Good MornING Asia - 7 November 2018

While we wait for the outcome of the US mid-term elections, everything else is on hold - but what difference could it make to Asia?

In this bundle

Opinion | 6 November 2018

New Zealand

And the winner is....

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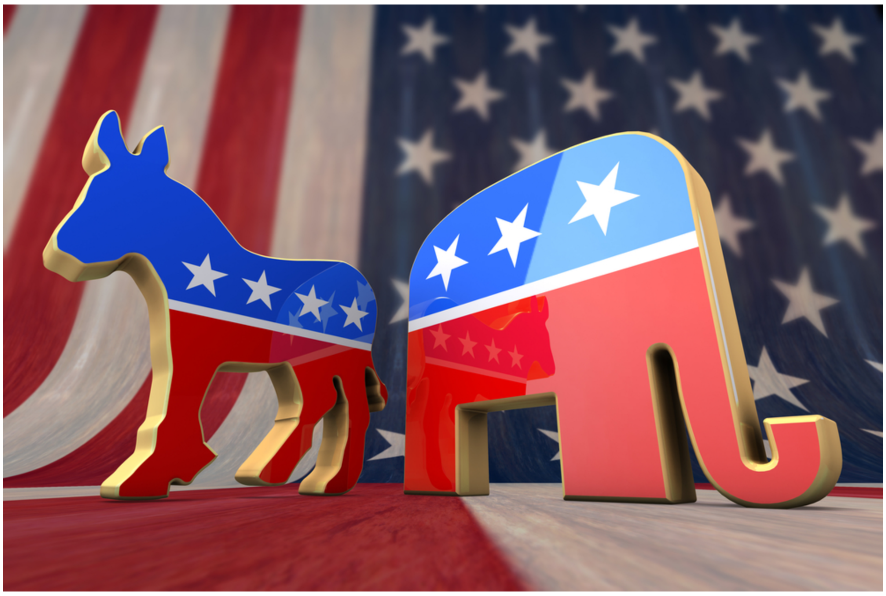

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The most watched mid-term I can remember

For the longest time, mid-terms were something that simply happened. Sometimes there was a notable shift in control of Congress. But I don't remember a mid-term being contested as avidly as this one, which probably goes to show the strength of feeling on both sides of the political divide about how this administration is faring.

As of writing, the polls on the East coast are closing, but it will be about early lunchtime in Asia before we get some sense of what has happened and can try to draw some conclusions.

For the views of our US economists and FX strategists on how this may all pan out, the note, "Feeling Blue?" is well worth a read. We are looking forward to the on-the-spot reaction of James Knightley writing from Texas later today, where he will be in the heart of the exciting Beto O'Rourke vs Ted Cruz Senate race.

But while this is good TV and fills the papers (and this note), what, if anything does it mean for us here in Asia?

What it all means for Asia...

I think there are a number of things to consider:

1. Market reaction. If Donald Trump secures both the House and Senate, then we can look towards a big middle-income tax cut next year and possibly increased infrastructure spending that will stave off any Wile. E. Coyote fiscal crash. This pushes back the likelihood of any US economic slowdown or technical recession. As a result, although this is good news for equity markets short term, it also suggests the Fed will be in hiking mode for longer, and the dollar will consequently be stronger - Asian currencies weaker. Conversely, a Democrat-controlled House would make any further fiscal expansion less likely, the dollar would weaken on softer growth and earnings expectations and bond yields and the dollar would be lower (weaker). Equity volatility - difficult to say, could fall as this is the market consensus, but it isn't clear-cut.
2. Economic policy: When we say economic policy, we are really talking about trade policy, since this is about all the President has left if he loses control of the revenue-raising House of Representatives. In my view, and I think in the view of a growing consensus, a loss of the House by the Republicans would likely encourage more aggressive trade policy, notably against China - probably not against the EU or close neighbours (see also this point in the earlier referenced note). Forget the recent olive-branch offered to China of talks at the G-20. A bad mid-term for Trump would, in my view, harden the US President's attitude towards any deal. Now at this point, there is not much else from China that could be tariffed, but the existing tariffs could be raised.
3. As well as China, don't forget Japan. PM Abe has been trying to cultivate good relations with the US president, but with Japan's economy doing better than for some time, and the trade balance trending around $300bn per month, Japan could also come into the cross-hairs of the US. Other countries that could suffer the ire of a renewed trade push include almost any Asian trade surplus country - Thailand is on this list, and despite the re-worked Korus trade deal, South Korea might come back into the spotlight - the Korus deal was not particularly onerous, and the US trade deficit with most of its bilateral trading creditors has not got any better. Now a more aggressive US on trade policy is likely to spell a stronger USD. That seems in some contradiction to the earlier comment that a successful mid-term was likely to be good for the dollar. It isn't, but whereas a mid-term victory for Trump is generally a strong dollar outcome, a mid-term defeat could spell a stronger dollar against specific Asian currencies.

