Good MornING Asia - 14 May 2020

US Fed's Powell says "no" once more to negative rates, but is this all that is unsettling the markets?

In this bundle

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No negative rates

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Source: Shutterstock

Markets looking nervy

The S&P500 fell further overnight setting us up for a risk-off tone in Asia today. Yesterday, I wrote that the equity market is hard to knock down, and stays resilient right up to the point where it is standing on the abyss and realizes there is no safety net any longer. I'm still not sure we are at that point yet. The last 48 hours have given us nothing new to digest. But then again, this crisis feels like more of a marathon than a sprint, and just maybe there are some runners out there who aren't built for the relentless slog that battered earnings and a painfully slow recovery will offer, irrespective of the amount of fiscal stimulus and virtually free money sloshing around the system.

Moreover, I'm no technical analyst, but even I can see how well the latest sell-off, recovery and renewed downturn are mapping onto Fibonacci levels, and unless I'm very much mistaken, we are sitting just above the bottom of a double top. Equity futures suggest that we will hold these levels, which could set up markets for more buying on dips. But the mood, which is so important for the equity sphere, seems to be changing perceptibly. This morning's newswire headlines are full of comments from top investors sounding pessimistic on the outlook for stocks, as well they might. The facts of the matter support a much lower market than is in fact the case. But the market mood has been by far the more important factor than (for example) the more than 30 million jobs lost in recent months, and that mood is what we should continue to monitor because moods are not substantial - they are built of fairy dust and can evaporate for no apparent reason.

No to negative rates

One factor that might not be helping market sentiment is the continued rejection of negative rates by the Fed. James Knightley in New York has written in more detail here on the Fed's latest economic assessment.

In a virtual conference with the Pieterson Institute yesterday, Fed chair, Jerome Powell, once more indicated that the Fed was not considering negative interest rates as an option. Personally, I'm with Powell on this. But I was a little surprised to see a number of research papers from some well known US banks and fund management companies suggesting that negative rates for the $4tr US Money Market industry might not be the disaster it sounds to me. Much of this is based on the experience of similar funds in Europe. And I'm not sure the comparison holds, given the much more important role played by Money market mutual funds (MMFs) in market liquidity provision in the US. I will write at greater length on this shortly, but for balance, here is a positive note on negative rates from Kenneth Rogoff as part of our "Think Outside" series, which I totally disagree with. So who are you going to believe? Rogoff or me? Don't answer that.

I'd add that it is not even clear if it is legal for the Fed to pay a negative rate on its reserves, as this paper from the St Louis Fed notes.

The St Louis Fed paper also quotes former Fed Chair, Ben Bernanke, who argues that the mere possibility of negative rates could have the effect of keeping the expected path of short-term rates more negative than otherwise. This could be right out of the playbook from the Reserve Bank of New Zealand's Governor, Adrian Orr, who yesterday expanded New Zealand's QE programme and also kept the door open to other policy moves, including negative rates. We don't think he will implement such a policy, but it probably doesn't hurt to have the market thinking that he might, especially if it helps keep yields over the entire yield curve low and the NZD soft.

Today in Asia Pacific

Australian labour market data is out later this morning, and it will look quite horrible. Anything between a few hundred thousand to a million job losses in April is the market view, so its really just a question of degree. But as the Reserve Bank of Australia has already pulled back from its QE programme slightly, and with copious fiscal stimulus in the pipeline, its hard to see this having a big market impact, aside from any temporary knocks to the AUD and government bond yields that may follow a weaker than expected number.

In the Philippines, Nicky Mapa notes: "The cabinet revised official economic projections for 2020 and 2021 in the wake of the Covid-19 outbreak with GDP expected to drop to -2.0 to -3.4% in 2020 before rebounding sharply to 7.1-8.1% in 2021. Government officials also expect the budget deficit to widen sharply to -8.1% of GDP on the projected drop off in revenue collection and increases in spending to offset the economic downturn. Bond yields have remained subdued due to BSP's aggressive rate cuts and benign inflation (April inflation at 2.2%) but we expect the Treasury to begin issuing longer-dated bonds once the 2-month lockdown is lifted to help finance the planned fiscal rescue bill".

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Malaysian economy beats expectations in first quarter

Yearly GDP growth remained in positive territory despite strong economic and political headwinds in the first quarter. But, a quarterly contraction sets...

