

India's Economy & FX Market Outlook in 2023 2H

Overlap of Geopolitical Gift & the Super El Nino

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Table of Contents

01 Executive Summary

Executive Summary

02 2023 1H Economy and Financial Market Review

2-1. Global Economy
2-2. Global Financial Market Trends
2-3. Indian Economy

03 2023 2H Economy and FX Market Outlook

3-1. Global Economy
3-2. Favorable Winds Towards India,
Opportunities for Manufacturing
Industry
3-3. India's Monetary Policy & USD/INR
Outlook

Part I

Executive
Summary

India's Economy & FX Market Outlook in 2023 2H

USD/INR, Expected to Rebound After Stabilization

The Value of the Rupee Will Remain Stable for a While, But Is Expected to Rebound As Inflation Concerns Resurface

<Weakness>

Global Economy Slowdown →
Decrease in External Demands
→ Sluggish Export

Aftermath of Tightening
in Developed Countries
Such As Credit Risk

Attack of Super El Niño →
Threat of Inflation
Triggered by Grain Prices

Poor Infrastructure
Compared to FDI's
Expectations



<Opportunity>

Inducements to Foreign
Investment Including Policy &
Institutional Reforms, etc.
→ Continuing FDI Inflow

Amid Intensifying G2 Conflict,
May Benefit from Supply Chain
Reorganization and Strengthen
Geopolitical Status

Participation in Free Trade
Agreement(FTA)
→ Securing New Export
Markets

Growth Potential of Domestic
Market & Immunity to the
Global Environment



<Overall>

Economy: Slight Slowdown in Growth

Despite dropping energy
prices, growth-friendly
policies, and sound service
industry, due to global
economic slowdown below
trend growth rate of 6% is
expected. Attack of the
Super El Niño is also a risk.

Exchange Rate: Will Rebound After Stabilization (2H Average: 82.2)

While the global economy is
bottoming out, global US
dollar is expected to
weaken in mid-long term.
Due to the impact of the
Super El Niño, inflation
concern is resurfacing and
USD/INR rate is expected to
rebound after stabilization.

Part II

2023 Review:

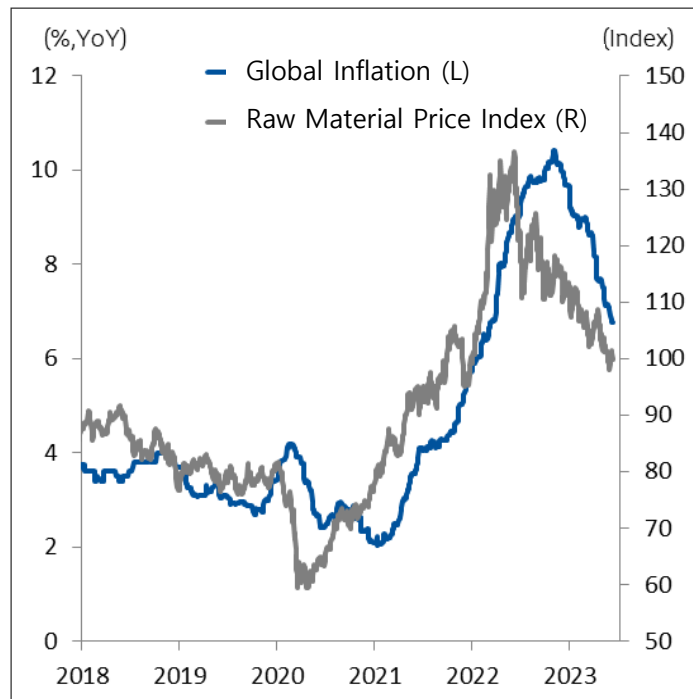
① Global Economy

Conservative Outlook on the Global Economy Due to High Inflation·Prolonged Tightening

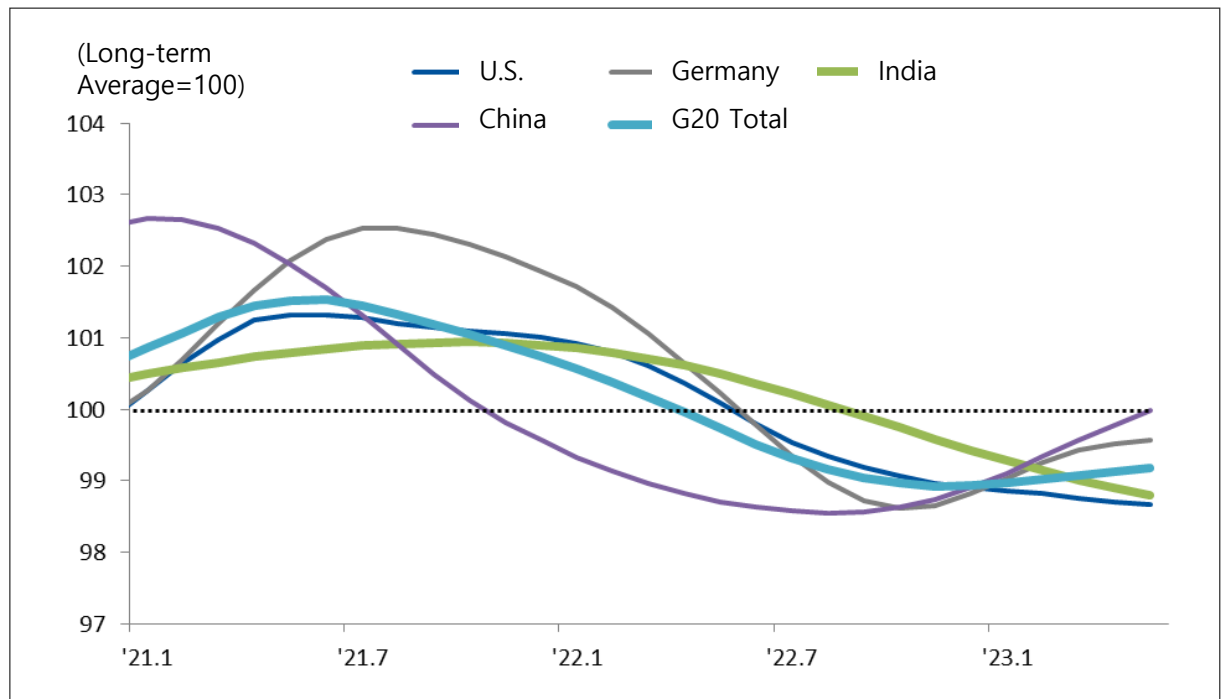
Inflation Remains High, Major Central Banks Maintain Tension

- Amid prolonged Russia-Ukraine Crisis, downward risk for the economy still remains due to the aftermath of high inflation and the Fed's rate hikes.
- Although global manufacturing industry is sluggish, the leading economic index of countries sensitive to manufacturing industry rebounded. On the other hand, the leading index of countries centered on service industry declined.
 - ▶ Global inflation is slowing down as raw material price drops. Thus, expectations on the completion of tightening in major developed countries remains.

Global Inflation Seems to Slow Down / Differentiation in Direction of Economy by Country
In Terms of Leading Economic Index, the U.S. and India Dropped While China and Germany Rebounded



Sources: Refinitiv, Bloomberg, SHB S&TCenter



Sources: OECD, Bloomberg, SHB S&TCenter

Part II

2023 Review:

② Global

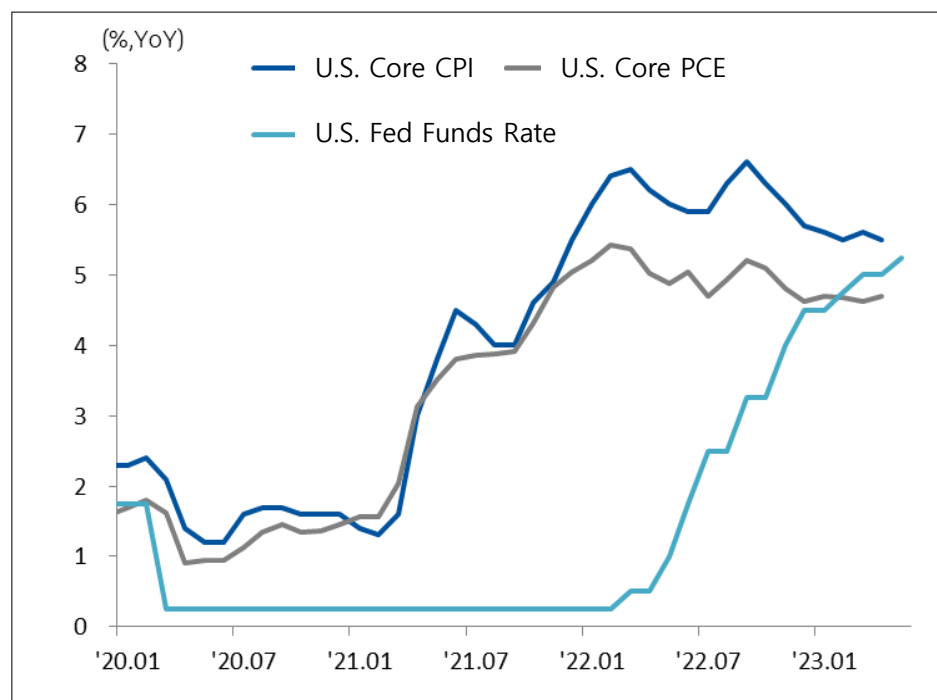
Financial Market

Between Derivation(Fine Change) & Integration(Accrued Burden)

Relieved on Expectations of the Completion of the U.S. Tightening, Cautious About the Aftermath of Credit Risk

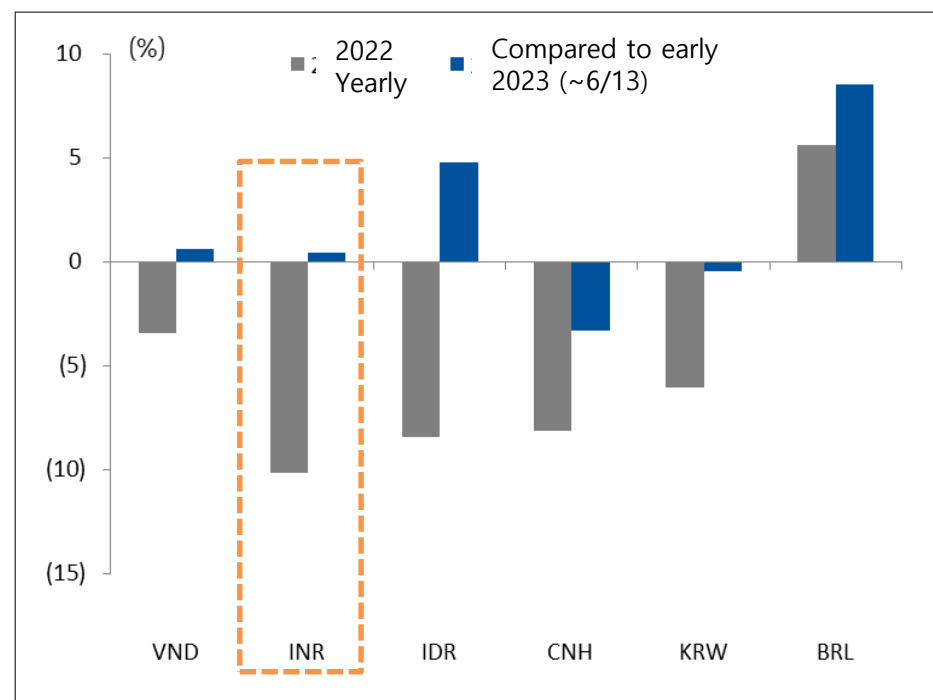
- The market was relieved as the U.S., which had been aggressively raising interest rates, approached the end of rate hike. But aftershocks such as regional bank crisis, etc. continued.
- The U.S. economy is slowing down. China's economic recovery is below market expectations and although overcame the energy crisis, the European economy hasn't been recovered fully due to rising burden on the interest rate.
 - ▶ But compared to the extreme caution during the previous year, the Chinese and European economies have improved. Despite the Fed's concerns on inflation, it has been attempting to soft land its policy.

