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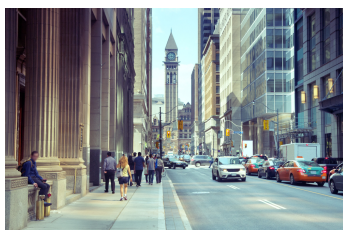
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# Australia: Mixed present, decent future

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## Author

**Robert Carnell**

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)



# Chinese GDP report card should be better than everybody expects

With a sizeable CNY 4 trillion fiscal stimulus and a monetary easing policy that has created 40% credit growth in 1Q19 alone, we expect the Chinese...



Source: Shutterstock

## ✓ Fixed asset investments should jump

The 'two sessions' meetings held in early March this year set a fiscal stimulus package of CNY 4 trillion, of which around half was tax and fee cuts. The other half comes from local government infrastructure projects, including new metro lines and toll roads. Aside from the stimulus, some local governments have quietly relaxed housing regulations too. As a result, fixed asset investment should jump with fiscal money propping up infrastructure.

Investments in 1Q19 will mainly be supported by fiscal stimulus projects, including metro lines, toll roads and water management systems. But bear in mind that these are not market-driven investments instead, they're government efforts to cushion the economy from heading south too fast. Our forecast on fixed asset investments is 6.5%YoY year-to-date in March from 6.1% a month ago.



## Retail sales will show that the job market is just fine

As the government continues to spend on new metro lines and toll roads, we expect the construction sector to add job vacancies to the market, which should hopefully keep the job market stable.

The gauge of job stability, in the absence of a good unemployment indicator, will be the growth of consumption and retail sales. We forecast retail sales to increase to 8.9%YoY in March from 8.2% in January-February. If the improvement in retail sales is like we forecast, it should reflect a healthy job market.

## ✔ Industrial production details should give hints about the export environment

We expect industrial production to increase to 6.2% in March from 5.7% in January to February.

The headline figure is likely to look positive because of all the infrastructure projects but we'll need to see the details to evaluate if there is an export-related sectors' production rebound. We're not optimistic as export-related manufacturers should not be willing to expand their production line when the trade talks between China and the US are still ongoing.

## ✔ Trade doesn't look that bad

First quarter exports grew by 1.4% YoY while imports shrank by 4.8% YoY. Trade with the EU was 15.8% of total trade while trade with the US was 11.6%. But this is only goods trade.

Trade of services has been in deficit since Chinese tourists' outbound tourism activities keep rising. This may change in 2019 as Chinese consumers will be cautious about spending on big-ticket items.

For the first quarter of 2019, combining the two, the growth of net exports of goods and services should be near zero assuming tourism spending rises 5%YoY. We could be too optimistic about the Chinese spenders, but we all shall be revealed on Wednesday, 17 April.

## ✔ Growth should be above the government's lower bound

Considering all of the above, we forecast GDP growth at 6.2%YoY in 1Q19, which will be lower than 6.4%YoY in 4Q18. But this is better than the government's lower bound target of 6.0%.

There is a real need to keep credit growth continuing to keep GDP growth above 6%. That's why we still expect a 0.5 percentage point RRR cut in April.

But we don't think there is a need for the government to increase fiscal stimulus as growth should continue to increase in 2019 when money is put into infrastructure production and so long as monetary easing continues.

## ✔ The yuan was almost flat in 1Q19

USD/CNY in 1Q19 depreciated by 0.18% but the high-low volatility was still quite small at 1.8% and this tells us that the central bank has carefully managed exchange rate movements.

The central bank has to make the yuan flexible enough to follow the dollar index's movements, i.e. when the dollar rises, the yuan weakens. But it also had to cater to political needs by depreciating the yuan when there were trade talks to defy what President Trump said: "the yuan cannot depreciate if there is any trade deal"

Our forecasts for USD/CNY at 2Q19 and 3Q19 are 6.85, which may have to be revised as the central bank has managed the yuan in a very narrow range. But our year-end forecast at 6.75 seems to match what the central bank is doing. At least for now.

## Why the six month Brexit extension may not be long enough

There are good reasons to think that the Brexit deadlock will not be broken before the new 31 October deadline, particularly if prime minister Theresa May...



British Prime Minister, Theresa May, after the EU summit on Brexit in Brussels

### What has been agreed?

After a classic evening of EU negotiations in Brussels, European leaders announced that the Article 50 negotiating period would be extended until 31 October. This assumes that the UK participates in the European elections in May, although the British government has indicated that this will be the case. If a deal can be approved earlier, then the EU has said that the Brexit date could be brought forward to the first day of the month following ratification.

The question now is will this be long enough to break the Brexit deadlock, and if it isn't, does 'no deal' become more likely?

