Economic commentary

12/10/2018

Week Ahead Asia-Pacific Economic Preview

- **China GDP growth likely to slow in Q3**
- **Other data from China include inflation, fixed investment, factory output and retail sales**
- **Trade data for Japan, Indonesia and Singapore**
- **US FOMC minutes, output and sales updates, plus Euro area inflation, UK price and job data**
- **Special focus on India's currency crisis**

The highlight of the coming week in Asia is the release of third quarter GDP data from China. The data will be eyed for insights of the extent that trade wars and tariffs may have affected Chinese economic activity. The release of trade data from Japan, Indonesia and Singapore will likewise provide further clues as to trade performance in the APAC region.

Other data highlights for Asia include inflation data for Japan, China, India and New Zealand as well as China's investment and industrial production figures.

Elsewhere, FOMC minutes and US retail sales and industrial production numbers will provide steers on the speed of Fed policy tightening. Euro area inflation as well as UK job data and inflation numbers will be meanwhile key to the timing of future monetary policy changes at the ECB and Bank of England respectively. The week also see a key EU summit on Brexit.

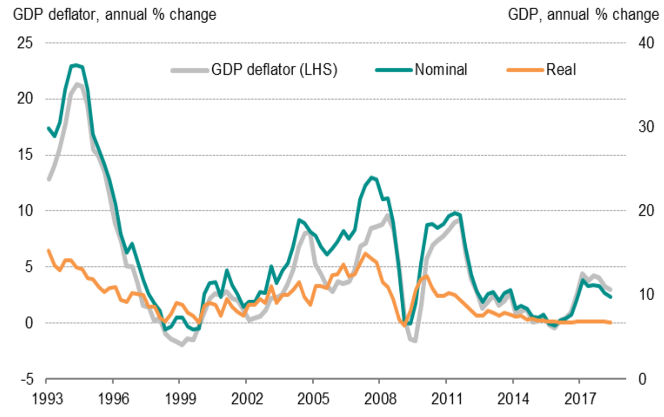
Our special focus this week looks at the factors driving India's currency crisis and the implications for 2019.

China GDP

The week features another busy data calendar for China, with third quarter GDP figures as the highlight. Analysts will keenly monitor the headline GDP numbers as the first official data on economic growth since the rollout of US tariffs on China's imports. The Chinese economy is expected to have slowed further to an annual real GDP rate of 6.6% in the three months to September, down from 6.7% in the second quarter, accompanied by a faster rise in prices. Latest PMI surveys pointed to resilient growth but also highlighted a sombre outlook in coming months amid rising concerns over trade wars.

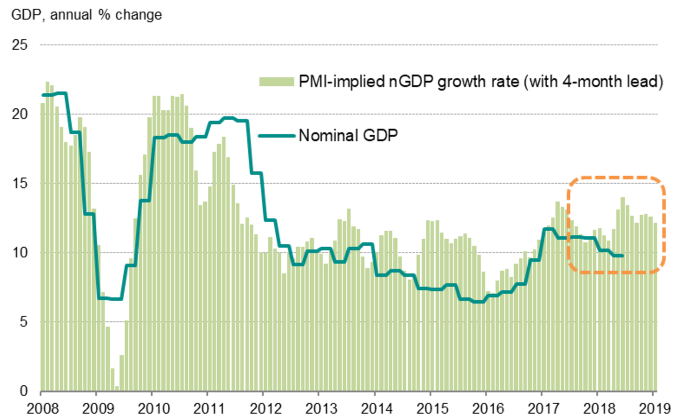
Other data highlights in China includes inflation, fixed asset investments, industrial production and retail sales, all of which will provide further clues as to the health of the economy and price trends.

