

## Good MornING Asia - 21 May 2019

Following the weekend's shock election win for Australia's Liberal / National coalition, markets are cutting back their expectations of an imminent rate cut from the Reserve Bank of Australia (RBA), while increasingly poor data from rest of Asia is raising odds of more regional central banks joining in the easing cycle

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2 weeks ago, I went on the road with some colleagues - the trade war has taken its toll on financial markets in those weeks



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##### Indian voters' verdict on Modi arrives

After more than a month of voting in India, hopefully, the long-standing political uncertainty is set to end. Exit polls suggest prime minister Narendra...

Opinion | 21 May 2019

# Financial fortnight

2 weeks ago, I went on the road with some colleagues - the trade war has taken its toll on financial markets in those weeks



Fortnite

## Lessons learned

I often say that you're never as good at this job as in the two weeks following a client roadshow. Today's note may put that theory to the test. So what exactly did I learn?

Well, I learned that Asian clients are prepared to listen to a story about Europe, the merry-go-round of top jobs at the various EU institutions, and the ECB outlook. But I also learned that this is an easier story to sell if you wrap it around a message about the global outlook, the Fed and President Donald Trump and the Trade War. I also learned that few of these clients expected, contrary to our Chief International Economist, James Knightley, for President Trump to get re-elected next year. That was a wake-up call for many.

I also learned that many clients were less upbeat than we were on the prospects of a deal in the trade war, though I should stress that neither myself nor Knightley (JK) sees any deal as the end of the war, merely a cessation of hostilities for a period. I have never considered this "an event", and always viewed it as a "process". I think JK agrees.

And in China, we learned from FX clients that they expect USD/CNY to hold below the 7.0 level. But close.

## Sell in May and go away

Reading the news on my morning wrap from one of the big newswires (you should know which one by now) it read today as if we were witnessing a "sell dollar assets" story. That was alarming against the backdrop of stories about China selling US Treasuries. So it is reassuring to check things out over the longer timeframe for which I have been away to see that this doesn't resemble the story at all.

The dollar over the last two weeks is generally stronger, bond yields generally lower, and stock markets lower too. This mix of financial metrics exactly fits a disinflationary trade war scenario. And right now, it is hard to see what will break it.

We do, yes, expect a trade deal. But the timing of that could be anywhere between now and the end of the year. Given the strength of the US economy, President Trump has the luxury of a bit of leeway before deciding when to call off his trade hawks.

What might hasten this decision is further weakness in US stocks, which he has pointed to in the past as the real barometer of his success as President. Though until the election race kicks off in earnest early next year, that is less pressing that it could be, so may not provide the excuse for a cease-fire that many are looking for. It could be a rocky summer for stocks then. The old adage, "Sell in May and go away" might not be such bad advice this year after all.

## Incumbents carry elections across APAC

(From Prakash Sakpal): Consistent with our baseline on the Indian election, exit polls are indicating a victory for Prime Minister Modi's Bharatiya Janata Party, albeit with a narrow margin, and requiring a coalition government for the second consecutive term. However, given the poor track record of exit polls in the past, uncertainty prevails and investors are likely to be on the sidelines until official results are known (23 May - Thursday).

Keeping the pro-incumbent wave in the region, Indonesia's President Jokowi is officially declared the winner of the elections held in April. Likewise, Thailand's new parliament to be conveyed this week may also endorse incumbent Junta leader Prayuth Chan-Ocha as prime minister of the new government.

## There's plenty of Australian interest today

Following the weekend's shock election win for Australia's Liberal / National coalition, markets are cutting back their expectations of an imminent rate cut from the Reserve Bank of Australia (RBA), rather expecting fiscal policy through tax cuts, to provide the rescue the economy seems to need.

They may be right, but last month's RBA minutes released this morning could provide us with a bit more insight, as could a speech by the RBA Governor today. The minutes will probably not have anticipated the election outcome though, which has taken everyone by surprise. So Governor Lowe's speech may be the one to watch.

