Covid-19, Asia's lamentable green response, and a slow, slow recovery

The woeful environmental response in most Asia-Pacific countries is the pick of our reports this week from ING Research. We're including the full report and the main summary article. We examine the desperate GDP numbers from major countries as well as also trying to predict where next for rates

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By Chris Turner and Francesco Pesole

Article | 11 August 2020

Asia's lamentable green Covid-19 response

The Covid-19 crisis has offered governments around the world an opportunity for a total rethink on how their economies will operate in the decades to come. Few governments in the Asia-Pacific region appear to have grasped this chance, with most choosing easier, but arguably less effective traditional stimulus approaches. Download the full report here

Rarely spotted dugongs swimming in clearer waters off the coast of Thailand

The environmental impact of Covid-19

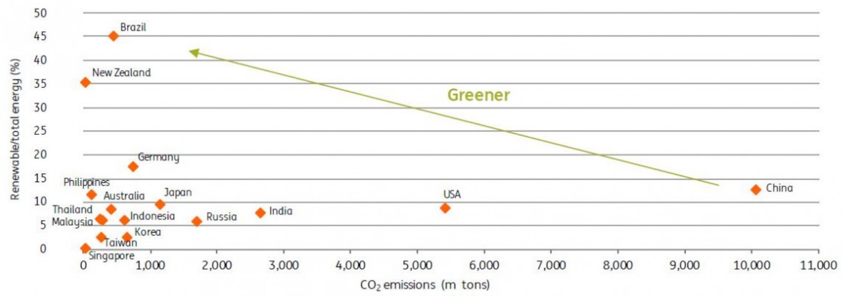
With most of our economies likely to look very different when we finally emerge from social distancing, this is being seen by some countries and regions as a once-in-a-lifetime opportunity to lock in these environmental gains. The fiscal rule books have been ripped up, and cost can no longer be cited as an excuse for inaction. This isn't quite a clean slate for a total rethink of our economies, but it is probably the closest thing to that we will ever get.

A once-in-a-lifetime opportunity

Regions such as the European Union, are using the pandemic as an opportunity to press the restart button on their economies and to focus hard on the environment. The UK too seems to be reinventing some green credentials and is also increasing its stimulus to measures concerned with energy efficiency. But is the same true for the Asia Pacific region? Is Asia reaching for the environment reset button too?

The short answer to that question, which we shall address in detail shortly, appears, disappointingly, to be a resounding "no". And this is particularly disappointing when you consider the big role Asia-Pacific plays in greenhouse gas emissions and global warming.

Total CO2 emissions vs Renewables as % of total primary energy consumption (2018)



Source: Global Carbon Atlas, BP Statistical Review of World Energy

Asia state of play

The APAC region is a substantial carbon emitter, making up around 47% of total global emissions. It really is no surprise that China is the main contributor, making up around 58% of the APAC total, or almost 28% of total global emissions. For comparison, the US contributes 15% to total emissions, whilst the EU's share is a mere 9%. Since 2000, carbon emissions from the APAC region have grown by 125% (China's emissions over the period have grown by about 200%), while over the same period US and EU emissions have declined by 10% and 18% respectively.

It is always going to be a difficult task for developed countries, which have already passed their peak industrialisation phase to persuade emerging economies to cut their emissions when these economies are focused on growth. On top of which, the low price environment we are currently seeing in fossil fuels will do little to push these emerging economies towards meaningful green policies.

Climate targets reached and missed

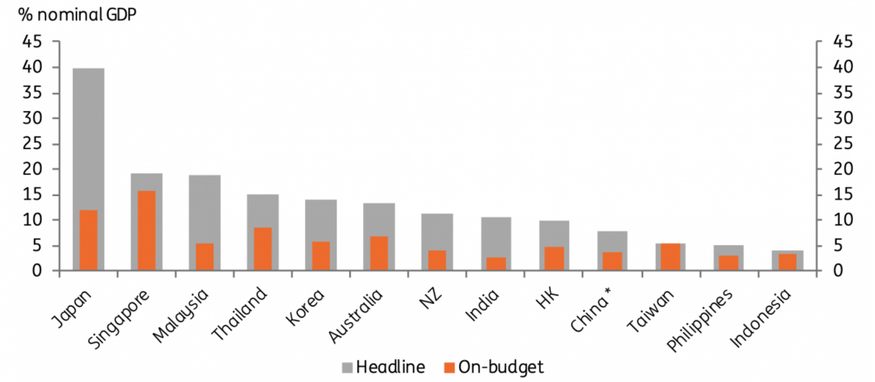
However, saying that, a number of countries within APAC have agreed on some target reductions. This includes the Copenhagen Accord, where participating countries agreed to reach certain emission targets by 2020. The results of this have been mixed for the region and for the vast majority of Asian countries participating, their target was more focused on reducing carbon intensity or reducing carbon emissions from "business as usual" (BAU) projections. Therefore, overall emissions from these countries are still clearly trending higher. But the likes of China and India have hit their targets, and have done so ahead of schedule.

