Good MornING Asia - 16 May 2018

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By Robert Carnell

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Burst bond Dam?

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Source: Niall Williams

Next stop....3.70%?

News headlines this morning led with the cancellation of the two-Korea talks due to start today following a US-Korean air-drill, which the N Koreans, perhaps reasonably, took offense at. This is a sensitive nation quick to take offense. Did no-one see this coming, seriously?

Stocks are off. The S&P 500 overnight gapped 0.7% lower, and Asian stocks and FX will likely follow suit this morning. But if this is a generalized risk-off situation developing, the combination of a stronger dollar (yes, that works) and weaker bonds (10Y US Treasury yields are now 3.07%) looks odd.

Yesterday we commented on the breaking of the 3.0% 10Y Treasury yield hurdle. Our consideration then was that this was best described as a 2bp move - nothing significant. But as today's moves have shown, they merely marked the start of a new trading range, where there is frankly no big psychological hurdle in sight. Looking back in history, the last significant peak in yields was in February 2011, when yields held up at about 3.70%-3.80%. Before then the yield trend was predominantly downward, from much higher levels.

Why this is significant, is that if bonds are embarked on a journey to higher yields, then the recent outflows from troubled EM countries (Argentina, Turkey, Indonesia) could become even greater. This does not inevitably mean that it will turn into a full-blown EM rout, but it makes it easier for one to develop should conditions worsen and spook investors.

If there is one silver lining in this otherwise unhelpful development, it is that at least the yield curve has steepened a bit. That's one source of doom that looks a little less threatening this morning.

3.07% US 10Y Treasury yield

It was 3.0% yesterday

US dataflow nothing wrong with that - Japan's disappointing...Europe?

Some headlines are reporting disappointment in US retail sales yesterday as a factor in the market's ructions, but this simply isn't fair. All the headline and core and control figures for retail sales were in line with expectations. Admittedly, I think they should have been higher in places as they should have been getting a tailwind from the rise in retail gasoline prices. But these on-target figures were also matched with upwards revisions to most areas last month. The market moves were simply not a US data-driven event.

Today though, we could see the data improve further. US Industrial production for April has to deal with the 13th coldest month on record since 1895. That's cold. That means more people leaving their thermostat's in their houses turned up. That means more electricity generated to provide that warmth. Other data may suffer. Housing starts and building permits will be negatively affected. Precipitation levels were about normal for April, but what fell, was more likely to have fallen as snow. Not good house building / buying weather.

Europe's data revolves around CPI for April, though final readings. We won't see if Europe's inflation backdrop has improved for a few more weeks yet. Otherwise, attention is focussed on the Italian political talks, with a Northern League / Five-Star (North-Star?) talks are said to be entering their final lap. Should we be worried about that? On the one hand - yes, this sounds like a potentially anti-EU, anti-establishment political development. On the other hand, was what went before it so good?

If you are looking for an economic scapegoat for market jitters, you need look no further than some frankly not very impressive Chinese figures yesterday, when we saw the release of all the major activity indicators for April, and there were downside misses for two out of the three main ones. Retail sales and fixed asset investment undershot both expectations and the previous month's growth rate. Some solace can be gleaned from better than expected industrial production, But not much. We'll be giving this some more thought over the next few days to see if we need to be more concerned about China's growth trends.

Data out of the APAC region's more troubled economies, Indonesia, Philippines and India, was mostly bad yesterday with the Indonesian trade deficit in March blowing out to $1.6bn from $1.1bn in February. A rate hike form BI tomorrow is looking very likely, but we are concerned that this may not cap the decline in sentiment. Philippine remittance data was also much weaker than expected, down 9.8%YoY, against expectations for a 3.7% gain. India stands out with some better trade data.

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Indonesia: April trade data and 1Q current account disappoint

A downside surprise in April's trade balance and the 1Q current account deficit pressure the rupiah (IDR)

Source: Shutterstock

-$5.5bn

1Q current account balance

Equivalent to -2.14% of GDP

Lower than expected

IDR has fallen by 4.3% since end January partly due to weak external payments position

The recent weakness of IDR is likely a reflection of a worsening external payments position. Indonesia's trade balance was a measly $315m surplus in contrast to $$4.1bn trade surplus in 1Q 2017. A larger deficit in service trade and limited incomes from abroad has brought this year's 1Q current account deficit to -$5.5bn, or to -2.14% of GDP from Q1 2017's current account deficit of only -$2.3bn or -1% of GDP. The April trade deficit surprised on the downside and may indicate another weak current account balance in the second quarter and a full-year current account deficit that is above -2% of GDP in 2018.

