

## Good Morning Asia - 15 March 2019

The US-China trade deal continues to be elusive with Trump-Xi meeting unlikely to take place until April. Softer China data suggests that further GDP slowdown in the current quarter is inevitable, though the stimulus is expected to prevent a hard landing of the economy

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By Robert Carnell



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## ASEAN Morning Bytes

General market tone: Wait and see. Market players will likely adopt a holding pattern for the time being on concerns about the US-China trade negotiations.



### EM Space: Trump's admission that the negotiations would take a bit longer than expected seen to sap risk sentiment

- **General Asia:** Trump and Mnuchin downplayed earlier speculation of a summit and a deal in place by March, indicating that a deal was likely to be struck sometime in April or in 3-4 weeks' time. With the Fed lined up in the next few days, investors will likely opt to wait for any news on the FOMC's call on the reduction in its balance sheet for direction.
- **Malaysia:** January industrial production growth of 3.2% YoY was better than expected, but it was still slowdown consistent with slower export growth. Data supports our forecast of a further slowdown in GDP growth to 4.2% in the current quarter from 4.7% in 4Q18. We have revised our view of the central bank (BNM) policy from one of no change this year to one 25bp policy rate cut as early as next quarter. There are no forceful arguments for easing just yet, but a pre-emptive easing to support future growth won't hurt when there is room for such a policy change now.
- **Indonesia:** Indonesia will report trade data for the month of February with market players expecting a contraction in exports given the on-going US-China trade war. Imports will also likely be subdued given the government's efforts to curb unnecessary imports and narrow the current account deficit. All in all the trade balance is forecasted to remain in the

negative, albeit at a narrower gap, which should lend some support for the IDR.

- **Philippines:** The Philippines will be reporting overseas Filipino remittance flows with median estimates pegging growth to settle at 4% for the month of January. Remittances continue to provide a steady stream of foreign currency but have yet to break out of the 3-5% growth range they have been stuck in recent years. Weaker remittance growth may not bode well for the PHP, which is suddenly pressured in March after registering a strong performance in February.

## What to look out for: US-China trade negotiations

- Indonesia trade (15 March)
- Thailand GIR (15 March)
- India trade (15 March)
- Philippines remittances (15 March)
- US JOLTS and consumer sentiment (15 March)

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## Asia week ahead: Central banks frenzy

Asian central bank meetings dominate the agenda next week, and while all four are likely to pass without any policy changes, we'll be looking for...



Source: Shutterstock

### ➔ Four central bank meetings, but only two matter

Asian central banks in Indonesia, Philippines, Taiwan, and Thailand all have monetary policy meetings next week.

We think the market is interested in what Indonesia and the Philippines central bank's will do and look for any signs of easing after their aggressive policy hikes in 2018. The inflation argument for easing is getting stronger in both countries, and the argument for currency stability doesn't seem to hold much ground anymore in an increasingly dovish G3 central bank environment. But the key resistance to currency appreciation in these countries is the wide current account deficit. We think the central banks will look over the inflation data and remain on hold next week.

In Taiwan, the central bank has been on hold since the last rate cut to 1.375% in June 2016. We don't think it will do anything this year despite falling exports dragging GDP growth lower in the recent quarter. The trend is likely to continue ahead while inflation is almost non-existent. And given that the Bank of Thailand tightened policy in December, it has been flagging a stable policy ahead even though economic data has shown increased downside growth risk. But look out for February export figures from Taiwan and Thailand next week.

## ➔ Malaysia's central bank likely to get ahead of the curve

Malaysia's consumer price data for February will be interesting to watch after the deflation surprise in January, which we believe was largely a transitory phenomenon due to administrative cut in fuel prices. Factors underlying our forecast of 0.5% year-on-year inflation, which is a reversal from -0.7% in January, are the Lunar New Year-related rise in the food component and narrowing negatives in the fuel-related transport component.

We don't think inflation will be a policy problem for the central bank in 2019, as risks remain tilted toward growth. Nor are there any strong arguments for central bank policy easing just yet, but a pre-emptive move to support growth won't hurt when there is room. We see the central bank moving to cut rates at the next meeting in early May 2019 - a shift from our previous forecast of no change in 2019.

