

# What's happening in Australia and the rest of the world?

Minutes from the Reserve Bank of Australia's last meeting confirmed that another interest rate cut is on the way. But the bank also signalled that rate cuts aren't the only policy option

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By James Smith

# Australia's central bank hints at more rate cuts

The Reserve Bank of Australia's June meeting minutes describe domestic and overseas economic data as "mixed", but the outlook remained "reasonable". Risks associated with global trade disputes have risen but the impact of further rate cuts wasn't viewed as unambiguously positive



Source: Shutterstock

Reserve Bank of Australia Governor Philip Lowe

## Key phrases of the minutes

If you've never had to comment on the minutes of a central bank before, the trick is to start at the end, with the discussion on the actual decision. The rest is usually fluff and padding. In the June meeting minutes, two key phrases in the last paragraph are:

1. Given the amount of spare capacity in the labour market and the economy more broadly, members agreed that it was more likely than not that a further easing in monetary policy would be appropriate in the period ahead. And:
2. However, lower interest rates were not the only policy option available to assist in lowering the rate of unemployment, consistent with the medium-term inflation target.

The final sentence went on to say that developments in the labour market would be of particular

importance in determining future policy.

## More rate cuts to come...but how much, and when?

The Australian central bank uses market rates in its modelling, and these are aggressively priced currently to show rates falling in total by somewhere between 50 and 75 basis points, which would at its extreme take the cash rate to 0.5%, which many have suggested marks the practical lower bound for the RBA.

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*Although we've only pencilled in a 25bp rate cut in August, we're certainly not ruling out more rate cuts in 2020, and this is where the risk to our forecast clearly lies*

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Even with these market rates plugged into their models (they use the market - not forecasts), the RBA's models point to only a small decline in the unemployment rate. As the RBA believes full employment now lies somewhere close to 4.5%, which implies that even aggressive easing won't enable them to meet their inflation target.

This can be interpreted in two ways. Either:

1. The only reasonable conclusion is that the RBA will have to cut quickly to 0.5% and hope that fiscal policy provides the shortfall of stimulus needed to get the unemployment rate to 4.5% and inflation moving back to target, or, and we prefer this,
2. Given rate cuts won't enable them to reach their target, and that they don't help everyone (savers for example, and pensioners on fixed interest incomes), a more cautious approach would be warranted - both slower, but also not cutting as far, whilst still looking for other policy measures (e.g. fiscal, macroprudential) to do more of the heavy lifting.

We think this interpretation is more consistent with the second key phrase we've mentioned in the RBA minutes. The text of the minutes elsewhere notes the mixed impact of rate cuts on different sections of the economy, backing up this view.

### No change to our forecast for now

We have been a little less aggressive than the market with respect to our forecast over the rest of this year and next, looking only for a further 25bp of easing, probably in August after the next "Statement on Monetary Policy", which would take the cash rate to 1.0%.

The Australian economy is still in "reasonable" shape, with "mixed" rather than outright bad newsflow according to this latest assessment, so anything further would take policy into the emergency territory, and we clearly aren't in an emergency mode yet and nor do we expect to be, unless the trade war escalates another couple of notches.

That said, as 50bp of easing in total is unlikely to do more than have a very negligible impact on the unemployment rate, and hence wages and price inflation, we certainly aren't ruling out more cuts in 2020, and this is where the risk to our forecast clearly lies.

## Author

**Robert Carnell**

Regional Head of Research, Asia-Pacific

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

# What will happen after Xi-Trump meeting in G20

China and the US have scheduled a sideline meeting at the G20 in late June. What will happen next?



Source: Shutterstock

Donald Trump, Xi Jinping. President Donald Trump, right, with China's President Xi Jinping, left

## China US meeting scheduled

Overnight, announcements from both China and the US have stated that the two Presidents will meet at the G20 summit in Osaka for "extended" meetings to discuss the ongoing trade conflict.

As we have claimed a few times in our notes, we do not believe that the meeting will deliver a trade deal, even if the meeting does take place. From the Chinese side, the discussion with US President Trump is expected only to exchange views on fundamental issues concerning the development of China-US relations.

## What will happen after Xi and Trump meet?

Reading carefully from the statement from China, we only expect that both sides will repeat their views on the already drafted terms. But it is difficult to see any concrete progress that would either lead to a deal or improve the current deadlock situation.

During the meeting, President Trump will probably leverage on recent weak China economic data to persuade President Xi to agree that a trade deal is in China's interests. President Xi may use this opportunity to show President Trump that as long as both sides keep talking it will be helpful for the US economy and therefore President Trump's election campaign.

As such we expect no real change following the G20 sideline meeting. The fact that both sides are talking should at least postpone thoughts of a further increase in tariffs, for a while at least, until either side comes up with different thoughts.

Preventing any meaningful all-encompassing trade deal, there are still some fairly substantial hurdles. One is reform of state-owned enterprises, which is related to a lot of laws in China and fundamentally an issue of the Chinese political and economic model - in a word, sovereignty. Technology will also be discussed, and we expect China will confirm that there are no security issues on Chinese-made technological equipment. Though we do not think the US will accept this claim.

So the news on the talks in Osaka is a short term positive for asset markets, but we believe any talks will change little unless either side makes some meaningful concessions, which we do not view as likely at this time.

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*"As such we expect no real change following the G20 sideline meeting. The fact that both sides are talking should at least postpone thoughts of a further increase in tariffs, for a while at least, until either side comes up with different thoughts. "*

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## Yuan has already reflected the good news

USD/CNY and USD/CNH have already appreciated from the range of around 6.93-6.934 at the end of the trading session on 18th June to around 6.90 level (as of writing) for both USD/CNY and USD/CNH.

