

19 April 2018
Opinion

More of the same

It feels like nothing has changed - more concern about the slope of the US yield curve and debt

Some things never change

It doesn't feel as if I have been away. Markets are roughly where I left them more than 2 weeks ago, and the same stories are doing the rounds on the newswires. Top of the bill today, the slope of the yield curve, and does it / doesn't it present cause for worry?

I have written about this before, at great length. So won't bore you with a repeat. But the simple answer is, no, not reliably, and less now than previously. Why? Past policies of QE. Enough said. Moreover, the fact that some members of the Fed are openly fretting about this now helps me to rant in a slightly different direction - forward guidance.

You know how more information is always good, right? Wrong. Well at least when that "information" isn't information at all, but the misguided worries of certain individuals at central banks. What I mean is this: Even the best-staffed research department at a central bank like the US Federal Reserve will tend to have a poorer grasp of where markets and indeed the economy are heading, than the collective wisdom of markets themselves. That's you and me. Not individually sadly, but collectively. So let's consider what people like the usually very sensible James Bullard and now William Dudley are now saying about the flattening yield curve, contrast it to their other colleagues, such as Eric Rosengren, and realize that one, or perhaps all of them are probably wrong.

Markets can, of course, be mispriced. And I think this is part of the problem for the yield-curve. But this too comes from years of forward-guidance aimed at keeping longer-dated yields low. That is proving a hard habit to break, even as the Fed unwinds its balance sheet. But it should get a helping hand from the other story today, the IMF's concern over burgeoning US public debt, which is set to exceed even that of Italy (as a % of GDP).

Saying all that, I think one point is worth making here, very plainly. High debt does not increase the chances of things going wrong for the economy. What high debt does is make the consequences of things going wrong in the economy considerably worse. So we can't smoothly segue from the yield curve story to US debt. Moreover, rising US debt levels are perhaps one of the strongest reasons for concluding that what is wrong with the yield curve story, is not expectations for Fed tightening, which seem broadly on the mark, or the appropriateness of that policy, which seems both restrained and reasonable to my mind, but the yield and expectations of that yield on longer-dated debt itself. Yes, markets can get it wrong too.

\$-Bloc...nothing happening here

So the Bank of Canada (BoC) left policy rates alone last night as widely expected, and BoC Governor Stephen Poloz remarked that higher rates will be required over time. But there seems no immediate rush. The economy needs more room to grow, Poloz added. And even though Canada's central bank raised its own forecasts for GDP growth this year, they also raised their forecasts for potential growth, enabling them to sit on their hands for longer. That's a useful trick, and ties in with some comments from other central banks, namely the ECB, that as the recovery takes root, potential growth also expands. This isn't totally daft, though the ECB has stretched that argument

further than is reasonable, in my view. Canada not so much. We do expect them to tighten policy later this year, but not until 3Q18.

New Zealand 1Q CPI out earlier today also indicates no urgency for the Reserve Bank of New Zealand (RBNZ) to act. At 1.1%YoY, inflation is nowhere close to requiring a policy response. Indeed, less so than ever now with the RBNZ's new dual mandate for both growth and inflation.

Moving on to Australia, labour market data today, which will likely be quite upbeat, will also still provide no strong impetus for the RBA to tighten imminently, without some movement in CPI or wages. These are stirring, but remain sufficiently subdued for us to believe no tightening will be necessary until 4Q18, for both the RBA and RBNZ.

Robert Carnell

Chief Economist Head of Research, Asia-Pacific

+65 6232 6020

robert.carnell@asia.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 NV 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. The producing legal entity 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 subject to limited regulation by the Financial Conduct Authority (FCA). 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.