Fed Funds Rate Has Risen to the Point That Constrain the Economy



Sources: Bloomberg, SHB S&TCenter

The Change in Value of EM Currencies, Which Came Out of the Grave of King Dollar



* As of the end of October; Rate of appreciation/depreciation of EM currencies to USD
Sources: Bloomberg, SHB S&TCenter

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2023 Review:

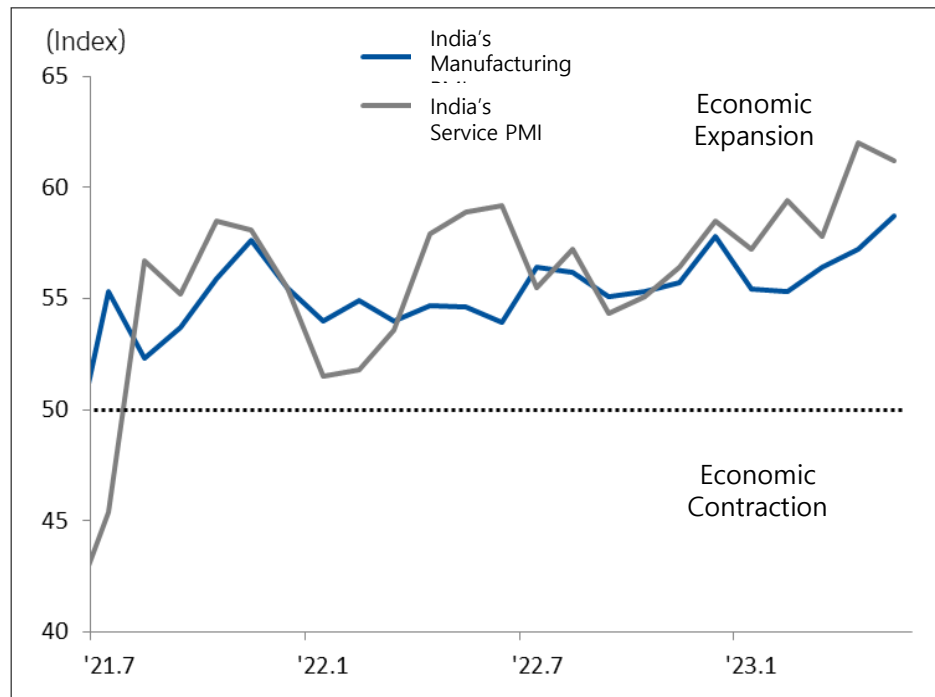
③ India's Economy

Despite Slowdown in Global Demand & Financial Instability, India's Domestic Demand Seems Fine

Amid Booming Manufacturing Industry, Expansion of Service Industry Is Driving the Economy

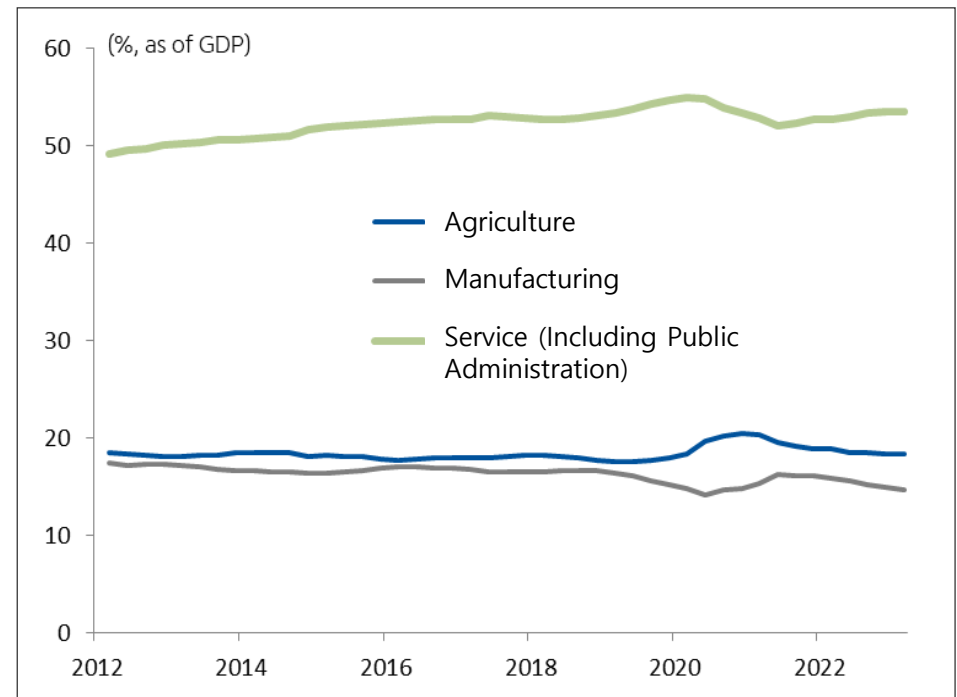
- Unlike global manufacturing industry which has entered contraction phase, India's manufacturing was relatively promoted with reflected benefits.
 - ▶ India is on the spotlight a new production base with consumer market potential to substitute China. The opening of the first Apple store in India in April was symbolic.
- The service industry, which is relatively insensitive to the global economy, is doing well. Monetary policy, which has suspended additional tightening, is favorable.

Continued Expansion of Manufacturing & Service Industries



Sources: Bloomberg, CEIC, SHB S&TCenter

Based on GVA(Gross Value Added), Service Industry Accounts for Large Portion in the Indian Economy



Sources: Bloomberg, CEIC, SHB S&TCenter

Part III

2023 Outlook :

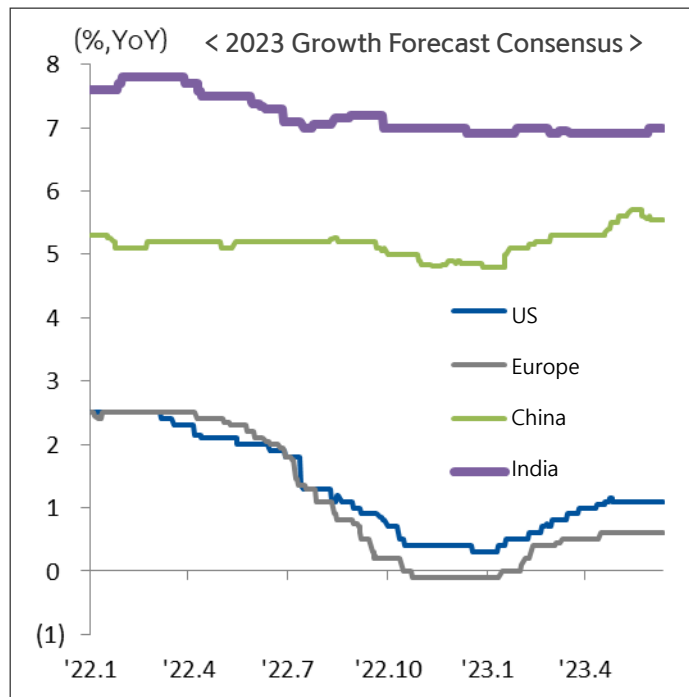
① Global Economy

The Consensus Is That 2023 Is the Bottom of the Global Economy

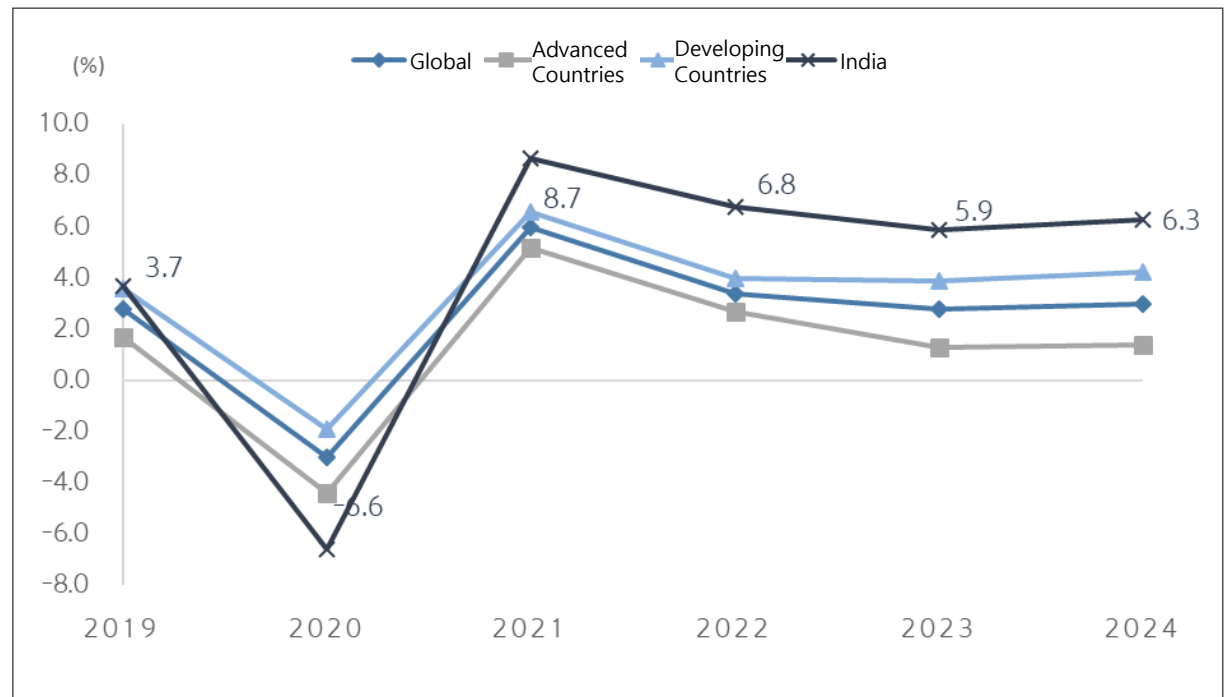
However, Risk Still Remains Including Inflation · Geopolitical Risk · Credit Risk

- Although the banking crisis in developed countries, which occurred as a result of prolonged tightening in major countries, has cooled down but downside risk to the economy continues.
- The global economy is expected to rebound in 2024 after bottoming out in 2023. The growth rate forecast for 2023 is slightly higher than the previous forecast.
 - ▶ IMF, in the April 2023 report, assessed this year's global economic conditions as "a rocky recovery".

