

## Good MornING Asia - 3 December 2019

No not China, at least not yet anyway, but Brazil, Argentina, and possibly France, Austria, Italy and Turkey. Markets are behaving in text-book fashion. Bond yields down, equities down, USD-Asia (in particular KRW) moving higher.

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#### Return of the tariffs

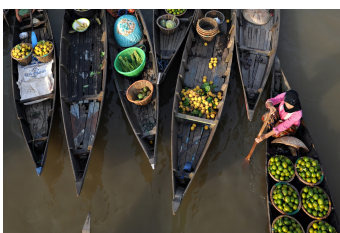
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Source: Shutterstock

### Trade, trade, trade

It took about 5 seconds this morning, maybe ten, to register that today's note was basically going to write itself. The home page of my go-to newspaper, the Financial Times, runs with:

- Trump to hit Brazil and Argentina with metals tariffs
- US threatens EU with new tariffs in Airbus-Boeing battle
- Beijing retaliated against Trump's signing off of Hong Kong act
- US manufacturing contraction worsens in November
- And Fed considers letting inflation run above target.

The first four are clearly part of the same overarching story - the Trade war. And it's not just the US and China. President Trump is taking the controversial decision to sanction Argentina and Brazil, two countries whose currency weakness stems from economic weakness, possibly a fair bit of mismanagement, with tariffs. Bloomberg adds a story that France and a handful of other European countries plus Turkey may get tariffed for imposing a digital services tax. This tax would predominantly hit US companies in the FAANG group. And then there are threats of new US tariffs

on Europe's Airbus.

The third bulleted story talks about the Human rights groups that China will sanction in retaliation for President Trump signing the HK bill. In my view, this was a very, very restrained retaliation, and while it may anger the US, and complicate any phase one deal, it does not totally rule it out. In tennis, this would be "15-all", and all to play for still.

But in total, the US' show of force on tariffs is as much a message to China as it is to the countries which are affected. It says, "tariffs are still a weapon we can use if you don't sign a deal".

However, the fourth story about manufacturing contraction stems of course from the effects of the trade war, and ties in possibly with why we still have not yet seen an agreement on the phase one deal. China knows that the additional tariffs scheduled for imposition on December 15 will do proportionately more harm to the US than to China. They may also believe, as a result, that the US would like, if it could, to find a way to avoid or defer them. China also has had some better economic news of its own: [See this FT story for more:](#) (I even get a small quote in that one). That gives it a stronger hand to play, and of course, data corroborating a US manufacturing slowdown (not backed up by the Markit PMI numbers I should add for balance), lends that view further weight.

## And the verdict is....

In a late-night chat with my colleagues last night, we discussed these various developments, some of which were already hitting newswires. Our considered opinion was that the chances of a December trade deal were diminishing. In fact, you could probably re-write that statement omitting the word: "December".

Failure to get a deal, will, we are told by the US President, result in much worse tariffs on China. Though I'm not sure this seems as credible a threat now that the damage to the US economy is looking more obvious. Moreover, President Trump is right, the PBoC can turn on looser policy to offset the tariff damage in a way that the US Fed would find hard to emulate. And this takes me onto the last bulleted story. Can the Fed indeed let the economy run a little hot?

## In your dreams!

I laid into this "a little hot" proposition last week when it was being touted by Lael Brainard. The latest version of it has Eric Rosengren mulling whether the Fed ought to target 2% inflation "on average" and not as a spot target.

The right answer is, of course, they should. Monetary policy, if based on an inflation target, should be symmetrical. So a prolonged undershooting of the target is no better than prolonged overshooting.

But this idea of letting the economy and inflation run a little hot is, in my opinion, utter nonsense, maybe worse.

The only time in which the Fed has overachieved its 2% PCE target (I'm going to focus on core PCE, as it is a more reliable gauge of underlying inflation, though the Fed's target is, of course, the headline rate), was in 2004-2008. It is probably no coincidence that this immediately preceded the global financial crisis. M2 money supply growth picked up during this period, but it is M3 that we really would want to look at - though this stopped being compiled in 2006 - funny that!

