Good MornING Asia - 24 August 2018

So what has changed about the US economy? What will Powell talk about? For us, the biggest changes in the economy concern the consumption and production of virtual goods, and the flattening of the Philipps curve. Both suggest that central bank policy needs to adapt. But has it?

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Singapore

Singapore core July inflation provides the MAS with options

Against the backdrop of the unfurling trade war, we don't expect the Monetary Authority of Singapore (MAS) to tighten policy any further at its...

Thailand

Thailand: Economy isn’t screaming out for tighter policy, yet

But the central bank (BoT) has already started thinking about the timing of policy normalisation. Although we aren’t expecting any change to BoT...

Opinion | 24 August 2018

Powell speaks on a changing economy

So what has changed about the economy? What will Powell talk about? For me, the biggest changes in the economy concern the consumption and production of virtual goods, and the flattening of the Philipps curve. Both suggest that central bank policy needs to adapt. But has it?

The economy has changed...

I don't think the world of finance and economics is ready for a complete re-think on monetary policy. But given the changes that have taken place in the economy in recent decades, a complete overhaul would not be a bad idea.

What changes? Ask yourself, what did you spend money on recently? Did you get a new app? Did you buy a new i-book? Or upload a movie onto a tablet to watch on a plane flight? More and more, what we buy is a mixture of pixels, photons and bytes. In short, it exists only in electronic form, not in "reality". Our consumption of these goods has no implication for the scarcity of factors of production, and therefore for inflation. The "platform economy" does not only deal in virtual goods but also delivers real consumables, food, services. It drives prices down by making instant price comparisons possible, and by massively broadening our choice options. It is like the world has moved from being a textbook one dominated by oligopoly, to near perfect competition, and in a very short time. We can spend and spend and spend, but prices will barely budge.

Throw in automation and AI, and there is also the beginnings of an explanation for the flattening relationship between labour market tightness, and wages growth. Running short of workers? Buy a box of electronic wizardry to do their job instead. Seriously, there are boxes out there writing economic data reports already. My working days are numbered (at least in their current form). What about yours?

...central banks should too

So how have central banks changed? The short, answer is, they haven't. Almost all of the major central banks still follow inflation targets. And that target is usually 2%. Given what I wrote in the previous paragraph, there is no reason why targeting a 2% inflation rate should deliver a rate of credit growth consistent with stable financial markets. In other words, following the current targets is a good way to build up excesses that will deliver the next financial crisis. Something much lower than 2% might be more appropriate. There may be times when a negative inflation target is appropriate - this is quite different from deflation by the way). Sometimes, the target should be much higher. And there is no reason why a central bank model where inflation outturns are wrapped around employment gap methodology should give you the right policy responses when the Philipps curve has shifted flatter.

Central banks have, for the most part, resisted calls to adopt policy rule frameworks beyond the simple inflation target. That is, in my opinion, a very, very good thing. When the economy changes - your models will give you the wrong answer. And there has been a lot of pressure for such adoption of rules based frameworks by some members of the current US administration.

Yet if you take a look at such rules (see image above), you find that Fed policy is exactly in line with them. A 2% inflation-target Taylor rule with inertia and a 4.3% unemployment target, delivers a 2.19% Taylor rule recommendation. The current effective Fed funds rate is 1.92% - after the September rate hike, it will be 2.17% - a difference of only 2bp.

In short, unless Jay Powell announces the end of a static inflation target, and the incorporation of a credit growth target info the Fed's deliberations (only the ECB does this, sort of) then I shall be disappointed. I expect to be.

Back me or sack me - Turnbull waits for vote

The fate of Australian PM, Malcolm Turnbull hangs on whether the contender for his job, Peter Dutton, can get enough votes today. This is Australian politics as normal. Remember, Turnbull ousted former PM Tony Abbot in much the same way. This is survival of the fittest politics. Watch your back for knives.

While we wait on an outcome, the AUD is under weakening pressure. A resolution, almost any resolution, is likely to see the AUD rally. There are other reasons to expect some weakness in the AUD though. We aren't convinced that the economy is in as good shape as the popular view on Australia runs. An absence of RBA policy changes over recent years has allowed household debt to balloon. Meanwhile, the property market across almost the entire country is beginning to cool, and we doubt an about-face in lending standards by APRA will be sufficient, or fast enough to turn it round. So a bounce today, but then weaker.

