

## Good MornING Asia - 1 March 2018

Ignore China's weak PMI data; supply-side reforms support prospects of steady manufacturing and GDP growth in 2018. India's GDP growth returns to a 7-8% potential range. And strong fiscal spending in the Philippines sustains a robust growth outlook.

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# China PMI surprisingly low but don't worry

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Source: Shutterstock

## Don't worry, even manufacturing was surprisingly low

Manufacturing PMI went down to 50.3 in February, which is the month of Chinese New Year in 2018. It came down from 51.3 in January.

It seems alarming, but looking at the breakdown of the index we can see that new orders from domestic market were still good at 51.0, and expectations of business activity stood at 58.2, higher than January's 56.8. These numbers imply that the low reading is likely driven by holiday effects, rather than by any underlying slowdown in coming manufacturing activity.

## Overcapacity cuts and environment protection to continue in 2018

Supply side reform that leads to the closing down of factories that produce materials inefficiently or with high pollution will continue in 2018. We expect overcapacity cuts to move from iron, steel and coal in 2017 to cement and glass in 2018.

This may not be as bad as it seems. Cutting production should mean lower GDP. But the factories that remain in business in those sectors should enjoy higher prices and therefore higher profits.

Environmental protection should force factories to upgrade their facilities to meet environmental regulations. These investments by factories will add to GDP.

All in all, we are still positive on manufacturing in 2018.

## **Lower non-manufacturing data shows that consumption still has room to grow**

Non-manufacturing PMI declined to 54.4 from 55.3 in January. On the one hand, this is understandable as the banking, financial and real estate sectors were off for at least two weeks in the month. But on the other hand, it shows that consumption, tourism, and the travel sectors did not balance off the lower activities during the long holiday period.

That implies there is still room for consumption to increase. Our view is positive on future consumption trends, that is, we may see higher non-manufacturing PMIs during long holidays when consumption continues to catch up as China is building up its middle-income class. Even so, that may not happen in 2018, however, it could be a likely scenario around 2020.

## India: Economic growth returns to potential range

The latest GDP data may instil some confidence in the Indian rupee. But the worst isn't over yet as downside risks to growth still persist while the...



**7.2%** YoY GDP growth  
Oct-Dec 2017

Better than expected

### Growth returns to the potential range

Indian's economic growth returned to the potential range of 7-8%. Gross domestic production (GDP) grew by 7.2% year-on-year in the October-December quarter of 2017, the third quarter of the current financial year ending in March 2018. This beat the consensus forecast of 7.0%. Growth in the previous quarter also was revised to 6.5% from 6.3%. It was a broad-based acceleration in the main economic sectors, led by manufacturing at 8.1% (prior 6.9%), construction at 6.8% (prior 2.8%), and financial and real estate services at 6.7% (prior 6.4%). On the expenditure side, the fiscal thrust stood out with 6.1% growth in government spending (prior 2.9%) while fixed capital

formation surged 12% (prior 6.9%).

## **But the worst isn't over yet**

Data shows the economy remains on track to achieve the official growth forecast for fiscal 2017-18, which has been revised to 6.6% from 6.5% (ING forecast 6.5%, consensus 6.6%). However, this also depends on the sustainability of the current pace of growth in the final quarter of fiscal 2017-18. This, in turn, hinges on the extent of damage to confidence from a spate of bad economic news recently, including fiscal slippage, elevated consumer price inflation, and a troubled banking sector. And full-year growth will still be short of the 7.1% seen in fiscal 2016-17.

## **Possibly more hawkish central bank stance**

The better-than-expected economic performance could lead the Reserve Bank of India (RBI) to step up its anti-inflationary rhetoric. The RBI has been warning about inflation risk in the period ahead on the grounds of a widening fiscal deficit, administrative hikes in minimum support prices for farm products and housing allowance for civil servants and the transmission of higher global oil prices to domestic fuel prices. This, and the recent sell-off in the Indian rupee, could shift the consensus within the six-member RBI Monetary Policy Committee toward a rate hike; only one MPC member voted for a rate hike at the January meeting.

## **INR to remain an underperforming Asian currency**

The Indian rupee was Asia's second-worst performer in February after the Philippine Peso. A strong GDP report isn't sufficient to suggest the worst is behind us, while India's twin-deficit problem and the beleaguered banking system continue to overshadow prospects for local financial assets. We expect the INR to remain among Asia's underperforming currencies through 2018.



# Philippines: Strong fiscal spending to continue

Fiscal spending has sustained double-digit growth over the past three years. GDP growth in 2018 should benefit from planned fiscal spending growth of...



Source: Shutterstock

**12%** 2017 core fiscal spending growth  
Double digit growth for three years in a row

## Government targets to sustain spending growth in 2018 and support GDP growth

Headline and core fiscal spending has sustained double-digit growth over the past three years with 2017 growth rates of 11% and 12% respectively. The increases were slower than 2016 which benefitted from spending for the national elections. The slowdown is normal but the 2017 pace of spending was elevated relative to previous post-election year sluggishness. Despite strong spending growth, the government posted a deficit of only -2.2% of GDP, lower than the -3% target. The government targets 20% growth in spending this year as infrastructure spending escalates to

5.3% of GDP, up from last year's target of 4.2%. This year's spending plan primes the economy to reach target GDP growth of 7-8%. We are confident that the government will succeed in escalating the pace of spending, helped by the January release of 80% of the budget. We expect 2018 GDP growth of 6.7% as the impact of higher inflation moderates household spending.



