Good MornING Asia - 29 July 2021

US Federal Reserve Chair, Jay Powell, says the US has made progress, but not "substantial further progress" towards attaining the goals that will allow for a taper. But he expects to discuss that progress further over coming meetings - so more than one meeting, two then? That basically takes us to December. Just as the market was expecting

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Fed Chair, Jerome Powell

ING's Chief US Economist still eyeing rate hikes in 2022

So let's start with a link to the FOMC meeting note that James Knightley wrote last night, helped by our rates and FX teams.

I won't paraphrase it here, as you might then not read it, and it is well worth the two or three minutes it will take of your day to do so. But there were further glacial shifts in the Fed's rhetoric that suggest we are inching fractionally closer to an announcement on the taper.

This sort of "Kremlin watching" gets a lot of scorn, and possibly rightly so. And all of what Powell told us last night we could have figured out without any comments at all from the Fed Chair, but it does seem that we take the word of Central Bank speakers terribly literally, even though:

1. We know that sometimes they tell us things just to achieve a certain economic or market outcome and
2. Their forecasting track record is usually worse than that of the market consensus

With the next FOMC meeting on 23 September, then one on 4 November, that should provide the Fed with the information it needs to make an announcement on 16 Dec, and start tapering in January 2022. That's our house view, and it is increasingly the market view. We remain more aggressive on rate hikes, but we'll leave that discussion for another day (see also JK et al note from last night). Let's get the taper out of the way first.

Last night's remarks that progress had been made (though not, notably, sufficient progress to enable the taper to start) could have been deduced by anybody who could read a newspaper. So it is perhaps not surprising that bond markets didn't do a lot on the news. Currency markets were perhaps a bit more reactive, with the USD selling off against the EUR, which pushed further above 1.18, possibly unwinding bets that the tone might have been a bit more hawkish than in fact it was.

Asian currencies were broadly positive against the USD yesterday, and we would expect that to continue during early trading this morning. The main exception to that rule was the KRW, which gapped higher on opening yesterday, tried to go higher still. Failed. And ended up roughly where it had closed 2 days previously. The CNH reversed some earlier losses, possibly following a call by Chinese Authorities to foreign banks to clarify their recent actions against some education firms - noting that this was targeted reform and did not imply a wider crackdown. Tech stocks in the US finished higher on the day and that has set the tone for today's early trading with Asian equity futures mostly suggesting a positive start to the day.

Normally, the day following an FOMC meeting is terribly dull. And indeed, there is almost nothing on the calendar in Asia today of note. But later on, we do get advance 2Q 21 GDP from the US, with the market looking for a gain of 8.5% on the previous quarter (not too shabby), and our house view courtesy of JK expects it to be higher still (ING f 9.5%QoQ).

We've also had some indication that Biden's (now only) $550bn infrastructure bill has enough support in the Senate to start moving towards the lawbooks, though this will likely take some weeks to actually get done. Still, in normal times, this would have been worth 5-10bp on the US 10Y Treasury yield. Yesterday, despite the Fed and this progress, UST10 yields were basically unchanged, declining less than a basis point to about 1.233%. Strange markets. Even Powell admitted he didn't understand them when questioned yesterday. If he can't, what hope have the rest of us?

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Australian 2Q21 inflation overshoots target - no worries

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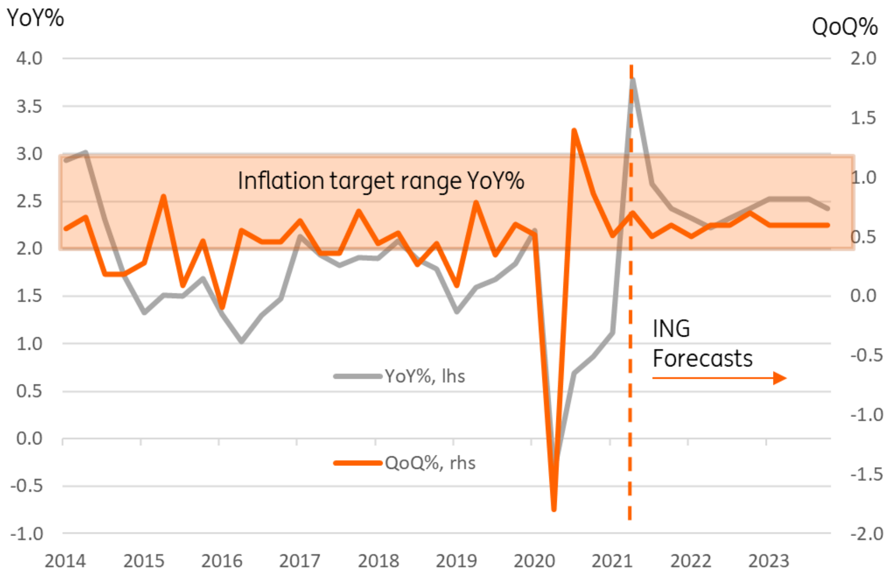
3.8%YoY

