Good MornING Asia - 3 January 2019

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First trading day of 2019...

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If a day were a year...

We probably can't read anything into the market action of the first trading day of the year, but it is probably no sillier than some of the other "analysis" performed on what may be mainly random walk processes. But if there were any messages in it, the first would be that the growing consensus that peak USD might be nearing could run into problems. Day 1 of 2019 saw a mixed pattern in Asia, with some winners and some losers, and no clear message emerging as to why some were up and some down.

But amongst the majors, the message was one of abject dollar strength, only the yen outperformed on the day, which won't please the BoJ, who have been doing their best to talk the currency weaker in recent weeks (unsuccessfully). The USD did particularly well against the EUR, where the ECB had to place an Italian bank under administration.

We have even seen the AUD lurch through 0.70, and we wouldn't be surprised to see it pushing lower still this year. In contrast to the BoJ, the Reserve Bank of Australia will be very relaxed about this. The NZD also weakened on the day, but not as much and AUDNZD continues to move towards parity, and we can expect more of this too in 2019.

At least the yield curve is steepening...

Fed funds futures implied interest rates over the course of the year are actually now signaling a chance of cuts in 2019. This seems far-fetched to us, and probably a reaction to the US government shutdown. Though one spillover of this, even with a dip in longer-term bond yields yesterday, is that the US Treasury yield curve has steepened back up a bit. This could temper thoughts of a 2019 US recession, though only a little less than 50% of US CEO's now anticipate this, according to a recent survey, and more than 80% expect recession by 2019, so perhaps this won't last, even if the Fed does pause / slow / stop in 2019.

Equities were mixed across the board, with Asia largely down, and the US markets eeking out some modest gains after early falls on weak guidance from the tech sector. This could also be a theme for the year ahead - broadly directionless, though with big swings.

49.7

Lower than expected

China: Dec Caixin Manufacturing PMI

Down from 50.2

On today's calendar...

After yesterday's mixed activity PMI data - notable standouts in Asia, fall in Vietnam - alleged to be the biggest regional winner of China-US trade dispute...doesn't seem to be playing out, and also sharp dip in China's Caixin index - as well as soft Singaporean GDP numbers for 4Q18, today is virtually a non-event. Hong Kong Retail sales and Singapore PMI are the only Asian releases of note (barely), though, in the G-10, the build-up to the first payrolls release of 2019 starts with the ADP release and manufacturing ISM.

Author

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

ASEAN morning bytes

General market tone: Risk-off. Fears of a slowing global economy sapped risk appetite overnight with the malaise seen to be carried over to Thursday.

International theme: Poor PMI numbers and trade anxiety dent risk taking

- Investors saw a volatile trading session with traders caught between stalling manufacturing momentum in China and Europe sparking concerns about global growth. Meanwhile, energy prices rebounded sharply overnight on slowing production even ahead of supply cuts from Russia. Investors will refrain from going headlong in either direction, awaiting clarity on the US-China trade situation and global growth.

EM Space: PMIs signal continued GDP slowdown through end-4Q18

- **General Asia:** Despite equity markets taking a hit on Wednesday, bargain hunters will likely remain sidelined on Thursday with uncertainty clouding the outlook. The rebound in global oil prices overnight is seen to muddle the growth picture further with investors looking to Friday's US job report and trade talks for direction.
- **Malaysia:** Nikkei manufacturing PMI slumped to an all-time low of 46.8 in December from

48.2 in the previous month. Weak sales and overseas orders were the main drags. The PMI index was in the sub-50 contractionary territory in all of 4Q18, which heralds continued manufacturing-led GDP slowdown through end-2018. Slowing GDP growth and lack of inflation raise the scope for the BNM policy easing, though we don't think the central bank will rush in that direction just yet.

- **Thailand:** The Bank of Thailand releases minutes of the December policy meeting today (9 am local time). December CPI inflation surprised on the downside at 0.4% YoY, the lowest in 16 months, against the consensus of no change from November's 0.9%. Fall in the food and transport components was responsible. The full-year 2018 inflation of 1.1% was up from 0.2% in 2017. The high base raises the prospects of inflation remaining below the BoT's 1-4% policy target this year. We are reviewing our 1.3% 2019 forecast for a downgrade (consensus 1.4%).
- **Indonesia:** Indonesian Inflation settled at 3.13% in December, bringing the full year average to 3.20% -within Bank Indonesia's (BI's) 2.5-4.5% target. Food inflation was tagged as the main reason for the December print with egg and chicken prices boosting the overall print the most. BI has raised interest rates in six times in 2018 for a total of 175 basis points and seems to be looking to take on a more neutral stance even as they forecast the Fed to hike two more times in 2019.
- **Philippines:** The Department of Finance (DoF) has indicated they would prefer to tap the international market early on and often in 2019 with the Fed seen to hike rates further in the year. DoF officials sounded off their preference for bonds issued in Yen (samurai) and Chinese Yuan (panda) while also keeping the door open for doing "something in England" and even Sukuk bonds. The government expects to issue panda bonds as early as March while samurai bonds sometime after August. The Philippine government looks to issue a total PHP1.189tr worth of debt with 25% of the borrowing to be sourced via foreign-denominated debt.

