

## Good MornING Asia - 27 July 2018

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By Robert Carnell



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## Always the Sun

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### Summertime snooze

It's summer in a sun-baked Europe, with temperatures hitting absurd records - families may be looking at cooler climes for their summer holidays. Indeed, the temperatures here in Singapore are rather cooler than in Europe right now. I too am off to cooler climes, and 2 weeks in Western Australia beckons. So there will be a fortnight's pause in this daily ramble (don't all cheer).

Actually, the temperatures in Europe are so extreme, that we could well see some severe distortions in data over the coming months. While a good summer is generally helpful for activity, spurring things like sales of seasonal clothing, when things get as extreme as this (38 Degrees C thought possible in the UK for example), then it can lead to exactly the opposite behaviour. Sure, shopping malls are air-conditioned, but you have to get there first, on a non-air conditioned bus or for Londoners, the tube (air-con will be installed by 2030!).

In non-air conditioned countries, like most of Northern Europe, such temperatures tend to lead to lassitude - watching TV in your pants (UK not US definition) while cooling down with a can of beer. Barbecues are compulsory. But eating out becomes a drag. Utility providers in the US would be cranking out the power for air-con - but that is almost non-existent in residential properties in much of Europe. Opening a window has no impact on industrial production figures. Whereas they would be spiking higher in the US.

It's not just Europe either. Closer to home, Japan has been experiencing ridiculous 40-degree plus temperatures too. These will also likely be taking their toll on the data. Food prices will be affected. Such extreme heat will be playing havoc with seasonal food production. So we should expect headline inflation to surge before falling back as Autumn looms.

OK, I know I should be talking about yesterday's ECB meeting, but the weather in Europe was frankly more interesting. [Please see my colleague's more professional approach to this subject](#), though spoiler alert, the weather also features prominently in his commentary.

## Juncker-Trump deal -implications for EURUSD

You can tell I'm off on vacation as I'm just re-hashing my colleague's work today. But [the piece by Viraj Patel on the implications of the Trump / Juncker deal is worth a look](#). Price action since the note was written has been largely USD positive. Draghi did, as Viraj noted, put a glossy spin on the outlook for the Eurozone, and hitting the pause (or should that be snooze) button on the EU-US trade skirmish should reduce the downdraft on the EUR.

That said, there is a lot of bullishness about the US right now. A trade deal could equally be seen as positive for the US, and with all talk about a 4-handle on the upcoming 2Q GDP figures, US support seems to dominate any EU news right now. A continuation of the range near-term still seems a decent call. Let's see if it is still in a 1.1560-1.18 range when I get back from holiday. I have a sneaky feeling it will be, and if it breaks out, I think it is an even bet which currency benefits.

## Go Large

To round off today's note, in what is frankly a very quiet and rather dull day in Asia, this is more than made up for by the 2Q18 US GDP release. And again, [James Knightley's thoughtful piece on data is probably all you need to know](#).

Frankly, such is the hype on this figure, that anything that started with a 3 would now be regarded as a disappointment.

But given the impact of Trump's fiscal reform (stimulus) on the US economy right now, the pertinent question is, not what today's GDP figure is, but when does this fiscal stimulus run out? And what happens then? What usually happens is that an economy seeing massive fiscal stimulus end, goes into a sort of arithmetical recession. A fiscal withdrawal shock. There is nothing really wrong when this happens. Activity levels are usually still quite high. But there is no growth. There may even be some pull-back in activity levels. That, in my view, is one of the bigger risks for hawkish views about the Fed in 2019. But that story, a version of Ben Bernanke's "Wile. E. Coyote theory" is a hard sell when current GDP is 4-something percent.

To be resumed in 2 weeks! Good Luck.

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## Asia week ahead: Will July data testify to trade war impact?

Korea's July trade data and central bank policy meetings in Japan and India will be the highlights next week



### Some relief on the trade front, but not a whole lot

A raft of economic data for July will come as the first test of the trade war that kicked off earlier this month.

While the 'soft' data on manufacturing purchasing managers' indexes (PMIs) may show the impact on sentiment, the hard data on trade should provide some sense of the actual hit. This keeps Korean trade data for July, the first for the month from Asia and probably the world, in the spotlight.

We expect a small annual decline of 2.6% in Korean exports - the second consecutive negative print.

**-2.6%** ING forecast  
Korean export growth in July

However, the trade data will also be weighed against the latest positive signs of more free trade across the Atlantic, which should limit the negative impact for markets of any bad trade report.

The US-EU deal to lift all bilateral trade tariffs may be a hopeful sign of a potentially positive end to the global trade war. But the hopes may be misplaced as the next stage of US tariffs on \$16 billion of Chinese exports looms large and this will, in all likelihood, face an equal amount of retaliation from China. As such, the trade risk is here to stay in the driving seat for the market.

## Central bank policy dilemma

Central banks in Japan and India will be in the spotlight for their monetary policy decisions.

