

Good MornING Asia - 29 August 2018

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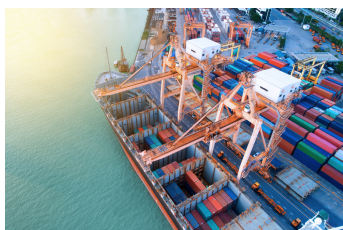
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By Robert Carnell



Thailand

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Every silver lining has a cloud

I have never been asked what chart I would take to a desert island if I was allowed only one, and still had to do my job. But that has never stopped me from sharing my choice, which would be the US GDP-based profits data. You see, in a very simple mental model of how the global economy works, profits are the feedstock that determines almost everything else. Higher profits mean more investment. More investment means rising employment. Rising employment means higher wages, and so on all the way to consumer spending, inflation, and central bank rates etc.

It is a simple model, and the world is far more complicated than this. But I find it has served me pretty well as a starting point over the last quarter century or so. The profits figures are released only with the first revision of the US GDP figures (out today), and they are often overlooked.

What is particularly helpful about US GDP-based corporate profits (choose the domestic-only series to avoid imported volatility), is that they are derived from corporate tax returns. That is important. Official earnings guidance from firms, even earnings announcements, are run through the mangle of accountancy tricks and fudges. Only when these are exhausted, does the grim reality emerge. On the other hand, when earnings really take a nose-dive, most firms will be pretty quick to tell the tax authorities. No one wants to pay more tax than they need to - especially in corporate America.

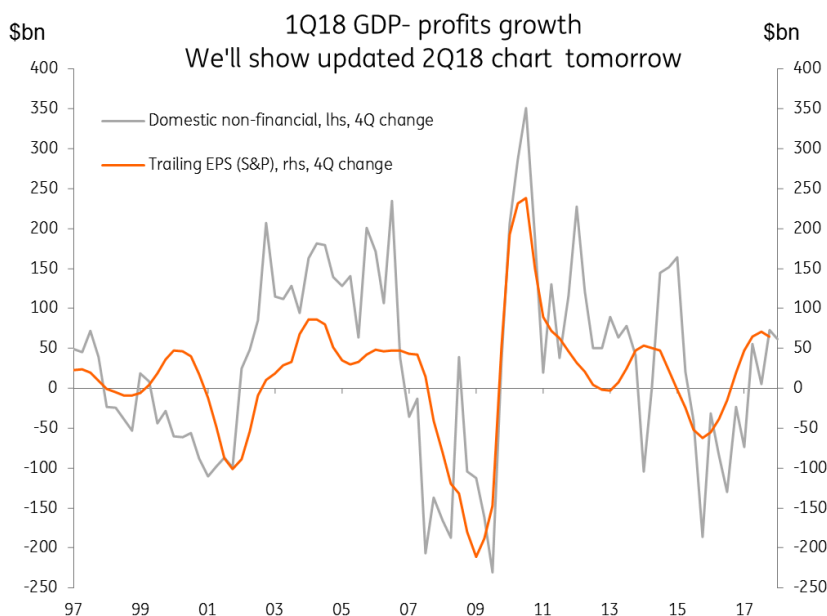
So what we find is that the GDP-based measure of corporate profits, despite the reporting lags, can

offer a lead to bad news (not good, only bad). This makes it a useful, albeit limited indicator for economic slowdowns. You can keep your yield curve slope and recession charts This one works because it really does get to the heart of what drives the business cycle.

Now I am not saying that we should expect any alarming signals from the data later today. But as people fret about the new highs reached in the S&P500, or the dip in copper prices, or Treasury curve inversion, this is the only one you need to consult to see if you should keep your head, or head for the hills.

Other than this, today looks as if it is searching for direction. Yesterday's Mexico trade deal is already today's fish and chip wrapping, there is nothing new on China trade or Canada. Asian equity futures seem mixed as do Asian FX, and bonds.

US GDP-based Profits up to 1Q18



Financial stability, or prudence?

I am continuously grateful for the comments and offerings of others with which I can vehemently disagree, providing me with (usually) something to rant about in this not-quite daily note. Today's vote of thanks goes to ECB Chief Economist, Peter Praet. He is quoted in a story today saying that financial stability is not the primary responsibility of central banks, rather "...Patient, prudent and persistent monetary policy is still needed".

I don't have the context, and so apologies Peter if this is unfair (I'm reasonably sure he doesn't read my stuff). But if you had to choose between financial market **instability**, or prudent, patient and persistent monetary policy, wouldn't you choose to avoid financial instability? Because to ignore it would undermine all the other goals. Isn't that what the GFC taught us? Have no lessons been learned in the ten years since then? I think I know the answer to this one, but I am saving that for another thin news day.

Thanks also to US Treasury Secretary Steven Mnuchin (certainly doesn't read me) for saying that China's support for the yuan isn't manipulation, but allowing it to weaken would be. I really don't

need to say anything here do I?

Asia day-ahead

We covered the G-7 releases earlier, and Asia is just about closed for the day as far as economic data releases go. If you are interested, take a look at Vietnamese data out today. We don't formally cover this very interesting economy, but the August inflation, trade, production and retail sales data released today could provide an early litmus test for the rest of the region. Vietnam strikes us as having huge potential as one of the few remaining genuinely cost competitive economies in the region. It offers what China once had, before it priced itself out of the manufacturing sector.

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4.6% July manufacturing growth

Better than expected

Above-expected July manufacturing growth

Thailand's July manufacturing output surprised on the upside with growth of 4.6% year-on-year, beating the consensus expectation for only 4.3% growth. The July growth rate was a slowdown from 5.0% growth in June, which was revised up from 4.7%. We were at the low end of the consensus forecasts range (3.6% to 5.2% growth), expecting base-year effects and tapering export strength in recent months to depress manufacturing. The manufacturing capacity utilization dipped to the lowest in nine months to 67.2% in July from 69.1% in June.

Although our forecast was wide of the mark, the manufacturing slowdown does tally with our forecast for a further slowdown in GDP growth in the current quarter from 4.6% in the second quarter, which in itself was down from a five-year high of 4.9%. We will refine our 4.1% GDP growth forecast for 3Q in the light of more high-frequency data in the weeks ahead. But for now, a GDP slowdown seems inevitable against a more unfriendly base-year effect, while the global trade war risk to exports remains elevated.

Increased central bank policy risk

There has been a significant increase in hawkish policy rhetoric by Bank of Thailand officials recently, especially from Governor Veerathai about the need for monetary policy normalization. Today's data may provide a further boost to such rhetoric.

Creating some policy space for the future is one thing. But, the economy isn't screaming out for a policy tightening just yet, while higher rates could also threaten the fragile recovery reflected by still anaemic domestic demand. Apart from consumer spending, which contributed to half of the 4.6% GDP growth rate in 2Q18, there is little vigour in other domestic spending-side GDP components. Moreover, inflation continues to be low and, unlike some of its Asian counterparts, the BoT isn't under any pressure to shield the currency from the emerging market rout (like the one earlier this month stemming from the Turkish financial crisis), thanks to a large current account surplus.

That said, our call for the BoT keeping policy unchanged this year remains at risk at the next policy meeting on 19 September.

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