Good MornING Asia - 2 February 2018

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By Robert Carnell

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Source: bubble

Back to the bond rout?

A quick chart of recent bond yield changes on the 10Y US Treasury looks not unlike the run-up of US house prices in 2005/2006, or the pre-correction bitcoin price moves. Indeed, on the sort of standard relative strength indicators available on some well-known news packages, it is sending a classic oversold signal. But that ignores the scope for actual fundamental data to play a role in the near term. In terms of fundamental support for markets, US tech earnings have been mixed to disappointing in the last few days, which may weigh on an equity market that has been relatively resilient overnight against the backdrop of rapidly rising bond yields, and could have weighed back on bond yields if equity indices had begun to falter more significantly. Offsetting this, rising US PPI data and red-hot manufacturing surveys provide some inflationary offset that would have helped push bond yields back up again.

As for today's US labour report....? In my opinion, this is the most over-watched and over-rated piece of economic data on the planet. But that does not stop the market from scrutinizing every number. For what its worth (and that is admittedly not much) I like our house call of further weak wages numbers (2.4%YoY - there are some calendar timing issues on the wages front with this survey), though the payrolls employment change headline could well surprise on the upside. For me, the wages data should dominate market reactions.

If what we are seeing in terms of market price movements reflects a rebalancing of portfolio investment away from US assets (notably bonds) towards European government bonds (German sovereign yields continue to nose slowly higher and away from zero, helped by taper comments from ECB Board member, Nowotny overnight), then the recent trend of USD weakness, EUR strength, Asian currency strength, UST sell-off, EU government bond more gradual sell-off is likely to continue. What is less clear is how stocks fit into this pattern. Though they may well get spooked if the bond yield ascent does not slow soon.

What about the call by a well-known US private financial institution to look for 3.0% on the US 10Y. Never say never, but this probably is a better reflection of that institution's internal positioning, than a fundamentally-backed analysis. Still, it's only a little over 20bp off, so it is hardly a bold call.

Aside from payrolls, it is a quiet day on the global calendar. And it is quiet in Asia too, although Bank of Japan bond purchases could be worth watching later this morning as the 10YJGB yield nears 0.1%.

Happy (hopefully lazy) Friday!

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Snap | 1 February 2018 China

Happy Chinese Yuan

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Dollars surrounded by Chinese yuan

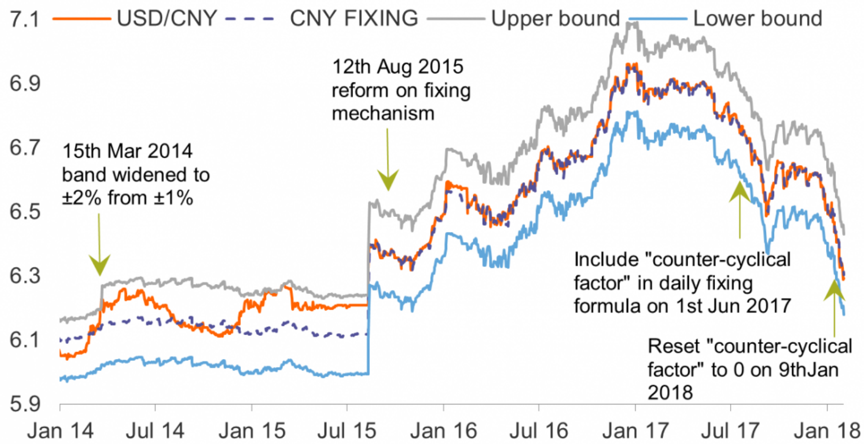
Strong yuan, weak dollar

USDCNY passed the psychological level of 6.30 on 31st January 2018. So far, the appreciation of the yuan is mostly driven by dollar weakness.

This has become more obvious since the central bank reset the counter-cyclical factor to zero in the daily fixing mechanism. It implicitly means that the yuan would move more according to market forces.

Moreover, domestic economic data has had little impact on the exchange rate. For example, the official manufacturing PMI was lower in January compared to December even though January is not the month of Chinese New Year. That shows a bit a slackness in manufacturing. This did not stop the yuan in January achieving the fastest rate of monthly appreciation in 10 years.

