Economics & Strategy Weekly

Reviewing global price trends

DBS Group Research

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- *There is considerable talk about global disinflationary trends, with G3 central banks falling short of their inflation targets persistently*
- *That this is taking place while there is decent global demand and wage conditions, along with ample liquidity, low interest rates, and pro-cyclical fiscal stance, is indeed striking.*
- *But how strong are the present disinflationary trends?*
- *We review a wide range of prices, from food to fuel to metals. In a number of cases, we see signs of prices bottoming, with inflation figures turning already or slated to turn by the middle of the year.*
- *These pipeline developments make us somewhat cautious about the fixed income market outlook.*

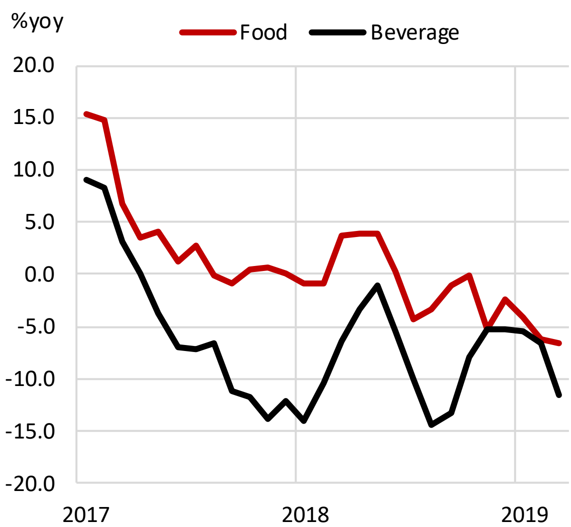
Disinflation pressures to dissipate soon

Global fixed income markets have all but given up on the inflation outlook, pricing in a prolonged period of disinflation and low interest rates. With US core PCE well below 2%, (well below 1% for Euro Area and Japan), discussions and expectations have yet again shifted to remaining levers of monetary policy that may be needed if inflation were to trend downward further.

But are global price trends that dire? Granted, between technological disruption, diminished pricing power among producers of manufactured goods, and a surge in oil production in the US, many drivers are conspiring to keep global prices low or stable. But there are also signs of buoyancy here and there, and we think that by the time we step into the second half of the year, many inflation markers will turn positive. The death of inflation is exaggerated, in our view.

Take, for instance, the trend in global food prices. The IMF's global food price index is about 20% below now compared to 5 years ago, thanks to softening of meat, cereal, edible oil, and soy bean prices. But among most of these items, the price levels have largely bottomed. As base effects disappear, we expect many such prices to show positive growth going forward.

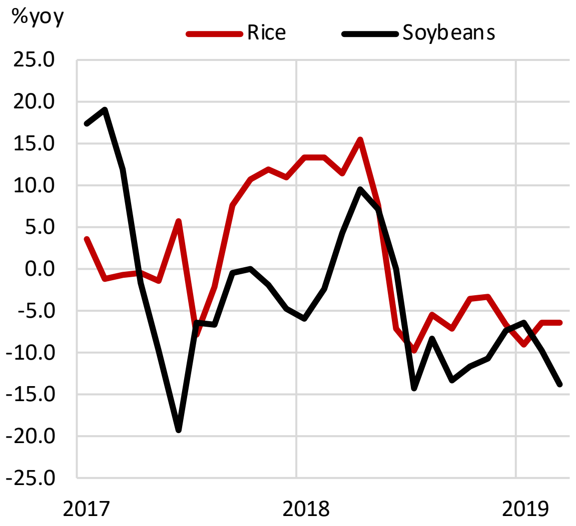
Base effect to keep food inflation in negative territory



Source: IMF, DBS.

Global **rice and soybean prices** have displayed considerable volatility in recent years; up sharply a year ago and now in deflation territory. As concerns about China's demand is eased and trade war resolution comes under focus, we expect some this volatility to make way for a more constructive supply/demand dynamic.

