Economics

Chart of the Week: Volatility strikes back

Group Research 26 November 2018

Duncan Tan
Strategist
duncantan@dbs.com

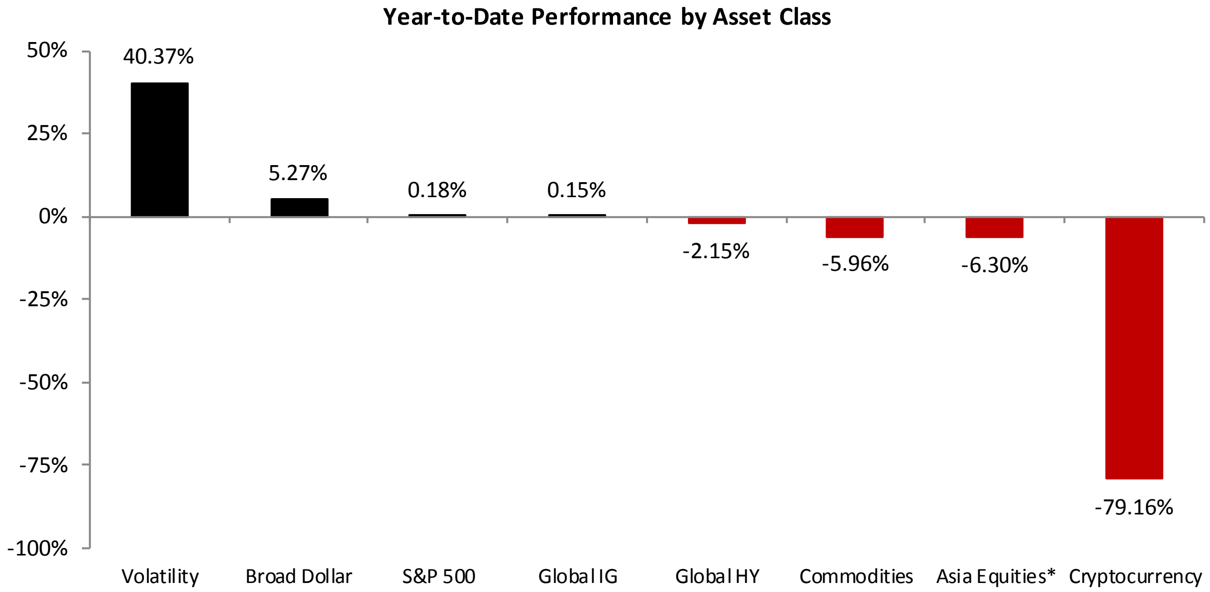
Please direct distribution queries to
Violet Lee +65 68785281
violetleeyh@dbs.com

Key Events:

- *China's manufacturing PMI is projected to fall to 50.0 in November.*
- *Singapore's industrial production is expected to rise by 2.9% YoY in October.*
- *A dovish 25bps rate hike could be expected from the Bank of Korea.*

Chart of the Week: Volatility strikes back

After nine straight yearly losses (average -54% between 2009 and 2017), volatility (equities) have struck back. A long volatility strategy via rolling positions in first and second month VIX futures have garnered a +40% ytd return, far superior than any major asset classes (see below). Looking ahead, we expect vols to remain high. Trade tensions, oil markets, European politics, Asian elections (India, Indonesia, Thailand), and late-cycle dynamics in the US will keep the markets on the edge, in our view.



Source: Bloomberg, Bloomberg Indices, S&P, DBS Group Research
* Average of Hang Seng, Nikkei, Straits Times, KOSPI, SENSEX and SET50 indices, weighed by market capitalization.

Event	Consensus	DBS	Previous
Nov 26 (Mon)			
Hong Kong: exports (Oct)	9.5% y/y	8.2% y/y	4.5% y/y
- imports	9.5% y/y	8.5% y/y	4.8% y/y
- trade balance	-HKD47.7bn	-HKD49.6bn	-HKD47.7bn
Singapore: industrial production (Oct)	2.9% y/y	2.9% y/y	-0.2% y/y
Nov 29 (Thu)			
US: PCE core (Oct)	1.9% y/y sa	2.0% y/y sa	2.0% y/y sa
Nov 30 (Fri)			
China: manufacturing PMI (Nov)	50.2	50.0	50.2
Eurozone: unemployment rate (Oct)	8.0%	8.1%	8.1%
Eurozone: inflation (Nov)	2.0% y/y	2.0% y/y	2.2% y/y
Hong Kong: retail sales (Value; Oct)	3.8% y/y	5.0% y/y	2.4% y/y
Hong Kong: retail sales (Volume; Oct)		2.5% y/y	1.4% y/y
India: GDP (3Q)	7.4% y/y	7.3% y/y	8.2% y/y
Japan: industrial production (Oct P)	1.2% m/m sa	1.5% m/m sa	-0.4% m/m sa
South Korea: 7-Day Repo Rate	1.75%	1.75%	1.50%
South Korea: industrial production (Oct)	1.2% m/m sa	1.9% m/m sa	-2.5% m/m sa

