Good MornING Asia - 25 May 2021

Asian markets to trend higher as inflation concerns fade somewhat

In this bundle

ASEAN Morning Bytes

Asian markets to trend higher as inflation concerns fade somewhat

EM Space: Fed officials continue to suggest inflation will be transitory

- **General Asia:** Asian markets will likely edge higher on Tuesday with risk sentiment improving as concerns about inflation fade. Fed officials reiterated their stance that the recent pickup in inflation would be transitory, suggesting that a taper would happen but not in the near term. Market participants will also be monitoring Covid-19 developments while also waiting on US economic data set for release later in the week.
- **Singapore:** Just released, the final estimate of 1Q21 GDP brings growth to 1.3% YoY/3.1% QoQ. As expected, manufacturing was the main source of upward GDP growth revision from the 0.2%YoY/2.0% QoQ initial reading -- manufacturing growth was revised to 10.7% YoY from the 7.5% initial print. We don't think the markets will pay much attention to this GDP release. Instead, they will focus on the industrial production release for April due later today as a guide to where GDP growth is headed in the current quarter. We already know that 2Q is off to a weak start judging from the slowdown in non-oil domestic export growth in April (6.0% YoY vs. 12% in March). Hence our forecast of a slowdown in IP growth to 2.1% YoY from 7.6% in March. Indeed, moderating export strength and a significant reduction in domestic economic activity during new month-long Covid-19 restrictions will weigh on GDP growth in 2Q.
- **Thailand:** April trade data are due today. April typically is the weakest trade growth month in the year due to the Songkran (Thai New Year) holiday. Yet, the low base effects will

outweigh seasonal weaknesses to support year-on-year trade growth. We forecast 5% YoY export growth and 20% YoY import growth in April, leaving a narrower trade surplus of $253 million than March's $711 million. This implies the cumulative surplus in the first four months would be $6.4 billion below the level a year ago. The narrowing trade surplus and a lack of tourism receipts mean a persistent current account deficit ahead (-$2.6 billion in the first three months). This is why we expect the THB to remain as one of Asia's underperforming currencies this year. The THB's 4.5% year-to-date depreciation against the USD is the second-most in Asia after the JPY's 5.1%.
- **Indonesia:** Bank Indonesia (BI) meets today to discuss monetary policy with the central bank widely expected to keep policy rates unchanged. Inflation remains below the central bank target due to sluggish domestic economic activity but BI will likely pause today to support the currency which has come under renewed pressure on concerns of rising global bond yields and an early Fed taper. BI Governor Warjiyo will likely support other measures to encourage a pickup in bank lending which has so far been in contraction for 7 months.

What to look out for: Covid-19 developments

- Singapore industrial production (25 May)
- Thailand trade balance (25 May)
- Bank Indonesia policy meeting (25 May)
- US new home sales (25 May)
- US conference board consumer confidence (25 May)
- US mortgage applications (26 May)
- Hong Kong trade balance (27 May)
- US durable goods orders, initial jobless claims, 1Q GDP (27 May)
- Malaysia trade balance (28 May)
- US personal spending and University of Michigan sentiment (28 May)

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CNY: Hints of a PBoC change in FX policy priorities?

A central bank official has today proposed that China should let the yuan appreciate to offset the rising costs of commodity imports. Does that herald a shift in policy from the People's Bank of China? If so, we read that as broadly bearish for the dollar