## Asia day ahead

20-Day export data for South Korea are a useful sneak preview for full month data, though can be a bit misleading at times. There is no consensus for these, rather, these are what forecasters will plug into their spreadsheets for the full figures, so scope for a market surprise is substantial. We

would need to see nominal exports for May rise to close to USD50bn for the full month if the year on year rate of decline is too narrow. And the base comparison with the second half of last year is a tough one. So ongoing weakness is probably the base expectation.

Singapore's final GDP for 1Q19 is a bit confusing. The year on year figure was a bit lower at 1.2% than either the preliminary number (1.3%) or the consensus (1.4%) but there was a massive jump in the QoQ seasonally adjusted number. Having struggled with reconciling these numbers in the past, I am tempted to put more weight on the year on year figures and largely ignore the QoQ data. This data won't have any impact on our GDP forecasts for the year 1.9% for the full year).

(From Prakash Sakpal): Meanwhile, the Thai GDP report for the first quarter of the year due today is likely to show a sharp slowdown in growth; the consensus centered on 2.8% year-on-year growth is the lowest in four years and down from 3.7% in 4Q18. This combined with heightened trade tension will make it increasingly hard for the Bank of Thailand to sustain its hawkish rhetoric going forward. Indeed, we are reviewing our on-hold forecast for the BoT policy this year.

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## ASEAN Morning Bytes

General market tone: Risk-off. The fallout from the trade war seen to spillover to the technology sector in Asia as the trading begins today.



**2.8%** Consensus on Thai GDP growth in 1Q

### EM Space: At the mercy of US-China trade war

- **General Asia:** Technology shares were pushed lower by concerns about the fate of a Chinese technology in the US which is set to hit suppliers in Asia. Meanwhile, oil prices continued to nudge higher as OPEC signals an extension to output curbs while the Fed remains neutral.
- **Singapore:** 1Q19 GDP growth is confirmed at 1.2% YoY, a downgrade from the 1.3% initial estimate making it the slowest pace in over six years. The sustained double-digit declines in exports in April will weigh on manufacturing and GDP growth in the current quarter, making it increasingly difficult for the central bank (MAS) to maintain its tighter policy stance going forward.
- **Thailand:** 1Q19 GDP report due today is likely to show a sharp slowdown in growth; the consensus centered on 2.8% year-on-year growth is the lowest in four years and down from

3.7% in 4Q18. This combined with heightened trade tension will make it increasingly hard for the Bank of Thailand to sustain its hawkish rhetoric going forward. We are reviewing our on-hold forecast for the BoT policy this year.

- **Indonesia:** The government seeks to achieve an acceleration of growth to 5.3%-5.6% range in 2020 (from 5.2% in 2018) despite concerns about slowing global growth and the poor performance of its export sector. Finance Minister Indrawati indicated that next year's investment growth would top 7% while government spending would grow by double-digits after President Jokowi indicated he would like growth to accelerate in the coming year aided by state spending.
- **Philippines:** The balance of payments posted a \$467m surplus in April, taking the gross international reserves to a multi-year high of \$84bn. Financial account flows in the first four months of the year offset sustained current account weakness with the government likely tapping the global bond market again in 3Q with a JPY-denominated bond issue.

## What to look out for: GDP numbers from region and FOMC minutes

- Thailand GDP (21 May)
- Fed Rosengren (21 May)
- Thailand trade (22 May)
- Fed Bullard, Williams, Bostic (22 May)
- Hong Kong CPI (23 May)
- US initial jobless claims (23 May)
- FOMC minutes (23 May)
- Malaysia CPI (24 May)
- Fed Kaplan (24 May)
- Taiwan GDP (24 May)

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## Indian voters' verdict on Modi arrives

After more than a month of voting in India, hopefully, the long-standing political uncertainty is set to end. Exit polls suggest prime minister Narendra Modi's return to power, but given the anti-incumbent sentiment seen in last year's state-level elections in Modi's stronghold states, the potential for surprise still remains



Source: Shutterstock

### Putting behind politics

Voting has ended in India and the final results will come through on Thursday. Exit polls suggest Narendra Modi is set to return as the prime minister for a second term.

