

## Good MornING Asia - 26 April 2018

Expect the Indian rupee's depreciation to nudge the central bank closer to a rate hike. Philippines' central bank chief signals a tightening. Downside growth risk in Taiwan warrants a status quo on monetary policy.

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## The Indian Rupee's plight is far from over

Expect the rupee's depreciation to nudge the central bank closer to a rate hike but for now, we see USD/INR ending the year at 68.3, higher than our previous forecast of 66.6



Source: Shutterstock

The Indian rupee's plight has been underway since mid-2017 but intensified this month after the publication of the US Treasury Currency report.

Since then, the rupee (INR) has seen a steep fall losing 2.5% of its value against the US dollar to a 13-month low of 66.9, at the time of writing this. We believe its troubles are far from over, as several external and internal factors will continue to expose it to considerable weakness in 2018 and beyond.

This is why we revise our USD/INR forecast for end-2018 to 68.3 from 66.6.

# 68.3

ING's USD/INR forecast for end-2018

Revised up

## ➔ Move to currency manipulator list

The latest US Treasury report placed India under the monitoring list of countries possibly tempering their currency exchange rates. Other countries under the scope are China, Japan, Korea, Germany and Switzerland. This wasn't a complete surprise for the markets as the previous US Treasury report had already flagged such a possibility.

Of the three criteria, Indian ticked two. A significant bi-lateral trade surplus with the US of at least \$20bn and persistent one-sided intervention with net foreign exchange purchases of at least 2% of GDP. It dodged the bullet on the third criteria of a material current account surplus of at least 3% of GDP.

In the fiscal year 2017-18, the trade surplus with the US amounted to \$22bn, and foreign reserve accumulation was 2.4% of GDP, whereas current account deficit was around 2% of GDP, from 0.7% the previous year.

## ➔ More hawkish central bank

The Reserve Bank of India (RBI) has also turned more hawkish.

In what we consider a premature move, the RBI downgraded its inflation forecast for the first half of fiscal 2018-19 to a range of 4.7-5.1% from 5.1-5.6%, while the forecast for the second half was also cut to 4.4% from 4.5-4.6% at the bi-monthly monetary policy meeting held on 5 April.

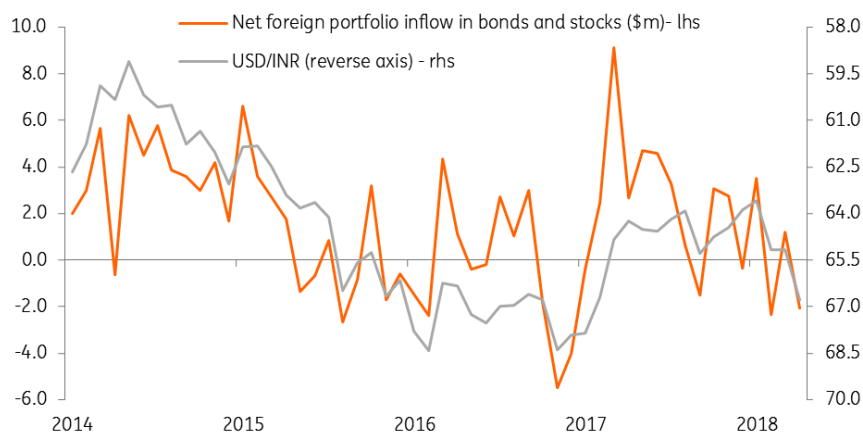
Contrary to an inflation forecast downgrade, minutes of the same meeting released on 19 April tipped the scale of monetary policy risk towards tightening from the current neutral bias, as Deputy Governor Dr Viral Acharya signalled his "decisive" vote for "withdrawal of accommodation" at the next meeting in June.

