

Good MornING Asia - 19 July 2018

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By Robert Carnell



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Source: Shutterstock

Take a break from politics

The UK parliament will be taking its summer recess at the end of this week - big sigh of relief for Prime Minister Theresa May, who still clings to a job, against the odds. Many of us would like to take a break from the Twitter stream from Washington too, though that seems more like wishful thinking. But though the political noise is as loud as ever, we will leave aside this for a day - the pantomime of the "Yes they did, no they didn't" from President Trump on Russian interference, the lambasting of Theresa May by the former Foreign Secretary, Boris Johnson, the worries about Brexit from the EU, and chatter of an extended article 50, not to mention Larry Kudlow's recent pop at China's President Xi, that he doesn't want a trade deal. Like the UK parliament, let's take a political recess, and focus back on the macro.

Fair, turning unsettled

Right now, the US earnings season is in full swing and the news is good, helping stocks to push above resistance and making the January peak look like the next target. But Alcoa's earnings

expectations downgrade on tariff costs for imported aluminium, remind us again that for all those seeking a positive outcome from the rapidly growing tariff wall, there are losers too. Direct gainers may do well, perhaps very well. But they will likely be in the minority. The losers may not lose so much, but they will be numerous, and the net losses will almost certainly outweigh any gains, on both sides of the Pacific.

In terms of hard macro data today, we got Japanese trade figures for June. For Asia so far, the news has already been poor this month. Both Korea and Singapore posted much worse than expected trade figures. And this has happened before the US-China tariffs have really had a chance to bite. Most of the tariffs were not even in place in June. Japan's trade figures today also showed slight signs of weakness, though mainly on the import side. That could point to a lack of 'oomph' in the domestic economy, despite better than expected wages figures in recent months.

Whatever the aggregate Asian story for June, the months that follow will be the real story to watch. On the assumption that this isn't going to be pretty viewing (parents, we suggest at least an 'R'- rating), we have already been taking the knife to our Asian GDP forecasts (watch out for detailed note to follow in a few days) - been nudging up the near-term inflation outlook (tariffs make stuff more expensive, exacerbated by weaker Asian FX) - and been nudging down the longer-term inflation outlook (the ensuing drop in growth and rise in local policy rates to offset the FX and inflation effects will turn the backdrop more disinflationary).

That's not a backdrop in which I would like to be going limit-long the stock market, even if I lack the guts to actually short it today.

Australia - place your bets

This morning's labour report from Australia will likely provide its monthly surprise, with the consensus of forecasters, of which we are a small part, scratching our collective heads to work out why we have got it wrong again. The Australian economy seems to be at a saddle point. It's not obviously slowing, as labour gains keep showing. But it is not growing fast enough to get wages to rise (unless we are very much mistaken again today) and there are pockets of market excess unwinding (five of eight metropolitan areas reported falling house prices in 1Q18), and as a major commodity producer, terms of trade have taken a sharp, turn for the worse. That should weigh on the AUD near term.

No wonder that no one expects anything from the Reserve Bank of Australia (RBA) for a very long time. We would concur with that view. Until wages data are released for 2Q18 in mid- August (15th), that view is not likely to change.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

China: Central bank finds different way to cut rates

The auction of government deposits at commercial banks reveals that the central bank is cutting interest rates, but not through its seven-day policy rate



Source: Shutterstock

Central bank guided government deposit rate lower

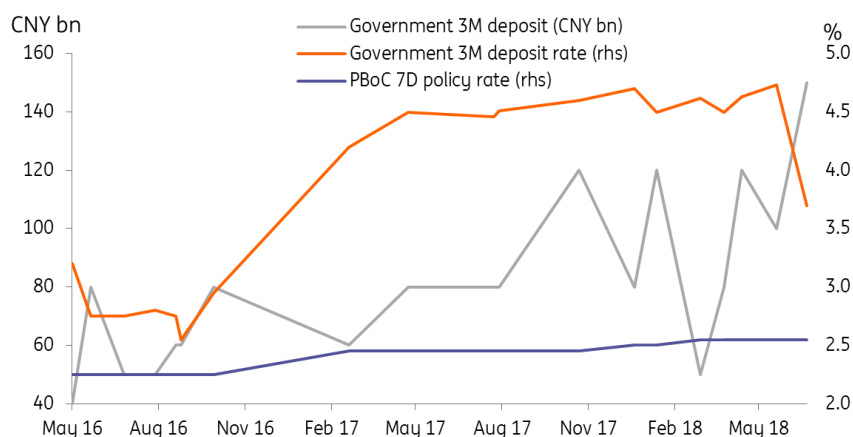
The central bank (People's Bank of China) guided auction rates on 91-day government deposits at commercial banks lower to 3.7% from 4.73% on 15 June.

