Good MornING Asia - 19 July 2019

Joining the global easing bandwagon, two more Asian central banks cut their policy interest rates yesterday. The monetary easing is getting further support from lower oil price keeping inflation subdued.

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South Korea

Korea: Central bank starts easing cycle with 25bp rate cut

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Indonesia

Indonesia cuts rates to boost economy as Fed turns dovish

With the Fed poised to cut rates in July, Indonesia's central bank cut policy rate after pausing for seven meetings

Asia week ahead: Fine-tuning 2Q GDP growth estimates

June activity releases will help us to fine-tune 2Q19 growth estimate for Asian economies. With downside growth risks persisting and inflation remaining low, the need for greater policy support will keep regional central banks on their toes

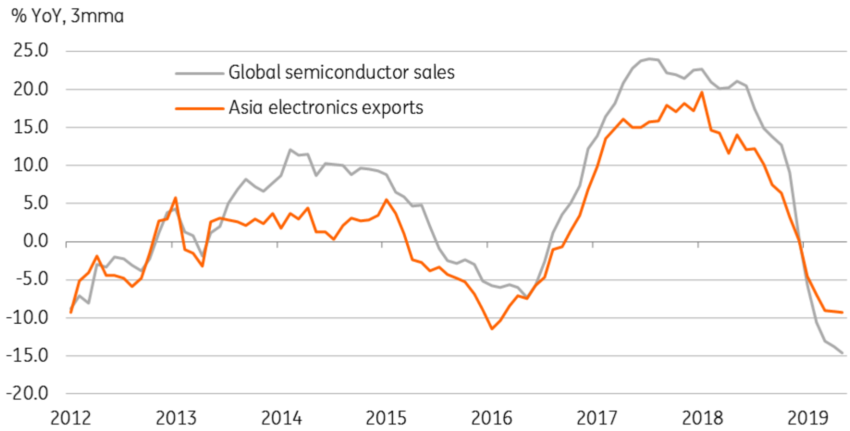
Source: Shutterstock

Intensified export-led slowdown

June trade and manufacturing figures are highlights of the Asian economic calendar for next week. Trade figures, and within that exports matter for manufacturing growth, which in turn drive GDP growth. We have seen accelerated export weakness coming through some Asian countries with electronic heavy-weights Korea and Singapore leading the pack.

A slightly positive turnaround in Taiwan's exports was a hopeful sign of recovery, though hopes are misplaced with the trade tensions between the US and China, and now between Japan and Korea, remaining elevated. As such, the balance of risk is tilted towards further export and manufacturing weakness across the region. Look out for trade data from Hong Kong and Thailand, and Taiwan's export order figures next week.

Asia: At the forefront of the global tech slump



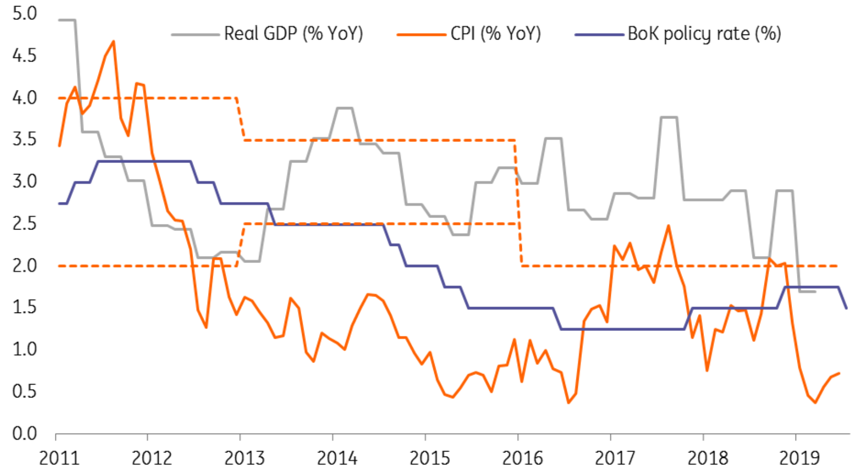
Source: Bloomberg, CEIC, ING

More downside growth risk

Taiwan also reports industrial production figures for June. The average industrial production growth for three months will help us to assess the risk to our 1.4% GDP growth forecast for 2Q19 (data due on 31 July). Likewise, Singapore's industrial production growth for June will indicate the likely direction of revision to 0.1% year-on-year GDP growth released as part of the advance estimate earlier this month (final estimate due in mid-August).

Korea's preliminary GDP data for 2Q19 will test our view that sharp export declines recently have pushed the economy close to a recession. The Bank of Korea's 25bp policy rate cut today probably heralds a worse growth figure. GDP shrank by 0.4% quarter-on-quarter (seasonally adjusted) in 1Q19. Another such negative print will confirm a (technical) recession. The trade rift with Japan dampens the export outlook, so, a couple more BoK rate cuts by the end of the year won't be an unreasonable view.

