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Non-oil domestic exports (NODX) fell 15.9%YoY in May. An erratic spike from pharmaceuticals stopped this being an even worse figure.

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eZonomics

The bias behind monetary policymaking

Minutes from the Federal Reserve meeting tonight may go some way to explaining why the bank left interest rates on hold in May. But to really understand...

Australia's unemployment rate stays at 5.2%

The Reserve Bank of Australia (RBA) thinks the unemployment rate needs to fall to 4.5% (or lower) to spur inflation back to target - so we can expect more...

5.2%

May unemployment rate

Unchanged from April

Higher than expected

Labour report not as strong as it looks

On the face of it, this was a solid looking labour report. Employment growth in May was up 42.3 thousand, and there were some upward revisions to the previous month's total, which was similar at 43.2 thousand (formerly reported as 28.4K).

The problem comes with the details. Full-time employment rose only 2 thousand four-hundred. So more than 94% of all employment created was part-time. And barely two-thousand full- time jobs have been created in total in the last two months.

Even so, a job is a job, and that ought to help lower the unemployment rate. But jobs created is not the same as unemployment reduced. Unemployment only fell by two thousand in May from April, and even with the participation rate rising a bit (66% from 65.9%) the denominator (labour force) didn't rise enough, and the numerator (unemployment) didn't fall enough to nudge the unemployment rate down from 5.2%, even on rounding.

RBA still has work to do

With the RBA believing that an unemployment rate of 4.5% (perhaps even lower if Assistant Governor Luci Ellis is to be believed) is now necessary to push inflation higher, and today's figure showing the gap between the current unemployment rate and the full employment rate as wide as ever, about the only conclusion you can draw is that the RBA will need to provide further monetary stimulus to bridge that gap.

The next rate meeting is on 2 July, and markets are already pricing in a 64.1% probability that it results in a further cut. We don't have a strong objection to this market pricing. Though it has come a long way in a short time. The one cut already made won't make much difference to the economy, and about the only argument for taking a slower and more considered approach to easing would be that it takes a long time for rate cuts to have their full effect, so it makes picking the point at which to cease easing without overshooting a little easier.

Then again, with limited room for easing in total (many believe that an effective lower bound for the RBA is 0.5%), the counter-argument is that you get more bang for your buck by being bold with policy. It is a tricky decision, but today's labour report does play to current market pricing of more, and more rapid easing than either we or the market thought likely a month or two ago.

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Article | 14 June 2019 China

China: Expect a long march

We think the authorities will increase fiscal stimulus, as well as cut interest rates and the reserve requirement ratio (RRR) to support growth, in what...

Source: Shutterstock

China-US tensions have spread beyond trade

China-US trade tensions deteriorated quickly after President Xi requested dignity in the trade talks, and both sides increased tariffs on each other. The US raised tariffs from 10% to 25% on the existing $200 billion goods, and China has increased tariff rates to 10% to 25% on $60 billion goods imported from the US.

Away from trade, US added Huawei, the Chinese pioneer in 5G, into its 'entity list', which deters US companies from buying and selling goods and services with Huawei. The Chinese government reacted by creating its 'unreliable entity list' and may reduce exports of rare earths. Further, the Chinese government interviewed multinational companies that have businesses in China. The tension between the two countries has extended from trade, technology to broader-based businesses.

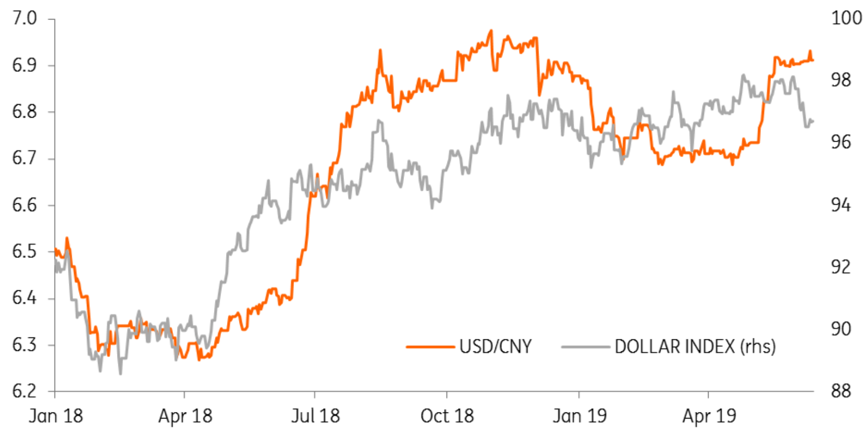
President Xi calls this increase in tensions the 'new long march'. In early June, China signalled that it will increase its fiscal and monetary stimulus to support the economy during this new long march.

China is expanding infrastructure investment further

On fiscal stimulus, the government has issued a document that encourages the issuance of local government special bonds to fund infrastructure projects, and it also welcomes financial institutions to invest in those instruments. The planned amount of issuance is around two trillion yuan. With the help of financial institutions, this amount can be leveraged to around two times, according to our estimates. That means infrastructure investments could increase to around four trillion yuan.

Together with tax and fee cuts of another two trillion yuan, the fiscal stimulus package may total six trillion yuan.

