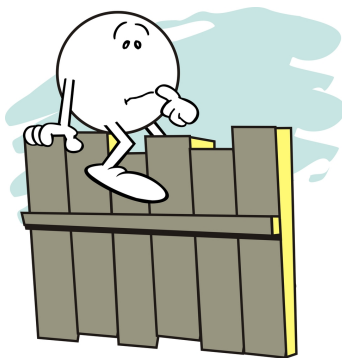


Good Morning Asia - 19 March 2018

Where will markets head next? And Why?

In this bundle



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By Robert Carnell



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Indonesia: Two key risks for the central bank

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Philippines

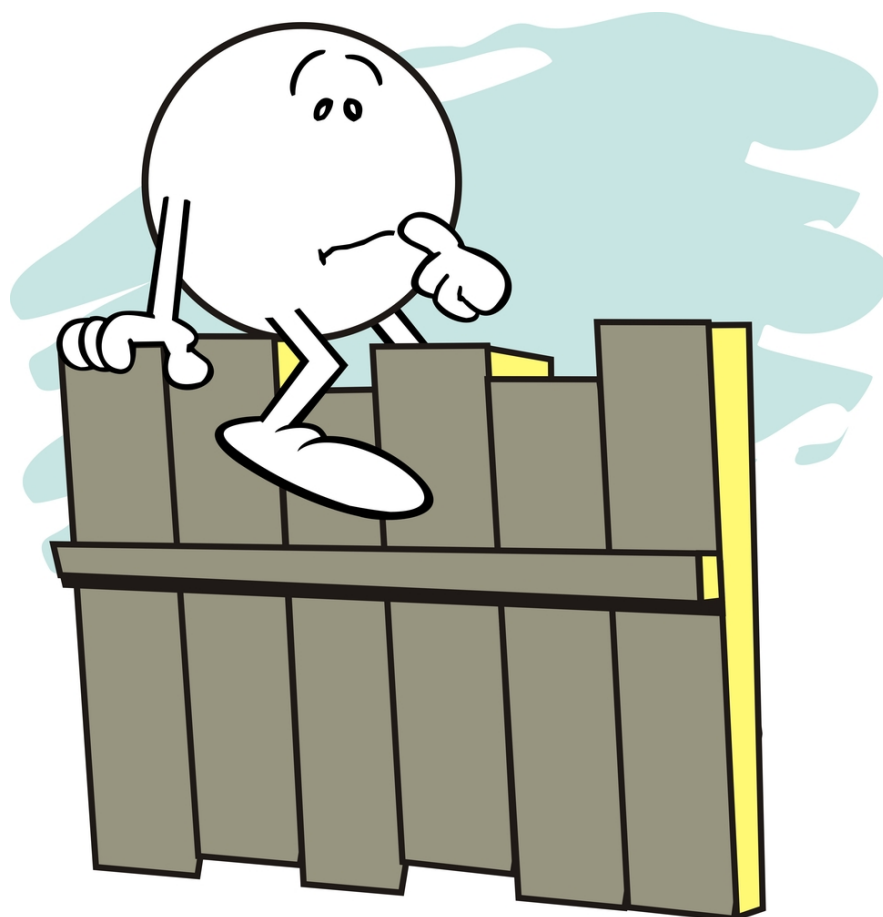
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Make your mind up time

Markets rarely stay still for very long. They go up. They go down. They go up then down. But range-trades always end in a breakout one way or another. Right now, range-trading is exactly what most markets have been doing. This is all the clearer to me having been away marketing for a week. Running through the screens this morning, it is as if I haven't been away at all. The EUR/USD is where I left it, as are Treasury yields, USD/JPY, Asian FX, and equity markets.

Moreover, it is hard to see just what is going to come along and change all this. Sure, we have a new Fed chair and his first rate-setting meeting this week. But there seems no chance of any surprise. We will get the 25bp that markets have priced in fully. There is little scope for any surprise

for the rest of the year too. A further two and a bit hikes are priced in, for a total of three and a bit. That is as close to the Fed's dot diagram as makes no difference.

And in Asia, the announcement of the new PBoC Governor, Yi Gang - former Deputy Governor, is a vote for continuity. China may follow the Fed in nudging rates higher this year, but will likely follow in much smaller increments, - say 5bp for every 25bp hike, according to our Greater China Economist, Iris Pang.

One currency pair that might see a little directional shift this week is EURGBP, which may or may not get a lift as the EU has to decide whether to sign off on a transition arrangement, with UK Brexit negotiators demanding the right to sign trade deals during such a time. Avoiding the "vassal state" status is an important factor for the UK. But Lead EU negotiator Michel Barnier seems in no mood to offer compromises. This is about the only area where things look like they could get a little spicy.

Day ahead

There is almost nothing on the calendar today, either in Asia or in the G-7. Japanese trade data out this morning for February showed a greater than expected dip (adjusted figures) to -JPY201.5bn, as gas prices pushed higher. LNG imports provide the bulk of the fuel for Japan's power generation these days, and contract prices for (for example) Qatari imports, for have almost doubled from their mid-2016 trough.

Japan's trade figures, like so much else currently, have been stuck in a range between about 0 and JPY500bn, with an average of about JPY260bn. Today's figures break that range on the downside. Though this is basically a price-effect. And while it marginally reduces the attractiveness of the JPY, tells us little about the evolution of the economy, or BoJ policy, or other things that are likely to have a bigger impact on the trend direction of the JPY. The currency seems unfazed by the release.

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Indonesia: Two key risks for the central bank

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Source: istock

4.25% BI 7-day repo rate
Likely steady policy rate this year

Policy rate steady, for now

Inflation will likely remain within the central bank's target range of 2.5% to 4.5% over the forecast horizon. The Jokowi government is expected to moderate price increases in administered or subsidised commodities or increase the budget for subsidies, which would keep headline inflation at moderate levels.

Pressure on the budget has increased due to oil prices and the level of the Indonesian rupiah, both of which are significantly higher than this year's budget assumptions. Oil prices in the past three months have averaged \$63/bl, more than 30% higher than this year's assumption. The IDR has traded at an average of 13580 in the last three months and is trading around IDR13765 in March,

almost 2% weaker than this year's budget assumption of IDR13500.

Leeway for keeping energy prices steady with higher subsidies is available with this year's deficit target at 2.2% of GDP. Higher oil prices at between \$55 and \$60/bl would cost the government an additional IDR8tr or 0.05% of GDP in subsidies. BI remains vigilant in moderating currency moves. The first action is to keep policy settings steady for now while directly intervening in the USD/IDR market. But excessive IDR weakness may challenge the steady policy rate view for this year.

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3%

BSP overnight repo rate

Steady policy rate likely in 2018

Forget breaching the inflation target

Philippines' central bank is likely to keep its policy rate steady at next Thursday's meeting and through the rest of the year, as inflation trends lower. At the meeting, the bank is expected to release inflation forecasts for CPI indices of 2006 and 2012. They will probably show inflation peaking around mid-year before trending lower in late 2018 and returning to the target range of 2% to 4% by 1H 2019.

With these inflation expectations over the policy horizon, and with a monetary policy lag of 12 to 18 months, we find no compelling reason to tighten anytime soon. The risk to this steady policy rate path is a significantly weaker Philippine peso. A decline of 4% to 5% generates not only

momentum but also fears of the exchange rate's impact on inflation. Constant and significant direct intervention in the currency market could establish a downward trend of the FX reserves, which may stoke fears of further weakness. The central bank may eventually turn to monetary policy and/or macro-prudential measures to support the currency.

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