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Opinion

What will 3Q18 bring?

2Q18 was a rough one for emerging markets including Asia, but will 3Q be any better?

After the rout, what next?

Investors licking their wounds after a harrowing second quarter may reasonably be wondering what comes next. Indeed, there are a number of articles floating around this morning that suggest that now may be the time to buy. I would not want to put my name to any of those.

Why not? Well, here are some of the reasons why the EM world has been being battered, in no particular order.

1. Descent into a global trade war
2. USD has been stronger
3. Reaction to policy tightening.

Starting with the trade issue, as of right now, practically no tariffs have actually been levied, though China has resorted to other means to retaliate against US trade threats (zealous inspections of arriving cargoes etc), The first tariffs get implemented on July 6th. There are still those who cling to the idea that this has all been a brilliantly executed bluff to get concessions and that it will all turn out fine. I do not believe that. I believe that President Trump wants tariffs, and sees these as a way to rebalance the global trading environment. I think he is dead wrong. But as long as he continues to believe this, and surrounds himself with 'advisers' who will not argue with him, then tariffs are coming, and this can only get worse.

As for the USD, its future is frankly uncertain, but in a risk-off world, it may perform adequately. Of course, this also ties in with the third point about policy tightening. And here, there is a tug of war here between a slowly tapering ECB and a Fed that has been sounding quite hawkish. On this front, it is interesting to hear Neel Kashkari muse about what to do with policy once Fed funds hit neutral - keep ploughing on? Or take a breather? He seems to favour the latter - so do we. And this would also lessen EM anxiety, though the reasons for any Fed pause will be as important as the action itself (is it a reaction to slowing demand brought on by trade wars, for example?). Watch today's University of Michigan data for some clues about the Fed's path, especially the slowly rising 5-10Y inflation expectations component, and of course, PCE and core PCE data for June due out later. All should show further increases.

Korea continues to work down its cyclical overhang

Data out of Korea this morning show further progress on the old-fashioned inventory led production slowdown that has been weighing on growth. Production was higher for the second month in a row, and capacity utilisation and shipments were up whilst inventories were down. We aren't quite out of the woods yet, and the index of leading indicators is still giving a negative reading, but it is closing in on zero and another month or perhaps two, and we ought to see Korean output growth returning to something closer to normal.

Bank Indonesia to hike rates thoday

Indonesia's central bank (BI) meets today - a day later than many had been expecting (the

decision was put back a day after public holidays were declared because of elections). The focus of BI has been currency stability, which they are clearly not achieving, so the message today will be an important one. On the inflation front, that story could look less of a worry for BI policy as figures released next week could show a further moderation in the headline inflation rate, currently 3.3%, and already on its way down from 3.4% in April. The Indonesian rupiah is the worst currency in Asia month to date apart from the Korean won. A more convincing message to markets is clearly needed.

EU Summit, and why it matters...

It might seem a million miles away, and of no relevance to our markets in Asia. But Italian PM, Conte, is threatening to veto any of the agreements at this week's EU summit, sending leaders back to their countries with nothing to show for all the talk. This could be particularly bad news for German Chancellor, Angela Merkel. With her coalition looking very weak and vulnerable, failure to reach some accord and tackle Europe's migrant problems could see one of Europe's most venerable leaders looking for work. That would hit the EUR hard. It would also make it more likely that the UK crashes out of the EU with no deal - Merkel is damaged by recent events, but there are few other politicians in Europe who are as likely to be able to get consensus on Brexit as her - the Netherland's Rutte perhaps?

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