Good MornING Asia - 12 November 2020

Tech stocks rebound as vaccine excitement wanes and markets refocus on surging US case numbers; Oil supported by OPEC+ deliberations on rolling cuts, but weighed by virus and demand concerns; Japan investment outlook remains weak ahead of 3Q GDP and India struggles with "stagflation"

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Virus concerns return

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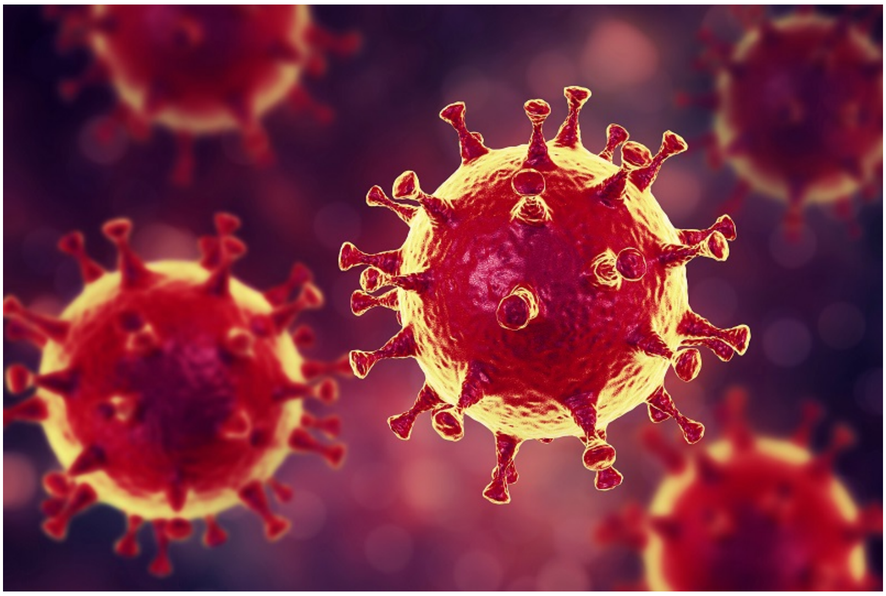

Corona virus

Market overview

My usual starting point of extrapolating the US close into the Asian open looks more questionable than usual today, with US equity markets dominated by a return to tech stocks (NASDAQ up 2.01%) as concern over surging US Covid-19 case numbers mounts, and prospects rise for renewed lockdowns (see also this by our strategists on the potential market impact of a vaccine). Industrial stocks in the Dow Jones index didn't fare so well and ended the day slightly in the red (-0.08%), and the S&P500 was someway in the middle, registering small gains (+0.77%). Equity futures in Asia today are greenish, but I wouldn't bet the farm on that being the theme for the whole day, and we need other yardsticks to figure out which way the market-wind is blowing today.

The same goes for FX markets. The USD had a strong day against some of the majors yesterday, including the JPY and the EUR. But it did less well against the commodity currencies. The NZD did particularly well as negative rate expectations were pared back. And in Asian EM space, it was also a mixed bag, with the THB unusually dominating the pack for a rare change, leading the KRW, and many of the other currencies languishing. Again, no clear theme here.

It is entirely possible that oil will play more of a role in FX space in the coming days, as the market tries to disentangle the negative signals coming from the pandemic figures, from the positive noises on OPEC+ rolling their cuts into next year. This OPEC+ view is increasingly becoming the consensus, the only question being whether this is for 3 or 6 months. So we should probably keep an eye on the MYR, as the region's main petro-currency.

G-7 outlook and events

As we get closer and closer to November 15th, it is worth reminding ourselves that this was once viewed as the last possible day for a Brexit deal. Time is needed for European countries to ratify any deal before the end of the year. So with each day that passes, the likelihood that we get a "deal/no-deal" decision grows. But as we have also learnt, deadlines can slip, and pragmatism can triumph if a deal looks within striking distance. Therefore we will not be surprised if Nov 15 comes and goes without any clear message on Brexit. Presumably, some sort of transition extension can be arranged if it's just a question of timing? And it's not as if all negotiations will immediately cease just because 15 Nov or even 31 Dec passes. I'm sure our UK and Brexit expert, James Smith, will have something to offer on this early next week, one way or another...

