

Good MornING Asia - 8 February 2018

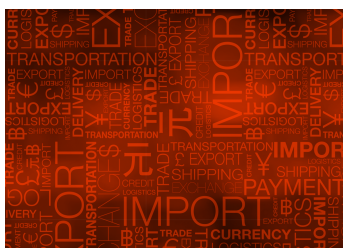
Monday markets down, Tuesday up, Wednesday down, Thursday....?

In this bundle



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China

Stronger yuan won't dent China trade

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Malaysia

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Opinion | 7 February 2018

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Coin toss

Markets circular dance as normalisation reality sinks in

At times in every business cycle, there is a significant negative relationship between stock prices and bond prices. Not surprisingly. One asset class, equities, is a risk-asset, that does well when sentiment is strong, and the other, bonds, is a safe haven play. But also, the valuation of equities depends in part on what the risk-free alternative rate (bond yield) is. So when yields rise, stock valuations dip (it is a net present value thing).

Right now, we have a tangled dance going on between a bond market that is rising because economic fundamentals are strong, inflation is, if not exactly rising, showing a tendency to rise slightly in the future, and central banks are either tightening, thinking about tightening, or thinking about not easing further.

This has met market pricing and positioning that was not priced for the beginning of the end of easy money, and as a result, we have experienced some interesting market fallout. On one day, when strong economic fundamentals would once have simply pushed equities higher, the underlying earnings story is now tempered by rising expectations of higher inflation, policy rates, and bond yields. With market valuations already looking stretched by some metrics, this has led to a sharp downward correction in stocks.

As stocks have fallen and hit market confidence, bonds have rallied and their yields have fallen. The equity market has gained hope as valuations improve. And so the cycle continues...

This might go on for a while yet. Are we close to the bottom? Honestly, this is anyone's guess, though my sense is that no one is really panicking yet, so perhaps. But if it isn't the bottom, it has been a pretty insignificant market correction. Increased volatility will enable those who missed much of the run-up in stocks to buy on dips, and at least get invested, though I suspect they would have been happier coming in after a 10-15% correction. Still, there is plenty of mileage left in this normalization story yet, so don't rule out further sharp falls.

Asian FX - mixed bag

Unhelpfully, the Asian FX story is not really following a strict risk-on / risk-off story. Two of the currencies that tend to get hit hard in any period of market uncertainty, the PHP and IDR are looking very different, with the IDR losing all the ground (and more) that it made in January. But the PHP is making gains against the USD as thoughts of BSP tightening grow (if not today then we expect a hike by quarter end and two more to follow over the course of 2018). Elsewhere, there are some signs of stability in some currencies, though the KRW still seems to be finding it hard to find a solid base in contrast to one of our other preferred currencies for 2018, the MYR, which has been far steadier. On the other side of the coin, the THB, which we view as one of the regions more overvalued currencies, continues to look solid. Whilst this volatility continues, we have no strong convictions as to the likely direction of these currencies and will wait for some further clarity.

What's on today?

In Asia, today's top story is undoubtedly the Philippine Central Bank (BSP) rate decision. The market consensus is for no hike today - a view with which we concur. Though the central bank governor has been sounding a little hawkish recently, and a hike cannot be ruled out. If no hike today, then a March hike seems probable, as the recent inflation rise has not yet run its course, and the arguments for a hike will seem even more compelling by then.

Elsewhere, China trade data is due. This has a bit less market prominence than it once had, given the greater emphasis on consumer-driven growth, but still has the power to surprise, especially in proximity to the data-distorting Chinese New Year.

In the G-7, Japan releases a raft of highly volatile and therefore not very informative data on trade, portfolio flows bank lending and bankruptcies. We would be surprised if any of these gave rise to significant market reactions.

The Bank of England also meets today and is widely expected to leave rates alone, though there remains a lingering threat of more to come from Governor Mark Carney, and the tone of the outcome could err on the hawkish side. There is little significant data to note in the US, though an overnight Senate budget agreement may help avert a government shutdown likely otherwise on Friday. The plan suspends the debt ceiling until March 2019, and provides more funding for the military (\$80bn) this fiscal year and (\$85bn) next. An interim spending bill will need to be passed in the meantime to keep the government afloat until the longer term budget measures are passed. The fight now passes to the House of Representatives, where it will meet opposition, but may still pass.

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Stronger yuan won't dent China trade

We expect China's exports in USD terms to grow 16.3% year-on-year in January and imports to expand 16.2% due to seasonal effects from the Chinese New Year



Source: Shutterstock

Seasonality of Chinese New Year plays a vital role

We expect China's exports in USD terms to grow 16.3% year-on-year in January compared to a low base in January 2017. We also expect import growth to reach 16.2%YoY in January compared to 4.5%YoY growth in December 2017.

