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ECONOMICS

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UK

Negative interest rates on the back burner for now

- Following three months of the emergency stimulus introduced by the Bank of England (BoE), the situation looks different now. A combination of a £200 billion quantitative easing package and the bank's commercial paper scheme has helped return money markets to something closer to normality.

- However, the economic outlook remains uncertain. While government schemes have helped avoid a spike in unemployment, concerns are brewing on the longer-lasting impact, especially as firms adjust to social distancing. On that note, the decision to expand quantitative easing albeit buying at a slower pace is not surprising.

- Given that the current buying pace of the original £200bil expansion would have only sustained purchases for about another month, the central bank has topped up the programme by £100bil. Assuming the pace of purchases remains around £10–11bil per week, it should last until sometime in September. However, the policymakers have signalled that the new £100b injection will be completed by the "turn of the year". This would mean that the rate of purchases will roughly halve.

- Negative rates are still probably low on the list of favoured tools for now and this may change as the economy moves ahead. While the economy could show some green shoots with broader areas of the economy reopening in the coming weeks, it is still unlikely for it to return to pre-virus levels for a year or two.

- Thus, with the need to support the economy, discussions will still centre around the need for negative rates. Although this topic was not discussed in the latest meeting, policymakers have been generally more open to the idea in recent weeks. We feel this mechanism will remain the least favoured tool given the potential costs and documented evidence seen in Europe and Japan has so far, which has been mixed.

- Nonetheless, we are not ruling out the possibility of negative rates as the economy moves ahead. An alternative option for the central bank to consider would be to adjust the term funding scheme (TFS) to offer banks cheaper funding on the basis that they increase lending to SMEs.

Indonesia

Room for more monetary easing

- The central bank's new projections are not exciting. Emerging from the partial lockdown in June, the economy is showing signs of stress from both trade and PMI data, indicating the 2Q GDP may contract.

- Bank Indonesia announced a downward revision to GDP growth for 2020 with the growth to expand by just 0.9–1.9%. Meanwhile, the central bank's latest forecast on the current account deficit is expected to settle at 1.5% of GDP due to import compression. What is clear is that the economic outlook remains dim.

- With economic growth faltering, the currency stability has allowed the central bank to cut rates in a move to shore up the sagging growth momentum. The central bank lowered its 7-day reverse repurchase rate policy rate by 25bps to 4.25%.

- Although the rupiah has been steady of late, it remains "undervalued". The currency could enjoy another bout of strengthening in the near term based on the economic fundamentals.

- With both inflation and the currency enjoying some stability, we expect the central bank to cut policy rates further in 3Q with the economy sorely in need of additional stimulus from both fiscal and monetary authorities.

Next week's focus on central banks decisions will be China, Philippines, Thailand and NZ.

- During the lockdown months when economic activities were hurt, calls for more policy easing were central. But with the lockdowns being lifted and economies slowly getting back on their feet, the focus now is on whether the aggressive fiscal and monetary easing that are already in place will facilitate a recovery before more easing is introduced. This is a tough challenge for central banks with barely any space left to manoeuvre.

- The clear candidates for next week are the Reserve Bank of New Zealand (0.25%) and the Bank of Thailand (0.50%). Both have hit their limits on rate policy easing. Their Covid-19 lockdowns have ended and their economies are back in action.

- The People's Bank of China will carry out its monthly exercise of adjusting the prime lending rates next week. Boosting economic growth remains a top priority for the central bank amid a second wave of the Covid-19 outbreak. It supports our view for a 10–20bps cut on the 1-year and 5-year lending rates.

- In the Philippines, Bangko Sentral ng Pilipinas (BSP) will take advantage of a strong currency and falling inflation to cut the policy rate by another 25bps.

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