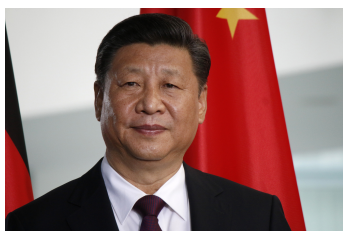


Good MornING Asia - 26 February 2018

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In this bundle



A week for speeches

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By Robert Carnell



India

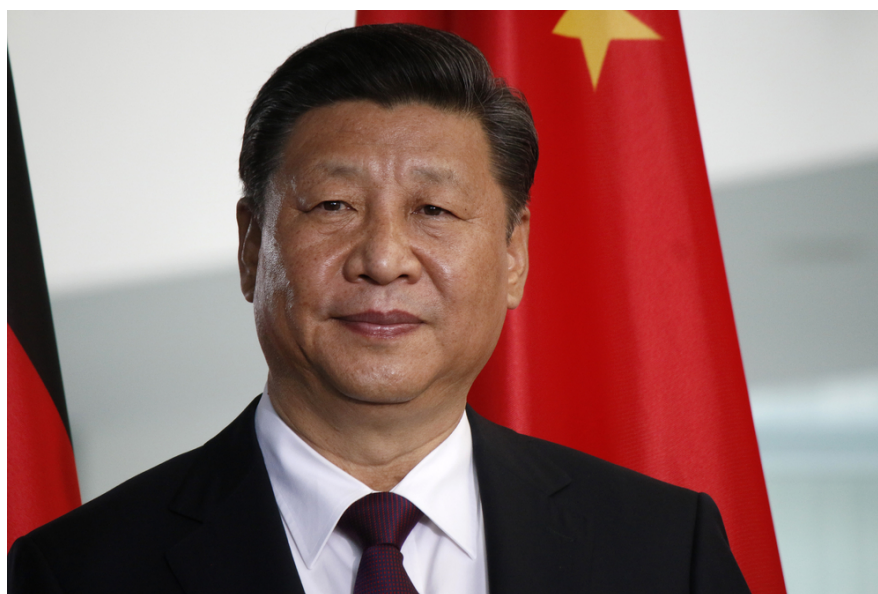
India: It's not a confidence crisis yet

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Opinion | 25 February 2018

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Xi

China: Xi to stay indefinitely

Newswires and newspapers are leading with the headline that the two-term cap on China's premiership is likely to be dropped to allow President Xi to remain in power after the end of this, his second term. While most of the stories on this have focused on growing authoritarian tendencies in China, there is another way to view this. And that is on China's ability to get things done.

Whilst many western investors still eye China with concern, worrying about high debt levels, it seems hard to argue that the ongoing deleveraging push, transition to a more consumption-based economy, the belt and road initiative, more flexible capital account and currency, and anti-graft measures are more likely to be successful with a strong and steady leadership. Certainly, the ability to get stuff done is something that the weak coalitions that govern, for example, most of Europe, would give their eye-teeth for. By all means, lament the lack of political debate in China. But from an investment perspective, there are some upsides.

Powell - tightrope walking

So with 10Y US Treasury yields poised to burst through the 3% rate any day now, stocks sensitive to any hint of looming aggression from the Fed, and the USD undecided whether it likes higher

bond yields or higher stocks, Fed Chair Jerome Powell has a tough job on his hands when he gives testimony to the House Financial Services Committee on Tuesday.

We like the idea of a relatively tough-sounding speech, one that suggests he will not drag his heels on hiking rates, but with any luck, achieve his goals of price stability with full employment at a lower terminal Fed funds rate than a more hesitant chairman might deliver. But we are not sure how far, if at all, Powell will be able to go before stocks undermine any attempt to sound "hawkish", and deliver "dovish". Good luck Jerome. This could be a choppy week.

Draghi - less on policy, more on Latvia

ECB President Mario Draghi already has enough on his plate trying to move the ECB towards a taper without causing a European bond market sell-off. Yields are lower today, but the German 10Y yield pushed above 76bp last week, and there seems likely to be more of that to come in the coming months. But Draghi's testimony to the European Parliament later today will likely focus more on what is going on in Latvia, where possible bank closures, and allegations of impropriety have been levelled at Central Bank Governor, Ilmars Rimsevics, also member of the ECB's Governing Council. Will Rimsevics continue on the board? Only Draghi has the answers, or more likely, the evasive answers, as the ECB tries to work out what on earth is going on.

Rambo gets tough

Bank of England Deputy Governor, Dave "Rambo" Ramsden seems to be reverting to type as he tells the Sunday Times that he can see a case for rates rising sooner than later, following his previous opposition to an earlier hike.

May's three baskets

Having already been told that her "Three basket" approach to a new relationship is likely to receive a short and sharp "Non!" from EU lead-negotiator, Michel Barnier, PM May now faces a challenge to her negotiating stance from Labour opposition leader, Jeremy Corbyn, who it seems now will back the UK staying in the customs Union, the single market, and thereby relinquish any power to control EU immigration. This may provide some support to the GBP along with the BoE's more hawkish stance, but it is hard to see how this will appeal to the millions of Labour voters who chose "leave" primarily based on the question of immigration.

