Brent and Brexit

Two stories will dominate markets in coming days - one is the plunging price of crude oil, the other, the latest twist in the Brexit saga - both have ramifications for Asia.

Source: iStock

Down the greasy pole

When I first started doing this sort of job, pre-internet, oil prices were still one of the key inputs to any forecasting process. I wasn't any better at second-guessing the direction of the greasy black stuff then, but at least we could apply "ready reckoners" of the impact of oil fluctuations on GDP. Of course, these were very imprecise and took place against the backdrop where the variance of crude was a few dollars, but at those levels, that still represented a sizeable percentage move.

Fast forward to today - and oil prices, even after their latest fall, are many times greater than they were when I first started (call it 1993 - and about $11/bbl). But oil also represents a much smaller proportion of the global economy than it did back then - we've weaned ourselves off oil to some extent. So the old ready reckoners at least need updating.

But they were in fact always wrong. At low prices and when all we cared about was the G-7, it made some sense. The G-7 made up most of global demand. There were no net producers amongst them. These days - that is just plain wrong.

So I prefer to think of oil not as a tax on growth, but as an imperfect transfer between producers and consumers, and with a range at which the consumers and producers are equally happy / unhappy, where the price of oil produces the least friction on the global economy. Not so much a "sweet spot" as an "indifference range".

Why am I boring you with this? Well, depending on which contract you look at, we are just about to bust through the bottom of that range ($65/bbl, by my reckoning for Brent, the top of that range being about $75).

So what was good news for India, Indonesia and the Philippines to some extent too, will start from now on, to be offset by falling demand for global output (Asian exports) from the oil producers (plus associated remittances etc). If OPEC manages to get a supply cut through in the coming months, it can limit this hit. But if its forecasts for falling global oil demand are accurate (they don't sound unreasonable to me) then they have their work cut out. Crude benchmarks like Brent and WTI could fall further first, and that would set us up for a re-run of 2015/2016, where oil-producing nations bought very little of Asia's manufactured output, Asian exports slumped and growth slowed sharply. From an Asian perspective, where falling oil prices had been helping Asian FX to firm against the USD, from now on, that relationship will likely fade away.

The moral of this story? Well, you decide, but it's probably a hybrid of "Be careful what you wish for" and "One man's feast is another man's famine". Your call.

Brexit brinksmanship

We wrote yesterday about why Brexit was potentially important for Asia - mainly through currency channels - and so forgive me for briefly mentioning it again today. Later on, UK PM May will (contrary to earlier indications) present a draft of the Brexit leaving agreement to the UK cabinet. NB - this is not about what sort of trade deal we might expect to get, merely the "leaving" arrangement. The trade deal has to be thrashed out later (if we get that far), probably during an extended transition period. Sterling is stronger overnight (hope springs eternal) and the EUR too. The dollar index is, as a result, a little weaker.

There's been a lot of huffing and puffing by May's Eurosceptic cabinet members, but in the last 24 hours, none have yet resigned (though watch this space) and if that continues to be the case by this time tomorrow, then we can probably conclude that at least this will then go to parliament for a vote.

That is where things get tricky. With such a wafer-thin working majority, and the population seemingly cooling to the idea of a Brexit, whatever form it takes, opposition politicians will have little incentive to back a deal that, if they withheld their support, would likely see the end of PM May, and possibly raise the prospect of a General Election. That might well put article-50 on hold until its conclusion. But it wouldn't be too much of a stretch to imagine one of the other political parties campaigning on a "Remain" ticket.

This sage could continue to drag on for many more months. We will post links to any reaction from our UK economists in tomorrow's note, though feel free to keep trawling the ING Think Website in the meantime to jump the queue.

Japan 3Q18 GDP - weak - but blame it on the weather

3Q18 GDP was quite a bit worse than we had anticipated after working through the numbers yesterday. We had expected a 0.1%QoQ (sa) decline and a -0.4%YoY annual contraction. The actual outcome was -0.3%QoQ and -1.2%YoY (consensus -0.3% and -1.0%YoY).

The main surprises for us from today's release were the much smaller drag on growth from net exports - we had believed most of the GDP blip would be due to trade weakness. But whilst the export figures were down 7.1%QoQ, Imports fell too (-5.6% QoQ ann).

More disappointing were the private consumer spending figures (-0.5%QoQ) and weaker non-residential investment (-0.9%). This is barely offset by a better residential investment outcome.

We are also somewhat surprised to see no offsetting rise in inventories to this sharp fall in domestic demand. That said, let's not forget that Japan was hit by Typhoon Jebi in September, and that caused substantial economic disruption in the West of the country. The impact looks to have been far greater than the high-frequency data suggested. But the aftermath of such natural disasters is almost always positive, so we would anticipate an even stronger bounceback in 4Q - and no need to alter any full-year forecasts or JPY outlooks.

Asia Day Ahead - waiting for China

We've already had much of the data for today, though the big data drop from China is still to come, with fixed asset investment and industrial production likely to look OK and supported by tariff front-running activity (though for how long...?). Retail sales are also in the spotlight.

South Korea's unemployment rate (released already) fell to 3.9% in October, from 4.0% in September, which is a positive outcome after some recent disappointments in terms of activity. The economically active population was roughly unchanged (down very slightly, 16,000). but employment rose by a more significant 35,000, almost all of whom were employed in the construction sector and business / personal services (public sector?). in contrast, there was a big drop in retail and hospitality sectors (aftermath of minimum wages and hours legislation?). The most positive aspect of this report is the 51,000 decline in unemployment.

The Bank of Thailand is also meeting today - we don't anticipate any policy change from them. Recent data-flow has been disappointing, and we anticipate a soft 3Q18 GDP release next week, so any tightening would be unwarranted.

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