A policy recommendation

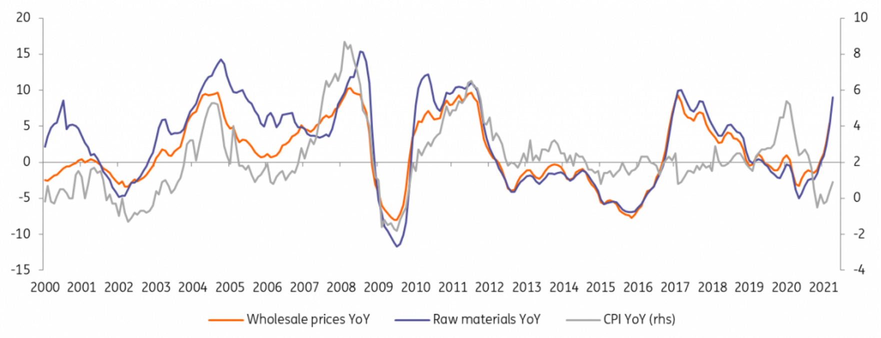
Writing in China Finance, the PBoC's Lu Jinzhong today suggested some policy responses to higher commodity prices, which have 'aroused widespread concern from all walks of life'. One such policy suggestion is to 'enhance exchange rate flexibility, appropriately appreciate the RMB and resist import effects'.

China has been struggling with the recent surge in commodities prices. As prices soar for everything from steel and raw materials to copper, alarm bells are ringing on imported inflation pressure. High prices have started to bite into downstream margins and have led to some small businesses cutting down operations, as they cannot pass on the costs of inflation.

Beijing has come up with several measures to cool commodity prices, including ratcheting up trading restrictions and increasing margins for iron ore trading from the Dalian Commodity Exchange (DCE). It has also introduced several measures to induce more supply, such as removing the import VAT tax on raw materials and the export tax on some steel products. Earlier, the State

Reserve Bureau was said to release some aluminium stocks; all aimed at increasing market supply.

Chinese wholesale prices take off (% YoY)



Source: Refinitiv, ING

Would the PBoC change FX policy?

It is early days, but here is Iris Pang's opinion on the matter:

"*Regarding the PBoC comment to let the yuan rise to offset higher commodity import prices, my opinion is that it is possible for the PBoC to let the yuan move by itself in reaction to those PBoC comments. The market could push the yuan higher against the dollar, in effect, the market will be fulfilling the PBoC's desire for a stronger yuan.*

But I wonder how much yuan strength, in terms of percentage gains against the dollar, can offset the high percentage increase in commodity import prices. The impact should be minimal. The Chinese government needs multiple tools to limit the increase in production costs brought about by higher commodity prices, which is partly due to expected US infrastructure projects.

My view is that it will be very hard for USD/CNY to reach 6.10. Our existing forecast is 6.30 by year-end. The main risk of such a strong yuan is that it hurts exports, and as such, it hurts exporters and therefore producers in the same way as high commodity prices. Exports are still very important to China as the western world recovers from Covid."

How will the FX market react?

If this is a trial balloon floated by the PBoC, then we should all be watching USD/CNY and the offshore USD/CNH a little more closely. While the PBoC does have a formal policy of enhancing exchange rate flexibility, the market still believes the CNY is one of the more 'controlled' currency pairs – with the PBoC quick to re-institute administrative controls, especially when the CNY is under pressure.

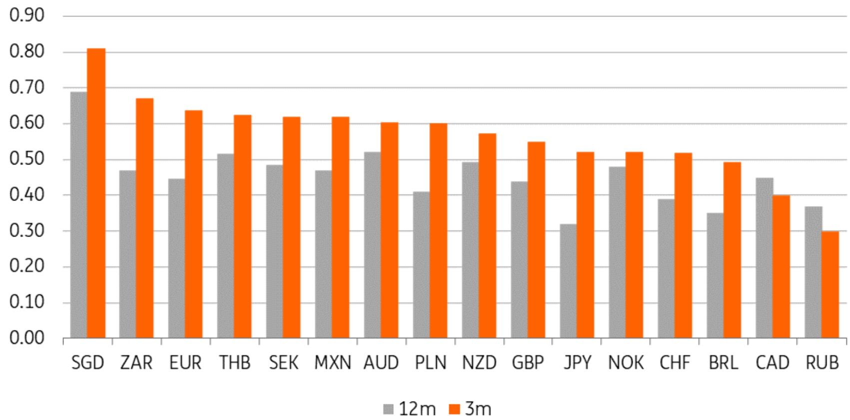
Let's see whether USD/CNY can break under the 6.40/41 area over coming weeks (we do in general like a soft dollar environment this summer) and in general, broad trends in USD/Asia – particularly in USD/CNY – do tend to support the overall USD trend. Such a move could encourage portfolio flows back into Asian equities – albeit warily watching developments in the semiconductor sector – and even encourage flows into the Japanese yen as investors consider rotating into Japanese equities.

