

Good MornING Asia - 8 August 2019

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3 Central banks cut 110bp yesterday - who's next?

It's all kicking off in Central Bank space with three cuts yesterday from the Bank of Thailand, Reserve Bank of India and the Reserve Bank of New Zealand. Pressure must be building on BSP Governor, Diokno, to deliver more than 25bp today, and the ECB too after dreadful German production figures raise spectre of recession. The Fed won't be far behind...



But is this actually good news?

Yesterday could hardly be described as "yet another day in the office".

We started off being surprised by the RBNZ move. I think it is fair to say that no-one saw 50bp of

easing coming. We were even thinking of chopping our rate cut call altogether - [here is our longer view](#). We then moved on to disappointment, [that the RBI did not pause, mixed with bemusement at the 35bp easing](#). I love the tweet from Lorcan Roche Kelly (see below) which offers an excellent if tongue in cheek answer as to why this odd number.

We switched to elation later on, as [the Bank of Thailand finally delivered 25bp of easing](#), and was probably the only move of the day that was fully justified. I might add, it would not have upset us to see 50bp of easing from the BoT, nothing from the RBI and only 25bp from the RBNZ - that is, if our job was to forecast what central banks "should" do (we do stray into that territory from time to time), not what they will do.

BSP today - 25 or 50bp?

Yesterday's CB action puts pressure on Philippine Central Bank Governor Diokno to deliver more than the 25bp of easing priced in by markets. He has already suggested that there will be 50bp of easing before the year-end. but that view may have lengthened after yesterday.

The main thing that may dissuade him would be the PHP, which has been in the vanguard of EM currencies hit by recent market turmoil kicked off by China's relinquishing of the USDCNY 7 level. So 25bp is the more likely outcome, but let's not rule anything out. [See Nicholas Mapa's thoughts following recent Philippine inflation figures](#). GDP data out this morning may add to the debate if they come in on the weaker side.

Will the Fed get in on the action?

It seems that all this rate-cutting is making President Trump jealous he does not have such an acquiescent central bank. Well, we think he does, he just needs to be a bit more patient. James Knightley has just added another cut from the Fed to our house forecast - that's on top of the September cut we had in before. Just for the record, they have already finished quantitative "tightening" though the term is a horrible misnomer. No time for a rant on that today - and it's only a few days since I last let rip on this subject too.

I told you commodities were looking miserable

While I am peppering today's note with tweets, I might as well add one from our Head of Commodity Strategy, Warren Patterson, who more eloquently summed up my clumsy observations on commodities in yesterday's note with this simple tweet...

Back to the matter in hand

This has rather taken me off track from whether any of this is good news or not. Equities have bounced a bit overnight, though in Asia the futures markets look a bit mixed. Good, I think that for once, this is an appropriate response. Yes the prospect of further easing does help the discounted cash flow calculations for equity valuation purposes, but it only makes sense to rally every time a central bank hikes if you don't change your earnings outlook, and that is the point that Warren's commodity chart is screaming loud and clear - the global demand backdrop is clearly slowing.

As for whether it makes sense to front-run or over-deliver on monetary easing - there are many conflicting arguments here, and the answer is partly dependent on what you think the demand outlook really is, the prevailing very low level of interest rates and bond yields, and the absence of

much fiscal support. We could spend all day on this, which really means - it isn't obvious.

ECB?

It won't surprise anyone that we are looking for a return to incremental easing from the ECB in September. Yesterday saw some squalid production figures from Germany that suggest GDP growth may have now turned negative. This may not be the time for half-hearted measures.

But with all this monetary easing going on, the principle currency pair - EURUSD, seems relatively stable at about 1.12. If this was a tug-of-war between the ECB and Fed, they both seem fairly evenly matched right now. Currency wars really are a zero-sum game.