Global Economy: Going Through a Downturn As the Banking Crisis Aggravates Due to Prolonged Tightening



Sources: Bloomberg, SHB S&TCenter



Sources: IMF WEO, SHB S&TCenter

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2023 Outlook :

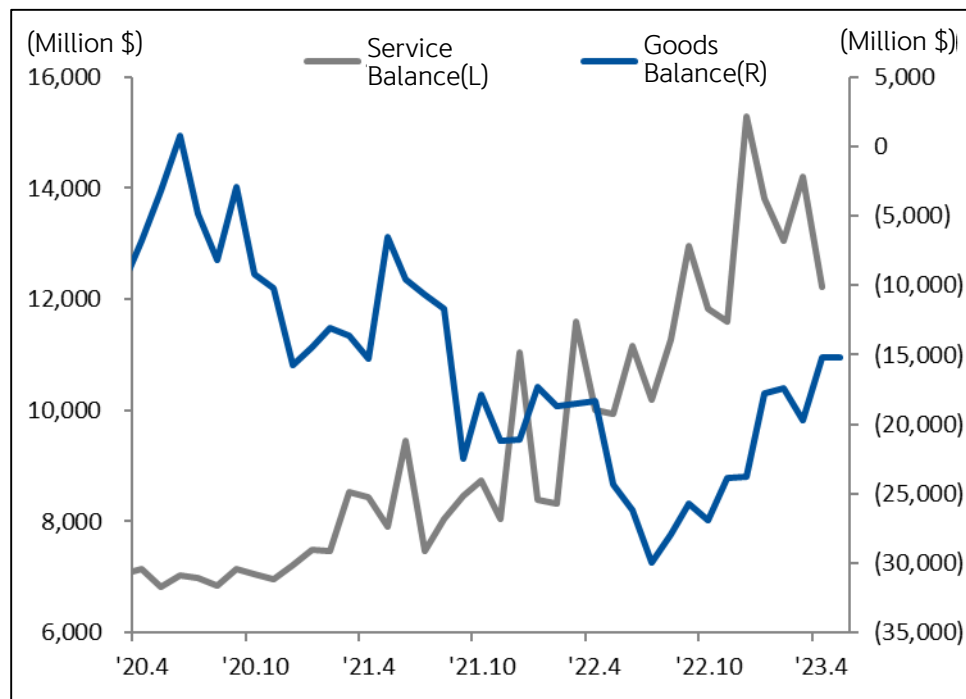
② Tailwind to India,
Opportunities for
Manufacturing Sector

Indian Economy Suffering from Chronic Current Account Deficit

Current Account Deficit Is Expected to Improve in 2H, As the Services Surplus Improves

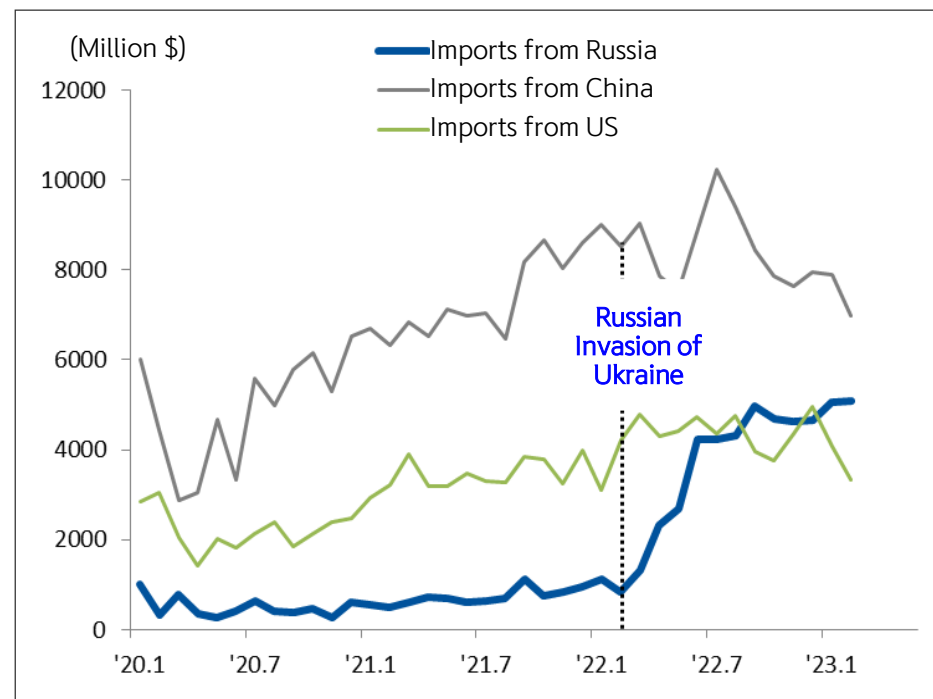
- India is rapidly growing country with increasing savings, but the current account deficit continues as investment increases.
 - ▶ As the financial sector develops, the constraints of economic entities are relaxed, and consumption and overseas imports are increasing.
- India is the 3rd largest energy consumer in the world, and its high oil import volume also contributes to the current account deficit.
 - ▶ The current account deficit is expected to narrow as oil prices fall and imports from Russia increase.

Trade Deficit Narrowing Due to Falling Commodity Prices



Sources: Bloomberg, SHB S&T Center

India Actively Purchasing Discounted Russian Oil



Sources: Bloomberg, SHB S&T Center

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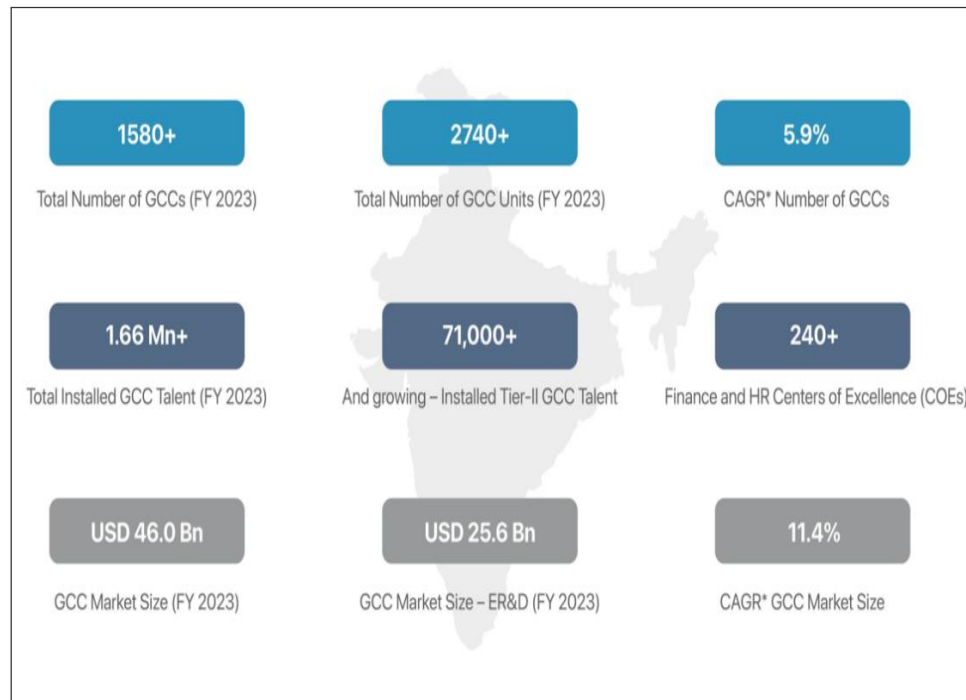
② Tailwind to India,
Opportunities for
Manufacturing Sector

India As a GCC Hub for Global Companies

The Improvement in Service Exports Has Contributed to the Narrowing of the Current Account Deficit

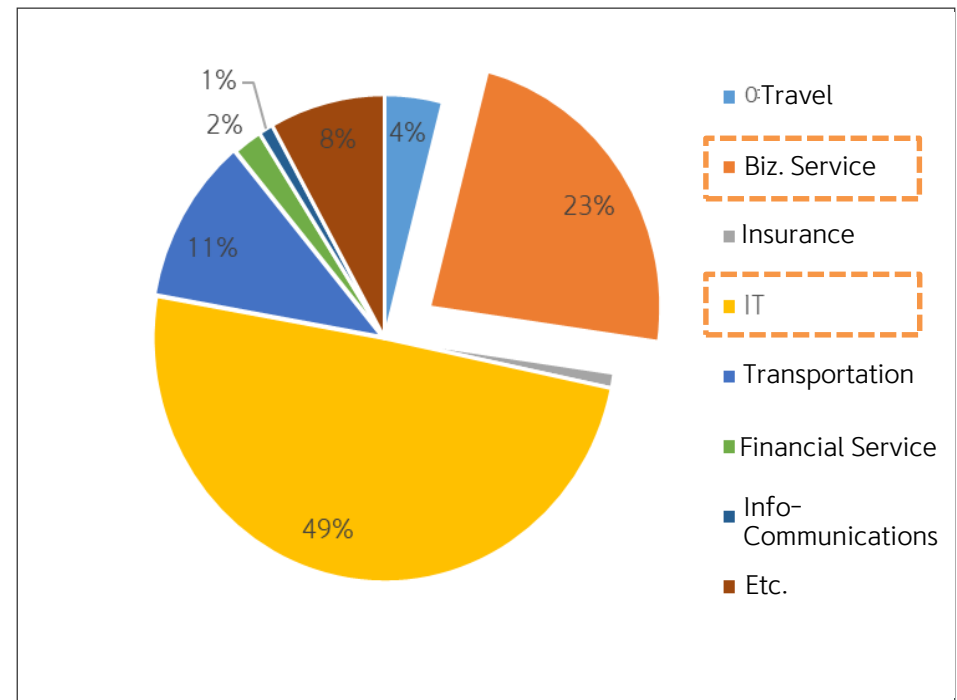
- The digitalization and remote work have led to an increase in the number of multinational companies that want to use India's cheap labor to perform R&D and other activities.
- The number of GCCs(Global Capacity Centers) that can handle back-office and middle-office work is increasing.
- India is attracting attention as a GCC base for multinational companies because it has a high education level and a large number of English speakers. More than 65% of the world's GCCs are located in India.
- As a global hub for IT, service, and business process outsourcing, India is expanding its service exports based on the high global demand for B2B solutions.

