

Good Morning Asia - 28 November 2018

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International theme: Calrida offers little clarity

- Investors remain without clarity on the outlook as Fed Vice Chair Clarida gave relatively balanced comments overnight, indicating that the Fed should remain data dependent but that they were getting closer to the neutral rate. Investors have been cautiously optimistic of some form of headway with US-China trade talks with risk-taking activity likely muted until the end of the week.

EM Space: Market to be on their toes with Powell on deck and the G-20 set to start on Friday

- **General Asia:** Investors will likely remain in holding pattern until more clarity is derived on the Fed dot plots for 2019 and beyond as well as the US-China trade relations with the G20 meeting slated for the end of the week.
- **Malaysia:** Malaysian Institute of Economic Research (MIER), a think tank, sees an acceleration in Malaysia's GDP growth in 4Q18 to 4.7%-4.8% range from 4.4% in the last quarter on firmer private consumption. This is more bullish than the latest Bloomberg

consensus forecast of 4.5%. Our below-consensus 4.1% forecast rests on continued downside risks from slower investment and exports demand.

- **Thailand:** The noise about the BoT hiking rates in December has intensified lately. Yesterday's data showing a stronger than expected 4.1% industrial production growth in October may be supportive, though the broader case for tightening isn't that strong. We maintain our view of no BoT rate hike in the remainder of the year.
- **Indonesia:** Bank Indonesia will be "preemptive and ahead of the curve" according to Governor Warjiyo as he looks to safeguard the economy against global risks and with the Fed still projected to hike in 2019. Warjiyo has indicated in the past that his priority is to maintain financial stability, while a 175bps rate hike keeps the IDR steady. Look for the central bank to hike further in 2019 to match the 2 Fed rate hikes priced in for the next year.
- **Philippines:** The legislative houses failed to pass the 2019 budget, increasing the likelihood that the government would need to operate on a reenacted budget from 2018 until the general appropriations act is signed into law sometime next year. Budget secretary Diokno expressed concern about growth with government expenditures seen to slow, all the more with the 5-month election ban kicking-in before the May polls. Thus we could see 1H 2019 GDP take a hit as the economy will no longer enjoy the boost from national government spending until the second half of the year.

What to look out for: Fed speakers, G20

- US GDP (28 November)
- Fed Bostic speech (28 November)
- Philippines bank lending and money supply (29 November)
- Euro zone GDP (29 November)
- Fed Powell speech (27 November)
- Thailand current account (30 November)
- Thailand trade (30 November)
- Taiwan GDP (30 November)
- China non-manufacturing PMI (30 November)
- G20 meeting (30 November)
- OPEC meeting (6 December)

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China: Industrial profits severely squeezed

China's industrial profit growth slowed in October, with just 13 out of 41 sectors (including the consumer goods group) posting improved profits on a monthly basis. But businesses could enjoy better profitability in 2019 if China were to cut import tariffs on more goods



Source: Shutterstock

Slower profit growth a widespread phenomenon in manufacturing

Industrial profit growth slowed to 3.6% year-on-year in October from 4.1% in the previous month. This puts the year-to-date growth at 13.6% YoY in October, a slowdown from 14.7% YoY growth as of September. Comparing the two growth rate measures, it would seem the profit squeeze among Chinese manufacturers has been severe.

On a monthly basis, there was a widespread slowdown. Lower commodity prices, like ferrous metals and crude oil, could be blamed for shrinking profits at mining companies and energy drillers. There may also be expectations of lower demand for commodities due to a slowing economy.

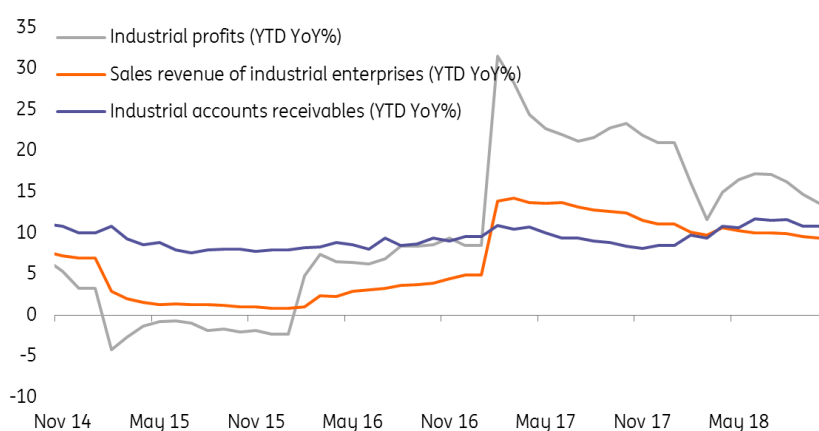
Not everything is unprofitable, consumer goods held up well

There are some bright spots. Profits from manufacturing consumer goods held up quite well in the last month. Textile and garments, food production, computers, telecommunication, and other electronics were among the 13 sectors which enjoyed monthly profit growth.

