

## What's happening in Australia and around the world?

At its latest meeting, Australia's central bank kept rates on hold and seems quite unlikely to come to the rescue of the Aussie dollar any time soon. But given that Australia is the most exposed G10 economy to Chinese imports, a lot depends on how the trade war develops. For now, the balance of risks for the currency remain heavily tilted to the downside

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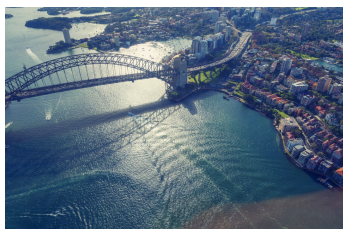


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By Warren Patterson

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## Australia

### **Australian 2Q19 CPI takes pressure off Reserve Bank**

Despite recent dovish remarks from Reserve Bank (RBA) Governor Lowe, the improved CPI figures for 2Q19 take the pressure off any need for an imminent...

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## RBA unlikely to help the Aussie dollar's clouded outlook

The re-escalation of trade wars and the drop in the Chinese Yuan is dampening appetite for the highly-exposed AUD. Tomorrow's Reserve Bank of Australia meeting is unlikely to deliver any cuts nor give relief to the battered currency



The Reserve Bank of Australia governor, Philip Lowe

A combination of rising trade tensions and monetary easing has kept any rally above 0.70 in AUD/USD short-lived during the past few months. As President Trump surprised the market with a new round of tariffs on Chinese exports, AUD dropped more than twice as much as its New Zealand and Canadian peers, NZD and CAD. That's hardly surprising given that Australia is the most exposed G10 economy to Chinese imports.

### RBA to pause while keeping the door open for more

The lack of appetite for the Australian currency is likely exacerbated by the dovish RBA stance that keeps the rate outlook unsupportive for the currency. Rate expectations for the RBA came under pressure two weeks ago as Governor Lowe made it clear that the central bank "is prepared to provide additional support by easing monetary policy" should inflation fail to approach the target.

2Q CPI numbers, released on Wednesday, marginally beat estimates (1.6% vs 1.5%). That helped convince the markets that the RBA will keep rates unchanged tomorrow after cutting in the last two meetings; that's indeed in line with our view. Signs of a stabilising housing market will also play a role in prompting a pause in the easing cycle. At the time of writing, the implied probability of a cut tomorrow is less than 9%, suggesting that rates are unlikely to find support should the RBA

match expectations and keep rates on hold. In terms of forward-looking language, we see very few reasons for Governor Lowe to deviate from his recent dovish rhetoric, not least since the re-escalation in the US-China trade war has reignited downside risks for the Australian export-based economy.

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*Another cut may be delivered by the end of the year*

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Looking ahead, headline inflation still appears far from the (ambitious) 2.5% RBA mid-point target, which – in line with Lowe’s recent rhetoric – makes us believe that another cut may be delivered by the end of this year. Markets have already priced in an 85% probability of this happening, so further pressure on Australian rates should not be massive. However, it will remain to be seen whether, in light of the new round of US tariffs and the recent rate cut by the Fed, markets will frontload more easing by the RBA.

## **AUD short-term downside risks remain high**

With the RBA unlikely to come to the rescue of AUD, the clouds above the currency are likely to linger for some time. Much will depend on the developments in the US-China trade war and in particular on how the tensions will impact Chinese economic data. But, for the time being, the balance of risks for the Aussie dollar remains heavily tilted to the downside. In turn, while we do not expect AUD/USD to trade far from our 0.68 forecast at the end of Q3, we acknowledge a sizeable risk of the pair moving below 0.67 in the coming weeks, especially given the absence of support from the dovish RBA.

Looking ahead, our trade team continues to expect a de-escalation in trade tensions towards the end of the year, with both China and the US making concessions on their way to strike a trade deal. Supported by a stubbornly short market positioning (-33% of open interest, as of last Friday), AUD/USD will likely have the chance to rebound towards 0.6900 in 4Q19.

