

Good MornING Asia - 7 July 2021

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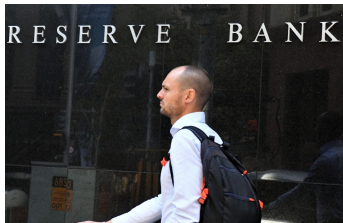


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Source: Shutterstock

Low growth world ahead - I doubt it

As the world's most dynamic region, the Asian market concern about an approaching slow-growth decade - presaged by falling US Treasury yields is worth pondering, but only briefly. The explanation for this slow growth angst, given out freely by newswires this morning, seems to stem mainly from a single data release, the July US non-manufacturing ISM index.

The index did fall several points, but at 60.1, remains in what I would normally regard as an extremely healthy level. Moreover, this index is quite nuanced in that it is a measure of how the future will look relative to the past - will activity be "**stronger**"? Not necessarily "will it be strong". As such, it is subject to all the same vagaries as year-on-year measures, when the past is strong, the future may not show much improvement even when it is still in absolute terms "strong".

For the same reason as you cannot accelerate indefinitely, this index cannot point to ever-stronger growth indefinitely. No, there is really nothing in the ISM data that is worth a 7bp decline in Treasury yields.

Our Head of rates strategy, Padhraic Garvey, [writes in his latest rates spark about this issue](#) (ahead of the ISM data, which he rightly dismissed in importance) and he touches on an important aspect of what may be going on.

He notes that expectations for rates, even though rate hike expectations may have been drawing closer, do not rise very far. Indeed, if you look at simpler measures than he does in his note, for example, at the implied rates on the Fed funds contract as far out as you can go, rates don't even get to 1.25% by 2026.

This, it seems to me, could be the key message we should be taking away from recent market movements. Rates may well rise a lot sooner than many of us are expecting. In Asia-Pacific, [the RBA yesterday seemed to undertake a shuffling of its positions](#) to allow for some earlier forward guidance than it has been making. 2023 rather than 2024 may soon be the new guidance. But like the Fed, some may consider an even earlier hike a possibility.

The Bank of Korea, likewise has already indicated that [it might like to start the normalization process this year](#). That still seems a bit aggressive to us while the jury is still out on Covid containment. But even here, we suspect that very high household debt levels in South Korea mean that rates may not rise much at all over the coming business cycle before they start to weigh on growth.

And elsewhere in the region, even when we don't see much imminent change in policy rates, where rates have been aggressively cut, some small reversals of emergency easing could come in sooner than expected, though may also stop well short of what we might consider a "tightening cycle".

So if longer-dated maturities are a function of the sum of shorter maturities, plus a term premium, which in theory, they are, then the rate at which longer-dated bond yields settles may not even be as high as the forecast peak in rates for this cycle, bearing in mind that there may well be subsequent declines. Can this conjecture square the circle with the pressure on prices we keep seeing? To some degree, I think it can. Sooner, but lower in total could well help us to reconcile what appears to be the new conundrum. It is also an outcome that is likely to be less hostile for Asian emerging markets, which would struggle more with a protracted tightening schedule by the Fed and major central banks, but could probably weather a shorter and capped tightening cycle better, depending on how the USD responds.

Dataflow today - not much

It is a quiet day today in Asia for data, with Taiwan trade and CPI data the highlights: Iris Pang in Hong Kong writes, "Taiwan trade data released today will likely point to faster growth, even during a month in which Covid picked up and led to stricter social distancing measures. And this is all because of the low base last year.

We also expect Taiwan CPI to edge down on a yearly basis, reflecting the impact of rising Covid rates on the economy, which would also match the higher unemployment rate released yesterday. The unemployment rate came in at 4.1% in May from 3.6% in April.

As a result, we expect a weaker TWD against the dollar as Covid continues to limit people flows".

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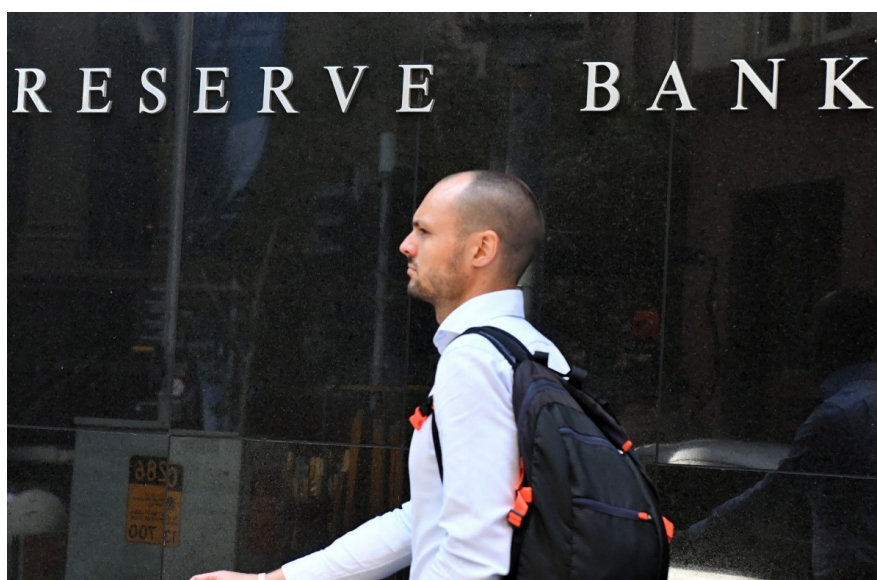
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Reserve Bank of Australia makes room for adjustment

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Cut to the chase

Perhaps the most important part of this RBA statement is always contained in the last paragraph, which this time states. *"It (the RBA) will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. The Bank's central scenario for the economy is that this condition will not be met before 2024. Meeting it will require the labour market to be tight enough to generate wages growth that is materially higher than it is currently".*

This tells us a couple of things. One is that, unlike the US Federal Reserve, there has not yet been any clear change in the Reserve Bank of Australia's commitment to keeping the cash rate unchanged until 2024. However, the small details matter. The new forward guidance has lost the additional qualifier "at the earliest." It has also added the caveat that this is dependent on the "central scenario" being met. That was not present in the June statement. Both provide some wiggle room.

