

## Good MornING Asia - 10 July 2018

The inclusion of A-shares in the MSCI from June prevented a fall in China's foreign exchange reserves in the last month. Taiwan's data showed signs of the trade war impact starting to come through

### In this bundle



FX | China

#### Rising foreign reserves gives room for a weaker yuan

Foreign exchange reserves in China rose \$1.51 billion in June from May, stopping the falling trend. A-share's inclusion in the MSCI from 1 June...



#### Taiwan: Trade war impact begins to come through

Headline export growth came in at 9.4% on the back of negative growth in electronic exports, which we see as an alarming signal. This could be the first...



India

#### India: Why we're now looking for two rate hikes this year

We expect the India central bank (RBI) to hike rates at the August meeting and again in October, taking the policy rate to 6.75%. We see USD/INR trading...

# Rising foreign reserves gives room for a weaker yuan

Foreign exchange reserves in China rose \$1.51 billion in June from May, stopping the falling trend. A-share's inclusion in the MSCI from 1 June...



Source: Shutterstock

## No depletion of foreign exchange reserves

Inflows have more than offset outflows in June.

On 1 June 2018, A-shares inclusion in the MSCI brought \$22 billion capital inflows into China. We also expect a trade surplus of near \$25 billion in June.

But as the dollar index rose by 0.5%, the valuation effect on non-USD dollar assets in China's foreign exchange reserves was negative. This was the main reason for the drop in foreign reserves in April and May.

Yuan depreciation of more than 3% in the month should have resulted in some capital outflows.

**+\$1.5  
billion**

Foreign exchange reserves

June 2018 at \$3.1121 trillion

Higher than expected

## Yuan can weaken further as persistent net outflows is no longer a concern

In the future, we expect inflow channels to continue to widen further. This is the main reason that we have revised our yuan forecast to 7.0.

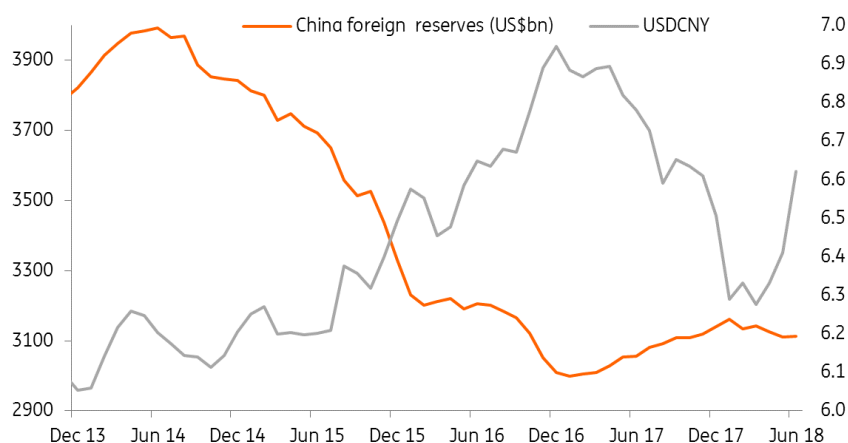
Inflows include investments in financial assets onshore (more A-share inclusion in the MSCI on 3 September 2018), and the opening up of business markets for foreign investors interested in financial sectors and transport manufacturing (the opening up of different sectors has a different timeframe from now to 2020).

If foreign exchange reserves fall only slowly or even rise due to inflows when the yuan weakens, then the concern about net capital outflows that would deplete fx reserves shouldn't be a concern.

We believe that a weaker yuan in the middle of a trade war between China and US is reasonable because a currency would depreciate to adjust for slower export growth. It would be strange if the yuan appreciates against the dollar when the trade war continues.

[We, therefore, confirm our yuan forecast at 7.0 by the end of 2018.](#)

## Foreign reserves rose in June even though the yuan weakened



Source: ING, Bloomberg

## Trade war's impact on asset market

The trade war started officially at the beginning of July, and we expect another \$16 billion of goods will be subject to a 25% tariff from the US and then from China as soon as before August.

All of this should have been priced in in asset markets.