But given the state election surprises in 2018, we think the results of this general election could still be unpredictable - and we're not alone. Recent opinion polls also indicate the main political rivals including the incumbent Bharatiya Janata Party (BJP), the right-wing National Democratic Alliance (NDA), and the Congress-led left-wing United Progressive Alliance (UPA) could come in neck and neck.

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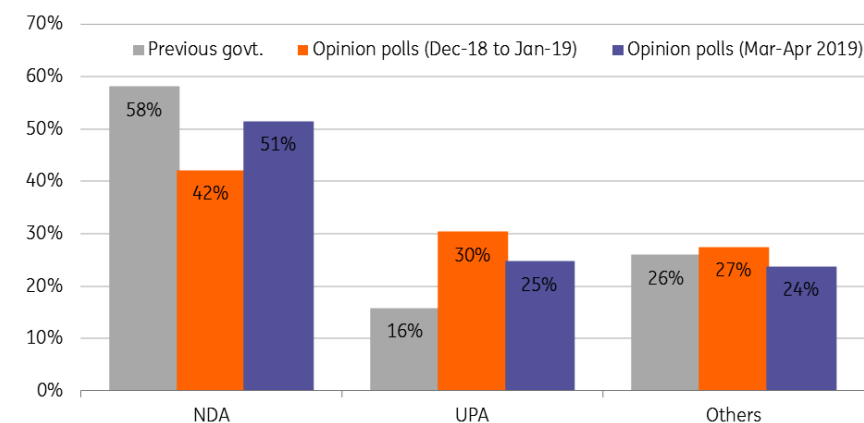
*Even if Modi's BJP party retains its absolute majority this doesn't quite guarantee the throne*

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Our base case remains seeing the Modi administration clinging to power for the second term, but given the anti-incumbent sentiment we saw sweeping through last year's state-level elections in Chattisgarh, Madhya Pradesh, and Rajasthan, back when the national level polls showed the NDA losing its grip on power, there remains the potential for an election surprise. A key risk for Modi is a consolidation of opposition under Congress.

Even if Modi's BJP party retains its absolute majority this doesn't quite guarantee the throne. Cast your mind back to a year ago in the legislative assembly elections in the Karnataka state where BJP won the majority of seats but failed to form a government and the Congress-led coalition stayed in the power till the end.

## What did pre-election opinion polls suggest?



Note: Average result of five major opinion polls.  
Source: Wikipedia, ING

## Not everything is great about Modi

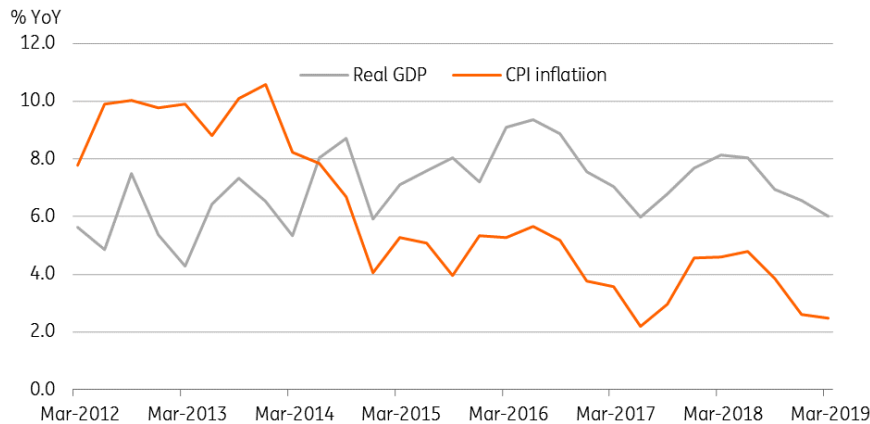
The Indian economy enjoyed solid growth of 7.5% per annum on average, during Modi's five-year term, and low inflation of under 4% at least in the final year of his term. The tax reforms, even the chaotic implementation of the goods and services tax in mid-2017, banking sector reforms, anti-corruption drive, financial inclusion programs, kick-starting a cashless economy, and 'Make in India' initiative were some of the creditable measures by the Modi administration. These deserve some of the credit for the strong run of the Indian stock market relative to its emerging market counterparts, with the main stock indices almost doubling over the past five years.

