

## Good Morning Asia - 3 June 2021

A quiet day for Asian markets beckons ahead of the US-non-farm payrolls report, but could the quiet be about to end? We hope so, but we wouldn't bet on it

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Australian GDP now exceeds pre-Covid levels, though the rebound is likely to slow down in the quarters ahead



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Inflation in Indonesia edges higher in May but still not a concern for policymakers

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Source: Shutterstock

### Range trade continues

I wrote at the beginning of this week - when my G-7 colleagues were on holiday and markets were quiet - that this week could see the tight ranges that markets have recently inhabited broken - though it was more of a hope than a prediction.

That range behaviour seems even more entrenched now. Take EURUSD for example. While it has been basically static at about 1.22 all week, it has on alternate days had a foray lower, then higher, then lower again in the most recent session. On all occasions, after straying a little from the prevailing trend, the opponents of the move have come in and swiftly brought it back in line.

Much the same is happening with 10Y US Treasuries. Asian FX has been more volatile, but has also shown little appetite for directional trends, especially after the PBOC's recent CNY cooling measures. Stocks too are essentially flat.

What's going to break this? There are numerous contenders...

## "Nerfing" the taper

One possible source of the range-trade breakout might be the Fed themselves. Having dampened markets' expectations for rate hikes and a taper with a seemingly coordinated chorus of "don't worry, inflation is only temporary" (T-shirts, coffee mugs and other merchandise will no doubt follow...) the only new direction the Fed can really take is to become slightly more hawkish. But they can also "nerf" any impact this will have by focussing any initial tapering on the MBS and not the Treasury market. So this may not deliver the jolt that many have been suggesting. Overnight comments from the Fed's Clarida and Harker suggest the Fed's response, for now, is to at least start talking about a taper, though without committing to anything for the time being. This is allaying some fears that the Fed is falling behind the curve, though it is a delicate balancing act between keeping anti-inflation credentials intact and avoiding spooking the front end of the bond market. So far, The Fed members are managing to do this pretty well. But accidents can happen, and given time, they become practically unavoidable. For more on this and some further commentary on market liquidity, [see the linked note from our Rates Strategy team.](#)

I read a news article today that suggested that inflation expectations are not where to look towards for any further break in Treasuries. I'm not sure about this. Inflation expectations the world round are an adaptive response to actual inflation. US Inflation hasn't peaked yet. And even when it does next month, any decline may be pretty moderate. I'd say there is definitely 10-20bp of 10Y yield increase possible from breakeven rates, maybe more. Last night's Beige Book certainly seems to suggest that inflation pressures remain a factor, and a real surprise would be if inflation managed to make a further small gain following next month's release, although the hurdle for doing so is high, with at least a 0.5-0.6%MoM increase needed for the June release (that's less than the recent 3m run rate however!).

As far as real rates go, Friday's payrolls may help to give them a small lift, though we concede that progress on any further fiscal spending in the US is probably going to be needed to give real rates a more significant push - and that is not likely to be forthcoming any time soon. Moreover, payrolls can disappoint just as easily as they may unwind last month's weakness. So directionally, payrolls aren't much help until we see the actual numbers.

## Aside from Fed and US stuff, China Covid is the thing to watch

But besides all the Fed and inflation-watching stuff that fascinates markets, closer to home, we are keeping a wary eye on the daily Covid-19 case numbers from China. 24 cases today and 23 yesterday. That isn't much. But the authorities there have already acted strongly in restricting travel in Guangzhou and temporarily shutting ports in Yantian, Shenzhen, where an outbreak of the Delta virus was first noted.

In Asia, it doesn't take much for the virus to have a big economic impact, as the authorities' reaction functions across the region are much more aggressive than they are in the US or in Europe.

Consequently, if a China outbreak becomes more widespread, then this has big ramifications for all markets, from commodities to currencies and bonds. This needs close watching.

