Good MornING Asia - 8 November 2019

Swings in sentiments associated with the US-China trade deal continue to rule the markets. And things seem to have turned for good for today.

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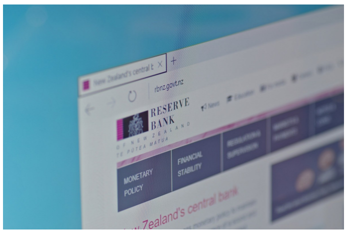

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By Robert Carnell and Francesco Pesole

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Source: Shutterstock

More central bank meetings

Among the Asian central banks, Thailand’s central bank finally gave in to easing pressure this week with a rate cut, but the Malaysian central bank continues to defy easing despite the increasingly weak state of the economy. Then there is New Zealand's central bank and the Philippines too, which both meet next week and both arguably near the end of their respective easing cycles. Perhaps ‘pause’ would be a better description than 'end' for these cycles, as both central banks may need to reassess the effects of their easing so far, while external uncertainty from the trade war between China and the US continues to linger.

For now, the policy pause may be justified on prospects for a Phase one of the trade deal, though that signing has now been pushed out to December from the much-touted mid-November schedule, reducing future certainty still further.

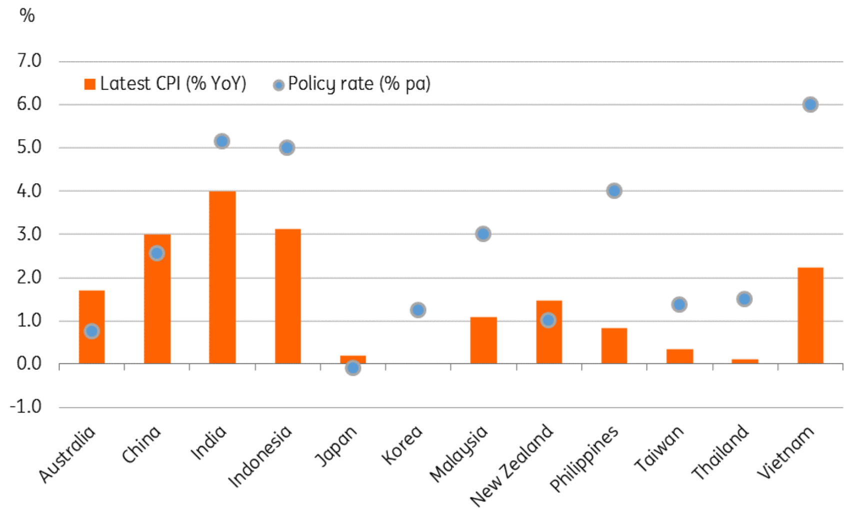
Pause, or out of policy space?

The key question is whether Asian central banks are left with any policy space in the event things really go south again.

Some of them have that space as reflected by their still-high real interest rates (Indonesia, Malaysia, Philippines, or Vietnam), while others have nearly exhausted it and, barring a significant economic deterioration ahead, are likely to stay on hold.

However, as our Asia Chief Economist Rob Carnell opines today, "... if we have learned anything from the period running up to and following the global financial crisis, it is that what we may have considered barriers to policy in the past no longer apply. Perhaps we should no longer consider negative real rates the "floor" to policy in Asia."

Anymore space for monetary easing?



Source: Bloomberg, CEIC, ING

But, where is growth?

While it may be fair to say that the Asian central banks easing cycle has almost troughed, for now, there is little evidence of whatever easing they have implemented so far, actually has helped growth.

As the noise around a trade deal continues, Chinese data will be gleaned for the economy's growth prospects in the current quarter. Our Greater China economist, Iris Pang, sees some pick-up in momentum and has recently revised the 4Q growth forecast higher, but it all depends on a trade deal materialising.

Lots of data from India will likely bear out the continued weak growth trend, while inflation rising past the central bank's 4% target reduces room for easing. Does the inflation target matter? We don't think so. We see one more 25bp RBI rate cut in December.

Indonesia's GDP growth remains stuck at the 5% rate it's been on since 2014. This is despite 100 basis points of central bank rate cuts. The October trade figures are unlikely to display any vigour coming into the final quarter of the year. In the Philippines, growth gained some traction in the third quarter, though that was all about pent-up government spending (due to the delayed budget) rather than monetary easing which, in fact, failed to pull investment growth out of the negative territory. Still, that's enough of a reason for the BSP to pause for now.