China GDP: Nominal v Real



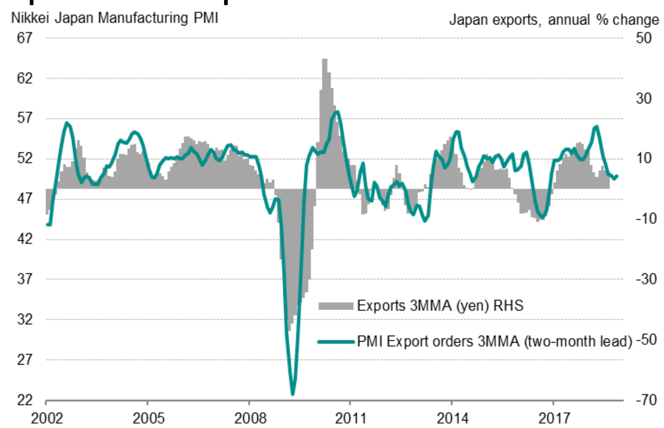
Source: NBS, IHS Markit calculations

China PMI-implied nominal GDP growth rates



Sources: IHS Markit, Caixin, NBS

Japan PMI and exports



Sources: IHS Markit, Nikkei, MOF

Continued…

Japan trade and CPI updates

September trade data are expected to show annual growth of Japanese goods exports moderating to 5.6%, down from 6.6% in August, mainly reflecting the deterioration in global trade conditions. The export growth trend is likely to remain well below 10% over the next couple of months, according to the latest Nikkei PMI's gauge for export orders, which exhibits a near 80% correlation with official export figures.

Bank of Japan watchers will meanwhile monitor inflation data. The consensus is for core inflation (the BoJ's preferred gauge) to increase at a 0.9% annual rate in September, the same as the previous month and well below the 2% target. Comparisons of Nikkei PMI and official data suggest that a markedly higher PMI Output Price Index (a reading of around 54 against the current reading of around 52) needs to be seen for core inflation to reach the target rate.

Singapore exports

Singapore's non-oil exports are projected to grow by an annual rate of 5.3% in September, up very slightly from 5% in August. Attention will be paid to the performance of electronics shipments amid signs of some waning of the global electronics upturn. The September update to trade numbers will provide clues as to whether advance third quarter GDP numbers will see any revision in the final estimates.

US and European interest rate guidance

Elsewhere, the month sees some important updates to assist with interest rate guidance in the US, UK and Eurozone. The FOMC minutes will be accompanied by fresh data on US industrial production and retail sales, all of which will be eyed for confirmation of Fed chair Powell's view that the US economy is currently enjoying a "bright moment" and that interest rates are therefore set to rise again soon. Most FOMC members (12 out of 16, up from 7 in June) expect a total of four rate hikes in 2018, meaning one more is pencilled in, likely December. Both manufacturing output and retail sales are expected to show robust monthly gains.

In the UK, the Bank of England will be expecting to see wage growth accelerate amid a tightening labour market when the employment numbers are updated, UK inflation meanwhile hit a six-month high of 2.7% in August and is likely to have remained elevated in September. Retail sales are also expected to have risen solidly in September.

Eurozone inflation numbers for September are meanwhile updated. The flash reading showed an annual rise of 2.1%

Monday 15 October

Indonesia trade (Sep)

Japan industrial production (final, Aug)

India WPI and trade balance (Sep)

US retail sales (Sep) and NY Empire State manufacturing index (Oct)

Tuesday 16 October

New Zealand inflation (Q3)

RBA meeting minutes

China inflation (Sep)

UK jobless rate and average earnings (Aug)

UK employment change (Jul) and claimant count change (Sep)

Euro area and Germany ZEW surveys (Oct)

Italy inflation (final, Sep)

US industrial production (Sep) and JOLTs job report (Aug)

Wednesday 17 October

Singapore NODX and trade balance (Sep)

UK inflation (Sep)

Euro area inflation (Sep) and construction output (Aug)

US building permits and housing starts (Sep)

Russia retail sales, jobless rate and wage growth (Sep)

Thursday 18 October

FOMC minutes

Japan trade (Sep)

Australia employment change and jobless rate (Sep)

UK retail sales (Sep)

US Philadelphia Fed manufacturing index (Oct)

Friday 19 October

Japan inflation (Sep)

China GDP (Q3)

China fixed asset investment (YTD, Sep), industrial production and retail sales (Sep)

Hong Kong unemployment rate (Sep) and business confidence (Q4)

Brazil business confidence (Oct)

US existing home sales (Sep)

By Bernard Aw, Principal Economist, IHS Markit

Special Focus

Can India Stem the Rupee's Slide?

