Fed deals Asian bonds reprieve for now

Markets generally finish "higher" (Stocks, longer maturity bond yields, EURUSD) though off their highs of the day - not much (think our colleagues in the US) to stop the bond selloff resuming in the days and weeks ahead, which should see some reflection in APAC bond yields

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Treasury selloff likely to resume in weeks ahead

Before going any further, here is the overnight contribution from our US-based Economist and rates strategist, along with comments from FX strategists in the UK on the implications of yesterday's FOMC decision and press conference.

In the aftermath of a big increase in the Fed's GDP outlook for this year (6.5%) and of PCE inflation (2.2%), and a few creeping dot forecasts for the first hike in 2023 (median just remains in 2024), Fed Chair Powell did a good job of balancing a forceful argument for lengthy inaction against possible criticisms of complacency. But as our US team notes, though he managed well with a difficult meeting and press conference yesterday, there isn't much to stop yields from moving higher again in the coming weeks.

We've been looking at what this means for Asian bonds, and what comes out is a very mixed picture. Yes, there is a general tendency for 10Y Asian bond yields to move higher as the Treasury selloff has occurred. But local factors seem to be playing a dominant role for now. The Philippines tops the list, with yields up close to 140bp since the start of the year. But it has had problems with inflation which has spiked above the central bank target of 2-4% (currently 4.7%YoY). Though with the bulk of that inflation coming from food following an outbreak of African swine fever, it is a fair bet that this spike will be transient and that bond yields may be better behaved than regional peers when pork prices start to moderate in the months ahead.

Not too far behind the Philippines is Indonesia, which may be paying the price for a 25bp rate cut in February which looked controversial even then as their bond and FX markets had required a fair bit of propping up prior to that. But then there follows a bunched group, including the MYR, AUD, SGD and THB all up between 60-80bp since 1 January. There are few inflation problems anywhere here, and little to distinguish between developed economies from emerging. What is fairly clear at this stage, is that there is no generalised EM selloff, just a sell-off that is still fairly discriminating between weak and strong.

At the bottom of the pack, KRW and INR bonds, the former with low inflation and a strong economy helping to offset the gravity exerted by Treasuries, the latter benefitting from a fall in inflation, though one that seems likely to be short-lived, which may pull its bonds into line with the rest of the APAC pack in the months ahead.

Asia today

There is a lot on the calendar today, with central bank meetings in Indonesia and Covid-19 support in Malaysia covered in our sister publication, ASEAN Bytes. Other central bank interest includes Taiwan's central bank, though nothing is expected from them.

We've already had a downside miss on 4Q20 NZ GDP, which registered a 1.0%QoQ decline against expectations for a small increase. But come on! 3Q20 GDP did grow 13.9% QoQ (yes, that's right, QoQ), so a bit of a blip downward is not at all unreasonable or worrying.

More excitingly, the February Australian labour market release was super strong. We've covered this separately too, but to cut a long story short, an 88,700 increase in employment, all of which was in the full-time sector, bodes very well for spending power and is reinforced by a drop in the unemployment rate from 6.3% to 5.8%. RBA assertions that rates will be on hold until 2024 are sounding rather hollow today.

And finally, Chinese and American diplomats will meet in Alaska today, here's what Iris Pang thinks about that meeting. "I don't expect anything positive from this meeting. If there is no bad news, then that will be good news as both sides' agendas are so different. The US is going to talk about democracy, and China is going to talk about rolling back Trump's policies, e.g. technology, trade. Neither are likely to gain any ground".

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