Weekly: Mood swings

Economics/Global/Asia/Strategy/Rates/FX/Equities/Credit

DBS Group Research

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- *A market exhausted from August's ups and downs has found five sources of relief in the early days of September.*
- *We explain how positive news out of China, Hong Kong, Italy, UK, and the US could easily fade.*
- *In the frenzy of flight to safety and negative yields, US wages and labour cost data are being ignored.*
- *Once news about the overheating labour market is absorbed, considerable volatility in the fixed income market could ensue.*

What goes up…

A market exhausted from August's ups and downs has found sources of relief in the early days of September. So far this week, five important developments have helped:

- **China:** Better than expected activity report, in the form of Caixin services PMI for August, broke a string of underwhelming data. The PMI report's job creation component was encouraging in particular, which helped assuage concerns about the ongoing slowdown in the world's most populous economy.
- **Hong Kong:** Chief Executive Carrie Lam stated earlier this week that the controversial extradition bill that had sparked this summer's protests will be withdrawn. Additionally, reports emerged that Chinese Vice President Wang Qishan has played a key role in helping matters.
- **Italy:** A highly volatile political crisis that brought the government close to a collapse last month was resolved this week as PM Conte put together a new cabinet with representatives from the left and right.
- **UK:** Signs emerged this week, amid numerous parliamentary manoeuvres and votes, that the October 31 Brexit cliff-edge (deal or no-deal Brexit, as vowed by PM Johnson) will likely be avoided.
- **US:** In contrast to the poor manufacturing PMI, ADP data released this week show that jobs growth picked up strongly in July, in

both manufacturing and services. The ISM non-manufacturing reading was also positive.

We will urge caution against this backdrop. In each of these developments, there was little by way of conclusive resolution. Let's begin with China, where manufacturing and sales data remain poor. Even the Caixin report that pleased the markets shows export orders pulling back. For the all the talk of trade talks resuming in October, the fact remains that tariffs were raised further just a few days ago. China's headwinds remain considerable.

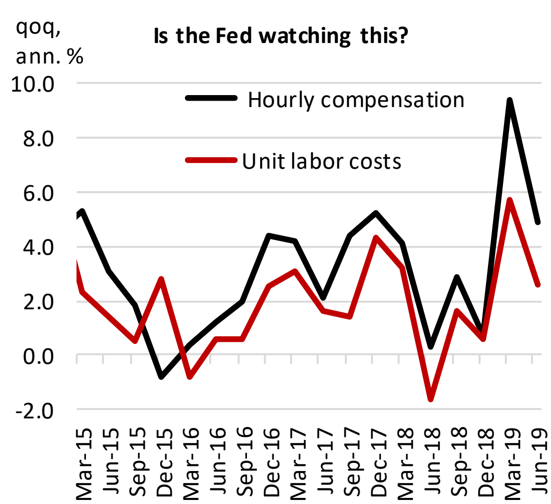
In Hong Kong, it is yet to be seen if the extradition bill's withdrawal will be sufficient to stem fomenting discontent. While the bill's introduction was the trigger that sparked the protests, it is clearly understood that grievances run deep and wide.

Italy's new coalition is fledgling at best; questions remain if an alliance between traditional antagonists (the populist Five Star and centre-left Democratic Party) will hold for more than a year.

In the UK, many pitfalls lie ahead. PM Johnson could choose to ignore the bills passed by the opposition to force the October 31 Brexit deadline; he could even bring a no-confidence motion (which requires a simple majority to pass) against his own government to ensure an election before October 31.

Finally in the US, good data may well be bad news for the markets. Several regional governors are against further monetary accommodation at this juncture, although markets are convinced from recent observations made by Chair Powell and New York Fed president Williams that another rate cut is around the corner and there will be even more before the year is over. In this politically charged environment, and rising nervousness about the global economic outlook, the Fed's position is increasingly tenuous. As markets rally in expectation of a trade deal and jobs data remain strong, the inclination to provide immediate accommodation recedes, but a Fed pause in September will shock the markets. The Fed may well be hostage to that risk.