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Snap | 2 June 2021

## Australia: 1Q21 GDP beats expectations

Australian GDP now exceeds pre-Covid levels, though the rebound is likely to slow down in the quarters ahead



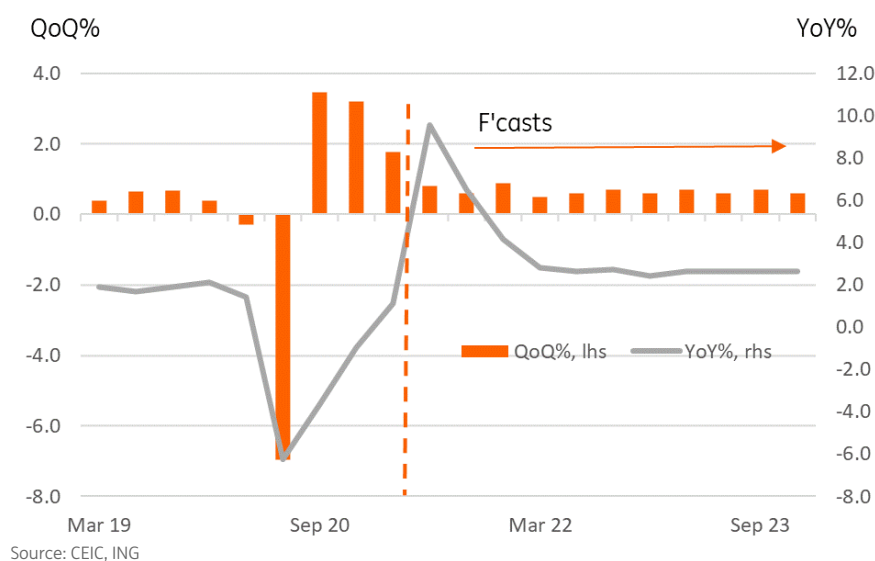
**1.8%** GDP QoQ%  
1Q21

Higher than expected

Pent up demand and the lagged effects of stimulus measures for household spending is still powering the Australian economy along. But with total (real, seasonally adjusted) GDP of AUD501bn in 1Q21, more than the previous pre-Covid high of 497bn in 4Q19, the period of most rapid catch-up has now probably passed. GDP growth is likely to be driven less by "recovery" and "stimulus" in the coming quarters, and more by underlying growth prospects.

That could still see full-year 2021 GDP growth exceed 5%. We've revised up our 2021 full-year GDP forecast to 5.2% on the back of these figures, and we are now also forecasting 2.9% for 2022 GDP growth too (up from 2.6%). Yesterday, the RBA released its own GDP growth estimates for 2021 and 2022 which were 4.75% for 2021 and 3.5% for 2022.

## Australian GDP: QoQ and YoY% and forecasts



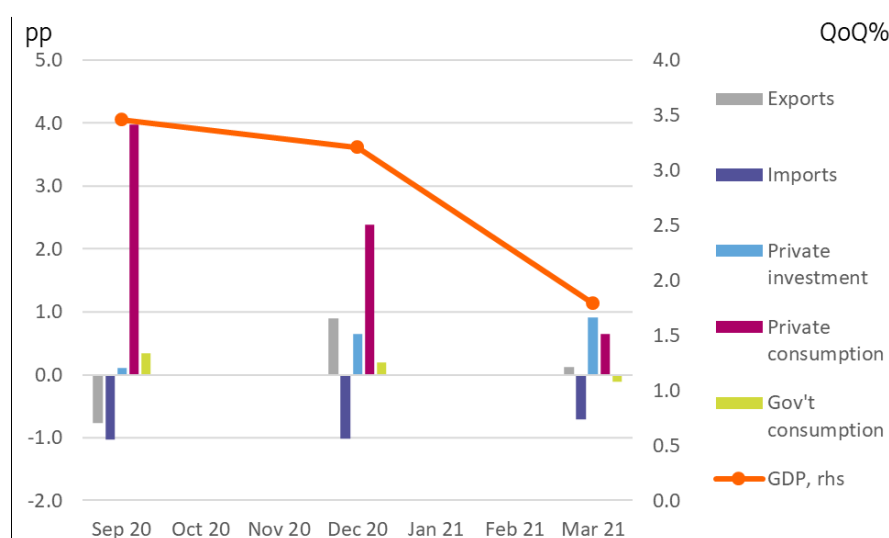
### What's driving GDP?