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

A widening current account deficit, exacerbated by higher world oil prices, combined with portfolio capital outflows and continuing financial sector fragilities, means downward pressure on the Indian rupee has intensified in recent months.

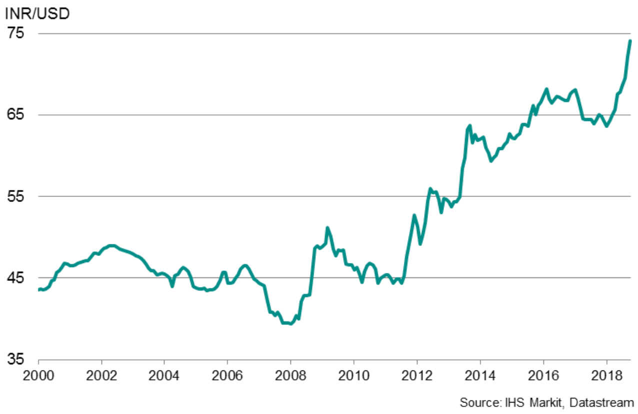
Overview

Oscar Wilde's delightful play 'The Importance of Being Earnest' was first performed in 1895 in the St James's Theatre in London. The play contained a sentence that has become much beloved by economists writing about the Indian economy in recent decades, as India has suffered repeated external account crises. Between 1873 and 1892, the rupee had plunged against sterling following the global decline in the value of silver, triggering Oscar Wilde's famous comic line about the rupee, spoken by the English governess Miss Prism as she instructs her young charge Cecily.

> *Miss Prism. "Cecily, you will read your Political Economy in my absence. The chapter on the Fall of the Rupee you may omit. It is somewhat too sensational. Even these metallic problems have their melodramatic side."*
>
> Source: 'The Importance of Being Earnest' by Oscar Wilde.

Over a century later, the Indian rupee (INR) is again experiencing a sharp depreciation, falling to new record lows relative to the US dollar (USD) in October 2018, having depreciated by around 14% since the beginning of the year. Moreover, memories of the recent rupee crisis of 2012-13 during the second term of the Manmohan Singh-led government are still very fresh.

Indian Rupee Slides against the USD



The latest INR depreciation has occurred against a background of broader weakness in many emerging markets currencies against the USD. This has included rather 'sensational' declines in the Turkish lira and Argentine peso and significant depreciations of the Indonesian rupiah, South African rand, Russian rouble and Brazilian real against the USD during 2018.

Meanwhile, in a currency crisis reminiscent of the German hyperinflation and the collapse of the German Reichsmark in 1923, the Venezuelan bolivar has become practically worthless as the economy has disintegrated from economic mismanagement that has resulted in hyperinflation.

Nevertheless, India should not draw much comfort in being part of the pack of worst-performing emerging markets currencies. Due to India's dependence on portfolio capital inflows to finance the large current account deficit, the slump of the rupee creates downside risks of capital flight and protracted portfolio capital outflows, which could further intensify rupee depreciation.

India's Vulnerability to Rising Oil Prices

Due to India's high level of dependency on imported oil and gas, which accounted for over 80% of Indian oil consumption in fiscal 2017-18, a key vulnerability for India is the impact of higher oil prices on the current account deficit. The deficit as a share of GDP had narrowed significantly in 2015 and 2016, as a result of the slump in world oil prices in late 2014.

However, with the rebound in world oil prices during 2017, Indian crude oil imports rose from USD 70 billion in fiscal year 2016-17 to USD 87.7 billion in fiscal year 2017-18, with the oil import bill set to widen further in 2018-19 to above USD 120 billion.

