Good MornING Asia - 7 June, 2019

Is the USD weaker on Mexico tariff delay, or is EUR stronger on Draghi disappointment?

In this bundle

Opinion | 7 June 2019

Bit of a mess

Is the USD weaker on Mexico tariff delay, or is EUR stronger on Draghi disappointment?

Mess

Disentangle at your peril

The apparent market disappointment with the latest ECB package of measures - tweaked forward guidance, and details of TLTRO3 (priced at 10bp above deposit rates) is a bit perplexing. Yes, ECB economists have downgraded their forecasts for growth and inflation next year (which remains well below target), but recent Eurozone data hasn't been too bad - certainly better than the most pessimistic forecasts a few months ago and may be turning the corner if sentiment indices are anything to go by.

Our economists and strategists have been very busy, I've found three separate articles on the ECB meeting on our "Think" Website this morning home page, or you can click here, here and here to see them.

To summarise these, it looks as if anything short of outright rate cuts or renewed QE are proving insufficient to appease a market that is increasingly talking itself into recession mode - and that is in the US as well as Europe.

Mexican standoff

As for the possible delay to Monday's tariffs on Mexico, this is running a pattern with which I am now becoming quite familiar. Raise market hopes for something reasonable, then dash them again. The usual market response to an apparent reduction in US trade aggression with respect to Mexico is delivering a generalized bout of USD weakness, as it should. It is also giving stocks a chance to recover, and bond yields have clawed their way back up to 2.11%.

But such moments of trade peace seem to be fleeting. I would not be at all surprised if we return to the "Not good enough" tweets that have greeted many of these episodes, and a return to falling stocks, a stronger USD and lower bond yields again. Give it a few days.

Today, Gold is a little softer, oil a little stronger. You can probably reverse that too once the "hope springs eternal" mode is replaced with "reality check" in a few days time.

Day ahead

Today will be totally dominated by the US labour report. James Smith's piece on that is here. Following Wednesday's weak ADP and my comments on the usefulness of this and other surveys, James very helpfully unearthed and updated some payrolls reliability work we did years ago. And the upshot confirmed my ramblings yesterday - namely the ADP and payrolls move in the same direction (i.e. they both rise month on month, or both fall) about 62% of the time. That is better than a coin flip, but not much. The ADP has been calling direction correctly at a better rate than this recently, and James' view is that non-farm payrolls may come in a bit softer this month. We'll know soon enough, which may open a new chapter in the saga of Fed chair, Jerome Powell, versus the markets.

Asia is looking pretty quiet this morning. Currencies are steady to firm versus the USD. Bond yields are generally following US Treasuries a little higher, though not much. Like the US, an air of imminent easing hangs over the region, given another boost by yesterday's rate cut in India.

Japanese data this morning is a little disappointing - labour cash earnings beat the consensus (-0.7%), but are still down year on year (-0.1%). Aussie home loan data today will be worth a quick look, given nascent signs of stabilization in the Sydney housing market. And then after that, you can probably take yourself off the gym, or pub, depending on your preference. Sadly I have a presentation to prepare, so will be stuck at my desk - but don't let that stop you!

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Article | 7 June 2019

Asia week ahead: Data dump from China and India

We'll be watching a raft of economic releases from China and India next week for evidence about GDP growth and the impact of the trade war in the...

Source: Shutterstock

China: Stimulus is helping

China reports most of the economic data for May next week. The combined April-May data will be a good gauge of GDP growth in the current quarter and will be scrutinised for clues about the impact of the ongoing trade war with the US. The economy seems to be experiencing only tremors right now and growth appears to be holding up, as in the first quarter of the year.

This will probably continue to be the case for the second quarter, judging from consensus forecasts for most of the upcoming economic indicators, especially forecasts of steady to slightly better growth of fixed asset investment, retail sales and industrial production. The money and lending data will offer clues about the fiscal stimulus efforts, which remain supportive for the domestic economy at least. Export weakness is just starting to come through but low single-digit export declines are still better than the declines seen in regional economies.

India: Inflation test of latest RBI rate cut

India's trade and industrial production figures will inform our view of where India's GDP growth is heading in the current quarter after a surprisingly weak, five-year low of 5.8% in the last quarter. The weak GDP was a trigger for the Reserve Bank of India's 25 basis points RBI rate cut this week – the third this year.

