

# Good MornING Asia - 11 October 2018

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Treasury yields may hold some important clues

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By Robert Carnell



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### An honest assessment...

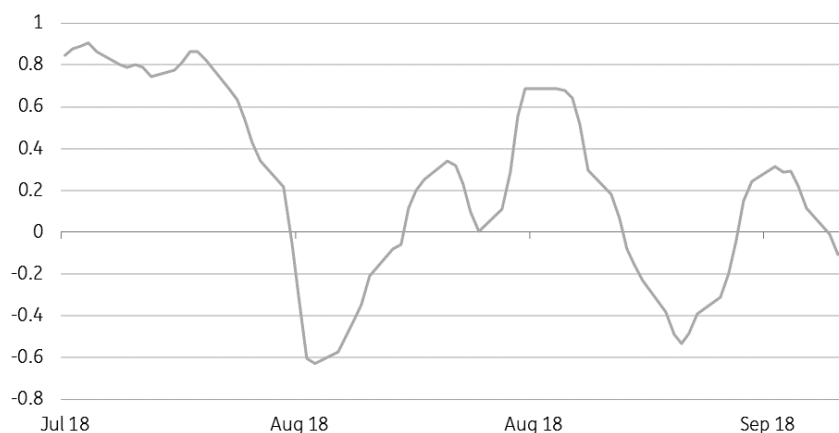
Regular readers will no doubt have realised that I am not a glass-half-full type of person. My glass has a nasty chip on the rim and a dead spider floating about in a dribble of fetid water at the bottom. I look at the world through a prism of gloom.

So what I am about to tell you might come as a surprise. After yesterday's piece about an imminent market correction, of which I am very proud, I am doubtful that this turns into a more lasting and sizeable fall. Believe me, I would love it to be. Personal wealth considerations aside, there's little I like more than a full-blown financial crash to make this job interesting. But I fear we may have to wait a little while longer. Why?

It's a simple matter of what the bond market is doing. Yesterday's stock market falls in the US were pronounced, but the fall in 10Y yields, about 7bp, was also enough to make the correlation chart we showed you yesterday, start to head back towards zero. Take a close look at this chart. When it starts to move in one direction, it tends to keep going.

So in all likelihood, this was a minor tremor. Not the big one. We'll keep watching the index, which seems well calibrated, but today may show the usual aftermath of bond rises, equities fall, bond yields fall, equities rise that we have seen in all such market gyrations this year.

## 10 day change in S&P price, 10Y US Treasury yield, 20-day rolling correlation



### Consider calendar effects

Although we might not be quite there in terms of a big correction, we may not be too far off either. There is an interesting story today on Bloomberg Daybreak about US earnings guidance falling short of analysts estimates, and another version of my correlation chart (NB I was not cited) that suggests market sentiment is turning.

But take a step back from finance and economics for a minute, to consider human behaviour instead - then aggregate it. Suppose you were a US equity fund manager. If so, you likely started the year on a big high, but have spent much of the year trying to recover lost ground from the February correction. From February onwards, your main ambition was probably to finish the year up. Along the route, there were frequent dips, all viewed as buying opportunities, with the usual accompanying bond yield falls to help valuations support a recovery.

It took until late August to regain the January highs, and then claw further gains to reach the early October peak. But at this point on, with barely two and a half months of the year left to go, isn't the main goal to avoid ending the year under, not necessarily to finish ahead?

In short, we may not be on the verge of a precipitous drop, but it is probably optimistic to believe this will be a V-shaped bounce. Moreover, the market is clearly highly sensitive to a negative valuation shock, for example, an unexpectedly high inflation (though data due today likely to show inflation peaking) or (more likely) wages print before the year-end, encouraging thoughts of faster Fed tightening.

### And what of the USD?

Asian currencies are by and large weathering this market shock quite well, and the USD is weak against all the majors too. If the world were in full panic mode, and about to sell further, then I doubt this would be the case.

We also have to bear in mind that the US President's latest Twitter intervention on the Fed is most likely also causing a little USD weakness too. So we aren't going to get over-excited about what is going on here based on the USD.

There may be a little further weakness. But give it a day or two, and we may be back to considering fundamentals. Just don't relax too much.

