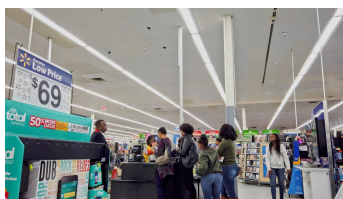


## Good MornING Asia - 2 February 2021

While the retail induced furor in US stocks has injected a fair bit of noise into markets, that seems to be fizzling out now, enabling us to look at some real issues again: This includes stimulus in the US as Biden talks to moderate Republicans, Covid-developments, central bank meetings (Australia today), inflation (Korean numbers released already)

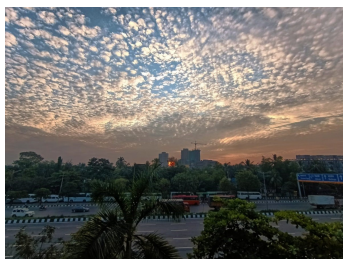
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Inflation in Indonesia fell below the central bank's target for the 8th straight month

# Long-dormant prices stirring

While the retail induced furor in US stocks has injected a fair bit of noise into markets, that seems to be fizzling out now, enabling us to look at some real issues again: This includes stimulus in the US as Biden talks to moderate Republicans, Covid-developments, central bank meetings (Australia today), inflation (Korean numbers released already)



## Let's start with inflation

Let's start with inflation: and the growing notion that inflation in the US is looming and could push bond yields higher gained further support from yesterday's prices-paid index within the manufacturing ISM survey. This price sub-index increased to 82.1 from an already high 77.6. The last time it was higher than this was in 1979, though I think the prices-paid element of the ISM services index will be a better barometer of the sticking power of US inflation, as it is likely to shed more light on what is happening to wages. On that, this week's payrolls survey will also be worth a look.

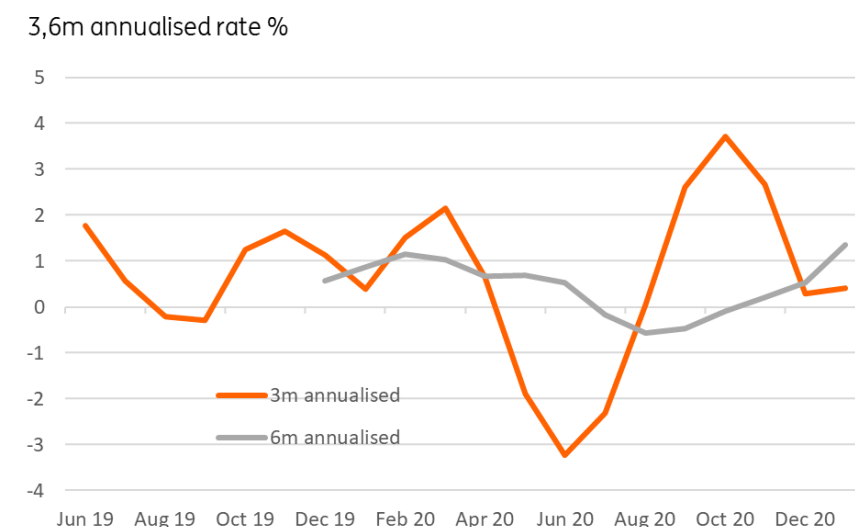
We have already had some inflation data out of South Korea this morning too. The month-on-month rate came in much stronger than had been expected, rising 0.8% in January from December. There were outside increases in food (1.9%), household furnishings and equipment (1.0%) health (1.0%), and transport (2.3%), along with miscellaneous (1.0%).

The headline Korean inflation rate only rose slightly though, to 0.6%YoY from 0.5%YoY, which suggests some big tweaks to the monthly seasonality or it would have been bigger. To see whether this is a meaningful acceleration in inflation, which is currently dominated by last year's

big pandemic-induced declines in the price level, in the chart below, you can see two series. One is the 3m annualized headline inflation series, the other the 6-month series. For full transparency, the 3m series does not contain any comparison with the immediate pandemic dip months, so gives a fairly "clean" indication of the current annual inflation "run rate".

This 3m annualized series has risen, but only to a shade over 0.5% from about 0.2%. Korea does have a base effect looming of about a full percentage point which should be fully accounted for in the May data released in June. Adding today's annualized rate to the base effects would give us 1.5% inflation in June, up from today's 0.6%. A bit more recovery in the economy and an uptick in the monthly run rate could see that figure surpassed, taking the peak rate closer to 2.0% by the middle of the year before it dips back again. None of which suggests any urgency of response from the bank of Korea.

