

Good MornING Asia - 2 July 2020

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By Robert Carnell



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Source: Shutterstock
Vaccine

A decent trial yes, but a practical vaccine remains way off

The cue for Asian markets from overnight US trading is a mixed to slightly positive one today.

On the plus side, yet another drugmaker has released promising details of the antibody response to its trialled vaccine, which is always a shot in the arm for the stock market (sorry, couldn't resist that one). But markets do seem predisposed to positive news these days, and for balance, it is worth noting that trial numbers in this study were fairly low, and one of the other promising vaccines has shown some undesirable side-effects in its larger doses which may prove troubling. In any case, the US Food and Drug Administration doesn't seem to be lowering its safety requirements for any potential vaccine, no matter how promising it looks, which suggests that the "realistic-optimistic" timeline for any vaccine will be next year at the earliest.

But if the news on a potential vaccine is looking a bit brighter, that is not the case for the current run rate of the virus, especially in the US, where the 7-day moving average of new daily cases continues to move higher. I am monitoring the daily death tally closely against anecdotes of ICU bed availability becoming exhausted in some of the most affected states, as it seems likely that this will start to pick up over the coming week. That may cause a rethink by markets (you'd think, though these days I'm not so sure).

And it's also payrolls day in the US today, which is always a bit of a lottery ahead of the Independence Day holiday. With the distortions clearly present in the data, it is just not clear how

one should respond to whatever data gets spat to by the statisticians today, and some market players may think it more prudent to sit this one out ahead of the long weekend. For what its worth (and right now, the answer to that is probably nothing) the ADP survey yesterday came in at 2369 thousand jobs created, a bit weaker than the consensus and lower than the 3 million-plus that is pencilled in for non-farm payrolls. Moreover, [as this note by James Knightley on yesterday's manufacturing ISM data highlight, there are still signs of significant strain in the US labour market.](#)

Fed taking its time to decide

Overnight minutes from the last **US FOMC** meeting suggest that the Fed is still some way off adopting yield curve control and has mixed feelings about the policy that has been adopted by several other central banks worldwide.

But it does seem to be mulling some more positive forward guidance, and in a way that will not cause me to go off on one of my usual rants. The version that seems to be favoured is predicated on rates not rising until (for example) the inflation rate not only reaches but overshoots its target rate for some time. By making policy state-contingent, rather than time-contingent (for example, we will not raise rates for the next two years at least), it avoids painting itself into a corner if the economy were suddenly to look much stronger, though it still has its pitfalls. Not the least of which is wondering if the US will ever manage to consistently hit (or exceed) its 2% inflation target again? It's not that ridiculous a question, look at Japan or the Eurozone.

House bill on China sanctions passed

In news that is a little closer to home, the US House of Representatives yesterday passed a bill sanctioning officials deemed to be exercising Hong Kong's new controversial National Security bill. The bill, which is not identical to one put forward by the Senate, now has to go back to the US Senate for approval before it passes to the President to be signed into law (or just left unsigned on his desk).

President Trump has remained very outspoken about China in recent weeks, but signing a bill and tweeting are very different things, and a bill is almost certain to lead to retaliation, as China will certainly view this as interference in its sovereign affairs. That is another potential hotspot for markets in the coming days.

The day today

South Korea has already released consumer price data for June which have come in a bit stronger than the consensus for no change, rising 0.2% on the previous month. That leaves the consumer price inflation rate at zero, which isn't great but is better than the May reading of -0.3%YoY. The Bank of Korea has been sounding cautious about the prospects of further rate cuts, now that the 7-day repo rate is only 0.5%. This helps them to leave economic stimulus to fiscal policy.

And we also get **Australian** trade data out this morning, China's slow recovery and some supportive commodity price data provide some optimism that the year-on-year decline in exports in May will show some improvement from the -11%YoY April reading, which should mark the low for Australian exports. Import data will also be worth a look as they will shed some light on how Australia's domestic recovery is going. Again, the news here may be mildly encouraging.

