

## In Case You Missed It: How much of this surprised you?

US GDP beat expectations, the ECB says nothing at all and the Bank of Japan abandons inflation target timing. We explain why we're revising our yuan and Indian rupee forecast. And if robots are taking over jobs in Belgium, how safe is yours?

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Source: Shutterstock

# 2.3%

## US 1Q18 GDP growth

vs 2.0% consensus forecast

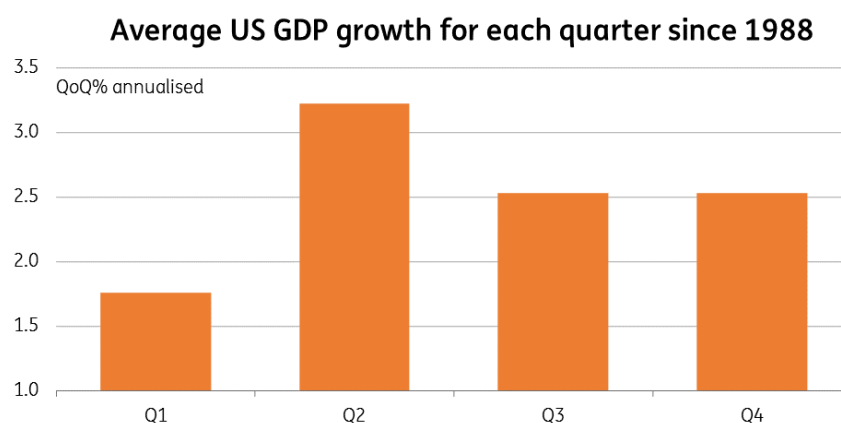
Better than expected

### Consumer soft, investment strong

US GDP came in at 2.3% for 1Q18, close to our 2.4% forecast and a bit ahead of the 2% consensus. The details show consumer spending was soft, rising 1.1% with bad weather playing a part, but we also have to remember there was a tough comparison with 4Q17 given the post hurricane rebound in spending we saw back then. Government spending also slowed to 1.2% for similar reasons.

Investment was good, rising 7.3% with structures a big positive while inventory building contributed 0.43 percentage points to growth and net trade added an extra 0.2%. Given the equity market volatility in the quarter and worries about protectionism this is a pretty good outcome all in.

## So much for seasonal adjustment... but good news for 2Q18



Source: Bloomberg, ING

### Outlook for Q2 and beyond

It is also important to remember (as the chart above shows) Q1 is typically the worst quarter for US growth, despite seasonal adjustment. Over the past 30 years, growth in the second quarter of any given year has on average been 1.4% faster than in the first. So here's to 3.7% growth in 2Q!!

In all fairness, it is close to what we are currently forecasting, which is 3.4%...After all, retail sales rebounded in March, suggesting the domestic economy has regained some momentum while confidence is strong and the jobs market is robust, which is contributing to higher wages. Tax cuts will also be supporting spending while a rebound in asset prices following 1Q volatility is helpful.

Meanwhile, the dollar's weakness means that exporters are in a competitive position which allows the US to really benefit from the upturn in global demand. With inflation pressures starting to become more evident and protectionism fears subsiding, this will help keep the Fed on course to hike interest rates three more times in 2018.

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## Silence is golden – the ECB way

A somewhat more cautious ECB plays it safe and buys time the least entertaining way. Crunch time will come in June...or July...or...



Source: Andrej Klizan

### Draghi says nothing at all

Very often, even the least informative ECB meetings can at least be entertaining. Today's ECB meeting, however, set a new milestone in terms of buying time. Unfortunately, in a hardly entertaining way. The unexpected drop in soft and hard data seems to have created new uncertainty at the ECB as regards the future path of monetary policy. It is very hard to believe but according to ECB President Mario Draghi, the ECB did not discuss the monetary policy outlook at all. The most cautious version of buying time, avoiding new speculation and really saying nothing.

The largest part of the ECB's introductory statement was a verbatim copy of the March statement. Only regarding the economic outlook, Draghi struck a slightly more dovish tone with a subtle change of the wording. According to the ECB, risks to the growth outlook are still "broadly balanced" but contrary to previous meetings, the ECB only mentioned downside risks without the corresponding upside risks. During the Q&A session, Draghi pointed to the fact that the loss of growth momentum was broadly spread across most countries and sectors. However, the main reasons for the downswing were one-off factors.

