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We're revising our yuan forecast again and expect far more volatility

China's unexpected retaliation last week and the hasty US reaction means means we can expect China to use tools other than tariffs for future retaliation. The yuan is likely to be one of these, but the central bank probably wouldn't want one-way depreciation lest it triggers capital outflows. Therefore, we revise our USD/CNY forecast.. again

Dollars surrounded by Chinese yuan

It's all kicking off again

Last Friday, China surprised markets by imposing new tariffs on more US goods imported into China.The retaliation in terms of the amount is small (simply because China exports more goods to the US than it imports), so in principle this shouldn't have much of an impact on the US. It could ignore this - after all it was retaliation.

The unexpected announcement hit a nerve

Another perspective on the entire situation is the flurry of tweets that came almost immediately from President Trump displaying his anger. The Chinese tariffs seem to have hit a nerve.

The wobbly stock market

This marginal increase in tariffs might not be a substantial issue for China as the initial tariffs should have already been enough of a hindrance for Chinese businesses exporting to the US.

But with the surprise increase in tariffs, the Chinese action pretty much had the desired impact on the stock market.

Over to China

The ball is now firmly in China's court. We think imposing more tariffs isn't the most effective way to create more hurdles for a Trump Administration that will soon begin to campaign in earnest for the 2020 presidential elections. Instead, China could probably cause more disruption if it keeps catching US stock markets - as well as potential Trump voters - off guard.

There are two possibilities open to China:

1. **Unreliable entity list:** Inclusion of any US companies in the list means those companies cannot tap into the Chinese market. This is a very powerful tool that has the potential to lead to increased volatility as well as periods of sudden yuan weakness.
2. **Firm stance on trade talks:** Talks without progress are more likely to provoke additional tariffs from the US. Even though this is to be expected, it is likely to weaken the yuan significantly. USD/CNY could cross 7.18 (the recent high) to near 7.20. This alone, without any retaliation from China, has the potential to create further market disruption.

Revising yuan forecasts

Arguing that both measures will end up with a weaker yuan, we revise our USD/CNY forecasts.

We also think the central bank won't want the market to believe that the yuan can only depreciate against the dollar. So we expect that - in between these “unexpected” events - the yuan will strengthen against the dollar from time to time.

If we draw a monthly chart of USD/CNY, we should see increased USD/CNY volatility, even we only see a linear weakening yuan trend at every quarter-end.

Our range forecast of USD/CNY for the rest of 2019 is 7.05 - 7.50. Volatility should be high given that China's objective is to use the yuan as a surprise tool for the market. The spikes in USD/CNY may not be reflected in the quarter-end point forecasts. Our previous forecasts were 7.10, 7.00 and 6.90 for the end of 2019, 2020 and 2021, respectively.

Revised yuan forecasts as of 27/8/2019

	1M	3Q19	4Q19	4Q20	4Q21
USD/CNY	7.18	7.18	7.20	7.30	7.20

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Snap | 24 August 2019 China

Time is running out for Trump to cut a trade deal

The latest escalation of the trade war is no surprise, but President Trump should hurry up to secure a trade deal before his battle for re-election really takes off

US President Donald Trump on the first day of the annual G7 Summit in France

On Friday, markets responded once again with surprise to a further escalation in the trade war. Actually, there was little reason to be so dumbfounded. Last October, after the US imposed a 10% tariff on US$ 200 billion of imports from China, we forecast that the Sino-American trade war would escalate along the lines that we have seen since. That's because we simply judged US demands to be too ambitious for China to accept. And also because we expected President Trump to respond in the manner to which we've become accustomed: ramping up the pressure in an attempt to strongarm his opponent into accepting his demands.

> *Trump will have to lower his demands to be able to get a deal done with the Chinese soon*

Since last October, there have been few signs that China would concede enough for Trump and the

China hawks such as economic advisor, Peter Navarro and US Trade Representative, Robert Lighthizer, to be satisfied. In the run-up to the summit between Trump and China's President Xi at the start of May, the US administration thought that a deal was very close. The Chinese government was much more cautious in its communications about the possibility of such a deal. This should have been a sign to the US that accepting far-reaching demands, such as giving up its autonomy over its own economic policy and accepting that the US would be entitled to decide for how long tariffs would stay in place, is asking too much from China.

So the big question is how the trade war will develop from here? Economically, Trump is right when he says that China needs a deal more than the US. China's direct and indirect exports to the US contribute more than four times as much to Chinese GDP as US exports contribute to the American economy. But the President needs a deal, too. If he does not succeed in cutting deals with China and other trading partners with whom the US runs a trade deficit, it will be hard for him to claim during his campaign for re-election that he is succeeding in improving the terms of trade for the US. Voters will not like this, mainly because they will increasingly pay the price for the trade war now that the tariff hikes are about to hit prices of imported consumer goods.

Trump has said several times that the trade war will not take long and that the US is winning. However, given the tougher stance of China since the failure to cut a deal at the Trump Xi meeting in May, Trump will have to lower his demands in order to get a deal done with the Chinese anytime soon.

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China hits back with surprise tariffs

China has eventually retaliated with tariffs but this retaliation is far from the last. Very soon, we expect American companies to be included in China's "unreliable entity list". If the trade talks in September don't make much progress, we think USD/CNY to move closer to 7.10 level or even cross 7.10 briefly

Source: Shutterstock

An unexpected Friday afternoon retaliation

China has just announced it will impose 5% to 10% tariffs on $75 billion of goods (including frozen pork and nuts) along with resuming the 25% duty on US automobiles and auto parts from 15th December. Some tariffs will come into effect on 1 September while others will kick in around 15 December.

What's interesting to note here is that the market was not expecting this tariff retaliation given that China did not immediately react to the 10% US tariffs on $300 billion goods and President Trump's unexpected tariff delays to 15 December.

But even though China's tariffs are smaller than what the US has imposed, the sudden surprise element of it all should cause a risk-off to asset markets globally.

But there will be more

But tariffs aren't the only tool China has to retaliate against President Trump's tariffs.

