Good MornING Asia - 12 July 2019

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A deep water port in Singapore

0.1%YoY

Worse than expected

2Q19 GDP growth

-3.4%QoQ annualised

What went wrong?

The figures say it all: 2Q19 GDP was 0.1%YoY, or -3.4%QoQ (annualised). This was worse than even our own sub-consensus forecast of 0.8%YoY and -0.2%QoQ.

So what went wrong?

Manufacturing was the main culprit. A 6%QoQ annualised decline in 2Q19 accounts for much of the damage to 2Q GDP, though services seem also to have taken some collateral damage from this, declining by 1.5%. Quarterly construction activity also shrank by 7.6%, though for both services and construction, the year-on-year figures remained positive and we can put some of their 2Q quarterly weakness down to erratic seasonals.

Outlook not great

Sometimes, when you get a big dip like this, you line up for a subsequent bounce. But this manufacturing dip has strong drivers. Singapore's highly export-driven economy leaves it very exposed to the US-China trade war and the broader slowdown in world trade. Singapore's concentration in the electronics sector during a global tech-slump and technology war also take their toll on the economy.

We don't see any prospect for a substantial improvement in these areas any time soon, though the rate of decline could now be moderating. Nevertheless, the longer the manufacturing sector remains depressed, the more likely this weakness will spill over into services and other sectors.

MAS to the rescue?

In a recent conversation, MAS (Monetary Authority of Singapore) Managing Director, Mr Ravi Menon, noted that there was possibly a case for an intra-meeting change in the MAS policy stance. This currently targets a modest and gradual appreciation in the SGD nominal effective exchange rate (SGD NEER).

We have looked back at previous examples of such policy changes, the last one being January 2015, fully three months before the scheduled April policy meeting. The point of mentioning this is that it is now barely 3 months until the MAS' October meeting. So if this, and ongoing inflation weakness are going to be countered with an off-cycle easing, then unless this happens soon, for example, this or next month, then the MAS might as well wait for October.

Today's data suggest that waiting would put the economy in greater than necessary jeopardy. An imminent move, therefore, looks probable.

What might this look like?

Given the NEER is the main policy target, this leaves a number of options available for the MAS.

1. Change the slope of the NEER from appreciation to flat (the most likely option)
2. Change the slope of the NEER to outright depreciation (a bigger move and contentious given US pre-occupations with currency manipulation which have flagged Singapore recently).
3. Change the breadth of the currency band (would allow for some near term depreciation but leave the longer-term trend intact)
4. Shift the mid-point of the band down (would achieve much the same as the previous option).
5. Or various mixtures of the non-mutually exclusive options above.

We will monitor the short term interest rates as a potential clue for upcoming policy changes, and note a small dip to just below 2.0% from the 3M SIBOR rate today.

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Asia week ahead: More central banks to join the easing bandwagon

Next week in Asia kicks off with China's 2Q19 GDP report and progresses with some central bank policy meetings and lots of trade data – making it an interesting week for markets

Source: Shutterstock

6.2% ING forecast of China's 2Q GDP growth

China's growth lowest in three decades

Our house view of 6.2% growth in China's GDP in the second quarter is in line with the consensus median - a deceleration from 6.4% in 1Q, making it the worst quarter in nearly three decades. Anything better or worse than this may move the market. However, deviations by one-tenth of a percentage point from consensus, which have been the norm for many quarters, are less of a concern than the direction that growth is going. Indeed, a downward trajectory will cast a shadow over investor sentiment as the trade dispute with the US continues to cloud the growth outlook for the rest of the year.

A silver lining in the dark cloud though, year-on-year growth may benefit to some degree from low base effects in the second half of the year. While it's too soon to close a trade deal, our Greater China Economist, Iris Pang, sees a strong macro policy boost keeping the economy afloat with growth above 6%.

China: Too soon to close a deal

More central banks on course for easing

With a US Federal Reserve rate cut just around the corner, we expect more Asian central banks to join the easing buzz. Central banks in Korea and Indonesia are likely to be next in line to ease policy. Both the Bank of Korea (BoK) and Bank Indonesia (BI) are due to announce their policy decisions next Thursday 18 July, and we expect each of them to cut policy rates by 25 basis points.

