

Good Morning Asia - 3 July 2019

Aside from a few PMI releases, it's a quiet day today in Asia.

In this bundle



Bienvenue Christine: IMF's Lagarde to take over ECB Presidency

The prospect of a more hawkish ECB President evaporates with the appointment of the IMF's Christine Lagarde - but EURUSD little changed so far

By Robert Carnell



Asia Morning Bites

ASEAN Morning Bytes

General market tone: Risk-off. Investors are likely to stay defensive as global growth concerns intensify.

By Nicholas Mapa and Robert Carnell



Australia

RBA cuts rates 25bp to 1.0%

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Opinion | 3 July 2019

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Source: Shutterstock
Lagarde

What sort of change could Lagarde bring?

The appointment of Christine Lagarde to take over from Mario Draghi when he steps down later this year is interesting. It highlights how weak the politics at the top of the EU are - that the front runner candidates could not gather sufficient consensus to be picked. It may also show that Germany and France are not above pulling rank to ensure that one of their preferred candidates (one from each country) gets one of the top jobs, after years of deferring to compromise or smaller countries, as Germany's Ursula von der Leyen gets the EU Commissioner job. I have yet to see any mention of the replacement Leader of the EU council...

Lagarde was certainly on the list of those compromise candidates that were considered early on in this process, but I remember seeing her name mentioned only a couple of times, compared, say, to Denmark's Vestager.

More importantly, is what Lagarde brings to the job. [My colleague, Carsten Brzeski adds his thoughts here](#), with which I completely concur. But to paraphrase, and add my own spin, here are

my own:

To the critics that note she is not a career economist, I would say, neither is Jermone Powell, and except for the President of the US, most people think he is doing a pretty good job. Moreover, the ECB is a committee, not a dictatorship, and as such, Lagarde's political background (France's Finance Minister before taking over at the IMF) should stand her in very good stead.

Furthermore, on its own, her CV is impressive enough. She stood by the EU during its debt crisis (attracted a deal of criticism from the US for doing so, but understood that without the IMF, the EU lacked sufficient political cohesion to act, and thus prevented crisis from becoming disaster). I also like the idea of having a few non-economists on the board of central banks. It should help prevent the sort of group-think that can lead to problems, while at the same time, its hard to imagine that as former G-7 Finance Minister, and IMF head, she has not picked up a few snippets of economics. Honestly, its not a tough subject to understand, and most central bank decisions seem to be based on little more than first-year economics, IS-LM, a bit of output gapology, maybe a nod in the direction of augmented Philipps curves. You could pick that up in an afternoon in a decent bookshop.

As for financial markets: Well, firstly, the ECB is in good, trusted hands so no need for too much anxiety. Second, as guardian of the EU during its debt crisis, it is hard to imagine that in terms of policy leanings, Lagarde will differ markedly from her predecessor. That takes a Weidmann-EUR rally off the table, though the single currency seems pretty steady this morning in Asian time, and this might pass with barely a ripple.

RBA's Lowe signals patience

After surprising us a little (though not the consensus) with their rate cut yesterday, RBA Governor, Philip Lowe, later gave remarks that support a less aggressive outlook for rates than the market has until very recently been pricing in. In a speech in Darwin, Lowe remarked " ...we will be closely monitoring how things evolve **over coming months** (our emphasis). Given the circumstances, the Board is prepared to adjust interest rates again if needed to get us closer to full employment and achieve the inflation target".

So it looks as if the RBA is prepared to ease again, but we should not rush into it. A further penciled in 25bp rate cut for 4Q19 should do the trick as far as our forecasts are concerned. That is a little lower than we previously anticipated rates falling, but only by one cut. It still won't get the Australian unemployment rate anywhere near 4.5%, but it might get it closer to 5% (currently 5.2%). The AUDUSD looks reasonably firm today at a shade under 0.70.

