

Good MornING Asia - 1 March 2021

Asian markets likely to see muted moves on Monday

In this bundle



Asia Morning Bites

ASEAN Morning Bytes

Asian markets likely to see muted moves on Monday

By Nicholas Mapa



China

China: Manufacturing activities expanded even during the holiday

Staying at work locations to spend the Chinese New Year helped manufacturing activities. Looking ahead, domestic demand should be solid but external...



Singapore

Singapore's manufacturing surpasses forecasts again in January

On the heels of strong exports growth, Singapore's manufacturing data confirms that the economy is off to a strong start in 2021, which provides more...



New Zealand's central bank is starting to feel the hawkish pressure

The New Zealand government has amended its central bank's remit to include house price considerations when setting monetary policy. This...

By Francesco Pesole

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EM Space: Sentiment to take its cue from data this week, kicked off by regional manufacturing reports

- **General Asia:** Asian markets will likely move cautiously to open the week with investors smarting from last week's upheaval. Market participants will be looking for evidence that would solidify expectations for faster growth and inflation with regional data set for release on Monday although Fed speakers will likely offload dovish commentary to calm frayed nerves. Manufacturing reports are scheduled for release in the US later on Monday with investors also monitoring developments related to the US rescue plan with Joe Biden's aggressive stimulus plan was approved by the lower house over the weekend. For the rest of the week, market participants will take their cue from manufacturing and services data with investors also eyeing the US jobs report on Friday and Covid-19 developments for further direction.
- **Singapore:** Surprisingly strong January industrial production growth of 8.6% YoY is further evidence of the export-driven recovery remaining on a strong footing. This suggests to us that year-on-year GDP growth could swing to a positive reading in the current quarter (from -2.4% YoY in 4Q20). We are revising our growth forecast for 1Q21 from -2.7% YoY to 0.2% and for full-year 2021 to 4.9% from 3.8%, putting it close to the government's 4-6% forecast range for the year. There is no change in our view of the MAS maintaining its neutral policy throughout the year. The USD/SGD has been firm in the 1.32-1.33 trading range during the recent rout. Our end-year forecast for this pair remains at 1.30.

- **Indonesia:** Indonesia will report CPI inflation for February later today with the market consensus pointing to a 1.4% increase in prices. Inflation will likely remain below Bank Indonesia's (BI) target of 2-4% as economic activity remains subdued due to the recession with authorities looking to measures to bolster sagging growth momentum. We expect inflation to remain below target in the near term although we do not expect BI to trim borrowing costs further as IDR comes under renewed pressure.
- **Philippines:** The Philippines received 600,000 doses over the weekend donated by China as the country struggles to secure vaccines from its other prospective suppliers. President Duterte ordered the start of the vaccination drive with symbolic inoculations scheduled on Monday with prominent government officials set to take their jab in front of television cameras. The president has also indicated that he is considering lowering quarantine restrictions once the vaccination rollout is underway although current quarantine restrictions have recently been extended into March.

What to look out for: Regional manufacturing data and Covid-19 developments

- Regional PMI manufacturing (1 March)
- Philippines bank lending and money supply (1 March)
- China Caixin PMI manufacturing (1 March)
- Indonesia CPI inflation (1 March)
- US ISM manufacturing (1 March)
- Taiwan PMI manufacturing (2 March)
- Singapore PMI manufacturing (2 March)
- China Caixin PMI services (3 March)
- US ADP employment, ISM services (3 March)
- Malaysia BNM policy meeting (4 March)
- US initial jobless claims durable goods and factory orders (4 March)
- Philippines CPI inflation (5 March)
- Thailand CPI inflation (5 March)
- Singapore retail sales (5 March)
- US nonfarm payrolls (5 March)

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

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Manufacturing activities outpaced our expectation

Manufacturing PMI was 50.6 in February and fell from 51.3 in January, but is still expanding.

