Good MornING Asia - 16 March 2020

In going "all in", the Fed has shown the way for many of Asia's central banks, including some of the more "reluctant easers". Expect some substantial easing across the region in the coming days and weeks. BI and BoJ up first, though the RBNZ may be leading the way with its non-scheduled 75bp cut

In this bundle

Australia | China...

Fed provides benchmark for Asia’s Central Banks

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By Robert Carnell

Asia Morning Bites

ASEAN Morning Bytes

Asian markets brace for another round of heavy selling as Fed conducts second and more aggressive emergency move

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FX | China

China: Downgrade GDP and yuan forecasts from double hit of global supply and demand

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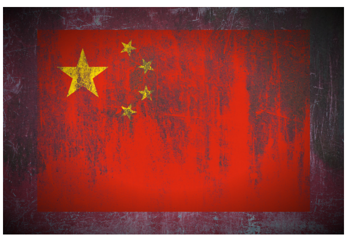

FX | China

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Opinion | 15 March 2020

Australia | China...

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Fed Chairman, Jerome Powell

Fed throws down the gauntlet

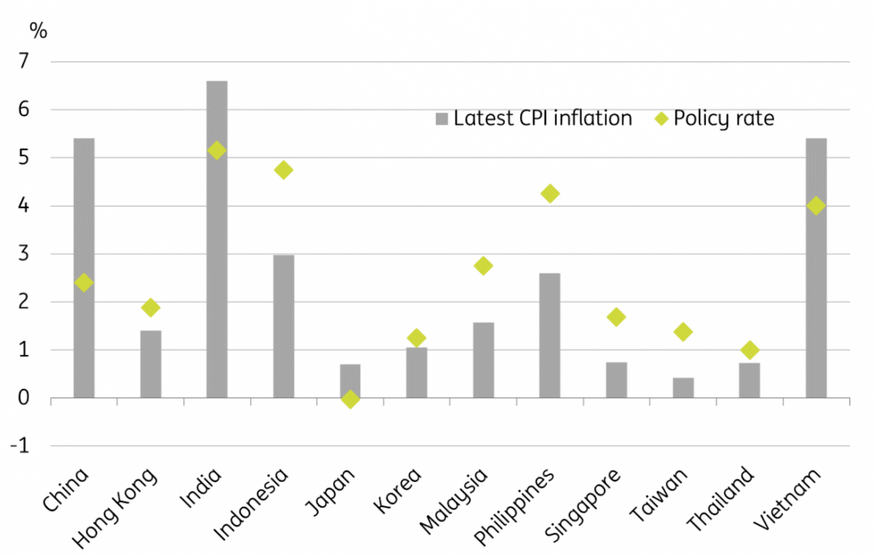
The Fed's easing to 0-0.25bp and adoption of $700bn of QE is not so much surprising in its scope - James Knightley's latest forecast update was in line - but it has come more quickly than expected, giving his update a shelf-life of about 3 hours. His (even more) latest thoughts are to be found here.

For us in Asia, the Fed's move is interesting not so much in terms of what it will do (it isn't harmful and will help a bit, but rates aren't really the issue right now, earnings are) but the powerful message it sends.

Central Banks around the region can take note, the Fed's actions make it much easier for them to follow suit, without needing to worry about currency weakness. Indeed, for those economies where rates had already fallen a lot or were perennially low, the recent collapse in oil prices provides even more room for cuts.

The chart below shows this easing "window" as the gap between current inflation and policy rates.

Easing room for Asia's Central Banks



Source: ING, Bloomberg

Real rate room for Asia's Central Banks

In order of easing, the CB's with the most room are...

From the chart above, we can readily see the CB's which have the most room to move. We would also add that the zero real-rate bound is not so much a "floor" as an "impediment", given that even the zero nominal bound doesn't seem to be a floor any more. Not shown on the chart are the RBNZ and RBA. The RBNZ has surprised overnight with the speed at which it has chopped rates to 25bp. We look for the RBA to get there shortly, and to investigate the scope for unorthodox policy measures too.

Of the remainder, BI (Bank Indonesia) and the Philippine Central Bank (BSP) have the most room to move. BI has a meeting scheduled this week and BSP may bring forward some of their easing. If we take the chart literally, this suggests up to 150-175bp of easing could be forthcoming. If that seems a lot, then just refresh your understanding of the Global Covid Pandemic with a quick look at the Worldometer website. It is quite sobering.