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

China: PMIs show shrinking domestic demand

The Caixin PMI (like the official PMI), fell below 50 in December, which means manufacturing activities are contracting. Even more eye-catching was that...

Workers at en electronic factory in Eastern China

PMIs show manufacturing activities shrinking

Today's December Caixin manufacturing PMI fell from 50.2 in November to 49.7. This echoes the official manufacturing PMI, which fell from 50.0 to 49.4. The sub-indices of both PMIs tell us more.

New orders of the two PMIs also fell from expansion to contraction. This means not only that the export sector faces shrinking manufacturing activities but that the domestic manufacturing sector in general also faces contraction.

Combining with other activity data, the economy is weak

Together with a fall in industrial profits of 1.8%YoY in November from +3.6%YoY in October, and softer retail sales growth (8.1% in November from 8.6% in October), we can confirm that the economy is weakening.

The trade war has affected domestic demand

We believe that the data reflect that not only has the trade war damaged growth in the export sector. It has also hurt export-related supply chain companies and in turn, domestic demand.

If domestic demand is not supported by fiscal stimulus quickly, then further weakening will pose a risk to job security. That could create a vicious downwards cycle.

As a result, we expect the Chinese government to speed up the delivery of infrastructure investment to support the economy, which will mainly be through projects governed by local governments, e.g. new metro lines.

GDP at 6.3%

We currently estimate CNY 4 trillion fiscal stimulus (though if the economy weakens much more, this figure is likely to rise) as well as 4 further required reserve ratio cuts (0.5% to 1% each) and two interest rate cuts (5bps each) in 2019 to support the economy. If needed, local governments will ease housing measures. These measures should help support our forecast of 6.3% GDP growth for 2019.

Singapore GDP ends 2018 on a weaker note

Annualized growth of 1.6%QoQ in the final quarter of 2018 means full-year GDP growth should reach 3.2%YoY, though 2019 GDP more likely to end in a...

A slow end to 2018

Although it would be easy to portray Singapore's final quarter of GDP growth of 1.6% QoQ annualised as a slowdown from previous quarters, the truth is that this has been a remarkably steady year for economic growth. Annualized figures exaggerate small differences. Whereas in fact, the range of non-annualized growth over the year has been only 0.4%QoQ, compared with more than 3% in 2017, and 2.2% in 2016. That steadiness reflects changes in the economy - no longer the big mid-year surge of exports to fuel global production ahead of the West's holiday season. This makes growth more predictable, planning easier, and investment less prone to unforeseen swings in external demand. We would view this as a positive development.

1.6%

GDP Growth

QoQ Annualized

Lower than expected

2019 - in a 2.5% to 3.0% range.

This year, using a similar quarterly profile to that seen in 2018, would deliver a growth rate for the full year of 2.6%. In reality, we suspect the quarterly growth profile could come in a little softer than that for 2018, though this would still be in line with MAS expectations for GDP to moderate a little from 2018. 2.5% seems a sensible starting point for the forecast, with room for amendment in both directions.

Headwinds are of course already evident. The global backdrop is one of slowing G-7 growth, not acceleration, and the outlook for the US, in particular, could see large deviations from current growth rates. China is already slowing and the full ramifications of that are yet to be felt across the region. Brexit and its impact as far away as Asia, if any, is as yet unknown. And the outlook for the rest of Europe murky.

But there is room for optimism too. US President Trump seems keen for some sort of deal with President Xi on trade, though it remains to be seen what sort of deal, and how quickly tariffs can be reduced or removed. In the meantime, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) of 11 countries, including Singapore, substantially reduces tariffs and could give other trade in the region a helpful boost.

Risks tilted towards the downside

To our way of thinking, this still leaves the balance of risks tilted towards the downside, though not markedly so, and we could yet have to revise our forecast numbers up, instead of down. But with the risks tilted in this way, we would expect the MAS to proceed cautiously, just as the US Fed is also more likely to tread a cautious path during 2019.

