

Good Morning Asia - 13 April 2021

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Source: Shutterstock
Federal Reserve

How to position for this figure?

The consensus figure for the March US CPI release is for a very chunky 0.5%MoM gain. If that happened, it would build upon a 0.4% increase in February and a 0.3% gain in January. Three very strong monthly figures that would take 3m annualised inflation to more than 4%, and the 6m annualised inflation rate to something like 2.6%.

That's if it happens though. 0.5%MoM is a big hurdle to climb and a downside miss is possible. But [James Knightley makes a compelling case for the upside for CPI](#), following from the recent PPI figures and other high-frequency indicators of pricing pressure. And he notes that with inflation likely to be closer to 3% than 2% over the coming years, this raises the chances of a late 2022 Fed rate hike. That would actually mean that the market-implied rates from the Fed funds futures, which fully price in 0.25% Fed funds by Dec 2022, may not be as crazy as they might at first seem. And if you run the argument further, could spell further near-term upside for US Treasury yields and the USD. We will know more in 24 hours. In the meantime, I expect Asian markets will tread

water.

Global newsflow is mixed

Yesterday's market movements highlighted the fact that global newsflow is pretty mixed right now. On the Covid front, there is some positive news, with the UK opening up following its successful vaccination programme. And there is some sign that European vaccination is also now picking up pace after its poor start. But in the US, there are new spikes in infections in Michigan, which means that this state may be heading back into lockdown until that reverses. Also, the numbers out of India continue to look dreadful - Prakash mentions those a bit later on in his commentary.

It seems like Janet Yellen will not be looking to name China as a currency manipulator in the forthcoming semiannual Treasury FX report, which is good news for China though it was only ever a semantic distinction. And interesting comments from the Fed's Bullard, that a 70-80% vaccination rate might be considered a metric for tapering asset purchases. Currently, the US has administered at least one shot to 55.93 people for every 100 population, so it is well on the way to delivering that, though it's not clear if Bullard means full vaccination with 2 shots or just one. Even so, it could put a taper on track for the end of this year.

Adding to the negative side of the ledger, an attack on an Iranian nuclear facility is being blamed by Iranian spokespeople on Israel. As well as the possibility of a revenge attack unsettling markets, this probably undermines attempts to try to bring Iran back on board a nuclear agreement which could open the way for Iranian oil to come back onto the market - another potentially inflationary development if it keeps oil prices higher for longer.

Asia today

As mentioned, here is Prakash Sakpal on **India's** economy: "The recovery of the Indian economy from a record plunge last year has started to flounder as the country rides the second wave of the Covid-19 pandemic. Data released yesterday showed the steepest fall of industrial production (IP) in six months in February by -3.6% YoY. The average -2.2% YoY IP fall in Jan-Feb undermines expectations of further pick up in GDP growth in 1Q21 from +0.4% YoY in the previous quarter, although it gets some lift from the low base effects. Separately, CPI inflation rose to 5.5% YoY in March from 5.0% in February, further limiting the scope for central bank easing. The rapid second wave spread of Covid-19 together with macro policy paralysis sets this economy up for a rough ride over the rest of this year at the least, if not beyond. We are reviewing our FY2021 GDP growth forecast of 9.2% for a possible downgrade.

Singapore: Singapore's advance GDP estimate for 1Q21 will accompany the MAS's half-yearly monetary policy statement tomorrow morning (8 am local time). The consensus is centred on a much more moderate GDP fall than the -2.4% YoY rate recorded in 4Q20. We are an outlier in the consensus with our 0.2% YoY growth forecast, which we even imagine being at risk of more upside than downside surprise following strong NODX and manufacturing growth in Jan-Feb. The shift a year ago to a neutral monetary policy targeting zero S\$-NEER appreciation has served well for the export-driven recovery. We don't think the MAS is in a rush to alter this policy stance just yet, given that the sustained Covid-19 spread globally continues to threaten the export recovery ahead. And, with the S\$-NEER remaining near the mid-point of the estimated policy band, the market hasn't priced in any policy move either".

And **China** trade data for March due today is expected to show dramatic increases boosted by both base effects and Lunar New Year bounces. A 28.6%YoY gain marks the consensus median in CNY terms (a bit lower than the USD-based data due to CNY strength) and accompanies a 17.6% consensus forecast for imports.

