Good MornING Asia - 13 February 2018

Saying that bonds are past their peak is not a useful contribution to the question of whether we are nearing a recession. Sadly, little else is either.

In this bundle

Opinion | 12 February 2018

Past its peak

Saying that bonds are past their peak is not a useful contribution to the question of whether we are nearing a recession. Sadly, little else is either.

rotten fruit

Billionaires can say what they want

Stocks rose yesterday. Some are calling this the end of the rout. That may be true. But it is only an opinion. Supporting the view, yesterday's S&P500 action saw every sector rise, though rate sensitive real estate only just made it into the green. Bond yields were dragged higher by equities - the causation shifting from bonds to equities to equities to bonds in the last session. All of this is encouraging, and technical analysts will no doubt also find some consolation in the charts that show the index recovering above key retracement levels, and bouncing off 200-day moving averages.

Yet others, notably certain billionaire investors, are pointing to the bond markets' continued rise in yields as indicative of an economy that is getting nearer to a recession, and thereby, imperiling this nascent equity recovery.What do I think?

I think that a lot of people waste a lot of other people's time with such views. Every day that passes is a day closer to the next recession. That is a fact. But that does not make recession imminent. Some months ago such commentators worried that the flattening yield curve was a harbinger of recession. We wrote that we disagreed with this analysis then. It is fairly easy to write off the view that a bear-steepening is also a harbinger of doom fairly easily too.

The unpalatable truth is that most of the big movements of financial markets and turning points of economies are next to impossible to predict. And mapping financial markets onto the economy is almost as unrewarding as trying to map the economy onto movements in financial markets. The scores of financial and economic models that get trotted out from time to time designed to predict recessions are all virtually alike in that by the time they provide a signal, it's pretty clear anyway. Others ruin their reputation with scores of false readings. The Samuelson quote, "the stock market has predicted nine of the last five recessions" is worth keeping in the back of your mind at all times.

Is recession a risk? It would take a fool to say no, but right now, all we have seen is a return to some "healthier" two-way risk in financial markets that means investors will have to think first before committing their funds. That, in my opinion, is not likely to bring recession any closer than it already is - whenever that is. As for the economy, it is another day almost devoid of information, so for our next installment of this recession argument, we need to look for tomorrow's US CPI data. That should calm recession fears, if only for one month.

Korean export prices fall for second month

It's clearly a quiet day for macro if we feel compelled to report Korean export and import prices. Korean export prices fell in January by a modest 0.4% MoM. but they are now down 3.5%YoY, and the January decline marked the third consecutive fall. Given the prominence of semiconductors in Korea's export basket, it is worth considering if this is a further indication that the semiconductor cycle has turned. If so, export volumes could be next. Given how widespread the semiconductor industry is in the region, this will not be only a Korean problem, but Korea and Taiwan are the canaries in this particular coal-mine and will need watching carefully

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Snap | 12 February 2018 India

India's growth has gained some traction

The balance of economic risks remains tilted toward inflation

Source: Shutterstock

5.1% CPI inflation in January

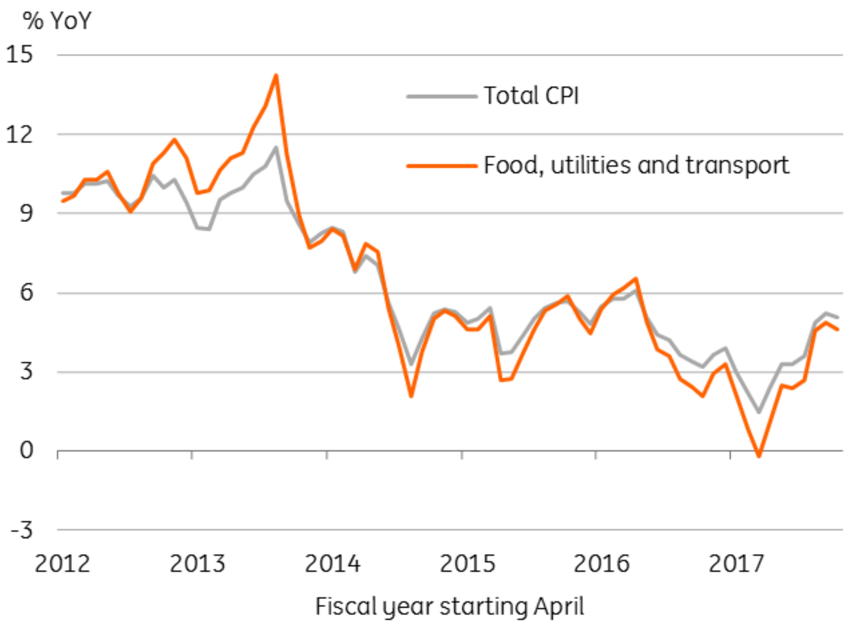
As expected

Stubborn inflation

India's consumer price inflation eased in line with the consensus to 5.1% year-on-year in January from 5.2% in the previous month. The seasonal month-on-month dip in food prices outweighed higher housing and transport prices while most other CPI components but for fuel posted month-on-month increases. The data is consistent with the Reserve Bank of India's (RBI), the central bank, forecasts for 5.1% average inflation in the current quarter, up from a 4.6% average in the previous quarter.

