

Tipping point

Turkey isn't enough on its own to flip the world into a global recession, but it is not alone.



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Turkey finds some respite, but it is not the whole story

Overnight, there have been new restrictions on Turkish Lira (TRY) FX swaps as well as efforts to bolster liquidity to keep the banking system and corporates ticking over. Combined with some assistance from Qatar in the form of a promise of \$15bn in investment, and some less spendable verbal support from Germany's Merkel, USD/TRY is trading at about 5.99, a vast improvement from the 7.32 rate reached a few days ago.

There isn't much respite from the US, which isn't even in negotiation mode over Pastor Brunson, the cleric at the heart of the political spat. He remains under house arrest in Turkey. And it doesn't look as if Turkey's President Erdogan is in any mood to row back from this issue either. Retaliatory tariffs on US food and cars probably won't do much on their own to damage the US, but it is wrong to think of this as a two-country battle, the US is engaged in trade skirmishes with a large part of the world right now. Turkey is just another name on the list.

What else? Commodities, China, Fed, USD....

At the very start of the year, optimism rode high on the synchronized global growth story. That no longer works. The US is still growing strongly. but take a look at the US Treasury yield curve, close to inversion. Expectations that US growth will persist once the fiscal stimulus wanes next year are dimming. China is still growing, but not as fast as it was, and again, expectations are rising that

Chinese growth moderates further. Activity data released for July earlier this week gave this hypothesis a further nudge. Other EM countries are struggling right now. Argentina, which actually has a worse currency performance year-to-date than Turkey, is a mess. Venezuela is a basket case. Even in our relatively insulated region of Asia, there is evidence of strain in the fragile three (Indonesia, India, Philippines), though pro-active central bank policy has done a lot to mitigate this.

The Fed is still in hiking mode. President Trump is still in trade-combative mode, and as long as this remains the case, don't expect to see the USD deviate from its current strengthening path. This not only weakens EM (and other DM) currencies but drags their short-term interest rates higher, exacerbating their problems. Don't also expect Fed Chairman, Jerome Powell, to change tack because of any of this. Despite the US indirectly running monetary policy for large swathes of the world, in particular any country with even the faintest dollar shadowing (e.g. much of the EM world) and also flipping the switch on any economy reliant on external funding (any current account deficit country), Fed policy has an almost exclusive domestic focus. That is, right up until the point where any collateral damage it creates becomes a domestic US problem. By this stage, it is usually too late.

Markets signalling trouble

From equity markets, where the S&P 500 has fallen for 5 out of the last 6 days, to bond markets, where the Treasury yield curve 2s10s slope is now only 26bp, and now to commodities, with copper plunging and now oil falling, a similar message is playing out. There is no one factor at play. But a combination and cumulative effect of many factors, Fed and US rates, Trump and trade, USD, EM flashpoints, are all adding up to something that could turn a lot uglier.

This isn't to say there is only a negative outlook. Much of what is resulting in the current bout of market pain is reversible. The Fed could signal a more cautious outlook, President Trump could make some positive overtures on trade (NAFTA, Mexico deal), China's policy stimulus could provide another lift to Asian regional demand. That said, the probability of a flip into a more negative economic equilibrium gathers by the day. We would be wise to be prepared.

Asia Day ahead

Weaker than expected Japanese exports started the Asia day on a sour note. The July trade balance has slipped back to a JPY 231.2bn deficit, rather more than the token JPY41bn deficit that had been expected. Export growth was a soggy 3.9%YoY, and imports remained strong at 14.6%YoY.

Australia's random number generator, otherwise known as the labour market report, will provide some additional market interest later on. June's 50.9K of largely permanent jobs growth looks unsustainable, and a softer figure today would seem a sensible call. But beyond that, it is hard to say anything sensible, except that whatever it does, it is unlikely to shift expectations that the Reserve Bank of Australia remains as far from any tightening as ever.

In India, the Reserve Bank (RBI) publishes minutes of the policy meeting held earlier this month. Even as inflation eased in July the accelerated currency depreciation since then will undoubtedly keep this at the top of policy worries for MPC members. Although RBI policy doesn't target the exchange rate, the intensified INR sell-off, which saw USD/INR testing an all-time high of 70 last Tuesday, will prompt the RBI to follow its counterparts in Indonesia and the Philippines on a path to more aggressive policy tightening ahead (see ['India: No respite for the rupee'](#)).

Malaysia reports GDP data for 2Q18. The consensus, which until a couple of days back, was looking for a steady growth at the 5.4% pace in 1Q18, has finally come around to our forecast of a slight slowdown to 5.2%. Net exports displaced domestic demand as the driver of GDP growth this year, while strong exports supported manufacturing as the industry-side driver. The MYR continues to be the Asian FX outperformer this year. Steady strong growth and low inflation allow for stable policies. We consider our 4.35 forecast for USD/MYR by end-2018 subject to more downside than upside risk.

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