USD/CNY has diverted from the dollar but yet to pass 7.0



Source: Bloomberg, ING

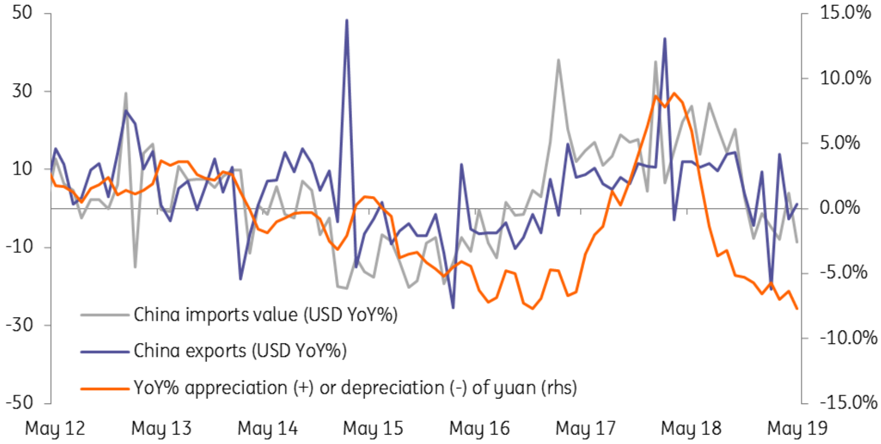
China is prepared to cut interest rates and the reserve requirement ratio

On monetary easing, the PBoC governor, Yi Gang, has claimed that the central bank has many tools to inject liquidity in the market. These include cuts in interest rates and reserve requirement ratio (RRR).

Combining fiscal and monetary easing capacity, China should be able to withstand a long pause in the trade negotiations while maintaining GDP growth above 6%, which will largely be stimulus-driven, unlike normal growth driven by business activities determined by market forces.

Yi Gang also mentioned briefly that no particular level of the USD/CNY is more important than other levels, signalling that the 7 handle of the USD/CNY is not a boundary set by the PBoC. But we still don’t believe the PBoC will take the big risk to allow USD/CNY to pass the 7.0 handle. Last year, the PBoC didn’t allow the USD/CNY to pass 7.0, because the central bank worried that it would create market chaos. Today, with the background of a trade and technology war, the central bank may be even more cautious not to let the exchange rate create chaos in other asset markets. Moreover, as we show in the chart, a depreciation of the yuan has no positive impact on trade.

Yuan depreciation hasn't helped trade



Source: Bloomberg, ING

We have revised our FX forecasts

As a result, we have revised the USD/CNY and USD/CNH exchange rates to 6.90 by the end of 2019. We also believe the central bank will cut 7D policy rate twice, each time by 5bps, with cuts the targeted as well as broad-based RRR by two times each.

We maintain our GDP forecasts at 6.2%YoY in 2Q19 and 6.3% for 2019, as we believe that the tough stance on trade will be balanced by stimulus measures.

Report | 14 June 2019

FX

Asia FX Talking: Caution ahead of Osaka G20

Although expectations of any trade breakthroughs at the Osaka G20 meeting are very low, passing this summit without trade tensions worsening substantially...

Source: Shutterstock

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Article | 17 June 2019 United States

Fed to signal cuts are coming

With trade tensions likely to escalate, this Wednesday's Fed meeting looks set to confirm market expectations - precautionary interest rate cuts are...

Source: iStock

After hiking interest rates four times in 2018 the Federal Reserve has taken a more cautious approach to monetary policy in 2019.

Concerns about the economic implications of President Trump's willingness to use trade tariffs in disputes with other countries means that downside risks to growth are building. On Wednesday, we expect the Fed to signal precautionary rate cuts are in the offing. Markets favour a 25bp rate cut in July with three additional rate cuts over the next twelve months.

We are a little more cautious seeing two 25bp moves in the second half of 2019, given the underlying strength of the US economy and our belief that President Trump will want a trade deal signed well ahead of the presidential elections next year - see our latest forecast update for more.

Trade tensions creating downside risks

US-China trade tensions continue to intensify and there seems little prospect of a deal later this month, as had once been hoped. China will not want to be seen as having been successfully bullied into agreeing to US demands while President Trump's view that tariffs are boosting US Treasury coffers and that the "strong" US economy can withstand near-term pain suggests he's not going to back down either. Tariff hikes seem likely.

Faced with the uncertainty of an intensifying trade dispute and the higher costs and weaker profit outlook it generates, many firms may act more cautiously. This implies a slowdown in investment and hiring, which in turn leads to lower consumer spending and the threat of an economic downturn. Recent data already suggests the economy is more vulnerable to the fallout than it was in the second half of 2018 with payrolls having softened substantially and manufacturing data looking weaker.

Language change - "patient" dropped, "closely monitoring" is in

Since January, the Fed has signalled a willingness to be "patient" on assessing whether a change in interest rate policy was going to be required. However, Fed Chair Jerome Powell has already laid the groundwork for a shift in stance by suggesting officials were now "closely monitoring" the implications of the protracted trade negotiations for the economy.

> *We expect the Fed to drop the use of the term "patient" from the accompanying statement and use the phrase "closely monitoring"*

St Louis Fed President James Bullard - an FOMC voting member was more direct, arguing that a rate cut "may be warranted soon" to provide some insurance in case of a sharper than expected slowdown". Other Fed officials, such as Charles Evans, President of the Chicago Fed, continue to talk about the US' "solid" fundamentals, but he too acknowledged that they can adjust policy "if that's necessary".

We, therefore, expect the Fed to drop the use of the term "patient" from the accompanying statement and use the phrase "closely monitoring". We also expect to see some downward revisions to their inflation forecasts to reflect the recent benign readings. This backdrop then gives them greater scope to clearly signal an easing bias within the so-called "dot diagram" of individual FOMC members expectations for interest rates.

ING predicted changes to FOMC median forecasts

Variable	Median			
	2019	2020	2021	Longer Run
Change in real GDP (Mar FOMC)	2.1	1.9	1.8	1.9
(Expected June FOMC)	2.0	1.9	1.8	1.9
Unemployment Rate (Mar FOMC)	3.7	3.8	3.9	4.3
(Expected June FOMC)	3.7	3.8	3.9	4.3
PCE inflation (Mar FOMC)	1.8	2.0	2.0	2.0
(Expected June FOMC)	1.8	2.0	2.0	2.0
Core PCE inflation (Mar FOMC)	2.0	2.0	2.0	-
(Expected June FOMC)	1.8	2.0	2.0	-
Fed funds rate (Mar FOMC)	2.4	2.6	2.6	2.8
(Expected June FOMC)	1.9	1.9	2.4	2.8

Source: ING, Federal Reserve

Market pricing looks too aggressive

At the last forecast update in March, four members expected rates to be hiked 25bp this year with two looking for 50bp of hikes and 11 expecting rates to be left on hold. 10 FOMC members expected a hike of some form next year while the longer run expectations were for the Fed funds rate to settle at around 2.8%. We imagine we will see the Fed put two rate cuts in for this year with stable policy next year, thereby lowering their profile by 75bp versus March.