We also hope that in the middle of flight to safety, negative yields, inverted curves, and stable core PCE inflation, Fed officials take note of other compelling data that show that wages and costs are rising. Latest productivity data from the Bureau of Labour Statistics show that hourly compensation has surged this year, pushing up unit labour costs. Under ordinary circumstances, this report alone would set off warning bells of incipient inflationary pressure. We would at least hope Fed communication picks this up later this month. But if it does indeed do that, the markets (not to mention President Trump) will be highly displeased. Mood swings are likely to be par for the course.



Source: US Bureau of Labour Statistics, DBS

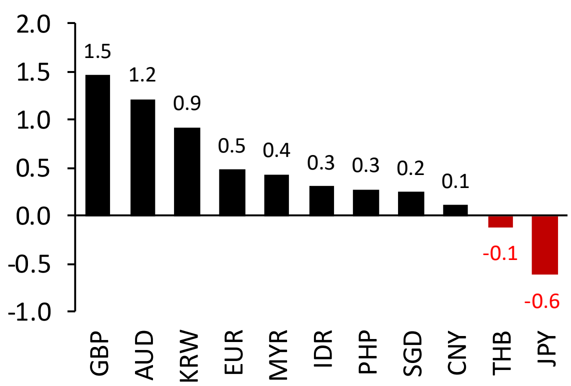
Taimur Baig

FX: Respite welcome but expectations realistic

Risk appetite has recovered in the first week of September but volatility has not subsided. Geopolitical risks have eased somewhat amidst hopes for more monetary and fiscal stimulus measures to combat growth risks. For example, the British pound has recovered after UK parliamentarians sought legislation to delay Brexit. The risk of a no-deal Brexit on October 31 has, however, not evaporated unless Prime Minister Boris Johnson agrees to the delay or resigns. Expect more twists and drama ahead.

A good start to September

% change vs USD, Sep 5 vs Aug 30



Sources: DBS Research, Bloomberg data

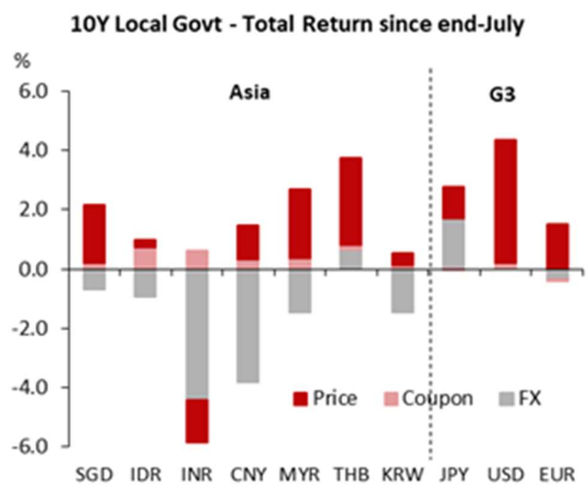
China and US have formally agreed to resume trade talks in early October. The South Korean won rallied most, not only against the greenback but also against the Japanese yen which gave up some of its safe-haven gains. Expectations for a trade deal are low without a commitment to stop escalating the trade war with tit-for-tat tariffs. Both sides also need to find middle ground on the conduct of negotiations.

Philip Wee

Rates: Tide of central bank easing may not lift all boats

As the external environment deteriorates, our confidence around the future performance of EM Asia sovereign bonds has declined. In our view, present times call for prudence and careful selection of higher-quality bonds that would stay resilient under difficult circumstances (e.g. deepening of global slowdown, prolonged US-China hostilities, competitive currency devaluation scenarios etc). Performances across EM Asia bonds since August is probably telling. We recall that the announcement of new tariffs between US and China and higher RMB volatility, last month, had weighed on Asian markets.

The performance of EM Asia bonds has lagged global core bonds (UST, Bund, JGB) despite increased market pricing of central bank easing. EM Asia bonds recorded good fixed income returns but they were offset by currency depreciation (against a strong dollar).



