

Good mornING Asia - 19 August 2019

The trade tensions will continue to decide the course for markets this week as they also look for policy hints at Jackson Hole symposium on Friday.

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"...surely supplied it..."



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Source: Shutterstock

Unprompted denial begs questions

Apologies for the lapse into primary-school poetry this morning, but grasping for a theme for today's note, the thing that sticks in my mind from all the various news stories I have read so far is the apparent denial of recession expectations from White House Advisers Larry Kudlow and Peter Navarro.

And in all fairness, I don't see much evidence for looming recession in the US either, and not wanting to put words into his mouth, but reading between the lines (and looking directly at his forecasts) neither does our Chief International Economist responsible for the US, James Knightley.

What makes me slightly uneasy, therefore, is why come out and make the case for no recession? Yes, I know the 2s10s yield curve briefly inverted last week - and data wonks and nerds the world round have been discussing this and the 3m10Y and various other curve slope permutations for more than a year now. My guess is that this has not yet entered dinner-party conversations for the majority though. Let's just say, if you were to go and ask Joe or Joanna Public whether the yield curve was inverted or not, my guess would be that the majority answer would be "c" what's the yield curve?

Other than that, US jobs numbers remain OK, wages steady if a bit slow to grow, house price growth in line with nominal GDP growth, and the stock market? It finished up again on Friday, and though off its recent highs, it is still up more than 15%ytd (S&P500).

So I'm just wondering, as a result, do they know something we don't?

For those of a bearish persuasion looking for a smoking gun of impending doom, my suggestion this week would be to watch the core durable goods orders and shipments data due next week, with an appetizer from the PMI indices later this week. The only place where we can see consistent signs of weakness so far is some of the soft business sector data like these.

Asia - the worst is over?

I don't usually link to my own notes, and this one is very short, but we finished last week [with a rare piece of decent news out of Singapore on exports](#). The smaller than expected non-oil domestic exports (NODX) contraction comes after months of declines and actually contained a month-on-month increase in electronics exports. Now, this stuff is extremely choppy, so don't get out the champagne bucket just yet. But it echoes some slightly better electronic export data seen elsewhere around the region and lends weight to my suggestion that this sector is beginning to find a bottom.

This doesn't herald a dramatic upturn, however. Cyclical though this sector is, demand for these goods is still extremely weak, and not helped by the trade war. But even if this cycle is more "L" than "V"-shaped, that beats an ongoing slide, and brings the prospect of better times for Asia a bit closer.

HK rain affects play

Asia has been nervously watching events in Hong Kong in recent weeks, anxious that protestors don't provoke a heavy-handed reaction from Mainland China that could see the Special Administrative Region status (SAR) challenged. This weekend's protests passed mainly peacefully according to the reports I have read (though I don't vouch for their accuracy), and if true, that should help calm markets. I've always felt that rioting was a good-weather event, and heavy rain may have helped keep things calmer than they would otherwise have been.

Provocatively, a separate story about Shenzhen being granted special status, legal reforms and freer flows of capital was interesting. Could this be the way Mainland China responds, without police or troops - but creating a sort of "Hong Kong-Lite" right on the border...? Your thoughts (as always) welcome.

Possibly in the same vein, China has announced some further liberalisation of its interest rate system over the weekend, which can be viewed as a further very small step in the direction of currency liberalisation. [Iris Pang provides more detail here](#).

Asia day ahead

It's a quiet start to the week here in Asia, though the mood is probably fairly good. Weak Thai GDP later today may not create too much disappointment if it encourages thoughts of further rate cuts. Bank of Thailand minutes on Wednesday may shed more light on that.

Bank Indonesia also meets this week, but will most likely continue to err on the side of caution whilst Emerging Market currencies remain vulnerable to volatility. Nothing from them is expected.

In Developed Market space, the Jackson Hole meeting later this week will hopefully provide me with some more content to write about, though a number of online stories suggest that it may be

a damp squib. The Fed's Jerome Powell is due to give a speech at 10 am Eastern Time on Friday. A bit late for most of us in Asia.

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ASEAN Morning Bytes

General market tone: Risk-on. The trade tensions will continue to decide the course for markets this week as they also look for policy hints at Jackson Hole symposium on Friday.



EM Space: More fiscal stimulus is coming

- **General Asia:** The governments are stepping up their stimulus efforts to counter the slowdown as global recession fears rise. The trade tensions will continue to decide the course for markets this week as they also look for policy hints at Jackson Hole symposium on Friday.
- **Malaysia:** 2Q19 GDP surprised on the upside with 4.9% YoY growth as steady strong domestic demand shielded the economy from the global trade war wrath while external trade growth was relatively firm. 2Q current account surplus of MYR 14.3 billion was also far better than expected and this contributed to near-doubling of the year-to-date surplus from a year ago to MYR 30.7 billion. We maintain our full-year growth forecast at 4.7% and are revising our current account surplus forecast for the year to an equivalent of 2.8% of GDP from 2.0% earlier. The Bank Negara Malaysia has announced further liberalization of the FX regulation to provide market players more flexibility and efficiency in managing their risks.
- **Thailand:** 2Q19 GDP is due today with consensus centered on a further slowdown in growth to 2.3% YoY from 2.8% in the first quarter. While the Bank of Thailand has already started easing with a 25bp policy rate cut earlier this month, the government is reportedly pushing for THB 370 billion (about \$12 billion or 2.4% of 2018 GDP) fiscal stimulus to keeping the

(annual) GDP growth from slowing below 3%. It needs to be seen how quickly the stimulus gets off the ground to kick-start the economy in the remainder of the year. Our full-year 2018 growth forecast remains at 2.8%.