## Will 6 months really be long enough?

There's little doubt that the agreement struck in the early hours of Thursday morning was a good old-fashioned fudge - the decision to extend Article 50 by six months was one few had predicted.

It is shorter than the 9-12 months European Council President Tusk and others had been pushing for, with the goal of kicking the can well into the long grass to give the UK time to break the deadlock, as well as allowing the EU some breathing space to focus on other priorities. It is also longer than the French side had pushed for, with the aim of keeping the pressure on Britain to make a decision, while limiting the ability of the UK to disrupt key legislative priorities over coming months.

In the end, it was a compromise between the costs of a short/long extension among EU leaders, but the big question is whether anything will really change during this time?

Well, in theory at least, six months should be long enough to facilitate change if the will exists to do so. For instance, UK lawmakers could decide to back the deal in its current form, potentially ending the extension early, though that still looks unlikely.

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*There are good reasons to think the deadlock will not be broken before October's deadline*

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Six months might also be long enough to hold a second referendum - the minimum time to pass the legislation, complete question testing and hold a campaign is assumed to be around 22 weeks. However, this assumes lawmakers decide to go down this path more or less immediately - again, unlikely.

We still think the most likely option to curry favour among British MPs is a permanent customs union, which the EU has made clear would take minimal time to make the necessary changes to the political declaration - the short non-binding part of the deal that looks at future trade aspirations.

In practice though, there are good reasons to think the deadlock will not be broken before October's deadline.

Even before the European Council, talks between PM May and Labour leader Jeremy Corbyn were moving slowly. While both leaders might not actually be that different when it comes to their favoured version of Brexit, their respective ministers, backbench MPs and grassroots supporters are poles apart. These talks may continue for few more weeks now Article 50 has been extended - and don't forget that Parliamentary recess begins from this evening until 23 April. But one way or another these talks still appear destined to be unsuccessful.

If that's true, then PM May has suggested she will instead give Parliament a voice through another round of so-called 'indicative votes' on different Brexit options. But even then, now that the deadline has been pushed back, some of the immediate pressure has been taken away and this reduces the chances of compromise among MPs at this stage.



## When will Theresa May be replaced as leader?

The other reason to think October could be too early is that the UK might have another prime minister by then.

Current PM Theresa May has hinted over recent weeks that she is prepared to step down. She told Conservative MPs that she would step aside if her deal was passed, having also said in fairly strong terms that she couldn't stay if Article 50 was extended beyond June.

There is little doubt that her position has been weakened still further over the past few weeks and it therefore seems likely that she will step down at some point this year – almost certainly before December when Conservative backbenchers will have their next opportunity to stage a no-confidence vote in her leadership.

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*If Theresa May were to resign though, then the chances are that her replacement will be more eurosceptic*

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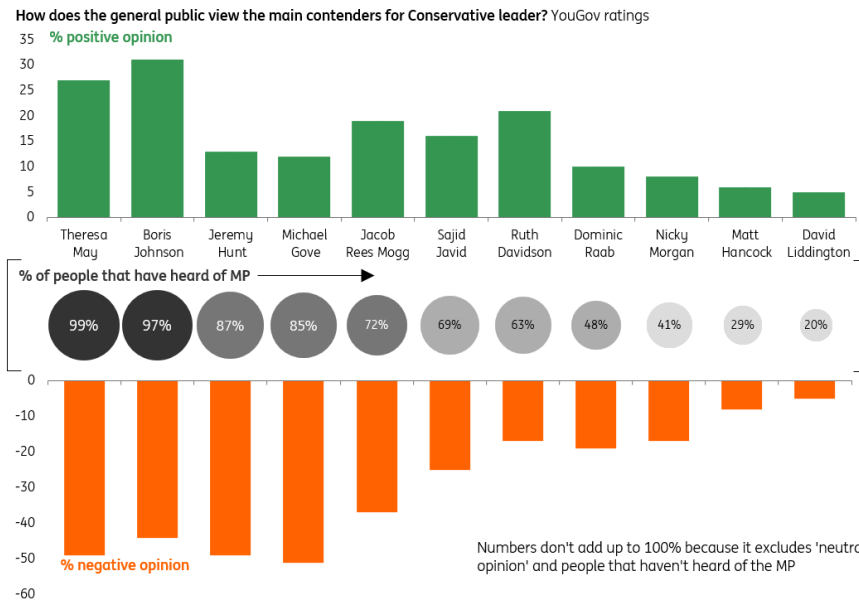
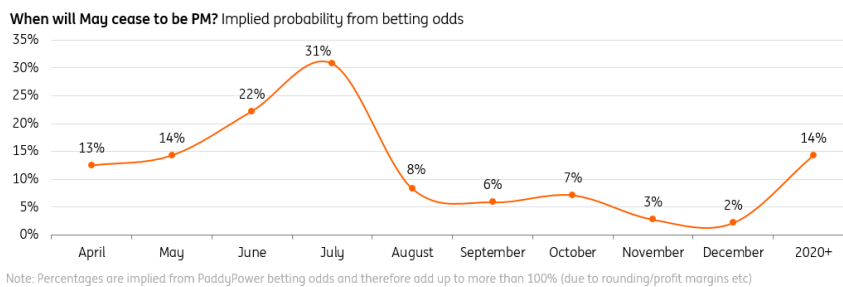
One possibility is that she chooses to step down to allow a leadership contest to take place over the summer, ahead of the annual Conservative Party conference at the end of September. This is certainly where the betting markets think things are heading, with July seen as the most likely time for PM May's departure. These contests do take time though, and unless things get moving soon, the window to hold a leadership challenge before the October deadline could close.