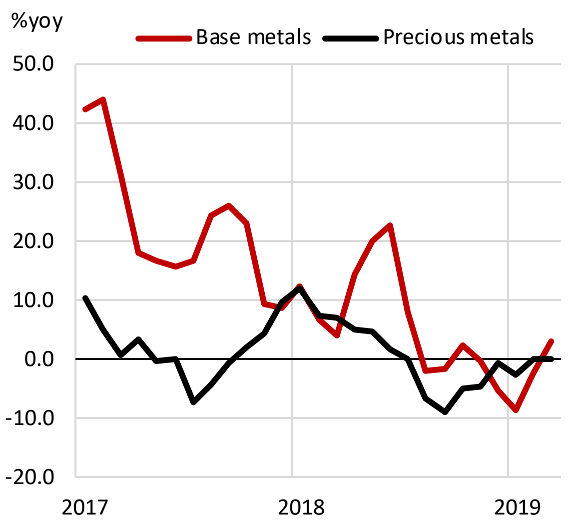
Rice is flat; soybean benefitting from trade war respite



Source: IMF, DBS

Lack of conviction on inflation, a subdued electronics cycle, and concerns about China's demand strength exerted downward pressure on **metals** last year, but as far as base metals are concerned, we think the worst is over. China's fiscal and monetary stimulus may not lead to an oil-fashioned investment boom, but signs of its efficacy will surely support base metal prices, in our view.

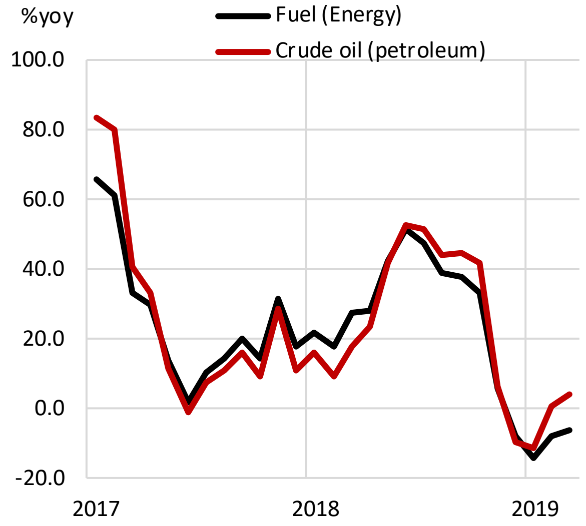
Metals bottoming; but base effect to persist till mid-'19



Source: IMF, DBS

Despite concerns about the supply outlook for Iran, Libya, and Venezuela, oil inventories look ample, reflecting substantial production capacity in Saudi Arabia and the US. We don't expect energy prices to spike this year, but at the same time headline inflation numbers around the world will likely see positive contribution from energy.

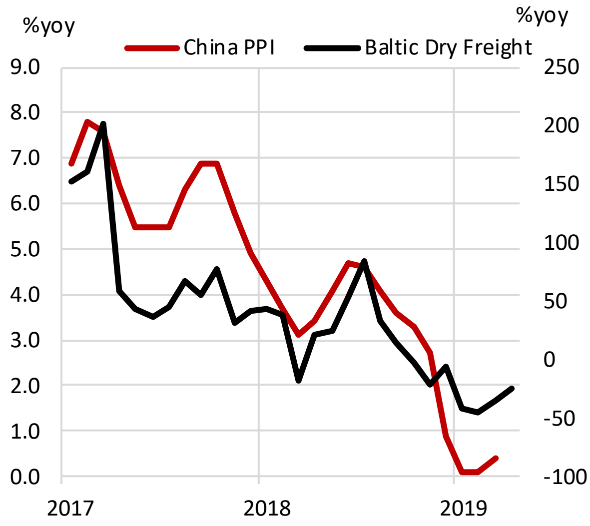
Energy has bottomed



Source: IMF, DBS

If global trade were to shrug off the doldrums of last year, there will likely be some reflationary tailwind. Looking at China's PPI and Baltic Dry Freight rates, we see encouraging signs that the worst of deflationary trends may be behind us.