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## NZD/USD: Ready for another leg lower

The trade war will probably keep striking the battered and bruised New Zealand dollar and the dovish central bank of New Zealand is unlikely to provide any solid armour. We think NZD/USD may soon edge below 0.6500



### RBA and Fed a good framework for the RBNZ

In the midst of recent market turmoil, the Reserve Bank of Australia kept rates on hold at 1% yesterday, while Governor Philip Lowe reiterated his recent rhetoric in favour of an 'extended period of low-interest rates' to support sluggish inflation.

In broad terms, the central bank has kept its forward guidance aligned with the Federal Reserve's 'openness to further rate cuts if necessary'. Turning to New Zealand's central bank meeting tomorrow, markets will scrutinise whether Governor Adrian Orr will align his forward-looking language in line with the Fed and RBA. In fact, guidance will drive the market's reaction to the rate announcement, given that a 25bp rate cut is fully priced in (100% implied probability) – and is [our call](#) too.

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*We don't necessarily see a weaker-NZD reaction right after the announcement, but expect forward guidance to confirm the rate outlook will continue to be unsupportive for the currency*

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The rate cut is expected in spite of the constructive 2Q labour data released overnight and is probably warranted given the negative dataflow (in particular, weaker business activity and confidence indicators) and price growth still below the central bank's target. We believe these factors along with trade-war-related risks (New Zealand is highly dependent on exports to China) will leave no choice for Governor Orr other than paving the way for more easing ahead.

We forecast another RBNZ cut in 2019, in line with market pricing of about 50bp of total easing. Given markets expectations, we do not necessarily see a weaker-NZD reaction right after the rate announcement but expect the forward guidance to confirm that the outlook will continue to be unsupportive for the currency.

**0.64** NZD/USD  
4Q19 Forecast

## Trade tensions to keep fuelling downside risk

It's been a tough start of the month for risk assets, and the New Zealand dollar hasn't been spared in the tariff-induced risk-off turn.

The lower than expected USD/CNY fixing by the People's Bank of China at 6.9683 has averted another round of sell-off in risk-sensitive assets for now, but the risk appetite remains muted. In such an environment, the New Zealand dollar is unlikely to see any rays of sunshine anytime soon, especially given the unsupportive rate outlook and the prospects that trade tensions have more room to escalate further rather than subside in the short term.

Therefore, we believe the balance of risks for NZD is heavily tilted to the downside and we would not be surprised to see NZD/USD edge below 0.6500 in the coming weeks and head towards 0.6400 in autumn.

### The recovery may be long and painful

In the longer term, we expect trade tensions to start abating in 4Q19 as both China and the US move closer to a trade deal. This would likely drain up the downward pressure on NZD, but we expect - [differently from AUD](#) - weaker economic fundamentals to make the recovery in NZD/USD quite lengthy and suspect the pair may need to wait until 2Q20 to climb back above 0.6600.

This implies that AUD/NZD could well reach 1.08 as early as in 1Q20.

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## China fixes the yuan higher

Today's fixing is an even bigger depreciation move, but some were expecting the fix to be higher still, and the market response is more balanced



### New mid-point for CNY is 6.9683

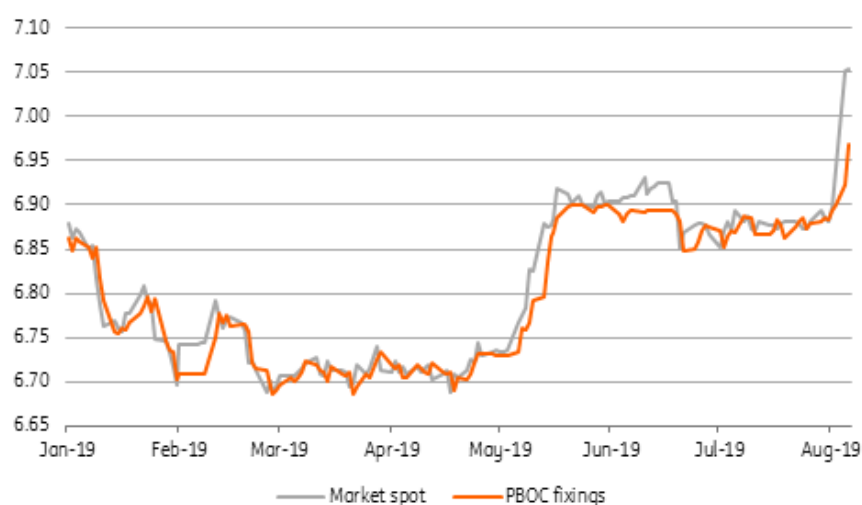
Today's fix at USD/CNY 6.9683 comes close to the estimates published each day by some of those attempting to mirror how the People's Bank of China sets its mid-point relative to its trading partners. But it is nonetheless quite a big move and about double the increase seen yesterday. As we noted in our morning note today, a move of this size could theoretically see USD/CNY spot rise to 7.10, given the 2% trading band permitted.