Asia today

Two other main events to watch today - both of them China-related:

1. Yesterday's CNY fix at 6.9996 indicates that we should expect a 7 - something fix today. That would be the first in a very long time, so watch out for the market reaction to that. Hopefully quite modest.
2. Chinese Trade data - Exports figures could look quite soft, and of course, this is pre-new tariffs, so whatever we see today, might not mark the low point.

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

Article | 8 August 2019

ASEAN Morning Bytes

Asian central bank easing cycle has intensified with the Philippines BSP joining the race today, possibly cutting rates by more than the usual 25bp.



EM Space: Central bank easing gets up to speed

- **General Asia:** It's all kicking off in Central Bank space with three cuts yesterday from the Bank of Thailand, Reserve Bank of India and the Reserve Bank of New Zealand. Pressure must be building on BSP Governor, Diokno, to deliver more than 25bp today, and the ECB too after dreadful German production figures raise spectre of recession. The Fed won't be far behind...
- **Thailand:** The Bank of Thailand caught the markets off-guard by cutting the policy interest rate by 25bp yesterday. The policy statement noted increased downside growth risks and continued subdued inflation prospects in support of easing. While rate cuts will take some of the appreciation pressure off the Thai baht, we don't see the currency losing its luster as a top-performing emerging market currency just yet. That said, we are revising our end-2019 USD/THB view to 31.5 from 31.0 ([here is more](#)).
- **Indonesia:** Bank Indonesia's new Deputy Governor Destry Damayanti indicated that central bank easing cycle "is set to last long" as the economy is in need of stimulus to boost growth amid darkening clouds on the global front. Furthermore, Damayanti said that BI will be utilizing a "mix of monetary and macroprudential policies to ensure financial stability". However, given the recent currency (IDR) volatility, we expect BI to be on the sidelines and

hold off on rate cuts until the IDR stabilizing.

- **Philippines:** June export growth of 1.5% YoY was in line but import decline by 10.4% was far worse than expected, which narrowed the trade deficit to \$2.5 billion from \$3.3 billion in May. The still wide trade gap will likely weigh on 2Q GDP numbers to be reported later this morning, sustaining it below 6% for the second consecutive quarter (consensus at 5.8%). And with continued deceleration inflation, there is scope for the BSP to ease by more than expected 25bp rate cut later today.

What to look out for: China trade data

- Philippines GDP (8 August)
- BSP meeting (8 August)
- Singapore retail sales (8 August)
- China trade balance (8 August)
- US wholesale inventories (8 August)
- Japan GDP (9 August)
- China inflation (9 August)
- US producer prices (9 August)

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

RBNZ delivers double-barrel 50bp cut

The Reserve Bank of New Zealand (RBNZ) appears to be adopting the "sooner is better" approach to monetary policy setting - cutting rates 50bp to 1.0%. This is a contentious decision - there was even a case for no change. This was not considered.



1.0% Cash rate target

Down from 1.5%

Lower than expected

Not one of the consensus expected 50bp of easing

18 out of 21 economists surveyed by Bloomberg forecast a 25bp rate cut today. We were one of them. The remaining three forecasters opted for no change, and there was a decent argument for that too, following strong employment and wages figures just the day before.

There is a respected stream of economic literature about expected versus unexpected monetary policy decisions. The latter are supposed to deliver more of a real impetus to the economy, whereas the former deliver more of a price level adjustment. The [accompanying statement to today's decision](#) does acknowledge the better labour market data, and even that inflation remains within range though below the mid-point of the 1-3% target (latest 2Q inflation was 1.7%, up from 1.5% in 1Q19).

But in keeping with concern over the state of the real economy, there are a number of somewhat perplexing references to weak GDP - the latest release of which was for 1Q19, which is now very dated. Either the RBNZ has some insight into the 2Q figure due on 19 September, which is possible, but still a long way off, or they are imputing a lot of transmitted weakness from the challenging

global conditions - namely trade war. This seems a sufficient excuse to justify a 25bp rate cut against a mixed domestic/ external backdrop, but it still doesn't deliver a very compelling case for a double-barrel 50bp cut.