China has managed to reduce carbon emission intensity by 40-45% from 2005 levels, whilst India reduced emission intensity by 20-25% from 2005 levels. Australia, New Zealand and Japan all pledged to reduce overall emissions by 2020, and unfortunately with the exception of Japan, it looks as if they will miss these targets. Australia was initially on track, with a carbon tax that was introduced in 2011, however, this was repealed in 2014, which has not helped. As for the Paris Agreement, it is yet to be seen how countries in the region will perform.

Are nationally determined contributions from countries ambitious enough?

Under current policies, the UN expects that of G20 members in the region, only China and India will achieve their 2030 targets, whilst Australia, Japan, South Korea and Indonesia will need additional policies to reach their targets. In addition, there are questions around whether the nationally determined contributions from countries are ambitious enough, with many of them falling short of the share that would be needed so that collectively, global warming limits are achieved. Therefore in the absence of more aggressive targets, we will need to see deeper cuts from other regions in order to meet the 1.5 degree Celsius increase target agreed under the Paris Agreement.

Fiscal packages – claimed and "real" (on-budget)



Source: ING, Local Finance Ministries, Newswires

Fiscal spending has been substantial

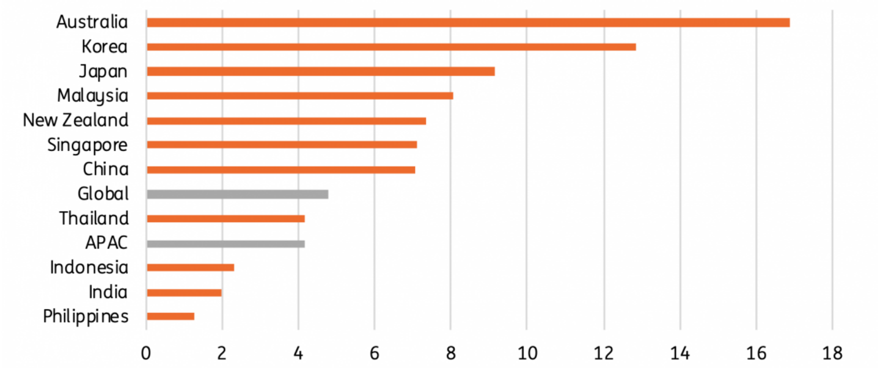
Setting the stage for some potential shift of government focus on the environment, fiscal stimulus plans in the APAC region have been huge. The convention in this part of the world is to throw the kitchen sink into official estimates of the scale of stimulus. Exactly why this is done is not clear, as it must be pretty obvious to most people that counting figures already included in previous budgets, soft loans and funds that will never be drawn or grants that will never be disbursed is not likely to provide much in the way of stimulus.

In the chart above, we show the difference between "on-balance sheet" spending figures, which we can reliably assume will make it into the economy and provide some support, and the myriad of other measures, which in all likelihood, largely won't, but which do boost the headline. Japan takes the gold medal for implausibly large support claims. But even their on-balance sheet figures probably won't all see the light of day in the 2020/21 period, and we would be extremely surprised if this significantly nudges the needle on Japan's perennially soft GDP growth.

How much of this spending can be described as green?

Others, notably Australia, New Zealand and Singapore are employing a lot more "real" support. And while this still probably won't lead to stellar growth, it will provide some insurance that there is at least an economy left to recover when Covid-19 is finally brought under control. But how much, if any, of this spending can be described as green? Has the world's largest emitting region, Asia-Pacific (50% of total global CO2 emissions), taken a leaf out of the world's greenest region, Europe (12%) ? Or is it back to business as usual?