China has said a few times that it has its own 'unreliable entity list' ready. The market has speculated that the first company to be included in that list is likely to be American, and we think that's when the war of 'entity list' will kick-off. This will be another risk-off factor for asset markets.

Yuan could be weaker

As China has allowed USD/CNY to cross 7.0, we think it is possible that this tactic is reused to weaken the yuan further to surprise the market again.

We expect USD/CNY to move closer to 7.10 level or even cross 7.10 briefly if the trade talks in September don't make any progress like the last round.

Over to the US

The unanticipated Chinese move to impose more tariffs on the US has caught the market off guard and has put the Trump administration in a position who is likely to retaliate but in an unprepared way.

If the US retaliates harshly, then we expect China to really kick off its unreliable entity list. But if it doesn't, it will be on the back foot during the upcoming trade negotiations in September - and given President Trump's latest tweets, that seems improbable.

In our view, one thing is for certain, this is a lose-lose situation for both China and the US in this trade and technology war.

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Australian employment comes in strong

A 41K increase in employment in July - most of it full-time, does not really tally with thoughts of a near-term further easing from the RBA, or a much weaker AUD.

Source: Shutterstock

41,000

Employment change

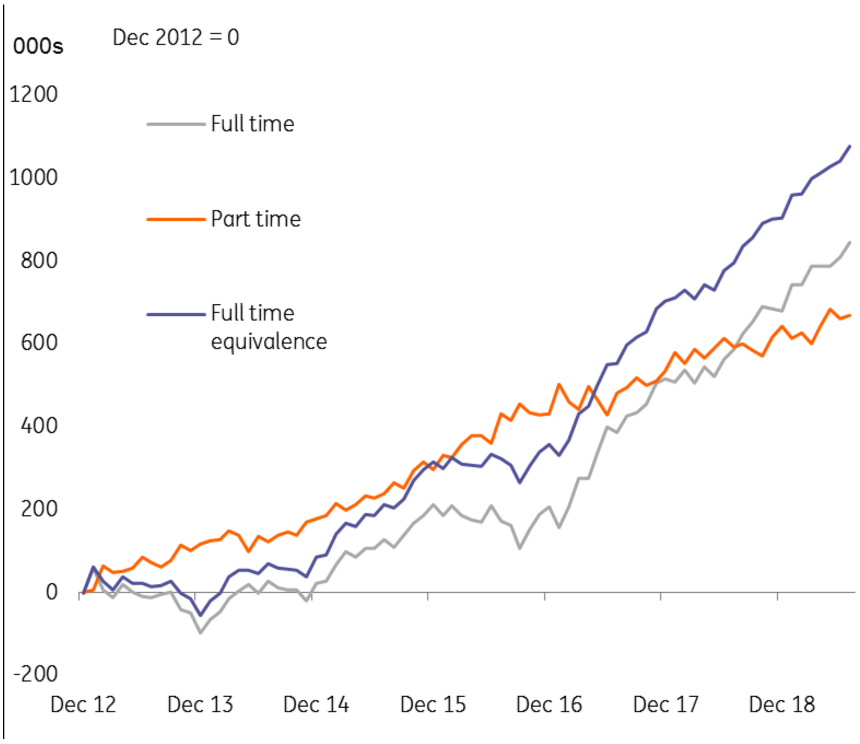
July, up from -2.3K in June

Higher than expected

RBA may ease again, but this data says "pause"

We don't rule out further easing from the RBA before the year-end, but they have done a lot already, and today's strong labour data suggest that the Fed is more likely to be easing before the RBA moves again.

Full and part-time employment



Source: Bloomberg, ING

Its a good 41K, not a bad one

The 41K employment change is even more impressive than it first looks as 34.5K of that total was full-time employment, and only 6.7K part-time. The consensus view was for only a 14K increase (ING f +37K). We were not too surprised by this data, which we find roughly follows a negative serial correlation pattern (in short, it saw-tooths).

The unemployment rate remained unchanged at 5.2%, but that was also well within expectations and came despite an increase in the participation rate.

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Article | 23 August 2019

Credit | Video

Watch: The yield curve isn’t saying anything nice

The yield curve is talking to you... and it's not saying anything nice. So says ING's Senior Rates Strategist, Antoine Bouvet. An inverted curve is usually a precursor to a recession. However, President Trump says the US economy is the best in the world. So what's it really telling us?

The yield curve isn’t saying anything nice

Watch video

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Asia week ahead: Will India's 2Q GDP validate rapid rate cuts?

July industrial production releases crowd next week's Asian economic calendar, though India's 2Q GDP and Korea's central bank policy will steal the focus

Source: Shutterstock

India's GDP growth has bottomed

Pronounced economic weakness was the likely reason behind the Reserve Bank of India's (RBI) policy rate cut earlier this month, which was the fourth this year and unusually large at 35 basis points. India's forthcoming GDP figure for the April-June quarter (1Q FY2019-20) should attest to worries about a significant weakening in the economy. GDP growth slipped to a five-year low of 5.8% in the Jan-Mar quarter. Since then, however, the high-frequency activity data has been a mixed bag.

While the accelerated weakness of exports and vehicle sales signal slower GDP growth, nearly stable imports and faster industrial production growth suggest the opposite. Despite a recent slump, exports are still doing well, with a rise of about 2% year-on-year in the first seven months of 2019, in contrast with sharp declines elsewhere in Asia. Providing a further positive spin to the growth story is an election-related surge in government spending as well as a total 75 basis points of rate cuts through June – by far the heaviest easing among Asian central banks this year, and supporting domestic demand.

All this leads us to the view that GDP growth improved in the reporting period, albeit slightly, to our 6.0% estimate. If it goes the other way, the key question would be what all that aggressive stimulus was for?

Bank of Korea waiting for Fed to go first

South Korea's central bank (BoK) holds a monetary policy meeting. To be unveiled on Friday 30 August, the policy decision will most likely be no change to the 1.50% policy rate after a 25bp cut at the previous meeting on 18 July. This means all attention will be on Governor Lee Ju-yeol's post-meeting press conference for hints about the timing of the next cut.

