

Good MornING Asia - 2 October 2018

Asian markets will tread cautiously on the developments on trade after the USMCA was forged with Trump seen to refocus on his trade negotiations with China

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General market tone: slight risk on. Investors will cheer the USMCA deal as the US now looks to renegotiate deals with China, Japan, India, and Brazil



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Indonesia

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International theme: Exit NAFTA, enter USMCA

- Canada and the US struck a deal ahead of the midnight deadline with NAFTA reworked to the USMCA, helping ease some concerns about global trade

EM Space: Asian markets seen to tiptoe higher, digesting USMCA with China still out for a holiday

- **General Asia:** Asian markets will tread cautiously on the developments on trade after the USMCA was forged with Trump seen to refocus on his trade negotiations with China.
- **Thailand:** As expected, CPI inflation eased to 1.3% YoY in September from 1.6% in August on lower food, housing, and transport prices. We expect inflation to hover close to the low end of the central bank's (BoT) 1-4% target through 2019. The BoT's desire to begin interest rate policy normalisation in order to create some policy space for the future continues to be a desire rather than a looming reality. September Business Sentiment Index was unchanged at the August level of 51.4, but the 3-month outlook index fell to 54.8 from 55.4 over the same months.
- **Malaysia:** Nikkei manufacturing PMI remained in expansionary territory for the second

consecutive month in September. Not only that, but the index at 51.5 in the last month was the highest since November. Rising oil price is positive for exports and manufacturing. It's also positive for the MYR. We are reviewing our end-2018 USD/MYR forecast of 4.25 for the downward revision.

- **Indonesia:** September inflation slipped to 2.88% as all major items saw disinflation despite a weaker currency. The latest print was a slowdown from the 3.2% gain in August while core inflation was also slower than previous, posting a 2.82% growth. With inflation relatively stable, look for Bank of Indonesia to focus on IDR stability in the near term as they deploy measures together with the national government to maintain financial stability by limiting volatility in the IDR.
- **Philippines:** Manufacturing in September continued to show a moderate expansion with PMI manufacturing at 52, slightly higher from the previous month although the report showed manufacturers were becoming increasingly concerned about inflation, suggesting that it may not have peaked in September. The expansion points to a still robust domestic economy but also highlights the weak demand for PHL exports, which could translate to sustained wider trade deficits.
- **Philippines:** Domestic pump prices saw another round of increases as crude oil prices remained above \$70/barrel. The much-anticipated 250,000 MT of rice imports arrived on 27 September and the government hopes this will be enough to slow the pace of price increases. Meanwhile, wheat and sugar prices are set to trend higher, seen to weigh on the consumer basket and keep the pressure on the BSP to hike rates anew at its November meeting.

What to look out for: US NFP and Fed speakers

- Argentina-IMF credit line request (on-going)
- Central bank meeting Australia (2 October)
- Fed Powell speaking engagement (3 October)
- Philippine inflation (5 October)
- India central bank meeting (5 October)
- US non-farm payrolls (5 October)

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Korea: Production bounces in August

South Korean industrial production grew 1.4%MoM in August, lifting the annual rate of growth from 1.0% to 2.5%YoY. With inflation soft, this isn't enough to spur the Bank of Korea to respond any time soon