We imagine we will see the Fed put two rate cuts in for this year with stable policy next year, thereby lowering their profile by 75bp versus March

Currently, markets are anticipating around 100bp of easing over the next twelve months with the first cut around 80% priced for July. We think this may be a little too aggressive and look for two 25bp moves in September and December. However, should the Fed warn of outright downside risks to growth this week we will likely need to move this forward to July and September.

A trade deal will eventually get done...

In general, our more upbeat assessment focuses on the strong US fundamentals, the tightness in the labour market, our view that President Trump wants to get re-elected next year and a trade deal will be signed. The often-repeated suggestion that equity markets are a better barometer of his success than opinion polls means that President Trump will need to be wary that pushing too far for too long on China runs the risk of weakening his re-election campaign.

After all, lower interest rates can only do so much to support the equity market if the core problem – trade – is not dealt with and global growth is deteriorating. That is not an environment within which it will be easy to retain the Presidency.

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Asia week ahead: Riding the wave of easing

With increased odds of the Fed easing, it's hard to see Asian central banks resisting easing pressure for too long now

Source: Shutterstock

Heavy central bank calendar

Four Asian central banks – Japan, Taiwan, Indonesia, and the Philippines meet next week alongside their counterparts in the UK and the US – all announcing their policy decisions on Thursday (20 June). While we expect all these meetings to be largely non-events, Bank Indonesia and Philippines central bank meetings could be of some interest.

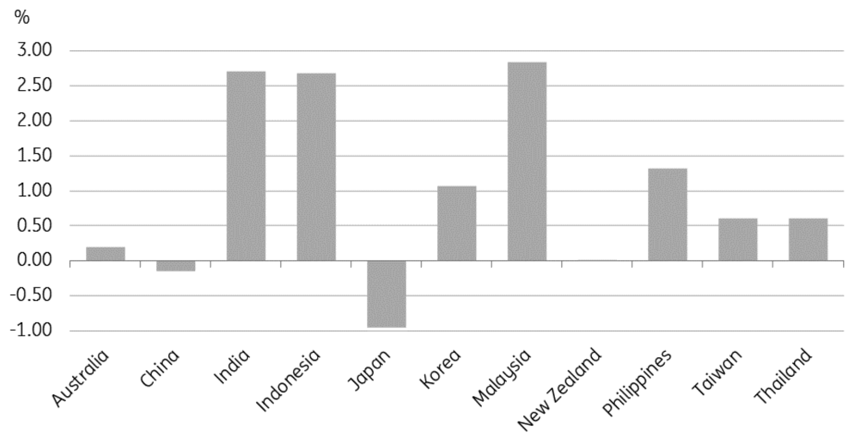
A surprise inflation spike in Indonesia and the Philippines in May has dashed hopes of rate cuts by their respective central banks. We view high inflation as an aberration from the low inflation trend these economies have been enjoying this year. The Philippines central bank started easing policy in

May while Indonesia's central bank isn't quite there yet, but it's probably just looking for the right timing.

The policy dilemma of these central banks comes from their high real interest rates among Asian economies. Even though high real interest rates provide scope for easing, which is the need of the day with the prevalent growth concerns stemming from the trade war, but rate cuts weigh down on currencies impaired by high trade deficits.

With increased odds of the Fed easing, we don't think Asian central banks will resist easing pressure for too long, while subdued inflation provides room to support growth with lower interest rates. We now see most Asian central banks riding a wave of easing by the next quarter.

Real interest rates



Source: Bloomberg, CEIC, ING

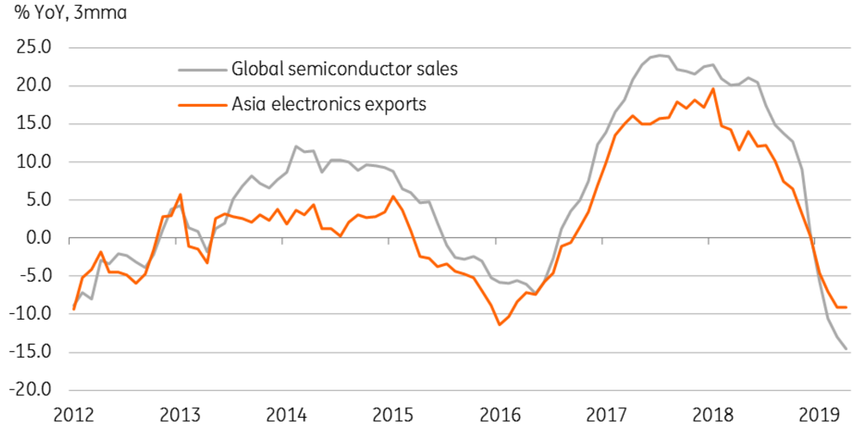
Central bank policy interest rate minus the latest inflation rate.

And lots of trade figures

Lots of May trade data from Japan, Taiwan, Singapore, and Thailand will be interesting for what it says about the trade war. It's no longer just a trade war, but also a technology war aggravating the ongoing slump in the global tech sector. With Asia's heavy reliance on electronics exports, we see nothing in the forthcoming releases calming the nerves of regional exporters and markets.