The Korean won depreciation this month, following the Chinese yuan, will likely keep the BoK from risking more currency weakness with another rate cut right now. We also believe the BoK would prefer to wait for the US Federal Reserve's next rate cut in September. However, unlike the Fed, which is in insurance easing mode, the BoK's easing is genuinely needed, as will be underscored by some key economic data next week on consumer and business confidence and industrial production. Indeed, we don't think the BoK is done with easing just yet. There will be at least one more 25bp cut before the yearend.

And lots of manufacturing releases

July industrial production releases from Japan, Korea (already mentioned), Singapore, and Thailand will be early indications of third-quarter GDP growth in these countries. There is little room for optimism here with an escalation of the US trade tensions with China and the rest of the world, and now that of Japan with Korea, working to depress exports and manufacturing alike.

Meanwhile, a sharp slowdown in China's industrial production growth in July bodes ill for profit growth in that month.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Monday 26 August			
Hong Kong, SAR	0930	Jul Exports (YoY%)	-11.3	-	-9.0
	0930	Jul Imports (YoY%)	-9.7	-	-7.5
	0930	Jul Trade balance (HK$ bn)	-48.2	-	-55.2
Singapore	0600	Jul Industrial production (MoM/YoY%)	-0.1/5.0	-/-	1.2/-6.9
South Korea	2200	Aug BOK Consumer Sentiment Index	96.9	-	95.9
		Tuesday 27 August			
China	0230	Jul Industrial profits (YTD, YoY%)	-2.0	-	-3.1
		Wednesday 28 August			
South Korea	2200	Sep BOK Business Survey Index, mfg	72	-	71.0
	2200	Sep BOK Business Survey Index, non-mfg	70	-	71.0
		Thursday 29 August			
Thailand	-	Jul Manufacturing index (YoY%)	-4.8	-	-5.5
		Friday 30 August			
India	1300	2Q GDP (Q) (YoY%)	6.0	-	5.8
	-	Jul Fiscal deficit (INR crore)	-	-	65898
Hong Kong, SAR	0930	Jul Retail sales value (YoY%)	-15.6	-	-6.7
	0930	Jul Retail sales volume (YoY%)	-15.0	-	-7.6
South Korea	0000	Jul Industrial production (MoM/YoY%)	-0.6/-4.1	-/-	0.2/-2.9
	0200	7-Day Repo Rate	1.5	-	1.5
Thailand	-	Jul Current account balance (US$bn)	1.2	-	3.9

Source: ING, Bloomberg, *GMT

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Article | 22 August 2019 FX | China

Why we're not worried about the Hong Kong dollar peg

There's been increasing speculation about Hong Kong's dollar peg, mainly because protests have lasted longer than expected. Here's why we don't think the monetary authority will change the linked exchange rate system or the currency range. We also include our views on HKD interest rates

Source: Shutterstock

We don't think the HKD peg will change

Due to the prolonged protests, investors have started to worry about Hong Kong's dollar peg.

The HKD is governed by a linked exchange rate system, which is written into the Basic Law of the Hong Kong Special Administrative Region. What can be changed is the linked currency, which is now the US dollar, and the range of the linked exchange rate level.

The HKD is freely traded internationally, which is important for China to do businesses with the rest of the world.

We expect the Hong Kong Monetary Authority (HKMA) to stick to the existing linked exchange rate system, now more than ever.

What is the linked exchange rate system?

The linked exchange rate system permits the HKD to range between 7.75 and 7.85 per USD. That is the range set by the Hong Kong Monetary Authority.

The HKMA does not have a policy interest rate. The interest rate of Hong Kong SAR is driven by the money flowing in and out.

In theory, when demand for HK dollar assets falls and the HKD weakens to 7.85, the HKMA should purchase HKD, leading to a fall of HKD liquidity in the system. Interest rates then rise versus the US dollar, which should attract capital inflows and keep the exchange rate between 7.75 and 7.85.

What can be changed in the linked exchange rate system?

Two variables in the linked exchange rate system can be changed. One is the linked currency, which is now the dollar, and the second is the band of the linked exchange rate system.

During times of high volatility or uncertainty in the asset market, changes to the linked exchange rate system, be it the linked currency or the band, could trigger speculation about further changes. This would create a lot of betting on USD/HKD and could hurt the HKMA's credibility. As such, it is not an appropriate policy action at this time, particularly because it would do nothing to address the demands of protestors.

HKMA has enough exchange funds to defend the peg via market channels, i.e. spot and derivatives, and it has experience in defending the peg successfully, as seen in the Asian financial crisis.

Interest rates in Hong Kong are tied to cross border fund flows

Interest rates in Hong Kong theoretically follow the mechanism of the linked exchange rate. But within the framework, there are other factors affecting the level of interest rates.

The most prominent one is cross border fund flows in and out of the Hong Kong equity market. This is obvious when there are hot IPO listings in Hong Kong SAR because IPO margin financing usually locks up a lot of cash, and therefore pushes up interest rates.

Other factors include the relative movements of HKD interest rates vis-a-vis the USD interest rate, as the linked currency is the dollar.

Forecasts of HKD and interest rate

We expect the HKD to fall from the current 7.84 level to 7.82 by end of 2019 as we expect some mega sized IPOs to be listed in Hong Kong SAR in the second half of the year.

For the same reason, we expect the three-month HIBOR to increase from 2.35 to 2.55 by end of 2019.

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Article | 22 August 2019 Malaysia

How is Malaysia bucking the global slowdown?

Firmer growth, low inflation, and a healthy external payments position – everything is coming together to support investor confidence despite the current global economic turmoil. That said, we don't think the authorities will relax just yet - we expect another 50 basis points of rate cuts in 2019

Source: Pexels

4.7% GDP growth

ING forecast

So far so good – an economy that surpasses expectations

Malaysia's economy seems to be relatively unscathed despite the ongoing global trade and tech war, as well as the slump in the tech sector.

