

Good MornING Asia - 27 November 2019

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Reserve Bank of Australia Governor Philip Lowe

Lowe on Unconventional monetary policy (UCMP)

Having presided over a recent [BIS report on unconventional monetary policy recently](#), which I read, and which I didn't much like (it seemed to basically endorse all that central banks have done since the GFC - not surprising, as it was their paper on themselves), Philip Lowe's speech last night is a rarity in my book - a central banker mainly talking common sense on UCMP.

It's worth a much longer read and a much longer write up than I can do here today, [so here is the link for those interested](#), but in a nutshell, here are my quick takeaways.

1. Negative interest rates - they do more harm than good. Regular readers will be aware that this is a personal bugbear. It now turns out that there is even a new term in economics/finance, to describe the point at which rate declines stop being helpful, and start doing damage. This apparently is the "reversal interest rate". (Note to self, go and write that critical book before it becomes mainstream!). As Lowe also succinctly puts it "there is evidence that...(low interest-rates)...can encourage households to save more and spend less,

- especially when people are concerned about the possibility of lower income in retirement". Importantly (and this is my main point), this can happen at low **positive** nominal rates. They don't need to turn negative. The AUD took slight comfort momentarily during his speech when he pointed out that negative rates were very unlikely for Australia.
2. Forward guidance - I don't share central bankers enthusiasm for "forward guidance". Indeed, I don't even consider it a "tool". So when these people start talking about their arsenal of policies and include forward guidance in the list, I basically conclude that they are out of ammunition (Bank of Japan, ECB). My point is, we (that is the market), are not stupid (at least not collectively - there will be exceptions). So when central banks try to drive longer yields down by claiming they won't do such-and-such until a certain date, or until certain conditions are met, we are either well ahead of them or have a more realistic future outlook. In other words, this only works if the central bank knows something we don't, and is solving a principal-agent failure. Otherwise, it's just hot air. "Forward nonsense". Here, I part company with Governor Lowe. This part of the speech I think you can skip. But it's short. Maybe he isn't much of a fan either.
 3. There is a section on extended liquidity provisions - read it if you want, I don't consider this unconventional so much as "modified". It's an important adaptation to changed circumstances, but an evolution, not a revolution in monetary policy.
 4. Asset purchases - or QE. The interesting part of this speech is the somewhat rambling explanation for what they are supposed to do. I think this owes to the fact that when they were first introduced, most central banks didn't really have much idea what they **were** trying to do, beyond stem a massive collapse in confidence. This worked, fortunately. Though most of the subsequent rationale for QE - portfolio balance theory, in particular, is in my opinion, ex-post justifications for policies that were made on the fly more in hope than in the certainty that they would do any good.

Lowe also set out some points for Australia:

- QE would not be started until and unless conventional rates fell to 0.25% (they are currently 0.75%).
- He noted that he didn't expect this point to be reached in the near future - (but then he would say that wouldn't he, which is another example of why forward guidance is such a waste of time)
- I was particularly encouraged by one of Lowe's concluding sentences, which I think is spot-on "In my view, there is not a smooth continuum running from interest rate reductions to quantitative easing. It is a bigger step to engage in money-financed asset purchases by the central bank than it is to cut interest rates". This is a hugely important admission.

Day ahead

We've had a further positive steer on trade talks according to the US President, which would normally be supportive for local currencies, including the CNY and CNH. Markets seem to be getting enured to such comments, though, especially when they don't come with any added supporting information, and the fact that we have heard these positive comments so often but are still waiting for a deal could be interpreted as meaning that significant problems still remain. This may be more than just dotting the "i's" and crossing the "t's" (this is another example of the irrelevance and overuse of forward-guidance - but here in a political setting).

We've already had some NZ trade figures for October - not terribly exciting. Both exports and

imports coming in close to expectations and the trade deficit narrowing a bit more on a 12M year-to-date basis (\$5.037bn now from \$5.330)bn. The NZD is looking reasonably perky this morning, so these figures may have provided some support.

We've got some China data out later too - industrial profits - a good contemporaneous indicator of where the Chinese economy is given the misgivings many of us have over the GDP figures. However, there may be some issues with today's release, and as Iris Pang writes "We expect a turn in the headline number from negative yearly growth to positive yearly growth because of base effects from the same period last year. This base effect will mask how the infrastructure projects have benefited related manufacturers, and how the trade war has hurt export-related manufacturers".

