

## Good MornING Asia - 31 May 2019

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Seldom has a central bank rate decision been so clearly flagged - the market focus will be on how much more easing is coming and how soon

By Francesco Pesole



Opinion | 31 May 2019

## Bond rally continues as Mexico tariffed

Arguments for a pause/correction are doing the rounds, but as of now, the rally in Treasuries remains in place helped by the surprise imposition of 5% tariffs on Mexico.



Source: Shutterstock

**5%**

US tariffs on Mexican goods

Rising to 25%

### Mexico tariffs stymie thoughts of a bond pullback

Perhaps helped by a smaller downward revision to 1Q19 US GDP, perhaps end-of-the-week / end-of-the -month short covering, or for possibly a million other reasons, US Stocks had a slightly better day yesterday, though it was marginal.

Bond bulls were maybe also beginning to feel a little jittery, with stories doing the rounds of technical factors that may put a dent in the bond bull run, if only for a few days. They might have been right. Certainly charts of the 10Y US Treasury note look overbought, though such conditions can persist for days, weeks even.

But the surprise imposition by the US of 5% tariffs on all Mexican goods to start on June 10 and be

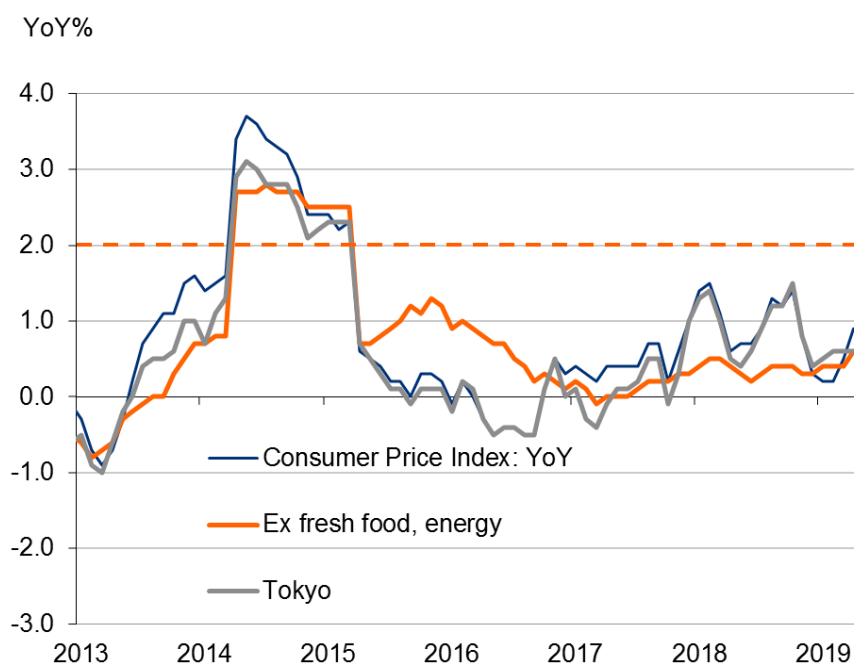
gradually increased up to 25%, has put the market in a risk-off mood, and that should ensure that the bull run continues today. The tariffs are in response to illegal immigration by Mexicans, and will not be removed until the US is satisfied that Mexico is tackling the problem.

Meanwhile, there is scant evidence of any movement on the US-China trade war, probably because the Mueller interview and subsequent reactions by the US President as well as these new tariffs on Mexico have taken the limelight. So with these issues dominating the headlines, I think the case for lower bond yields, lower stocks, and a slow grind stronger by the USD vs Asia currencies remains in place.

## Korea in the spotlight

A slightly better than expected April industrial production figure for South Korea today (+1.6%MoM) pared the year on year rate of decline to only -0.1%YoY. If we ever had a chance of our BoK rate cut decision paying off today (and realistically, we never have) then this was probably the last nail in its coffin. The arguments for a cut remain overwhelming in my view. Weak growth, and seriously sub-target inflation. But the best we can probably hope for today is some dissent amongst BoK voters to tee us up for a July cut. Fingers crossed though, as there is nothing to be gained by waiting and plenty to lose.