Last week, the country's GDP growth improved to 4.9% year-on-year in 2Q19 from 4.5%. It wasn't a complete surprise though. A pick-up in exports and manufacturing growth foreshadowed the

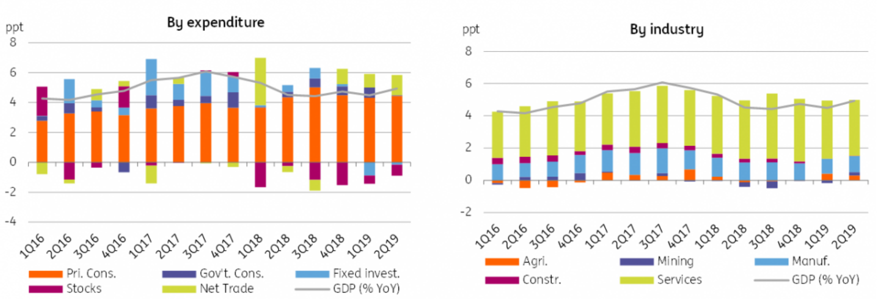
GDP improvement, leaving the year-to-date economic performance on par with that in the full-year 2018.

Private consumption continued to be the key GDP driver from the spending side, making up for the continued slack in investment demand (both public and private), while inventory depletion also continued to drag headline growth downwards in the first half of the year. Stronger private sector performance was underpinned by persistently low inflation and accommodative monetary policy and weak public spending hasn't been a surprise either as the government is reigning in its expenditure after a blow-out deficit last year.

Despite external headwinds, exports were almost flat in the first half of the year compared with sharp declines in neighbouring economies. As such, net trade contributed more to the GDP growth in the first half of the year than it did all of last year, which, in turn, was consistent with a near-doubling of the current account surplus to MYR 30.7 billion from a year ago.

Services remained the key growth driver from the industry side, though the improvement in the manufacturing contribution is noteworthy.

Expenditure and industry-side sources of GDP growth



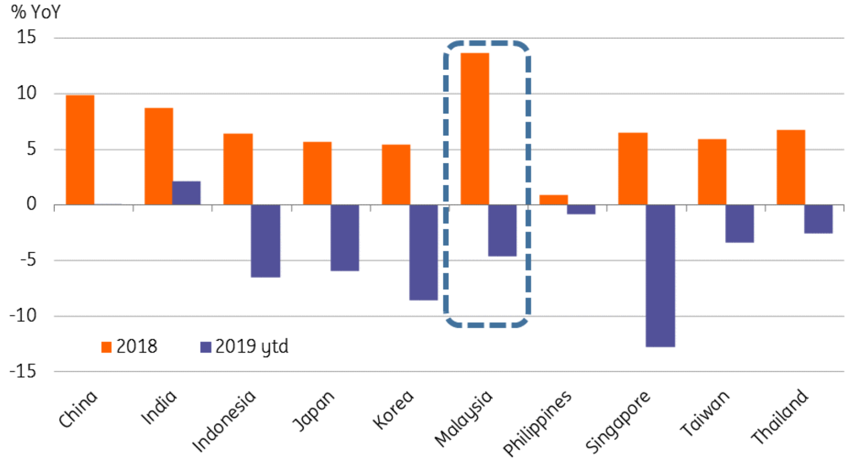
Source: CEIC, ING

What's behind the export outperformance?

Following a 14% (USD denominated) surge in exports last year – the fastest in Asia - some export weakness was inevitable this year.

Given Malaysia's heavy export exposure to electrical and electronic goods, the outlook for Malaysia's export sector was about as bad as you could imagine. But a 5% fall in exports in the first half of 2019 from a year ago wasn't at all bad in comparison with sharp export declines elsewhere in Asia.

Asian export performance

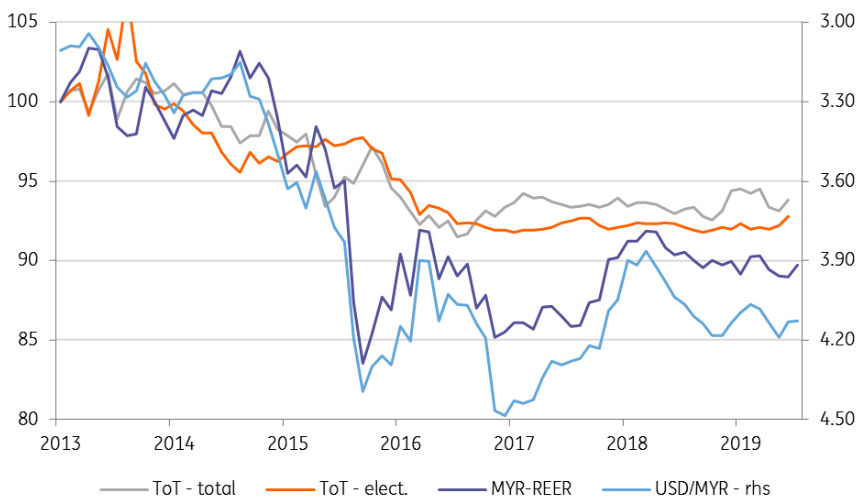


Source: Bloomberg, CEIC, ING

Among the key factors supporting Malaysia's export performance this year are continued favourable terms of trade, an undervalued currency, relative electronics strength, and maybe some supply chain diversion.

- **Terms of trade:** The 2014 commodity price crash was a huge negative shock for Malaysia's commodity-driven economy. Commodity prices started to recover in 2016 but the terms of trade failed to follow suit. While the recovery in both global commodity prices and Malaysia's terms of trade was further hampered with the onset of the trade war between the US and China last year, this probably helped sustain Malaysia's exports competitive advantage in international markets.
- **Undervalued currency:** The Malaysian ringgit (MYR) hasn't escaped the emerging market contagion. The MYR lost 2% of its value against the USD in 2018 and another 1% so far this year. This despite a relatively stable economy with a healthy balance of payments. The weak currency is boon for exports.