As regards inflation, Draghi repeated the well-known story of the ECB's confidence that inflation will converge towards the 2% goal, while at the same time stressing that currently there were very little signs of this actually unfolding.

## Next steps

For the rest, Draghi did not send any signals regarding next steps. He did not even confirm earlier statements that there would not be any abrupt end to QE in September. By saying that the ECB did not discuss the outlook for monetary policy, Draghi chose the most cautious option to avoid any misguidance.

What does this mean? Weaker economic data since the start of the year have probably brought back old memories of 2008 and 2011 when the ECB prematurely hiked interest rates. These two episodes are clearly strongly built into the ECB's institutional memory. Therefore, the ECB will be very cautious in unwinding QE. In our view, the June meeting will be crunch time for the ECB. With the next round of growth and inflation projections, the ECB will have a better view on whether weak economic data was just a soft patch or the start of a downswing and on whether inflation moving to 2% is still more wish than reality.

### Crunch time postponed

In our view, the next meeting in June, which will be held in Riga, should bring some guidance for the future path of QE. Given today's caution and dovishness, anything but another extension beyond September would be a big surprise. The two main questions for any roadmap should be whether it will be an extension for three or six months and whether there will be an end-date to the extension or not. However, June does not necessarily have to be crunch time. Don't forget that by then the ECB will only have hard data up to April and inflation data up to May. It could very well be that the economy has not taken a sharp turn by then but that uncertainty still prevails. Given the ECB's previous preference for a rather piecemeal approach in its communication, crunch time could easily be postponed to July or even September. The good thing is that saying nothing at all, like today, does not look like an option in June.

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## BoJ tweaks its statement - this could be important

The Bank of Japan (BoJ) has removed any reference to reaching its 2% inflation target by some time around fiscal 2019 in its latest statement - this can...



Source: Shutterstock

### Kuroda's linkage of the end of QQE to the inflation target is still haunting him

At a press conference a month or two back, Bank of Japan Governor Haruhiko Kuroda made a link between the end of Qualitative and Quantitative Easing (QQE) and the BoJ achieving its 2% inflation target sometime in 2019. Since then, markets have been wondering if the BoJ was quietly working towards an exit strategy based on this time horizon. Indeed, whilst inflation data were heading higher earlier this year, you could make a case for the BoJ gradually cutting back on its asset purchases, perhaps under cover of similar moves by the ECB to end its QQE purchases by mid-2019. The obvious advantage of such "stealth-unwinding" would be that it would moderate the currency impact on the Japanese yen.

But whilst the growth data for Japan remains pretty good, the same can't be said of the Eurozone, where 1Q18 delivered a notable soft patch on activity. Moreover, both economies have seen disappointing inflation data recently. So extrapolating from today's run of recent data to less accommodative monetary policy over any sort of reasonable time span is looking very tough for

the ECB, and by extension, equally tough for the BoJ.

So did today's statement change that at all?

## What? No inflation target forecast?

With no change to policy and little change to the growth or inflation forecasts, the only thing for markets to focus on was the omission of the forecast that the inflation target (2.0%) would be met sometime around fiscal-year (FY) 2019.

There are a number of ways you can interpret this. Here are two:

1. The BoJ acknowledges the recent softness in inflation, persistent lack of inflation upturn and low probability of meeting its target on the previous timeframe. As a result, the BoJ has dropped it. This would also imply a much lower probability of an end to QQE by mid-2019.
2. The BoJ realises the low probability of meeting its 2% target - but also downgrades this as an intermediate target, as the rest of the economy looks in good shape - arguably, this could result in an earlier or unchanged exit strategy for QQE. 2% was always an unrealistic target and dropping the reference merely gets rid of something that was harming credibility.

The ensuing press conference has sought to downplay the significance of this statement change. With the basic message coming out that this was just a "forecast", and not a limit, and that monetary policy was not being determined on a calendar basis, but according to conditions. Together with a downgrading of the balance of risks to the inflation outlook, it looks to us as if there is more truth to scenario 1) than to scenario 2). If so, then we might also expect the JPY to run softer than we have been forecasting.

That said, there is still plenty of ambiguity over this decision, and ongoing problems for the BoJ in meeting its asset purchase targets or maintaining Japanese government bond yields at zero percent. So finding an exit strategy would not be a bad idea. Today's move may be the first in a very long series of changes designed to achieve that.