Markets are reacting positively to the fact that at least both sides are willing to talk about trade, even if this is only likely to deliver a short-term boost.

The yuan appreciation matches our forecast of USD/CNY at 6.90 by the end of June 2019.

### Author

#### Iris Pang

Chief Economist, Greater China

[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

## Asia week ahead: Thailand likely to join the easing buzz

Yet another busy week ahead with a couple more central bank meetings lined up and a host of the usual month-end economic releases from across Asia. Investor anxiety about trade may grow ahead of the Trump-Xi meeting, which takes place alongside the G20 leaders' gathering



Source: Shutterstock

### ➔ RBNZ to stay on hold

*While it is unlikely the RBNZ will drop its easing bias anytime*



*soon, it's in no rush to deliver a second rate cut. Besides, the broadly tight labour market may imply a low probability of inflation falling further away from the 2% target. – ING Asia Chief Economist, Rob Carnell*

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The Reserve Bank of New Zealand (RBNZ) will review its monetary policy and announce a decision on Wednesday, 26 June. The RBNZ just eased policy at the previous meeting in May, cutting the cash rate by 25 basis points to 1.50%, the first cut after a long hiatus in the easing cycle, which started four years ago. We don't anticipate a back-to-back cut, with RBNZ's Assistant Governor Christian Hawkesby ruling out another cut just yet. However, with the balance of risks skewed towards economic weakness, our house view remains one more 25bp cut in 3Q19.

### ➔ **BoT to join easing buzz**

Thailand's central bank, the Bank of Thailand (BoT), also announces its policy decision on 26 June.

A month ago, Thailand's dismal 1Q GDP report, which showed growth falling to a four-year low of 2.8%, forced us to revise our BoT policy view from no change this year to a 25 basis point rate cut within the current quarter. This puts us outside the consensus, which is still solidly behind a stable policy path this year.

However, earlier this week BoT policymaker Somchai Jitsuchon signalled that policy would be data-dependent, with fallout from the US-China trade war on the local economy leaving the bank "open to all possibilities". This being the case, it's hard to imagine the BoT ignoring the 1Q GDP data, while activity data for the second quarter doesn't offer much hope that the worst is over. The time is coming for a BoT rate cut, if only to reverse the 25bp rate hike from late-2018.

### ➔ **Disappointing data elsewhere in Asia**

A raft of activity data is expected to reinforce the downside growth risk for Asian economies.

China's industrial profit figures for May are expected to show a steeper contraction, by over 10% year-on-year, according to our Greater China economist Iris Pang (-3.7% in April). This follows the slowest industrial production growth of 5% YoY in May since the global financial crisis.

May manufacturing releases from Japan, Korea, Taiwan, Singapore, and Thailand will provide a good sense of 2Q19 GDP growth of these economies. As with the BoT, most other Asian central banks are gauging the impact of the trade war in determining their policy course. Indonesia's trade and the Philippines' government budget data are important from the same perspective.

### ➔ **And, the climax of the week will be...**

The global market angst about trade may increase in the run-up to the Xi-Trump meeting taking place alongside the G20 leaders gathering in Osaka at the end of the week (28-29 June). That's something we would rather save for this space in the next week. But we have already thought about the title. How about 'Make or Break'?

## Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
<b>Monday 24 June</b>					
Indonesia	0500	May Exports (YoY%)	-	-14.1	-13.1
	0500	May Imports (YoY%)	-	-14.5	-6.6
	0500	May Trade balance (US\$m)	-	-1379	-2501.9
Singapore	0600	May CPI (YoY%)	0.6	0.8	0.8
	0600	May CPI core (YoY%)	1.3	1.4	1.3
Taiwan	0900	May Industrial production (YoY%)	-5.0	-	1.0
South Korea	2200	Jun BOK Consumer Sentiment Index	99.1	-	97.9
<b>Tuesday 25 June</b>					
Hong Kong	0915	May Exports (YoY%)	-10.1	-	-2.6
	0915	May Imports (YoY%)	-11.8	-	-5.5
	0915	May Trade balance (HK\$bn)	-32.0	-	-35.1
Philippines	-	May Budget balance (PHP bn)	-81.0	-	86.9
<b>Wednesday 26 June</b>					
Malaysia	0500	May CPI (YoY%)	0.3	-	0.2
Singapore	0600	May Industrial production (MoM/YoY%)	2.0/0.0	-/-	2.4/0.1
Thailand	0805	Benchmark Interest Rate	1.50	-	1.75
South Korea	2200	Jul BOK Business Survey Index, mfg	77	-	75.0
	2200	Jul BOK Business Survey Index, non-mfg	74	-	72.0
<b>Thursday 27 June</b>					
China	0230	May Industrial profits (YTD, YoY%)	-10.2	-	-3.7
Thailand	-	May Manufacturing index (YoY%)	-1.5	-	2.0
<b>Friday 28 June</b>					
India	-	May Fiscal deficit (INR core)	-	-	-206132
South Korea	0000	May Industrial production (MoM)	0.9/0.7	-	-0.1/1.7
Thailand	0830	May Current account (US\$bn)	1.00	-	1.8

Source: ING, Bloomberg, \*GMT

### Author

#### Alissa Lefebre

Economist

[alissa.lefebvre@ing.com](mailto:alissa.lefebvre@ing.com)

#### Deepali Bhargava

Regional Head of Research, Asia-Pacific

[Deepali.Bhargava@ing.com](mailto:Deepali.Bhargava@ing.com)