We believe that this rate cut through a different channel than the PBoC seven-day (7D) policy rate means the central bank would like to see lower interest rates but doesn't want to send an obvious signal that it is loosening policy because financial deleveraging reform should still be ongoing.

The move has likely been triggered by the lower GDP growth rate of 6.7% in 2Q18 from 6.8% in 1Q18.

Though this is not a usual tool used by the PBoC, it's not the first time the bank has cut rates in this way. We saw this in June 2016 when GDP growth fell to 6.7% in 1Q16 from 6.8% in 4Q15.

Interest rate is set to fall from lower government deposit rate



Source: ING, PBoC, ChinaBond

Further stimulus from fiscal and monetary policy coming to cushion trade war impact

We expect the PBoC to cut its reserve requirement ratio (RRR) at the beginning of each quarter from now to 1Q19. This may extend further out if the trade war escalates.

Still, the marginal impact from monetary policy will not be enough to support the economy in this trade war. The central bank has commented that the Ministry of Finance should implement more aggressive fiscal stimulus. It's rare for the PBoC to make such a comment. The central bank has sent a strong signal to the market that further stimulus from both fiscal and monetary policy, is more likely than before.

We expect fiscal stimulus to come mostly in the form of investment pools for high-tech R&D to foster future growth. Tax relief would be a supplementary boost as the impact is more short-lived.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Malaysia: GST removal dents inflation

We revise our 2018 inflation forecast from 1.8% to 1.0%. Lower inflation allows greater scope for the stable central bank policy



Source: Shutterstock

Gone with the Goods and Services Tax (GST) are inflation worries. This could be a loud statement about Malaysia's just-released consumer price data for June. We revise our full-year 2018 inflation forecast from 1.8% to 1.0%. Lower inflation will allow a greater scope for the central bank (Bank Negara Malaysia) to keep the monetary policy stable for a prolonged period, or even ease in the event the global trade war adversely impacts the economy.

0.8% CPI inflation in June

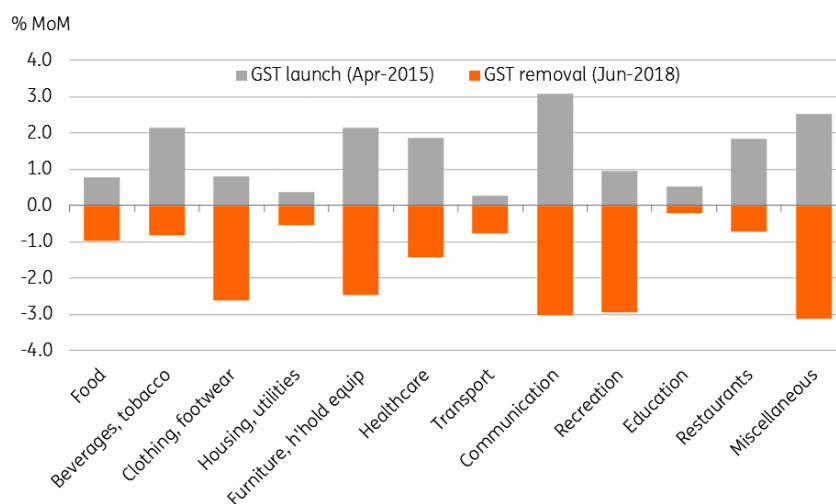
Lower than expected

A downside inflation surprise in June

In a huge downside surprise, CPI inflation slowed to 0.8% year-on-year in June from 1.8% in the

previous month. The consensus was centered on 1.3%. A sharp slowdown was mainly the result of the cut in the GST rate from six to zero percent effective June 1 by the new government. The effect is clear from the month-on-month price changes across CPI components, almost mirroring the impact upon the introduction of GST in April 2015 (see figure).

The GST impact



Source: Bloomberg, ING

Downgrade of 2018 inflation forecast, again

The year-to-date inflation of 1.6% YoY has more than halved from 4% a year ago, led by a steep slowdown in key components of food and the transport prices. The GST will be replaced by a less severe Sales and Services Tax (reportedly by September), and any impact is likely to be transitory without significantly reversing the ongoing inflation downtrend.

Headline inflation is likely to turn negative in some months and remain low in the first half of 2019 - BNM policy statement in July

We now see inflation remaining well below 1% in the remainder of the year, or possibly even turning negative as the central bank has pointed out in the latest policy statement. This prompts another downgrade to our full-year 2018 forecast from 1.8% to 1.0%, the second since May when we cut it from 2.4%.

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

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