International Commentary — April 16, 2021

India's Second Wave

Summary

Following months of receding COVID cases, India is currently in the midst of a second wave of infections. Restrictions have been imposed on major cities and a migration out of business hubs is likely to complicate the short-term outlook for India's economy. As a result, it is very likely we will be making downward revisions to our 2021 GDP forecast in our April *International Economic Outlook* publication. In addition, we maintain our view for gradual rupee depreciation and will only become more pessimistic on the currency if the Reserve Bank of India turns more dovish than we currently expect.

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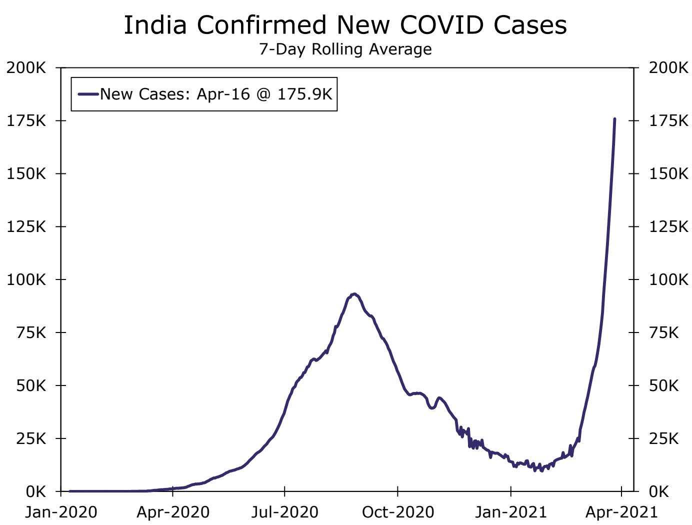
India's Economy Under Pressure Again

Early on in the COVID pandemic, India was one of the countries hardest hit by the virus, both from a human health perspective as well an economic perspective. As confirmed cases rose, Prime Minister Modi implemented one of the strictest lockdowns in the world, essentially shutting down the entire nation in an effort to contain the spread of the virus. The economic consequences of the nationwide lockdown were harsh as India's economy experienced one of the largest contractions in the world. However, the second half of 2020 proved to be more encouraging as COVID cases receded quickly and lockdowns measures were gradually lifted. India's economy saw activity indicators rebound to close out the year, in particular the manufacturing PMI, which hit a record high in October. As mobility and activity indicators improved, we revised our GDP forecasts for India's economy higher heading into 2021. While the economy still contracted on an annual basis in 2020, the decline was less severe than intially expected, while we made upward revisions to our annual 2021 GDP forecast as well. As of now, we forecast the economy to expand 11.7% this year.

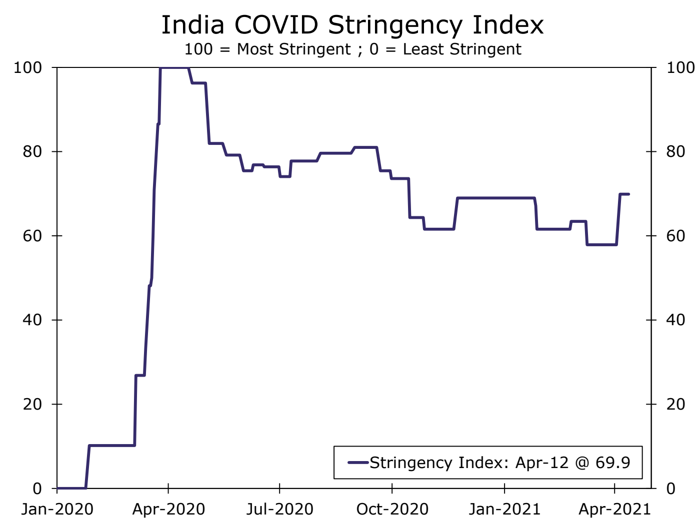
However, over the last few weeks COVID cases have risen significantly in India, complicating the economic recovery and raising downside risks to our GDP forecast. To that point, India's second wave of infections has been worse than the initial wave with daily confirmed cases at record highs. In just the last two days, India has reported over 200,000 infections each day, and on a rolling average basis, around 175,000 new daily confirmed cases (Figure 1). India is now the second most affected country, surpassing Brazil, while the trajectory of cases is concerning. While Prime Minister Modi has been hesitant to implement another nationwide lockdown, local governments have imposed restrictions of their own. In Maharashtra, the most populated state of India and where Mumbai is located, local officials have ordered business to close for at least 15 days and banned gatherings. New Delhi, India's capital, has also been hit with similar restrictions, pushing the Oxford University COVID Stringency index higher over the last few weeks (Figure 2). Local media reports suggest restrictions could be tightened ever further in an effort to protect the health of a large portion of the Indian population.

Figure 1.



Source: Bloomberg LP and Wells Fargo Securities

Figure 2.



Source: Bloomberg LP and Wells Fargo Securities

With businesses in major cities forced to close, local media outlets have also reported a new migration out of Mumbai, New Delhi and other hubs back toward more rural towns and villages. Reports suggest mass transportation options are limited and particularly crowded, which could result in COVID infections continuing to rise, as well as more suppressed economic activity across major cities. The combination of elevated COVID cases, new lockdown measures and a migration out of economic hubs introduces short-term hurdles to India's economic recovery and will likely result in downward revisions to our GDP forecast when we publish the April *International Economic Outlook* publication in a few weeks. Downward revisions will likely be made to our Q2 GDP forecast, and depending on the evolution of COVID cases, later quarters could be revised lower as well.

India's second wave of infections has rattled local financial markets as well. India's SENSEX equity benchmark has fallen 6.5% from its high in mid-February, while local currency bond yields have been volatile and risen 13 basis points over the same time period. In fact, the government recently canceled a sovereign debt offering as a result of elevated bond yields and limited bids as a result of the uncertainty created by the resurgence of COVID. As far as the rupee, we recently turned more optimistic on the currency. We maintained our view that the rupee will weaken into 2022; however, we revised our forecast to reflect a more gradual depreciation. As COVID cases have gathered momentum, rupee volatility has risen and the currency has come under pressure, more so than we would have expected. Going forward, we expect authorities to intervene in FX markets and stabilize the currency, at least while the current wave of infections is in place. Once the currency and COVID cases stabilize, it is entirely possible the Reserve Bank of India looks to intervene in currency markets in favor of accomodate, or even encourage, a weaker currency. A weaker currency can act as a shock absorber and help facilitate the economic recovery, a policy option the central bank will likely employ as a result of the economic consequences of the current wave of infections and restrictions. At this time, we maintain our view for gradual rupee depreciation and will only revise our forecast to reflect more currency depreciation if the central bank suddenly turns dovish and appears to entertain more policy rate cuts, which we view as unlikely at this time.

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