

Good MornING Asia - 21 June 2018

The Asian central banks are busy contemplating monetary policies. Yesterday the Philippines central bank hiked the policy rate by 25bp, the second hike in as many months, but Thailand central bank kept rates unchanged. Taiwan central bank is widely expected to keep the policy on hold today.

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Sense spoken in Sintra

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Powell says some words

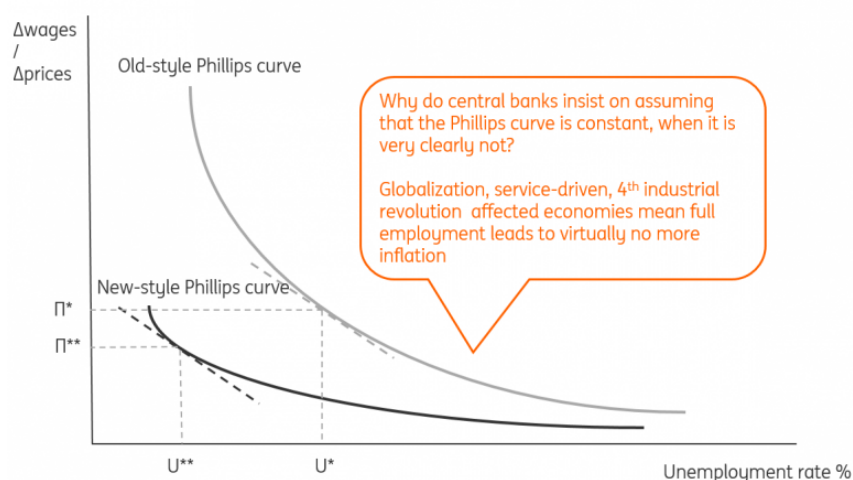
Central bankers from around the world have got together in Sintra, Portugal, to top up their tans and talk shop. I'm liking quite a lot of what I hear (unusual, I am quite hard to please), and it is not all from the big guns.

The RBA's Governor Lowe, said something that on the face of it, seems unremarkable, but has strong implications: "The system we're operating in looks less inflation-prone than it once was," he added that this was not something central bankers were finding easy to accept.

True, but more importantly is what this means for monetary policy. What it does not mean is that this is a free ticket to easier monetary conditions, though it does mean that the optimal trade-off between a little less unemployment and a little more inflation will happen at lower levels for each. It also suggests that traditional inflation targets of 2% might well deliver too easy a policy mix, as central bankers strive to drive inflation up, and in so doing, lead to a misallocation of credit, and support for unproductive activity. Ever wonder why productivity growth was so low? Look no further than your friendly neighbourhood central banker. Lowe seems to be getting it, but are the others?

Promisingly, after scaring markets a little at the last FOMC meeting with the accelerated pace of tightening illustrated by the dreadful and misleading dot-diagram, Jerome Powell also seems to be getting it. "The US economy has changed in many ways over the past 50 years" he remarked: Yes Jerome, it has. which means you don't have to run monetary policy the same way as in the 1960s. Powell suggested that the path ahead would continue to be gradual, which is encouraging. He also said, and this is important because he denied this at the FOMC meeting, that "Changes in trade policy could cause us to have to question the outlook...for the first time, we're hearing about decisions to postpone investment, postpone hiring". Perhaps the only surprise here is that he didn't think this before. If only the US President were to start to understand the impact of trade wars...

Out with the old, in with the new (paradigm?)



Source: ING

May wins a vote

She hasn't won one for a while, so it is noteworthy that UK PM, Theresa May, has won a vote to reject an amendment by pro-European rebels to get a substantive vote on whatever deal (if any) she secures from the EU. May says Parliament will get a vote to accept or reject any deal, but as a 'take it or leave it' vote. She does not want to be sent back to Brussels to argue for changes to any deal secured. Her argument is that to give parliament (in other words, opposition parties as well as government) a vote on any deal weakens her bargaining position, as whatever she secures may not receive parliament-wide backing. Failure yesterday to win might have cost May her job, and might have brought the Conservative government down. But there are still miles to go, and little sign of any emerging deal with Europe yet. This will be a long summer for PM May.

The Bank of England has a meeting

Our colleague, James Smith, has written [an excellent piece](#) on today's Bank of England (BoE) decision. but for those of you who are rushed for time, here's the gist: The BoE wants to be ready to hike if necessary, with August the most likely window for any hike if the data supports it. After that, Brexit wrangling will probably keep the BoE on the sidelines, depending on how the negotiations go, perhaps for a long time. As well as Brexit, the decision to hike later this year will also depend on the run of data. Here, apart from some slightly better wages data (labour supply drying up as European's race for the exit?), the newsflow has been hugely unconvincing.

So August remains on the cards, but with a history of false "guidance", the BoE will probably be a little more tight-lipped than usual at today's meeting.

Day ahead - not much

Today's Asian calendar is mainly second-tier stuff, Thai customs basis trade data (unlikely to provide support for the Baht), Malaysian FX reserves etc. We do get the Taiwan Central Bank Meeting - but [no change is expected from them](#).

The Philippine Central Bank (BSP) met yesterday and hiked 25bp. [We expect more hikes ahead](#) as they battle to stabilize the peso. But we're also not convinced that this attempt to prop up the currency will succeed on its own.

With the exception of the Bank of England meeting, the G-7 is also quiet. French confidence indicators provide about the only interest later on.