For what it is worth, the UK releases 3Q GDP data today, which of course precedes the latest lockdown. The consensus is for a 15.8% QoQ surge after the 2Q 19.8% plunge.

And Japan has released core machine orders data for September ahead of next week's 3Q GDP release. The -4,4% MoM September figure was worse than expected, though the year-on-year print beat expectations. This either means you should put no faith in consensus figures as they clearly contain no information. Alternatively, it means that because of substantial historical revisions to data like this, forecasts are a massive waste of time. It's probably both. And neither explanation helps.

I am looking for a fractionally weaker 18.6% pick up in 3QGDP after the 28.1% decline in 2Q20 (consensus is virtually the same at +18.9%QoQ, which is no guarantee of accuracy).

India - weak output, high inflation

Prakash Sakpal has this update on Indian data due today: "CPI inflation for October and industrial production for September are due today. Inflation exceeded the Reserve Bank of India’s 6% policy limit in all but one month in the year through September. We don’t think October will be any different, though there might be a slight dip to 7.1% YoY (from 7.3%) on the back of a high base effect. Food and transport prices remained the main drivers of high headline inflation. Meanwhile, persistently weak domestic demand outweighed firmer exports in September to keep the negative spell on industrial production growth, although to a lesser extent (INGF -3.2% YoY vs. -8.0% in August). We will review our 3Q GDP growth forecast, currently -17.6% YoY, in light of today's IP data".

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China's loan growth shrinks

Loan growth shrank on a monthly basis, but that's a seasonal phenomenon, and it still rose year-on-year. Shadow banking continues to shrink on a yearly basis, which is good news for the financial sector

A woman walks by a money exchange shop decorated with different countries' currency banknotes in Hong Kong

Don't worry about the small loan growth

Although the monthly change in loan growth may look worrying, it is no cause for alarm. It's actually quite normal to see small loan growth in October - the beginning of the fourth quarter. Yuan loans increased CNY689.8 billion in October after an increase of CNY1.8957 trillion in September. Though falling on a monthly basis, the increase was 4.1% year-on-year.

We should see a large increase in loan growth again at the beginning of 2021 which, again, is a seasonal phenomenon.

We are still positive about China's outlook

So we are still comfortable with this small loan growth in October.

We see a better recovery in activity data in October, especially in the domestic economy, as there was a long holiday in the month. We expect retail sales to rise 2.2% YoY though this is slower than the previous month's 3.3% increase due to some limitations on travel activities from Covid, and the high base effect from last year.

Industrial production in October should be slightly lower, at 6.7% YoY growth from 6.8% in September. Export orders were weaker as the pandemic weighed on foreign demand in the US and Europe. Technology production for exports should also slow down because there has been more resistance in the US and Europe to using Chinese technological products.

Fixed asset investment should rise faster, at 1.1% YoY in October from 0.8% a month ago. Foreign demand does not affect investment in China as most of the fixed asset investment comes from government stimulus projects, which echoes the fast increase in government bond issuance. These projects include investment in technological self-reliance, which means building up the whole vertical chain of production, including parts and equipment. We are also likely to see projects for reconstruction after recent flooding.

Shadow banking continued to shrink

Shadow banking items continued to shrink, trust loans, entrusted loans and undiscounted bills all contracted on a yearly basis. This shows that the central bank's policies to reduce shadow banking activities have been effective so far.

Where is the risk then?

We saw a jump in the net issuance of government bonds of CNY493.1 billion, an increase of 62% YoY. Though the scale is still small, it shows that the Chinese government has continued with its fiscal stimulus, with some of the money coming from the issuance of government bonds. In this first data release, we can only see the headline number of government bond issuance, which does not break down into central and local government bonds.

Our worry is about local government bond issuance which supports infrastructure programmes. Local governments are keen to contribute to the economic recovery but they may end up investing in projects which do not yield a sustainable return. The risk is not here yet but it is a concern for the years to come.

