Economic commentary

14/12/2018

Week Ahead Asia-Pacific Economic Preview

- **Central banks to dominate market attention in coming week, with FOMC and BOE the key meetings to watch**
- **In Asia, Japan, Thailand, Indonesia and Taiwan also decide on monetary policy**
- **Taiwan export orders**
- **Special focus on India's central bank**

Several major central bank meetings will command market attention in the coming week, with policymakers in the US, UK and Japan all deciding on monetary policy while in Asia, central banks in Taiwan, Indonesia and Thailand will also set interest rates. Trade data from Japan, Singapore, Thailand and Taiwan will offer clues as to trade conditions across the region while the latest RBA's meeting minutes provide insights into future monetary policy moves.

Other data highlights for Asia include inflation figures for Japan, Malaysia and Hong Kong, New Zealand's third quarter GDP, and Australia's job data.

Our special focus this week looks at the challenges facing the incoming governor of India's central bank amid concerns about the bank's independence.

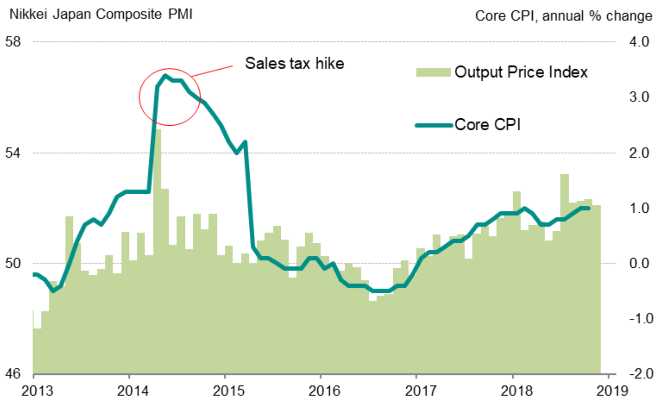
Bank of Japan

The Policy Board of the Bank of Japan meets next week to set interest rates, but markets widely expect monetary policy to remain unchanged. Analysts will eagerly parse the quarterly economic projections, particularly the BOJ's inflation estimates, to gauge the bank's views on the underlying health of the economy after GDP declined in the third quarter. Latest PMI surveys pointed to resilient growth and a fourth quarter rebound, but also warned that the upturn could slow in coming months as the post-typhoon demand boost fades. Other Japanese data updates includes inflation figures and trade performance.

Asia monetary policy

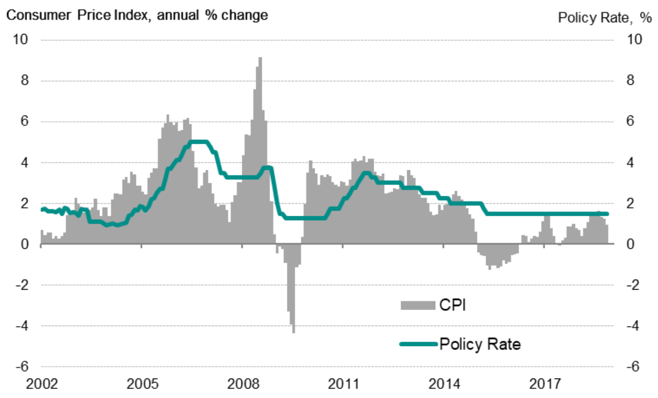
Indonesia, Thailand and Taiwan are also deciding on monetary policy in the coming week. Bank Indonesia's policy meeting will be keenly eyed following an unexpected rate hike in November. PMI data continued to point towards a slowing manufacturing sector, but firms faced strong inflationary pressures, partly due to a relative weak exchange rate.

Japan PMI and inflation



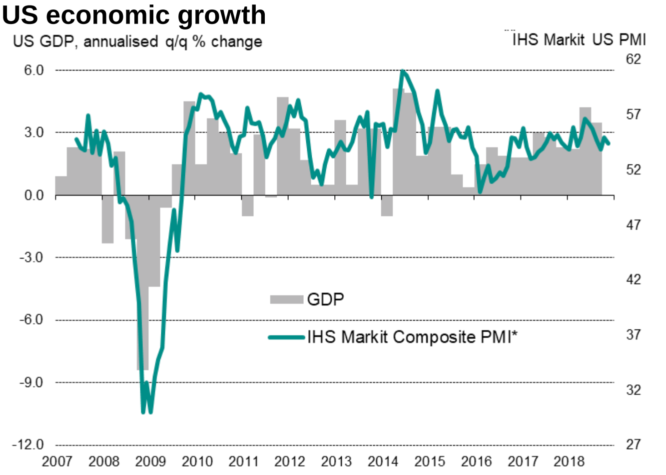
Sources: IHS Markit, Nikkei, MIAC

Thailand monetary policy and inflation



Sources: Ministry of Commerce, Bank of Thailand

US economic growth



Sources: HIS Markit, US Commerce Department.

