Good MornING Asia - 18 January 2018

Global sentiment has been bouyed by optimism that a US government shutdown can be avoided - but we see this as a temporary lull in the fortunes of the USD. Otherwise, a day of inaction beckons from Asian central Banks

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By Robert Carnell

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Rising sentiment ahead of Senate vote on spending bill

With the end of the week spelling make or break time for discussions over averting the US government shutdown, Republican lawmakers are expressing optimism that enough Democrats sign up to the extension to avert a crisis. Markets seem to be leaning that way too. And as we noted in yesterday's ramble, that is allowing the USD to push back against the EUR, in what we view as a temporary correction of a broader EUR rally. Stocks too seem to be making the best of the limited good news emanating from the Capitol, and bond yields are nosing higher again. About the only constant in markets right now seems to be the front end of the US Treasury curve, where 2Y yields keep pushing higher. You can almost use a ruler to chart this rise.

The good news is not confined to the political backdrop. US production soared 0.9%MoM in December and capacity utilisation is pushing sharply higher. As well as suggesting a pick up in already healthy business investment, in the past, this might also have suggested higher inflation. We aren't so sure today if that follows. If in doubt, assume not.

The G-7 saw some central bank action yesterday, with the Bank of Canada hiking rates to 1.25%, and hinting at more to come, depending on how NAFTA talks go. We get some central bank action or rather, inaction in Asia today. The Bank of Korea has been making noise about the strength of the KRW in recent weeks, which 1) suggests that they aren't going to hike today and 2) they might have considered probable when they hiked rates at the back end of last November. We wonder if they will take the opportunity of today's meeting to pour a little cold water on hike expectations. We are a little more hawkish than the consensus, with 2 further hikes from the BoK this year, but in any case, we don't look for anything more until 2Q18. Despite strong growth, output remains narrowly based and vulnerable in our opinion, and inflation remains very benign currently, as it is almost everywhere. Unless the USD maintains today's rally, we might have to shift our rate forecasts back a bit.

The other Asian central bank meeting today is in Indonesia. Back-to-back rate cuts in Indonesia last year caused the IDR to sell off through 4Q17, but the currency has been resurgent since the beginning of the New Year and is now approximately 13360, virtually back to pre-sell of levels. Consensus is unanimous in looking for no further cut from BI today (see also our BI preview), but it isn't unthinkable that there is more easing in 2018 (not our house view incidentally) if growth does not push meaningfully above 5.0% and inflation remains at the low end of the 3-5% target range. Again, the direction of the USD could be pivotal.

Aside from Central Banks, Chinese GDP is the other big regional release. And although headline numbers attract the usual degree of suspicion, there may be some positive response to an upside surprise to the consensus 6.7YoY figure, if hints by Premier Li Keqiang are accurate.

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Philippines: BSP tightening could be sooner

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Philippine Central bank stamp

Possible second-round effects of tax-reform related price increases raise caution

BSP Governor Espenilla has turned more cautious recently in terms of monetary policy due to possible second round effects from higher excise taxes on oil products and sweetened beverages. These taxes form part of the tax reform package that was recently signed into law last month. The tax reform cuts individual income tax rates but also raises excise taxes to not only cover government's losses from the income tax cut but also raise additional revenues for government's infrastructure and social service spending programs. The incremental government revenues of P90bn come from the excise tax component of the package. BSP, government and economists believe that the direct impact of the excise taxes would be between 0.4ppt to 1ppt increase on inflation. BSP in the past view the inflaiton impact as transitory which would not require a monetary policy response. But second-round effects are looming and could threaten the inflation target range of 2% to 4%. Second-round effects are possible increases in minimum fares for public transport and a possible domino effect on wages. We estimate that a 25% increase in minimum transport fares could raise inflation by as much as 1ppt on CPI. There are already petition to the regulatory agency for a 25% to a 50% hike in minimum fares. Labor unions are preparing to also seek an increase in minimum daily wages. The likely wage petition seeks to raise wages especially for minimum wage earners who do not benefit form the reform's income tax cuts.

