Good MornING Asia - 6 March 2019

Australian dollar sitting a little above 0.7050. A push below 0.70 wouldn't take too much and the RBA Governor seems happy to help

In this bundle

Australia

Lowe helps AUD lower

Australian dollar sitting a little above 0.7050. A push below 0.70 wouldn't take too much and the RBA Governor seems happy to help.

By Robert Carnell

China

China: Pro-growth policies signal headwinds remain

China set its GDP growth target for this year at 6.0% to 6.5%, lower than last year's target. Pro-growth measures, despite positive progress in...

Philippines

Philippines: Inflation back within target

Philippine consumer price inflation of 3.8% in February is back within the central bank's (BSP) policy target range of 2-4% after 11 months of...

Lowe helps AUD lower

Australian dollar sitting a little above 0.7050. A push below 0.70 wouldn't take too much and the RBA Governor seems happy to help.

Just a little bit further...

It's hard to find outright calls to make on markets these days, with the US Treasury market priced about right, the dollar too, so aside from the INR, there are few conviction calls to make. One of these is the AUD, which we see weaker this year.

It isn't that there is anything particularly wrong with the Australian economy (see our recent note for reasons why we think this), but there are few other currencies around which are so wholeheartedly wished weaker by their central bank than the AUD.

In this morning's comments, following the no change decision of the RBA on rates yesterday, RBA Governor, Phillip Lowe said, "It’s hard to think of a scenario where interest rates would need to go up this year. Inflation pressures are very benign, wage growth remains low, and the current rate of wage growth is unlikely to generate an inflation rate of 2.5%, and there are a number of other factors that are weighing on inflation at the moment”

A growing number of market economists are rushing to add rate cuts to their forecasts. I don't see it. The economy is going forward, not backward. It just has some issues. The following additional remark by Lowe seems to sum up our expectation of nothing for ages. “...I think it’s quite unlikely that inflation’s going to be a problem anytime soon, and if it’s not, then we can keep the ***current setting*** of monetary policy for some time” (our emphasis)

BIS warns of risk from Investment Grade bonds

Normally, an investment grade is an indicator of a degree of safety in an investment. But in a very thin day for news, one story has caught my eye, which is the risk posed by the pile of low rated, but still investment grade credit that high yield investors would struggle to absorb in the event of a mass downgrade.

The bit that made me cringe, was an analyst saying words to the effect that "Don't worry, the economic outlook remains benign". in other words, it is a theoretical risk only, but one that is unlikely to occur.

We wrote late last week about Paul Krugman's view that the world is headed for recession. Moreover, the un-named analyst's comments are also a bit chicken-and-egg.

It's an interesting story, but it would be a bit more interesting if high yield credit spreads were at a multiperiod low. We'll leave this one for the credit guys to disentangle. It's a bit too hard for a mere economist.

Day ahead - not much

Aside from Australian GDP, which is released about when this note gets published (expected 0.3%QoQ, 2.6%YoY) there isn't a lot going on in Asia today.

The G-7 is only a bit more lively, with ADP figures providing a prelude to Friday's labour report. Another strong number must surely cause some re-think of the rate cuts priced into the market for the US, though maybe we need to see the March 20 FOMC dot diagram before markets will revise their thinking.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

Article | 5 March 2019 China

China: Pro-growth policies signal headwinds remain

China set its GDP growth target for this year at 6.0% to 6.5%, lower than last year's target. Pro-growth measures, despite positive progress in...

Source: Shutterstock

GDP growth target of 6% to 6.5% worries the market

Although the market probably should have expected a lower growth target, investors reacted negatively when the 6% to 6.5% range for 2019 was announced. Our forecast is 6.3%.

We think it is more important to understand how the Chinese government plans to support the economy to achieve this growth rate, especially in terms of providing job security.

6.0% - 6.5% GDP growth target 2019

The government emphasised fiscal stimulus more than monetary easing

The fiscal deficit target for this year is 2.8%, higher than 2.6% a year ago. And we know that the actual fiscal deficit is around 0.5 percentage points higher than the planned target.