We anticipate accelerated export weakness in most reporting economies next week. Of most interest will be Singapore's non-oil domestic export growth - an economy at the forefront of the tech downturn. The forecast by our in-house Singapore watcher, Rob Carnell, of about 19% year-on-year NODX contraction is the worst reading in over six years. But he isn't alone; the consensus estimate (as of this writing) is -20.4%. If this is correct, the data will push the Monetary Authority of Singapore towards easing in October.

Asia following the global tech downturn



Source: Bloomberg, CEIC, ING

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
		Monday 17 June			
Philippines	-	Apr OCW Remittances (YoY%)	-	-	6.6
Singapore	0130	May Non-oil Domestic Exports (MoM, SA/YoY%)	5.5/-18.7	-/-	-0.6/-10.0
		Tuesday 18 June			
China	0230	May New Home prices (MoM/YoY%)	0.7/12.0	-/-	0.6/11.4
		Wednesday 19 June			
South Korea	2200	May PPI (MoM/YoY%)	0.2/0.6	-	-/0.6
		Thursday 20 June			
Indonesia	-	Jun BI Policy Decision (7-day reverse repo, %)	6.00	-	6.00
Philippines	0900	Overnight Borrowing Rate	4.5	-	4.50
Taiwan	0900	Benchmark Interest Rate	1.38	-	1.38
	0900	May Export Orders (YoY%)	-7.2	-	-3.7
		Friday 21 June			
Hong Kong	0915	May CPI (YoY%)	3.2	-	2.9
Taiwan	-	May Money Supply (M2) (YoY%)	3.7	-	3.7
Thailand	-	May Exports (Cust est, YoY%)	-5.5	-	-2.6
	-	May Imports (Cust est, YoY%)	-4.5	-	-0.7
	-	May Trade Balance (US$m)	1045.0	-	-1457.0

Source: ING, Bloomberg, *GMT

Article | 14 June 2019 Japan

Japan: Not as good as it looks

With the Fed looking more dovish, the Bank of Japan will be looking anxiously at the USD/JPY rate and wishing it had some effective tools left in its...

Source: Shutterstock

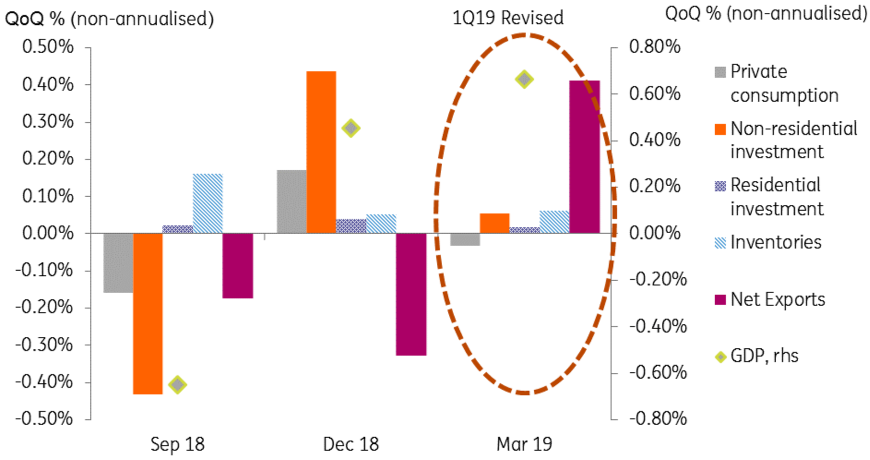
No consumption tax hike leads to more stable growth and inflation forecasts

A few months ago, we took the gamble of removing the scheduled October consumption tax hike from our forecast numbers. The effect of this was to smooth both the inflation figures (we no longer have a 12-month bump from 4Q19 to 3Q20), and also the GDP figures (we no longer have the front loading and subsequent consumption and investment lacuna).

All of this is fairly cosmetic, and has very little bearing on overall annual GDP figures, though removing the tax hike does remove the temporary lift that inflation would otherwise get, and makes it harder to see by just how much the Bank of Japan is missing its 2% underlying inflation target.

The revised 1Q19 GDP figure of 2.2% is being touted as the final nail in the coffin for those like us who speculated on a third delay to the scheduled tax hike. But this contrasts with the other message of this release. Namely: outside of some very modest business investment figures, which show few signs of remaining positive in the coming quarters, much of the 2.2% annualised GDP growth came from a rogue net export figure which had imports falling far more sharply than exports, and which in all likelihood, also presages a sizeable inventory drawdown in the quarters ahead.

Contribution to GDP (QoQ%)



Source: CEIC, ING

Softer data means no rush to re-insert consumption tax hike into the mix

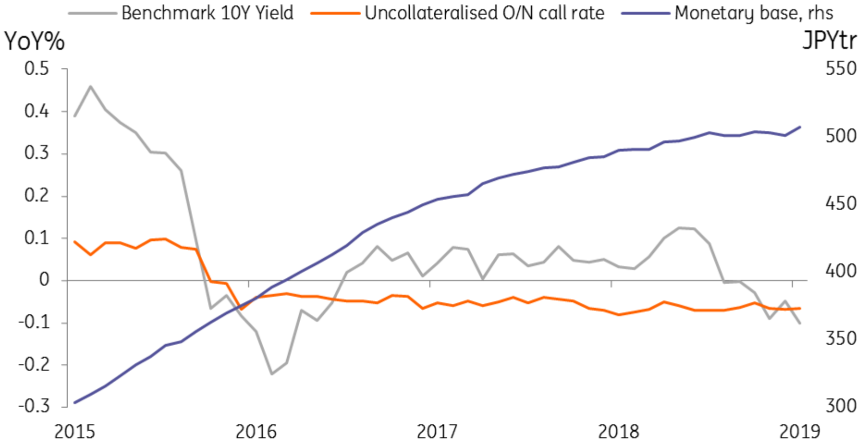
So although we concede that we may have to put the consumption tax hike back into the numbers, we won't rush this decision. Indeed, Japan's data remains moribund. Household spending started 2Q19 much softer than it ended 1Q19, which may also reflect the plunge in labour cash earnings, now running at a negative year on year rate.