One way or another, we should have a better idea of how the land lies by the end of the day.

New Zealand - great labour market report, strong NZD

The Reserve Bank of New Zealand (RBNZ) Governor, Adrian Orr, has for some time painted a fairly mediocre picture of the NZ economy and prospects for any policy change, with risks of rate cuts, flagged as a future possibility just as much as rate hikes. As of today, the rate cut scenario for New Zealand looks extremely unlikely, and the odds of a nearer term hike have improved substantially, pushing the NZD up against the USD, and also, the AUD. In Australia, in contrast, although the labour market is also doing well, the rest of the economy looks distinctly patchier, and the Reserve Bank of Australia, although still leaning towards eventual tightening, seems in no mood to do anything this side of Christmas, that's Christmas 2019 incidentally.

The unemployment rate in New Zealand has dropped to a 10-year low of 3.9% (from 4.4%). Despite the unemployment rate fall, the participation rate has risen, and there is now a surge in hourly wages growth, which at 1.4%YoY, is the fastest they have grown since 2014. The RBNZ meet tomorrow to discuss rates incidentally... I still think wages growth is too low for them to hike at this meeting, even if the direction and improvement in wages is very positive. But I also think the RBNZ will have to ditch the potential rate cut talk and acknowledge the possibility that if wages growth puts on another spurt next quarter, rates could be going up a whole lot quicker than anyone has imagined.

With the Australian economic data remaining mixed, and the RBA in benign neglect-mode the likelihood of AUDNZD testing (at least) the April 2018 low in the coming weeks and months is looking very strong.

Author

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

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ASEAN Morning Bytes

General market tone: Wait and see. Global markets are trained on streaming results for the US elections with oil prices dipping despite recently...

International theme: Markets tiptoe higher but focus still on US elections and European politics

- Results will be trickling in with investors waiting to see the outcome of the US mid-term election, which could have a significant impact on bond yields depending on the composition of the Congress. In Europe, conflicting Brexit reports drove sentiment while anxiety remains elevated regarding the Italian budget.

EM Space: Asian markets may take their cue from the US election results

- **General Asia:** Market players will remain focused on the outcome of the US mid-term elections with the Fed meeting later in the week. Meanwhile, Asian economies will be set to release foreign exchange reserves numbers later in the session. Were the Asian central banks able to replenish lost reserves after the September swoon?
- **Indonesia:** Bank Indonesia indicates that it expects growth in 4Q to be flat from 3Q at 5.17% with full-year growth seen to settle within the 5-5.4% target. Furthermore, Deputy

Governor Waluyo indicated that future monetary policy decisions will remain data dependent and that government efforts to limit the current account deficit had begun to bear fruit after Indonesia posted its first trade surplus for the year in September of $227m.

