

Good MornING Asia - 29 January 2019

The dollar looks weak against Asian FX and the majors. Over time, there is a very good chance that it will go weaker still against Asian FX. But the chance of a final market-busting hurrah remains

In this bundle



Uneasy calm

The dollar looks weak against Asian FX and the majors. Over time, there is a very good chance that it will go weaker still against Asian FX. But the...

By Robert Carnell



ASEAN morning bytes

General market tone: Risk-off. Risk aversion may dominate markets with renewed concerns on US-China trade relations.



India

India: Bracing for yet another turbulent year

Markets are bracing for intensified political risk as a general election looms in May. Losses by Modi's incumbent party in recent state elections...

Opinion | 28 January 2019

Uneasy calm

The dollar looks weak against Asian FX and the majors. Over time, there is a very good chance that it will go weaker still against Asian FX. But the...



Source: Shutterstock

Continued trade progress

Progress on trade negotiations, we are told, is ongoing. That is reason number one for taking a relaxed attitude to risk and holding any Asian currency except the USD. That trade progress may be supported by a foreign investment bill being discussed by China's NPC Standing Committee today, which will support US calls for China to open up its markets, and some further USD weakness.

At the same time as all this is going on though, the US, according to Bloomberg Daybreak, is charging Huawei with bank fraud (amongst other things) and it feels like the US is treading a dangerous path in seeking difficult concessions on one hand, whilst vigorously pursuing Huawei on the other. I'm not questioning the legal processes underway, but the timing could be better, just as the US and Chinese negotiators settle down to pivotal talks with just one month until the end of the trade truce. From March 1 onwards, assuming that China does get granted an extension to the truce (I don't expect it to be more than that), the scope for some pushback and worsening of the trade backdrop will rise. Markets may simply digest any March announcement and decide that it lacked substance on reflection. With it, the dollar's fortunes may also get revised.

Too much data

It will be hard to cope with the slew of US data scheduled for release today and over the coming weeks. Durable goods, trade balance, home sales, home prices, inventories, retail sales, building permits. It will be harder still to disentangle the signal from the noise of the government shutdown. Is weakness really weakness? The estimates of the hit to GDP (the data release of which may well be delayed because of the shutdown) abound. These are also weighing on Fed views, which are already primed for inactivity.

Adding to the sense of lassitude on rate policy, Arch-dove, Narayana Kocherlakota (and former Minneapolis Fed President) is arguing for rate cuts, not hikes, and for renewed net asset purchases by the Fed. We doubt Fed Chair Jerome Powell will feel the need to go this far after his FOMC press conference on Thursday, but he will most likely feel obliged to reiterate the message of caution expressed late last year, and which has provided the market with a much more benign Fed outlook than the one suggested by the dot-plot. All this is currently in the price.

But in case you were getting taken in by talk of recession and Fed easing, and assuming that this is a one-way bet for Asian FX this year, don't forget, parts of the US economy are still red hot - the labour market in particular. We may not see that in this Friday's labour report, as the shutdown will likely have taken its toll. But in a month from now, this may, along with a revised view of trade, provide Fed expectations and the dollar with a further upwards boost before more data and sentiment take over.

Asia - quiet

Asia is pretty quiet in contrast to the US and will provide little cause to review currency or rate forecasts one way or the other today. New Zealand trade, already released, has remained fairly resilient in the face of global trade concerns, with December exports only fractionally undershooting expectations and imports only straying a bit below the consensus too. This leaves the December trade balance a small NZD264m surplus. This isn't enough to excite the FX markets, and both NZDUSD and AUDNZD are ignoring this data.

NAB business conditions and confidence due out shortly, have been trending down in recent months. A further decline may tilt down the balance of expectations for the Australian economy which is perched precariously between a strong labour market and rising wages, and a weakening housing market and deteriorating business outlook. One way to rationalise the dichotomy is that the labour market, and wages in particular, are the more lagging parts of the economy. These indicators may still be on an upward trend as the economy turns over. We'll let you know where our view lies just once we prise ourselves uncomfortably off the fence. For now, flat seems the safest call for the economy and the Reserve Bank of Australia.

