Economics

Chart of the Week: Asia inflation watch—easing headline vs stubborn core

Group Research

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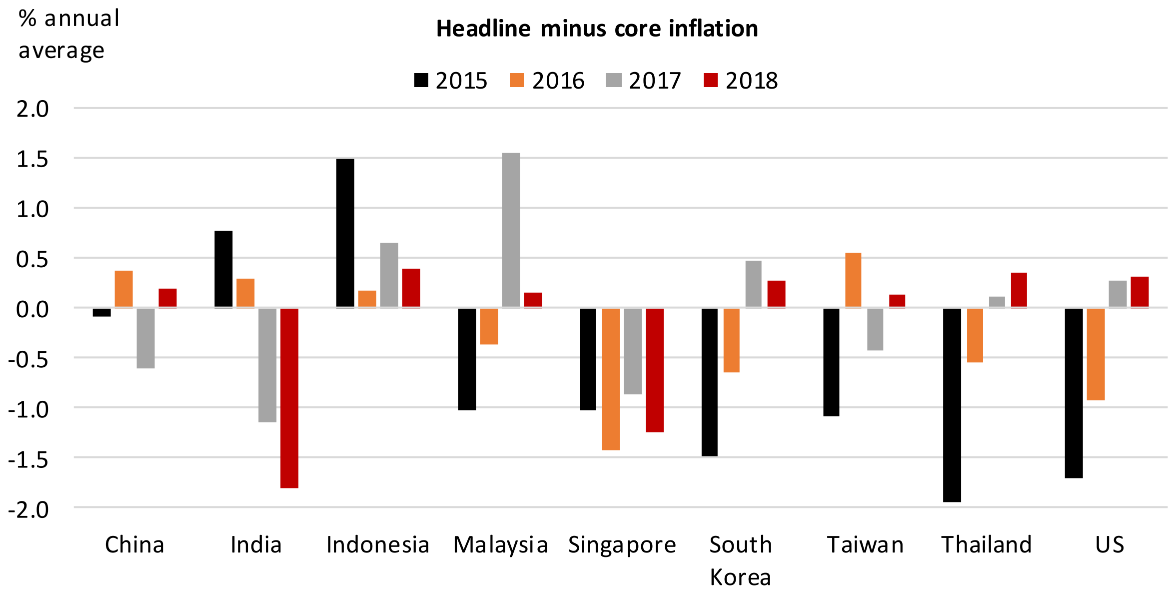
Key Events:

- *China's manufacturing PMI is projected to drop further to 49.0 in Jan 19 alongside the trade tension with the US*
- *GDP growth of Taiwan is expected to have decelerated to 2.1% YoY in 4Q18 due to external headwinds*
- *Hong Kong's trade and retail sales performance should have eased further in Dec 18 due to external uncertainties and its spill-over to domestic economy*

Chart of the Week: Asia inflation—falling headline but stubborn core

A sharp decline in energy prices and a remarkably stable food price dynamic have made inflation a non-issue in most of the world, for now. Headline inflation rates have eased considerably over the last six months in the US (2.9% to 1.9%), India (4.9% to 2.2%), Malaysia (1.8% to 0.2%), Taiwan (1.7% to 0%), Thailand (1.4% to 0.4%), and so on. But core inflation rates have corrected far less. As of December 2018, core rates in the US (2.2%), India (5.7%), Singapore (1.9%), and Indonesia (3.1%) only provided mild comfort. As a result, a peculiar phenomenon of core rates being higher than headline has materialised in several economies. Going beyond the near-term and looking at annual average inflation data, we see that the trend is broader. Headline-core differentials have narrowed in many economies; the two most glaring instances are India and Indonesia. A prolonged period of low headline inflation can pave the way for lower core through the expectations channel, but we are not quite there yet.



Source: Bloomberg, data transformations are by DBS Group Research

Event	Consensus	DBS	Previous
Jan 28 (Mon)			
Hong Kong: trade balance (Dec)	-HKD57.2bn	-HKD56.6bn	-HKD45.0bn
-- exports	-1.7% y/y	-2.0% y/y	-0.8% y/y
-- imports	-2.2% y/y	-2.5% y/y	0.5% y/y
Jan 30 (Wed)			
Hong Kong: retail sales (Value; Dec)	2.6% y/y	-0.3% y/y	1.4% y/y
Hong Kong: retail sales (Volume; Dec)	3.2% y/y	-1.0% y/y	1.2% y/y
Malaysia: trade balance (Dec)	MYR6.7bn	MYR7.4bn	MYR7.6bn
-- exports	2.6% y/y	4.5% y/y	1.6% y/y
--imports	2.7% y/y	5.0% y/y	5.0% y/y
Jan 31 (Thu)			
China: manufacturing PMI (Jan)	49.3	49.0	49.4
US: FOMC rate decision	2.50%	2.50%	2.50%
Taiwan: GDP (4Q, P)	2.1% y/y	2.1% y/y	2.3% y/y
South Korea: industrial production (Dec)	-0.3% m/m sa	0.3% m/m sa	-1.7% m/m sa
Feb 1 (Fri)			
South Korea: CPI (Jan)	1.3% y/y	1.5% y/y	1.3% y/y
South Korea: trade balance (Jan)	USD3.1bn	USD3.4bn	USD4.6bn
-- exports	-7.5% y/y	-3.2% y/y	-1.2% y/y
-- imports	-4.0% y/y	-2.4% y/y	0.9% y/y
India: FY20 Interim Budget	-	-	-
Thailand: CPI (Jan)	0.3% y/y	0.2% y/y	0.4% y/y
Indonesia: CPI (Jan)	N/A	3.1% y/y	3.1% y/y

China: The manufacturing PMI is projected to drop further to 49.0 in Jan 19 from 49.4 in Dec 18. Industrial activities are expected to moderate due to weakening domestic demand. Index for new export orders should stay in contraction territory for the 8th consecutive month as the potential trade deal in March remains a concern. In fact, exports growth already turned negative in Dec 18. Production will be weakened further down the road.

