

Good MornING Asia - 25 April 2019

Disappointing data from both Germany and Korea are likely to keep investors defensive ahead of the US GDP figures on Friday. Meanwhile, persistently low inflation in Asia is the standout theme guiding central banks policy interest rates lower to shore up growth

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arrows

Distance brings perspective - usually

A couple of weeks away usually helps put the global macro and market story into a better perspective. Getting away from the thick of the woods does really seem to make the trees stand out better. Not so much this time, though things have definitely changed. Some of the big worries seem to have been replaced by smaller but persistent irritants. A few weeks ago, we spent time mulling the prospects of a global recession. We didn't buy into that story then and it seems to have largely gone away. Little time is also spent worrying about a Chinese hard landing - that too has been written off, as too are concerns about an escalating trade war.

Some central banks are returning to action

The persistent irritant comes from the observation that central banks no longer seem to have any of the answers to a persistent undershoot of inflation or of tepid growth. Those central banks that might have spent some of this year starting or extending policy normalization seem on hold, as inflation stays low, whilst others now look likely to move the cycle back towards easing. Illustrating the former group, Bank Indonesia will likely fall into this camp today, and in all likelihood, so too will the Bank of Japan. Yesterday's inflation driven hit on the AUD, as Reserve Bank of Australia rate cut expectations mount is a good example of the latter case. The RBNZ may be close behind in cutting.

A new approach may be needed to deal with "lowflation"

So if there is one thing that stands out amidst a sea of "meh!", it is the slow chipping away at the growth/inflation framework that central banks have relied on as the yardstick for how to set policy. For all of the aggressive easing of past years to spur recovery, today's economies simply don't seem to respond to lower rates with much stronger activity or with higher prices or wages. The question is, should central banks respond with even more aggressive easing. We are beginning to suspect not, though that doesn't mean we don't think Central Banks like the RBA will hold back. They just won't achieve much by sliding back in the direction of zero rates.

Outlook for the BoK changes after terrible GDP

Another central bank that may well be reflecting over recent decisions to leave rates on hold is the Bank of Korea. They left rates at 1.75% at their meeting whilst I was on holiday earlier this month. I had thought that there was a chance they would cut. Their October 2018 25bp rate hike was hard to reconcile with the data back then, and it now looks clear that it was premature as the economy contracted -0.3%QoQ in 1Q19 to take year on year growth down to only 1.8%. 4Q18 GDP growth was 3.1% in comparison.

The KRW has already hit our 2Q19 target of 1150, and we may have to extend that forecast higher as expectations will surely mount that the BoK will reverse last year's decision, or even exceed it in reverse. Korean Treasury bonds also look set to see yields approach or push through the March lows, perhaps breaching the 1.8% level.

But until the global technology slump passes, this probably won't do all that much good. Government concern about the build-up of South Korean household debt may have some justification. And sometimes, a slowdown like this is inevitable. But finding the right balance between fighting the business cycle only to drive through undesirable unintended consequences is hard to do. Inaction will be criticized as weakness, and central bank independence will be threatened. There are no easy answers to this.

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6.00%

Bank Indonesia's policy rate

No change expected today.

EM Space: Wall Street pulled back overnight while German data points to slowing growth

- **General Asia:** Stocks in the US eased of highs after investors booked gains and looked to possible weaker sales due to the US-China trade spat. Disappointing data out from both Germany and Korea are seen to keep investors defensive ahead of the US GDP numbers on Friday.
- **Malaysia:** CPI inflation was back in positive territory in March after two consecutive months of negatives. We don't see inflation becoming a problem anytime soon, at least not until the removal of the Goods and Services Tax in June 2018 moves out of the base of comparison. Our annual inflation forecast for 2019 remains at 1%. Meanwhile, persistently low inflation has brought central bank (BNM) monetary easing back on the table for the next policy

meeting on 7 May, when we expect a 25 basis point cut in the overnight policy rate to 3.00%.