Facing the brunt of the trade war and the tech slump, Korea's growth is poised for more weakness ahead from export declines, which have now moved into double digits. The BoK policy decision will also be accompanied by the central bank's quarterly economic outlook report. We anticipate further cuts to the BoK's 2019 growth and forecasts, currently 2.5% and 1.1% respectively. If so, the fifth forecast cut in a year should force the BoK's hand into easing. The economy is flirting with recession and the consensus has still to come to terms with this, with a split-view of a 25bp BoK rate cut and no cut in the current quarter.

> *The Korean economy may actually be in a recession right now, we're simply waiting for the data to confirm it. – ING Asia Chief Economist Rob Carnell*

Meanwhile, BI has already started on an easing path by cutting banks' reserve requirement ratio (RRR) by 50bp at the June policy meeting. With a Fed rate cut just around the corner, our Indonesia expert, Nicholas Mapa, now thinks the door is open to a BI rate cut, possibly as soon as next week. The appreciating currency (IDR) allows for some unwinding of aggressive BI policy tightening in 2018. Even as GDP growth remains well supported at a 5% level for the rest of the year, still a decent performance among Asian countries, an insurance rate cut won't hurt when inflation is anchored around 3%.

And lots of data to gauge trade war impact

The trade figures from India, Indonesia, Singapore, and Japan will also be watched closely for what they say about the trade war impact.

Just like Korea, Singapore is one of the economies most impacted by the trade war and tech slump. June data on non-oil domestic exports (NODX) next week will reinforce this trend. The sustained deep declines in NODX depressing GDP growth are bringing the Monetary Authority of Singapore (MAS – the central bank) closer to reducing or even flattening the SGD-NEER appreciation path, possibly even earlier than the October meeting.

There is some good news from the Indonesian trade figures. A 10-fold widening of the trade surplus to our estimated $1.9 billion will relieve BI from worries of imminent policy rate cuts hurting the currency. Unlike Indonesia, India's trade balance remains in red, likely posting a $15 billion deficit again in June – not good news for the Indian rupee despite its recent outperformance on the back of a weaker US dollar and lower global oil prices.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Monday 15 July			
China	0300	Jun Fixed asset investment (YTD, YoY%)	5.7	5.6	5.6
	0300	Jun Industrial Production (YoY%)	5.5	5.3	5
	0300	Jun Retail Sales (YoY%)	9.1	8.5	8.6
	0300	2Q GDP (QoQ% SA/YoY)	-/6.2	1.5/6.2	1.4/6.4
India	0730	Jun WPI (YoY%)	2.3	2.2	2.5
	-	Jun Imports (YoY%)	-3	-	4.3
	-	Jun Trade deficit (US$bn)	-7	-14600	-15360
	-	Jun Exports (YoY%)	-15	-	3.9
Indonesia	0500	Jun Exports (YoY%)	-8.7	-	-9.0
	0500	Jun Imports (YoY%)	-11	-	-17.7
	0500	Jun Trade balance (US$mn)	1885	-	207.6
Philippines	-	May OCW remittances (YoY%)	-1.7	-	4.0
		Wednesday 17 July			
Singapore	0130	Jun Non-oil domestic exports (YoY%)	-8.7	-	-15.9
	0130	Jun Non-oil domestic exports (MoM% SA)	-6.2	-	6.2
		Thursday 18 July			
Indonesia	-	BI policy decision (7-day reverse repo, %)	5.75	-	6.00
South Korea	0200	7-Day Repo Rate	1.50	-	1.75
	2200	Jun PPI (YoY%/MoM)	0.4	-	0.4

Source: ING, Bloomberg, *GMT

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Asia FX Talking: North-South divide

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Article | 11 July 2019 South Korea

Is the South Korean economy headed for a recession?