GCC Market Size in FY 23 : \$46 Billion Expected



Sources: Nasscom Insights, SHB S&T Center

The Share of Exports in Service Sectors



Sources: RBI, IBEF, SHB S&T Center, FY22

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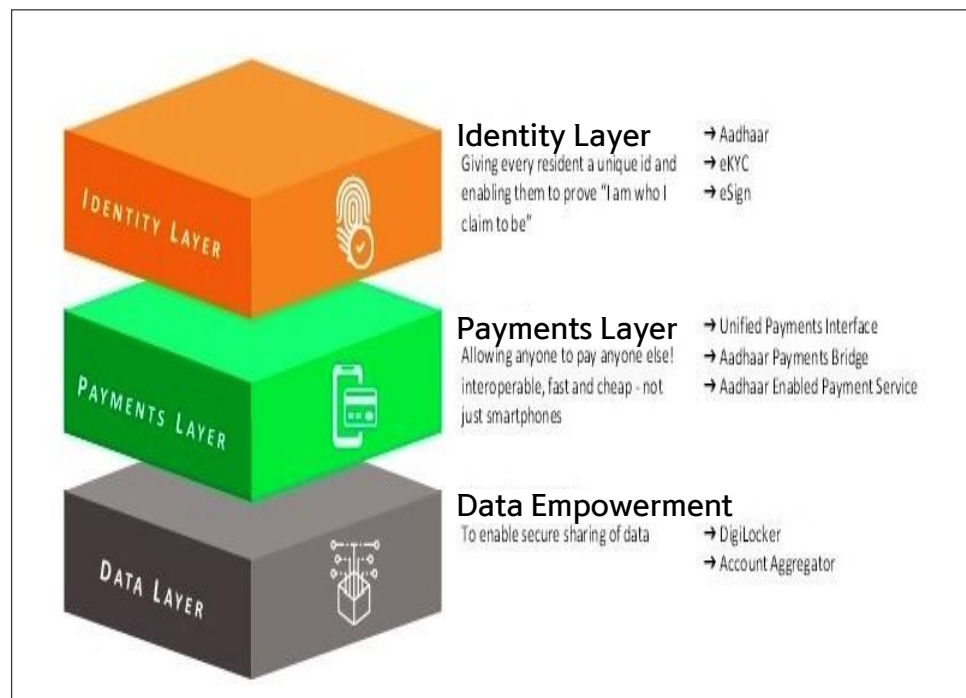
② Tailwind to India,
Opportunities for
Manufacturing Sector

India's IT Technology, Attracting Attention in Digital Transformation Age

Global Expansion of Digital Public Infrastructure Is the Potential for Stock Market

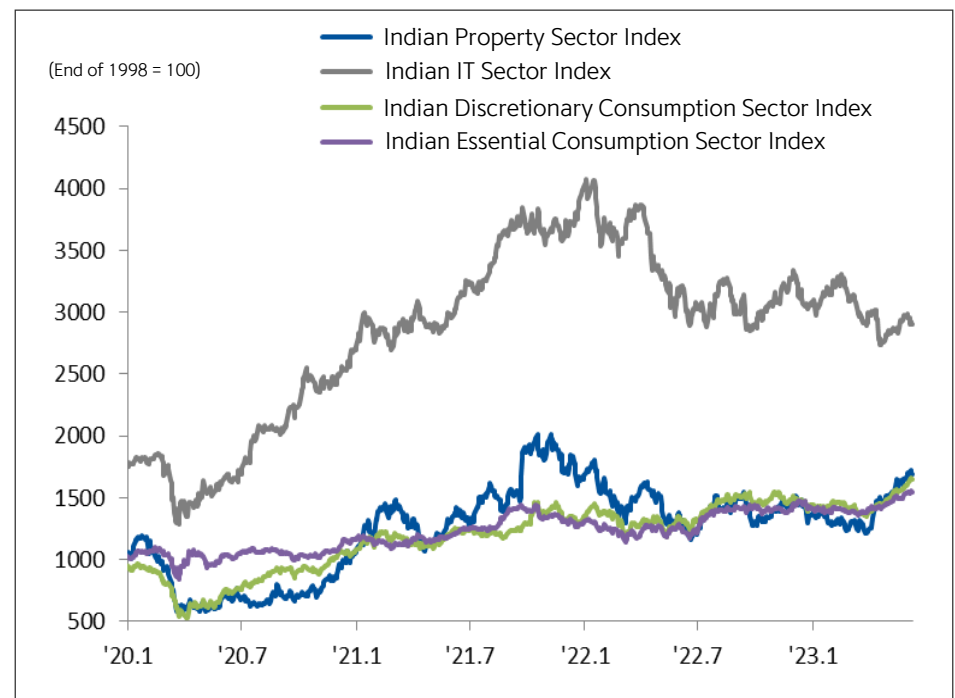
- Digital Public Infrastructure(DPI) is a program that can identify individuals, make payments, and manage data.
 - ▶ DPI is composed of biometric digital identification system (Aadhaar), digital payment system (UPI), and public information data management system(Digilocker).
- India is planning a software export strategy based on IT technology that can rival China's 'One Belt One Road.'
 - ▶ India intends to raise its influence by exporting the system to emerging countries with insufficient infrastructure and to emerge as an alternative to Western-centric system.

India's DPI(Digital Public Infrastructure) System



Sources: Bloomberg, SHB S&T Center

India's Information Technology(IT) Sector's Growth Is Slowing, But It Is Still a Pillar of the Stock Market



Sources: Bloomberg, SHB S&T Center

Part III

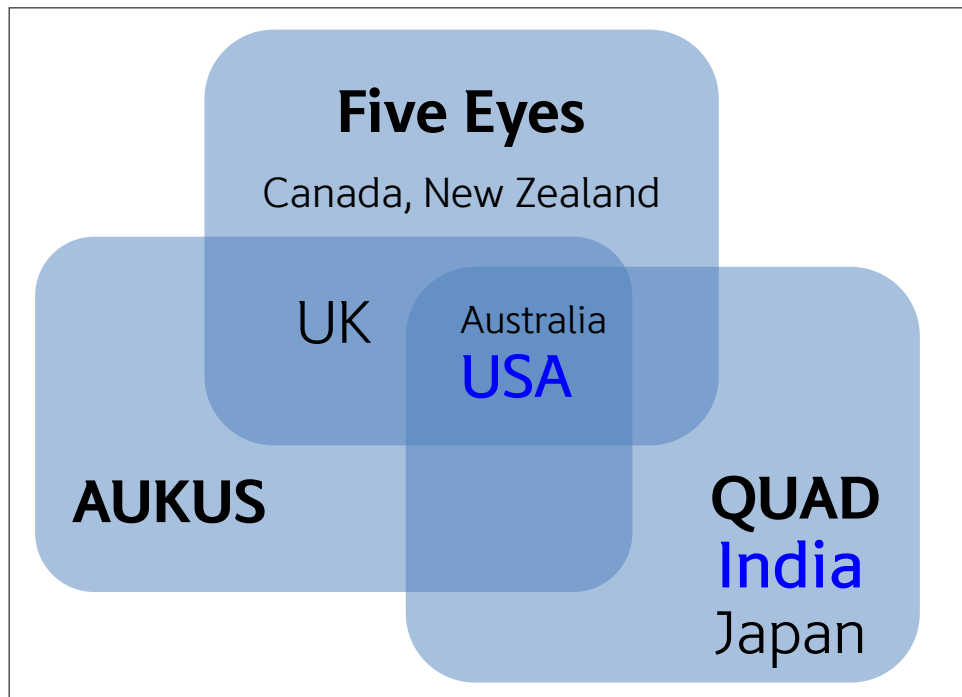
2023 Outlook :

② Tailwind to India,
Opportunities for
Manufacturing Sector

India, Strengthening “Strategic Autonomy” With Growing Geopolitical and Strategic Stature Allied with West for Security, Selectively Cooperating with China for Economy

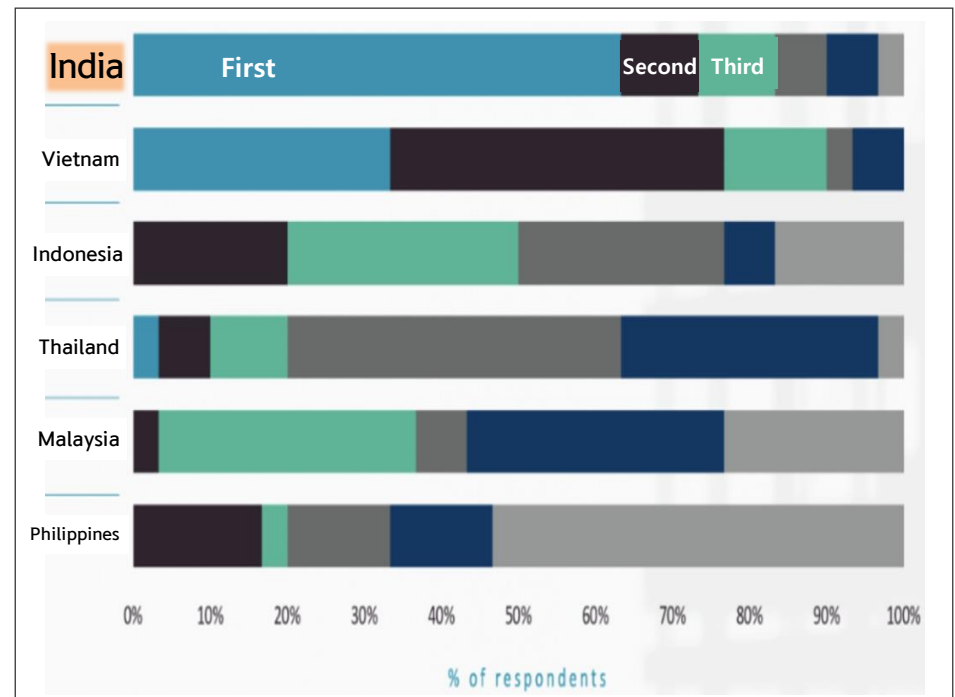
- **Security** : India’s strategic position in the global security balance is rising as rivalry between the US and China deepens.
 - ▶ India is strengthening its security alliance with Western countries such as US, and is participating in the US-led Indo-Pacific strategy and the QUAD, but is somewhat passive.
- **Economy** : India has traditionally maintained a friendly relationship with Russia in order to check China. India did not participate in the Western’s sanction on Russia after the Ukraine war.
 - ▶ India is actively participating in multilateral organizations led by China(AIIB, BRICS etc.), and imports from Russia have increased since the outbreak of the Ukraine war.

