Good MornING Asia - 1 March 2019

The US-North Korea summit disappointed markets - although expectations were probably unrealistic. Seen as a process, not as an event, some progress of sorts was still made. The bigger prize remains the US-China trade deal - much more positive noises are emanating from the US.

In this bundle

China: PMI continues to sink

China's manufacturing and non-manufacturing PMI continued to fall in February. Unless the trade war truly turns into an extended truce, the weakening...

Opinion | 28 February 2019

You win some, you lose some...

The US-North Korea summit disappointed markets - although expectations were probably unrealistic. Seen as a process, not as an event, some progress of sorts was still made. The bigger prize remains the US-China trade deal - much more positive noises are emanating from the US.

Korean market sell off in perspective

The early end to the Trump-Kim shutdown is a shame, not least for Vietnam, an economy I like, and which had an opportunity to showcase itself on an international stage.

The Kospi index fell by 1.8% on the day, a sizeable move, but not an unprecedented one. What did equity markets really believe was going to come out of this summit? I assumed we would get virtually nothing, and I'm not feeling too bad about it this morning. Currency markets responded far less. Yesterday's KRW decline was unexceptional by daily standards. The uptick of the 5Y sovereign CDS of 0.5% is equally unremarkable. In two months time when you look back at some of these charts, you will be hard-pressed to identify yesterday's price action.

And actually, in some ways, progress has been made. Both sides know more about each other than they did before they sat down. North Korea knows that the US knows about its other nuclear facilities, and won't be able to pass off token gestures as meaningful moves. And the US knows that the North Koreans are prepared to move, though perhaps not at the pace and to the extent currently desired. A deal is still possible. The relationship is still intact. Though it will probably require a lot more legwork.

Kudlow sounds positive about trade deal

According to Larry Kudlow, the US President's Economic Adviser, the US and China are close to a "remarkable historic deal" with progress apparently on state-owned enterprise subsidies and currency intervention. A final deal could be signed in weeks, according to the same article.

This is a far more important development than any disappointment felt over the Vietnam summit, and could provide a substantial boost to markets, not least those in Asia, which stand to benefit the most.

We'll believe it when we see it. We have had far too many conflicting reports over recent months to get too carried away with one soundbite, and despite a certain near term boost to market sentiment, the devil of any deal in the following months will be in the detail. Crucially, we don't know if this deal will deliver a removal of existing tariffs. That would be a massive boost. Or just a suspension of increased tariffs, which would be less helpful, but still deliver a relief rally.

India: 4QGDP growth of 6.6%

(from Prakash Sakpal)

India's 4Q18 GDP growth of 6.6% YoY was spot on our forecast. The slowdown from 7.1% in the previous quarter isn't out of sync with what's observed elsewhere in Asia. The growth slowdown coupled with low inflation might vindicate the central bank's (RBI) latest policy rate cut in February. But unlike some other Asian central banks, the RBI's options of further easing are limited. We believe inflation has bottomed and the low base effect together with the impact of rising global oil prices and weak currency will begin to push inflation higher in the period ahead. Meanwhile, there is some relief on the horizon for the rupee with Pakistan moving to diffuse the border tension with India. We might see some consolidation from the recent sell-off, though we expect geopolitics will remain a key headwind for local markets until elections in May.

Asia Day ahead

The expansion of Chinese shares in the MSCI index provides some interest for equity investors. The Shanghai Composite index has been rising since the beginning of the year - a combination of liquidity injections and probably a bit of MSCI front running providing the impetus.

But is this a "sell on the fact" story? The index's recent price action has seen it stalling a little below 3000. But liquidity measures are likely to remain supportive in the medium term.

South Korea's exports fell by 11.1%YoY in February. This was worse than the consensus forecast, and our own forecast was well wide of the mark. Falling semiconductor prices are apparently doing most of the damage. Shipment volumes are holding up better. So this is less a trade war story and more of a global semiconductor slump story. That means it is cyclical, and will at some point end. Though I'm wondering if it might take the 5-G roll out to deliver a meaningful recovery.

Manufacturing PMI data forms the bulk of other releases. Following yesterday's disappointment from China, these will probably also decline. Figures due from Malaysia, Japan, Thailand, Philippines, Indonesia, Vietnam and the Caixin China PMIs, where the consensus is controversially for a slight bounce from last month.

Inflation forms the other core component of today's Asia releases, with data from Thailand and Indonesia. Thai inflation should increase to about 0.5-0.6%, though principally a base effect increase. We don't see Thai inflation entering the BoT's 1-4% inflation target at all this year. Scope for a rate cut later in the year? It's unlikely I think, despite relatively high real rates, a soft domestic economy, and a strong currency. That doesn't mean it wouldn't be helpful to the economy.

Indonesia's inflation still looks to be trending lower, and they are another central bank with high real rates, though their priority seems to be reducing the current account deficit, so rate cuts are probably off the table for them too.

