Economies, Currencies, Rates

Daily Breakfast Spread

DBS Group Research — 21 June 2013

Economics

Greater China, Korea

- **HK:** The CPI for May came in at 3.9% YoY, down from 4.0% in April. Component wise, housing and food accounted for about three-quarters of inflation, down significantly from last year, when they contributed to more than 90%. Overall food inflation fell to 4.0% from 5.2% in April, as prices of fresh vegetables fell and meat prices held steady. On the housing inflation front, property prices have recently reversed course and rose for five consecutive weeks. Should this trend solidify and confidence returns to the property market, private rents will likely pick up in 3Q. Private rents fell in May (HK$22.5/sqft versus $22.8/sqft in April) after rising for 12 months up to March. However, the housing component of the CPI does not fully capture recent dynamics in the property market as rentals are reflected in the CPI with a lengthy time lag. In May, the housing component of the CPI was still on an uptrend and increased to 6.2% from 5.9% in April.

Southeast Asia, India

- **TH:** The outperformance of the domestic economy is starting to show in the custom trade numbers with imports staying elevated relative to exports. Notably, the rolling 12-month trade balance deteriorated from a surplus of USD 3bn in September 2011 to a deficit of USD 22bn in April. Over the time period, manufactured goods exports were generally weak even though supply side effects from the floods of late 2011 have essentially dissipated by 2H12. In level terms, manufactured products fell to their lowest point in a year at USD 13.1bn in April amid lackluster external demand. Meanwhile, the import of capital goods remains high relative to the pre-flood period despite a slight easing in the more recent 2-3 months.

  Going forward, we maintain that domestic demand is likely to be well supported. Although, there have been plans by the government to scale down on its rice pledging scheme (through lower guaranteed prices), the authorities have indicated that this program is set to be in place until 2017. Continued consumption stimulus and the ramp up of public sector investment in the coming months are likely to put downward pressure on the trade balance and a larger deficit cannot be ruled out if the global economic recovery does not gain traction. For May, we expect exports and imports to contract by 10.6% YoY and 7.2% YoY respectively, largely on account of base effects.

US Fed expectations

Source: Bloomberg fed fund futures

Implied fed funds rate

	Jun13	Dec13	Jun14
Market			
Current	0.10	0.14	0.20
1wk ago	0.09	0.13	0.17
DBS	0.25	0.25	0.25

Notes: Given a FF target rate of 0.25%, an implied FF rate of 0.30 is interpreted roughly as the market pricing in a 20% chance of a Fed hike to 0.50% from 0.25% (30 is 1/5th of the distance to 50 from 25). DBS expectations are presented in discrete blocks of 25bps, i.e., the Fed moves or it does not. See also "Policy rate forecasts" below.

G3

- **US:** Markets are taking the tapering plans hard. Equities (SPX) fell by another 2.5% yesterday following on a 1.4% drop Wednesday. All of May's gains wiped out in two days. Do investors think the Fed's outlook too rosy? It would be hard to fault them. The unemployment rate has fallen all of two-tenths of a point in the 8 months since QE3 was launched. That's not exactly a landslide. Were that (quarter-of-a tenth-of-a-point-per-month) pace to continue, 7% unemployment wouldn't be reached until June-2015, a year later than the June-2014 date currently envisioned in the Fed projections. Six-point-five percent unemployment – the threshold for raising Fed funds – wouldn't be reached until February 2017. Why rush things?

Because growth is going to pick up, it seems. The Fed looks for 3.25% (mid-point) growth in 2014. That's possible of course. But certainly bold. The IMF recently dropped its 2014 forecast to 2.7%. Consensus currently stands at 2.7% as well. For what it's worth, DBS expects 2.4%, still fearing the $85bn of sequester cuts will have secondary impacts on the private sector.

Are the data accelerating? They don't seem to be. True, as Bernanke noted at yesterday's press conference, payroll gains have averaged about 200k per month over the past six months. That's a decent pickup over the 6mma figure that prevailed back in September when QE began (194k vs 130k for total non-farm payrolls). But other indicators don't look better at all when you make the same 6-month comparisons between today and September 2012.