*The Indian economy enjoyed solid growth of 7.5% per annum on average, during Modi's five-year term, and low inflation of under 4% at least in the final year of his term*

But the misery caused by the sudden ban of high-value currency at the end of 2016 remains vivid in voter's minds and this was a big factor in the BJP's loss in its power bastions such as Chattisgarh, Gujarat, Madhya Pradesh, and Rajasthan. Adding to the negatives are continued farm distress, the excessive government intervention in central bank's affairs, bankruptcies of non-bank finance companies, banking sector scams and rising non-performing assets, and most importantly the

elevated unemployment rate of 6.1%, according to the latest government survey making it the highest in 45 years - all undermining Modi's 'Make in India' initiative to transform the country into a global manufacturing base.

## Strong growth, low inflation during Modi's first term



Source: Bloomberg, CEIC, ING

## How markets are likely to react to election results?

The outperformance of the Indian markets and the rupee since February 2019 reflects increased investor confidence in prime minister Modi staying in power, but the uncertainty surrounding election results will undoubtedly sustain the negative sentiment in local markets already roiled by contagion from the escalation of the US-China trade war recently.

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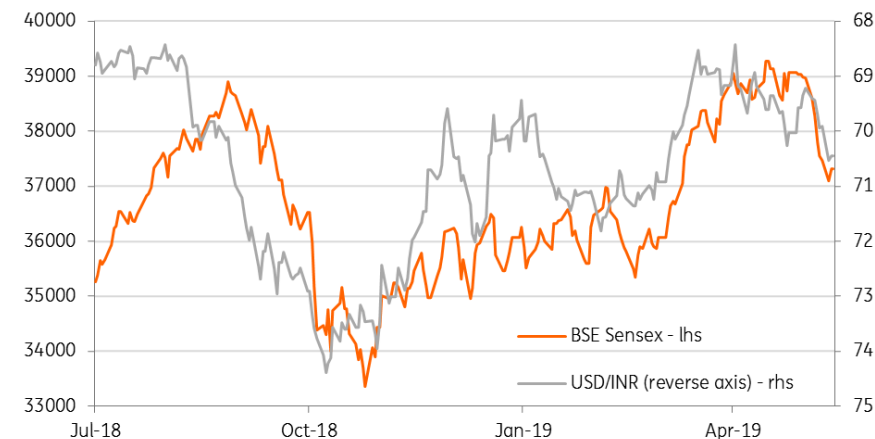
*We believe the markets are priced in for (our) baseline scenario of a BJP-led coalition, retaining power albeit with a thin margin*

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We believe the markets are priced in for (our) baseline scenario of a BJP-led coalition retaining power albeit with a thin margin. Such an outcome means that the election results should have little impact on markets, and in turn should be left to be driven by non-political factors, domestic and external. Indeed, the currency market has so far vindicated our forecast of the INR weakening past 70 against the USD. We see the pair trading in a tight range around 71 until the election dust settles.



## Markets are pricing in a Modi return



Source: Bloomberg, ING

## Alternative events risks

As we've mentioned above, the results could go either way and depending on how the swing states - the states where BJP has lost power in state elections over the last two years - perceive the party at the national level. The alternative outcomes and our view of what these would mean for markets are:

1. **NDA remains in power:** The BJP loses its absolute majority but still forms the government with the coalition partners and Modi stays prime minister. Just as the baseline, this is likely to have little impact on markets, with USD/INR continuing to trade in the 70-71 range.
2. **A landslide victory for BJP:** This would come as a big positive for markets, with the USD/INR grinding for re-test of the March low of 68.42 and eventually settling in the 66-68 trading range.
3. **Congress-led UPA government:** Investors are likely to see this as instilling significant political and economic uncertainty for the future, by derailing economic reforms. The resultant market sell-off could see USD/INR pushing higher to a 72-74 trading range.
4. **Third front government:** A government without the BJP or the Congress would mean a significant jump in uncertainty on all fronts and for a prolonged period of time. Although such an outcome is highly unlikely, this could spell disaster for markets, driving the rupee down for a significant depreciation above 75 against the USD.

