

Lowflation strikes again

10Y US bond yields are back below 2.50% as of writing this, despite strong GDP figures last week. This is not a bad backdrop for EM Asia.



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Asian FX a little weaker, but outlook calm

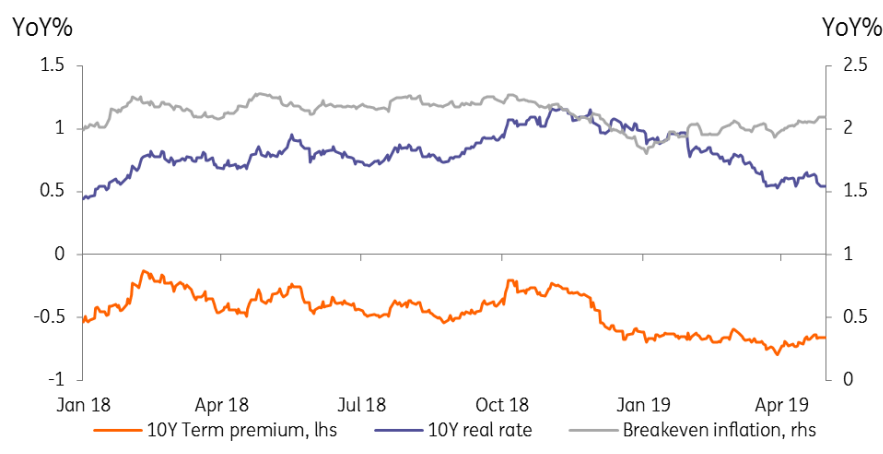
Thanks to recent USD strength, most Asian currencies are a little weaker than they were a few weeks ago. But despite an apparent re-run of some EM currency distress outside Asia, it does not look as if we will see a re-run of the contagion that led to widespread Asian FX weakness in 2018. And for the current account deficit currencies of the region, IDR, INR and PHP, the talk is still of the potential for easing, not the likelihood of protective tightening. For example, the Philippine Central Bank (BSP) Governor, Diokno, was reported as talking about "when", not "if" for policy easing recently.

One of the factors that has changed the outlook for Asian FX, is what is happening to US inflation and consequently the outlook for Fed policy. While last year, until Powell's December capitulation, the talk was about how much more tightening was coming, the mood-music on Fed rates has entirely changed to consideration of likely cuts. Real rates in the region are also high, relative to last year, so international investors are well compensated for taking on local currency risk.

Flying in the face of calls for Fed easing, last week's 1Q19 US GDP of 3.2% was way above expectations, though it was largely driven by transitory factors that our [US Economists see likely to be unwound in coming quarters](#).

What may also have weighed on bond markets was the inflation data accompanying the GDP numbers. The Core Personal Consumption expenditure deflator (Core PCE inflation), slipped back to 1.3% from 1.8%. That's way off the Fed's 2% target. But our US team don't expect the Fed to cut whilst growth and the labour market are apparently so strong. Markets seem confused over which way to turn.

10Y US Treasury yield breakdown



Inflation expectations aren't collapsing

I was slightly surprised to see US inflation expectations holding up as well as they seem to be in the face of last weeks core PCE figures. Checking this morning against a newswire story that seemed to suggest the opposite, the 5Y-5Y forward breakeven rate (a widely watched measure of market inflation expectations) was firm at 2.09%. The same story was true of the 10Y nominal versus inflation-linked bonds, though the level was a little lower at 1.97%. All of which tells us that if markets have not totally bought into recent economic strength, they don't seem to believe the disinflation story either. In fact, most of the decline in bond yields seems to be through the real rate, as even the term premium is fairly steady, though at rock-bottom levels.

In short, bond yields seem to be torn between downbeat views on US growth and strong growth data, and between low inflation data, and firm inflation expectations. A distinct absence of market volatility adds further blandness of this mix. While these factors remain in place, it is hard to justify directional calls.

Asia week ahead

It is a quiet start to the week, but it hots up as the week progresses. For the full blow-by-blow view, [see our latest week ahead note](#). But among the highlights are South Korean export data for April, that will add to our understanding of the global technology slump, along with Singapore reports on this industry.

Korean inflation could also spur thoughts of a BoK easing, and New Zealand labour market data could also spur RBNZ easing thoughts, weighing on the currencies of these two countries.

GDP data is also due from HK and Taiwan, following on from recent soft Korean and Singaporean data. PMIs across the region including from China finish off the week.

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