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Surprise, surprise

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By Robert Carnell



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Source: Shutterstock

Bets on RBA rate cuts growing

The RBA's Governor Lowe testified this morning to the Australian Parliament and expressed surprise at the AUD's reaction to the coal unloading ban at the Chinese port of Dalian. I'm surprised he was surprised. I'm also surprised to see how many people are now rushing to predict rate cuts from the RBA, with one well known Aussie pundit now calling 2 cuts.

I make these comments from the relatively steady position we have been viewing Australia from for some time. Way back last year, we took a more dovish line than the consensus, which was firmly looking for eventual hikes. We felt the risk back then was two-way. Governor Lowe now does too. But the market seems to be rushing headlong into predicting cuts, in spite of the very strong labour market data yesterday.

Lowe himself this morning suggested that there was nothing particularly alarming going on in the property sector. We concur. And although late to the two-way-risk party, his comment that the outlook is not bad, but the risks are up, remains firmly in the neutral camp. Others may rush to call the next move as a cut, but if its still years off, isn't the right message that the next move is no move? Isn't being early almost as bad as being wrong? We won't be joining the herd just yet.

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More positive noises on trade - no response from USD

The rule of thumb that positive trade news in the trade dispute between the US and China will result in a weaker USD, appears not to be working anymore. However, I think the rule of thumb is still working, it's just that none of this is really news anymore. The market seems to have come around to the idea that there will be a deal of sorts. China's commitment to take on another \$30bn of agricultural goods is as welcome as it was entirely predictable. No doubt we will hear something similar on LNG in the coming days. Then machinery. All things China needs. This is not a breakthrough, it is self-interest at work.

Likewise, the apparent olive branch offered by President Trump over Chinese tech suppliers shows that the US president also recognizes the value in a positive announcement on the trade war. This is all good, it supports (rather than drives higher) risk assets. The risk is now all on the downside in case the prospects of a deal flounder. That would put the USD back on a strengthening tack,

Bullard says Fed went too far in December

Its always interesting to report on St Louis Fed President, James Bullard. For me, although I don't always share his view on rates, I find him one of the most thoughtful of FOMC members, and also prepared to challenge the orthodox view. He argued against the December hike, saying that this was too far. And he is now reported as saying that he thinks the Fed's normalization is done. We wrote yesterday that this was a risk to our house forecast of one more rate hike this year. I still think the house forecast is right. But don't dismiss Bullard. He is no crank. And the market seems to agree, with Fed funds futures showing a small, but perceptible downward slope over the coming years.

Like the trade story though, this dovishness seems to be fully priced in with little room for more. Another reason to be wary of any news that challenges that view.

Asia Day ahead

Japan's CPI for January is already out, and bang in line with expectations, staying at 0.2%YoY, and 0.8% ex-fresh food. The ex food and energy measure lifted slightly to 0.4% from 0.3%. This is insignificant and irrelevant for the Bank of Japan.

And from Prakash Sakpal:

Released yesterday, the minutes of the Reserve Bank of India's policy meeting held in early February, reinforced growth worries in support of the decision to cut policy interest rates by 25 basis points at that meeting. The decision wasn't unanimous though, as two of the policy committee members who voted for on-hold rates cited risks from a surge in fiscal spending, oil prices, already high non-food inflation, and rising household inflation expectations. And Governor Das, who voted to cut, favoured more policy accommodation to growth. That said, we believe the latest cut was the last this year.

Malaysia releases January CPI data. Inflation hasn't been a problem since the GST removal in June last year and it's unlikely to be one at least until the middle of this year. Thailand reports trade data for January with our forecast of steeper fall in exports swinging the trade balance to a deficit from a surplus in December.

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ASEAN Morning Bytes

General market tone: Risk-off. Risk sentiment may take a hit on disappointing economic data as global growth prospects dim.