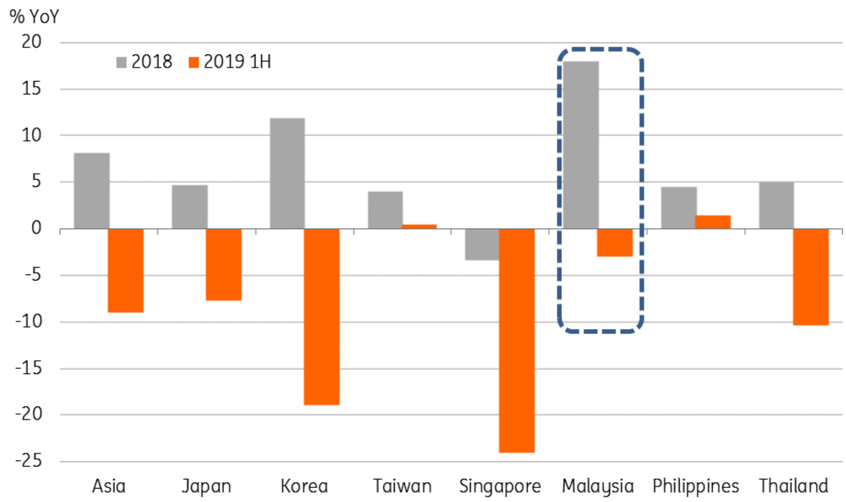
Still favourable terms of trade, undervalued currency



Source: Bloomberg, CEIC, ING

- **Electronic export outperformance:** Even though Malaysia's E&E exports aren't immune to ongoing global electronics weakness, a 3% YoY fall in these shipments in the first half of 2019 compares very favourably with large declines elsewhere in the regions. (24% fall in Singapore, 19% in Korea, and 10% in Thailand's electronics exports). Malaysia isn't very far off the Asian outperformers including Taiwan (+0.4%) or the Philippines (1.5%), whose relative strength this year follows excessive weakness last year.

Asian electronics export performance

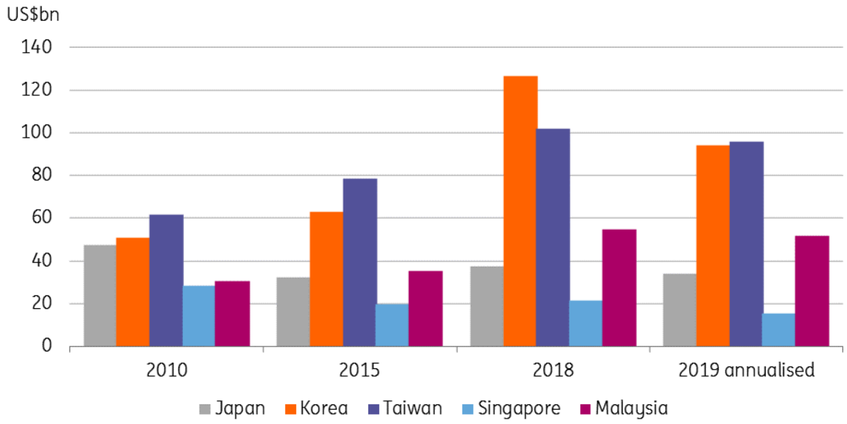


Source: Bloomberg, CEIC, ING

- **Supply chain diversion:** The outperformance of Malaysia's electrical and electronics industry relative to its Asian counterparts may lead one to wonder whether Malaysia is taking market share from other Asian countries. Not necessarily from Singapore, though Malaysia appears to be gaining some edge here too.
  Some of the facts substantiating this view include a big surge in foreign direct investment inflow in the northwest coastal states as well as a surge in semiconductor manufacturing and exports this year. A Bloomberg story recently pointed out the state of Penang, already home to big tech companies, has attracted large FDI inflows this year, which together with a surge in semiconductor manufacturing this year (23% YoY in the first half of 2019) and in exports (up 6%) are hopeful signs that Malaysia is moving up the value chain.

Trade War Spurs 1,360% investment jump in Malaysian State

Asian semiconductor exports - Is Malaysia moving up the electronics value chain?



Source: Bloomberg, CEIC, ING

Further exploring electronics potential

The electrical and electronics sector forms a significant part of Malaysia's economy. Exports from this sector account for about 38% of Malaysia's total exports and were equivalent to about 26% of the country's GDP in 2018. Virtually all of Malaysia's trade surplus is being generated from the electrical and electronics sector, while the sector also accounts for almost a quarter of manufacturing output (GDP), employment and investment.

Despite the big weighting in trade and manufacturing, the electrical and electronic sector's contribution to overall GDP and employment has been pretty low. Although this may come across as a low-value adding nature of the sector, which also conforms to high import content of E&E exports, the fact that virtually all of Malaysia's trade surplus is generated from the E&E trade challenges the low value-added argument.

Until recently most of the E&E imports were processed for re-export, and even the strong surge in exports in recent years (19% in 2017 and 11% in 2018) failed to stimulate Malaysia's manufacturing out of its low single-digit growth path. However, this seems to have changed since the outbreak of the trade war.