Until recent reports about the Japanese central bank possibly tweaking policy, there was little to no market interest in the upcoming Bank of Japan policy decision on 31 July. The two possible tweaking options are:

- 1) Adjusting or abandoning the 2% inflation target, as might have been heralded by the BoJ when it dropped the reference to an inflation target in its April policy statement, and
- 2) Adjusting the pace of asset purchases, which too have undershot the target.

We don't think the first of this is on the table but the second might be. Here is what our Chief Economist Asia-Pacific, Rob Carnell, thinks about the [BoJ policy confusion](#).

We think the policy confusion for the Indian central bank might stem from recent developments of re-acceleration in the country's consumer price inflation above 5% in June and some stabilisation of the Indian rupee exchange rate in July. While we observed from the high-frequency data that GDP growth slowed down in the last quarter, we believe inflation and currency stability remain a strong argument for the RBI to remain on the tightening path. We forecast it will hike rates next week and again in October.

[Read why we're now looking for two rate hikes in India this year](#)

## Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
<b>Friday 27 July</b>					
China	0230	Jun Industrial Profits (YTD, YoY%)	18	-	21.1
Singapore	0330	2Q Jobless rate (Q) (%), SA)	2	2	2
<b>Monday 30 July</b>					
South Korea	2200	Aug BOK Business Survey Index, mfg	79	-	80
	2200	Aug BOK Business Survey Index, non-mfg	81	-	80
<b>Tuesday 31 July</b>					
China	0200	Jul Non-manufacturing PMI	55	-	55
	0200	Jul Manufacturing PMI	51.3	-	51.5
India	1200	Jun Fiscal Deficit (INR crore)	-	-	193526
Taiwan	0900	2Q P GDP (YoY%)	2.8	2.83	3.02
Thailand	0430	Jun Manufacturing Index (YoY%)	3	-	3.2
South Korea	0000	Jun Industrial Production (MoM/YoY%)	-1.3/0.7	-/-	1.15/0.9
<b>Wednesday 1 August</b>					
China	0245	Jul Caixin Manufacturing PMI	50.5	-	51
India	0600	Jul Nikkei Manufacturing PMI	51.5	-	53.1
	1000	Aug 1 RBI Policy Decision (Repo Rate, %)	6.5	-	6.25
Hong Kong	0930	Jun Retail Sales Value (YoY%)	13.4	-	12.9
	0930	Jun Retail Sales Volume (YoY%)	12.5	-	11.6
Indonesia	0500	Jul CPI core (YoY%)	-	-	2.72
	0500	Jul CPI (YoY%)	3.2	-	3.12
Taiwan	0130	Jul Nikkei Manufacturing PMI	-	-	54.5
Thailand	0030	Jul Nikkei manufacturing PMI	50.5	-	50.2
	0400	Jul CPI (YoY%)	1.4	-	1.38
	0400	Jul CPI Core (YoY%)	0.8	-	0.83
South Korea	0000	Jul CPI (MoM/YoY%)	-/-1.7	-/-	-0.2/1.5
	0100	Jul Exports (YoY%)	-2.6	-	-0.1
	0100	Jul Imports (YoY%)	-1.3	-	10.7
	0100	Jul Trade balance (US\$m)	3214	-	6240
	0130	Jul Nikkei Manufacturing PMI	49.5	-	49.8
Malaysia	0030	Jul Nikkei manufacturing PMI	48.5	-	49.5
<b>Thursday 2 August</b>					
Singapore	1400	Jul Purchasing Managers Index	52.3	-	52.5
Korea	2300	Jun Current A/c Balance (US\$m)	6180	-	8680.6
<b>Friday 3 August</b>					
India	0600	Jul Nikkei Services PMI	50.5	-	52.6
Hong Kong	0130	Jul Nikkei PMI	-	-	47.7
Malaysia	0500	Jun Trade balance (RM bn)	9.9	-	8.12
	0500	Jun Imports (YoY%)	13	-	0.13
	0500	Jun Exports (YoY%)	15	-	3.39

Source: ING, Bloomberg

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## Japan: Policy confusion

Japan's Central Bank (BoJ) dropped any reference to meeting its inflation targets in 2019 in its April statement. Since then, pundits have been trying to figure out what is coming next. The next monthly policy meeting on July 31, for so long a complete non-event, is now moving markets. Read further to see what we think.



### Is there more than meets the eye to the BoJ's inflation target tweak?

That earlier statement change has prompted some to suggest that the BoJ was going to downgrade its inflation forecast and adopt a lower target – perhaps at the forthcoming 31 July meeting.

We strongly doubt it. But there are good arguments for doing so.