#### Ruben Dewitte

Economist

+32495364780

[ruben.dewitte@ing.com](mailto:ruben.dewitte@ing.com)

#### Kinga Havasi

Economic research trainee

[kinga.havasi@ing.com](mailto:kinga.havasi@ing.com)

#### Marten van Garderen

Consumer Economist, Netherlands

[marten.van.garderen@ing.com](mailto:marten.van.garderen@ing.com)

**David Havrlant**

Chief Economist, Czech Republic

420 770 321 486

[david.havrlant@ing.com](mailto:david.havrlant@ing.com)

**Sander Burgers**

Senior Economist, Dutch Housing

[sander.burgers@ing.com](mailto:sander.burgers@ing.com)

**Lynn Song**

Chief Economist, Greater China

[lynn.song@asia.ing.com](mailto:lynn.song@asia.ing.com)

**Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

**Michal Rubaszek**

Senior Economist, Poland

[michal.rubaszek@ing.pl](mailto:michal.rubaszek@ing.pl)

**This is a test author**

**Stefan Posea**

Economist, Romania

[tiberiu-stefan.posea@ing.com](mailto:tiberiu-stefan.posea@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Jesse Norcross**

Senior Sector Strategist, Real Estate

[jesse.norcross@ing.com](mailto:jesse.norcross@ing.com)

**Teise Stellema**

Research Assistant, Energy Transition

[teise.stellema@ing.com](mailto:teise.stellema@ing.com)

**Diederik Stadig**

Sector Economist, TMT & Healthcare

[diederik.stadig@ing.com](mailto:diederik.stadig@ing.com)

**Diogo Gouveia**

Sector Economist

[diogo.duarte.vieira.de.gouveia@ing.com](mailto:diogo.duarte.vieira.de.gouveia@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Ewa Manthey**

Commodities Strategist

[ewa.manthey@ing.com](mailto:ewa.manthey@ing.com)

**ING Analysts**

**James Wilson**

EM Sovereign Strategist

[James.wilson@ing.com](mailto:James.wilson@ing.com)

**Sophie Smith**

Digital Editor

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

**Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

**Adam Antoniak**

Senior Economist, Poland

[adam.antoniak@ing.pl](mailto:adam.antoniak@ing.pl)

**Min Joo Kang**

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

**Coco Zhang**

ESG Research

[coco.zhang@ing.com](mailto:coco.zhang@ing.com)

**Jan Frederik Slijkerman**

Senior Sector Strategist, TMT

[jan.frederik.slijkerman@ing.com](mailto:jan.frederik.slijkerman@ing.com)

**Katinka Jongkind**

Senior Economist, Services and Leisure

[Katinka.Jongkind@ing.com](mailto:Katinka.Jongkind@ing.com)

**Marina Le Blanc**

Sector Strategist, Financials

[Marina.Le.Blanc@ing.com](mailto:Marina.Le.Blanc@ing.com)

**Samuel Abettan**

Junior Economist  
[samuel.abettan@ing.com](mailto:samuel.abettan@ing.com)

**Franziska Biehl**  
Economist, Germany  
[Franziska.Marie.Biehl@ing.de](mailto:Franziska.Marie.Biehl@ing.de)

**Rebecca Byrne**  
Senior Editor and Supervisory Analyst  
[rebecca.byrne@ing.com](mailto:rebecca.byrne@ing.com)

**Mirjam Bani**  
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)  
[mirjam.bani@ing.com](mailto:mirjam.bani@ing.com)

**Timothy Rahill**  
Credit Strategist  
[timothy.rahill@ing.com](mailto:timothy.rahill@ing.com)

**Leszek Kasek**  
Senior Economist, Poland  
[leszek.kasek@ing.pl](mailto:leszek.kasek@ing.pl)

**Oleksiy Soroka, CFA**  
Senior High Yield Credit Strategist  
[oleksiy.soroka@ing.com](mailto:oleksiy.soroka@ing.com)

**Antoine Bouvet**  
Head of European Rates Strategy  
[antoine.bouvet@ing.com](mailto:antoine.bouvet@ing.com)

**Jeroen van den Broek**  
Global Head of Sector Research  
[jeroen.van.den.broek@ing.com](mailto:jeroen.van.den.broek@ing.com)

**Edse Dantuma**  
Senior Sector Economist, Industry and Healthcare  
[edse.dantuma@ing.com](mailto:edse.dantuma@ing.com)

**Francesco Pesole**  
FX Strategist  
[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

**Rico Luman**  
Senior Sector Economist, Transport and Logistics  
[Rico.Luman@ing.com](mailto:Rico.Luman@ing.com)

**Jurjen Witteveen**

Sector Economist  
[jurjen.witteveen@ing.com](mailto:jurjen.witteveen@ing.com)

**Dmitry Dolgin**  
Chief Economist, CIS  
[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

**Nicholas Mapa**  
Senior Economist, Philippines  
[nicholas.antonio.mapa@asia.ing.com](mailto:nicholas.antonio.mapa@asia.ing.com)

**Egor Fedorov**  
Senior Credit Analyst  
[egor.fedorov@ing.com](mailto:egor.fedorov@ing.com)

**Sebastian Franke**  
Consumer Economist  
[sebastian.franke@ing.de](mailto:sebastian.franke@ing.de)

**Gerben Hieminga**  
Senior Sector Economist, Energy  
[gerben.hieminga@ing.com](mailto:gerben.hieminga@ing.com)

**Nadège Tillier**  
Head of Corporates Sector Strategy  
[nadege.tillier@ing.com](mailto:nadege.tillier@ing.com)

**Charlotte de Montpellier**  
Senior Economist, France and Switzerland  
[charlotte.de.montpellier@ing.com](mailto:charlotte.de.montpellier@ing.com)