After BI and BSP, Malaysia's BNM still has room to act and may need to given that the current political mess there may delay fiscal support. Singapore too though will do so through adopting changes to its NEER currency band, perhaps dropping the midpoint to something close to where it currently sits and also flattening the slope.They are due to examine their policy setting next month, but I would be surprised if they wait that long.

Taiwan is often referred to as having no scope to ease, with its policy rate having sat at 1.375 for longer than I care to remember. These are not normal times. Cutting is easy. And Thailand's BoT, which has already proved that even for a reticent and hawkish central bank, cutting is possible, should be able to provide at least a further 25bp and possibly 50bp of easing. The same applies to the Bank of Korea.

The BoJ has apparently shifted forward the meeting scheduled for later this week to today. This is the time for Governor Kuroda to stop just saying that they won't hesitate to act and to actually act. It's a hard job when you essentially have no ammunition, but surely he can think of something beyond forward-guidance, which is simply worthless words.

Even where there is no more real interest rate room to move, there is still scope for easing from the likes of India's RBI, which could drop rates another 50bp easily, and before its next scheduled meeting on 3 April, though the INR would certainly be hit as a result. Collateral damage some might say.

Watch out for today

There isn't a lot on the calendar today, besides the possibility of some complementary action from the BoJ, and maybe some other central banks may decide to move early as well.

In China, there could be tweaks to recent policy easing measures. Iris Pang writes "CBIRC, the banking regulator suggests including “first-time" borrowers” as one of the indicators to examine banks. This should help SMEs to get loans from banks after the targeted RRR cut on last Friday.

And activity data to be announced today should be dismal. The market will likely focus more on March and April figures, though these could be also weak as global demand and supply chains will be hit".

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ASEAN Morning Bytes

Asian markets brace for another round of heavy selling as Fed conducts second and more aggressive emergency move

EM Space: Emergency slash by Fed sets tone for the week

- **General Asia:** Jerome Powell and the Fed frontloaded their stimulus with a bazooka-type 100 bps rate cut while pledging to step up bond purchases to help support the economy amidst the Covid-19 outbreak. Powell did, however, stress the following: 1) that fiscal stimulus will also be necessary and 2) that negative rates were not considered at this time. The aggressive move by the Fed underlines how bad the situation is becoming, and there will be a selloff today in Asian markets reflecting this dismal reality.
- **Singapore:** The Jan-Feb non-oil domestic exports data due early morning on Tuesday will provide a sense of Covid-19 damage to the economy, of which the worst is yet to come. Prime Minister Lee Hsien Loong expects the fallout to be worse than the 2008 global financial crisis and the pandemic to last at least this year. We expect the MAS to ease by recentering the S$-NEER policy band at a lower level (currently about 1.3% below the mid-point of the band) and flattening the appreciation rate at the next policy review in April. With the global central bank easing cycle in full throttle, don't be surprised if we see these moves coming way ahead of the scheduled meeting, possibly in over the next few days.
- **Thailand:** Prime Minister Prayuth Chan-Ocha is considering a proposal to set up a stock market stabilisation fund to prevent a market collapse amid heightened volatility due to Covid-19. We expect some announcement towards this today as the market is poised for another day of beating. We also think that our forecast of an additional 50 basis point Bank

of Thailand policy rate cut in this cycle is now a matter of days.
- **Indonesia:** Indonesia reports trade numbers on Monday with market analysts expecting weakness in both exports and imports in light of the impact of Covid on supply chains and demand for goods. The Indonesian government approved a second rescue package last week which covers support to importers who will be granted tax breaks for the next few months. We expect both imports and exports to remain in contraction for the next few months leading to trade deficits which would exert additional pressure to the already pressured IDR.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno indicated that growth fundamentals remained strong and that GDP could still hit 6% growth "under the worst-case scenario" as the BSP was ready to deploy all its tools if needed. In light of the Fed move, we expect Diokno to front-load his policy action and we revise our expectation for Thursday's meeting for a 50 bps rate cut and a possible announcement for additional liquidity via a reduction in reserve requirement or a lowering of the volume for its term deposit facilities.