- **Thailand:** A senior central bank officer signaled GDP growth slipping below 3.2% in 1H 2019, which is consistent with our view of 3.1% growth for the period. And two separate headlines in the Bangkok Post suggested further downside growth risk. First, “Uncertainty hurts GDP view”, points to political uncertainty leading to delayed investments. Second, “Thailand’s economy is headed for new recession” narrates structural issues of high leverage (up to 80% debt-to-GDP ratio) weighing down domestic demand and thus economy’s increased reliance on exports for growth. While both stories argue for more BoT policy accommodation, they also highlight the policy dilemma. For now, we maintain our view of an “on-hold” BoT policy throughout 2019.
- **Indonesia:** Bank Indonesia (BI), the central bank, unveils its policy decision today with the market pricing in an “on-hold” policy. With Jokowi likely staying in for a second term, some investors are now banking on a possible reversal from the rate hike cycle in the near term as inflation remains subdued and Jokowi hints at pro-growth policies.
- **Philippines:** Several institutions continue to whittle down growth projections for the Philippines with the World Bank (WB) and Fitch trimming their respective forecasts. The WB shaved 0.3 percentage points from its October review to 6.4%, and Fitch sees growth slowing to 6.2% (from 6.6%) due to the BSP aggressive rate hike cycle last year, the budget delay this year, and the ongoing US-China trade tensions.

What to look out for: US GDP

- US durable goods (25 April)
- Bank of Japan (25 April)
- Bank Indonesia meeting (25 April)
- Singapore industrial production (26 April)
- US GDP and core PCE (26 April)

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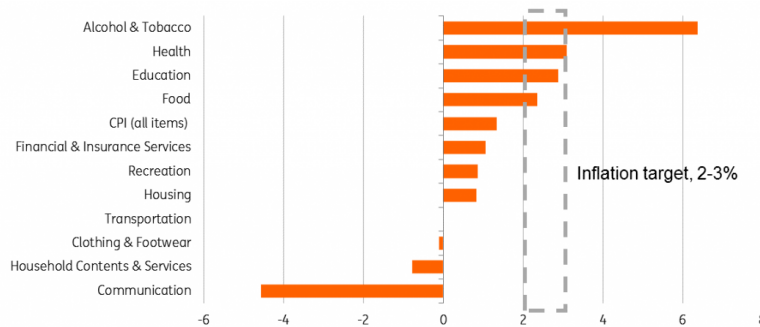


A cash-rate cut now seems entirely warranted

Despite strong labour market data last week, which seemed likely to keep a finely-balanced Reserve Bank of Australia (RBA) from any imminent change in the policy cash rate (1.5% currently), the latest inflation data flip the balance firmly back in favour of some easing. Possibly sooner rather than later.

The headline inflation rate for 1Q19 fell to only 1.3%YoY. This was lower even than the 1.5% consensus forecast, which itself was a sharp fall from 1.8% recorded for 4Q18.

Australian inflation by component (YoY%)



Uniformity in price weakness

By sub-group, goods prices fell 0.2% over the quarter, mainly in the tradeable goods sector. But service sector prices were also softer, though still only managed to eke out a 0.2%QoQ gain. Non-tradeable goods price inflation fell to 1.8%YoY from 2.4% in 4Q18. It hasn't been this low since 3Q 2016.

Inflation wasn't markedly less pessimistic when stripping out volatile items. Indeed, the QoQ ex-volatile items index was slightly worse than the overall headline figure, falling 0.1%QoQ.

At a more granular level, there were big negative QoQ swings in many subgroups from the previous quarter - food, alcohol and tobacco, clothing, furnishings, health, transport, communications, recreation, education, insurance and finance, medical / hospital, in fact, practically everything.

Whither the RBA?

We have been holding on to a low conviction view of "no change" in RBA rates for a very long time now. But this data has painfully jettisoned us off the fence, and we can't now see how the RBA can ignore such a bad inflation miss, even with last week's strong employment gains.

The logic for waiting to assess more data seems quite unnecessary now. Even an August meeting rate cut, as most forecasters have been moving towards, now seems too long to wait, and a cut this quarter, possibly even as soon as the 7 May meeting, would seem quite justified under the circumstances.

