Good MornING Asia - 26 March 2021

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By Francesco Pesole

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Source: Shutterstock

Soft data – Purchasing Manager Indices

The typical focus around this time of the month is the manufacturing and service sector PMIs. Released earlier this week, the advance PMIs for March from developed economies (the US, eurozone and Japan) revealed firmer activity in both manufacturing and non-manufacturing areas. We hope to see the same in Asian PMIs next week.

China's PMIs are the usual standouts and are expected to follow their developed market counterparts higher. If you want a sense of how these could go -- industrial profits data for February due over the weekend (27 March) should be a good guide. As for most other February indicators, the low base effect likely swelled profit growth.

Among other soft indicators coming our way, are Japan's quarterly Tankan Survey for 1Q21 and Korea's Business Survey Indices for April, both expected to show some pick-up over the previous periods.

Hard data - Exports and manufacturing

Markets will also be swamped with hard activity releases on trade and manufacturing, which come as guides to the post-Covid recovery.

Korea's exports for March, the first export data for this month from the region, will be an interesting insight into the semiconductor cycle as the global chip shortage continues to make financial headlines. A 14% year-on-year rise in Korean chip exports in the first 20 days of the month was good news that the full-month data should testify to. Meanwhile, Korean industrial production for February is likely to show some retracement of growth, though that's clearly a distortion from the Lunar New Year holiday rather than underlying weakness.

Japan and Thailand are other countries reporting industrial production and Malaysia is going to release its trade data -- all for February, We see nothing particularly exciting in these.

Lastly, Korea and Indonesia's consumer price data may be something worth watching as inflation worries are mounting elsewhere. We don't think a sharp rise in inflation will be a cause for concern at the Bank of Korea just yet, while Bank Indonesia remains relaxed on this front.

Key events in Asia

Country	Time	Data/event	ING	Survey	Prev.
		Saturday 27 March			
China	0130	Feb Industrial Profit (YoY% YTD)	175		20.1
		Monday 29 March			
Malaysia	0400	Feb Trade Balance (MYR bn)	15.5		16.6
	0400	Feb Exports (YoY%)	7.1		6.6
	0400	Feb Imports (YoY%)	3.9		1.3
		Tuesday 30 March			
Hong Kong	0830	Feb Retail Sales (YoY%)	-		-13.6
	0830	Feb Retail Sale Vol (YoY%)	-		-14.5
South Korea	2100	Apr BOK Manufacturing BSI	86		85
	2100	Apr BOK Non-manufacturing BSI	75		73
	2300	Feb Industrial Output (MoM/YoY%)	-2.2/-2.7		-1.6/7.5
		Wednesday 31 March			
China	0100	Mar NBS Non-Mfg PMI	51.6		51.4
	0100	Mar NBS Manufacturing PMI	50.8		50.6
	0100	Mar Composite PMI	-		51.6
Hong Kong	0830	Feb Money Supply M3	-		23.2
India	-	4Q20 Current account balance (US$bn)	-3.1		15.5
Malaysia	0700	Feb Money Supply (YoY%)	-		4.3
Indonesia	0400	Feb M2 Money Supply (YoY%)	-		11.8
Thailand	0330	Feb Manufacturing index (%YoY)	-1.8		-2.8
	0730	Feb Current Account (US$mn)	-1070		-673
		Thursday 1 April			
China	0145	Mar Caixin Mfg PMI Final	51.2		50.9
Malaysia	0030	Mar IHS Markit Mfg PMI	-		47.7
Indonesia	0030	Mar IHS Markit PMI	-		50.9
	-	Mar Inflation (YoY%)	1.4		1.38
	-	Mar Inflation (MoM%/YoY%)	-/-		0.1/1.53
Taiwan	0030	Mar IHS Markit Mfg PMI	60.6		60.4
Thailand	0030	Mar Manufacturing PMI SA	-		47.2
South Korea	0000	Mar Export Growth Prelim	-		
	0000	Mar Import Growth Prelim	-		
	0000	Mar Trade Balance Prelim	-		
	0030	Mar IHS Markit Mfg PMI	55.5		55.3
	2300	Mar CPI inflation (YoY%)	1.7		1.1
	2300	Mar Core CPI inflation (YoY%)	1.1		0.8

Source: Refinitiv, ING

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Snap | 25 March 2021 **Philippines**

The Philippines' central bank looks past inflation and keeps rates on hold

The central bank of the Philippines kept rates unchanged even as inflation accelerated, citing the need to support the economic recovery

