

## Good MornING Asia - 7 May 2018

No matter how fast the US economy grows, or how low its unemployment rate falls, wages remain muted - it really is different this time

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## One step forwards, two steps back

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Source: Shutterstock

### US jobs report - wages disappoint

At the end of last week, we repeated our view that things really have changed in developed economies such as the US. Most notably, when it comes to inflation and wages. All the signs of price pressures are there. Job switching in the JOLTS survey, skills shortages in the NFIB survey, underemployment in the jobs report itself. If, when all of these things are screaming "wage pressure", the rate of wages growth comes in at only 2.6%YoY, with the previous month's number also revised down to 2.6%, it is time to accept that the elasticity of wages to all these perfectly reasonable measures of wages pressure, has substantially weakened, maybe permanently.

In fairness to financial markets, it seems as if this message has already been learned. Market reaction to the wages weakness, despite a moderate bounceback in the employment part of the report (+164K), has been very muted. The dollar shrugged off the jobs report, ending slightly stronger after some very temporary weakness, 10Y US Treasury yields dipped, recovered, and then finished up on the day, though still no nearer to 3.0% than they were last week. Stocks treated the report with a big yawn.

With payrolls and the FOMC out of the way, there isn't much on the calendar to take us back to 3% any time soon, unless bond issuance (there is a lot this week in the US) fails to attract a bid.

## We can still be friends, right?

The US has left China without a trade deal. The lack of any market response to the news may show how little anyone believed in the chances of a deal anyway. Both sides have agreed to further talks, but the demands made by the US seem to show that the hawks, (Lighthizer, Navarro) are running this show, not the doves (Mnuchin). The US demands call for a reduction in the bilateral deficit with China (which is about \$340bn) of \$200bn. Perhaps they were hoping to come away with the \$100bn reduction that had been the previous demand. Maybe China is learning the Trump negotiation tactic of asking for the moon, but settling for far less, and deciding to call his bluff. Who knows. One thing is apparent, China is in no mood to be bullied by the US over trade. We take a step nearer to trade-war with this outcome. That could take US Treasury yields right back from the 3% level, hit stocks negatively, though the USD impact is not as clear - we would like to say it would be negative, but we don't believe it is that simple, and in a generalised risk-off environment, the USD could actually do quite well.

## Day ahead

It is very quiet in the G-7 region today, with vacations in the UK. Factory orders in Germany are expected to bounce after their sharp dip last month, though may not deliver full clarity on the recent European slowdown.

It's not too much more exciting in the Asia-Pacific region. Australian NAB business confidence will likely nudge higher from its March 7.0 reading, though the trend is basically flat - so nothing really to do here.

Ahead of Malaysia's election on Wednesday (we anticipate no change in government), there are foreign reserve figures today. Taiwan's trade figures for April are also due. Earlier in the month, Korea released some better than expected figures (ex-shipping) with semiconductor exports doing very well, so that could be a harbinger of better export data from Taiwan.

And Indonesia's 1Q18 GDP is not expected to differ materially from the 5.19%YoY rate delivered for 4Q17. Though let me express my incredulity as to the lack of volatility in these numbers. I could barely draw a line that straight with a pencil. Is there genuine news in these figures? I don't think so.

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## China foreign reserves to drop

We expect China's foreign reserves to drop in April. This is for the same reason that drove the rise in previous months-- the US dollar



Dollars surrounded by Chinese yuan

### Value effect from dollar move to dominate

The dollar has increased more than 2.5% in April. This would be big enough to reduce the value of non-USD denominated assets in foreign reserves. As we expect the dollar effect to dominate, foreign reserves could fall to \$3.128 trillion in April from \$3.143 trillion in March.

### Inflows from net exports should be bigger than outflows from yuan depreciation

If we take off the valuation effect, and look into the flows of money across the border, we expect a net inflow into China. On trade, we expect net exports of \$23 billion in April to add to foreign reserves after a net trade deficit of nearly \$5 billion in March. Having said that, we are aware that there is a risk of net outward remittance driven by yuan depreciation in the month. If this effect was significant in April- and we don't think it was- then the fall in foreign exchange reserves would be driven by both the valuation effect and yuan depreciation. Under such circumstances, the central bank would try to avoid yuan depreciation in the coming months.

## Inflows to continue due to relaxing FDI in financial sector

We expect inflows will continue to be greater than outflows for the rest of the year, which would help to build up foreign exchange reserves.