Trade talks come to nothing - as expected.

China and the US have concluded their mid-level talks on trade, and they have agreed to nothing.

Overnight, the US has imposed tariffs on an additional $16 billion of Chinese imports, and China has reciprocated in like manner.

China is saying it will not even resume talks until the November mid-terms are over, viewing much of the US stance on trade as having a political motivation. It probably does. Maybe China is also listening to chatter about a possible impeachment of President Trump. We wrote about this yesterday before the file crashed and lost everything before publication. But if that had saved, it would have pointed out that impeachment is very rare, needs to be passed by the House of Representatives, and then needs the subsequent trial to be decided by a two-thirds super-majority of the Senate to remove the President. In short, If I were Trump, I would not be worried.

Were the unlikely to happen though, the market reaction could well be an unexpected rally in stocks and decline in the dollar (as a winding back of trade wars was factored in) and bond yields would likely rise.

Asia Day ahead

In Singapore, industrial production year-on-year growth was 7.4% in June, and will likely stay about that rate in July when data is released at 13:00 local time. It might be perhaps a smidgen weaker. Recent activity data for Singapore has held up reasonably well, and though some statistical flip to the month-on-month figures is likely for July, it won't likely make a significant dent in the production trend. With data holding up a bit better over the last month, we are less inclined to forecast a much weaker SGD. As one of the better performing currencies since April, USD/SGD 1.38 might prove to be close to the recent peak, and we anticipate it at roughly the same level by the end of the year.

In Malaysia, the removal of Goods and Services Tax dented CPI inflation sharply in June. Data today for July due at noon local time is expected to show that the GST impact continues to linger. Our forecast of a slight uptick to 1% YoY from 0.8% in June results from low base effects, especially in the transport component. The replacement of GST with the Sales and Services Tax (SST) in September, is likely to be benign. After one-off rises in July, we expect inflation to decelerate below 1% in August and remain there over the rest of the year. This, and slowing GDP growth are reasons we expect no change to central bank (BNM) monetary policy over the remainder of the year.

In Thailand, we have revised our end-year USD/THB forecast to 33.5 from 35.0 on the back of recent THB outperformance and as the central bank (BoT) monetary policy committee has already started thinking about the timing of policy normalization. However, we aren't forecasting any change to the policy this year because growth has already started to ease and inflation is likely to slip below the policy target in coming months. We need to see a significant shift in consensus within the BoT policy board in favour of tightening, from the 6-1 vote for no change at the last meeting, before revising our policy view.

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Article | 22 August 2018 China | India...

Asia week ahead: Bank of Korea policy standoff

The Korean central bank policy meeting will be a non-event. China’s August PMI will reflect the first full month of the trade war impact, while India looks poised to post a GDP slowdown

Source: Shutterstock

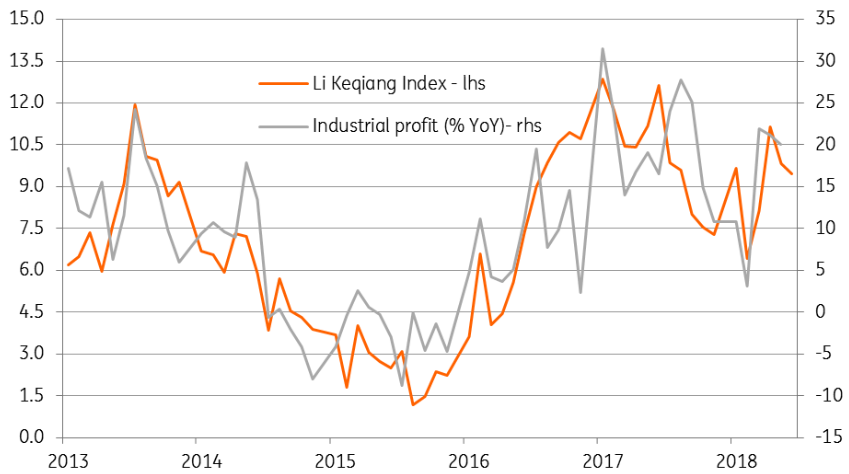
China: PMI to reflect full-month of trade war impact

The ongoing trade war with the US has put China’s high-frequency activity data under an intense spotlight. Next week's data includes industrial profits for July and the manufacturing and non-manufacturing Purchasing Managers Indexes (PMIs) for August.

