

Good MornING Asia - 6 December 2019

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Opinion | 5 December 2019

Central banks holding back

After the Reserve Bank of Australia recently left rates unchanged, yesterday it was the turn of the Reserve Bank of India (RBI). We think the RBI definitely has more work to do, and the RBA probably does too



Source: Shutterstock

There's no point denying we were a bit flummoxed by yesterday's "no change" decision by the RBI. Yes, inflation is rising, but that is largely a seasonal effect that will come and go. The deterioration of growth looks to have stronger underlying drivers, requiring further pushback by the authorities.

Markets responded with a stronger INR, but I wonder if that strength will hold. Yesterday's decision looks like one that will simply make the recovery of growth take longer, and as such, may require greater overall easing. I would think the more likely direction from here is for some depreciation.

Not one of the Bloomberg consensus expected "no change", and we don't think this is the last word on Indian easing. More looks likely next year. [See the linked note by Prakash Sakpal for details.](#) We think USDINR weakens to 73.0 by 1Q2020

Data not running the RBA's way

It wasn't a good day for RBA hawks either, with the retail sales number for October coming in at zero month on month. It was forecast to rise by 0.3%.

Following its "no change" decision this month, the RBA has tied the future direction of its monetary

actions to household spending, of which retail sales are a sizable portion.

The recent GDP disappointment challenged Governor Philip Lowe's notion of "gentle upturn". Couple that with last month's poor labour market data, and the backdrop is looking quite challenged. About the only thing that will stop us from adding a couple of rate cuts from the RBA into our forecasts for next year, would be a recovery in the 19 December labour data. In the meantime, the AUD is likely to remain pressured.

Japan open's the spigot on fiscal spending

For some days, the news on Japan's fiscal stimulus has been churning, with the numbers getting bigger each time they are released. Japan was the first economy I ever covered in its entirety when I made the move to the dark-side from the UK Government Economic Service back in 1997, and if I learned anything in that time, it was this: Never change your forecast in the face of a Japanese stimulus package.

Why? Well if the government are throwing money at the economy, it usually means something is going wrong, and that means your original forecasts were too high. But the stimulus will largely offset that, leaving you roughly where you originally were.

Moreover, a fiscal stimulus isn't great news long term. As it shows that Abenomics is failing to make a meaningful difference to Japan's potential growth rates. It also means that the economy will be saddled with even more debt. But no one seems to care any more, and we suspect that ultimately, the portion of this debt that is held by the Bank of Japan, will be written off, in a sort of behind closed doors deficit monetisation.

China trade comments

Iris Pang in HK SAR picked up a few Chinese comments on the Trade War from spokespeople. "Spokesmen from China's ministries reiterated that a tariff roll-back is a necessary condition for any phase-1 deal and that tariffs will ultimately hurt the interests of US consumers. It is getting closer to the next tariff imposition date, 15th December, which schedule 10% tariffs on around \$160 billion that are mostly consumer goods. The US needs to decide if it wants to give concessions to China on tariff rollback in exchange for China's purchase of US agricultural products".

OPEC decision still a bit murky

(Head of Commodities Strategy, Warren Patterson adds this on OPEC and oil): After a long day of meetings, it is still not 100% clear what OPEC+ have agreed to do, with OPEC deciding to skip the press conference, following closed-door meetings. Reports suggest that they will increase output cuts by 500Mbb/d. However, it appears that this cut may just reflect formalisation of the over-compliance that we are already seeing from the group, rather than fresh cuts. Details should become clearer later today, with OPEC+ meetings set to get underway. The market so far seems somewhat unimpressed with the noise coming out of Vienna, with WTI trading somewhat lower this morning.

Impeachment proceedings coming

US speaker of the House of Representatives, Nancy Pelosi, has asked leaders of the House

committees that have been looking into allegations of Presidential wrongdoing relating to Ukraine, to draft articles of impeachment.

I mention this today as I can't really ignore such a big news story. However, I'm torn as I don't really think this has any financial market implications. As I see it, and I'm no political expert, this has no chance of making it through the Senate. It may not even affect President Trump's opinion poll ratings, at least not in the way you might expect. This is great news for the news industry. But beyond that, I'm not so sure what material impact it has.