## Japanese inflation



## Japanese inflation drifts lower

Japan's inflation is only newsworthy to the extent that it has serially failed to come close to the BoJ's target. And even within the BoJ, it now seems as if 2% is being reconsidered as a sensible yardstick by which to set monetary policy.

This is a good argument to have, and one that is not irrelevant to many other OECD economies that are systematically failing to meet inflation targets, notwithstanding exceptionally

accommodative monetary policies.

Tokyo inflation, which leads the national figures by one month, drifted lower in May, with the ex-fresh food and energy figure now at 0.8%. This has been a good run since 2017 though, and an uptrend may still remain in place, though 2% remains an unattainable target in my view.

## India slows

(From Prakash Sakpal) Like pretty much everywhere else in Asia, India's growth appeared to slow in 1Q19, the final quarter of the financial year 2018-19 for which GDP data is due today. If so, our forecast of a slowdown of growth to 6.0% from 6.6% in the previous quarter will make it the slowest growth quarter in two years. While this will validate the Reserve Bank of India's two rate cuts this year, we don't think the central bank would want to risk tempting the inflation genie by cutting rates again at the next meeting. We see no further downside in growth from here as RBI easing so far, together with a surge in election-related government spending and favourable base effects should help the recovery in the period ahead.

## Rest of Asia - China PMIs

With the trade war in full focus, China's PMIs will get top billing amongst the other Asian releases today. The consensus has the manufacturing PMI dipping below 50 (just) to 49.9 from 50.1 last month, though the non-manufacturing index is thought likely to hold its ground at 54.3. Our China economist, Iris Pang sees a slightly different mix, with the non-manufacturing index slipping slightly, as dampened sentiment about the tech sector weighs on consumers, but the manufacturing index nudging up fractionally helped by government stimulus measures.

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## ASEAN Morning Bytes

General market tone: Wait and watch. Investors will take their cue from manufacturing data from China today.



### EM Space: Market will look to PMI from China for direction

- **General Asia:** Trump threatened fresh tariffs on Mexico if they would not slow the flow of immigrants with tariffs as high as 25% should Mexico not comply. The Asian markets will likely take their cue from China's PMI data.
- **Thailand:** April balance of payments data is due today. A sharp swing in the customs-basis trade balance to a deficit in April from a surplus in March leads us to forecast a sharp narrowing of the current account surplus to \$2.2bn from \$6.1bn over the same months. This would put the cumulative surplus in the first four months at \$16.8bn, or little changed from a year ago. Large current surplus supports THB as Asia's outperforming currency in the ongoing market rout resulted from the escalation of the US-China trade tensions.
- **Indonesia:** The protracted US-China trade war weighs on activity growth as the manufacturing PMI data is likely to show today. Market concerns about Indonesia's current account position has hounded the IDR and weaker manufacturing and exports could mean more pressure on the IDR in the near term.
- **Philippines:** The Bangko Sentral ng Pilipinas will be implementing the 100 bps reduction in the reserve requirement ratio for universal and thrift banks. These moves will result in roughly Php108 bn in fresh funds available to banks for lending, which could help boost growth in the Philippines as well as help push interest rates lower on the short end of the curve. Meanwhile, Fitch has affirmed the Philippines' BBB sovereign rating with a stable

outlook, citing sustainable growth and high level of foreign reserves.

## What to look out for: China data

- China PMI manufacturing and services (31 May)
- Thailand GIR and trade (31 May)
- Bank of Korea meeting (31 May)
- Indonesia money supply (31 May)
- Philippines money supply (31 May)
- Fed Clarida and Bostic (31 May)
- South Korea trade (1 June)

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Article | 30 May 2019

## Asia week ahead: Central bank meetings in Australia and India

The trade war remains the key theme for markets in a week that will see China's retaliatory tariffs on \$60 billion of US goods come into effect. Adding to the volatility is a raft of economic data and two central bank meetings



Source: Shutterstock

### ➔ PMIs will indicate slowdown in activity

It's a heavy economic calendar packed with the usual start-of-the month releases of purchasing manager index, trade, and inflation, as well as two central bank policy meetings.

