

## Good MornING Asia - 17 May 2018

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## Euro problems

Euro takes a beating as coalition talks suggest an anti-European government could emerge in Italy



Source: istock

### Never a dull moment in the Eurozone!

After suggesting yesterday that Italy's prospective government might not be much less market-friendly than previous ones, we feel we owe our readers a swift retraction. It is hard to say exactly what the latest state of play is, there have been so many allegations and denials. This is a fast-moving event. Full details of the Northern League / Five Star (North-Star?) coalition manifesto should be out within a few days, But despite suggestions to the contrary, it will apparently **not** contain a demand for Italy's debt held by the ECB to be cancelled, or a mechanism for countries to leave the Eurozone. It may, however, ask for some treaty changes. Whatever it contains, it is hardly going to support the Macron-Merkel (Mackerel?) plans for reform of the Eurozone, and the Euro (EUR) is caught in the cross-fire. EURUSD was down below 1.18 last night, before staging a modest recovery this morning. Asian FX might stage a modest rally as the EUR momentum shifts back in the EUR's favour in the short-term.

This story will doubtless deliver more entertainment over the coming days. But it is hard to see how it will be particularly Euro supportive. That said, there are plenty of factors on the other side of FX crosses to please all sides of the market, not least, what is happening in terms of the US-China trade talks.

Sterling has been a surprise gainer against the EUR (not the USD though). Our feeling is that trouble

with Italy will make the Europeans even less likely to throw a lifeline to the UK in Brexit negotiations. It will be all hands to the pump to secure and save the single currency project. So there may be some room for a reversal here, with the USD probably the most likely way to play this if it begins to turn ugly.

## Not too boring in the US and UK either

Whilst the allegations over who paid whom for what in the US continue to provide news channels a steady stream of pap to dull the senses of their viewers, the fallout from the US-Korea air-drills this week has still not fully settled. N Korea is allegedly announcing it is not going to trade in its nukes for an economic boost. As that's all that Trump wants, the June 12 talks in Singapore may be a little less constructive than was initially hoped for.

We haven't talked about Brexit here for some weeks - deliberately, as we assume that tolerance for this is limited. But according to stories running in the British Press, PM Theresa May will set out to the EU her clarification on Brexit this week before they meet in June to discuss how to proceed. The latest reports suggest a combination of sliding extensions to the Customs Union post-2019 to enable the UK to come up with effective border controls and a feasible solution to the Irish border. Sounds a bit feeble to me. But anything that postpones the plunge into the abyss of life outside the EU seems welcome right now - that is if the EU decides to accept this proposal, which they may not.

## Run of G-7 economic data supports the geopolitical bias

Yesterday's data flow confirmed that core inflation in the Eurozone remains way off target and heading in the wrong direction. Oil price rises will in due course feed into core figures through second round channels like airfares. And with summer approaching in Europe, that probably won't take too many more months to become apparent. The US dataflow held few surprises yesterday. With April 2018 one of the coldest April's on record since 1895, it wasn't too surprising to see the housing starts and permits figures undershooting expectations - but not by much, so all in all, not a bad result. April industrial production was also pretty good - probably also helped by low temperatures.

Today's data flow from the G-7 can probably be mainly ignored. Japan's Machine orders data is mainly noise (-3.9%MoM), though the US Philly Fed survey may be worth half a glance when it is out later.

## Asia today - the fallout from EM concerns should see BI hiking

Today, another Asian central bank will likely have to respond to international capital outflows by hiking rates. First it was the Philippine Central bank, now it is Bank Indonesia. We expect a 25bp hike from them today, taking the policy 7-Day Repo rate to 4.50%. The real question is, will this be enough? For either them or the Philippines? The only sensible answer is that it will be sufficient once current account deficits generated by overstimulated economies start to respond. This may require further hikes, a slowdown in growth, and perhaps some winding back of fiscal stimulus. None of this will be easy, or popular. A stronger USD makes it harder still. Governments have fallen over less. The political calendar hots up from this August before national elections next year.

Malaysian GDP for 1Q18 should come in in-line with consensus at 5.6%, a little slower than the

5.9%. A little slowdown here won't hurt from these rates, and in any case, Malaysia does not have the current account issues of the other two SE Asian economies mentioned.

Singapore's April NODX was stronger than expected, rising 6.5%MoM, which was a good bounce back from March weakness, even when you take downward revisions for March into account. There was, however, another negative electronics element to these numbers, with electronics falling 6.9%YoY, so we will be poring through the data when more detail is released to get to the bottom of this.