Per capita CO2 emissions (2018)



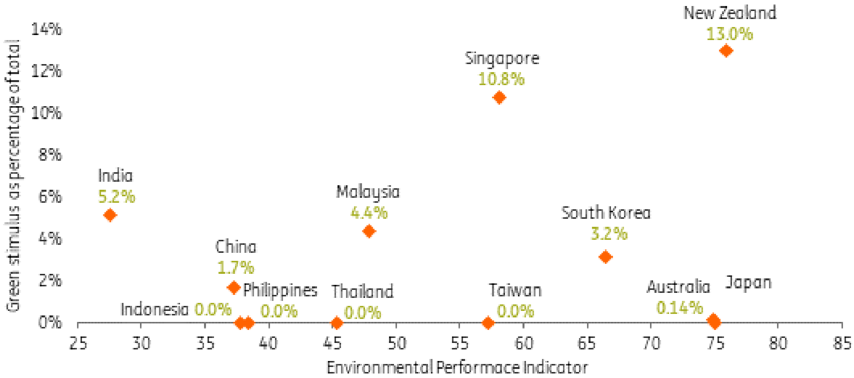
Source: Global Carbon Atlas, UN

Reasons why Asia has not acted

That the near absence of any green policies in Asia's Covid-stimulus packages is a missed opportunity is one thing, it is doubly disappointing given how important Asia- Pacific is for global greenhouse gas emissions. This was an opportunity not just to catch up with other regions, but to restore trajectories towards Paris Agreement objectives. Instead, several countries in our region have taken decisions which lock themselves into a trajectory of even higher greenhouse gas emissions from which it will be even harder to back-pedal.

The chart below shows green stimulus as a % of total Covid-19 stimulus measures, plotted against their Environmental Performance Index. For a disappointing number of countries, their marker has not even risen off the X-axis. It looks as if the poorer the EPI, the less effort has been made to improve conditions with Covid-19 stimulus – whereas those with better scores continue to make more efforts. For environmental targets to be achieved globally, we need to see this chart deliver the opposite slope.

Environmental Performance Indicator and green spending as a percentage of total Covid-19 stimulus



The power of green stimuli

One or two countries were already placing more stress on the environment before the pandemic (India, China), and the dearth of specifically green policies in their Covid-19 stimulus packages can be partly explained via a background of general environmental progress. But while there is undoubtedly some truth in this, you could also make this argument for Europe, and they have not shirked from a much bolder environmental push. Indeed, to many, this will sound a fairly hollow excuse. Others may not explicitly be embarking on environmentally harmful stimulus policies themselves, but are continuing to fund these overseas.

This is a particular trait of some of Asia's richer countries (e.g. Japan) which are continuing to fund coal-fuelled electricity generation capacity in developing nations as they look for a quick, and quite literally dirty boost to the economy. Others have talked up their green credentials while delivering relatively little in terms of actual spending (South Korea falls into this camp). Only New Zealand comes out of this analysis looking like it has enhanced its green credentials to any extent. Singapore may possibly also come out on the positive side of the ledger.

There don't seem to be any clear reasons why countries in Asia-Pacific have not taken a greener route to Covid-19 stimulus. A lack of imagination enhanced by lower cultural weights placed on environmental sustainability than on economic growth and wealth creation probably explains part of this outcome. That said, research suggests that in many if not most cases, green stimuli can deliver a stronger boost to the economy than other policies, and generate a greater number of jobs. So if this is the reason, it may well be a misguided one.

Download the full report

You can download our full report here.

From China to Japan, India, Thailand, Australia, Malaysia and beyond, we look at where we stand, what 'green' measures have been taken and what more perhaps could have been considered as the world adapts to the new Covid-19 realities.

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Report | 11 August 2020

Asia's lamentable green Covid-19 response

The Covid-19 pandemic has offered governments around the world an opportunity for a total rethink on how their economies will operate in the decades to come. Few governments in the Asia-Pacific region appear to have grasped this chance. Our major report looks at what we're calling a 'lamentable response'

Rarely spotted dugongs swimming in clearer waters off the coast of Thailand

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Article | 14 August 2020

Rates: where to now?