Korea: Growth, inflation, and central bank policy rate



Dotted lines are BoK's inflation target, shifted from a range to point target in 2016.

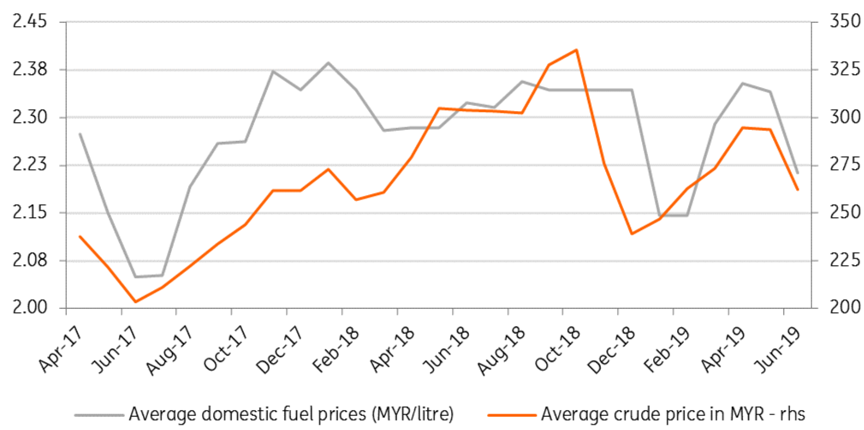
Source: Bloomberg, CEIC, ING

And subdued inflation

Lately, inflation releases have been largely uninteresting drivers for the markets. We don't think next week's CPI data for June due in Hong Kong, Singapore, and Malaysia will be any different.

Yet, there is likely to be some interest in Malaysia's CPI as the Goods and Services Tax (GST) elimination in June 2018 moved out of the base comparison and likely caused a spike in the year-over-year inflation rate from the near-zero level it had been in the first five months of 2019. On the flip-side, we believe low global crude oil prices drove domestic fuel prices lower and this prevented a sharp rise in headline inflation. Our forecast is 1.1% YoY, up from 0.2% in May. That said, we see average annual inflation in 2019 staying close to the low end of Malaysia's central bank 0.7-1.7% forecast range.

Malaysia: Falling fuel prices keep CPI inflation low



Source: Bloomberg, CEIC, ING

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Monday 22 July			
Hong Kong	0915	Jun Composite CPI (YoY%)	3.0		2.8
Malaysia	0800	Jul 15 Forex reserves- Month end (US$bn)	-	-	102.7
Philippines	-	Jun Budget balance (PHP bn)	-72.6	-	2.6
Taiwan	0900	Jun Export orders (YoY%)	-	-	-5.8
	0900	Unemployment rate (%)	3.76		3.8
Thailand	-	Jun Exports (customs estimates, YoY%)	-8.5	-	-5.8
	-	Jun Imports (customs estimates, YoY%)	-4.5	-	-0.6
	-	Jun Trade balance ($m)	831	-	182
		Tuesday 23 July			
Singapore	0600	Jun CPI (YoY%)	0.7	-	0.9
	0600	Jun CPI core (YoY%)	1.2	-	1.3
Taiwan	0900	Jun Industrial production (YoY%)	-1.0	-	-3.1
		Wednesday 24 July			
Malaysia	0500	Jun CPI (YoY%)	1.1	-	0.2
Taiwan	0920	Jun Money supply (M2) (YoY%)	3.5	-	3.4
		Thursday 25 July			
South Korea	0000	2Q P GDP (QoQ/YoY%)	0.0/2.1	-/-	-0.4/1.7
	-	Jul BOK Consumer Sentiment Index	97.2		97.5
Hong Kong	0915	Jun Exports (YoY%)	-2.7		-2.4
	0915	Jun Imports (YoY%)	-3.0		-4.3
	0915	Jun Trade balance (HK$ bn)	-51.7		-34.7
	2200	Jul BOK Consumer Sentiment Index	-	-	97.5
		Friday 26 July			
Singapore	0330	2Q Jobless rate (Q) (%, SA)	2.3	-	2.2
	-	Jun Industrial production (MoM/YoY%)	4.2/-2.1	-/-	-0.7/-2.4

Source: ING, Bloomberg, *GMT

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ASEAN Morning Bytes

Investors will likely turn defensive on Monday as strong US data overshadows the Fed easing prospects.

