

Good MornING Asia - 2 July 2019

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What's to blame for the 'unremittingly bad' economic data from Asia

ING's Rob Carnell on why the economic data from Asia appears to be 'unremittingly bad'.

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ASEAN Morning Bytes

General market tone: Wait and watch. Setting the mixed tone for markets today, escalation of geopolitical tensions in the Gulf region counters the positive investor sentiment from rising expectations of the US Fed easing.



EM Space: Oil moves higher on attacks in the Middle East

- **General Asia:** Attacks on two oil tankers caused oil prices to rise with the US blaming Iran for the attacks. Economic data from the US supports growing expectations of the Fed easing, while the markets await more economic data out from the US and China today.
- **Indonesia:** Finance minister Indrawati indicated that the government was aware of the downside risks to the country's economic growth momentum, which are mostly external in nature - the trade war and China's moderating growth. But she also highlighted the need for improvement in investments to maintain the overall growth momentum.
- **Thailand:** Moody's sees Thailand's aging society, moderate competitiveness, and labour skill shortages as key headwinds to growth going forward, while the economy is likely to benefit from continued domestic and foreign investment via the Eastern Economic Corridor (EEC) project as well as potential supply chain relocation due to the US-China trade conflict. Moody's investment grade, Baa1 rating on Thai sovereign credit has been in place since 2003, and it's on par with other main rating agencies - S&P and Fitch.

What to look out for: China retail sales and US retail sales

- Thailand GIR (14 June)
- China retail sales, industrial production (14 June)
- US retail sales, consumer sentiment (14 June)

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RBA Preview: A tough call, but not a hard decision

There are good reasons for the Reserve Bank of Australia to cut at its meeting on Tuesday. Good ones to pause too. This is a hard one to call. One thing's clear, they haven't stopped easing yet



Source: Shutterstock

Reserve Bank of Australia Governor Philip Lowe

1.25%

RBA current cash rate target

Consensus is for a cut to 1.0%

A cut or a pause - it doesn't really matter

Whether or not the RBA decides that a back-to-back cut is warranted at this meeting, or whether they decide to leave things for a bit and ease further at a future meeting, say August, will make very little difference to the economy. Not will it make much difference to the unemployment rate outlook, and consequently the future for inflation relative to its 2-3% target. So, let's take a look at the pros and cons.

All those in favour...

The following is not an exhaustive list, but represents what we believe to be the main arguments for a rate cut at this week's meeting.

1. The market has priced it in (78% anyway), though simply doing what the market wants merely increases its appetite for more. It's a dangerous way to play policy, as the US Fed will likely soon find out.
2. The consensus forecast leans slightly in favour of a cut, with the big Australian Bank Chief Economists, many with an RBA pedigree, almost all veering towards a cut. But then they may be being swayed by the market pricing. There could be a bit of what the statisticians call multicollinearity here, or in English, 1 and 2 are different ways of saying the same thing.
3. The rate cut last month won't be enough to make a meaningful dent in the RBA's inflation target gap, so more needs to be done.
4. With the Fed leaning towards an easing, this diminishes the likely effectiveness of the AUD depreciation channel, so the RBA will need to do more than if they were keeping policy unchanged. Indeed, the AUD has recovered back to over 0.70 since its run at 0.68, and the RBA would probably like to see it back below 0.70 again.

All those against...

On the other side of the argument:

1. Since last month's decision, there has been minimal newsflow - services and manufacturing PMIs have actually improved. 1Q19 GDP at 0.4% wasn't all that bad. The labour data was weak, but that often precedes a better month, with part-time jobs converting to full-time. Importantly, we have no new data on inflation or wages.
2. Knowing full well they have limited ammunition, the RBA will be keen not to squander it unnecessarily. If a cut isn't needed this month, then a further rate cut is best saved until it *is* needed. It would be awkward to need to cut in several months and have nothing left.
3. The Trade war hasn't actually got any worse, and the Osaka meeting at least opens the door to a deal at some stage, though maybe not imminently.
4. The Fed didn't cut at their last meeting, though it looks pretty clear that it is only a matter of time. Nevertheless, there is no catch-up to be done.

And the winner is...

For completeness, here are some of the most recent quotes from RBA governor, Phillip Lowe, with our take on whether they represent a marginal argument for cutting (dovish) or a pause (hawkish).