- **Indonesia:** President Jokowi unveiled his fiscal plan for 2020, vowing to lower the budget deficit to 1.76% of GDP even if he looks to invest his way to faster growth. Jokowi does look to focus on infrastructure investment as well as human capital development while banking on foreign investment to help bridge the shortfall. Meanwhile, finance minister Indrawati flagged downside risks to growth. Although she expects policy rates to fall further, she indicated a gradual reduction to take off the pressure on the IDR after recent struggles.
- **Philippines:** The Bangko Sentral ng Pilipinas (BSP) Governor predicts 2019 growth to crest the 6% handle with a strong finish in the second half of the year as government spending goes into “catch up” mode. 2H growth is expected to hit 6.5% which will get full-year growth to 6.1% to sustain the recent string of above 6.0% growth. Slowing inflation allows greater scope for a growth-friendly monetary policy.

What to look out for: Thailand GDP, Jackson hole

- Thailand GDP (19 August)
- Euro zone inflation (19 August)
- Taiwan trade (20 August)
- Hong Kong inflation (20 August)
- US existing home sales (21 August)
- Thailand trade (21 August)
- Fed Quarles speaks (21 August)
- Malaysia GIR (22 August)
- Taiwan unemployment (22 August)
- US Markit PMI manufacturing (22 August)
- Bank Indonesia (22 August)
- Japan inflation (23 August)
- Singapore inflation (23 August)
- Taiwan industrial production (23 August)
- Fed Powell speaks at Jackson hole (23 August)

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China liberalises interest rate system, a step closer to free floating currency

China announced liberalisation of its interest rate system on 17th August. This takes it one step closer to a free-floating currency but of course, progress will be slow. Net interest margins for banks (NIMs) will be narrower, but it shouldn't affect the yuan trend.



Source: Shutterstock

China needs banks to quote interest rates linked to market rates

China announced that the Loan Prime Rate (LPR) has to be quoted to customers. And the formation of LPR will be priced on a +/- basis point basis from open market operation interest rates.

Initially, the open market operation interest rate chosen is the Medium Term Lending rate (MLF). The MLF is currently quoted in 1Y mostly but will add a 5Y quote, so that the LPR curve is more applicable to bank loans.

Frankly speaking, we do not think the MLF is a 100% market-based interest rate, but of course more market-based than the 1Y benchmark interest rate, which is a fixed rate announced in the past by the central bank.

Still, we expect further liberalisation of the LPR to be quoted based on SHIBOR for short term loans

and based on the China sovereign yield for long term loans.

Impact on banks and borrowers

Such liberalisation is part of a process towards achieving freely quoted bank interest rates to customers.

As such we expect that the material impact on banks will be to:

- adopt a market interest rate mechanism. That is, when quoting interest rate to customers, they will also need to consider liquidity and credit risks.
- face a narrower net interest margin. This is because all banks need to quote according to a more market-based interest rate, competition on loans will increase.
- not benefit small firms. As small firms' credit profile will likely be reflected in higher interest rates and higher borrowing costs quoted from banks.
- affect the deposit rate. As loan rates are quoted according to a more market-based system, deposit rates of each bank will reflect loan demand and other liquidity factors, which will indirectly reflect in deposit rates. This could narrow banks' net interest margins.

What about the policy interest rate?

It is still unclear if the 7D repo is the PBoC's policy interest rate. This is because:

1. This new LPR policy's suggested link to open market operation interest rates is the Medium Term Lending rate (MLF), not a short-term interest rate. We understand that this could be a process towards a "Fed style" interest rate policy, but it seems to us that this process will take a long time.
2. In recent interest rate policy, the central bank used the 7D repo as a policy rate (+/- 5 basis points for each move). But other central banks usually use an overnight rate. This issue is not addressed in this interest rate liberalisation progress.

We are still looking forward to a more complete market-based interest rate quoting system, and a clear policy rate from the central bank.

Will a lower interest rate reflect in a weaker yuan?

We don't believe that lower interest rate system from competition of banks will guide the USDCNY. The USDCNY is still guided by the daily fixing. As such this policy doesn't change our forecast of USDCNY at 7.10 by end of 2019.

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Malaysian economy beats expectations with 4.9% 2Q GDP growth

Firmer growth, low inflation, and a healthy external payments position – all are coming together in support of positive investor confidence in the economy in the current global economic turmoil. That said, we don't think the authorities will relax just yet and we have stuck in an additional 50bp of BNM rate cut in our forecast for the rest of the year.