EM Space: With trade talks ongoing investors continue to worry about global growth

- **Indonesia:** Bank Indonesia (BI) kept policy rates unchanged as expected with Governor Warjiyo pointing to macroprudential measures to boost growth in the meantime. With the IDR seeing some gains to start the year, BI opted to refrain from hiking but also appears averse to slashing rates any time soon as they preach stability. Unless we see a stark improvement in the current account position, BI may keep rates at current levels to help the IDR maintain some measure of strength.
- **Philippines:** Unofficial reports show that the Philippines posted a budget deficit of Php558.259 bn, much higher than the previous year's level of Php350.6 bn in 2017 as spending was brisk towards the end of 2018. This would mean the budget deficit was 3.17% of GDP, higher than the target of 3% for the year as government expenditures helped offset slowing growth momentum in the second half of the year.
- **Malaysia:** January CPI data is due today. Inflation hasn't been a problem since the GST removal in June last year and it's unlikely to be one at least until the middle of this year. A Bloomberg story quoted Finance Minister Lim Guan Eng saying that the government met the 3.7% of GDP fiscal deficit target in 2018, has completed the review of public projects, and is on its way to normalize state spending going forward. He added that the revival of

the \$20bn East Coast Rail Link project is on the cards.

- **Thailand:** January trade data due today is likely to show a steeper export contraction swinging the trade balance to a deficit from a surplus in December.

What to look out for: US-China trade talks and Draghi speech

- ECB Draghi speech (22 February)
- Malaysia GIR (22 February)
- Thailand GIR (22 February)
- Hong Kong inflation (22 February)
- Singapore inflation (25 February)
- Taiwan industrial production (26 February)
- Hong Kong trade (26 February)
- US GDP (28 February)
- Bank of Korea (28 February)
- Thailand inflation (1 March)
- Indonesia inflation (1 March)
- US core PCE (1 March)
- US PMI (1 March)

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Asia week ahead: Deal, no deal, or extended truce

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Source: Shutterstock

➔ US-China trade truce ends, or it doesn't?

One more week before we wake up to the 1 March deadline that marks the end of the trade truce between the US and China. It's not a hard deadline as President Trump recently suggested before the last round of talks currently taking place in Washington. We think this round of talks is unlikely to be the last round, given the scepticism, and with both sides miles apart – an extension of the truce appears to be the most likely outcome.

I can't tell you exactly about timing. The date is not a magical date because a lot of things are happening. We'll see what happens. - President Trump

For now, markets should take comfort in the fact that both sides are aiming for a deal, have started to outline it, and are working out agreements on the stickier issues. Nothing concrete yet, and we may not see anything until the next Trump-Xi meeting later in March.

Aside from the looming deadlines, the focus will be on China's Purchasing Managers Index data. The Lunar New Year holiday slack imparts downside risk to the consensus of little-changed manufacturing PMI from the January reading of 49.5.

➔ **The second Trump-Kim Summit may not be the last either**

The second Trump-Kim Summit takes place in Hanoi, Vietnam, on 27-28 February, and this too is unlikely to be the last meeting between the two leaders aiming to end North Korea's nuclear programme. There was little progress after the Singapore summit, with no significant indications by North Korea for complete de-nuclearisation, while President Trump seems to be in no rush to achieve it either as the US sanctions on North Korea continue.

Like the Singapore meeting, we may end up with too much fanfare and not any meaningful advance. However, the news that the North Korean leader is prepared to shut a main nuclear facility is a hopeful sign.

We're in no rush whatsoever, we're going to have our meeting... we'll see what happens and I think ultimately we're going to be very successful. - President Trump

The Trump-Kim summit is likely to overshadow economic news from South Korea where lots of activity data including business confidence and exports, as well as the central bank meeting is scheduled. Latest export data with deepening contraction isn't good news for the Bank of Korea after having hiked the policy rate by 25 basis points in late 2018. Our base case is a stable central bank policy well into 2020.

➔ **Things aren't looking too great for Asia's growth numbers**

Aside from February manufacturing PMI from the region, January industrial production data will be a guide to GDP growth in the first quarter, as weakening exports weigh down manufacturing and GDP growth.

Meanwhile, Hong Kong and India are the last Asian countries to report fourth-quarter GDP data for 2018, and we expect them to join the majority of regional countries who have posted slower growth. In our view, if India gets 6.6% GDP growth in 4Q18, this won't be great news for Prime

Minister Modi just before the election, though it would validate the central bank's policy rate cut earlier this month.