**\$2.1bn** Net portfolio investment outflow in April

## ➔ Increased capital outflows

According to Bloomberg, foreigners sold \$2.1bn of Indian stocks and bonds month-to-date in April, more than reversing \$1.2bn of inflows in March. We anticipate no near-term respite from the outflow of confidence sensitive capital from India even if the central bank, which reportedly defied the US Treasury's warning, comes to the rescue of the rupee.

## Foreign portfolio flows vs. USD/INR exchange rate



Source: Bloomberg, ING

Moreover, we have also entered a seasonally weak period (April-June) for the currency, the period when the typical surge in demand for gold demand for the wedding season contributes to INR weakness.

Add to this rising oil prices which accounts for almost half of India's trade deficit, which surged 44% YoY to \$157bn, \$70bn was oil-related.

Both gold and oil prices have been on an upward trend and, based on ING's house view of a weak USD for the rest of the year, the trend will persist.

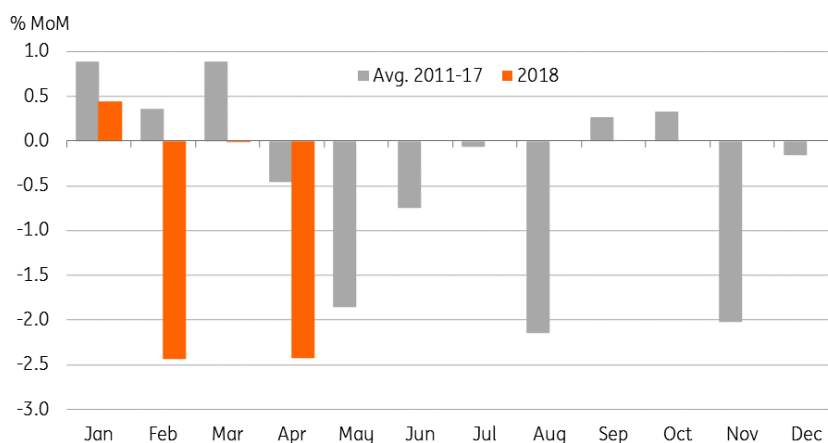
### ➔ Other headwinds

External and internal headwinds to the rupee remain. These include a potential global trade war, rising crude oil price and tightening monetary policies in developed markets. The domestic headwinds which include twin-deficits, a scandalous banking system further aggravating policy bottlenecks, and above all rising political risks before the general elections in 2019 are not insignificant. All these factors undermine the prospects of growth.

### ➔ Sell in May and go away?

The rupee's predicament will be put to the test next month in May, one of the three weakest months of the year for the currency. As the chart shows, the other two are August and November.

## Indian rupee seasonality



Source: Bloomberg, ING

An exacerbated INR depreciation will move the central bank closer to a rate hike. But for now, we maintain our view of a 25bp rate hike in August, followed by another hike next year, in February 2019.

This is why we revise our USD/INR forecast to end the year at 68.3, higher than our previous forecast of 66.6.

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## Philippines: BSP Governor turns hawkish

The Philippine central bank (BSP) Governor has turned hawkish; our dovish policy rate outlook is now at risk



# 3%

BSP overnight reverse repurchase rate

Rate hike chance rises

### **BSP Governor Espenilla says it is “just a matter of time”.**

Governor Nestor Espenilla Jr, pictured, is referring to a policy rate hike. Months of bringing other short-term rates higher may have been ignored. BSP has not been idle in the past month. It has been on a stealth tightening path for some time, with its weekly term deposit auctions that have kept M3 at a pace that limits demand-pull price pressures. BSP term deposit rates and government

T-Bill rates and bond yields have increased. In addition, BSP's sale of USD in the spot market also cut liquidity while reducing PHP volatility.

However, the market remains unsatisfied. The Governor recognised the need for an additional signal – a rate hike. Justification is that rising inflation expectations could lead to second round effects such as demands for higher minimum wages and transport fares. A few tripartite regional wage boards have been conducting public hearings. Petitions for higher minimum fares are under consideration by the regulator.