## Asia Day ahead

Tomorrow morning, at 08:00 local time, we will get the Monetary Authority of Singapore's policy announcement and advance estimate of 3Q18 GDP. It's not all bad for the economy, [as I wrote in a longer note yesterday](#). But there are still many good reasons why the MAS will likely deliver no additional steepening of the SGD-NEER path or change to exchange rate bandwidth or central point. Not least of which will be the 3Q18 GDP result itself, which will likely show a sharp slowdown in year on year terms.

Watch out also for China's money supply data for September, which could come out today (or not) - New yuan loans should have picked up in response to the negative impacts of the trade-war on growth.

(And from Prakash Sakpal...) Malaysia's industrial production for August is due today. Dismal August export performance underpins our forecast of IP growth slowdown to 1.6% YoY from 2.6% in July. The MYR's gain yesterday after a week-long selloff isn't out of sync with gains in other ASEAN currencies, while local stocks slumped the most in four months. The clawback of the recent MYR underperformance relative to the oil price hinges on the trajectory Malaysia's exports and GDP growth take going forward. However, the activity data doesn't bode well here.

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## ASEAN Morning Bytes

General market tone: slight risk-off Risk assets took a tumble on Wednesday with tech shares leading the sell-off amid intensified worries about rising bond yields and slower economic growth



### International theme: Techs are falling and rates are rising

- Risk-off sentiment remained the general theme with most US markets down significantly, although Asia managed to bounce on hopes that the Chinese yuan would steady.
- Fed president Charles Evans indicated that he believes the neutral rate is closer to 3%, suggesting that he supports up to 3 more rate hikes by the Fed before pausing. This points to a more dovish side for the President from Chicago. Meanwhile, the US President appears unhappy at the pace of rate hikes by the Fed but this is not the first time the President has thrown criticism the way of the Fed. Both developments may help yields from rising much further from here.

### EM Space: EM Asia managed to steady somewhat

- **General Asia:** Asian markets still looking to rebound significantly with the USD pulling back slightly as President Trump appears unhappy with the Fed's recent spate of rate hikes. Oil prices were also down more than 2%, which should help limit concerns about crude trending towards the dreaded \$100/barrel level.
- **Singapore:** All eyes are on the MAS policy announcement and advance estimate of 3Q18



GDP, both due at 8 am local time tomorrow. It's not all bad for the economy, though, as our Asia chief economist, Rob Carnell thinks ([read here](#)), there are many good reasons why the MAS will likely deliver no additional steepening of the SGD-NEER path or change to exchange rate bandwidth or central point.

- **Malaysia:** Industrial production for August is due. Dismal August export performance underpins our forecast of IP growth slowdown to 1.6% YoY from 2.6% in July. The MYR's gain yesterday after a week-long selloff isn't out of sync with gains in other ASEAN currencies, while local stocks slumped the most in four months. The clawback of the recent MYR underperformance relative to the oil price hinges on the trajectory Malaysia's exports and GDP growth take going forward. However, the activity data doesn't bode well here.
- **Indonesia:** Bank Indonesia's Governor Warjiyo defended the central bank's actions to hike rates aggressively in 2018 in order to stabilize financial markets from EM contagion. Tighter monetary policy in the US and the anxiety over the fallout from the trade war between the US and China have soured sentiment towards EM Asia. Warjiyo indicated that the current IDR rate is not in line with fundamentals, which suggests the Governor would like to see the currency appreciate in the medium term. Look for the BI to remain vigilant on rate hikes in the near term to cushion the currency's slide.
- **Philippines:** Imports for August grew by 11.0% YoY while exports growth was a tepid 3.1% despite strong growth in the mainstay electronics shipments. The year-to-date trade gap widened to \$26 billion, which should keep the current account in the red and put added pressure on the BSP to hike rates to curb Peso's weakness. Countering the news about the swelling deficit for goods was the sustained inflow of foreign direct investments, up 52.1% for the year to total \$6.67 billion with the Philippines likely needing to rely more on the financial account as a source of its foreign exchange.

## What to look out for: Fed speakers, IMF-WB meetings

- Fed Evans and Bostic speak (11 October)
- US inflation (11 October)
- China trade balance (12 October)
- IMF-WB annual meeting in Bali (12-14 October)

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## What can we expect from Singapore's central bank?

