Good MornING Asia - 20 September 2018

EM currencies have stabilized over the last couple of weeks, and local currency bond yields have retreated from their highs. Has this sell-off ended, or is it merely marking time?

In this bundle

Opinion | 19 September 2018

Is the EM sell-off running out of steam?

EM currencies have stabilized over the last couple of weeks, and local currency bond yields have retreated from their highs. Has this sell-off ended, or...

Source: Shutterstock

Tariff announcements no longer moving the needle

When the US President announced the latest round of tariffs on Chinese imports this week, markets didn't do an awful lot. At least in part, this may be because markets had already taken a very dim view of how this trade war would actually develop. And in the end, this latest $200bn of tariffs is perhaps being phased in a little slower than many had believed. Of course, there are more Tariffs in the pipeline, but like many episodic market drivers, there comes a point when incremental changes cease to have much economic impact. Think of the North Korean missile tests last year... In the end, the market seems to just lose interest unless the story fundamentally changes.

Moreover, the EM sell-off wasn't driven solely by the Trade war. The strength of the US dollar from the end of April, though connected with President Trump's tariffs, could also be viewed as the main catalyst that drew attention to current account deficit countries within the EM universe, pouring fuel on the already flickering flames - these flames started by interference with the independence of some EM central banks, high external debt, fiscal deficits, and high inflation. Over the last month, however, the USD has traded in a fairly tight range, with even some tendency for EURUSD to test that range's upside.

Within the Asia region, markets are also looking calmer. Exchange rates for Indonesia, India and the Philippines have all retreated from their recent highs, and local government bond yields are also lower.

A steady China is helping

Helping to provide a semblance of calm in the region, and perhaps globally, the stability shown by the Chinese yuan since mid-August after it pared back moves towards USD/CNY7.0, is certainly a helpful addition to recent stability.

Chinese Premier Li Kequiang is reported as saying that China will not stimulate exports by devaluing the yuan. And although this could be viewed more as a backward-looking description of reality than any pledge about the future, it does confirm that for the moment at least, the gravity exerted on other Asian currencies by the yuan is not pulling them weaker.

What could change this?

With rising twin deficits in the US weighing on the USD and the ECB finally moving away from its ultra-loose policy stance, there looks to be a good case for this period of currency stability, even perhaps some retracement of the move since April, to continue.

About the only thing we think might alter this outlook could be a change in views about the Fed, driven perhaps by stronger than expected inflation or wages data, and capitulation by the market, which remains in partial denial of the Fed dot diagram - that diagram is finally beginning to look at if it might not be that far off the mark after all. I'm not sure that more bad news from EM countries would shift the balance much.

Stronger than expected NZ GDP figures lift the NZD

The NZD has been on a downward march since April, dropping from USD/NZD 0.74 to as low as 0.6501 only a few weeks ago. Expectations for any tightening from the RBNZ are very low, with hints by the RBNZ at the August meeting that rate cuts should not be ruled out. These hints have been reinforced by weak business confidence readings and low expectations about future activity.

Market chatter was that even an upside shock like this would have little impact on these downbeat RBNZ expectations. But the upside miss, 1.0%QoQ, against a 0.8% expectation, is quite a big one. And we wonder if business confidence might pick up a bit if the economy is shown to be growing faster than most observers had imagined. It is not always clear what is driving what with such surveys. Are they really forward-looking? Or do they also respond reactively to backward-looking data releases like GDP?

In line with downbeat business surveys, gross fixed capital formation in 2Q18 did grow only 0.1%QoQ, and most of this comes from residential construction, suggesting very soft business investment in plant and machinery. Exports rose by 2.4% from the first quarter, improving from the flat outcome in 1Q18, whilst imports only nudged up to 1.5%QoQ from 1.1%.

We aren't going to alter our RBNZ forecasts, which keep rates unchanged through the rest of this year and 2019. But we are being a bit more open-minded about the future for the RBNZ, and perhaps a little less inclined to blindly accept the RBNZ's rate guidance.

Abe on course for third term at head of LDP

Not that there was really any doubt, but Japan's PM Abe will almost certainly win the leadership of the Liberal Democratic Party today, allowing him to continue serving as Prime Minister for another three years.

Abe may be being helped by the good performance of the Japanese economy, and amongst other policy initiatives, leaves the consumption tax hike on track for an increase next October. and move forward with efforts to amend Japan's pacifist constitution.

We don't see Abe's election today having any significant market impact.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

Article | 20 September 2018

ASEAN Morning Bytes

General market tone: Wait and see. The market seems to have judged the latest round of the US-China trade tariff salvo to have been less than severe...

International theme: That wasn't so bad now was it? Or is there something more?

- With scant developments on the economic data release calendar, save for mixed US housing data and the expected BoJ inaction, the market rallied slightly judging that the US-China trade debacle was less severe than anticipated. Investors will continue to monitor developments on this front but rising US Treasury yields may keep the rally at bay.