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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...



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.

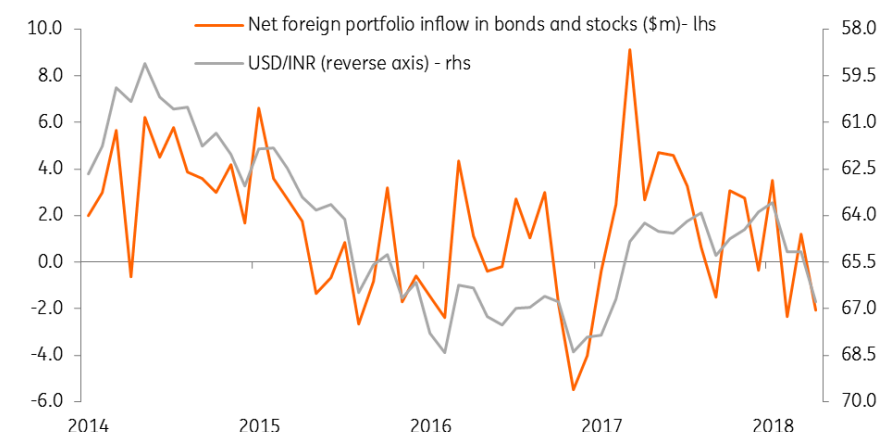
Contrary to an inflation forecast downgrade, minutes of the same meeting released on 19 April tipped the scale of monetary policy risk towards tightening from the current neutral bias, as Deputy Governor Dr Viral Acharya signalled his "decisive" vote for "withdrawal of accommodation" at the next meeting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

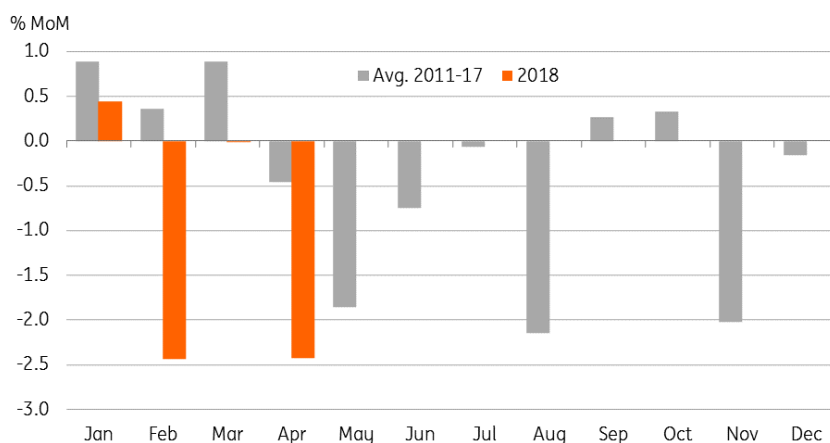
### ➔ Other headwinds

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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Article | 27 April 2018

## China: Revising our yuan forecast

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Dollars surrounded by Chinese yuan

### Chinese yuan not as strong as expected

We have been bullish on the yuan, against the backdrop of a strong economy and with business earnings growing at a decent rate. However, this looks to have changed according to recent data (see below).

Further, escalating tension between China and the US has moved from trade to investment. This could affect business earnings in some sectors negatively.

The trade tension could also lead to shrinking global trade volumes. This would affect not only China but also the supply chain in Asia to a large extent. Asian currencies, in general, may run much flatter against the dollar, requiring the yuan to also flatten its appreciating path to protect competitiveness.



## Revising USD/CNY to 6.33 by end of 2018

Based on such thoughts, we revise our forecasts on USD/CNY:

- from 6.25 to 6.35 by the end of 2Q18, and
- from 6.20 to 6.34 by the end of 3Q18, and
- from 6.10 to 6.33 by the end of 4Q18, and
- from 5.80 to 6.20 by the end of 2019.

Under these new forecasts, the yuan against the dollar would still appreciate in 2018 compared to 2017's closing of 6.5067, but at a slower speed at around 3%, and at 2% in 2019.

## Thinner profits for factories even before escalating trade tensions

Growth in industrial profits fell to 3.1% year-on-year in March from 10.8% the previous month. But with strong growth in the first two months of the year, growth of industrial profits in 1Q18 was still decent at 11.6% YoY.