Uncertainty may well weigh on New Zealand's business investment decisions in the months ahead to deliver a weaker 2Q19 GDP result. That would merit a second 25bp rate cut then. But it is hard to make that judgment now and raises the prospect that even today's 50bp of easing may not look like enough later on this year.

NZD on the receiving end of double-barrel rate blast

Not surprisingly, the NZDUSD has taken quite a blow from this policy action, dropping to 0.6423 before pulling back a little. The AUDNZD rate has spiked up to 1.0456, though if this move from the RBNZ was supposed to front-run some of their anticipated easing, then we would expect the RBA to pull ahead in the coming months with further cuts. They are also already at a 1.0% cash rate. The AUD itself has been dragged lower by this action, and AUDUSD fell to 0.6720 on this news.

We will have to consider whether or not to add further easing to our RBNZ forecast, as today's decision delivers what we had penciled in for the rest of the year. Our initial gut feeling is, that we probably will. It also begs a re-look at the RBA forecast, where we only had one further rate cut forecast.

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

Bank of Thailand catches markets off-guard

Our high-conviction, low-probability call of a rate cut has paid off. While rate cuts will take some of the appreciation pressure off the Thai baht, we don't see the currency losing its luster as a top-performing emerging market currency just yet. That said, we are revising our end-2019 USD/THB view to 31.5 from 31.0.



Source: Shutterstock

1.50%

BoT policy rate

After 25 basis point cut today

Lower than expected

Our high-conviction, low probability call paid off

Contrary to the solid consensus forecast of no change, the Bank of Thailand (BoT) Monetary Policy Committee voted five-to-two to cut the policy rate by 25 basis points to 1.50%.

We were one of only two forecasters looking for a BoT policy rate cut at today's meeting. All 27

other participants in the Bloomberg survey were looking for rates to stay on hold. The BoT's sustained hawkish rhetoric has solidified the consensus view even as economic growth continued to weaken this year and inflation continued to be subdued.

Indeed, the [BoT policy statement](#) noted increased downside growth risks and continued subdued inflation prospects in support of today's move. It also cited weak tourism as a factor dragging the economy into further weakness, while elevated household debt has been weighing on private consumption. On a positive note, the Committee sees economic potential benefiting from the relocation of production to Thailand (amid the ongoing US-China trade war) and implementation of public-private partnership infrastructure projects (Eastern Economic Corridor).

We see today's move followed by a cut in the central bank's growth and inflation forecasts for 2019, currently 3.3% and 1.0% respectively. We have recently cut our growth forecast to 2.8% from 3.1% ([read more here](#)), but we are reviewing our 1.0% inflation forecast for a downgrade in view of the recent dip below the BoT's 1-4% policy target (0.9% average in the year to July).

Not a one-and-done, more rate cuts to come

We don't think this is going to be a 'one-and-done' move. The easing cycle has just begun, and today's rate cut merely reverses a 25bp hike the BoT implemented late last year – not yet a real stimulus for the economy given the likelihood of further economic weakness ahead.

Judging by the BoT's routine hawkish rhetoric, it's hard to imagine that it will set itself off on an aggressive easing cycle. However, we don't see any reason why the BoT can't cut rates further, given the economy seems stuck on a low growth-low inflation path. For now, we have pencilled in one more rate cut in the fourth quarter of the year. But there may well be more to come.

What this means for the markets?

The authorities have been worried about rapid currency appreciation pressure with the view that this is potentially bad for exports as well as tourism. Foreign investors have been taking the Thai baht as a safe-haven bet given the strong backing from the large current account surplus and record stock of foreign reserves. As recent BoT measures to stem short-term confidence-sensitive capital inflows are proving inadequate, rate cuts should provide some additional help.

