

Good Morning Asia - 18 March 2021

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Fed deals Asian bonds reprieve for now

Markets generally finish "higher" (Stocks, longer maturity bond yields, EURUSD) though off their highs of the day - not much (think our colleagues in the US) to stop the bond selloff resuming in the days and weeks ahead, which should see some reflection in APAC bond yields



Source: Shutterstock

Treasury selloff likely to resume in weeks ahead

Before going any further, [here is the overnight contribution from our US-based Economist and rates strategist, along with comments from FX strategists in the UK on the implications of yesterday's FOMC decision and press conference.](#)

In the aftermath of a big increase in the Fed's GDP outlook for this year (6.5%) and of PCE inflation (2.2%), and a few creeping dot forecasts for the first hike in 2023 (median just remains in 2024), Fed Chair Powell did a good job of balancing a forceful argument for lengthy inaction against possible criticisms of complacency. But as our US team notes, though he managed well with a difficult meeting and press conference yesterday, there isn't much to stop yields from moving higher again in the coming weeks.

We've been looking at what this means for Asian bonds, and what comes out is a very mixed picture. Yes, there is a general tendency for 10Y Asian bond yields to move higher as the Treasury selloff has occurred. But local factors seem to be playing a dominant role for now. The Philippines tops the list, with yields up close to 140bp since the start of the year. But it has had problems with

inflation which has spiked above the central bank target of 2-4% (currently 4.7%YoY). Though with the bulk of that inflation coming from food following an outbreak of African swine fever, it is a fair bet that this spike will be transient and that bond yields may be better behaved than regional peers when pork prices start to moderate in the months ahead.

Not too far behind the Philippines is Indonesia, which may be paying the price for a 25bp rate cut in February which looked controversial even then as their bond and FX markets had required a fair bit of propping up prior to that. But then there follows a bunched group, including the MYR, AUD, SGD and THB all up between 60-80bp since 1 January. There are few inflation problems anywhere here, and little to distinguish between developed economies from emerging. What is fairly clear at this stage, is that there is no generalised EM selloff, just a sell-off that is still fairly discriminating between weak and strong.

At the bottom of the pack, KRW and INR bonds, the former with low inflation and a strong economy helping to offset the gravity exerted by Treasuries, the latter benefitting from a fall in inflation, though one that seems likely to be short-lived, which may pull its bonds into line with the rest of the APAC pack in the months ahead.

Asia today

There is a lot on the calendar today, with central bank meetings in Indonesia and Covid-19 support in Malaysia covered in our sister publication, [ASEAN Bytes](#). Other central bank interest includes Taiwan's central bank, though nothing is expected from them.

We've already had a downside miss on 4Q20 NZ GDP, which registered a 1.0%QoQ decline against expectations for a small increase. But come on! 3Q20 GDP did grow 13.9% QoQ (yes, that's right, QoQ), so a bit of a blip downward is not at all unreasonable or worrying.

More excitingly, the February Australian labour market release was super strong. [We've covered this separately too](#), but to cut a long story short, an 88,700 increase in employment, all of which was in the full-time sector, bodes very well for spending power and is reinforced by a drop in the unemployment rate from 6.3% to 5.8%. RBA assertions that rates will be on hold until 2024 are sounding rather hollow today.

And finally, Chinese and American diplomats will meet in Alaska today, here's what Iris Pang thinks about that meeting. "I don't expect anything positive from this meeting. If there is no bad news, then that will be good news as both sides' agendas are so different. The US is going to talk about democracy, and China is going to talk about rolling back Trump's policies, e.g. technology, trade. Neither are likely to gain any ground".

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ASEAN Morning Bytes

Asian markets to open with a positive tone driven by dovish Powell comments



EM Space: Powell keeps dovish leaning, signals support until US economy improves significantly

- **General Asia:** Asian markets will likely edge higher on Thursday, emboldened by Powell's dovish comments at the close of the Fed policy meeting. Economic projections were upgraded but Powell signalled that the Fed's bond purchase program would be around for some time or until the economy made some big strides towards its full employment goals. Thursday features a couple of regional central bank policy meetings but markets will likely focus on the Fed's tone while also looking to US labour market data for more direction.
- **Malaysia:** The government yesterday announced an additional Covid-19 stimulus worth MYR 20 billion (1.4% of GDP) as the economy is feeling the brunt of a second-wave outbreak and tighter movement restrictions earlier this year. The sixth package since the start of the pandemic a year ago follows an MYR 15 billion package in mid-January when daily new infections were nearing their peak. Separately, Bank Negara Malaysia also announced yesterday an MYR 700 million of funding for the automation and digitalisation of SMEs. The increased fiscal thrust should revive the economy from 2Q21, while the year-on-year GDP growth will also get a significant boost from low base effects. But in the meantime, we look for a deeper GDP fall in the current quarter, by -6.2% YoY than -3.4% YoY in 4Q20, to be followed by over 15% YoY bounce in 2Q21. We expect no more BNM policy moves this year.