2.0% Overnight reverse repurchase rate

policy rate

As expected

Philippines central bank looks past “transitory” price spike

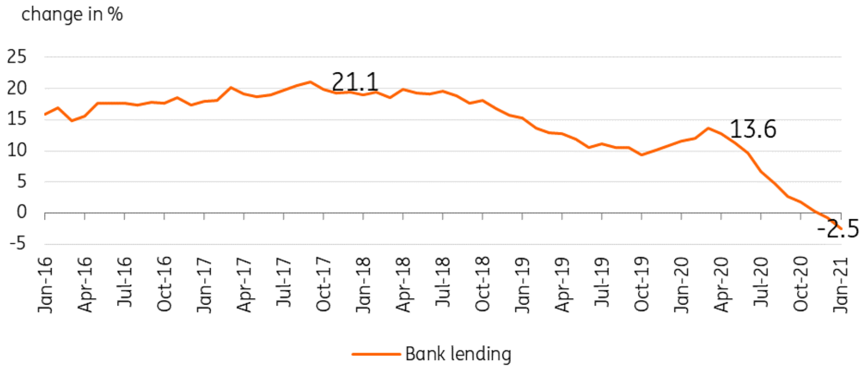
Bangko Sentral ng Pilipinas maintained its policy rate at 2.0% despite headline inflation surpassing the target as monetary authorities believe the rise in prices is transitory.

Inflation surged to 4.7% in February, moving well-past the central bank's 2-4% target range with supply-side shocks forcing food and transport costs higher. The Philippines is dealing with an outbreak of African Swine Fever (ASF) which has forced meat inflation to spike more than 20%, forcing authorities to implement price caps in the capital.

With the economy in recession and increasing numbers of Covid-19 cases resulting in a two-week partial lockdown, governor Benjamin Diokno opted to accommodate the current price spike while indicating that supply-side remedies, such as increased pork importation, would be more effective in stabilizing meat prices.

The governor remains confident that prices pressure will gradually fade with inflation decelerating in the second half of the year, but conceded that the average inflation rate for the year could settle above target at 4.2%.

Philippines bank lending growth



Source: Bangko Sentral ng Pilipinas

Not time to pull the plug just yet

The central bank governor reiterated his support for the fledgeling economic recovery, highlighting that 2021 would be the start of the recovery phase for the economy in recession.

> *Despite substantial rate cuts and liquidity support, bank lending has crashed into negative territory given weak demand from both corporates and households*

He hinted at retaining monetary support as long as the economy required it, suggesting that the previously mentioned "long pause" would in effect be here for a little while longer. He also indicated that monetary authorities were carefully crafting an exit strategy from its current liquidity support program while also qualifying that it was not time to pull the plug on monetary stimulus.

Despite substantial rate cuts and liquidity support, bank lending has crashed into negative territory given weak demand from both corporates and households given the recession, suggesting that last year's easing efforts have yet to assist.

We expect the central bank to keep policy rates unchanged in the near term, with the Bank willing to look past the supply side-induced price spike for now to maintain support for the economic recovery. The central bank may consider a rate hike if inflation remains stubbornly high, which could dis-anchor inflation expectations and spark second-round effects such as wage and transport fare adjustment.

With the central bank on hold, we expect the currency to remain stable in the near term as corporate dollar demand stays soft given fading economic output.

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Article | 25 March 2021 FX | New Zealand

Why we think the NZD drop doesn't have legs

The New Zealand dollar fell significantly this week after a move by the government to curb the housing bubble caused a re-pricing of the central bank's hawkish expectations. We estimate NZD/USD is now 2.7% undervalued in the short term and a rate hike in the next year has been fully priced out, suggesting almost all the negatives are already in the price

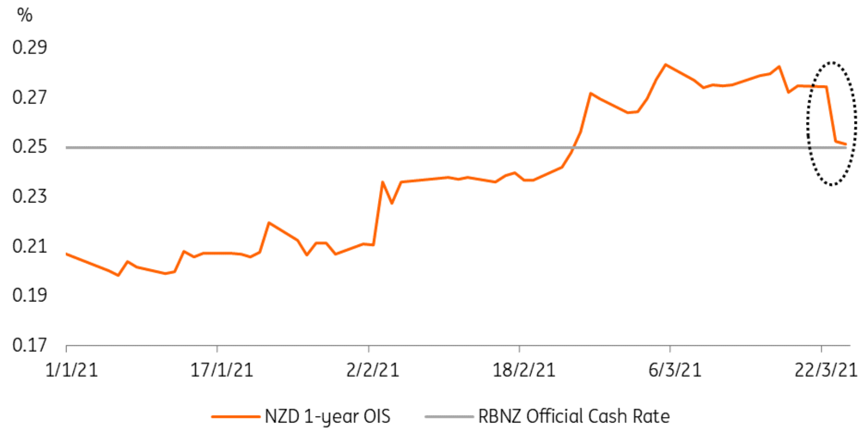
No further room to fall for rate expectations

The New Zealand government took bold steps to address the country's surging housing prices by announcing on Tuesday the suspension of some tax incentives for investors speculating in the housing market. In February, those investors accounted for around 40% of purchases of houses in New Zealand.