The escalation of the US-China trade war – the US raised tariffs on \$200bn of Chinese goods from 10% to 25% effective 10 May, and China matched the hike on \$60bn of US goods from 1 June – is

likely to have weighed on activity growth. The impact might be more striking in the sentiment-driven PMI data as advance estimates of manufacturing PMI for G3 economies (US, EU, and Japan) have shown a sharp slowdown in activity – in fact, contraction in EU and Japan. Judging from the consensus forecasts, China's manufacturing is likely to have taken that path too.

Korea's trade figures for May, the first trade data release of the month from the region is expected to show a steep export decline. Inflation hasn't been an issue across pretty much the entire region but the Philippines will be under scrutiny for CPI data that's likely to show lower food prices denting inflation below the central bank's target of 3% and thus pave the way for further policy easing.

And, then the spotlight shifts to Reserve Bank of Australia and India.

## ➔ Australia's central bank rate cut in the bag

There is almost a unanimous consensus forecast of the Reserve Bank of Australia cutting the cash rate by 25 basis points to 1.25% at its meeting on 4 June.

The minutes of the May meeting revealed policymakers' increasing concerns about growth, stemming from ongoing weakness in household consumption, the housing market, and the slump in the mining sector. Even as employment and wage growth continued to be strong this failed to stimulate consumption, leaving inflation well under the RBA's 2-3% policy target (1.3% year-on-year in 1Q19). The RBA has cut the outlook for both growth and inflation. Testifying to this will be the GDP report for 1Q19 coming a day after the central bank meets.

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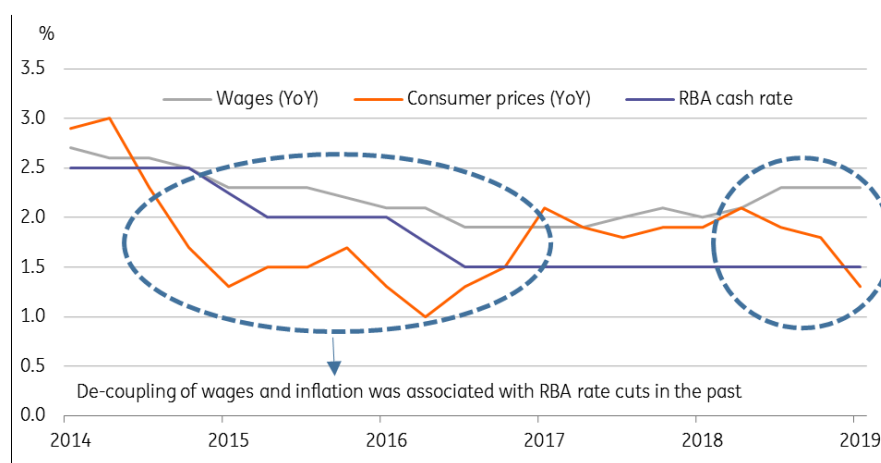
*A lower cash rate would support employment growth and bring forward the time when inflation is consistent with the target. Given this assessment, at our next meeting, we will consider the case for lower interest rates. - RBA Governor Philip Lowe*

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Earlier this month, Governor Lowe signalled that rate cuts would be discussed at the June meeting. We believe one cut will not be sufficient. Rob Carnell, our in-house RBA-watcher, is looking for one more cut in the third quarter.



## Australia: De-coupling of wages and inflation



Source: Bloomberg, ING

## ➔ India: RBI ending its easing cycle

The Reserve Bank of India also meets next week on 5 June with consensus almost evenly split between a 25 basis point policy rate cut and staying on hold. We've been calling for stable policy after back-to-back rate cuts in February and April meetings.

The third consecutive cut looks a bit like too much accommodation for the economy facing the risk of rising inflation. GDP growth looks to have slipped further to 6.0% in the final quarter of FY18-19 (data due on 31 May) and probably stayed around there in the current quarter. But we see no more downside from here as two RBI rate cuts together with a surge in election-related government spending and favourable base effects should help the recovery in the period ahead.