Continued…

In Thailand, with November's close decision of 4-3 to maintain policy rates steady and increasingly hawkish signals coming from the central bank, analysts will eagerly await this year's final monetary policy meeting.

Taiwan's central bank is meanwhile expected to keep rates on hold amid increasing concerns regarding the adverse effects of the US-China trade war

FOMC and BOE rate decisions

Elsewhere, the FOMC is widely expected to lift US interest rates again to 2.25-2.50%, albeit with some uncertainty creeping in. What happens next year has also become more uncertain. Although current economic growth looks relatively robust, markets have begun pricing in a far slower pace of monetary tightening amid increasing concerns about the health of the US economy in 2019, as well as signs that inflationary pressures have started to cool. A 'dovish hike' is therefore being increasingly talked about for the December meeting, with the Fed likely to stress that it is not tied to any set course for future rate hikes, which will be data dependent.

The Bank of England's Monetary Policy Committee is meanwhile expected to sit on its hands, keeping rates on hold at its final meeting of the year. Although wage growth has picked up, in line with the bank's hawkish stance, business survey data and GDP numbers have indicated a marked moderation in the rate of economic growth as Brexit worries and business uncertainty have escalated.

Please note that the next Week Ahead will be published 4th January 2019.

We would therefore like to take this opportunity to send all our readers best wishes for the Christmas holidays and for 2019.

Monday 17 December

Singapore trade (Nov)

Euro area inflation (final, Nov)

Brazil business confidence (Dec)

UK Household Finance Index (Nov)

Tuesday 18 December

RBA meeting minutes

Hong Kong jobless rate (Nov)

Germany IFO surveys (Dec)

Brazil consumer confidence (Dec)

US building permits and housing starts (Nov)

Wednesday 19 December

Japan trade (Nov)

Malaysia inflation (Nov)

Thailand monetary policy decision

UK inflation (Nov)

Euro area construction output (Oct)

Russia jobless rate (Nov)

US current account (Q3)

Thursday 20 December

FOMC meeting and release of economic projections

New Zealand GDP (Q3) and trade (Nov)

Australia employment change and jobless rate (Nov)

BOJ monetary policy decision

Hong Kong inflation (Nov)

UK retail sales (Nov)

Indonesia monetary policy decision

BoE interest rate decision

US existing home sales (Nov)

Friday 21 December

Japan inflation (Nov)

Thailand trade (Nov)

Taiwan export orders (Nov) and interest rate decision

UK consumer confidence (Dec)

Germany consumer confidence (Jan)

France and UK GDP (final, Q3)

US durable goods orders (Nov)

US GDP (final, Q3) and PCE price index, personal income and spending (Nov)

Euro area consumer confidence (flash, Dec)

Special Focus

High Noon at India's Central Bank

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

Incoming RBI Governor Das will face a baptism of fire as he firefights on many fronts. Maintaining the independence and credibility of the Indian central bank will be one of his most important challenges in his first year of office.

Fears about future RBI Independence

Indian central bank governor Urjit Patel resigned on 10th December 2018, the second Reserve Bank of India (RBI) governor to quit during the past three years. His resignation has heightened concerns in global financial markets about the future independence of the RBI.

In 'Goldfinger', Ian Fleming's seventh novel in his James Bond series, published in 1959, the villainous Auric Goldfinger warns James Bond:

> *"Mr Bond, they have a saying in Chicago: 'Once is happenstance. Twice is coincidence. The third time it's enemy action'.*
>
> Extract from Goldfinger by Ian Fleming, 1959

With India ushering in its third governor since the veteran former RBI Governor Dr Subbarao stepped down in September 2013, global investors are increasingly concerned about the future independence of the central bank. The resignation of the acclaimed international economist Dr Raghuram Rajan as RBI Governor in September 2016 had already raised concerns in financial markets, due to Rajan's highly capable management of the RBI during his tenure.

Patel, with his track record as a Deputy Governor at the RBI, brought experience and continuity when he was appointed as the new RBI Governor. He had to manage the RBI through some turbulent times, including the Indian government's demonetization program when Prime Minister Modi announced the cancellation of all high value banknotes overnight, creating chaos in the Indian economy for months. The eventual finding of the RBI after the demonetization process had been completed was that 99.3% of all the cancelled banknotes had been returned through the banknote exchange program, casting doubt about the effectiveness of the draconian and disruptive demonetization process.

A key focus for the RBI during Patel's term had also been on tackling the rising non-performing loans and stressed assets in the public sector banks, which had resulted in a significant slowdown in credit expansion during 2016-17, constraining India's economic expansion.

