effects at the margin may have an influence, but only the Korean Won has underperformed CNY since 2018. We also have to consider that some of this slack may have been picked up by Mexico and the EU given expanding US deficits with those trade partners.

Change in USD value of imports into the US from China versus other Asia



Source: Macrobond, ING

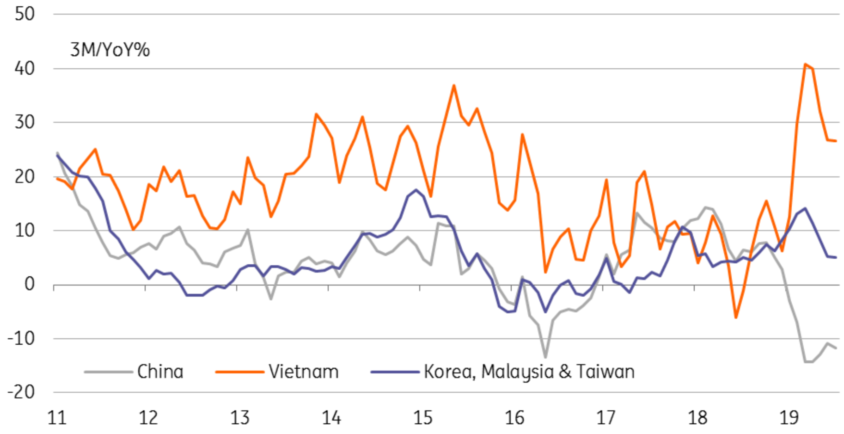
… or work-arounds…

Of course, it is possible that the economic pain China is feeling from the trade war has been mitigated by some businesses trying to "work around" the tariffs. This is typically done by exporting to an unsanctioned country where some "value added" is created before being shipped onto the final destination – thus avoiding the tariff.

This is a tried and tested formula with one of the more extreme examples being Russia. It takes time to find alternative suppliers from different countries or to develop domestic ones. When sanctions were first imposed on imports from the EU, Russia companies used business relationships to import EU products via 3rd party countries, including Belarus. This put up costs, but ensured supply chains could continue functioning until alternatives were found.

If that has indeed been happening as a result of the US-China stand-off, the most likely avenue is Vietnam. While US imports from Korea, Malaysia and Taiwan have certainly increased, it is from Vietnam that they have surged.

Growth in US imports from selected Asia countries - Vietnam the outperformer



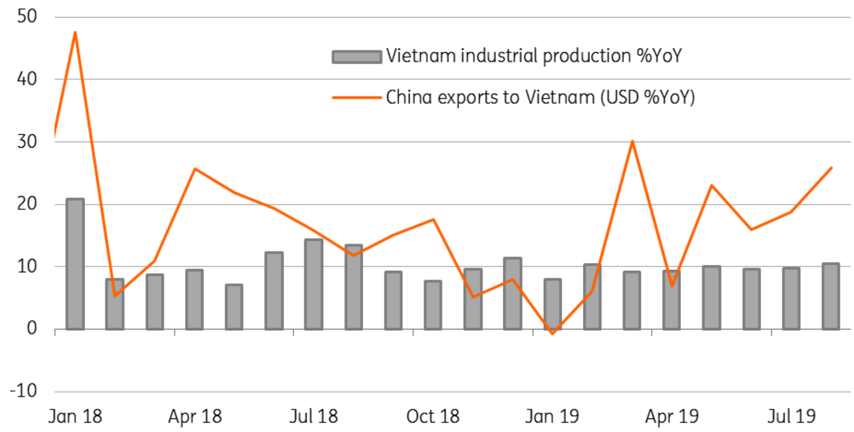
Source: Macrobond, ING

Chinese, but "made in Vietnam"?

It is difficult for an economy to build extra production capacity and related supply chains in a short period of time to substitute even part of the production from China. Vietnam's manufacturing production growth was quite flat at around 10% year-on-year in 2019. It was even slower in 2018. It is hard to believe that the surge in Vietnam's exports to the US (in US dollar terms, remember) has all come from production within Vietnam.

The obvious response is that it hasn't. Chinese exports to Vietnam have displayed a strong upward growth trend in 2019, which is in contrast to the slowdown in 2018, and also in contrast to the moderately flattish growth of Vietnam's production.