If Theresa May were to resign though, then the chances are that her replacement will be more eurosceptic. Assuming that a member of the pro-Brexit European Research Group (ERG) is one of the two MPs on the ballot paper, it seems likely that the grassroots of the Conservative Party would vote them in as leader. A recent YouGov poll indicated that 48% of Conservative voters believe a 'no deal' Brexit is a good outcome, and it's possible the percentage among actual party members is higher still.

With a eurosceptic leader in place, it's likely that the government would try to re-negotiate with the EU on the contentious issue of the Irish backstop – although it's highly unlikely that Brussels will budge. That could see a new leader simply push for 'no deal' instead.

The key question then is whether Theresa May tries to tie the hands of her replacement before stepping down. During the recent cross-party talks with Labour, there have been reports that negotiators have been looking at ways of creating a so-called 'Boris-proof Brexit'. As we said above, these talks are unlikely to bear fruit. But if Parliament instead can get behind a particular Brexit option sooner rather than later, it could be followed up with legislation to crystallise the decision in law, making it harder for a future PM to change course.

## The British political situation



Source: PaddyPower, YouGov

## Does this make 'no deal' on 31 October more likely?

If we are right and the landscape doesn't significantly shift before October, then the perceived risk of 'no deal' is likely to rise once again. If a new Eurosceptic leader is in place, then markets may become more concerned that they could be prepared to take the UK over the cliff-edge. Equally, we could see the EU become more fed-up. There is a view emerging among some officials that the costs of 'no deal' are lower than allowing the UK to stay half-in-half-out for a prolonged period of time.

*If push comes to shove and lawmakers haven't been able to back any deal, we suspect a majority would choose to revoke Article 50 rather than accept 'no deal'*

However, we still think the chances of 'no deal' are relatively low at this stage. Don't forget that in either scenario, the final decision rests with British MPs. While a new prime minister might be more open to 'no deal', the majority of MPs are not.

If lawmakers aren't able to back any deal, we suspect a majority would choose to revoke Article 50

rather than accept 'no deal'. After all, in the last round of 'indicative votes', 191 MPs voted in favour of revoking if a deal hadn't been agreed earlier this week. While this may be viewed as a fairly extreme move, it would likely be spun as a way of stopping the clock to allow time for a rethink on the Brexit plan, rather than revoking to remain permanently.

We wouldn't rule out a further extension to Article 50 either, and European Council President Tusk hinted at this on Thursday morning. And while he may not represent all the views among member states, there was a sense on Wednesday night that many within the EU are reluctant to be seen 'kicking the UK out' and taking any blame for 'no deal'. This stance could harden over the next six months, but for now we think the probability of 'no deal' remains around the 20-25% level.

## Author

### James Smith

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

## Watch: Don't panic, but be cautious!

Trade wars, slowing growth and Brexit: How is all this feeding into global economic sentiment? Get answers from ING's economists in Singapore,...



### Don't panic, but be cautious!

ING economists in Singapore, Frankfurt and Amsterdam assess how the global economy's doing as we enter the second quarter of 2019

[Watch video](#)

## Authors

### **Marieke Blom**

Chief Economist and Global Head of Research

[marieke.blom@ing.com](mailto:marieke.blom@ing.com)

### **Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

### **Robert Carnell**

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)



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Article | 11 April 2019

## How will Indonesia's elections results impact the economy?

Growth in Indonesia has hovered about the 5% level since 2016 and going forward its trajectory will largely depend on who wins the elections next week....



Indonesian President Joko Widodo on the election campaign

### Take two: Jokowi vs Prabowo (again in 2019)

Indonesia will hold elections next week with incumbent President Joko Widodo, also known as Jokowi widely expected to secure a second five-year term. Latest polls show Jokowi leading his second-time challenger, the former general and now businessman, Prabowo Subianto, who Jokowi defeated in the previous election.