Trade markers are making a comeback



Source: IMF, DBS

Taimur Baig

Taiwan: No recession, but tepid growth ahead

The economy has avoided a contraction in 1Q, with real GDP posting 2.0% QoQ saar (1.7% YoY). This eliminates the concerns about a technical recession this year (like during the China slowdown in 2015). **We therefore keep our 2019 growth forecast unchanged, at 1.9%.**

Tepid growth is expected ahead. **A V-shaped recovery in exports is unlikely.** The dip in China's April PMI suggests that the stimulus-driven economic recovery in China has remained fragile. Despite the prospect of a China-US trade deal in the coming months, chances are not high for the US to completely withdraw its tariffs imposed on the USD 250bn Chinese exports. It would also prove overoptimistic to expect a full-scale upturn in the tech sector, given the lack of comprehensive 5G rollouts and other revolutionary technology changes this year.

On the domestic front, **an interesting development is the rise in capital repatriation from overseas Taiwanese**. According to the government, 40 Taiwanese companies with offshore operations have committed to invest a total of TWD 205.7bn (USD 6.7bn) in Taiwan during the first four months of this year. External push factors have been at play, namely, the lingering China-US trade conflicts, rising wage and other production costs on the mainland, as well as China's implementation of Common Reporting Standard to crack down tax evasion. Having said that, domestic pull factors have remained weak and some important structural issues have remained unresolved (e.g., labour/land shortage), which still constrains the long-term investment outlook in Taiwan.

Another domestic focus is the January 2020 presidential election. Terry Gou, the founder and chairman of Foxconn, has said in April that he will contest the election and take part in the opposition KMT party's primaries. Foxconn is the world's largest contract manufacturer of electronics, and the largest private employer and exporter in mainland China; which bolsters the expectations for Gou to support the pro-business and pro-trade policies. Any election-related impact should be mainly on investor and consumer sentiments this year. Real economic impact will only be available in 2020, which to a large extent, still depends on the election outcome and the post-election policy delivery.

Ma Tieying

India: Resilient remittances

Earnings from invisibles have played an important role in containing India's overall current account deficit (CAD). Amongst the sub-components, remittances have been a key source of resilience for India's external balance, accounting for more than half of the total invisibles last year, and offsetting 40% of the trade deficit.

India was the highest recipient of remittances last year, at a record high of USD79bn, up from USD50bn in 2008-09, followed by China, Mexico, Philippines and Egypt, according to World Bank data.

Assessing factors that influence remittance trends, historically, there is an observable correlation between remittances and a) global growth; b) broad direction of oil prices; and more recently likely c) restrictive migration polices. On a), tougher economic times in the host country, episodes of fiscal tightening and political compulsions, can also cause volatility in the migrant flows and earning capacities, as well as volume of remittances transferred back home.

Under b) anecdotal trends point to a linkage between oil and remittances, along with a decent correlation coefficient. This could be causal as well, since a sizeable funds are sent from Gulf/ oil-producing countries. And more recently, the risk of restrictive migration stemming from protectionist and nationalist policies; a case in point are stricter income and skill requirements for labour movement into the US in the past two years.

There are few factors that could soften the downside impact. Effect of oil is two-pronged, while high oil prices increase the import bill, there is also a concomitant improvement in remittances, thus acting as a counterbalance for the current account math. On a related vein, dependency on the Middle east, though still sizeable, has moderated, as the share of other destination countries (that of the West) has risen. Lastly, with most beneficiaries likely to utilise these funds towards their consumption and sustenance needs, these are bound to continue barring unforeseen circumstances.

For the detailed note, real our Focus: Resilient Remittances; April 30, 2019

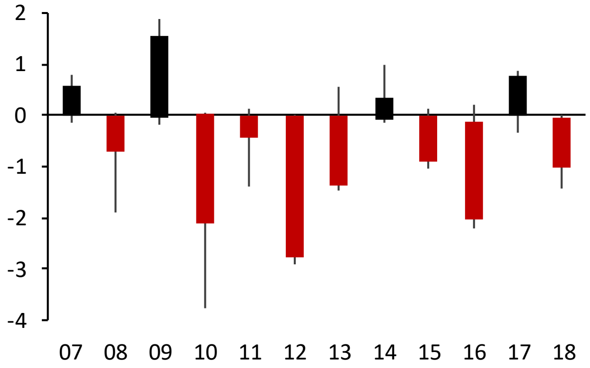
Radhika Rao

FX: Higher USD ranges in May

Data show that the month of May tends to be positive for the USD. This year is unlikely to be any exception, in our view. US growth beat the 2.2% QoQ saar and accelerated to 3.2% QoQ saar from 2.2% in 4Q18. In YoY terms, US growth held at/above 3% for the third straight quarter. In turn, this has diluted the dovish tilt in the Fed's extended pause, as reflected by the US 10Y treasury bond yield holding firmly above the 2.50% ceiling of the Fed Funds Rate.