What to look out for: Covid-19 developments and central bank action

- Malaysia Industrial production (16 March)
- China retail sales and new home prices (16 March)
- Indonesia trade (16 March)
- Philippines remittances (16 March)
- Indonesia non-oil exports (17 March)
- US retail sales (17 March)
- US housing starts (18 March)
- Philippines BSP policy meeting (19 March)
- Indonesia BI policy meeting (19 March)
- Bank of Japan policy meeting (19 March)
- Taiwan policy meeting (19 March)
- US initial jobless claims (19 March)
- Malaysia GIR (20 March)
- Thailand GIR (20 March)
- US existing home sales (20 March)

Article | 15 March 2020 **FX | China**

China: Downgrade GDP and yuan forecasts from double hit of global supply and demand

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A busy road in Shanghai

More supply chains are broken and global demand will shrink

As China's coronavirus cases subside, the rest of the world has more confirmed cases, including China's manufacturing partners in Europe, the rest of Asia and the US. This means supply chains are broken.

Equally important, demand from these economies will shrink substantially when people avoid shopping and gathering at restaurants, just like the experience of China during the past two months. This is another severe hit for China's factories and exporters, as orders should pull back.

Fiscal support is key to recovery

The government has increased its support for smaller companies to survive through the pandemic, and has delivered a lot of fiscal spending to maintain GDP growth.

- Fees and taxes have been cut to ease cash flow pressures of smaller companies, including exporters and manufacturers. This in turn should stabilise employment. With that, the recovery of domestic consumption will be easier, and as the coronavirus subsides more employers will operate and pay wages, allowing consumers to spend as they did previously.
- Fiscal stimulus on 'new investments' has been confirmed by the State Council. This includes speeding up the 5G network infrastructure, building more big-data centres, and transportation networks. These aim to support GDP growth.

These fiscal measures amount to 6% to 6.5% of nominal GDP in 2020, an increase from our initial estimate of around 4%. In addition, the government has continued to ramp up fee and tax cuts. We see the fiscal measures not so much as a package but as more fluid measures, which the government aims to increase further if needed.

Monetary policy is supplementary to fiscal

The People's Bank of China cut the target reserve requirement ratio by 0.5-1.0 percentage points for inclusive finance, and this scheme extends to more banks. This will help affected smaller companies directly by both extending their existing loan repayments and obtaining new loans to ease cash flows. But the degree of help depends on how the banks assess the credit risks of small firms versus the interest savings from participating in the inclusive finance scheme.

The chance of another rate cut in March has been reduced as the targeted RRR cut should put enough downward pressure on interest rates in the month, and banks’ interest rates for inclusive finance should be lower than lending to bigger corporates. That is, the targeted RRR cut should serve the purpose.

We don’t rule out a policy rate cut of 10 basis points in April for the 7D reverse repo, 1Y Medium Lending Facility and 1Y Loan Prime Rate if the spread of the coronavirus globally does not fall substantially.

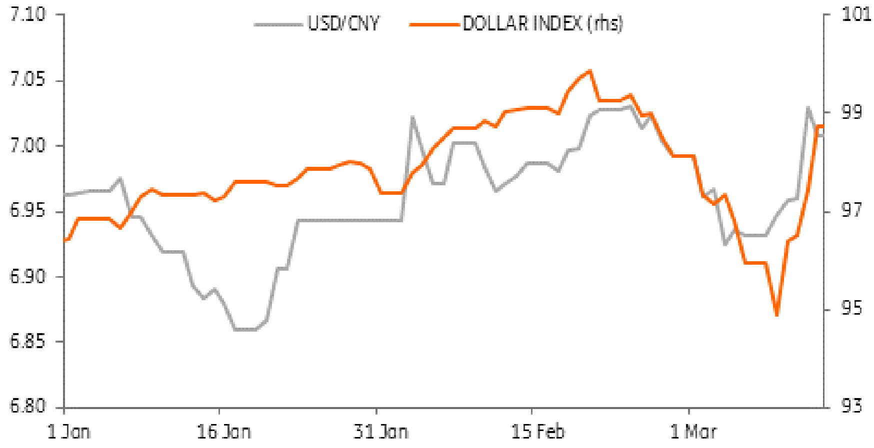
USD/CNY and USD/CNH likely to cross 7.0

The yuan has been more stable than the dollar during the outbreak of the coronavirus.

But this should not stop the USD/CNY and USD/CNH crossing 7.0. The dollar is expected to strengthen further from the increasing flight to safety demand for US Treasuries as the number of confirmed Covid-19 cases increases.