- **Philippines:** CPI inflation remained steady at 6.7% year on year in October on still elevated food price pressures. Prices accelerated by 0.3% versus September, indicating that the "hump-shaped" inflation path would be more drawn out. Given that inflation has not been able to show a substantial deceleration trend, the likelihood of that "moderate" rate hike at the 15 November meeting has increased. The Peso should continue to benefit from structural as well as capital flows in the coming week, which the BSP maintained its hawkish bias of late.
- **Philippines:** Efforts to augment the supply of all-important rice stocks hit a snag with the government announcing that it failed to secure bids for a tender to import 203,000 MT of rice, which could keep rice prices elevated going into the holiday season. The government had allotted 750,000 MT for rice imports before December but only 47,000 have been procured to date. This could keep the deceleration in overall inflation much slower as rice accounts for roughly 9% of the CPI basket.
- **Thailand:** In a second consecutive slide, the University of the Thai Chamber of Commerce's Consumer Confidence Index fell further to 81.3 in October from 82.3 in the previous month. Data signals a weakening private consumption support to GDP growth coming into the final quarter of the year. More reasons for the central bank to maintain the current policy stance at the upcoming meeting on 14 November, and beyond.

What to look out for: China trade data, FOMC meeting

- PH trade (7 November)
- ID GIR (7 November)
- PH GIR (7 November)
- CH GIR (7 November)
- PH 3Q GDP (8 November)
- CH trade (8 November)
- US FOMC (9 November)
- US consumer sentiment (9 November)

Author

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

Philippines: October inflation boosts odds for November hike

Philippines inflation hit 6.7% year-on-year in October as base effects were unable to compensate for still elevated food price pressures. Prices...

Source: Shutterstock

6.7% October inflation

Higher than expected

Inflation shows decelerating m-o-m trend but headline remains elevated

Price pressures abated somewhat in October but inflation remained elevated at 6.7%, unchanged from September. Despite the decelerating trend, inflation remains well above the central bank's (BSP) inflation target as a variety of cost push and demand pull pressures have built up over the past few months. Stubborn food inflation may have been the likely culprit as follow-on effects from typhoon Ompong continued to hound the basket-heavy food component (38% of total).

BSP's "hump-shaped curve" to be more drawn out

The 6.7% print validates earlier expectations that inflation was close to or had peaked for the year and is now expected to taper off slowly going into the year-end. Measures undertaken by the government to address supply chain bottlenecks appear to have found their way to price tags, alleviating some pressure on food prices. But inflation remains sticky given supply constraints. Rice imports helped whittle down the price for the all-important staple and up to 500,000 MT are expected to arrive to augment supply further. We hope non-monetary policy measures will continue to be deployed to help limit price gains ahead of the Christmas season. On risks to the upside, oil prices remain elevated despite trending lower in recent weeks while second-round effects are scheduled for November with minimum wages adjusted in the metropolis and transport fares increased.

Food prices had actually come down from September, slowing from 9.7% to 9.4% although rice and fish prices accelerated to offset slower price gains in meat, fruits and vegetables. In terms of the contribution to the overall 6.7% print, food prices alone rendered 3.61 percentage points to the total (54%) making it the major culprit for the still-elevated reading. Despite imports and better weather, food prices remain sticky with supply bottlenecks still not completely resolved though price gains on a month-on-month basis dropped from 0.98 to 0.25. Other major sources of inflation were utilities (1.05 percentage points or 16% of the total) and transport, given the bump in oil prices seen in late September and early October. What's clear is that food price pressures appear to be abating, and will likely be the single most important subsector that the government can target to alleviate the bane of inflation. If food prices continue to trend lower, the rice tariffication bill passes as expected and oil prices decelerate, we could very well see inflation trend quickly back to within target in 2019.

"Moderate" rate hike in the offing

That being said, the central bank (BSP) remains vigilant against any signs of second-round effects and will look to anchor inflation expectations going forward. Governor Nestor Espenilla made note of a "moderate" policy adjustment to do just this, with the BSP expected to hike rates by 25 basis points before year-end. Given that inflation has not been able to show a substantial deceleration, the likelihood of that "moderate" rate hike at the 15 November meeting has increased. The peso should continue to benefit from structural and capital flows in the coming week as well as the BSP's hawkish bias of late.

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