EM Space: Waiting to exhale on possible fallout from initial US-China tariff salvo

- **General Asia:** Asian financial markets will likely continue to trend gingerly higher with market players assessing the extent of the latest round of tariffs thrown about by China and the US. Rising US Treasury yields may cap gains while optimism will also likely be tempered as Canada and the US appear miles apart on a deal.
- **Malaysia:** CPI inflation dipped to over three-year low of 0.2% in August. With sufficiently positive real interest rates, the Malaysian ringgit will remain among Asia's top-performing

currencies in the remainder of the year, and probably beyond. The risk to our end-2018 USD/MYR rate forecast of 4.25 is tilted to the downside. Malaysia's anti-graft body yesterday arrested former PM Najib in relation to 1MDB and $628m he received in his personal account in 2013.

- **Thailand:** Car sales continued on a steady strong pace they have been on since April this year and surged by 28% YoY in August. The Bank of Thailand policy committee voted 5-2 for an on-hold policy yesterday, a shifted from 6-1 at the August meeting. The policy statement was almost verbatim as the previous one. The BoT maintained its forecast GDP growth of 4.4% this year and 4.2% next but trimmed inflation and export growth forecast for 2019. We remain of the view that there will be no change to BoT policy in the remainder of the year.
- **Indonesia:** Indonesia's central bank continued to shore up the currency through rhetoric with Deputy Governor Dody Waluyo pledging support from the Bank of Indonesia to maintain the stability of the IDR. The BI is expected to follow through on this sharp hawkish commentary with a rate hike on 27 September 2018.
- **Philippines:** The price of staple rice surged by 20.3% in September which will likely push the overall inflation print past the 6.5% level. This puts additional impetus for the BSP to hike rates by 50 bps at its upcoming policy meeting on 27 September 2018.

What to look out for: Any developments on the trade front

- Eurozone consumer confidence 9/20/2018
- US existing home sales 9/20/2018
- US-Canada trade negotiations (deadline: end of September)
- Argentina-IMF credit line request (on-going)

Article | 19 September 2018 Malaysia

Malaysia: Enjoying the lowest inflation in Asia

Inflation missed estimates again in August. But with sufficiently positive real interest rates, the Malaysian ringgit will remain among Asia's...

Malaysia continues to enjoy the lowest inflation in Asia. Even though the Goods and Services Tax will be replaced with the Sales and Services Tax from September, inflation isn't going to be a policy concern anytime soon, at least not through most of 2019. Subdued price growth along with the threat to the economy from rising US-China trade tensions suggest the central bank (Bank Negara Malaysia) has a solid reason to keep the 3.25% overnight policy rate unchanged for a prolonged period. Yet we consider the risk to our end-2018 USD/MYR rate forecast of 4.25 being tilted to the downside rather than to the upside (spot 4.14).

0.2%

August CPI inflation

Lowest since early 2015

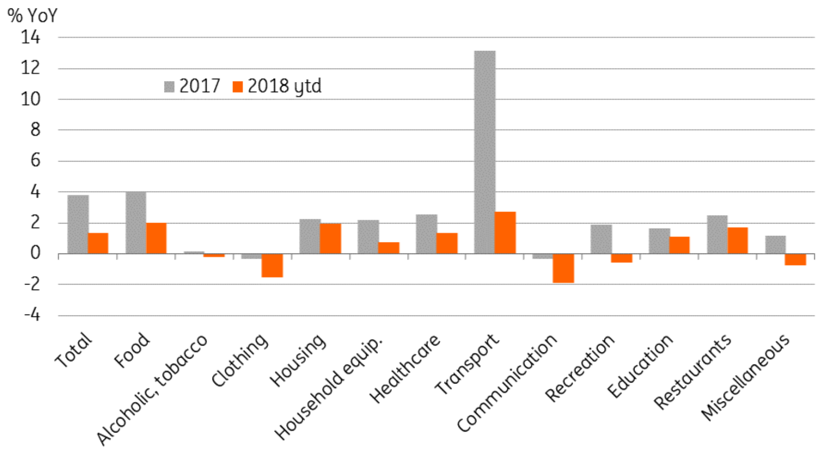
Lower than expected

Inflation undershoots again

In yet another downside surprise, CPI inflation slowed to a three-and-half-year low of 0.2% year-on-year in August, from 0.9% in the previous month. The consensus was centred on 0.4%. The key factors beneath this steadily falling inflation rate in recent months include:

1. **The lingering impact of GST removal:** month-on-month movements in most CPI components in the last two months have been nowhere near retracing the GST-related declines in June.
2. **The high base-year effect:** the base effect is more pronounced in the transport CPI component, denting the year-on-year increase to 2.1% YoY in August from 6.7% in July. This trend has a further leg to run.
3. **Nearly two-decade low food inflation:** the food component accounts for almost a third of the total CPI basket, and has steadily slowed to 0.4% YoY in August from a recent peak of 4.4% in October last year.
4. **Well-anchored inflation expectations:** the second consecutive monthly fall in core CPI, by 0.2% YoY, reinforces low inflation expectations. The healthcare and education CPI components are good guides to inflation expectations, both showing a sharp slowdown so far this year (see chart).