4.9% 2Q19 GDP growth

Better than expected

Bucking the global slowdown

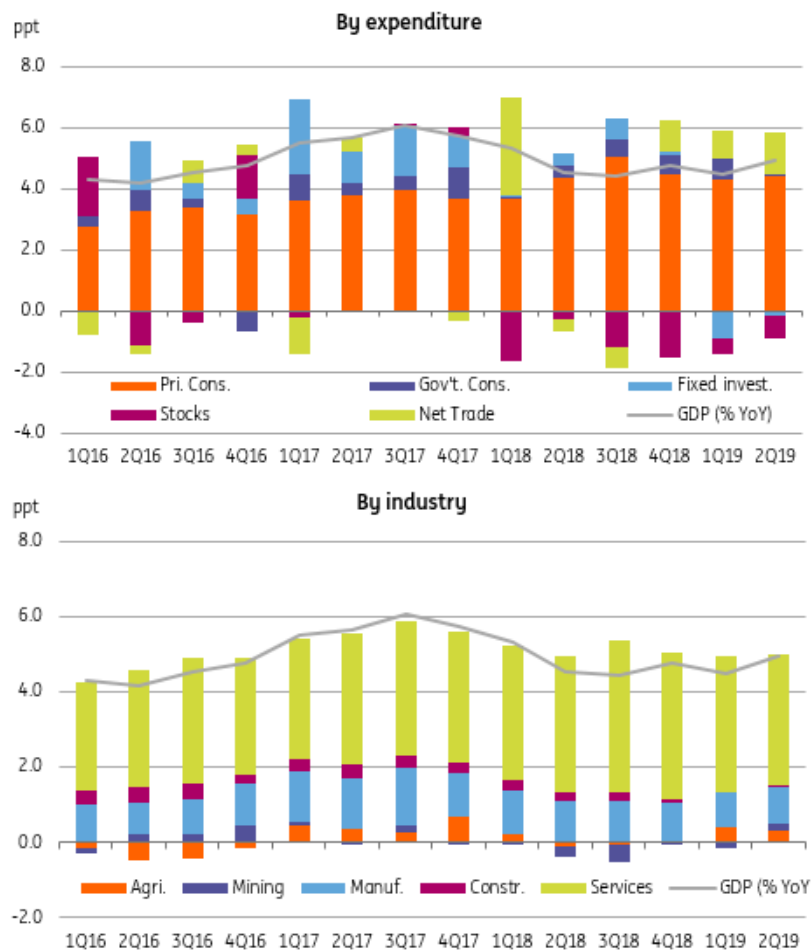
Contrary to the slowdown everywhere else, Malaysia's GDP growth accelerated to 4.9% year-on-year in 2Q19 from 4.5%. This was ahead of the consensus estimate of 4.7% and our 4.8% forecast.

Aside from government consumption, the contribution of all spending side GDP components – private consumption, gross fixed investment, and net trade – improved. But private consumption

remained the key driver. Investment remained a weak link, albeit with a smaller negative than in the first quarter as the key infrastructure projects stalled a year ago are now being revived, e.g. East Coast Rail Link project as part of China's Belt-and-Road initiative. Yet, the drive to consolidate public finances explains some of the weakness in government spending.

Services remained the key growth driver from the industry side, though the improvement in the manufacturing contribution is noteworthy.

What's driving GDP growth?



Source: Bloomberg, CEIC, ING

Healthy external payments

Even as domestic demand continued to be strong and exports affected by the trade and tech war, the net trade contribution rose to 1.4 percentage points (ppt) from 0.9 ppt in 1Q. This also squares with a steady and strong current account surplus. Released alongside GDP, the balance of payments for 2Q19 showed a current surplus of MYR 14.3 billion, also far ahead of the consensus of MYR 6.8 billion, though slightly smaller than MYR 16.4 billion surplus in 1Q.

This still leaves the cumulative MYR 30.7 billion surplus in the first half of 2019 nearly double the year-ago level.

Outlook for rest of 2019

Firmer growth, low inflation, and a healthy external payments position – all are coming together in support of positive investor confidence in the economy in the current global economic turmoil. Yet, it's hard to imagine the economy continuing to outperform the rest of the world as global trade tensions scale new heights. Nor do we see Malaysia's low value-added electronics sector continuing to beat the global tech slump, though some green shoots of a bottoming of the tech slump have started to emerge from regional data.

That said, we see GDP growth in the rest of the year remaining close to the top end of BNM's 4.3-4.8% forecast for 2019. We maintain our full-year growth forecast at 4.7%. We have cut our inflation forecast for the year to 0.8% from 1.0%, and are now looking to revise our 2% of GDP current account surplus forecast higher.

We don't think the authorities will relax just yet. Persistently low inflation allows scope for more Bank Negara Malaysia (BNM) policy easing. We have stuck in an additional 50bp of BNM rate cut in our forecast for policy rates for the rest of the year, taking them to 2.5% by year-end. Even so, the MYR should remain a resilient Asian currency within emerging markets.

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