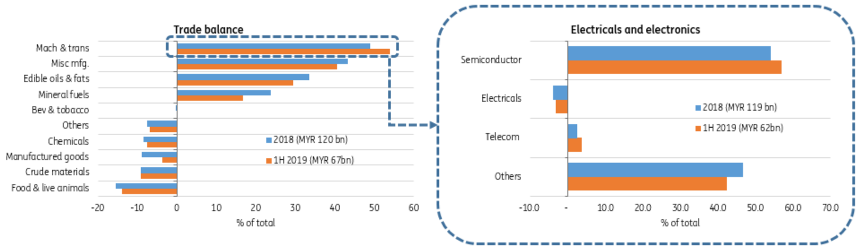
Electrical and electronics - key facts

%	2018 Share
38	Total exports
30	Total imports
99	Trade surplus
13	Approved manuf investment
19	Approved FDI
26	Exports in GDP
28	Manufacturing GDP
23	Manufacturing employment
6	Total GDP
4	Total employment

Source: Bloomberg, CEIC, ING

Share of electrical and electronics in total economic activity

E&E - the biggest contributor to the trade surplus

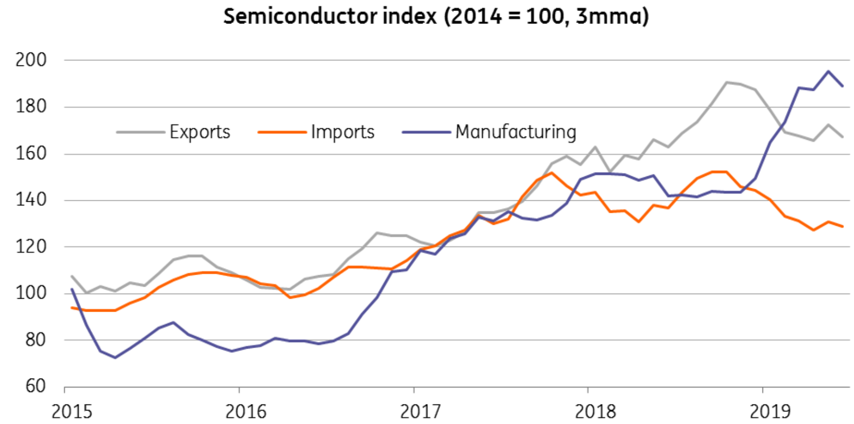


Source: CEIC, ING

The recent outpacing of Malaysia's electrical and electronics exports over imports may well be a transitory side-effect of the global trade war exerting weakening pressure on the currency and thus depressing imports (but then that would have also benefited neighbouring economies, which it doesn't seem to have done).

Or, more likely, this may be evidence of a structural shift as part of the supply chain relocation in the intensifying US-China trade and tech war.

Malaysia's semiconductor surge



Source: CEIC, ING

Near-term economic outlook - steady as she goes

Yet, it's hard to imagine the economy continuing to outperform the rest of the world as global trade tensions touch new heights. Nor do we see Malaysia's electronics sector continuing to beat the global tech slump, though elsewhere in the region, some green shoots may have started to emerge in this sector.

Nevertheless, we see growth lingering close to the high end of the government's 4.5-5.0% forecast range (revised from 4.3-4.8% following 2Q GDP report earlier this month) in the remaining two quarters of the year. We maintain our growth forecast at 4.7% for the current year and 4.9% in 2020. Any easing of trade tensions will be more positive for growth next year, though as things stand now there are no reasons to be too hopeful about the trade war. We expect sluggish global demand and subdued commodity prices to limit upside growth potential, while firmer domestic demand will limit any downside to growth from here on.

Barring any more severe trade shocks, or a commodity price shock, we see no reason for GDP growth to drift far from the 5% potential level the economy has managed in recent years. In its 2018 Annual Report, the central bank estimated a range of potential growth in the current year at 4.6-5.1%, just a tick down from 5%.

Weak public finances, healthy external payments

While talk of fiscal stimulus to boost growth has been gaining traction around the world, Malaysia's tight public finances offer little scope for a big fiscal boost. However, a renewed boost to investment by reviving some of the key infrastructure projects stalled last year should help.

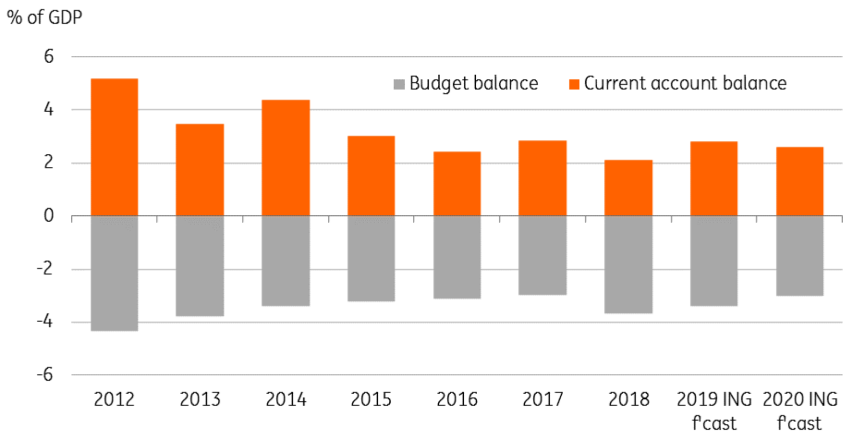
The East Coast Rail Link (ECRL) project is back on track in a significant sentiment booster for foreign investors in Malaysia. After being suspended for a year, China and Malaysia have reportedly resumed construction of the 640km rail line forming a part of China's Belt-and-Road initiative. Meanwhile, the government has also managed to bring the project cost down by a third to about $44 billion and aims for completion by end-2026. Hopefully, this spins the wheels for another key rail project, the Kuala Lumpur-Singapore High-Speed Rail (HSR), that's on hold currently.

Malaysia's authorities are concerned about public finances staying on track for a target consolidation of the deficit to 3% of GDP by 2020. Their concerns are valid given growing external risks and the current high level of public sector debt, estimated at over MYR 1 trillion. In contrast, we see firmer growth creating scope for the deficit to come in below the 3.4% target this year government revenues are boosted. An 18% YoY rise in revenue in the first half of 2019 was associated with a 27% YoY reduction of the deficit for the period.

Hopefully, this improvement will be sustained over the rest of the year, though we don't think the government will be rushing into outperforming its target given the wave of fiscal easing taking off globally. We maintain our 3.5% deficit forecast for the current year and 3.3% forecast for 2020.

Meanwhile, Malaysia's external payments position continues to be healthy with 2019 likely marking a turnaround in the trend narrowing of the current account surplus. As mentioned earlier, the MYR 30.7 billion current account surplus in the first half of 2019 was nearly double last year's surplus, prompting a big upward revision to our full-year forecast for the surplus equivalent to 2.8% of GDP from 2.0% earlier.