The manufacturing PMI for August will reflect the first full month of the US-China trade war impact. The consensus is centred on our 51.2 forecast, unchanged from July, but the risk is tilted on the downside rather than upside.

Consistent with the Chinese stock market sell-off underway since the start of the year, industrial profit growth has slowed to 17.2% year-on-year in the first half of the year from 22% a year ago. This closely tracks the Li Keqiang index (the composite index of year-on-year activity growth, including growth in outstanding bank lending- Premier Li's preferred gauge of the economy) which shows the slowdown continued in July (see figure).

Li Keqiang Index points to slower profits growth



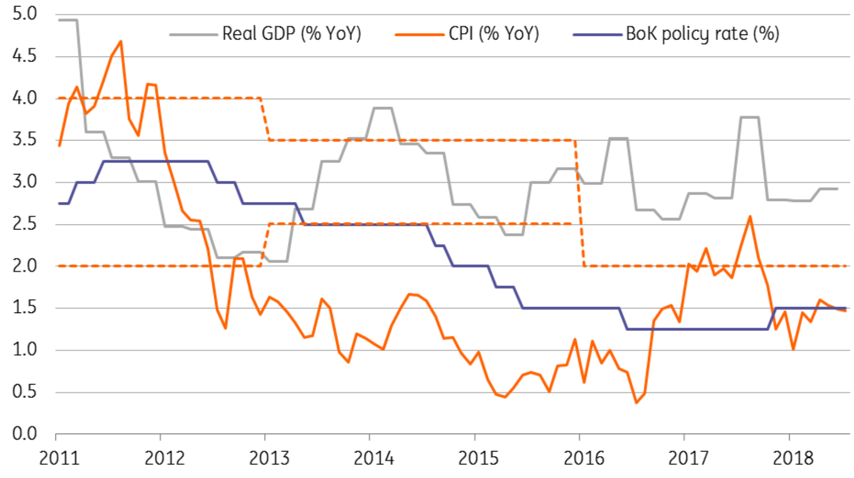
Source: Bloomberg, CEIC, ING

Korea: A big week ahead, though nothing exciting

After the usual end-of-month Korean activity data, the central bank (Bank of Korea) will hold its monetary policy meeting on Friday, 31 August. We aren't forecasting the BoK to change policy next week. Korea's GDP growth has been stuck under 3% for the last three quarters, and new job creation dipped to an eight-year low in July. A further escalation of the US-China trade tension also reduces the potential for any export-led growth recovery in the period ahead. We expect these risks to manifest in the activity data in coming months. With below-target inflation right now, the argument for the BoK to maintain its accommodative policy stance for the rest of the year remains strong (see figure).

Among the slew of activity releases next week, the forward-looking BoK Consumer and Business confidence indexes and July industrial production data for July will be under scrutiny for clues about the economy's performance in the current quarter.

No pressure on BoK to change policy



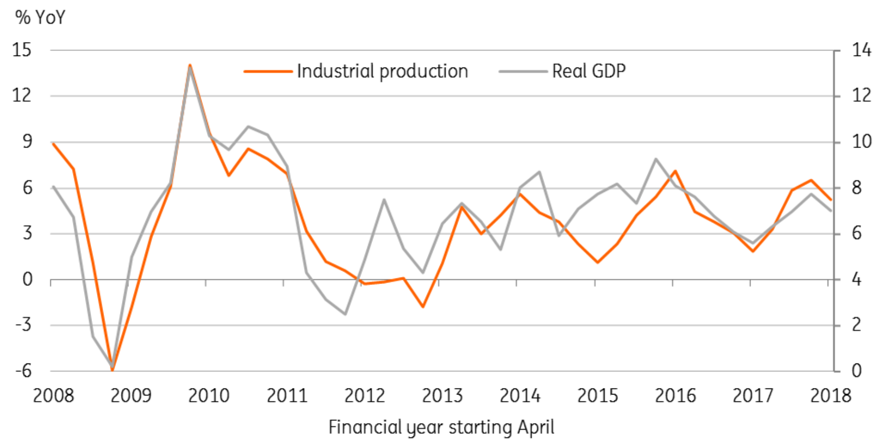
Dotted lines are BoK's inflation target, shifted from a range to point target in 2016.