Japan and Malaysia report their 3Q GDP figures. Japan's growth probably got a boost from the front-loading of spending before the consumption tax hike in October. That's indeed going to be transitory. In Malaysia, an accelerated export decline probably dragged GDP growth lower, ending the economy's relative outperformance in the first half of the year. We think this is a good enough trigger for the central bank to utilise some of the policy space it has at the next meeting in January.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Saturday 9 November			
China	0130	Oct CPI (YoY%)	3.0	3.4	3
	0130	Oct PPI (YoY%)	-1.0	-1.5	-1.2
		Oct Money supply (M2) (YoY%)	8.2	8.4	8.4
		Oct Aggregate finance (CNY bn)	1135.0	-	2272.5
	-	Oct New Yuan loans (CNY bn)	845.0	-	1691
		Monday 11 November			
Malaysia	0400	Sep Industrial production (YoY%)	1.0	-	1.9
		Tuesday 12 November			
India	1200	Sep Industrial production (YoY%)	-4.5	-1.2	-1.1
Singapore	0500	Sep Retail sales value (MoM SA/YoY%)	0.5/-3.6	-/-	-1.3/-4.1
South Korea	2300	Oct Unemployment rate (% SA)	3.5	-	3.4
		Wednesday 13 November			
India	1200	Oct CPI (YoY%)	4.3	-	4.0
		Thursday 14 November			
China	0200	Oct Fixed asset investment (YTD, YoY%)	5.4	5.4	5.4
	0200	Oct Industrial Production (YoY%)	5.8	5.4	5.8
	0200	Oct Retail Sales (YoY%)	8.00	7.8	7.8
Philippines	0800	Overnight Borrowing Rate	4.00	-	4.00
		Friday 15 November			
India	-	Oct Imports (YoY%)	-17.8	-	-13.9
	-	Oct Exports (YoY%)	-8.1	-	-6.6
	-	Oct Trade deficit (US$bn)	-12.2	-	-10.9
Hong Kong	0830	3Q F GDP (Q) (QoQ SA/ YoY%)	-/-2.9	-/-	-3.2/-2.9
Malaysia	0400	3Q GDP (QoQ SA/YoY%)	1.0/4.4	-/-	1.0/4.9
	0400	3Q Current account (Q) (MYR bn)	15.1	-	14300
Indonesia	0400	Oct Exports (YoY%)	-2.1	-	-5.7
	0400	Oct Imports (YoY%)	-9.2	-	-2.4
	0400	Oct Trade balance (US$mn)	-496	-	-160.5
Philippines	-	Sep OCW remittances (YoY%)	3.9	-	4.6

Source: ING, Bloomberg, *GMT

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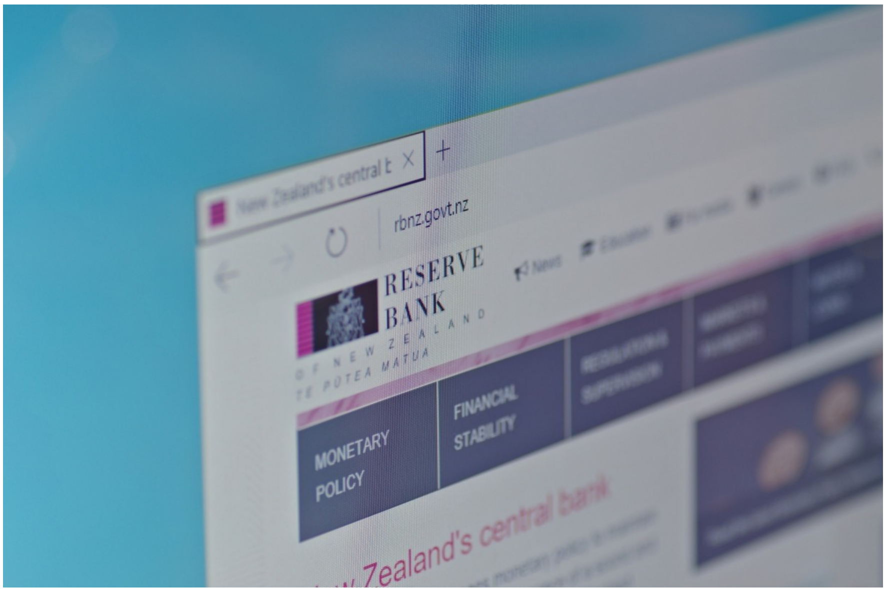


Source: Shutterstock

The arguments for a rate cut...

