Good MornING Asia 22 February 2021

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In this bundle

Opinion | 22 February 2021

Rising yields aren't necessarily bad

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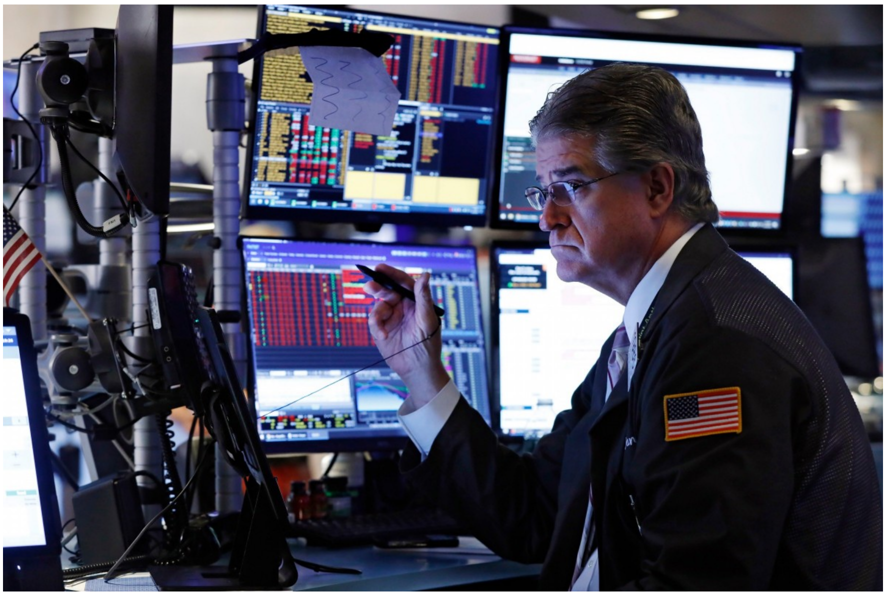


Source: Shutterstock

If you read nothing else, read this...

I do like to give a plug to others' work in this note, where deserved of course, and today, I would like to draw your attention to an excellent and also short article by John Dizard in the Weekend Financial Times. The article is called "Do not rule out a market panic next month", and breaks the golden rule of forecasters by giving both a forecast *and* a date. In fact, it only just manages to claw back some ambiguity (which we all normally hide behind) by adding "Do not rule out..." which essentially means that anything *can* happen, but if it does do this, then "...I told you so!". Clever, but not smug.

Dizard notes that there is a scramble for short-dated T-bills in the US which has caused their yields to drop. Dizard perhaps overdoes the scale of the decline - we are talking a few basis points in reality, though this is admittedly a large percentage of the yield which is practically zero anyway. But the message is not diminished by this, and is essentially the following "If large financial institutions are taking precautions against a market crash, then perhaps we ought to do likewise..." There is also a good refresher on convexity trading, which always gives me a bit of a headache, like cross-currency basis, but is put in such a way that even I can understand it.

So much for the plug, and I agree, the probability of some market sell-off is increasing with rising yields. But here's the thing, what we now seem to be witnessing, as much as a rise in inflation expectations, is a rise in real yields. To put this in primary school language, the rise in "bad" yields is being offset by a rise in "good" yields. That leaves the net effect a bit ambiguous - at least until I do some number crunching and see what is winning this battle - more on that later in the week if I have time.

We also have to acknowledge that although we are all aware that headline inflation is picking up and that even the run rate of monthly inflation numbers has picked up a bit, no one really expects inflation to push up and stay at levels that will require central bank tightening anytime soon, especially not the Fed or the ECB. And that means no mirroring movements here in Asia by our central banks. Moreover, let's just try to remember a little further back than 12 months. In December 2019, just a few weeks before Covid changed all our lives, 10Y US Treasuries happily yielded about 1.9%. And no one thought this was unreasonably high. Indeed, the equity market back then was powering higher.

And much as the financial media tends to focus on the impact of higher yields on equities and other risk assets, large parts of the real economy will benefit from higher yields. Ever wonder why there isn't much feedthrough from low rates to bank lending in many of our economies in the region? Well with economic activity weak, banks will be setting aside capital for potential default charges, and frankly, the price of money which they borrow short-term isn't much of an incentive when the long-term rates are barely any higher. This is still a maturity transformation business, and a steeper yield curve and recovering economy will help banks to lend more.