EM Space: Surprisingly strong payroll figure weighs on Fed easing

- **General Asia:** The US created more than expected 224k jobs in June, which could delay the Fed rate reduction while the market continues to price in aggressive easing ahead and President Trump continues to prod Powell slashing rates. Chairman Powell is expected to reveal his thinking in his testimony to the Congress on Wednesday and Thursday. Meanwhile, Asian markets may pull back and look to US inflation and China trade data for direction.
- **Malaysia:** S&P Global Ratings affirmed Malaysia's long-term sovereign ratings of A- and short-term rating of A-2 with a stable outlook. The agency cited strong external payments position and monetary flexibility offsetting relatively weaker yet stable (public) finances, while current ratings also reflected the depth of the domestic bond market reducing reliance on external financing. Finance Minister Guan Eng welcomed the news as demonstrating Malaysia's positive economic outlook.
- **Indonesia:** Bank Indonesia (BI) Governor Warjiyo continued to lean dovish indicating that inflation was well within target and that the economy was in need of a boost. Warjiyo shared that inflation will likely slip to 3.1% in July while the current account is seen to improve to just under 3% of GDP. Despite concerns about the current account deficit, the BI

chief said that foreign investment continues to flow in, helping the country post a capital account surplus to offset the shortfall in the current account.

- **Philippines:** June CPI inflation slipped below consensus to 2.7% YoY from 3.2% in May (consensus 2.8%). Disinflation was noted in the index-heavy food subcomponent led by a second consecutive contraction in rice price as imports are flooding the market. With a 3.4% year-to-date rate, inflation is on course to remain within target for the rest of the year and next. Bangko Sentral ng Pilipinas (BSP) Governor Diokono has pledged further rate cuts and these can resume as early as August if inflation continues to slide and growth momentum slows.

What to look out for: Fed speakers, US inflation data

- Taiwan trade (8 July)
- Singapore GIR (8 July)
- Malaysia BNM meeting (9 July)
- US JOLTS jobs opening (9 July)
- China money supply (9 July)
- China trade (10 July)
- Fed Bostic and Powell speak
- Philippines trade (10 July)
- US wholesale inventories (10 July)
- FOMC meeting minutes (11 July)
- Fed Bullard speaks
- US inflation (11 July)
- Singapore GDP and retail sales (12 July)
- Malaysia industrial production (12 July)
- Japan industrial production (12 July)
- India inflation (12 July)
- US PPU (12 July)
- China trade (12 July)

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Article | 18 July 2019 South Korea

Korea: Central bank starts easing cycle with 25bp rate cut

The Bank of Korea's rate cut today is a mere reversal of a 25 basis point hike in November 2018 rather than a real policy stimulus for the economy, which is close to or already in recession. We believe this is just the beginning of the easing cycle

Source: Shutterstock

1.50% **BoK policy rate**

After 25bp cut today

Lower than expected

A surprise for the market, not for us

The Bank of Korea (BoK) surprised the market today by cutting its policy rate by 25 basis point to 1.50%. The consensus was still largely in denial of easing; 15 out of 25 participants in a Bloomberg survey expected no change, with many likely expecting the BoK to wait until after the Fed rate cut later this month. We were in the minority forecasting a 25bp rate cut.

As it is expected that domestic economic growth will be moderate and it is forecast that inflationary pressures on the demand side will remain at a low level, the Board will maintain its accommodative monetary policy stance. - BoK policy statement

The policy statement pointed to a deepening slowdown in exports and construction and facilities investment, while inflation continued to be low and falling short of the central bank's projected path. The statement also signalled a downgrade of the central bank's growth and inflation forecasts for this year, while Governor Lee Ju-yeol formally announced new forecasts in his press conference subsequently.

Policy guidance of more easing ahead

The BoK governor's press conference typically steals all the market attention on these decision days. And the focus is especially more intense when the policy is actually changed, just as it is today. The key takeaways from his remarks are:

- **Weak economic outlook:** Downgrade of forecast GDP growth in 2019 to 2.2% and CPI inflation to 0.7%, from the previous forecasts 2.5% and 1.1%, respectively in April. This is BoK's fifth forecast downgrade over the last 12 months, putting growth at the lowest level since the 2008-09 global financial crisis.
- **Trade rift with Japan:** Given the scale of bilateral trade, Governor Lee warned about a significant impact on the Korean economy in the event that Japan's export restrictions against Korea become a reality and even broaden, though it's hard to gauge the actual impact.
- **Market volatility:** No clear direction on (KRW) exchange rates with changes in expectations about the Fed policy and uncertainty from the US-China trade war adding to FX market volatility. A rate cut could have a negative impact on financial stability.
- **Housing market risk:** A rate cut could fuel a further surge in housing prices, though that's probably more a concern for the government, which has a strong will to curb home prices.
- **Policy guidance:** Growth takes priority over financial market stability. Yet, undermining the impact of today's rate cut, Governor Lee sees monetary policy at a level that doesn't hurt the real economy, though the central bank could still take policy action to some degree as it has yet to reach its effective bottom for lowering rates.

