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By Robert Carnell

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Having sat through a number of recessions and crises in a professional capacity over the nearly 30 years I have done this sort of thing, I've taken on board a number of life lessons. One of them is the resilience of equity markets. The psychology of most equity investors is intrinsically optimistic. Each new bout of bad fundamental news can herald a further life-giving dollop of liquidity from the central bank. And it really takes the realization that one is standing on the edge of the abyss, with no remaining safety nets, for real and protracted selling to set in. Indeed, as each new crisis and recession is met with ever more willing and often able central banks to pick up the slack, that tendency to keep looking through any bad news has tended to grow over time.

Regular readers (if there are any of you?) will know that I have been quite disparaging about the recovery of (in particular) US equities since their March 23 trough. I have smacked my head in exasperation as it rallied in the face of more than 20 million payrolls losses this month, or on every ill-conceived and non-credible rumour of an effective treatment for the Covid-19 virus. Re-opening of economies was another factor to cause optimism-led buying. Second wave risks were just something to brush aside. V-shaped recovery is implied by the relatively small earnings declines suggested by equity pundits. You can't blame the dismal scientists for this as for once, we are virtually united in our view that this recovery will be any other shaped than V.

But like so much else in life, in the end, it doesn't matter what we (and especially I) think. Just as it doesn't really matter what the facts are in this post-truth world. What really matters is whether or not the equity investor community still has that inherent optimism, and is willing to look through every knock to their view as a temporary setback that will get nursed back to health by more policy band-aids.

So in this respect, it is worth asking, have the recent comments by Fed speakers downplaying the likelihood of negative rates in the US shut the last door for further discount rate cuts? Maybe. And is the prospect of any further fiscal stimulus also dimming? Probably. Are there also genuine concerns about the impact of premature reopening of the states? There should be. And further afield, similar concerns could be levied at the prospects for ongoing ECB stimulus given the recent unhelpful intervention by the German Constitutional Court. Though the recovery in European stocks has been far less striking.

The bigger question is, is all this enough to result in more than a one or two day dip in stocks...? And from what I've picked up along the way, I honestly wouldn't bet on it, no matter how supportable a proposition that would seem to be.

RBNZ - no need to do anything

WIth Covid-19 the single biggest driver for economic prospects in any economy these days, New Zealand finds itself in the enviable position of appearing to have their outbreak well under control, and re-opening measures for the economy proceeding. Like all small open economies, New Zealand will face headwinds in the months ahead. But as an exporter of primary produce at a time when food supply chains have been heavily disrupted, this might not turn out to be such a strong headwind after all for them.

So having sounded open-minded to a number of policy options in recent months, including negative rates, we don't think Governor Adrian Orr will feel the need to do anything radical at today's Reserve Bank (RBNZ) meeting. Most likely, he will downplay the optimistic recovery view and stress the options still available to the central bank if things take a turn for the worse. But perhaps like recent US Fed speakers, if he suggests that negative interest rates in New Zealand are looking a little less likely, the NZD could see some near-term support.

Asia today

This morning, we've already had South Korean Unemployment for April, which was surprisingly good, remaining unchanged at 3.8% of the labour force.

Prakash Sakpal writes about the other developments and scheduled releases in our region today:

"**India:** Prime Minister Narendra Modi has announced INR 20 trillion (10% of GDP) stimulus package to help the economy weather the Covid-19 storm. The details are yet to be out but the package aims to support businesses, workers, and financial system liquidity. It also contains previously announced measures, including the monetary stimulus by the central bank (RBI). The announcement is a big push to an otherwise anaemic initial move comprising only 1.3% of GDP fiscal support and 2.4% of GDP RBI liquidity boosting measures. However, with rapidly rising Covid-19 infections (current count 74,292) it's a long wait before the economy responds to the stimulus.

Malaysia: 1Q20 GDP is due today. The consensus is centred on a -1% YoY growth. We are more bearish with -4.2% forecast, the worst in over a decade. The political turmoil overthrowing the Mahathir government in late February, the Covid-19 lockdown since mid-March, and plunge in the global oil price – all came crashing down on the economy. Surprisingly exports and manufacturing eked out small yearly gains, but services including retail, transport, tourism, etc. likely took a strong beating. On the spending side, it should be an across-the-board dip in consumption, investment, and net trade. The first-quarter GDP doesn't capture the full impact of Covid-19, which is for the current quarter much which is gone in movement restrictions (now extended until 9 June). We doubt aggressive fiscal and monetary stimulus would be effective in arresting more steeper GDP fall in 2Q (ING forecast -6.6%).