We revise our forecasts for USD/CNY and USD/CNH to 7.20, 7.25, 7.00 and 6.90 for the end of each quarter from 1Q to 4Q in 2020.

Yuan to weaken further against the dollar during the global flight to safety for US Treasuries



Source: ING, Bloomberg

Broken global supply chain and sudden shrinkage in demand a double hit to China

With the broken global supply chain, there will be an abrupt shrinkage in global demand during the pandemic. Even though there is fiscal spending to support GDP growth, we further downgrade China's 1Q20 GDP growth to 3.6% from our prior forecast of 4.4% published in early March. We also reduce our full year 2020 forecast to 4.8% from our previous 5.2%.

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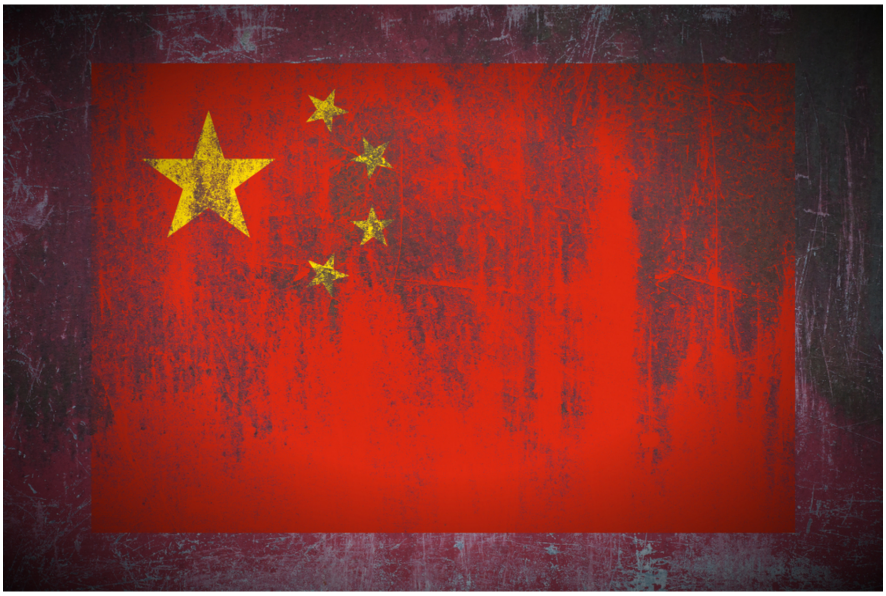

Source: Shutterstock

More banks to enjoy the targeted RRR cut

The People's Bank of China has cut the reserve requirement ratio (RRR) today for some banks by 0.5 to 1 percentage point, effective from 16 March, releasing 550 billion yuan in liquidity to shore up the economy amid the coronavirus fallout.

This targeted RRR cut is bigger than expected. But not only does this move, increase the degree of the cut, it also expands the scope of banks that can lend to smaller companies.

For banks that were not in scope before, the cut is 0.5 percentage points, but for banks that were already part of the scheme, the cut will be 1.0 percentage points.

More loans for smaller companies?

This time, the central bank expects the liquidity release to be around CNY 550 billion, of which CNY400 billion is expected to be lent out for inclusive finance that benefits smaller firms. The remainder is for long-term loans.

With the pandemic rapidly spreading, supply chains are not the only thing taking the hit, global consumption demand will also fall too. Smaller factories and exporters face bigger risks and banks will be taking this into consideration when they assess credit risks.

This is why we're not that optimistic and believe the ultimate amount of inclusive finance will be significantly smaller than what the central bank expects.

Interest rates to move downwards?

We believe the actual liquidity increased by the targeted RRR cut, will probably be even smaller than is expected but this should still push down market interest rates from the short end to the long end. As such the yield curve may shift down parallel by 30-50 bps.

A rate cut is coming

We think an interest rate cut is coming, but it may be deferred to April as there is already a deeper targeted RRR cut in March.

We expect 10 basis point cuts in 7D reverse repo, 1-year medium lending facility and 1-year loan prime rate in April and this set of rate cuts will push sovereign yields down further.

Weaker yuan ahead

We expect this deeper than expected targeted RRR cut will make the yuan weaker against the dollar on Monday and believe USD/CNY and USD/CNH could cross 7.0 soon.