Budget and current account balances



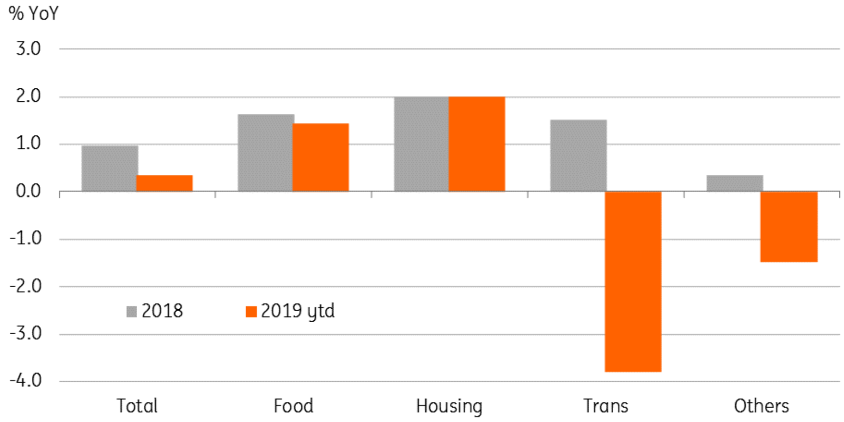
Source: CEIC, ING

Inflation isn't an issue, nor will it be anytime soon

Inflation has surprised on the downside so far this year. At only 0.3% year-to-July we don't see inflation becoming an issue for the economy anytime soon. The transmission of lower global oil price to domestic fuel prices has been a key source of lower inflation this year. And with prevailing downside risks to global demand, we don't see oil price inflation posing any inflation threat in the near-term. Inflation in the important transport component should continue in negative territory for the foreseeable future. Among other key drivers, food inflation has risen past 2% in recent months but it's now close to peaking, while housing inflation remains contained below 2%.

Inflation expectations also remain well-anchored, imparting a downside risk to BNM's view of inflation this year to be broadly stable at 2018's 1% rate. We have cut our full-year inflation forecast to 0.8% from 1.0%. Beyond that, we see it staying under 2% for the next couple of years.

Consumer price inflation



Source: Bloomberg, CEIC, ING

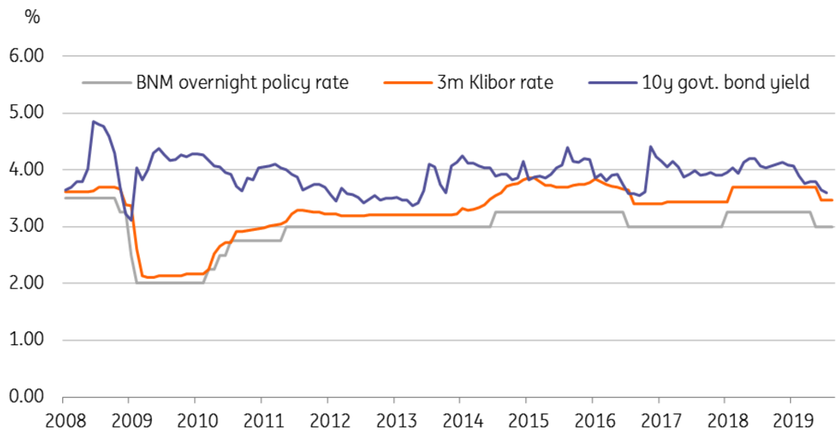
How low can BNM policy rates go?

With persistently subdued inflation we don't think the central bank (BNM) will be left behind in the easing cycle. BNM started easing in May this year with a 25bp cut in the overnight policy rate to 3.0%.

Although the current US-China trade war and tech slump don't compare to the global financial crisis, its impact is more focussed on Asia. Consequently, we believe we can draw parallels between BNM's behaviour then and in the current situation.

If so, then BNM policy rates could go as low as 2.0%. Even so, we believe the central bank will tread a cautious path and abstain from excessive easing. We now anticipate two more 25bp BNM rate cuts taking the overnight policy rate down to 2.50% by end-2019.

BNM policy and market interest rates



Source: Bloomberg, ING

Bottom line

Firmer growth, low inflation, and a healthy external payments position – are all coming together in support of positive investor confidence in the economy in the current global economic turmoil. Recent affirmation by rating agency S&P's Malaysia's 'A-' long-term sovereign ratings with a stable outlook was a vote of confidence in country's balanced economic outlook for the near-term, with monetary flexibility offsetting weaker yet relatively stable public finances.

With this, we see the Malaysian ringgit continuing to be among the most resilient Asian currencies in the period ahead with the exchange rate against the USD hovering just around 4.2.

Malaysia - Key economic indicators and ING forecasts

Malaysia	2017	2018	2019F	2020F
Real GDP (% YoY)	5.9	4.7	4.7	4.9
CPI (% YoY)	3.8	1.0	0.8	1.4
Unemployment rate (%)	3.4	3.3	3.4	3.3
Fiscal balance (% of GDP)	-3.0	-3.7	-3.5	-3.4
Public debt (% of GDP)	50.7	51.8	46.5	47.2
Current account (% of GDP)	2.8	2.1	2.8	2.6
FX reserves (US$bn)	102.4	101.4	105.0	108.0
External debt (% of GDP)	69.2	64.9	66.6	69.7
Central bank policy rate	3.00	3.25	2.50	2.50
3M interbank rate (%, eop)	3.44	3.69	3.00	3.10
10Y govt. bond yield (%, eop)	3.91	4.08	3.20	3.30
MYR per USD (eop)	4.05	4.13	4.20	4.18

Source: ING

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Snap | 22 August 2019

The ECB is concerned

That is the main message from the just-released minutes of ECB's July meeting which stress the central bank's growing concerns about both the growth and inflation outlook. A 20bp deposit rate cut, a small tiering system, a repricing of the TLTROs and a restart of QE with some 30 billion euro per month could be Mario Draghi's last hoorah

ECB President, Mario Draghi

The ECB is concerned. This is probably the main message from the just-released minutes of the July meeting. In its discussion on both the outlook for eurozone growth and inflation, the ECB's assessment had become more pessimistic. As regards growth, the minutes say that it "was also considered that these downside risks had become more pervasive and that their persistence could ultimately also necessitate a revision to the baseline growth scenario". Looking at inflation, the recent declines in both actual inflation and longer-term inflation expectations were "a matter of concern".