Nevertheless, we don't see the currency losing its luster as a top-performing emerging market currency just yet. We are only revising our end-2019 USD/THB forecast slightly higher (currently 31.0) to 31.5 (spot 30.8) as an intensified currency war could help the THB to sustain its regional outperformance through the rest of the year.

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

India's RBI cuts more than consensus by 35bp

The Reserve Bank of India's decision to cut rates by another 35 basis points today will undoubtedly worsen the Indian rupee's plight during the ongoing emerging market turmoil. Meanwhile, renewed tensions over Kashmir won't have been helpful for the currency either. We are revising our end-2019 USD/INR forecast higher to 72.0 from 70.0 (spot 70.8)



Source: Shutterstock

Reserve Bank of India's new Governor Shaktikanta Das

5.40%

RBI Repurchase Rate

After 35 basis point cut today

Lower than expected

Our high-conviction, low probability call fails

Exceeding the consensus expectations of a 25bp cut, the Reserve Bank of India (RBI) Monetary Policy Board decided to provide even more of a boost to the economy with a 35bp cut today. And,

just as widely expected, there was no change to the banks' cash reserve ratio, currently 4%.

We were one of the 'only' two odd ones out in the consensus with our call for an RBI policy pause. Most of the 38 other participants in the Bloomberg poll forecast a 25bp rate cut, with a few even forecasting a 50bp cut. Our conviction for no change stemmed from the fact that the RBI had got well ahead on the easing curve with three rate cuts (for a total of 75bp) in as many meetings earlier this year. Moreover, we judged that prudent policy wouldn't want to fuel inflation, which is already slowly creeping up this year on the back of rising food prices, an excessive fiscal policy boost during the elections, and currency weakness since last year.

Further strengthening our conviction was Governor Das' recent remarks that the easing already undertaken was more than the sum of the rate cuts so far, as he viewed the very shift of the RBI policy bias from neutral to easing in the June meeting as amounting to an extra 25bp rate cut.

Is aggressive easing required...?

The consensus view may have been helped by the shift in the RBI policy stance from 'neutral' to 'accommodative' at the last meeting in June. Likewise, recent data signaling continued weak growth prospects could have supported a rate cut view. While these are valid factors supporting the consensus view, we differed, as earlier policy decisions weren't all necessarily consistent with the RBI's prevailing stance (it's easy to find from past statements).

In terms of data, yes, there have been more signs of economic weakness, though we don't see any more downside to overall GDP growth from a five-year low of 5.8% in the final quarter of FY2019 (January-March 2019). Indeed, loose macro policies should prevent growth from weakening further, while favourable base-effects should have begun to push growth higher from the first quarter of FY2020 (April-June 2019) and continue to do so in the rest of the year. Furthermore, the resiliency of the economy to current trade turmoil is also reinforced by roughly 2% export growth in the first six months of 2019 compared with falling exports from other Asian countries this year.

On inflation, we admit that it isn't out of control just yet and that the RBI can afford few more doses of easing in the event that growth does get worse from here on.

... as it adds to the INR's ongoing plight?

The emerging-market turmoil this week triggered by a spike in the USDCNY exchange rate above 7 saw the INR reasserting its status as Asia's weakest currency. And the outlook for the currency has turned more negative still with the move by the government this week to withdraw autonomy from the disputed state of Jammu and Kashmir - escalating border tensions.

In the steepest depreciation among Asian currencies this week, the INR has lost 1.9% of its value against the USD, taking the exchange rate past the 70 level last seen in late February - another of our high-conviction, low probability forecasts, though it's paid off, unlike our RBI policy call.

Judging from the limited negative impact on the INR from the RBI rate cut as of writing, we can only conclude that the cut was already largely priced in. That said, the larger than expected rate cut today may well foreshadow continued policy easing and further currency weakness ahead. As such, we are revising our end-2019 forecast for USD/INR from 70.0 to 72.0 (spot 70.8).

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

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This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

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