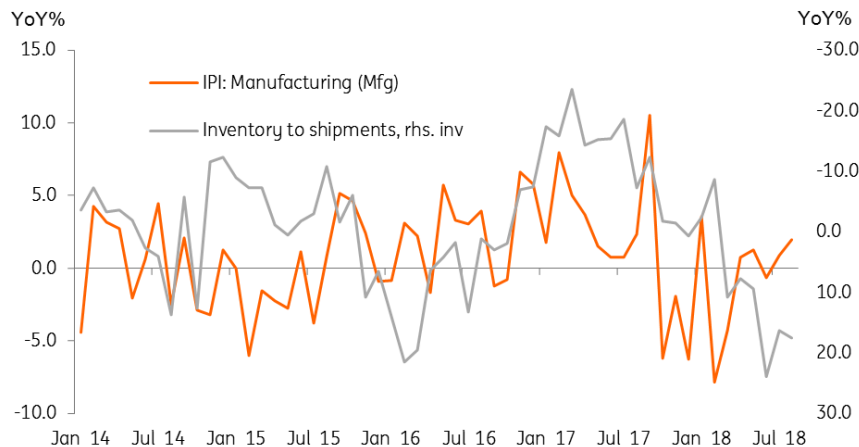
Source: Shutterstock

The Bank of Korea is caught between a weak currency and weak growth

Korean production data - better than feared

Recent Korean data has not been very uplifting, so today's August production release showing growth of 1.4%MoM, 2.5%YoY, makes a welcome change. We think Korea has been undergoing an old-fashioned inventory-led slowdown, the sort that used to be "fashionable" before the global financial crisis hit and unorthodox monetary and fiscal policies sought to boost asset prices and squeeze growth higher by any means possible. Korea didn't engage in any of that, but like everywhere else, was swept along on a tide of production that wasn't quite matched with genuine demand.

Production and inventory to shipments ratio (inverted)



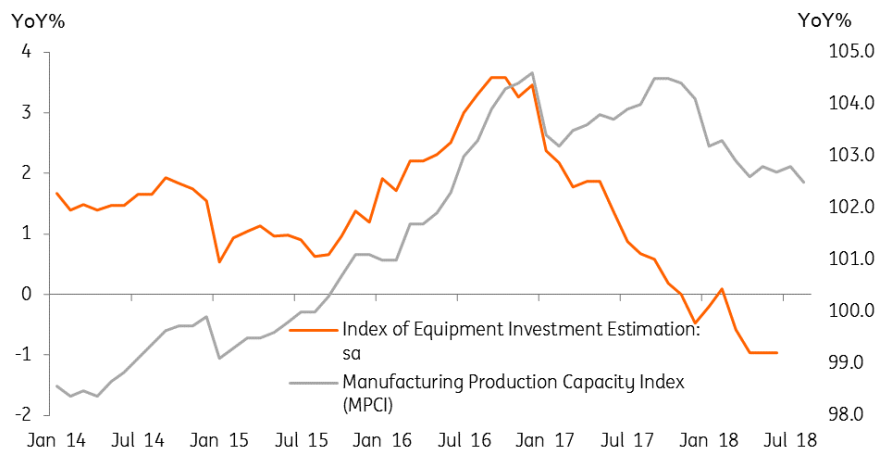
Inventory ratios still weighing on production

Rising inventory ratios (shown inverted so falling in the above chart) look as if they may be bottoming out, although manufacturing output seems to be leaping ahead of any genuine improvement here, and we may see a further pullback in the months ahead.

But manufacturing operating ratios are improving, thanks mainly to continued weakness in equipment investment, and this is helping to lift profitability, and in turn, output.

While the investment story does not sound an encouraging one, it too should turn in due course, and may already be starting to do so, which will provide a broader boost to what is currently fairly soggy and consumption-driven economic growth.

Korea investment and production capacity



BoK on hold for rest of the year

Overall, this is a satisfactory, rather than good set of figures, but it does at least hold out the prospects of further improvements ahead, which is encouraging. But there is still little chance of the Bank of Korea coming out of hibernation any time soon. For that, we need to see more confirmation of a turn in the growth data (recent export figures were not encouraging). We also

need to see some more firmness in pricing, with core inflation pushing closer to 2.0%YoY. At 0.9%YoY currently, this is unlikely before mid-2019 (ING forecast next rate hike in 3Q19).

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Indonesia: Inflation surprises on the downside

September inflation slipped to 2.88% from 3.20% in August. The Bank of Indonesia is likely to focus on the stability of the rupiah as inflation remains within target



Source: t-bet

2.88%

Lower than expected

September inflation rate

Second period of month-on-month disinflation

Inflation in 2018 and 2019 likely within the central bank's target range of 2.5% to 4.5%

Inflation settled at 2.88% in September, a second month-on-month deceleration and well-within the Bank Indonesia's (BI's) 2.5-4.5% target. A moderation in prices of all major components contributed to the lower headline number while core inflation slid to 2.82%, despite a weaker currency. Despite a drought in central Java, food inflation (16.19% of the consumer basket) slowed to 3.75% from 4.9% as timely government rice imports helped to maintain a plentiful supply.

Inflation is likely to remain within-target over the monetary policy horizon, with the Bloomberg consensus forecasting an average inflation rate of 3.5% this year and 3.8% next year. BI Governor Perry Warjiyo remains confident that inflation will stay within target this year and next while we continue to expect an average inflation rate of 3.3% this year and 3.6% in 2019.