Market is calm...too calm

It all looks a bit too calm at the moment. Stocks rose yesterday - the absence of any bad news seemingly the catalyst, rather than any intrinsically good news. Tonight we get the US labour report. Following from the weak (+67K) ADP report earlier this week, there is some added risk of a disappointment here. The consensus payrolls expectation is +179K. Good luck and have a great weekend.

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke

Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania
valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Kloek

Senior Economist, Netherlands
marcel.kloek@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Asia week ahead: Another big data splurge

Activity releases from China, Japan and India, and central bank meeting in the Philippines dominate Asian economic calendar, making it another busy week for markets



Source: Shutterstock

Trade news dominates

As the noise around 'phase one' US-China trade deal intensifies further as the mid-December deadline approaches, China's combined October-November activity growth will give some sense of the economy's performance in the current quarter. Judging from a rebound in manufacturing PMIs last month, things have stopped getting worse. We anticipate more evidence of this in the forthcoming data supporting our view of GDP growth gaining some traction in this quarter.

Japanese economic data should reinforce the continued weak state of the economy as the

markets digest today's announcement by prime minister Shinzo Abe of \$240 billion in fresh stimulus. The key item on the calendar is the Bank of Japan's quarterly manufacturing Tankan index with expectations of the lowest reading of large manufacturing Tankan in seven years. This comes as domestic spending is taking a hit from the consumption tax hike this quarter, while exports remain under pressure from the trade war.

Of all the Indian data next week, November consumer price inflation will be closely watched in light of surprise pause in RBI easing. Food prices are pushing inflation higher, taking prices above 5% in the last month, closer to the top end of the RBI's 2-4% policy target. Persistent downside growth risk will be revealed by another deeper fall in industrial production in October, we don't see inflation becoming a hurdle for more RBI easing.

Elsewhere, Taiwan's exports and Malaysia's manufacturing data should shed some light on the stage of the electronics cycle. We have seen signs of it bottomed out and would look for more evidence of the same.

Finally, the Philippines central bank policy meeting next Thursday (12 December) should be a non-event with higher November inflation likely to force a pause in rate cuts.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Saturday 7 December					
China	-	Nov Forex Reserves (US\$bn)	3115	3100	3105
Sunday 8 December					
China	-	Nov Imports (YoY%)	-5.8	-1.5	-6.4
	-	Nov Trade Balance (US\$bn)	52.0	45.2	42.8
	-	Nov Exports (YoY%)	0.0	0.7	-0.9
Monday 9 December					
China	-	Nov Money supply (M2) (YoY%)	8.5	8.4	8.4
	-	Nov Aggregate finance (CNY bn)	1200	1485	619
	-	Nov New yuan loans (CNY bn)	1282	1200	661
India	-	3Q Current account balance (Q) (US\$bn)	-6.8	-5.7	-14.3
Taiwan	0800	Nov Exports (YoY%)	2.4	-	-1.5
	0800	Nov Imports (YoY%)	-0.5	-	-4.1
	0800	Nov Trade balance (US\$bn)	5.5	-	4.0
Tuesday 10 December					
China	0130	Nov CPI (YoY%)	3.0	4.2	3.8
	0130	Nov PPI (YoY%)	-1.7	-1.4	-1.6
Philippines	0100	Oct Trade balance (US\$mn)	-3703.0	-	-3119.0
	0100	Oct Exports (YoY%)	-2.8	-1.0	-2.6
	0100	Oct Imports (YoY%)	0.1	-6.8	-10.5
Singapore	-	Oct Retail sales value (MoM SA/YoY%)	-1.5/-3.7	-/-	1.9/-2.2
South Korea	2300	Nov Unemployment rate (% SA)	-	-	3.5
Thursday 12 December					
India	1200	Nov CPI (YoY%)	5.0	5.3	4.6
	1200	Oct Industrial production (YoY%)	-5.3	-3.6	-4.3
	-	Nov Imports (YoY%)	-13.5	-	-16.3
	-	Nov Trade deficit (US\$bn)	-13.1	-	-11.0
	-	Nov Exports (YoY%)	-5.0	-	-1.1
Malaysia	0400	Oct Industrial production (YoY%)	2.3	-	1.7
Philippines	0800	Overnight Borrowing Rate	4.0	-	4.0

