Good MornING Asia - Friday 13 November

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In this bundle

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A shift in market correlations

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arrows

A perennial problem

One of the biggest problems with economics, apart from the fact that a lot of the underlying assumptions are quite stupid, and many of the models so simplified as to be unusable, others just plain wrong, is that even if we know the macroeconomic stuff inside out and backwards, overlaying this onto markets is a very fiddly business.

For example, the last 24 hours has seen the following patterns - US equities have stopped taking comfort from commercial reports of vaccine progress, and in the absence of peer-reviewed approval and regulatory licensing, have started focussing again on the daily case numbers. And here, the news is terrible. Further lockdowns and restrictions are probably only days away in some jurisdictions. In others, they are already underway.

So as well as weaker equities, bond yields, which had been flirting with the 1.0% level in terms of the US 10Y Treasury, have also snapped back sharply in terms of yield. That move most likely got a further nudge from the softer-than-expected US inflation data for October which were released yesterday, and which tally with a weaker economic reality.

So what did the USD do? Well, looked at entirely through the prism of the EURUSD exchange rate, the USD softened. The EUR made gains once more, clawing its way back above 1.18 again. WIth more of an Asian spin, most currencies managed small gains over this period, except (after India) our most Covid-affected currency, the IDR, and the region's highest beta currency, the KRW. Both fell.

That might not strike you as particularly odd. It seems in line with your gut instinct for how these things should work, and even manages to deliver what economic theory would suggest.

But if you roll the calendar back as little as a month, the relationship was quite different. For complicated and boring regulatory reasons, I can't show you the chart I have just drawn in excel, but what it shows is the 20-day rolling correlation of the daily change in the EURUSD exchange rate and the change in 10Y US Treasury yields over the same timeframe.

Right now, that correlation is negative. A falling UST yield, associated with a weaker economic outlook, is resulting in a softer USD. A month ago, the reverse was true. In other words, the USD was gaining in a softer environment, even as UST yields fell. Back then, the USD was acting like a safe haven currency, which is what it often does.

What's new?

Clearly something has changed. It's not entirely clear what that "something" is, but a quick scratch of the head comes up with the following factors which have "changed" from a month ago, and which could be playing a part in this altered environment:

1. The US election result is now known, but it did not deliver the blue wave that was supposed to bring a big stimulus and higher bond yields (also probably higher equities)
2. The pandemic, which is delivering a present second or even third wave to many countries, resulting in near-term lockdowns and more distancing but...
3. ...where the forward-looking evidence in terms of vaccines past the immediate near term pain is much improved.

There are probably other factors too, but I think it is worth keeping an eye on the transition from near-term economic pain to imminent recovery, as that is likely to see a combination of rising bond yields, rising equities, though whether that still delivers a near term stronger USD remains to be seen. We'll have to keep watching those correlation charts (at least I will, you'll have to draw your own).

ASEAN love triangle

My HK-based, colleague, Iris Pang, reminded me that the Regional Comprehensive Economic Partnership (RCEP) is due to be signed this weekend. Eh? (I hear you say...),

RCEP is the regions big new trade bloc, accounting for something like 30% of global GDP, with the ASEAN region sitting right at its heart. Indeed, the trade deal takes the 10 ASEAN countries and brings in any country with which ASEAN has a bilateral deal, with the exception of India. That means, importantly, that it brings in China, but also Japan, Australia and New Zealand.

The rival trade deal, the CPTPP (look it up here, life's too short), covers only about 13-14% of global

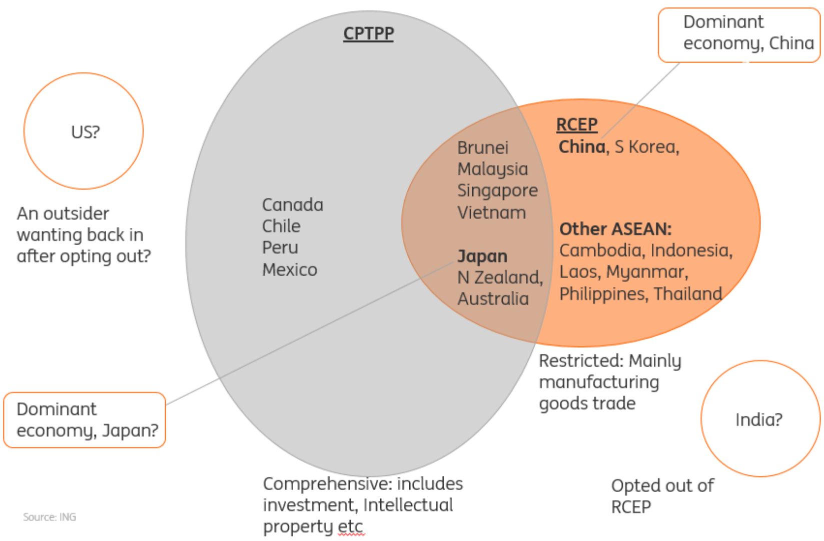
GDP. Japan is the biggest economy in the CPTPP, which lost its dominant player, the US, the day President Trump took power almost 4 years ago.

