

Good MornING Asia: 12 January 2018

A combination of factors should see higher US inflation over the coming months, though much of this will be USD and energy-related – the direct impact on US yields may be muted. Weaker USD will help Asian central banks keep policy accommodative.

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Shouty man

Inflation upturn coming in the US - not yet though

Our G-7 economists expect little uptick in today's US inflation, which could weigh back on US Treasuries. The benchmark 10Y bond is now yielding about 2.53%, a little down on yesterday's 2.55%, not helped by very disappointing factory gate prices from the US. The lack of overlap between these two series is one reason not to despair of a potentially higher figure, but we suspect our guys are right. This is not yet the time.

But that may be about to change, as our Chief International Economist, James Knightley writes today in a comprehensive look at inflation. Even so, with a weaker USD and higher energy prices likely to account for a good chunk of any rise, and core inflation increases likely to be more subdued, we doubt this is going to deliver more than a gentle nudge higher to longer-dated Treasury yields. The trend may be for these to rise, but this could be a very slow burner.

[Read more on US inflation](#)

2.1% December 2017 US CPI inflation YoY%
Consensus forecast

The biggest threat to US Treasury yields is European Bond yields

A more exciting bond story is potentially unfurling in the Eurozone. Grab a look at the equivalent 10Y Bund yield in Germany, up to 0.57-0.58 this morning, after minutes from the ECB indicated that they could change their forward guidance early this year. While US Treasuries have at least priced in a decent chunk of Fed tightening this year, European bonds have all the unwinding of QE to go and have nothing priced into the shorter end of policy rates. For a more misaligned market relative to our medium-term policy projections, you would have to travel a long way from the Eurozone to find a competitor. This sheer scale of the potential unwind of ECB policy measures is only hinted at in recent market movements, but will take place in both bond and FX space. Our FX forecast for EUR by end of this year is EUR/USD 1.30, our 4Q18 bond yield forecast at only 0.75% looks a little low in comparison, though the direction is right.

Indeed, one of the stronger arguments for higher US Treasury yields is stronger European government bond yields. Most forecasters start from the other direction, but this is one of those occasions where the tail wags the dog, not the other way round. Many traditional buyers of Eurozone government bonds look to have been displaced by ultra-low yields – an assertion backed up by European portfolio outflows. The ultimate destination of this displaced investment is unclear, but a combination of US Treasuries, EM bonds, high yield debt seem likely. As Eurozone bond yields normalize, these errant flows are likely to return. In the process, yields in these other debt products should rise, though more modestly.

Asia today - trade data a bit softer - mainly due to strong 2017 base

It's a relatively quiet day in Asia. We have already had Japanese current account data, which showed a smaller than expected surplus (adjusted November figure JPY1700.gbn vs consensus JPY2168bn). A weaker trade balance on stronger imports seems to have done some of the damage (though consistent with stronger domestic demand) along with a dip in primary incomes. China also releases trade data today (for December), and it too is likely to show some moderation from last month, though mainly because the November export figures were so strong (12.3%YoY in November). Put this down to a statistical payback rather than anything more meaningful. Retail sales in Singapore will also remain subdued, with an annual growth rate of only about 1%, indicating that the household sector is still in early recovery mode, and not much more. And finally, Indian CPI should rise again this month, along with stronger industrial production data. We don't see either having any impact on the RBI's neutral policy stance. The CPI rise is mostly a food price effect which should wear off, and overall growth, despite some better production data today remains sluggish.

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Exports should be strong but imports should be even stronger

While our forecasts on December trade growth (8.7%YoY exports and 10.4%YoY imports respectively) are lower than consensus (10.8% and 15.1%) and the prior month's data (12.3% and 17.7%), they do not change the picture that China's export and import growth is robust. For the whole of 2017, we expect 8% export growth and 16.5% import growth.

China's trade will be helped by a better global economy in 2018. We expect that imports will grow 12%, faster than export growth at 8%. The slower pace is a result of a high base in 2017. We see domestic demand as the main factor behind strong import growth, as spending from the middle classes keeps growing.