Higher yields are also an indication of expectations of a stronger macroeconomy, where it makes sense to lend to profitable companies, and where it is possible to make a return from doing so. And don't get me started on the large portion of many populations that is currently panic-saving to offset the anticipated shortfall in income in retirement from woeful returns on fixed-income investments. Some of them might be able to spend a little more freely in a higher yield environment.

In short, while there is every chance that we will see some fairly choppy market action if, as we suspect is the case, bond yields rise much further (that will be convexity at work), let's not get overly worked up about this. The economies of the world are still in a very early cycle upturn. There is still plentiful economic slack in most economies, and central banks really will be *very* slow to start taking away their stimulus. So any pullback may be more of a correction in a market that is still trending higher, and not necessarily the end of the bull-run. Bleeding out some air from over-inflated risk assets may be no bad thing if it breathes some life into the real economy.

The Wall St vs Main St argument is playing out in front of us as the adjustment from emergency policies unfolds, and there will undoubtedly be some unwelcome jolts along the way, but it isn't all bad.

Calendar

It is very quiet in both the G-7 and Asia today. There is lots of Fed speaker action over the course of the week. This includes Fed Chair Powell's semi-annual testimony. No one should imagine that he will be anything except very dovish.

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com

Snap | 18 February 2021 Indonesia

Indonesian central bank cuts policy rates as growth momentum fades

Bank Indonesia cut its key rate by another 25 basis points after downgrading growth projections

Source: IMF/Flickr
Perry Warjiyo, Governor of Bank Indonesia

3.5% 7-day reverse repurchase rate

As expected

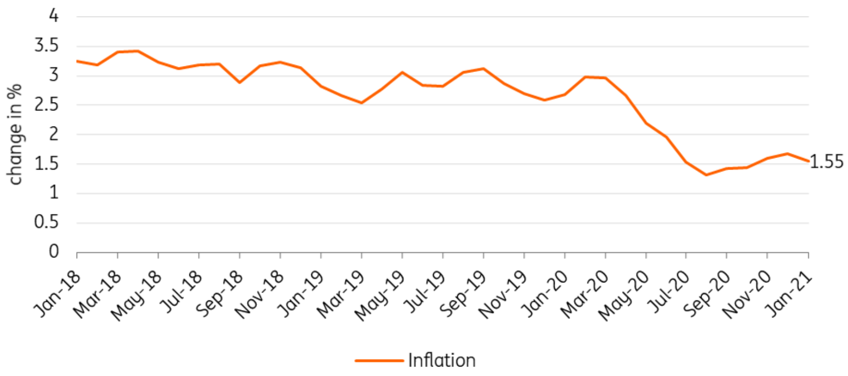
Bank Indonesia moved quickly to support sagging growth momentum

Indonesia' central bank cut the policy rate by 25 basis point to 3.5% in a bid to revive fading growth momentum.

With inflation below the central bank's 2-4% target and the economic recovery faltering, Governor Perry Warjiyo pulled the trigger to deliver another round of easing.

Days after finance minister Indrawati downgraded official growth projections, the central bank also tempered its GDP forecast to 4.3-5.3%, which was previously at 4.8-5.8%. But the central bank remains hopeful for domestic economic activity to recover supported by more fiscal stimulus and vaccination efforts.

Low inflation and fading growth momentum gave BI space to cut rates



Source: Badan Pusat Statistik

Lost in transmission? BI steps up efforts to bolster lending

It's worth noting that the emphasis on ensuring that the string of rate cuts delivered by the central bank would eventually transmit to lower borrowing costs and faster bank lending. Warjiyo highlighted the slow transmission of the central bank's easing, citing that banks had lowered borrowing rates by roughly 83 bps compared to the 125 bps cumulative rate reduction in 2020.

Nonetheless, the central bank hoped that banks would pass on the lower borrowing costs to consumers with bank lending now expected to grow between 5-7%.

On top of the rate cut, the Bank also unveiled new rules on lending to the automotive and property sector, with loans for automobiles now no longer requiring a down payment, in a bid to bolster demand for credit.

Easy on the easing

One other interesting development was the shift in tone.

After months of indicating the central bank's willingness to provide monetary stimulus and support the economic recovery, the central bank hinted that the scope for further rate reductions was now "more limited". The sudden shift in tone may hint at a more measured pace of rate cuts in the near term with the Governor suggesting that the central bank would select the proper tool to support the recovery.

Going forward, we now expect the Bank to pause in the near term as they monitor the recent pickup and global bond yields and what it could mean for both inflation and IDR stability in the coming months.

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

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