[Malaysia: The doors open for central bank policy easing](#)

## ➔ Singapore NODX data will help shape central bank

In Singapore, the non-oil domestic exports is the critical data release for next week, signalling the possible course the central bank could take at the next semi-annual meeting in April. 2019 started with weak export and manufacturing performance, and both indicators posted sharp year-on-year declines in January. The Lunar New Year effect is likely to have sustained the weakness in February and if so; quarterly GDP growth is poised to slow further in 1Q19 from 1.9% YoY in 4Q18 - which was already the slowest in two years.

Having tightened policy twice in 2018, a stable Monetary Authority of Singapore policy in April seems to be the safest forecast for now. But we're not ruling out the central bank joining the potential easing bandwagon led by G3 central banks just yet.

## Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
<b>Monday 18 March</b>					
Philippines	-	Jan Budget Balance (PHP bn)	-	-	-81.0
Singapore	0030	Feb Non-oil Domestic Exports (MoM/YoY%)	2.4/-6.1	-/-	-5.7/-10.1
<b>Tuesday 19 March</b>					
Philippines	0845	Feb Balance of Payments (US\$m)	500.0	-	2704.0
South Korea	2100	Feb PPI (YoY%)	0.0	-	0.2
<b>Wednesday 20 March</b>					
Malaysia	0400	Feb CPI (YoY%)	0.5	-	-0.7
Taiwan	0800	Feb Export Orders (YoY%)	-5.0	-	-6.0
Thailand	0705	Benchmark Interest Rate	1.75	-	1.75
<b>Thursday 21 March</b>					
Hong Kong	0815	Feb CPI (YoY%)	2.0	-	2.4
Indonesia	-	Mar Policy Decision, 7-day Reverse Repo (%)	6.0	6.0	6.0
Philippines	0800	Overnight Borrowing Rate	4.75	-	4.75
Taiwan	-	Benchmark Interest Rate	1.38	-	1.38
-	-	Feb M2 Money Supply (YoY%)	-	-	3.1
Thailand	-	Feb Exports (Cust est, YoY%)	-1.0	-	-5.7
-	-	Feb Imports (Cust est, YoY%)	8.0	-	14.0
-	-	Feb Trade Balance (Cust est, US\$m)	-883.0	-	-4032.0
<b>Friday 22 March</b>					
Malaysia	0700	Mar Forex reserves, Month-end (US\$bn)	-	-	102.4
Taiwan	0800	Unemployment Rate (%)	3.8	-	3.7

Source: ING, Bloomberg, \*GMT



# China: Data shows fiscal stimulus is working

Infrastructure investment and real estate development has supported the economy while retail sales growth has stabilised. We don't read too much into...



Source: Shutterstock

## Fiscal stimulus on infrastructure investment is working

Fixed asset investment increased by 6.1% year-on-year, year-to-date in February, faster than the 5.9% rate in December.

Infrastructure investment grew 4.3%YoY YTD in February, 0.5 percentage points higher than the average rate in 2018. Road and transport investment, which is the main category of investment funded by local government special bonds, rose 13%YoY YTD, an increase of 4.8 percentage points from the average 2018 rate.

Faster growth in these areas helped to mitigate slower growth in the manufacturing sector.

The impact of fiscal stimulus on infrastructure investment is likely to become even more obvious as the year goes on, and will be the main driver of economic growth in 2019. This will be particularly true if there is no imminent agreement on a trade deal.



## Strong real estate development growth

Real estate development rose by 11.6%YoY YTD in February from 9.5% in December. Within that, residential property development grew 18.0%YoY YTD, making up 72.1% of total real estate development. This is due to the fact that some local governments have started to relax home buying measures, with lower mortgage rates, taxes and down payments as well as fewer purchasing restrictions.

We are likely to see more local governments relax home buying policies to support growth.

**18%** Residential property developments (YoY YTD)  
Feb 2019

## Retail sales stabilised but big ticket items are weak

Retail sales growth was flat at 8.2%, with consumers more cautious about buying expensive items; jewellery grew just 4.4%YoY YTD and auto sales essentially shrank by 2.8%YoY YTD.

Consumers spent more on catering, which grew at 8.7%YoY YTD, although this could be a Chinese New Year effect.

## A surprisingly high jobless rate but is it another Chinese New Year effect?

We monitor the correlation between retail sales and China's surveyed unemployment rate in urban areas, which rose to 5.3% in February from 4.96% in December.

