Good MornING Asia - 31 October 2019

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Fed and what it means for Asia

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A good or a bad pause?

James Knightley (JK's) overnight coverage of the Fed contains all you need to know about that decision and our skepticism that this marks the last cut in this cycle.

It is interesting that the 75bp of "mid-cycle" adjustment took place largely because of concerns about the global economy and the impacts of the trade war. The domestic economy was "in a good place", words still used by Jerome Powell, though these days to describe where monetary policy sits.

But the global environment is less of a concern now. It isn't actually improving, but the negative tail risks of the trade war seem to be receding (I won't add "hard Brexit" to this list, as I don't believe it is a global risk, rather a local/regional one for the UK/Europe). Talk of a global recession has diminished. In its place though, is rising concern about the momentum of the US economy.

One of the few helpful things about forecasting, is that economies tend **not** to turn on a dime. That is to say, an economy that is losing momentum tends to continue to lose momentum and does so until no further reasonable declines can be expected (it hits recession), or a policy response so powerful that it can't be ignored comes along (though probably at the point where it was about to start improving anyway, having already hit a recession).

The sort of fine-tuning of the economy the Fed has been undertaking is, quite frankly, of second-order (maybe third order) relevance, and argues without much justification for a far more powerful role for monetary policy than can legitimately be claimed. If the US economy is slowing, then I don't think 75bp of rate easing is going to stand in the way of that. And there isn't any fiscal help coming.

But what about Asia?

For our markets in Asia, the immediate reaction from the Fed pause might be to conclude that further rate cuts from central banks here might be harder to squeeze out. Not so if JK's reasoning is right, and I suspect it is. So that's good right?

But, and this is always worth bearing in mind, if rate cuts are becoming less powerful for the Fed, they are probably losing some steam here too.

Moreover, we are bullish on more Fed cuts for genuinely bad reasons - the US economy is slowing - maybe not as fast as we had thought after last night's 1.9% 3Q19 GDP figures showed, but enough that we should be concerned about global demand for exports - with or without a trade deal. Either way then, this isn't great news for the medium-term outlook for Asian economies. Worse for the more export-oriented economies, (HK, Singapore), less bad for the less open ones (China, India).

No APEC, no deal?

The APEC Summit in Chile has been canceled due to civil unrest. There was some optimism that Presidents Xi and Trump would use that meeting to sign a trade deal, or at least phase 1 of a deal. That now looks unlikely, but that doesn't mean that a deal will not get signed, it just now lacks a venue for the two Presidents to sign pieces of paper with ceremonial pens in front of the cameras.

And to some extent that was important, since for both sides, presenting a deal as a "victory" was needed.

But presentation is not everything. For China, real issues such as getting a further postponement or cancelation of tariffs scheduled to be imposed on December 15th is also important. I would be surprised, therefore, if the "deal" does not get signed, simply for lack of a venue, but equally, I am concerned that any "deal" will be very light on any genuine substance. That could set us up for further trouble ahead.

Asia today

It's a busy day today in Asia: Iris Pang writes: "On Hong Kong, GDP data will likely show a -0.2% quarterly contraction, which means Hong Kong entered a technical recession in 3Q19. The trade war and protests have put severe pressure on the economy. These pressure points have continued into 4Q19. We expect that the economy will continue to contract until these two factors subside".

"On Taiwan, the 3Q19 GDP report will be released today. We expect increased investments stemming from the policy “Invest Taiwan”, which aims to attract Taiwanese manufacturers based in Mainland China to move factories to Taiwan. This should push GDP growth slightly higher to 2.6%yoy in 3Q19 from 2.4% in the previous quarter. Other than this, we don't see much change in the growth prospects for Taiwan".

Korean industrial production in September has risen a stronger than expected 2% MoM, taking year-on-year production growth to 0.4%. This reading is in keeping with our hypothesis that the worst of the global tech slump is behind us.

Australian data on everything from building approvals to business confidence and private sector credit are hitting the headlines as I write today. On balance, the tone is a positive one and tends to support recent optimism expressed by the RBA governor. The RBA's easing work may now be done. The AUD is bouncing accordingly

And the BoJ meets later. Yesterday's 9.1%YoY retail sales growth for September shows that there is no sensible reading of Japan's economy right now. The BoJ shouldn't be changing policy at a time like this.

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Singapore update

The Monetary Authority of Singapore (MAS) updated its macroeconomic review today - here are some personal reflections on the economic briefing.

Source: Shutterstock

October MAS Macroeconomic Review - some personal takeaways

Alongside the twice-yearly publication of their Macroeconomic review, the Monetary Authority of Singapore (MAS) provides a briefing to economists (as well as journalists).