The minutes suggest that there is a majority at the ECB in favour of a package of new measures, rather than a series of single measures

The official views and tone presented during the press conference in July were just a normal consequence of the discussion. The minutes do not say anything about how close the ECB is to actually act but reading between the lines, the July meeting was probably as close as it can get without actually acting. Interestingly, the minutes also suggest that there is a majority at the ECB in favour of a package of new measures, rather than a series of single measures. A "combination of instruments with significant complementarities and synergies, since experience had shown that a policy package – such as the combination of rate cuts and asset purchases – was more effective than a sequence of selective actions".

Hardly any hope that these concerns get less before September

Looking ahead, the "relevant committees" are still preparing different options for the Governing Council meeting on 12 September. While most ECB members should have returned from summer vacation by now, the macro economic picture has not improved. To the contrary, the slowdown of the eurozone economy in the second quarter, tentative signs that external problems have reached the domestic part of the economy as well as somewhat lower oil prices and a stronger euro should weaken the inflation outlook further. Still, as illustrated by today's PMIs, the eurozone is rather in a period of stagnation than at the risk of a severe recession.

> *There are increasing doubts that additional monetary easing will be a game-changer for the economic outlook*

Against all of this, the ECB has a difficult task, preparing for its 12 September meeting. At the July meeting, Mario Draghi's comments at the press conference and recent comments by the Finnish central bank governor Olli Rehn have increased expectations. At the same time, however, there are increasing doubts that additional monetary easing will be a game-changer for the economic outlook.

Interest rates across the entire board are close to record lows, financing conditions have never been more favourable and there are adverse effects stemming from unconventional measures. Still, to paraphrase Jean-Claude Trichet, the ECB's has only one needle in its compass and that needle is price stability. With no signs of inflation picking up any time soon, doing nothing is not an option. However, when looking at the different options for September action, it is not always easy to find – what Peter Praet once called - a monetary policy case.

What will happen at the September meeting?

Here is what we think the "relevant" committees at the ECB's Governing Council will discuss as possible new measures in September.

- A deposit rate cut would probably weaken the euro exchange rate but is unlikely to have a positive marginal effect on bank lending. Together with the de facto zero bound on bank interest rates, there is an adverse effect on bank profitability. Even though a tiering system could bring some relief, due to the uneven distribution of reserves and excess liquidity across Eurozone countries the implementation of any such system will be highly complicated.

- Instead, a repricing of the TLTROs would be a stronger monetary policy case. Linking the new round of TLTROs to the deposit rate, instead of the MRO, would incentivise lending growth.
- Whether lower yields on the back of restarting QE would be the game-changer for the real economy is also questionable. However, the focus on corporate bonds could support corporate investment. There should also be spill-over effects.
- Buying equity has been the Bank of Japan's last policy resort. Currently, clearly, one bridge too far for the ECB but eventually also in the eurozone the last resort.
- The rather limited marginal effects from new easing measures could in our view also bring back the concept of helicopter money. It could be a possibility to circumvent the bank-investment channels of monetary policy transmission but would support consumer spending

All of the above means that the ECB finds itself in a rather uncomfortable position. It is to demonstrate its willingness and determination to act, while at the same time it also knows that monetary policy alone can longer solve the low-growth-low-inflation problem of the eurozone. However, doing nothing isn't really an option.

Therefore, we continue to see the ECB starting a final monetary firework at the September meeting: a 20bp rate cut of the deposit rate, a small tiering system, a repricing of the TLTROs and a restart of QE with some 30 billion euro per month could be Mario Draghi's last hoorah before handing over to Christine Lagarde.

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Report | 22 August 2019

Where is Chinese industrial metals demand heading

Given the protracted trade tensions and concerns about global growth, the industrial metals market seems to be overwhelmed by increasing macro risks and slowdown in demand growth.

Source: Shutterstock

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Snap | 22 August 2019 **Indonesia**

Indonesia: Warjiyo whips out preemptive cut against global headwinds

Bank Indonesia surprised markets on the timing for a second rate cut to help spur economic growth amidst global headwinds

Perry Warjiyo being sworn in as governor of Bank Indonesia in 2018

5.5% 7-day repurchase rate

Lower than expected

Warjiyo surprises with the timing but not the move

Wary of brewing headwinds given the US-China trade war, the Bank Indonesia (BI) Governor opted to cut policy rates once more in a bid to boost growth momentum. In line with re-elected President Jokowi's bid to stimulate growth, it looks like BI has joined up with the rest of the economic cluster to insulate Indonesia's economy and to push forward to help lift growth away from the lower end of the 5% handle. Warjiyo now sees growth for Indonesia to settle between 5.1% and 5.5% with the upper end of that range now increasingly possible given the stimulus from the monetary side to help stir household consumption and investment.

BI's preemptive strike

Governor Warjiyo indicated that the rate cut was a preemptive move to support economic growth as he vowed to ensure ample liquidity to help foster accelerated growth. Recent trade numbers illustrate how Indonesia has returned to a trade deficit, indicating the ill effects of the US-China trade spat are already weighing on Indonesia's export engine. Warjiyo hints that Bank Indonesia will retain its accommodative monetary policy mix but we expect BI to monitor closely the next moves of the Fed as well as the stability of IDR before seriously considering further rate cuts in the near term. In the meantime, it does appear that it's all hands on deck for Jokowi's bid to give growth a decent shot in the arm, which could entice some interest from foreign players to return (and prop up IDR) as Jokowi and his party chase faster growth going into 2020.

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