

Good MornING Asia - 14 September 2020

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Phoney inflation war

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Federal Reserve

Headline inflation in the US is 1.7%

Last Friday, the US released its August inflation figures. The month-on-month change came in higher than expected at 0.4% taking the headline rate of inflation to 1.7%. You might well ask, so what's the big deal (which would not be a stupid question)? In fact, the Fed prefers to target a broader measure of inflation called the personal consumer expenditure deflator (PCE). In July, this was running at only 1.0%, a full 0.6pp lower than the equivalent July headline CPI.

That said, most countries use a headline or core CPI as their target, not some local version of PCE, begging several questions. Firstly, does this mean on average, and on a comparative basis, that the Fed is already targeting a higher rate of (equivalent) CPI inflation (it would certainly seem so), and therefore also, what is the "right" inflation target anyway? That last question almost never gets asked, but it is a pertinent one because if you target an inflation rate using interest rates, the residual of that outcome is credit growth, which affects things like asset prices. Get that wrong, and you end up with an asset price bubble, and eventually a bust. That is what worries me and a number of other commentators, but seemingly does not worry any central banks, who keep plugging away at the same old formula.

Another way of doing this, for a central bank, would be to target an appropriate rate of credit growth by setting interest rates and letting inflation vary as the residual. Absent structural shocks to the economy, that should deliver an appropriate credit growth although inflation might fluctuate a bit below or a bit above current target levels, it really doesn't matter - just as it doesn't really matter where you target inflation in an inflation-setting regime, so long as you target a rate you can *actually* achieve - which currently, doesn't seem to be the case for many central banks. Importantly, switching the target of policy, but leaving the policy lever unchanged, would considerably reduce the risk of inappropriate and unsustainable credit flows to asset markets, which have dominated the last number of decades.

Last Friday, despite the higher than anticipated inflation figures, US 10Y Treasury yields fell slightly, perhaps because markets are looking forward to some more soothing words from the Fed this week. This week's Fed meeting is [written up in much greater detail here by James Knightley](#). But interestingly, since his Jackson Hole speech hinting at average inflation rate targeting (an irritating irrelevance in my opinion), a number of FOMC members have suggested that they don't see any great need for changing the Fed's strategy any time soon. I don't really agree with them, I think the strategy needs a radical overhaul, but I would agree that what seems to be being suggested now is not only not necessary, but finessing a policy that is already inherently unsustainable. Moreover, it comes against a backdrop where low-inflation, at least on some measures, is looking less of a problem that it has done for a while, and certainly not a problem that needs addressing with even more accommodation.

Asia Day ahead

It's a quiet day in Asia for economic releases. Prakash Sakpal has this to add on India's inflation numbers. "India's August CPI and WPI inflation data are due today. The Covid-19 supply shock to food prices and administrative hikes in fuel prices drove CPI inflation above the central bank's (Reserve Bank of India) 6% policy limit in April, which is where it has been since, including the 6.9% recorded in July. We believe there was no let-up in price pressure in August; our CPI inflation forecast for the month is 7.1%. The forecast for WPI inflation is -0.2%, up from -0.6% in July. We believe the RBI is done with its policy easing in this cycle. The next move in policy rates will be upward, though not in the foreseeable future as the worsening Covid-19 situation will delay economic recovery".

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Asia week ahead: Central bank policy dominates

Three Asian central banks hold their policy meetings. And, there is a flood of activity data from around the region. All this will make it an exciting week for markets



Source: Shutterstock

➔ Central bank policy-making

Central banks in Japan, Taiwan and Indonesia meet next week. All are expected to leave policies on hold. Yet, there will be some interest here. Especially so in the Bank of Japan's meeting, which is the first since Prime Minister Shinzo Abe's resignation in late August, the event that might have fuelled speculation about even easier BoJ policy to soften the Covid-19 blow to the economy. ING's Japan watcher, Rob Carnell, however, cautions against it ([here is why](#)). The markets will also be watching Japan's August CPI inflation and trade figures next week, none of which is going to make

much sense from the BoJ policy perspective.

For the central bank with the longest history of unorthodox policies, doing yet more of the same seems a particularly pointless exercise. – Rob Carnell on BoJ policy

The interest in Bank Indonesia's policy stems from the steady downward grind in CPI inflation, which at 1.3% year-on-year in August was the lowest in the last two decades (since April 2000). Will this move BI for the fifth rate cut this year? ING's Indonesia expert, Nicholas Mapa, doesn't think so amidst intensifying currency depreciation due to debt monetisation worries ([here is more](#)). Coming ahead of the BI meeting, August trade data should continue to reflect downside pressure on growth.

What about Taiwan's Central Bank of the Republic of China (CBC) policy? CBI's has been one of the steadiest monetary policy in Asia. It didn't change from mid-2016 until the Covid-19 outbreak at the start of this year. And, with just one 25bp rate cut in March this year, the easing cycle is done, in our view. Our Greater China Economist, Iris Pang, doesn't expect another move, in either direction, over our forecasting horizon until end-2022.

