

Good Morning Asia - 11 September 2019

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- **General Asia:** Some breather from the Brexit noise and thawing of US-China trade relations support risk appetite ahead of the key central bank policy meetings - the ECB tomorrow and the Fed next week. There is little going on in Asia today aside of Malaysian manufacturing data shaping expectation of BNM policy outcome tomorrow.
- **Malaysia:** July industrial production data due today will provide a glimpse of where GDP growth is headed in the current quarter. The consensus forecast of a slowdown in IP growth to 3.1% YoY from 3.9% June appears to be at risk of upside surprise based on surprising swing in exports to 1.7% growth from 3.4% fall over the same months. The central bank (BNM) begins its two-day policy meeting today. We believe more pre-emptive easing to counter potential downside growth risks will be a strong consideration at this meeting ([read more here](#)).
- **Philippines:** Exports grew for the fourth consecutive month in July on the back of firmer electronics exports and improved shipments to the US. But imports continued to struggle with weak fuel and raw materials imports while aggressive BSP rate hikes last year and the government budget delay this year continued to depress demand for capital goods. Despite these trends, the trade deficit widened further to \$3.39 bn from \$2.47 bn in June, which

could exert some depreciation pressure on the Peso.

- **Indonesia:** The World Bank sees Indonesia's GDP growth slipping below the 5% threshold to 4.9% in 2020 due to global risks such as the trade war and potential "severe" capital flight that may ensue due to slowing global growth. This would be the worst showing in almost four years and below the government's own projection for 5.2% growth next year. President Jokowi is scrambling his cabinet to jumpstart the economy via investments. We expect more stimulus efforts to sustain growth above 5%.

What to look out for: ECB meeting

- Malaysia industrial production (11 September)
- US PPI and wholesale inventories (11 September)
- Singapore retail sales (12 September)
- India inflation and trade (12 September)
- ECB meeting (12 September)
- Malaysia central bank meeting (12 September)
- Thailand GIR (13 September)

Malaysia: Why we buck the consensus on BNM policy

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Source: Shutterstock

Governor of the Central Bank of Malaysia Nor Shamsiah Mohd Yunus

2.75% ING forecast of BNM policy rate on Wednesday
A 25bp cut

Consensus favours stable policy

Bank Negara Malaysia's (BNM) Monetary Policy Committee begins its two-day meeting on Wednesday, 11 September. The policy decision is expected on Thursday at 3pm local time.

The consensus is skewed towards no action with 15 out of 23 analysts in a Bloomberg survey calling for the BNM's overnight policy rate of 3% to remain unchanged. We are in the minority expecting a 25 basis point (bp) rate cut to 2.75%.

The BNM's last policy move was a 25bp rate cut in May this year. That was more like an insurance cut rather than one needed by the economy. Things haven't got any worse since then to warrant another cut. On the contrary, the economy has been bucking the global slump on the back of a surprisingly strong semiconductor sector, despite the ongoing slack in global electronics demand.

GDP growth accelerated to 4.9% year-on-year in the second quarter from 4.5% in the first, prompting the authorities to raise the growth outlook for the year to 4.5-5.0% from 4.3-4.8%. We see growth hovering near the top-end of this range for the rest of the year, with full-year growth staying steady at the 4.7% pace of 2018. Meanwhile, inflation continues to be benign with a 0.3% rate in the year through July, down sharply from 1.5% a year ago.

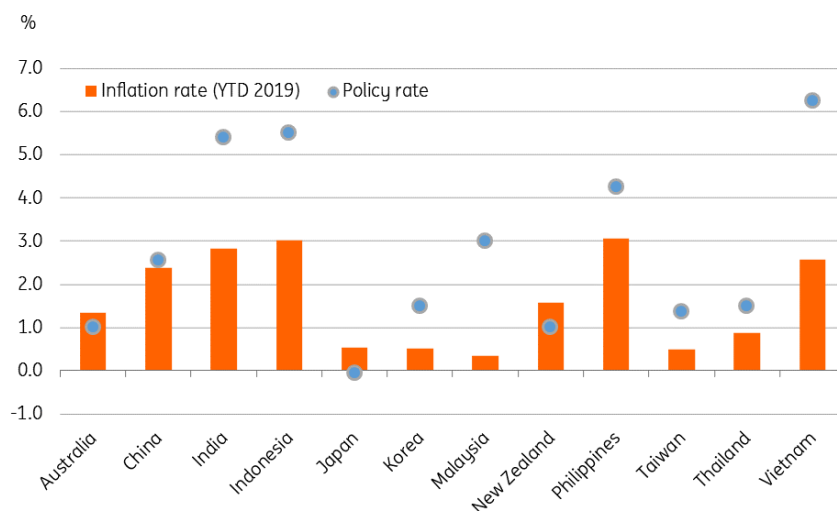
Some more insurance easing won't hurt

The economic risks may appear to be fairly balanced between growth and inflation right now. However, it will be challenging for the economy to maintain this outperformance in an increasingly unfriendly external trade environment. Therefore, we believe more pre-emptive easing to counter potential downside growth risks will be a strong consideration at this meeting.