Indian gasoline demand has shown strong growth, rising by just under 8% on a year ago in August. Indian crude oil imports during April to August period of fiscal year 2018-19 have already risen to USD 58.8 billion, up by 54% compared to the same period a year ago. This has been a key factor contributing to India's widening current account deficit, which rose from 0.6% in 2016-17 to 1.9% in 2017-18, and is expected to widen further in 2018-19. India's current account deficit was USD 15.8 billion in Q1 (April to June quarter) of fiscal year 2018-19, equivalent to around 2.4% of GDP.

A key risk is from any upturn in consumer price inflation pressures due to higher oil prices. The Reserve Bank of India (RBI) has already hiked policy rates in June and August 2018, reflecting worries amongst the majority of the Monetary Policy Committee members about rising oil prices and risks of a broader upturn in inflation pressures. Further near-term tightening of monetary policy by the RBI would constrain growth momentum.

Portfolio Capital Outflows

Adding to depreciation pressures on the INR, the gradual tightening of monetary policy by the US Fed during 2018 has supported USD appreciation against many emerging markets' currencies, as US fixed income yields have risen relative to yields in many emerging markets. This has triggered portfolio capital outflows from many emerging markets during 2018, including from India. India recorded net portfolio capital outflows of USD 8.1 billion in the first quarter of fiscal year 2018-19, which compares with an inflow of USD 12.5 billion in the same quarter a year earlier and total portfolio inflows of USD 22.1 billion in fiscal year 2017-18.

This outflow has contributed to a significant depletion of official foreign exchange reserves in the April to June quarter of 2018, which fell by USD 11.3 billion. In contrast, an increase in FX reserves of USD 11.4 billion was seen in the same quarter of the previous year.

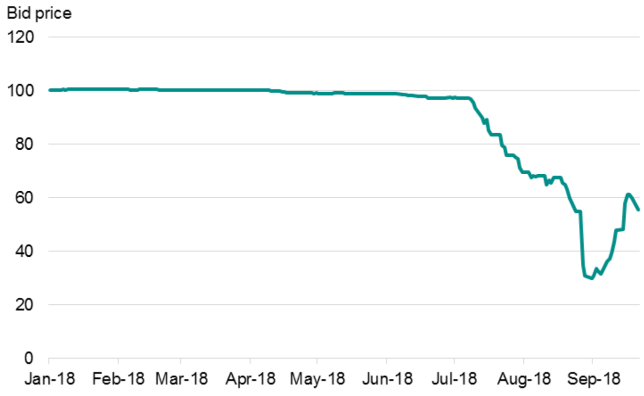
India's FX reserves have steadily declined from a peak of USD 426 billion in mid-April 2018 to USD 400 billion by end-September 2018, a decline of USD 26 billion over this six-month period. While the level of FX reserves still remains strong when measured by months of import cover, the pace of depletion of reserves signals the downside risks to the INR if FX reserves continue to be gradually eroded due to capital outflows and RBI intervention to smooth the INR depreciation.

The IL&FS Crisis

Adding to depreciation pressures on the INR, global investor concerns about fragilities in India's financial system have intensified following several bank loan defaults by Infrastructure Leasing & Financial Services (IL&FS), an Indian non-bank financial institution providing infrastructure financing. In early October 2018, the Indian government replaced the IL&FS board, as concerns mounted about potential contagion effects to the financial system from a broader IL&FS default.

The bond issued by its wholly owned subsidiary, ITNL Offshore Pte Limited, has experienced a slump in price, as the bond price tanked to less than half its face value just eight months after issuance amid credit rating downgrades to junk status, weakening liquidity profile and sizeable debt servicing obligations.

