

## Good MornING Asia - 8 February 2019

Concern that no trade deal between the US and China may be struck ahead of the March 1 trade truce deadline means only one thing in currency terms - a stronger dollar

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By Robert Carnell



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### Possibility of no deal boosting the USD

It's hard to spot against the EUR, but against the CNY and KRW, the recent playing down of optimism about a trade deal between the US and China is playing out, as it should, through a stronger USD (weaker Asian FX).

This could become more evident if recent hesitancy about the progress made towards a deal grows, and yes, the CNY and KRW are the two currencies that will probably see the greatest impact: CNY because, well, this is all about China. And the KRW because it is the regional trading powerhouse and liquid currency.

This is playing out in a modified version of what we imagined would be the case at the beginning of the year, except that we felt that there would be some semblance of a positive announcement first, before everything fell apart. This could still happen, in which case, there could become final modest relief rally in Asian FX and in particular, the CNY and KRW, before the USD comes crawling back through late 1Q19 / 2Q19. Something to keep watching!

### RBA monetary policy statement

Governor Lowe admitted yesterday what we have been saying for some time now, and bank bill

futures markets recently began to echo: Namely, that there is two-way risk around Australian rates, and that the next move, whichever direction it is, would be some way off. We concur with all of that. Today's monetary policy statement will merely repeat this message, with some bells and whistles.

The AUD is looking weaker again, as if should also if trade worries are well founded. But it probably won't lose much further ground on today's statement. This is becoming old news now. But we still like an AUD/USD sub-0.70 figure in the near-term. The trade story might deliver it before a weaker domestic demand story in Australia does.

## Nothing much wrong with Japan's wages...

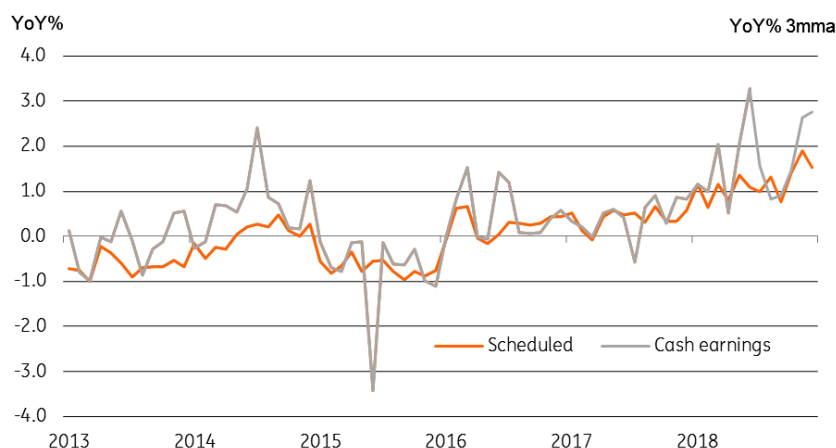
...but where is the spending?

Japan's wage growth became one of Abe's main targets during his Abenomics project, about which we hear relatively little these days. And we have to say that on this, he has actually managed to pull off quite a victory. Wages growth, for the longest time virtually zero, has picked up since mid-2017 and is now running at a 1.8%YoY pace. Even in real terms, this is 1.4%.

While this is a good result, it should also have spurred some stronger household spending. In contrast, this remains pathetically weak. The latest read of (real) 0.1%YoY is not markedly different from recent years, though perhaps it was in a slight trend decline before, and is now merely flat. It may just take more time for workers to view wage increases as permanent before they spend them, rather than saving them.

But one thing we would suggest, the BoJ's current extension of unorthodox monetary policy probably isn't helping. It may not actually be making things worse (discuss...), but as the increasing rate of Japanese pensioners committing petty crimes to get shelter and food in jail shows, for parts of the population, zero yields are actively hurting.

