Inflation dominates market outlook

CPI data is due out of China today, and the US overnight - indications are that we are due more inflation strength - but bond markets seem relaxed

Why no concern?

As Us Treasury bond yields drop again overnight, we have to make a decision. Maybe bond markets are absolutely right. The inflation we are seeing now, and are likely to see more of later today in China, and overnight from the US really is just transitory. This is a case of "nothing to see here, move on".

Or, and this is looking more likely, even if this is transitory - in the sense that it does not give rise to a spiral of wage and price increases that drags on for a while - it might still drag on for a while and in the meantime, remain higher than anticipated, or wished. Firms really do seem to be using the unprecedented opportunity of the disruption of the pandemic to undertake adjustments to prices - helped in the knowledge that everyone else is doing so too. And workers, flush with cash from handouts and realizing that life at home isn't so bad anyway (and what's the point of working if you can't blow it all on a nice overseas holiday) decide to hold out for higher wages, or at the very least, for a nice fat signing on bonus.

So there are a couple of points to make about this. The first is that the consensus seems to be a bit low for the May US CPI figure. The 0.4%MoM consensus call is quite a lot weaker than the recent run rate for the inflation prints (3m annualised rate is more than 6%!). Furthermore, in time we may find out that the number released overnight from the US turns out not to be the inflation peak after all. We won't know that until next month. And that will require next month's figure to deliver a 0.5%MoM or higher print to keep the annual inflation rate either stable or edging higher. But even though 0.5%MoM is quite a high hurdle, it is well within recent ranges, and definitely achievable.

China's inflation poses fewer concerns

We're a bit less concerned about today's Chinese inflation. For the most part, the increase in inflation we expect (we forecast 1.5%YoY in May from 0.9% in April, just a little below the 1.6% YoY consensus) is almost entirely a base-effect driven increase. In that sense, this month's figure will be very like last month. A notable rise in the headline rate, but little of substance underlying the change.

That said, we could see China's May PPI inflation push higher than the 8.5%YoY consensus forecast, raising the prospect of a possible double-digit PPI increase (up from 6.8%YoY), driven by rising commodity prices and higher semiconductor prices. This might well spur thoughts of further direct dampening measures from the authorities on firms' commodity purchases. There isn't much that anyone can do about higher semiconductor prices, and we don't think there will be any meaningful response from the PBoC.

Asia today

The China inflation data is definitely the main highlight for Asia today.

We have already had some revised 1Q21 GDP data for South Korea - that was a little higher at 1.7%QoQ (initially reported as 1.6%). We have some "banked" forecast increases we are holding back for Korea currently, while we wait to see if it manages to avoid going the way of many of its neighbours with a new wave of Covid and imposition of movement restrictions. If it does, we can add this held back reserve to our forecasts in a month or two. If not, then we can reduce the magnitude of any back-flip we have to perform.

Philippine trade data for April is today's other release. Eye-watering year on year growth figures (146%YoY growth forecast for imports) lose all meaning against the backdrop of huge falls last year, and the main focus should be on the trade balance, which is expected to remain roughly unchanged at -$2400m.

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