Inflation risks stem from the excessive loosening of fiscal policy in the run-up to elections, the pent-up passage of higher global oil prices to domestic fuel prices, weak currency, and supply shocks to food prices. While we don't see these risks materialising just yet, not for another quarter or two, excessive policy loosening could backfire with an inflation spike amid already elevated inflation expectations.

## Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
<b>Saturday 1 June</b>					
South Korea	0100	May Exports (YoY%)	-8.0	-6.6	-2.0
	0100	May Imports (YoY%)	-7.7	0.5	2.4
	0100	May Trade Balance (US\$mn)	3884.0	2450.0	4003.0
<b>Monday 3 June</b>					
China	0245	May Caixin Manufacturing PMI	50.2	50.0	50.2
India	0600	May Nikkei Manufacturing PMI	51.3	-	51.8
Malaysia	0030	May Nikkei Manufacturing PMI	48.2	0.8	49.4
	0500	Apr Exports (YoY%)	-9.0	0.8	-0.5
	0500	Apr Imports (YoY%)	-10.0	1.4	-0.1
	0500	Apr Trade Balance (RM bn)	12.5	12.7	14.4
Singapore	1400	May Purchasing Managers Index	50.5	-	50.3
Taiwan	0130	May Nikkei Manufacturing PMI	48.0	-	48.2
Thailand	0130	May Nikkei Manufacturing PMI	49.9	-	51.0
South Korea	0130	May Nikkei Manufacturing PMI	48.6	-	50.2
<b>Tuesday 4 June</b>					
Thailand	0430	May CPI (YoY%)	1.0	1.0	1.2
	0430	May Core CPI (YoY%)	0.6	0.5	0.6
South Korea	0000	1Q F GDP (QoQ/YoY%)	-0.3/1.8	-0.3/1.8	-0.3/1.8
	0000	May CPI (YoY%)	0.6	0.7	0.6
	0000	May Core CPI (YoY%)	0.8	0.8	0.9
<b>Wednesday 5 June</b>					
India	0600	May Nikkei Services PMI	50.8	-	51.0
	-	1Q Current Account Balance (Q) (US\$bn)	-	-	-16.9
Hong Kong	0130	May Nikkei PMI	-	-	48.4
Philippines	0200	May CPI (YoY%)	2.8	2.8	3.0
Taiwan	0900	May CPI (YoY%)	0.6	-	0.7
	0900	May WPI (YoY%)	-2.0	-	0.6
	0900	May Forex Reserves (US\$bn)	465.0	-	464.8
South Korea	0000	Apr Current Account Balance (US\$bn)	3954.0	-	4819.0
<b>Thursday 6 June</b>					
India	0715	RBI Policy Decision (Repo Rate, %)	6.0	6.0	6.0
Hong Kong	-	May Forex Reserves (US\$bn)	-	-	436.4
<b>Friday 7 June</b>					
China	-	May Forex Reserves (US\$bn)	3089.0	-	3095.0
Philippines	-	May Forex reserves (US\$bn)	-	-	83878.8

Source: ING, Bloomberg, \*GMT

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# RBA to cut next week, and again in August

Seldom has a central bank rate decision been so clearly flagged - the market focus will be on how much more easing is coming and how soon