**Laura Straeter**  
Behavioural Scientist  
+31(0)611172684  
[laura.Straeter@ing.com](mailto:laura.Straeter@ing.com)

**Valentin Tataru**  
Chief Economist, Romania  
[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

**James Smith**  
Developed Markets Economist, UK  
[james.smith@ing.com](mailto:james.smith@ing.com)

**Suvi Platerink Kosonen**  
Senior Sector Strategist, Financials  
[suvi.platerink-kosonen@ing.com](mailto:suvi.platerink-kosonen@ing.com)

**Thijs Geijer**

Senior Sector Economist, Food & Agri

[thijs.geijer@ing.com](mailto:thijs.geijer@ing.com)

**Maurice van Sante**

Senior Economist Construction & Team Lead Sectors

[maurice.van.sante@ing.com](mailto:maurice.van.sante@ing.com)

**Marcel Klok**

Senior Economist, Netherlands

[marcel.klok@ing.com](mailto:marcel.klok@ing.com)

**Piotr Poplawski**

Senior Economist, Poland

[piotr.poplawski@ing.pl](mailto:piotr.poplawski@ing.pl)

**Paolo Pizzoli**

Senior Economist, Italy, Greece

[paolo.pizzoli@ing.com](mailto:paolo.pizzoli@ing.com)

**Marieke Blom**

Chief Economist and Global Head of Research

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

**Raoul Leering**

Senior Macro Economist

[raoul.leering@ing.com](mailto:raoul.leering@ing.com)

**Maarten Leen**

Head of Global IFRS9 ME Scenarios

[maarten.leen@ing.com](mailto:maarten.leen@ing.com)

**Maureen Schuller**

Head of Financials Sector Strategy

[Maureen.Schuller@ing.com](mailto:Maureen.Schuller@ing.com)

**Warren Patterson**

Head of Commodities Strategy

[Warren.Patterson@asia.ing.com](mailto:Warren.Patterson@asia.ing.com)

**Rafal Benecki**

Chief Economist, Poland

[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

**Philippe Ledent**

Senior Economist, Belgium, Luxembourg

[philippe.ledent@ing.com](mailto:philippe.ledent@ing.com)

**Peter Virovacz**

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

**Inga Fechner**

Senior Economist, Germany, Global Trade

[inga.fechner@ing.de](mailto:inga.fechner@ing.de)

**Dimitry Fleming**

Senior Data Analyst, Netherlands

[Dimitry.Fleming@ing.com](mailto:Dimitry.Fleming@ing.com)

**Ciprian Dascalu**

Chief Economist, Romania

+40 31 406 8990

[ciprian.dascalu@ing.com](mailto:ciprian.dascalu@ing.com)

**Muhammet Mercan**

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

**Iris Pang**

Chief Economist, Greater China

[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

**Sophie Freeman**

Writer, Group Research

+44 20 7767 6209

[Sophie.Freeman@uk.ing.com](mailto:Sophie.Freeman@uk.ing.com)

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

**James Knightley**

Chief International Economist, US

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

**Tim Condon**

Asia Chief Economist

+65 6232-6020

**Martin van Vliet**

Senior Interest Rate Strategist

+31 20 563 8801

[martin.van.vliet@ing.com](mailto:martin.van.vliet@ing.com)

**Robert Carnell**



Regional Head of Research, Asia-Pacific  
[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

**Karol Pogorzelski**  
Senior Economist, Poland  
[Karol.Pogorzelski@ing.pl](mailto:Karol.Pogorzelski@ing.pl)

**Carsten Brzeski**  
Global Head of Macro  
[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

**Viraj Patel**  
Foreign Exchange Strategist  
+44 20 7767 6405  
[viraj.patel@ing.com](mailto:viraj.patel@ing.com)

**Owen Thomas**  
Global Head of Editorial Content  
+44 (0) 207 767 5331  
[owen.thomas@ing.com](mailto:owen.thomas@ing.com)

**Bert Colijn**  
Chief Economist, Netherlands  
[bert.colijn@ing.com](mailto:bert.colijn@ing.com)

**Peter Vanden Houte**  
Chief Economist, Belgium, Luxembourg, Eurozone  
[peter.vandenhoute@ing.com](mailto:peter.vandenhoute@ing.com)

**Benjamin Schroeder**  
Senior Rates Strategist  
[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

**Chris Turner**  
Global Head of Markets and Regional Head of Research for UK & CEE  
[chris.turner@ing.com](mailto:chris.turner@ing.com)

**Gustavo Rangel**  
Chief Economist, LATAM  
+1 646 424 6464  
[gustavo.rangel@ing.com](mailto:gustavo.rangel@ing.com)

**Carlo Cocuzzo**  
Economist, Digital Finance  
+44 20 7767 5306  
[carlo.cocuzzo@ing.com](mailto:carlo.cocuzzo@ing.com)

## Watch: China to double fiscal stimulus

China finds itself in difficulty amid the trade war with the US. Its manufacturing sector is now weaker than during the Global Financial Crisis of 2008/09. We expect the authorities to double fiscal stimulus to maintain GDP growth of more than 6% this year



### China to double fiscal stimulus

[Watch video](#)

#### Author

##### **Iris Pang**

Chief Economist, Greater China

[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

## A Dovish, but cautious shift from the Fed

The Fed has opened the door to rate cuts, but it may not be as aggressive as the market expects. For now, we're sticking to our recently revised forecast for rate cuts in September and December, but if the data deteriorates and President Trump and President Xi's meeting next week goes badly, we're open to moving that to July and September



Source: Shutterstock

The Federal Reserve has opted to leave monetary policy unchanged, but as widely expected (and forewarned by Fed Chair Jerome Powell), has adopted a more dovish stance today. James Bullard, the St Louis Fed President, went further and voted for an immediate 25bp rate cut.