Our last report on Korea flagged the difficulties the economy was facing. Since then, things have worsened - the economy may even be in a recession. The central bank looks close to responding with some easing, though they have dragged their feet, which hasn't helped. The government may also have to relegate longer-term restructuring for short term support

Source: Shutterstock

1.75% BoK base rate

Expected 1.25% by year end

In need of some stimulus

Around the region, rates are being cut. Malaysia, Philippines, India, New Zealand and Australia have all cut rates, and more are likely to be on the way now that the US Federal Reserve seems to have shifted to an easing bias.

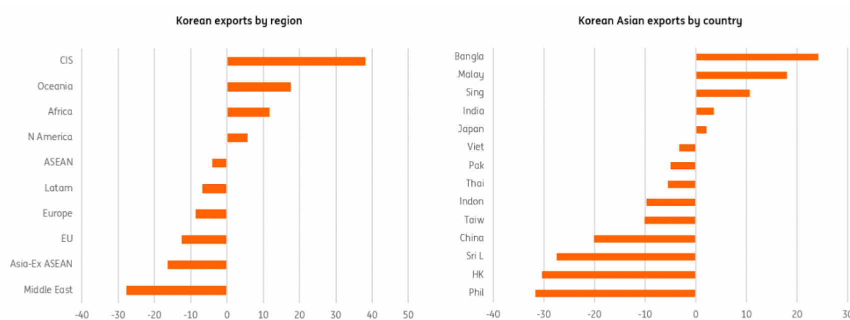
The Korean economy may actually be in a recession right now, we're simply waiting for the data to confirm it

Compared to most of these economies, the argument for some easing from the Bank of Korea is considerably more compelling and is exacerbated by the rate hike in November 2018 which we never felt was justified by the Korean macroeconomic situation. Moreover, since we last wrote about this economy at length, economic conditions have deteriorated further with the escalation of the trade war and the morphing of the global technology slump into a tech war of its own.

The best you can say about the Korean economy right now is that year-on-year comparisons will be less unhelpful in 2019. But this is an economy that may actually be in a recession right now, we're simply waiting for the data to confirm it. Forecasting an imminent upturn is a difficult thought-experiment.

Read our country profile on South Korea from January

Korean exports by region and by Asian country YoY% (May 2019)



Source: CEIC

More than temporary weakness for the external sector

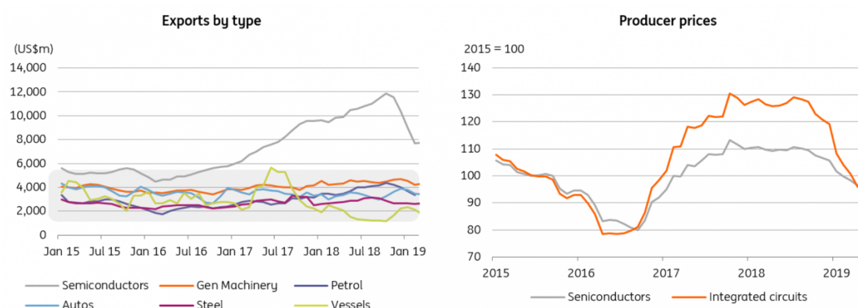
Korea is an export power-house, punching well above its place of the 11th biggest global economy by GDP to rank fifth by export share. But what ought to be a sign of strength is a serious handicap against the backdrop of slowing global trade growth. The World Trade Organisation (WTO) forecast for global trade growth this year is only 2.6%, which is slower than global GDP growth (3.3%), so the headwinds for Korea's external sector are very severe indeed. This is more than a little temporary external weakness (as the BoK initially suggested as a reason not to respond with more accommodative policy).

Though the decline in Korea's exports is predominantly a semiconductor phenomenon, it's not as if Korea's other major export sectors are looking like they'll make up for this

Though the decline in Korea's exports is still, predominantly, a semiconductor phenomenon, it is not as if Korea's other major export sectors are looking like they'll make up for this. Indeed, the more traditional sectors of steel, autos, petrol etc. are also looking a bit subdued, probably reflecting a more general slowdown in global demand.

In the semiconductor industry itself, the Bank of Korea asserts that volume exports are picking up. That may well be the case, but producer price series for semi-conductors still show prices declining at anything between 11%YoY for semiconductors themselves, to 23% YoY for integrated circuits. It will take more than a slight uptick in volumes to offset that.