Source: Bloomberg, CEIC, ING

India: A slowdown in GDP growth

India's GDP data for 1Q FY2018-19 (April-Jun quarter of 2018) is due. Underlying our projected slowdown in GDP growth is a slowdown in manufacturing (see figure). Export growth accelerated in the last quarter, though exports account for a small share of GDP (average 13% in the last five years). With an oil-led surge in imports and widening trade deficit, net exports have acted as a drag on GDP growth. We forecast a GDP slowdown to 7% YoY in 1Q from 7.7% in the previous quarter, not a good start to the year, the rest of which will remain exposed to greater global economic uncertainty and rising domestic political risk.

Manufacturing leads GDP slowdown



Source: Bloomberg, CEIC, ING

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Monday 27 August			
China	0230	Jul Industrial profits (YTD, YoY%)	17	-	20
Hong Kong	0930	Jul Exports (YoY%)	6	-	3.3
	0930	Jul Imports (YoY%)	9	-	4.4
	0930	Jul Trade balance (HK$ bn)	-42.1	-	-54.137
South Korea	2200	Aug BOK Consumer Sentiment Index	100.3	-	101
		Tuesday 28 August			
Thailand	0450	Jul Manufacturing Index (YoY%)	3.6	-	4.7
		Wednesday 29 August			
South Korea	2200	Sep BOK Business Survey Index, mfg	75	-	73
	2200	Sep BOK Business Survey Index, non-mfg	76	-	74
		Thursday 30 August			
Hong Kong	0930	Jul Retail Sales Value (YoY%)	11.8	-	12
	0930	Jul Retail Sales Volume (YoY%)	9.3	-	9.8
		Friday 31 August			
China	0200	Aug Non-manufacturing PMI	53.8	-	54
	0200	Aug Manufacturing PMI	51.2	-	51.2
India	1200	Jul Fiscal Deficit (INR crore)	-	-	83540
	1300	2Q GDP (Q) (YoY%)	7	-	7.7
South Korea	0000	Jul Industrial Production (MoM/YoY%)	1.7/3.1	-/-	-0.6/-0.4
	-	7-Day Repo Rate	1.5	-	1.5
Thailand	0400	Jul Current account (US$bn)	2.6		4.084

Source: ING, Bloomberg

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Article | 23 August 2018 China

Trade war: China retaliates but with a punchier list

China's decision to include automobiles in the retaliatory tariffs list is a more aggressive move than we expected, but for now the real concern is what the 'qualitatively measures' will be if the US imposes 25% tariffs on $200 billion of goods

Source: Shutterstock

As the US imposes 25% tariff on $16 billion of imported goods from China, China retaliated with the same amount but with a revised list of goods that contains automobiles, which we see as a more aggressive retaliatory measure.

> *Qualitative retaliations could include placing administrative measures on US companies operating in China or following the US lead and leveraging 'national security' to prevent American companies operating in the country*

The $16 billion revised tariff list from China includes medical equipment and automobiles when the

US administration would like to help American automobiles fare better in the international market. We see this list as more punchy than the previous one even the amount involved stays the same at $16 billion.

The dollar index has reacted in strengthening trend and the yuan weakened against the dollar.

What will the 'qualitative retaliations' be?

The uncertainty now lies in how China would retaliate qualitatively and this the main concern for markets rather than today's tariffs implementation.

If the trade talks between China and the US do not yield positive results this week, the US is set to impose another 25% tariffs on $200 billion of imported goods from China. The amount would be around half of the goods US imports from China, but China will only retaliate with tariffs on $60 billion because the US doesn't export as much. But China has repeatedly stated that it can retaliate qualitatively.