For example, on-year GDP growth was averaging 2.4% in the two quarters ending Sep12. Today, the latest 6 month figure is 1.7%. Much slower. Consumption is running at the same (but very low) 1.9% rate. Six month business investment growth has fallen to 4.8% from 7.2% back in September. Labor force participation has dropped. Inflation has fallen. Both significantly. And payroll gains measured in the household survey have fallen to 104k from 159k back in September – an equal-and-opposite mirror image of the gains seen in the nonfarm survey.

Economic data comparison: Sep12 with May13

GDP components	Sep 2012	Mar 2013	Better / Worse
GDP growth (% YoY, 2qma)	2.4	1.7	↓
Consumption growth (% YoY, 2qma)	1.9	1.9	=
Business investment growth (%YoY, 2qma)	7.2	4.8	↓
Housing investment growth (%YoY, 2qma)	12.0	13.9	+
Labor & prices	Sep 2012	May 2013	
Nonfarm Payrolls, 6mma	130k	194k	+
Household survey payrolls, 6mma	159k	104k	↓
Unemployment rate	7.8	7.6	+
Percentage of pop'n in labor force (%, 3mma)	63.7	63.3	↓
Core CPI inflation (% YoY, 3mma)	2.1	1.9	↓
Core PCE inflation (%YoY, 3mma)	1.7	1.2	↓
Unit auto sales growth (%YoY, 3mma)	14.5	7.7	↓

So which data should one believe? The improvement in the nonfarm payrolls? Or the deterioration in almost everything else? Markets seem to be voting for the latter.

The good news, as Bernanke stressed a couple of times yesterday, is that none of this tapering is pre-determined. If the data don't unfold as envisioned in the Fed's projections, the tapering won't unfold either. Our sense is that Bernanke himself doesn't believe it's time to taper but sees no profit – at the moment – in debating the average forecast of 19 Fed officials. If the forecast turns out to be correct, the whole world will be happy. If it turns out to be wrong, tapering will remain on hold; QE will continue. The numerical framework for guiding an eventual tapering will still exist. That, not the forecast, was the key achievement of Wednesday's FOMC meeting.

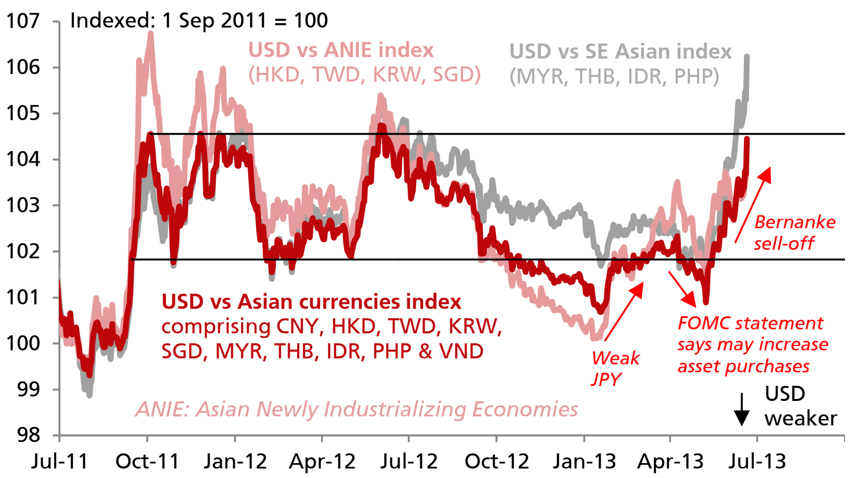
Currencies

- FX: Asia ex Japan (AXJ) currencies have, on average, traded back towards their lows seen at the start of the Eurozone crisis in September 2011. This was worse than the sell-off in 1Q13 from a weak Japanese yen. Domestic-led Southeast Asian markets were hit harder than their export-led counterparts. Why? During the Eurozone crisis, these Southeast Asian economies did not suffer a growth deceleration because they were able to depend on domestic demand to keep up their growth rates. They were the main beneficiaries in the region from the negative real interest rate environment during the Eurozone crisis. Today, bond yields are higher in the US and globally, and more importantly, above inflation again.

