Good MornING Asia - 11 June 2020

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In this bundle

Opinion | 11 June 2020

Japan | Malaysia...

Promises are made to be broken

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I'm going to cut out gin and curry until the New Year

Anyone who knows me would regard a statement like "I'm going to cut out gin and curry until the New Year" as an obvious lie, or at best, a good intention that is likely to last no more than week. And so it is with the Fed's pronouncements overnight to keep rates at least as low as they are now until the end of 2022 (here's a link to their latest statement).

So, what if the US economy does actually come roaring back? And employment too? I don't think this will happen quickly, and with this, I am totally in line with Jerome Powell that many of the jobs lost as a result of the pandemic will come back slowly if at all. But we both might be wrong. It happens.

If we are both wrong, then Powell has two choices:

1. to muscle it out, and keep rates low even when the data says hike;
2. or do a U-turn and hike

Ignoring a better economy probably isn't the risk it once was, and I very much doubt this would do more than enable a further positive distortion to risk assets. But a U-turn would damage the Fed's credibility for any forward guidance they attempted to give in the future (but then such promises are pretty empty anyway, as markets seemed to demonstrate last night, as they sold off during the press conference).

As usual, all the gory details are covered by our Chief International Economist James Knightley, so here is the link to his note on the statement and press conference. I'm going to focus on the market reaction, and the commitment to keep rates no higher than they are today until end 2022 suffers from the same problem as my curry commitment, that it is time-inconsistent.

That means that when circumstances change, for example, if I get hungry, or the US economy grows more than expected, then my incentives will also change, and so will those of the Fed. A more credible, and therefore more effective statement would have been to say that rates will remain no higher than they are today until the unemployment rate has fallen to X%, with X being a number not too far above the US full-employment rate, whatever the Fed claims that to be at the time (it does change). That could happen quicker, or it could happen slower. But the incentives on adhering to such a promise would not change.

In addition, markets might just also be showing how dependent they are on incremental policy easing. Simply remaining ultra-loose may not be enough any more, especially when a V-shaped economic or corporate earnings recovery seems an unrealistic dream. In which case, Jerome Powell may look at the 0.5% drop in the S&P500 yesterday and conclude that it was not a bad day's work. It could certainly have been worse. But it does raise the question of "What if we need to do something more?". That "something" appears at this stage to be yield curve control. The Fed is still keeping its options open on this. It's a reasonably effective policy when coupled with credible economic commitments, as the Reserve Bank of Australia has shown. But from where the Fed sits today, it is a very marginal incremental easing when policy rates are already zero, and bond yields are also very low requiring minimal asset purchases from the Fed.

This isn't quite an Emperor's New Clothes moment, but it isn't far off in my opinion and comes at a time when the US new Covid-19 case numbers are looking a bit more threatening, with notable increases in Arizona, Florida, North Carolina, Texas and Utah. Renewed lockdown feels like an incredibly difficult step for these states to make if the numbers worsen further, which could provide markets with new grounds for concern. As well as some equity weakness, the latest move also showed the USD firming a little, which is consistent with a broader risk-off move. That could threaten to undo some of the big moves we have seen in Asian currencies, particularly the IDR and KRW - Asia's best performing currencies month to date (throw in the AUD and NZD too).

Asian data out and looming

Back in Asia now, and **Japan's** 2Q20 business sentiment indicators have plunged further, offering an insight into the chasm into which GDP in 2Q is likely to fall. The all-industry index dropped from -10.1 to -47.6. That's within a whisker of the 2009 GFC low of -51.3. And the large manufacturing index fell to -52.3, which is also just a shade less bad than the 1Q2009 figure of -66. We are officially forecasting a quarter-on-quarter decline of 7.1% in 2Q20, which translated into a sensible forecast excluding decimal places means anything between -5% and -10%. This is consistent with these latest sentiment indices. No revisions needed.

And elsewhere in Asia, Prakash Sakpal picks up the narrative:

"**Malaysia**: April industrial production (IP) data today will shed light on GDP growth coming into the second quarter. We are looking for a 25% YoY fall, following a 24% plunge in exports in the month. We recently cut our 2Q20 GDP growth forecast to -8.3% YoY from -6.6%, and the full-year 2020 forecast to -3.9% from -2.9%. The case for an additional 100bp of central bank (BNM) policy rate cuts in this easing cycle remains strong, which is likely by end-3Q20 and would take the rate to an all-time low of 1%.

Thailand: The Cabinet approved a draft bill imposing a 7% value-added tax on foreign tech companies operating in Thailand. The bill awaits parliamentary approval for it to become a law. This may be an added source of revenue for the government, but given the fact that the digital tax will be eventually borne by consumers, it will be an added drag on already weak demand".