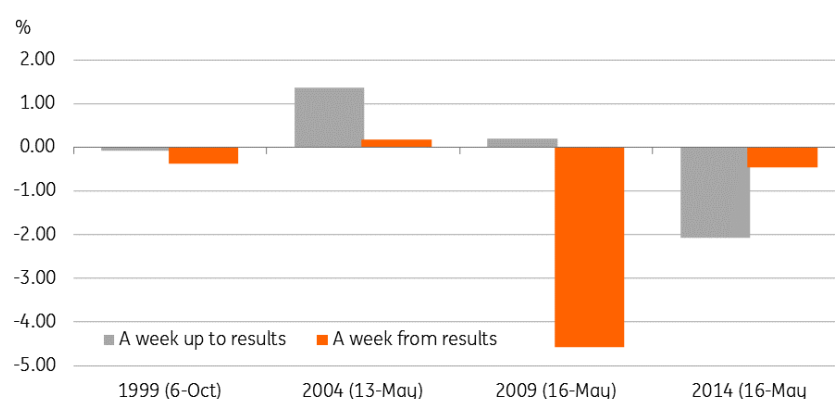
## USD/INR performance in the week up to and after results of past elections

**1999 result:** NDA swept back to power after being ousted with no confidence vote leading to fresh elections.

**2004 result:** NDA lost power to UPA

**2009 result:** UPA remained in power

**2014 result:** NDA returned to power on landslide BJP victory



Note: Election results dates in parenthesis. Negative values means INR appreciation and vice versa.

Source: Bloomberg, ING

## As political uncertainty lifts, the economy will be back in focus

Like elsewhere in Asia, recently released Indian economic indicators paint a picture of continued slowdown in growth and benign consumer price inflation – both supporting expectations of greater policy accommodation amid persistently wide fiscal and current account deficits.

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*For now, we retain our annual growth forecast of 6.8% for the current financial year*

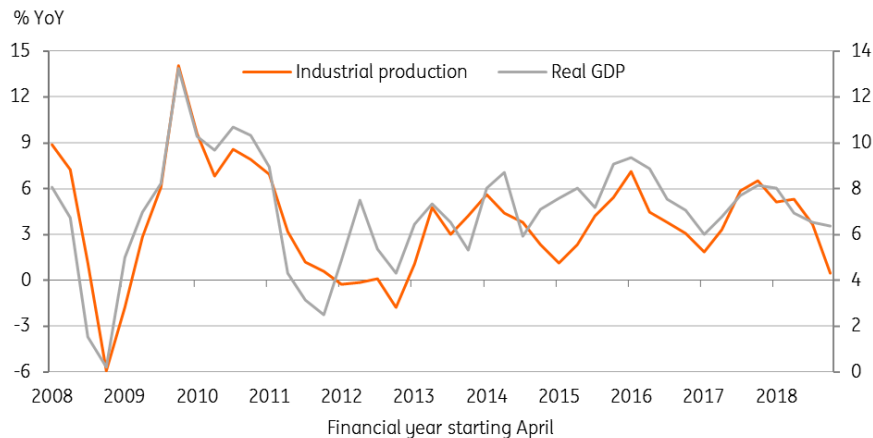
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Keeping with the broader global trend, exports and manufacturing posted a slowdown in growth in recent months. As this feeds into the overall economic growth, a downward trend in GDP growth appears to have gained pace between January-March - the last quarter of the financial year 2018-19. On our forecast, GDP growth in that quarter slipped further to 6.0% year-on-year from 6.6% in the previous quarter, making it the slowest growth quarter in two years. This puts FY18-19 growth at 7.0%, only marginally better than 6.7% in the previous year.

We anticipate growth to hover around 6% in the current quarter before the pre-election boost to government spending kick-starts the economy. However, with growing headwinds to growth, especially from weak exports and higher oil prices, sustaining growth at or above 7% will be a challenge. On technical grounds, the low base effect is likely to contribute to some acceleration in

the remaining FY19-20. But for now, we retain our annual growth forecast of 6.8% for the current financial year.