Source: Pexels

0.7% 1Q20 GDP growth

Year-on-year

Better than expected

A pleasant upside miss

Malaysia's first-quarter GDP posted 0.7% growth from a year ago, a better performance compared to the consensus forecast of a -1% contraction (far better than our -4.2% forecast). This still represents a sharp slowdown from 3.6% YoY growth in 4Q19, and the worst quarterly outcome in over a decade (since the 1.1% fall in 3Q09 induced by the global financial crisis). Moreover, a 2% quarter-on-quarter (seasonally adjusted) GDP fall sets the economy on the path of a recession, probably deeper than the GFC.

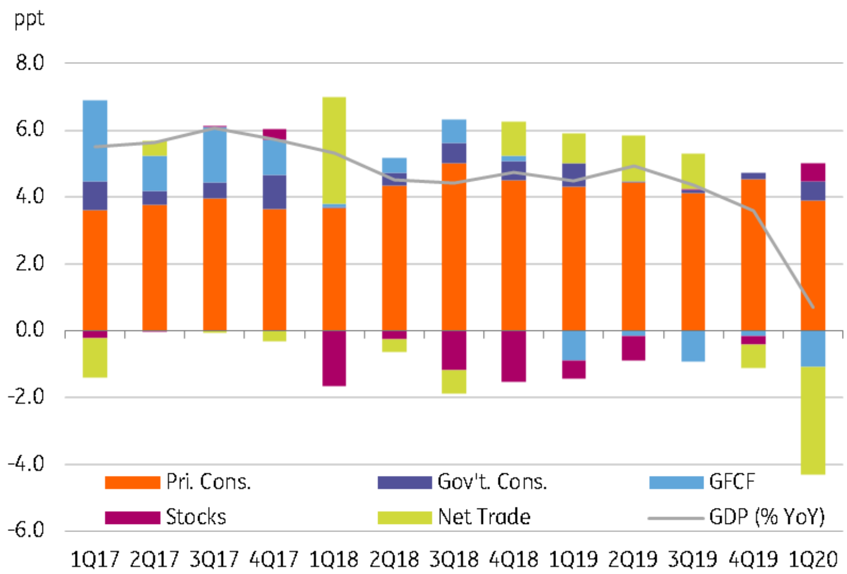
A better 1Q GDP performance relative to other Asian countries comes against an adverse economic and political backdrop in the period. First, the political turmoil leading to the end of the Mahathir government in late February depressed economic confidence. Just as the Muhyiddin administration assumed power, it was forced to implement Covid-19 movement restrictions in mid-March, bringing the economy to a standstill. As if all this wasn't enough, a crash in the global oil price in March made matters worse for Asia's net oil-exporting economy.

Badly hit external sector

Consistent with the message from the high-frequency data, manufacturing growth stayed in positive territory, although it slowed to 1.5% YoY from 3.0% in the previous quarter. Agriculture and construction were badly hit with -8.7% and -7.9% YoY growth, while services growth halved to 3.1% from the previous quarter.

Private consumption remained the spending side GDP driver with a 3.9 percentage point contribution to headline growth, yet smaller than 4.5ppt in 4Q19. Government consumption helped with another 0.6ppt (we doubt it was entirely stimulus). Exports turned out to be the bigger drag, shaving off 4.7ppt from GDP growth (a stark contrast to firmer customs-basis export growth), imports subtracted 1.4ppt, and fixed capital formation got it down by another 1.1 ppt.

Expenditure-side sources of GDP growth



Source: CEIC, ING

More pain ahead

The first-quarter GDP doesn't capture the full impact of Covid-19, which will mainly impact the current quarter due to movement restrictions. The authorities have decided to relax restrictions starting 4 May, but the broader control measures remain in place until 9 June. This means a virtually entire quarter of significantly sub-normal economic activity. We aren't rushing to change our view of as much as 6.6% YoY GDP contraction in 2Q, or 2.9% full-year contraction in 2020.

The new government of Prime Minister Muhyiddin Yassin spared no time in rolling out massive stimulus -- amounting to about 18% of GDP, though mostly including easier credit avenues and early access to pensions. The real fiscal thrust is only 4% of GDP. The Bank Negara Malaysia has also accelerated its easing with a 50 basis point rate cut on 5 May. We doubt aggressive fiscal and monetary stimulus will be effective in preventing a recession.

While already stretched public finances limit the scope of more fiscal stimulus, we believe monetary easing has further to run given falling inflation. We continue to expect an additional 50bp BNM rate cut in this cycle.