## Japanese wages growth



## Where India goes...

**(From Prakash Sakpal)** India's central bank (RBI) has ignored the inflationary consequences of their fiscal splurge and eased policy in support of the government's drive to boost growth before the elections. The 25bp 'election cut', a somewhat surprising move (though we did warn about the risks

to this last week), was done on the grounds of inflation continuing to be "benign". We aren't expecting inflation is to hit the RBI's 4% policy mid-point anytime soon but we believe the underlying pressure remains upward. As such, we consider the policy move premature and the rupee will be the main victim of such a policy ([India: RBI's surprise rate cut appears premature](#)). In separate announcements yesterday, the RBI is also planning to ease restrictions on foreign investment in corporate debt by removing a 20% limit on investment in a single company. Relaxation of guidelines for borrowing for bankruptcies is also in the pipeline. We remain sceptical of these measures bringing any support to the beleaguered currency when the broader investor sentiment is likely to remain fragile.

## ...others may follow

We also noted last week that there were other central banks in Asia that might also take advantage of 1) a weaker USD and 2) low inflation stemming from low oil prices, to undo some of the arguably unwarranted tightenings from 2018. Bank of Thailand ranks amongst those on our list, as well as the Philippine Central Bank (BSP), and Bank Indonesia (BI) We could even squeeze the Bank of Korea (BoK) on to this list.

Time may be running out though if trade anxiety comes back with force and the USD with it. So this window is open now but is closing. BI meets the week after next...

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## ASEAN morning bytes

General market tone: Risk-off. Investors will likely book gains and pull back given renewed US-China trade and global growth fears.



### EM Space: Wait and see as leaders opt not to meet before March

- **General Asia:** Risk-off sentiment will dominate Friday's trading after growth forecasts have been lowered in Europe given ongoing trade negotiations between major economies. Meanwhile, investors are also now growing anxious on the trade front with Trump confirming that his meeting with President Xi will not happen until after the end of trade truce on 1 March.
- **Indonesia:** Bank Indonesia reported that the fall in gross international reserves (GIR) to \$120.1 bn in January from \$120.65 bn was due to maturing external debt payments. Latest GIR level covers about 6.7 months of imports and 6.5 months of imports and debt payment, while BI assesses the economic outlook continuing to be sound.
- **Philippines:** The Bangko Sentral ng Pilipinas (BSP) left the policy rate at 4.75% even as the central bank pared its inflation forecasts. It sees 2019 inflation settling at 3.07% (vs. 3.18% earlier) on expectations of lower oil prices, the base effects, and stable food supply. The BSP made no mention of the reserve requirement ratio although we continue to expect a RRR cut this month. Meanwhile, gross international reserves continued to climb with the January reading now at \$82.1 bn, up from \$79.2bn in the previous month and worth up to 7.2 months of imports.

## What to look out for: Developments on trade

- Hong Kong PMI (8 February)
- Thailand GIR (8 February)
- Indonesia current account (8 February)
- Fed Bullard speaks (8 February)

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## Asia week ahead: China back in limelight

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Source: Shutterstock

### Next round of China-US trade talks

The Chinese markets will be back from the 'Golden Week' Lunar New Year holiday, though players are likely to tread a cautious path, taking cues from the January economic data and progress on the US-China trade talks.

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*Will the forthcoming round of the US-China trade negotiations bear out President Trump's recent positive rhetoric on a trade deal?*

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The delegation led by US Treasury Secretary Steven Mnuchin and Trade Representative Robert Lighthizer will hold trade negotiations with their counterparts in Beijing next week. As in the last high-level meeting in late January (attended by China's Vice Premier Liu He), we may hear about some more trade concessions from the Chinese side, though the most contentious issue about technology theft and intellectual property rights will continue to linger. Moreover, any major announcements, positive or negative, might well be withheld until after the Trump-Xi meeting in Vietnam at the end of the month.

Meanwhile, China's January data calendar is shortened as the National Bureau of Statistics holds back the release of some indicators (industrial production, fixed asset investment, retail sales) deemed to be distorted by the timing of the Lunar New Year holiday, which either falls in January or in February. So far, signals have been mixed – the manufacturing economy continues to be weak while services are holding up. We will be watching the trade and monetary data to see the impact of the trade war and for signs of stimulus.

## More trade releases elsewhere

India, Indonesia, the Philippines and Taiwan also report their trade figures next week. All will be scrutinised for clues about the impact of the trade war. But it's not just the trade war. The ongoing downturn in global electronics demand has already started to depress regional exports. A steeper decline in Korea's exports in January suggests we can expect the same from Taiwan.