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### *We are more pessimistic than the consensus*

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We believe that modest second-round effects are already incorporated in BSP's inflation forecast. BSP forecasts a return to the target range over the policy horizon of by early 2019 with its 3% 2019 inflation outlook from 2018 forecast of 3.9%. We are more pessimistic than the consensus forecast with our 4.3% forecast (against consensus of 4%) this year and 3.7% next year (against consensus of 3.5%). A Monetary Board member could support a rate hike with a prolonged elevated inflation prognosis or with a fourth hike of the US FOMC this year. Chances of our dovish policy rate view have dropped even as expectations in 2019 show a return to the inflation target range. The market expects a policy rate hike at the May or June meeting.

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# Taiwan's economy facing slowdown

The focus on electronics production and exports has been the strength of the small and open economy but could become a pain point if global trade flows shrinks. This is why we revise our GDP and USD/TWD forecast



Source: Shutterstock

## Why Taiwan is prone to risks from global demand

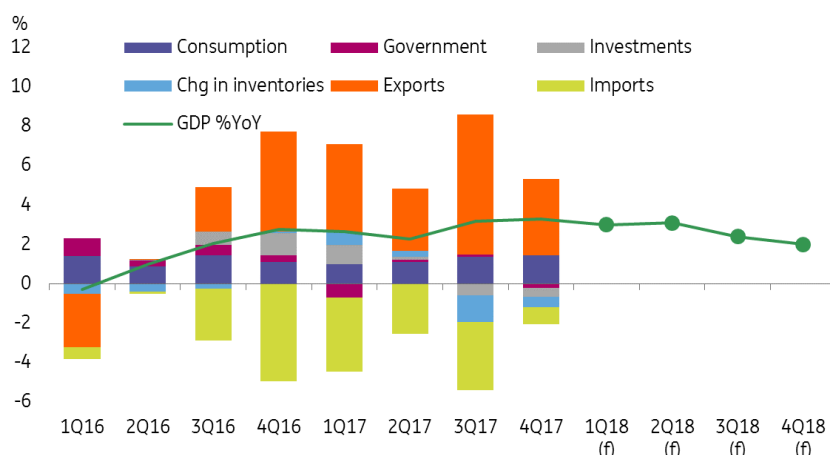
Taiwan is famous for its strength in producing electronic parts for smart-devices. This has been the growth engine of exports as well as GDP growth of the economy since late 2016.

But as global demand for smart-devices slacks, as we [highlight in this note](#), past strengths could become a pain point for the future. If global demand for smart-devices and related parts continues to slow and combines with Taiwan's lack of buffer to make up for the loss of growth from trade, the negative impact would first hit trade volumes, then business investments, production, wages, and finally consumption.

As a result, the economy would slow down from 2.9% year on year in 2017 to 2.63% in 2018. We expect 3.0% YoY in 1Q, 3.1% in 2Q, 2.4% in 3Q and 2.0% in 4Q, respectively.

[Read why Taiwan's industrial production is missing important estimates](#)

## Softer GDP growth ahead



Source: ING, Bloomberg

## If trade tensions escalate, things could get worse

It is tempting to conclude that trade tension between mainland China and the US, especially in the telecom and IT production sector would benefit Taiwan as it focuses on production related to these sectors.

But we would like to reiterate that if there is a trade war in the sector, neither side would win because trade volumes are likely to shrink. This would hurt the whole supply chain of electronic products. It is likely that the sector would suffer from a smaller pie, so not all the sellers of substitutes for the "banned" Chinese products could enjoy sales increase.

We believe Taiwan export growth would slow from 11.75% in 2017 to 4% in 2018, and imports would slow from 11.63% to 6%. Higher raw material and energy import prices would be the reason behind the narrow trade surplus.