The arguments for another rate cut in New Zealand seem to boil down to the following:

1. Inflation remains below the central bank's target
2. Growth and the labour market are weak
3. External headwinds need some offsetting support

To which you could add some supplementary arguments along the lines of:

- The New Zealand dollar has appreciated recently tightening financial conditions
- Reserve Bank of Australia rates are lower than policy rates in New Zealand;
- Markets are still pricing in a cut

This last argument is a frequent fallback for forecasters. These days, it almost seems inconceivable that a central bank should do anything that might take markets by surprise. Yet the recent behaviour of financial markets suggests that in terms of monetary easing, they always want more. The last cut is never quite enough, and every rate cut sets up an expectation for another. At some stage, you have to bite the bullet and ask, who is setting monetary policy, markets or central banks?

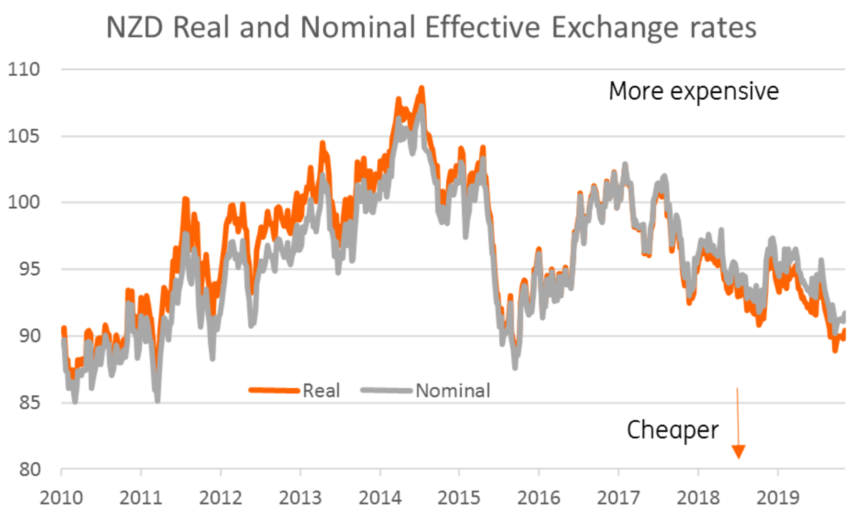
> *A rate cut now that was followed by higher inflation in a few months' time might look like a brilliant piece of central banking, but it would have been totally unnecessary*

Even now, at about 70%, the market pricing of a further cut does not come across as particularly heartfelt. Before the recent labour market "disappointment", it was only just over 50%. A single decent data release might eradicate any lingering expectation of another cut. Unfortunately, there is no top tier data due before next week's meeting on 13 November.

As for what Australia's central bank has done - historically, New Zealand's policy rates have exceeded those in its bigger neighbour by about 25bp - as they do currently. They only tend to coincide briefly, when easing or tightening cycles overlap and timing differs slightly. In other words, there is no sense in which the current difference in cash rates between these two economies is anything other than normal, or that it has any undesirable connotations for AUD/NZD movements.

And as for the current value of the NZD, in neither real nor nominal terms, does its effective exchange rate index look anything other than fairly weak, If there are deficiencies in the economy (and that is looking increasingly debatable), they are not there because of an overvalued currency.

Few valuation concerns about the NZD despite recent pick up



Source: Bloomberg

Back to the fundamentals then?

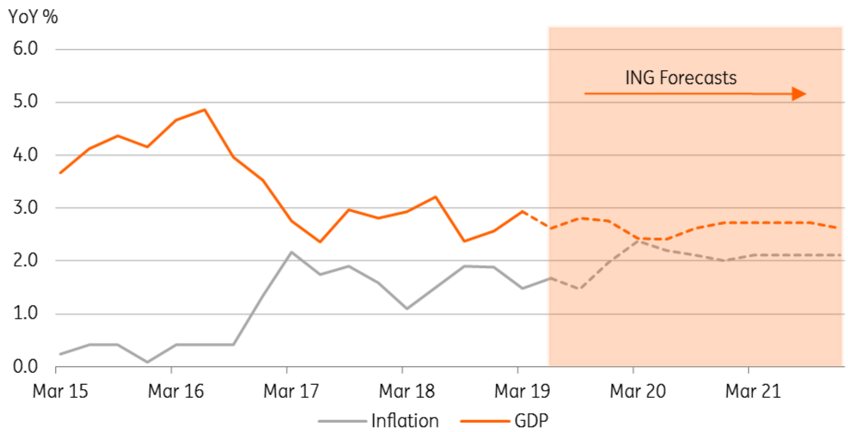
Well at 1.5% for 3Q19, inflation is lower than it was in 2Q19 (1.7%) but came in higher than expected as consensus was 1.4%. Moreover, the hurdle for it to climb back to 2.0% - the RBNZ's target midpoint in 4Q19 is very low. Two consecutive 0.1% QoQ readings in 4Q18 and 1Q19 mean that New Zealand's inflation should hit 2.0% in 4Q19, and something in the 2.3 - 2.4% range in 1Q20 if current trends persist, and depending on series noise. A rate cut now that was followed by higher inflation in a few months' time might look like a brilliant piece of central banking, but it would have been totally unnecessary.

