

Good Morning Asia - 25 September 2018

After a brief hiatus, the global risk aversion resumed as the new US tariff on China kicked off and another Fed tightening loomed. Little on the way today to alter the risk-off sentiment today

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ASEAN Morning Bytes

General market tone: Risk off. Sentiment reversed on Monday with last week's rally proving short-lived as the US tariffs on Chinese imports kicked in.



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By Robert Carnell



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Ongoing financial trouble comes as a fresh blow to the rupee as well as a political blow to Prime Minister Narendra Modi just ahead of the general...

Article | 24 September 2018

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International theme: Trade issues back in focus, Fed dot plots awaited

- The recent rally quickly faded with traders pulling back on Monday after the US tariffs on \$200 billion worth of Chinese imports kicked in. With China looking more intent on retaliating via both quantitative and qualitative measures, investors are now readying for a long drawn out trade dispute.
- The Fed begins its two-day policy meeting with market full pricing-in a rate hike by the FOMC. With the dot plots likely to show further rate hikes down the road given accelerating inflation, Mario Draghi apparently has begun to sing a hawkish tune as well as flagged inflation building momentum in the Eurozone.

EM Space: Emerging markets head for cover with trade spat and Fed

- **General Asia:** Well that didn't last very long. The risk rally quickly dissipated with the market finally reacting to the US tariffs on China, which went into effect on Monday.

Investors now turn to the Fed for clues on the rate hike momentum with the Powell press conference and dot plots seen to be the highlight on Wednesday.

- **Singapore:** August headline CPI inflation rose in line with the expectation to 0.7% YoY from 0.6% in the previous month, but core at 1.9% was surprisingly unchanged. Despite a modestly improved outlook for headline inflation over the coming months, the escalating trade war makes a change of the already slightly tightening MAS monetary policy stance in October seem very unlikely.
- **Thailand:** August manufacturing index is due. Our estimate of 3.2% YoY growth is consistent with consensus implying a sharp slowdown from 4.6% in July. We are getting more support for our view of an on-hold Bank of Thailand policy through the end of the year. A Bloomberg report quoted the Bank of Thailand governor Veerathai saying that monetary policy was data-dependent and was unlikely to shift to tightening from an accommodative stance.
- **Philippines:** The Philippines reported substantial crop damage as a result of the recent super typhoon Mangkhut. Total crop damage was pegged at PHP26.7 billion while the all import rice damage climbed to PHP14 billion, which will likely keep inflation elevated and the BSP busy even after their projected rate hike on Thursday.
- **Philippines:** The Philippines posted a budget deficit of PHP2.6 billion as core spending surged to 32% while collections grew 11% for the month of August. For the year, the national government spending was at PHP281.99 billion as the government looks to keep up the pace of spending to augment overall GDP growth. With expenditure rising rapidly, interest rates are seen to rise as well with the government needing to fund the overall national government spending agenda.

What to look out for: Calendar loaded with CB meetings, Argentina says deal with IMF close

- FOMC meeting September 25-26
- Taiwan central bank meeting September 27
- Bangko Sentral ng Pilipinas meeting September 27
- Bank of Indonesia meeting September 27
- US-Canada trade negotiations (deadline: end of September)
- Argentina-IMF credit line request (on-going)

Singapore inflation rises less than expected

A bit of food and a bit of clothing helped keep inflation heading up this month - next month may see a return to 1.0% inflation



