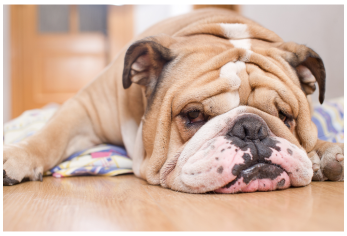
Good MornING Asia - 12 February 2018

What is happening in stock and bond markets currently is not pleasant to watch and will be delivering pain to some, but it is not a disorderly move - this is a correction, not a meltdown

In this bundle



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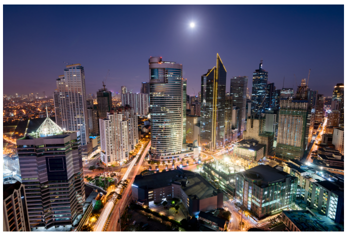
By Robert Carnell



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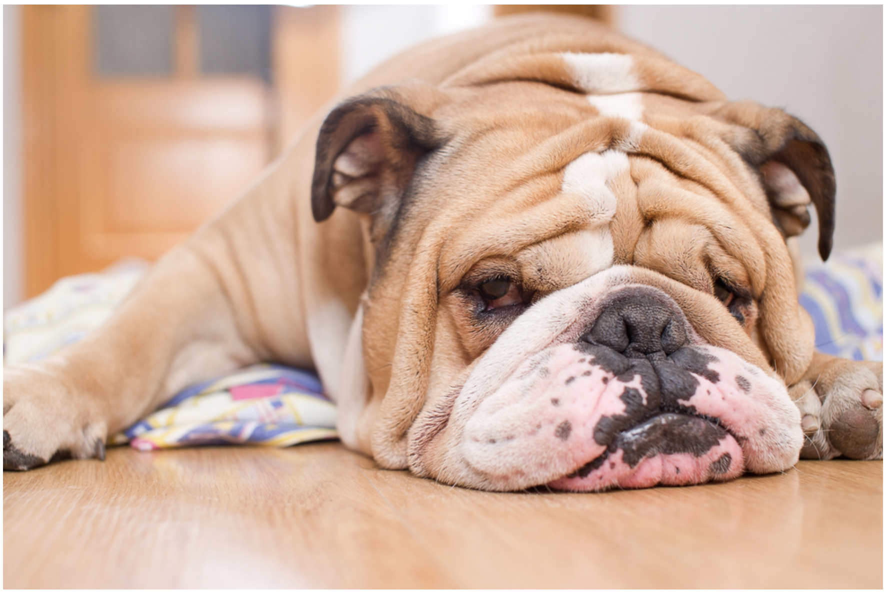

Ugly, but not disorderly

-2.02%

S&P500 year-to-date change in index level

Could be worse

Inflation in the headlamps

After last week's void on economic data, markets do get some economic hooks on which to hang their market convictions this week. Most important of these will be January US consumer price inflation on 14 February. The consensus is looking for a decent 0.3%MoM increase (more than 3% at an annualised rate), but which would result in the year on year rate of growth actually dipping to 1.9%YoY from 2.1%, thanks to a 0.5% MoM bump in the January CPI in 2017.

That dampening base effect completely drops out in February, when the base comparison form the previous year was zero, and then in March 2017, CPI fell by 0.2% MoM. So if the CPI index notches up two 0.2%MoM gains in the coming two months after a 0.3% for the figures released this week, then US CPI inflation should increase to 2.3%YoY by March, more if there is a genuine upturn in inflation.

Adding to this week's soft US CPI date, we may also see an uncharacteristically soft 4Q17 GDP figure form Japan. The consensus is for something close to zero. We have stuck our necks out with a negative figure. We don't actually have any problems with Japanese growth but look for a pull-back in 4Q as inventory destocking and net exports provide a temporary correction.

All this inflation moderation and temperate growth ought to weigh on recent long-term bond yield increases, and could provide some support for the beleaguered stock market, But with Chinese New Year coming at the end of the week, we imagine a lot of risk will be taken off the table this week. So the backdrop would remain quite risk averse.

