Searching for a theme

Several weeks of absence has not led to a build-up of exciting themes - persistently low inflation is the stand out

arrows

Distance brings perspective - usually

A couple of weeks away usually helps put the global macro and market story into a better perspective. Getting away from the thick of the woods does really seem to make the trees stand out better. Not so much this time, though things have definitely changed. Some of the big worries seem to have been replaced by smaller but persistent irritants. A few weeks ago, we spent time mulling the prospects of a global recession. We didn't buy into that story then and it seems to have largely gone away. Little time is also spent worrying about a Chinese hard landing - that too has been written off, as too are concerns about an escalating trade war.

Some central banks are returning to action

The persistent irritant comes from the observation that central banks no longer seem to have any of the answers to a persistent undershoot of inflation or of tepid growth. Those central banks that might have spent some of this year starting or extending policy normalization seem on hold, as inflation stays low, whilst others now look likely to move the cycle back towards easing. Illustrating the former group, Bank Indonesia will likely fall into this camp today, and in all likelihood, so too will the Bank of Japan. Yesterday's inflation driven hit on the AUD, as Reserve Bank of Australia rate cut expectations mount is a good example of the latter case. The RBNZ may be close behind in cutting.

A new approach may be needed to deal with "lowflation"

So if there is one thing that stands out amidst a sea of "meh!", it is the slow chipping away at the growth/inflation framework that central banks have relied on as the yardstick for how to set policy. For all of the aggressive easing of past years to spur recovery, today's economies simply don't seem to respond to lower rates with much stronger activity or with higher prices or wages. The question is, should central banks respond with even more aggressive easing. We are beginning to suspect not, though that doesn't mean we don't think Central Banks like the RBA will hold back. They just won't achieve much by sliding back in the direction of zero rates.

Outlook for the BoK changes after terrible GDP

Another central bank that may well be reflecting over recent decisions to leave rates on hold is the Bank of Korea. They left rates at 1.75% at their meeting whilst I was on holiday earlier this month. I had thought that there was a chance they would cut. Their October 2018 25bp rate hike was hard to reconcile with the data back then, and it now looks clear that it was premature as the economy contracted -0.3%QoQ in 1Q19 to take year on year growth down to only 1.8%. 4Q18 GDP growth was 3.1% in comparison.

The KRW has already hit our 2Q19 target of 1150, and we may have to extend that forecast higher as expectations will surely mount that the BoK will reverse last year's decision, or even exceed it in reverse. Korean Treasury bonds also look set to see yields approach or push through the March lows, perhaps breaching the 1.8% level.

But until the global technology slump passes, this probably won't do all that much good. Government concern about the build-up of South Korean household debt may have some justification. And sometimes, a slowdown like this is inevitable. But finding the right balance between fighting the business cycle only to drive through undesirable unintended consequences is hard to do. Inaction will be criticized as weakness, and central bank independence will be threatened. There are no easy answers to this.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

Disclaimer