We believe that Chinese exporters will pull forward the shipping of orders, if they able, to January rather than waiting until February, which is the month of the Chinese New Year. Workers usually leave the factories a week or so before the Chinese New Year, making the shipment in early February busy and tight.

On imports, we believe that China will import more strategic raw materials to take advantage of the strong yuan. These raw materials could include crude oil and gasoline.

Strong yuan won't hurt overall exports

The yuan appreciated more than 3% in January but that would not hurt China's overall exports. Around 50% of imports are electronic or mechanical parts and products, which are then used to

produce exported goods. If the import and export invoices are denominated in the same currency, there is little effect on overall exports.

What's more, other currencies in Asia have strengthened more than the yuan, so China isn't the only country to have been affected in the region. In addition, most of the products produced nowadays include parts from more than one location, so the global production line may make the currency impact on trade less obvious than in the past.

6.10 USD/CNY
end 2018

But exporters may need to hedge currency risks

With the speedy fall in the dollar, exporters might chase after the fast appreciating yuan trend to convert their dollar receipts into yuan. This could create a self-fulfilling cycle for the yuan to strengthen. We expect that there would be more exporters hedging their currency exposure to keep their yuan earnings stable.

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Malaysia: Trade growth ends 2017 on weak note

Malaysia's December trade surprised on the downside but 2017 was still the best year for exports since 2011



Source: shutterstock

December trade growth misses expectations

Malaysia's December trade surprised on the downside with Malaysian ringgit (MYR)-denominated export growth of 4.7% year-on-year and import growth of 7.9% against the consensus forecasts of 12.7% and 13.6% respectively. The high base effect has begun to affect the year-on-year trade growth. The trade surplus narrowed to MYR 7.3bn in December from MYR 9.9bn in the previous month. Electronics and oil-related products remained the main trade drivers.

15%

Export growth in 2017

Among best performers in Asia

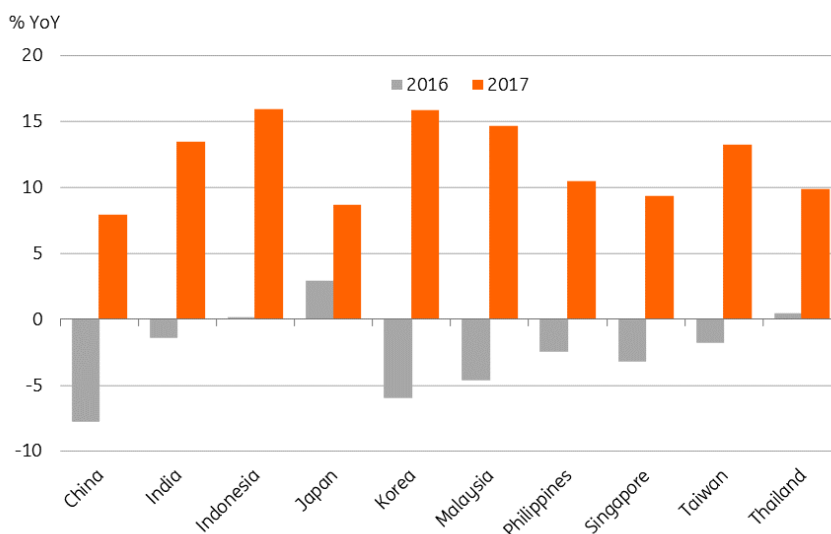
Positive terms of trade shock

Despite weak December growth, 2017 was the best year for Malaysia's exports since 2011.

Although 2017 export strength across regional countries was partly a function of 2016 weakness, the terms of trade were more favourable for Malaysia than for other Asian countries, thanks to a recovery in global oil prices, an upturn in the global electronics cycle and an undervalued MYR.

The 15% US dollar-denominated export growth was a big positive swing from -5% in 2016, the second best in Asia after Korea. However, unlike Korea whose export strength was narrowly based due to its concentration in semiconductor exports, Malaysia's export strength was broad-based. Non-oil exports contributed 12 percentage points to the 15% headline growth, of which semiconductor contribution was only three percentage points (in Korea, half of 16% total export growth was from semiconductor exports).

Asian export performance



Source: Bloomberg, ING

Widening external surpluses

The high import content of exports and strong domestic demand supported imports with USD-value growth of 16% in 2017, up from -4.2% in 2016. The annual trade surplus of USD 22.7bn was slightly wider than USD 21.3bn in 2016. The trade surplus drives the current account surplus and we forecast a current surplus of 2.9% of GDP in 2017, up from 2.1% in 2016 (consensus 2.7%).

Outlook for 2018

The recovery in global commodity prices should continue to support Malaysia's trade in 2018. While MYR's 10.8% appreciation against the USD in 2017 has it approaching fair value, Malaysia's strong economic fundamentals and weak USD environment mean the currency should remain on an uptrend this year. We forecast another 5% MYR appreciation against the USD this year to 3.72 by end-2018 (spot 3.91, consensus 3.85).

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