Emerging Markets: What Has Changed

1) The Brazilian central bank has shown its hawkish side; the focus turns to FX now.

2) Taiwan's new stimulus plan disappointed markets by not surprising on the upside.
3) Indonesia may start stepping up support for the rupiah soon.
4) Bank of Thailand resumed the easing cycle.
5) Signs that China is looking for more (and better) sources of external funding sources is mounting.
6) Turkish central bank governor Basci seems ready to take action to stabilize markets.

1) The Brazilian central bank has shown its hawkish side; the focus turns to FX now. Bacen accelerated the pace of hikes to 50 bp as we had expected, but against the majority of forecasters. The most notable development was the committee's vote count: unanimous, which is in contrast to the April meeting when 2 of the 8 members voted for maintaining rates stable. Now the focus shifts towards FX markets. Before the COPOM announcement yesterday, FM Mantega said that the he sees "no reason to intervene in FX markets." Now, intervention on Friday will not only provide an important signal about how they will manage the currency, but it will also directly contradict Mantega. This would be a welcome development, in our view, as it will show that Tombini is again trying to establish the central bank's independence and regain his battered credibility.

2) Taiwan's new stimulus plan disappointed markets by not surprising on the upside. The new measures include allowing insurers to invest in infrastructure projects, establishing a 'cash for clunkers' scheme, starting an 'angel fund' to invest in private companies, subsidizing energy-saving home appliances, and revising the capital-gains tax rules on stocks. President Ma's disapproval rating is around 70%, largely due to the sluggish economy which is forecast to grow just 2.4% this year. Like Korea, Taiwan is sensitive to competitiveness loss against Japan from the weaker yen, which will aggravate the already weak economy. We prefer to play TWD from the short side in relative value trades against other EM Asian currencies.

3) Indonesia may start stepping up support for the rupiah soon. Earlier this week, central bank governor Martowardojo said that despite high inflation over the last few months, "interest rates are not in a condition to be lowered." Before that, he added that the bank would strengthen the policy mix using interest rate, exchange rate, and macroprudential policies to achieve the inflation target. In addition, a senior central bank official was quoted as saying that there is room to raise the FASBI rate (deposit facility) to maintain capital inflows and support the ailing rupiah. Indeed, central bank deputy governor Sarwono has already noted that the FASBI rate can be used "to manage inflows from leaving the country due to uncertain fuel policies." In short, it seems as if a combination of higher deposit rates plus a stronger currency may be the policy mix for the near term.

A stronger IDR could catch many investors who are short or underweight Indonesia on the back foot.

4) Bank of Thailand resumed the easing cycle. The bank delivered its first rate cut since October, 25 bp to 2.5%. Resumption of the easing cycle was long overdue, but it seems that policymakers wanted to see how the economy fared after the distortions from the flooding played out. Data hasn't been very uplifting, and so the BOT is likely to continue cutting rates ahead. Consumption and investment slowed sharply in Q1 while IP contracted -3.8% y/y in April. Inflation continues to fall, with headline CPI at a cycle low 2.4% y/y in April. More importantly, targeted core inflation is at its cycle low of 1.2% y/y, very near the bottom of the 0.5-3.0% target range. Officials are also signaling greater willingness to combat baht strength, and rate cuts should help here.

5) Signs that China is looking for more (and better) sources of external funding sources is mounting. This week, the media suggest that plans are moving ahead to cut red tape to boost foreign investment by easing application and approval procedures for foreign investors. Separately, we are hearing more talk about the development of local bond futures markets to give investors better hedging tools. These developments are in line with the view that there may be growing urgency to attract more stable funding capital to make up for the diminished capacity of local lenders. In fact, reports suggest that China's big four banks issued only RMB208 bln loans in May (down from RMB245 bln in April). This will surely lead to a downward revision of expectations for the May new yuan loans data release next week, where consensus is currently at RMB850 bln.

6) Turkish central bank governor Basci seems ready to take action to stabilize markets. Expectations have now rightfully shifted from easing to tightening of monetary conditions. We could see the bank return to the policy framework of using "special" days and "normal" days for liquidity management and guiding the interbank rate higher. The interbank rate has risen from around 4.0% in mid-May to 5.6% now. At this point, the upper end of the corridor set at 6.50% represents the upper limit for the interbank rate. Raising the top end of the corridor would be a drastic measure, and we don't think it will happen unless the situation gets a lot worse. We do note that rising political concerns go hand in hand with steadily deteriorating economic fundamentals in Turkey.