Singapore: The authorities announced the suspension of operations of one more airport terminal, Changi Terminal 4, from 16 May. This follows the suspension of operations of Terminal 2 started on 1 May for 18 months. These moves provide a glimpse into a prolonged economic gloom ahead. With policy stimulus maxed out, hopes are pinned on the pandemic ending for the stimulus to kick-start the economy".

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ASEAN Morning Bytes

Investors may turn defensive on Wednesday as health experts express caution over reopening economies too quickly

EM Space: Sentiment likely to sour as US health experts testify and Fed officials offer sobering outlook

- **General Asia:** Investors will likely turn defensive on Wednesday with top US health officials expressing caution over reopening too quickly while previous hotspots like Korea and China record spikes in cases after relaxing restrictions. Meanwhile, Fed officials painted a gloomy outlook for the economy in the coming months but officials ruled out the Fed resorting to negative interest rates to combat the Covid-19 impact. Fed Chair Powell is scheduled to speak later on Wednesday but investors will likely be monitoring new infections around the globe after several countries and US states have begun to relax restrictions over the past few days.
- **Malaysia:** 1Q20 GDP is due today. The consensus forecast is centred on a -1% YoY result. We are more bearish with a -4.2% forecast, which would be the worst quarterly outcome in over a decade. The political turmoil embroiling the Mahathir government in late February, the Covid-19 lockdown since mid-March, and the plunge in global oil prices – have all come crashing down on the economy. Surprisingly exports and manufacturing eked out small yearly gains in 1Q20. But services including retail, transport, tourism, etc. likely took a strong beating. On the spending side, it should be an across-the-board dip in consumption, investment, and net trade. First-quarter GDP doesn't capture the full impact of Covid-19,

which will mainly impact the current quarter due to movement restrictions (now extended until 9 June). We doubt aggressive fiscal and monetary stimulus will be effective in arresting a steeper GDP fall in 2Q (ING forecast -6.6%).

- **Singapore:** The authorities announced the suspension of operations of one more airport terminal, Changi Terminal 4, from 16 May. This follows the suspension of operations of Terminal 2 started on 1 May for 18 months. These moves provide a glimpse into the prolonged economic gloom ahead. With policy stimulus maxed out, hopes are pinned on the pandemic ending for the stimulus to kick-start the economy.
- **Philippines:** President Duterte extended lockdown measures in the capital region and surrounding provinces while relaxing restrictive measures in regions with a low density of cases of Covid-19. Manufacturing activity will be restarted but capped to 50% capacity to ensure social distancing is practised. After 1Q GDP fell into contraction, government officials opted to lift some restrictions to get the economy back on track while the secretary of finance pledged that a fresh round of fiscal stimulus was in the works. The extension of the lockdown in the capital will lend support to the Peso for another 2 weeks as import demand is projected to remain muted, but we expect an eventual depreciation for PHP once the lockdown is lifted.

What to look out for: Covid-19 developments

- Malaysia GDP (13 May)
- US producer prices (13 May)
- Fed's Powell speaks (13 May)
- US initial jobless claims (14 May)
- China industrial production and retail sales (15 May)
- Indonesia trade (15 May)
- Hong Kong GDP (15 May)
- US retail sales and industrial production (15 May)
- US consumer sentiment (15 May)

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Hong Kong quarterly: which industries will survive the deep recession?

Trade war. Social unrest. Covid-19. These three hits to Hong Kong's economy have resulted in a difficult recovery path. Now, Covid-19 has subsided but...

Source: Shutterstock

Hong Kong has had difficulty coming out recession

The economy has been in recession since 3Q19, and fell by -8.9%YoY in 1Q20, which is the deepest contraction since 1974 when the data was first compiled.

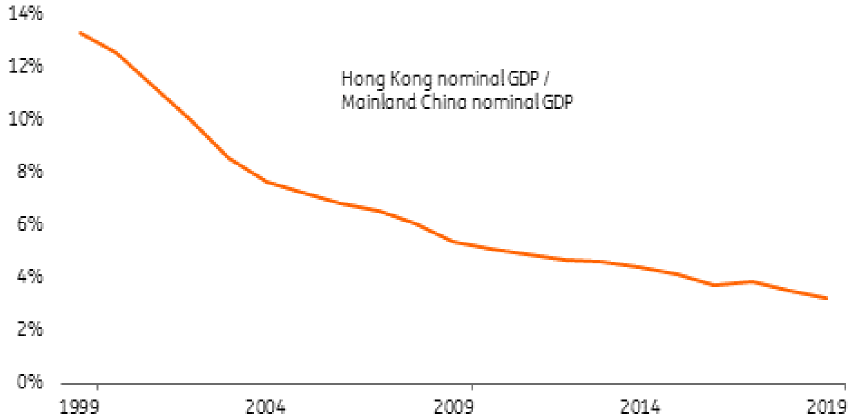
The trade war clearly hurt economic growth in 2019, with GDP growth of just 0.7%YoY and 0.4%YoY in the first two quarters of 2019, respectively.