For the first two months of 2019, there seems to have been a slight bifurcation in these two data points. But we will keep monitoring them because we're surprised that the unemployment rate jumped quite quickly. Again, this could be due to the Chinese New Year effect, with some factory workers staying in their rural home towns to find jobs or to set up their own businesses. So we will have to wait another month to confirm if the deterioration in the job market is really that severe.

## Long factory holiday during Chinese New Year may distort the picture for industrial production

Taking into account the Chinese New Year, industrial production grew 6.1%YoY YTD. If you exclude this factor, however, the growth rate went down to 5.3%YoY, while the previous data was 5.7%YoY.

Our preferred gauge, the production of industrial robots fell 11.0%YoY YTD, and production of automobiles continued to shrink, by 5.3%YoY YTD, while new energy vehicle production rose 53.3%YoY YTD.

We are cautious about this data because factories close for three weeks or more during the Chinese New Year, and the holiday fell into different calendar months for 2018 and 2019, so the base effect is an issue when calculating year-on-year numbers. We can draw better conclusions

about the manufacturing sector's growth rate when we have the March data.

## **The economy will need to rely on fiscal stimulus if a trade deal is delayed**

Overall, the activity data shows us that the economy has started to rely on fiscal stimulus, especially for infrastructure investment. This will continue for the rest of 2019, and will be particularly important if a trade deal comes later than expected.

The data was somewhat weak but that could be a result of the Chinese New Year's base effect. We suggest waiting for March to confirm this weakness.

Looking at the data as a whole, our GDP growth forecasts at 6.3% for 2019 and 6.2% for 1Q19 remain intact.

# Why Brookings is right on China growth, and why we're not surprised

Chinese growth since 2008 has been almost 2 percent lower than official numbers indicate, according to a recent Brookings research paper. We think the...



A busy road in Shanghai

## Ordinal or cardinal?

Saying that official Chinese GDP figures are not all they appear to be is a bit like saying that professional wrestling might not, in fact, be a competitive sport as claimed. But it is always helpful to be able to put some scale to that belief.

A recent Brookings Institution paper has done just that, and in ways that seem highly credible. The report, titled "[A forensic Examination of China's National Accounts](#)" shows that Chinese GDP growth since 2008 may be close to two percentage points lower than the officially published figures suggest.

That means that at best, the official numbers are an ordinal measure of economic activity - helpful in terms of illustrating direction - but far more limited in terms of providing information about magnitude. It is not for nothing that alternatives to GDP, for example, [the Premier Li index](#), have been popular unofficial supplements to the official data for years.

## Crunching the numbers

The four authors of this report take a rigorous approach to the data. Local GDP data is compared with national data, unveiling consistent discrepancies for industrial sector output and net exports. China's National Bureau of Statistics (NBS), attempts to reconcile the local figures which typically sum to more than the national total, by adjusting the figures down. By comparing the official numbers calculated in this way to GDP estimates based on value-added tax revenue growth reported by the State Administration of Taxation, the authors conclude that the adjustments made to local GDP were indeed roughly accurate up until around 2008. After then, the published data overestimate national GDP by around 1.7 percent per year.

The appeal of using VAT revenue data to adjust the figures is that the incentives to inflate these numbers are exactly the opposite to the incentives to inflate local GDP figures. That said, this does perhaps raise the prospect that systematic under-reporting of VAT revenue to avoid an offsetting fiscal adjustment might also bias the figures the opposite way. It's worth adding that when timely reporting is not an issue, tax data is often one of the most comprehensive and reliable sources of information on economic activity, so this is a minor caveat.

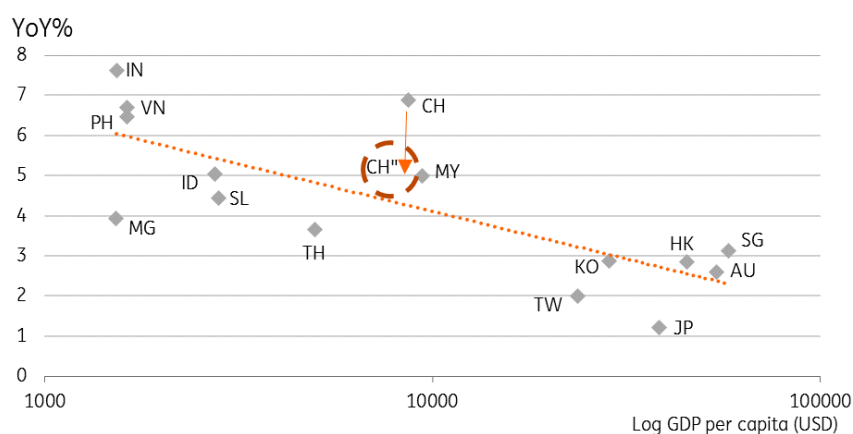
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### *Top down meets bottom up*