## Korean annualized inflation rates



Korea annualized inflaiton

## Reserve Bank of Australia

Later this morning, the Reserve Bank of Australia will make their decision on monetary policy, and the consensus is that they won't touch any aspect of their current policy setting. That includes the 0.1% cash rate target and 0.1% 3Y yield target, together with the AUD100bn government bond QE programme. The AUD has been a fair bit weaker in the last few days, taking pressure off the RBA to respond by talking the currency down further, perhaps by hinting about further easing. And with a lull in Covid infections and therefore lockdowns, the real economy looks in decent shape to grow in 2021, so the more pertinent question would be what comes after the QE programme ends? And when will the yield curve control policy be scaled back? We probably won't get any clear hints today - it is too early.

## Bio-economics

There isn't too much to add on the Covid-pandemic front, except that the global daily trend of new cases seems to have dipped, so barring a resurgence in one of the new variants, or another new one emerging, this trend is encouraging. There is a bit of shuffling for podium places at the top of

the daily-case list, with the US still on top, but dropping sharply, as is Brazil and the UK. France, Russia and Spain are moving up the table, and we may see some switches in the coming days if the UK vaccine rollout and lockdown continues to work well. India has dropped well down the table.

I would say that this tells us very little about the next 3 or 6 months though. But it will encourage markets to take a brighter view.

## Geo-economics-politics

And further reasons for optimism may come from talks between President Biden and moderate Republicans over a stimulus package. It remains to be seen if Biden can demonstrate the "art of the deal", but it looks to me that there is a compromise deal somewhere between the Republican \$618bn and Biden's \$1.9tr, even if it has to come at the expense of money for the states and local government or for federal minimum wages.

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# India's budget: Aiming for a V-shaped recovery?

The Indian annual budget seems to be pursuing a v-shaped recovery but the mixed market reactions – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggest investors aren't entirely convinced. And neither are we



Mumbai skyline

## An exemplary show of policy support for the economy

Indian prime minister Narendra Modi's budget for the fiscal year 2021-22 is aiming for a strong v-shaped economic rebound next year to 11% GDP growth from a record -7.7% contraction in the current fiscal year – both the projections are a part of the government's annual Economic Survey for FY20-21.

Indeed, growth outweighs fiscal austerity. Though the measures would have gone some way in reviving investor confidence in the government's economic management after a spending surge and revenue shortfall widened the budget deficit and the public debt in the current fiscal year.

The budget contained significant surprises, especially on the fiscal deficit side. The finance minister announced that the deficit as a proportion of GDP in the current fiscal year is estimated to swell to

a record 9.5%, which was substantially more than our forecasts and also the broader consensus view of over 7.0% deficit.

In some display of fiscal tightening, the government is aiming to narrow the deficit down to 6.8% of GDP.

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*The mixed market reactions to the budget announcement – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggests investors aren't quite convinced either*

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That said, the INR 34.8 trillion spending budget for the next fiscal year is little changed from this year.

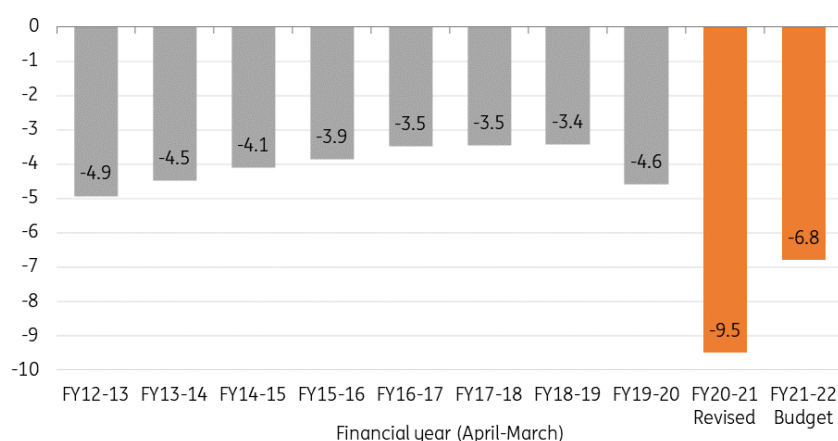
This suggests all the hopes of trimming the deficit below 7% of GDP rest on recouping revenue losses suffered in the current year and more, which in turn depends on the economy achieving double-digit growth. We are sceptical of this and we're not alone. The mixed market reactions to the budget announcement – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggests investors aren't quite convinced either.

The current revenue receipts are projected to grow by 15% in the next fiscal year. This is slightly faster than 13.9% of nominal GDP growth underlined by the official budget projections, which appears to be a bold assumption.