< Security > Axis of US-led QUAD



Sources: Bloomberg, CEIC, SHB S&T Center

Global Capital is Vying for Investment in India and Vietnam (Excluding China)



Sources: Cushman&Wakefield, SHB S&T Center

Part III

2023 Outlook :

② Tailwind to India, Opportunities for Manufacturing Sector

India Seizing Opportunity to Expand Manufacturing Base

Policy Support to Attract Investment from Overseas Manufacturing Corporates

- Modi government is continuing to support policies to promote manufacturing and is expecting a rebound in the Indian manufacturing sector due to the US-China conflict.
 - ▶ To become a manufacturing hub, India needs foreign direct investment from multinational corporations in addition to cultivation of domestic companies.
- Therefore India is supporting production of multinational corporations through the production-linked (PLI) policy, which provides financial support based on the increase in production.
- The government has announced a foreign trade policy that includes measures to facilitate trade and activate e-commerce to achieve a total export of \$2 trillion by 2030.

Foreign Trade Policy 2023 Which Includes Facilitating Exports



Sources: Ministry of Industry and Trade in India, SHB S&T Center

Composition of Production Linked Incentives

Priority	Support Areas	Approved Amount (10 million rupees)
1	Electric Vehicle Battery(ACC Battery)	18,100
2	Electronic. IT Devices (Electronic/Technology)	5,000
3	Cars and Parts	57,042
4	Medicine	15,000
5	Mobile and Network	12,195
6	Fabrics	10,683
7	Food and Beverages	10,900
8	Solar Modules	4,500
9	White Goods	6,238
10	Steel	6,322
Total Amount		145,980

Sources: IASbaba, SHB S&T Center

Part III

2023 Outlook :

② Tailwind to India,
Opportunities for
Manufacturing Sector

The Lack of Infrastructure, Which Hinders India's Manufacturing Competitiveness

Infrastructure Investment to Foster Manufacturing and Economic Growth

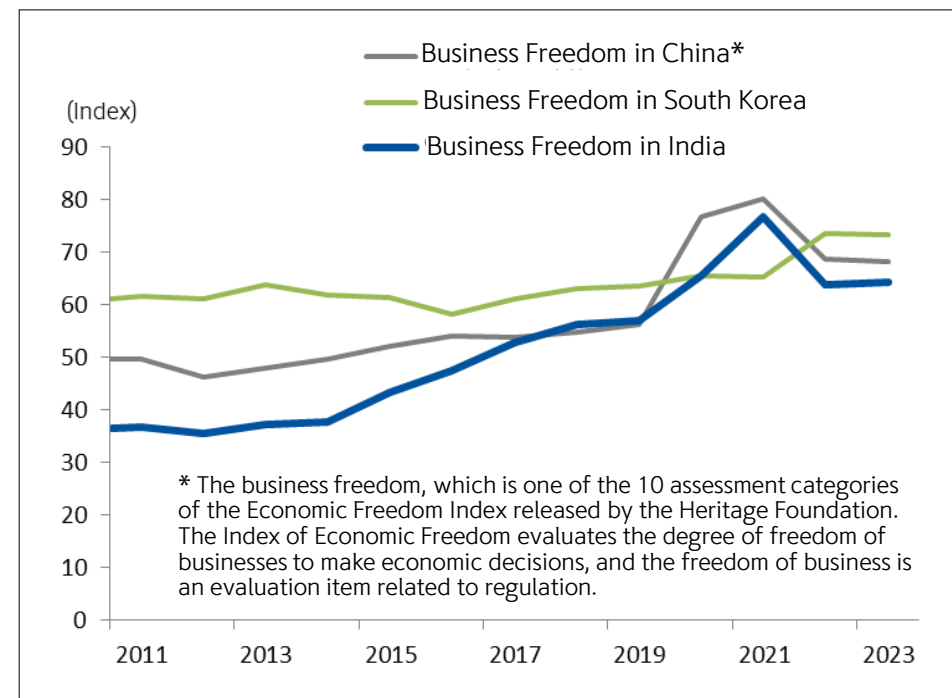
- The Indian government is working to develop manufacturing, but the lack of infrastructure makes it difficult to improve manufacturing competitiveness.
 - ▶ The power infrastructure, such as the transmission network, has improved over the past, but the transportation infrastructure, such as roads and ports, is still lacking.
- In response, the government is increasing its spending on infrastructure investment, and the expansion of infrastructure is expected to lead to job creation and economic growth.
 - ▶ The government is aiming to boost economic vitality and reduce the budget deficit by focusing on infrastructure investment rather than simply providing subsidies.

Increasing India's Capital Expenditure



Sources: The Ministry of Finance in India, pib.gov.in, SHB S&T Center

To Attract Foreign Investment by Improving Its Regulations



Sources: The Heritage Foundation, Bloomberg, SHB S&T Center

Part III

2023 Outlook :

② Tailwind to India,
Opportunities for
Manufacturing Sector

Increased the Share of India in Korea's Exports Amid the Reshuffle of the Supply Chain

The Opportunity to Upgrade India's Manufacturing Sector, Which Has a High Proportion of the Service Sector

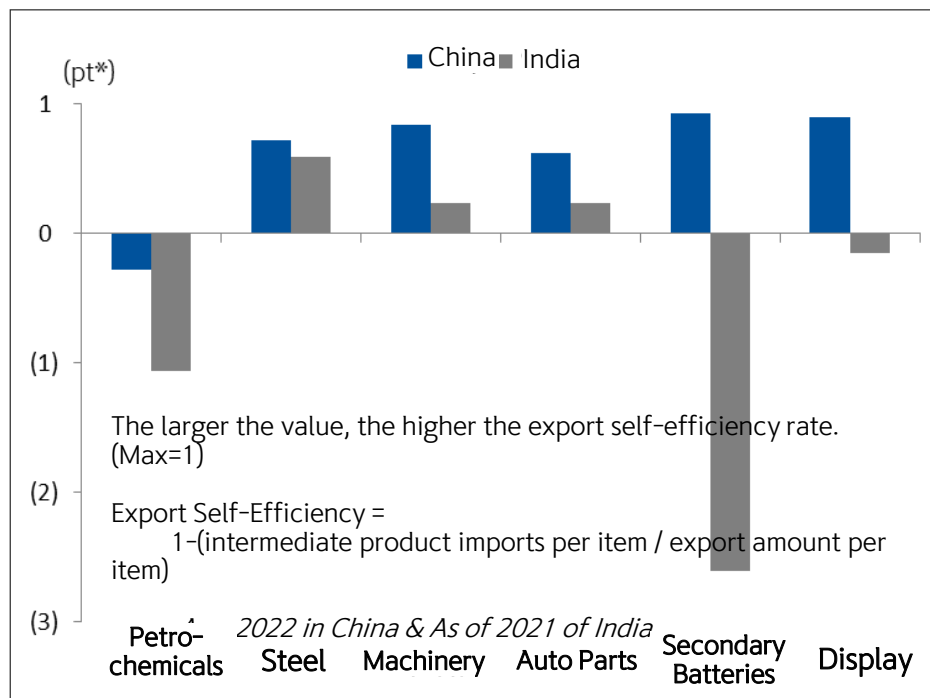
- As Korea's exports to China have decreased, the gap has been filled by the United States and India, the trade and economic relations between India and Korea have deepened.
- In particular, exports to India are expanding, centered on Korean petrochemicals, steel, displays, secondary batteries, and plastic products.
- The decrease in exports to China is due to the improvement of China's technological capabilities and self-reliance, in addition to the reshuffle of the supply chain. In addition, the growth rate of exports to India is slow, which limits the ability to compensate for the decrease in exports to China.

Trend of Korea's Exports : Intermediate Goods by Country

[2022]				[2023 1Q]		
	Export Vol. (\$100 mil)	Growth Rate (%,yoy)	Proportion (%)	Export Vol. (\$100 mil)	Growth Rate (%,yoy)	Proportion (%)
China	1,303	0.4	25.7	246	-29.6	23.4
US	663	19.7	13.1	144	-9.5	13.6
Vietnam	541	9.2	10.7	108	-27.5	10.3
Japan	237	4.6	4.7	54	-12.2	5.1
Hong Kong	253	-24.8	5	40	-44.7	3.8
India	152	12.9	3	39	4.6	3.7

Sources: KITA, SHB S&T Center

The Technical Gap in Export Self-Sufficiency



Sources: KITA, SHB S&T Center

Part III

2023 Outlook

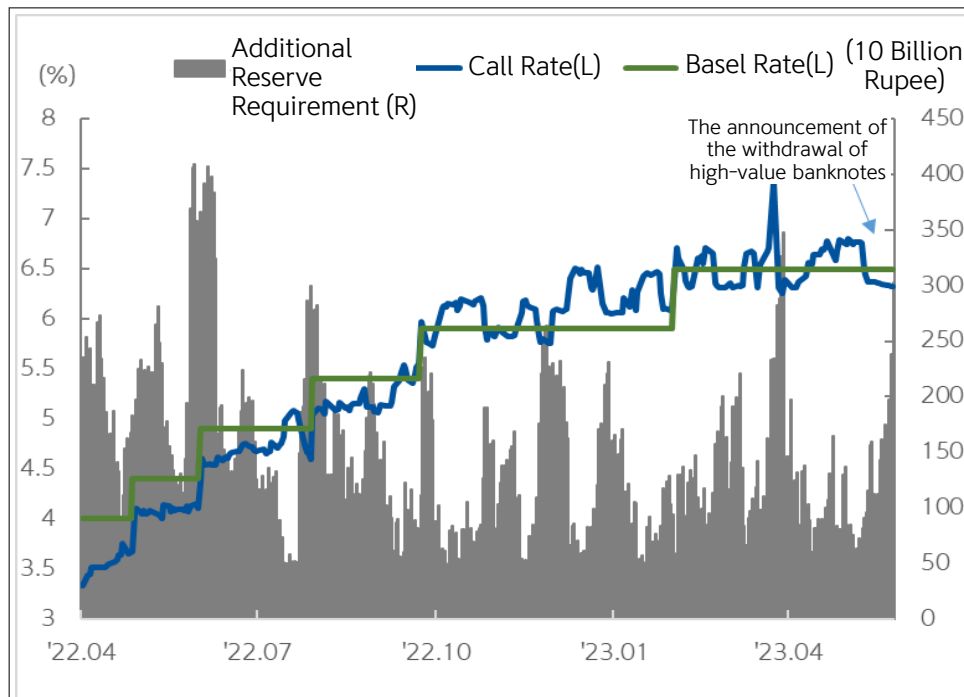
③ Indian Monetary Policies and Rupee

The Intent of the Indian Government in the Decision to Withdraw High-value Banknotes