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ASEAN Morning Bytes

General market tone: Wait and see. The markets will continue to move sideways and digest data from the US and the latest geopolitical developments.

EM Space: US-NoKor summit ends abruptly, US GDP comes in higher than expected

- **General Asia:** US officials continue to blow hot and cold over developments on trade with China while the US economy performed better than expected and close to Trump's 3% target for the year. These developments should keep traders on their toes, given that trade issue with China remains unresolved while a stronger economy could mean the Fed rethinks its dovish stance.
- **Thailand:** The consensus of a rise in CPI inflation to 0.6% YoY in February from 0.3% in January rests on the low base effect. Inflation hasn't met the BoT's 1-4% target on a sustained basis in the last many years and we doubt it will this year. Besides the lack of demand-pull pressure, the strong currency has dampened imported inflation. We also see the risk of the Nikkei manufacturing PMI falling below 50 in February. Given the continued hawkish tone, we see little chance of the BoT easing this year, though we aren't ruling out a tale risk if other Asian central banks shift on the easing path.
- **Malaysia:** Nikkei Malaysia manufacturing PMI has been below the 50 boom-bust threshold since October and likely remained there in February as weakening exports weighed down manufacturing.

- **Indonesia:** Bank Indonesia (BI) Governor Warjiyo pledged to provide liquidity and supply banks ample funds to shield them from the impact of their 175 bps rate hike in 2018. Warjiyo has centered his policy making on keeping the IDR stable, indicating his belief that the currency is currently undervalued and it could strengthen further. Indonesia also reports inflation later in the session with the market expecting February price gains to settle at 2.75%, well within the 2.5-4.5% target.
- **Philippines:** The central bank reported domestic liquidity growth slid to 7.6%, the 5th straight month of a single-digit growth and the slowest print since 2012 as liquidity conditions tightened. This could give the BSP some indications that a reserve requirement ratio (RRR) cut would be warranted in the near term, especially with its forecast of inflation settling between 3.7% and 4.5% in February.

What to look out for: US data dump

- Thailand inflation (1 March)
- Indonesia inflation (1 March)
- US core PCE (1 March)
- US PMI (1 March)

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Asia week ahead: China's 'two sessions' and more

China's 'two sessions' will inform the macro policy directive for 2019. Inflation and trade releases will shape economic policies elsewhere in the region. Malaysian central bank meeting will be of some interest after deflation returns for the first time in nearly a decade

Source: Shutterstock

China: An annual rite of spring

Top government officials from all over China will gather in Beijing for the annual rite of spring - the Chinese People's Political Consultative Conference (CPPCC) and the National People's Congress (NPC) sessions to be held on 3rd and 5th March respectively. The typical focus in these meetings is Premier Li Keqiang's work report, as well as speeches by the heads of the central bank and other regulatory bodies.

Premier Li's report sets out economic targets for the year – GDP growth, inflation, money supply, bank lending, etc. – and also policy changes required to achieve these targets. The trade rift with the US is playing a significant role in shaping the economy and macro policy in China. The media has signalled a possible growth downgrade target for this year to a '6.0% to 6.5% range' from 'around 6.5%' in 2018, which makes more stimulatory policies the order of the day. The stimulus is already being rolled out within the confines of the current policy stance of 'prudent' monetary policy and 'pro-active' fiscal policy - the stance likely to be reinforced next week.

China's economic growth continues to soften as the sixth consecutive drop in the manufacturing PMI in February suggests. The message from the forthcoming data – February trade, inflation, and monetary data, all due next week – is unlikely to be any different. We believe the markets will be biding time until the Trump-Xi summit on trade at the end of March.

Rest of Asia: Falling inflation allows for central bank easing

Trade and inflation data dominate the economic calendar for the rest of the region. Asian exports have been under pressure from the trade war and slumping global electronics demand, as the data from Taiwan and Malaysia is likely to reinforce.

Among all inflation releases, Philippines' steals the focus. From a peak of 6.7% YoY high in September-October 2018, inflation has slowed sharply through January to 4.4%. Further fall in February will see it return to the central bank's 2-4% target, thus opening the doors for reversal of some of last year's 175 basis points rate hike this year, while the dovish US Fed policy allows for some local currency strengthening. We anticipate two 25bp cuts in the second and fourth quarters of the year.

Inflation in Korea continues to be low, and in Taiwan, it's almost non-existent. We don't think the Bank of Korea's 25bp rate hike last November was at all needed. The BoK left the policy on hold today. Governor Lee Ju-Yeol cited the Fed's and ECB's policy stance as important factors in deciding the policy. We think the weak domestic economy, trade uncertainty, and dovish G3 central banks' policy puts the BoK next in the line of Asian central banks to cut rates later this year.

