Asia Morning Bites

Inflation worries likely to dampen sentiment again on Tuesday

Source: shutterstock

Macro outlook

- **Global:** The last 24 hours has seen a lot more market "noise" on the Russia-Ukraine War, with some stories citing optimism about progress in talks as an excuse for some commodities to fall, and still others talking about the possibility of China aiding Russia militarily, which would work the other way if true. With "truth" always being the first casualty of war, we're not sure how much if any weight should be put on either of these conflicting stories, though it adds to the daily volatility. What we can say with some certainty, as it is in market data in black and white, is that bonds took a beating yesterday. And for once, it was the back end of the yield curve that sold off the hardest. 10Y UST yields rose 14bp compared to only 11bp for their 2Y counterparts. There is an argument that the inflation expectation upside for yields is becoming greater than any upside in policy rates, so the flattener-steepener debate may be shifting. Benchmark FX didn't do too much yesterday. EURUSD is now about 1.0935, compared to 1.0930 this time yesterday, though it did have a couple of attempts to go higher – both failed to hold. And the AUD has moved lower to about 0.72 along with some of the commodities that underpin its external valuation. Other APAC FX is looking a lot weaker now, including the CNY, where stock outflows seem to be part of the story – that may be tied to fears of future sanctions in the event that China does play a more active role in the Russia-Ukraine conflict, together with the dampening effect of covid outbreaks. In any event, CNY has been a solid anchor in the region, so if that is beginning to shift, there could well be more collateral damage to the rest of APAC FX.

- **G-7** data is limited today, though Germany releases its headline sentiment index, the ZEW survey, where consensus expectations are for a sharp decline. We will also see US PPI for February released, where a double-digit year-on-year growth rate is possible.
- **General Asia and Pacific**: Asia's data calendar on Tuesday features several data releases from China on top of trade reports out from India and Indonesia.
- **Australia:** The 4Q21 house price index rose more than expected, reaching 23.7%YoY, up from 21.7%YoY in 3Q21 (21.9% expected). There have been some signs in major urban areas that price increases are topping out, so this may be close to the peak. Though with the AUD showing some renewed signs of softness, and bond yields and spreads over US Treasuries widening out, it adds some pressure onto the Reserve Bank of Australia to consider some normalisation of policy rates this year.
- **China**: Activity data for January to February, including retail sales, industrial production and fixed asset investment will be released this morning. We expect weak retail sales will result from strict people flows during the Chinese New Year holiday as well as lower spending power from bonus cuts for those working for big tech companies. We believe fixed asset investments had a slow start to the year. Most local governments waited for the Two Sessions for direction on what type of infrastructure projects to spend on. Industrial production should also start the year slower on supply chain disruption. The 1Y Medium Lending Facility should be cut to 2.75% from 2.85% together with a full roll over of the facility for another year to keep liquidity stable.
- **Korea:** Import prices (KRW basis) rose 29.4% YoY in February mostly due to higher commodity prices and the weaker currency. The increase mostly came from raw materials and intermediate goods which rose by 57.7% and 24.8% respectively while capital and consumption goods prices gained at the relatively stable pace of 6.8% and 7.1% respectively. Currency effects also pushed up import prices as contract currency-based import prices rose at 21.5%. Given the recent weakness in the KRW and higher Dubai crude prices, these upside price pressures will continue in the coming months. Exports prices (KRW basis) rose 20.3% YoY. So it looks like exporters are passing on some of the input price increase to output prices.
- **Indonesia**: Indonesia reports trade figures on Tuesday. Exports and imports are forecast to show strong double-digit gains with exports surging as the ban on coal shipments was lifted. Meanwhile, imports are expected to rise sharply as capital goods shipments trend higher. The overall trade balance may improve to $1.7 bn. In the coming months, we expect this trend of outsized gains for exports and imports to continue as rising commodity prices bloat both exports and imports. Pricier wheat, a key commodity import from the conflict area, could however impact domestic food prices.

What to look out for: China activity data and geopolitical developments

- China retail sales and industrial production (15 March)
- Indonesia trade balance (15 March)
- India trade balance (15 March)
- US PPI inflation (15 March)
- Japan trade balance and industrial production (16 March)
- US Retail sales (16 March)

- Fed policy meeting (17 March)
- Australia labor market (17 March)
- Singapore NODX (17 March)
- Taiwan central bank policy meeting (17 March)
- Bank Indonesia policy meeting (17 March)
- US initial jobless claims, industrial production (17 March)
- Japan CPI inflation (18 March)
- Malaysia trade balance (18 March)

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