The market has taken this as a signal that a July 25bp rate cut is virtually a done deal with three more to come, but we are not so sure. The path of trade talks is critical and if there are some positive messages, if not actions, and the activity data holds up, the market will be disappointed. Moreover, the “dot” diagram of forecasters has a median of NO cuts this year and only one next year.

While the news in the near term is likely to get worse before it gets better, we think there are decent fundamentals. More importantly, we think President Trump’s desire to win re-election means that he will be wary of pushing too far for too long on trade, thereby

damaging his own chances. We continue to look for two rate cuts in 2H19 and favour September and December.

## A clear shift in language,

The big change in the accompanying statement is the dropping of the description of the Fed's stance as being "patient". Instead, the Fed believes "uncertainties about the outlook have increased" which mean the FOMC will be "closely monitoring the implications of incoming information... and will act as appropriate to sustain the expansion".

The current economic situation has also been downgraded from one that was "solid" in May to one that is "moderate" today. This is largely down to "soft" business investment, which is enough to offset the fact consumer spending "appears to have picked up". Yet they have actually revised up their 2020 GDP growth forecast to 2% and lowered their prediction for unemployment. Meanwhile, market-based measures of inflation "have declined" and they have lowered their near-term forecast profile, but have headline and core inflation returning to target next year.

## But not in forecasts...

The tone of this statement is clearly suggesting that rate cuts are in the offing and markets are increasingly confident that the first move will be in July with three more probable over the next year. Yet the "dot" diagram of predictions from Fed officials warns markets they perhaps shouldn't get too far ahead of themselves. The median forecast is for NO rate change this year. Seven officials are looking for two 25bp rate cuts and one is looking for a single 25bp move. Eight expect no change while one individual is actually still penciling in a rate hike!

For end 2020, Fed officials are suggesting they may only need one rate cut thanks to the fact that one additional official is now looking for a single 25bp next year - no-one is looking for more than two rate cuts in total over the forecast period. The median then suggests that one cut is reversed in 2021 - returning the Fed funds target rate to its current level - with the longer run forecast for where the Fed funds rate settles has been lowered from 2.8% to 2.5%.

As such it's dovish, but certainly not that dovish.

## Federal Reserve median forecasts

Variable	Median			
	2019	2020	2021	Longer Run
<b>Change in real GDP (June FOMC)</b>	<b>2.1</b>	<b>2.0</b>	<b>1.8</b>	<b>1.9</b>
(PREVIOUS)	2.1	1.9	1.8	1.9
<b>Unemployment Rate (June FOMC)</b>	<b>3.6</b>	<b>3.7</b>	<b>3.8</b>	<b>4.2</b>
(PREVIOUS)	3.7	3.8	3.9	4.3
<b>PCE inflation (June FOMC)</b>	<b>1.5</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>
(PREVIOUS)	1.8	2.0	2.0	2.0
<b>Core PCE inflation (June FOMC)</b>	<b>1.8</b>	<b>1.9</b>	<b>2.0</b>	-
(PREVIOUS)	2.0	2.0	2.0	-
<b>Fed funds rate (June FOMC)</b>	<b>2.4</b>	<b>2.1</b>	<b>2.4</b>	<b>2.5</b>
(PREVIOUS)	2.4	2.6	2.6	2.8

Source: Federal Reserve, ING

## All to play for

The press conference has allowed Fed Chair Powell to put a bit more colour on the situation, suggesting that the Fed will learn a lot in the near term - next week's G20 and associated trade discussions - and that the Fed should not overreact to individual data points.

Nonetheless, even those officials that are forecasting no rate cuts acknowledge the case for action has strengthened.

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*We are sticking to our recently revised forecast for now, but if the data deteriorates further and President Trump and President Xi's meeting next week goes badly, we are open to moving that to July and September*

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We recently switched to a view that the Fed would cut rates twice this year – once in September and once in December on the basis that trade tensions are likely to get worse before they get better. This will weigh on sentiment, which could see firms pull back on investment and hiring, thereby threatening a broader economic slowdown and justifying precautionary policy easing.

We are sticking with this for now, but should the data deteriorate and next week's meeting between President Trump and President Xi go badly, we are open to moving that to July and September. Should payrolls rebound to 250k next month, and trade discussions offer signals for encouragement it is the market that will have to move.

### Author

**James Knightley**

Chief International Economist, US

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

# Watch: Why USD/JPY will lead the dollar lower

The dollar's selling off across the board this Thursday on the back of a dovish Fed. And given the uncertainty over trade wars, we think it will be USD/JPY that will lead the dollar lower still this summer



## Why USD/JPY will lead the dollar lower this summer

[Watch video](#)

### Author

#### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

## The eurozone's Japanification - more to come

With the eurozone economy stuck in a low growth, low inflation and low rates environment, it's really hard not to make 'Japanification' comparisons. If we're honest, the eurozone is probably already in the thick of it, which means rates are likely to remain lower for longer and every new crisis or recession will bring the bloc closer to more Japanification



Haruhiko Kuroda, Governor of the Bank of Japan, left, talks to Mario Draghi, President of the ECB in 2015

### A brief history of Japan's lost decades – Japan's first crisis

The roots of Japan's subdued economic performance can be traced back as far as the late 1980s.