India, Indonesia, and the Philippines are all suffering from a rising trade deficit, a trend that's likely to continue due to strong domestic demand and firmer oil prices, while exports continue to be subdued.

On the other end of the spectrum are countries like Malaysia, where electronics exports are still holding up. This, together with the recent strengthening of global oil prices, has supported exports and the trade surplus. Malaysia's current account and GDP data for the fourth quarter of 2018 are due next week and we estimate a wider current surplus and pick up in GDP growth. Both are positive for the Malaysian ringgit.

India's consumer price inflation data will be viewed in the context of the Reserve Bank of India's latest move to cut interest rates by 25 basis points. Inflation is unlikely to hit the RBI's 4% policy mid-point anytime soon but we expect the underlying pressure to remain upward. As such, we consider the decision to [cut interest rates premature](#).

[India: RBI's surprise rate cut appears premature](#)

## Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
<b>Monday 11 February</b>					
China	-	Jan Forex Reserves (US\$bn)	3082.0	3081.85	3072.7
Malaysia	0400	Dec Industrial Production (YoY%)	3.5	-	-0.5
<b>Tuesday 12 February</b>					
China	-	Jan Aggregate Finance (Yuan bn)	2989.0	-	1589.8
	-	Jan Financial Institution Loans (Yuan bn)	2030.0	-	1080.0
	-	Jan Money Supply (M2) (%YoY)	8.1	-	8.1
India	1200	Jan CPI (YoY%)	2.4	-	2.2
	1200	Dec Industrial Production (YoY%)	2.1	-	0.5
Malaysia	0700	Jan Forex reserves, Month-end (US\$bn)	-	-	101.7
Philippines	0100	Dec Imports (YoY%)	4.9	-	6.8
	0100	Dec Trade Balance (US\$m)	-4055.4	-	-3901.0
	0100	Dec Exports (YoY%)	3.3	-	-0.3
Singapore	0500	Dec Retail Sales Value (MoM/YoY%)	-0.1/-3.5	-/-	0.2/-3.0
Taiwan	0800	Jan CPI (YoY%)	2.0	-	-0.1
	0800	Jan WPI (YoY%)	-2.0	-	0.8
South Korea	2300	Jan Unemployment Rate (% SA)	3.8	-	3.8
<b>Wednesday 13 February</b>					
Taiwan	0800	4Q F GDP (YoY%)	-	-	1.8
<b>Thursday 14 February</b>					
China	-	Jan Imports (YoY%)	-6.5	-11.0	-7.6
	-	Jan Exports (YoY%)	-4.1	-2.7	-4.4
	-	Jan Trade Balance (US\$bn)	22.0	32.0	57.1
India	0630	Jan WPI (YoY%)	3.5	-	3.8
Malaysia	0400	4Q GDP (SA, QoQ/YoY%)	1.2/4.6	-/-	1.6/4.4
	0400	4Q Current Account (Q) (MYR bn)	12.4	-	3.8
South Korea	2300	Dec Current A/c Balance (US\$bn)	4.1	-	5.1
<b>Friday 15 February</b>					
China	0130	Jan CPI (YoY%)	2.0	-	1.9
	0130	Jan PPI (YoY%)	-2.0	-	0.9
	0730	4Q18 Current Account Balance (US\$ bn)	23.0	-	23.3
India	-	Jan Imports (YoY%)	-5.0	-	-2.4
	-	Jan Trade Deficit (US\$bn)	-13.8	-	-13.1
	-	Jan Exports (YoY%)	2.0	-	0.3
Indonesia	0400	Jan Trade Balance (US\$m)	-600.0	-	-1102.0
	0400	Jan Imports (YoY%)	2.1	-	1.2
	0400	Jan Exports (YoY%)	3.9	-	-4.6
Philippines	-	Dec OCW Remittances (YoY%)	-	-	2.8
Taiwan	0800	Jan Exports (YoY%)	-3.9	-	-3.0
	0800	Jan Imports (YoY%)	-5.7	-	2.2
	0800	Jan Trade Balance (US\$bn)	1.8	-	4.7

Source: ING, Bloomberg, \*GMT

# India: RBI's surprise rate cut appears premature

The Reserve Bank of India (RBI) has ignored the inflationary consequences of the fiscal splurge and eased policy in support of the government's...