But the extra \$200 billion worth of goods subject to a 10% tariff from the US after China retaliates is still to be fully priced in. When the \$200 billion tariff becomes more imminent then the market should be more volatile than the current environment.

---

Snap | 9 July 2018

# Taiwan: Trade war impact begins to come through

Headline export growth came in at 9.4% on the back of negative growth in electronic exports, which we see as an alarming signal. This could be the first...



Source: Shutterstock

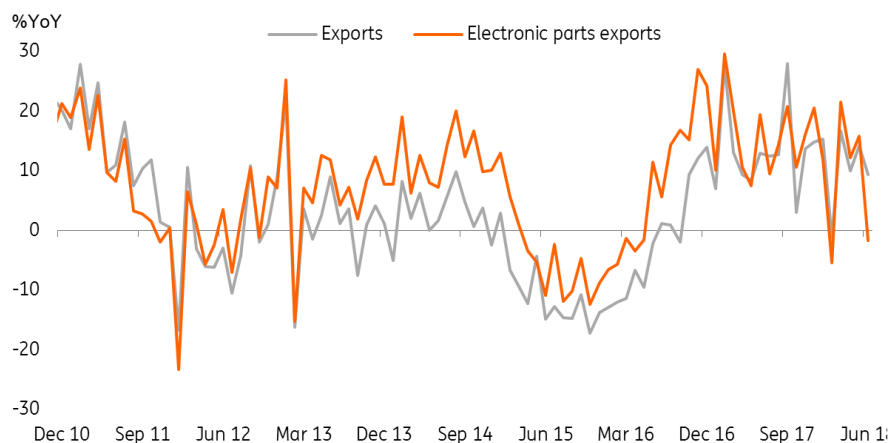
## Alarming signals from negative electronic exports growth

Taiwan's headline export growth slowed down to 9.4% year on year from 14.2%YoY, on the back off negative growth in electronic exports. In contrast, higher energy and metal prices pushed up import growth to 15.4%YoY from 12.0%YoY.

We see alarming signals from the negative annual growth of electronic parts exports (-1.7%YoY), and integrated circuits (-3.0%YoY). Electronic parts exports, which are important to Taiwan made up 30.9% of total exports in June.

Combining the data of export destination, we believe that the export growth of electronic parts to the US and China have slowed which could be a harbinger of the upcoming slowdown to the sales of new smart devices.

## Electronic parts exports led the fall



Source: ING, Bloomberg

## These numbers don't fully account for the ongoing trade spat .. yet

We have to realise that trade data in 1H18 has yet to reflect the full impact of the trade war between Mainland China and the US. We've only seen metal prices going up, which could be a result of the US tariffs on aluminium and steel and therefore, this data would only affect second quarter's GDP slightly.

For now, we maintain our forecast of Taiwan GDP at 3.1%YoY in 2Q18

### Trade war impact on Taiwan - for better or worse?

How the trade tariff war impacts China, and the US affect Taiwan is an interesting topic.

Taiwan is an exporter of electronic parts and machinery and also has an agriculture sector. Taiwan's electronic goods could benefit from the trade war as a substitution for Chinese electronic products subject to a 25% tariff from the US. Taiwan could also export its agriculture produce to China as a substitution for US agricultural products that face a 25% duty from China.

But we'd like to highlight that not every company faces a positive prospect. Given that supply chain in the electronics sector is closely linked, tariffs on Chinese electronic products could also negatively affect Taiwan if it is a supplier to a Chinese firm that loses its export orders because of the 25% tariff.

As expected, the impact on the labour market lags export activities, but we believe that the low unemployment rate (3.63%), could edge up gradually as the trade war escalates.

Only time will tell if Taiwan benefits from the trade war as a substitute exporter or get hurts as its supply chain is hammered, but if things continue to escalate - one thing is sure - as the global economy is affected, global demand would fall and so would Taiwan's economic growth.



# India: Why we're now looking for two rate hikes this year

We expect the India central bank (RBI) to hike rates at the August meeting and again in October, taking the policy rate to 6.75%. We see USD/INR trading...



