

Good MornING Asia - 21 February 2019

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In this bundle



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By Robert Carnell



Asia Morning Bites

ASEAN Morning Bytes

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By Nicholas Mapa

Opinion | 20 February 2019

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It's all an illusion

Short of reducing some of the inherent demand at ongoing Treasury auctions, the glacially slow roll off of the Fed's maturing assets has no relevance for financial markets. That is a pretty bold statement and is almost right except for one thing. Financial markets think it is relevant. That, therefore, means that it is. This roll-off does not deplete bank reserves. It does not limit the financial sector's ability to extend loans. It has, since it's initial use to buy assets, little impact on the current price or yield of existing assets, though I will accept an argument that it keeps the term premium on longer-term bonds artificially low (negative) as until a shortage in overnight dollars re-emerges in the distant future, there is really no need to reward locking yourself into a longer-term asset with a higher yield.

Indeed, any suggestion that the "balance sheet" effects of quantitative easing had an effect on financial markets by limiting the supply of risk free assets and encouraging the purchase of equities, and higher risk credit, was surely totally undermined when the current tax reform flooded the market with Treasury bills and notes to fund the rapid increase in the budget deficit. Sure we can add the economists "everything else being equal..." qualifier to this. But when does that ever hold?

So the FOMC's strong hint that the balance sheet roll off might end by the end of the year is simply

an extension of the smoke and mirrors approach to monetary policy that has been entrenched in recent years. This seeks to influence behaviour by doing and saying things that on their own, have little meaning, but which collectively, are taken to be important. As such, they can work...a bit. Though it takes huge sums to have any significant impact, as the trillions employed in QE have demonstrated.

I am in a vanishingly small minority calling the "Emperor's new clothes" of modern monetary policy a bluff. And perhaps I should shut up. If others begin to agree, none of this will make a blind bit of difference, and central banks will appear even weaker than they already do now. For now, markets are responding positively to this. The USD continues to look a bit soft, and that is helping to lift Asian FX.

Still some scope for a further hike this year

While the proposed end of the balance sheet roll-off might be providing some support to markets, the FOMC minutes have not written off further rate hikes this year altogether. ING still sees room for one further hike this year. And I fully share the house view on this, though it is subject to the lags inherent in the inflation process and monetary policy. And there may still be a horse race at work between the slowing parts of the economy (business investment and property) and those parts that are still red hot (labour market). Time will tell, but it is possible that the peak Fed funds has already been reached.

UK political implosion

I don't want to spend time lamenting the abysmal debacle that is the Brexit negotiation. Wake me up when it is all over. The pound is getting battered. And rightly so. Rating agencies are adding to its woes talking of downgrades. That won't cut any mustard with those in the Conservative clique, the European Research Group (a more inappropriately named group has arguably yet to be devised).

What I will say, however, is how interesting it is that the apparent implosion of UK politics is happening from both sides of the political spectrum, with Labour and Conservatives alike abandoning their mother parties. This is coalescing into a new movement around a moderate centre party. In all of the political madness that has gripped much of the world in recent years, with swings to various hues of populism, this is a rare backlash towards moderation and pragmatism, and away from dogma and nationalism. The only other instance I can think of is the surprise election of President Macron in France. Cries of "traitor" in social media only make these people seem more principled. I wonder if it could catch on?

Asia Day ahead

Australian labour data is out at almost the time this note gets distributed, so if it shows anything worth reporting, we will cover it separately. The consensus is pretty meaningless for this choppy data. But it isn't too far from our own house view of a further 15K rise in employment, with the full time/part time split as ever being important.

Bank Indonesia is meeting today - we don't expect them to change policy rates. Their primary concern is still addressing the current account deficit, which won't be helped by cutting rates. Though if they make progress on the current account, then a small cut could still be a possibility later in the year.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

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EM Space: Focus shifts to not so dovish Fed, EM rally seen to slow

- **General Asia:** With limited developments on the trade front, the focus shifted to the Fed minutes which showed that although most FOMC members were in favor of a pause, a good number of officials still believed that a rate hike sometime in 2019 would be needed if data evolved positively.
- **Thailand:** In a mixed message, the Bank of Thailand's policy minutes noted 'gradual' and 'data-dependent' rate increases, yet a likelihood of an 'accommodative' policy stance in the period ahead. The BoT views recent THB strength in line with the emerging markets. The softer USD has pushed the THB to its strongest level since October 2013, undermining our view of the pair re-testing 32 in the near term on rising political uncertainty. But we remain confident about our view of the BoT leaving the policy unchanged this year.
- **Indonesia:** Bank Indonesia (BI) meets to decide on policy later on Thursday with market consensus pointing to a pause from the central bank. After hiking rates aggressively in 2018 to stave off a run on the IDR, BI is seen to leave rates unchanged with the currency recouping roughly 2.5% year to date. Although Governor Warjiyo has projected BI to retain its hawkish stance, given IDRs strength, BI is afforded some space to keep rates steady to

boost the economy going into the April elections.

What to look out for: US-China trade talks

- US durable goods (21 February)
- Indonesia policy meeting (21 February)
- ECB Draghi speech (22 February)

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

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