The argument that growth is weak is old, and no longer really stacks up against the evidence. The economy looks as if it will show year on year growth of about 2.8% in 3Q19 and 4Q19

The argument that growth is weak is old, and no longer really stacks up against the evidence. The economy looks as if it will show year on year growth of about 2.8% in 3Q19 and 4Q19. And though this will have been flatter in comparison to the weak base, underlying growth adjusting for that should be about 2.4% - not a bad result, even if it is a bit slower than the 3% historical trend. Economic momentum seems to be creeping back into the economy. The housing market is showing signs of renewed life. Business confidence is improving. Employment growth is positive albeit not very strong, and the uptick in the unemployment rate in 3Q19 looked to be more to do with increased participation in the labour force than a genuine rise in the proportion of joblessness. In 3Q19, the labour force increased by 13,000, unemployment increased by 7,000, so for all the new entrants to the labour force last quarter, almost half went straight into employment. The residual will probably be mopped up next quarter.

Even the external headwinds don't seem quite as threatening as they did a few months ago. Admittedly, part of this stems from the US administration taking a softer tone with China as their own economy shows signs of faltering. But the tit-for-tat escalation in the trade war seems to have stopped. So even if current expectations are, in our view, too optimistic about the prospects of any sort of deal, sentiment-boosting rate cuts at today's already very low levels also seem an unnecessary waste, when there may be a genuine need for such cuts in the future.

Inflation should hit its target next quarter



Source: Bloomberg, ING

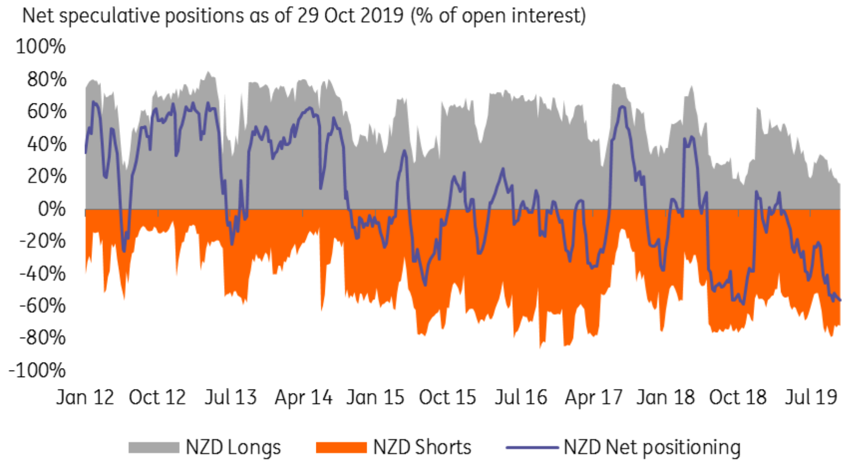
Net result...

Of course, we don't get away with just making the argument for or against a particular decision, we also have to second-guess what the central bank will do, even if we disagree with their reasons for doing it. That is much harder. The early easing in May showed the Reserve Bank of New Zealand more ready to act then Australia's central bank which didn't cut until June and then left rates unchanged this month. The back to back RBNZ cuts that then followed in July and August also showed the RBNZ is happy to be aggressive.

Our call then is for no change at this meeting since any rate cut this month would be seen in all likelihood as the last in a series

Our call then is for no change at this meeting since any rate cut this month would be seen in all likelihood as the last in a series, and make little difference to current activity or sentiment, and would also be more useful held in reserve in case really needed in the future. But this isn't far off being a 50:50 call.

NZD is the biggest speculative short in G10



Source: CFTC, Bloomberg, ING

NZD: Positioning to exacerbate positive catalysts

The kiwi dollar has enjoyed a very positive October but things corrected in the first week of November. The optimism around trade talks has not only pushed yields higher but also contributed to a re-pricing in rate cut expectations. Over the past three weeks, the implied probability of a November rate cut went from 100% to a low of 50% and is now hovering around 70% after the disappointing labour market data this week.