Here's a quick look at what we can expect from each candidate in terms of their economic policies.

### Jokowi to push investment with an eye on globalisation

President Jokowi's economic platform rests on his push to improve the economy through investments in infrastructure in a bid to gain global competitiveness and lower Indonesia's reliance

on minerals and other resources exports. Jokowi hopes for Indonesia to move up higher-value-added ventures to help provide jobs through high technology industrialisation.

However, his push for investments and infrastructure has resulted in both current account and fiscal deficits. The president has defended the 'twin deficits', saying investments would eventually boost growth and help the economy reverse these deficits down the line. His push for investments has also contributed to Indonesia's strengthening ties with China.

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*Although we can't see any near-term respite from the twin-deficit problem, the long-term prospects for Indonesia remain positive. A greater emphasis on infrastructure, health and education investment should help wean itself off lower-value added exports and evolve into a more dynamic economy*

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At the same time, Jokowi has chosen to boost imports of basic foodstuffs to help stabilise prices - a move that seems to have worked in keeping domestic price growth in check, and inflation at the lower end of the central bank's 2.5 - 4.5% target range. Meanwhile, in response to his challenger's bid to lower corporate and personal taxes, he's also pledged to look into cutting taxes further, given that over the course of his term, he's effectively given tax breaks to lower income households.

If Jokowi is elected to a second term, we are likely to see the country push on with his infrastructure and investment plans. Inflation is likely to remain in check given Jokowi's program to import basic foodstuffs, but wider current account and fiscal deficits will remain the key overhangs on the Indonesian rupiah (IDR). Besides existing import curbs to rein in the current deficit, including consideration of increasing the biodiesel blend in local fuel, any future dip in global oil prices may help the government cut back on fuel subsidies.

Although there is unlikely to be any near-term respite from the twin-deficit problem, the long-term prospects for the economy remain positive. A greater emphasis on infrastructure, health and education investment will all help Indonesia wean itself off dependence on lower-value added exports and evolve into a more dynamic economy.

## **Prabowo wants to take Indonesia back to its core strengths**

The challenger Prabowo is making an aggressive bid to lower both corporate and income tax as he criticises the president's push outwards. If he manages to deliver this, it will boost the consumer's purchasing power and help the economy become more competitive and an attractive destination for foreign investment. Although lowering taxes are seen to bloat the country's deficit, Prabowo vows to boost the efficiency of the tax collecting machinery and achieve more revenue via consumption taxes.

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*With less than a week to go before Indonesians head to the polls, Jokowi remains comfortably in the lead, but we've seen our fair*

## *share of election surprises in recent years*

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Unlike Jokowi's globalisation drive, Prabowo seems to preach a return to Indonesia's core domestic strengths sourcing both food and energy domestically. This is why he's been critical of Jokowi's foods and oil importing policy to keep inflation low. Prabowo is encouraging a push inwards by helping local farmers via subsidies, while also planning to secure renewable energy via Indonesia's vast forest lands. Prabowo has also criticised his competitor's infrastructure drive because of the pressure it exerts on deficits, as well as publically denouncing ties with China.

However, it remains unclear, how Prabowo hopes to achieve industrialisation without pushing for investments, which may result in lower deficits but also slower growth. He may currently trail in the surveys leading up to the polls, but we won't rule out a surprise victory.

With less than a week to go before Indonesians head to the polls, Jokowi remains comfortably in the lead, but we've seen our fair share of election surprises in recent years.

Although the candidates are similar in their drive for industrialisation, increasing or preserving purchasing power and job creation, the two differ in their approach to these goals. The economy will continue to chug along at the current 5% handle, and we'll have to see who the people choose to get the economy jump-started through [reforms](#).

[Read our country profile on Indonesia and why reforms are needed for lift-off](#)

# Finland: Elections buck European trend with social democrat win

The social democrats won the vote by a narrow margin over the nationalist Finns Party. The strong result for the Finns Party is unlikely to be a...



Source: Liam Lysaght

## Fragmented Finland

The Social Democratic Party won 17.7% of the vote in Finland's general election on Sunday, helping it to become the largest party in Finland for the first time since 1999 and bucking the recent trend of social democrats losing votes across Europe. However, the margin over the far-right Finns Party, which won 17.5% of the vote, was smaller than expected and does not make coalition talks any easier. Like in many European countries, the political landscape in Finland has become more fragmented, with no party winning more than 20% of the vote for the first time in over a century.