-$1.6bn

April trade balance

Reversal of April 2017 surplus of $1.3bn

Worse than expected

April trade deficit was a downside surprise as imports surged

Indonesia posted a trade deficit of $1.6bn, which was a reversal of the $1.3bn surplus in April 2017 and worse than consensus. The April trade deficit is a downside surprise and would likely see the 2Q current account deficit at more than -2% of GDP. In March, Bank Indonesia (BI) expected a 2018 current account deficit of -2% to -2.5% of GDP. BI Governor Agus Martowardojo in April expected a 2018 deficit equivalent to -2.2% of GDP, above the consensus forecast of 2%.

In the coming months, the trade balance is likely to remain weaker than last year. Import growth surprised on the upside, with a 35% year-on-year increase, almost double the consensus forecast and four times the pace seen in March. Oil and non-oil imports accelerated in April and resumed the strong growth of non-oil imports seen in January and February. The weaker IDR may have also contributed to the surge in imports especially without indication of monetary tightening during most of last month. A strong domestic demand growth outlook is also contributing to strong imports. Consumer confidence in 1Q was higher than 1Q 2017 while April consumer confidence was steady at April 2017's level. Export growth, on the other hand, moderately improved to 9% YoY in April from 6.2% in March but slowed from the 14% pace a year ago. Moderate export growth seems to be broad-based with non-oil exports growth of 8.5% in April from the 14% pace of the 12-moving average up to March this year.

Indonesia: A policy rate hike this week

A rate hike at the 17 May meeting is now likely after the governor of the central bank signalled the need to take pre-emptive action to support the currency

4.25% Prevailing BI policy rate

Likely 25 bps higher at this week's meeting

The timing of our rate hike view has been accelerated with the bank governor's statement

Bank Indonesia (BI) Governor Agus Martowardojo signalled that BI has room to adjust its policy rate as a preemptive measure to ensure the stability of the currency and the economy. In our recent notes about monetary policy, inflation and the Indonesian rupiah (IDR), we had increasingly flagged a rate hike possibility this month or in June. However, we were then still leaning towards a June rate hike as the new BI governor takes the helm on 24 May. This implies that we were favouring a 28 June rate hike, which would also serve as a signal to the market about the change in the leadership. This expectation was in line with recent history when the then new BI Governor Martowardojo tweaked policy rate at the start of his governorship. The reason for the recent hawkishness is due to the likely impact of a significantly weaker IDR on the economy. Delaying monetary tightening to June could bring about uncontrolled weakness of the currency, which has lost as much as 5.9% in the past three and a half months (despite a significant amount of central bank intervention in the FX spot market). If the depreciation continues, then inflation and inflation expectations could jump while economic growth would be at risk due to slower household spending. With the hawkish signal from the outgoing BI governor, we now expect a BI rate hike as early as this week.

Article | 15 May 2018 Malaysia

Malaysia: So far, so good

But it depends on what turn economic policies take in the first 100 days of the Mahathir administration

Although the muted market reaction to last week's unexpected election outcome lessens our confidence in our forecast that the Malaysian ringgit (MYR) will breach through the 4.00 level against the US dollar in the near term, we are not rushing to revise it just yet.

5.6%

Consensus forecast for 1Q18 GDP growth

Slower than 5.9% in 4Q18

Steady GDP growth

Malaysia's first key economic data under the new government- GDP for the first quarter of 2018- is due on Thursday, 17 May. Our forecast is 5.6% year-on-year growth, in line with the consensus. A modest slowdown from 5.9% in the previous quarter is largely due to the high base effect rather than any underlying economic weakness.

Malaysia's exports outperformed the rest of Asia's with 20% YoY growth in USD-terms in 1Q18. Industrial production growth, which is closely correlated with GDP growth, accelerated, too. We also think that elections spending supported the strength of domestic demand coming into 2018. The consumer-friendly policies under the new government should keep domestic demand supportive of GDP growth in the period ahead, even if the global trade war threatens exports.