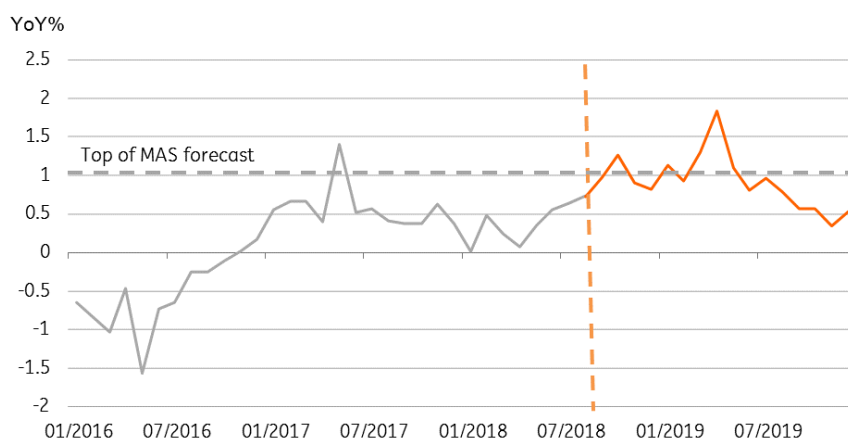
Source: Shutterstock

Headline inflation doesn't really warrant any MAS response

AT 0.7%YoY, Singapore's inflation is low and has been below 1.0% since May 2017, when it briefly spiked higher on a technicality. Prior to that, you have to go back to August 2014 to find headline inflation at 1.0% "legitimately". Today's figures don't appear to take us much closer to 1.0%, the top of the Monetary Authority of Singapore's target range for 2018.

But the long wait may soon be over. If average monthly outcomes for all of the Singapore's components over the last three years prevail next month, and that includes a fairly soggy 2016/2017 set of figures, then we could see a 1.0% inflation rate reached again as soon as the September figures next month.

Actual headline and forecast inflation

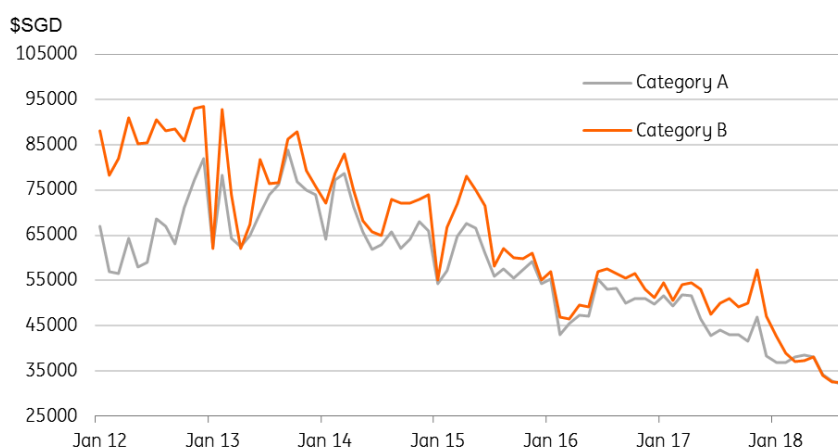


Core inflation unchanged at 1.9%

The MAS core inflation rate which excludes private transport costs and accommodation did not rise in August from the July 1.9% rate. This inflation rate already looks fairly good compared to the usual 2.0% international benchmark for "sensible" core inflation. But unlike most core measures which exclude externally driven food and energy prices, The Singapore measure is flattered by the exclusion of two of the most negative components of all items CPI basket - private transportation and accommodation. These items are not irrelevant from a consideration of domestic demand pressures, and therefore, from the stance of monetary policy.

So despite a modestly improved outlook for headline inflation over the coming months, the escalating trade war makes a change of the already slightly tightening MAS monetary policy stance in October seem very unlikely.

Certificates of entitlement (COE) premium (SGD)



Accommodation price deflation moderating

One small element of good news as far as the core rate of inflation goes is that deflation in the accommodation sector is abating. Though at -2.6%YoY in August, its recovery back to positive

annual price changes (last seen in 2014) is being painfully slow.

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India: More pain for rupee

Ongoing financial trouble comes as a fresh blow to the rupee as well as a political blow to Prime Minister Narendra Modi just ahead of the general...



Source: Shutterstock

As if India's weakening external payments and budget situation aren't enough, reports of trouble at a non-bank finance company, a housing company, and a couple of private sector banks come as a fresh blow for the Indian rupee (INR). Recent developments have regulators, including the central bank (RBI), on their toes. The negative news from the financial sector is keeping the USD/INR firmly on track to meet our 73.50 forecast for end-2018.