Here's what we think

Today's policy rate cut is a mere reversal of a 25 basis point hike in November 2018 and doesn't represent a real policy stimulus for the economy, which is close to recession. Watch out for next week's release of preliminary GDP figures for 2Q19. GDP contracted by 0.4% in 1Q19 from the previous quarter. Another such (quarter-on-quarter, seasonally adjusted) contraction would confirm the (technical) recession.

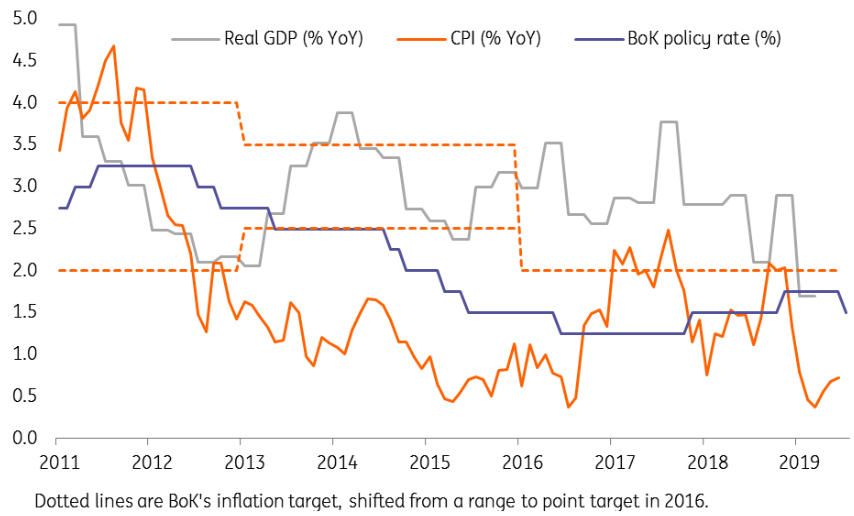
The Korean economy may actually be in a recession right now, *we're simply waiting for the data to confirm it. - ING Asia Chief Economist, Rob Carnell*

We believe this is just the beginning of an easing cycle and there is more to come. Just as the US-China trade friction, Korea's trade tensions with Japan could get worse before they get better. With the growth outlook likely turning gloomier in the rest of the year, the BoK will be forced into more policy easing. We consider our forecast of a 1.25% policy rate by year end subject to more downside than upside risk.

One could view the year-to-date KRW underperformance as the market appreciating the need for easier policy, and thus getting the central bank to deliver on it. If so, the worse of the KRW performance this year is probably over. We think the markets are already pricing in more BoK rate cuts ahead. And with the imminent Fed rate cut supporting the weak US dollar trend ahead, we don't see today's rate cut or future moves as having much of a detrimental impact on the Korean won (KRW). Our year end USD/KRW forecast remains at 1180 (spot 1177).

Is the South Korean economy headed for a recession?

Growth, inflation and Bank of Korea policy rate



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Snap | 18 July 2019 Indonesia

Indonesia cuts rates to boost economy as Fed turns dovish

With the Fed poised to cut rates in July, Indonesia's central bank cut policy rate after pausing for seven meetings

5.75% 7-day reverse repo rate

As expected

BI slashes rates to boost economy with IDR stable

Indonesia's central bank cut its key rate after keeping policy unchanged for seven meetings in a bid to boost the economy as the rupiah has been performing relatively well in 2019.

With the Fed all but promising to deliver a rate cut at the end of the month, Governor Warjiyo was finally afforded proper scope to walk back a part of his 175 bps rate hike from 2018. The two key developments that sealed the deal were IDR's strength in 2019, up 3.73%, and confirmation that a Fed rate cut was on the cards.

With inflation at 2.8% and well-within the BI's target band of 2.5-4.5%, there was little reason to hold off on rate cuts as Warjiyo looks to do his part in President Jokowi's bid to boost growth momentum.

One and done or have they just begun?

After BI's first rate reduction, the next question would naturally be: will there be more?

Global headwinds continue to swirl with the US-China trade spat festering and any escalation in tension has the ability to knock back the IDR with the May episode enough evidence of this as the rupiah fell 1.08% for the month. The decision for further easing would likely rest on the stability of the currency with Governor Warjiyo clearly highlighting its importance in providing financial market stability.

However, it does appear that Governor Warjiyo is very open to easing further as he described BI's stance as "accommodative" and we believe further rate cuts can be carried out if IDR remains stable despite potential global headwinds and if growth data remains uninspiring to justify additional accommodation to boost the economy.

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