Philippines central bank on a stabilisation path...for now

The central bank raised policy rate by 25bps to 3.5% after last month's tightening, in a bid to stabilise inflation expectations. We think another rate hike is possible later this year and two more in 2019 to moderate the peso's depreciation back to around two percent in 2019



Source: Shutterstock

3.5%

Policy rate

Second consecutive hike in two meetings

As expected

Philippine's central bank hiked the overnight policy rate further not only to stabilise inflation expectations but also bring expectations within the target range over the policy horizon.

Bangko Sentral ng Pilipinas (BSP) expects inflation to remain elevated in 2018 and average at a downwardly revised 4.5% from the previous forecast of 4.6%. The BSP expects inflation to slow down to 3.3% which is lower than the previous forecast of 3.4%. Bloomberg consensus still expects

around 3.5% inflation for 2019.

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The moderation of inflation reflects in part the government's efforts to address supply-related price pressures, slower oil price increases and more positive base effects. Headline inflation is seen to moderate or possibly stabilise starting this month. However, the peso is likely to remain under pressure for various reasons – deteriorating external payment balances, strong fiscal stimulus on top of favourable household and business spending and emerging market-negative external developments including a faster pace of US monetary tightening and trade fears.

The peso has been the worst performing Asian currency year-to-date losing almost 7% and recently trading at a 12-year low. Although the pass-through impact of inflation has moderated over the past decade, a significant depreciation still contributes to inflation pressures and fuels concern of inflation remaining at elevated levels.

We expect the tightening to help contain such concerns.

However, the central bank's hawkish tendency would be needed as emerging market sentiment remains weak and US monetary tightening continues with added pressure on moderating global liquidity in the next few years.

Another rate hike is possible later this year and two more in 2019 to moderate the peso's depreciation back to around two percent next year from this year's likely average depreciation of six to seven percent which would contribute to stabilising inflation expectations.

Taiwan: Central bank to stay put

We expect Taiwan's central bank to leave rates unchanged 21 June for an eighth straight quarter amid concern the economy could be affected by trade wars between China and the US (through the supply chain of China's export goods.) The already low policy rate provides little room for a cut



Source: Shutterstock

Taiwan electronics industry at risk

Taiwan is caught in the middle of the US-China trade war and is deemed to face increasing risks of an economic slowdown via its electronics industry. This sector has served as part of the supply chain for Mainland China's smart-device manufacturing. If the US imposes tariffs or another sanction on Chinese smart-devices, Taiwan's electronics industry will suffer.

The most likely scenario is that Mainland China buyers will ask for lower prices for parts. And buyers will possibly buy fewer parts if they expect lower export volume due to the tariffs. Put simply, Taiwan's electronic producers could face lower selling prices and sales volume if the US imposes 25% tariffs on Mainland China's high-tech goods.

GDP growth to edge lower

Even though the government has put together some policies to restructure the economy, we cannot see a new growth engine arising. The economy is still very dependent on electronics. As a result, GDP growth will likely peak in 2Q18 at 3.1% year on year from 3.0% in 1Q, followed by growth of 2.4% and 2.0% for 3Q and 4Q18, respectively.

The central bank will stay put

As the economy faces higher risks from global trade wars, the central bank won't be raising interest rates. But it's not good timing to lower rates either. The policy rate is already at a low level of 1.375% and cutting it would do nothing to reduce the risk of a trade war. The Taiwan central bank, just like the economy, is now trapped by escalating tensions between Mainland China and the US, and as such, we don't expect any policy rate change in 2018.

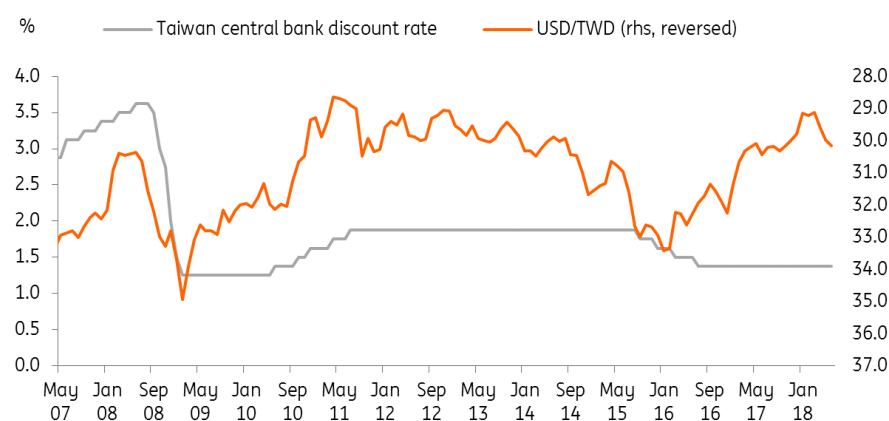
Even with a pause, TWD would weaken

With a possible negative effect on the electronics industry, previous capital inflows into Taiwan's stock market could turn to outflows in the second half of the year. Together with a strong dollar from escalating trade tensions and European political uncertainties, we expect the Taiwan dollar (TWD) to weaken against the US dollar through the rest of the year to 30.60 at the end of 2018, that is equivalent to a 2.5% depreciation of TWD against the USD.

The Taiwan central bank, just like the economy, is now trapped by escalating tensions between Mainland China and the US

This would support exports, but only slightly. If the US were to impose a 25% tariff on Chinese high-tech goods which affected parts produced in Taiwan (thus lowering prices and sales volumes), a marginally weaker currency wouldn't change Taiwan's weaker growth trend.

We expect TWD to weaken even as central bank stays put



Source: ING, Bloomberg

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

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