Source: ING, Bloomberg, *GMT

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Japan: Smoothly does it

So far, Japan's consumption tax hike seems to have gone down far more smoothly than its previous equivalents in terms of both GDP growth and inflation. Though the coming months could still see some fallout even if the front-loading was smothered by inventory fluctuations



Source: Shutterstock

Japanese Prime Minister Shinzo Abe

3Q19 GDP rises only 0.1% QoQ

Japan is now in the midst of an adjustment phase following on from its consumption tax hike from 8% to 10% in October. So far, this has gone far more smoothly than the previous episodes of this tax hike. The 3Q19 GDP result was only 0.1% QoQ, or 0.2% annualised, down from the previous quarter despite front-loading of consumer spending in September on some items affected by the hike.

The GDP figures were also negatively affected by a big drawdown in inventories. The QoQ contribution of private inventories was -0.3%. That was enough to totally offset the growth in private consumption. Net exports stripped a further 0.2pp from the total, with the result that the front loading of residential and non-residential investment, which in any case was fairly subdued, was totally offset.

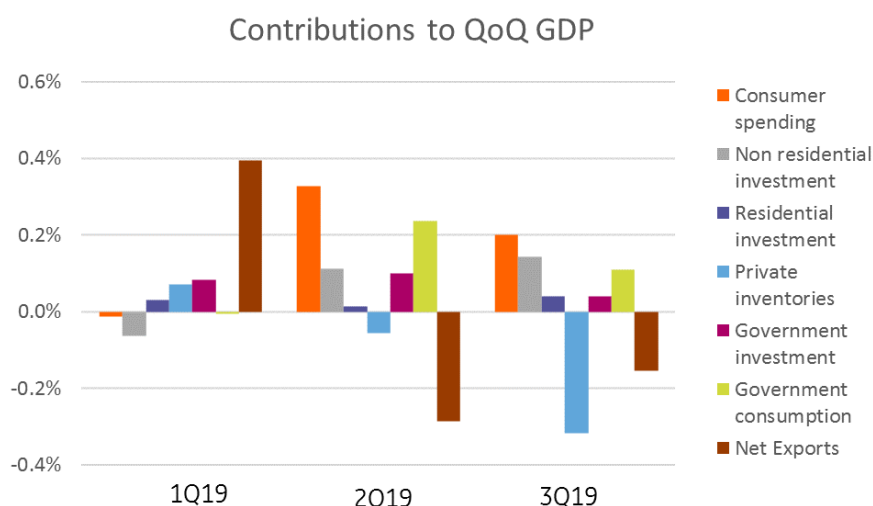
0.1% QoQ

3Q19 GDP

0.3% saar

Lower than expected

Contributions to QoQ GDP growth



Source: CEIC, ING

Contributions to QoQ GDP growth %

Front-loading buried, but a big drop still probable

But if the front-loading was denatured, does that mean that 4Q19 figures will escape the big drop that usually follows the front loading? In our view, probably not.

For one thing, it seems a stretch to rebuild inventories against a known background of likely weak 4Q19 demand. Sure, if it were involuntary, then it could happen, but it is not as if a weak quarter of demand in 4Q19 is likely to be a surprise. More probable, inventories will be roughly unchanged rather than fall sharply as they did in 3Q19. Their contribution might rise to something closer to zero, so it gives 4Q19 GDP a better starting point. But that is likely to be offset by falling household consumption and falling investment.

Retail sales for October fell by 17.4%YoY, having risen by 11.0%YoY in September. Compared to 2014, this means that sales rose slightly less just ahead of the tax hike, and have also fallen slightly less too immediately afterwards. So perhaps the 4Q19 collapse will not be as abrupt.

The other hope is for a bigger decline in imports and recovery in exports. That is not impossible. Though exports are still likely to struggle against a weak global demand backdrop, some softer imports may at least soften the blow of weak domestic demand.