If as we are inclined to believe, the RBNZ stays on hold, this will set NZD to substantially outperform the rest of G10 next *week*

At the same time, these dynamics in spot prices were not matched by similar moves in the markets speculative positioning. According to CFTC data, the net short positions on NZD have been consistently more than 50% of open interest since mid-September. This suggests that there is a high potential for some short-squeezing to exacerbate any positive catalyst for the currency.

The high uncertainty around the RBNZ meeting suggests caution around next week's performance for the kiwi dollar. However, the balance of risks seems marginally tilted to the upside. Even if the Bank decides to cut, markets may well assume this would represent the end of the cycle, and price out more easing for the months ahead, thereby mitigating the fall in rates and in NZD.

If as we are inclined to believe, the RBNZ stays on hold, this will set NZD to substantially outperform the rest of G10 next week. When adding the over-mentioned extended short positioning, it is fair to assume a more limited downside room compared to the upside potential ahead of next week's meeting.

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Philippines: 3Q GDP growth quickens to 6.2%

Economic activity picked up in the third quarter with steady consumption and resurgent government spending lifting growth above 6%

Source: Shutterstock

6.2% 3Q GDP growth

Higher than expected

PHL 3Q GDP growth quickens to 6.2%

Snapping two quarters of sub-6% expansion, the Philippines managed to churn out growth of 6.2% to keep the bid for 6% full year growth alive. Besting market consensus for a 6.0% gain, growth was boosted by heavyweight household consumption which was up 5.9% as inflation dipped below 1%. Also contributing to growth was the resurgence of government spending which jumped to 9.6% while investment remained an overall drag to economic growth, posting a -2.1% print for the quarter.

The good

Household consumption, which accounts for roughly 57.4% of economic activity, was the main driver for the better than expected 3Q result. Growing by 5.9%, the sector delivered 3.3 percentage points to the overall 6.2% expansion with purchasing power lifted by the slide in inflation. Government spending (+9.6%) continued to recover as the 2020 budget bill finally came online, mirroring the 39% jump in overall government expenditure growth posted in September. Spending by the government on operating expenses contributed roughly 0.89 percentage points to the total and we can expect this pace to accelerate going into 4Q with the administration pledging even faster spending to chase the -3.0% deficit-to-GDP target for the year.

The not so good

Capital formation was negative for the second straight quarter, weighed down mainly by the contraction in investment for durable equipment (-9.1%). Construction activity was the bright spot for the sector, posting a strong 17.3% expansion but ultimately was unable to lift the segment into positive territory. Capital formation accounts for roughly 25% of the economy and as a whole, it weighed down on growth by 0.56 of a percentage point. With the recent policy easing from the central bank, Economic Minister, Pernia, shared that growth should get a boost, in particular with investment activity to continue to rebound and lead to purchases of durable equipment in 4Q. Meanwhile, the trade sector managed a flat performance in 3Q as exports appeared to struggle, weighed down by the US-China trade war. Meanwhile, imports of capital goods and raw materials were disappointing with the poor performance tagged to the budget delay. Going forward, we can expect the trade gap to widen but this may actually be a welcome sign should imports of machinery and durable equipment return to help drive the investment engines of the Philippine growth story.

Philippines chases full year 6% growth

With the 6.2% growth print in 3Q, we expect the Philippines to continue to chase full-year growth of 6% to keep the string of strong growth alive (streak of 7 straight years). Household consumption may continue to deliver, given that inflation in the fourth quarter remains largely benign. Meanwhile, if recent trends shown in 3Q data foretell the pace of spending in 4Q, government expenditure on both operating costs as well as public construction should surge to close out the year. In order to complete the growth picture however, the PHL will need to see a positive contribution from the investment picture, which has languished in contraction for two straight quarters. Monetary easing and improving investor sentiment will likely lift capital formation to close out the year with an accelerated pace of capital formation growth expected in 2020, with recent Bangko Sentral ng Pilipinas (BSP) rate cuts feeding into the economy. Pernia estimates that the PHL will need to achieve 6.7% growth in 4Q to get full-year growth above 6% and we believe this remains highly achievable if the economy finally fires on all cylinders once again. The better-than-expected growth will, however limit pressure on the BSP to cut rates again in early in 1Q 2020. But given the dovish rhetoric from BSP Governor Diokno, we continue to pencil in further easing from the BSP in 2020.

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