The Move to Formalize the Underground Economy and Prepare for the General Election Scheduled for Next Year

- The RBI has decided to withdraw the currently 2000 rupee note, highest denomination, and make it valid only until Sep 30th.
 - ▶ There is a political interpretation that this is an attempt to prevent the circulation of illegal election funds ahead of the general election next year. The 2000 rupee note can be deposited or exchanged in banks.
- India, which is experiencing a shortage of bank funds due to the signs of a liquidity shortage with the rise in interest rates, is expected to see an increase in liquidity as the use and deposit increase.
 - ▶ On the other hand, India plans to regulate the market liquidity by implementing a policy of recovering liquidity through RRP transactions.

Call Rate, Which Once Exceeded the Benchmark Interest Rate Due to a Shortage of Liquidity



Sources: Bloomberg, CEIC, SHB S&T Center

2000 Rupee Note Valid Until Sep 30



Sources: livelaw.in, SHB S&T Center

Part III

2023 Outlook

③ Indian Monetary Policies and Rupee

The Active Credit Creation of Indian Regional Banks, Unlike the US Banking System

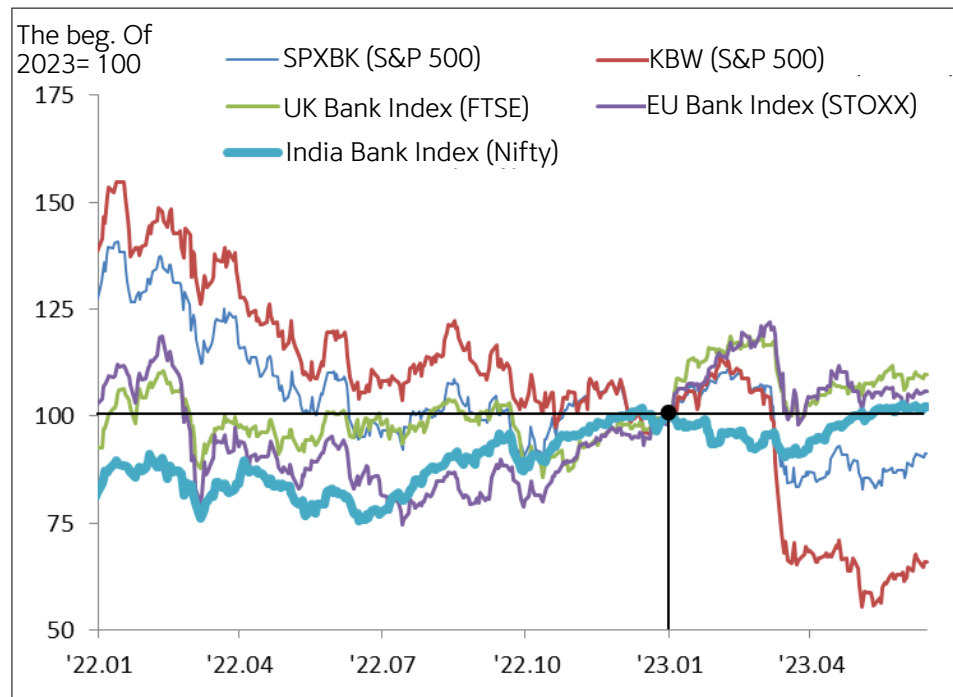
The Indian Banking System Is Functioning Normally and Supporting Growth

- The Indian banking sector is not exposed to the U.S. regional bank crisis, and only some tech startups are affected, but the amount is small (less than \$8 million).

- ▶ Some Indian banks are exploring the opportunity to use startups as a business opportunity. 2/3 of the deposits in the Indian banking sector are household funds, so the possibility of temporary withdrawal is low

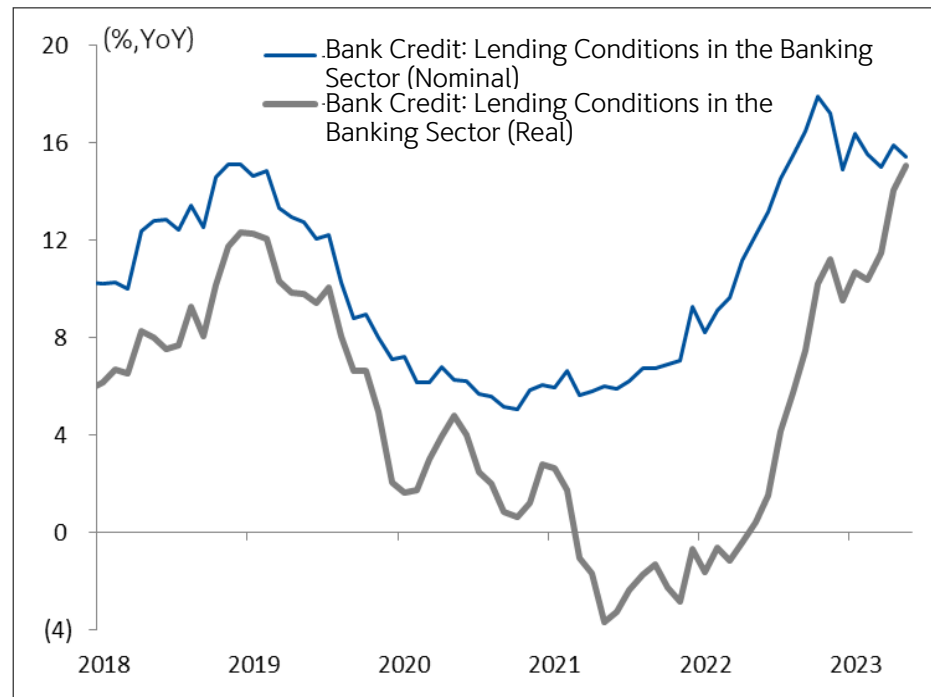
* India is actively supporting growth as the real lending conditions, taking into account inflation, have improved significantly, and this is the background for the Indian central bank to be confident in growth.

Indian Banking Sector, Not Shaken by the Turmoil in the Developed Country Banking Sector



Sources: Bloomberg SHB S&T Center

Actively Creating Credit & Supporting Growth



Sources: Bloomberg, SHB S&T Center

Part III

2023 Outlook

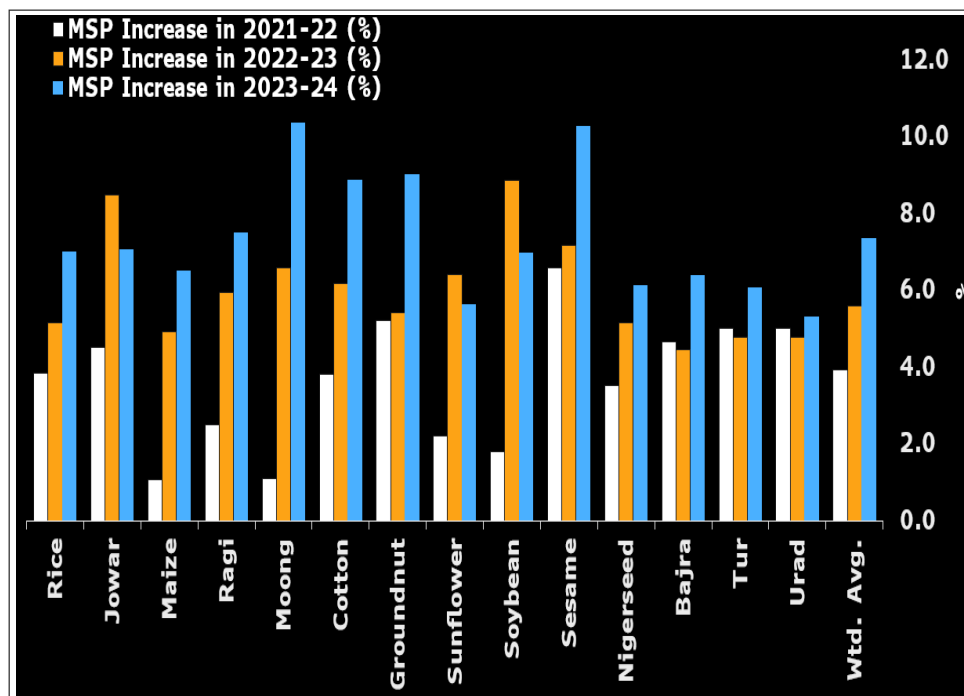
③ Indian Monetary Policies and Rupee

RBI Has Stopped Raising Interest Rates and Will Keep Rates Unchanged from April

However, Open to the Possibility of Raising Interest Rates Further Due to Concerns over Inflation

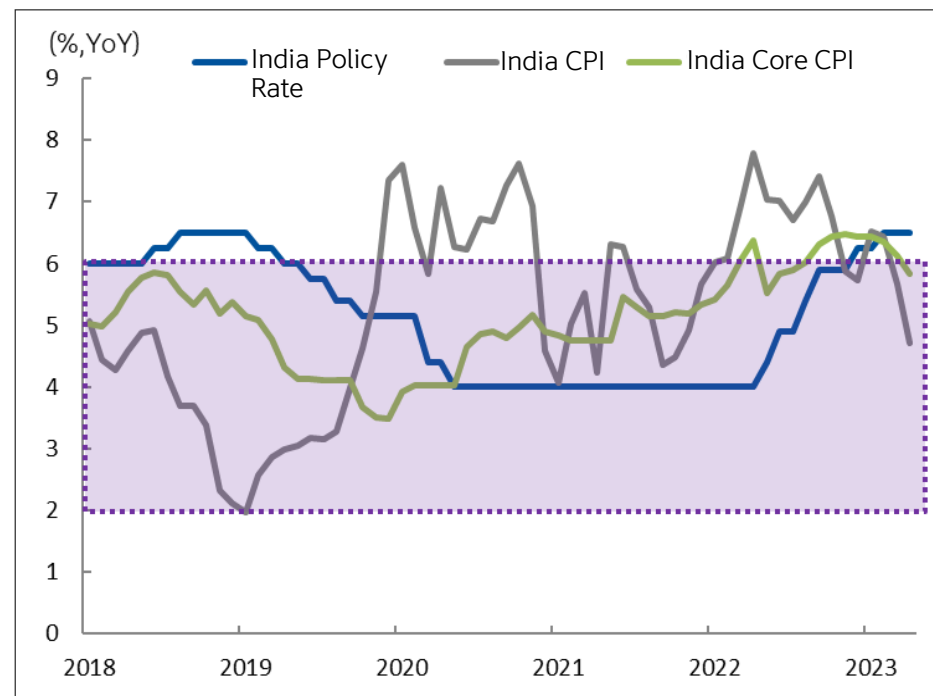
- CPI continued to decelerate as energy prices fell, followed by a slowdown in the rise in food and manufacturing product prices.
 - ▶ Despite the slowdown in consumer prices, the RBI maintained its tight monetary policy due to the possibility of an increase in inflation in 2H 2023.
- However, the government's decision to raise the procurement price (Minimum price) of crops purchased from farmers is an upward pressure on inflation.