The move higher and steeper in global rates should extend further in the near term, up to 0.90% in 10Y US Treasuries. We see it as mainly technical and not supported by fundamentals but supply pressure continues to be felt

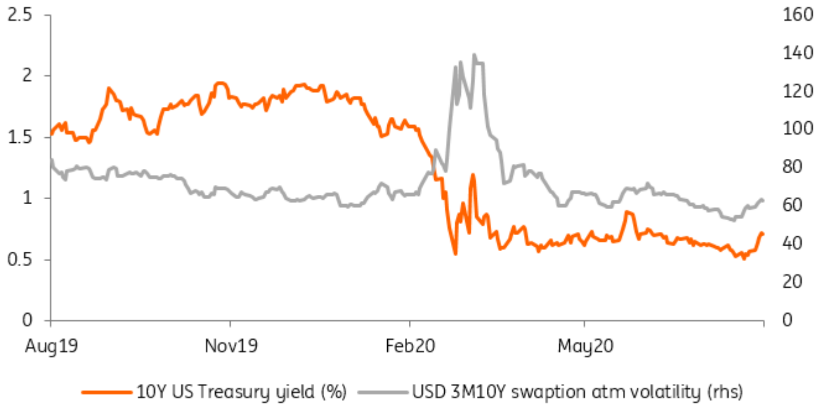
Ground zero: US Treasury supply pressure

The week came and went and with it the adjustment higher and steeper in the USD yield curve driven mostly by supply as we expected. Given that we withheld our judgment about the prospect for another leg higher in USD rates until after the result of yesterday's 30Y auction, we owe you a tactical rates direction update.

The auction itself was poor. Besides the lower bid to cover ratio and discount compared to secondary market levels, weak price action around the sale speaks to the soft demand. The signal about the US Treasury market's ability to absorb large amounts of duration is not encouraging, especially as the Treasury has another $25bn 20Y auction lined up next week.

Truth be told, we tend to be dismissive of the macroeconomic drivers behind the adjustment higher in rates. Granted, economic data of late have presented investors with a glimmer of hope but the outlook remains resolutely gloomy, especially with diminished fiscal support to US consumers. If there is a relevant macro backdrop to this adjustment higher in rates, it is to be found in the lengthening duration of government supply.

The move higher in rates and volatility has been modest so far



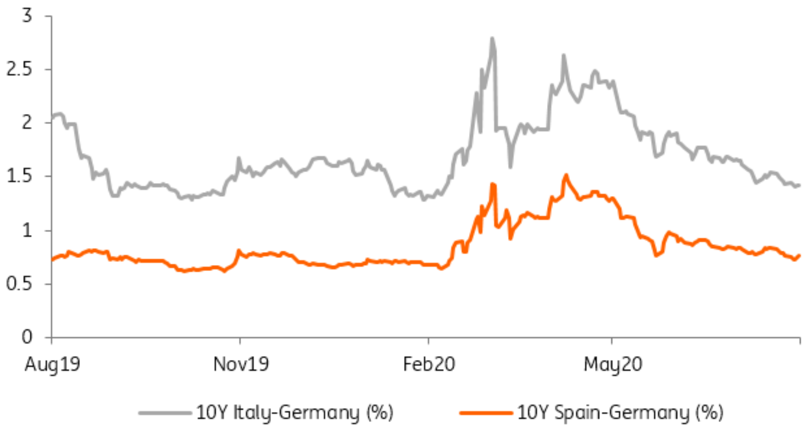
Near-term target: 0.90% in 10Y US Treasuries

Both in EUR and USD, the prospect for higher duration issuance is well flagged and our expectation was that yield curves would have to adjust steeper at the end of August to accommodate it. Markets being forward-looking in nature, it is not entirely surprising the move came a couple of weeks earlier than we thought.

In short, we see the August rates sell-off has having called time on carry-driven summer trading conditions. Low realised rates volatility is key in attracting investors to fixed income assets over the summer months. The recent sharp adjustment higher has shattered that illusion which in turn should limit rates' ability to revisit their recent lows, both in EUR and USD. This is all the more true since a lot of the bad economic news is already priced in, for instance, Congress's inability to reach a deal on fiscal support for the US economy.

Going forward, USD rates strike us as having a greater scope to adjust higher. 10Y US Treasury yields are currently about 20bp from their all-time lows, and we see scope for the move to extend another 20bp to 0.90%, the level reached in its June spike. To be clear, we have doubts about the fundamental case for higher rates but think summer liquidity conditions and angst about the upcoming wall of supply skews the odds in favour of higher rates.

Peripheral spreads undeterred



Source: Bloomberg, ING

Beyond US Treasuries: No threat to periphery spread tighteners

In the near term, stocks and the Fed are the potential kill switches to a USD rates sell-off. On the former: risk assets do not seem troubled by the, admittedly small by historical standards, rise in rates and rates' volatility so far. A correction lower in risk assets would help stabilise price action in US Treasury by re-directing some much-needed flight to quality flow toward them. Fed verbal intervention could also help investors regain confidence in US Treasuries. The Fed's caution in its recent communication echoes our own, but we think something more tangible, for instance, a discussion of longer duration of QE purchases in next week's FOMC minutes, is needed.