Emerging Asian currencies – sell in May again

% mth/mth change vs USD in May of each year



The US economy has outperformed other large economies. First quarter growth in China and the Eurozone stabilized at the same rate as 4Q18, at 6.4% YoY and 1.2% respectively. In turn, USD/CNY has traded above 6.73 from 6.70 while EUR/USD's fall below 1.12 could bring it closer towards 1.10. The euro and the yuan are the largest components in the major USD indices for Developed Markets and Emerging Asia respectively. The USD Index (DXY) has traded above its 95.5-97.5 range of the past six months.

Some Emerging Asian currencies have started to trade into weaker trading ranges last month. The Malaysian ringgit has depreciated into a 4.10-4.15 range from 4.05-4.10 in February March, and the South Korean won into 1150-1200 from 1100-1140 range of the previous 9 months. **Our economists expect Malaysia and Korea to lower rates later this year.** The Thai baht and the Singapore dollar may be next to weaken past their multi-month ranges, currently at 31.5-32.0 and 1.3450-1. 3620 respectively.

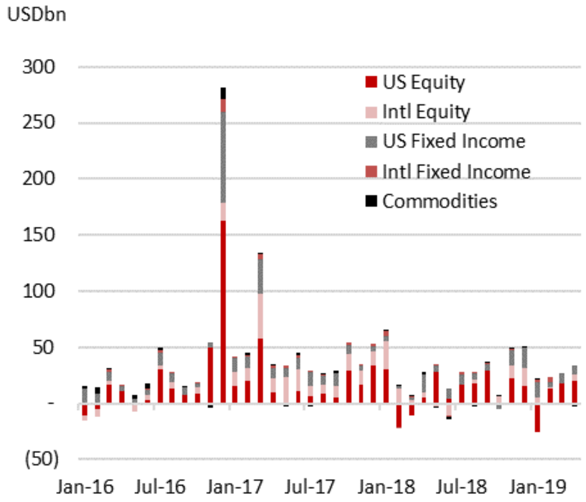
Philip Wee

ETF Equities: Flows show split views on growth outlook

Net flows to US-listed ETFs continued on a positive momentum seen during the past two months. **April recorded the strongest monthly flows year-to-date**. Flows into US equities were still the strongest among all asset classes, followed by US fixed income, and international equities. Commodity, predominantly Gold ETFs, were the least favoured, followed by international fixed income, both recording negative flows.

We think the dynamics affecting flows may have started to shift since the beginning of this quarter when both China's and US' GDP surprised on the upside. **Investors are now more receptive to equities after growth risks are perceived to have diminished.** Besides US equities, there is also more evidence of steady return of risk appetite to international equities, with a substantial improvement in flows from the previous month.

Monthly flows of US-listed ETFs



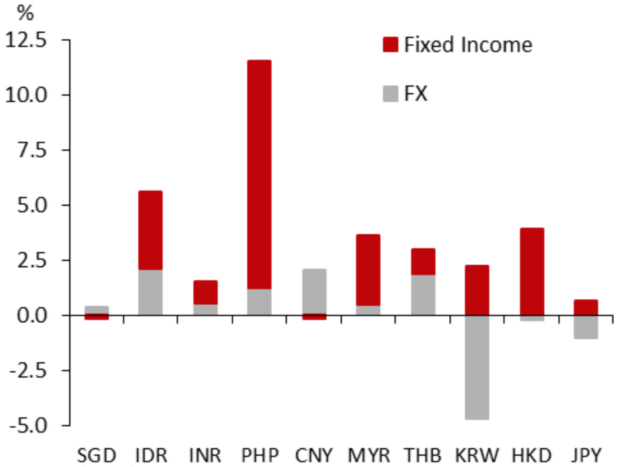
Source: ETF.com. As of April 2019.