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Moreover, the authors' bottom-up number crunching is supplemented by top-down statistical modeling. The model inputs include satellite night lights, electricity consumption, railway cargo flow, and trade flows. Many of these inputs will be familiar as inputs in the Li Keqiang index, and should also be relatively immune to human manipulation or mismeasurement. This statistical approach also found a structural break at 2008 consistent with the bottom-up analysis and supports the initial conclusions.

## Average Asian GDP growth (4Y) and GDP per capita (log scale)



Source: ING

## Does this matter?

On one level, the potential for inaccuracy in China's GDP reporting is neither surprising nor terribly

concerning. It is what I refer to as the "Celsius versus Fahrenheit issue". In other words, we know that a GDP growth rate of 6% is not as good as a GDP growth rate of 7%. What we don't know is whether GDP growth of 6% is really "hot" or really "cold", or neither.

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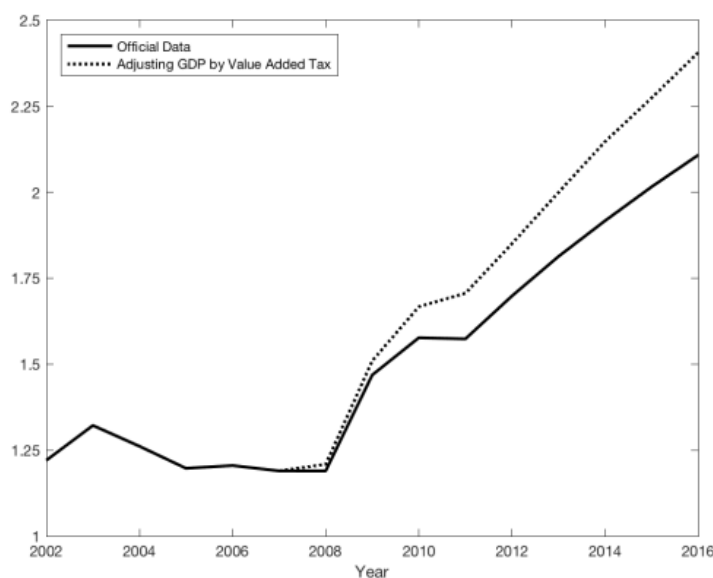
*The potential for inaccuracy in China's GDP reporting is neither surprising nor terribly concerning*

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The Brookings paper doesn't get us much further, though to the extent that we can compare the newly computed Chinese figures with those for other countries in which we may have more trust, it might make comparisons easier. As a point of reference, GDP growth in Asian countries is explained to a large extent by the level of development (as measured by GDP per capita - also subject to mismeasurement, but measured on a log scale, this is far less serious). Such approaches show China as a massive outperforming outlier, though if we adjust Chinese growth in line with the Brookings paper suggestion (CH' in the chart above), it would lie much closer to the best-fit line. In other words, although the findings of the paper suggest that China is still growing fast for a nation at its stage of development, the discrepancy is credibly within the normal range of deviation.

Where the analysis is a bit more concerning, is in relation to China's debt to GDP ratios. With debt likely to be far more accurately measured relative to GDP, the analysis suggests that China's debt ratio might be about 30% (GDP) greater than ordinarily assumed. For those who worry about China's leverage, this doesn't provide any comfort. Total economic debt in China appears high relative to GDP even using official data, and very high for an economy at China's level of economic development. Though this data doesn't actually change that indebtedness, just our level of understanding.

## Debt to GDP - official and re-estimated ratios



Source: Brookings' Economic Papers

## People in glass houses

Before we get too judgemental, it is also worth reflecting on other countries' measures of GDP. Within the Asia region, many historical GDP releases lack the quarterly volatility that you would expect from such data, which undermines their credibility. That isn't to say that they are overstated, but they do seem to be unnaturally smoothed. Even in developed markets, statistical approaches such as hedonic price adjustment could be argued to artificially inflate real GDP estimates, and downplay inflation. Where inflation is used to adjust public payments such as pensions over time, this can save governments billions of dollars, at the expense of their population's incomes.