CPI inflation by components: 2017 vs. 2018 year-to-date



Source: Bloomberg, CEIC, ING

Future inflation and policy outlook

The year-to-date inflation of 1.3% YoY is a significant deceleration from 3.8% a year ago, with a broad-based slowdown in all CPI components. The GST is to be replaced by a less severe Sales and Services Tax, and we share the central bank's view that any impact will likely be transitory, without significantly reversing the ongoing inflation downtrend.

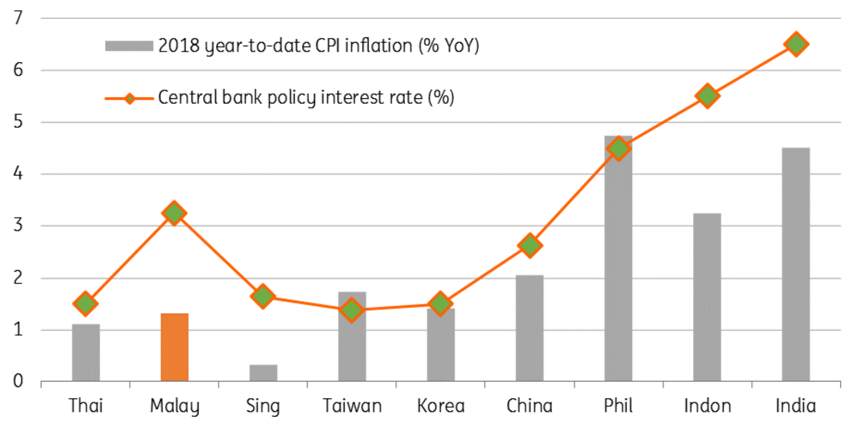
The impact of the changes in consumption tax policy on headline inflation will be transitory and lapse towards the end of 2019. – the BNM September policy statement

We see inflation remaining below 1% for the remainder of the year, supporting our forecast of full-year average inflation of 1.0% (consensus 1.3%). We believe BNM will be under no pressure to alter the current monetary policy stance until after 2019.

Positive real interest rates bode well for MYR

Real interest rates are sufficiently positive in Malaysia (see chart), thus obviating any need for policies to prop up the currency during external contagion. The outperformance of the Malaysian ringgit (MYR) among Asian currencies in the recent emerging market currency contagion testifies to this. We expect the MYR to remain among Asia's top-performing currencies throughout the rest of the year, and probably beyond. As such, the risk to our end-2018 USD/MYR rate forecast of 4.25 is tilted more to the downside than to the upside (spot 4.14).

Asia ex-Japan inflation and policy rates



Source: Bloomberg, CEIC, ING

Snap | 19 September 2018 Philippines

Philippines: Typhoon Mangkhut to push inflation higher

Rice prices continue their upward trend, pointing to an elevated inflation reading for September

Source: Shutterstock

20.3%

YoY price increase for rice

Rice prices elevated ahead of typhoon damage

Rice prices trend higher in September

Rice is a staple food in the Philippines and fast-food restaurants have previously offered “unli-rice” or free refills of rice to attract customers. In terms of the CPI basket, rice constitutes roughly 9%, one of the heaviest single item contributors to overall inflation.

The latest report from the Philippine Statistics Authority shows retail prices for regular-milled rice have hit Php45.71, 20.26% higher than the same period in 2017. Meanwhile, month-on-month prices of the all-important staple have increased by 7.35%, ostensibly due to adverse weather conditions in the Philippines. The most recent reading from the PSA does not account for the projected crop damage from the recent super typhoon Mangkhut.

Given this backdrop, we may continue to see accelerated price pressures on the overall September inflation print, with food and energy prices possibly lifting inflation past 6.5% growth. The market expects inflation to peak in the third quarter and although the September reading may remain elevated, we continue to believe that the path of inflation will eventually move towards target going into 2019.

This solidifies our view that the central bank (Bangko Sentral ng Pilipinas) will enact "substantial" monetary action at the upcoming Monetary Board meeting on 27 September 2018. Although the protracted inflation overshoot may be tied in large part to bad weather and rising oil prices, monetary authorities will look to anchor inflation expectations and remain vigilant against a possible de-anchoring. Thus, the BSP will need to maintain their current hawkish stance and continue to assure markets that they remain committed to bringing inflation back to target over the medium-term.

https://psa.gov.ph/sites/default/files/Updates%20on%20Palay%2C%20Rice%20and%20Corn%20Prices%2C%20August%202018%20%28Week%202%29_0.pdf