Finally, Australian labour market data. Yesterday, wage cost indices were no better and perhaps even a little bit softer than the consensus view. I wouldn't be surprised to see whatever the headline employment figure is, to be dominated by part-time jobs. That could mean a decent headline, but a poor Full-time equivalence.

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## Japan's GDP declines 0.6% in 1Q

Is there more to this than meets the eye? Or is this like all the other weak G-7 GDP reports in 1Q?



Source: Shutterstock

### Japan's GDP is choppy

The first thing you notice when you look back at a time series of Japanese GDP is that from time to time, it delivers either an outside spike or a dismal-looking trough. Unlike some of its regional neighbours, Japan's GDP does not look as if it is massaged by statisticians to make it look more palatable. That also makes it more credible. And as a result, we need not worry overly when the occasional bad quarter comes. This was not a particularly shocking result. Markets were braced for 1Q18 weakness. The data merely came in a little weaker than had been imagined.

Amongst the weaker elements (all figures QoQ% non-annualised), private consumption (0.0%), residential investment (-2.7%), non-residential investment (-0.1%). Net exports were about the only bright spot, contributing 0.1pp to overall GDP growth.

# -0.6%

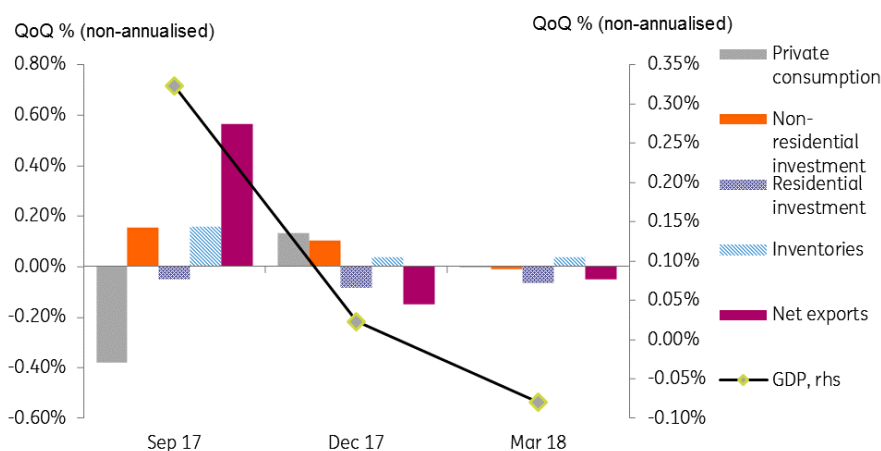
1Q18 GDP QoQ annualised

Downward revisions to previous quarters

Worse than expected

## Contributions to GDP growth (QoQ%)

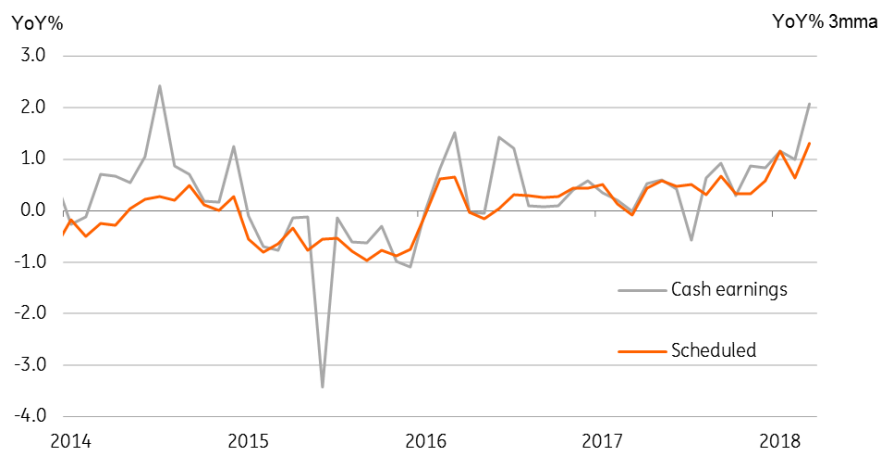
Recent trend has been down



## The outlook is improving

Just like the weakness in the US and Eurozone in the first quarter, we don't think this is more than a seasonal blip. Forward-looking indicators are painting a more upbeat picture. The best of these indicators is cash wages, which at 2.1%, are higher than they have been for a very long time, and that will help private consumption to bounce back into healthy territory in 2Q18.

