Economics

Chart of the Week: Fed vs Markets

Group Research

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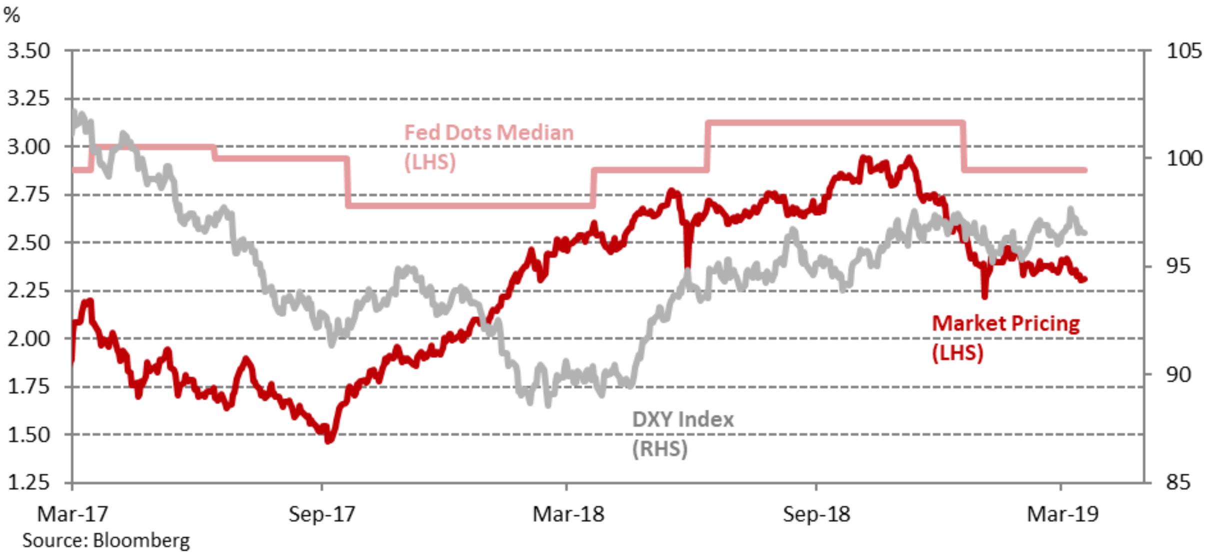
Key Events:

- *Fed rate pause is expected to continue at Thursday's decision.*
- *Asian central banks (BOT, BSP, CBC, BI) are expected to stay on hold.*
- *Malaysia's CPI inflation is expected to be -0.4% YoY for February.*

Chart of the Week: Fed vs Markets

A strong recovery in asset prices, considerable easing of financial conditions, and much-improved risk sentiments have not materially changed markets' pricing of forward Fed hikes. Fed funds futures show that markets are still expecting the Fed to pause in 2019. Considering the wide gap between Fed and markets, March's new dot plots (released after the March 20 FOMC meeting) could have significant implications for the USD. Back in 2018, markets' pricing had to move up to meet a hawkish Fed, which helped to underpin USD strength. If the median dot stays at two hikes for 2019, that could be hugely positive for the USD as markets' pricing would likely have to move much higher (to close some of the gap, again!). If the median dot shifts down to meet markets (at zero hikes for 2019), that could be a slight negative for the USD (smaller impact because it has been priced in), in our view.

End-2019 Fed Funds Rate - Fed vs Markets



Source: Bloomberg

Event	Consensus	DBS	Previous
Mar 18 (Mon)			
Japan: exports (Feb)	-0.6% y/y	-0.5% y/y	-8.4% y/y
- imports	-6.4% y/y	-6.2% y/y	-0.8% y/y
- trade balance (adj)	JPY86.0bn	JPY80.0bn	-JPY370.0bn
Mar 19 (Tue)			
Hong Kong: unemployment rate (Feb)	2.8% y/y	2.8% y/y	2.8% y/y
Mar 20 (Wed)			
Thailand: BOT benchmark rate	1.75%	1.75%	1.75%
Mar 21 (Thu)			
US: FOMC rate decision (upper bound)	2.50%	2.50%	2.50%
Philippines: BSP overnight borrowing rate	4.75%	4.75%	4.75%
Hong Kong: CPI (Feb)	2.0% y/y	2.0% y/y	2.4% y/y
Taiwan: CBC benchmark rate	1.375%	1.375%	1.375%
Indonesia: BI repo rate	6.00%	6.00%	6.00%
Thailand: customs exports (Feb)	1.10% y/y	0.70% y/y	-5.65% y/y
- customs imports	4.10% y/y	4.00% y/y	13.99% y/y
- customs trade balance	-USD0.10bn	-USD0.5mn	-USD4.03bn
Mar 22 (Fri)			
Japan: CPI (Feb)	0.3% y/y	0.3% y/y	0.2% y/y
Malaysia: CPI (Feb)	-0.4% y/y	-0.4% y/y	-0.7% y/y

Hong Kong: Thanks to the recovery in inbound tourism (visitor arrivals increased 21.9% in Jan 2019 (3mma)), the labor market should have remained tight. The seasonally-adjusted unemployment rate is forecasted to remain at a 20-year low of 2.8%. Looking forward, the labour demand will hinge on the playout of external uncertainties including the Sino-US trade friction, Brexit and global economic slowdown. The demand for labor, of which over 10% comes from the import/export trade and wholesale sectors, is set to slow. On inflation, the consumer prices should have slowed to 2.0% YoY in February from 2.4% in January. This is largely due to the usual Chinese New Year effect. In the near term, moderation in residential rentals as well as a strong USD will keep both domestic and external prices in check.