Although we concede, we may have to put the consumption tax hike back into the numbers, we won't rush this decision

On the trade side, Japan is still running a marginal deficit, but there doesn't seem to be any noticeable improvement from 1Q19, so the likelihood this delivers any boost to 2Q19 GDP growth looks small. Indeed, unwinding the big boost in 1Q19 seems far more likely with the trade war showing no signs of easing and the technology slump still in full swing.

Furthermore, both construction orders and housing starts registered large declines in April and will have their work cut out to claw their way back to positive growth by the end of the quarter.

The BoJ's policy options – none are easy



Source: CEIC, ING

If the Fed cuts rates, the Bank of Japan might well follow suit

For its part, Japan's central bank is still talking up their potential firepower should renewed stimulus be needed, though Governor Haruhiko Kuroda also stresses the need to be wary of the unintended consequences of further easing. Kuroda notes that policy rates could be lowered still further (currently -0.1%), the target for 10-year bond yields could also be lowered, the monetary base could be expanded, or asset purchases could be boosted (which is almost the same as saying the monetary base could be expanded, so really three, not four options).

If the Federal Reserve cuts rates in the coming months, as markets seem to increasingly believe, then depending on how the Japanese yen responds, we might well see the Japanese central bank respond with some additional easing of their own. Though each of the measures outlined above comes with its own particular set of problems, and none are guaranteed to offset a generalised spell of USD weakness completely, should this follow a Fed rate cut.

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Article | 14 June 2019 United Kingdom

Three scenarios for Brexit under Boris Johnson

A new eurosceptic UK prime minister will face stiff opposition from Parliament if they push for a 'no deal' Brexit. That might lead to another...

Five scenarios for Brexit under a new leader

	ING probability	How scenario could materialise	Article 50 extension?	Market reaction
Parliament forces a general election	35%	Parliament stops 'no deal' by passing no confidence motion. General election takes place in late Nov/early Dec	✓ At least 3 months	EUR/GBP: **0.95** GBP/USD: **1.18**
Revamped deal	25%	To avoid election at all costs, pro-Brexit MPs reluctantly back tweaked deal given there's a Brexiteer in place for next stage of trade talks	✓ Possibly (for legislation)	EUR/GBP: **0.85** GBP/USD: **1.34**
Second referendum	15%	Parliament may struggle to force a 'People's vote'. But can't fully rule out PM triggering one as "least worst" option versus an election	✓ At least 6 months	EUR/GBP: **0.82** GBP/USD: **1.40**
No deal	20%	If EU rejects further A50 extension, or a new leader pushes for a hard Brexit, Parliament may lack the legislative tools to stop it	X	EUR/GBP: **1.00** GBP/USD: **1.10**
Revoke Article 50	5%	Parliament may prefer this over a 'no deal' exit, but like a 2nd ref, MPs could lack a legislative tool to force the new PM's hand.	X	EUR/GBP: **0.78** GBP/USD: **1.47**

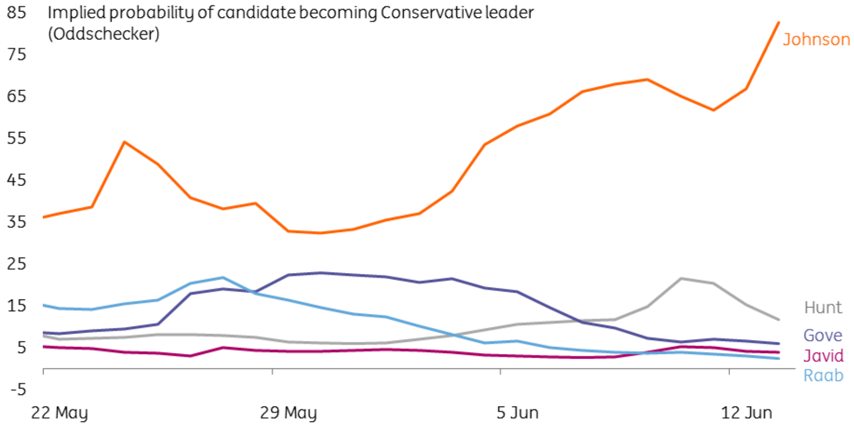
Source: ING

What would a 'Boris Brexit' really look like?

Former UK foreign secretary Boris Johnson is now odds-on to replace Theresa May as Conservative leader. But what would a 'Boris Brexit' really look like?

Markets, at least, have become warier that it could result in a 'no deal' Brexit. In the first instance though, we assume that the first act of any new leader will be to return to Brussels and at least attempt to renegotiate the current deal.

Johnson is easily the favourite to become leader



Source: Bloomberg, Oddschecker

Some candidates have gone one step further by saying they would try to seek a Parliamentary majority for an adapted deal upfront – e.g. one that adds a time-limit on the Irish backstop – to try and demonstrate to the EU that they have the necessary support to get their vision ratified at home.

In reality, it's very unlikely that a new leader will be able to achieve something Theresa May could not. The EU has been extremely clear that is not prepared to reopen negotiations on the withdrawal agreement, which includes the controversial Irish backstop.

But what would happen then? Taken at face value, recent comments from Johnson and other Eurosceptic candidates suggest they want the UK to leave in October, whether a deal is in place or not.

If a new PM did push for 'no-deal', Parliament would likely do all it can to stop it from happening. But unlike in earlier in the year, there may be few legislative mechanisms available to do so (for more, see this Institute for Government report). That's partly why we think the probability of MPs stepping in and revoking Article 50 is still only around 5%.

Having said that, we think the risk of 'no deal' is still relatively low (20% probability) and we think there are three main alternative scenarios that could prevail instead.