- Philip Lowe is "very hopeful" that policy rates will not need to go into negative territory (hawkish)
- "A cut of a quarter percent in interest rates has helped but realistically, it, by itself, is not going to be enough" (dovish)
- "...it's reasonable to expect a further cut in interest rates at some point, whether it will be (at

the July 2 policy meeting) in Darwin or at some other point. We'll have to wait and see."
(dovish)

- "I don't expect that we'll have to get down to the very low interest-rates that other countries did. We have the capacity to do it if we need to" (hawkish)
- "What we're hoping to do is put ourselves on a better path and we don't need a massive change in interest rates to do that." (hawkish)
- "Fiscal policy and structural policies have a role to play, so I'm hopeful, and I think it's realistic to expect us to be able to keep away from these very low rates and unconventional measures." (hawkish)
- "It's clearly the case that a weaker U.S. dollar, whether that would come from lower U.S. interest rates, would be a complication for us. Because a weaker U.S. dollar, all else equal, means a stronger Australian dollar and we don't need that at the moment. (dovish)

As we said at the beginning, it doesn't really matter all that much what the RBA does at this meeting. We think the balance of risks is actually that the RBA pauses, but they will raise rates soon after if so; in the greater scheme of things, the difference between a cut and a pause is marginal.

AUD: the long-term outlook remains clouded

The trade truce between the US and China has been a short-lived boosting factor for AUD, as a weak Chinese PMI read lifted concerns on the export-oriented Australian economy. Given such contrasting drivers, the RBA meeting will be crucial to either fuel a further drop or a rebound in AUD/USD.

We believe that, on the day, the balance of risks for the AUD appears skewed to the upside, considering that the markets may have overstated (78%) the probability of a rate cut at this meeting. Furthermore, the persistent market's short positioning on the AUD suggests a higher potential for upside pressure as positions are squared.

In the longer term, external factors will likely be the predominant drivers of AUD/USD and the lack of a clear resolution in the US-China trade tensions suggests that a re-escalation is still possible. A cut in July or August by the RBA may, therefore, have a limited impact on the long-term AUD outlook. As long as the central bank maintains its easing bias, the upside potential for AUD will likely be limited, leaving it to trade-related news to move the market.

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Thailand: Weak June inflation provides another reason for a rate cut

We continue to expect a 25 basis point cut in the Bank of Thailand's policy rate in the current quarter. However, that would be a mere reversal of the hike in late 2018, not much of a stimulus to the sagging economy. We are now adding one more 25bp rate cut to our policy rate forecast in the last quarter of the year



Source: Shutterstock

0.9% June and 1H19 inflation rate

Inflation slides below 1%, again

Thailand's consumer price index (CPI) rose by 0.9% year-on-year in June, slower than the consensus of 1.1% (we expected no change from the 1.2% rate of inflation in the previous month). Core inflation of 0.5% YoY was in line with expectations of a slight slowdown from May. Food and transport have been the key inflation drivers recently. A sharp negative swing in transport inflation

(-1.6% vs. 0.1% in May) more than outweighed an acceleration in food inflation (3.1% vs. 2.8%).

The year-to-date inflation rate also is 0.9% - unchanged from the same period last year. We expect the inflation outturn for the rest of the year to remain benign, especially with strong currency appreciation this year keeping imported inflation at bay and anaemic domestic demand limiting any upside at home. The Commerce ministry cut its 2019 inflation forecast to 1.0% from 1.2%. Our 1% annual inflation forecast remains on track though with the risks tilted more to the downside than the upside.

Strengthening calls for BoT easing

This inflation data further strengthens our call for Bank of Thailand policy easing. The case for easing is very clear (see our latest note explaining [why the central bank should ease policy](#)). It's not just us, the government has also added its voice to the easing cause. On the day the BoT policy meeting started last week (26 June) when the bank left policy on hold, Deputy Prime Minister Somkid Jatusripitak said that "It can't go against the trend if the economic situation continues to be like this".

While the BoT left the policy rate unchanged last week, the statement was largely dovish and was accompanied by a downgrade of the central bank's growth forecast for 2019 to 3.3% from 3.8%. We take this as a signal that a rate cut is just around the corner. We continue to expect a 25bp rate cut in the current quarter, more likely at the next meeting on 7 August rather than at the 25 September meeting. However, that would still only be a reversal of the hike in late 2019, and not provide much stimulus to a sagging economy. We are therefore adding one more 25bp rate cut to our policy forecast in the fourth quarter, taking the policy rate to 1.25% by end-2019.

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