Source: Shutterstock

A slew of Indian economic releases over this week and next will set the expectation-agenda for the Reserve Bank of India's policy for the rest of the year. While we continue to expect the RBI to raise the policy interest rates by 25bp at the next meeting on 1 August, we have added one more hike at the October meeting to our policy forecast. We're looking to a USD/INR exchange rate at 71.5 by end-2018 (spot 68.7).

## 5.4%

CPI inflation in June

ING forecast



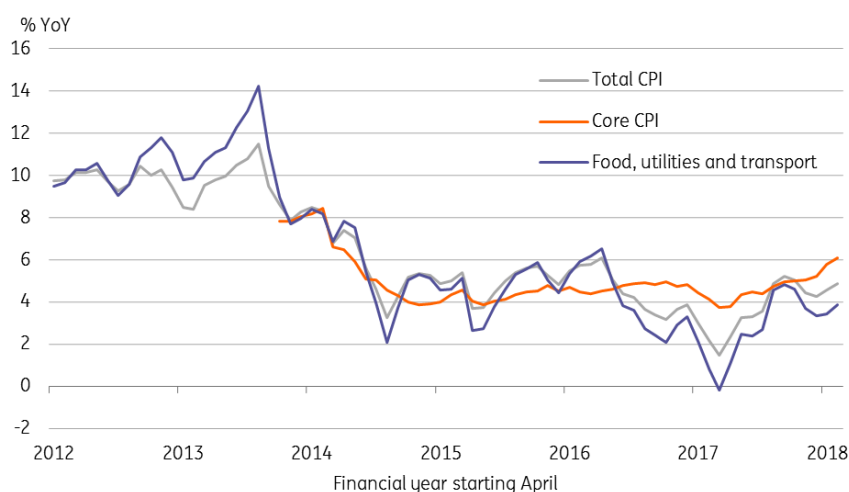
## Inflation above 5%, again

June consumer price data due Thursday is likely to show the year-on-year inflation rate accelerating above 5%, a level last seen in December and January, from 4.9% in the previous month. We're forecasting 5.4%, which is above the consensus of 5.25%. The main culprits remain food and oil-related fuel and transport costs. While both the CPI components are bouncing off the low base from a year ago, the weak currency and the pass-through from high global oil price are strong factors here.

The base effect will turn favourable (for a lower year-on-year inflation reading) as soon as July. But other factors together with administrative measures and the hike in minimum support prices for farmers will continue to pressure inflation higher in the remainder of the current financial year 2018-19 (April-March). The RBI forecasts inflation in a 4.8% to 4.9% range in the first half of the financial year and at 4.7% in the second half.

The wholesale price inflation data for June is due next week (Monday, 16 July) and we're forecasting an increase to 5.3% from 4.4% in May.

## Food and fuel prices drive inflation



Source: CEIC, ING

**5.8%**

Industrial Production in May

ING forecast

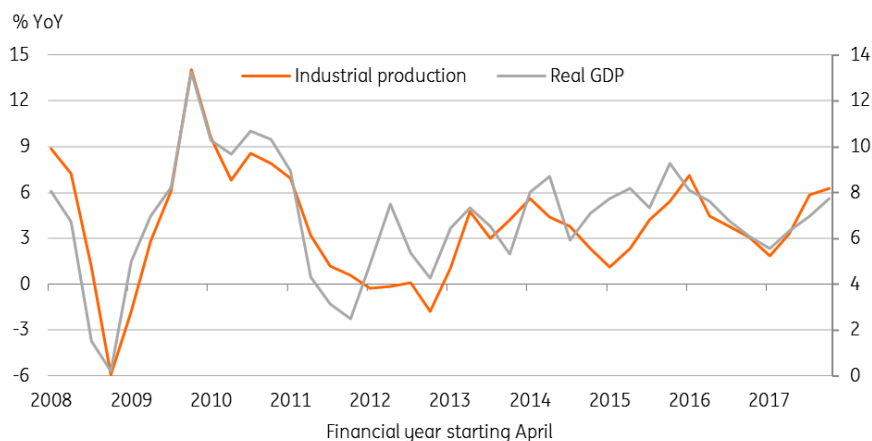
## Moderate GDP growth

Industrial production data for May, due on the same day as the inflation numbers, will be pored over to get a sense of the direction of GDP growth in the first quarter of FY2018-19. As we already know, the growth of output in core industries (eight infrastructure industries) slowed to 3.6% in May from 4.6% in April, which points to slower overall IP growth. However, strong exports in May, up 20% YoY, prompt us to forecast a faster IP growth of 5.8% YoY than 4.9% in April. And we aren't

alone; the consensus forecast is 5.9% growth.