Source: Shutterstock

**6.25%** RBI repo rate  
25 basis point cut

Lower than expected

## An RBI rate cut with neutral policy stance

The RBI Monetary Policy Committee voted 4-2 to cut the key policy rate by 25 basis points, taking the repurchase rate to 6.25% and the reverse repo rate to 6.00%. The decision was surprising in that very few, only eight out of 38 participants in the Bloomberg survey anticipated it. As widely expected, there was no change to the banks' reserve requirement rate of 4.00%. The MPC also switched its policy stance to 'neutral' from 'calibrated tightening', which was a unanimous decision by all members.

What's more amazing though is the sharp swing in the policy perception within the MPC. Until late 2018, all but one member expressed caution on inflation and advocated a tighter stance with stable rates, whereas all favoured a neutral stance and the majority voted for a rate cut today.

## A change in policymakers' thinking

MPC member	Dec-2018 meeting	Feb-2019 meeting
<b>Governor Patel =&gt; Das *</b>	<b>Tight - no change in rate</b>	<b>Neutral - rate cut</b>
Dr. R. H. Dholakia	Neutral - no change in rate	Neutral - rate cut
Dr. Pami Dua	Tight - no change in rate	Neutral - rate cut
Dr. Michael Patra	Tight - no change in rate	Neutral - rate cut
Dr. Chetan Ghate	Tight - no change in rate	Neutral - no change in rate
Dr. Viral Acharya	Tight - no change in rate	Neutral - no change in rate

\* Shaktikanta Das replaced Urjit Patel as RBI governor after the later resigned in December.

Source: RBI policy statements and meeting minutes, ING Bank

## Benign inflation, strong growth outlook

The [RBI statement](#) began by noting that, "These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 percent within a band of +/- 2 percent while supporting growth". Inflation for the current quarter (the final quarter of FY2019 ending in March) is projected at 2.8%, picking up to 3.2-3.4% in 1H FY2020 and then to 3.9% in 3Q FY2020. This outlook rests on expectations of continued food and fuel price trends, the transitory nature of currently high healthcare and education costs, and moderating household inflation expectations. The upside risks stem from volatile vegetable prices, an abnormal monsoon, and the fiscal boost to aggregate demand.

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*Headline inflation is expected to remain contained below or at its target of 4 percent. - Governor Das.*

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The central bank forecasts an acceleration of GDP growth to 7.4% in FY2020 from 7.2% estimated for the current financial year, supported by strong credit growth, softer crude oil prices, and the lagged impact of the weak currency on net exports.

## A premature policy move

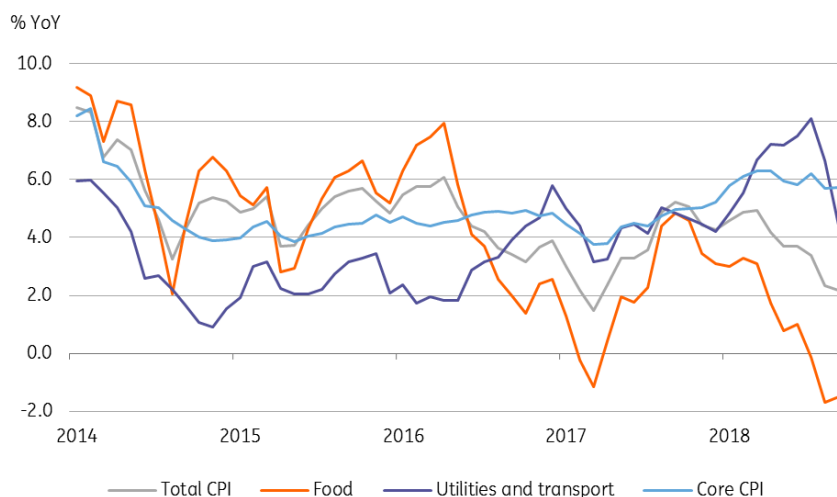
It was a surprise that the RBI eased policy on the grounds of inflation continuing to be benign. Indeed inflation is unlikely to hit the RBI's 4% policy mid-point anytime soon. But we expect the underlying pressure to remain upward. Food price inflation has bottomed as the January CPI data is expected to show, while the adverse base effect will likely push it higher going forward. High core inflation, running at about 6% in the current financial year, reflects still elevated inflation expectations. The loose fiscal policy and a weak currency are the other factors likely to push prices up going forward. We expect average inflation of 3.6% in 1H FY2020, rising to 5.4% in 2H 2020.