But the moves so far don't look anything like this big, and it seems that some market participants were expecting the fix today to be even higher, so the actual result is "less unsupportive" than some had imagined.

High yielders in the region, like the Indonesian rupiah and Indian rupee, are still looking soft, but the low yielders, Korean won, Singapore dollar, seem to be taking some support from this fix.



## USD/CNY - PBOC Fixing and the market spot rates



Source: Bloomberg, ING

### Bill issuance announcement also provides some CNY support

Backing up what some are viewing as a stronger than expected fix, the PBoC also announced they would issue 30 billion of yuan bills in Hong Kong next week. The sales are part of regular issuance, but the amount is larger than needed to simply replace maturing bills, so should provide some boost to short term Chinese rates, and thereby to the CNY.

So, far from looking like the PBoC is embarking on an aggressive depreciation, it is looking more likely that they are now trying to put the brakes on yesterday's move and bring some two-way risk back to the CNY outlook.

This probably has nothing to do with the announcement from the US earlier this morning, that they would label China a "currency manipulator". Moreover, with that decision now made, and the implications of this less worrying than tariffs already in place, that genie is now out of the bottle, and can't readily be re-used.

We now have to wait to see how the US President views today's move, as it looks like he is personally taking control of US trade policy. If he views it negatively, the next step for the US could be to consider increasing the tariff rate on the latest \$300bn of goods from the planned 10%, to 25%. Then we will have to see how China responds to that. Watch this space...

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## RBNZ set to cut rates

Wednesday's Reserve Bank of New Zealand is widely expected to deliver a further cut in the cash rate to 1.25%



RBNZ Governor, Adrian Orr

### Catching up with the RBA and Fed

At its meeting last month, the RBNZ did not cut rates but instead, leaving rates unchanged, Governor Adrian Orr, noted that "more support from monetary policy was likely to be necessary".

Since then, not only has the Reserve Bank of Australia cut its own cash rate target a second time to 1.0%, but the US Federal Reserve also cut rates by 25bp and left it looking like they will ease further in the coming months. In short, the RBNZ looks as if it will be left behind if it does not cut rates at this week's meeting.

### Not everyone agrees a cut is coming

Although only one of the seventeen economists providing forecasts for this meeting expects the RBNZ to leave rates unchanged, the "Shadow RBNZ" concluded that rates did not need cutting, noting that there were also negative consequences from excessively low rates. We don't expect the RBNZ to take this view, however. And with the further worsening of the external outlook following the latest escalation in trade tariffs, it would be very odd indeed if the RBNZ decided to

pause again.

## Macro numbers also point to a further cut

The macro numbers released since the last RBNZ meeting also suggest that a cut is forthcoming. Business activity and confidence indicators have fallen further, house price growth has moderated again and the labour market is also looking softer, with expectations for some further increase in the unemployment rate.

More positively, inflation has edged a little higher, managing to rise to 1.7%YoY in 2Q19 from 1.5% in the first quarter. That said, inflation still remains well below the RBNZ target mid-point so, on balance, the macro story also seems to solidly support the notion of another RBNZ rate cut at this week's meeting.

