

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

In this bundle



Australia

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...

By Robert Carnell



China

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?



Asia week ahead

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....

China | Video

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...



United States

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...

By James Knightley

FX | Video

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...

By Chris Turner



Japan

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'...

By Carsten Brzeski and Inga Fechner



United Kingdom

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...

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...



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.

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

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

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.

"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. "

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.

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....



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

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.
Monday 24 June					
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
Tuesday 25 June					
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
Wednesday 26 June					
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
Thursday 27 June					
China	0230	May Industrial profits (YTD, YoY%)	-10.2	-	-3.7
Thailand	-	May Manufacturing index (YoY%)	-1.5	-	2.0
Friday 28 June					
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

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...



China to double fiscal stimulus

ING's Iris Pang on what China needs to do next to ensure stability amid the trade war

[Watch video](#)

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...



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
Change in real GDP (June FOMC)	2.1	2.0	1.8	1.9
(PREVIOUS)	2.1	1.9	1.8	1.9
Unemployment Rate (June FOMC)	3.6	3.7	3.8	4.2
(PREVIOUS)	3.7	3.8	3.9	4.3
PCE inflation (June FOMC)	1.5	1.9	2.0	2.0
(PREVIOUS)	1.8	2.0	2.0	2.0
Core PCE inflation (June FOMC)	1.8	1.9	2.0	-
(PREVIOUS)	2.0	2.0	2.0	-
Fed funds rate (June FOMC)	2.4	2.1	2.4	2.5
(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.

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

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

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...



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

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'...



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]

The lending standards of banks became more cautious

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.

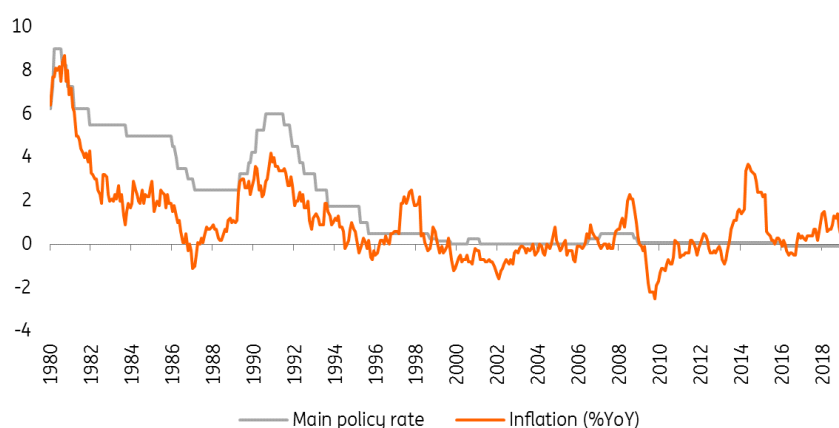
Japan's low inflation seems to be more structural

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.

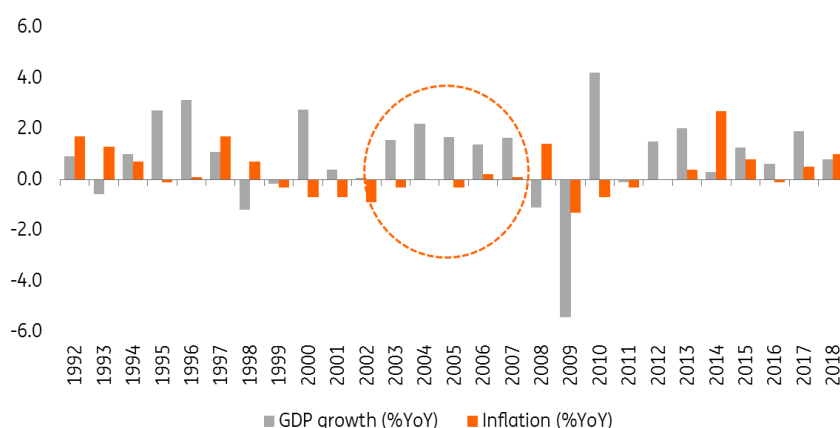
So why should we care? Because of the next downturn...

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.