China exports to Vietnam growing much faster than Vietnamese manufacturing output



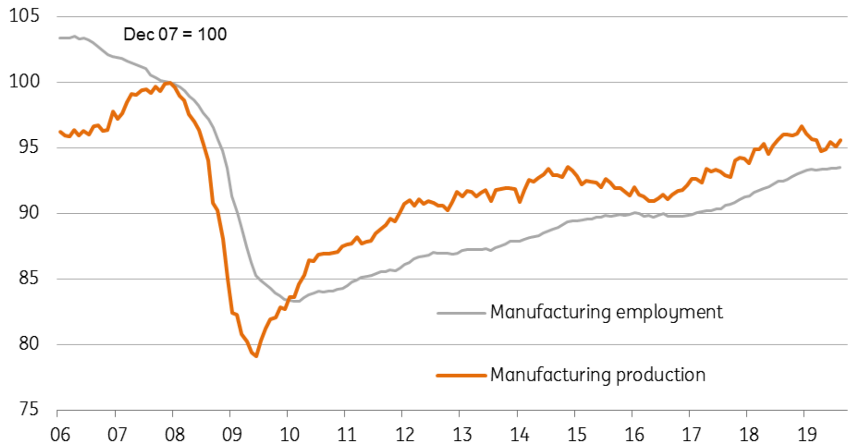
Source: Bloomberg, ING

FDI is starting to flow

But this kind of re-routing could be temporary as Chinese companies start shifting production lines to other economies given the fear that poor US-China trade relations and prolonged use of tariffs could be the new norm. For example, it has been widely reported that a Chinese manufacturer of bluetooth earphones plans to move production of Apple AirPods to Vietnam for an investment of US$260 million.

The longer the trade disruption lasts more Chinese manufacturers will likely go down this route to tap the new opportunities. And, those emerging economies that receive these FDIs will benefit from the China-US trade war and could experience better economic growth.

Level of US manufacturing output and employment versus 2007 peak



Source: Macrobond, ING

US manufacturers still waiting for the boost

President Trump would ideally prefer US manufacturers to benefit, but with US manufacturing output down 1.1% year-to-date and 4.4% below the peak levels of December 2007, there is little evidence yet that domestic manufacturing is picking up the slack in any meaningful way. The caveat to this statement is that this is very much a headline figure and it is possible that some US manufacturers are receiving orders for some of what was serviced by Chinese imports at a time when demand for US manufactured goods is falling overall. This downturn in itself may be in large part caused by worries over the lingering effects of the trade war.

With durable goods orders pointing to a contraction in domestic capital expenditure in coming quarters and the manufacturing ISM in negative territory, there seems little prospect that we will see a near-term build-up in domestic US manufacturing potential. Maybe one solution to the impasse is if China was instead to move some of its production to the US, but this looks highly unlikely to happen in the near-term given the current political stand-off. Despite their respective claims, the US and China look set to both remain losers from the trade war.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Germany: Breather but no relief

The increase in today's Ifo index is too little to take away fears of a further downward slide of the economy

Source: Shutterstock

Anyone looking for a bit of shiver these days only needs to take a look at German macro data - a series of horrific macro news. This morning's Ifo index brought some relief but as in tunnels of horror, there is no guarantee that the next monster isn't round the corner. Germany's most prominent leading indicator, the Ifo index, increased for the first time in a year, coming in at 94.6 in September, from 94.3 in August. While the current assessment component unexpectedly increased to 98.5, from 97.5 in August, the expectations component continued its recent fall.

Closer to a technical recession

A breather but no relief. The small increase in the Ifo index does not take away the fact that the German industry continues to suffer from structural changes and the ongoing trade conflict.

In fact, the industry has seen a complete reversal within a year. Cast your minds back to last summer when the biggest problem for the German economy was supply-side constraints? But the lack of demand has now become one of the most pressing issues.

According to the European Commission's sentiment indicators, the issue of demand as a limiting factor to production is at its highest level since 2012. Consequently, our previous hopes for investment being the growth wild card for this year have faded too. All supply-side constraints in the industry are disappearing quickly. Unfortunately, this is not, as hoped, on the back of new investments but simply driven by weaker demand. Equipment as a limiting factor to production has dropped to its lowest level since the end of 2017. The lack of skilled workers has dropped to its lowest level since 2Q17. Capacity utilisation has fallen to its lowest levels since 1Q16. At least in the short run, there is very little hope for a rebound. High inventories and smaller order books do not bode well for industrial activity in the coming months.

The likelihood of another contraction of the German economy in the third quarter and hence a technical recession increases almost by the day. While a “light” technical recession is not the end of the world for an economy which has been growing for more than ten years and has an unemployment rate at all-time lows, it is the lack of any signals of an imminent rebound which is more concerning. Calls for government action will continue.

Climate change investment improves longer-term prospects but not short term

The German government’s plans to tackle climate change drew lots of attention. The introduction of a carbon price on transport and buildings, bigger incentives for buying electric cars, investments in the railway system, higher duties on domestic flights, as well as other measures, will add some 54bn euro into the economy between 2020 and 2023.