## Investment not looking so rosy

If you look at the details, investment has contributed negatively to GDP growth both in the third and fourth quarter of 2017. The trend indicates businesses do not believe that a bright outlook for their sector would continue. [Data from the statistic office](#) shows that imports of equipment from the private sector fell 5.8% in 2017, in particular, the fall dived to -13.3%YoY and -11.57%YoY in the third and fourth quarter respectively.

The weakness in investment came in even before trade tension between mainland China and the US started, which implies if they escalate then investment would experience an even dimmer outlook.

We expect investment growth to further decline from 0.0% in 2017 to -0.5% in 2018.

## Wage and consumption would also be affected

The 1.8% trivial increase in wages in 2017 was already the fastest in three years, and it was a reflection of good growth in the production of smart-devices parts.

The projection of milder growth in exports implies that wage growth would also shrink in 2018 to around 1.5%. Weaker wage growth and an ageing population at a rate of around 5% are likely to have a direct impact on consumption growth which is also likely to shrink from 2.2% in 2017 to 1.0% in 2018.

Retail sales growth comes from domestic and external drivers. When domestic consumption growth slows, the economy has to rely on tourist spending. But Taiwan has suffered negative growth in tourist revenue for three years after mainland China largely stopped mainlanders visiting Taiwan for leisure tourism. Though the US has offered some reprieve, the contribution to total tourist arrivals and retail sales in Taiwan is limited.

## Government spending to be limited

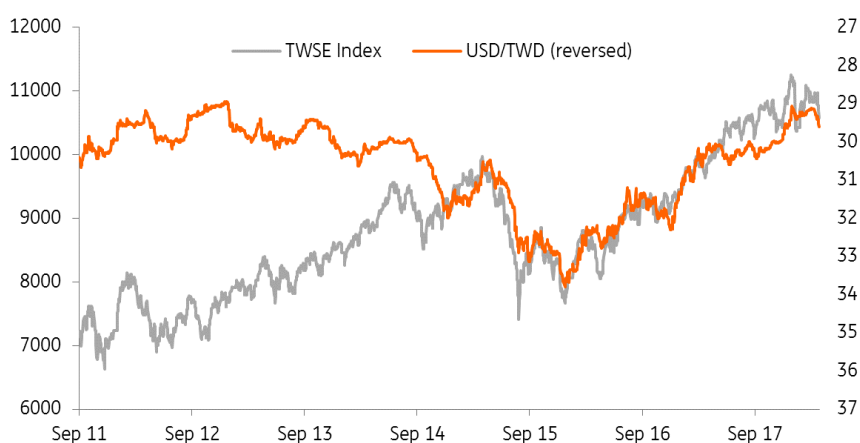
The government contribution to GDP was -0.15% in 2017, partly because the economy ran well last year with the recovery of global demand.

It is quite certain that the economy needs help from the government in 2018. However, this would still be small as seen in the past. We expect a mere contribution of 0.2 percentage points by the government in 2018 given that it has been running at a deficit.

## Central bank to stay put

Similar to the government, the central bank of Taiwan has little room to boost economic growth by lowering interest rate as the 1.375% policy rate is already very low and close to the historic low level of 1.25%. The softness of the economy in 2018 is not comparable to the dive down global economic cycle in 2009-2010, so we're not expecting the central bank to lower the policy rate in 2018.

## USD/TWD follows stock market closely



Source: ING, Bloomberg

### Weaker TWD driven by a lower stock market index

The dim outlook for the sales of smart-devices is already reflecting in the lower stock market index of Taiwan. Foreign capital flowing out of Taiwan's stock market has created a weakness in TWD. If trade tensions between mainland China and the US escalate, a lower earning prospect of Taiwan companies could put further pressure.



But if the dollar continues to weaken, which is our house view, then the weakness on TWD might be offset.

By considering these two factors together, we revise our forecast of USDTWD from 28.50 by the end of 2018 to 29.00. We expect 29.40 in 2Q, 29.2 in 3Q and 29.00 by the fourth quarter respectively.

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