Right now, probably only the US President would argue that the Fed was running policy too tight and that this was the cause of the lack of inflation. The labour market is exceptionally tight, yet still, wages will not grow faster. Would still looser monetary policy achieve faster growth and push up prices and wages? The overwhelming evidence suggests, no, it would not. So even if they wanted to, I doubt the Fed, or the ECB, or the BoJ, or any of the central banks that have practised unorthodox monetary policy, could manage to consistently push inflation above 2%. If they could, they would have done it by now, with all the trillions of dollars, euros, yen, pounds and kronor printed and pumped into the financial system. Attempting such a feat would only push up financial and real asset prices further, raising the odds of the next financial crisis. Such ideas not only lack credibility and would utterly fail to achieve their objectives but in my opinion, could be very damaging to the economy.

## RBA - easy now

One central bank that is so far resisting the lure of unorthodox monetary policy (UMP), is the Reserve Bank of Australia. They meet today at 1130 Singapore/HK time, and we tend to agree with the consensus that they will resist the temptation to cut rates. However, their ability to keep holding off will need the run of data to improve.

This week, we get 3Q19 GDP data. Though even if that exceeds the consensus 0.5%QoQ/1.6%YoY outcome, will still probably leave annual growth sub-2%, and in that insipid - "B+ could do better" range that will have market pundits crying out for more easing. The RBA's calls for some supporting fiscal policy seem to be falling on deaf ears, with the government apparently intent on returning the budget to surplus.

I think the market view could change on one single labour market number, and these are fickle figures, so a big win after the last big miss is not to be ruled out. But a further downside miss would probably tip the balance in favour of a February 2020 cut. If so, we probably wouldn't stop at one cut. But two would take policy rates to only 0.25%, and the next stop for the RBA would indeed be QE. I don't think they want to go there, but the data may provide them with little choice.

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## Hong Kong's dire economic situation gets dramatically worse

Hong Kong retail sales were in a sea of red in October. Both domestic and tourism spending were dismal. This situation will only reverse once we see a long-term end to violent anti-government protests



Anti-government protests continued in Hong Kong over the weekend

**-24.3%** Hong Kong retail sales  
YoY, October

### Violent protests continue to wreck the economy

Hong Kong retail sales fell 24.3%YoY in October after falling 18.2% the previous month. It is the ninth consecutive month of negative yearly growth. The continuing violent anti-government protests and ongoing China-US trade tensions account for this dismal situation.

As we have [explained before](#) this is very different from the disruption we saw during the SARS epidemic in the early 2000s.

## Tourists not landing in Hong Kong

Tourists are not going to Hong Kong due to the brutal incidents at the airport, increasingly violent activities elsewhere and not to mention dreadful traffic conditions.

Sales of jewellery, mainland China tourists' favourite shopping item in Hong Kong, fell 42.9%YoY in October after big declines in August (-47.1%YoY) and September (-40.8%YoY).

And, of course, it's not just tourism from mainland China that's declined. Tourism from everywhere (literally everywhere [according to the Statistics Department](#)) on a monthly basis since August has dropped by double digits. And this has widespread impact on accommodation and catering spend.

And it's not just foreigners who are reducing their spending. From the retail sales data, we note that domestic spending is way down, with clothing sales falling 36.9%YoY in October after a fall of 25.9%YoY in September. It was a similar story for shoes and accessories (-37.0%YoY in October after -17.0%YoY in September).

## Vicious circle coming: more consumers will become unemployed

The trade war has led to redundancies in that sector. Since 1Q18, when it all started to kick off, employment there has fallen by 15%, affecting 67,500 people up to 3Q18. These people would normally be expected to get a job in the retail sector. But unfortunately, due to the violent protests, we see a 6% decrease in employment in both retail and catering affecting some 35,600 people just in the third quarter.

These people are themselves, consumers. If they cannot find a new job, this will put additional pressure on retail sales and will create more unemployment in the industry, thus creating a vicious circle.

### Hong Kong is entering a hard-landing recession

No one is expecting a sudden end to the violent situation. We're forecasting GDP growth at -7%YoY for 4Q19, and full-year growth will be -2.25% in 2019, which is close in scale to 2009's recession of -2.5%.