There are many good reasons why a meeting of the Monetary Authority of Singapore (MAS) on Friday 12 October will likely deliver no additional steepening of the Singapore dollar's nominal effective exchange rate (NEER) path or change to exchange rate bandwidth or central point



Source: Shutterstock

### Why even consider anything other than no change?

It might seem like we are preaching to the converted. After all, why on earth would the MAS tighten monetary policy on Friday? I admit we don't see it.

But MAS Managing Director, Ravi Menon, gave an upbeat view of the global economy in comments to Bloomberg at the recent Singapore Fintech Festival. He felt that China's growth was still pretty healthy, though the trade wars did deliver cause for concern if, for example, growth fell below 6%. His description of the US economy as "chugging along" also sounds like quite an understatement given 2Q18 growth in excess of 4%. But although he viewed the global economy as fairly resilient, he did indicate that global growth would likely slow a touch next year and the year after.

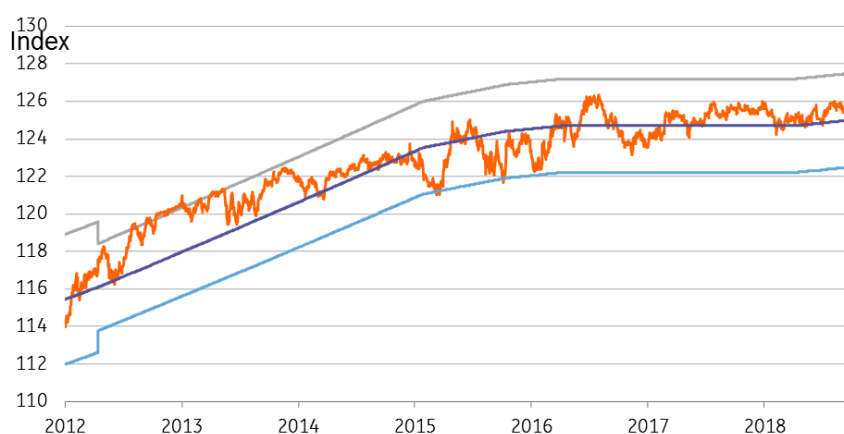
## Reasons not to be cheerful

But were Mr Menon's remarks those of a man about to tighten policy and either push up the slope or the central point of the MAS Nominal Effective Exchange Rate (NEER) band? Or were they simply observational?

Reasons not to hurry into changing the MAS' policy target are legion:

- The SGD is doing nicely without any change in target. Indeed, recent regional FX weakness has seen the SGD appreciate quite sharply before returning to its current value of USD/SGD 1.38.
- During this recent SGD volatility, the 3M Sibor rate has been very steady - so it does not look like the MAS is leaning against either recent appreciations or depreciation.
- The outlook for the international economy is highly uncertain - Chinese GDP Growth, trade wars, oil prices, Brexit, risk appetite and financial market valuations might all turn more negative in the near future, so why not wait?
- The domestic economy is not in amazing shape either. Recent production data growth has slowed to 3.3%YoY, down from 20.5% just over a year ago. And non-oil domestic export growth is not that good either at 5.0%YoY, though the trend rate of growth is maybe firming a little.
- The NEER is already a little stronger than the mid-point of our calculated band and requires no further official response.
- Some of the better signals of domestic economic strength, such as the certificate of entitlement (COE) for car ownership, keep falling.
- Private home prices and rentals are apparently now rising quarter on quarter, month on month according to official figures. But the official view does not stack up against anecdotes and some private measures, which suggests that condo rentals at least, are still struggling.