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Article | 31 July 2019

## The Fed's pre-emptive strike

The Federal Reserve has cut the fed funds target range by 25bp. We characterise this as an early pre-emptive move to help ensure the longest US economic expansion on record continues. It will likely ease again, but not by as much as the market is pricing

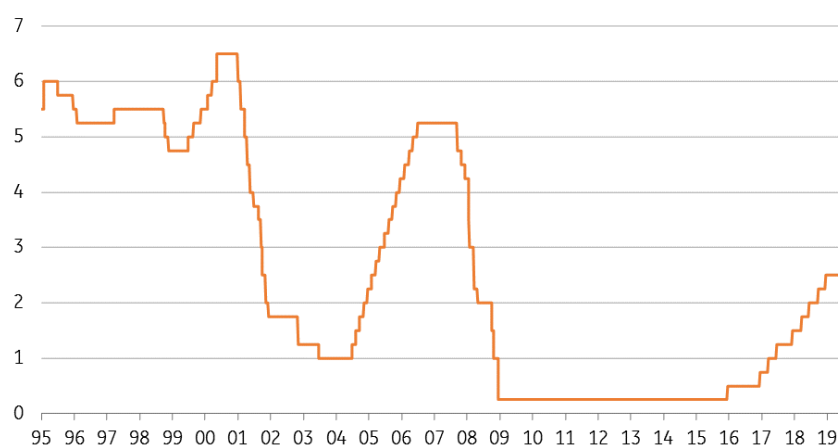


Source: Shutterstock

### A 25bp rate cut

As widely expected, the Federal Reserve has lowered the target range for the federal funds rate by 25bp to 2.00-2.25% and left the door open to more easing. It has also decided to conclude its balance sheet run down in August - two months earlier than previously announced. Today's decision to cut interest rates, for the first time since December 2008, was not unanimous though with Esther George and Eric Rosengren preferring to see policy left unchanged.

## Fed funds target rate (upper bound) 1995-2019



Source: Bloomberg, Federal Reserve, ING

### They never cut just once...

The Fed has been building up to this move over a number of weeks. Officials have frequently cited the weaker global backdrop and uncertainty over trade as factors that could act as a brake on US growth. Fed Chair Jerome Powell had already suggested they have contributed to business investment growth slowing “notably” and they were watching for signs of weakness elsewhere in the economy. Given the benign inflation backdrop, the Fed had room to loosen policy early and chose to take it.

### An early, pre-emptive move

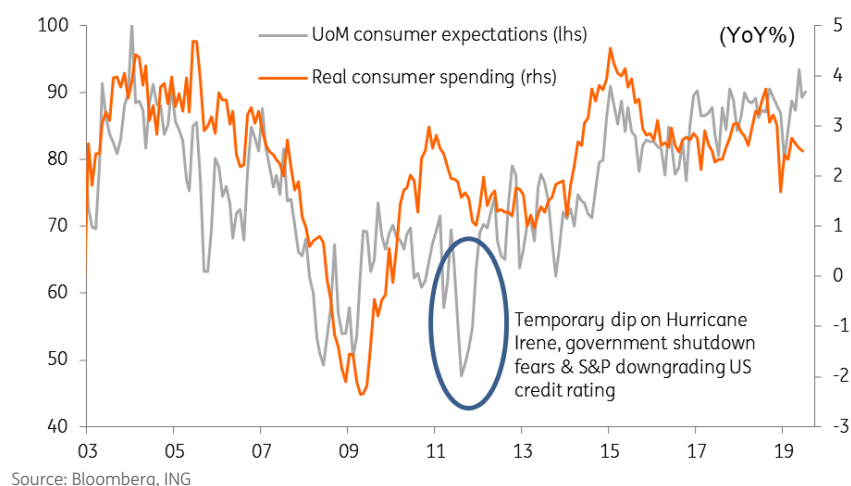
We characterise today’s move as a precautionary, pre-emptive policy change to ensure that the US economic expansion – already the longest since the National Bureau for Economic Research’s database began in 1854 – continues for a good while longer. However, the Fed never cuts rates just once and we doubt it will this cycle.

The language in the Fed statement is fairly vague and offers room for flexibility over coming months. It keeps in play what futures markets are pricing - at least another three rate cuts before the end of 2020. But, if anything, the statement (and vote outcome) offers more support to our more cautious outlook of only one further rate cut, most likely coming in September.