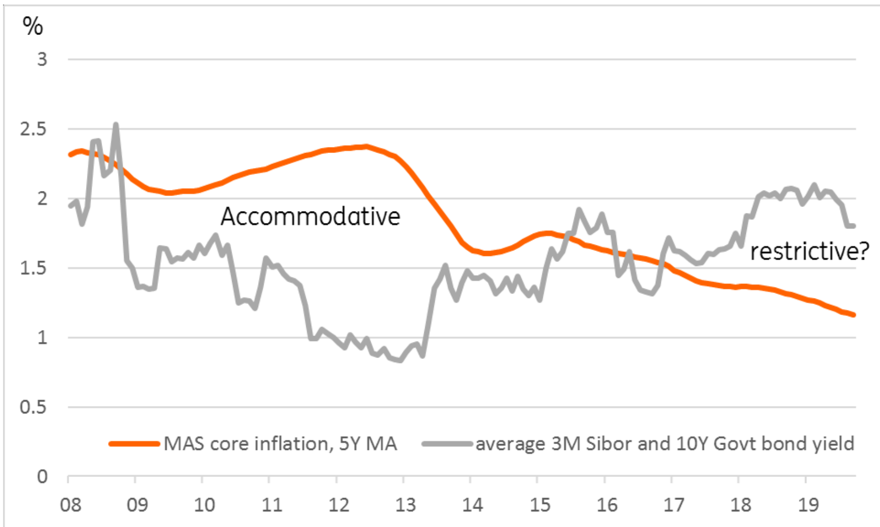
The briefing is non-attributable, so the following represents my personal reflections and conclusions from the session, and should not be viewed as a paraphrased version of the briefing itself. In particular, given that it reflects my own thoughts of the session, it may differ substantially from the views of others also present. I have also only focused on areas I thought were particularly interesting. But for what its worth, here goes:

1. We were wrong to anticipate a greater response from the MAS in October than the slight reduction in the NEER path that actually took place (see also the October statement). We, along with quite a few of the consensus, thought the MAS would go straight to flat;
2. Absent a marked deterioration in macroeconomic conditions, we would be wrong to anticipate a more aggressive action in the future too. To be fair, at this MAS meeting, we already felt that the macroeconomic deterioration was not only sufficiently severe but that

it had been in place for so long without any remedial action, that it merited a bigger policy change. Lesson learned.

3. It would take something well out of the ordinary (in either direction from the MAS baseline) to consider an inter-meeting move. Some market pundits have seized on recent text changes in the latest statement as a hint in this direction. This seems very unlikely;
4. There is the possibility for a further easing of the policy stance at the April 2020 meeting. But the most likely assumption now would be that the stance remains unchanged, given that the economy may not be worsening particularly. That said, the economy will probably fail to deliver a notable upturn also.
5. As important as the rate of core inflation (bearing in mind there is no explicit target) will be its momentum. This is currently negative. If this persists, then the MAS may see this as a necessary, though not necessarily sufficient, condition to ease policy further.
6. The latest change in the MAS stance is intended to deliver a mildly accommodative outcome. We might define this as moving towards a negative real interest rate (nominal rates minus inflation expectations). But if we define nominal interest rates as the average of short (3M SIBOR) and long term (10Y Government bond yields), and inflation expectations as a 5Y lagged average of the MAS core rate (debatable but reasonable if expectations are a backward-looking function of actual inflation, which they usually are), then the current policy stance may in our view still deliver a slightly contractionary stance. If our assumptions are right, then the skew to policy risks at this stage is most likely towards a further easing in April - even if the base case is for no change.
7. So the MAS cannot be accused of being ahead of the curve, or even on the curve, but might actually be a little behind it. This may not be accidental. The MAS likes to characterize itself as acting in a measured fashion, and it does anticipate the macroeconomy to stabilize somewhat. It also may believe that monetary policy is not particularly effective in the current global environment, and that fiscal policy may have a broader role to play. If so, its current stance could be considered consistent with what the MAS expects to be a slightly improved macroeconomic situation next April.

Where is Singapore monetary policy now?



Source: Bloomberg, ING

So where next?

It is probably fair to say that this closes the door to anything imminent from the MAS in terms of additional policy moves. Our house forecast does envisage some improvement from this year's full-year GDP growth total. We currently think this will come in at only 0.3% in 2019, but rise to 1.6% in 2020.

We see inflation remaining soft in 2020, but nonetheless picking up to 1.0%. The current headline rate is 0.5%.

With these house forecasts, there is still a chance that policy is eased further, resulting in a flat nominal effective exchange rate path. But along with our interpretation of what is always a somewhat esoteric presentation by the MAS, the more likely outcome is that the current stance is maintained at next April's meeting, and consequently, short term interest rates are also likely to remain similar to current levels.

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