In September 1985, following the Plaza Accord – an agreement by Japan, the United States, France, West Germany and the UK to depreciate the US dollar against the Japanese yen and the German Deutsche mark, the Japanese yen appreciated sharply. Being highly export-oriented, Japan's exports and GDP growth dropped considerably in 1986. Because of the deteriorating economy, to stop speculative capital inflows and limit the yen's appreciation, the Bank of Japan

lowered interest rates from 5% to 2.5% between January 1986 and February 1987. Furthermore, fiscal packages were compiled in September 1985 and May 1987 to support the economy. Although the economy rebounded significantly in the second quarter of 1987, the central bank kept its policy rate at 2.5% until May 1989.

Fuelled by a mixture of declining lending standards, financial regulation in the years before, low interest rates, cheap money and the belief, that the only way was up, Japanese stock and real estate prices grew at a staggering speed towards the end of 1986 and until 1990, pushing the Nikkei index from 13,000 points to an all-time high of 39,000 points in December 1989. [1]

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### *The lending standards of banks became more cautious*

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In May 1989, the central bank raised interest rates from 2.5% to 6% in just 16 months as it became concerned about asset price increases, banks' lending behaviour and upward pressure on prices. At the beginning of 1990, stock prices started to decline with the yen depreciating and long-term yields increasing. However, the BoJ kept raising rates until August 1990 – also in the wake of the Gulf war leading to an increase in oil prices. Subsequently, the lending standards of banks became more cautious, money supply growth decelerated sharply and the pace of economic growth started to slow.

When the stock market and real estate bubble started to burst in 1990 and 1991, the Japanese banking sector faced a pile of non-performing loans with Japan's corporate sector being characterised by excess debt. According to the IMF's systemic banking crises [database](#), Japan's non-performing loans (NPLs) peaked at 35% (of total loans) during the banking crisis - a level which neither Greece nor Italy reached during the European sovereign debt crisis. However, the magnitude was not immediately recognised and authorities were slow in reacting. Only in the second half of the 1990s, when large institutions started to fail, the full extent became visible. [2]

## **The Bank of Japan's courageous monetary policy**

Meanwhile, the Bank of Japan was quite brave with introducing new monetary policy measures beyond textbook knowledge. In October 1999, the interest rate was lowered to zero and ZIRP (zero interest rate policy) was born. Japan's central bank started to use quantitative easing policies, back in 2001, setting the outstanding balance of current accounts at the Bank as the operating target [3]. But the monetary stimulus didn't result in higher inflation as the authorities had waited too long before taking decisive action. Initially, the BoJ had raised rates during the burst instead of lowering them and it was only in 1999, a comprehensive disclosure requirement for bad loans was put in place.

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### *Japan's low inflation seems to be more structural*

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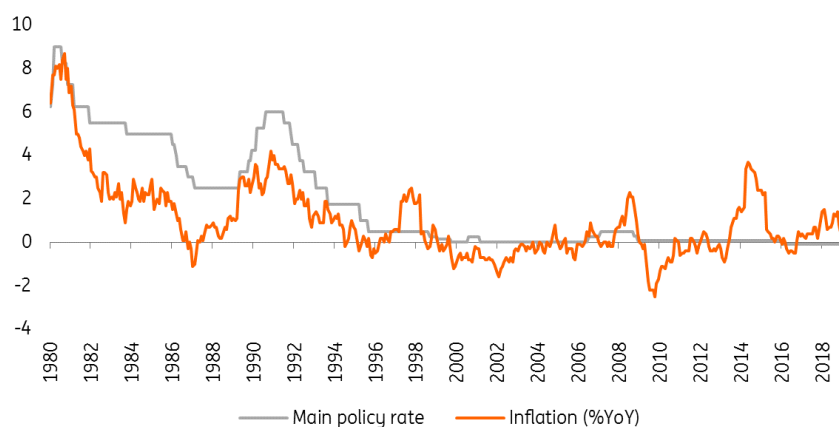
Japan's low inflation seems to be more structural, causing low-interest rates, for which numerous factors can be cited. Research has identified factors like the “zero-lower bound on nominal interest rates, public attitudes toward the price level, central bank communication, weaker growth



expectations coupled with declining potential growth or the lower natural rate of interest, risk-averse banking behaviours, deregulation in the distribution chain and the rise of emerging economies” as possible factors depressing inflation.[4]

The Federal Reserve Bank of St. Louis (2018) adds to that technological progress, globalisation and demographic transitions [5]. Another factor weighing on inflation might actually be deleveraging. After the bursting of the bubble, the private sector deleveraged, cutting borrowing and spending.[6]

## Japan's main policy rate and inflation (%)



Source: Refinitiv, ING Economic & Financial Analysis

## Eurozone's lessons from Japan – the same causes or only similarities?

By now, an environment of low inflation has also reached the eurozone. It probably is structurally low inflation, driven by globalisation and digitalisation. However, the question is whether Japan-specific factors can help to explain the current low growth and low inflation situation or whether the eurozone and Japan are 'only' experiencing similar external factors.

Savings glut, central bank credibility, globalisation, the 1990s and 2000s saw a general decline in inflation and interest rate levels, which go beyond Japanification. But right now, the eurozone is showing similarities with Japan of the early 1990s. A financial crisis turns into an economic crisis, which then turns into a banking crisis, and finally into an existential crisis.