A move in that direction wouldn't hurt either, especially when there is sufficient room for cutting rates to shore up growth going forward. With the lowest inflation rate in Asia, Malaysia's real (policy) interest rate is among the highest in the region. This is not good for investment demand which has, in fact, contributed negatively to the country's GDP growth in the first half of the year.

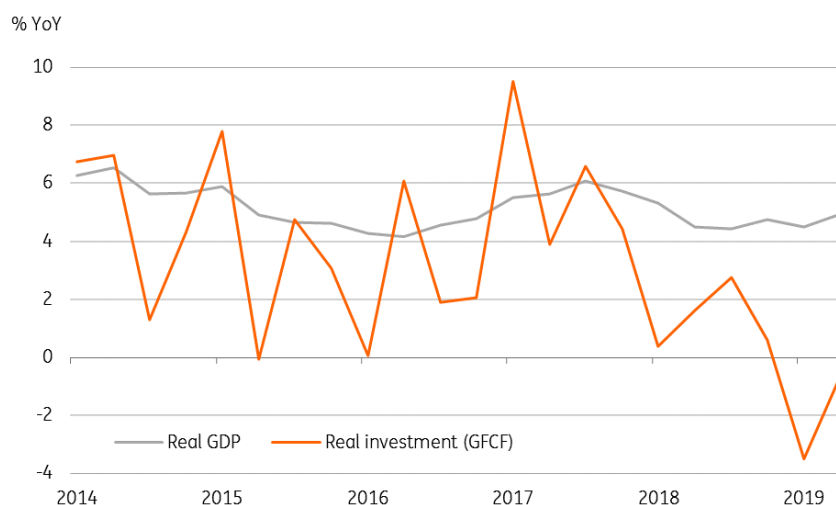
Moreover tight public finances, with the government aiming to cut the fiscal deficit down to 3% of GDP by 2020 from 3.4% projected for the current year, puts the onus on the central bank for growth-boosting policies.

Real interest rates among highest in Asia



Source: Bloomberg, CEIC, ING

Investments have been a drag on GDP growth this year



Source: CEIC, ING

No end of the easing cycle just yet

We don't think the BNM's easing cycle will end with a rate cut this week if indeed we get one. We are also looking for one more cut in the fourth quarter of the year, taking the policy rate down to 2.50%. And with persistently low inflation - a trend which has a long way to run amid low commodity prices - the central bank will still be left with enough policy space for the future.

How low could the policy rate go? The lowest level it dropped to was 2% during the global financial crisis in 2009. Although the current US-China trade war and tech slump don't compare to the global financial crisis, its impact is more focused on Asia. Consequently, we believe we can draw parallels between the BNM policy response then and the current situation. Even so, we believe the central bank will tread a cautious path and abstain from excessive easing.

Philippines: Exports post fourth month of gains amid trade war

The Philippines posted a fourth straight month of gains as shipments to the US jumped 8.9%



Source: Shutterstock

\$3.39bn July trade deficit

As expected

Trade war?

The Philippines recorded a fourth straight month of rising exports despite the escalation in the US-China trade spat, while imports contracted for a fourth month. Despite the growth in exports and the pullback in inbound shipments, the trade deficit widened to \$3.39 billion, only slightly wider than expected and roughly \$1bn more than the deficit posted in the previous month. The still substantial trade gap will likely curtail the peso's appreciation but the direction of the local currency appears to be more affected by sharp swings in sentiment related to the trade war and the direction of global monetary policy.

Looks like you made a new friend

Exports to the United States jumped 8.9% in July with outbound shipments to the US posting growth for six out of seven months of the year as electronics exports proved expectations wrong by showing 2.9% growth for the month. Electronics corner the lion's share of the Philippine export sector and where the mainstay sector goes, we can expect the fortunes of the entire export sector to follow. Despite the trade war and the relative strength of the peso, exports have managed to post gains (albeit on the back of a favourable base) with manufacturers finding creative ways to skirt the new levies.

Rate hikes and budget delay hit home

The recent run of GDP above 6% coincided with a stable base of household consumption complemented by a nascent investment-driven expansion and topped off by government spending. This year however presented the double whammy of a heavy-handed Bangko Sentral ng Pilipinas (BSP) rate bazooka- which all but knocked out capital formation- and the budget delay, which scuttled public construction. The July import numbers show a stark contraction in raw materials (-11.7%) as construction components such as iron and steel (-35.8%) and non-ferrous metals (-14.5%) weighed on the subsector. Meanwhile, 2Q GDP showed that capital formation, in particular durable equipment cratered, plunging the entire capital formation account into the red. BSP's 175 basis point rate hike barrage, which was designed to combat inflation, did its job but at the cost of capital formation, with capital goods showing a mere 3.4% growth for July.

Imports a barometer for 3Q GDP

With the July import numbers showing likely weakness in capital formation as capital imports show modest gains and raw material inbound shipments contracting, we may have to rely once again on household spending to carry the load as we chase 6% growth. BSP's 50-bps redux on rates and the government budget online will probably help but jump starting the Philippine economy in time to save the second half may be increasingly challenging, as the ill effects of rate hikes and budget delays continue to sap already fading growth momentum.

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