Market moves after the announcement signalled a rather strong confidence that the measures will effectively curb the housing bubble in the country. This was quite evident in the rates and – by extension – in the FX sphere. Reserve Bank of New Zealand rate expectations dropped significantly as markets priced out the possibility of the Bank shifting to a more hawkish stance and possibly hike rates in the next year with the aim of curbing the housing bubble. The drop in the 1-year OIS segment (Figure 1) essentially reversed the increase seen in February, when the change in the

RBNZ remit by the NZ government to include housing prices in policy considerations prompted a spike in rate-hike expectations. NZD/USD is down 2.80% from Friday's close.

Fig 1 - RBNZ rate expectations



Source: Refinitiv, ING

As shown in the chart above, markets have completely priced out any minimal probability of a rate hike in the next year. Despite the unexpected slump in 4Q GDP (-0.9% year-on-year), New Zealand still stands out as having had a relatively contained economic impact of the pandemic when compared to other developed countries. Furthermore, inflation and employment have showed encouraging signs of resilience. The latest CPI read (4Q20) saw YoY inflation unchanged from the previous quarter at 1.4%, not too far from the 2% central bank target. The RBNZ sees inflation back at target only in 2023, but the Bank's projections make the assumption that NZ borders will remain shut until the end of 2021, which may be an excessively pessimistic scenario considering the vaccination progress worldwide.

What counts in an FX perspective is that the risk of cuts by the RBNZ is extremely low, and markets will most likely not attempt to price in an OCR below the current 0.25%, which means the negative impact on NZD of the rate expectation re-pricing has likely worn off.

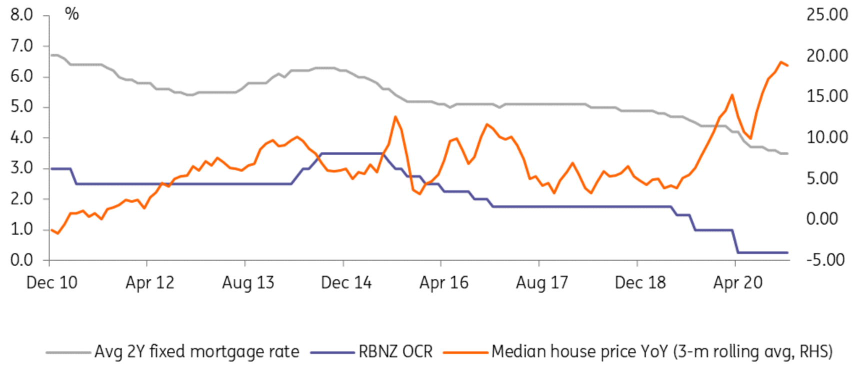
Don't be too quick to write off RBNZ tightening

Arguably, the resilience in inflation and employment are still valid points in favour of an earlier-than-expected tightening by the RBNZ. In addition, there is no certainty that the measures by the NZ government aimed at curbing surging house prices will be enough to fully serve the government's ambitions on improving housing affordability.

Resilience in employment and inflation may still point at earlier-than-expected monetary tightening

New Zealand has the largest homeless population per capita in the developed world, and Prime Minister Jacinda Ardern has been increasingly engaged in addressing this issue. In a market perspective, we suspect investors may have moved too fast to think that the move by the government will take almost all responsibilities from the RBNZ when it comes to addressing the housing situation.

Fig 2 - Low yields' impact on housing prices



Source: RBNZ, ING

As shown in Figure 2 above, there was an evident impact on housing prices of lower mortgage rates – prompted by RBNZ rate cuts. The RBNZ efforts to re-impose loan-to-value restrictions on lending, even when paired with the tax measures just announced by the government, may fall short of fully achieving the government's goals on housing affordability.

Pressure on the RBNZ to hike rates for housing purposes is off now, but may come back on later

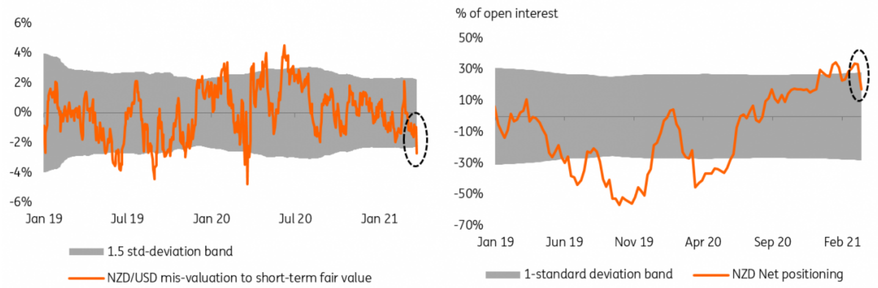
In other words, pressure on the RBNZ to hike rates for housing purposes is off now, but may come back on later, possibly once again from the government if the tax measures on speculative investing do not prove effective enough.