Consumer price inflation will also be in the spotlight following that decision. Inflation is creeping higher as rising food prices kick in after weak farm output growth in the last quarter, while the favourable base year effect is also nearing its end. We believe the RBI easing cycle is over for now (See "We were wrong on RBI policy, but for the right reasons").

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
		Sunday 9 June			
China	-	May Money Supply (M2) (YoY%)	8.5	8.6	8.5
	-	May Aggregate Finance (Yuan bn)	1933.0	1410.0	1359.2
	-	May Financial Institution Loans (Yuan bn)	1450.0	1300.0	1020.0
	-	May Loan Outstanding YoY%	13.5	-	13.5
		Monday 10 June			
China	-	May Trade Balance (US$bn)	-6.2	23.3	13.8
	-	May Exports (YoY%)	-3.8	-3.8	-2.7
	-	May Imports (YoY%)	11.4	-3.0	4.0
Indonesia	-	May CPI (YoY%)	3.1	3.2	2.8
	-	May Core CPI (YoY%)	-	3.1	3.1
Taiwan	0900	May Exports (YoY%)	-6.1	-	-3.3
	0900	May Imports (YoY%)	0.1	-	2.6
		Tuesday 11 June			
Malaysia	0500	Apr Industrial production (YoY%)	2.4	2.7	3.1
	0800	May Forex Reserves, Mth-end (US$bn)	-	-	102.8
Philippines	0200	Apr Exports (YoY%)	-1.8	-	-2.5
	0200	Apr Imports (YoY%)	0.2	-	7.8
	0200	Apr Trade Balance (US$mn)	-3583.0	-	-3138.0
		Wednesday 12 June			
China	0230	May CPI (YoY%)	2.0	2.7	2.5
	0230	May PPI (YoY%)	-0.5	0.6	0.9
India	1300	May CPI (YoY%)	3.0	-	2.9
	1300	Apr Industrial Production (YoY%)	0.5	-	-0.1
	-	May Imports (YoY%)	-5.0	-	4.5
	-	May Trade Deficit (US$bn)	-15.2	-	-15.3
	-	May Exports (YoY%)	-8.0	-	0.6
Singapore	0600	Apr Retail Sales Value (MoM, SA/YoY%)	-/-	-/-	1.0/-1.0
South Korea	0000	May Unemployment Rate (% SA)	-	-	4.1
		Friday 14 June			
China	0300	May Fixed Asset Investment, YTD (YoY%)	6.5	6.1	6.1
	0300	May Industrial Production (YoY%)	5.5	5.5	5.4
	0300	May Retail Sales (YoY%)	8.1	8.2	7.2
India	0730	May WPI (YoY%)	3.3	-	3.1

Source: ING, Bloomberg, *GMT

Article | 6 June 2019 **India**

We were wrong on RBI policy, but for the right reasons

The shift in Indian central bank policy stance from 'neutral' to 'accommodative' doesn't' mean there will be more rate...

Source: Shutterstock
Reserve Bank of India's new Governor Shaktikanta Das

5.75% RBI repurchase rate

25bp cut today

Another RBI rate cut - not quite what we expected

As expected by an overwhelming majority in the Bloomberg survey, the Reserve Bank of India slashed the key policy rate by 25 basis point for the third time this year, taking the repurchase rate to 5.75% and reverse repo rate to 5.50%. The central bank also changed its monetary policy stance from 'neutral' to 'accommodative' but there was no change to the 4.00% cash reserve requirement ratio for commercial banks.

We thought the RBI would see through the latest GDP slowdown *recognising pipeline inflation pressures from food and fuel prices, a weaker currency and an excessively loose fiscal policy*

We were a consensus outlier in our forecast of an 'on-hold' policy, partly based on our conviction that this is what we think the central bank should be doing rather than what it would necessarily do, given that the economy has had enough stimulus - two rate cuts earlier this year, plus significant fiscal boost from government's re-election bid.

We believed the RBI would see through the latest GDP slowdown recognising pipeline inflation pressures from food and fuel prices, a weaker currency and an excessively loose fiscal policy.