CPI inflation

0.8%QoQ

Higher than expected

Australian inflation and forecasts



Source: CEIC, ING

Will be dismissed as "transitory"

Central Bankers' favourite "T" word, "transitory" will likely be dusted off again after Australia's 3.8%YoY inflation print for the second quarter of 2021. This is up from an inflation rate of only 1.1% in 1Q21. However, almost 2 percentage points of this inflation increase is entirely due to base effects. The CPi index for 2Q 2020 fell by 1.9% from the previous quarter. And of the 0.8%QoQ print for 2Q21, we probably would have anticipated something around the 0.6-0.7% range even in normal times, so this doesn't look at all like what is going on in the US, where the run-rate of CPI really has picked up dramatically, making it more than just a base-driven increase.

Without a monthly release, it is harder to perform an equivalent run-rate analysis for Australia. But it is instructive to look at the trimmed means and weighted median inflation measures to get a similar idea of what is really going on once all the frothy outliers are removed. These measures are certainly reasonable substitutes for annualised run rates. And they show a much more moderate pick up. The trimmed mean CPI inflation rate rose to just 1.6%YoY from 1.1% in 1Q21, thanks to a 0.5%QoQ increase. And a similarly modest quarter-on-quarter increase took the weighted median inflation rate to 1.7% from 1.3%.

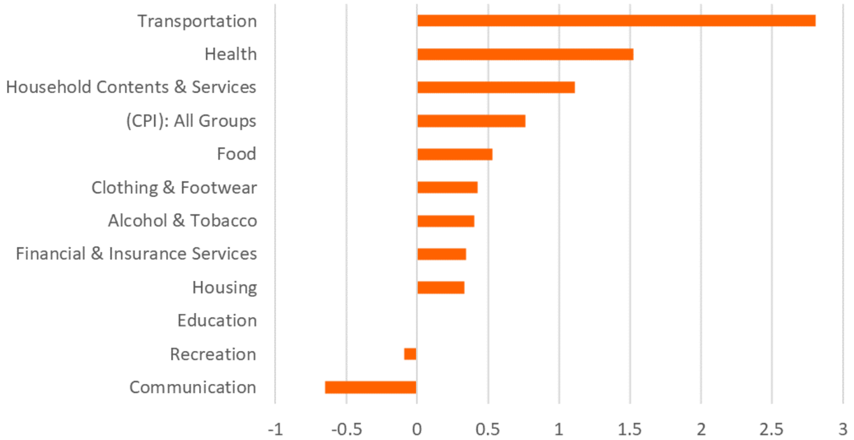
So underlying inflation is rising. It just isn't rising very fast. And it still looks quite subdued relative to the RBA's 2-3% longer-term target, which as we all now know, they aren't too worried about exceeding in the short-term.

Subcomponent story hasn't changed much from 1Q21

In terms of the drivers of QoQ inflation, which is a much more meaningful metric than the year-on-year measure when base effects are as large as they are right now, the story has moved on very little from the first quarter. Transportation continues to show a big increase - a combination of retail gasoline prices reflecting higher crude, plus a global shortage of vehicles due to semiconductor shortages keeping prices elevated.

Healthcare costs also remain high, for obvious demand-related reasons. Services are also seeing prices rise a bit faster than elsewhere, which is perhaps more interesting as this could imply faster-rising wages growth. But we'll have to wait and see on that. And besides those components, nothing rose much more than 0.5% on the quarter, with quite a few sectors seeing weak pricing pressure persisting.

Inflation for subsectors of CPI (QoQ%)



Source: CEIC, ING

Reserve Bank of Australia won't be too bothered by this

We can't see the Reserve Bank of Australia (RBA) being too alarmed by this data. They have made it quite clear that they anticipated a short-lived spike in inflation above the upper bound of their target and were unlikely to be moved by this. In recent months, we have seen the RBA statements on policy change to allow for a more flexible response to growth, inflation and most importantly, labour market developments. And in due course, we suspect that they may concede that a rate hike before 2024 is possible. That is not their current guidance though. And this data won't influence that decision if and when it is eventually made.

The wage price index released on 18 August has a greater potential to influence the official policy stance, and there is another RBA meeting between now and then, which is unlikely to shift guidance meaningfully in the meantime. So a period of "watching and waiting" beckons. Australian FX and bond yields are more likely to be influenced by external factors in the meantime, as well as the authorities' response to local pandemic problems, rather than by any monetary policy thoughts.

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