We see this profit growth coming from:

1. Lower raw material and energy prices.
2. Steady demand for consumer goods, both from domestic and foreign economies.

Profit squeeze came from high account receivables and slower sales revenue



Source: ING, Bloomberg

China cutting tariffs could help lower production costs in 2019

Looking forward, production costs could be lower if China were to cut tariffs on more imports. This would offset higher tariffs on imports from the US, at least to some extent.

That's not to say an escalation of the US-China trade war won't hurt profits of Chinese manufacturers. It will, especially in terms of exports and related supply chain manufacturers. But if China were to cut import tariffs, more businesses will survive.

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India: Lower oil price a boon, politics a bane for the rupee

In yet another revision, we lower our USD/INR forecast for end-2018 to 71.5 from 74.0 and for end-2019 to 69.0 from 73.2. In the meantime, mounting political uncertainty in the run-up to general elections in May 2019 makes us think the rupee will weaken past the 73 level in the next three to six months

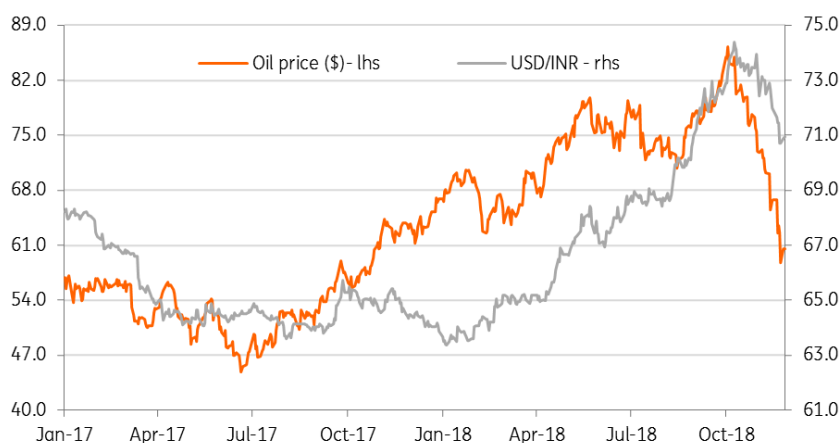


Lower oil price a boon for the rupee...

The Indian rupee's (INR) 4.4% month-to-date appreciation against the USD has it on track to be an outstanding Asian currency this month. At 70.9 the USD/INR has retraced a chunk of the 15% depreciation that drove the pair above 74.0 in the first 10 months of the year. The more than 30% collapse in the crude oil price since October explains the reversal of fortune for the currency (see figure).

The expectation of slower global growth amid an intensifying US-China trade war and increased supply are depressing the oil price ahead of the OPEC meeting in early December at which US - Saudi Arabia diplomacy will weigh heavily on future supplies.

Longest INR appreciation streak in two years



Source: Bloomberg, ING

... despite slowing growth, and

Aside from the falling oil price boon and the broader USD weakness, India's economic dynamics have hardly changed in favour of the INR. The GDP data for 2Q FY2019 (July-September quarter of 2018) due later this week (30 November) is expected to reinforce the fact that growth has peaked and the slowdown has begun. While the high base effect from the post-denomination bounce in growth from 2Q FY2018 is at work in depressing annual increase, weakening exports and private consumption, and increasing drag from net trade are also contributing to the slowdown. In addition to this are the persistently tight banking system liquidity and tough lending guidelines for public sector banks dragging investment demand.

Our view of a slowdown in India's GDP growth to 7.5% YoY in 2Q FY2019 from 8.2% in the previous quarter, which was the fastest rate of growth in two years, is consistent with the median consensus estimate of 7.4%. Anything weaker than consensus will be bearish for the local financial assets, including the INR.