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*Before we get too judgemental, it is also worth reflecting on other countries' measures of GDP*

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In truth, all measures of GDP are subject to the criticism that they provide only a partial description of the economic activity occurring at a national level. They frequently omit sizeable elements of economic activity, such as home working, grey or black market activity and voluntary work. All measures of GDP should, therefore, be considered as indicative measures of economic activity, rather than concrete representations of reality. The Brookings estimates shift China's GDP measurement in the direction of measures like EU and US GDP. But those measures themselves are far from problem-free.

You can download the full Brookings' report from their website [here](#)

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# Malaysia: The doors open for central bank policy easing

We are revising our view of Bank Negara Malaysia monetary policy from one of no change this year to one 25bp policy rate cut as early as next quarter...



Source: shutterstock

## Increased scope for pre-emptive BNM easing

We believe the latest consumer price data showing inflation at -0.7% YoY in January, the first negative reading in nearly a decade, has opened the door for a more accommodative monetary policy setting.

There are no forceful arguments for policy easing just yet, but a pre-emptive move to support growth won't hurt when there is room for such a policy now. We now see the central bank (Bank Negara Malaysia) moving to cut rates at the next policy meeting in early May 2019, a shift from our earlier forecast of no policy change this year.

## Balance of risks is tilted toward growth

Following on from the surprising return to deflation in January, both exports and manufacturing growth came in on the softer side, so undermining growth prospects.

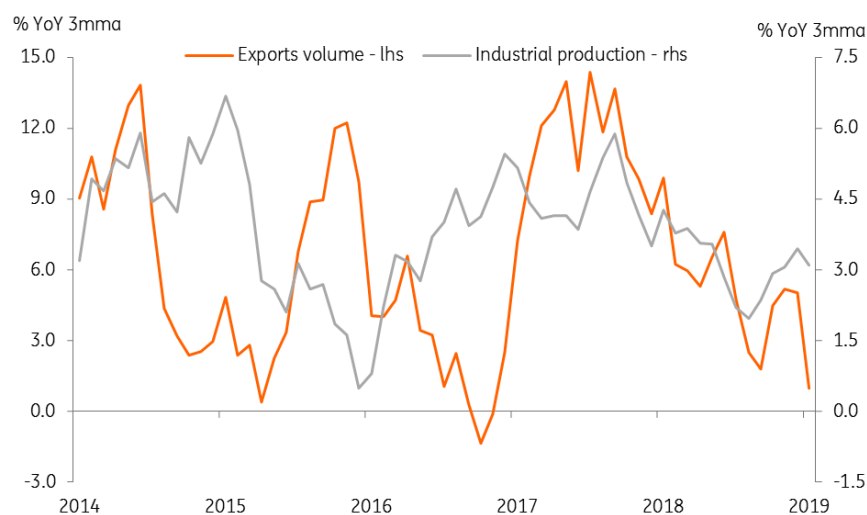
Released today, industrial production growth slowed to 3.2% year-on-year in January, from 3.4%

in December. The outcome was better than expected (ING forecast 3.0%, consensus 2.3%). An IP slowdown squares with that in the export sector (at 3.1% growth vs. 5.1%). Among the other activity indicators released alongside the production data, manufacturing sales growth eased slightly (to 7.0% in January vs. 7.5% in December). Employment growth in the sector picked up (to 2.0% vs. 1.7%), but salary and wage growth slowed (to 8.9% vs. 10.1%).

The balance of economic risks is tilted toward growth. Exports and manufacturing drive GDP and their slowdown in January foreshadow a further GDP slowdown in the current quarter. We expect GDP growth to slow further - to 4.2% in 1Q19 from 4.7% in 4Q18. This is in line with the Bloomberg consensus forecast of 4.3% growth in the current quarter.

External uncertainties from trade tensions, weak global demand, and oil prices will all weigh on GDP growth over the rest of the year, amid anaemic investment spending at home. On the flipside, the favorable base effect and accommodative economic policies should prevent a sharp GDP slowdown should these risks intensify.