# Malaysia: 2018 shaping up to be a better year for inflation

Barring a political uncertainty, the Malaysian ringgit should remain among Asia's top-performing currencies this year



## 2.7%

January CPI inflation

Year-on-year

As expected

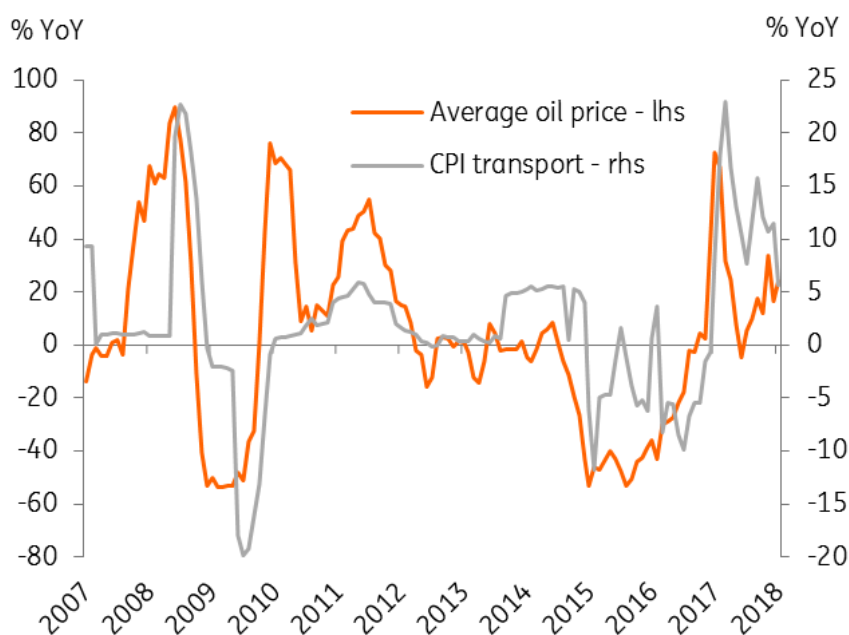
## Inflation slows in January

Malaysia's consumer price inflation dipped in line with the consensus to a one-year low of 2.7% year-on-year in January from 3.5% in the previous month (consensus 2.8%, ING forecast 2.7%). Food and transport prices were the main sources of lower inflation with both CPI components starting to enjoy favourable base effects.

2017 was the worst year for Malaysian inflation in a decade with a near-doubling of prices to 3.9% from 2.1% in 2016. Higher transport costs led by fuel prices were mainly responsible. Higher import prices, as well as factory gate prices, were the other factors. A strong Malaysian ringgit (MYR) last year wasn't much help to prevent imported inflation. The average 6.1% YoY rise in the import unit

value index in 2017 compares with a 1.4% rise in 2016. The corresponding figures for producer prices are 6.7% and -1.1%.

## Global oil price vs. Malaysia transport price



Source: Bloomberg, ING

## 2018 a better year for inflation

2018 is shaping up to be a better year for inflation. The high base should continue to dampen year-over-year price increase this year. And the sustained MYR appreciation trend should mitigate the spillover of rising global commodity prices. On the flip-side, strong domestic demand should exert an upward pull on prices. Rapid wage growth (8.6% YoY growth in manufacturing wages in 2017 was the fastest in seven years) and election cash handouts should boost consumer spending.

As things stand, the risk to our 3.0% full-year 2018 inflation forecast appears tilted to the downside. Bank Negara Malaysia (BNM), the central bank, forecasts inflation this year in a 2.5-3.5% range. That said, we expect BNM to continue to normalise monetary policy. BNM raised the policy rate by 25bp to 3.25% in January. We forecast one more 25bp rate hike in the third quarter. Barring a political uncertainty, the MYR should remain among Asia's top-performing currencies this year. Our USD/MYR forecast for end-2018 is 3.72 (spot 3.91, consensus 3.85).

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## Thailand: Slow growth, low inflation, rising political risk

We anticipate some re-pricing for political risk to weigh on THB performance going forward



# 3.4%

## Manufacturing growth in January

Year-on-year

As expected

### Manufacturing slowed in January

Thailand's industrial production growth slowed in line with consensus to 3.4% year-on-year in January from 5.0% in December (revised up from 2.4%). IP slowdown contrasts with strong exports in January with 17.6% YoY growth. While export growth accelerated in the last year IP growth remained in low-single digits. The de-coupling of export and manufacturing, which could be traced to weak domestic demand, persists coming in to 2018. We are placing our 3.8% forecast for GDP growth in the current quarter under review for a possible downgrade (consensus 3.9%).

## Inflation remains low

February consumer price data is due on Friday, March 2. Inflation has been under 1% YoY since March 2017, which is where consensus forecast is for it to stay (consensus 0.7%, ING forecast 0.8%). Outside housing and transport sectors there is no inflation in Thailand. We forecast inflation in 2018 averaging at 1.1%, which is in line with the Bank of Thailand (BoT) forecast (consensus 1.4%, 2017 0.7%).

Released today, the BoT minutes of last Monetary Policy Committee meeting held on February 14, pointed to still sluggish domestic demand recovery with low demand-pull inflationary pressure. The document revealed policymakers' preference for continued accommodative monetary policy to support recovery of domestic demand. We reiterate our forecast of no change to the BoT rate policy through 2018.

## Politics to weigh on markets

The political uncertainty is starting to creep up as the military government once again postponed timing of general elections, which now will not be held until after February 2019 as against previous guidance of November 2018. If intensified, the political uncertainty will be a big negative for Thai financial markets. The THB remains among Asian outperformers with 3.9% year-to-date appreciation against the USD. We anticipate some re-pricing for political risk to weigh on the THB performance going forward. Our end-2018 USD/THB forecast is 31.0 (spot 31.5, consensus 31.2).

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