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China: Credit growth limited by deleveraging reform

Although China's aggregate finance grew at a slower pace than last year, yuan loan growth was faster than a year ago, showing that shadow banking has continued to shrink. Together with deleveraging reform, this suggests that financial market risks are under control. We expect no change in monetary policy for 2021



Source: Shutterstock

Credit data matches deleveraging reform on real estate developers

China's total credit grew by CNY3.34 trillion in March and CNY10.24 trillion in 1Q21, down CNY873 billion from 1Q20. But yuan loans grew by CNY7.91 trillion in 1Q21, which was an increase of CNY659 billion from 1Q20.

The difference comes from a fall in shadow banking activities, including trust loans, entrusted loans, and less funding raising from corporate bonds and stocks.

This shows that China is in the midst of deleveraging reform, and will not expand credit in 2021.

Smaller shadow banking together with deleveraging reform suggests that financial market risks

are under control.

The deleveraging reform started with real estate property developers in early 2021, and there have been added regulations on how banks lend to these developers. Together with moves to shrink shadow banking businesses, this deleveraging reform should help real estate property developers to reduce debt. This is also important to the health of the financial sector in China because real estate property developers have borrowed heavily in the past.

"Smaller shadow banking together with deleveraging reform suggests that financial market risks are under control."

Liquidity was tight, but returned to normal after the Two Sessions

The increase in undiscounted bills of CNY325 billion in 1Q21 shows that liquidity in 1Q21 was tight as undiscounted bills have a function similar to cheques between corporates. The increase in undiscounted bills reflected higher demand for cash like credit. The tightness mainly came in January and ended in early March. The tone set by the Two Sessions in early March of a balanced monetary policy stance should have an impact on the central bank's daily liquidity management.

We believe that the People's Bank of China will continue to use 7D repo rate as a gauge of liquidity. We expect the 7D to hover around 2.2%, which is the 7D policy interest rate.

We expect no change in monetary policy

Before the government completes its deleveraging reform, we expect there to be no change in the PBoC's monetary policy, from the Reserve Requirement Ratio to 1Y and 5Y Loan Prime Rate, to the 7D reverse repo policy rate.

The chance of having a targeted RRR cut is also small. The economy is in recovery mode and there is no significant natural disaster, which would require such a cut. A targeted RRR cut could be justified for the agricultural sector, however, if it is affected by climate change.

Our USD/CNY forecast is 6.30 by end of the year as we expect a weaker dollar in the second half of the year.

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RBNZ preview: Quietly monitoring house prices

The Reserve Bank of New Zealand should simply reiterate that prolonged stimulus remains necessary on 14 April, and the impact on NZD, which seems to be pricing in most negatives should be limited. Housing demand appears to be weakening after some government measures but their effectiveness will be key in keeping rate expectations capped



Source: Shutterstock

Luxury apartments in Auckland waterfront, New Zealand

Central bank likely to stick to its recent stance

The Reserve Bank of New Zealand's meeting on 14 April should be a rather uneventful one. The policy message will likely be very similar to the February meeting.

Back then, the central bank stressed how the improvement in global and domestic conditions was not changing the fact that prolonged monetary stimulus was necessary to sustainably reach inflation (1-3%) and employment goals.

Since then, the Bank has received only one important data input, which probably endorsed the need to maintain a dovish tone: GDP unexpectedly dropped 0.9% year-on-year (-1.0% QoQ) in 4Q20, falling short of central bank expectations of 0.3% YoY growth as was specified in February forecasts.

However, that isn't enough to suggest that the Bank will step in with even more stimulus than it is currently providing. Negative rates appear out of the question (if nothing else, because of housing-bubble concerns), and more quantitative easing seems unlikely considering that total purchases under the Large Scale Asset Purchase Programme's (LSAP) are still far from reaching the NZD 100bn ceiling.

The Bank will release new economic projections at the next policy meeting, scheduled for 26 May.

Housing remains the key factor to watch

Despite the central bank fiercely defending its independence and its inflation-and-employment remit after the government asked to consider house prices when setting policy, the size of the housing bubble in New Zealand has become too large to believe it won't impact monetary policy.

Some tax-related government measures announced at the end of March aimed at curbing surging housing prices are expected to take some burden off the central bank, and the market has subsequently reacted by [scaling back expectations for policy normalisation](#) in 2021-2022.