Our GDP growth forecast for 2020 is -5.8%, assuming that the trade war uncertainty will still be present, the violent protests will continue for the whole year, and unemployment will deepen, not least because of the impact on retail sales.

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# Indonesia: Inflation dips again in November

Price pressures in Indonesia remain muted, supporting our expectations for further Bank Indonesia stimulus in the short term.



Source: Shutterstock

**3.0%** November CPI inflation

Lower than expected

## Headline and core inflation dip in November

Price pressures remain subdued for Indonesia, with November registering the third straight month where inflation has dipped. Slowing economic growth and subdued energy prices helped keep price gains within target. The latest reading brings the year-to-date inflation print to 3.1%, at the lower end of Bank Indonesia's (BI) target range of 2.5-4.5%. Core inflation was on a downtrend as well, suggesting that inflation will remain less of a worry in coming months. Basic and processed food costs were both slightly higher than in the previous month but decelerating housing and transport costs weighed more heavily on the overall headline figure.

## Data matches dovish Warjiyo

Governor Warjiyo delivered relatively [dovish comments last Friday](#), indicating that the central bank had retained its "accommodative" stance in order to help support sagging growth momentum. With inflation data remaining subdued, we continue to believe that governor Warjiyo has ample scope to cut policy rates further in early 2020 to give the Indonesian economy a shot in the arm. In the near term the lower-than-expected inflation print could push IDR to weaken slightly, given our expectation of a dovish BI while investors await the fate of the phase one deal.

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## India: Weak growth paves way for bigger rate cut

The Reserve Bank of India's Governor Shaktikanta Das is determined to ease for as long as it takes, particularly now that weak investment has pushed GDP growth lower. We expect a bigger, 40 basis point rate cut this week (consensus 25bp) and we're cutting our full-year growth forecast



Source: Shutterstock

Reserve Bank of India's new Governor Shaktikanta Das

# 4.75%

ING forecast of RBI repo rate

After 40bp cut this week

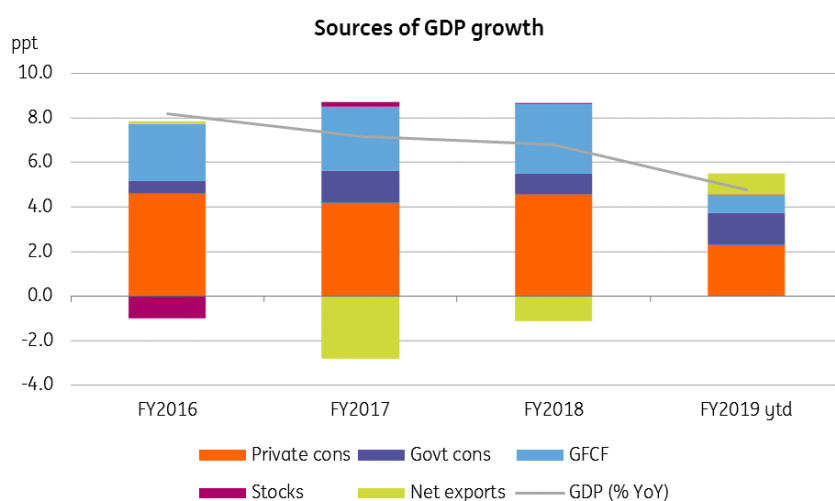
### Stimulus so far failed

Has stimulus failed to revive the Indian economy? It seems so, judging from headline GDP growth, which slipped further to more than a six-year low of 4.5% year-on-year in 3Q19 from 5.0% in 2Q, marking the seventh consecutive quarter of slowing growth.

Fiscal stimulus was evident from a near-doubling of government spending growth (15.6% YoY vs. 8.8% in 2Q) and also from a pick-up in private consumption growth (5.1% vs. 3.1%). Even so, a large part of the fiscal stimulus was pumped in the last quarter itself, and we have yet to see the full impact of that. This left investment as the main drag on GDP growth, subtracting one full percentage point from the GDP total, which tells us that aggressive RBI easing (by 110 basis point rate cuts through August) hasn't worked either.