More contenders for Fed vacancies

Bloomberg is running with a story today about two nominations to fill empty Federal Reserve Board posts. The two named are Christopher Waller, and Judy Shelton. Waller is the more conventional pick. Director of Research for the St Louis Fed President, James Bullard. Bullard dissented (alone) at the last Fed meeting, but there is nothing crazy about his views. Indeed, he is probably one of the more thoughtful and insightful of all the regional Fed Presidents, and his unorthodox views provide an intellectual foil to the conventional wisdom that can dominate such institutions. I don't agree particularly with his current view, but that doesn't diminish the validity of his standpoint. Waller, if he matches any of Bullard's strengths, would be a solid addition to the Fed, though in all likelihood, take it in a more dovish direction.

Shelton is harder to call. Apparently a "conservative economist" (does that mean anything?) and informal adviser to the US President. Her academic background is more Business Administration than pure Economics, but as noted in the comments about Christine Lagarde, that isn't necessarily a handicap. She has already apparently been approved for a job at the European Bank for Reconstruction and Development, so her confirmation for a Fed job by the Senate might be oiled by that. Other than that, I am in the dark about where her policy stance would lie. Probably also on the dovish side, or why would the US President have nominated her?

Asia day ahead

It's a quiet day today in Asia. Australian PMI data is already out, and it is a bit softer, with the CBA PMI's for both services and the composite index drifting a little lower, though still comfortably North of the 50 boom-bust line.

Of the two Singapore PMI releases, the Markit measure has already been published, and shows a sharp fall to 50.6 from 52.1, only a little above contraction territory. The later release of the official measure, is likely to follow in the same direction (lower), though it is already in contraction territory, so may not fall quite as much. Further declines in that PMI could well spur thoughts of an intra-meeting adjustment of Singapore's monetary policy. MAS (Monetary Authority of Singapore) Managing Director, Ravi Menon, hinted in comments yesterday that such an outcome couldn't be ruled out. Indeed, the trade war, tech war and global tech slump hanging over the entire region, I should think that waiting until the next policy-setting meeting in October to downscale the SGD appreciation path might be too long a wait for the MAS. Look out also for Singapore's electronics sector index due this evening which could throw more light on this.

If an intra-meeting modification is indeed the next direction for MAS policy, it is not yet evident in short-term interest rates, where 3M SIBOR remains approximately 2.0%. We might look for short term rates to ease back a bit if the MAS is preparing to curb SGD strength.

China's Caixin services PMI is the other key release for the region today and is expected to fall slightly, though remain in expansion territory.

In the G-7, the main focus ahead of Friday's payrolls data may be the ADP survey of employment. The ADP was more accurate than normal last month, getting not only the direction of the payrolls move but also its magnitude broadly right. But with the market geared for Fed cuts, I suspect any rebound may be largely shrugged off today.

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ASEAN Morning Bytes

General market tone: Risk-off. Investors are likely to stay defensive as global growth concerns intensify.



EM Space: Intensifying growth concerns

- **General Asia:** Market players continue to worry about the state of the global economy with oil prices tumbling despite continued supply curbs. Meanwhile, the US announced possible tariffs on Vietnamese exports that had previously been manufactured out from South Korea and Taiwan, highlighting that the trade war could be a long drawn out episode.
- **Singapore:** Of the two manufacturing PMI releases today, the Markit measure has already been published, and shows a sharp fall to 50.6 from 52.1, only a little above contraction territory. The later release of the official measure, is likely to follow in the same direction (lower), though it is already in contraction territory, so may not fall quite as much. Further declines in that PMI could well spur thoughts of an intra-meeting adjustment of MAS's (Monetary Authority of Singapore) monetary policy. MAS Managing Director, Ravi Menon, hinted in comments yesterday that such an outcome couldn't be ruled out. Indeed, the trade war, tech war and global tech slump hanging over the entire region, we should think that waiting until the next policy-setting meeting in October to downscale the SGD appreciation path might be too long a wait for the MAS. Look out also for Singapore's electronics sector index due this evening which could throw more light on this.
- **Thailand:** The Bank of Thailand releases minutes of the June policy meeting when the policymakers unanimously voted to leave the policy rate unchanged at 1.75%. The statement issued on the day of the meeting was pretty dovish and it was also accompanied

by the downgrade of the central bank's GDP growth forecast for this year to 3.3% from 3.8%. While we see the minutes echoing the bearish tone, we do see the BoT delivering a 25bp rate cut at the next meeting in early August and another cut in the fourth quarter of the year.