The labour market was still described as “strong” and activity is still expanding at a “moderate” rate. Moreover, the Fed’s base case remains that “sustained” growth, a “strong” labour market and inflation “near” the 2% target “are the most likely outcomes”.

We see no reason for this situation to change in the near term. After all, domestic demand is strong, asset prices are high, the labour market is robust and even the manufacturing sector has shown renewed signs of life thanks to the US-China trade truce. Indeed, the strength of the consumer sector can certainly offset some of the headwinds from lingering global growth worries.

## Consumers have the confidence and the cashflow to spend



## Trade to determine the policy outlook

Nonetheless, the Fed continues to highlight the “uncertainties” and it is the trade story that remains critical to the outlook for policy. This is very firmly in President Trump’s hands. Should tensions escalate once again, tariffs are hiked, markets sell-off and economic weakness spreads then the Federal Reserve will respond with more stimulus given the benign inflation backdrop.

However, we remain open to the view that the fear of economic weakness for both sides will lead to China and the US finalising a deal later this year, even if it doesn’t necessarily achieve all of President Trump’s initial demands. President Trump wants to go into next year’s election with the economy in the best shape possible. A positive boost to sentiment from a trade deal would be a shot in the arm for the economy and help his re-election chances. It would also clearly reduce the need for additional Fed policy easing.

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Article | 6 August 2019

## Crude oil: Further OPEC+ cuts needed?

There is a clear battle going on in the oil market- uncertainty over demand growth versus a constructive supply picture in the near term. But which will prevail? For the remainder of this year, the market should tighten, but moving into 2020 we see a looser balance once again



Source: Shutterstock

### ING price forecasts

Current	2019				2020				2021			
	1Q	2Q	3QF	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
ICE Brent (US\$/bbl)	64	68	65	68	63	61	65	70	68	73	73	71
NYMEX WTI (US\$/bbl)	55	60	57	60	56	54	58	63	61	66	66	64
Previous												
ICE Brent (US\$/bbl)	64	68	69	73	70	74	76	74	72	77	77	74
NYMEX WTI (US\$/bbl)	55	60	61	65	63	67	69	67	65	70	70	67

Source: ING Research

### Constructive in the short term

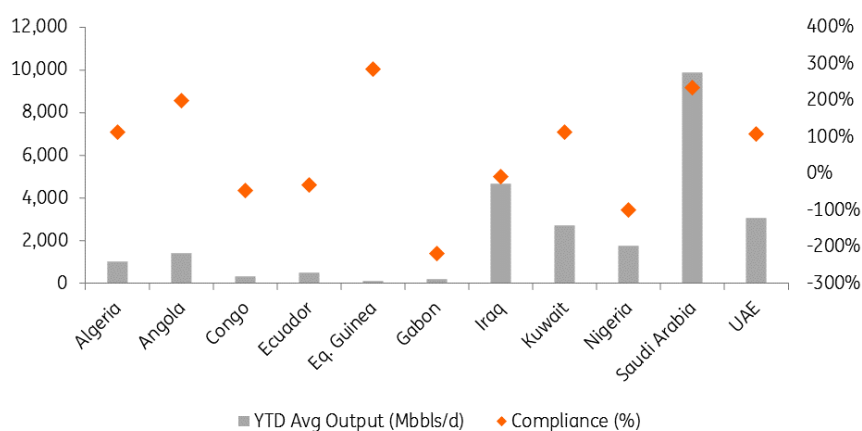
OPEC+ cuts should do a good job in drawing down global inventories for the remainder of this year. Overall, members have over-complied with the deal, and this is largely due to Saudi Arabia producing more than 500Mbbbls/d below their quota level. Although there are other producers, such

as Iraq and Nigeria, who have failed completely to comply with the production cut deal. Under the deal, Iraq was meant to produce a little over 4.5MMbbls/d, down from 4.65MMbbls/d in October 2018- the reference month for cuts- however the country has in fact increased output, pumping on average 4.7MMbbls/d since the start of the year.

However, strong overall compliance, along with falling Iranian oil supply, coupled with stronger seasonal demand over the latter part of the year should see global inventories fall by around 1MMbbls/d in 3Q19, and a little over 700MMbbls/d in 4Q19. Therefore we continue to believe that prices should trade higher from current levels. Although in the current macro environment it is likely to be a bumpy ride.