Thailand has also been addressing its weak domestic demand problem with some fiscal stimulus: Praksah Sakpal notes that "The government yesterday rolled out additional stimulus worth \$3.3 billion (0.6% of 2018 GDP) to support growth. Almost all of it is directed toward additional support to farmers and village cooperatives. October manufacturing data today will inform about the direction of GDP growth in the current quarter. The consensus is a slightly steeper 5% YoY fall in output than September's 4.7% fall. We continue to look for signs of a bottoming in activity. We are seeing this in exports but not yet in manufacturing, which means continued sluggish GDP growth in the current quarter. Even so, we don't think the BoT will ease policy again at the December meeting, especially now that the government has unveiled more stimulus".

The big G-7 data out tonight will be the October US personal spending figures. The outlook for the Fed, the USD and US Treasuries changes completely if the US household stops supporting the rest of the economy. Durable goods data is likely to keep showing weak business investment.

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ASEAN Morning Bytes

Game of Throes: President Trump hints that a deal is close but investors need more evidence.



EM Space: Trump signals progress on trade deal

- **General Asia:** Keeping hopes for a partial trade deal before the end of the year alive, President Trump indicated that trade negotiations were in the “final throes”, though he was holding up a deal that's 'Got to Be Good'. However, the lack of follow-through evidence keeps investors on the sidelines as they watch China's industrial profits data to know where all this is taking the economy.
- **Singapore:** In a big upside surprise, industrial production (IP) bounced by 4.0% YoY and 3.4% MoM SA in October. Data points to continued upward GDP growth momentum in the current quarter, which the MAS will likely regard as sufficient reason to leave policy on hold at its next review in April 2020 ([read more here](#)).
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- **Malaysia:** Finance Minister Lim Guan Eng expects the economy to gain traction in the last quarter of the year after GDP growth slowed to 4.4% YoY in 3Q. He is confident of the annual growth meeting the government's projection of 4.7%. Even if the fourth quarter is a seasonally strong growth quarter, the unfavourable base effect is likely to dent the year-on-year growth further (ING forecast 4.1%), imparting the downside risk to the official growth forecast for the year. We continue to see the central bank (BNM) cutting rates at the next policy review in January.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno continued his dovish rhetoric indicating that a policy rate cut at the December meeting was a real possibility. The BSP has cut rates by a cumulative 75 bps in 2019 and Diokno pledged to remain data-dependent in his policy decisions. These dovish undertones could keep the Peso on the backfoot ahead.

What to look out for: China industrial profits and US GDP

- China industrial profits (27 November)
- Thailand manufacturing (27 November)
- US 3Q GDP, durable goods orders and core PCE (27 November)
- Fed Brainard speech (28 November)
- Fed beige book (28 November)

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Singapore: October manufacturing beats expectations

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Source: Shutterstock

4% October manufacturing growth

Higher than expected

Electronics, pharma boost growth

Industrial production (IP) surprisingly bounced by 4.0% year-on-year in October, marking the second consecutive month of positive growth after a 0.7% rise in September (revised up from 0.1%). The consensus of a 1.4% fall in YoY industrial production was drawn from a steeper decline in non-oil domestic exports (-12.3% vs. -8.1%). It wasn't just the yearly growth which came in stronger than expected, on the month, IP (seasonally adjusted) rose 3.4% on top of a 4.0% surge in September (also revised higher from 3.7%).

Electronics and pharmaceuticals were the weak spots in October NODX but they were the sources

of strength in IP. Electronics production recovered to 0.4% YoY growth in October, up from -8.9% in September. And a 29.6% surge in pharma output was a touch better than 28.2%. Chemicals and transports sectors were the drags.

Underlying trend is improving...

As can be seen from the graphs below, significant seasonality and volatility make it hard to take both NODX and IP growth rates at face value. Adding to the noise are base year effects, which in the case of NODX were unfavourable in October but absent for IP.

Therefore, besides the year-on-year or the month-on-month growth rates, it pays to observe six-monthly annualised growth for a clear underlying trend. And this has been on an upward trend since the middle of the year for both NODX and IP.

Separating noise from trend



Source: Bloomberg, CEIC, ING

...And so is GDP growth

Firmer activity growth in recent months is a hopeful sign that the worst of the current economic cycle is behind us. GDP growth gained some traction in the third quarter (0.5% YoY was up from 0.1% in 2Q). We are looking for a further uptick to 0.8%, which will be subject to upside risk if the October momentum is maintained in the remaining months of the quarter.

Today's data should be music to the ears of the Monetary Authority of Singapore, which is the only central bank in the region (and probably in the world) to maintain its tighter policy stance this year, although there was some easing in October through a reduced slope of the S\$-NEER appreciation path. We believe the MAS will view upward growth momentum as sufficient reason to leave policy on hold at its next review in April 2020.

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