- **Philippines:** Philippine authorities have been reinstating tight lockdown measures and have closed the borders to non-residents and citizens in a bid to slow a recent spike in new Covid-19 infections. Despite the uptick in infections, the national government has pushed back on resorting to a full lockdown, citing the slow trickle in of vaccines and the need to support the ailing economy. The resurgence in daily cases will further dampen fragile consumer sentiment which will complicate recovery prospects in 2021, with PHP likely outperforming peers in the near term as import demand stays soft.
- **Indonesia:** Bank Indonesia (BI) holds a policy meeting later today with the central bank widely expected to keep the policy rate unchanged at 3.5%. A month after trimming policy rates in February, IDR has come under extreme pressure in connection to movements in global bond yields. IDR stability has been at the forefront of BI decisions of late and Governor Warjiyo had clearly signalled that the central bank had “limited space” to cut policy rates further after the February cut. We expect BI to be on hold with the central bank opting to provide monetary support via incentives to boost bank lending.

What to look out for: Covid-19 developments

- Bank Indonesia policy meeting (18 March)
- Taiwan CBC policy meeting (18 March)
- US initial jobless claims (18 March)
- Thailand GIR (19 March)
- BoJ policy meeting (19 March)

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Super-strong Australian employment growth

The Reserve Bank of Australia (RBA) will have its work cut out to keep sounding dovish if it is faced with more data like this latest February employment release. Their defence will be "There is still a long way to go". Maybe. But at this sort of pace, it won't take until 2024 to get there



Source: istock

88,700 Employment change
February

Higher than expected

The numbers

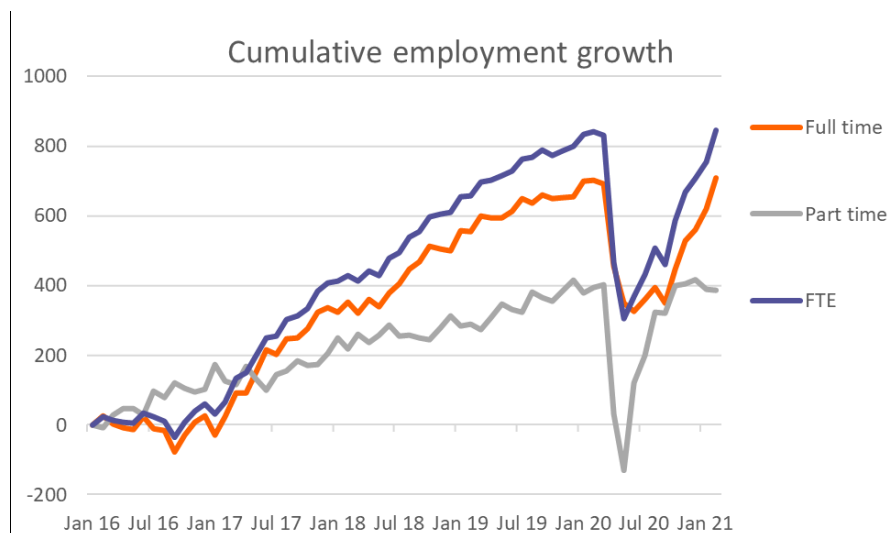
The bare facts of this latest labour release don't take much explaining. After a very solid 29.5K increase in employment in January, Australia added a further 88,700 jobs in February. Not only that, but these were entirely in the full-time sector, which means that the spending power implications of this are much stronger than had this been split between part-time and full-time jobs.

The unemployment rate for January was revised lower to 6.3%, but the February release showed it falling still further to only 5.8%. This came about from a 28,200 fall in the numbers of unemployed. There were minimal changes in the labour force (participation rate remains 66.1%) so we can't attribute anything meaningful to the drop in the unemployment rate to quirks in the denominator

of that calculation.

Looking at the employment side of the release, full-time jobs look to have regained all the ground lost as a result of the Covid-19 pandemic. Everything from here on in will eat away at any slack the RBA believes still exists in the labour market. And the faster that happens, the sooner we can expect them to have to concede that their policy stance is no longer appropriate.

Australian employment back to pre-covid-19 levels



What does this mean for the Reserve Bank of Australia

From March 10, when RBA Governor Lowe stepped up to the podium to deliver a speech designed to bring Australian government bonds back under control and moderate AUD strength and followed by the dovish minutes released on 15 March about the March rate meeting, the RBA's message has been clear. They consistently state that there is still a very long way to go before they will change their policy stance. And any eventual change rests firmly on actual progress being made in the labour market, without which, they feel, no sustained increase in inflation is likely.

But while all that is fair, they have been pushing back at a market that has at times challenged their statement that such progress is not likely until 2024. Today's employment release provides the market with another excuse to challenge the RBA's assertions, and reasonably so. And just as the FOMC may have managed to avoid a bigger selloff in US Treasuries overnight, but will still likely see bond yields drift higher over the coming weeks, the same looks likely for longer-maturity Australian government bonds, and for that, we don't need the RBA to do anything with rates.

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