## Bellwether for European elections?

A strong result for the Finns Party came after internal struggles that led to a breakup in 2017. Until the start of the year, the party was polling at just 10% before gaining momentum in recent weeks. Still, the party did marginally worse than in the 2015 elections, when it won 17.7% of the vote. The recent surge could be taken as a bellwether for the performance of other eurosceptic parties in the European parliamentary elections, but with current polls still showing a strong lead for centrist

parties, momentum would have to change radically across Europe for a large nationalist bloc to change EU policy making.

Finland certainly serves as a bellwether for Europe regarding its demographics, which were an important factor in the campaign leading up to the elections. The battle against an ageing population is causing concern about health care and wealth reforms and the sustainability of Finland's public finances. The Center Party of caretaker Prime Minister Juha Sipila failed to get reforms through parliament recently and was punished in the elections for it, with just 13.8% of the vote after 21.1% in 2015.

The social democrats have promised to let in work-related immigrants to battle the ageing population, along with refugees, and raise taxes to maintain the Finnish welfare state. They now have a difficult task ahead of them in finding allies for this agenda after a fragmented election result.☒

## Author

### **Bert Colijn**

Chief Economist, Netherlands

[bert.colijn@ing.com](mailto:bert.colijn@ing.com)



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Report | 5 April 2019

## April Economic Update: Cheer up! The gloom is mostly set to fade

A sense of gloom has been hanging over markets for the past few months. However, the situation may already be starting to improve with progress on...



Source: Shutterstock

A sense of gloom has been hanging over markets for the past few months, reflecting trade tensions, softer activity data and political strife. However, the situation may already be starting to improve with progress on US-China trade talks and tentative signs of stronger activity from major economies. Nonetheless, politics are never far away, with European parliamentary elections and Brexit creating uncertainty. We are also waiting for President Trump's decision on possible auto tariffs. So while we are becoming a little more optimistic, market caution is likely to linger for a little while longer.

The US yield curve inverted and interest rate cuts are being priced in from the Federal Reserve as fears of an economic slowdown gripped financial markets. This largely reflects some mixed domestic data and worries about demand from China and Asia. However, we are more upbeat, with clear signs that 1Q GDP growth may be significantly stronger than initially feared, while a

robust labour market should underpin consumer sentiment and spending.

We would also argue that the yield curve is not as powerful recession predictor as it has been in the past. Moreover, if we see a positive resolution to US-China trade tensions this may lift more of the gloom and lead to a re-pricing of the path for interest rates.

While first-quarter Eurozone growth was weak, March data seems to suggest a rebound is in the offing. With improving consumer sentiment and international trade off lows, the second quarter could come a bit stronger, provided that a 'hard Brexit' is avoided. Inflation continues to surprise to the downside, justifying continuing monetary stimulus. Reports of the European Central Bank contemplating a two-tier system for excess liquidity, thereby helping the banks, are perhaps a bit premature. We believe this scheme will only be put in place if an additional rate cut would be considered.

Nobody knows for sure where Brexit will take us over coming days, but talk of a long extension to the Article 50 period is growing. That would continue to put pressure on investment, not just because of the uncertainty, but also because firms may have to restart their contingency planning. The chances of a 2019 UK rate increase are fading, but don't rule one out completely if a Brexit deal can be approved by MPs relatively soon.

China's fiscal stimulus has begun to work. Manufacturing PMI showed activity expanded in March. We believe this is in large part thanks to the fiscal measures taken over recent months. Continued support from fiscal policy will likely be required to maintain activity even if a trade agreement with the US is reached.

Japan's economy continues to disappoint on both growth and inflation, though the latter presents few genuine problems except presentational for the Bank of Japan, and a debate about the logic of continued negative rates and money printing is beginning to gather volume. We have dropped out the consumption tax hike from our forecast.

The markets see a US rate cut as probable. If the next move in the Fed funds rate is down, then history also shows that the 10yr can trade 25-50bp through in anticipation. At the same time, we believe the pessimism about growth is a tad overdone.

Unless Eurozone growth can prompt a re-rating of European equities or longer-tenor debt spreads move substantially against the dollar, it is hard to see EUR/USD breaking out of a 1.10-15 range in the next 3-6 months. We are thus downgrading our end 2019 and 2020 forecasts to 1.18 and 1.25 respectively.

