Good MornING Asia - 11 November 2019

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By Robert Carnell

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Up, up and away!

Since their September intraday low of 1.4271%, 10Y US Treasury yields have moved erratically higher. But the recent move taking them to 1.94% sets a new high since that low. You have to wonder, how much more? The answer is relevant for us, since the fate of Asian currencies such as the KRW and CNY will rest on similar considerations. The next retracement level of note for yields from charts looks to be 2.12%, so a further 20bp or so increase in yields looks to be eminently plausible in short order. But is this also consistent with fundamentals?

Model-based approaches are one way of looking at this question, but then I don't think fundamentals were what took bond yields to their recent lows, so asking how high they might go "fundamentally", ignores what happens if the same factors return again. I refer of course to trade war fears.

And the news here remains messy, but perhaps in a different way than before. I checked my phone as usual this morning on the way into work for any tweets or clues as to which way this was going. But aside from one tweet from the US President, saying that talks were coming along "very nicely" but adding that China wanted a deal much more badly than he did, there wasn't much. This tweet doesn't, in fact, tell us anything new. I think it is virtually a verbatim repeat of one from several months back, when bond yields were heading in the opposite direction.

So if there is nothing new here, are markets simply now talking themselves out of recession fears in the same way that they talked themselves into them previously?

The outcome is looking increasingly binary

I confess that some sort of trade deal does look in the works, but the other news from the twittersphere is less comforting. The problem is that it is not at all clear who, on the US side is in charge of the negotiations. Robert Lighthizer is officially the lead negotiator. But ultimately, it seems as if the President alone can decide whether a deal will happen. His adviser, Peter Navarro, is taking a characteristically tough line, and as his comments reported on line suggest (he doesn't appear to tweet himself), talk of rollback of tariffs may simply be fake news. Still, even he seems to view some sort of "glide path to a phase one" deal as being a realistic assessment of the current state of play. If so, then how does this relate to the bond market and Asian currencies?

From our perspective, some rollback of tariffs would need to be delivered in order for China to sign up to any deal. Let's not forget that China also has needs and demands from this deal, it is not all about what the US wants. So if no rollback, it is hard to see even a phase one deal happening. And if not, and no deal ensures, then a rapid plunge to new bond yield lows would likely be on the cards.

But that then also suggests that any deal that ***does*** get done, ***will*** involve rollback, and ***will*** involve some concessions on Intellectual Property (a US red-line), and so could be regarded as somewhat substantive.

That could be enough to see bond yields pushing up against that 2.12% resistance. and maybe even through it.

What it does ***not*** look like we will now get, which was once a third option, was a deal which basically just acknowledged the Chinese efforts on increased agricultural purchases, and made some half-hearted commitments to looking again at tariffs based on some future contingencies. That sort of "Dino" deal (deal-in-name-only) would have been unlikely to support bond yields at today's levels, and so would likely have given way to a slide back down, though perhaps not as rapidly as with a clear no-deal outcome, complete with recriminations and escalation.

At least this helps clear the options a little. Our probability tree now looks to have one less node on it.

Asia Day ahead

We have already had core machine orders for September from Japan today. That data is a proxy for current business investment in plant and machinery, so it helps form opinions about the strength of overall economic growth. 3Q19 Japanese GDP is due out on Thursday, so this is one of the last bits of hard data before that figure will be released. And it wasn't good. Despite rising 5.1%YoY, up from -14.5% in August, September orders fell 2.9%MoM. This is hardly the front-loading ahead of the October consumption tax hike that saw orders in March 2014 rising 13.7%MoM (admittedly falling sharply thereafter). So it now looks as if we are relying on what looks like it will have been about a 2.8% real consumer spending boost to deliver a stronger outcome than the 0.9%QoQ (seasonally adjusted annualised rate) forecast.

(And From Prakash Sakpal): Bank Negara Malaysia's (BNM) move on Friday to ease via a 50 basis point reserve requirement cut comes amid deteriorating economic conditions. And we expect BNM to go further with overnight policy rate cuts. This week's data on September industrial production (due out today) and 3Q19 GDP (due on Friday) should underpin rising downside growth risks. We have recently revised our 3Q GDP forecast to 4.4% from 4.8%, taking down the full-year 2019 forecast to 4.5% from 4.7%, and expect at least 50bp BNM policy rate cuts in the first quarter of 2020.

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China: Exports stabilise but uncertainty clouds yuan

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Source: Shutterstock

China's export stabilised on electronics

Exports contracted 0.9% year-on-year in October after contracting 3.2%YoY in the previous month.

Some export items experienced clear growth on a monthly basis, for example, automatic data processing parts and products (+14%MoM). This could be a result of increased smartphone orders. But exports may contract again in November and December, as exports for Western holidays will have already been shipped.

Imports were more related to trade negotiations

Imports contracted 6.4%YoY in October after an 8.3%YoY contraction in September.

Most of the contraction came from a decrease in fruit (-35%MoM), soybean (-24%MoM) and LNG (-20%MoM) imports. These are items which are all on the table in trade talks between the US and China. We expect these imports to rise somewhat when the phase one deal is signed in December.

So many uncertainties in the phase one deal

The market has reacted positively to the news about a potential phase one deal, especially the possible rollback of tariffs imposed in September on $112 billion of goods.

We are sceptical about the size of the rollback, however. If it's too big, China could be more reluctant to return to the negotiating table later on, or the terms could be much harsher for the US in future deals, so we think the US is unlikely to agree to this. If it's too small, China may see the move as an insignificant concession that will do little to help its economy. It is difficult for the two sides to compromise on the size of the rollback, which seems to be the key factor in getting a deal signed.

We think USD/CNY will reflect these uncertainties once the market realises that the phase one deal is not a one-way bet.

Snap | 8 November 2019 Malaysia

Malaysia cuts reserve requirement by 50 basis points

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Source: Shutterstock
Governor of the Central Bank of Malaysia Nor Shamsiah Mohd Yunus

3.0% Statutory Reserve Requirement

After 50 bps cut today

A surprise SRR cut of 50 bps

Just days after leaving the main policy rate (overnight policy rate or OPR) unchanged at the meeting earlier this week, the Bank Negara Malaysia announced a surprise reduction in the bank's Statutory Reserve Requirement (SRR) rate from 3.5% to 3.0%.

The BNM statement said the move was to maintain sufficient liquidity in the domestic financial system and it expected it to support the efficient functioning of the domestic financial markets and facilitate effective liquidity management by the banking institutions.

A precursor to weak growth

We view the SRR cut as a clear precursor to the deteriorating growth outlook. We should get confirmation of this next week when third-quarter GDP numbers are released on 15 November.

Indeed, we have revised our growth forecast for the third quarter down to 4.4% year-on-year from 4.8%. Full-year 2019 GDP should come in at 4.5% rather than the 4.7% we had expected. That said, it's still within the central bank's 4.3-4.8% forecasts range.

Easing cycle has further to go

The BNM statement also noted that the SRR cut wasn't a signal on its monetary policy stance and we need to look at the overnight policy rate as the 'sole indicator' for that. However, we believe the central bank will be prepared to provide further policy accommodation through more OPR cuts ahead, as continued low inflation and a stable-to-strong currency provide scope for such a policy and should a prevent significant deterioration in the economic outlook.

The BNM cut the OPR by 25bp at this year's May meeting. Today's move raises confidence in our forecasts of an additional 50bp OPR cut in the current easing cycle, and we're looking for that to happen in the first quarter of 2020.