6.6% India's GDP growth in 4Q18
ING Forecast

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
Monday 25 February					
Philippines	-	Dec Budget Balance (PHP bn)	-	-	-39.1
Singapore	0500	Jan CPI (YoY%)	0.4	-	0.5
	0500	Jan CPI Core (YoY%)	1.8	-	1.9
South Korea	2100	Feb BoK Consumer Sentiment Index	97.0	-	97.5
Tuesday 26 February					
Hong Kong	0830	Jan Exports (YoY%)	5.0	-	-5.8
	0830	Jan Imports (YoY%)	-1.0	-	-7.0
	0830	Jan Trade Balance (HK\$ bn)	-10.6	-	-51.2
Singapore	0500	Jan Industrial production (MoM/YoY%)	1.5/-2.4	-/-	-5.6/2.7
Taiwan	0800	Jan Industrial production (YoY%)	-3.0	-	-1.2
	0820	Jan Money Supply (M2) (YoY%)	3.1	-	3.1
South Korea	2100	Mar BoK Business Survey Index, mfg	63.3	-	65.0
	2100	Mar BoK Business Survey Index, non-mfg	69.0	-	70.0
Wednesday 27 February					
Hong Kong	-	FY2019 Budget			
	-	4Q GDP (Q) (QoQ, SA/YoY%)	-/2.2	-/-	0.1/2.9
Thailand	-	Jan Manufacturing Index (YoY%)	1.5	-	0.8
South Korea	2300	Jan Industrial Production (MoM/YoY%)	0.2/-6.4	-/-	-1.4/1.6
Thursday 28 February					
China	0100	Feb Non-manufacturing PMI	54.5	-	54.7
	0100	Feb Manufacturing PMI	49.0	-	49.5
India	1200	4Q GDP (Q) (YoY%)	6.6	-	7.1
	1200	2019 GDP Annual (YoY%)	-	-	7.2
	-	Jan Fiscal Deficit (INR crore)	-	-	-15168.0
South Korea	-	7-Day Repo Rate	1.75	-	1.75
Taiwan	-	Peace Day Holiday			
Thailand	0730	Jan Current Account Balance (US\$bn)	3.7	-	5.0
Friday 1 March					
China	0145	Feb Caixin Manufacturing PMI	48.0	-	48.3
	-	End, or Extension, of Trade Truce with US			
India	0500	Feb Nikkei Manufacturing PMI	53.5	-	53.9
Indonesia	-	Feb CPI (YoY%)	3.0	-	2.8
	-	Feb CPI Core (YoY%)	-	-	3.1
Thailand	0030	Feb Nikkei Manufacturing PMI	49.8	-	50.2
	0400	Feb CPI (YoY%)	0.5	-	0.3
	0400	Feb CPI Core (YoY%)	0.7	-	0.7
Malaysia	0030	Feb Nikkei Manufacturing PMI	47.5	-	47.9
South Korea	0000	Feb Exports (YoY%)	2.9	-	-5.8
	0000	Feb Imports (YoY%)	5.8	-	-1.7
	0000	Feb Trade Balance (US\$mn)	4718.0	-	1294.0
	-	Independence Day Holiday			

Source: ING, Bloomberg, *GMT

Stable Yuan Memorandum: More about shutting the door on depreciation

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Source: Shutterstock

Defining a stable yuan

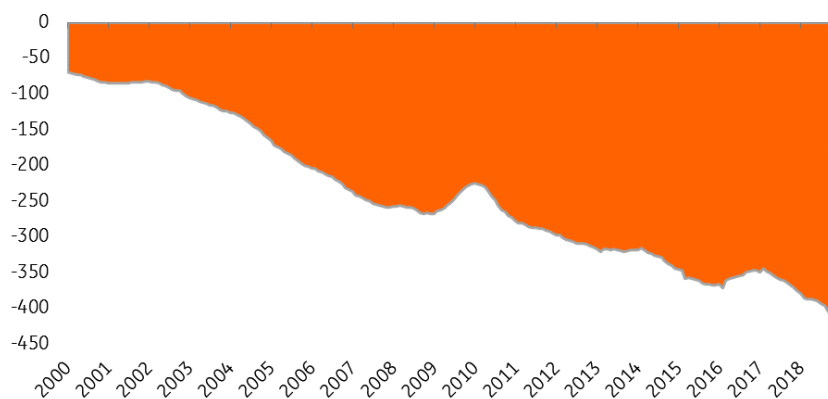
Reports emerging over recent days suggest that the US and China will somehow try to incorporate a soft commitment to stability in the renminbi into a Memorandum of Understanding (MoU) on trade relations. This MoU looks to be part of the preparatory work before a meeting between Presidents Trump and Xi in March in an attempt to diffuse the trade war.