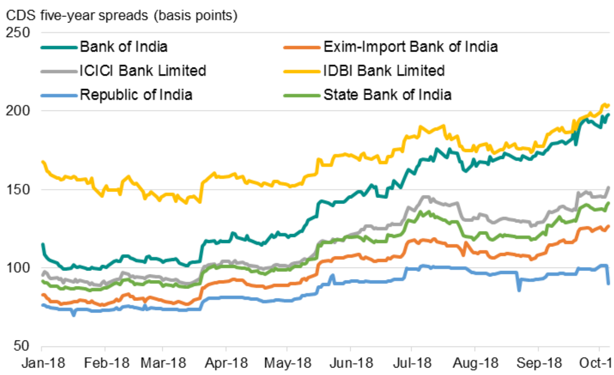
ITNL Offshore Pte Ltd senior unsecured 2021 bond



Source: IHS Markit.

Other non-bank financial firms could face a liquidity squeeze as banks curtail exposure to the infrastructure sector. This latest financial sector crisis comes after protracted problems in India's public sector banks, which had suffered from rising non-performing loans since 2012, and had triggered recent Indian government interventions to recapitalize the balance sheets of public sector banks. On 9th October, the State Bank of India, India's largest public sector bank, opened a facility to buy assets of other non-bank financial companies (NBFC), to alleviate liquidity pressures on NBFC firms which are facing difficulties in raising wholesale financing from money markets following the IL&FS defaults.

Credit default swaps



Source: IHS Markit.

Outlook

Although the momentum of economic growth remains strong, with GDP growth forecast to be slightly above 7% in 2018 and 2019, India faces external account vulnerabilities that continue to pose further downside risks for the INR over the next 12 to 18 months. These negative factors include the widening current account deficit, gradual erosion of FX reserves and the impact of portfolio capital outflows on the balance of payments. With Indian national elections due to be held in the first half of 2019, this could add to risk aversion by global investors.

The downside risk of further increases in world oil prices would also be a significant negative factor for the INR, due to India's high level of reliance on imported oil and gas.

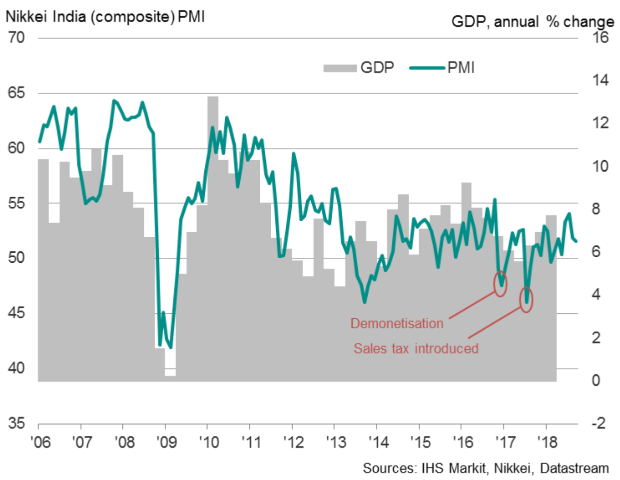
Therefore although India's macroeconomic fundamentals still look very favourable compared to many other large emerging markets, India's external account vulnerabilities and financial sector fragilities will be a key downside risk factor for the economic outlook in the lead-up to the 2019 national elections.

Economics trends in India

While economic growth in India remains well below that seen prior to the global financial crisis, the economy has shown resilience in the face of 'shocks' such as the country's demonetisation in late-2016 and the introduction of the goods and services tax in mid-2017. Both shocks led to a steep deterioration in the rate of growth indicated by the Nikkei PMI survey (compiled by IHS Markit), but the slowdowns proved short-lived.

More recently the upturn in price pressures has dampened the pace of economic growth and business optimism, as indicated by both the manufacturing and services PMI surveys, but the survey indicators remain at levels broadly consistent with the Indian economy expanding at an annual rate of approximately 7%.

Indian PMI and GDP



For more information on the PMI surveys contact economics@ihsmarkit.com.

For further information:

If you would like to receive this report on a regular basis, please email economics@ihsmarkit.com to be placed on the distribution list.

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