Joanne Goh

Rates: Fixed Income to drive total returns

The rally in EM Asia government bonds has stalled in April due to a modest bounce in global core yields (from the lows of late-March), stronger USD and higher oil prices. 10Y bond yields have risen across the board in April, as much as 34bps for Philippines and 24bps for Hong Kong. When we examine the year-to-date total return profiles, one phenomenon becomes immediately apparent. That is, Fixed Income returns outweigh FX returns. This is somewhat unusual considering that for EM Asia, FX returns are typically the more volatile component.

10Y Local Government Bond - YTD Total Return

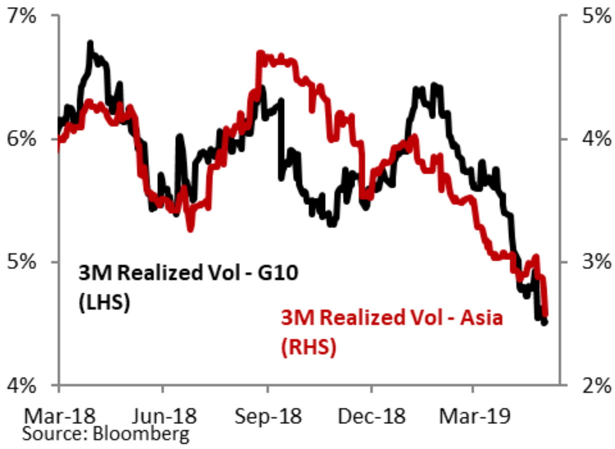


Source: Bloomberg

Looking ahead, we think there is room for Fixed Income returns to rise further. Expectations are rising for several EM Asia central banks to cut policy rates later in the year, namely Philippines, Indonesia, India, Malaysia and South Korea. The rest (Singapore, Thailand, China) could stay on pause. Thus, short-term interest rates are likely to be biased lower, providing some support to long-tenor bond prices. Rangebound global core rates also provide a conducive environment to accumulate coupons in higher-yielding EM Asia.

FX returns could remain muted ahead. One of the key themes of 2019 has been the relative stability in the currencies space (vs the strong rallies in equities, interest rates, credit and commodities). With global central banks tilting dovish together and global growth slowing synchronously, there just does not seem to be much differentiation amongst currencies (hence, the stability in global exchange rates). Focusing on EM Asia currencies, scope for significant appreciation is likely to be limited as long as global growth worries still linger and the outlook of key anchor currencies like EUR and CNY remain stable to weak.

Currencies have been stable in 2019, as evidenced by the fall in 3M realized volatilities.



Source: Bloomberg

For bond investors, there are a couple of key implications. One, total returns would continue to be driven primarily by Fixed Income component. Two, the current carry environment could have a bit more to run. With that in mind, we favor the EM Asia high-yielders against the low-yielders. Our key picks are 10Y RPGB and 5Y Indonesian government bonds.

Duncan Tan

Highlights of the week:

Taiwan: No recession, but tepid growth ahead
China: Economy still fragile despite stabilisation policies
India: Resilient remittances
Malaysian bonds: from bullish to neutral
Chart of the Week: Weak trade figures will persist, but don't worry

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018	2019f	2020f	2017	2018	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	8.2	7.2	7.0	7.0	4.5	3.6	3.4	3.8
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.6	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	1.7	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.2	3.9	3.8
Singapore	3.9	3.2	2.6	2.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	1.1	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.7	1.6

Policy interest rates, eop

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.95	1.95	1.95	1.95	1.95	1.95	1.95	1.95
South Korea	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50

* 1-yr lending rate; ** 3M SOR ; *** prime rate

Exchange rates, eop

	Mar 29	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.85	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.4	70.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14248	14300	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.10	4.20	4.25	4.20	4.15	4.10	4.05
USD/PHP	52.7	54.0	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.37	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1137	1170	1180	1170	1165	1160	1155	1150
USD/THB	31.7	32.5	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23201	23250	23300	23280	23300	23250	23200	23150
AUD/USD	0.71	0.70	0.68	0.68	0.68	0.69	0.70	0.71
EUR/USD	1.12	1.12	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	111	113	115	114	113	112	111	110
GBP/USD	1.31	1.30	1.28	1.29	1.30	1.31	1.32	1.33

Australia, Eurozone and United Kingdom are direct quotes

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