Time spreads continue to suggest a tighter physical market. While the prompt ICE Brent spread has been volatile in recent weeks, it remains firmly backwardated along with much of the front end of the curve. Even the US market has tightened up recently. The prompt WTI timespread has swung into backwardation this week, after the front end of the curve was largely in carry. US crude oil inventories continue to decline- they have fallen for seven consecutive weeks, with stocks now down almost 49MMbbls since early June. This has also seen WTI strengthen relative to Brent, with the WTI/Brent discount narrowing from more than US\$7/bbl in late July to almost US\$5/bbl currently. US inventories should continue to edge lower over the next couple of months, which would be in line with seasonal trends, although keep an eye on US exports- a further narrowing in WTI/Brent could see exports slow.

## OPEC-10 YTD compliance



Source: OPEC, Bloomberg, ING Research

## A more bearish 2020

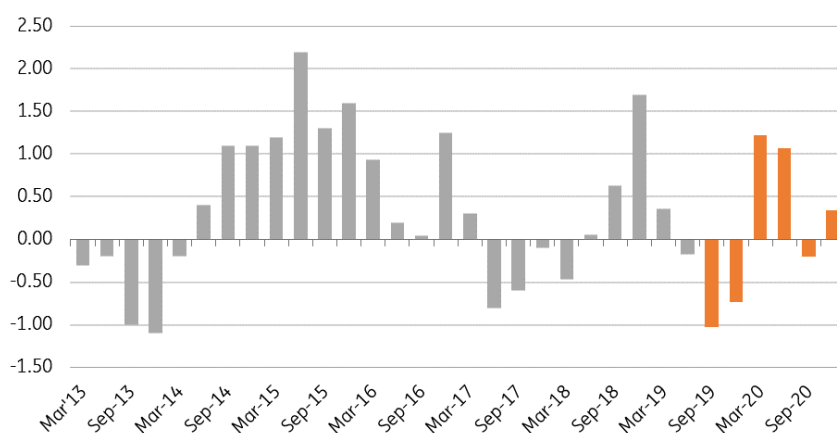
However, the balance changes drastically as we move into 2020, and as a result we have revised lower our price forecast for next year. While OPEC+ cuts are set to run through until the end of 1Q20, weaker seasonal demand in the first quarter of the year means that the global balance is set to see sizeable stock builds over 1Q. This is even assuming that Saudi Arabia keeps production at 9.8MMbbls/d over the period- which is 500MMbbls/d below their quota. As a result of strong non-OPEC supply and weaker seasonal demand, we estimate that the call on OPEC production in 1Q will be around 28MMbbls/d, which is 1.9MMbbls/d lower than estimates for the group's production in July, and 1.2MMbbls/d lower than what we are currently forecasting for 1Q20. This does suggest that we would need to see further action taken by OPEC+. A starting point would be to ensure all

members are at least in compliance with the deal, and then look at whether deeper cuts are needed over 1Q20.

At the moment, given the deal is set to end in 1Q20, the market is also set to see a sizeable surplus in 2Q20. As a result, we believe that OPEC+ will likely have to extend the current deal through until at least the end of the second quarter or risk lower prices. However, such a decision will likely only be made at the OPEC+ meeting in December at the earliest- assuming market moves don't force OPEC+ to act sooner.

Looking at 2020 as a whole, we estimate the call on OPEC will be 29.1MMbbls/d- which is almost 800Mbbls/d lower than estimated production in July.

## Global oil market set to return to surplus in 1H20 (MMbbls/d)



Source: IEA, EIA, OPEC, ING Research

## Demand concerns linger

Clearly, the current weakness in the market reflects concerns over demand growth for the remainder of this year, as well as 2020, particularly given the current macro environment, and a ratcheting up in the trade war. There is a large degree of scepticism around demand growth forecasts moving forward. The IEA is currently estimating that demand will grow by 1.8MMbbls/d over 2H19, this is up from around 300Mbbls/d in 1Q19 and 800Mbbls/d in 2Q19. Therefore given the current macro climate, this number might be a bit too ambitious for the remainder of the year. Furthermore, the longer the trade war drags on, the more downside risk there is around the demand growth number of 1.4MMbbls/d in 2020.