Read the Institute of Government report here

1 Scenario 1: Parliament forces an election through no confidence vote (35%)

While the legislative options may be limited, there is one obvious way that Parliament could block 'no deal', and that's to try and force a general election. The leader of the opposition, Jeremy Corbyn, could put forward a motion of 'no confidence', and it wouldn't take many Conservative MPs to back it. Several moderate Conservative lawmakers have hinted they would be prepared to collapse their own government if that was the only way of stopping 'no deal'.

> *A no-confidence motion is unlikely to be successful unless 'no deal' is truly imminent*

This poses two questions: when could an election happen, and what would be the result? On the former, the minimum time between a successful no-confidence vote to election day is seven weeks. The first opportunity for a confidence vote would be at the start of September when MPs return after the summer, which could allow just enough time to hold an election before the end of October.

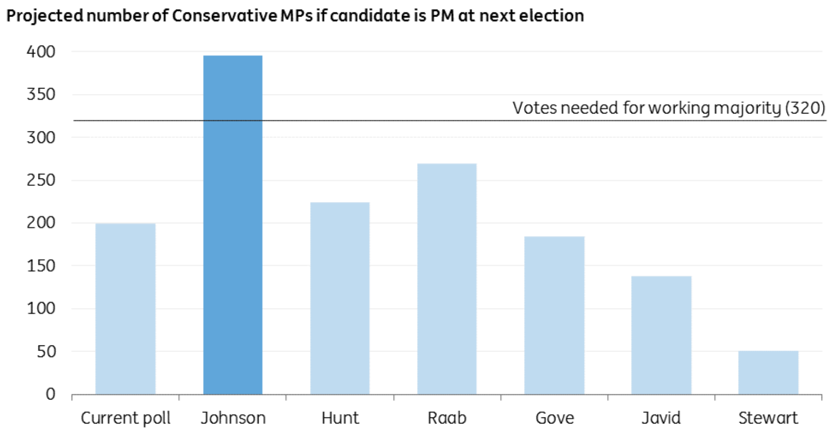
In reality though, a no-confidence motion is unlikely to be successful unless 'no deal' is truly imminent. That suggests that if an election happens, it's unlikely to be triggered until mid/late October, and therefore wouldn't take place until late November/December at the earliest. Another Article 50 extension would be needed, although it's unlikely the EU would try to block it in this scenario.

Calling the winner of a late-2019 election is much trickier. A simple mapping of recent polling onto the UK's electoral system suggests Boris Johnson could hypothetically secure an absolute majority for the party at the next election (Figure 2). But that prediction comes with several caveats (electoral calculators can be relatively crude), and an election forced upon him by Parliament could prove very tricky for the Conservatives. A failure to live up to his promise of achieving Brexit by October would undoubtedly give leverage to the Brexit Party.

A lot would also depend on Labour's Brexit position - so far leader Jeremy Corbyn has been reluctant to back a second referendum. But polls suggest that if he is to become prime minister, he would need to join forces with several other political parties – almost all of which would set a second referendum as their price for a coalition/confidence and supply arrangement with Labour.

It's not impossible therefore that Labour opts to campaign for a second referendum from the start, to try to limit losses to other remain-supporting parties.

Polls suggest Johnson would be the best candidate for the Conservatives at an election – but that could change…



Source: Telegraph, ComRes, Electoral Calculus

Electoral calculus have translated recent polling into projected seats under the first past the post system – although there are various caveats with this method

2 Scenario 2: 'Revamped deal' receives Parliament's backing (25%)

The upshot is that there is a clear risk that a new leader could be knocked out of power if they try to push for 'no deal'. This begs the question: would Boris Johnson (or an alternative Eurosceptic candidate) be more pragmatic in office than current rhetoric suggests?

On the face of it, this sounds unlikely. Mr Johnson said at his campaign launch that "we must do better than the current withdrawal agreement", but as we noted above, meaningful changes are unlikely to be forthcoming.

But assuming Boris Johnson and other leading Brexiteers believe the election threat to be credible, it's not impossible that they'll be more open to approving May's deal (with cosmetic tweaks) than it currently seems. Don't forget that in the third meaningful vote back in March, a number of leading pro-Brexit Conservatives actually voted for May's deal – something that was unthinkable just weeks before - on the basis that they would have a 'true Brexiteer' in Number 10 for the next phase of trade talks.

That's not to say it will be easy to get a stable majority for the deal. There are a handful of MPs who want nothing short of 'no deal', while concern within the more moderate factions of the party could increase. It also seems unlikely that the DUP would sign up to a deal with the backstop. We, therefore, think this scenario is relatively unlikely, and if Boris fails to get Parliament fully on-board, he could quickly revert back to pushing for a 'no deal' exit.

3 Scenario 3: The wildcard - Johnson backs a second referendum (15%)

Ultimately, a new leader may well conclude that the current deal is just as unpalatable as the risk of a 'general election'. So what about a second referendum?

On the face of it, it sounds unthinkable that a Brexiteer prime minister could decide to initiate a second referendum. However, according to the Eurasia Group, Johnson may be more open to this option than he admits publically.

This would undoubtedly be a high-risk strategy. While Boris Johnson would presumably push for a remain vs. no deal vote to try and maximise the leave share of the vote and gain a mandate for a harder vision of Brexit, Parliament could force a different choice of referendum question into the legislation, or even block it all together – perhaps culminating in an election after all. A botched referendum attempt, where either it took too long to arrange, or where 'Remain' won, would spell disaster for the Conservatives at the ballot box.

We, therefore, think it's unlikely a Eurosceptic prime minister would go down this route – and as we mentioned earlier, we think the legislative options for Parliament to force a second referendum upon the government are fairly limited. We currently put a 15% probability on one being triggered before October.

Lesser of two evils: Losing power vs losing a hard Brexit

The bottom line is that a new prime minister could easily find themselves boxed in by the same hurdles as Theresa May. Ironically, this means there is also a fairly good chance that a new leader will try and kick the can down the road for another six months, to allow more time to break the deadlock. There are question marks over whether the EU would grant more time without justification (France, in particular, is reluctant to allow further extensions), but even if they did, the leader will still arrive back at the same scenarios further down the road.