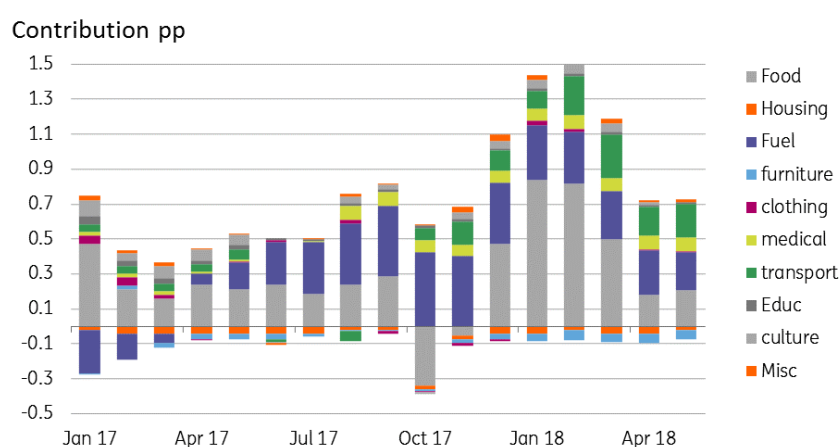
1. The likelihood of Japan ever reaching its 2.0% inflation target without either a massive devaluation of the yen, surge in consumption tax, or ballooning of oil or other energy or food prices is vanishingly small.
2. Who said 2% was a sensible number anyway? For an economy with a potential real GDP growth rate of only about 1.0%, inflation is likely to be similarly muted – perhaps 1% would be a better target to aim for, and one that the BoJ might actually hit from time to time?
3. There appears to be very little room for expanding the policy to make up the inflation shortfall - more leeway could be engineered by reducing the target to, or even below the current rate.

## Probably not – it just was not a very flexible policy stance in the first place.

For all that it may tinker with other aspects of its policy, the BoJ, in our view, does not, seem to have any intention of changing its inflation target, and any changes may amount to no more than tweaking their ETF buying. Indeed, in a [supplementary paper last July](#), examining reasons for failing to achieve their inflation target, the authors put most of the blame for failure to hit 2% on external factors, such as the decline in oil prices. Not their fault then!

Since then, oil prices have risen by not far short of 100%, and Japanese inflation is only about 0.3pp higher than it was then.

## Contributions to Japan's CPI inflation (pp)



## The 2% target will probably not be consistently achieved - ever

Why will the BoJ never reach its target? This author believes that across the world, the relationship between economic activity and price changes has altered, perhaps for good. There are many underlying reasons for this. Some of them local (changes in labour market structure) some global (globalisation and the increasing consumption of virtual goods). Whatever the causes, a shift in relationships also implies a shift in the inflation rate trade-off with unemployment – in this case, to much lower rates for both.

A better explanation for the BoJ's abandonment of the mid-2019 calendar date for reaching its inflation target, is that date dependent policies are fine when the date is a long way away. But when it gets closer, if it does not look as if the target will be hit, your options are

1. to shift the target further out (and keep doing that as long as it takes with the ensuing loss of credibility, or
2. to get rid of the date entirely but keep the target (this is what the BoJ is doing now), or
3. scrap both date and target, and do something else (this could, in our view, deliver a more consistent policy mix for Japan, but seems off the agenda for now).

## But that is not a failure by the BoJ, just a poor choice of target

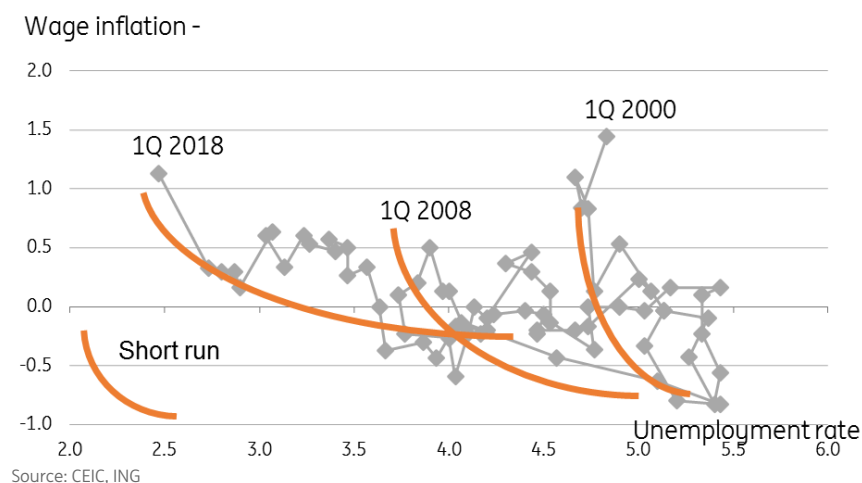
By losing the date element of the target, markets should not anticipate additional easing each



time the BoJ has to push the date of normalization back, as might previously have been the case. This is probably the best excuse for cutting the date out of the target (something the ECB might want to consider given its recent hints at an end to QE after Summer 2019).

Does tweaking the BoJ's target have any other implications, for example, next year's touted consumption tax hike? In our view no. The tax hike can still go ahead. Japan's labour market is still really tight. And the downside miss on inflation does not mean that the economy is not robust enough to tolerate some fiscal tightening. However, depending on how the unfurling trade war is affecting Asian regional growth, there could be other reasons for abandoning this policy by then

## Japan's Philip's curve



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