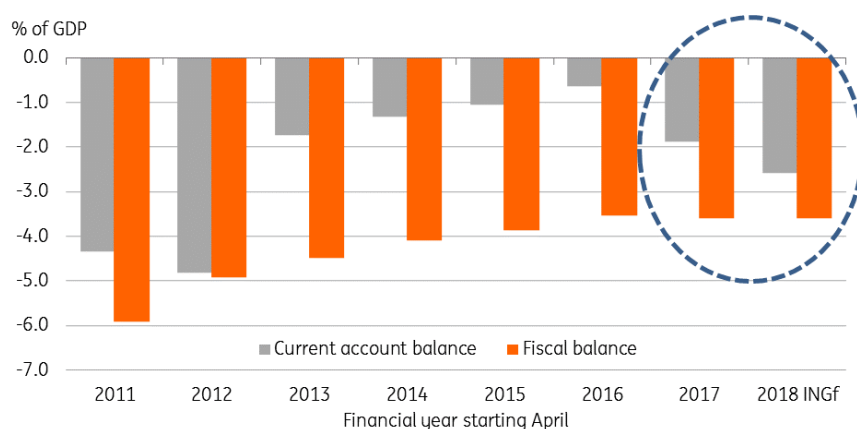
... widening twin-deficits

The key economic resistance for the INR appreciation, the twin-deficits (current account and government budget) remains intact and could even get worse. The cumulative budget deficit in the first half of FY2019 was 19% higher than a year ago and was 95% of the full-year target deficit. The pressure on public finances was obvious from recent pressure by the government on the central bank for more funds. Yes, the thawing of tensions between the Reserve Bank of India (RBI) and the government is another positive for now, though recent tensions will continue to lurk in the background and are not positive for the currency. And on the external front, the financial year-to-date trade deficit of \$111bn is 26% wider on the year, with more than half of the widening coming from oil trade.

The benign inflation backdrop, which is puzzling in view of INR's dismal performance, has allowed the RBI to hold the line on policy interest rates. But the wide fiscal deficit will eventually be inflationary while crowding out of private sector investment will also weigh on GDP growth. That said, we have recently scaled back our RBI view from a rate hike at the last meeting of the year in December to no more hikes this year. We do, however, expect the RBI to resume tightening once

the elections are out of the way by mid-2019.

Resurgent twin-deficit problem



Source: Bloomberg, CEIC, ING

Politics the key headwind to INR in 2019

Above all, politics is likely to decide the course for the INR in 2019. The political heat is already rising as the elections being held in five states currently will set the tone for the national elections scheduled in May 2019. Considering the public wrath following chaotic demonetisation in late 2016 and GST implementation in mid-2017, it will be a tough task for the incumbent Modi government to retain power for another term. We expect it to be a too close-to-call poll.

Snapping the longest appreciation streak in two years the USD/INR started trading this week on the weaker side. We aren't seeing the pair drifting far from the current level as the year draws to close, though the bias will be more on the weaker than stronger side depending on the outcomes of the state elections.

We revise our USD/INR forecast for end-2018 to 71.5 from 74.0 and that for end-2019 to 69.0 from 73.2. In the meantime, the mounting political uncertainty in the run-up to general elections leads us to a view of the INR weakening past the 73 level in the next three to six months. Once the political overhang lifts we anticipate a steady consolidation below the 70 level by the end of next year.

India: Economic forecast summary

India (FY April-March)	2017	1Q18	2Q18	3Q18F	4Q18F	2018F	2019F
Real GDP (% YoY)	6.7	7.7	8.2	7.5	6.8	7.2	7.0
CPI (% YoY)	3.6	4.6	4.8	3.9	3.5	4.0	5.0
RBI repo rate (% eop)	6.00	6.00	6.25	6.50	6.50	6.50	7.00
3M T-bill rate (% eop)	6.15	6.09	6.46	6.99	7.00	7.00	7.50
10Y govt. bond yield (% eop)	7.23	7.40	7.90	8.02	8.00	8.00	8.30
INR per USD (eop)	63.87	65.18	68.47	72.49	74.00	74.00	73.20
Note: Annual growth and inflation forecast on financial year basis, rest on calendar year basis.							
Sources: Bloomberg, CEIC, ING forecasts							

Source: Bloomberg, CEIC, ING

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