Good MornING Asia - 1 September 2021

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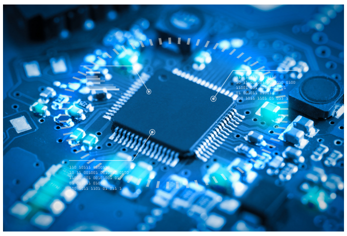

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Source: Shutterstock

Woof Woof

The US and USD-centric nature of Asia was well highlighted in our morning sales/trading call today. After my usual opening salvo covering anything and everything I thought relevant for the day ahead, including all the news from the ECB, it was noteworthy that most of the subsequent speakers still referred not to the Bund yield moves overnight, but those of US Treasuries. This is a classic case of the tail wagging the dog. And this latest market movement really did originate in comments from Klaas Knot and Robert Holzmann in Europe, with a bit of added spice from a potential future German Finance Minister (pending election results of course).

Their comments, driven by rising European inflation (for example, German HICP inflation for August is now running at 3.4%YoY, the highest since July 2008), centred around tapering the ECB emergency asset purchases (PEPP) which they felt could begin imminently, and this has also given the EUR a boost against the USD, taking it back above the 1.18 level for the time being.

There is an ECB meeting on 9 September, and ECB President, Christine Lagarde, may try to throw cold water on such ideas. So the current market switch may not last. But it is worth bearing in mind, and I would urge a little more attention paid to Europe over the coming weeks from this part of the world than is usually the case .

Much the same arguments for asset purchase reduction in Europe are of course being waged in the US. The consistent $1tr+ deposits of cash with the Fed's overnight reverse repo facility are one symptom of an emergency policy that is well past its shelf-life. Just ask James Bullard or Raphael Bostic. Further symptoms may include house price acceleration. We are used to that as an excuse for the withdrawal of emergency policy settings here in Asia. The Bank of Korea's recent rate hike is a case in point, with household debt an added excuse. S&P Case Shiller house price growth in the US for June (quite lagging and the real-time measure could well be higher) is now 19.08%. This is not something Jerome Powell should ignore.

Asia news

One local story that caught our collective attention this morning, was the report from Chinese state media that China will hold a key political plenum in November. This plenum is not usually super-interesting, but with the seismic upheavals resulting from President Xi's "common prosperity" drive over recent months, we wonder if it won't be more interesting than usual. My initial thoughts that this could potentially be a forum for some pushback on the Xi agenda have been correctly swatted down by my colleague Iris, who notes that this would be a bit like admitting to having benefitted from the previous system - not too sensible during an anti-corruption drive. But still, it could well produce some further clarity on how the new agenda will run. So add that to your list of things to watch which you wouldn't normally.

Today we have a raft of PMI data in Asia, as well as Australian 2Q GDP, which after some fairly negative net export figures yesterday, is now expected by the consensus to come in at about 0.4%QoQ. South Korean trade data already out were close to expectations and probably won't result in much market reaction, and Japan corporate profits data is more interesting from an academic perspective than market-moving, so we'll pass on commenting on that today.

We did get some eye-watering Indian GDP yesterday though, and though the moment has passed, Prakash Sakpal has provided the following thoughts. "Indian markets will react today to the 1Q FY2021-22 GDP report which came out after the end of the trading day. 20.1% YoY GDP growth was the fastest among Asian economies but a -12.7% QoQ (seasonally adjusted) fall was the worst. Despite a much-flaunted fiscal boost to the economy, government consumption was missing in action in the last quarter. Carrying this message forward, the budget data for July showed a sharp fall in the fiscal deficit to INR 469 billion from INR 1.5 trillion in June, putting the cumulative deficit in the first four months of this fiscal at INR 3.2 trillion or 60% below the year-ago level. One positive note about the latest quarterly GDP figures, July infrastructure output growth, which is a leading indicator for industrial production, accelerated to 9.4% YoY from 8.9% YoY in June. And, today's manufacturing PMI data could be a prelude to the IP performance in August".