As such, we consider the decision to cut the policy interest rate premature. The key question it poses is: why do we need a loose monetary policy when the fiscal policy is already supporting growth well above 7%? Maybe a political push from the incumbent government aiming for

a second term.

Now that elections are just around the corner, we aren't expecting the RBI to move policy again this year. However, as inflation accelerates above 5%, the tightening pressure will return. We believe the next RBI policy will be a 25 basis point tightening by the end of FY2020.

## CPI inflation by key components



Source: Bloomberg, CEIC, ING

## INR to remain Asia's weakest currency

Government bonds gained and the Indian rupee weakened in a knee-jerk reaction to the RBI's decision.

It's unlikely to be a lasting relief for bonds as the supply overhang to plug a persistently wide fiscal deficit will continue to pressure yields higher. The INR7.04 trillion government borrowing plan for FY2020 announced in the budget a week ago represents an over 30% increase from the revised INR 5.35 trillion borrowing in the current year. This will not only pressure borrowing costs higher but also will cause a significant crowding out of private investment, thereby weighing on GDP growth.

The INR has been the worst performing Asian currency since last year. Despite persistent wide relative interest rate differentials, the lower domestic rates will sustain the INR's underperformance throughout 2019. We maintain our view of the USD/INR rate re-testing 73 in the near-term.

## ING's key economic forecasts for India

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	-3.5	-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	6.25	6.50	6.50
3M T-bill rate (% eop)	7.27	5.82	6.09	6.50	6.80	6.80
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.50	7.90	7.90
INR per USD (eop)	66.33	64.84	65.18	72.50	68.00	65.00

Sources: Bloomberg, CEIC, ING forecasts

## Philippines: Reserve requirement ratio cut may be on the way

Inflation forecasts have been lowered due to lower oil prices and base effects



**4.75%** BSP policy rate

As expected

### Inflation hazard appears averted

The Philippine's central bank (BSP) kept policy rates steady with the threat of contemporaneous



inflation likely in the rear view mirror. Forecasts continue to show inflation gliding back within target for the year, with the latest readings showing inflation at 3.07% in 2019 (from 3.18%) and to 2.98% (from 3.04%) in 2020 owing to lower oil price assumptions and base effects.

BSP continues however to preach “data dependency” and may await further validation that inflation will settle within target, by their own accounts, as early as end-1Q before changing course. Given the supply-side nature of the recent inflation spike, we can expect price pressures to dissipate further even as the rice tariffication bill remains unsigned and crude oil prices remain muted. BSP’s inflation forecasts validate that the BSP is likely done with its tightening cycle, with a policy reversal in sight given slowing growth momentum and inflation in check.

## **Reserve requirement cut in the works, RTB to follow?**

The central bank will likely slash reserve requirement ratios (RRR) as early as February with inflation decelerating while domestic liquidity conditions remain relatively tight (latest M3 growth registering four straight months of single digit expansion). We expect the BSP to announce a reduction in reserve requirements at an off-cycle meeting given the governor’s assertions that the RRR is no longer a policy tool. Meanwhile, reports circulated on Thursday that the Bureau of the Treasury (BTr) was looking to issue a retail treasury bond (RTB) in the near term, with an RRR cut from the BSP one of the deciding factors for the timing of issuance.

## **Inflation in rear view mirror, time to ease off the brakes**

The BSP slammed on the brakes in 2018 given the hazard of second-round effects in full view. Now that the inflation threat appears safely in their rear view mirror we can see the central bank easing off the brake pedal ever so slightly by cutting rates in May after reducing RRR in 1Q. With growth expected to teeter close to the edge of 6% given the recent budget delay and with the inflation objective safeguarded, BSP may finally opt to give the economy an added boost to regain flagging growth momentum.

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