Indonesia: Bank Indonesia (BI) is likely to keep the policy rate unchanged at 6% in the upcoming policy meeting as pressure to Rupiah has come down overall this year with stronger inflows in both bonds (USD 2.9bn) and equities (USD 0.68bn). However, Rupiah has depreciated by 1.5% since February 21, the last policy meeting, due to capital outflows and widening trade deficit. 10Y government bond yield has decreased by 186bps YTD following the US trend. Yet, we see the prospect of higher trade deficit could limit monetary policy options to support growth. Yet BI has shown commitment to maintain banking system liquidity by conducting repo and foreign exchange swap auctions three times per week vis-à-vis once a month previously. To increase certainty for market players, fixed auction schedule for upcoming six months (until Sep 19th) is published. We see risk to inflation to remain moderate, CPI edged lower to 2.57% YoY in Feb19 from 2.82% YoY in Jan19.

Japan: CPI inflation is expected to rise mildly to 0.3% YoY in February, up from 0.2% in the previous month. Energy inflation should have bottomed out, thanks to the recovery in global oil prices and depreciation in the yen versus the dollar. The underlying, demand-side price dynamics should have remained steady, given the tightness in the labour market, uptick in wage growth and increase in inflation expectations. Factoring in a moderate rebound in oil prices to US$70-75/bbl in 2H19 and a 2ppt hike in consumption tax in October, we continue to expect CPI to rise 1.1% in the full year of 2019.

Malaysia: CPI inflation for Feb19 is on tap this week. After the downside surprise where the headline number dipped to -0.7% YoY, expectation is for the figure to remain stuck in negative territory. A forecast of -0.4% YoY has been penciled in. The steep fall in inflation was largely driven by two factors – a slew of fiscal policies aimed at lowering the cost of living, including the zero rating of the Goods and Services Tax (GST), and a correction in oil prices in late 2018. We expect inflation to bottom in 1Q19 and to start rising from 2Q19 onwards. The increase will be even more pronouncedly in 2H19. Oil prices are likely to average about USD 70-75/bbl and the base effect from the fiscal policy changes will also dissipate by 2H19. Taking all into account, we now expect full year inflation to register 1.7% in 2019.

Philippines: As inflation has come down quite significantly and external pressure has subsided, we think BSP might keep policy rate unchanged at 4.75%. Yet, the new BSP governor, Mr Benjamin Diokno mentioned that lower inflation, more dovish Fed and significantly lower oil price give room for rate cut. He also mentioned that they might cut bank reserve requirement ratio (currently at 18%) by 1% every quarter. Sounded more dovish, Mr Diokno also emphasized that policy rate decision would be data dependent. In fact, inflation has decelerated to 3.8% in Feb19 from a recent peak of 6.7% in Oct19. Risk to inflation might increase slightly due to the impact of El Niño to agricultural product. According to Disaster Risk Reduction and Management (DRRM) the current El Niño caused production loss equivalent to P377.9mn (rice) and P86.4mn (corn). Besides risk to inflation we see that budget approval delay could weigh on growth this year. Higher risk to growth might increase the likelihood of monetary easing as long as inflation and external pressure remain manageable. For this week policy meeting, we still think BSP might keep policy rate yet decrease reserve requirement by 1%.

Taiwan: Taiwan's central bank (CBC) is expected to hold the benchmark discount rate steady at 1.375% this week. Growth outlook is deteriorating amid weaker overseas demand, while inflation is also easing on lower oil prices. Exports contracted notably by -4.5% YoY in Jan-Feb, compared to 0.1% in 4Q18. CPI inflation slipped further to 0.2% in the first two months this year, down from 0.5% in 4Q18. Barring a technical recession (two consecutive quarters of negative GDP growth), however, the CBC may not move to slash rates. Interest rates currently stay close to the GFC lows and excess reserves are far above the long-term normal levels, suggesting that liquidity environment has remained favourable and the effects of additional easing would be limited. Meanwhile, the TWD effective exchange rates have come off the peak recently (NEER: -1.3% MoM in Jan), thanks to the strong rebound in CNY and other emerging Asian currencies. This also suggests the de facto easing of monetary conditions and no urgency to cut rates.

Thailand: The Bank of Thailand is expected to keep rates on hold this week. This pause will reflect the policymakers' cautious economic assessment in the face of slowing inflation and easing growth. Minutes from the previous BoT review had highlighted their bias to maintain a hawkish bias, but the path remains data-dependent. The urgency to tighten policy this month, has also receded owing to a more cautious US Fed and outperformance of the Thai Baht; regional outperformer at 2.8% gains vs USD. Separately, February trade data is likely to see exports slip into red and posting a small trade deficit, weighing on this year's current account balance. Separately, five years since the military coup, Thais will go to the polls on March 24 to usher in a civilian government.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).