Moreover, the economy isn't out of the woods yet. The pandemic may be under control currently with the authorities launching a massive vaccination driver, but the risk of the virus resurfacing remains. In the event, GDP growth falls short of the official target, so would the revenue. Leaving alone the retrograding effects of new revenue generations measures.

As such, extremely weak public finances will continue to be a key overhang on markets well into 2022, probably even beyond.

## Fiscal deficit as proportion of GDP (%)



Source: CEIC, Indian Ministry of Finance, ING Bank

India's fiscal year runs from 1 April to 31 March.

## Key budget assumptions

With a little-changed spending programme, it will take higher revenue to trim down the fiscal deficit.

- FY20-21 budget deficit of 9.5% of GDP - the highest since 1987 (consensus 7.3%).
- FY21-22 deficit programmed at 6.8% (consensus 5.5%).
- FY21-22 total expenditure at INR 34.8 trillion - little changed from the current fiscal year.
- FY21-22 development spending of INR 5.54 trillion, up 26% from revised estimate for FY20-21. This with little-changed total spending implies a significant cut to current spending ahead.
- FY21-22 divestment revenue of INR 1.75 trillion. These targets have hardly been met in the past.
- Additional market borrowing of INR 800 billion in FY20-21 (in the remaining two months of the financial year), on top of INR 12 trillion earlier plan.
- Borrowing planned at INR 12 trillion for FY21-22

## ➔ Spending-side measures

Infrastructure continues to dominate the spending side measures.

- INR 641 billion for boosting healthcare infrastructure for over six years.
- INR 350 billion for Covid-19 vaccination programme.
- INR 1.1 trillion for 'future-ready' railway infrastructure.
- INR 3 trillion for revamping the power distribution sector over five years. Carrying on with 8,500 km of roads and highway projects announced in the past budgets.
- INR 1.97 trillion support for the production-linked incentive scheme for key sectors for five years.
- INR 1.41 trillion allocations for clean cities initiatives (13.50)
- INR 2.87 trillion for clean water programme for five years.
- INR 200 billion capital base for the proposed Development Financial Institution for infrastructure project financing.
- INR 200 billion for the recapitalisation of Public Sector Banks. Setting up an asset

- management company to manage bad loans.
- INR 157 billion support for SMEs.

## ➔ Revenue-side measures

Aside from revamping the customs duty structure, the real thrust of revenue generation seems to be largely missing in the new budget.

- Tax filing exemption to senior citizens above 75 years with only pension income.
- Extension of tax relief for home buyers and affordable housing projects with loans for one more year, up to 31 March 2022.
- Extension of tax holiday for start-ups by one year.
- Tax holiday for airlines and aircraft leasing companies.
- Revamping customs duty structure -- rationalisation of duties on precious metals of gold and silver; hike in duty on solar inverters; mobile phones and auto parts; withdrawing duty exemption of products supporting domestic infrastructure.
- The monetisation of assets: including rails roads, airports, sports facilities, and fuel transmission systems, warehouses, etc.
- Sale of government's ownership of two state-run banks and insurance companies.

## ➔ Other measures

- Easing tax administration, reducing compliance costs.
- Voluntary vehicle scrapping policy - phasing out old vehicles (not applicable for commercial vehicles).
- Increase in foreign investment limit for the insurance sector to 74% from 49% currently.
- Developing a digital payments system.
- Review the Companies Act with a view of easing regulations for SMEs.
- Ensuring credit flows to agriculture and enhancing marketing infrastructure for this sector.
- Protecting depositors in troubled banks.
- The liberalisation of the electricity market.
- Setting up seven textile parks over three years.

