Good MornING Asia - 17 August 2021

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EM Space: Focus shifts to growth as delta variant threatens outlook

- **General Asia:** Asian markets are likely to remain focused on the global growth outlook as the recent wave of Covid-19 infections threatens to slow growth momentum. The collapse of Afghanistan and the Taliban takeover of the country has dominated headlines with the potential fallout possibly more on the political front likely to make it harder for US President Biden to pass further spending packages. Monetary policy will also be in focus this week with Fed Chair Powell speaking later in the day (early Wednesday in Asia) while the minutes of the latest FOMC meeting are set for release on Wednesday. US retail sales data and industrial production are also scheduled for release on Tuesday with investors gauging whether the recent dip in consumer sentiment has translated to softening demand.
- **Singapore:** Just released this morning, July non-oil domestic exports growth of 12.7% YoY and -0.9% MoM was a slight upside surprise for the markets (consensus +12% YoY and -1.7% MoM). Electronics remained a key driver here although a -5.5% MoM fall pulled year-on-year growth down to 15.0% YoY from 25.5% in June. Semiconductors continue to lead the charge with a 4.6% MoM rise (up 11.1% YoY) as the global semiconductor cycle remained in full swing amidst persistent supply shortages. In non-electronics clusters, a 7% MoM and 48% YoY surge in pharmaceuticals was a standout. Firmer exports together with the reopening of

the domestic economy support expectations of an accelerating economic recovery over the rest of the year. We revise our 2021 GDP growth view from 4.9% to 6.2%, putting it within the official forecast range of 6% to 7% for the year. However, the increasing spread of delta variants in key trading partners (US, Eurozone, Japan and China) might play against optimism about an export-led recovery.

- **Malaysia:** Prime Minister Muhyiddin Yassin's resignation yesterday had a muted reaction on local markets, a sign that market players have already taken an escalation of political risk into account. The USD/MYR was steady at around 4.24, while the main stock index followed global weakness with a 0.15% drop. Muhyiddin stays on as caretaker prime minister. With general elections not an option during the pandemic, and no single party having a clear majority of 111 out of 220 parliamentary seats, the leadership crisis may drag on for days or even months. Our end-2021 USD/MYR exchange rate forecast remains at 4.40 (spot 4.24).
- **Thailand:** The Thai economy avoided a recession as GDP eked out 0.4% QoQ growth in 2Q21, leading to a 7.5% YoY increase. This brings cumulative GDP growth in the first half of the year to 2%. However, as an acknowledgement of greater downside growth risk over the rest of the year, the National Economic and Social Development Council cut its 2021 GDP growth expectations to a 0.7% to 1.2% range from 1.5% to 2.5% previously. We are keeping our 1.4% forecast for full-year growth for now but will look to scale it back on any evidence of greater economic weakness. Our end-2021 USD/THB exchange rate forecast is 35.00 (spot 33.40).
- **Indonesia:** President Jokowi indicated that his government was committed to bringing down the deficit-to-GDP ratio to 3% by 2023, suggesting that government outlays may slow next year to help contain the hit on the deficit. Next year's budget deficit ratio is expected to dip to 4.85%, down from the projected 5.7% this year. Finance Minister, Indrawati, cited continued support from the central bank through its "burden-sharing arrangement". Central bank support via direct bond purchases of government debt has been tolerated by markets so far but an extended dependence on Bank Indonesia support for the budget may increasingly be viewed as a risk, especially as Jokowi plans to return to pre-Covid-19 fiscal metrics by 2023. We expect the IDR to average 14,350 next year.

What to look out for: US retail sales and Covid-19 developments

- Singapore non-oil domestic exports (17 August)
- US retail sales and industrial production (17 August)
- Fed Chair Powell speech (18 August)
- Indonesia trade balance (18 August)
- US housing starts and building permits (18 August)
- FOMC minutes (19 August)
- Hong Kong CPI inflation (19 August)
- Bank Indonesia policy meeting (19 August)
- US initial jobless claims (19 August)
- Regional GIR data (20 August)
- Fed Kaplan speech (20 August)

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China

China: slower activity growth in July to continue in August

We see slower growth in economic activity in July mainly the result of flooding. But slower growth is here to stay. More floods, tighter social distancing measures affecting port operations and people flows are all going to weigh on growth in August.

Source: Shutterstock

Very weak growth in July

Let's do a count of all the weak growth elements in July.

Retail sales growth dropped to 8.5% in July after 12.1% in June. Clothing and smartphones were badly hit. Clothing sales growth dropped to 7.5%YoY from 12.8% in June. Smartphone sales dropped to almost no growth at 0.1%YoY from 15.9%YoY. This reflects that demand for new smartphone models has not persisted from the previous month as consumers are not as keen to upgrade their phones as before. The same applies to weak automobile sales. Dismal retail sales growth reflects softer consumer confidence. The clampdown on technology companies and education centres has led to an unemployment rate increase from 5.0% to 5.1%. These sudden job losses may make it difficult for those affected to regain employment in the same industries. Switching to a new industry probably means a longer job search.

Industrial production grew only 6.4%YoY in July after 8.3% in June. One factor is slower coal mining to reduce pollution. But the policy has changed to speed up some mining activity to supply electricity to meet demand during the hot summer. Automobile manufacturing contracted 8.5%YoY in July, which was due to the semiconductor chip shortage. Production for technology and computers continued to grow but at a slightly slower pace of 13.0%YoY in July from 13.4% in June. We don't believe this growth will be sustained in the coming months because the chip shortage is a global issue. China cannot escape from it.