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Snap | 31 August 2021 China

Non-manufacturing PMI in contraction from Chinese government clampdown

The contraction in non-manufacturing activity was unexpected. Some negative factors, including government clampdowns, will continue to put downward pressure on the non-manufacturing PMI in the coming months. To support the economy, China needs a lower interest rate to fund infrastructure projects. A weaker yuan is expected

Source: Shutterstock

Contraction in non-manufacturing activity comes from Covid and the clampdown on technology and education centres

China's manufacturing PMI was 50.1 in August, down from 50.4 in July, while the non-manufacturing PMI fell below 50 to 47.5 from 53.3 a month earlier.

For manufacturing activity, chip shortages are important, since production capacity for electronics is close to a bottleneck, if not already there. This affects production as well as export orders.

In contrast, the sudden contraction in the non-manufacturing sector comes from several parts of the economy.

- Policies aimed at reforming the technology industry e.g. data privacy, and the clampdown

on education centres to reduce the costs of raising children. Both of these have hit non-manufacturing activity.
- The weakness of non-manufacturing activity also came from suspended port operations due to social distancing measures after some Covid cases were found in two ports and one airport in August.
- People have deferred cross-provincial trips as they are worried about being under lockdown away from their home cities in case Covid cases are found in a tourist city.

Some damage is short-term but some is not

Localised lockdowns from Covid and the suspension of ports and airports will be short-lived. Covid is subsiding in China and these measures should not affect manufacturing activity in a prolonged way unless new Covid cases are found again at ports.

But the chip shortage could be a problem that lingers on into at least 2022 and perhaps even into 2023 as chip manufacturers install more production lines. This is not going to happen overnight and will continue to affect the manufacturing PMI.

Some changes in the technology industry are happening, especially on data privacy after the clampdown. This could be positive for the industry. But shutting down tuition centres is hurting the jobs market. The most recent policy to cap the time spent on online games for youngsters may also create redundancies.

Consequently, we expect both manufacturing and non-manufacturing PMIs to be lower in the coming months. The contraction in non-manufacturing activity is likely to continue in September as the job market has become shakier and this will affect consumption.

Weaker yuan

As the government needs to find a way to support economic growth, infrastructure will likely be the first choice. The central bank will keep injecting liquidity into the financial system to suppress market interest rates so that local governments can fund infrastructure projects at a lower cost. This is in contrast to the Fed's tapering talk. As such, we expect the yuan to weaken to 6.7 against the US dollar by the end of the year.

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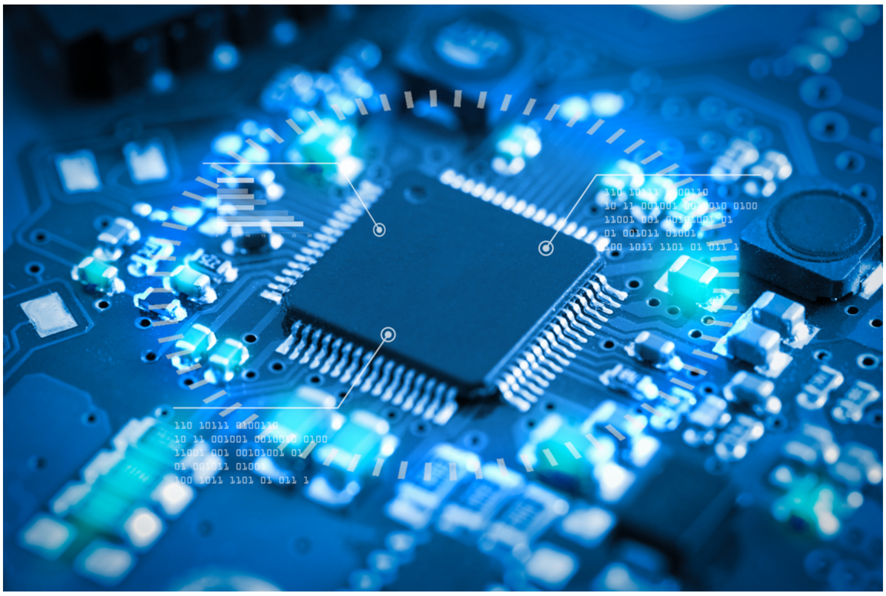
South Korea