A new prime minister could easily find themselves boxed in by the same hurdles as Theresa May

In the end, it will come down to whether the new prime minister is prepared to risk losing a 'no deal' Brexit, in order to retain power and control of the next stage of negotiations. Taking recent comments from the leadership contenders at face value, we think there is a reasonable chance that a new Eurosceptic leader will attempt to push for a 'no deal' Brexit if they are unable to rework the deal before the end of October. That leaves a general election as the most likely scenario out of the ones we've considered, but a more pragmatic approach certainly shouldn't be ruled out either.

For the time being, the uncertainty surrounding the process will continue to restrict economic growth. As a result, we do not think the Bank of England will hike interest rates this year, particularly given the broader risks to global growth.

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ECB: About bazookas and water pistols

At last week's meeting in Vilnius, ECB president Mario Draghi sent a strong signal that the ECB was only one small economic slip away from new...

Source: Shutterstock

It was not so much the announced actions – new forward guidance and TLTRO pricing – which surprised financial markets last week but Draghi's comments during the Q&A session, stressing the ECB's readiness to act "if adverse contingencies were to materialise" (see our review of the ECB meeting here. The surprise moment was when Draghi actually reported that the ECB had discussed options such as rate cuts and restarting quantitative easing in such a scenario. According to Draghi, no one should have doubts about the ECB's policy space.

What could the ECB still do?

Since last week, many market participants are scratching their heads, wondering what the ECB actually still could do if it felt the need to act. Here are some thoughts:

- **Another cut of the deposit rate – the safe bet.** As long as the ECB believes that negative interest rates actually stimulate the economy and do not have significant negative effects (as suggested by a recent ECB working paper bank profitability is not affected by negative deposit rates) another rate cut looks like the easiest first option. Even without a tiering system. Combined with a tiering system, the ECB would shift away from the bank lending channel towards the fx channel, possibly bringing the Eurozone back on the US radar screen

as a potential currency manipulator.
- **Restart QE – possible but only with some tweaks.** Another relatively easy-to-do option for the ECB. However, a valid question is how much "headroom", as Draghi put it, the ECB really has to purchase bonds. According to ECB estimates, the current reinvestments still absorb close to 30% of the planned new issuances in Germany in 2019 and 2020 but less than 15% in France, Spain and Italy. Don't forget that the 33% issuer limit was one of the main arguments used by the European Court of Justice in its ruling that QE was not monetary financing. As a result, headroom to significantly restart the sovereign bond purchases is rather limited, unless the ECB would be willing to deviate from the capital key. Instead, the ECB could either increase the issuer limit for EU supranationals (from currently 50% up to 100%) or step up its corporate bonds purchasing programme.
- **Buying stocks – the bold option.** So far only a theoretical or rather hypothetical option but if the ECB really wanted to make a difference, buying equity – or going Japanese – would be the ultimate answer. Obviously, with many strings attached but just think of purchasing stocks, funds or baskets aimed at supporting investments into green technologies or linked to "green" ratings.

Bazooka or water pistols?

All in all, while further rate cuts and restarting QE look like the most likely policy options for the ECB in case it really feels the need to act, none of these options is a magic bullet. In fact, technical, legal or economic limitations to these two types of policy instruments bring back previous euro-crisis memories of wanna-be bazookas, which actually are rather water pistols.

Eventually, the entire discussion of whether monetary policy still can kick-start a stagnating economy in a zero-rate environment will get more attention. If bazookas turn out to be water pistols, the only resort left is fiscal policy. Probably, the only thing that could really work to fight a recession or a protracted stagnation would be fiscal stimulus backed by monetary policy. However, this would require either a Eurozone budget or loosening the fiscal rules. None looks likely in the short run.

Over the last few years, the ECB under Mario Draghi has frequently proven that no one should ever underestimate its willingness to act or simply do "whatever it takes". At least as long as Mario Draghi is in office, there is nothing worse for the ECB than admitting it has run out of ammunition. The ECB will do everything it can to avoid such a confession. Secretly, most ECB officials will keep their fingers crossed that the ECB's determination to act will not be tested and that the Eurozone economy can avoid new slippages. If not, the next months will quickly show whether Draghi can once again overachieve or whether he has lost his magic touch.

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Singapore exports down 15.9%YoY in May

Non-oil domestic exports (NODX) fell 15.9%YoY in May. An erratic spike from pharmaceuticals stopped this being an even worse figure.

Pills

-15.9%YoY

Non-oil domestic exports

Saved by pharmaceuticals

Better than expected

Electronics fall 31.4%YoY

By product, electronics was again, far and away the worst performer, falling 31.4%YoY in May. This reinforces a point we have made repeatedly, but which is worth repeating. The trade war is damaging Asia, but it is the global technology slump (of which China's technology war with the US is only a recent part) which is doing the most damage to exports in the region.

Put another way, even on the very unlikely assumption of an all-encompassing trade agreement at the G20 with President's Xi and Trump, and the immediate removal of tariffs, electronics exports are going to continue to be weak.

Without the outsize 28.5%YoY rise in pharmaceuticals, which was worth a swing of about $US1.32bn and stopped the total NODX figure from coming in at -23.5%, which it would have done on a flat pharmaceuticals outcome.

Fortunately, pharmaceuticals do throw out occasional spikes like this, as it tends to be a batch process, and so it is only when the pills come spitting ff the conveyor belt that they tend to be recorded for the purposes of production and subsequently exports. But big spikes tend to be followed either by steadier figures the next month, or declines, so unless one of the other components decides it is time to make a reappearance, then we may expect a resumption of softness next month, offset only by the fact that the June 2018 NODX total was only that hot at only $14.936bn, so the year on year decline should moderate to only a -10 to -012% YoY decline.