Still, we are concerned. Though the number of working days in March was affected by Chinese New Year holidays, which will not repeat in April, the lower selling price of raw materials together with rising financial costs means there are fundamental changes in industrial profits.

Falls in material prices is a result of both the high base effect from last year and an increase in production (it is usual for businesses to produce more when prices are falling to maintain the profit level).

Though we expected rising financial costs in an environment of financial deleveraging reform, the rise in financial costs at 15.1% YoY in March compared to 12.3% YoY in the first two months means that financial cost increases are speeding up. As financial deleveraging reform will continue for the rest of 2018, this could continue.

All in all, we believe that industrial profits could fall from more than 10% YoY to high single digits in the coming months.

# Belgium: Automation-induced shifts in the labour market

Technological progress is gaining strength. Even though most people see the benefits of this, there is also some concern for the negative effects on the...

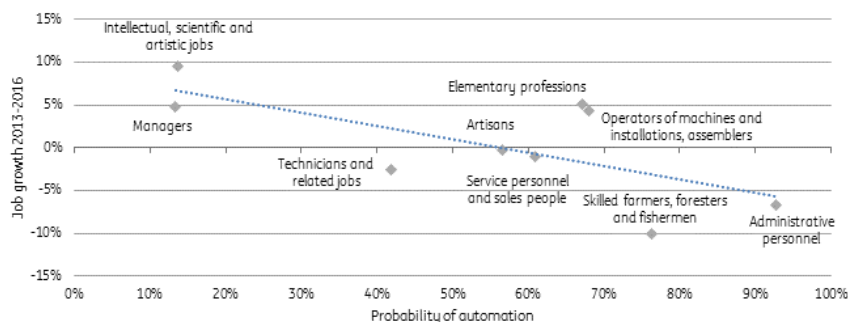


## A negative relationship

Our new study (read the full study in [French](#) or in [Dutch](#)) shows that there is already an effect of automation on the Belgian labour market. We looked at job growth of all jobs in Belgium (based on the ISCO classification) over the period 2013-2016 and linked it with the probability of automation of that particular job. The analysis shows that there is indeed a negative relationship.

Job growth was lower for the job categories with a high degree of automation, such as administrative jobs, and higher for job categories that are less automatable, such as managers. On a more disaggregated level, job growth for accountants, a profession that faces high automation risk, was much weaker than growth of jobs with a low probability of automation, such as social workers.

## Growth of jobs with a high probability of automation did less well



*Note to the graph: The probability of automation of the job categories is a weighted average of the individual jobs within that category. The estimated relationship equals:  $\text{Job growth} = 0.09 - 0.16 \times \text{probability of automation}$ . The estimated relationship using all jobs (we have data for 300 jobs) is very similar:  $\text{Job growth} = 0.09 - 0.13 \times \text{probability of automation}$ . Source: Baert and Ledent (2015) (See this study here in [French](#) or in [Dutch](#)) and FOD economie.*

## Technology also creates jobs

Even though the above finding sometimes causes fear, automation does not necessarily lead to higher unemployment as technological change also creates jobs. In that way, job losses can be compensated. An app developer or a drone operator are examples of jobs that didn't really exist only a couple of years ago. Moreover, it is important to recognise that our analysis does not take these new jobs fully into account. The definition of jobs is fixed in our sample period and so it is impossible for new categories to enter the analysis. When the database gets revised, new categories could be added.

In addition to the emergence of new jobs, automation can also lead to stronger economic activity and so higher demand for human labour. As new technology increases productivity, wages should also increase. The increased spending power, in turn, stimulates demand and therefore production that uses human labour.

## The importance of adaptability and social skills

So our study shows that automation is already causing a shift in the Belgian labour market and we expect that this trend will strengthen. How can people prepare themselves for this?

Due to the constant change of our technological possibilities, it will become increasingly important that people remain active in the labour market and don't drop out of it. It may be stating the obvious, but having the right education and (re-)training will be vital. Adaptability and the will to change will therefore be an asset in the job market.

In addition, we must continue to recognise the importance of strong social skills, such as teamwork and communication. Despite new technologies, and so a strong demand for people with technical skills, the importance of social skills does not disappear. It becomes even more important!

[Academic research](#) for the US shows that the share of jobs where strong social skills are important

grew by 12 percentage points between 1980 and 2012. Wages of such jobs also grew faster over that period.

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