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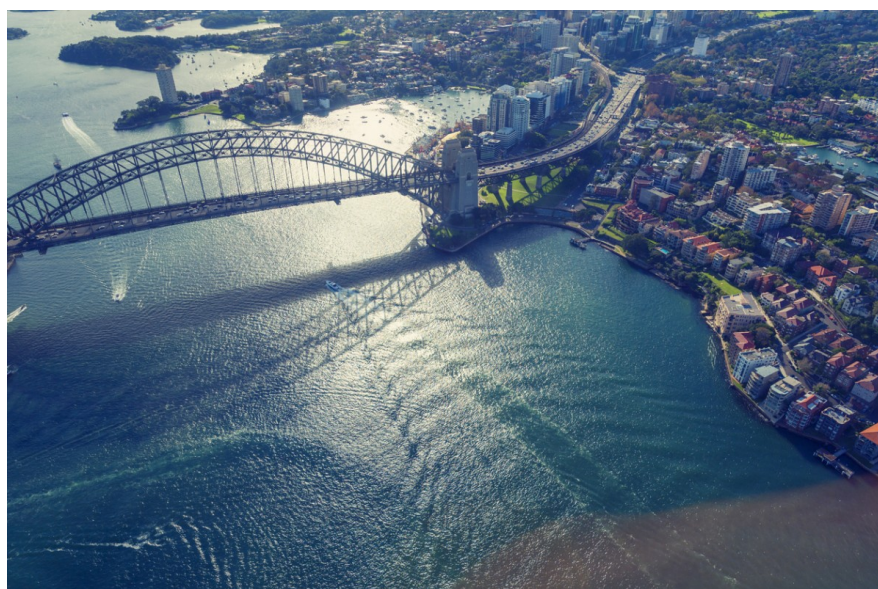
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# Australian 2Q19 CPI takes pressure off Reserve Bank

Despite recent dovish remarks from Reserve Bank (RBA) Governor Lowe, the improved CPI figures for 2Q19 take the pressure off any need for an imminent follow-up to recent back-to-back easing.



# 1.6% YoY

2Q19 inflation

Up from 1.3% in 1Q19

Higher than expected

## Higher inflation, but still way below target

Australia's Central Bank (the Reserve Bank, RBA) has a tougher job than most central banks around the world, given that it targets an inflation range with a mid-point half a percentage point above most other developed-market central bank inflation targets .

So today's rise in the headline inflation rate to 1.6% in 2Q19, represents a welcome directional shift given the steep drop to 1.3% in 1Q19, but leaves a still substantial gulf to be filled to get inflation closer to the medium-term target.

## RBA outlook - nothing for now

So what does this mean for RBA policy?

In the short term, it means that the back-to-back cuts, with the most recent at this July's meeting, are probably enough for now. The government's tax cut package passed parliament this month too, which will deliver a tax rebate of AUD255 to AUD1,080 for many earners on tax returns now being filed. That should provide a lift to spending, and hopefully, in time, employment, wages and inflation. That said, these transmission channels are a lot weaker than they used to be, so the full extent of the outcome remains uncertain.

The RBA has not been silent on its view that fiscal policy needs to do its share of the heavy lifting to bring economic growth, employment and inflation back to a more reasonable path, and whilst it waits to see how this pans out, there seems little prospect that the RBA will need to provide any further monetary stimulus.

## Longer term - possibly another cut

We still have a further cut penciled in for 4Q19. This isn't a particularly strong conviction call, especially in terms of the timing. But recent dovish comments by Governor Lowe indicate that the RBA may not have quite finished its easing yet. While we wait for the impact of the earlier monetary easing and the forthcoming tax rebates, we will retain a cautious outlook for policy, though it may be that we end up shifting this cut back into 2020, or even removing it entirely if the economic backdrop improves sufficiently.

Markets are still fully pricing in a further rate cut by the year-end, with a further cut of the cash rate to 0.5% partly priced in. This sounds too much for us.

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