Asia Morning Bites

Asian markets respond to thoughts of more and quicker rate hikes from the Fed ahead of this week's meeting

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Macro outlook

- **Global**: Risk assets didn't respond favourably to the surprisingly high US May CPI release, which showed inflation accelerating to 8.6%YoY, above its previous high, and against expectations for a small decline. The S&P500 fell by close to 3% on Friday, the NASDAQ fell more than 3.5%. This now puts the S&P500 within one bad day's move of a bear market, and equity futures suggest that we haven't seen all the negative sentiment expressed yet. The higher inflation rates (core was also higher than expected at 6.0%) have caused a substantial rethink of the Fed. The Market now expects not just more front loading of rates, but a higher peak too. Peak Fed funds now comes in at about 3.79% by mid-2023, and by the end of the year, Fed funds futures contracts imply a rate of about 3.17%, up from about 2.78% on Friday before the inflation figures. The upshot of this is that 2Y US Treasury yields have surged by more than 25bp to 3.063%, while the 10Y rate rose only 11.4bp to 3.156%. For those worried about recession, the 2s10s spread is now less than 10bp, too close for comfort. For those who claim that the 3m10Y spread is the better measure of recession risks, that gap is still wide, but then you don't have to be a rocket scientist to see where 3m rates will be by year-end if the Fed funds rate ends at 3.17% as is currently priced by markets. Even without adding a term premium to the Fed funds rate, we are effectively pricing in curve inversion now.

- Not surprisingly, the slump in market risk appetite has buoyed the USD, and the rise in yields probably also helped. EURUSD is now back below 1.05, down from its Friday open of 1.0729. The AUD has also taken a beating, and is now down to 0.7030, while the JPY has been steadier, and remains in the mid-134s. We probably haven't seen the full extent of passthrough to the Asian FX basket yet. Friday's price action was negative, except for the IDR, which eked out a small gain. Otherwise, losses were led by the KRW and THB, with USDCNY also pushing back above 6.70. Potentially adding to the negative sentiment today, a resumption of mass testing in Shanghai and Beijing in the face of some new Covid cases has sparked fears of a return to lockdown. There is little of interest in today's G-7 macro calendar.

- **China**: Loans tripled in May to CNY1890 bn from 645 bn in April. Aggregate finance also tripled. This mainly comes from the government's urge to banks to increase loan growth to support the economy. Most of the loan growth came from corporates. The increase in aggregate finance came from bank loans and central and local government bond issuance. There was a jump in bill-financing and increased loans and deposits from corporates. Overall, the data implies that the increase in credit will be used on infrastructure spending and SOEs.

  Regarding the 1Y Medium Lending Facility rate (to be released between 13th to 16th June), we expect no change from the current rate of 2.85% for this month as the central bank will use more targeted instruments like re-lending facilities to help SMEs to recover from the lockdowns.

What to look out for: FOMC meeting

- India CPI inflation (13 June)
- Japan industrial production (14 June)
- India trade balance (14 June)
- Philippines remittances (14 June)
- US PPI inflation (14 June)
- South Korea unemployment (15 June)
- Japan core machine orders (15 June)Australia consumer confidence (15 June)
- China 1-year medium term lending (15 June)
- US retail sales (15 June)
- FOMC meeting (16 June)
- Taiwan CBC meeting (16 June)
- New Zealand GDP (16 June)
- Japan trade balance (16 June)
- Australia employment change (16 June)
- BoE meeting (16 June)
- US initial jobless claims, building permits and housing starts (16 June)
- Singapore NODX (17 June)

- Malaysia trade (17 June)
- BoJ meeting (17 June)
- US industrial production (17 June)

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