G7 and Asian calendar

Besides all the central bank and political noise, the G-7 economic calendar for this week is quite dull. Inflation in the Eurozone could be interesting, but as it is likely to show no change to the roughly 1% core and headline inflation backdrop, this will leave the ECB debate as to the taper largely unchallenged. Revised 4Q17 US GDP data always has some ability to surprise, but this is now pretty historical, so is unlikely to be of substantial interest.

The Asian calendar has more of interest. It's a busy week in Korea, with Bank of Korea (BoK) and Korean trade data. At Governor Lee Ju-yeol's last meeting as head of the BoK, there is not likely to be any change to policy. But trade data will be worth a second glance, as Korea is something of a bellwether for the rest of the region, and could provide further clues as to the health or otherwise of global semiconductor demand.

Inflation in Indonesia and Malaysia are both out. While Malaysia's inflation rate is likely to dip on last year's administered price increases dropping out of the year-on-year comparison, this should have no bearing on Bank Negara Malaysia's gradual normalisation strategy. Regional PMI data is also likely to remain in the low 50's, consistent with growth, but giving no cause for anything other than a realistic assessment that the year of the dog will be no walk in the park (bad pun intended!).

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India: It's not a confidence crisis yet

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USD/INR spike above 65

The Indian rupee (INR) breached above the 65 level against the US dollar this week, a level previously seen in November. The week looks set to end with the biggest weekly INR depreciation since the third week of November 2016, when demonetisation hit the currency hard. A deluge of negative news from derailed consolidation of public finances, which first came to the fore in the third quarter of 2017, to last week's report of a \$1.8bn scam at a nationalised bank have depressed the currency. India's broader economic performance hasn't been any friendlier either.

A confidence hit

A recent BBC article titled "[The Indian coin that set off millions of messages](#)" caught our eye. The article talks about falling acceptance of small (10 rupee) denomination coins and the Reserve Bank of India's (RBI), the central bank, efforts to restore public trust in the legal tender. The article also points to a potential crisis of confidence in the currency. Is this really the beginning of a crisis in confidence? Maybe or maybe not.

The hit to confidence mainly comes from India's fragile banking system, with scams adding to the already high level of non-performing assets (NPAs), hitting banks' balance sheets and the credibility of their operations. These scams undermine the government's drive to clean up the banking system, the latest and most significant of which is the INR 2.1tr recapitalisation

programme for public sector banks. The programme is slated to be implemented over two years, though almost half of it will be front-loaded in the current financial year ending March 2018. Recapitalisation is positive but it also raises the risk of more NPAs.

Some positives

Delayed consolidation of public finances, a widening current account deficit and elevated consumer price inflation have been the main negatives for the rupee. These forces are likely to remain in play for some time.

On a positive note, an expansionary fiscal policy with increased spending in the election year should provide some boost to growth this year. The RBI has little scope to raise interest rates but the country's rising foreign exchange reserve provide it with wriggle room to support the currency. India's reserves hit the \$400bn mark in November and have since risen to \$417bn despite all the economic jitters. The fourth-largest reserves in Asia (after China, Japan and Taiwan) cover almost a year of Indian imports, at four times short-term external debt (\$93bn as of September 2017).

\$417bn India's foreign reserves

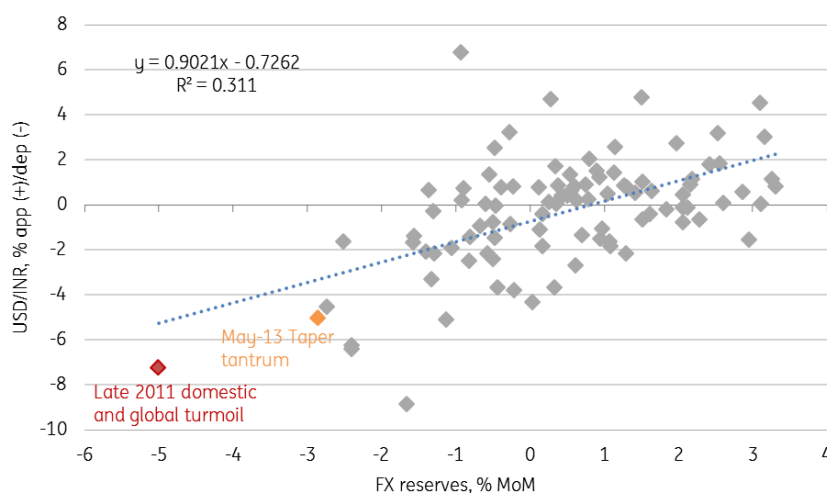
As of September 2017

Crisis or not?

Domestic economic jitters typically expose the vulnerability of the rupee, getting worse during times of global market turbulence. INR is Asia's weakest currency this month, with 2.2% month-to-date depreciation. The current situation resembles that of late 2011 when the INR came under intense weakening pressure from domestic and external factors. A significant run on the currency is associated with large reserve outflows – the extreme dots in the negative quadrant of the chart plotting monthly reserves and currency moves (see chart).

We don't think we are at a juncture of a crisis. Moody's recently upgraded India's investment grade rating with a stable rating, the first upgrade in more than a decade. S&P and Fitch maintaining their stable rating outlooks suggests a 'no crisis' situation. Moody's described the budget for fiscal year 2018-19 as striking a balance between fiscal prudence and growth. While it may be too early to call it a crisis, the present weakening pressure on the INR is unlikely to go away any time soon. Our end-2018 USD/INR forecast is 65.8 (spot 65.0).

Movements in foreign reserves and INR



Source: Bloomberg, ING

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