Malaysia's central bank announces the outcome of its policy meeting on 5th March. BNM meetings had been really boring lately, but this one may be less so after the latest CPI data showing negative inflation for the first time in nearly a decade, thus raising the prospects of policy easing. However, the recent falling streak in CPI is the result of supply-side factors (the administrative cut in domestic fuel prices) that nothing the monetary policy could do about.

We believe BNM will see through the latest data and leave policy unchanged.

Read Deflation returns in Malaysia after nearly a decade

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
		Monday 4 March			
Malaysia	0400	Jan Trade Balance (RM bn)	8.2	-	10.4
	0400	Jan Exports (YoY%)	-4.6	-	4.8
	0400	Jan Imports (YoY%)	-3.1	-	1.0
Singapore	1300	Feb Purchasing Managers Index	-	-	50.7
Taiwan	0030	Feb Nikkei Manufacturing PMI	47.0	-	47.5
South Korea	0030	Feb Nikkei Manufacturing PMI	-	-	48.3
	2300	4Q F GDP (QoQ/YoY%)	1.0/3.1	-/-	1.0/3.1
	2300	Feb CPI (YoY%)	0.5	-	0.8
	2300	Feb Core CPI (YoY%)	0.9	-	1.2
		Tuesday 5 March			
China	-	Annual Session of National Peoples Congress Starts			
India	0500	Feb Nikkei Services PMI	-	-	52.2
	-	4Q Current Account Balance (Q) (US$bn)	-15.0	-16.0	-19.1
Hong Kong	0030	Feb Nikkei PMI	-	-	48.2
	0830	Jan Retail Sales Value (YoY%)	1.1	-	0.1
	0830	Jan Retail Sales Volume (YoY%)	1.3	-	0.2
Malaysia	0700	Overnight Policy Rate	3.25	-	3.25
Philippines	0100	Feb CPI (YoY%)	3.8	-	4.4
		Wednesday 6 March			
Taiwan	0800	Feb Forex Reserves (US$bn)	463.6	-	463.0
		Thursday 7 March			
China	-	Feb Forex Reserves (US$bn)	3097.9	-	3087.9
Hong Kong	-	Feb Forex Reserves (US$bn)	-	-	432.0
Indonesia	-	Feb Forex Reserves (US$bn)	120.9	-	120.1
Malaysia	0700	Forex reserves, Mth-end (US$bn)	-	-	102.3
Philippines	-	Feb Forex Reserves (US$bn)	85.1	-	82.5
		Friday 8 March			
China	-	Feb Trade Balance (US$bn)	51.2	-	39.2
	-	Feb Exports (YoY%)	9.0	-	9.1
	-	Feb Imports (YoY%)	-1.4	-	-1.5
Taiwan	0800	Feb CPI (YoY%)	0.1	-	0.2
	0800	Feb Exports (YoY%)	0.2	-	-0.3
	0800	Feb WPI (YoY%)	-0.3	-	0.8
	0800	Feb Imports (YoY%)	5.1	-	6.8
	0800	Feb Trade Balance (US$bn)	3.0	-	0.9

Source: Bloomberg, ING. *GMT

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China: PMI continues to sink

China's manufacturing and non-manufacturing PMI continued to fall in February. Unless the trade war truly turns into an extended truce, the weakening trend may not end quickly. As such we expect March's PMI to fall too

Workers at en electronic factory in Eastern China

Manufacturing PMI continues to fall below 50

February's manufacturing PMI data came in at 49.2, lower than January's 49.5. And more importantly, it continues to lie below the boom-bust 50 line. New export orders continued to sink, falling to 45.2 in February from 46.9 last month.

Slight good news

One piece of slightly good news comes from new orders, which represent new domestic orders. These rose to 50.6 in February from 49.6 last month. There are two explanations for this. One is that the stimulus and monetary easing have been effective in bringing domestic demand back to expansion. Another is that this data is just a one-off and will not persist.

We believe that it will be better to monitor these data for another month before we jump to any conclusions.

Different picture for non-manufacturing PMI

Though the non-manufacturing PMI also continued to fall, dropping to 54.3 in February from 54.7 last month, new orders in this sector fell to 50.7, (near the 50 threshold), from 51.0.

With massive credit growth in January, which is expected be passed on to the real economy, it is difficult to explain such weak growth in new orders in the service sector, which includes financial services.

This data makes us worry that the service sector is slowing alongside the manufacturing sector.

Truce impact

We believe a trade deal, especially over the longer run, will be positive for both the Chinese and US economies. But this will not immediately reflect in economic data. For example, manufacturers could continue to adopt a wait-and-see approach with respect to any ultimate deal before committing to expensive and irreversible CAPEX investment decisions.

Any such deal is unlikely until the end of March at the earliest. This means we probably will have another month or two of bad PMI data before signs of improvement begin to emerge.

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