- **Philippines:** The Bangko Sentral ng Pilipinas (BSP), the central bank, will be reporting money supply, bank lending, and international reserves data today. Judging from the Peso's recent strength, gross reserves likely edged higher in June from the previous month's \$85.4 bn.
- **Indonesia:** Finance Minister Indrawati sees the Indonesian economy growing by 5.2% for 2019, led by a post-election pick-up in growth in the second half of the year. The minister also forecasts 2Q growth between 5.02%-5.13% with a drag from government capital investment amid import curbs to narrow the trade deficit. She had previously hinted at central bank policy rate cuts in the near term to boost growth. We expect Bank Indonesia to consider slashing borrowing costs in the 3Q.

What to look out for: US data

- China Caixin PMI services (3 July)
- Singapore PMI (3 July)
- US ADP employment (3 July)
- US trade (3 July)
- US ISM services (3 July)
- Malaysia trade (4 July)
- Thailand consumer confidence (4 July)
- Philippines inflation (5 July)
- Taiwan inflation (5 July)
- US non-farm payroll (5 July)

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RBA cuts rates 25bp to 1.0%

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1.0%

RBA Cash rate target

Cut from 1.25%

As expected

Prospects of aggressive easing receding

Where their first rate cut seemed to provide the affirmation bias that a string of further easing was on its way, the latest rate cut does not seem to have had such an effect. At the end of last week (29 June), the probability that rates would have fallen to 0.75% by next month's meeting on 6 August, was 26.7%. Today, it is only 21.0%, and the probability does not rise to 30% until the following month. Mid-June (14th), the likelihood of rates falling as low as 0.25% was a non-negligible 6.5%, and the overall chance of rates being cut to 0.5% or lower was about 27%. Today, these implied probabilities have declined to 4% and 23.9% respectively.

Reality check

The net result of this is that rather than depreciate on the rate cut news, the AUD has found some resilience. The AUD sell-off had already happened to a large extent. And more recently, it had been under pressure from a US Fed, that seems destined to match all the easing the RBA has now done. The main difference between these two markets is that the US money market futures still seem to be fired up with rate cut fever, whilst the Australian market is having a spell of clearer thinking.

Statement says little

The RBA statement said that the easing "[will support employment growth and provide greater confidence that inflation will be consistent with the medium-term target](#)". And that "The central scenario for the Australian economy remains reasonable, with growth around trend expected".

There are few substantive changes to the statement that was submitted at the time of the June cut. Governor Lowe speaks later at a press briefing and may provide more for markets to digest.

Contrary to our assumption before this meeting, the RBA seems to be taking the view that with ammunition limited and ineffective, it is better to use it aggressively to have any effect at all, not to ration it out. Consequently, it seems reasonable to view another rate cut in the coming months as probable, and we are amending our forecast for a further 25bp cut to 0.75% by the year-end, with the next cut sometime in 4Q19, though more than this, and earlier, is clearly the main risk to this new forecast.

Lessons for the Fed?

It's not clear that the Australian market can provide any lessons for US markets and the Fed, though the situations are broadly similar. One observation is in terms of market pricing, where successively more easing has been priced out of the Australian market as the RBA has actually delivered. This has prevented the AUD from taking more of a beating. A similar story could prevent a bigger USD sell-off and keep the EURUSD within the 1.10-1.15 ranges that our [FX strategists have referred to in their recent publications](#).

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