Resetting the counter cyclical factor to zero means that USDCNY will now more closely follow market forces



Source: ING, Bloomberg

Chinese exporters hurry to convert dollar into yuan

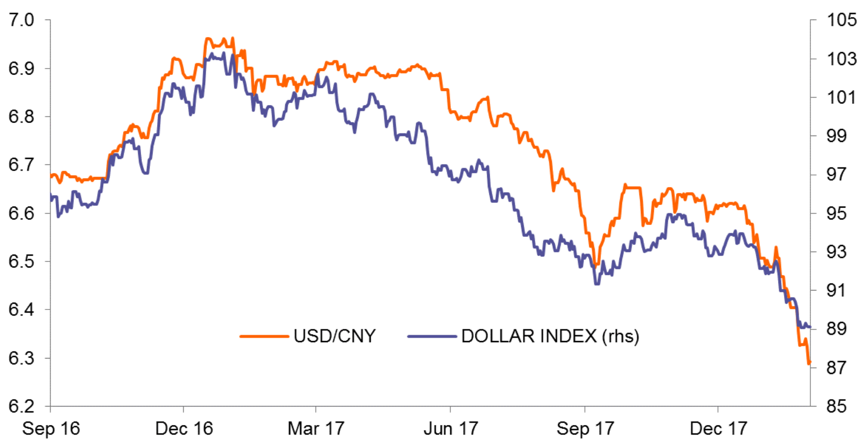
With the quick fall in the dollar, exporters might chase after the trend to convert their dollar receipts into yuan. This may look illogical but could happen if exporters believe that the yuan will continue to strengthen, meaning they could get even fewer yuan later.

This factor could give the yuan an extra push nearer the Chinese New Year when the exporters need to pay "bonuses" to their employees before they return home for the Chinese New Year.

We forecast USD/CNY of 6.10 by end 2018

Due to the dollar weakness and the reasons stated above, we revise our forecast of USD/CNY to 6.10 by the end of 2018, which is equivalent to around 6% appreciation for the year.

The dollar index is talking the lead of USD/CNY



Source: ING, Bloomberg

Any possibility of central bank intervention in the USD/CNY market?

We do not believe that the central bank has a strong view on a particular level of USD/CNY that it would come into the market to intervene.

It is more about the speed of appreciation if the central bank deems to intervene.

A yuan appreciation that is too fast would attract not only "normal" investment money into China but also "hot money" that would easily turn into "hot outflows" when the yuan depreciates.

As such, we expect that the central bank may monitor which assets the money inflows are invested in. When there are hot money inflows, the central bank may work with other financial regulators to step in to stop it.

Snap | 1 February 2018 **Indonesia**

Indonesia: Steady monetary policy despite slower January inflation

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IDR

3.35%

Better than expected

January inflation rate

Monetary policy is likely to remain steady in 2018

Slower inflation does not necessarily mean monetary policy easing.

Inflation in January moderated due to a significant slowing of transport, healthcare, and housing prices. Slower inflation rates for these components offset rising food and clothing prices, which accounted for the upside surprise of December inflation. We believe that there are no compelling reasons for the central bank (BI) to alter policy rates this year. Inflation could turn higher later in the year due to rising household spending and higher global commodity prices despite favorable base effects until August. We expect inflation to average 3.7% this year, which is above BI's point inflation target of 3.5% but within its target range of 2.5% to 4.5%. Moderate inflation would also support the recovery of household spending while spending on regional elections and higher government construction activity would contribute to meeting BI's growth forecast of 5.1% to 5.5%. IDR, a BI concern also, is likely to be prone to weakness as US interest rates rise. We believe that BI will keep policy rates steady.

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3.5%-4%

BSP's January inflation forecast

Surprisingly high

A precursor to an early tightening?

BSP surprised markets with its 3.5-4% January inflation forecast, which is higher than government's 3.3% forecast. We expect a moderate impact of higher excise taxes from the tax reform package in the first month of implementation. We forecast a 3.4% January inflation rate. With such a high January inflation forecast, the market may become worried that inflation will accelerate faster than expected in the coming months. Second round effects are still to be determined in March-June. Significant second-round effects could cause inflation to breach the target range of 2% to 4%. An inflation report this coming Tuesday that is in line with BSP's forecast could raise inflation expectations which may spur BSP to tighten as early as the March meeting.

Our base case is for a rate hike at the May meeting.