

Good MornING Asia - 11 July 2019

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By Robert Carnell



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Source: Shutterstock
Fed Chair, Jerome Powell

USD weakens on Powell comments

[James Knightley's summary of the Powell testimony](#) affirms what newswire headlines are leading with today, that Fed Chair Powell has virtually delivered the July rate cut already, and written off the recent strength in the labor market.

What it also does, but what most of the markets are missing, is set out the case for the opposite side of the argument - that the US economy is actually running pretty well, with strong consumer spending and a steady labour market. Put this all together, and yes, another rate cut after July is probably on its way. September would seem a sensible choice for another insurance cut. But after that, then it ought to require a further lurch down in global market conditions - perhaps another ratcheting up of the trade war, to make a case for further insurance cuts to be taken out.

Not surprisingly, the USD has lost most of the gains it made following the payrolls surprise. EURUSD is now up at about 1.1260. There is a surprisingly little reflection of the changes in outlook for the Fed in Asian FX markets. The KRW - for example, our current go-to fir-cone of Asian market squalls,

is pretty steady at 1181. Perhaps this is because a Fed rate cut makes it easier for the BoK to follow with a cut of their own, though there isn't much life elsewhere. There's more life in the AUD and NZD. Perhaps thoughts of a Trans-Tasman final for the ICC World Cup may be buoying these units, though more likely they are catching a prevailing G-10 wind.

US Treasury curve steepens

The Powell testimony has pushed down short-dated Treasury yields. The 2Y benchmark is now about 1.82%. 10Y yields are not down as much in net terms but were nosing higher to 2.11% at times yesterday, so Powell cut short the sell-off there that seemed to be brewing.

Markets are still pricing in a lot of Fed easing. The combined probabilities of rates at or below the 1.25-1.5% range (current range 2.25% to 2.5%) is 45.3%, only slightly down from the beginning of the month, when they were 46.9% or the pre-G20 probability of 53.3%.

It may take markets some more months to figure out that the Fed is not embarking on a series of cuts. That, I think, should play out more at the front end than the back, for some bear flattening. The sell-off that was brewing yesterday may return on any doubt resurfacing about Fed dovishness.

Thailand Government formed - for now

As Prakash Sakpal also writes elsewhere today "Thailand's civilian government is finally formed with the Royal Gazette unveiled 36-member cabinet under Prime Minister Prayuth Chan-Ocha. The key ministers include Deputy Prime Minister Somkid Jatusripitak, who previously served as commerce and finance minister in the Thaksin administration; Commerce Minister Jurin Laksanawisit, who had been education and public health minister in the Abhisit administration; and Finance Minister Uttama Savanayana, the industry minister in military government after the 2014 coup. However, as we have noted earlier, doubts remain about the Prayuth's fragile coalition surviving its entire term. But for now, the end of the political stalemate is positive news for the local markets even as the economy continues to struggle".

Day ahead

More Powell testimony today will in all likelihood add nothing to what we learned yesterday. Or at best, push a little further in the same direction. US inflation is the main G-10 release. Insufficient inflation is frequently cited as one of the arguments for central bank dovishness, including the Fed. US headline CPI inflation could tick down to 1.6%YoY in June, which supports the case for some further easing, or does it? Core inflation (we should probably focus on this more?) is 2.0% now and is expected to remain 2.0%. That's the target. What's the big worry?

In Asia, China's June Aggregate Financing is the key release: Iris Pang expects an on-consensus CNY1.9tr figure for the June aggregate number but thinks we should focus on Trust Loan figures where there have been some recent legislation changes. She also writes about yesterday's PPI figures and trade war developments: "Premier Li Keqiang emphasised in a meeting that China will study reducing import tariffs in general and speed up export tax rebates. This should be positive for China's trade partners, not only to the US, and is also good news for importers and consumers. The way China is doing tariffs is the opposite to what the US is doing, which is imposing more tariffs on more trade partners. China's actions hopefully can earn some recognition from its trade partners, and hopefully will be positive to China trade.

Source: http://www.xinhuanet.com/politics/leaders/2019-07/10/c_1124736351.htm

Yesterday's data release on China CPI and PPI at 2.7%YoY and 0.0%YoY reflect that swine flu is still pushing up food prices. But the PPI story is more complicated. Export-related PPI, e.g. packaging materials, showed negative inflation, but infrastructure-related materials, e.g. metals prices were on the rise. In other words, the economy is still stimulus-driven, and will be so until the trade war is over".

