20 July 2018
Asia

Asian FX TalkING

Helmets on!

The time for talking, threats and counter threats has passed. Tariffs are now being imposed, and the damage to the regional and global economy will follow. We believe that Asian GDP and FX will be particularly vulnerable to the impacts of this developing trade war. Last month we changed our FX forecasts, this month we have also cut our GDP assumptions.

Even before the phoney trade war was over, when all that we had was threats of tariffs and retaliation, Asian FX started to take a beating.

Over the last three months, all Asian currencies are weaker. Most of them by 4% or more. The CNY has led the charge, with the PBoC tolerating weakness of more than 7% – a marked change from the deliberate appreciation engineered earlier this year.

Another victim of Asian currency weakness, the KRW, was hit early on by concern about the tech industry, though we believe that this will be transitory. The Fragile-3, India, Indonesia and the Philippines, though initially hit hard, have benefited to different degrees due to their central banks' tightening of policy. Excluding the Hong Kong dollar, the Philippine peso is Asia's best performing currency on a 1 and 3 month basis.

The next wave of the trade war may hit Asia's commodity currencies hardest (MYR and IDR). But as the trade war moves away from talk to become more of a reality, smaller very open economies and their currencies (SGD) are likely to suffer more.

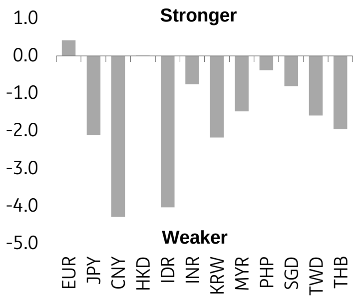
In short, the outlook is negative, but likely to unfurl in multiple, and possibly overlapping waves. There will probably be more central bank tightening action than we had previously believed - not because of growth, but to prop up weakening currencies and cap inflation. There are too many moving parts to this story to be precise about timing. But the direction is clear.

ING's 12-month currency view vis-à-vis forward/NDF market forecasts

	USD/CNY		USD/INR		USD/IDR	
Spot	**6.7727**		**68.87**		**14525**	
1M	6.8000	=	69.20	=	14540	=
3M	6.9000	>	70.10	>	14630	<
6M	7.0000	>	71.50	>	14660	<
12M	6.8000	=	72.80	>	14550	<
	USD/KRW		**USD/MYR**		**USD/PHP**	
Spot	**1134**		**4.0628**		**53.50**	
1M	1140	>	4.1000	>	53.75	=
3M	1150	>	4.2000	>	54.50	>
6M	1180	>	4.3500	>	54.10	=
12M	1150	>	4.1500	>	54.90	=
	USD/SGD		**USD/TWD**		**USD/THB**	
Spot	**1.3680**		**30.69**		**33.39**	
1M	1.3750	>	30.60	=	33.60	>
3M	1.3900	>	30.80	>	34.20	>
6M	1.4200	>	31.00	>	35.00	>
12M	1.3700	>	30.70	>	34.30	>

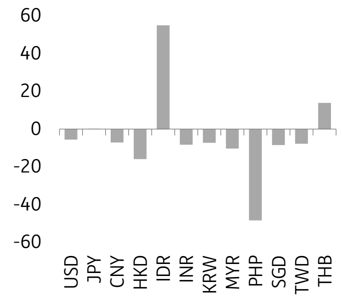
> / = / < indicates our forecast for the currency pair is above/in line with/below the corresponding market forward or NDF outright. Prices as on July 20, 2018 at 3pm Singapore time
Source: Bloomberg, ING estimates

Exchange rates vs USD (%MoM)



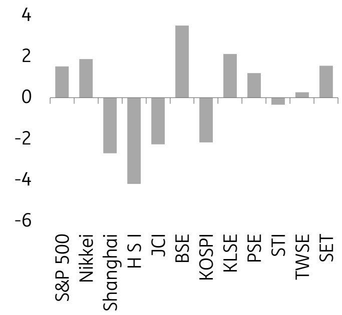
Source: Bloomberg

10Y local currency gov't bond yields (MoM bp)



Source: Bloomberg

Stock indices (%MoM)



Source: Bloomberg

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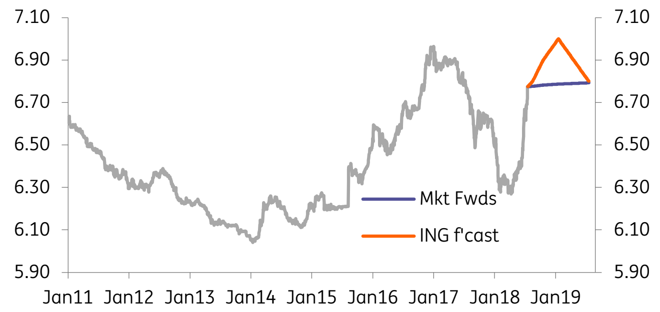
USD/CNY