## SGD Nominal Effective Exchange Rate band



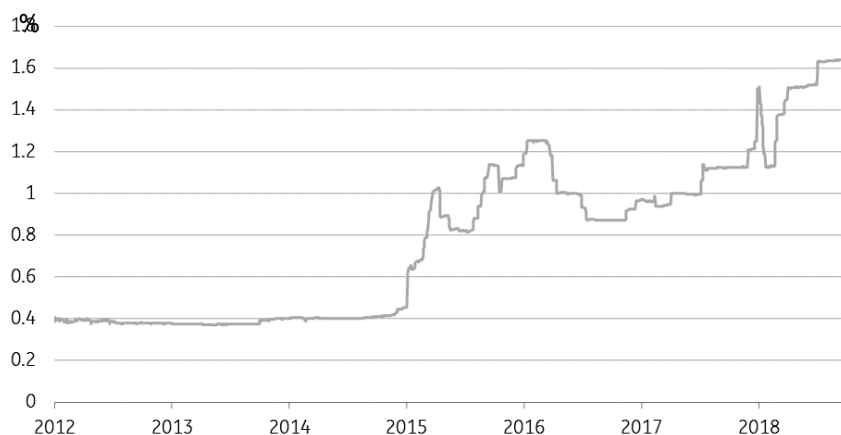
## Its not all bad

But then on the other hand, inflation is now on a core basis, virtually at 2.0% (1.9%YoY), though this sounds less impressive when you realize that the core MAS measure subtracts exactly those meaningful domestic demand signals, such as private transportation (the COE) and accommodation (rentals), so the headline measure at 0.7%YoY, may be a better indicator of actual



"core" inflation. And is clearly less impressive.

### 3M SIBOR



### Though GDP might be very soft

In addition to the MAS' currency path decision, the Ministry of Trade and Industry (MTI) will also release advance GDP estimates for 3Q18. The QoQ annualized figure we estimate doesn't sound bad at all, at 5.5%. But this will still leave the annual growth rate at only 2.6%YoY, a noticeable slowdown, even if this leaves the economy still on track for a 3.3% growth total for the year.

We will also get the MAS range for GDP in 2019. This is currently 1.5% to 3.5%, with a midpoint of 2.5%. We don't see this changing, though there is a risk it gets trimmed to 1-3%, for a midpoint of 2%, reflecting the risks facing the global and Singaporean economy.

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# Philippines: Deficit surges to \$26bn this year

Imports keep up the pace while exports underperform, yielding yet another substantial trade gap to keep the current account in the red



Source: Shutterstock

## -\$3.513bn

August trade balance

YTD trade balance wider 64.7%

As expected

## Imports sustain double-digit expansion, up by 11.0% while exports tepid at 3.1%

- Philippine imports for August grew by 11.0% YoY to deliver another month of robust growth. Capital equipment and the oil bill powered overall import growth, translating to annual growth rates of 12.9% and 42.3% respectively.
- Positive demand was seen across all subsectors, although consumer goods imports and raw materials import growth slowed to single-digit growth prints of 5.9% and 4.3%, respectively.
- Electronics exports, which command the lion's share of total exports (54.3% of the total),

grew by 7.0% to lift overall exports to a 3.1% growth print. All other exports however contracted by 1.2% despite a much weaker Peso, which has failed to boost export competitiveness to date.

- Manufacturers continue to import raw materials used for electronics exports. These are up 22.1% for the year. The prospect is for sustained growth of the export sector for the rest of the year.
- Capital goods imports in tandem with the bloated oil bill have kept the trade balance in the red as exports continue to underperform, down 2.0% for the year.

## Trade gap to remain wide as imports sustain growth while exports disappoint despite weaker Peso

- The trade deficit in July of \$3.513 billion will likely keep the country's current account in deficit as capital imports and oil import growth are not expected to slow down in the near term. Raw materials used for construction posted 38.7% growth in August, moving in-line with the aggressive building plans of the private sector and government alike. The 8-month 2018 trade deficit reached \$26 billion, 65% wider than the deficit of \$15.791 billion in the same 8-month period of 2017.
- Despite protracted weakness in the Philippine Peso, exports continue to underperform, posting a 2% contraction YTD and only a feeble 3.1% growth in August. In turn, the weaker currency may have fomented even more inflationary pressure given the hefty import bill related to consumption and transportation.
- Recent strong rhetoric from the central bank in response to soaring inflation and to a weakening PHP could help to stem the currency's weakness and prevent the trade gap from widening further. But exports will need to rebound in the coming months to truly make some headway. The prognosis is for the current account to remain in the red, exerting further pressure on the local unit despite BSP's already very hawkish stance.

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