And this from Prakash Sakpal on the Thai production data due out later this morning: The only other Asian economic data due today is Thailand's manufacturing data for December. This will help us to fine-tune our GDP growth estimate for 4Q 2018. Coming on the heels of a steeper export contraction last month, this data is poised to provide a negative surprise to the consensus view centered on 0.6% YoY growth (prior 1%). The ING forecast is -1.0%. However, the low base effect is likely to have aided a slight pick-up in GDP growth to 3.5% in 4Q18 from 3.3% in the previous quarter. We are wondering why the Bank of Thailand even bothered to tighten the policy in December. We aren't expecting any move this year.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Article | 29 January 2019

ASEAN morning bytes

General market tone: Risk-off. Risk aversion may dominate markets with renewed concerns on US-China trade relations.



EM Space: Traders to head for cover as US charges a Chinese telecommunications company

- **General Asia:** The US-China trade spat is starting to turn ugly with the US Department of Justice filing charges against the CFO of a Chinese teleco giant. Furthermore, the Justice Department is also filing charges against the parent teleco giant for stealing trade secrets from an American company. This leads us to expect a broader risk-off tone today.
- **Indonesia:** Bank Indonesia's Governor Warjiyo expects the IDR to remain stable with a strengthening bias as foreign investor confidence is expected to remain positive. The Governor also sees sufficient liquidity in the spot, swap, and non-deliverable forwards market. Meanwhile, BI reiterated its coordination with the national government and financial services authority to prepare policies to improve the current account balance.
- **Thailand:** The manufacturing data for December due today will help us to fine-tune our GDP growth estimate for the fourth quarter of 2018. Coming on the heels of a steeper export contraction last month, data is poised to surprise the consensus centered on a 0.6% YoY growth (prior 1%). ING forecast is -1.0%. However, the low base effect likely to have aided a slight pick-up in GDP growth to 3.5% in 4Q18 from 3.3% in the previous quarter. We are wondering why the Bank of Thailand even bothered to tighten the policy in December. We aren't expecting any move this year.

What to look out for: Fed decision, US-China trade talks

- US wholesale inventories (29 January)
- Hong Kong retail sales (30 January)
- China PMIs (31 January)
- India FY2020 budget (1 February)
- US NFP (1 February)

India: Bracing for yet another turbulent year

Markets are bracing for intensified political risk as a general election looms in May. Losses by Modi's incumbent party in recent state elections...



Source: Shutterstock

2% Month-to-date INR depreciation
Signals a start to another turbulent year

A tumultuous 2018

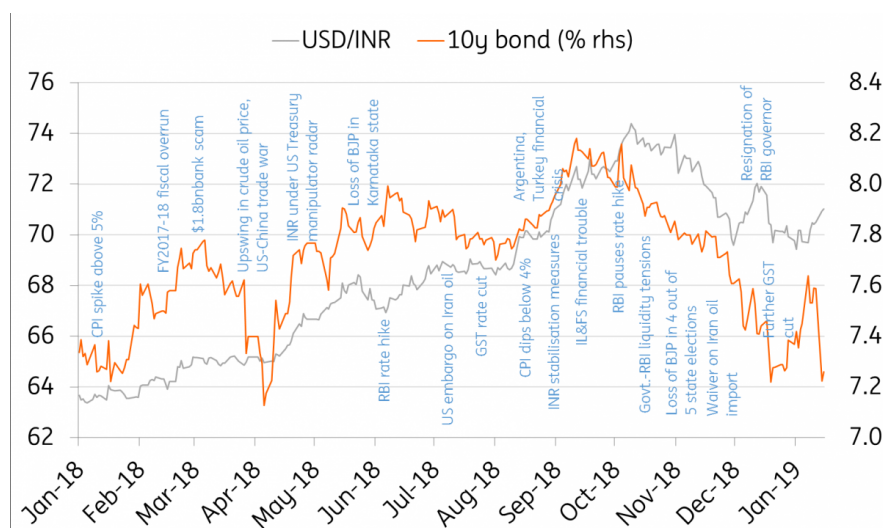
The economy ended 2018 on a mixed note. Growth continued to grind lower as reflected by the slowdown in exports and industrial output towards the end of the year, while inflation dipped to the lowest in 18 months on persistently low food and energy prices. But core inflation remained high, feeding into rising inflation expectations. Public finances and external payments remained on weakening trends owing to high oil imports and election-related spending.