Korean exports and electronics producer prices



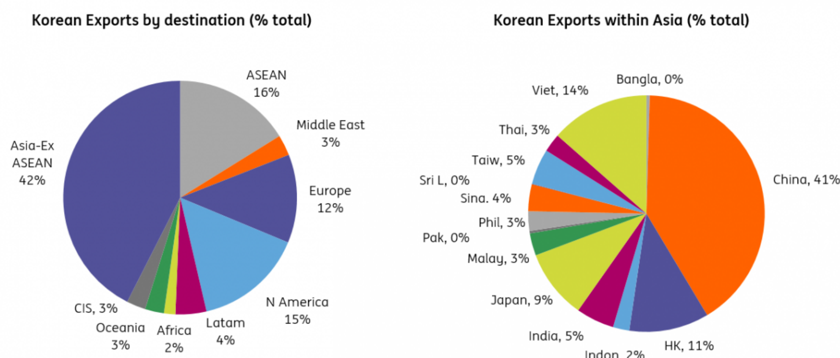
Source: CEIC

Where do Korean exports land?

By destination, more than 50% of Korean exports are destined for other parts of Asia, with North Asia - China (41%), Hong Kong (11%), Japan (10%) and Taiwan (5%) taking the lion's share.

Within South East Asia, Vietnam is the standout recipient at 13.5%, dwarfing the Korean export receipts of most other Southeast Asian economies, even some many times its size. The 2015 Free Trade Agreement has probably helped this, with Vietnam reducing its tariffs by 89% and South Korea reducing its tariffs by 95%. Today, about 40% of Samsung handphones are reportedly made in Vietnam, so electronic imports for assembly and then re-export make up a significant amount of this intra-regional trade.

Korean exports by destination



Source: CEIC

Philippines, another standout

The other standout country in Asia, though for the wrong reasons, is the Philippines. The Philippines is seeing the strongest decline in growth of exports from Korea when compared to any Asian country. A database of trade shows that electronics goods, mainly integrated circuits, make up about a third of all South Korean exports to the Philippines - far more than any other category. While most reports cite exports from the Philippines to Korea being mainly agricultural produce (bananas and pineapples) as well as copper, the Observatory of Economic Complexity (OEC) of MIT shows electrical and electronic goods making up more than half Philippine - Korean exports. There is clearly a strong degree of interlinkage in this sector.

The Philippines is seeing the strongest decline in growth of exports from Korea of any Asian country

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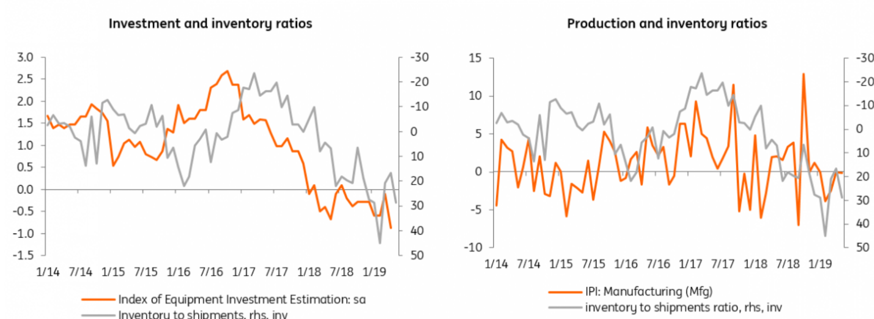
With a free trade deal between Korea and the Philippines due in November, some firms may be holding back exports until after that deal is signed. But the global tech slump may also be playing its role here by weighing on intra-regional exports.

Domestic economy looks (slightly) better

While the external economy is struggling, and the best that can be said of it is that it may be showing signs of reaching a floor, the domestic economy looks slightly better. Inventory to shipments ratios are now falling (see charts below, where inventory ratios are inverted) and together with rising production in the quarters ahead, they also point to rising investment and capacity building.