## FY21-22 Budget at Glance

Financial year (April to March) INR bn	FY18-19 Actual	FY19-20 Actual	FY20-21 Budget	FY20-21 Revised	FY21-22 Budget
<b>1. Revenue receipts</b>	<b>15530</b>	<b>16841</b>	<b>20209</b>	<b>15552</b>	<b>17884</b>
(% YoY)	<b>8.6</b>	<b>8.4</b>	<b>20.0</b>	<b>-7.7</b>	<b>15.0</b>
2. Tax revenue (Net to Centre)	13172	13569	16359	13445	15454
3. Non-tax revenue	2358	3272	3850	2107	2430
<b>4. Capital receipts a/</b>	<b>7621</b>	<b>10023</b>	<b>10213</b>	<b>18952</b>	<b>16948</b>
5. Recovery of loans	180	183	150	145	130
6. Other Receipts	947	503	2100	320	1750
7. Borrowing and other liabilities b/	6494	9337	7963	18487	15068
<b>8. Total Receipts (1+4)</b>	<b>23151</b>	<b>26863</b>	<b>30422</b>	<b>34503</b>	<b>34832</b>
<b>9. Total expenditure (10+13)</b>	<b>23151</b>	<b>26863</b>	<b>30422</b>	<b>34503</b>	<b>34832</b>
(% YoY)	<b>8.1</b>	<b>16.0</b>	<b>13.2</b>	<b>28.4</b>	<b>1.0</b>
10. On revenue account; of which	20080	23506	26301	30111	29290
11. Interest payments	5826	6121	7082	6929	8097
12. Grants in aid for creation of capital assets	1918	1856	2065	2304	2191
13. On capital account	3071	3357	4121	4392	5542
<b>14. Revenue deficit (1-10)</b>	<b>-4550</b>	<b>-6665</b>	<b>-6092</b>	<b>-14560</b>	<b>-11406</b>
% of GDP	-2.4	-3.3	-2.7	-7.5	-5.1
<b>15. Effective revenue deficit (14-12)</b>	<b>-2632</b>	<b>-4809</b>	<b>-4027</b>	<b>-12256</b>	<b>-9215</b>
% of GDP	-1.4	-2.4	-1.8	-6.3	-4.2
<b>16. Fiscal deficit [9-(1+5+6)]</b>	<b>-6494</b>	<b>-9337</b>	<b>-7963</b>	<b>-18487</b>	<b>-15068</b>
% of GDP	<b>-3.4</b>	<b>-4.6</b>	<b>-3.5</b>	<b>-9.5</b>	<b>-6.8</b>
<b>17. Primary deficit (16-11)</b>	<b>-668</b>	<b>-3216</b>	<b>-881</b>	<b>-11558</b>	<b>-6971</b>
% of GDP	-0.4	-1.6	-0.4	-5.9	-3.1
a/ Excluding receipts under Market Stabilisation Scheme					
b/ Includes drawdown of Cash Balance					

Source: CEIC, Indian Ministry of Finance

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# Indonesia: Inflation stays below target as economic recovery remains fragile

Inflation in Indonesia fell below the central bank's target for the 8th straight month



Source: Shutterstock

**1.6%** January inflation

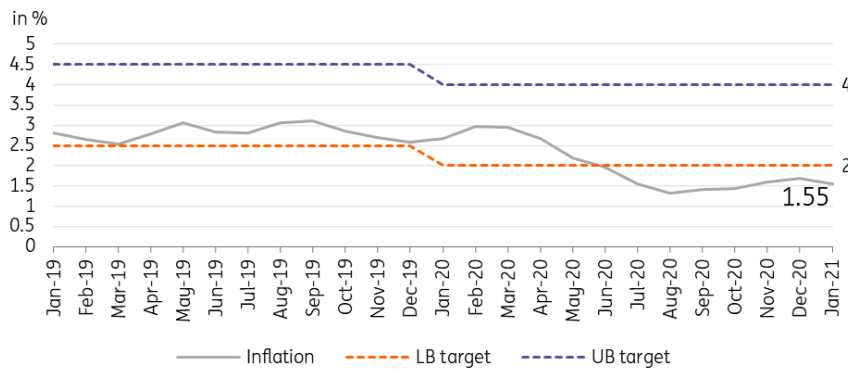
Lower than expected

## January inflation at 1.6% with demand pressures muted

Price pressures remained subdued in early 2021 with demand pressures muted by the ongoing economic recession and January inflation settling at 1.6%, slightly below market expectations. Economic activity slowed further in January after a spate of natural calamities while a spike in Covid-19 infections forced the authorities to reinstate partial lockdown measures in both Java and Bali to slow the spread of the virus. Core inflation came in-line with market consensus at 1.6%, but also remains below the 2-4% inflation target of Bank Indonesia (BI). BI Governor Warjiyo flagged a possible pickup in price pressures in the second half of the year, on improving economic conditions coupled with base effects kicking in.



## Indonesia inflation below target for 8 months now



Source: Badan Pusat Statistik

## Below target yet again

Inflation stayed below target for an 8th straight month and is not expected to accelerate sharply in the near term given the challenging economic outlook. Finance minister Indrawati flagged these concerns recently after the authorities upsized their stimulus efforts given damage caused by natural disasters in January and the ongoing partial lockdowns in Java and Bali. With inflation below target, we believe BI is also on standby to ease monetary policy to bolster the recovery efforts but monetary authorities will likely wait for more stability for IDR (with depreciation of 0.96% in January) before easing policy further.

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