The JPY 13 trillion support package arrives

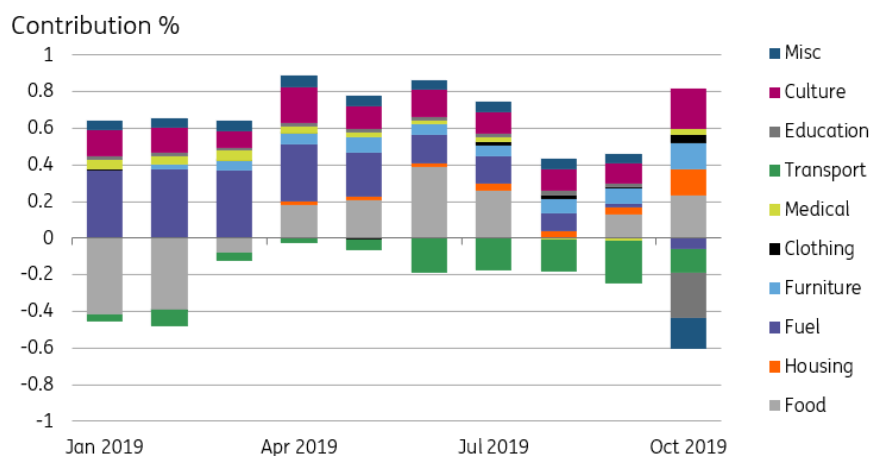
Looking beyond the immediate period of economic disruption, prime minister Shinzo Abe launched

a fiscal package of JPY13.2tr (\$121bn). That is about two to three per cent of GDP, though we expect the effective element of this will be far smaller in terms of 2020 GDP as it is to be spent over 15 months, and will likely contain some spending already accounted for, or include soft loans, not real spending.

The spending could help Japan get over another hump – namely the end of construction investment following the conclusion of next year’s Olympic Games. Exactly what the package will entail is not yet public knowledge, but it will likely contain a number of natural disaster protection elements, (flood defences etc) as well as infrastructure.

Typically, it is not a good idea to bump up GDP forecasts in response to stimulus packages such as this, though they also tend to provide very lumpy support and it may well be that 2020 is every bit as bumpy as we thought 2019 would be.

Japanese inflation dampened by education



Source: CEIC

Inflation unchanged - or is it?

The other big change to our forecasts for 2020 is in terms of inflation.

Our previous forecast treated the consumption tax in the same way as previous hikes, which led to a 12-month price spike and raised inflation that then dissipated. This time, there has been no such price spike – well there has – but it has been almost totally offset by the impact of pre-school childcare, which has been made free. So in October, alongside a rise in clothing and footwear costs of 1.6% (on top of 4.1% the previous month), a 0.9%MoM medical care spike, 2.2%MoM entertainment increase and 1.1% increase in transport and communication costs, education prices fell 8.4%.

The other big change to our forecasts for 2020 is in terms of inflation

From the previous month, national CPI inflation remained unchanged in October. And we have had

to drop our inflation profile for next year substantially to reflect this offsetting price reduction. Saying that there was no change in Japan's price level in October is a bit of a simplification though. Considering how few people in Japan have children of pre-school age, for most households, prices have risen quite a lot without any offsetting declines.

In other words, the lack of movement in Japan's price level is a statistical simplification for the majority of households.

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

China: How alarming is the default risk?

We have seen default cases rising in China's bond market. But is it really a bad thing?



Source: Shutterstock

Is this a fall off the cliff or a healthy clean up?

As always defaults are eye-catching and bad news for investors, issuers and the market.

For the economy, if poor credits can access funding to cover existing debts, and rollover "forever" then accumulating these debts, without defaults, isn't a great situation as it has the potential to create a default time bomb.

Therefore, the question is if the recent round of defaults is a large scale fall-off-the-cliff event that will rock the market or just a cleanup of bad credits.

China bonds default cases have increased

We think there are three reasons why the number of defaults in China has increased:

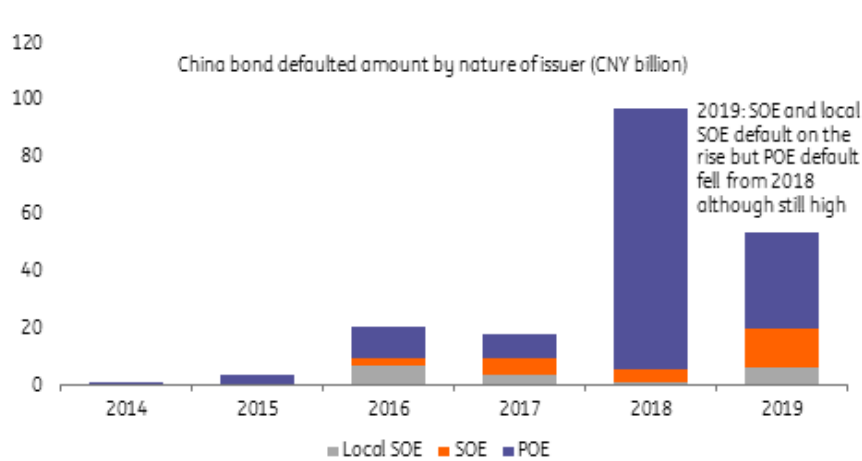
1. Lots of local government special bonds - around CNY2.5-3 trillion - have been issued in 2019 to support infrastructure projects. The market has started to question if this influx could generate a series of defaults, which would be on what are by nature corporate bonds and therefore not guaranteed by the local government.
2. Land sales revenue for some local governments has been small while relief measures have increased due to the trade war. The combined effect of these factors impacts local

governments' ability to pay. Default from local SOEs jumped from nearly zero in 1Q18 to more than CNY6 billion in 3Q19.

3. Defaults on bonds issued by privately-owned enterprises have been high though these have fallen since 2018. Then, the government aimed to clean up POE bonds after the cleanup of SOE loans in 2016-2017. The issue with POE is more complicated as major shareholders usually pledge their shares as collateral for loans. Should the company be unable to repay the loan, the stock market then reflects this through a lower share price, in turn making repayment more difficult.

China bond default on the rise

Data as of 4th December 2019 from Bloomberg do not include private placements.



Source: ING, Bloomberg

Shadow banking is shrinking at the same time

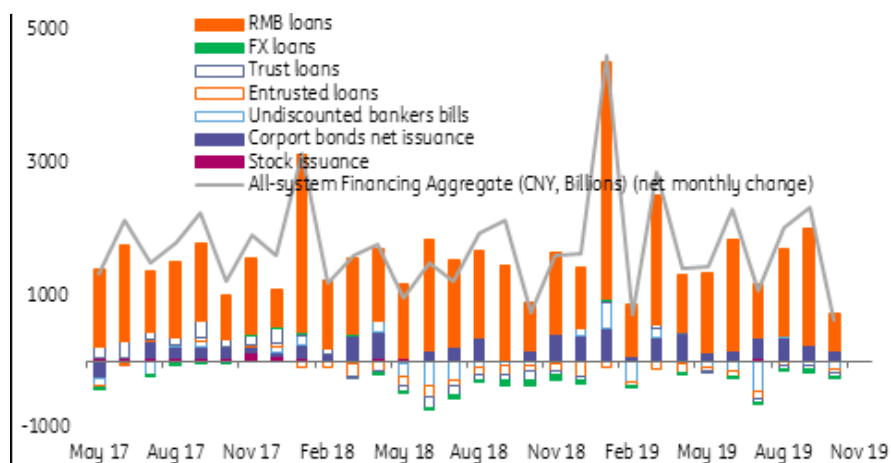
This view is confirmed by shrinking shadow banking activities.

Shadow banking activities have been shrinking since early 2018, thanks to the efforts of the central government to restrict these. In 2019, the shadow banking activities most affected have been peer-to-peer (P2P) lending platforms, which accepted loans drawn by mostly smaller firms that were facing difficulties. Trust companies then packaged the P2P loans and sold these to investors seeking yields.

In 2019, the central government has driven most P2P activities out of business. The Chinese central bank has increased incentives for banks to lend to smaller firms.

Shadow banking has been shirinking

Hollow bars are shadow banking activities



Source: ING, Bloomberg

More defaults to come in 2020

We expect more local state-owned enterprises to default in 2020 - land sales will be limited by restrictive housing measures and the credit ratings of local governments will continue to be diverse.

Local government special bond issuance has increased since late 2018. Usually, these bonds have maturity of five to 10 years. The concern isn't about these credits defaulting in 2020, but rather in 2023. By that time infrastructure projects should be completed and should begin to generate cash flows to repay the debts. In 2019, the rate of local state-owned company defaults has been faster than in 2018, also reflecting the government's intention to stop overlending at the local government level.