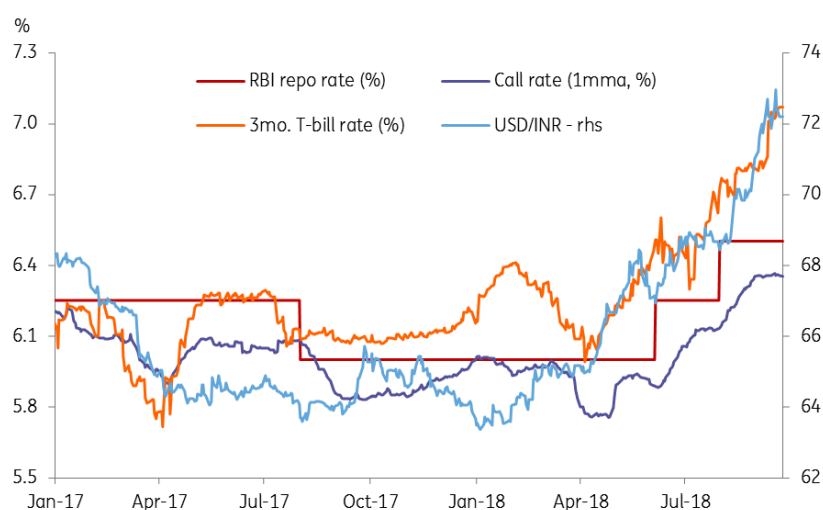
Financial sector trouble

A major infrastructure financier, Infrastructure Leasing & Financial Services Ltd., has been in the limelight since last week due to a serial default on its debt obligations. The company known previously for its solid credit standing- with major domestic and foreign banks and corporates as its shareholders- holds a large infrastructure portfolio. The problems started with cash on hand being drained amid delayed implementation and cost overruns on ongoing projects. It's now complicated by rising market interest rates. This has left the company with only \$27 million against the \$500

million required to meet debt obligations due over the next six months, according to Bloomberg. A downgrade of the company's credit rating poses a hurdle for the rollover of maturing debt. Absent any bailouts by the government or shareholding companies, this could drag the company into further defaults.

And it doesn't stop there. The problem appears to be spreading to the broader infrastructure and financial sector. Financial stresses at a mortgage lender and two private sector banks have been making matters worse. The result is tighter liquidity conditions driving short-term rates higher and the INR towards more weakness (see figure).

Rising short-term interest rates, weakening INR



Source: Bloomberg, ING

Political and economic policy implications

The financial problems of a major infrastructure company don't come without political implications for the current administration. This could put Prime Minister Modi's infrastructure-boosting policies on the back burner, a setback to his bid for a second term at general elections in early 2019.

These troubles also complicate RBI policymaking ahead of the next bi-monthly meeting in early October when another policy interest rate hike is looming large. The rate hike will push market rates higher and squeeze liquidity conditions further, making things even worse for troubled players in the sector. Add to these woes, the crowding out of private investment likely as a result of government borrowing requirements, which authorities will unveil for the second half of FY2019 sometime this week.

Not enough policy support for INR

We believe the INR is in for continued losses ahead. We are sceptical that the RBI will raise rates by more than 25 basis points at the next meeting given that inflation is, at least for now, running below the 4% mid-point of the central bank's target. This will be just enough to make up for the rate gap to be opened by the US Federal Reserve's 25 basis point hike expected later this week, nothing more. If so, then three Fed rate hikes this year will be merely matched by the RBI, without giving the INR any interest edge to gain against the USD. The RBI will have to do more, though that looks unlikely on the grounds of on-target inflation and stress in the financial sector. The situation

leaves the bank with a policy dilemma.

The spot USD/INR at 72.67, as of this writing, is just shy of our 72.80 forecast for the end of 3Q18. We maintain our view of the pair rising further to 73.50 by end of 2018.

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