ING global forecasts

	2017					2018F					2019F					2020F				
	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY
<b>United States</b>																				
GDP (% QoQ, ann)	1.8	3.0	2.8	2.3	2.2	2.2	4.2	3.4	2.6	2.9	1.7	2.2	1.8	1.9	2.4	1.7	1.7	1.7	1.7	1.8
CPI headline (% YoY)	2.6	1.9	2.0	2.1	2.1	2.7	2.7	2.6	2.2	2.4	1.6	1.7	1.8	2.0	1.8	2.4	2.3	2.1	2.1	2.2
Federal Funds (% eop) <sup>1</sup>	0.75	1.00	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
3-month interest rate (% eop)	1.15	1.30	1.35	1.55	1.55	2.30	2.35	2.45	2.65	2.65	2.60	2.62	2.62	2.62	2.62	2.57	2.57	2.57	2.39	2.39
10-year interest rate (% eop)	2.40	2.30	2.30	2.40	2.40	3.00	3.00	3.00	2.80	2.80	2.30	2.60	2.50	2.45	2.45	2.35	2.30	2.25	2.20	2.20
Fiscal balance (% of GDP)					-3.5					-4.0					-4.7					-5.0
Fiscal thrust (% of GDP)					0.0					1.2					0.5					0.8
Debt held by public (% of GDP)					76.1					77.4					80.2					83.3
<b>Eurozone</b>																				
GDP (% QoQ, ann)	2.7	2.7	2.7	2.7	2.5	2.7	1.7	0.6	0.8	1.8	1.1	1.6	1.4	1.4	1.2	1.1	1.2	1.0	0.9	1.2
CPI headline (% YoY)	1.5	1.3	1.5	1.4	1.4	1.3	1.7	2.0	2.0	1.8	1.4	1.1	0.9	1.3	1.2	1.5	1.5	1.6	1.6	1.6
Refi minimum bid rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (% eop)	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	-0.32	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
10-year interest rate (% eop)	0.45	0.40	0.45	0.42	0.42	0.50	0.30	0.40	0.24	0.24	-0.07	0.20	0.30	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Fiscal balance (% of GDP)					-0.9					-0.6					-0.9					-0.8
Fiscal thrust (% of GDP)					0.2					-0.1					0.2					-0.2
Gross public debt/GDP (%)					89.2					87.7					86.5					85.3
<b>Japan</b>																				
GDP (% QoQ, ann)	1.9	2.3	1.6	1.3	1.9	-0.4	1.9	-2.4	1.9	0.8	-0.1	-0.2	-0.2	1.0	0.1	0.8	0.6	0.7	0.8	0.6
CPI headline (% YoY)	0.2	0.4	0.6	0.6	0.5	1.3	0.6	1.1	0.9	1.0	0.3	0.8	0.4	0.1	0.4	0.6	0.6	0.8	1.0	0.8
Excess reserve rate (%)	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0
3-month interest rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.05	-0.05	-0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.10	0.10	0.10	0.10
10-year interest rate (% eop)	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fiscal balance (% of GDP)					-4.8					-4.1					-3.6					-3.0
Gross public debt/GDP (%)					221					223					224					226
<b>China</b>																				
GDP (% YoY)	6.9	6.9	6.8	6.8	6.9	6.8	6.7	6.5	6.3	6.6	6.2	6.2	6.3	6.3	6.3	6.3	6.2	6.2	6.2	6.2
CPI headline (% YoY)	1.4	1.4	1.6	1.8	1.6	2.2	1.8	2.3	2.5	2.2	2.0	2.5	2.6	2.6	2.4	2.6	2.6	2.5	2.4	2.5
PBOC 7-day reverse repo rate (% eop)	2.45	2.45	2.45	2.50	2.50	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55
10-year T-bond yield (% eop)	3.29	3.57	3.61	3.90	3.90	3.75	3.48	3.63	3.30	3.30	3.10	3.05	3.00	2.95	2.95	2.95	2.90	2.90	2.85	2.85
Fiscal balance (% of GDP)					-3.7					-4.5					-4.5					-4.0
Public debt, inc local govt (% GDP)					50.0					88.0					102					103
<b>UK</b>																				
GDP (% QoQ, ann)	1.3	1.0	1.9	1.6	1.5	0.2	1.6	2.8	0.9	1.4	0.7	1.1	1.7	2.2	1.3	1.5	1.7	1.2	1.1	1.6
CPI headline (% YoY)	2.1	2.7	2.8	3.0	2.7	2.7	2.4	2.5	2.3	2.5	2.0	2.0	1.8	1.9	1.9	2.2	2.1	2.1	2.0	2.1
BoE official bank rate (% eop)	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.50	1.50
BoE Quantitative Easing (Ebn)	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445
3-month interest rate (% eop)	0.35	0.35	0.35	0.50	0.50	0.60	0.80	0.80	0.80	0.80	0.85	0.85	0.85	1.05	1.05	1.30	1.35	1.60	1.65	1.65
10-year interest rate (% eop)	1.15	1.10	1.35	1.20	1.20	1.45	1.48	1.57	1.30	1.30	1.00	1.20	1.30	1.40	1.40	1.50	1.50	1.50	1.50	1.50
Fiscal balance (% of GDP)					-2.5					-1.4					-1.5					-1.5
Fiscal thrust (% of GDP)					-0.5					-0.4					-0.4					-0.3
Gross public debt/GDP (%)					87.0					84.0					83.0					81.5
EUR/USD (eop)	1.08	1.12	1.20	1.20	1.20	1.20	1.17	1.15	1.12	1.12	1.12	1.10	1.12	1.18	1.18	1.20	1.22	1.23	1.25	1.25
USD/JPY (eop)	112	115	110	113	113	107	110	114	113	113	112	113	110	108	108	105	103	102	100	100
USD/CNY (eop)	6.89	6.78	6.65	6.51	6.51	6.28	6.67	6.87	6.88	6.88	6.74	6.85	6.85	6.75	6.75	6.70	6.60	6.70	6.70	6.70
EUR/GBP (eop)	0.87	0.88	0.94	0.89	0.89	0.88	0.88	0.89	0.90	0.90	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Brent Crude (US\$/bbl, avg)	55	51	52	61	55	67	75	76	69	72	65	68	69	73	69	70	74	76	74	74