Railway infrastructure investment was also weak in July, coming in at -4.4%YoY YTD. Local government debt is one obstacle to the financing of infrastructure projects. There is occasionally some news on the tightening of local government debt slowing down infrastructure growth. The central government has tried to address this, as such, I believe growth in infrastructure will improve in August.

Even slower in August

Looking forward, we see few positive factors for the economy, instead, we see more risk factors. There have been more floods in China. The Delta Covid-19 variant is spreading in the Mainland, although the number of cases remains fewer than 200 per day. Strict social distancing measures have affected the ports in Ningbo and Shanghai, which are close to each other. This will negatively affect import and export activity around the area of Shanghai. We expect terminal congestion might take several months to clear. Strict social distancing measures also limit people flows around the Mainland, which limits domestic leisure travel and spending during the summer holidays.

The chip shortage is likely to linger for at least two years, according to reports, which will gradually be reflected in slower production growth and related exports.

Reforms are ongoing for real estate developers, which continues to put pressure on home prices and land-bidding activity. Data privacy, anti-trust, company structure, ESG are all shadowing the growth of technology companies. We see these policies as curtailing growth in the sector in the short term but bringing more sustainable growth in the long term.

The China-US relationship is not going to improve anytime soon. There are many disagreements between the two on international politics. Furthermore, there remains a technology war between the two countries.

Looking towards 4Q21, there should be more activity from construction to rebuild areas affected by the recent floods.

Policies

We expect fiscal policies to be more proactive at pushing belated infrastructure projects. There is no need for policy interest rate cuts as the RRR cut has pushed down market lending rates. Another RRR cut should happen in 4Q21 if there are more incidents and dramatic policy actions.

Our China GDP forecast is currently 4.5%YoY for 3Q21 and 5.0%YoY for 4Q21.

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Japan’s 2Q21 GDP is slightly stronger than expected

2Q21 GDP is lifted by stronger than expected domestic demand growth and some slight upward revisions to previous data. We now expect GDP in 2021 to reach 2.3%.

0.3% QoQ

Japanese GDP growth

2Q21

Higher than expected

Marginal improvement in the headline and underlying components also encouraging

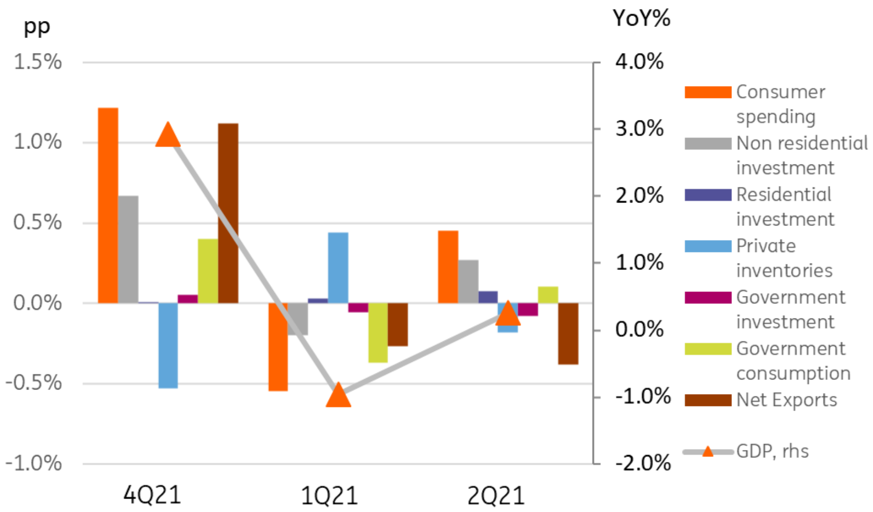
If it were not for the fact that Japan's confirmed daily Covid-19 case count has now exceeded 20,000, the highest since this pandemic began, we would have found today's 2Q21 release more uplifting.

Even then, the 0.3%QoQ growth recorded for the second quarter was fairly modest by the standards of some other economies - equivalent to 1.3% at an annualised rate. We have seen far stronger growth elsewhere - the US for example, where growth was recorded at a 6.5% annualised rate in the same quarter.

But there was some more encouragement from the nature of Japan's latest growth release. As the chart below shows, most of the strength came from domestic demand components, such as private consumer spending, and business investment. We are more encouraged to see this rather than growth in government spending or inventories because it is more likely that these can be repeated in the coming quarters than one-off policy-related boosts.

Likewise, the sizeable drag from net exports in the second quarter owes a lot to the recovery in domestic demand, sucking in imports which are a drag on the GDP figures. Assuming that this is less glaring next quarter, even if domestic demand is a little softer too, we may see this overall drag subside. And inventories, which also dragged a little this quarter, may start to be rebuilt next.

Contributions to QoQ GDP growth by component



Source: CEIC, ING

What next?

Normally, we'd put all of this together and forecast a slightly stronger GDP result for the third quarter based on the factors described above. But these are not normal times, and the possibility of further more severe states of emergency to deal with the rising Covid-19 infection rate, alongside Japan's disappointing vaccination statistics make us wary of doing so. Arithmetically, today's release makes it look more likely that we will hit 2.3% growth for full-year 2021 (up from 2.1%), but we have been scaling back, not building on our 3Q and 4Q numbers due to the ongoing pandemic.

The JPY has strengthened fractionally on the back of this data, and 10Y Japanese Government bond yields (JGBs) have also nudged slightly higher, but we would not imagine much more than small temporary effects on the back of this data. Neither the Bank of Japan (BoJ) nor Japan's government has much in the way of remaining firepower to help deliver a stronger outcome than the one we are now forecasting.

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