The conflict between the Reserve Bank of India (RBI), the central bank, and the government over the issue of the RBI sparing more of its reserves to fund a wider fiscal gap rocked markets in the

last quarter. The rift ended with the resignation of Governor Urjit Patel in early December. Just as this paved the way for a stepped-up liquidity injection into the financial system under new governor Shaktikanta Das, the fiscal floodgates opened with further cuts in the Goods and Services Tax and extra-budgetary support measures for farmers.

Global market volatility spiked towards the end of 2018 but local markets enjoyed a brief respite from lower oil prices. The government bond market had its best quarter in four years in the final quarter of 2018. Yet a rally in the Indian rupee (INR) in November with a more than 6% monthly appreciation against the US dollar was short-lived and the currency returned to being Asia's worst-performer in December. 2018's annual depreciation of 8.5% was the most since 2013.

What made 2018 a turbulent year?



Source: Bloomberg, ING

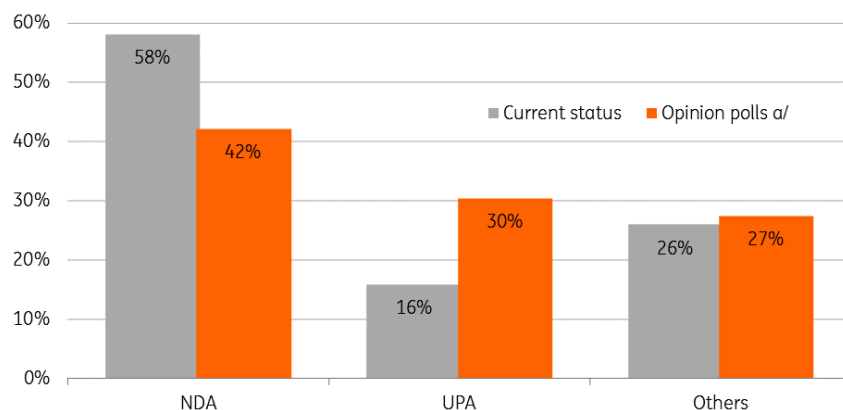
Politics overshadows economy in 2019

A general election is scheduled for May this year and the environment will likely become murky as we get closer to polling day. With his popularity falling, Prime Minister Modi has reason to be concerned. The losses of Modi's Bhartiya Janata Party (BJP) in recent state assembly and other by-elections have significantly diminished the prospects of a clear win for the party, while the opposition, led by the Congress Party, is consolidating its position.

We think it will be too close to call. Something similar to last year's assembly election in Karnataka state, in which the BJP came out as the winner and yet couldn't form a government, could be imagined at the national level. Even if the BJP retains its majority, with a slim margin over the opposition, the likelihood of the Congress-led coalition forming a new government cannot be ruled out. The opinion polls have been predicting such an outcome.

If indeed the poll predictions as laid out in the following figure become a reality, a 16 percentage point loss of parliamentary seats of Modi's National Democratic Alliance (NDA) in favour of the Congress-led United Progressive Alliance (UPA) represents a significant shift in the political landscape – not good news for the markets.

Lok Sabha (Lower House) party positioning - current and expected



a/ Average of five major opinion polls held in December 2018 and January 2019.