## Manufacturing has dragged GDP growth lower



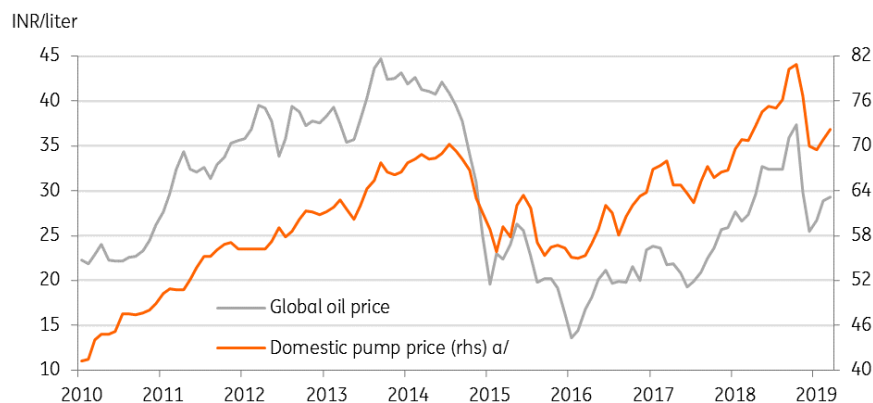
Source: Bloomberg, CEIC, ING

## Inflation genie still bottled, but not for too long

Consumer price inflation continues to be defiant to increasingly weak public finances and pass through from higher global oil prices. Annual inflation has been creeping up after it bottomed at 2% in January. It has risen to 2.9% as of April - still well below 4% - the mid-point of the RBI's 2-6% policy target.

State-owned oil companies have been blamed for holding on to the pass-through of higher global oil prices to domestic fuel prices during the election period, even though pump prices in India are adjusted on a daily basis. If so, consumers should be bracing for a significant spike in fuel prices post-election. Adding to their woes will be the lifting of the US waiver of imports from Iran. Among other inflationary drivers are higher import duties on food grains as in late April the government raised duty on wheat imports by 10 percentage points to 40 percent in protection for local farmers.

## Be prepared for higher fuel prices after election



a/ Average of petrol and diesel price in four metropolitan cities

Source: Bloomberg, CEIC, ING

## Misplaced hopes of another RBI rate cut

Low inflation has allowed the RBI to cut rates twice in February and April, which apparently were political moves (the government's drive to boost growth before the election) rather than a real need by the economy already stimulated by the surge in election-related spending. We believe the expectation of the third rate cut in June, as some in the markets have been calling for, are misplaced.

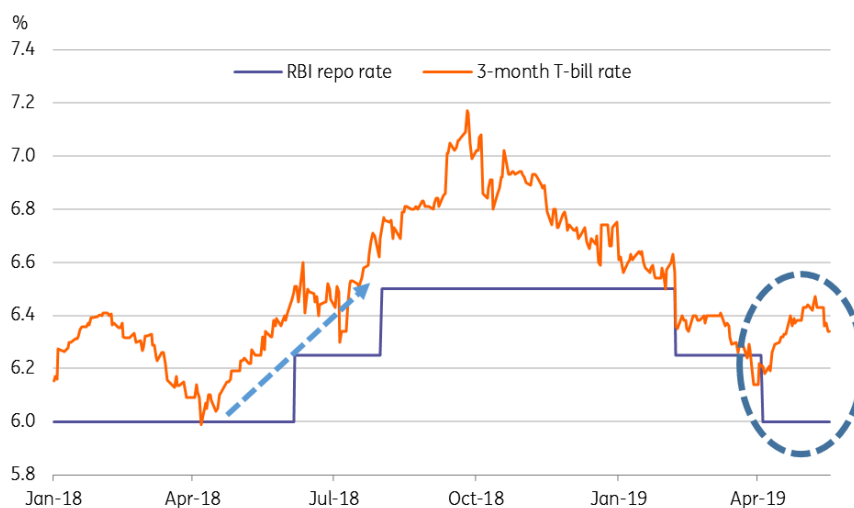
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*We forecast no more RBI policy rate cuts this year*

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Given a significant policy lag and the potential inflation headwind, we believe the RBI will stay on hold in June and rather allow the hitherto easing to sink in. We think rising short-term rates since April – the rate on 3-month T-bills is up 20 basis points – underscore a stable RBI policy in the next meeting. We forecast no more RBI policy rate cuts this year.