<sup>1</sup>Lower level of 25bp range; 3-month interest rate forecast based on interbank rates  
Source: ING forecasts

Source: ING

# Canada's housing market: Is it really all that bad?

The housing market is under pressure in Canada and coupled with household debt problems, you can see why this factors into the central bank's...



Source: Shutterstock

Higher interest rates and tighter mortgage rules have been feeding their way into the housing market and will continue to do so for a while. This has inevitably taken the steam off things and is arguably one of the main reasons the Bank of Canada (BoC) is happy to prolong its pause.

## Three reasons why household finances are undergoing a tricky period

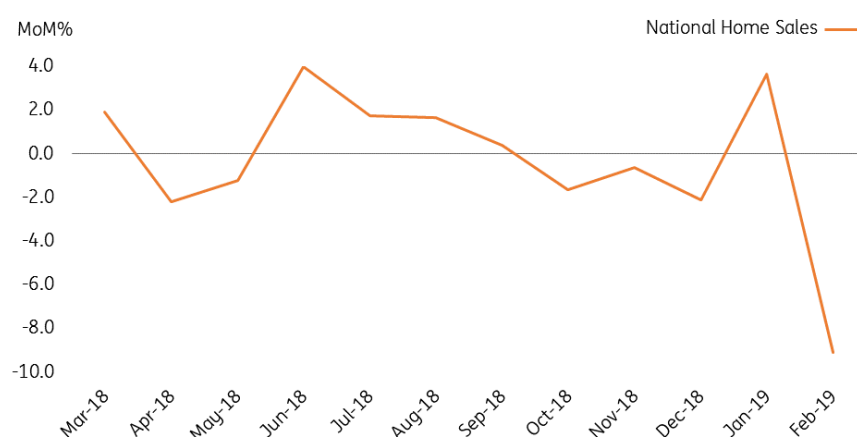
1. Homeowners are watching the value of, typically, their largest asset plateau – or even drop. It's also possible that some homeowners would like to sell their homes if they're at the risk of entering negative equity territory.
2. Mortgage repayment costs are creeping up as interest rates edge higher, and the fact that a lot of Canadian households are running high levels of debt isn't great news.
3. Nevertheless, it isn't an easy selling environment. Not only is it harder for prospective buyers to get a mortgage, but finding affordable homes is still an issue.

These factors don't bode well for housing demand.

## Home sale figures support view it's becoming difficult to sell your home

Canada's real estate association (CREA) recently reported home sales sunk 9.1% month on month in February and hit the lowest level since November 2012. Although the colder climate might have suppressed the figure, it's unclear if the broad-based slowdown is solely a weather story.

## Monthly decline was the largest since new mortgage regulations were introduced



Source: CREA

## New mortgage regulations likely to hurt already vulnerable areas

Canada's new mortgage regulations were introduced in January 2018. In short, the new rules have made it tougher for those with 'fragile finances' to obtain a mortgage and (as a secondary effect) prompted a slowdown in the housing market.

The 2014 oil price shock took a lot of momentum out of Alberta's housing market and, coupled with the below-par trajectory for the energy sector; you can argue the implementation of a stress test will only make matters worse. Data collected last year confirmed this, where provincial sales reached the lowest level since 2010.

## But there are some positives

GDP growth in January not only came as an upside surprise (+0.3% MoM) but also offered some upbeat news for real estate. As reported by Statistics Canada, the construction sector grew for the first time in eight months - with residential construction posting its second consecutive monthly gain. Now, although the sector tends to be quite volatile, as we wrote earlier in [our GDP preview](#), the recovery in building permits provides us with some reassurance when it comes to investment in the housing market going forward.