Retail sales volumes have been slowing on a trend basis, but overall, sales volumes are still holding up reasonably well. And though the unemployment rate has been heading the other direction (higher) it has been doing so at a very gradual pace. However, that hasn't propped up inflation, which at 0.7%, is too far from the Bank of Korea's inflation target for it to be ignored further, and together with weakness elsewhere, make the case for rate cuts almost overwhelming.

Production, investment and inventory cycle troughing (YoY%)



Source: CEIC

Bank of Korea coming round to the idea of some easing

The central bank governor, Lee Ju-yeol admitted at the BoK's semi-annual briefing recently that Korean inflation would likely miss the Bank's 1.1% forecast from April. He also suggested that there was a rising chance that the semiconductor recovery would be delayed. These and other comments seem to be warming the market up for a rate cut, perhaps as early as this month when they next meet (18 July).

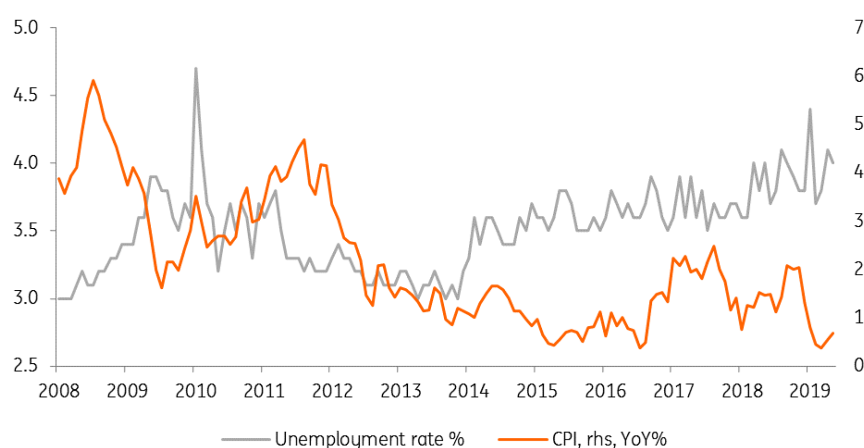
> *While Governor Lee has indicated that there is not much room for monetary policy easing, we believe there is certainly room for at least two 25bp rate cuts*

Downward revisions to both growth and inflation forecasts in the BoK's quarterly Economic outlook for July look highly probable, which should further increase the chances of a rate cut at that meeting. The last BoK meeting already had one dissenter to the no-change policy, and that too could be a precursor to a broader change of mind within the Bank.

While Governor Lee has indicated that there is not much room for monetary policy easing, we believe there is certainly room for at least two 25bp rate cuts. One to reverse last November's unnecessary hike and another to deliver some genuine easing. If we get a July cut, then we may not have to wait too much longer until the next.

Some slight won (KRW) appreciation since May, driven by Federal Reserve rate cut expectations, makes it easier for the BoK to move, though it is difficult to come up with a cogent set of explanations as to why the BoK previously felt that the currency's weakness made it harder for them to act. Nonetheless, to the extent that they felt this was a constraint before, now they should be slightly more relaxed.

Korean unemployment and inflation



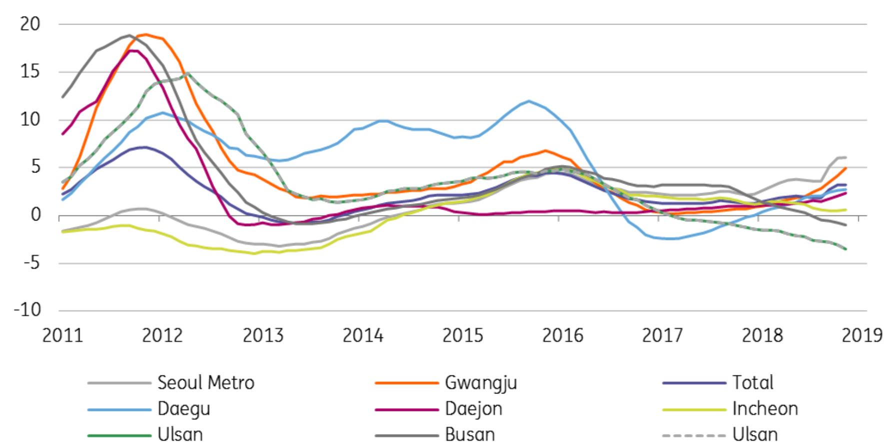
Source: CEIC

Housing - not a bubble, but another reason to ease

One other factor that prompted the rate hike in late 2018 was housing. This was never a convincing story back then, when house price growth was modest, and largely confined to the Seoul Metropolitan area, which still remains one of the strongest regions nationally for house price growth, but even there, house prices are barely keeping pace with wages, and in other parts of the country, is either very weak or falling.