Though merchandise imports will grow at a slower speed, services imports could rise faster. We expect tourism, which is part of services imports, to grow considerably among the middle classes.

As such, the current account surplus as a percentage of GDP will fall to around 0.8% in 2018, against 3Q17's 1.0%. That would imply the CNY could be around its equilibrium level in 2018. Our projection of USDCNY is 6.30, appreciating 3% in 2018.

8% Export growth 2018

12% Import growth 2018

Technology is another trade growth driver

We believe that technological-related products are driving part of this trade growth. According to China Customs, exports and imports of mechanical, electrical goods and parts amounted to \$1185 bn and \$769 bn, respectively YTD in Nov 2017, which was 58% of total exports and 46% of total imports during the first eleven months of 2017. Exports of these items (+9%YoY Ytd) outgrew total exports (+8%YoY Ytd) in the first eleven months of last year. These data highlight the importance of technology in production of consumer goods and business tools.

We expect this trend to continue in China in 2018. And there could be a gradual increase in the value-add of technological products produced by Chinese companies, as growing high-tech sectors is part of the government's agenda.

0.8% Current account as % GDP

India: Inflation hits RBI's forecast but growth remains slow

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5.1% ING forecast for December inflation

Inflation hits RBI's forecast

India's consumer price inflation data for December and industrial production data for November are due today. CPI inflation is creeping higher and with a low base effect in the food CPI component, it is poised to exceed the Reserve Bank of India's (RBI) 4.3-4.7% forecast for the second half of the fiscal year 2017-18 (ends in March 2018). Our forecast for December is 5.1% year-on-year, in line with consensus.

Near-term inflation outlook

The likelihood of inflation remaining within the RBI's forecast range depends on seasonal cooling of food prices in the Rabi (Spring) crop harvest months of January to March. However, the upside risk stems from rising global oil prices working their way through domestic fuel prices, which is likely to

keep CPI inflation sticky downward.

30% Export growth in November

Exports support consensus of faster IP growth

However, the industrial production data is expected to reinforce slow growth. The consensus forecast of acceleration in IP growth to 4.4% YoY in November from 2.2% in the previous month rests on strong exports. A 30% YoY surge in exports in November was the fastest in six years. However, it was merely the result of a low base on both monthly and yearly basis, imparting a downside risk to consensus on IP growth.

Policy implications

India's GDP growth may be gaining some traction, but with elevated inflation the RBI has little scope to move from the neutral policy stance in the near-term. The return of the Indian rupee to an appreciation trend after a selloff from September through November reduces pressure on the RBI to raise interest rates. We reiterate our forecast of no change to the RBI policy in 2018.

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Source: shutterstock

Above-expected November manufacturing

Malaysia's industrial production surprised on the upside in November with 5% year-on-year growth against the consensus expectation for growth of 4.6%. Acceleration from 3.4% October growth happened despite a slowdown in export growth over the same months (14.4% from 18.7%).

5.5% ING's GDP growth forecast for Malaysia in 4Q17

What does this mean for 4Q17 GDP growth?

After a strong run in the first three quarters of 2017 the export-led manufacturing recovery appears to have taken a breather in the final quarter of the year. Average October-November IP

growth of 4.2% YoY was a slowdown from 5.9% growth in the third quarter. The corresponding figures for export growth are 16.5% and 22.1%. The activity data supports our forecast of a slower 4Q17 GDP growth rate of 5.5% YoY compared to 6.2% in the previous quarter. That was the fastest pace of growth in three years. Our full-year 2017 growth forecast is 5.8%.

Policy implications

Strong GDP growth has put upwards pressure on inflation and this has prepared markets for Bank Negara Malaysia monetary policy normalization earlier than most other Asian central banks. We forecast two 25bp BNM rate hikes in the first and third quarters of 2018, taking the overnight policy rate to 3.50%. The Malaysian ringgit's 11% appreciation in 2017 was the second-best among Asian currencies. The tighter BNM policy bias will likely sustain the MYR outperformance in 2018. Our end-2018 USD/MYR forecast is 3.80 (consensus 3.95).

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