Weaker daily fixing signals an even weaker yuan

Current spot: 6.7727



Source: Bloomberg, ING

- The US announcement to impose 10% tariffs on US$200bn worth of goods surprised markets on 10 July. The yuan reacted by weakening further.
- Since then China's government has calmed asset markets by talking down the risks of a trade war on the economy.
- But the central bank has weakened the yuan daily fixing rate bit by bit. This signals a weaker yuan trend ahead - even intraday volatilities sometimes push yuan closing slightly stronger.
- The yuan will weaken even more if the US does not limit the tariff rate and/or the amount of goods to face tariffs by 30 August.

ING forecasts (FWDs)	**1M** 6.8000 (6.7753)	**3M** 6.9000 (6.7808)	**6M** 7.0000 (6.7855)	**12M** 6.8000 (6.7915)

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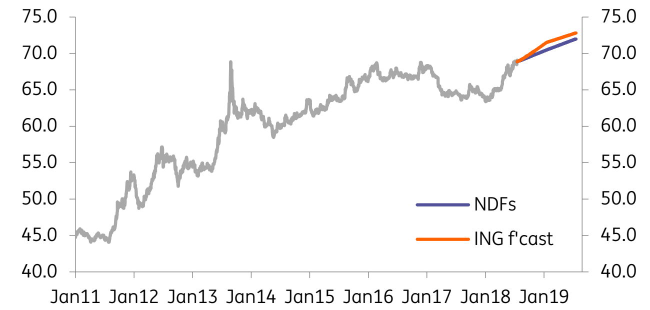
USD/INR

Some stability, but not forever

Current spot: 68.87



Source: Bloomberg, ING

- The depreciation pressure on the INR has eased a bit since June, swinging the currency from underperformer to outperformer in the region. But the worst isn't over yet, as high oil imports cause the trade deficit to balloon. The $45bn deficit in 1Q F18-19 was $5bn wider on the year, and half of it was from oil.
- The economy slowed coming into FY2018-19 on weaker manufacturing, an increasing drag from net exports, and elevated inflation. We have cut our GDP growth forecast for the current financial year from 7.2% to 6.7%.
- A weak currency, leading to rising import prices worsens the inflation outlook. CPI inflation rose to 5% in June. RBI policy remains on track for a second rate hike at the August meeting. We now forecast one more hike in October.

ING forecasts (FWDs)	**1M** 69.20 (69.10)	**3M** 70.10 (69.67)	**6M** 71.50 (70.48)	**12M** 72.80 (72.00)

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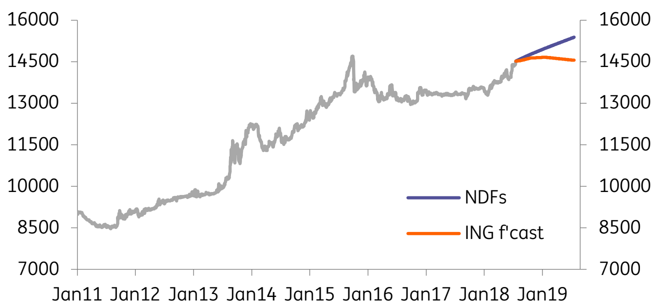
USD/IDR

BI remains vigilant

Current spot: 14525



Source: Bloomberg, ING

- Bank Indonesia (BI) and the government remain in stabilization mode following 100bp of hikes since May.
- IDR has traded in a range of IDR14350 to IDR14480 since BI's aggressive 50bp rate hike at its last policy rate meeting. With a more stable IDR, BI paused at the July 19 meeting.
- The Hawkish tone remains. BI stands ready to act against any instability or significant weakness of the IDR. We expect IDR to gradually weaken in the next twelve months as BI resumes its tightening cycle in 3Q or 4Q with a total of another 75bp of hikes by end 2019. Presidential elections raise leadership and policy uncertainties. A worsening current account deficit, global trade tensions and continued US monetary policy tightening add to the local concerns.