On the supply side, there was a slowdown across all key industrial sectors (mining, manufacturing, and utilities) and also as in construction activity. Agriculture and services growth rates, 2.1% and 6.8%, respectively, were little changed from the previous quarter.

## Where is stimulus?



Source: CEIC, ING

## More is on the way

At 4.8%, growth in the first half of the current fiscal year (FY2019 started in April) has made the government's 7% full-year growth forecast utterly unrealistic. The central bank's (Reserve Bank of India, or RBI) forecast of 6.1%, revised in October from 6.9% (and likely to be nudged down again this week), is also far out of reach now. Dismal data, coupled with reduced hope of any recovery in the remainder of the fiscal year, leads us to cut our FY2019 forecast by half a percentage point to 5.1%.

The stimulus tap should remain open and we don't have to wait too long.

The RBI's Monetary Policy Committee is meeting this week and it will announce the decision on Thursday, 5 December. There is little doubt that it will ease again. And don't be surprised if it's another big rate cut, perhaps equal to the 35bp cut at the August meeting, or even more. We think a 40bp cut is probable, taking the repurchase rate to 4.75% and reverse repurchase rate to 4.50%. We don't anticipate any change to the 4% reserve requirement ratio for banks.

## An extended RBI easing cycle

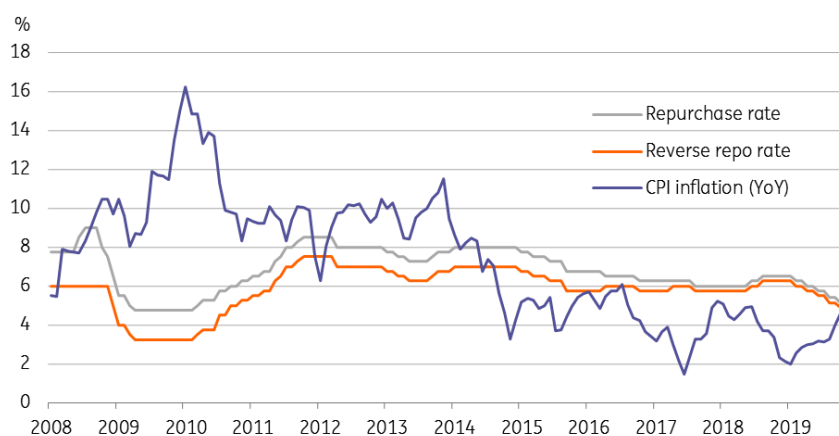
Will that be all the RBI easing in the current cycle? If historic lows in the policy rates are any guide – 4.50% for repo rate and 3.25% for the reverse repo rate at the height of the 2009 global financial

crisis – we could see these levels again given the current state of the economy and dull outlook ahead. However, it may take a continued slide in growth over coming quarters, which is not our baseline, as growth will likely get some lift from here, at least from a favourable base.

What about inflation, which has surpassed the RBI's 4% target (mid-point of 2-6% range) for three months through November? Again, looking back in time, inflation hasn't been a hurdle to RBI easing, even when it was running in double-digits. We think the same is true this time around. Therefore, with growth outweighing inflation as the policy driver, we expect the RBI to extend the easing cycle into 2020 with one more 25bp rate cut in February, possibly marking an end of the current cycle.

Against such a backdrop, the Indian rupee's weakening seems to be far from over. We revise our end-2019 USD/INR forecast to 72.50 from 72.00 and now see the pair re-testing 73.00 by March 2020 (spot 71.72).

## Inflation hasn't been a hurdle for RBI easing



Source: Bloomberg, CEIC, ING

## Will it help?

The question is, what good will that do for the economy? Besides the cyclical element, we believe structural bottlenecks are reasserting themselves in dragging down growth.

We think the economy needs more than fiscal or monetary stimulus. Accelerated economic and banking sector reforms and strong infrastructure investment are needed to regain the 7-8% growth potential". Absent this, Prime Minister Narendra Modi's vision of boosting India to be a \$5 trillion economy in five years (over his second term) will be something of a pipe dream.

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