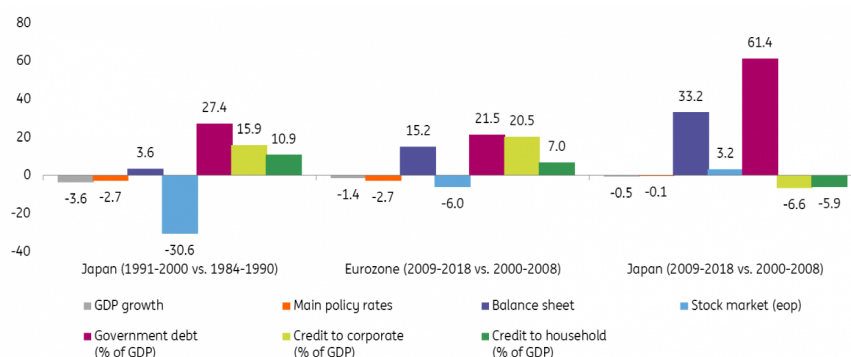
Japan's central bank hasn't raised main interest rate more than 50 basis points for over 24 years now and still has the largest central bank balance sheet measured as a percentage of GDP compared to the US and the eurozone. So, for the eurozone, the most important lesson is probably not so much the root 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

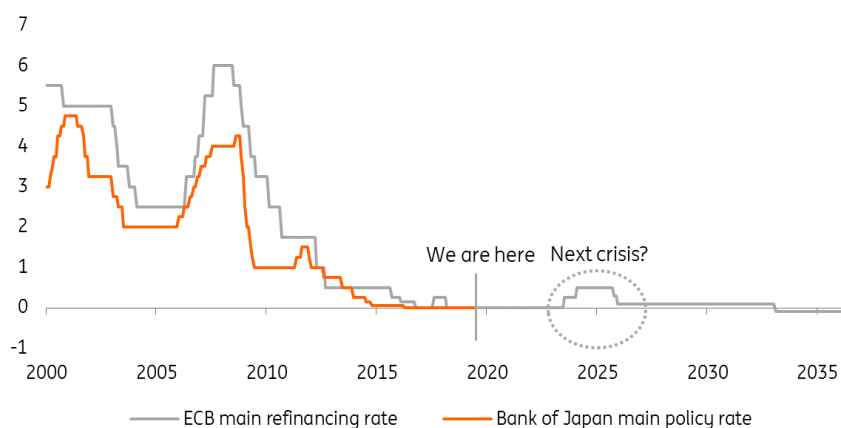
Having said all of this, Japanification doesn't have to be a bad thing, instead, it is rather a description of the state of an economy.

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

References

1. *IMF World economic outlook: tensions from the two-speed recovery, 2001; Nakaso, H., Japan's Economy and the Bank of Japan: Yesterday, Today, and Tomorrow, Speech at the Economic Conference in Tokyo, 2016; Ito, T., Japanization: Is it endemic or epidemic? NBER Working Paper, 2016*
2. *Nakaso, H., The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt, BIS Papers, 2001; Hoshi, T., Kashyap, A., The Japanese Banking Crisis: Where did it come from and how will it end?, NBER Working Paper, 1999.*
3. *Nakaso, H., Evolving Monetary Policy: The Bank of Japan's Experience, Speech at the Central Banking Seminar, 2017.*
4. *Nishizaki, K., Sekine, T., Ueno, Y., Chronic Deflation in Japan, Bank of Japan Working Paper, 2012.*
5. *Sanchez, J. M., Kim, H. S., Why is inflation so low, <https://www.stlouisfed.org/publications/regional-economist/first-quarter-2018/why-inflation>*

-so-low#endnotes

6. *Borio, C., Low inflation and rising global debt: just a coincidence?, 2018:*
*<https://www.bis.org/speeches/sp180802.htm>; Kushinov, D., Müller, G. J., Wolf, M.,
Deleveraging, deflation and depreciation in the euro area, 2015.*
7. *Nakao, T., Japan's experience with fiscal policy in the 1990s in the aftermath of the bubble
economy, 2002.*

Authors

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Inga Fechner

Senior Economist, Germany, Global Trade

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...



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.

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

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

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.