- There will be CNY 2 trillion of cuts in taxes and fees. Among these, cuts in VAT for various sectors are eye-catching. For example, VAT has been reduced to 13% from 16% for the manufacturing sector, and to 9% from 10% for the transportation and construction sectors.
- There will also be CNY 2.15 trillion of local government special bonds to support infrastructure projects.
- We have estimated that the economy needs CNY 4 trillion of stimulus to be able to grow at 6.0% to 6.5%.

However, the government work report did not highlight monetary policy as a tool for stimulating the economy, and the description of "prudent" has re-appeared, which suggests there could be debates within the government about how strong credit growth should be.

The good news is that private enterprises will get more credit so that they can keep, or even grow, the number of jobs, as the target for such loan growth is set at over 30%.

3% VAT cut for manufacturers

from 16% to 13%

+30% Small business loan growth

The surprise is in the yuan mechanism

We are surprised by the wording of the yuan mechanism, which is very vague.

As we discussed in a previous note, the main focus of this government work report, for us, was the description of the yuan's trend, as this is one of the topics to be resolved before any trade agreement between China and the US. The US has already requested that China keep the yuan stable.

The wording of the yuan mechanism in this government work report simply repeats the 2016 version, citing plans to "improve the exchange rate mechanism and maintain the basic stability of the RMB exchange rate at a reasonable and balanced level".

Since 2016, the USD/CNY has closely followed the dollar index. The repetition of the 2016 wording on the exchange rate mechanism could mean that USD/CNY will continue to follow the dollar index. Our forecast of USD/CNY is 6.75 by the end of 2019.

We will have to see if the US accepts this vague exchange rate mechanism as an answer to its request not to depreciate the yuan.

> *"The wording of the yuan mechanism in this government work report repeats the 2016 version.... Since 2016, the USD/CNY has closely followed the dollar index."*

Do pro-growth measures mean the economy will be just fine?

China is again relying on infrastructure investments and construction activities to help its manufacturing sectors. We believe that with so many pro-growth measures, the economy can grow within the target range of 6.0% to 6.5%.

Data related to the manufacturing sector and investments will improve gradually, particularly manufacturing PMIs, industrial profits, raw material prices and fixed asset investments of construction, property developments and infrastructure.

But if consumers worry and job security and wage growth continue to fall, consumption will take a hit. We will put more weight on consumption growth to gauge this year's economic growth.

The fact that China needs such sizeable fiscal stimulus to support economic growth suggests that the headwinds are significant and will not go away easily. The Chinese government is presumably cautious about the development of the trade war. And businesses are also likely to be careful about making big investment decisions until it is very clear that business risks from the trade war have ended.

Snap | 5 March 2019 Philippines

Philippines: Inflation back within target

Philippine consumer price inflation of 3.8% in February is back within the central bank's (BSP) policy target range of 2-4% after 11 months of...

Source: Shutterstock

3.8%

February inflation

Back in the BSP's policy target range

Lower than expected

Back within target

Consumer price pressure in the Philippine continued to dissipate in February, returning inflation back to within the BSP's 2-4% target range after 11 months of breach. The 3.8% year-on-year CPI inflation of the last month was in line with our forecast and below the Bloomberg consensus median of 4.0%. As is often the case in a cost-push induced inflation episode, inflation has slid from its peak of 6.7% in September-October 2019, to 3.8% in a matter of 4 months. This was thanks to more stable supply chains and relatively well-behaved oil prices. This adds another data point suggesting that the inflation spectre has been tamed for the time being and, more importantly, inflation expectations are now well-entrenched.

Food basket weighs on headline

The basket-heavy food index, the bane of 2018, has helped bring down headline inflation in 2019 with rice prices showing just a 2.9% increase from a year ago.

Easing inflation leaves policy door wide open

With inflation back within the target range, this leaves the door wide open for newly appointed Governor Ben Diokno to think about easing off the brakes and looking to help support the growth side of the equation.

Governor Diokno has spent his career on the fiscal side of the fence and has indicated that the "role of the BSP is to ensure sustained inclusive growth". With the price goal seemingly in hand, it may be time for the BSP to consider the possibility of reducing the reserve requirement ratio in the near term, and eventually lower policy rates to help chase the 7-8% growth target.