

Good MornING Asia - 2 October 2020

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It's payrolls day today

There's a very good piece by James Knightley on today's [US non-farm payrolls release](#), which notes how the rapid job gains of recent months are now slowing. The consensus view for non-farm payrolls today is for 875 thousand new jobs to be created (1.371 million last time), and for the unemployment rate to drop to 8.2% from 8.4%. In recent months, the consensus has been too conservative on the unemployment rate numbers, so if that trend continues, it could come in a bit lower still.

Anyway, the US labour report is a statistical lottery, so let's not spend any more time on that. Instead, one other comment in JK's note caught my eye - namely the rise in the August core PCE inflation rate to 1.6%.

Now, the US Fed has recently saying stated that:

1. rates will not be increased until 2024 at the earliest and;
2. that rates would also not be raised until inflation exceeded the 2% target for some time.

This raises an interesting question. Suppose the PCE deflator measure of inflation does indeed rise

above 2% and does so quite soon. What will the Fed do then? I actually think the US beating its inflation target consistently is very unlikely in the near term. But on the off-chance that this does occur (I've been wrong before!), the Fed's options include:

- to do nothing, and simply live with it, which will see longer-dated bond yields powering higher, which could weigh on growth (10Y US Treasury yields did spike above 0.7% yesterday);
- Or it could renege on previous date-contingent promises, saying conditions had changed, but meaning a loss of credibility for all future-forward guidance as they build a reputation for lying, or incompetent forecasting.

Neither option is a good one, which is why I have written in the past quite critically of these forward guidance measures.

Why this is particularly interesting right now is in the context not of the US, but of the Eurozone, where the ECB is, by all accounts, also mulling taking a different inflation target approach along similar lines to the Fed. Preliminary EU inflation for September is released today, and the headline rate is expected to come in at -0.2%YoY.

But we also have good historical examples of what happens when a central bank raises its inflation target, in the form of the BoJ. They raised their inflation target from 1% to 2% in January 2013. For the record, their inflation now stands at a "heady" 0.2%YoY.

The lessons from all of this are numerous and too complicated for a short note like this. But they include being very, very careful about what you promise, and also not fighting a symptom of weak demand (low inflation), especially when you have limited tools available to fight its cause. Not that anybody at either central bank will care what I think, but forewarned is forearmed as they say...

Quiet day in Asia today

There isn't much on the Asia Calendar today. Japan has just released its monetary base figures for September, and they show another pickup, after the moderation exhibited since June. The monetary base now stands at JPY606tr, up quite a bit from the JPY582.9tr recorded for August.

10Y JGB yields have been nosing higher in recent weeks, so this could reflect the BoJ's resolve to try to push them down again to their 0% target (currently yielding 0.025%). We might anticipate outright purchasing picking up pace until the JGB yield closes in on 0% again.

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Philippines: BSP opts for prudent pause though inflation is poised to slow

Philippines' central bank has opted to hold interest rates steady even though inflation is expected to decelerate further



BSP keeps rates steady with inflation expected to be benign until 2022

The Bangko Sentral ng Pilipinas (BSP) opted to keep interest rates unchanged at 2.25% even as it lowered its inflation forecasts all the way out to 2022. BSP unveiled its latest expectation for the inflation path with price gains likely to settle at 2.3% in 2020, 2.8% in 2021 and 3.0% in 2022. The central bank believes that price pressures will remain subdued over the policy horizon with risks to the outlook tilted to the downside. Governor Benjamin Diokno signalled previously that he would pause for “at least 2 quarters” to allow the recent flurry of moves to take root. To date, the BSP estimates it has released up to Php1.5 trillion into the financial system, helping to keep borrowing

costs low to aid the recovery.

We do not expect BSP to adjust monetary policy in the near term given that the real policy rate remains negative with headline inflation at 2.4%. Governor Diokno will continue to monitor price developments over the policy horizon to determine if further policy action is required. The central bank, however, did note the key role of fiscal policy in the pandemic response, with the BSP hopeful that the recently passed fiscal stimulus package would complement the string of rate cuts and infusion of liquidity.

BSP approves second cash advance to national government

Investors had priced in a pause from the BSP, as Governor Diokno had signalled that monetary policy would likely be accommodative for at least two years, with the economy currently recovering from the fallout from Covid-19. BSP approved the PHP540 billion cash advance to the national government via a repurchase agreement to help finance relief efforts. Just recently, BSP closed out a PHP300 billion cash advance to the national government, with fiscal authorities promptly securing a more substantial fresh line of credit worth PHP540 billion. The second tranche of cash advances will have a marginal impact on inflation and the currency but successive rounds of such agreements may eventually call into question the central bank's independence. BSP has justified such arrangements given the urgent need to help finance government outlays to offset the economic downturn, pledging to wind down such extraordinary measures when economic activity normalises.

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Indonesia: Inflation still below target but BI's hands remain tied with IDR pressured

Depressed demand keeps a lid on prices as GDP outlook dims



Source: t-bet

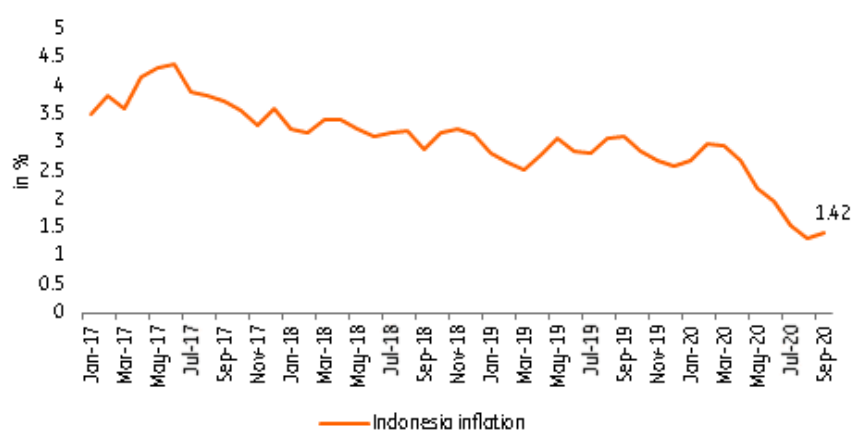
1.4% CPI inflation

As expected

September inflation at 1.4%, remains below target

Price gains remain subdued in Indonesia with the economy likely in recession due to the pandemic and the latest CPI inflation at 1.4%, in-line with expectation. Economic activity is on a downtrend, with lockdown restrictions remaining in place in the capital of Jakarta as daily Covid-19 infections accelerated in September. This marks the third month that inflation remains below Bank Indonesia's (BI) target of 2-4% and we expect inflation to remain subdued for the balance of the year with the outlook for growth dimming.

Indonesia CPI inflation



Source: Badan Pusat Statistik

Bank Indonesia likely on hold as IDR weakens

Despite inflation slipping below target for a third month, we expect Bank Indonesia to keep policy rates unchanged given the recent currency struggles. IDR has been pressured of late due to concerns about the growth outlook, with officials downgrading their GDP projections for the year. BI's hand will likely be stayed from any further rate cuts, despite the need to provide the economy with a shot in the arm, as Governor Warjiyo opts to prioritize currency stability in the near term while providing support through other macroprudential measures such as recently announced changes to rules on liquidity loan access.

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