We imagine any US-China currency pact would be short on detail and would loosely refer to the need to keep the renminbi stable, and that both sides would avoid competitive devaluations (the latter already a part of existing G20 policy).

We doubt there would be any detail on what constitutes a stable yuan, however. For example, we doubt the People's Bank of China would be backed into a corner by committing to keep the trade-weighted CFETS Renminbi index stable. And the IMF's annual work on renminbi fair value, using its External Balance Assessment model, looks too opaque to be highlighted. Actually that model, last produced in summer 2018, suggested the renminbi in real terms was anywhere between 13% undervalued and 7% overvalued.

Washington wants to fix the goods deficit with China

US goods deficit with China (12m rolling sum, USDbn)



Source: Macrobond, ING

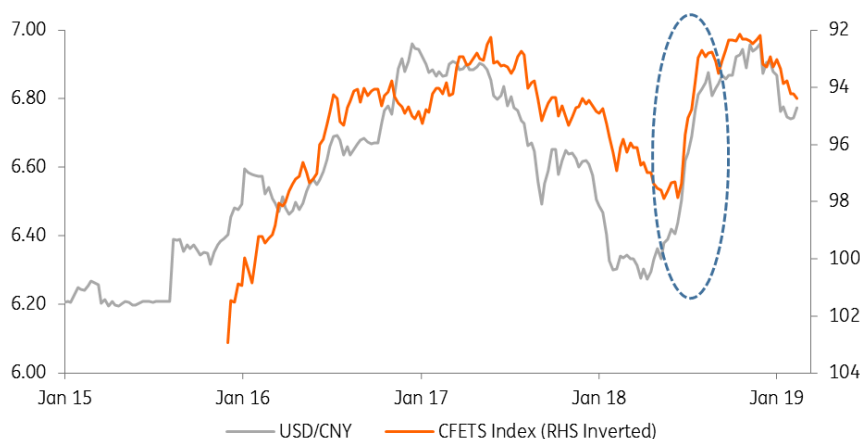
What do Beijing and Washington really want?

For the PBOC, it would like to have a currency policy that looks like a floating exchange rate. The central bank is trying to fulfil this ambition by allowing the USD/CNY to follow the dollar index in general.

For the US Treasury, we suspect a stable yuan means a stable USD/CNY – or at least a USD/CNY bilateral rate that doesn't trade substantially higher. Certainly, the core objective of Washington is to shrink the US\$400bn+ bilateral goods deficit with China, suggesting the US Treasury will have more interest in the bilateral rate than any CNY trade-weighted index.

While acknowledging the appreciation of the real trade-weighted renminbi over the last decade, the [latest US Treasury semi-annual FX report highlighted](#) that on a bilateral basis the renminbi had fallen back to a level last seen over a decade ago. Here, the US Treasury probably suspects that the 8% rally in USD/CNY last summer was not an entirely market-led move. In fact the CFETS Index (the renminbi versus a basket of 24 currencies) fell nearly 6% during this period, confirming independent CNY weakness here.

Washington doesn't want a repeat of last summer's CNY sell-off



Source: ING, Bloomberg

The unwritten understanding

We can't know for sure, but one could argue that the unwritten understanding of any agreement in the MoU could be for the PBOC to keep USD/CNY south of 7.00, such that China would be prevented from devaluing its way out of a sharp narrowing in its trade balance. It is also not in China's interest to sharply devalue the yuan, which could trigger a new round of capital outflows. Certainly we saw China's resistance to a weaker yuan last year, where authorities re-introduced both the counter-cyclical factor (greater PBOC control in the daily fixings) and measures to make it more expensive to sell the CNY forward.