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EM Space: Dovish FOMC minutes and Powell's testimony confirm Fed cut

- **General Asia:** Chairman Powell hinted at an insurance rate cut given the prevailing headwinds, while the markets are all but pricing in a rate cut in July. Minutes from the last FOMC meeting also sounded a dovish policy tone. The Dollar will likely pull back on falling Treasury yields while investors look to US inflation data for cues on the magnitude of the Fed rate reduction.
- **Thailand:** The Royal Gazette unveiling 36-member cabinet under Prime Minister Prayuth Chan-Ocha. The key ministers include Deputy Prime Minister Somkid Jatusripitak, who previously served as commerce and finance minister in the Thaksin administration; Commerce Minister Jurin Laksanawisit, who had been education and public health minister in the Abhisit administration; and Finance Minister Uttama Savanayana, the industry minister in military government after the 2014 coup. However, as we have noted earlier, doubts remain about the Prayuth's fragile coalition surviving its entire term. But for now, the end of the political stalemate is positive news for the local markets even as the economy continues to struggle.
- **Philippines:** Exports surprisingly grew for the second straight month in May by 1.0% YoY,

while import growth continued to be negative at -5.4%. This narrowed the trade deficit to \$3.28 billion from \$3.47 billion in April and also from \$3.88 billion in May 2018. Still, we expect the trade gap to remain wide. While the data is positive for the Peso, for now, we don't rule out renewed import growth momentum weighing on the currency in the second half of the year.

What to look out for: US inflation data

- US inflation (11 July)
- Singapore GDP and retail sales (12 July)
- Malaysia industrial production (12 July)
- Japan industrial production (12 July)
- India inflation (12 July)
- US PPI (12 July)
- China trade (12 July)

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BSP credibility key to efficacy

BSP Governor Diokno stressed the importance of credibility in crafting monetary policy, indicating that “without credibility, central banks resort to traditional aggressive tools to achieve the same result”. Oftentimes, the ability of the BSP to communicate its policy stance and direction effectively to the market is enough to manage not just inflation but inflation expectations as well. Managing expectations in many instances may be just as integral to inflation targeting if the BSP has an effective “hold” on the markets through its credibility.

Diokno signals policy rate cut

With inflation down again in June, the BSP governor hinted at potential policy rate (RRP) cuts in the near term, even indicating that a rate cut will likely come before further reductions in reserve requirements (RRR). With the last instalment of the RRR reduction scheduled for the end of July, we expect the BSP to gauge the effect of this additional liquidity on the financial system before making more adjustments on this front. Previously, Diokno had said he was open to reducing reserve requirements further should the funds be put to “good use”. Today's term deposit facility (TDF) auction showed that the already doubled PHP 60 billion worth of offering was fully awarded and oversubscribed, which could indicate that the influx of liquidity has yet to find its way to the real sector.

As such, we can expect the BSP to slash borrowing costs further as inflation grinds lower. We have pencilled in a 25bp RRP cut as early as the August meeting with 2Q GDP likely to have fallen below potential. Meanwhile, we can expect reductions to the RRR to be carried out at a non-monetary policy meeting, perhaps after the 26 September policy meeting via a phased 50bp reduction at the end of October and another 50bp by year-end.

Timing is everything

Diokno's predecessors Amando Tetangco and Néstor Espenilla helped to lay the groundwork for a successful and almost seamless exit from an era of high RRR. Governor Tetangco's constant clamour for amendments to the BSP charter, such as the ability to issue BSP bonds, was fulfilled during his successor Espenilla's term with implementation of the interest rate corridor laying the foundation for the eventual first RRR reduction.

Diokno espouses the belief that central bank credibility is integral to monetary management, and his version of RRR cuts are viewed to be gradual and well-telegraphed. Although seemingly unorthodox, the pre-announced schedule of phased reductions for RRR (100bp in May, 50bp in June and 50bp in July) was welcomed by the market. Timing his resumption of RRR cuts when inflation was decelerating was well-received by the market and consistent messaging helped keep market panic to a minimum.

For the rest of the year, we expect BSP to continue to normalise policy rates after its aggressive rate hike in 2018 while at the same time signal effectively to market players that reductions in the RRR will follow in a scheduled and phased manner.

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