National house price growth is now less than 2%YoY. We expect it to fall further and even register some negative year-on-year comparisons in the quarters ahead. Easier monetary policy would provide some insurance against a harder and more painful decline in house prices, though we don't think there is a bubble on the verge of bursting. House price growth has never been that strong.

Korean residential house prices (YoY%)



Source: CEIC

The Korean won and bond yields

Despite the likelihood of some policy easing from the central bank, the main drivers for the currency are:

1. Global financial market risk appetite, in particular, sentiment about the trade war
2. Korea's trade balance
3. The US dollar

Recent swings in the Korean won are down to almost exclusively non-domestic factors: the growing expectation of Fed easing, ever-declining US Treasury yields, and some sense of relief following the G20 meeting which averted even greater tariff rates on China or retaliation. But looking ahead, we are a bit concerned that Fed easing, and subsequent dollar weakness that has helped the KRW swing from 1180 to break 1150, is overdone and could flip back. To some extent, this has already happened with the KRW already now at 1180. Higher still, is of course possible.

Our forecast of a gradual appreciation of the KRW is centred on an expectation of a gradually improving global outlook as we

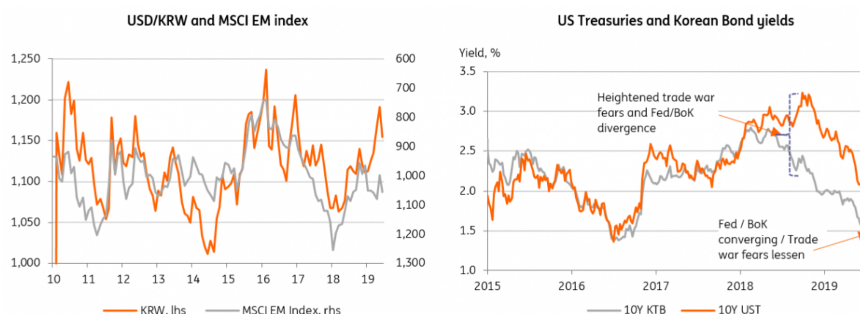
reach the end of the year

A catalyst for this is hard to predict in advance, though could include anything that undermined the easier Fed view – More evidence of strength on the labour market will remain key, but also stronger activity, wages and inflation data. If the US really is slowing now, then this probably won't be a problem, but if recent softer data flows are more a result of inherent noise rather than genuine signal, then it can't be ruled out.

Our forecast of a gradual appreciation of the KRW is centred on an expectation of a gradually improving global outlook as we reach the end of the year and as the commencement of the US Presidential race-proper limits further trade aggression, if only for 2019.

Korea's Treasury bonds rallied on the weak Korean story before they were pushed even lower by the US Treasury story. We have been surprised at just how far US Treasury yields have fallen, and remain suspicious that current levels are sustainable especially if the US is simply showing signs of slowdown, not hurtling into recession, consequently, for both Korean Treasury bonds and the KRW, we have some reversal of recent moves, though the conviction on the timing and extent of this is very low.

Korean Treasury yields and the Won



Source: Bloomberg

Government and fiscal policies

President Moon Jae-in's government continues to focus on measures to provide peace and reconciliation on the Korean peninsula, and in that respect, although there has been no breakthrough on North Korea, the support of US President Trump and recent revitalisation of talks is proof of some progress.