However, at the same time, the government has kept the option open to levy new taxes, which would reduce the net impact. As it normally takes some time before investment programs are actually implemented, this climate package will do little for a short-term boost but will rather improve the economy’s longer-term prospects. Does this mean that any additional fiscal stimulus can be excluded? No. There still is enough fiscal space, even without breaching the constitutional debt brake, but it looks as if the government will wait with any short-term stimulus until there are credible signs that the labour market is turning.

> As much as we would like to see an end to the downward trend in the German economy, today’s Ifo index is not the indicator signalling it. It’s a short breather, which keeps both the hopes for a bottoming out as well as the fears of another downward slide alive.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Report | 23 September 2019 **Russia**

Russian de-dollarization: Banks on board, others need convincing

Over the last 5-6 years, Russia has made some progress in diversifying its trade flows and international liabilities away from the US dollar. We note, however, that USD is still quite popular as an asset for the private sector despite the persisting risks of US sanctions. This is relevant for companies and banks focused on doing multi-FX business in Russia

Source: istock

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

A $20 billion tax boost to corporate India

Whether this helps to kick-start the economy is still to be seen. For now, the negative consequences of derailed fiscal consolidation on India's external creditworthiness keeps a weakening pressure on local financial assets. We retain our end-2019 USD/INR forecast at 73.50

3.9% ING's fiscal deficit forecast for FY2020

Revised up from 3.5%

Unexpectedly big tax boost

In a surprise move last Friday, Finance Minister, Nirmala Sitharaman, announced a significant tax reduction for domestic companies. The move is estimated to cost about $20 billion to the government in lost revenue, includes a cut in the corporate tax rate to 22% from 30%, taking effect retrospectively from 1 April 2019, the start of the current financial year. This takes the effective tax rate after all additional levies to 25.2% from 25.9%.

In more incentives for new start-ups, for companies to be incorporated from 1 October 2019, the tax rate is set at 15%, down sharply from the existing 25%. Furthermore, reversing some of the tightening measures announced in this year's budget, the government rolled back surcharges introduced on capital gains from the sale of securities, including derivatives, and exempted companies from share buyback taxes for buybacks before July this year. Also announced on Friday was a reduction in the Goods and Services Tax (GST) for some sectors.

Incessant stimulus

The latest round of fiscal boosts followed a slew of measures announced over the last month.

- **23 August:** Withdrawal of surcharge on long and short-term capital gains tax on foreign portfolio and domestic investors; $9.8 billion (INR 700 billion) capital injection for public sector banks; lifting of curbs on new vehicle purchases by government departments.
- **29 August:** Easing of foreign investment regulation for retail, manufacturing and coal mining sectors. Relaxing local sourcing norms for foreign companies selling their own brand in India. Removal of caps on investment in commercial coal mining. Up to 26% investment permitted in digital media.
- **30 August:** Consolidating 10 public sector banks into four - A) Punjab National Bank, Oriental Bank of Commerce, and United Bank; B) Canara Bank and Syndicate Bank; C) Union Bank of India, Andhra Bank and Corporation Bank; and D) Allahabad Bank and Indian Bank.
- **14 September:** $7 billion tax incentive for exporters. Measures to boost the real estate sector.
- **20 September:** $20 billion corporate tax reduction for domestic companies (details as described at the onset). Reduction of GST on hotel rooms (18% from 28%) and catering services (5% from 18%), but a hike in that on caffeinated beverages (40% from 28%).

Near-term pain, long-term gain

The reduction in tax rate puts corporate India on par with Asian neighbours (standard rate of about 25% in most Asian countries, 17% in Singapore and Hong Kong), which is significantly positive for the economy over a longer-term.

Indeed, the latest measures should do what they are intended to – revive growth. But how quickly and effectively this will happen in the current climate of strong external risk remains to be seen. There is little that fiscal policy can do to overcome external hurdles to growth, in particular, the recent spike in global oil prices. With 80% of its energy requirement imported, India will have difficulty in keeping the oil price spike from affecting domestic fuel prices and overall inflation. On the domestic front, the still high level of personal income taxes of more than 30% and a decade-high unemployment rate are sapping the vigour of consumer spending - the key driver of GDP growth.

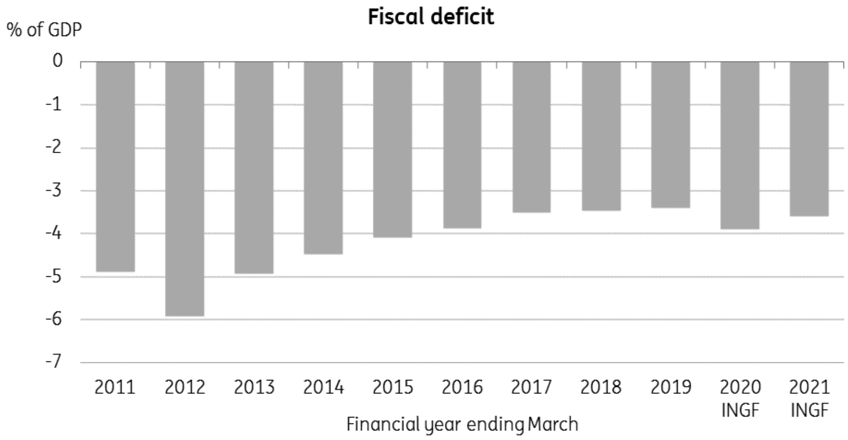
Where is the fiscal deficit headed?