In EUR rates, we feel this is not enough to call our view of ever-tighter peripheral spreads into question. Granted, higher rates' volatility puts carry-driven longs in peripheral bonds at risk but, as our economics team pointed out, hopes of the ECB boosting PEPP should more than offset this temporary spike. We thus stick to our 125bp target for 10Y Italy-Germany spreads. Core and EUR swap rates should suffer from the same pullback as their USD counterparts but we see their capacity to rise as being more limited. The result should be a further widening of USD-EUR yield spreads.

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Opinion | 14 August 2020 **Japan**

Prepare for another huge fall in Japanese GDP

A fall of about 20% (annualised) in second-quarter Japanese GDP is not a big event these days - but for what it is worth, this is how we arrive at our forecasts

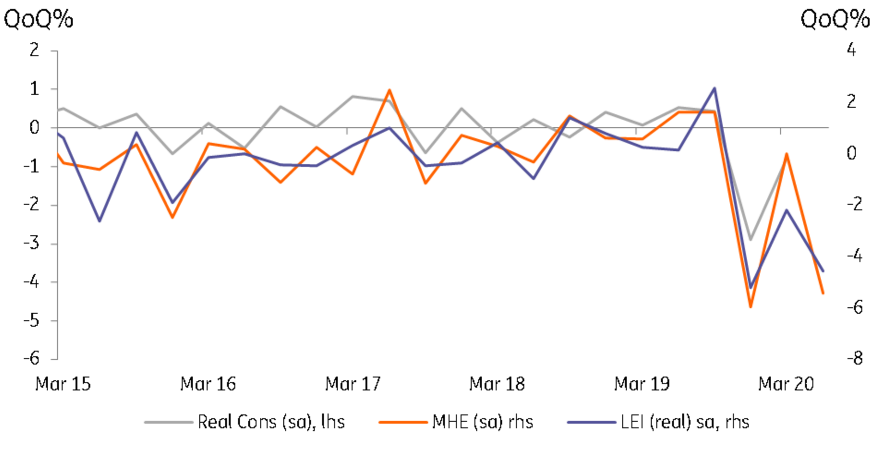
Japanese Prime Minister,Shinzo Abe, in a national address earlier this year

Private consumption down 19%

At 56% of real GDP, private consumer spending is the biggest component of the GDP forecast, so if we get this wrong, it will colour the entire forecast. So we take two approaches to this. Firstly, we seasonally adjust the monthly household expenditure (MHE) data, which is a nominal series, so we also ought to deflate this (though with inflation so low currently, it's not essential). As an audit on this approach, we also take the real living expenditure (LEI) survey data, which is already adjusted for prices and seasonal adjustment.

Both indices point to strong contractions, which equate to about a 5% QoQ decline in private consumer spending, or about a 19% decline at a seasonally adjusted annualised rate (SAAR).

Private consumer spending forecast



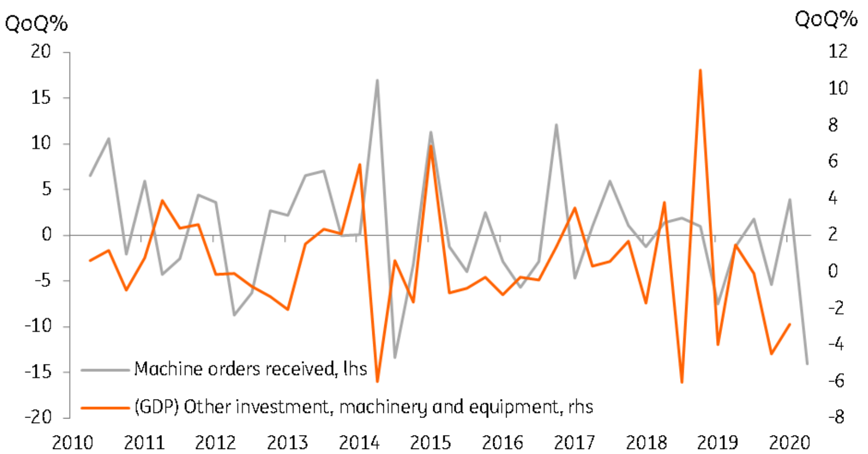
Source: ING

Private consumer spending - Japan

Investment

Private business investment in plant and machinery is another sizeable component of GDP (about 15.6% of the total), but more volatile than consumer spending. So while consumption is bigger, you are more likely to get investment wrong. There are a number of higher frequency economic series we can look at to help us judge how this will work out, but the machinery orders series is a good place to start. All such indices point to sharp declines in business investment of a little under 6% QoQ, or about a 21% fall (SAAR).