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Rates unchanged in New Zealand

New Zealand's central bank delivers a mixed message while leaving rates unchanged and introducing a new funding-for-lending program

0.25%

Official cash rate

Unchanged

As expected

No change in rates

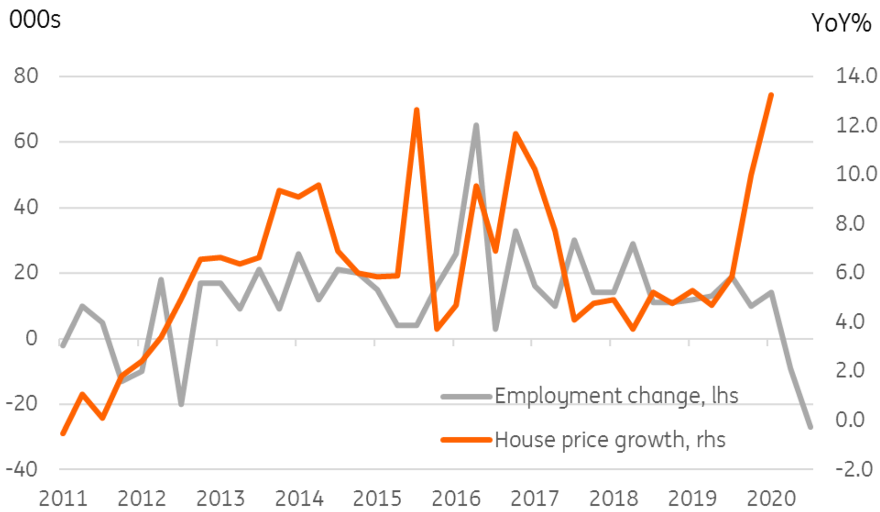
The Reserve Bank of New Zealand (RBNZ) did not cut rates as we suggested last week might happen, following the recent 3Q20 spike up in the unemployment rate, and the 15bp cut administered by their central bank neighbours in Australia.

But where we go from here is considerably less clear.

On the one hand, you could argue that the new $100bn funding-for-lending (FFL) program will circumvent the issues of housing-market overheating that further rate cuts might deliver. But there are problems with this. Unless the RBNZ can ensure that this lending predominantly supports businesses, it is often easier for cheap funding to simply fuel more mortgage lending, which has been the experience of a lot of other countries that have gone down this FFL route.

Likewise, the RBNZ's quantitative easing measures have also got it to the point where it now owns more than a third (37%) of all the outstanding stock of government bonds, with little further room to move. Such policies also tend to just drive down market and retail rates more generally, so any problems (such as overheating property) associated with easing policy rates further are shared by the current QE scheme.

House prices and employment change in New Zealand



Source: CEIC

Then there is the inconsistency between the RBNZ noting that the economy has actually been stronger than anticipated, but painting a downbeat picture of the quarters ahead, saying they won't be tightening policy any time soon, and noting they are making progress on being able to deliver a negative cash rate. It's very hard to reconcile today's rate pause (if it is just a pause) with the economic realities and keep a credible view open for negative rates in the not too distant future.

One interpretation of all this, and the one we are leaning towards, is that the RBNZ is playing a complicated game of expectations management, though one that trips over some existing economic realities. So the RBNZ is keen to keep expectations alive to the prospects of further easing and to dim the prospects of future tightening in order to keep rate expectations low, and thereby longer-term market rates and yields low.

But this is also pushing the housing market into overheating while the economy as a whole seems to be in decent shape. All things considered, New Zealand probably doesn't need any further monetary stimulus and is running out of effective channels through which to implement this if it doesn't want to create further distortions.

So if that is the case, despite all the talk to the contrary, then the RBNZ is probably done with easing, unless the economy does deliver a double-dip. As the same is almost certainly also true for the RBA, then both the NZDUSD and AUDUSD are likely to be dominated by anticipated USD weakness rather than local monetary policy actions over the coming months. We anticipate the NZD remaining close to 0.68 by the year-end, before rising to 0.70 in 1Q20.

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