With inflation in check, BI will likely focus on maintaining financial market viability through a stable currency (IDR). Hawkish rhetoric from the central bank for “front-loaded and pre-emptive action” have helped limit the initial panic of emerging market contagion. BI hiked rates as expected on [27 September](#) and looks to coordinate with the national government in deploying measures to provide IDR stability, which could in turn also keep a lid on inflation. IDR hit a high of 14,938 on 5 September and is currently down 9.8% year-to-date but recent moves of the BI appear to have calmed markets for the time being.

Monetary authorities have raised interest rates by 150 basis points this year and further monetary tightening is possible should volatility return to the IDR spot market. However, should both the IDR and Indonesia’s inflation remain stable, this could afford the BI some breathing room to allow other measures, such as its various hedging facilities, to take root and keep the powder dry on rate hikes going into 2019.

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Thailand: Inflation downturn starts

The Bank of Thailand's desire to begin interest rate policy normalisation in order to create some policy space for the future continues to be a desire rather than a looming reality



Source: Shutterstock

Thailand's consumer price index (CPI) data for September today affirmed what we said a month ago, that **'Inflation has peaked'**. The start of what we see as yet another prolonged stretch of subdued inflation will be a blow for the central bank (Bank of Thailand) policy hawks. Not only do we maintain our view of no change in BoT policy this year, but we also are reconsidering our forecast of the BoT starting to normalise policy rates next year. Nonetheless, drawing support from the strong external surplus the THB should remain an Asian outperforming currency in the period ahead.

1.3% September CPI inflation

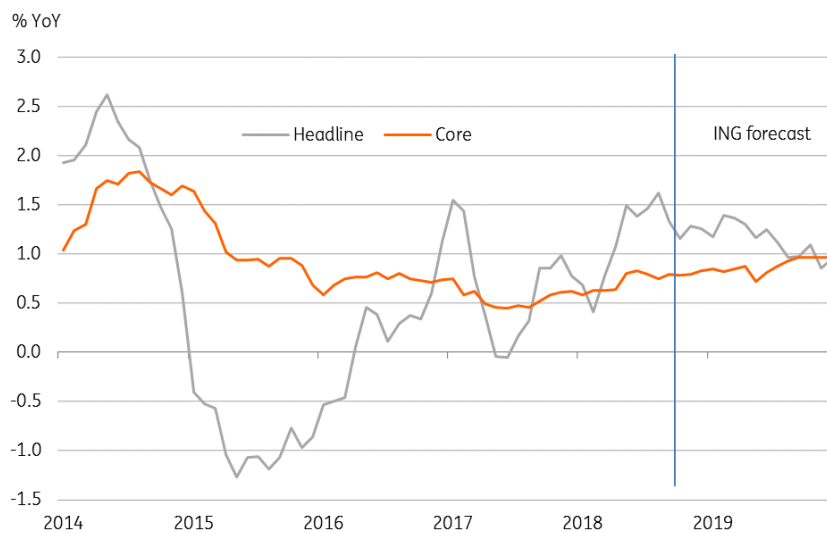
As expected

Food, housing and transport pulled CPI lower

The 1.3% year-on-year CPI increase in September was a bit above our 1.1% estimate but in line with the consensus estimate. High base-year effects in play in three key CPI components – food, housing and transport (with a combined 83% weight in the CPI basket) – weighed on the headline index. Inflation in the remaining components either slowed or was unchanged. Core CPI, stripping out food and fuel prices, remained close to the 0.8% level it has hovered around since May.

The 1.1% year-to-date rate of inflation is close to the low-end of the BoT's policy target of 1-4%. While we leave our full-year 2018 average inflation forecast at 1.1%, we do not see inflation in the next year being far off from this level either. As such, the central bank's desire to begin normalising interest rates in order to create some policy space for the future will continue to be a desire than becoming a reality. Meanwhile, GDP growth looks set to slip below the 4% mark in the coming quarters and remain on a tapering trend due to weak external demand.

Where CPI inflation is heading in 2019?



Source: Bloomberg, CEIC, ING

A prolonged period of stable central bank policy

We haven't been among the BoT policy hawks with our long-held (for over a year now) view of no change to BoT policy through the end of this year. Now we are even re-considering a view of a gradual normalisation underlined by our current forecast of a 25bp rate hike in 2Q19 and another similar move in 1Q20. Even so, we don't see this nudging the THB from its Asian outperformer status, which the currency continues to enjoy on the back of its persistently large current account surplus.

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