Moreover, in the recently announced federal 2019 budget, first-time buyers were amongst the



winners. The government has created an incentive for individuals to jump onto the property ladder by offering to absorb part of the associated costs, namely an \$885 million investment over five years. However, this won't come into effect until autumn.

As a result, home buyers might be tempted to delay their decisions, meaning, until then, our view on what's happening in the market will be clouded. This reinforces our previous argument that - if the BoC opts to hike in 2019 - it wouldn't arrive until the fourth quarter as the housing market is likely to appear weaker-than-expected in the near-term.

### To follow, or not to follow (the Federal Reserve)?

A more unwelcome start to 2019 was Canada's percentage of household debt to income standing at 176.3%, which is the highest it has been since 1990. Given that - when the next downturn in the economy arrives - the persistence and depth of household debt levels will only enhance an already difficult environment, and remains a key vulnerability to the health of the economy.

*The persistence and depth of household debt levels remains a key vulnerability to the health of the economy*

It seems that, for now, policymakers are happy to sit back to see how the global trade backdrop, oil prices and household activity all evolve. And with the [Fed firmly in the dovish territory](#), it's possible that this could sway the central bank to follow suit and prolong its pause further.

#### Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

# China: Relaxing residency restrictions positive for ageing economy

China has announced a new policy to relax some of the existing residency restrictions (hukou). In the long term, this will release a "new"...



A busy road in Shanghai

## New policy: Relaxing residency restrictions

Under China's residency system, citizens born in a rural city can only enjoy social benefits in that city alone. These benefits include education for children and family medical services. Even if citizens move to an urban city for work, the residency restrictions (hukou), in most cases, cannot be lifted, and hence these citizens can't enjoy the same social benefits.

The hukou policy has been relaxed slightly for a few years but there has been no significant reform. That's about to change.

On 8 April 2019, the government announced [a new policy](#) to remove the hukou restrictions in some cities.

## No flood of labour in mega cities

[The policy](#) will remove residency restrictions completely for cities with a population of between one to three million (including citizens moved from rural cities). It will also relax some residency

restrictions for cities with a population of three to five million.

Following the [definition](#) set by the government, cities with a population of one to five million are considered "big", five to 10 million "very big" and over 10 million are "mega" cities.

With these population sizes in mind, we note that these cities are not the first-tier cities (i.e. not Beijing, Shanghai, Guangzhou and Shenzhen) and aren't even the second-tier cities. As a reference, Shanghai's population is 24 million. A city with a population of three million would be Qinhuangdao City, located in Hebei province.

The big cities have common characteristics; they are either manufacturing hubs with factories or are famous for cultural and scenic tourism. These characteristics make them potentially attractive to workers from rural areas.

The idea is to give social benefits to people in the cities where they work without flooding first-tier mega cities with extra workers.

## A new workforce for mid-size cities

We believe that with this new policy, there will be more rural citizens moving to the big cities where they can enjoy more social benefits. This could create a new workforce for the manufacturing and tourism industry.

It's also positive for the ageing population. With better social benefits, younger people from rural cities can raise children in the places they live and work. This could encourage younger couples to raise more than one child, as living costs will fall.

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*"On 8 April 2019, the government announced a new policy to remove the 'hukou' restrictions in some cities....This is positive for the ageing population. "*

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## This will lead to an upgrade of mega-cities

The policy could also encourage rural labour currently working in mega-cities to move to the big cities where they can get social benefits. Factories could then potentially relocate to chase the labour supply. This happened around 10 years ago when some factories in Shenzhen (then a low-end factory hub) moved to the inner area of the Mainland, and some moved to south-east Asia.

We believe that this policy is an attempt to repeat the Shenzhen story by relocating low- to mid-end factories in larger cities to mid-size cities. This would free up land in the larger cities to cater to higher value-add companies.

## Short-term challenges

There are at least two short-term challenges.

1. The success of the policy relies on how many jobs are immediately available in the big cities that remove the residency restrictions. If factory relocations from larger cities to mid-size

- cities are slow then the policy impact will also be slow.
2. Housing prices and rentals in those cities will rise when more citizens move from the rural areas to the cities. The higher rental costs will offset some of the benefits created by the policy, making the policy less attractive.

## Residency reform to continue

We recognise that this is a meaningful milestone in reforming the residency restriction (hukou) system. If successful, the policy will bring the rural workforce to manufacturing and tourism industries in the big cities, which goes some way to addressing the ageing workforce. But the reform progress is slow, this policy only relaxes residency requirements for cities with a population of between one to five million. There is still a long way to go before the hukou system is removed nationwide allowing full labour mobility within the country.

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