Korean production makes small gains in July

Better than expected production data for July, but the main story remains that electronics are hitting bottlenecks so year-on-year growth will struggle from here



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Industrial production

July MoM%

Better than expected

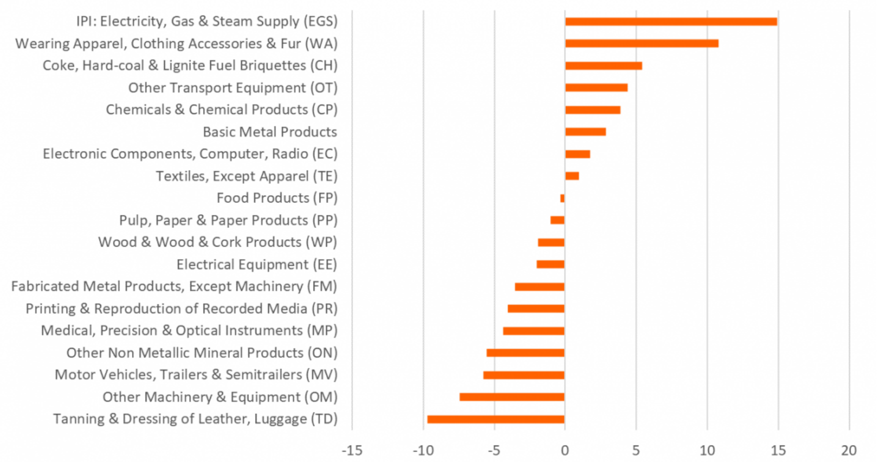
Focus on the month-on-month figures

Korean industrial production rose 7.9% in July from the same month a year ago, though it makes sense to resist looking at year-on-year figures in the current environment, as they tell you next to nothing about what is going on today. The year-on-year figures are further distorted by historical revisions, and last month's 11.9% gains were revised lower to 11.5%YoY.

A 0.4% MoM increase in industrial production was an improvement on the anticipated 0.5% MoM decline, though again, with revisions, it's not clear how much of an improvement this really is relative to expectations. The market reaction should be muted as a result.

Perhaps the most helpful thing we can say from this mangled set of figures is that industrial production appears to be growing still, but that the pace of growth is pedestrian.

Industrial production by component (MoM%)



Source: CEIC, ING

What, no electronics?

The thing that jumps out of the chart above, which shows month-on-month growth in production by component, is that electronics (semiconductors mainly, plus integrated circuits and other such items), barely managed even 2% MoM growth. At least it is still growing, but it highlights that capacity constraints are still weighing on this industry.

This is reflected lower down in the chart, with motor vehicle production, which is heavily reliant on semiconductor supply, contracting in July. Other electrical equipment (will almost all require semiconductor inputs) is also going backwards. It will be no surprise to see the manufacture of luggage struggling at the bottom of the chart.

Economy split

The recent increase in the 7-day repo rate by the Bank of Korea (BoK) will not help the manufacturing sector, though it has come against a backdrop of considerable KRW weakness, so overall, we don't think it will have much bearing on the manufacturing sector in the months ahead.

That path will be dominated by supply constraints in the electronics sector, and the spillover effects this has on other industries which are heavy users. The knock-on effects of logistics disruption stemming from the partial closure of some of China's port facilities in August will not have helped and it may take some weeks as congestion clears for the situation to ease.

In short, we expect Korean production growth to remain very modest over the coming months.

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