

Good MornING Asia - 15 May 2018

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In this bundle



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India

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Opinion | 15 May 2018

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Source: iStock

It's been a long time coming, but now it's here, markets seem relaxed

I have been watching the screens anxiously in the last few weeks, with US 10-year Treasury yields poised just below 3%, and chatter rising about an emerging markets sell-off. In the event, the 3% level has been achieved with minimal fuss, and markets are if anything, in an upbeat frame of mind today. Asian FX seems, on the whole, to be looking stronger today, not weaker, and so too are local stock and bond markets.

Malaysia has made the biggest turnaround, following the calming announcements and cabinet appointments from Dr Mahathir Bin Mohamad, and our other favourite amongst the Asian FX world, the Korean won, also seems to be holding on to recent gains.

Why the newly found optimism? Well, it is entirely possible that today's mood proves to be misplaced. But one explanation is that in taking so long to cross the 3% Rubicon, investors realised, correctly, that 3% is not so high, and that this really isn't that momentous after all. At the front end of the US yield curve, the latest metric to trigger doom-mongers hoped-for disaster scenarios

is the dividend yield, which at 1.89% on the S&P500, now equals the yield on a 3-month T-bill. T-bills will, of course, go higher, as the Fed continues to hike rates (unless the rest of the FOMC suddenly takes note of James Bullard - the lone dove). But I always preferred the prospective earnings yield as a measure of equity return, and that still looks quite favourable against a 3% risk-free rate.

There is, of course, another story in EM bond markets. And yields have risen quite meaningfully in the APAC region since the beginning of the year, most notably for the Indonesian rupiah. The Philippine peso and Indian rupee have also lost ground at longer tenors, as investors show their preference for economies with current account surpluses in times of anxiety.

There is, though, no sense of an EM sell-off today, in spite of the US yield story. And what is happening in Argentina, is, for now, staying in Argentina (and a bit in Turkey too), not spreading to other EM markets. This may not last. But if we do see today's calm shattered in the weeks ahead, it will not be because US 10Y Treasury yields nosed up 2bp and crossed the 3% line.

3% 10Y US Treasury yield
Not such a big deal after all...

Day ahead - China activity data

China's activity data for April should be untainted by Lunar New Year distortions, so will be worth a good look today. We don't think the recent trade issues will have any bearing on today's data, with industrial production likely to firm from last month's 6.0% to 6.3%YoY (consensus 6.4%). Retail sales also should deliver a decent 10.1%YoY growth rate - up from 10.0% in March as the government's plan to boost the consumer sector of the economy gains further ground. Consensus expects fixed asset investment (FAI) to buck this positive trend, though remain decent, at 7.4% (was 7.5% in March), but we have a more optimistic take, as old industry contraction is replaced with new technology investment, and look for a rise to 7.7%.

In the G7, European GDP data will struggle to interest markets, but the UK labour market data has the possibility to keep interest in forthcoming Bank of England rate meetings if wages remain above inflation or push further ahead. Retail sales are today's big US activity release. Something around 0.3%-0.4%MoM would be in line with the recent trend, though this data is particularly choppy, and one factor that could deliver a higher sales figure is retail gasoline prices, which moved up by about 6.5% at the end of April from March.

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India: Inflation accelerates in April

We expect a decisive shift within the central bank policy committee to tightening at the August meeting, when we forecast a 25bp policy rate hike



Source: Shutterstock

4.6% CPI inflation in April

Higher than expected

➔ Rising inflation

Two measures of India's inflation, the consumer and wholesale price indices, posted faster than

expected inflation in April. The year-on-year rate of CPI inflation accelerated to 4.6% in April from 4.3% in March. The corresponding figures for WPI inflation were 3.2% and 2.5%. The consensus forecasts were 4.4% CPI inflation and 2.9% WPI inflation. Housing, healthcare and transport components were responsible for higher CPI inflation, while the WPI inflation tracked oil prices higher.

What matters more for central bank monetary policy is CPI inflation. We consider the Reserve Bank of India's (RBI) downgrade of its inflation forecast at the bi-monthly policy meeting in early April to be premature. The RBI forecasts CPI inflation in a 4.7-5.1% range in the first half of FY2019, revised from 5.1-5.6%. Higher food, utilities and transport prices will likely push inflation above this range within the current quarter. Among other factors contributing to India's rising inflation is the transmission of higher global oil prices. This transmission is amplified by the weakness of the currency.

As things stand, there is no near-term respite from rising inflation. We see a greater upside risk to our 4.9% full-year inflation forecast for FY2019.

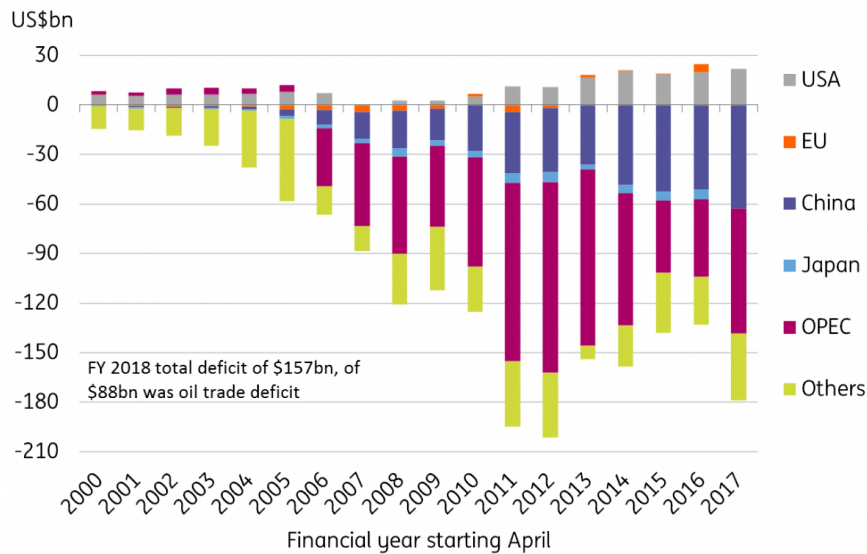
\$15bn Consensus of trade deficit in April

➔ Widening external trade deficit

Trade data for April is due today and is expected to reinforce the uptrend in the trade deficit. We forecast the April deficit at \$14.5bn, up from \$13.7bn in the previous month. Consensus is for an even bigger deficit of \$15.0bn.

Rising oil imports are pressuring the trade deficit. The total trade deficit widened to \$157bn in FY2018 from \$109bn the previous year. More than half of this rise was from oil. Rising global oil prices will sustain this trend in the near-term. By destination, China was the biggest source of India's trade deficit (see figure).

Oil and China are the biggest sources of trade deficit



Source: CEIC, ING

➔ Policy and market implications

Elevated inflation and persistent currency weakness could nudge the RBI toward tightening. However, the consensus within the six-member policy committee is still tilted toward a policy status quo. We expect a decisive shift to tightening at the August meeting, when we forecast a 25bp policy rate hike.

But for now, the data will maintain the weakening pressure on government bonds and the Indian Rupee (INR). Recent RBI support to local bond markets is proving insufficient, while increased liquidity infusion by buying bonds is also adding to further currency weakness. We do not see an easy way out of the trap. Our year-end forecast of USD/INR at 68.30 (spot 67.5) is subject to continual upward assessment in this environment.

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