1.9%YoY

Consensus forecast for January US Headline CPI

Down from 2.1%YoY in December 2017

Senate passes bill - finally

The US Senate passed their budget bill after a lot of effort last week that resulted in a mini-government shutdown on Thursday night running into Friday. The bill raises budget caps by $300bn over the next 2 years, increases the debt ceiling accordingly and offers around $90bn in hurricane disaster relief to Texas, Florida and Puerto Rico. To bring Democrats on board, which was necessary to offset the dissenting Republicans, a week has been offered to debate the festering immigration issue.

Elsewhere in politics, the GBP has not responded well to further verbal bashing of the UK Brexit negotiations by EU lead negotiator, Michel Barnier. That said, not all on the EU side are happy at the aggressive tone Barnier is striking, which they fear increases the chance of the UK crashing out of the Union with no deal (worst case scenario for all sides).

And In Japan, BoJ Governor Kuroda looks as if he is going to get another term at the helm of the central bank. This may dampen any thoughts that BoJ policy may move towards some form of taper later this year, though we continue to think this is likely.

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Philippines: Worsening trade balance to hit currency

The trade deficit of $4bn in December is a record high and worsened the overall trade deficit to $30bn in 2017. Soft exports and strong imports mean...

Source: Shutterstock

-$4bn

December trade deficit

Record high

Worse than expected

Imports outpacing exports lead to wider trade gaps and weaker Philippine Peso

Soft export growth and sustained high imports account for the deterioration of the trade balance. December's trade deficit of $4bn is a record high and worsened the overall trade balance to a deficit of $29.8bn in 2017. This is $3bn worse than 2016. The trade deficit is likely to worsen to $35bn in 2018 on 11% import growth and an 8% export increase. Exports are likely to moderate after the 9.5% YoY rebound in 2017, largely due to favorable base effects. Exports net of electronics drag overall export performance in December and in 2017. The export sector remains shallow and relies heavily on electronics exports which account for almost 50% of total exports. Imports are likely to remain strong in 2018. Domestic demand driven economic growth will continue to see strong imports of consumer goods, capital equipment and oil. Consumer goods imports were 16% higher YoY in December and 10% stronger in 2017. The double-digit growth of capital equipment imports in November and December brought the full-year gain to 5.3%. Durable equipment investments are likely to sustain the upturn. Oil imports soared, with December growth of 65% bringing the full year increase to 34%. The worsening trade balance will likely lead to another year of underperformance for the Philippine peso. Yesterday's relatively dovish central bank assessment of inflation for 2019 also contributes to the weakness.

Malaysia: The best is behind us

We see no threat to our forecast of continued Bank Negara monetary policy normalisation with one more 25bp rate hike this year

Exports drag manufacturing lower

Malaysia's industrial production growth slowed more than expected to 2.9% year-on-year in December, down from 5.0% in the previous month (consensus 4.6%, ING forecast 3.5%). The slowdown isn't a complete surprise though, as growth in the volume of exports dipped to 3.0% from 9.7% over the same months.

Nevertheless, the growth of manufacturing sales and employment in the sector held up quite well in December at 9.4% and 2.4% respectively, possibly supported by strong domestic spending. Salaries and wages growth at 9.4% was also pretty good..

High base effect dampens activity growth

This latest production data puts fourth quarter 2017 IP growth at 3.7%YoY, down from 5.9% in the previous quarter. The corresponding figures for export volume are 8.5% and 13.9%. The high base effect has been dampening the year-over-year activity growth pretty much everywhere in Asia, including Malaysia. And this is associated with a slowdown in GDP growth. We have already observed a GDP slowdown in other Asian regional economies in 4Q17 (Korea, Singapore, Philippines). China's growth was steady while there was a modest uptick in Indonesia's and Taiwan's growth. Malaysia is likely to join the majority.

The key message here is that the best of Malaysia's GDP growth in the current cycle, 6.2% in 3Q17, which is the fastest in more than three years, is behind us. The 4Q17 GDP report is due next week, February 14. We forecast a slowdown to 5.5%, in line with the consensus median. This still implies a faster full-year 2017 pace of 5.8% than the official forecast of 5.2-5.7%.

No impact on BNM policy normalisation

The best may be behind us, though rising commodity prices will continue to support exports and election spending will support domestic demand, sustaining a 5%-plus pace of GDP growth through 2018. This should keep Bank Negara Malaysia (BNM) on the policy normalization path that started in January with a 25 basis point interest rate hike. We have pencilled in one more 25bp BNM policy rate hike in the third quarter of 2018.