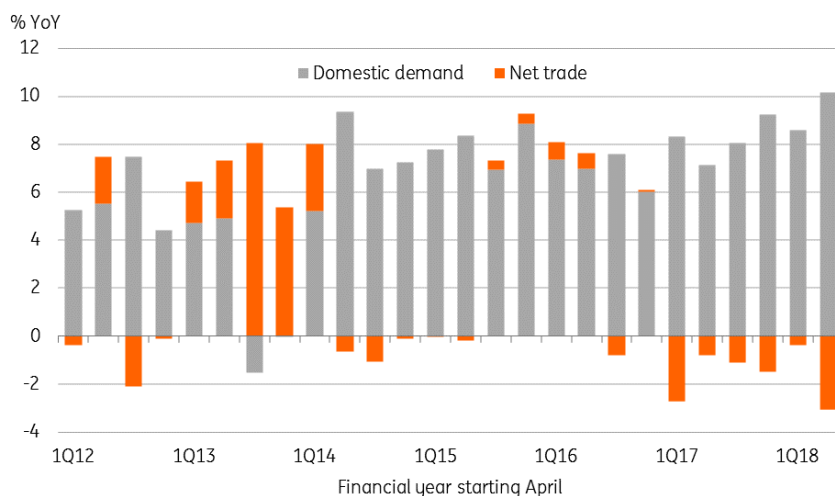
Source: Wikipedia, ING

The real economy is stuttering

An early estimate by the National Statistics Office puts GDP growth in the current financial year ending in March 2019 (FY2019) at 7.2%, in line with consensus and up from 6.7% in FY2018, a year that was marred by the effects of demonetisation and the chaotic GST implementation. Growth peaked above 8% in the first quarter of the year but slowed to 7.1% in the subsequent quarter. The latest economic data is pointing to a further drift below 7%. Hence, the 7.2% official estimate remains at downside risk - not good news for PM Modi before the elections although the final figure isn't expected to be out until after the elections.

It's hard to imagine fresh stimulus, both monetary and fiscal, helping growth in time for the vote in May. While the economy may still benefit from stimulus in the end, the external headwinds (the US-China trade war, the downturn in technology cycle, slowing global growth, and rising oil prices) are likely to prevail throughout FY2020. We expect this to nudge India's GDP growth below 7% in the upcoming year. However, a significant hit to GDP growth will likely be prevented by strong domestic demand on the back of the government's populist spending measures.

Domestic demand-driven growth



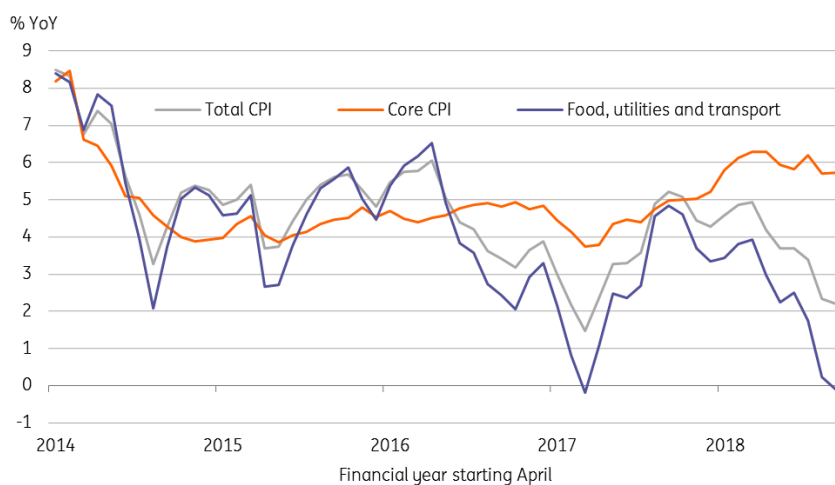
Source: CEIC, ING

Elevated inflation expectations

Meanwhile, absent significant supply-side shocks to food or fuel prices, the inflation outlook looks to be benign through mid-2019, beyond which high base effects will wear off to pull the year-on-year inflation rate higher. While the demand-pull price pressure from ample liquidity and election cash handouts could exert upward pressure on prices, it also depends on the extent the extra cash is recycled back into the economy amid prevailing uncertainty.

After all, loose fiscal policy is inflationary and it tends to fuel inflation expectations. High core inflation hovering close to a 6% rate so far in FY2019 reflects elevated expectations. New RBI Governor Das has admitted that the wide gap between the headline and core CPI measures is a policy challenge.

