Good MornING Asia - 7 March 2018

NEC Director, Gary Cohn, resigns over tariffs. N Korea's Kim signals he is open to talks with the US. Central banks in Malaysian and Philippines are in no rush to change monetary policies

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Trump still talking about trade wars - Cohn resigns

Markets have been shrugging off the threat of trade wars in the last few sessions. But despite trade-fatigue (and it has only been a few days) there has really been very little change in the comments from Donald Trump, despite other members of the administration (notably Gary Cohn and Steven Mnuchin) apparently trying pressure him to change his mind or at least scale back the tariff rates. This doesn't seem to have worked, and the breaking news this morning is that Gary Cohn, Director of the National Economic Council, is resigning over the issue.

Trump, for now, seems unbowed. A 25% tariff on EU cars is his response to potential retaliation to the aluminium and steel tariffs by the EU. It won't end there. It is hard not to characterise current market behaviour as complacent.

Stock futures are lower on this news, the US dollar looks weaker, but bond markets seem unclear whether to rally on the growth dampening impact of potential tariffs, or to sell off on their inflationary potential.

Peace to break out in Korea?

I've just returned from Korea, where I imagine the suggestion that North Korea is open to talks about its relationship with the South, and its nuclear future will be being viewed with extreme scepticism. Kim Jong-Un has seemingly indicated that he is willing to discuss a peace deal and de-nuclearisation with the US, subject to guarantees about his regime's future.

Whilst no-one likes the way North Korea is run, the bigger deal for the US is denuclearisation for North Korea. China will also view this as an acceptable balance, as it prefers to maintain the regime rather than see it collapse and spark a refugee crisis.

While a positive view on the offer of talks will add to the risk appetite of markets, and the Korean won has made gains against the US dollar in the last 24 hours, this offer may well come to nothing, and there are other issues that are pushing market sentiment in the other direction.

Day ahead - labour data from the US, EU Growth

There is really only one source of potential market interest on the G-7 economic calendar today, and even that may underwhelm. The US ADP survey of employment due just a few days before Friday's non-farm payrolls would be interesting if financial markets were concerned about US job creation. They aren't. They are, however, wondering if last month's modest hourly wages increase (2.9% YoY) will be maintained, exceeded, or revised away. There is, unfortunately, no likely indication of wages in these data, only employment.

- In China, eyes will remain on the National People's Congress (NPC), and press conference by Finance Minister, Xioa Jie. Further detail may emerge on the suggested merger of many government agencies. FX reserve data will likely be dominated by currency valuation fluctuations.
- We also get Taiwan trade data today. We are looking for a stronger trade balance figure than the $2.4bn consensus figure. Earlier, Korean trade figures were also a little stronger than expected.
- Bank Negara Malaysia (BNM) meets today to discuss rate policy, but it's unlikely to tighten rates ahead of the Parliamentary Elections to be held by August at the latest.
- Australia releases 4Q17 GDP data, which could come in a little softer than previous quarters (0.6% in 3Q17). RBA Governor Philip Lowe has been on the wires overnight, noting that the next movement by the RBA would be higher. But this won't be anytime soon, he says.

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Malaysian central bank on hold

The macro policy mix of tightening monetary and loose fiscal policy is favourable for the Malaysian ringgit, allowing it to sustain its position among...

Source: shutterstock

3.25% **BNM policy rate**

No change expected this week

Unanimous consensus for on-hold policy

Bank Negara Malaysia's (BNM) Monetary Policy Committee meets on Wednesday, March 7. There is a unanimous consensus forecast of no change to the overnight policy rate of 3.25%. BNM started monetary policy normalisation with a 25bp OPR hike at the last meeting on January 25. Nothing has changed in terms of Malaysia's economic dynamics since the last meeting to warrant another change to monetary policy.

Nothing changed since January rate hike

Two data points since the last meeting are noteworthy:

- First, year-on-year GDP growth (of 5.9%) in the fourth quarter of 2017 was the sixth consecutive quarter with an upside growth surprise (Read more here).

- Second, a sharp slowdown in consumer price inflation in January to 2.7% YoY was the lowest in a year. This data bears out our view of 2018 shaping up to be a better year for inflation after a decade-high 3.9% average inflation in 2017 (Read more here).

Next BNM rate hike in 3Q18

January trade data released yesterday signalled a continuation of the strong trend in Malaysia's exports into 2018. The global trade war will be a threat to exports going forward. We expect strong domestic demand to cushion the impact of a trade shock, if any, and keep the economy on track for another year of 5%-plus growth. And absent a supply shock to food prices or an oil shock to fuel prices, the inflation outlook for this year appears to be more benign. Such an economic backdrop supports expectations of a gradual normalisation of BNM policy going forward. We forecast the next 25bp OPR hike in the third quarter of 2018, once the political uncertainty associated with general elections in August this year lifts.

The macro policy mix of tightening monetary and loose fiscal policy is favourable for the Malaysian ringgit (MYR), allowing it to sustain its position among Asia's outperformers this year. The MYR's 3.3% year-to-date appreciation against the USD is the second-best among Asian currencies. Our end-2018 USD/MYR forecast is 3.72 (spot 3.90, consensus 3.85).

Philippines: No monetary tightening even as inflation rises

Inflation in February is higher (for consumer price indices with base years of 2012 and 2006). BSP reiterates its steady policy rate stance with the view...

Source: Shutterstock

4.5%

Higher than expected

February headline inflation with 2006 base year

Inflation with 2012 base year is 3.9%

BSP's steady policy rate stance relies on inflation returning to the 2-4% target range

The Philippine central bank (BSP) has reiterated its view that inflation would return to the target range of 2-4% in the next 12 months or over the policy horizon. Since the monetary policy lag is 12 -18 months and since inflation is expected to moderate during this period, BSP believes that there is no reason to tighten monetary policy. This conviction does not waver despite upward trending inflation which we expect to peak in the next three to six months. February headline inflation using the policy-operative 2006 base year climbed to 4.5% from January's 4% and December 3.3%. This uptrend is replicated with the 2012 CPI base year which becomes BSP's policy operative data in 2H. February inflation with the 2012 CPI base year increased to 3.9% from January's 3.4% and December's 2.9%. The difference between the two base years reflects higher weights for rice, communication, transport, health, tertiary education and restaurants. Tax reform related impact together with higher oil prices, power rates and food prices accounted for the acceleration in inflation last month. We expect these price pressures to keep inflation elevated in the next six months. With BSP's conviction and reiteration, we now expect a steady monetary policy decision at the March 22 policy rate meeting.