We also expect the default of private-owned enterprise bonds to continue at a high level of around CNY35 billion in 2020, similar to the level expected in 2019. Critical here is that shareholders pledge shares to get loans, which in turn has the potential to increase risk correlation between the share prices and the loan and bond markets.

China's sovereign bonds will remain intact as these are seldom affected by state-owned players' default situations.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

India: A central bank surprise

The Reserve Bank of India's on-hold policy decision comes as the central bank cut its growth outlook for the current fiscal year, the fifth cut so far, and also raised its inflation forecast. We expect one more 25 basis point rate cut in the current cycle



Source: Shutterstock

5.15% RBI repurchase rate

No change today

Higher than expected

Stable policy

Confounding the broad consensus of one more 25 basis point rate cut, and our more bearish 40 basis point cut forecast, the Reserve Bank of India decided to leave the repurchase and reverse repurchase rates unchanged at 5.15% and 4.90%, respectively. There was also no change to the 4.0% cash reserve ratio for banks.

It was a unanimous decision by all six policy committee members. The [statement](#) noted that the policy stance would remain accommodative “as long as it is necessary to revive growth while ensuring that inflation remains within the target”. This is despite continued inflation risks ahead

from higher food prices going into 2020 amid rising inflation expectations. The RBI now sees inflation rising above 5% in the second half of the current fiscal year (FY2019 started in April), against an earlier forecast in October of under 4% inflation. It also cut its growth forecast for this year to 5.0% from 6.1%, the fifth cut so far.

End of easing? Not yet..

The policy pause comes after 135 basis points of rate cuts earlier in the year did little to revive the economy while rising inflation has also started to reduce the policy space.

While inflation isn't going to be a hurdle to further RBI easing if needed, we do believe that the downward growth cycle has reached a trough. However, against a backdrop of rapid easing earlier this year and persistent downside growth risks ahead, we think the easing cycle might have a bit further to run. We maintain our forecast of a 25bp rate cut at the February 2020 meeting, which we expect to be the last cut in this cycle.

Good for INR, but not great

The RBI's decision was a disappointment for the markets which, we think, had priced in a 25bp rate cut. But it's positive for the Indian rupee (INR), Asia's underperforming currency this year, partly due to aggressive rate cuts.

The INR lost some ground today in trading until the RBI's decision. Its reaction to the decision was positive, though not enough to offset weakness before the decision. We don't think the worst is over for the beleaguered currency, not least from a policy perspective, and maintain our view of USD/INR rate at 73.00 by end-March 2020.

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com

Philippines: November inflation at 1.3%, BSP likely on hold.. for now

Philippine inflation edged higher in November to 1.3% which should convince the data-dependent BSP Governor to refrain from rate hikes..for now



Source: Shutterstock

1.3%

November CPI inflation

ING forecast at 1.3%

Higher than expected

Philippine November inflation rises to 1.3%

After dipping to 0.8% in the previous month, inflation for November settled at 1.3% with price gains in the top three subsectors remaining subdued. This was slightly faster than the market expectation for a 1.2% increase and should be enough to persuade the central bank to pause at its next meeting.

Food inflation was flat on the back of improved supply conditions and ample rice supply thanks to legislation that removed quotas on rice imports. Relatively stable global crude oil prices also

helped both utility (1.2%) and transport costs (-2.4%) to keep headline inflation below the lower-end of the Bangko Sentral ng Pilipinas' (BSP) 2-4% inflation target. Taken together, food, utilities and transport account for 68% of the CPI basket.

Bounce and settle: Inflation to trend higher from hereon

With base effects from last year's inflation spike fading quickly, we expect the acceleration in inflation to continue into 2020 and settle at around 3% throughout most of next year. For as long as supply conditions remain favourable, we can expect inflation to remain in-check, though we are unlikely to re-visit sub-2% inflation for at least the next 12 months.

November headline inflation to convince BSP to pause

Given the higher than expected inflation, we expect BSP Governor Diokno to refrain from reducing policy rates at the 12 December 2019 meeting, Diokno has indicated that his policy decisions remain data-dependent with inflation being the primary consideration for rate adjustments. Given his dovish leaning, Diokno could resume his rate cut cycle as early as 1Q 2020 to chase a higher growth target (6.5-7.5%). The Peso may receive some near-term support as faster inflation means that a BSP rate cut is off the table for now.

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

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