  The latest sell-off started after the Fed inserted a new line "to increase or reduce the pace of its purchases" into its FOMC statement at the FOMC meeting on May 1. Since then, more Fed officials started talking about rolling back asset purchases sooner-than-later. This, however, did not stop equities from rising. Equities peaked around May 22, the day Fed Chairman Ben Bernanke told the Joint Economic Committee that the first tapering could be "in the first few meetings". The market's fixation with the timing of the tapering was also evident during Bernanke's press conference after the FOMC meeting this week on June 19. Despite his efforts to explain the Fed's policy decision-making process, markets only heard that the Fed could stop asset purchases by mid-2014.

  The Dow Jones Industrial Average fell a total 560 points (-3.7%) in the past two trading sessions to 14758, its lowest close since the start of May. For markets, this raises one doubt. The US is not immune to the Fed either. Is the US dollar truly a safe haven when both stocks and bonds are under selling pressures too? For now, markets may cover their shorts for the weekend. Sentiment remains fragile. There will be many Fed speakers next week. Will they "taper" their comments? If so, this could well tamper the selling pressure on AXJ currencies at current levels.

Fed tapering fears returned Asia ex Japan currencies to EU- risis lows



Economic calendar

Event	Consensus	Actual	Previous
Jun 17 (Mon)			
SG: NODX (May)	-0.2% y/y	-4.6% y/y	-1.0% y/y
Jun 18 (Tue)			
US: CPI (May)	1.4% y/y	1.4% y/y	1.1% y/y
US: housing starts (May)	950K	914K	853K
US: building permits (May)	975K	974K	1017K
EZ: ZEW (Jun)		30.6	27.6
Jun 19 (Wed)			
MY: CPI (May)	1.7% y/y	1.8% y/y	1.7% y/y
PH: balance of payments (May)		$75M	$274M
Jun 20 (Thur)			
US: initial jobless claims (May)	340K	354K	334K
US: existing home sales (May)	5.00M	5.18M	4.97M
HK: CPI (May)	3.9%	3.9%	4.0%
TW: export orders (May)	-1.2% y/y	-0.4% y/y	-1.1% y/y
Jun 21 (Fri)			
none			

Central bank policy calendar

Date	Country	Policy Rate	Current	Consensus	DBS	Actual
17-Jun	IN	o/n repo	7.25%	7.25%	7.25%	7.25%
19-Jun	US	FDTR	0.25%	0.25%	0.25%	0.25%
Next week						
27-Jun	TW	disc rate	1.88%	1.88%	1.88%	
Last week						
11-Jun	JP	o/n call rate	0.10%	0.10%	0.10%	0.10%
13-Jun	KR	7 day repo rate	2.50%	2.50%	2.50%	2.50%
13-Jun	PH	o/n rev repo	3.50%	3.50%	3.50%	3.50%
13-Jun	ID	o/n reference rate	5.75%	5.75%	5.75%	6.00%

DBS

GDP & inflation forecasts

	GDP growth, % YoY					CPI inflation, % YoY				
	2010	2011	2012	2013f	2014f	2010	2011	2012	2013f	2014f
US	3.0	1.8	2.2	1.6	2.4	1.6	3.1	2.1	1.6	2.0
Japan	4.5	-0.6	2.0	1.8	0.9	-0.7	-0.3	0.0	0.0	2.0
Eurozone	1.9	1.6	-0.5	-0.6	0.1	1.6	2.7	2.5	1.5	1.9
Indonesia	6.1	6.5	6.2	6.3	6.5	5.1	5.4	4.3	5.3	5.4
Malaysia	7.2	5.1	5.6	5.0	5.5	1.7	3.2	1.7	2.0	2.4
Philippines	7.3	3.6	6.8	6.4	6.0	3.8	4.8	3.1	3.1	4.0
Singapore	14.8	5.2	1.3	2.5	4.0	2.8	5.2	4.6	2.8	3.6
Thailand	7.8	0.1	6.4	5.0	5.0	3.3	3.8	3.0	2.9	3.7
Vietnam	6.8	5.9	5.0	5.3	5.7	9.2	18.6	9.3	6.7	6.8
China	10.3	9.3	7.8	8.0	8.5	3.3	5.4	2.6	3.5	3.5
Hong Kong	7.0	4.9	1.5	4.0	4.0	2.4	5.3	4.1	4.5	3.5
Taiwan	10.7	4.1	1.3	2.6	4.2	1.0	1.4	1.9	1.0	1.3
Korea	6.2	3.6	2.0	2.8	4.0	2.9	4.0	2.2	1.5	2.9
India*	8.4	6.5	5.0	5.7	6.1	9.6	8.9	7.4	6.7	7.0