Qualitative retaliations could include placing administrative measures on US companies operating in China or following the US lead and leveraging 'national security' to prevent some American companies operating in the country. Given that, 'national security' examination has recently been added as a clause in foreigners' investment policies in China, this seems like a possibility.

Will there be any beneficiaries?

We are aware there could be some substitution effect.

Some economies may benefit by providing goods that are produced in China or the US. For example, Brazil soybean is a substitute for US soybeans, and similarly, some Asian manufacturers may now be in a better position to compete in export orders to the US. But these substitution effects won't be huge as there isn't enough time to rapidly expand product lines in such a short time.

But overall, both American and Chinese manufacturers are likely to face slower growth in manufacturing and trade-related activities or even record a fall. And this fall isn't just limited to the two countries; the global supply chain will face similar prospects.

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Singapore core July inflation provides the MAS with options

Against the backdrop of the unfurling trade war, we don't expect the Monetary Authority of Singapore (MAS) to tighten policy any further at its October meeting, but with growth and inflation data holding firm in recent months, the balance of risks has shifted back slightly towards more tightening.

Source: Shutterstock

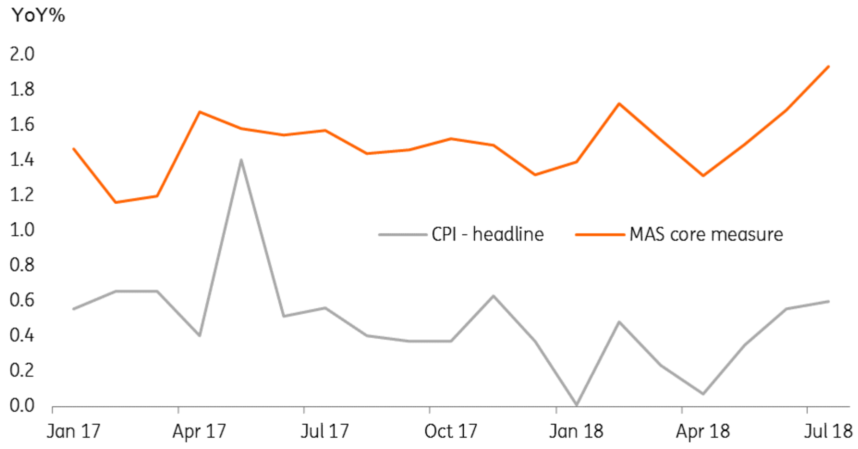
Recent activity data hasn't been bad, now the inflation figures are following suit.

Looking back over the last month, and Singapore's run of data has been a bit better than we had expected. At the end of July, Industrial production surprised on the upside, retail sales weren't bad, 2Q GDP was a slight miss, but is more about the past than the present, so we will ignore that (conveniently), and non-oil domestic exports (NODX) were also decent. 3Q18 has started well, and from a reasonable 2Q18 base.

Today's inflation figures slot into that picture, with a satisfactory reading that saw headline consumer prices fall 0.1% on the previous month to leave inflation at 0.6%YoY, but the core rate focussed on by the MAS, pushing up from 1.7% to 1.9%YoY, above our and consensus expectations.

There is no MAS inflation target as such (just some expectations), but at close to but just a little below 2.0%, we imagine the MAS will be happy with that outcome.

Singapore inflation - Headline and core MAS measures



Does this justify more MAS tightening?

If nothing else were changing, we might be sympathetic to some more tightening by the MAS at the October meeting. But the global economic outlook is far from clear, and with the only other Asia economies tightening being those under FX depreciation pressure (Singapore dollar has been one of the regions outperformers since April), the rationale for stepping up tightening again seems poor.

This could change. If for example, the trade war ended, and Emerging Market pressure lifted amidst a weakening US Dollar, tightening could resume. But if anything, we expect the global growth and trade backdrop to get worse, not better, and that suggests the MAS will keep conducting monetary policy much more cautiously.