This signals some factory workers were still working during the Chinese New Year, where manufacturing activities sub PMI was 51.3 in the month, having fallen from 53.5 in the previous month. This should be the result of workers staying at work locations to spend the Chinese New Year. Some workers found a nice salary working during the holidays. Domestic orders continued to stay above 50 at 51.5 from 52.3 in January.

But external demand fell to contraction level at 48.8 in February from 50.2 before the Chinese New Year. That reflects the fact that Covid-19 cases were still high in export markets.

Honestly, the manufacturing PMIs surpassed our expectation, and shows that domestic demand can continue to support the manufacturing sector. This demand came from the technology sector, commodity sector and the construction sector.

51.5

New domestic orders

Manufacturing PMI

48.9

New domestic orders

Non-manufacturing PMI

Service demand expanded but not as great as we thought

Non-manufacturing PMI was 51.4 in February down from 52.4. We expected domestic orders would expand in the month but it continued to shrink from January's 48.7 to February's 48.9. This could largely be a result of continual limited orders for transportation services, both from inbound and outbound travels, as well as a lower expectation of sales after the long holiday. The next long holiday is in May.

We expect retail sales to jump over 10% year-on-year as domestic demand should be solid from job stability and wage increases. But we won't get this data until the end of March as the first three months' data are usually reported as quarterly data to avoid seasonal misalignment from the Chinese New Year.

Within all the categories of retail sales, **we expect catering to resume to positive growth, which is an important indicator to show that the Covid impact on the Chinese service economy continues to fade, but a full recovery is yet to come with travel restrictions.**

Singapore's manufacturing surpasses forecasts again in January

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Source: Shutterstock

8.6% January IP growth
Year-on-year
Higher than expected

Another upside manufacturing surprise ...

January turned out to be the third consecutive month that Singapore's industrial production growth surprised on the upside.

Coming in at 8.6% year-on-year, it was more than twice the consensus median growth estimate and faster than our 6.4% YoY forecast. December growth was revised higher to 16.2% YoY from the initial reading of 14.3%.

We are reviewing our -2.7% YoY GDP growth forecast for the current quarter and +3.8% FY21 growth forecast for a possible upward revision

The tapering of industrial production growth in January from the double-digit year-on-year surges in the previous two months is explained by a high base year effect, while the third straight month-on-month rise by 4.6% in January (up from 2.4% MoM rise in December) suggests that the underlying trend remains strong.

The non-oil domestic exports with about 13% YoY jump in January continued to be the main source of manufacturing strength. By product types, electronics have been the main driver of both exports and manufacturing growth, while pharmaceuticals and transport were dragging the recovery.

... heralds steady GDP recovery

The data confirms that Singapore's economy is off to a strong start in 2021 despite the pandemic weighing on the economic recovery in the region and the world. We are reviewing our -2.7% YoY GDP growth forecast for the current quarter and +3.8% FY21 growth forecast for a possible upward revision.

Meanwhile, the macro-policy has been accommodative enough for steady economic recovery this year. Released earlier this month, the government's FY21 budget underscored persistent fiscal policy support.

Singapore's central bank shift to a neutral monetary policy targeting zero appreciation of S\$-NEER a year ago has also served well for the export-driven recovery. There are no compelling grounds for them to change this policy stance in 2021.

Article | 26 February 2021

New Zealand's central bank is starting to feel the hawkish pressure

The New Zealand government has amended its central bank's remit to include house price considerations when setting monetary policy. This...