3.4%

BSP 2018 inflation forecast

BSP to review the forecast at February 8 policy rate meeting

Higher chances of monetary policy tightening in March or in 2Q

BSP would likely come out with a revised inflation forecast at the next policy rate meeting on February 8. A higher inflation forecast may pre-sage a tightening move by BSP. We belive that inflation forecast revision would reflect BSP's assessment of second-round effects. BSP currently forecasts 3.4% average inflation for 2018 which incroporates direct inflation impact of the excise tax increases of the tax reform program. We currently forecast an average of 3.7% inflation rate for 2018 with some upside risks depending on the extent of minimum fare adjustments. We still need to incorporate minimum wage increases to our inflaiton forecast. Public transport regulators are likely to rule on the fare hike petitions by March or April. Tri-partite regional wage boards are likely to evaluate wage hike petitions in 2Q. We believe that the possiblity of BSP raising its ppolicy rate at the March 22 meeting has increased. However, our base case is for a policy rate hike in 2Q. The first BSP policy rate meeting in 2Q is on May 10. In the meantime, we believe that BSP would likely prepare the market for a tightening move at the February 8 meeting.

Article | 17 January 2018 Indonesia

Indonesia: BI is likely to keep policy rates steady

Bank Indonesia (BI), Indonesia's central bank, is likely to keep monetary policy settings steady at tomorrow's meeting

Source: istock

There are no compelling reasons to tweak policy settings

Recent factors that BI considers in deciding on monetary policy settings are quite favorable. Inflation is expected to remain within the 2018 target range of 2.5% to 4.5%%. Growth is expected to moderately accelerate. The IDR has recently appreciated and is likely to achieve the target rate of Indonesia's fiscal program.

Inflation in 2018 is likely to remain within target.

We expect inflation to average 3.7% in 2018, a shade below the Bloomberg consensus forecast of 3.8% and near the government's 2018 point-target of 3.5% inflation. Nevertheless, the inflation forecasts are within the central bank's inflation target range of 2.5% to 4.5%. Preliminary January inflation forecast by BI is 0.6% MoM which translates to a 3.2% YoY inflation. The government continues to take steps to address some inflation pressures that led to the upside inflation surprise of 3.6% in December. Food inflation accelerated to 1.3% in December from November's YoY contraction of 0.5%. The government is allowing rice imports to augment local supplies from next month. This year's energy subsidies will likely keep administered energy prices stable at least in the short-term. Fiscal leeway could allow this stability to continue in 2H as the country heads to regional elections by mid-year and national elections in 2019.

3.7% 2018 inflation forecast

Within BI's target range of 2.5% to 4.5%

Growth is likely to improve in 2018

Growth prospects are favorable this year. Bloomberg's consensus forecast shows a mild acceleration of growth to 5.3% in 2018 from the estimated 2017 GDP growth of 5.1%. We believe that there are reasons why GDP growth should achieve the government's target rate of 5.4%. Sustained infrastructure spending together with improvements in business spending will underpin overall economic activity. Household spending, a concern in 2017, is likely to also improve as inflation has moderated and is expected to stabilize. In addition, a mild push from election spending would contribute to a higher overall economic growth.

5.4% GDP growth in 2018

Improvements in business and household spending

IDR strength would moderate inflation pressures

The IDR has appreciated by 1.8% in the past two weeks. Indonesia's local currency bond yields are one of the highest in the region. This has attracted investors to increase their local currency bond exposure. We estimate that investors have poured an additional $1.9bn into local currency government bonds recently. We are in line with Bloomberg consensus of a year-end currency exchange rate of IDR13500. This is also in line with this year's government budget assumption of IDR13500. Trading of the IDR will likely range from the prevailing IDR13300 to IDR13500 this year. The stronger IDR recently and in the near term could help moderate import-related inflation pressures.

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