China: The manufacturing PMI is projected to fall to 50.0 in November from 50.2 in October. Industrial activities are expected to moderate further due to weakening domestic demand. Index for new export orders should remain in contraction territory due to second round of tariffs imposed on Chinese exports by the US. Exports will be dampened should the US impose tariff on all Chinese exports in Jan 2019.

Eurozone: Lagged impact of higher energy prices and a weak EUR is likely to keep inflation close to the ECB's 2% target. We expect inflation to register 2.0% YoY rise in November, with year-to-date pace tracking 1.7%, close to our full-year forecast. Core inflation is likely to continue trailing the headline, up 1.1% in the month. Despite on-target inflation, financial metrics of inflationary expectations (5Y5Y swaps) remain relatively benign at 1.6-1.7% in the past 3 quarters signaling that the markets don't expect price pressures to go out of hand, which in turn lowers the need for a hawkish policy response from the central bank in the near-term.

Hong Kong: On the external front, exports and imports growth are projected to bounce back from 4.5% and 4.8% (respectively) in September to 8.2% and 8.5% in October. Yet, this is largely due to the low base effect seen in September due to the super typhoon. Exports to China and US are expected slow as front-loading activities for products subject to first round tariff has ended. Meanwhile, imports growth will likely stay at single-digit because domestic demand will be hampered by the ongoing stock market correction.

Likewise, retail sales are expected to have increased in October by 5% YoY in value terms (2.5% YoY in volume terms), a faster pace than 2.4% (1.4%) in September. Although local consumption sentiments are well supported by rising wages of low-skilled workers (3.8% YoY in 2Q18) amid full employment (unemployment rate at 20-year low of 2.8% in September), the outlook is hinged crucially on the equity market correction brought by an intensifying Sino-US trade war. Looking forward, tourist spending is also likely to moderate due to a weakening CNY that constrains the purchasing power of Chinese visitors.

India: Growth likely decelerated in 3Q18 (second quarter FY19) from a two-year high of 8.2% YoY in 2Q18. We forecast growth to have slowed to 7.3% YoY, as activity was dampened by slowing rural incomes – as inferred from lower tractor and two-wheeler sales, tight financing conditions, fading base effects and a larger oil import bill weighing on the net trade position. Further out, unfavorable base effects will slow growth till mid-2019 beyond which the pace will turn-up. With inflation continuing to surprise on the downside (November's CPI is likely to slip below 3%) and a widening output gap, the Reserve Bank of India (RBI) will leave rates unchanged in December.

Singapore: Industrial output for October could see some marginal respite. The headline industrial production index is expected to rise by 2.9% YoY in the month, up from -0.2% previously. This corroborates a robust expansion in the non-oil domestic exports (+8.3%) in the same months. Although the potential adverse impact from the trade war is always a concern, the main impetus in recent months is coming from the biomedical cluster, which is relatively unscarred from the trade disputes. Pharmaceutical exports surged by 89.8% in October even as electronics continued to slump (-3.5%). Indeed, we expect such phenomenon to be manifested in the industrial figures as well.

South Korea: A dovish 25bps rate hike could be expected from the Bank of Korea this week (50-55% chance). The governor has been signaling rate hikes over the past couple of months, to address the risk of financial imbalances. Property prices have continued to surge recently (10.8% YoY in Seoul in October), fueling concerns about the side effects of an accommodative monetary policy. While capital outflows are not a serious problem for the time being, the BOK also appears cautious about the potential risks, given the prospects of widening negative KRW-USD rate differentials, and the high degree of foreign participation in the KRW bond market.

That said, it would prove difficult for the BOK to justify a hawkish tone at this week's meeting. The 3Q GDP missed expectations by rising 2.0% YoY (consensus: 2.3%). The labor market remained sluggish with the unemployment rate falling only slightly to 3.9% in October from the peak of 4.2% in August. While inflation touched the BOK's 2% target in October, core CPI remained low and stable at 1.1%. Given the weak macroeconomic prospects, we now expect the BOK to pause after this week's move and keep rates flat at 1.75% next year.

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

Neel Gopalakrishnan
Credit Strategist
+65 68782072 neelg@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
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).