However, with this forecast, the average April-May IP growth of 5.3% will still be slower than 6.3% average in the previous quarter. And June typically is a weak IP month. As a result, a modest slowdown in GDP growth in the last quarter can't be ruled out. We forecast 1Q FY2018-19 GDP growth of 7.5%, consistent with the consensus view and down from 7.7% in the previous quarter. GDP data for 1Q isn't due until mid-August.

## GDP growth closely tracks industrial production growth



Source: CEIC, ING

**\$15.9bn**

Trade deficit in June

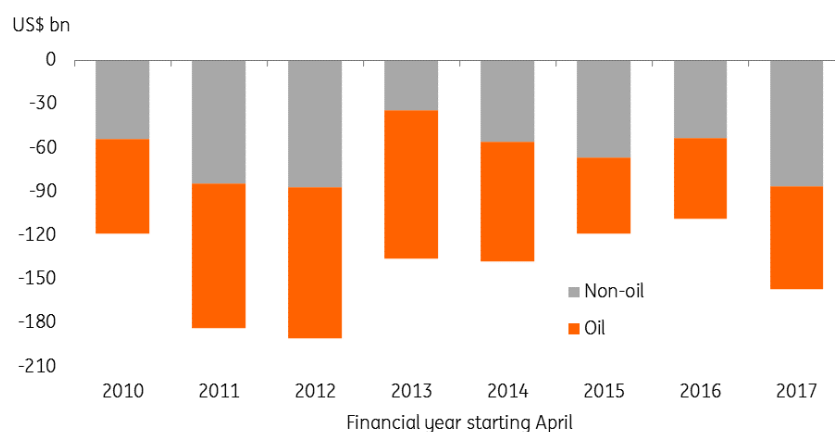
ING forecast

## Widening trade deficit

The external trade data for June is due sometime between 12-15 July, where our attention will be on the trade deficit figure. We consider the consensus of a slightly narrower deficit of \$14bn than \$14.6bn in May subject to upside risk. Our forecast of \$15.9bn deficit results from expectations of a near-halving of export growth to 11.0% YoY from May but steady import growth of around 15%. If that happens, the deficit in the first quarter of the financial year 2018-19 will be \$44.2bn, or \$4.1bn wider than the quarter a year ago.

The \$157bn annual trade deficit FY2017-18 was the largest in the last five years and little under half of that, \$70bn, was from the oil trade. With trade war sentiment weighing on future exports and rising oil prices, and strong domestic demand boosting imports, we're looking at another year with a large trade deficit in FY2018-19.

## Oil drives trade deficit



Source: CEIC, ING

## Policy implications

In June, the RBI joined its Asian counterparts (in Indonesia and the Philippines) in raising the policy interest rate to stem the depreciation pressure on the Indian rupee (INR). This has helped the INR to some extent, turning it from an Asian underperformer earlier in the year to an outperformer in the recent sell-off. But there was no end to the weakening trend that's likely to persist in the near-term as the trade war risk works its way through the actual trade figures.

---

*We have added one more rate hike at the October meeting to our forecast*

---

With inflation poised to overshoot the RBI's forecast, another rate hike at the next policy meeting on 1 August looks like a done deal. That's not all. We have added one more rate hike at the October meeting to our policy forecast, taking the policy rate to 6.75% by the end of the year. Higher interest rates should hold the ground under the INR, though other key negatives including persistently high inflation, a trade war, and wider current account and fiscal deficits will remain in play for the rest of this year. Add to this the political risk premium in the run-up to general elections in early 2019. We now see USD/INR trading toward 71.5 by end-2018 and further to 72.8 by mid-2019 when the political risk will have intensified (spot 68.7).

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.