There is a much more balanced contribution to GDP growth in 1Q21 than in the previous two quarters, which were dominated by the rebound in private final household consumption spending. This spending contributed 0.7pp to the 1.8% total GDP growth in 1Q21, much less than the 2.4pp contribution in 4Q20, or the 4.0pp surge in 3Q20. The trend contribution of household consumption since 2013 has been about 0.3-0.4pp per quarter, and we would anticipate consumer spending reverting to levels just a bit higher than this towards the end of the year and into 2022.

Net trade was a drag on growth in the first quarter of this year. As domestic demand recovers, so too will imports. And to the extent that this is not netted off in rising inventories, will tend to weigh on the overall contribution of trade to growth. That said, trade figures are still also in transition/recovery mode. And as the year drags on, the net trade contribution should tend towards more of a neutral contribution from this quarter's drag.

Private investment has remained a fairly solid underpinning to growth in the last couple of quarters and with demand strengthening, we would anticipate further reasonable growth ahead.

## Contributions to QoQ GDP growth (pp)



Source: CEIC, ING

## What does this mean for policy?

With macroeconomic numbers still hard to interpret in the aftermath of Covid-19 pandemic effects - rebounds and base-effects distorting what is really going on - we don't believe that today's numbers will have a substantial impact on policy setters in the near future. The labour market and its developments, rather than GDP, will most likely continue to play a larger role in deliberations over rate policy, asset purchases and yield curve control. Though to the extent that GDP and the labour market are correlated, today's figures do show that Australia remains on a solid recovery path and markets may from time to time push back at the suggestion that there will be no change to rate policy until 2024 at the earliest.

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Snap | 2 June 2021

# Indonesia: Inflation ticks higher but still below target

Inflation in Indonesia edges higher in May but still not a concern for policymakers



Source: t-bet

**1.7%** May CPI inflation

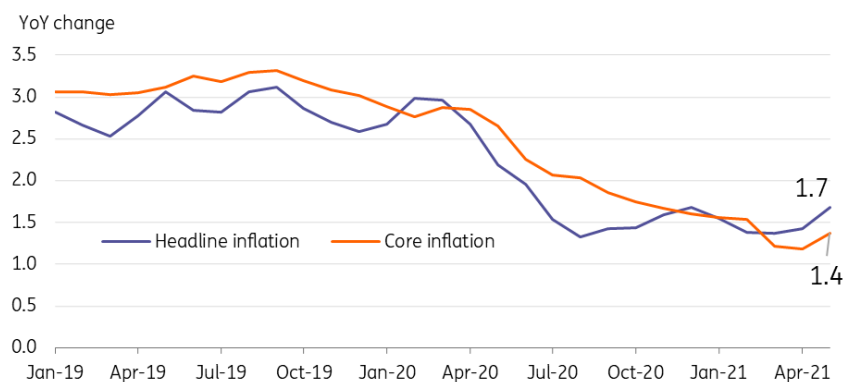
As expected

## 10 months below target

Inflation picked up slightly to 1.7% YoY in Indonesia with core inflation also accelerating. May featured a holiday and commodity prices rose. Inflation quickened across nine of the eleven categories in the CPI basket, with core inflation settling at 1.4%. Despite the slight pickup in both core and headline inflation, price pressures remain relatively subdued with inflation settling below target for a 10th straight month due to overall depressed domestic demand. We do expect this trend to reverse in the near term, with base effects washing out and as commodity prices head north due to improving global economic conditions. Inflation will likely settle within the target band of 2-4% starting July although any upside price pressures will be capped by tepid domestic

demand with the entire country placed under partial lockdown conditions (PPKM) for at least the first half of June.

## Inflation remains below target for a 10th straight month



Source: Badan Pusat Statistik

## See you in 2022

Despite expectations for a pickup in prices, Bank Indonesia (BI) Governor Warjiyo remains confident that inflation will settle within target in 2021. With inflation expected to remain within target in the second half of 2021, we forecast a pause from the central bank for the balance of the year. However, Governor Warjiyo's comments at the most recent policy meeting suggest that he is carefully monitoring price pressures although he also clarified that inflation pressures would only likely be of concern sometime in 2022. With price pressure expected to remain benign in 2021, any adjustments to the policy stance will likely be delayed to 2022 with a rate hike in 2021 only possible should IDR come under considerable pressure.

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