Business investment



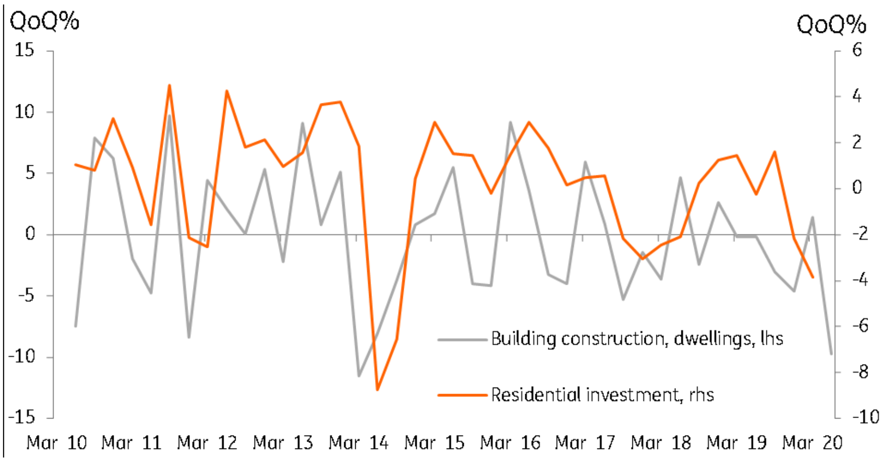
Source: ING

Residential investment

Residential investment accounts for less than 3% of total real GDP, so we don't need to be too careful about this, although it is also volatile, and scope for error is large. From monthly construction data on dwellings, it appears that private residential investment will decline by about 7.5% QoQ in 2Q20.

Another component of investment is government investment. This is typically captured by series on the construction of non-residential buildings and structures (roads, bridges, schools, hospitals etc). At about 5% of GDP, it is a bit larger than residential construction, but it is also hard to find consistent data proxies. Our data suggests about a 5.8%QoQ increase, reflecting the government's stimulus measures, and is one of the few positive contributions to private domestic demand this quarter. But this is not a high conviction part of the forecast and this could well contribute significantly to any overall forecasting error.

Private residential investment



Source: ING

Residential investment

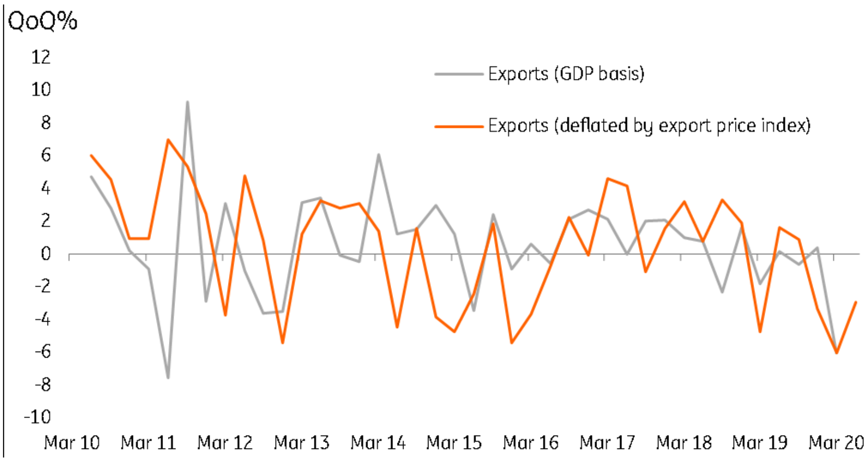
Trade

Net trade could be a substantial drag on GDP in 2Q20. But exactly how much remains an open question. Quarterly nominal export growth fell by about 6%QoQ in the second quarter. The equivalent figure for imports actually rose by 2%. But those figures have to be deflated for export and import price changes, and this series was very volatile in 2Q20, with export prices falling 3% (increasing the real decline in exports), while if we can believe the data, import prices fell by more than 12% over the quarter (increasing the rise in real imports).

For all the number crunching, the correlation between price adjusted trade data and the GDP series is not very good, so we have applied a liberal dose of "wet finger" to this part of the forecast, and again, the scope for error is large.