ING forecasts (NDFs)	**1M** 14540 (14604)	**3M** 14630 (14765)	**6M** 14660 (14985)	**12M** 14550 (15385)

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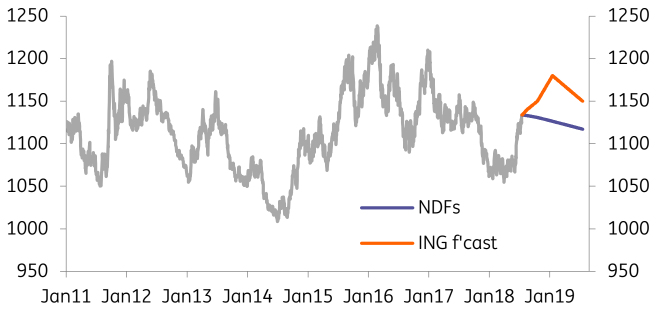
USD/KRW

Down, but not out

Current spot: 1134



Source: Bloomberg, ING

- If there was a peace dividend for the KRW following the Trump-Kim 'love-In' in Singapore, we can't spot it. Concern about the tech industry in the wake of China's ZTE issues with the US may be partly to blame for the KRW's regional underperformance.
- But the Korean economy has also not been looking nearly as good as it had, with exports and production slowing. This is partially transitory, the result of an old-fashioned inventory cycle. That said, there is a lasting impact, and we have trimmed our GDP forecasts as a result (2019 now 2.3% from 2.6%), and also because of the likely impact of the trade war.
- While central bank action does not look imminent, the weakness of the currency has caused import prices to spike. An eventual BoK response will depend on how the KRW evolves from now.

ING forecasts (NDFs)	**1M** 1140 (1133)	**3M** 1150 (1131)	**6M** 1180 (1126)	**12M** 1150 (1117)

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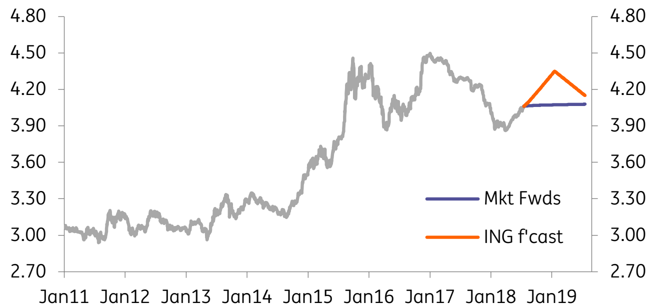
USD/MYR

Trade war clouds economic outlook

Current spot: 4.0628



Source: Bloomberg, ING

- We have revised our USD/MYR forecast higher on our view that the pass-through of weak global trade to commodity prices, and then to Malaysia's export weakness, will shift the MYR from being Asia's outperformer to being one of its underperformer in the rest of the year.
- Weak exports have already started to depress manufacturing, a sign that the Malaysia's GDP growth is poised to slow. The second quarter GDP data due in mid-August will testify to this. We have cut our GDP growth forecast for 2018 to 5.2% from 5.5%.
- We have also cut our inflation forecast for this year to 1.0% from 1.8%, as 'removal' of the GST tax dented inflation below 1%. This allows more scope for stable BNM rate policy to support GDP growth.

ING forecasts (FWDs)	**1M** 4.1000 (4.0668)	**3M** 4.2000 (4.0709)	**6M** 4.3500 (4.0741)	**12M** 4.1500 (4.0791)

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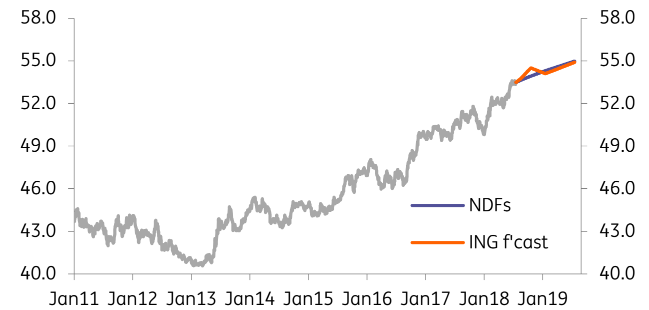
USD/PHP

Central bank is reluctant to take aggressive action

Current spot: 53.50



Source: Bloomberg, ING

- The PHP has stabilized since the central bank (BSP) decided to raise policy rates a second time this year in June. Some hawkish tone as well as direct market intervention has kept PHP in a narrow range of PHP53.20 to PHP53.55.
- Talk of a more aggressive BSP action came after the upside inflation surprise for June. The market started to entertain views of a 50bp hike at the next meeting, as second round effects on prices kept inflation on a rising trend. The market considers the BSP to be behind the curve with real policy rates at -1.7% in June.
- However, the recent central bank tone has dialled back policy rate expectations. A key monetary official indicated that the next policy rate hike of 25bps would likely be the last this year. Direct intervention through the use of its FX reserves is likely to continue to moderate any weakness.