We forecast full-year 2018 GDP growth of 5.5%, the low end of the official 5.5-6.0%.

Critical 100 days

The markets outperformed expectations in the first two days of trading after the election holiday, although there was some weakness of the MYR (see figure) which can be attributed to broad USD strength.

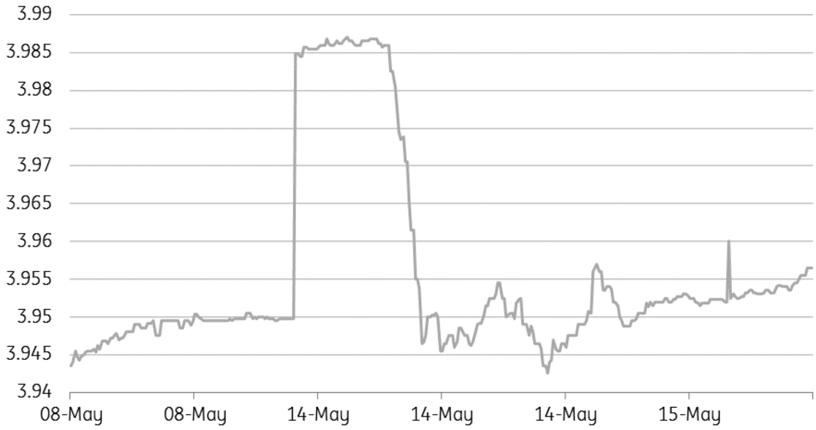
The election holiday allowed market players time to digest the election surprise and adjust expectations of policies under the new administration. A smooth transition of power to Mahathir Bin Mohamad and his swift move to spearhead policy initiatives by getting his economic team (the "Council of Eminent People") in place, deserve some credit for an almost unshattered market confidence. But at the same time, some differences with the coalition partners on initial cabinet appointments cannot be fully ignored.

> *The fundamentals are still there. When the fiscal conditions improve, this will be the final factor to have our ratings improved. – Zeti Akhtar Aziz, former central bank governor and a member of Mahathir's economic team*

The resilient markets, by no means, suggest there is no further uncertainty ahead. The big issue for the markets, however, is Mahathir's plan to eliminate the Goods and Services Tax within the first 100 days of his rule. So far, there are no signs of Mahathir backtracking on this promise. Mahathir's economic team, which is comprised of people from a former finance minister and central banker to corporate leaders, is confident that scrapping the GST will not dent government revenues.

However, backtracking on economic reforms will certainly dent investor confidence, in our view. The current strong growth may help the economy absorb any GST revenue loss now, but that won't be the situation forever.

MYR per USD: A short-lived post-election spike



Source: Bloomberg, ING

Snap | 15 May 2018

Philippines remittances plunge in March. Is it a one-off?

Overseas Filipino worker remittances dropped 9.8% to $2.36bn in March due to fewer banking days and high base effects. Weak remittances are keeping the...

Source: Shutterstock

-9.8%

Worse than expected

March overseas worker remittance YoY change

Recovery possible in April

Remittances across major regions were down YoY in March and reinforce the norm that underscores the bias for peso weakness

Overseas Filipino worker remittances fell -9.8% YoY in March as remittances in major host regions were down. Remittances from Asia, Oceania, Americas, Europe and the Middle East were -3%, -19%, -2.3%, -9.4% and -23.1% YoY, respectively. The central bank pointed to fewer banking days due to the Holy Week commemoration. This implies that April should show a good rebound since Holy Week in 2017 was in April. Base effects may have also contributed to the weak March inflows since March 2017 posted an almost 11% YoY increase. This could explain the drop in remittances from Asia, the Americas, Oceania and Europe. But there is also a sustained weakness of remittances in the Middle East. Remittances from Saudi Arabia, Qatar, and Kuwait posted two straight months of YoY drops while UAE posted a drop only in March. We expect remittances to exhibit some resilience in April. However, PHP was relatively weak in March and traded as weak at PHP52.39 and closed at PHP52.16. We had expected that remittances would more than cover the March trade deficit by $100m. Instead remittances in March were $248m short to cover the trade gap. The shortfall of remittances is the norm and contributes to the underlying weakness of PHP. The recent bout of PHP weakness is a combination of this shortfall, low emerging market risk appetite, the market's dovish take of the central bank's policy rate hike and higher oil prices.