## Market rates suggest no more policy rate cut



Source: Bloomberg, ING

## US trade war risk shifting to India

The external risks could manifest if the US potentially targets India as its next trade enemy, after China.

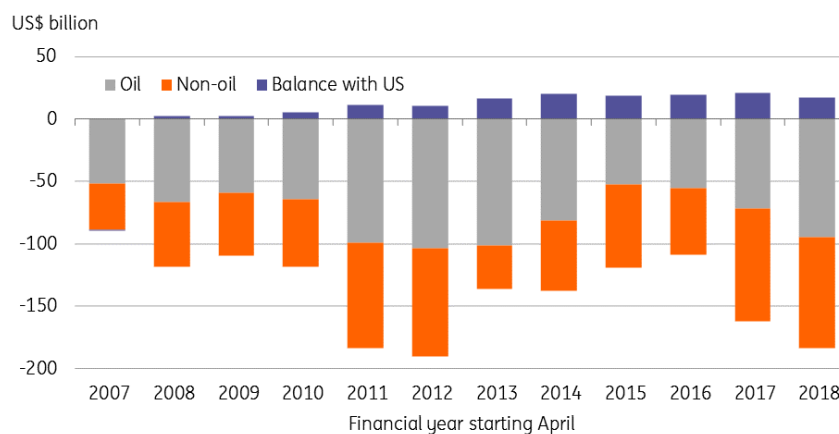
In early March, President Trump issued a notice to end trade benefits to India under the generalised system of preferences (GSP), which allows duty-free exports to the US of about 2000 products from developing countries. This special status has been put under review on the grounds that India, supposedly the largest beneficiary of the GSP, wasn't reciprocating with free access to its market. However, India's commerce ministry downplayed the potential impact from this on the basis that benefits from GSP had been negligible.

*India is also among the countries running a wide trade surplus with the US, which has brought it under scrutiny from the US Treasury for currency manipulation along with China, Japan, and Korea*

India is also among the countries running a wide trade surplus with the US, which has brought it under scrutiny from the US Treasury for currency manipulation along with China, Japan, and Korea. But the annual surplus with the US in FY18-19 fell 20% below the Treasury's \$20 billion threshold - one of the three criteria for a country to be labelled as a currency manipulator. And India has dodged the bullets on the other two criteria - a wide current account surplus of at least 3% of GDP, and persistent one-sided market intervention with FX purchases of at least 2% of GDP.

It would be interesting to see the US Treasury's assessment in the forthcoming semi-annual manipulator report later this month, which will be based on the more stringent criterion - now less than 2% of GDP current surplus, though India still doesn't meet this, and this is likely to see more countries falling in this category.

## Widening total trade deficit, but still large surplus with the US



Source: Bloomberg, CEIC, ING

## India - Key economic indicators and ING forecasts

India (FY starting April)	FY2015	FY2016	FY2017	FY2018 f	FY2019 f	FY2020 f
Real GDP (% YoY)	8.2	7.1	6.7	7.0	6.8	7.2
CPI (% YoY)	4.9	4.5	3.6	3.4	4.5	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.5	-3.4	-3.3
Public debt (% of GDP)	70.0	69.5	71.2	72.5	72.0	71.0
Current account (% of GDP)	-1.1	-0.6	-1.9	-2.6	-3.1	-2.9
FX reserves (mth of imports)	10.2	10.6	10.2	8.3	7.9	7.8
External debt (% of GDP)	182.1	168.2	171.4	160.0	162.2	175.5
RBI repo rate (% eop)	6.75	6.25	6.00	6.25	6.00	6.25
3M T-bill rate (% eop)	7.27	5.82	6.09	6.14	6.50	6.60
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.35	7.80	7.80
INR per USD (eop)	66.33	64.84	65.18	69.16	69.50	68.00

Sources: Bloomberg, CEIC, ING forecasts

Source: Bloomberg, CEIC, ING

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