President-Elect Biden has hinted that the US might be interested in negotiating a re-joining (though only if the terms are right). But let's face it, this is a sellers' market right now for CPTPP incumbents, which include many members of the ASEAN, and which from this weekend, will also be cosseted within the RCEP.

I tentatively believe that this is a very good time to be in SE Asia, with both China and potentially the US (who knows, even the UK) looking to expand trade with the region through the CPTPP, and with China looking to offset that from its part within the RCEP. That could mean a lot of concessions from both sides, a lot of FDI inflows...

I ***can*** show you the Venn diagram below, which might help explain all this a bit more.

ASEAN in the middle



Source: ING

Asia today

There isn't a huge amount on the calendar for today. Malaysian 3Q GDP comes out at lunchtime and should show the usual 3Q post-pandemic outsize bounce. But Malaysia is having some issues of its own with Covid-19 right now, and I don't think you can read too much into backwards-looking indicators of the economy when they don't tell us much about the way forward.

And Indian trade data is also due. Without wanting to get bogged down in the minutiae of extremely volatile monthly trade figures, it's worth pointing out that the pandemic has been a mixed blessing for India's chronic trade deficit. Thanks to decimated domestic demand, India's trade deficit has almost approached balance. Of course, this is not exactly the preferred route for balancing the external sector, and the INR has not been rewarded with any appreciation as a result, quite the opposite. We continue to see the INR as the regions most underperforming currency.

Author

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

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

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering

Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com

Snap | 11 November 2020 China

China’s loan growth shrinks

Loan growth shrank on a monthly basis, but that's a seasonal phenomenon, and it still rose year-on-year. Shadow banking continues to shrink on a yearly basis, which is good news for the financial sector

A woman walks by a money exchange shop decorated with different countries' currency banknotes in Hong Kong

Don't worry about the small loan growth

Although the monthly change in loan growth may look worrying, it is no cause for alarm. It's actually quite normal to see small loan growth in October - the beginning of the fourth quarter. Yuan loans increased CNY689.8 billion in October after an increase of CNY1.8957 trillion in September. Though falling on a monthly basis, the increase was 4.1% year-on-year.

We should see a large increase in loan growth again at the beginning of 2021 which, again, is a seasonal phenomenon.

We are still positive about China's outlook

So we are still comfortable with this small loan growth in October.

We see a better recovery in activity data in October, especially in the domestic economy, as there was a long holiday in the month. We expect retail sales to rise 2.2% YoY though this is slower than the previous month's 3.3% increase due to some limitations on travel activities from Covid, and the high base effect from last year.

Industrial production in October should be slightly lower, at 6.7% YoY growth from 6.8% in September. Export orders were weaker as the pandemic weighed on foreign demand in the US and Europe. Technology production for exports should also slow down because there has been more resistance in the US and Europe to using Chinese technological products.

Fixed asset investment should rise faster, at 1.1% YoY in October from 0.8% a month ago. Foreign demand does not affect investment in China as most of the fixed asset investment comes from government stimulus projects, which echoes the fast increase in government bond issuance. These projects include investment in technological self-reliance, which means building up the whole vertical chain of production, including parts and equipment. We are also likely to see projects for reconstruction after recent flooding.

Shadow banking continued to shrink

Shadow banking items continued to shrink, trust loans, entrusted loans and undiscounted bills all contracted on a yearly basis. This shows that the central bank's policies to reduce shadow banking activities have been effective so far.

Where is the risk then?

We saw a jump in the net issuance of government bonds of CNY493.1 billion, an increase of 62% YoY. Though the scale is still small, it shows that the Chinese government has continued with its fiscal stimulus, with some of the money coming from the issuance of government bonds. In this first data release, we can only see the headline number of government bond issuance, which does not break down into central and local government bonds.

Our worry is about local government bond issuance which supports infrastructure programmes. Local governments are keen to contribute to the economic recovery but they may end up investing in projects which do not yield a sustainable return. The risk is not here yet but it is a concern for the years to come.

Author

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

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