January's slight slowdown in inflation doesn't offer much hope of a lasting relief from inflation. The RBI has warned of continued upward inflation pressures this year from persistent high food and oil-related components, hikes in housing allowance for civil servants, higher customs duty on several imported products, the fiscal overrun, and rising inflation expectations. On the RBI's forecast, inflation could accelerate to as much as 5.6% in the first half of FY2018-19, followed by some moderation to 4.5-4.6% in the second half.

Upward inflation pressure



Source: Bloomberg, ING

7.1%

Industrial production growth in December

Better than expected

But some good news on growth

Also released yesterday, industrial production growth in December was better than expected at 7.1% YoY (consensus 6.0%, ING 5.6%), while the November reading was revised up to 8.8% from 8.4%. The 5.9% IP growth in the October-December quarter was up from 3.3% in the previous quarter, pointing to an acceleration of GDP growth over the same period. This data imparts some upside risk to our forecast of a modest pick-up in GDP growth to 6.5% in the October-January from 6.3% in the previous quarter (consensus 7.0%, data is due February 28).

Little policy leeway for the RBI

Growth has gained some traction but economic risks remains tilted toward inflation. With rising government borrowing constraining monetary tightening, our baseline for 2018 remains no change to RBI rate policy.

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China: Shadow banking shrinking

China's loan data shows that shadow banking is shrinking, this could be the result of financial deleveraging reform. We expect the reform to continue for the rest of 2018

Source: Shutterstock

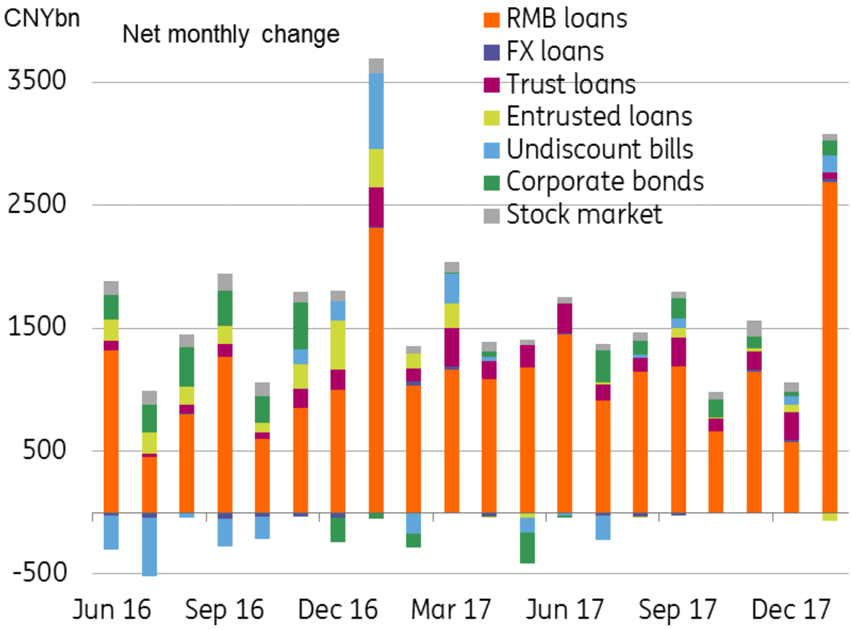
China may have succeded in reining in shadow banking

Data released by the Chinese central bank (PBoC) reflects that core shadow banking items shrank in total social financing, a measure of standard banking plus shadow banking activities. Meanwhile, loans going to standard channels, namely, new yuan loans grew 40% year-on-year to CNY2.69 trillion and contributed 87.9% of total social financing.

Even though banks are usually eager to book loans at the beginning of the year in order to enjoy a full year of interest income, it seems that financial regulators, including the central bank, the banking regulator, insurance regulator and the securities regulator, have gained some success in limiting shadow banking activities. New trust loans fell to CNY45.5 billion, and new entrusted loans contracted by CNY71.4 billion, which resulted in a 17%YoY reduction of total social financing.

Shadow banking items have moved to yuan loans

Core shadow banking items are trust loans, entrusted loans and undiscounted bankers acceptance



Source: ING, Bloomberg

Core shadow banking = trust loan + entrusted loan + undiscounted bankers acceptance

CNY2.7tr

New yuan loans

Jan 2018

Implication for 2018 - tightness of liquidity to continue

The change in the structure of total social financial shows that the impact of financial deleveraging reform may have started to kick in. We expect yuan loans to continue to grow faster than shadow banking items in 2018. We believe that this is only the beginning of financial deleveraging in China. This success needs further policy consolidation.

It is therefore likely that the central bank will tighten liquidity for the rest of the year. The recent temporary liquidity injection was to avoid spikes in short-term interest rates around the Chinese New Year. After the Chinese New Year, we expect to see more regulations on financial deleveraging. And that could be the result of tighter liquidity through daily open market operations.

Aside from tightening through daily liquidity management, we expect the central bank to follow the Fed in raising interest rates (or the 7D reverse repo rate) three times in 2018. But as liquidity tightening could have already pushed up short-term rates by then, the magnitude of the PBoC's rate hike could be as mild as five basis points, the same as the December hike.

This is to make sure that the PBoC would not create an environment where interest rates in China are too high. It is true that financial deleveraging needs higher interest rates to drive out poor quality corporates and financial institutions, so the regulators would also be careful enough not to create a liquidity or credit crunch.

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