Author

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

Indonesia: Inflation falls below midpoint of central bank target

December inflation came in at 3.13%, a slowdown from the November reading of 3.23% but faster than expectations with food prices boosting the headline number

Source: t-bet

3.13% December inflation

Higher than expected

Inflation within the central bank's target range of 2.5% to 4.5%

Inflation settled at 3.13% in December, slightly faster than expected but still within Bank Indonesia's (BI's) 2.5-4.5% target. Core inflation was also faster in December at 3.07%, matching analysts' expectations. Food inflation was tagged as the main reason for the December print hitting 3.14% with egg and chicken prices boosting the overall print the most. Inflation is likely to remain within target over the monetary policy horizon, with government officials like Economic Minister Darmin Nasution expecting inflation to "fall below 3%" for the full year with the central bank's forecast at 3.2%.

Inflation well-behaved, BI to focus on FX again in 2019

Monetary authorities have raised interest rates in six separate meetings in the past year amounting to a total of 175 basis points, with the central bank looking to take on a more neutral stance even as it forecasts the Fed hiking twice more in 2019. BI Governor Perry Warjiyo indicated at the last meeting- where the central bank paused- that they believe "that the current interest rate level is still consistent with efforts to lower the current-account deficit to reach the safe level and to maintain the attractiveness of domestic financial assets". The central bank, however, looks ready to defend the stability of the Indonesian rupiah going forward to help provide financial stability.

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Philippines: Inflation to close 2018 below 6%

Index heavyweights food and energy items to pull inflation lower, with the December print seen at 5.5%.

Source: Shutterstock

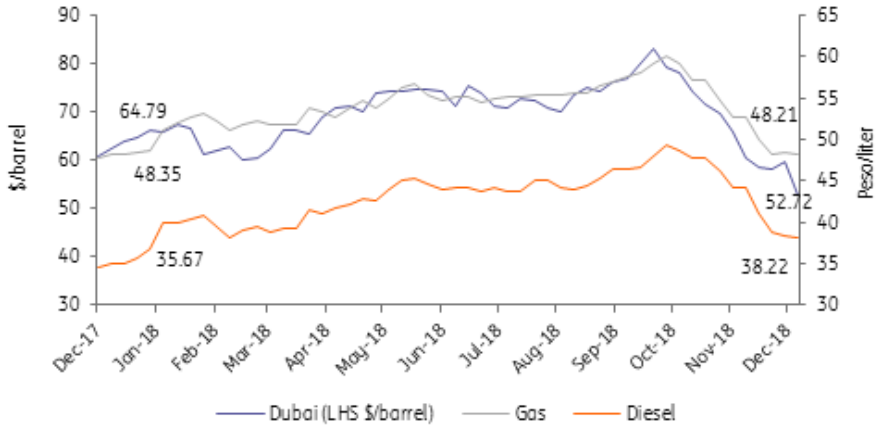
5.5% ING forecast for December inflation

Finally below 6%

Index heavyweights food items and energy-related sub-indices are seen to have pulled inflation below the 6% handle as supply chains normalize and global energy prices plunged faster in November and December than they rose from September to the 2018 peak in October. The 4Q harvest season and imports of grains have helped stabilize supply (and price) for most food items, with the latest government bulletin showing second week of December rice inflation at 10.03% down from November 2018's 14.46%. Meanwhile, domestic pump prices have tracked the freefall seen in Dubai oil prices, with gasoline prices now below pre-2018 tax reform levels and with diesel not far behind. The November-December plunge led to transport fare adjustments being rolled back, although the government has decided to proceed with the second tranche of its excise tax

adjustment to fuel (both gasoline and diesel) of P2.00 for 2019.

Philippine pump prices and Dubai crude prices



Source: Bloomberg

Supply side inflation

2018 inflation moved well past BSP's inflation target as a confluence of bad weather, disrupted supply chains, currency depreciation and tax reform fomented cost-push inflation. With these supply-side oriented bottlenecks mitigated or removed, we can expect inflation pressures to dissipate quickly and the overall headline print to slide in 2019, barring any return of these supply issues. Should inflation continue to trend lower and move within target as early as 2Q19, the BSP could move to unwind some of its aggressive hike cycle to help buttress forecasted slower GDP growth for the year. Cuts to the BSP's policy rate are expected to be carried out even with the central bank widely expected to slash reserve requirements (RRR) as early as 1Q19.

Risks to the inflation outlook appear tilted to the downside

With the rice tarrification law all-but waiting President Duterte's signature and oil prices sliding to levels last seen in mid-2017, risks to the inflation outlook appear now more tilted to the downside although upward pressure looms with possible extreme weather conditions with El Niño forecasted in the first half of 2019. Surprise OPEC supply cuts could cause crude oil's recent plunge to reverse.

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

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