High core consumer price inflation



Source: CEIC, ING

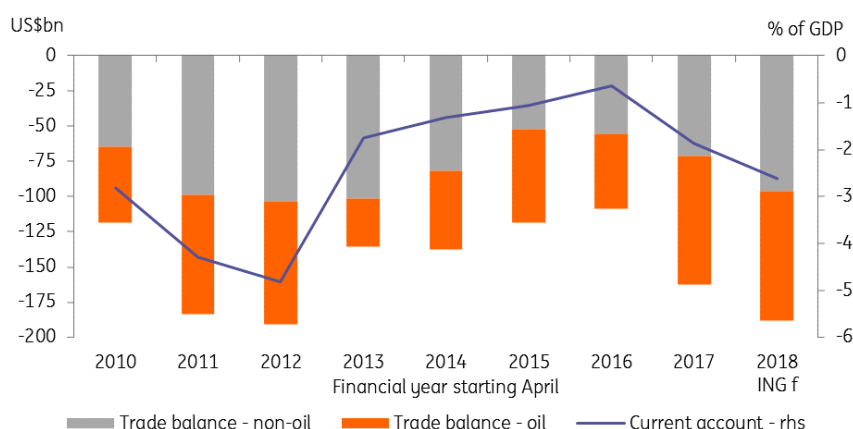
Deteriorating external payments

The widening trade and current account deficits will persist as drags on India's GDP growth. Almost half of the widening of the trade deficit is coming from the oil trade. Global crude prices resumed their upward march in December and are expected to remain on that trend this year as OPEC+ streamlines supplies to support prices. This means that the upward pressure on the trade deficit will persist. Moreover, a further hit from the end of the waiver of US sanctions on oil imports from Iran in March this year could make matters worse.

Besides oil, firmer domestic demand will keep overall imports strong, while export growth falters due to slower global growth. We expect these factors to push the current account deficit higher to about 3% of GDP in FY2020, the highest in seven years, from an estimated 2.6% for the current year, which is up from 1.9% in the last year.

Meanwhile, political uncertainty could have foreign investors treating Indian markets cautiously. Net foreign portfolio flows swung from a brief inflow toward the end of 2018 to an outflow starting 2019. This does not just reflect the politics. The troubles at non-bank finance companies are far from over with media reports of another infrastructure lender defaulting on its debt due this month. We see no near-term respite from negative foreign investor sentiment.

Oil pressures trade and current deficits higher



Source: CEIC, ING

Loose macro policies are inflationary

The government's drive to boost growth has shifted economic policies into an expansionary mode. Last October the RBI moved its policy stance to 'calibrated tightening' citing sustained inflation risks. The events since, especially after the resignation of Urjit Patel, have clearly shifted the bias towards easing. New RBI governor Das is likely to endorse the shift to a 'neutral' stance at the next meeting on 7 February. We have recently downgraded our RBI policy forecasts from two rate hikes this year to no more hikes. However, with the sustained pressure from the government to ease, we won't be surprised if the central bank decides to cut rates in February.

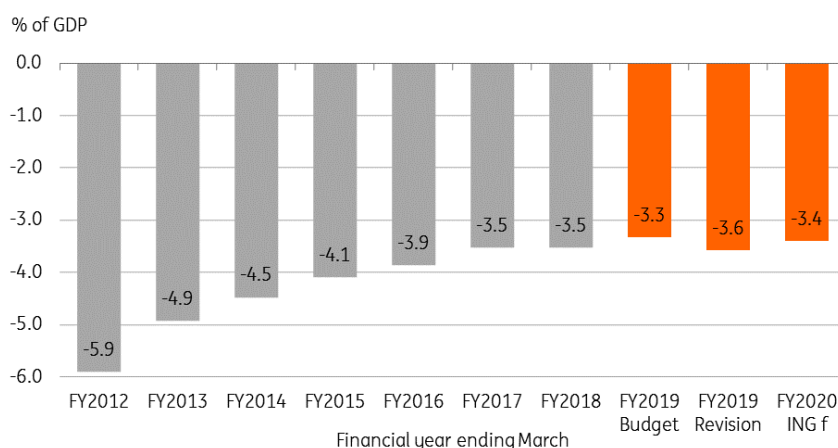
Before the RBI meeting, the interim finance minister Piyush Goyal is due to present the FY2020 budget to the parliament on Friday, 1 February (Finance Minister Jaitley is reportedly on medical leave). Growth will outweigh fiscal discipline as the Modi administration pushes for a second term. As such, after an overshoot of the deficit in the last financial year and more likely again in the

current year, hopes of any fiscal consolidation receiving prominence in evolving macro policy are largely misplaced.