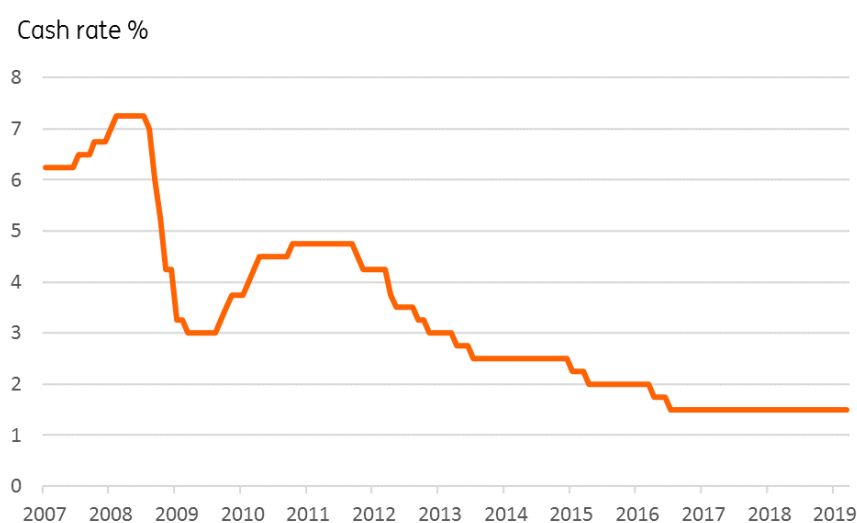
Source: Shutterstock

**1.3%** CPI Inflation  
Target rate is 2-3%

## New easing cycle, or just the old one extended?

August 2016 was the last time the RBA changed interest rates. This was the last cut in a series of eleven rate cuts that started in 2011 when the cash rate was 4.75%. One could make a case that the extent of the easing was in part determined by the rate increases that preceded it, with emergency easing during the global financial crisis being unwound rapidly from late 2009 until late 2010. You could say that next week's cut and the likely cut or cuts that follow this year and possibly next will simply mark a continuation of the interrupted easing process that started in 2008.

## Cash rate history



Source: Bloomberg

## What has changed?

So much for the history lesson, what about this particular meeting?

There has been a distinct change in rhetoric from the RBA this year. This started in February with a move from a tightening bias (though admittedly with a long time horizon) to a neutral stance. The full argument for the change is fleshed out in the [Opening Statement to the House of Representatives Standing Committee on Economics](#) in February this year by Governor, Phillip Lowe.

But in short, this shift acknowledged some softer consumer spending figures and house price corrections, together with enhanced risks from the global environment - the trade war and China. 4Q18 inflation at this time was 1.7% and had just shown some signs of softening, having been 1.8% in 3Q18.

## Switch to easing bias

By the time he made his [speech to the Brisbane section of the Economics Society of Australia on May 21](#), 1Q19 inflation had dropped to only 1.3%YoY. Governor Lowe turned the screw even more firmly in a dovish direction.

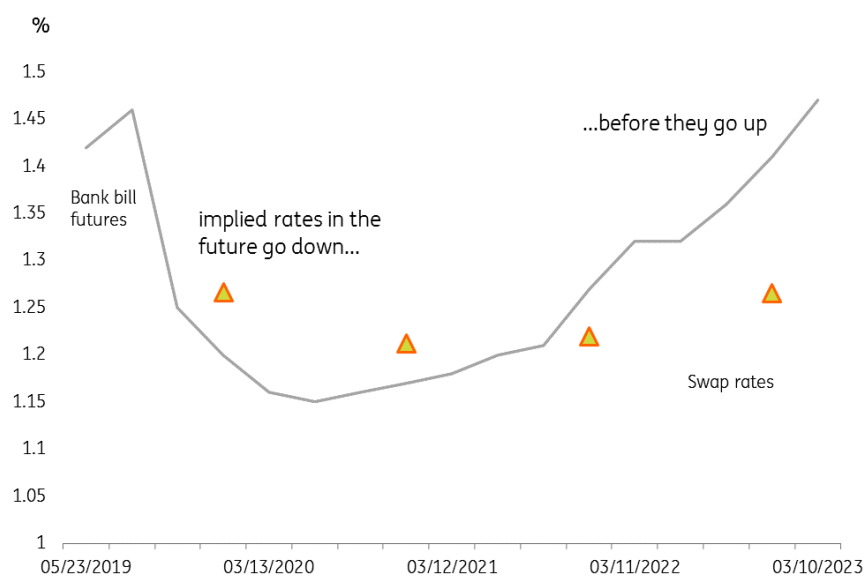
Here, he described the discussions of the RBA board, saying, "*...we discussed a scenario in which there was no further improvement in the labour market and the unemployment rate remained around the 5 percent mark. In this scenario, we judged that inflation was likely to remain low relative to the target and that a decrease in the cash rate would likely be appropriate. A lower cash rate would support employment growth and bring forward the time when inflation is consistent with the target. Given this assessment, at our meeting in two weeks' time, we will consider the case for lower interest rates*".