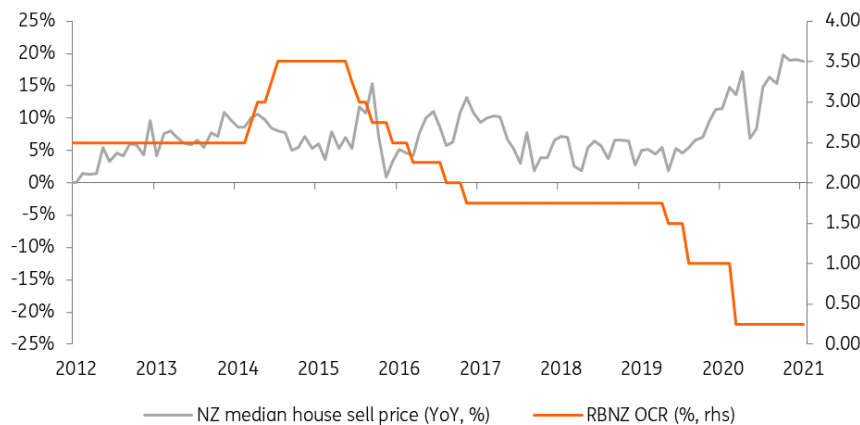


Source: Shutterstock

New Zealand's new cabinet with PM Jacinda Ardern (front L), and finance minister, Grant Robertson (front R)

Amid the overall successful response to the pandemic, New Zealand has seen its longstanding house affordability issue worsen, which has been central to prime minister Jacinda Ardern's political rhetoric. Despite the economic slump, house prices have jumped as a result of the ultra-loose monetary policy by the central bank as it reduced mortgage rates. Fig-1.

Fig -1 Housing prices surged as monetary policy was eased



Source: ING, Refinitiv

Government piles pressure on the central bank

Late in 2020, the government had asked the central bank to take the surge in housing costs into account when making monetary policy decisions, and - despite the central bank's response restating its independence - it poured cold water on the market's negative rate expectations.

Yesterday, Grant Robertson, New Zealand's finance minister, announced that the central bank remit will officially be amended to include the goal of supporting "more sustainable house prices, including dampening investor demand for existing housing stock".

New Zealand's finance minister, announced that the central bank remit will officially be amended to include the goal of supporting "more sustainable house prices"

This confirms that negative rates (which already looked unlikely) are completely off the cards. At the same time, it suggests that the central bank will face more pressure than other developed central banks to hike rates before previously intended. The combination of rock bottom rates and economic recovery in the coming months may well generate even more unwanted upside pressure on house prices.

The central bank has tried to address the housing issue without touching its monetary policy plans, by moving to reinstate the loan-to-value ratio restrictions (to limit high-risk lending), which was suspended as the pandemic hit. While this measure may help avoid a fully-fledged housing bubble, it would hardly be able to effectively mitigate the government's housing affordability concerns, where monetary policy may well be needed.

Policy normalisation may come earlier than other central banks

The RBNZ governor, Adrien Orr, responded to the change in the Bank's remit by stressing that macro-prudential measures will remain the main route to address housing concerns and that the

monetary policy direction will remain driven by inflation and employment targets. This reaction is not surprising, given that the governor has hardly any interest in sounding unduly hawkish now and was probably just defending the Bank's independence.

Still, the RBNZ may soon (or at least sooner than other major central banks) face the question of unwinding its monetary stimulus, and at that point, the housing factor will indeed come into play as an incentive to normalise policy.

After all, New Zealand is faring better economically than most other developed countries thanks to its low Covid-19 cases that have enabled lax movement restrictions.

Also, inflation is at 1.4%, which is not very far from the 2% target mid-point. The central bank is estimating inflation to be back at 2% only in 2023, but that may look a bit conservative and implies that New Zealand borders will remain shut until the end of 2021, which may not be the case if global vaccine roll-out programmes gather pace.

NZD to benefit from tightening expectations

Markets moved after Thursday's news and priced in some monetary tightening in New Zealand in the medium term, with a 25 basis point rate hike now fully in the price for 2022. We suspect that speculation for an even earlier or a more substantial policy normalisation cycle will continue mounting for the rest of the year.