Moreover, the aggressive stimulus adds to the economy's long-term plight by further delaying fiscal consolidation. Certainly, the immediate implication will be a blowout of the fiscal deficit well above the government's 3.3% of GDP projection for the current fiscal year.

The $20 billion worth of revenue loss from corporate tax measures (leaving aside other stimulus efforts announced over last one month) itself amounts to 0.7% of GDP, which on its own will swell the deficit to 4% of GDP. While some of this revenue loss will be shared by state governments and the central government may count on improved tax compliance due to lower rates as an offset, an additional whammy from slower GDP growth depressing revenue cannot be ruled out.

We are revising our deficit forecast for the current fiscal year from 3.5% to 3.9%, wiping out nearly all the deficit reduction over the last three years.

Derailed fiscal consolidation



Source: CEIC, ING

What about financing?

There is no clarity about how the government will be financing this wider deficit. The $24 billion payouts from the RBI's coffer won't be enough, nor can the government continue to rely on such monetization of the deficit.

The prospect of turning to global debt markets for financing remains clouded amid the prevailing uncertain market environment, more so now as the global investors will, in all likelihood, be viewing excessive fiscal loosening negatively. S&P has left no time in warning of the negative implications of recent fiscal actions. This is a further blow to the government's plan to borrow overseas, which, in turn, means a greater strain on domestic debt markets where excessive government borrowing leads to crowding out of private investment demand – a recipe for continued sluggish GDP growth ahead. A vicious cycle could go on.

And RBI is ready to do more

The Reserve Bank of India's (RBI) aggressive monetary easing with a total 110 basis point (bp) policy rate cuts implemented in four policy meetings so far this year has failed to arrest the growth slowdown. Last week Governor Shaktikanta Das assured markets of continued monetary stimulus for the economy through more policy interest rate cuts ahead. This makes another 25bp rate cut at the next bi-monthly policy review in early October almost certain. And there could be even more with our forecast of a further 25bp of cuts in December.

> *We identified growth as our highest priority in August. We have also maintained that it cannot be business usual now and the economy needs something more. Therefore, we went for 35 basis points cut in August. - RBI Governor Shaktikanta Das.*

All this is potentially inflationary. But nothing matters beyond growth, at least while inflation is running below the RBI's 4% target.

Bottom line

Whether this helps to kick-start the economy is still to be seen. For now, the negative consequences of derailed fiscal consolidation on India's external creditworthiness keeps up weakening pressure on local financial assets. While more RBI easing is positive for the bond market, the negative from the supply overhang from a wider fiscal deficit is likely to outweigh this, and bond yields will remain under continued upward pressure. Last Friday's market reaction with a strong rally in the stocks but a huge selloff of government bonds speaks for itself.

The INR did gain some ground amidst the positive swing in sentiment towards the equity market, though we don't think this will persist given that currency will likely be undermined by weakening public finances, the renewed threat of higher oil prices leading to higher domestic inflation, and the persistently wide current account deficit.

We retain our end-2019 USD/INR forecast at 73.50 (spot 70.95).

India: Key economic indicators and ING forecasts

India (FYending March)	FY2016	FY2017	FY2018	FY2019	FY2020 f	FY2021 f
Real GDP (% YoY)	8.0	8.2	7.2	6.8	6.1	7.0
CPI (% YoY)	4.9	4.5	3.6	3.4	4.0	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.4	-3.9	-3.6
Public debt (% of GDP)	69.9	69.0	69.8	72.5	73.0	72.0
Current account (% of GDP)	-1.1	-0.6	-1.8	-2.1	-2.5	-2.4
FX reserves (mth of imports)	10.2	10.6	10.2	8.7	7.8	7.2
External debt (% of GDP)	182.1	168.2	171.3	165.3	174.2	178.0
RBI repo rate (%, eop)	6.75	6.25	6.00	6.25	4.90	5.15
3M T-bill rate (%, eop)	7.27	5.82	6.09	6.14	5.10	5.50
10Y govt. bond yield (%, eop)	7.47	6.68	7.40	7.35	7.10	7.30
INR per USD (eop)	66.33	64.84	65.18	69.16	73.80	69.80

Sources: Bloomberg, CEIC, ING forecasts

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebre@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 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.schroder@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

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