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Thailand: Economy isn't screaming out for tighter policy, yet

But the central bank (BoT) has already started thinking about the timing of policy normalisation. Although we aren't expecting any change to BoT policy this year, the currency's (THB) position as one of Asia's outperformers since July has prompted a revision of our year-end USD/THB forecast to 33.5 from 35.0

Source: Shutterstock

Two things setting a mixed tone for THB

First, the trade data showed a significant negative swing in the trade balance to a deficit of $516 million in July from a $1.6 billion surplus in the previous month. This came amid steady trade growth; export growth of 8.3% year-on-year and import growth of 10.5%, both little-changed from their pace in June. The cumulative trade balance of a $2.9 billion surplus in the first seven months of the year compares with a $7.5 billion surplus a year ago.

The trade surplus is on track to narrow in 2018 for a second straight year. The annual surplus narrowed by $6 billion year on year in 2017 to $15 billion. At the year-to-date pace, we anticipate an $8-9 billion full-year narrowing in 2018, with the potential escalation of a global trade war also boding ill for exports and the trade balance in the rest of the year. This is negative for the Thai baht.

Second, the Bank of Thailand's minutes of the policy meeting held earlier this month revealed that policymakers pondered over the timing for monetary policy normalisation. However, the timing depends on continued economic growth and inflation 'firmly' in the target range of 1-4%. In his response to better-than-expected 2Q18 GDP growth earlier this week, BoT Governor Veerathai Santiprabhob signalled the unwinding of an 'extremely accommodative stance'. This has set the positive tone for the THB.

> *We need to look at policy space in the future, we need to have enough bullets in hand - BoT Governor Veerathai*

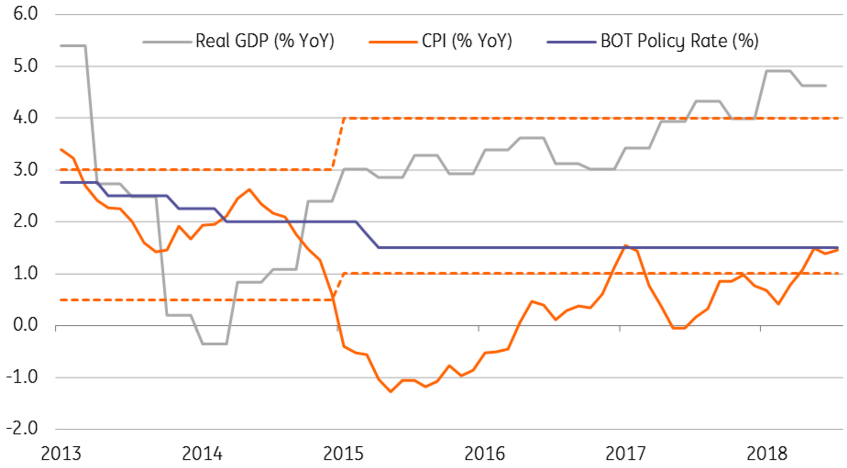
However, the central bank's optimism on growth and inflation remains at risk. Growth eased to 4.6% in 2Q18 from a five-year high 4.9% in 1Q18. The high base effect together with still-weak domestic demand and the global trade war could push it below 4% in the second half of the year, imparting a downside risk to the BoT's 4.4% forecast for 2018. And absent a food or oil price shock, inflation is likely to slow below the BoT target in coming months.

Economy isn't screaming for tighter policy

Unless it's simply to create policy space for the future or to prevent the currency from weakening, the economy isn't screaming for monetary tightening just yet. We maintain our view that the BoT will keep policy on hold for the rest of the year. We need to see a significant shift in consensus within the BoT policy board in favour of tightening, from the 6-1 vote for no change at the last meeting, before revising our forecast.

Our view of the THB depreciating to 35 against the USD by end-2018 assumed a continued narrowing of the trade surplus and potential escalation of the US-China trade war weighing on the currency. However, the THB has returned to be among Asian outperformers since July, from the worst-performer in the second quarter of the year. This together with the fact that the central bank (BoT) is already deliberating tightening, prompts a revision of our USD/THB forecast for a smaller depreciation to 33.5 by the end of the year (spot 32.8).

Growth, Inflation and BoT Policy



Dotted lines are BoT's target for CPI inflaltion, currently 1-4%.

Source: Bloomberg, CEIC, ING

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