We see the revised budget for current FY2019 producing a deficit equivalent to 3.6% of GDP, well above the government's initial projection of 3.3% (consensus 3.5%). Our forecast for FY2020 deficit is 3.4%. In the event of the incumbent government staying in power or the Congress-led coalition taking over, fiscal policy will likely remain overly loose, with the deficit likely to remain well above the 3% comfort level.

We consider such fiscal-monetary policy mix exceptionally expansionary. Although the economy is expected to slow, it's not likely to crash. A nearly 7% India's growth puts it among the ranks of the world's fastest-growing economies, which argues against stimulatory policies. Moreover, such a policy mix will further add to inflation, which is already under pressure from high oil prices and the weak currency.

Derailed consolidation of public finances - fiscal deficit



Source: CEIC, ING

The markets at the receiving end of it all

Loose financial policies are good for the people – make hay while the sun shines. But the financial markets continue to be at the receiving end of it all.

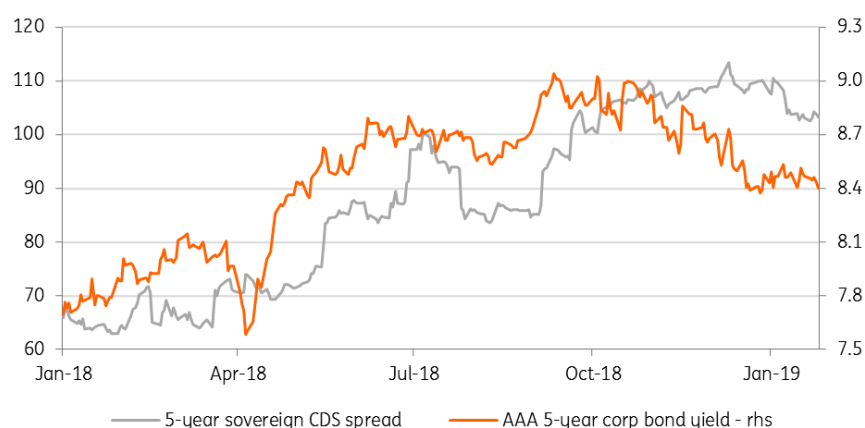
Weakening fiscal and external payments and uncertainty about future policy directives to mend this state of affairs suggest that local financial assets will remain under steady weakening pressure. Government bonds may be enjoying the comfort of low inflation currently but the increase in public debt issuance to plug a wider deficit is likely to re-exert upward pressure on yields. The AAA-rated corporate bond yields, as well as sovereign default spreads, have risen sharply over the last year and we anticipate no let up in these trends. All it will take is a single negative nudge from rating agencies.

Relatively strong growth performance may keep any negative rating action at bay. But it also depends on how rating agencies view the government's progress in consolidating its finances. Moody's, S&P and Fitch all have a stable outlook on India's long-term foreign currency debt ratings.

The INR's 8.4% depreciation in 2018 was the worst in half a decade. 2019 isn't off to a good start

either with a 2% month-to-date depreciation against the USD being the steepest among regional economies. We see the USD/INR rate re-testing 33 within the current quarter.

Rising risk premium



Source: Bloomberg, ING

The economy at glance - ING forecasts

India (FY starting April)	FY2015	FY2016	FY2017	FY2018 f	FY2019 f	FY2020 f
Real GDP (% YoY)	8.2	7.1	6.7	7.1	6.8	7.2
CPI (% YoY)	4.9	4.5	3.6	3.5	4.5	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.6	-3.4	-3.2
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	6.50	6.50	6.50
3M T-bill rate (% eop)	7.27	5.82	6.09	6.75	6.90	6.90
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.60	7.80	7.80
INR per USD (eop)	66.33	64.84	65.18	72.50	68.00	65.00

Sources: Bloomberg, CEIC, ING forecasts

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.