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0.2% March CPI inflation
Year-on-year

Lower than expected

Yet another downside inflation miss though

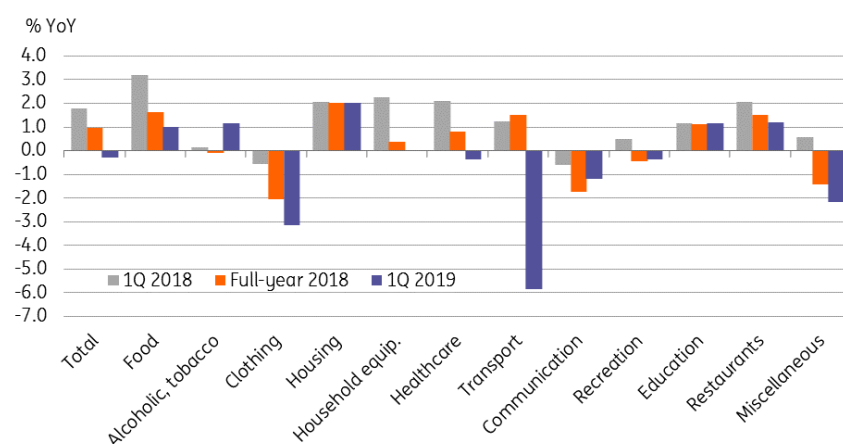
As widely expected, Malaysia's consumer price index (CPI) inflation was back in positive territory in March, though it was yet another downside miss. The 0.2% year-on-year rise was smaller than the consensus median of 0.3%. This followed two months of negative inflation; -0.7% YoY in January and -0.4% in February.

The seasonal post-Lunar New Year retracement of the food component, which fell 0.5% month-on-month, was a source of downside inflation surprise this time. But, barring this seasonal dip, the low

base effect has started to benefit the food component in its return as the key inflation driver in the months ahead. Indeed, the 1.1% YoY rise in food was the steepest in four months.

And a further boost to headline inflation came from the higher transport component, which has recovered more than half of the 5.5% MoM fall in the aftermath of administrative fuel price cuts in January.

Where is low inflation coming from?



Source: Bloomberg, CEIC, ING

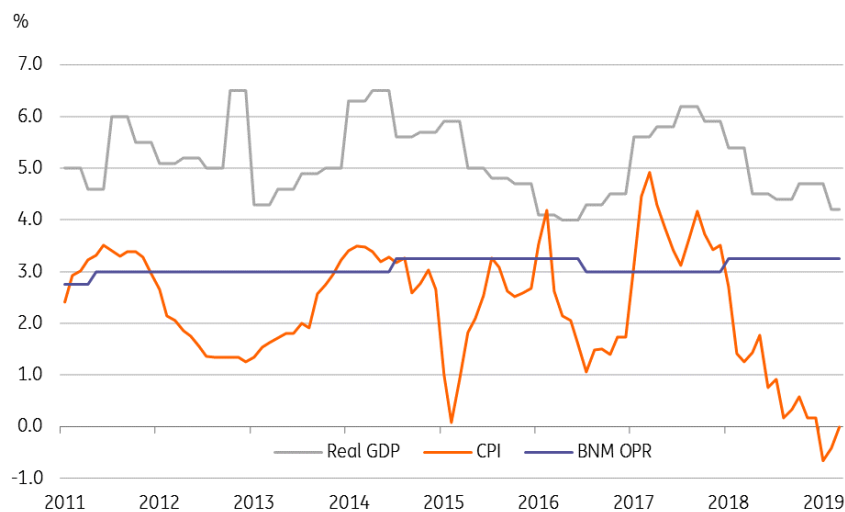
What it means for policy and markets

Still, we don't see inflation becoming a threat anytime soon, at least not until the removal of the Goods and Services Tax in June 2018 moves out of the base of comparison. And even as food inflation continues on a rising trend over the rest of the year, this will likely be offset by weakness in other CPI components such as clothing, healthcare, communication, and miscellaneous goods – all implying well-anchored inflation expectations.

Average CPI in the first three months of the year is still down 0.3% from a year ago. We maintain our 1% annual inflation forecast for 2019, which is at the low end of the central bank's (BNM) 0.7-1.7% forecast range for this year. Persistently low inflation has brought central bank (BNM) monetary easing back on the table for the next policy meeting on 7 May, when we expect a 25 basis point cut in the overnight policy rate to 3.00%.

We still believe the recent sell-off in Malaysian government bonds and the currency (MYR) sparked by news that FTSE Russell will likely dump Malaysian government bonds from their global index, is overdone. Both bonds and MYR have started to recover. A policy rate cut will further support bonds, while firmer oil prices together with existing undervaluation should prevent further downside in the currency.

It's time for a BNM monetary policy easing



Source: Bloomberg, CEIC, ING

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