In terms of correlations with the CNY/CNH move, our chart below shows the highest correlations with the Singapore dollar – which is because the Monetary of Singapore formally manages the SGD against a basket of currencies in which the CNY will have a large weight. The South African rand also pays quite a lot of attention to the path of USD/CNH.

It is also interesting to see the high correlation between the EUR and CNH. Yes, you may say that the PBoC is also managing the CNY against a basket of trading partners where the EUR has a large weight. But if we do see an independent move lower in USD/CNH as the market does the PBoC's bidding of delivering a stronger currency to fight import prices – stable correlations suggest EUR/USD would be rallying at the same time. Such a move would support our end year EUR/USD forecast of 1.28.

The European Central Bank might also be a little more tolerant of EUR/USD strength in such a situation since the trade-weighted (TWI) EUR would not be moving as much. This is because the high weight of China (17%) in the ECB's TWI EUR would limit the EUR TWI's advance.

Daily correlations between G10 and EM FX currencies with the CNH



Source: ING

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Singapore inflation hits a 7-year high in April

As elsewhere, high inflation in Singapore is likely to be transitory. The second wave of the Covid-19 pandemic has begun to depress demand. There is no change in our view that the Monetary Authority of Singapore will maintain its neutral policy stance throughout 2021

Source: Shutterstock

2.1% CPI inflation in April

Year-on-year

Higher than expected

April inflation spikes to 2.1%

Singapore's CPI inflation accelerated to 2.1% year-on-year in April from 1.3% in March, ahead of our 1.9% forecast for the month. This was the highest reading since mid-2014. However, core inflation ticked up only slightly to 0.6% YoY from 0.5% - signalling muted underlying inflation pressure.

Indeed, the low base effect was at work in pushing total inflation higher in the last month. But that's not all. The quarterly adjustment of electricity tariffs, this time an 8.6% hike for the current quarter, and rising private transport costs due to higher car CoE (Certificate of Entitlement) and gasoline prices also contributed to April's inflation spike.

As a result of the electricity tariff hike, the year-on-year fall in utility prices slowed to -2.3% YoY from -6.3% in March. But the quarterly S&CC (Services & Conservancy Charges) rebate for public housing partly offset the impact of higher utility prices on the housing cost. The net result was a swing in the housing component of inflation to +0.5% YoY in April from -0.2% in March.

Inflation in the transport component jumped to 9.7% YoY, from 5.7%. Among other key CPI components, food eased slightly to 0.9% YoY from 1.0% and clothing posted a smaller fall - down 4.1% YoY after being down 4.9% in March.

Nothing significant for monetary policy

As elsewhere, rising inflation in Singapore is likely to be a transitory phenomenon, while the second wave of the Covid-19 pandemic has also begun to depress demand.

We expect inflation to hover around 2% through August until the low base effect runs its course, and then ease towards 1.5% by the end of the year. We revise our 2021 forecast from 1.3% to 1.5%, putting it at the top end of the Monetary Authority of Singapore's (MAS) 0.5% to 1.5% forecast range for this year. Our forecast for core inflation is 0.7% (MAS 0% to 1.0%). We see the risks to these forecasts as tilted on the downside, especially as weak demand due to the resurgent pandemic outweighs supply shocks such as administrative hikes in utility prices or supply chain disruptions.

There is also little that monetary policy can do about supply-side inflation shocks. Greater policy accommodation is the order of the day, with tighter pandemic-driven restrictions on movement hitting growth prospects. While fiscal policy will continue to bear the onus of supporting growth, a stable MAS monetary policy stance remains our baseline for the rest of this year.

Consistent with the MAS's neutral policy stance, S$-NEER remains steady near the mid-point of the estimated policy band. Our end-year USD/SGD forecast of 1.31 stands.

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