Taiwan: GDP growth is projected to have decelerated to 2.1% YoY in 4Q18 from 2.3% in 3Q18. Exports deteriorated last quarter, as global growth lost momentum and seasonal demand for smartphones and other electronics products proved to be weaker than expected. Domestic segments held up relatively well, with the stock market declines and negative wealth effects offset by the easing of energy inflation and improvement in real wages. The cyclical recovery in the property market and construction sector should also help to offset the slowdown of machinery investment in the manufacturing sector for the time being. Given the recent disappointment in the key leading indicators (export orders, PMI), however, we see downside risks to our 2019 GDP growth forecast of 2.2%.

Hong Kong: On the external front, exports and imports growth should have went down further from -0.8% and 0.5% (respectively) in November to -2.0% and -2.5% in December, mirroring the trade performance of the Mainland China. Re-exports to China and US are expected fell as front-loading activities for products ended. Imports growth is likely to weaken because domestic demand will be hampered by the ongoing stock market correction.

Likewise, retail sales are expected to have dropped in December by 0.3% YoY in value terms (decrease by 1.0% YoY in volume terms), compared to 1.4% (1.2%) in November. Although local consumption sentiments are well supported by rising wages of low-skilled workers (4.1% YoY in 3Q18) amid full employment (unemployment rate at 20-year low of 2.8% in December), the outlook is hinged crucially on the equity market correction brought by external uncertainties.

South Korea: Jan trade and inflation are the key data this week. Export growth should have contracted further after sliding -1.2% YoY in Dec18. The peak of US growth, slowdown in China, weakness in electronics demand, and sluggishness in commodities market all bode ill for South Korea's exports in the near term. The calendar effect may not help much either, given that the Lunar New Year falls in the same month this and last year. CPI inflation, meanwhile, is projected to have remained subdued at 1.5% YoY in January, below the central bank's 2% policy target for the second month in a row; largely thanks to the decline in oil prices and import costs.

Malaysia: Trade data (Dec18) is on tap this week. Expectation is for export growth to register a marginal improvement of 4.5% YoY, up from 1.6% previously. Low base effect is at work but frontloading of orders ahead of the Lunar New Year could potentially provide some upside as well. Import growth is likely to clock an expansion of 5.0%, which thus delivers an overall trade surplus of MYR 7.4bn. However, beneath the slight improvement in lies potentially downside risk on export sales ahead. Malaysia's exports are highly dependent on electronics. As it is, global shipment and billings of semiconductors have continued to slide. In fact, growth in global semiconductor sales are already in contraction. This could potentially point to more drag on the external front for overall GDP growth.

India: The Indian government will table its FY20 Interim Budget on Friday. With Finance Minister Arun Jaitley on medical leave, the interim Finance Minister Piyush Goyal will present the Budget this week. Ahead of the general elections in April/ May, the interim budget will a budget of intent i.e. it will outline expenditure and revenue projections for FY20, along with revised FY19 deficit and budgeted FY20 deficit target, assuming the incumbent government is voted back to power. An overview of the past five years' achievements and blueprint for the upcoming year is also expected to be a part of the announcement.

The government has prioritised fiscal consolidation in recent years, but markets eye risks to the outlook. Spending requirements have increased for a support package for the farm sector (estimated at 0.5-1.5% of GDP), capital infusion into banks, better procurement for minimum support prices, etc. Revenues, particularly indirect tax collections (GST) and non-tax receipts (divestment proceeds) have lagged targets in FY19. Despite these increased commitments, we don't expect the government to deviate sharply from its fiscal consolidation path, with FY19 revised estimate to stand at -3.3% of GDP (any deterioration limited to -3.5%) and a higher FY20 deficit of -3.2% of GDP vs previously outlined -3.1%. The underlying math for FY20 might include ambitious growth assumptions, higher GST revenues (building in better compliance and wider tax base) and increased divestment proceeds (estimated at INR800bn). A modest slippage in FY20 math is likely to cheer the markets, even as the quantity over quality of the consolidation efforts partly clouds optimism.

Indonesia: Inflation numbers for Indonesia are on tap this week. We expect CPI to stabilize at 3.1% YoY in Jan19 on the back of easing rice price. In addition, stable domestic retail fuel and electricity price have also contributed to the stable inflation. Core inflation is also stable at 3.1% as domestic demands might started to recover as consumer confidence improved on the back of lower global pressure to Rupiah, higher inflows and more stable rice price. We see less risk to elevated inflation this year as oil price has come down significantly and government has committed to keep retail fuel and electricity price fixed this year. However, we think core inflation will continue its upward trend this year especially in the 1H19 due to pick up in consumption as sentiment improves and catalyze further by the general election (May19) and Eid al-Fitr (Jun19).

Thailand: January inflation report is due on Friday, where we look for headline CPI to ease to 0.2% YoY from 0.4% in December. Decline in oil prices have reduced supply-side pressures, with high base effects likely to keep readings weak over the course of the year. The transport and communication segment likely declined for a second consecutive month, with a firm baht helping to keep a lid on imported pressures. Core inflation will exceed the headline for the second consecutive month. For the BOT, easing inflation, easing growth outlook (see here) and an already strong THB lower the need for follow-up rate hikes this year.

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