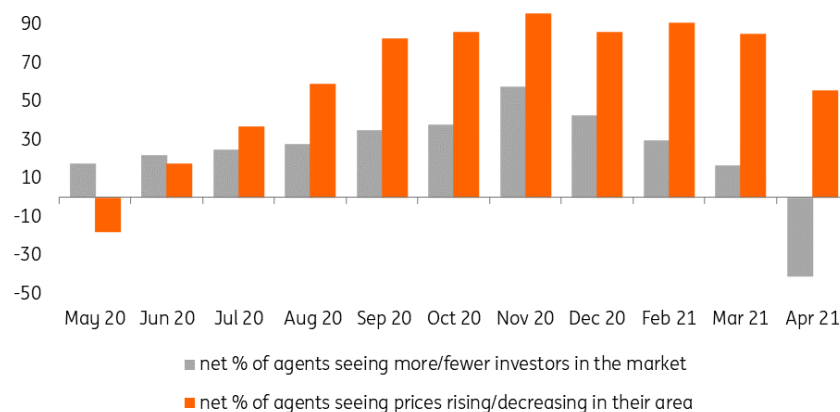
To keep the RBNZ rate expectations capped, markets will likely require evidence in the coming months that the government's measures are effectively curbing house prices

But to keep the RBNZ rate expectations capped, markets will likely require evidence in the coming months that the government's measures are effectively curbing house prices. We may have to wait until May to have enough data to gauge the effect on the housing market, but a [survey](#) of real estate agents conducted by the Real Estate Institute of New Zealand (REINZ) published on 07 April already provide some interesting hints.

As shown in the chart below, for the first time in a year, the majority of agents are seeing fewer rather than more investors in the housing market. The survey also showed a majority of agents reporting fewer people turning up at auctions and empty houses, and also fewer offshore inquiries. While those are early encouraging signs that government measures are hindering investor demand for housing, a sizeable majority of respondents still saw house prices rising in their area.

All this suggests it may still take time to see the impact on housing prices, and that that will most likely be a key determinant of where rate expectations go, as the RBNZ will inevitably (though implicitly) need to keep a close eye on that market.

Early signs of slowing housing demand



Source: REINZ

Limited impact on the undervalued NZD

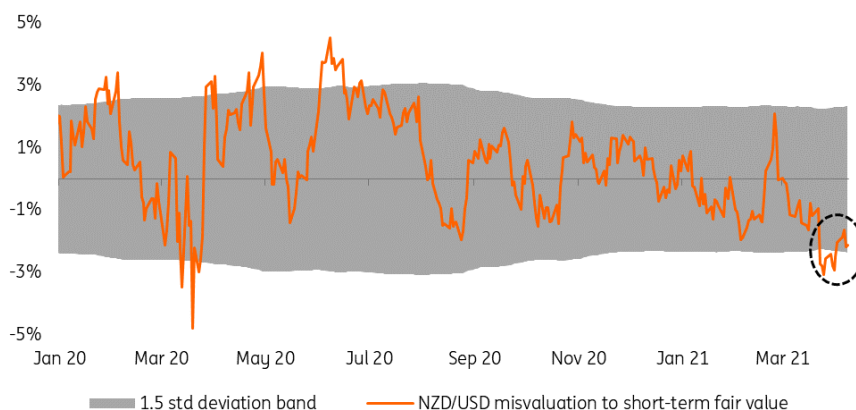
We think there is a significant probability that the April central bank meeting will be a non-event for NZD.

With rate expectations already low and unlikely to drop further (considering the unlikelihood of negative rates), the dragging impact of monetary policy on NZD is likely to be quite limited from now on.

It appears that most short-term negatives are already priced in when it comes to NZD/USD. Our short-term fair value model (calculated using short-term rate spread, the shape of the yield curve, equity performance, commodity prices and global risk appetite as factors) indicates that the pair is undervalued by 2.1% (as shown in the chart below).

This mis-valuation is close to the bottom of its 1.5 standard deviation band.

NZD/USD remains undervalued in the short-term



Source: ING, Refinitiv

Incidentally, data published by CFTC showed that NZD has returned to a much more balanced

speculative positioning (net-longs amount to 11% of open interest), suggesting limited scope for long-squeezing events.

Considering the relevance of the reopening of international travel for the tourism-centred New Zealand economy, NZD will be extremely sensitive (also considering its pro-cyclical nature) to the speed of the Covid-19 vaccine roll-out across major economies.

We continue to see NZD/USD make a move above 0.75 by this fall in line with our expectation for the global reflationary narrative to gather pace and the USD to enter a new downtrend.

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