Table: Non-Oil domestic exports by major product

Non-oil Domestic Exports, May 2019 YoY%

	May 2019	April 2019	March 2019	Feb 2019
NODX	-15.9	-10.0	-11.8	4.8
Electronics	-31.4	-16.3	-26.7	-8.2
Non-electronics	-10.8	-8.0	-7.1	9.4
Total Chemicals	7.6	-21.4	-19.0	2.0
Pharmaceuticals	28.5	-46.6	-36.5	12.0
Petrochemicals	-14.7	-13.6	-15.2	-6.1

NODX by country

The Trade war thesis is also not backed up by the country destination of NODX. Yes, Exports to China are down 23.3%, but they are down 31.2% to Japan. Exports to the US are actually up, though only just, at 0.2%YoY. but exports to the EU are down 10%YoY.

Further weakness adds to argument for MAS to take easier stance

Added to soft domestic activity (retail sales, production), today's data add further credibility to arguments for the MAS to move to a more expansionary policy stance at their October meeting. Given the scale of recent bad news, it is not inconceivable that this is more than just a scaling back of the NEER appreciation path, and may for a time set a flat trajectory for the SGD, though our base case remains the former. .

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The bias behind monetary policymaking

Minutes from the Federal Reserve meeting tonight may go some way to explaining why the bank left interest rates on hold in May. But to really understand...

Source: Shutterstock

Each month, the interest rate setting committees of central banks typically meet to decide whether to change key interest rates. While these committee members have large amounts of data available to help them reach a decision that is as objective as possible, researchers are investigating the role of more subjective factors like past experiences and cognitive biases such as loss aversion and inertia to explain hawkish and dovish behaviour.

These behavioural effects may be significant, especially where decisions can be split between action and no change.

Consider the situation faced by the central banks of neighbouring New Zealand and Australia recently this month. The Reserve Bank of New Zealand cut the official cash rate to 1.5% while the Reserve Bank of Australia kept its cash rate unchanged at 1.5%.

Factors specific to each country undoubtedly played a role in the different decisions but each noted risks of slower growth in the global economy and in domestic consumer spending. However, research suggests those making decisions on interest rates may be affected by more than direct evidence. Behavioural factors may come into play, such as the past inflation experience of policy makers and differing levels of loss aversion.

These observations imply that the depiction of individual policy makers as hawks (i.e. being inclined to take steps to prevent higher inflation) and doves (i.e. those inclined towards accepting the possibility of higher inflation) may need to be expanded to include another avian species: pigeons, who sit on the fence and could swing either way.

Inflation memories

The financial professionals who have been appointed to the monetary policy committee (MPC) will be expected to use their wealth of knowledge and analytical experience to decide whether to change interest rates.

However, just as consumers and investors are susceptible to cognitive biases, central bankers may also be vulnerable. Ulrike Malmendier, Stefan Angel and Zhen Yan set out to test their hypothesis that the beliefs about future inflation and consequently, the decisions of the members of the US Federal Reserve's Board of Governors are influenced by the inflation experiences they have had during their lifetime.

In their experiment, they built an economic model that incorporated lifetime inflation experience to forecast each board member's voting behaviour. They compared those forecasts with members' votes between March 1951 and January 2014 and found that those with more exposure to inflation in the past were more likely to have hawkish voting patterns. The effect was striking: someone who had an above-average experience with inflation was one third more likely to take a hawkish stance that went against the committee majority, and also one third less likely to take a dovish stance.

In other words, if governors lived as adults through periods of high inflation, such as the 1970s, they tended to be much more fearful of runaway prices than if they came of age during later decades, when inflation was largely under control.

Metamorphosis caused by inertia and loss aversion

A key feature of central bank activity since the global financial crisis has seen policies aimed at supporting the economy. This has led to long periods of very low interest rates and use of alternative forms of policy such as quantitative easing. Reversing these approaches has proved difficult. Some may claim inertia has affected members of the policy committees. Some research supports this idea.

A paper by Donato Masciandaro argues that an increased sense of loss aversion felt by individual monetary policy committee members may lead to inertia in policy setting.

When loss aversion increases, doves on the policy committee overestimate the losses that would flow from taking actions aimed at encouraging inflation. As a result, they do not rush to cut rates. Meanwhile, hawks overestimate the losses that might come from raising interest rates, and shy away from taking action. In effect, increasing loss aversion decreases the difference between hawks and doves. In Maschiandaro's view, monetary policy committees can be better described as being populated by pigeons, rather than hawks or doves.

One factor that may increase loss aversion is increased uncertainty about conditions in the economy. Evidence from Hites Ahir, Nicholas Bloom and David Furceri suggests uncertainty about conditions in the global economy has increased. If this has contributed to increased loss aversion by members of central bank policy committees, this may also have contributed to policy inertia.

Impact on consumers

While consumers typically don't need to worry about how interest rates are set, they are clearly affected by the decisions. Monetary policy influences mortgage and other loan repayments, as well as economic growth, inflation and unemployment.

The level of interest rates can also affect the behaviour of consumers. Research suggests the amount of risk individual investors are prepared to take increases as rates fall, especially to historically low levels, as they have in many countries since the global financial crisis. This can act as an added tool to boost growth but could also encourage excessive risk-taking, which may threaten financial stability.

Are algorithms the answer?

Behavioural bias is hard to escape, often resulting in bad decisions and costly outcomes. But is there a way to overcome it? Nobel-prize winning economist Daniel Kahneman thinks the answer could lie in algorithms and rules-based decision-making, which he says outperforms expert judgement.

In his 2011 book, 'Thinking, Fast and Slow,' he says the accuracy of predictions could be maximised if final decisions were "left mostly to formulas". But which formulas? The Federal Reserve argues there are a lot to choose from. And while rules provide "useful benchmarks," the central bank insists that following them mechanically would not capture the complexity of the US economy.

For now, at least, deliberation and discretion still rule the day.