

Good MornING Asia - 17 January 2018

Dollar blues, debt worries, Yen strength and oil re-think. Markets may be about to have one of their periodic re-alignments with many of the moves connected. Get one right, and you will probably get most of them right

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By Robert Carnell



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Signposts saying everything or nothing

The pause that refreshes?

Fears that the recent upswing in the EUR has taken it to oversold territory have seen it tread water in the last few days. But although we would argue that the current EUR surge has further to run (mainly because we haven't really begun to see the full extent of the unwind in the European government bond market) the next few days could see some two-way movement that makes caution sensible.

Most notably, the looming government shutdown in the US may not happen. These things tend to go right to the cliff edge before those involved remember they are afraid of heights (or of losing votes more likely) and pull back from the brink. This could see a short-term relief rally, including in equity markets, which have also begun to express concerns. However, politics is a murky business, and we view the whole shutdown fiasco is a coin-toss in terms of probability.

Then there is oil. The dollar and oil are negatively correlated. And both drive each other to greater and lesser degrees at times. The recent oil price surge also looks a bit overdone to us, amid soaring shale supply expectations and we may see oil prices fall in the coming weeks, which could provide a little short-term support. Obviously, OPEC is trying to maintain the fiction that it is still in control of this market, but that has not been true for years. The downswing is only a matter of time in this author's view.

Less clear is the JPY direction. Recent BoJ moves have spurred thoughts of some tinkering with QQE this year, and this is giving the JPY a lot of support. But for the BoJ, experimenting with exit positions is one thing, a surging currency entirely another and we may see some push-back from Japan's central bank if this move continues much further, even if (as we believe) the general proposition that they are looking to normalize policy is a good one. Today's machine orders data lend further support to the notion that Japan really is seeing a sustainable growth pick up.

We could throw cryptocurrencies into this mix. They are getting beaten up by monetary authorities worldwide right now. But blockchain technology has a long way to go, and most likely, one or more of the tokens that typically underpin transactions in this sphere will be carried along with it, perhaps to unthinkable highs. Right now though, their recent weakness is another reason to hold the alternative, and for most, that is probably the USD, given an excuse to do so.

Summing up, longer term, we like the EUR and the JPY more than the USD, we like oil prices a bit lower, and longer-dated bond yields higher, though mainly in the Eurozone. But in the shorter term, markets tend not to move in straight lines, and if we see a correction in one of these markets, we could well see a correction in them all. That's all it would be though.

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China: Qualitative and quantitative growth

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2017 GDP could surprise on the upside

Our forecast for GDP growth is the same as consensus at 6.8% for 2017, and 6.7% YoY for 4Q17. As Premier Li hinted at 6.9% growth for 2017, the GDP data is likely to surprise on the upside. The key is which part of the GDP will surprise? This could come from trade as imports in December were exceptionally low, partly due to restrictions on solid waste imports.

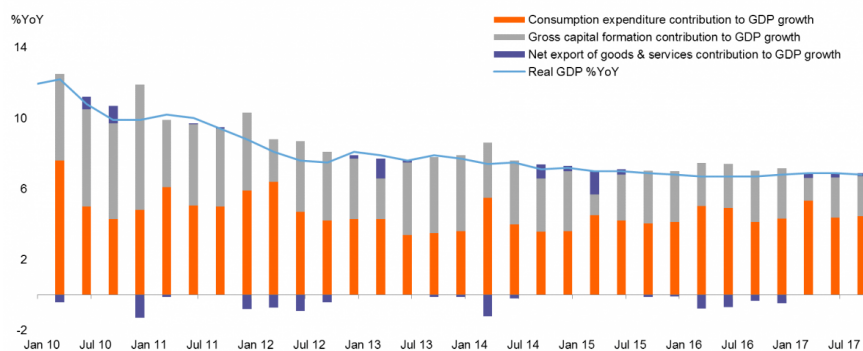
Retail sales could take the lead

Within the three main components of economic activity, we expect retail sales to stand out - growing at 10.4% YoY in December compared to the prior month's 10.2%. Spending growth should benefit from the western holiday atmosphere.