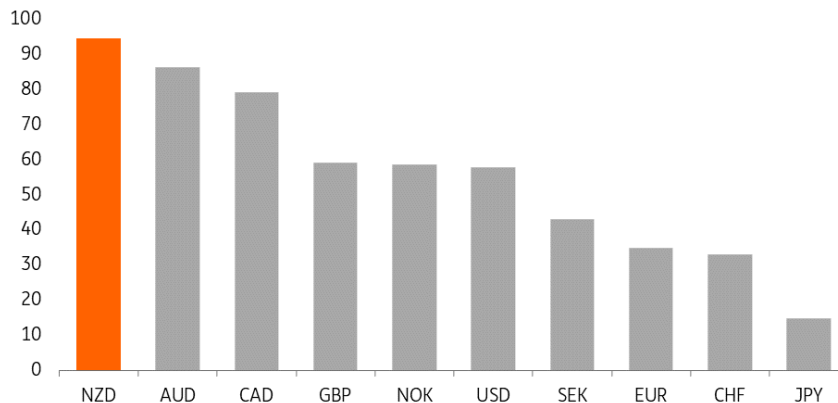
Markets are clearly moving towards higher inflation expectations and the global bonds sell-off is a clear testament of this. New Zealand bonds have been the most heavily impacted in the G10space, with 10-year government yields rising by approximately 95bp since the start of 2021. Fig-2.

We suspect that speculation for an even earlier or a more substantial policy normalisation cycle will continue mounting for the rest of the year

Bond purchases on longer maturities are proving to be blatantly unsuccessful in keeping yields checked in Australia and Canada given the high correlation with US Treasury yields, so that may not be a viable option for the RBNZ. An excessively steep yield curve on the back of rising back-end yields may well add fuel to the speculation of an early rate hike.

Fig -2 New Zealand bonds sold off more than others in G10

Change in 10Y sovereign yields since the start of 2021 (bps)



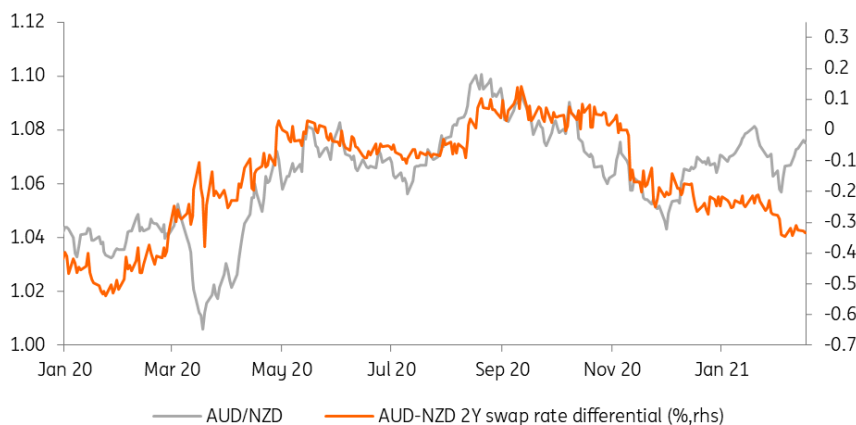
Source: ING, Refinitiv

From an FX perspective, higher chances of a tightening in New Zealand before other major economies bodes well for NZD prospects. In particular, we continue to expect the monetary policy divergence between New Zealand and Australia to remain wide and favour NZD over AUD.

For now, AUD has been sustained by rising iron ore prices, but our commodities team has been highlighting how the current levels in iron ore do not look sustainable, and the risk of a downward correction appears rather material.

We expect AUD/NZD to start realigning with its short-term yield differential (Figure 3) which mirrors the less dovish RBNZ compared to the RBA. We see the balance of risks for AUD/NZD as still tilted to the downside in the coming months, and see room for a move to the 1.04 region.

Fig -3 AUD/NZD rate differential suggests downside for the pair



Source: ING, Refinitiv

The risk to this scenario remains any explicit aversion of the RBNZ to a strong NZD. However, with limited options to ease policy further, FX interventions may remain the only alternative. But plenty of potential negative implications ([we discussed some in this piece from August 2020](#)) may suggest the RBNZ is unlikely to undertake the FX intervention route with a light heart.

Incidentally, Governor Orr recently referred to NZD as "fairly valued" according to most widely used models, which would suggest no immediate plans to intervene in the FX market.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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