

New conundrum could be good for Asia

With bond yields falling further, one explanation for this could indicate a more supportive environment for Asian economies.



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Low growth world ahead - I doubt it

As the world's most dynamic region, the Asian market concern about an approaching slow-growth decade - presaged by falling US Treasury yields is worth pondering, but only briefly. The explanation for this slow growth angst, given out freely by newswires this morning, seems to stem mainly from a single data release, the July US non-manufacturing ISM index.

The index did fall several points, but at 60.1, remains in what I would normally regard as an extremely healthy level. Moreover, this index is quite nuanced in that it is a measure of how the future will look relative to the past - will activity be "**stronger**"? Not necessarily "will it be strong". As such, it is subject to all the same vagaries as year-on-year measures, when the past is strong, the future may not show much improvement even when it is still in absolute terms "strong".

For the same reason as you cannot accelerate indefinitely, this index cannot point to ever-stronger growth indefinitely. No, there is really nothing in the ISM data that is worth a 7bp decline in Treasury yields.

Our Head of rates strategy, Padhraic Garvey, [writes in his latest rates spark about this issue](#) (ahead

of the ISM data, which he rightly dismissed in importance) and he touches on an important aspect of what may be going on.

He notes that expectations for rates, even though rate hike expectations may have been drawing closer, do not rise very far. Indeed, if you look at simpler measures than he does in his note, for example, at the implied rates on the Fed funds contract as far out as you can go, rates don't even get to 1.25% by 2026.

This, it seems to me, could be the key message we should be taking away from recent market movements. Rates may well rise a lot sooner than many of us are expecting. In Asia-Pacific, [the RBA yesterday seemed to undertake a shuffling of its positions](#) to allow for some earlier forward guidance than it has been making. 2023 rather than 2024 may soon be the new guidance. But like the Fed, some may consider an even earlier hike a possibility.

The Bank of Korea, likewise has already indicated that [it might like to start the normalization process this year](#). That still seems a bit aggressive to us while the jury is still out on Covid containment. But even here, we suspect that very high household debt levels in South Korea mean that rates may not rise much at all over the coming business cycle before they start to weigh on growth.

And elsewhere in the region, even when we don't see much imminent change in policy rates, where rates have been aggressively cut, some small reversals of emergency easing could come in sooner than expected, though may also stop well short of what we might consider a "tightening cycle".

So if longer-dated maturities are a function of the sum of shorter maturities, plus a term premium, which in theory, they are, then the rate at which longer-dated bond yields settles may not even be as high as the forecast peak in rates for this cycle, bearing in mind that there may well be subsequent declines. Can this conjecture square the circle with the pressure on prices we keep seeing? To some degree, I think it can. Sooner, but lower in total could well help us to reconcile what appears to be the new conundrum. It is also an outcome that is likely to be less hostile for Asian emerging markets, which would struggle more with a protracted tightening schedule by the Fed and major central banks, but could probably weather a shorter and capped tightening cycle better, depending on how the USD responds.

Dataflow today - not much

It is a quiet day today in Asia for data, with Taiwan trade and CPI data the highlights: Iris Pang in Hong Kong writes, "Taiwan trade data released today will likely point to faster growth, even during a month in which Covid picked up and led to stricter social distancing measures. And this is all because of the low base last year.

We also expect Taiwan CPI to edge down on a yearly basis, reflecting the impact of rising Covid rates on the economy, which would also match the higher unemployment rate released yesterday. The unemployment rate came in at 4.1% in May from 3.6% in April.

As a result, we expect a weaker TWD against the dollar as Covid continues to limit people flows".

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

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

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com