Fixed asset investment should hold up at 7.2% YoY as infrastructure investment (around 20%YoY) continues to keep overall investment growth stable. Investment in real estate should continue to

grow, albeit at a slower rate (around 4% YoY).

Industrial production should be slower in December to 6.0% YoY, from 6.1% YoY in November, as some coal and copper factories stopped production in the month for the sake of better air. We expect that production of technology-related parts and products will continue to be strong. This includes industrial robots and integrated circuits.



Source: ING, CEIC

2018 is a year for qualitative growth

We expect the Chinese government to put more emphasis on striving for qualitative growth and at the same time keeping quantitative growth stable at 6.7%.

This in fact would be a continuation of the 2017 growth pattern but through different channels. In 2017 qualitative improvement came from overcapacity cuts that have forced corporates to deleverage and also help in the fight against pollution.

In 2018, we see at least two source of qualitative improvement:

The first comes from financial deleveraging reforms already in progress. This progress could be more gradual than corporate deleveraging via overcapacity cuts. The risks could be systemic if reform is too aggressive - shadow banking and the banking sector are interlinked. Depressed growth in the shadow banking sector would have a direct feedback effect on banks and other non-bank financial institutions. Therefore we see that quite a few regulations and guidelines have been issued and the speed of implementation varies. We do not expect strict implementation of all the restrictive measures at once but instead a gradual approach.

Another qualitative improvement channel would come from the desire to have a better and more sustainable environment. This includes generation of more power from clean energy instead of polluting sources such as coal. The impact is two-fold. Building more infrastructure on clean energy production would offset the loss of production from polluting energy sources. But the change process will be painful for these polluting sectors.

6.7%

China GDP growth in 2018

versus 6.8% forecast in 2017

As well as quantitative growth

To keep economic growth stable at 6.7% in 2017, consumption from the rising middle income class would be key. There should not be any difficulties in growing consumption. However, there is a small hidden risk of decreasing wealth effect for wealth management product investors. Financial deleveraging reform could reduce the return of wealth management products because fewer producers would invest in high-risk investment tools.

Fixed asset investments would continue to be the secondary driver of the economy, mostly coming from infrastructure investments, including water management and clean energy investments.

Industrial production would continue to be derailed by slower growth in energy production but on the other hand supported by products for the high-tech and services sectors.

Again, we are not particularly worried that export growth will slow because of yuan appreciation, with imports of parts that are part of value add production for exports.

Our expectation of 3% yuan appreciation against the dollar in 2018 is mild enough to avoid a fall in export growth, given global demand is rising.

Singapore: December Non-oil domestic exports disappoint

Total non-oil domestic exports rise 3.1%YoY, fall 5.0%MoM, with an electronics export decline unwinding all of last month's electronics gains



Container yard

Underperforming the regional trends

Asian exports are battling much tougher year-on-year comparisons and most of the trade releases over the last month have shown year on year growth slowing. But exports from Malaysia and Korea have held up quite well despite some slight moderation of pace. Taiwan's exports even registered some year on year acceleration. The Philippines did less well, and now Singapore's key trade statistics puts it into the underperformer camp too.

3.1%YoY

Worse than expected

Singapore's Non-Oil domestic Exports (NODX)

Down 5.0%MoM - electronics exports soft

Weak exports to China. Hong Kong account for much of the undershoot

By country, some of the biggest month-on-month declines in USD terms were in Singapore's exports to Mainland China and to Hong Kong (which may also be destined for Mainland China ultimately). This also tallies with recent soft China import data, which we had put down partly to declines in imports of solid waste, but clearly also has hit imports from other regional electronics parts suppliers too.

Other than electronics, pharmaceuticals put in a creditable performance, rising 7.0%YoY, and chemicals exports held up reasonably at 7.1%YoY, only slightly down from 9.9% in November.

Singapore still on track for April policy change by MAS

Despite this disappointment, we don't believe today's data drastically changes our outlook for a modest tweak to the MAS currency policy at their April meeting, which we believe will shift to a very slight nominal effective exchange rate (NEER) appreciation. But we would be happier if we could see some more evidence that the domestic economy was picking up some of the slack that the tradeables sector now seems to be leaving. We will be keeping this forecast under review in case we need to downgrade it.

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