We also get confirmation that it is changes in the labour market that are going to be pivotal to any future changes in policy. So we know what data we need to scrutinise. Even though we have known this for a while, this is confirmation.

So one could argue that though the 2024 commitment to an unchanged cash rate remains intact, the commitment is being softened up in preparation for a possible shift forward. Which, given the description of the economy that precedes it, is not at all surprising.

The economy is great - rates on hold?

Indeed, this commitment to keeping the cash rate on hold until 2024 looks increasingly strained relative to the description of the economy that the RBA provided earlier in its statement.

For example:

- *"The economic recovery in Australia is stronger than earlier expected and is forecast to continue".*
- *"The outlook for investment has improved and household and business balance sheets are generally in good shape"*
- *"National income is also being supported by the high prices for commodity exports."*
- *"The labour market has continued to recover faster than expected."*
- *"...more Australians have jobs than before the pandemic"*

The fact that wage and inflation outcomes remain "*subdued*" is also at least partly a function of the fact that this quarterly data comes out with a considerable lag. We don't get any new wages data for 2Q21 until 18 August, though CPI for 2Q21 is released a bit earlier on 28 July. Current justifications are being made with reference to some fairly dated figures.

Other decisions today

As flagged at the June meeting, the RBA made a decision on which bond to target with its 3Y yield curve control policy, and it has stuck to the April 2024 issue. This is in line with our prior thinking. You certainly wouldn't target a longer-dated issue if you were seriously considering shifting your first cash rate hike forward, conceivably to 2023. That would make it very hard to control. The rate for the yield curve control target was left at 0.1%. We were told that last month - this was never in doubt.

The RBA has also been quite clever with its asset purchase targets. Whereas previous policies aimed to purchase AUD100bn over a six month period, the latest plan to purchase AUD4bn per week represents about the same pace, though allows for a near-term adjustment at the November meeting.

Conclusion - markets being prepared for a shift to 2023 guidance - they are already there

Taking all of these small changes together, it looks to us as if the market is being softened up to accept a change in guidance on the cash rate at forthcoming meetings to a first hike during 2023, not 2024. If so, then the market was pretty much there already. It is also being conditioned to accept an incremental lowering of the asset purchase pace over coming quarters. We could imagine an AUD3bn per week target in November, reducing to an AUD2bn target in February and so on.

Implied rates on the 3m bank bill future were at 0.95% on the December 2023 contract yesterday. They have risen only to 0.98% today following this statement. Consequently, we suspect any boost

to the AUD or to Australian longer-dated bond yields that this statement will provide will be fairly modest.

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Philippines: Inflation dips to 4% in June

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Source: Shutterstock

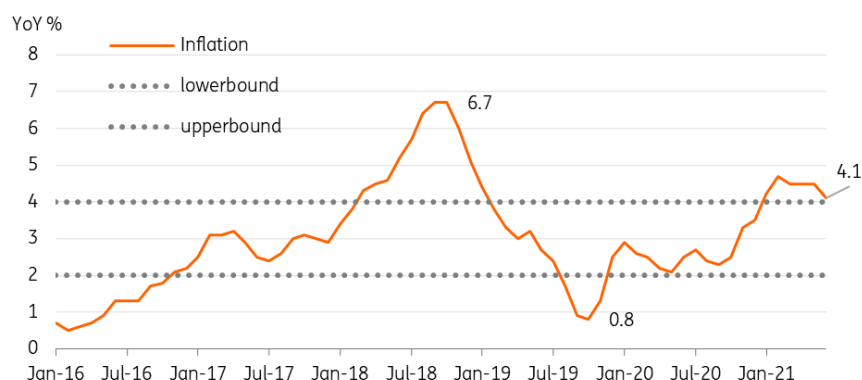
4.1% June CPI inflation

Lower than expected

June inflation at 4.1%, YTD at 4.4%

Philippine inflation decelerated to 4.1% in June, lower than market expectations as transport inflation eased significantly for the month, outweighing still-elevated food prices. Food inflation, which accounts for the bulk of headline inflation, accelerated slightly to 4.7% (from 4.6%) as meat prices stayed stubbornly high due to ongoing supply disruptions caused by African Swine Fever. The big surprise for the month was the stark deceleration in transport inflation which slowed considerably to 9.6% from 16.5% in May as base effects from pandemic-related rules for public transportation faded. Year-to-date inflation remains at 4.4% and we expect inflation to slide back within target by July should both food and transport costs behave.

Philippine inflation



Source: Philippine Statistics Authority

BSP still not likely to alter course anytime soon

Bangko Sentral ng Pilipinas (BSP) Governor Diokno has signalled that he will likely retain his accommodative stance for at least another year as he provides monetary support for the economic recovery. BSP has looked past the 6-month inflation target breach citing the need to deliver stimulus at a time of economic struggle. Subsiding inflation will relieve some pressure on the central bank to hike policy rates. With price pressures fading, we expect inflation to decelerate in the second half of the year as meat prices normalize with authorities allowing higher import volumes for the commodity. Meanwhile, base effects tied to social distancing guidelines for transport and other services are also likely to fade in the coming months, offsetting a projected acceleration in utility and fuel costs given the surge in global oil prices. With inflation set to glide back within target, we expect BSP to retain policy rates at 2% for the balance of 2021 and only consider adjusting policy by mid-2022.

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