Significant rifts had been evident during 2018 between the Indian government and the RBI on the stance of monetary policy as well as the potential alternative uses of RBI foreign exchange reserves. While these tensions had been papered over at the 19th November meeting of the RBI Central Board with the decision to appoint an expert committee to consider the Economic Capital Framework of the RBI, speculation had been mounting in financial markets that Governor Patel might resign as government pressures on the RBI's independence increased.

With key tasks of any central bank being to ensure stability of the financial system and conducting monetary policy to constrain inflation pressures, instability in the leadership of any central bank becomes a significant concern for international financial markets and global investors.

There will therefore be intense scrutiny from international financial markets of the new RBI governor appointed by the Modi government. The incoming governor is a retired former senior public servant, Shaktikanta Das, with extensive experience in high level roles in the Indian government, including Economic Affairs Secretary.

He will inherit a raft of difficult challenges, including ongoing management of RBI foreign exchange reserves, reviewing the appropriate use of FX reserves, and tackling the high level of non-performing loans in a number of public sector banks. The Indian government is seemingly keen to remove the 11 public sector banks and one private bank out of the Prompt Corrective Action (PCA) framework, which will enable short-term reprieve to capital constraints and boost lending, but this will mean the asset quality problem will persist in the Indian banking sector.

Risks to the Economic Outlook

Despite sustained rapid economic growth over the past decade, the Indian economy continues to face significant risks and over the medium-term outlook. The RBI will have a key role to play in addressing many of these risks and challenges.

An important medium-term risk to the Indian economic outlook and stability of the financial system is from the continuing problems facing the Indian banking sector, which has experienced rising non-performing loan ratios since 2012, particularly among the public sector banks. The Indian government announced another recapitalisation package for public sector banks in October 2017 amounting to INR 2.11 trillion, comprising a government capital injection of INR 1.53 trillion, with the balance to be raised from funding from capital markets by March 2019.

Despite various measures by the Indian government to recapitalize the public sector banks, their non-performing loan problems remain a constraint on the pace of expansion of the Indian economy. Many public sector banks continue to struggle with high non-performing loan ratios, increased capital needs to meet the Basel III capital requirements and the still slow bankruptcy process through the Indian courts.

From a banking risk perspective, the IHS Markit Banking Risk Service assesses that the RBI will be unlikely to relax or delay Basel III capital requirements as it is already lagging international norms (having already delayed the last tranche of the capital conservation buffer of 0.625% by one year to March 2020), and further delays would damage the banking sector's reputation.

Another key macroeconomic vulnerability is India's chronic current account deficit. The current account deficit as a share of GDP had narrowed significantly following the slump in world oil prices in 2014-16. However, with the rebound in world oil prices since 2017, Indian oil imports have risen 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.

At the core of the RBI mandate will be its role in containing risks from any upturn in inflation pressures, particularly given India's past experience of vulnerability to higher oil and food prices. The RBI had hiked policy rates in June and August 2018, reflecting concerns about rising oil prices, the impact of INR depreciation on import prices and the potential for a broader upturn in inflation pressures. However, some rifts became apparent with the Indian government due to the RBI's hawkish stance on monetary policy, at a time when the Indian government felt that additional liquidity was needed in the Indian financial system, particularly following the high profile default of Infrastructure Leasing & Financial Services (IL&FS) and the broader transmission effects on liquidity for non-bank financial companies (NBFCs).

Even though the central bank has already implemented a number of policies to incentivise banks to lend more to NBFCs, the now potential closer link between the RBI and the government may see further relaxation in terms of the aforementioned PCA and loan restructuring standards to further boost NBFC liquidity. If such a scenario unfolds, it could create more contagion risk to the banking sector as well as delaying the resolution of structural problems in the NBFC sector.

The new RBI governor takes office just ahead of Indian national elections, which are due to be held by May 2019. The current BJP government has a majority in the Lok Sabha, India's lower house of parliament, albeit without a majority in the Indian upper house, the Rajya Sabha. However, if the next government is more reliant on coalition partners to pass legislation, this could impede the pace of economic reforms.

The risk of any weakening of economic reform momentum under the next government could add to India's external account vulnerability, particularly if portfolio capital outflows trigger further INR depreciation, which could put the spotlight on the RBI's role in managing FX reserves and smoothing INR volatility.

Indian rupee per US dollar

Sources: IHS Markit, Datastream

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.

Contact for further APAC commentary:
Rajiv.Biswas@ihsmarkit.com or Bernard.Aw@ihsmarkit.com.

Editor and contact for European and US PMI commentary:
chris.williamson@ihsmarkit.com