## Slowing exports and manufacturing



Source: Bloomberg, CEIC, ING

**4.2%** ING forecast for 1Q19 GDP growth

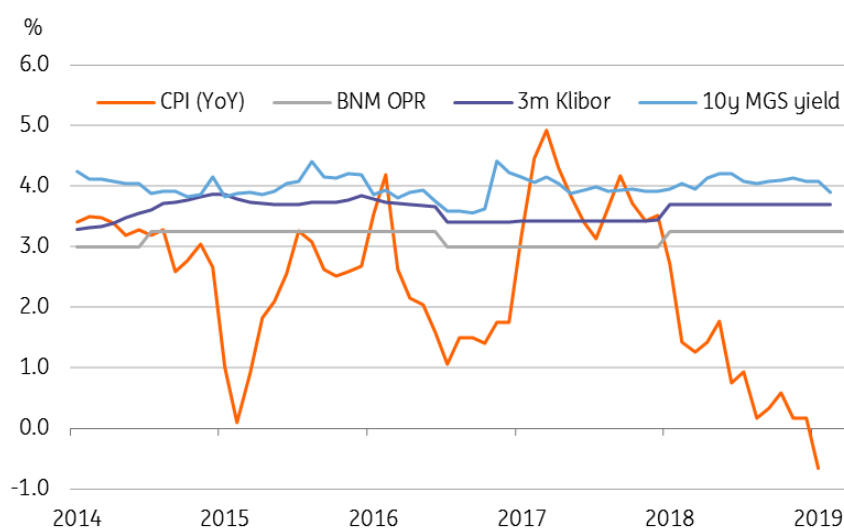
## Why might BNM ease?

Besides the downside growth risk, there are other reasons why we think BNM should cut the overnight policy rate by 25bp to 3.0% in May:

- **Subdued inflation:** January's slide into negative territory is likely to be reversed in February (with data due next week, on 20 March). Despite steady strong employment and wage growth, the demand-pull pressure on prices has been absent. Administrative measures – including the low price ceiling for fuel prices until mid-2019 – are keeping cost increases

- contained.
- We see inflation remaining below 1% through the first half of the year. The impact of the Goods and Services Tax (GST) elimination moves out of the base in June 2019 and this is likely to push inflation to about 2% in the second half of the year. This would deliver a full-year average inflation rate of 1.4%, far below the 2.5-3.5% official forecast range as in the 2019 budget.
  - **High real interest rates:** The recent disinflation trend has pushed real interest rates higher. Investment spending was the weak spot in GDP growth in 2018, especially after increased scrutiny by the Mahathir government of key infrastructure projects undertaken by his predecessor.
  - **Better now than later:** Being ahead of the curve should allow sufficient time for the impact of monetary easing to trickle down to the real economy, thus preparing the economy to ride the slowdown trend. It won't hurt that there is scope for easing now.
  - **Mature tightening cycle:** Based on recent BNM policy history the current tightening cycle appears to have matured. Previous BNM tightening cycles have sometimes been short-lived and we think this could be another short one, particularly given prevailing growth-inflation dynamics.
  - **Market re-pricing for an easing:** We infer from the greater than 20 basis point drop in the 10-year local government bond yield to the current 3.85% that the market has been re-pricing for a rate cut. Meanwhile, a sound external payment position is keeping the currency (MYR) among Asia's outperformers this year. In a soft USD environment, this supports BNM easing now, rather than waiting to cut later.

## High real interest rates



## Malaysia: Key economic indicators and ING forecast

Malaysia	2015	2016	2017	2018	FY2019 f	FY2020 f
Real GDP (% YoY)	5.1	4.2	5.9	4.7	4.6	5.0
CPI (% YoY)	2.1	2.1	3.8	1.0	1.4	1.9
Unemployment rate (%)	3.2	3.5	3.4	3.3	3.4	3.3
Fiscal balance (% of GDP)	-3.2	-3.1	-3.0	-3.6	-3.3	-3.4
Public debt (% of GDP)	54.4	52.7	50.7	51.8	45.8	46.0
Current account (% of GDP)	3.0	2.4	3.0	2.3	2.0	1.6
FX reserves (US\$bn)	95.3	94.5	102.4	101.4	108.0	116.0
External debt (% of GDP)	65.4	68.6	69.2	64.9	65.2	66.2
Central bank policy rate	3.25	3.00	3.00	3.25	3.00	3.00
3M interbank rate (% eop)	3.84	3.41	3.44	3.69	3.45	3.45
10Y govt. bond yield (% eop)	4.19	4.23	3.91	4.08	3.70	3.80
MYR per USD (eop)	4.29	4.49	4.05	4.13	4.10	4.00

Sources: Bloomberg, CEIC, ING forecasts

Source: Bloomberg, CEIC, ING

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