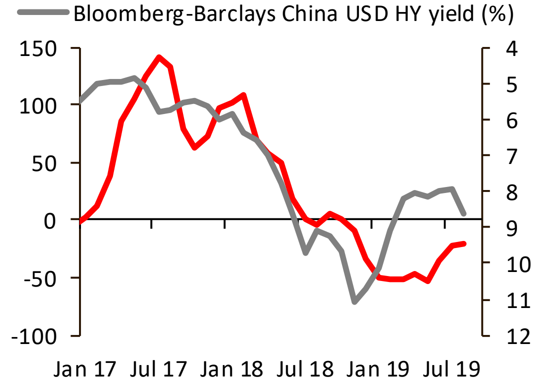
Source: Bloomberg

Duncan Tan

Credit: China's offshore issuance slows amidst rising spreads and regulatory curbs

The Chinese offshore credit markets have borne a blow from escalating US-China trade tensions. The Bloomberg Barclays China USD credit index has seen its average OAS widen by 30bps in August, with Chinese HY debt registering the worst impact (see DBS Flash - Credit: China-driven divergence, 28 Aug 2019).

Historically, Chinese offshore bond issuance has been quite responsive to financing costs. We note that the period of rising yields from 2017 to 2018 coincided with slower growth in offshore non-bank net bond issuance. **The widening of credit spreads in August, alongside sharp RMB losses, should thus dent appetite of Chinese corporates in tapping the offshore FX bond market.**

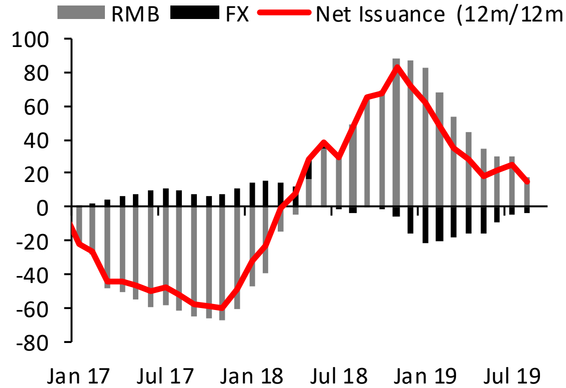


Sources: Bloomberg, DBS

Indeed, **there was a sharp falloff in net non-bank issuance**, which shrank to $4.75bn in August, or half of the average $10bn seen in the first 7 months of 2019. Going into late 2019, net issuance will be further crimped by regulation changes as well, with the NDRC recently introducing curbs on offshore debt issuance by Chinese property companies and LGFVs.

Should investors be concerned about the drop-off in offshore Chinese issuance and tightening of financial conditions? Not excessively, we think. Remember, the offshore Chinese bond market, with around $800bn of outstanding corporate bonds, is paltry compared to the $6trn onshore corporate bond market.

In fact, Chinese offshore net bond issuance was already starting to contract in mid-2018, just as US-China trade tensions emerge. Nevertheless, contraction in offshore issuance was more than offset by a sharp pick up in onshore bond issuance. The key question is whether caution in the offshore market could migrate to the onshore market.



Sources: Bloomberg, DBS

Chang Wei Liang

Equities: International equities suffer year-to-date outflows

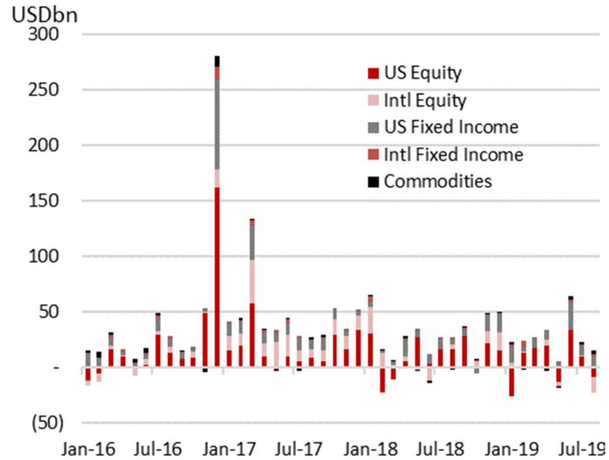
US-listed ETFs experienced the first outflow since May following persistent volatility across global financial markets. August outflows totaled USD5.8bn, effectively bringing down YTD inflows to USD147.9bn. Among the line-up of events that prompted the funds exodus is the inversion of the 10/2 year treasury yield curve which sparked an equity selloff amidst increasing growth concerns and recession fears.

