Asia-Pacific not immune to Treasury rout

As 10Y US Treasuries briefly touch 1.6% yesterday, Asia will be feeling the effects today

Treasuries

Source: shutterstock

US Treasury reach is huge

Years ago, and I am literally talking decades here, a colleague recommended an article called something like, "Everything you need to know about markets". I don't remember the author. Perhaps my colleague was trying to tell me something...?

The key message I took from it was this, the US treasury market accounts for about 80% of the variance of all other markets. I'm not sure if this was exclusive to other bond markets, or all other markets, but even if only bond markets, it was a useful snippet, and one I have relied on since. The variance may have changed, but even if it has fallen, I'm sure it still remains huge.

So the news that 10Y US Treasuries had hit 1.6% intraday yesterday has big implications for Asia.

Japan: The 10Y benchmark Japanese Government bond (10Y JGB) has pushed up to 0.155%, a yield where the BoJ has intervened in the past to pull yields back towards their 0.0% target. The rationale for them to do this is highly questionable with a large chunk of the population reliant on savings income, and back in January, BoJ Governor Kuroda suggested the BoJ might be warming to ideas of allowing the JGB yield to fluctuate in a wider band than previously, possibly with a view to the effect of such intervention on the super-long end of the yield curve where savers are typically parked. So intervention is not guaranteed because of the current yield, though they and other central banks may well take offense at the speed of recent moves. It's not impossible to imagine a hurried G-7 phone call to ask for some co-ordinated intervention, if only oral, to calm things down.

Australia: The Reserve Bank of Australia (RBA) has a yield curve control policy aimed at the 3Y government bond, and has recently extended its QE purchases of the rest of the curve, on which it will now be nursing sizeable losses. 10Y Australian government bonds are now yielding more than 1.90%, almost a full percentage point higher than at the start of the year, and a bigger sell-off than in the comparable US Treasury. 3-year yields are up 0.105%. It would not be unthinkable for the RBA to step up its asset purchasing as part of an effort to calm its own markets, though on its own, we doubt it would achieve much - free money for traders some might argue. Conversely, this might also be argued to be a reasonable correction with comments from NZ politicians recently aimed at their central bank, arguing that they should take into account soaring house prices into their rate deliberations. Something for the RBA to consider also...?

Indonesia: A 33bp rise in the benchmark 10Y Indon to 6.49% from the beginning of the year is not a pure US Treasury effect, with some IDR currency weakness concerns probably also hanging over local currency government bond yields, especially following the recent, and somewhat controversial rate cut decision by Bank Indonesia. For a central bank that dabbled with unorthodox monetary policies during the height of the pandemic, we wouldn't rule out anything from BI at this point.

Philippines: And in the Philippines, the central bank (BSP) also undertook low-level unorthodox policy measures in 2020. With a local inflation issue (even though mainly food), they might also see some merit in weighing on bond yields, with the benchmark 10Y local currency yield currently at about 2.2%, up about 49bp from the beginning of the year.

Korea: Korea's central bank (BoK) left rates on hold this week, but we suspect they might be less upset to see bond yields rising than some other central banks in the region, noting the rise in household debt and widespread house price gains in their recent statement. 10Y KTB yields have been rising, but at a very sedate and steady pace since the beginning of the year, with the 10Y now at 1.917%, up from 1.677% at the beginning of the year.

So, a lot to look forward to today, and tonight's US Treasury and equity market price action promises to make it an interesting start to Asian markets next week.

Powell is right, it is a mark of confidence

In attempting to calm markets, Fed Chair, Jerome Powell has made much of the fact that the rise in bond yields is a mark of confidence in the economy. He's not wrong, though I suspect this will come as scant consolation if your 401K is limit long NASDAQ shares.

I updated a little spreadsheet of bond yield composition this morning (which I can't share in this note unfortunately due to licensing issues) but which shows that since 1 Jan 2021, real yield increases account for about 45bp of the total rise in the US Treasury yields, with inflation expectations only about 15bp, (and dropping in recent days).

You may also remember that I have been musing whether the rise in Treasury yields would provide some support to the USD, given that front-end yields are virtually locked down by central bank policy (more on that in a minute). And somewhat disappointingly, I can confirm that this still does not get convincing support from my correlation chart. With a macroeconomist's hat on, looking at yesterday's price action across asset classes, it was almost as if investors started with a "sell US assets" mentality before going "Blimey, look at the yield on that!", and became buyers again.

There was also some confusing price action in Asian FX, where the JPY weakened despite what appeared to be a fairly clear risk-off market. Bitcoin was also pressured - maybe being sold to cover losses elsewhere, and also potentially a victim to rising real USD yields, like gold.

I mentioned the front end of the yield curve - well, it may not be so locked down as you would think. 2Y US Treasury yields rose more than 4bp yesterday, and looking at even shorter maturities, the fed funds futures market was this morning fully pricing in a 25bp Fed funds rate by Feb 2023, and very nearly by January 2023. So there is a challenge here from markets to the Fed, which claims that rates will not rise until 2024 at the earliest, and is also apparently not even thinking about altering its asset purchase stance. The market pricing can be interpreted as a rather sarcastic "Sure!".

Calendar today - busier!

The G-7 offers us a bit more interest today if you can stay awake that long. We have US personal income and spending figures for January today, which comes with the latest measures of PCE inflation, which will be topical, especially as the consensus is for the Fed's preferred inflation measure to decline to 1.4% from 1.5%. There could be an ugly mess if that doesn't happen.

And we also get the University of Michigan consumer confidence figures, which come complete with their very own inflation expectations series. Last month, the 1-year ahead series spiked up to 3.3%, in line more or less with our own house expectation for peak US inflation in 2021.

Here in Asia, we have 4Q Indian GDP. Prakash Sakpal writes: "We expect the year-on-year GDP contraction to moderate to -4.7% from -7.5% in the previous quarter, though this is at odds with the consensus of slightly positive growth. GDP growth of the majority of Asian economies stayed negative through the end of 2020. It's hard to imagine the Indian economy turning the corner to positive growth just yet. India suffered the worst-ever 24% YoY collapse in 2Q20 at the height of the Covid-19 crisis. We don't think the impact of such a huge blow will have faded so quickly. We anticipate one more quarter of YoY GDP contraction in the current quarter before low base effects lift GDP to positive growth in 2Q21. Even as macro policies remain accommodative, the official target of 11% GDP growth in FY2021-22 appears optimistic.

And in Singapore, January's industrial production figures will shed light on where GDP growth is headed in the current quarter. A surprisingly strong 13% YoY surge in January non-oil domestic exports augurs well for IP growth. However, after double-digit year-on-year surges in the previous two months, some retracement seems to be in order on the back of a high base year effect. Hence our forecast of a slowdown to 6.4% YoY in January from 14.3% in December. The MAS's shift a year ago to a neutral monetary policy targeting zero appreciation of S$-NEER has served well for the export-driven recovery. There are no compelling grounds for them to change this policy stance in 2021".

Author

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

Disclaimer