- **Leveraging and deleveraging:** In fact, the eurozone's development between 2009 and 2018 has a high degree of Japanification. Government debt increased by more than 25% GDP in Japan during the bust period of the 1990s while in the eurozone, on average it increased by some 20% of GDP. Credit to households on the back of loose monetary policies increased by 7% GDP in the eurozone and by around 9% in Japan. At the same time, however, credit to the corporate sector increased more significantly in the eurozone (+20% GDP) than in Japan (+6% GDP).
- **Central bank action:** The Bank of Japan and the European central bank behaved similarly during the crisis years. The BoJ didn't only cut rates to the zero-bound in 1999, it cut interest rates by 600bp in the 1990s while the ECB cut rates by 425 bp. However,

the ECB started to use its balance sheet extensively as a policy instrument earlier than the BoJ.

- **Financial sector:** Both Japanese and eurozone banks accumulated a huge pile of non-performing loans during the crisis years, with Japan's NPL ratio at 8.4% in 2001 and the eurozone's NPL ratio at 8.1% during the height of the sovereign debt crisis in 2012. In both countries, the financial sector had to be supported by large capital injections.
- **Demographic change:** An often-mentioned structural factor for the slowdown of Japan is ageing. In fact, Japan's working-age population (aged 15-64) has been on a declining trend since the mid-1990s, while the population as a whole started to decline from 2011 onwards. Although the eurozone still has some breathing room, the working-age population is also on a declining trend since 2009.

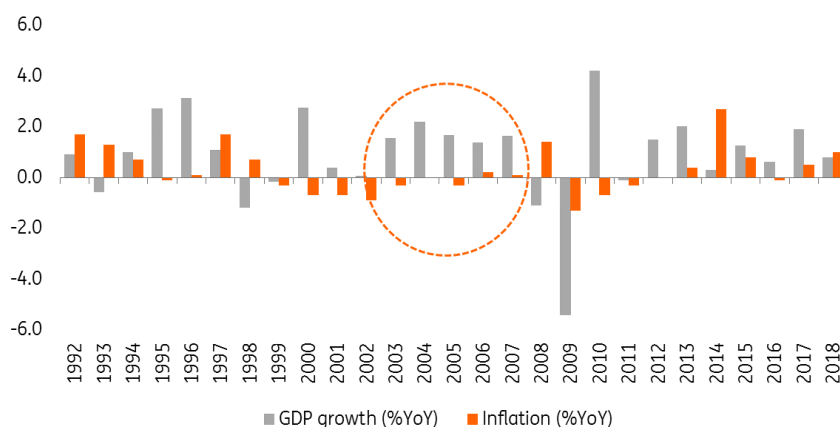
## So why should we care? Because of the next downturn...

While Japan's experiences in the 1990s were engraving, they are not enough to explain Japan's prolonged subdued economic growth environment up until today. Timing was not on its side.

The recovery of the Japanese economy was thrown back by three major events: the Asian crisis in 1997/1998, the dot-com bubble burst in 2000/2001 and finally and most importantly the global financial crisis of 2008/2009. Whenever it looked as if the Japanese economy had finally bottomed out, the next external shock came along. With the economy growing by 1.8% on average between 2003 and 2005, the Japanese central bank cautiously raised its main interest rate in July 2006 by 25 basis points to 50 basis points in September 2008.

But then, the financial crisis hit and the hiking cycle was over before it really began.

## GDP growth in Japan and inflation (%)



Source: Refinitiv, ING Economic & Financial Analysis

This is an important lesson for the Eurozone: the next crisis can always be just around the corner. Without a strong recovery, it is difficult to escape the low growth, low inflation and subsequently low rates environment. An economic upturn could quickly be over and monetary policy might not have enough ammunition up its sleeve, with interest rates remaining stuck at the zero lower bound for years to come.

Japan's central bank hasn't raised main interest rate more than 50 basis points for over 24 years

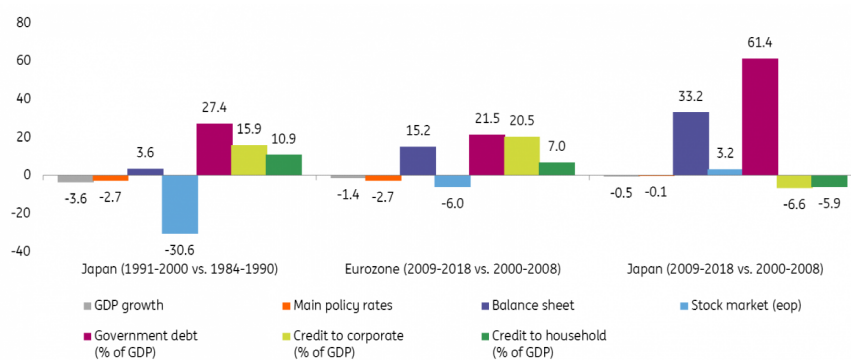
now and still has the largest central bank balance sheet measured as a percentage of GDP compared to the US and the eurozone. So, for the eurozone, the most important lesson is probably not so much the root cause of Japanification but the desperate attempts to get out it.