With the market wide equity selloff in August, US Equity ETFs reported outflows of USD8.3bn and International Equity ETFs reported outflows of USD13.7bn. **International Equity ETFs now have net negative flows for the year at approximately USD4.0bn**. Both EAFE and emerging markets had contributed to the outflows amid USD liquidity tightening.

On the contrary, the fixed income space garnered strong inflows over the month. US Fixed Income ETFs reported inflows of USD10.1bn and International Fixed Income ETFs reported inflows of USD1.8bn. Further, Commodities too experienced inflows of USD3.8bn, and amongst all, **Gold ETFs were among the top asset gainers during the month**. Gold has been experiencing a good run since around May owing to its safe-haven status and increasing volatility in the market.

Joanne Goh

US-listed ETFs monthly flows



Source: ETF.com

Highlights of the week

- [India: More policy support likely after weak 2Q growth]
- [Hong Kong: Brakes on the property boom]
- [Chart of the Week: Foreign demand for CNY bonds]
- [Gold prices: Higher impact from interest rate ahead]

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	0.0	0.5	1.5	2.5	2.7	2.5
India*	8.2	7.2	6.8	6.2	4.5	3.6	3.4	3.6
Indonesia	5.1	5.2	5.0	5.1	3.8	3.2	3.2	3.4
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	0.9	1.6
Philippines**	6.7	6.2	6.1	6.1	2.9	5.2	3.1	3.1
Singapore	3.9	3.2	0.7	1.8	0.6	0.4	0.5	1.1
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	0.5	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.4	3.5	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	0.8	0.7	0.5	0.5	1.0	0.8	1.3
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.7	1.6

* refers to year ending March ** new CPI series *** eop for CPI inflation

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	5.40	5.00	5.00	5.00	5.00	5.00
Indonesia	6.00	6.00	5.50	5.25	5.25	5.25	5.25	5.25
Malaysia	3.25	3.00	3.00	2.75	2.75	2.75	2.75	2.75
Philippines	4.75	4.50	4.25	4.00	4.00	4.00	4.00	4.00
Singapore**	1.95	1.95	1.80	1.60	1.60	1.60	1.60	1.60
South Korea	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.25
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
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	2.25	2.00	2.00	2.00	2.00	2.00

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

Exchange rates, eop

	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.87	7.10	7.20	7.15	7.10	7.05	7.00
USD/HKD	7.85	7.81	7.85	7.85	7.85	7.84	7.84	7.83
USD/INR	69.2	69.0	71.0	71.5	72.0	72.5	73.5	74.0
USD/IDR	14243	14126	14450	14500	14550	14600	14650	14700
USD/MYR	4.08	4.13	4.22	4.25	4.24	4.23	4.22	4.21
USD/PHP	52.6	51.3	53.3	53.6	53.9	54.2	54.5	54.7
USD/SGD	1.36	1.35	1.40	1.42	1.41	1.41	1.40	1.40
USD/KRW	1135	1155	1230	1250	1240	1230	1220	1210
USD/THB	31.7	31.0	31.0	32.0	31.8	31.6	31.4	31.2
USD/VND	23189	23301	23200	23220	23250	23270	23300	23330
AUD/USD	0.71	0.70	0.66	0.64	0.65	0.65	0.66	0.66
EUR/USD	1.12	1.14	1.10	1.08	1.09	1.09	1.10	1.10
USD/JPY	111	108	107	109	109	108	108	107
GBP/USD	1.30	1.27	1.18	1.16	1.17	1.18	1.19	1.20

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).