ING forecasts (NDFs)	**1M** 53.75 (53.65)	**3M** 54.50 (53.93)	**6M** 54.10 (54.32)	**12M** 54.90 (54.97)

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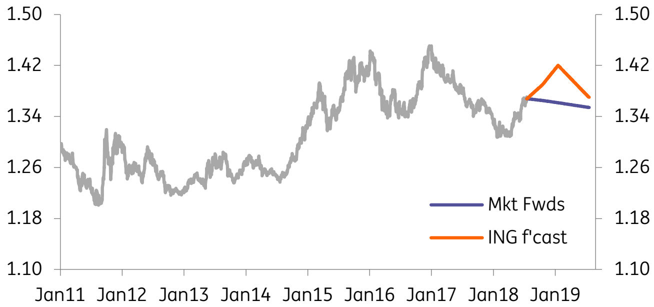
USD/SGD

Change of underlying assumptions

Current spot: 1.3680



Source: Bloomberg, ING

- The SGD has barely depreciated any less than any of its ASEAN neighbours over the last three months (Baht excluded). That suggests that the NEER has been broadly flat, rather than modestly appreciating as the MAS indicated at the April meeting.
- Indeed, the SGD NEER is broadly unchanged since April, which suggests that if this policy is still in place, it doesn't seem to be being followed mechanically.
- Indeed, recent economic performance has been quite disappointing – June NODX in particular. And we can envisage the MAS slipping policy back to neutral at the October meeting, as the Singaporean economy is vulnerable to a regional and global slowdown. We have cut our 2019 GDP forecasts this month from 2.7% to 2.5% (2018 now 2.8% from 3.2%).

ING forecasts (FWDs)	**1M** 1.3750 (1.3671)	**3M** 1.3900 (1.3652)	**6M** 1.4200 (1.3617)	**12M** 1.3700 (1.3543)

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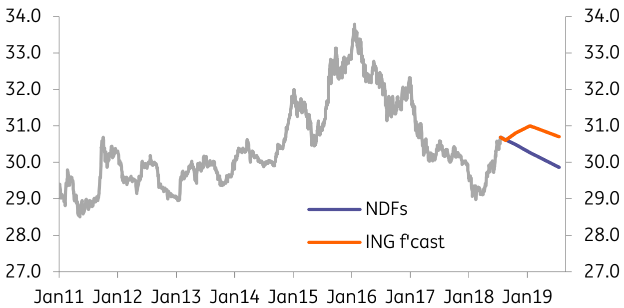
USD/TWD

Taiwan central bank – can't hike, no need to cut

Current spot: 30.69



Source: Bloomberg, ING

- The beginning of the bilateral trade war between China and the US could benefit economies that produce substitute goods. Taiwan may be one of them. It produces electronic machinery, which can substitute for Chinese production. Agriculture too, can substitute for US produce.
- But if the trade war is long-lasting (over a year), then even economies that produce substitute goods could be unable to avoid falling profits, reduced business opportunities, and even job cuts.
- We do not think the Taiwan central bank has room to raise interest rate against this backdrop. But the economy is not bad enough to merit rate cuts either. Policy will likely remain on hold.

ING forecasts (NDFs)	**1M** 30.60 (30.63)	**3M** 30.80 (30.49)	**6M** 31.00 (30.27)	**12M** 30.70 (29.86)

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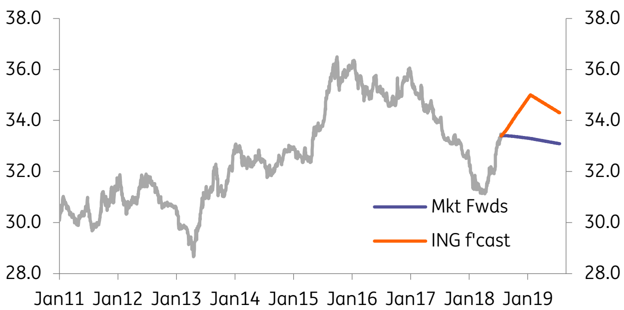
USD/THB

Falling trade surplus

Current spot: 33.40



Source: Bloomberg, ING

- The THB has lost 4.4% of its value against the USD since June, the third-most after the KRW and the CNY. This comes as a test of claims of insensitivity of local financial markets to external turmoil due to low foreign ownership.
- A shift of the THB from Asia's outperformer in 2017 to underperformer this year may be ascribed to Thailand's falling trade surplus. The $1.9bn trade surplus in the first five months of 2018 was $3.8bn narrower than year ago. This was associated with $1.4bn narrowing in the current surplus to $17.3bn.
- The global trade war raises the risk of GDP growth slipping below 4% and inflation ticking higher in the rest of 2018. We don't think the central bank (BoT) will rush to tighten policy this year.

ING forecasts (FWDs)	**1M** 33.60 (33.41)	**3M** 34.20 (33.37)	**6M** 35.00 (33.30)	**12M** 34.30 (33.10)

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