There are three reasons:

- First, the government has relaxed restrictions on foreign direct investments in the financial market. These include removing capital restrictions on foreign-owned banks and asset management companies that operate in China and easing ownership restrictions on foreign life insurance, securities and fund companies. The market expects these to be in place around June. At the same time, the central bank has increased outbound financial investment quotas slightly, though they should be small compared to the FDI. The quota for the Qualified Domestic Limited Partnership (QDLP) programme in Shanghai and the quota for the Qualified Domestic Investment Enterprise (QDIE) programme in Shenzhen will be expanded to \$5 billion each from \$2 billion and \$2.5 billion, respectively.
- Second, though trade tensions are escalating, we do not expect China to experience a persistent trade deficit. A smaller trade surplus is more likely.
- Third, we expect yuan appreciation to continue, albeit mildly, at around 2.6% in 2018. This would be enough to prevent continuous capital outflows from China.

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# Malaysia: Trade surplus hits six-year high

Data supports expectations of strong and steady GDP growth, but nothing matters more for the markets than politics ahead of next week's general elections



Source: Shutterstock

## MYR14.7bn

March trade surplus

A six-year high, above consensus

## Weak imports boost trade surplus

Malaysia's trade surplus surged to a six-year high of 14.7bn Malaysian ringgit (MYR) in March as imports contracted more than expected by 9.6% year-on-year, while exports rose in line with consensus by 2.2%. Electronics and commodities continued to be the main drivers of Malaysia's trade growth. The cumulative surplus in the first quarter of the year more than doubled to MYR 33.4bn from a year ago. However, the 5.8% export growth and -0.8% import growth in 1Q18 represent a sharp slowdown from 21% and 28%, respectively, from a year ago.

## Still strong trade growth in USD-terms

The authorities report trade data in local currency terms. And the sharp slowdown in trade growth

so far this year reflects the high base effect and the price effect from a significant currency appreciation over the year rather than any underlying weakness. The average exchange rate of the MYR against the USD appreciated 13% YoY to 3.92 in 1Q18. Offsetting some of this is the continued upswing in global commodity prices and electronics demand.

After converting to US dollars, export growth of 20% in 1Q18 was the second best in Asia (after Vietnam's 25%, see chart), and up from 14% a year ago. Almost half of this was from electrical and electronics exports, while commodities including natural gas, crude petroleum, petroleum products, and palm oil contributed three percentage points of total export growth. Import growth in USD terms slowed to 12% from 21% over the same period, and the trade surplus doubled to \$8.5bn from a year ago.

### Strong economy, strong currency

The wider trade surplus indicates an improved net export contribution to GDP growth in 1Q18, while election spending continued to support domestic demand. We consider our forecast of 5.6% YoY GDP growth in 1Q18 (a slight slowdown from 5.9% due to the high base effect) subject to more upside than downside risk (data due 17 May).

**5.6%** GDP growth forecast for 1Q18  
ING

Malaysia's growth-inflation dynamics continue to favour a stable macroeconomic policy. Election jitters will keep the central bank (BNM) from altering policy at the next meeting on 10 May. We retain our view of monetary policy normalisation with one more 25bp BNM policy rate hike in the third quarter, once the political jitters lift. We have revised our end-2018 USD/MYR forecast higher to 3.84 from 3.72 a month ago (spot 3.93, consensus 3.81).





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## Philippines: Likely tightening as inflation accelerates in April

The central bank (BSP) is likely to hike policy rates at the 10 May meeting as April inflation rose to 4.5% from March's 4.3% and February's 3.8%



# 4.5%

April inflation rate

Rate hike at 10 May Policy rate meeting

As expected

### BSP is likely to hike policy rates to assure markets and to moderate second-round effects

Inflation accelerated to 4.5% in April from the 1Q18 average inflation rate of 3.8%. The April figure was in line with the consensus forecast and near the upper end of the BSP's April inflation forecast of 3.9% to 4.7%. Eight of the 11 sub-index categories were higher YoY in April while food inflation remained elevated. We expect inflation to peak in May or June at around 4.8% to 4.9%. The MoM inflation rates are slowing or are steadier. We also expect the government's rice imports to enter the market in late May or in June at lower than prevailing retail prices. Rice accounts for



nine percent of the CPI. Although inflation may peak in the next two months, it is likely to remain elevated at above 4% - the upper end of BSP's inflation target range of 2% to 4% - for the remainder of this year. The high inflation environment feeds second-round effects with demands for higher minimum wages and transport fares. Firm oil prices and a relatively weak PHP also contribute to expectations of high inflation this year. Like BSP we expect inflation to return to within the target range in 2019, but if expectations are not contained, this could lead to firmer-than-expected inflation. We expect BSP to hike policy rates by 25bp at the 10 May meeting. This would also support PHP and help moderate inflation pressures. We expect another rate hike in 4Q while BSP keeps a hawkish tone in between rate hikes.

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