The arrival of social unrest, together with the trade war, brought the economy into recession, with drops of -2.8%YoY and -3.0%YoY in the third and fourth quarters of 2019.

Then came Covid-19.

But just as the pandemic seems to be subsiding in Hong Kong, social unrest is returning. We expect full year GDP growth at -4.1%. This is based on the assumption that there will be no material trade war between China and the US.

Hong Kong's importance to Mainland China in terms of GDP



Source: ING, National Statistic Bureau (Mainland China), Census and Statistics Department (Hong Kong)

Who's been hurt most?

Looking at the damage to industry, we believe that a better gauge would be employment data. In Hong Kong, redundancy costs are not as high as in Europe. So when businesses expect a long term downturn, they hire fewer people or even lay off staff.

Industries affected by the trade war

Hong Kong has only a tiny manufacturing sector, so essentially we can describe Hong Kong as not having factories. It provides services to merchandise trade, e.g. sourcing, shipping, port service, freights and trade finance. The number of companies in import/export trade and wholesale fell 2.8% in 2019 compared to 2018. This does not sound a lot. But the number of people employed in this industry fell 7.3%, (around 39,000 people).

The impact of the trade war is therefore large. It's still uncertain whether there will be a new round of tariffs between China and the US. If that happens, it will be the fourth hit to Hong Kong's economy.

Industries affected by social unrest and Covid-19

Attracting Mainland tourists to shop in Hong Kong was a comparative advantage over many other economies in the world due to the lower travel costs, a high standard of restaurants, good services, and no value-added tax. This made Hong Kong appealing to Mainland tourists who want a luxurious shopping experience.

But with social unrest increasing from the second half of 2019, this advantage has gone. While Hong Kong and Mainland China may relax quarantine measures and travel restrictions for each other fairly soon, Mainland tourists are unlikely to visit Hong Kong if the threat to personal security persists.

Social unrest in Hong Kong has been rare in the past. Even the 2014 Occupy Central protest was a very peaceful one. But since 2019, demonstrations have become increasingly violent. Many shops and restaurants closed early to avoid damage. The unemployment rate in the category of retail, accommodation and food services increased from 3.6% at the beginning of 2019 to 6.1% at the end of the year.

Covid-19 further hit the tourism industry and local retail and catering businesses. Unemployment in this category rose further, to 6.8% by the end of March 2020, which was higher than the headline unemployment rate of 4.2%.

As such, airlines, retail and catering will continue to be hit. These industries rely on domestic demand, which is under threat due to high unemployment.

Which industry stands out?

Hong Kong should continue to leverage its financial and legal system to serve the offshore financial needs of Mainland companies. This will continue unless Mainland China's financial system matures, e.g. via interest rate liberalisation. Hong Kong could have another 10 years to enjoy this privilege.

Businesses of residential property developers should be fairly stable because the unemployed are mostly in the low-income group, which could not afford to buy a private flat even before the triple hits to the economy. But property investors of commercial and retail could stay on the sidelines as they wait for the social unrest to fade and to see how the trade conflict pans out.

While there are policies to encourage the development of technology as an industry in Hong Kong, Shenzhen is located very nearby, and there is already a cluster of well-established tech companies here, as well as a pool of talent from other cities in Mainland China and from the rest of the world, including Hong Kong. As such, Hong Kong can't really compete on this one.

Hong Kong	1Q19	2Q19	3Q19	4Q19	1Q20F	2Q20F	3Q20F	4Q20F
Real GDP (YoY%, period average)	0.6	0.5	-2.9	-2.9	-8.9	-8.0	-0.7	1.4
CPI (%YoY, period average)	2.2	3.0	3.3	3.0	2.0	-0.5	0.0	0.5
HIBOR 3M (%, period end)	1.76	2.46	2.26	2.43	1.93	0.90	1.00	1.10
10Y government bond yield (%, period end)	1.47	1.51	1.56	1.76	0.78	0.55	0.60	1.00
USDHKD exchange rate	7.850	7.812	7.838	7.791	7.751	7.752	7.760	7.765

Source: ING, Census and Statistics Department of Hong Kong SAR

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