A Cause of Inflation :The Rise in Grain Prices



Sources: Bloomberg SHB S&T Center

Inflation Slowed Rapidly and Fell to the Low 4% Range



Sources: Bloomberg, SHB S&T Center

Part III

2023 Outlook

③ Indian Monetary

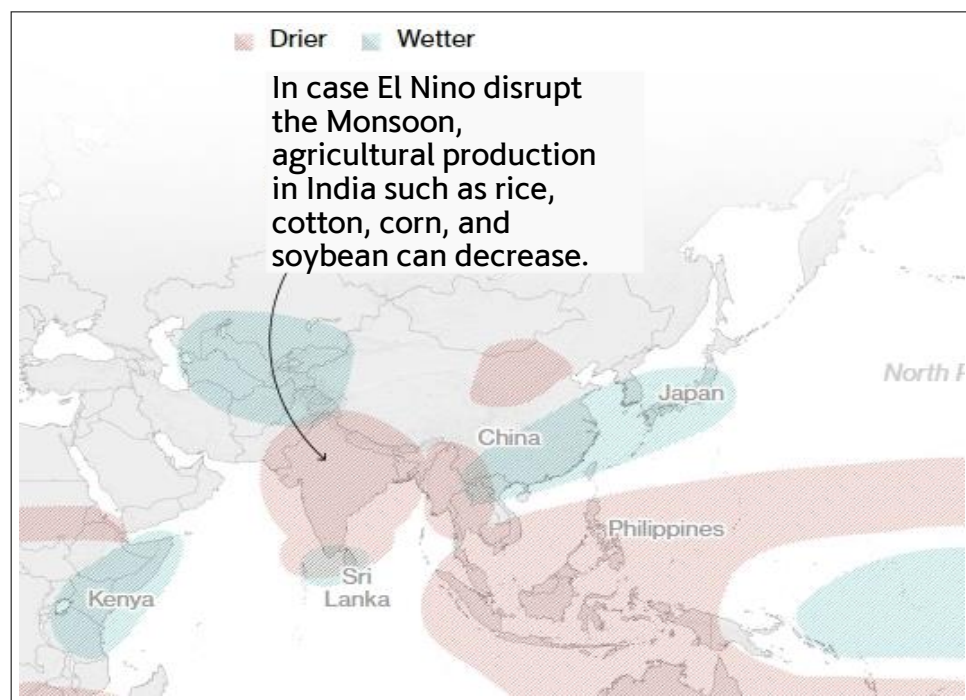
Policies and Rupee

INR, Which was Stable in the 1H, is Facing Risks in 2H

Biggest Risk is Possibility of 'Super El Nino' in 2H

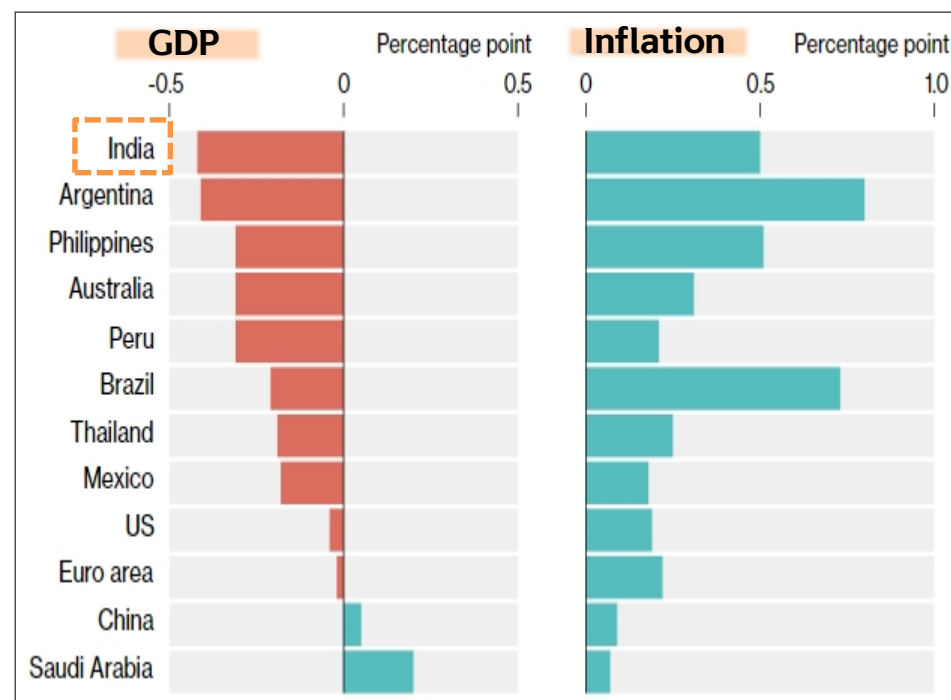
- Number of factors such as strong service balance, decline in commodity prices, and influx of foreign capital can lead to decline in the exchange rate.
- Despite Indian government's measures to stabilize Rupee, a 'Super El Nino' in 2H could have a game-changing impact on the Indian economy by causing a food crisis.
 - ▶ El Nino is a climate pattern that occurs when the average sea surface temperature in the Eastern Pacific Ocean is 0.5 degrees Celsius or more above average for five consecutive months, Super El Nino is particularly strong El Nino with sea surface temperature of 2 degrees Celsius or more above average. Major global institutions are predicting a Super El Nino in the 2H.

Impact of El Nino in Global Climate and Indian Agricultural Production



Sources: Bloomberg, SHB S&T Center

Estimated Impact of El Nino in Economic Growth and Inflation



Sources: Bloomberg, SHB S&T Center

Part III

2023 Outlook

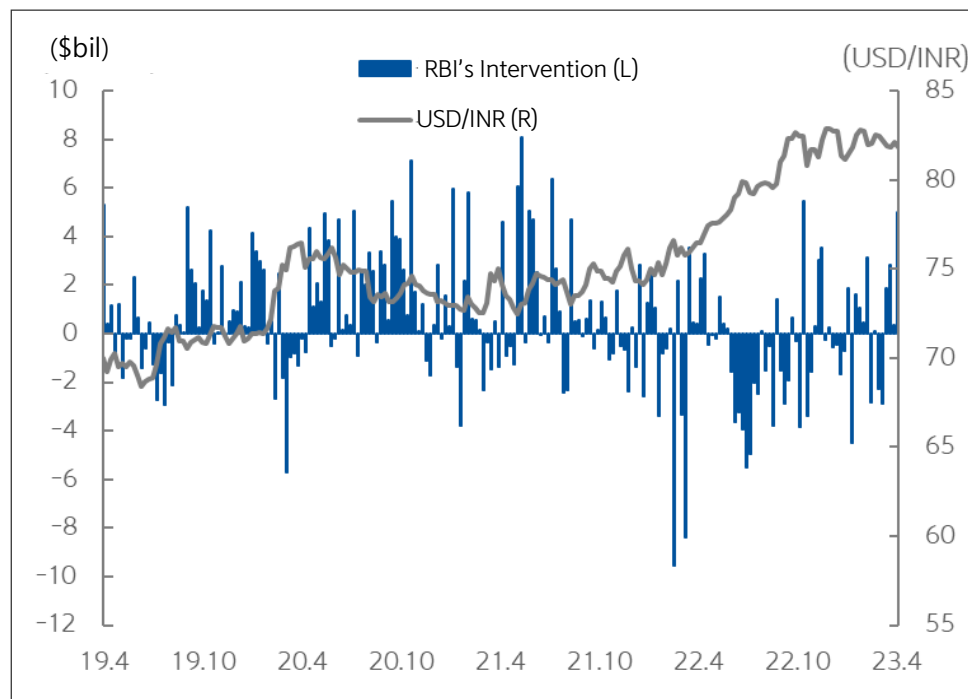
③ Indian Monetary Policies and Rupee

RBI, Managing Volatility by Actively Selling/Buying Foreign Exchange

RBI is Expected to Continue Intervening Foreign Exchange Market to Stabilize Exchange Rate

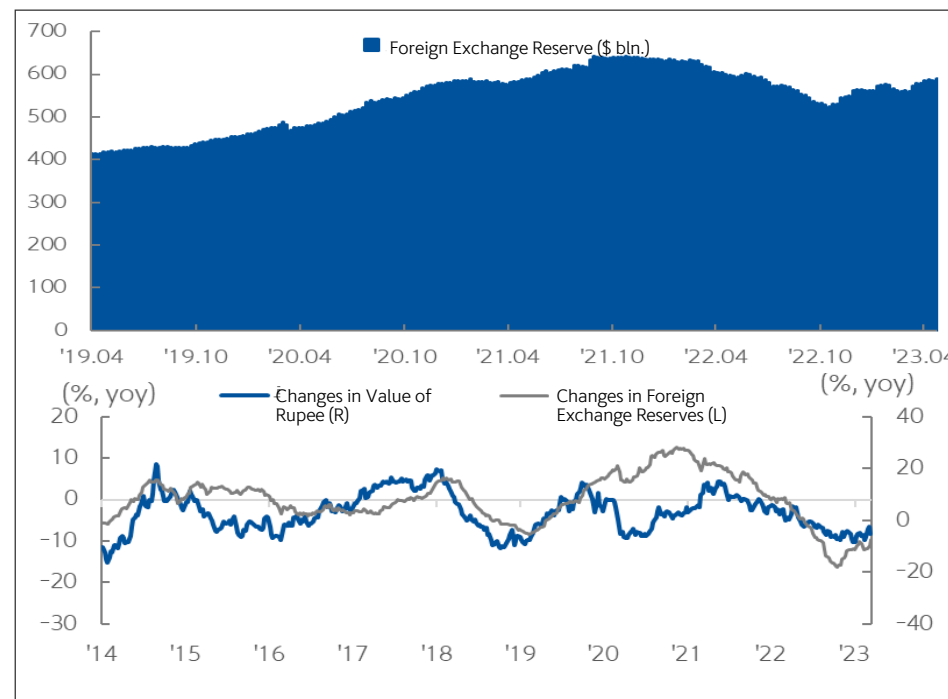
- RBI's sharp interest rate hikes and active US dollar selling–Rupee Buying intervention mitigate further rise of exchange rate and widening volatility.
 - ▶ RBI will buy back foreign exchanges in the phase of stabilization to expand previously reduced foreign exchange reserves.
- Trade deficit is expected to narrow due to decline in commodity prices and foreign capital is expected to flow into the stock market, RBI is expected to respond by purchasing foreign exchange assets. Volatility in foreign exchange rate will be small due to RBI's active intervention.

