

Good MornING Asia - 24 May 2018

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By Robert Carnell



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Malaysia: Downgrade of inflation, BNM policy forecasts

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Source: Federal Reserve

Fed minutes spread a little calm

OK, the Fed are going to hike in June - but we knew that. The relevant text from the latest FOMC minutes says, "...it would likely **soon** (our emphasis) be appropriate for the Committee to take another step in removing policy accommodation". Having dealt with that, let's quickly pass onto the more interesting question of "What then?". Here, the minutes from the last FOMC meeting note that on inflation, "...many participants emphasized that, after an extended period of low inflation, the Committee's longer-run policy objective was to return inflation to its symmetric 2 percent goal on a sustained basis". And also "It was also noted that a temporary period of inflation modestly above 2 percent would be consistent with the Committee's symmetric inflation objective and could be **helpful** (again, our emphasis) in anchoring longer-run inflation expectations at a level consistent with that objective". Which in plain English seems to say that as inflation has undershot its target for so long and depressed inflation expectations, a bit of above-target inflation would not warrant any change from the gradual tightening the Fed has been pursuing.

One interesting side observation was that the unsettled trade and tariff backdrop was having a real impact on investment decisions. The message for Trump on this is, make your mind up. We got a further Presidential vacillation on the trade story today, with news that Trump has maybe not let China off the hook after all, and wants to firm up the framework for talks, saying in a tweet that the current proposal "...will be too hard to get done and to verify results after completion". The

tweet coincided with the cancellation of Wilbur Ross' appearance at a trade event. If nothing else, this back and forth is making it very hard for economists to put presentations together on trade, though the latest move takes a presentation I have to do tomorrow and which had been overtaken by events, back into synch again. Thanks Mr. President.

Automakers in Asia and Europe won't be thanking the President though, as he announced that he is looking into tariffs on imported cars. This is beginning to read like Dr Jekyll and Mr Hyde.

Day ahead - BoK to leave rates on hold - we have pushed our rate hike forecast back

The main event in Asia-Pacific today is the BoK meeting. No change to policy is expected here (7-day repo rate = 1.5%), but the tone from officials has turned decidedly dovish in recent weeks. BoK Governor Lee remarked on May 17 in a comment published on Bloomberg May 17 that it was "...difficult to remain optimistic about the South Korean economy considering various uncertainties, even though the economy has continued relatively steady growth since last year". Sub-target inflation, reports of softening consumer spending and anemic industrial production add to the sense that policy is unlikely to change imminently. And the KRW is holding its ground despite the Fed's relentless upwards march with rates.

We have pushed our rate hike forecast back from 3Q18 to 4Q18, but are wondering if the BoK will find conditions warrant any hike at all possible this year this year and have this forecast under continuous review for a further nudge backward.

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Source: Shutterstock

1.4%

April CPI inflation

Year-on-year

Lower than expected

Persistent low inflation

Malaysia's consumer price index rose by 1.4% year-on-year in April, slower than the consensus of 1.6% but slightly up from 1.3% in March which was the lowest inflation rate in almost two years. Food remained the main inflation driver albeit at a slower year-on-year rate of increase of 2.6% than the 2.8% recorded in March. Low base effects swung the change in the transport component, the other main CPI driver, to positive from negative over the same months, but the effect was less pronounced than anticipated. Inflation in most other components was little

changed, while core inflation slowed to 1.5% from 1.7%.

The Ramadan-related increase in food prices will add to CPI inflation pressure over the coming months (this year Ramadan is from 17 May to 14 June). However, with the Goods and Services Tax in Malaysia to be set at zero starting this June, any inflation spike will be transitory. The GST will be replaced by a less severe Sales and Services Tax, though there is no clarity on the timetable for this move.

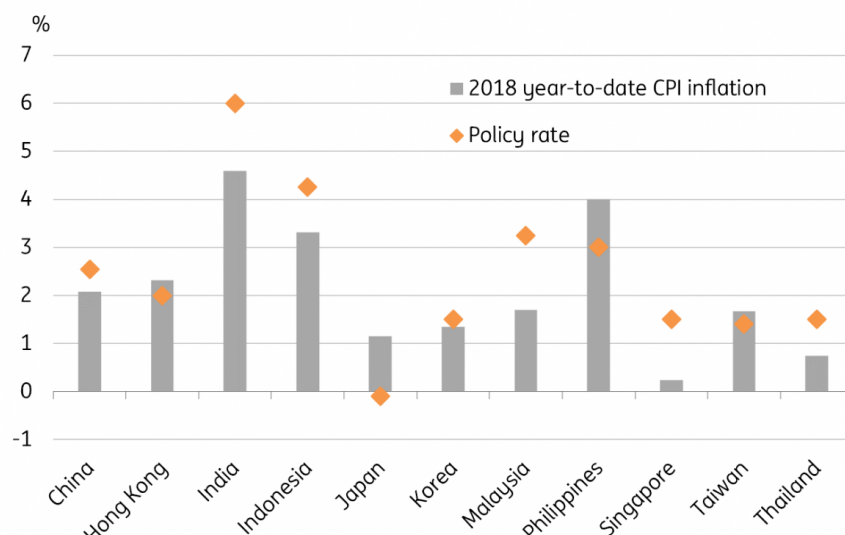
We expect inflation to remain well under 2%, the low end of the central bank's (Bank Negara Malaysia) 2-3% forecast, over the rest of the year. We are revising down our full-year 2018 inflation forecast to 1.8% from 2.4%. The consensus forecast of 2.9% looks way out of date.

Stable central bank policy

BNM started withdrawing policy accommodation earlier this year with a 25bp hike in the overnight policy rate to 3.25% in January. The latest inflation data together with a downward GDP growth surprise in the first quarter and prospects of further softening of both growth and inflation ahead, lead us to revise our BNM policy forecast from one more 25bp rate hike in the third quarter to no more hikes this year.

Real interest rates in Malaysia are relatively high compared with most other Asian economies (see figure), suggesting that BNM not mechanically following the Fed with rate-hikes, will not do much harm to investor confidence towards local financial assets, especially the Malaysian ringgit (MYR). But pending clarity on economic policy under the new government, the MYR is likely to remain under weakening pressure. We see the currency soon testing the 4.00 level against the USD. Our USD/MYR forecast for end-2018 is 4.05 (spot 3.98).

Asian central bank policy space



Source: Bloomberg, ING

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