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ASEAN Morning Bytes

Asian markets are expected to edge lower as Fed signals a long path to recovery

EM Space: Fed paints gloomy economic outlook for next couple of years

- **General Asia:** The Fed pledged to keep rates unchanged all the way through to the end of 2022 to help heal the battered jobs market, with economic activity expected to be downbeat for some time. Inflation data out from the US and China supports this view with price pressures fading quickly as demand remains subdued due to the pandemic. The gloomy economic outlook and lack of additional stimulus from the Fed may convince investors to pull back from the recent rally for the time being with the data calendar thinning out towards the end of the week.
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the digital tax will be eventually borne by consumers, it will be an added drag on already weak demand.

- **Philippines:** Bangko Sentral ng Pilipinas (BSP) governor Diokno will be working back some of his liquidity enhancement measures as the economy grinds back to life. With lockdown measures eased, businesses have been allowed to operate up to 50% capacity and BSP will be monitoring excess liquidity to decide when to restore its term deposit window in the near term. BSP flooded the financial system with liquidity equal to 5% of GDP to help prevent panic, but with sentiment improving, they will likely wind down liquidity support as well as their bond purchasing program.
- **Indonesia:** Bank Indonesia (BI) governor Warjiyo reiterated that the IDR was "undervalued" but at the same time pledged to ensure that IDR would be kept at levels that helped improve the competitiveness of its export sector. The conflicting remarks sent the IDR sliding on Wednesday after its recent surge to the 13,000 level and we expect IDR to remain steady as we head into the central bank decision next week. Should IDR remain stable in the coming week, we expect BI to finally pull the trigger on policy easing to bolster sagging growth momentum.

What to look out for: Covid-19 developments

- US PPI and initial jobless claims (11 June)
- Hong Kong industrial production (12 June)
- US consumer sentiment (12 June)

Snap | 10 June 2020 China

China: Bank lending - is it effective?

In China, bank loan growth is almost led by the government‘s policy stance. During this important recovery stage, the government wants banks to lend...

Source: Shutterstock

Credit data shows stable money growth

Aggregate financing increased by CNY3.19 trillion in May after rising CNY3.094 trillion in April.

Most of the increase came from yuan loan growth, at CNY1.48 trillion, followed by government-related debt net issuance of CNY1.14 trillion. Corporate debt net issuance was CNY297.1 billion.

Shadow banking items continued to shrink in May.

Where are the loans going?

The government has urged banks to lend to corporates and has asked corporates to make use of the loans by rebuilding their businesses in order to help the economic recovery. But this may be wishful thinking at a time when demand is so low.

There are media reports that the regulator has ordered banks to shrink the structured deposits balance to the 2019 year-end level by the end of September, and to two thirds of the 2019 year-end balance before the end of this year. The media has also reported that the interest rate offered by structured deposits should be market based. Overall, deposits went up by CNY1.29 trillion in

May, excluding government deposits.

These new regulations tell us that even if banks do lend out more, the loans may not be used to fund operations or investment. In fact, they could be used for placing deposits; some have gone to high-interest rate structured deposits.

The behaviour of banks and corporates is based on market conditions.

At this moment of high credit risk, banks have to be careful in their lending practices. They may want to lend to corporates where the business has not been hit hard by the trade war or by Covid-19 because the credit risk is lower but, at the same time, these corporates may not have a strong need for loans to rebuild their business. Those who can't get loans from banks are likely to be those that need them most.

The same applies to households, that generally want to save more rather than spend when the job market is unstable.

Monetary policy ahead

Without much genuine need for bank loans to rebuild the economy in this low demand environment, the People's Bank of China may defer liquidity injections with targeted RRR cuts and broad-based RRR cuts only when the economy really begins to recover.

We have, therefore, cancelled our call for RRR cuts, for now, and we will return to this call later depending on the speed of the economic recovery. The recovery will mainly be based on government support.

A rate cut of 10-20 basis points in June is still possible because the interest rate cut by the PBoC will affect the interest rate in the bond market. Cheaper fundraising in the debt market would help economic growth.

Philippines: trade data shows scars of lockdown

Philippines trade numbers knocked down by lockdown measures

Source: Jun Acullador

Lockdown measures stifle trade activity

Under the lockdown to help prevent the spread of the virus, checkpoints and curfews were in place while businesses were shuttered - hampering the once free flow of goods and services both in and out of the country. Exports in April fell 50.8%YoY, while imports cratered by 65.3% resulting in a trade deficit of $499 mn for the month. The drop in imports is mirrored in the fall in corporate demand for the US dollar during the lockdown period with the Peso managing to remain steady throughout the same month with peso spot trading volumes nearly half of the normal amount.

Import demand to resume, exports not likely

The government has pointed to the resumption of its "build-build-build" infrastructure program as a means to combat the fallout from the Covid-19 pandemic, and we expect import growth to return in the coming months. Inbound shipments for construction materials, fuel and capital machinery used for construction will likely bloat the import bill at a time when export prospects look bleak given projected recessions in major trading partners like the US, Japan and China. The widening of the trade gap coupled with the absence of usual dollar inflows from remittances could translate to a swelling of the current account deficit which could spark renewed depreciation pressure on PHP in 2H.

We look for the USD PHP to weaken from just over 50 currently, to just over 52 by the end of 2020.

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