## What are the developments the Eurozone could be facing soon?

- **Deleveraging of the private sector:** Over the last ten years, the balance sheet problems of financial institutions and non-financial corporations have been one of the most important factors keeping the economy subdued for a long period of time, prolonging the subdued inflation environment [7]. Both credit to corporates and households have actually shrunk.
- **Ballooning of central bank balance sheet:** Over the last ten years, the balance sheet of the BoJ has increased by more than 75% of GDP. In the Eurozone, the ECB's balance sheet is currently some 18% of GDP bigger than in 2009.
- **Fiscal policy to the rescue:** Over the last ten years, Japanese government debt increased from 183% GDP in 2008 to 236% in 2018. The fiscal budget has been running deficits for 26 years, implementing countless fiscal packages to stimulate the economy.
- **Higher retirement ages:** While there has been a drop in the working age population of people aged 15 to 64, older employees and women have remained in or joined the workforce in Japan. Employment in Japan has actually been growing for seven years as the effective retirement age has moved up to close 70. Also, robotics and automation is well-advanced in Japan, keeping GDP per capita at high levels. All of this means that the expected wage-price spiral as a result of a shrinking labour force has never happened. Important lesson for the Eurozone: without these developments or measures, stagnation could easily turn into stagflation.[8]

## Economic developments in Japan and the Eurozone

(mean values over respective periods, %)



Source: Refinitiv, corporate and household credit data = BIS, government debt = Refinitiv/DG Ecfm Ameco.

### Why Japanification might be worse for the eurozone than for Japan

Having said all of this, Japanification doesn't have to be a bad thing, instead, it is rather a description of the state of an economy.

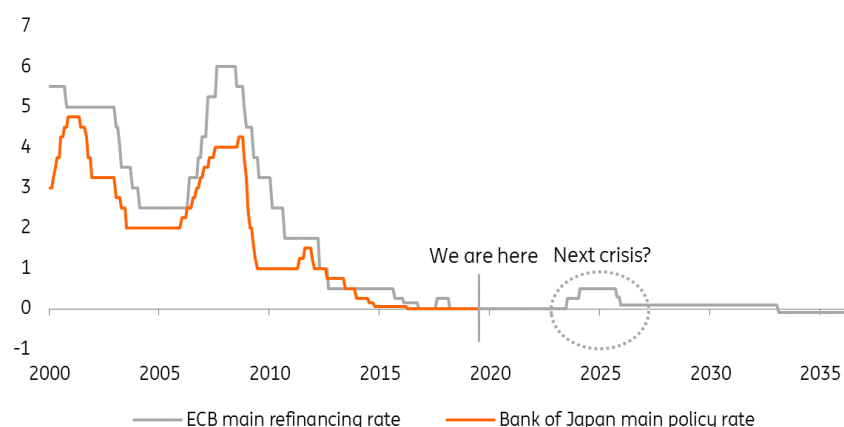
Despite Japan's prolonged period of subdued economic performance, the economy is still the third largest in terms of nominal GDP and is one of the most innovative and digitally

conscious economies in the world and thanks to the government's fiscal packages, Japan continues to enjoy a modern and well-maintained infrastructure. At the same time, however, Japan is also a relatively homogenous society.

On the contrary, in the heterogeneous eurozone, political tensions within and between countries might rise given differing interests, economic developments and the controversial use of fiscal policies among members, making forward-looking reforms more important than ever. Particularly, the discussion about the role of fiscal policy in attempts to stabilise or kick-start the economy clearly have the potential for greater conflicts in the eurozone than in Japan.

For the eurozone, the lessons from the future from Japanification are more important than the lessons from the past. The Japanese experiences show that it will be very hard to actually escape a low growth and low inflation environment without reverting to loose fiscal policies and policies aimed at increasing productivity growth. For the ECB, this means that even looking beyond the short-term horizon with economic and trade uncertainties, the possibility of Fed rate cuts and the ECB's easing bias, there will not be much room for rate hikes in the coming years.

## Main interest rates Eurozone Japan (%)



Source: Datastream, ING

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## Author

### **Carsten Brzeski**

Global Head of Macro

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

### **Inga Fechner**

Senior Economist, Germany, Global Trade

[inga.fechner@ing.de](mailto:inga.fechner@ing.de)

## Caution creeps in at Bank of England as 'no deal' fears resurface

The fact that Bank of England policymakers are flagging that the perceived risk of a 'no deal' Brexit is rising suggests that interest rates are unlikely to rise this year, despite recent signals that markets may be underestimating future tightening



Source: Bank of England

### Policymakers decided against offering an explicit signal

While the Bank of England unanimously opted to keep rates on hold, all things considered, the latest statement is slightly more dovish than might have been expected.

Back in May, Governor Mark Carney warned investors that, with just one rate hike priced in over the next two years, they may be underestimating the pace of future tightening. Since then, the revaluation of global monetary policy in light of the escalation in trade tensions has seen investors lower their expectations even further. In fact, markets now think UK interest rates are more likely to fall over the next couple of years.

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*The latest statement is slightly more dovish than might have been expected*

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We had wondered if this would lead the Bank to hint more explicitly that market rate expectations are too low. In the event, however, they chose not to and interestingly have made reference to the fact that the perceived risk of a 'no deal' Brexit is rising. This is perhaps a subtle nod to the fact that risks to growth could lie to the downside over the summer months if uncertainty continues to ratchet up.

We tend to agree - while the recent growth numbers are being thrown around by sharp changes in inventories, we think underlying economic momentum will remain slightly weaker in the near-term as businesses ramp up preparations for an October 'no deal' Brexit.

## We don't expect a rate hike this year

We wouldn't totally rule out a rate hike from the Bank of England later this year if wage growth continues to perform solidly and the immediate threat from Brexit recedes - either through another Article 50 extension or less likely, a deal being ratified by parliament ahead of the October deadline.

In reality though, we think it is unlikely the Bank will hike rates this year. Domestically, uncertainty is likely to remain elevated - particularly given that we see an [increasing probability of a general election later in the year](#). Globally, our team expects trade tensions to get worse before they get better, and this will act as another reason to proceed cautiously when it comes to possible future tightening.

### Author

#### James Smith

Developed Markets Economist, UK

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

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