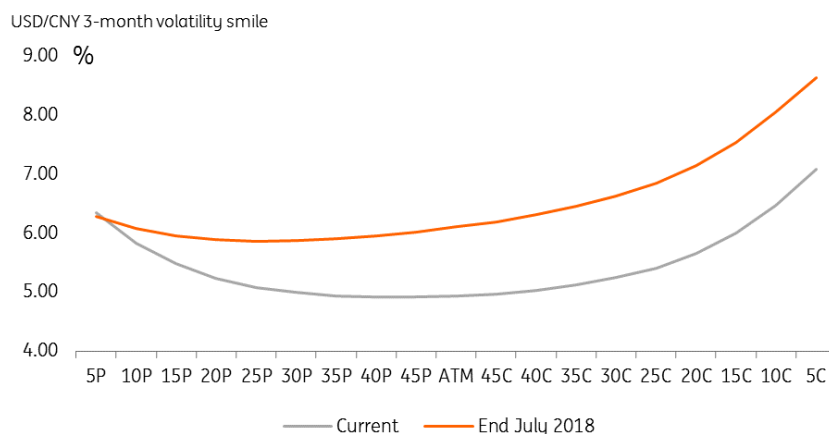
On the other hand, one could argue that yuan stability means just that - yuan stability. That could be interpreted as the USD/CNY just being left to track the DXY, which it seems is what the PBoC is trying to do currently. Fortunately, our views on DXY (topping later this year) would be supportive of such a strategy, such that USD/CNY should turn gently lower. However, we very much doubt - should the DXY surge for whatever reason - that Washington would be happy to see USD/CNY trading substantially above 7.00, even though the CNY basket was stable. It's just too difficult a message to get across to US voters - that it's a dollar move not a CNY move.

Market implications

Any agreement on the need to keep the renminbi stable could reduce the tail risk of a competitive devaluation in the renminbi. Again, Washington is more interested in its trade deficit with China (and the USD/CNY bilateral rate), than it is about an IMF-style need for a clean float in the renminbi. The FX options market is well on the way to pricing lower tail risk of a CNY devaluation, where the CNY smile curve now shows much lower implied volatility levels for low delta USD calls/CNY puts (see chart below).

Stability in USD/CNY and lower levels of volatility should be positive for Asian FX. Were the USD/CNY stability story to develop, CNY realised volatility could actually drop back (e.g. 3m USD/CNY realised volatility to 3% from 4% currently) helping Asian FX volatility lower across the board. Such a trend could be beneficial for risk-adjusted carry trades in Asia. This environment could see the Indonesian rupiah outperform its steep forward curve (where implied 3m yields through the Non Deliverable Forward are still a high 7.3%).

CNY tail risk is being downgraded in the FX options market



Source: Bloomberg

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Indonesia: Central bank keeps rates unchanged at 6%

Bank Indonesia left its key policy rate at 6%, looking to macroprudential measures to bolster the economy



Source: Stenly Lam

6.0% 7-day reverse repurchase rate

As expected

Bank Indonesia holds as IDR rebounds

The central bank opted to keep policy rates unchanged, a move expected by the market given the relative strength of the Indonesian rupiah in 2019. A dovish Federal Reserve has helped push funds back into emerging markets this year, lending strength to the IDR and helping it to post the second best performance year-to-date among its peers. In 2018, Bank Indonesia (BI) unleashed a flurry of rate hikes to help steady the currency but with the currency enjoying renewed strength, the central bank was not called into play. With concerns about Indonesia's current account struggles still fresh on investors' minds, BI Governor Perry Warjiyo will likely refrain from reversing course in the near term as he preaches stability while the government works to jumpstart reforms in the trade and tourism sectors to alleviate pressure on the current account.

With the Fed seen to be on hold at least for the time being, we can expect the IDR to enjoy some short term appreciation with BI likely to retain its current stance until we see some improvements on the current account balance. Warjiyo has also indicated that BI will likely rely on soon-to-be

announced macroprudential measures to bolster the economy after raising rates aggressively last year.

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