Loosely tied to the net trade figures is private inventory adjustment. Together with trade, this component can deliver a big shock to forecasters, as it is often the repository for whatever the official statisticians could not find a home for in other components. GDP negative import surges in the trade data, such as we have here, are often accompanied by big (GDP positive) surges in inventories. Monthly inventory data is of almost no help in gauging the extent of this, and we are left making an educated guess about the extent of the import surge in 2Q that simply accrued to inventories. Our best guess is that the net effect of this is to roughly halve the drag that would have occurred from net trade.

Exports



Source: ING

Putting it all together, about -20% (SAAR) seems right

When you throw all of the various constituent parts of this GDP forecast into a spreadsheet and add them all up, what drops out is a QoQ decline of a little under 5%, which delivers an annualised decline in the region of 20%.

We would not be surprised to see the number come in considerably different to this, though this is also not far from the consensus view (about a 25% decline). In terms of the risk to this forecast, it probably lies in a slightly less awful (less negative) figure, and will probably come through surprises in the net trade and inventory contributions. Nevertheless, it is difficult to see the market reading in anything particular positive into an annualised GDP decline of close to 20%, even if it comes in below consensus, so the market response, in that case, might be quite muted.

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The Netherlands: Ouch, that GDP number hurts

Dutch GDP fell by 8.5% in the second quarter of 2020, delivering the worst performance ever recorded. Although the mechanics of the lockdown promise strong growth figures for the third quarter, a complete V-shaped recovery seems unlikely

Source: Shutterstock
Airport traffic down during coronavirus restrictions in Netherlands, Schiphol

-8.5% GDP growth rate

2Q20 (QoQ)

Especially bad numbers for investment, but largest drag from households consumption

Compared to 4Q19, Dutch GDP was down 9.9% in 2Q20, dwarfing the total top-to-bottom fall during the global financial crisis of 4.3%, although it is fair to say that the recovery kicked off much quicker now.

Among expenditures, gross capital investment declined the most compared to the first quarter at (-12.4%) and investment in transportation equipment nosedived (-48%). Only investment in IT-equipment rose (3.1%).

Consumption by households (-10.4%) also fell in double digits, even though these expenditures were on the rise again in May and June. In fact, retail sales surpassed pre-Covid-19 levels for two months in a row, however, this didn't prevent household consumption from delivering the largest negative contribution of all expenditures (-4.6%-points).

Public consumption dropped 3%. Exports declined by 9.8% QoQ, while imports fell by 8.3%, leaving a net trade contribution of -2.1%.

While service sectors felt the decline, retail sales expanded

Among the major industries, agriculture and fishery (-2.4%) and water & waste management (-3.0%) declined the least in value-added, in large part because these sectors were not restricted by the Dutch government. Gas & oil (15.1%) and utilities (6.3%) actually expanded. The large “commercial service sector” declined by 8.7% QoQ, non-commercial services by 11.4% and construction by 8.8%. As noted, the retail component of commercial services actually increased QoQ, especially online. DIY, furniture and consumer electronic shops performed well. On the contrary, sales of clothing shops and pharmacies declined.

Manufacturing/industry also took a considerable hit of -7.7%, but the Dutch numbers look quite favourable in comparison to a number of European counterparts.

Calendar adjusted production was -8.6% year-on-year in June compared to the eurozone average of -12.3%. It is notable that the composite manufacturing NEVI PMI (purchasing managers' index) never bottomed at the record lows of the global financial crisis. Coming in at 47.9 at the start of July, it is still not indicating growth, but compared to the readings of previous month's pessimism is steadily declining. In fact, the sub-indicator on future production was clearly signalling growth for the second month in a row.

The pace of recovery, however, seems more uncertain for industry than for retail and parts of the service sector, since it depends to a large extent on foreign demand picking up.

Mild policy response to rising number of cases

Like every other European country, the number of new daily Covid-19 cases continues to rise during the summer. Even though April levels of cases have not yet been reached, members of the government came back early from their summer break to deliver new containment measures on 6 August.

The new measures by no means imply a return to the first and most strictest lockdown.

Closure of specific bars and restaurants for 14 days has been made possible if several infections took place there. This was accompanied by increased contact information requirements for people visiting bars and restaurants. Furthermore, local officials were granted the authority to impose stricter opening hours for bars, restaurants and night shops and rules for crowd control for events such as football matches.