* India data & forecasts refer to fiscal years beginning April; inflation is WPI
Source: CEIC and DBS Research

Policy & exchange rate forecasts

	Policy interest rates, eop					Exchange rates, eop				
	current	3Q13	4Q13	1Q14	2Q14	current	3Q13	4Q13	1Q14	2Q14
US	0.25	0.25	0.25	0.25	0.25	...	...	...	...	...
Japan	0.10	0.10	0.10	0.10	0.10	97.2	100	102	104	105
Eurozone	0.50	0.50	0.50	0.50	0.50	1.322	1.31	1.32	1.34	1.35
Indonesia	6.00	6.00	6.00	6.00	6.25	10,070	9,850	9,800	9,750	9,700
Malaysia	3.00	3.00	3.00	3.00	3.00	3.21	3.02	2.99	2.96	2.94
Philippines	3.50	3.50	3.50	3.75	4.00	43.8	41.5	41.0	40.5	40.0
Singapore	n.a.	n.a.	n.a.	n.a.	n.a.	1.27	1.24	1.23	1.21	1.19
Thailand	2.50	2.50	2.50	2.50	2.75	31.2	29.9	29.8	29.7	29.6
Vietnam^	7.00	7.00	7.00	7.00	7.00	21,036	21,100	21,200	21,300	21,400
China*	6.00	6.00	6.25	6.25	6.50	6.13	6.09	6.06	6.03	6.00
Hong Kong	n.a.	n.a.	n.a.	n.a.	n.a.	7.75	7.77	7.78	7.79	7.80
Taiwan	1.88	1.88	1.88	2.00	2.13	30.2	29.6	29.4	29.2	28.9
Korea	2.50	2.50	2.50	2.75	2.75	1158	1100	1080	1060	1040
India	7.25	7.00	7.00	7.00	7.00	59.6	56.2	56.6	57.0	57.4

^ prime rate; * 1-yr lending rate

Market prices

	Policy rate	10Y bond yield		FX		Equities		
	Current (%)	Current (%)	1wk chg (bps)	Current	1wk chg (%)	Index	Current	1wk chg (%)
US	0.25	2.41	26	81.7	1.3	S&P 500	1,588	-2.9
Japan	0.10	0.88	2	97.2	-3.0	Topix	1,092	4.6
Eurozone	0.50	1.67	10	1.322	-1.0	Eurostoxx	2,578	-2.6
Indonesia	6.00	6.88	44	10070	-1.8	JCI	4,630	0.5
Malaysia	3.00	3.60	14	3.21	-2.3	KLCI	1,762	1.1
Philippines	3.50	3.90	32	43.8	-1.7	PCI	6,327	3.5
Singapore	Ccy policy	2.35	18	1.274	-1.8	FSSTI	3,133	0.1
Thailand	2.50	3.91	6	31.2	-1.9	SET	1,402	-0.1
China	6.00	...	...	6.13	0.1	S'hai Comp	2,084	-3.0
Hong Kong	Ccy policy	1.61	-3	7.75	0.1	HSI	20,383	-2.4
Taiwan	1.88	1.35	135	30.2	-0.9	TWSE	7,899	-0.7
Korea	2.50	3.41	16	1158	-2.1	Kospi	1,850	-1.7
India	7.25	7.38	7	59.6	-2.7	Sensex	18,719	-0.6

Source: Bloomberg

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