To cut a long story short, without a sizeable fall in the unemployment rate, the RBA now does not believe that inflation can move back to target and that one of the things they can do to make up for this shortfall, is to cut rates.

There has been no labour market data since then, and there will be none before the meeting on 4 June. The next labour market report is not until 13 June, and the subsequent rate meeting not until 2 July. Further labour market data for June is released on 18 July, and the next quarterly inflation report is not due until 31 July.

We would be very surprised if the RBA did not kick off its easing process at the meeting on 4 June. Markets are certainly geared up for it, with Bloomberg showing the implied market probability of a cut standing at 87.2% at that meeting. By August, markets imply more than a 50% probability of a further cut. We concur. By then, the RBA will have received more data on inflation, as well as further labour market information.

## 90-Day bank bill futures (implied 3m rates)



Source: Bloomberg

## How low can they go?

After that, rate cut probabilities remain quite high. The 3 December RBA meeting is now priced at about a 40.4% chance of a further cut, though for the moment, we are holding off at 2 cuts this year.

- Firstly, the government is likely to have put together some fiscal stimulus by then, and this can take over some of the heavy-lifting from monetary policy in late 2019 / early 2020. At the very least, it may make sense for the RBA to see how this plays out before embarking on further easing.
- Secondly, the viewpoint that the unemployment rate can probably go lower before it starts to drive inflation higher, is subject to the possibility that Australian unemployment may not ever fall far enough to bring inflation back to 2.5%. This is a global rather than Australian phenomenon and reflects globalization. It also reflects the change in the nature of goods and services we buy, as well as automation of jobs, even in the service sector courtesy of Artificial Intelligence and other technology. At some point, the RBA may recognise that this is the pursuit of the unattainable and reconsider its tactics.
- Thirdly, by early 2020, with the US Presidential election race having kicked off in earnest, we

imagine that the trade war will at least have entered a state of cease-fire, and global tensions may have eased somewhat. The risk to our forecast of 50bp of rate cuts before cash rates trough is that we will have to be somewhat more aggressively dovish. But we are not going to rush to join the race to the bottom that some of our peers seem engaged in, with some houses penciling in a full 100bp of easing before policy rates trough.

## AUD to drift lower, gradually

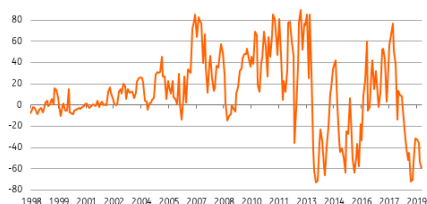
Given the aggressive market pricing of rate cuts by the RBA, we suspect that the negative impact on AUD could be relatively limited for the time being. Three additional considerations support this view:

1. In the absence of a clear commitment by the RBA to more rate cuts, the 3M-1Y segment of the yield curve could face little risk of downward adjustments for now.
2. CFTC data show that market short positions on AUD are close to historically high levels, which suggests that further depreciation could face some position-squaring related resistance.
3. Correlation between AUD/USD and the short-term swap rate differential has slightly recovered of late, but is still far from being a significant driver of the pair.

Despite expecting a relatively contained move in the immediate aftermath of the meeting, we remain in favour of AUD/USD downsides in the upcoming months. In addition to gradual market pricing of future RBA cuts, we expect a further deterioration in US-China trade relationships to pressure the pair. We therefore expect AUD/USD to approach the 0.68 area in Q3 2019, in line with our most recent forecast.

## Positioning and correlation suggest relatively limited downside risk for AUD

CFTC net non-commercial positions on AUD (1000s contracts)



Source: Bloomberg, ING

4-month correlation AUD/USD and 2Y swap rate differential



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