Economics

# Chart of the Week: Buffers to defend HKD

**Economics/Strategy/Rates/FX**

Group Research

June 17, 2019


**Nathan Chow**
Strategist / Economist
nathanchow@dbs.com



**Please direct distribution queries to**
Violet Lee +65 68785281
violetleeyh@dbs.com

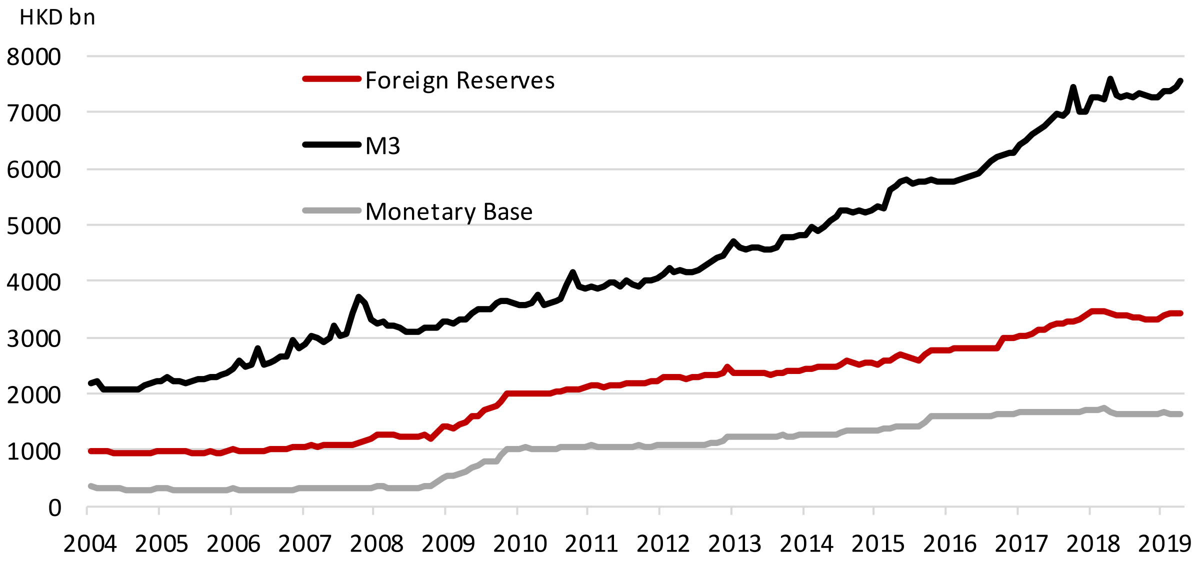

**Key Events:**

- *The Bank of Japan (BOJ) is expected to keep the short-term and long-term interest rate targets unchanged this week.*
- Taiwan's central bank (CBC) is expected to hold the benchmark discount rate steady at 1.375% this week.
- Hong Kong's jobless rate is expected to stay at 20-year low of 2.8%.

## Chart of the Week: Hong Kong's remarkable rise in M3 relative to reserves and base money

Hong Kong's economy has experienced a sharp leverage build-up in the past decade, largely due to a property market bubble. Hong Kong today boasts the highest per square meter price for residential properties in the world, helped by enormous buying interest from mainland China. The rising prices have been associated with a leverage-fuelled frenzy, and the sharp rise in leverage has affected Hong Kong's monetary aggregates. M3 has quadrupled over the past decade and half, while nominal GDP has expanded by just two times. The currency peg against the USD looks fine when the reserves-to-base money ratio is considered, but the fact is if there is a sharp correction in the property market or a panic selling of the HKD due to the ongoing political situation, the peg would be challenged. Recent movements in HIBOR already show that the cost of defending the currency will have to be borne by higher interest rates, as selling of USD by HKMA is unlikely to be a sufficient tool.

**Sharp rise in M3 relative to reserves**




Source: HKMA, DBS

| Event | Consensus | DBS | Previous |
|---|---|---|---|
| **June 19 (Wed)** | | | |
| Hong Kong: unemployment rate (May) | 2.8% | 2.8% | 2.8% |
| Japan: trade balance (May) | -JPY806.9bn | -JPY495bn | JPY56.8bn |
| -- exports | -8.4% y/y | -3.6% y/y | -2.4% y/y |
| -- imports | 1.0% y/y | -4.5% y/y | 6.5% y/y |
| **June 20 (Thu)** | | | |
| US: FOMC rate decision (upper bound) | 2.5% | 2.5% | 2.5% |
| Indonesia: 7D reverse repo rate | 6.00% | 6.00% | 6.00% |
| Taiwan: export orders (May) | -7.2% y/y | -8.4% y/y | -3.7% y/y |
| Taiwan: discount rate | 1.38% | 1.38% | 1.38% |
| Japan: policy balance rate | N/A | -0.10% | -0.10% |
| - 10Y yield target | N/A | 0% | 0% |
| **June 21 (Fri)** | | | |
| Hong Kong: CPI (May) | 2.8% | 2.5% y/y | 2.9% y/y |
| Japan: CPI (May) | 0.7% y/y | 0.7% y/y | 0.9% y/y |

**Hong Kong:** Thanks to the recovery in inbound tourism (visitor arrivals increased 9.3% in Apr (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.

CPI inflation should have fell to 2.5% YoY in May from 2.9% in April. This is partly due to the usual seasonal factor during Mar-Apr, where Easter Holiday was in late April this year. The depreciating CNY amid China-US trade war should have added downward pressure on import costs. Local costs are largely contained due to slow economic growth. However, the spreading of swine fever in China is expected to boost food prices.

**Japan**: The Bank of Japan (BOJ) is expected to keep the short-term and long-term interest rate targets unchanged this week. Growth outlook is weakening, with manufacturing PMI dipping below the 50 mark in May. Inflation momentum is also easing, with headline CPI projected to slip to 0.7% YoY in May from 0.9% in the previous month. Nonetheless, the labour market and inflation expectation indicators have continued to hold up well for the time being. Meanwhile, the room for monetary easing is pretty limited, given that interest rates are already in the negative territory and the total assets held by the BOJ are already equivalent to 100% of Japan's GDP. We don't expect the BOJ to further ease monetary policy in the near term after strengthening its forward guidance at the April meeting. Fiscal policy adjustment (e.g., a delay in the planned consumption tax hike) appears more likely than monetary stimulus, in order to cope with the downside economic risks posed by the trade war.

**Taiwan:** The central bank (CBC) is expected to hold the benchmark discount rate steady at 1.375% this week. Growth outlook is deteriorating in the context of escalating trade war, as evidenced by the widening of export declines in May and the persistent contraction of manufacturing PMI. That said, the labour market has remained largely stable and domestic demand/services industry has continued to hold up well. Meanwhile, monetary environment stays accommodative, thanks to the decline in short-term real interest rates (due to the rise in food prices and inflation), slide in bond yields and recent weakening of the TWD. The CBC is likely to closely monitor the impact of trade war on the economy for the time being and move to cut rates only when the risk of a full-fledged slowdown/recession shoots up.

# Group Research

## Economics & Strategy Team


**Taimur Baig, Ph.D.**
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

**Nathan Chow**
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

**Masyita Crystallin, Ph.D.**
Economist – Indonesia & Philippines
+62 21-2988-4003 masyita@dbs.com

**Joanne Goh**
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

**Eugene Leow**
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

**Chris Leung**
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

**Ma Tieying, CFA**
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

**Radhika Rao**
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

**Irvin Seah**
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

**Samuel Tse**
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

**Duncan Tan**
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

**Philip Wee**
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com


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