We don't think the government should abandon its reform goals of making the economy less reliant on a few big family-run conglomerates

But on the economy, the approach of tax and spend has been somewhat less successful, though it is hard to draw firm conclusions given the hostile global environment, and the counterfactual of

what might have happened in the absence of a trade war or tech slump would probably have been considerably better. Active industrial policy is not the direction this current government follows, though in April a supplementary budget was crafted, amongst other things, to provide economic support.

The overall size of the budget was KRW 6.7 trillion, about 0.3-0.4% GDP, though arguably on the low side given the scale of the external problem and also the fact that about one-third of that total was related to health and safety, not economic support.

Korea has low rates of public debt to GDP. Consequently, given the uniquely difficult state of the external and domestic environment, one can make a very good argument for further targeted support, especially bearing in mind that the BoK's room for manoeuvre is limited.

We don't, however, think the government should abandon its reform goals of making the economy less reliant on a few big family-run conglomerates, known as chaebol. A more competitive market structure would be positive for Korean growth, even if it meant giving up some of its market share of global exports. In the current environment that doesn't seem like a bad trade-off.

Korean Supplementary budget (April 2019)

Measure	Cost (KRW tr)	Description
Health and safety related	**-2.2**	
Reduce Fine Dust	-0.8	Promote scrapping of old vehicles, support remissions restrictions at industrial sites
Promote environment friendly technologies	-0.4	Promote environment friendly vehicles, installation of solar panels, expand financial support for R&D and new technology
Fine dust monitoring	-0.1	Strengthen fine dust monitoring, work on cooperation with China
Health concerns	-0.2	Hand out dust masks and support purchase of air purifiers, improve subway air quality
Citizen Safety	-0.7	Strengthen mountain fire management, other disaster management, promote corporate investment in workplace safety
Economy boost	**-4.5**	
Export support and ventures	-1.1	Support exporters going into new overseas markets, promote venture startups and support upscaling, develop tourism
Promote new industries	-0.3	Help develop 5G technologies, promote smart factories and fintech services, expand job training programs
Support local economies	-1	Support local economies affected by restructuring, invest in local infrastructure projects, provide emergency funding to small merchants
Increase working class support	-1.5	Expand unemployment benefits, social security benefits, emergency payments and energy vouchers
Support for employment	-0.6	Provide employment support, career change, create public sector jobs
Total	**-6.7**	

Source: Ministry of Finance - Korea

Longer term government plans - service sector the focus

The government seems to see more promise in the services sector, where it feels it lags behind the most developed world economies. Policies to push Korea to a more developed services future include:

- Providing the same level of support to services that has been extended to manufacturing firms
- Invest in basic infrastructure, including national statistics
- Promote convergence between the manufacturing and service sectors
- Build a regulatory foundation
- Relax regulations on promising service sectors, including healthcare and tourism
- Improve the logistics agency

These are of course very long run ambitions, but consistent with a modern developed economy. Though it brings with it a number of problems, including slower economic productivity growth, and in turn slower wages growth across both manufacturing and service sectors. One could argue that

in trying to rid itself of some of its current problems, this policy direction will simply swap them for problems being suffered by most G-7 economies, and for which there seem few obvious remedies.

Korea forecast summary

	1Q 19	2Q19	3Q19	4Q19	2019	2020	2021
GDP (%YoY)	1.7	2.1	0.6	1.1	1.4	2.5	2.3
CPI (%YoY)	0.5	0.7	0.6	1	0.7	1.7	1.9
Unemployment rate (eop)	3.8	4.1	4.2	4.1	4.2	4.2	4
Residential real estate (%YoY)	2.7	1.9	1	-0.3	1.3	0.9	3.4
Fiscal balance (consolidated ex soc sec)					-1.9	-3.9	-3.8
Debt/GDP (%)					38.6	41.3	43.5
Current account balance (US$bn and % GDP)	11.6	17.5	27.5	26.5	3.9	3.8	3.7
7-day repo rate (eop)	1.75	1.75	1.5	1.25	1.25	1	1
10Y yields (eop)	1.83	1.6	1.5	1.45	1.45	1.7	1.9
USD/KRW (eop)	1,135	1,155	1,150	1,180	1,180	1,160	1,140

Source: ING

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