RBI's Active Intervention to Stabilize USD/INR



Sources: Bloomberg, SHB S&T Center

RBI, Which Had Been Actively Selling USD, is Buying Back USD to Expand Foreign Exchange Reserves



Sources: Bloomberg, SHB S&T Center

Part III

2023 Outlook

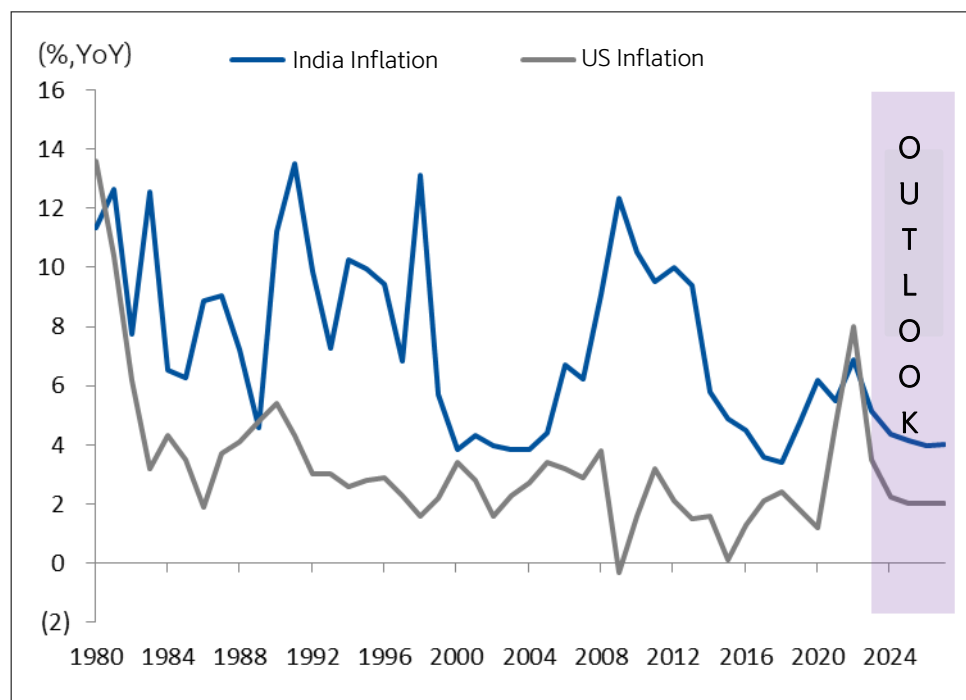
③ Indian Monetary Policies and Rupee

INR, Depreciating Over Long Time

Currency Depreciation Is Highly Correlated with Inflation

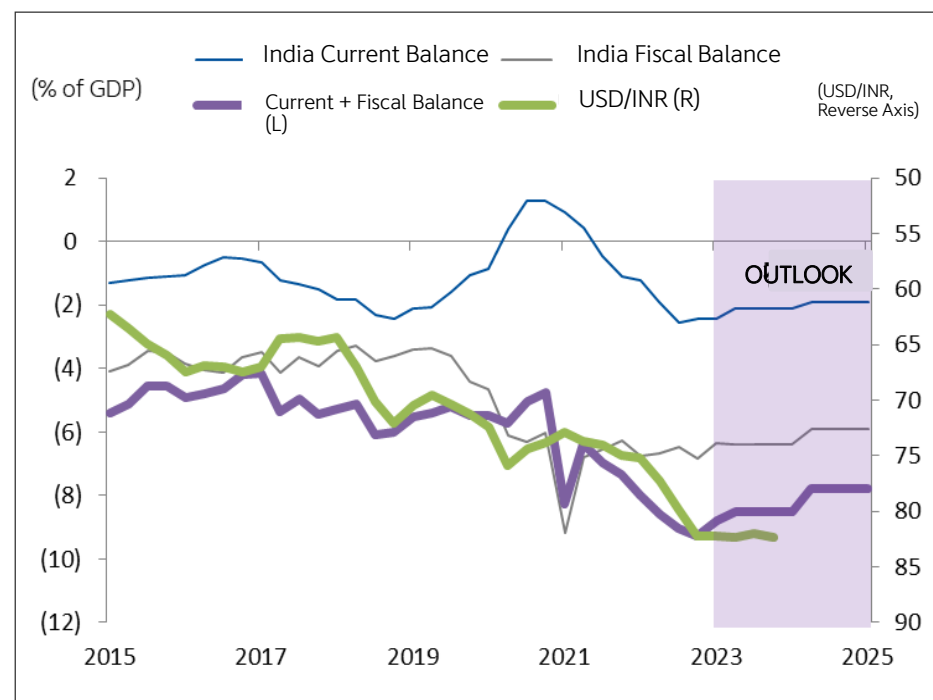
- Most of EM currencies tend to have long-term upward trend against US dollar. The most convincing explanation is the accumulated inflation gap.
- US inflation soared due to the aftermath of COVID-19, but historically, India's inflation has exceeded US inflation for most of the time.
- Relatively high inflation means a relative depreciation of the currency, putting upward pressure on the exchange rate.
 - ▶ Even if the dollar index falls, if the inflation environment of both countries returns to the historical trend, it will not be easy for INR/USD to fall in long term.

Relatively High Inflation Means Depreciation of the Currency



Sources: Bloomberg, SHB S&T Center

Twin Deficit (Current + Fiscal) Will Decrease and Value of Rupee Will Stabilize



Sources: Bloomberg, SHB S&T Center

Part III

2023 Outlook

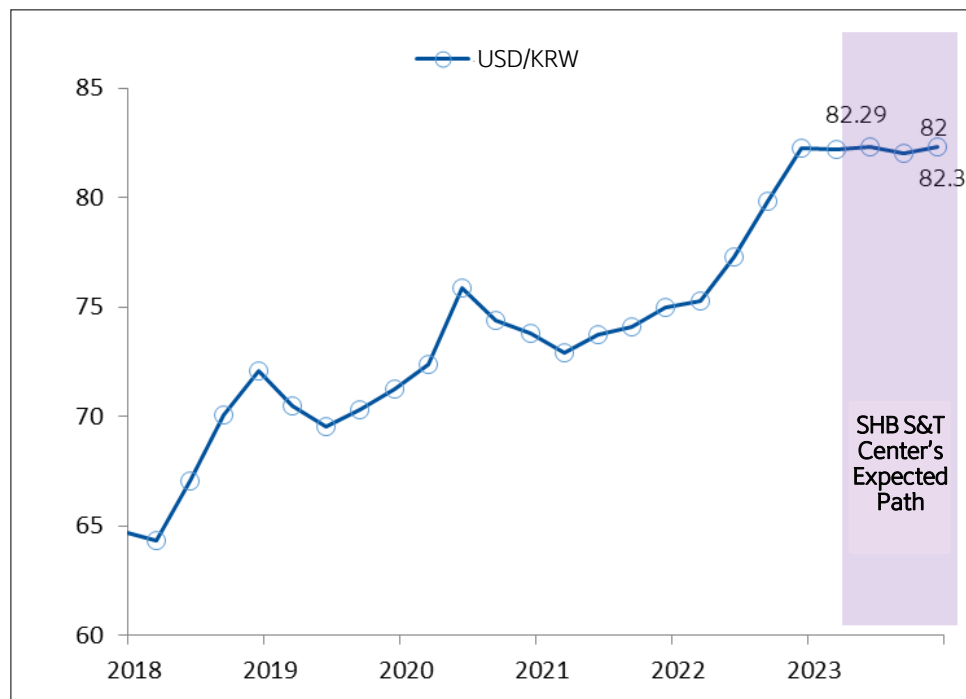
③ Indian Monetary Policies and Rupee

USD/INR Outlook for 2023

USD/INR Is Expected to Rebound After a Period of Stability As Inflation Concerns Rise

- USD/INR is expected to stabilize in 2023 as the global US dollar weakens in mid-to-long term.
 - ▶ Due to the impact of monetary tightening, there was bank crisis in advanced countries, but it has calmed down as the governments have responded quickly.
 - ▶ Rupee is expected to remain stable for a while as oil prices stabilizes, India's inflation slows, and trade deficit decreases on expanding service exports. However, inflation concerns are rising in the 2H due to warnings of Super El Nino, and USD/INR is expected to rebound.

Expected USD/INR Path in 2023



* Quarterly Average
Sources: Bloomberg, SHB S&T Center

2023 Outlook of USD/INR and Consensus of Major Institutions

	23.1Q	23.2Q(E)	23.3Q(E)	23.4Q(E)	Yearly Avg.
SHB S&T Center (Range)	82.30	82.29 (81.1~82.9)	82.00 (80.5~82.8)	82.30 (79.9~82.9)	82.22 (79.9~82.9)
Institutions Survey			23.3Q(E)	23.4Q(E)	
Median	-	-	82	81.5	
High	-	-	83.8	83.5	
Low	-	-	80	79	
BNP Paribas (6/13)	-	-	82.6	82	
ING (6/9)	-	-	81	80	
MUFG (6/8)	-	-	80.5	79.5	
Nomura (6/8)	-	-	82	81	

Sources: SHB S&T Center, Bloomberg Consensus (After '23. 6)
 * Shinhan Bank's Outlooks are Quarterly and Yearly averages.
 * Bloomberg Consensus is the closing value for the period.

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