NZD/USD is undervalued in the short term

NZD/USD is undervalued by approximately 2.7% according to our short-term fair value model, which takes into account short-term rates, equity performance, shape of the yield curve, commodity prices and global risk appetite. As shown in Figure 3 below, the mis-valuation of NZD/USD is now below the lower-bound of its 1.5 standard deviation band: this means the undervaluation is at abnormal levels, and therefore suggests we could see a convergence of NZD/USD with its fair value model in the near term.

Part of the recent underperformance of NZD has also been likely due to the unwinding of some speculative long positions on the currency – as discussed in our latest G10 positioning note. As shown in Figure 4, the NZD net-long positioning has now moved back inside its one-standard-deviation band, and is therefore no longer abnormally high. The re-pricing of RBNZ rate expectations and the NZD underperformance this week may have prompted an even larger long-squeezing effect on the currency and we therefore expect any additional position-squaring-related downside risk for NZD to be more limited from now on.

Fig 3 & 4 - NZD/USD mis-valuation and positioning

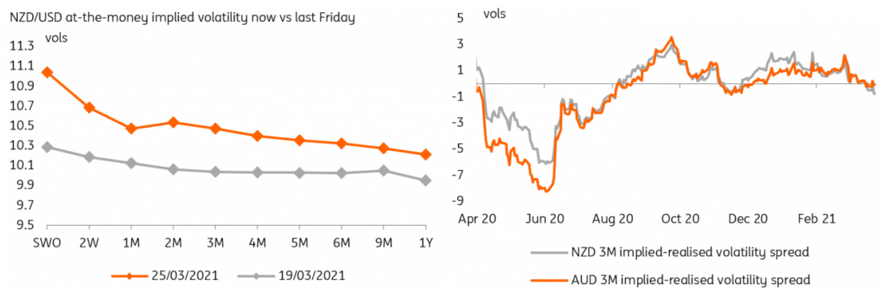


Source: ING, CFTC, Macrobond

Option market sees no idiosyncratic risks in NZD

The NZD/USD option market saw some wide moves following the big fall in the pair this week. As shown in Figure 5, the implied-volatility curve on NZD/USD has shifted higher when compared to last Friday's values, due to the drop in spot, with the increase in the short-end of the curve being particularly pronounced. This indicates that markets are expecting a period of higher volatility in NZD/USD in the short term and it is therefore more expensive to hedge against wide moves on the pair.

Fig 5 & 6 - Rising implied volatility but no signs of idiosyncratic risks for NZD



Source: Refinitiv, ING

However, when looking at the options' relative value– i.e. the difference between implied and realised (historical) volatility – the spreads across front-end tenors did not show any increase, meaning that markets are not pricing in volatility in excess of what is warranted from the historical moves in spot.

Comparing the NZD option market with the one of its closest peer AUD can provide an indication of how much NZD idiosyncratic risk is expected. In Figure 6 we show how the implied-realised spread for NZD/USD on the 3-month tenor is no larger (actually, marginally lower) than the one of AUD/USD. This indicates that markets are seeing no clear short-term idiosyncratic risks for NZD that could make it stand out from another commodity currency such as AUD, in line with our view.

Stabilisation before recovery?

Considering that short-term rates have reached the bottom (and may actually tick back up if markets start to re-price some RBNZ hawkishness), the material undervaluation in the short term and the more limited scope for further long-squeezing, NZD/USD appears to have most of the negatives in the price.

Given the highly positive beta of NZD (and the negative beta of USD) to global risk appetite, the near-term outlook for NZD/USD remains strictly dependent on external factors. Even if risk appetite remains choppy in the next weeks (possibly on the back of third virus wave concerns, especially in Europe), we think that NZD should experience more limited downside pressure than other pro-cyclical currencies, considering the factors highlighted above.

Beyond the very short term, some further stabilisation in the bond market will be needed to allow a rebound in commodity currencies and generate some fresh selling pressure on USD. We think yields will continue to rise in 2021 but possibly in a more controlled manner once investors feel yields are pricing the right amount of future inflation. This may happen already in 2Q21, and with the global reflationary narrative consolidating, we expect NZD to be at the forefront of any pro-cyclical rally.

We remain in the view that NZD/USD will move above the 0.75 mark in the second half of the year. In the short term, the correction in the pair may struggle to go much further (for the reasons highlighted above) barring a material risk-off shift by the market, and the 0.6870 200-day moving average may prove to be a solid support even in case of a continuation of the current NZD weakness.

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