## Japanese Cash wages point to brighter future



## This data does not help the BoJ

But whether it is real or just an aberration, we will have to wait now until August for confirmation of this rosy interpretation of not-very-good Japanese GDP data, with high-frequency data in the meantime only likely to partially assuage any residual doubts.

For the Bank of Japan, it means it is now virtually impossible to see it adjusting its quantitative and qualitative easing programme to a less accommodative setting this year, irrespective of what the European Central Bank manages to do in the background. Clearly it would be easier for the BoJ to make adjustments if it were not the only G-7 central bank trying to extricate itself from a bond

purchasing dilemma. But the ECB doesn't look much closer to a change of policy either, despite market (over) reaction to some comments from the ECB's François Villeroy yesterday. This picture also does not help the yen either. Thoughts of a move towards USD/JPY 100 by the turn of the year look harder to justify today.

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# Thailand's central bank leaves policy on hold

We maintain our view of no change to the Bank of Thailand policy anytime soon



Source: Shutterstock

We recently revised our USD/THB forecast for end-2018 to 32.3 from 31.0. However, just as for most other emerging market currencies, the new forecast could become stale sooner rather than later. We maintain our view of no change to the BoT policy anytime soon.

# 1.5%

BoT policy rate

No change

As expected

## On-hold monetary policy

As widely expected, The Bank of Thailand's (BoT) monetary policy committee unanimously decided



to leave policy unchanged at the meeting held today. The decision comes as the Thai baht (THB) weakened 3% against the US dollar over one month, while there were no other economic motives for change from an on-hold policy stance that's been in place for over three years now. The last policy move was a 25bp cut to the policy rate to 1.50% in April 2015, marking the end of that easing cycle.

## Weakening currency

The 16% THB appreciation against USD from end-2016 through April this year allows the central bank to accommodate some depreciation pressure. The broad USD strength and outflows from the local bond market since April are associated with a 3% depreciation of the THB above the 32 level against USD. The hit to local currency bonds is evident in a 20bp spike in the 10-year yield, the steepest selloff since late 2016.

Today's policy statement noted that, "In the period ahead, the baht would likely remain volatile mainly due to uncertainties pertaining to monetary, fiscal and foreign trade policies among major advanced economies."

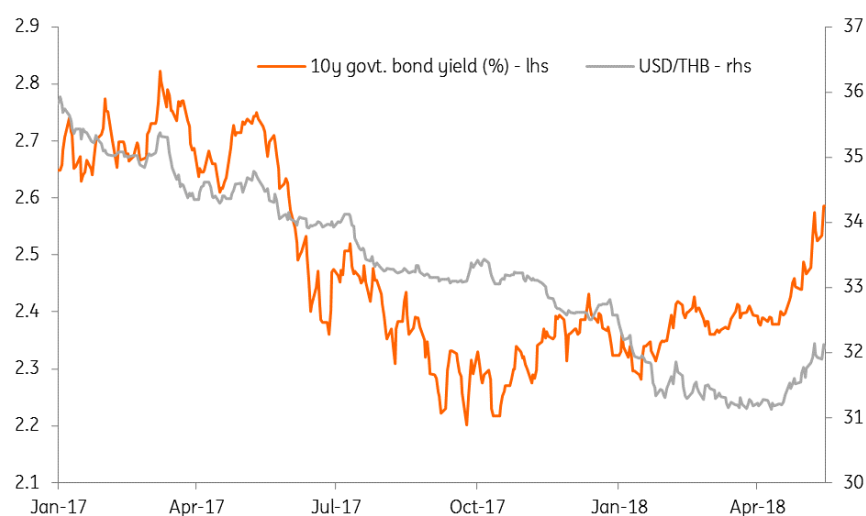
The only support for the currency is the prevalence of large current account surpluses, which amounted to \$48bn or about 11% of GDP in each of the last two years, and at \$17bn in the first quarter of 2018 was \$2bn wider on the year.

## Slow growth, low inflation

Thailand's GDP growth is poised to moderate as the data for the first quarter of 2018 is expected to show next week (May 21), while inflation remains negligible at 1.1% in April or close to the low end of the BoT's 1-4% medium-term target. As elsewhere, high household debt further constrains any monetary tightening along the way.

With expectations of these trends continuing, we aren't forecasting any change to the BoT policy for the rest of the year.

## Weakening government bonds and THB



Source: Bloomberg, ING

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