[Abe resigns as Japan's PM](#)

[Indonesian inflation cools further but focus shifts to central bank charter changes](#)

➔ And, busy data schedule

China's remaining activity data for August, including industrial production, retail sales, fixed asset investment, and home sales will be in focus. Iris Pang doesn't see growth for these differing much from the July pace.

August CPI inflation will be the highlight of India's data calendar. The Covid-19 supply shock to food prices and administrative hikes in fuel prices drove inflation above the central bank's (Reserve Bank of India) 6% policy limit in April, which is where it has been since, including the 6.9% recorded in July. We expect no let-up in price pressure in August. Our forecast for August is 7.1%. Also, look out for India's August trade figures for what these say about growth.

Singapore's non-oil domestic exports for August is an interesting release too. Pharmaceutical exports, the key support to NODX earlier this year, has lost its vigour in recent months, but a pick-up in electronics exports kept the headline NODX growth in positive territory. We expect pretty much the same in August, though with a more moderate NODX growth than July's 6.0% YoY.

Down under, Australia's jobs report for August and New Zealand's 2Q20 GDP will be the ones to watch. The worsened Covid-19 outbreak in the state of Victoria underpins our house forecast of a sharp slowdown in Australia's employment growth, which is also the consensus view. Our forecast for New Zealand GDP is a 7% quarter-on-quarter fall.

Asia Economic Calendar

Country	Time Data/event	ING	Survey	Prev.
Monday 14 September				
China	0230 Aug New home prices (YoY%)	4.8	-	4.8
India	0730 Aug WPI (YoY%)	-0.2	-0.27	-0.58
	1300 Aug CPI (YoY%)	7.1	6.86	6.93
Tuesday 15 September				
China	0300 Aug Industrial Production (YoY%)	5.0	5.2	4.8
	0300 Aug Retail Sales (YoY%)	-0.6	0.0	-1.1
	0300 Aug Fixed asset investment (YTD, YoY%)	-1.4	-0.4	-1.6
India	- Aug Trade deficit (US\$bn)	-7.6	-6.8	-4.83
	- Aug Exports (YoY%)	-8.0	-	-10.2
	- Aug Imports (YoY%)	-21.0	-	-28.4
Indonesia	0500 Aug Trade balance (US\$mn)	2185	-	3263
	0500 Aug Exports (YoY%)	-10.2	-	-9.9
	0500 Aug Imports (YoY%)	-25.3	-	-32.55
Philippines	- Jul OCW remittances (YoY%)	-5.7	-	7.7
Thursday 17 September				
Indonesia	0820 BI policy decision (7-day reverse repo, %)	4.0	-	4.0
Singapore	0130 Aug Non-oil domestic exports (MoM/YoY%)	0.5/1.5	-/-	1.2/6.0
Taiwan	- Benchmark Interest Rate	1.125	-	1.125

Source: ING, Bloomberg, *GMT

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China: credit growth supports stimulus and GDP

China's credit growth increased in August. Some of the money may have been spent on infrastructure stimulus, which should boost GDP growth in 3Q and 4Q. It is expected that the People's Bank of China will maintain this credit growth momentum through its daily open market operations



Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

More credit growth means stimulus measures are in progress

Aggregate finance grew CNY3.85 trillion in August after growing CNY1.69 trillion in July.

CNY1.42 trillion was yuan loan growth and there was a CNY1.38 trillion increase in the issuance of government bonds. These two categories outstripped the others, e.g. corporate bond net issuance was a mere CNY363.3 billion. But when we combine loans drawn by corporates for long term use, amounting to CNY725.2 billion, and the net issuance of corporate bonds in August, total credit going to corporates reached CNY1.089 trillion.

Despite the need for credit growth, China continued to shrink its shadow banking market. An exception was undiscounted bills, which increased CNY144.1 billion. An increase in undiscounted

bills is usually due to tight liquidity, which was the case in early August.

Housing market is also helping growth

Loans to households came in at CNY841.5 billion. Most of them are long-term loans such as mortgages, reflecting the fact that sentiment in the housing market in China has continued to rise even though there have been tightening measures by some local governments.

We expect property developers and the construction sector to have benefited from this rising momentum in the housing market. And this will continue in the third and fourth quarters.

Expect credit to keep growing even if the PBoC does not easing further

Analysing the credit data, we think stimulus measures are in progress, which includes traditional infrastructure stimulus and 5G infrastructure. These projects will continue to support GDP growth in 3Q and 4Q. We believe that credit growth momentum should last into the end of the year, although we don't expect any cut in interest rates or the Required Reserve Ratio.

We have revised our USD/CNY forecasts from 6.97 to 6.70 by the end of 2020. This is mainly a result of the weak dollar as we do not expect the PBoC to ease further in 2020.

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