There would also be more testing of people travelling via the national airport Schiphol. All in all, the press conference was merely a call upon the public to show better behaviour rather than introduce major containment policies. For economic activity in the third quarter, this means that the recovery that took off in May and June can continue, barring new future measures to contain the virus of course.

Full recovery still far away

Although a large decline was expected for 2Q20, the outcome is somewhat more favourable than we forecasted in our baseline scenario. Even though we expect considerable growth for the third quarter, unemployment and bankruptcies are set to rise as firms are still in the process of adjusting to the massive output shock.

So even in the absence of a second lockdown, which still cannot be fully ruled out, it will likely take years rather than a few quarters for the economy to fully recover.

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Snap | 12 August 2020

Eurozone industrial production recovers, but it's far from completing the V

The mechanical recovery from lockdown remains underway and has not yet lost speed. This is encouraging, but at -11.6% below February levels, it is still unclear how large the lasting damage will be

Workers at a Mercedes factory in Germany

Industrial production grew by 9.1% in June, confirming that the recovery from lockdown continues to quickly add to production. The recovery can be considered mechanical as mandatory shutdowns and voluntary closures or limited production to curb the virus have been gradually lifted, causing production to automatically increase. The 9.1% increase follows a 12.3% increase in May, meaning that the pace of recovery has fallen only slightly in the second month of reopening. The improvements were widespread across production categories with non-durable consumer goods production even accelerating in June.

Recent survey data has been encouraging

The improvements still leave production at -11.6% compared to February, which means that there is still a large gap to bridge to pre-coronavirus production even though the start of the recovery is v-shaped. Whether the V will be completed in the summer months remains the question. We expect that it will fall short due to a lack of demand in the aftermath of the crisis, supply chain disruptions and even a possible flareup of the trade war. We now have to ask at what point will the mechanical recovery level off, giving a better idea of the lasting damage of the coronavirus crisis.

Even though it is unlikely that the V will be completed soon, recent survey data has been encouraging. Manufacturing businesses indicate that output has continued to recover in July and that new orders have also been returning quickly. Some pent-up demand will likely continue to cause industrial production to trend higher in the coming months, but due to all the downside risks to the manufacturing outlook, concerns about a sustained quick recovery of production remain justified.

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China’s central bank unlikely to ease further this year

With such unexpectedly small credit growth, we believe China's central bank has used actions rather than words to let the market know that it won't be easing any more this year

Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

Chinese credit growth was unexpectedly low in July

New yuan loans were only CNY992.7 billion in July, falling from CNY1,810 billion a month ago. Aggregate financing was only CNY1,690 billion for the same period, decreasing from CNY3,430 billion in June. Both numbers were the lowest growth numbers since February 2020 when banks were closed for the Chinese New Year holiday.

All items in aggregate financing grew less than a year ago, except for yuan loans and stock fundraising.

This means that not only shadow banking activities decreased on a yearly basis but also corporate and government bond issuances decreased too.

PBoC has acted as if the economy will continue to recover

Apart from not cutting the reserve requirement ratio (RRR) and interest rates, the central bank has absorbed liquidity from the interbank market, which has moved the 3-month Shanghai interbank overnight benchmark rate, or Shibor, from 2.12 at the end of June to 2.60 as of today.

It is clear that the central bank is not going to ease unless Covid-19 returns on a large scale, which seems unlikely at this stage given China's continued tight social distancing measures even given that there are only small clusters of cases.

The central bank may also ease again if the technology war hurts Chinese short-term growth significantly. However, we doubt this will be the case as we see the tech war hurting long-term growth more than short-term growth.

We think the central bank may only provide some liquidity support on a small scale to SMEs and agricultural activities, and this will be too small to move the interbank rate.

But we don't expect any tightening from raising RRR or policy interest rates. Tightening monetary policy is only expected when the economy is overheating, and we do not see this happening in 2020.

Forecasts

We expect the RRR to stay at 12.5%, and the seven-day reverse repo, 1-year Medium lending rate, 1Y and 5Y loan prime rates to stay at 2.20%, 2,95%, 3.85% and 4.65%, respectively, at least until the end of 2020.

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FX Talking: 'Opportunistic reflation' sinks the dollar

Much discussed in financial markets this summer is the drop in US real yields as the Fed keeps rates low, while US inflation expectations are on the rise. Expect this macro-policy theme to play a major role in FX market pricing ahead of a possible Fed adoption of an average inflation target in September. This theme is a broad dollar negative

Source: Shutterstock

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