Does change of policy stance matter?

We think the RBI's easing cycle is now finally over, especially after today's rate cut and despite shifting the policy stance from neutral to accommodative. Also, the previous two rate cuts in February and April were despite the 'neutral' stance, which was changed from 'calibrated tightening' stance in the February meeting (the same meeting they in fact cut rates). Another rate cut with neutral stance might not have gone down too well, which is why we view today's shift in stance as nothing more than justifying today's rate cut decision.

If risks are 'broadly/evenly balanced'in India, why has the central bank changed the policy stance from neutral to accomodative?

However, we are reading today's RBI statement as recognising some inflation risk from 'a broad-based pick-up in prices in several food items', even as the statement points to weak domestic and external demand weighing down non-food items while muted passthrough of global crude price volatility keeps domestic fuel price in check.

The RBI has nudged its inflation forecast for the first half of FY19-20 higher to 3.0 - 3.1% from 2.9 - 3.0% but cut that for the second-half to 3.4 - 3.7% from 3.5 - 3.8% with risks broadly balanced. They've also lowered the growth forecast for the current fiscal year to 7.0% from 7.2%, again with risks evenly balanced, which begs the question - why change the policy when risks are 'broadly/evenly balanced'?

In our view, the RBI easing cycle is finally over

By the time, all these rate cuts and the fiscal stimulus come through the real economy over the next two quarters, the inflation genie is most likely to be out of the bottle.

We maintain our forecast for a rate hike in the second quarter of 2020

A weak currency and increasing tariff barriers are likely to encourage imported inflation, amid risks of supply shocks from food and fuel prices. Negative growth in agriculture GDP in the last quarter of FY18-19 doesn't bode too well for food prices, for which prospects also hinge on the monsoon season.

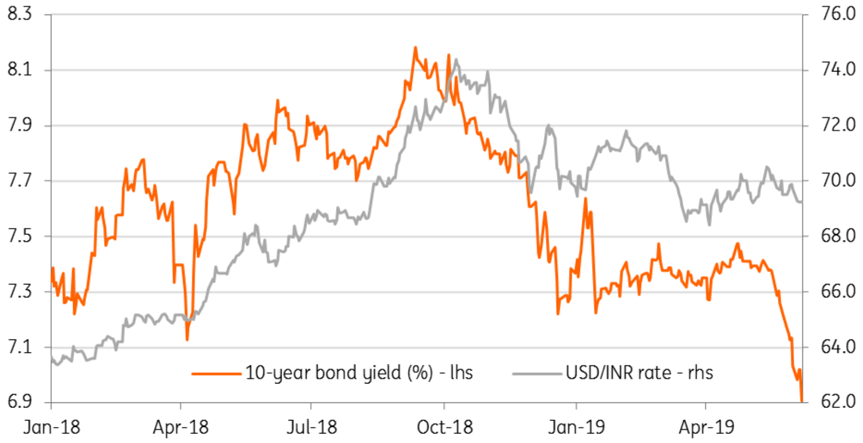
We continue to see inflation reaching the 4% mid-point of the RBI's target zone over next two quarters. Hopefully, the RBI will eventually see this as coming and leave policy on hold in the forthcoming meetings. Barring a prolonged slowdown in the economy and muted inflation in 2020, we believe the next move in the RBI policy rates would be higher.

We maintain our forecast for a rate hike in the second quarter of 2020.

What's in it for the markets?

Ideally, a widely expected policy decision should have no impact on markets, but we still think the recent strength of the government bond and the rupee is transitory. Besides potential inflation risk, the wide fiscal deficit and supply overhang from that on the bond market should make the yields sticky downward going forward.

A short-living rally in government bonds and INR



Source: Bloomberg, ING

As for the rupee, we think the market overbought the currency amid the euphoria of prime minister Narendra Modi returning to power for the second term. As for most emerging market currencies with a backdrop of twin deficits (fiscal and current account deficit), the external environment currently hasn't been friendly and it's unlikely to be so in the near-term as long as the trade war continues.

Moreover, with President Trump now shifting focus towards India, there will be more tailwind for INR depreciation going forward. We wouldn't be surprised if the currency re-asserts its recent status as an Asian underperformer in the days ahead.

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