China's central bank (PBoC) has finally cut rates after the government signalled some weeks ago that further monetary stimulus was on its way. The targeted rate cuts will help many SMEs and firms in the agricultural sector, and won't have much impact on broader rates of the USDCNY. [Iris Pang writes about the latest PBoC move in more detail here.](#)

And Prakash Sakpal also notes some **ASEAN** developments from yesterday ahead of other data today:

Thailand: The manufacturing PMI rose to 43.5 in June from 41.6 in May but remained in contractionary territory. The Business Sentiment Index followed on with a rise to 38.5 from 34.4 over the same months. The Consumer Confidence Index due today is unlikely to be left behind either (48.2 in May). Despite improvements, these indices remain consistent with our forecast of a greater than 8% YoY GDP fall in 2Q20.

Malaysia: The manufacturing PMI rose to 51.0 in June from 45.6 in May as easing of Covid-19 movement controls released some pent-up demand and factories moved back into action. This is the second Asian economy with a PMI back above the 50 threshold for expansion (the other is Vietnam). However, it only underscores some recovery over dramatic manufacturing declines in the preceding months. A 32% YoY plunge in manufacturing output in April was the worst ever. May wasn't any better given the accelerated export fall by over 25%. Indeed, overseas orders remained a weak spot in the PMI in June".

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ASEAN Morning Bytes

Sentiment remains mixed as investors await the US jobs report on Thursday



EM Space: US data dump later on Thursday to give additional direction

- **General Asia:** Market sentiment improved marginally with investors reacting to better than expected manufacturing data out from the US while the Fed mulled revisiting forward guidance to help maintain stability in financial markets. Investors were also reacting to developments on the vaccine front although optimism was capped with several US governors struggling to contain the outbreak in their respective states. On the geopolitical front, the US House of Representatives passed a bill that would sanction Chinese officials on human rights violations as China flexed the reach of its recent security bill to crack down on dissent in Hong Kong. Investors will be looking to key economic data (trade, payrolls and factory orders) out from the US later on Thursday while also keeping an eye on developments related to Covid-19.
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- **Philippines:** Bangko Sentral ng Pilipinas (BSP) will soon be issuing short-term bonds after getting the go signal from legislation earlier in the year as the central bank looks to deepen its policy tool kit. Governor Diokno indicated that the maiden issue will take place within the quarter with relatively short tenors that would not compete with issuances by the Treasury. Given that the directive of the BSP is to flood the market with liquidity, we expect BSP to delay the issuance of their own bonds or to keep the volume of such issuances at token levels during the economic recovery phase. This development will have a limited impact on the bond market for now as the BSP conducts its daily purchase window to help support the local bond market.
- **Indonesia:** Indonesia's inflation settled at 1.9% for June, the slowest pace of price gains since 2000 as consumer demand faded amidst the ongoing pandemic. Inflation is expected to remain subdued in the coming months given the bleak economic outlook but Bank Indonesia will be hard-pressed to cut policy rates in the near term given renewed depreciation pressure on IDR. The currency has faced some weakness in recent days given the risk-off tone as Covid-19 cases spike in Indonesia and others parts of the globe with investors also growing uneasy over plans for the central bank to monetize debt. We expect the IDR to face depreciation pressure in the coming days with the central bank stepping up its triple intervention while sentiment remains fragile.

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

- US trade, non-farm payrolls, factory orders, durable goods orders (2 July)
- China Caixin PMI (3 July)
- Thailand inflation (3 July)
- Malaysia trade (3 July)
- Singapore retail sales (3 July)

China: Targeted rate cut, finally

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Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

PBoC cut rate only for small firms and agricultural sector

The People's Bank of China cut the re-lending rate for micro-SMEs as well as the agricultural sector by 25bp on 1 July 2020. After the rate cut is effective, these rates will now be 1.95%, 2.15% and 2.25% for 3M, 6M, and 1Y, respectively.

Separately, the central bank also cut the rediscount rate by 25bp to 2%.

Targeted

The purpose of these rate cuts is to increase the incentives for banks to lend to small firms and the agricultural sector, which have higher credit risks. The central bank hopes that this will increase the willingness of banks to lend to these targets and therefore can stabilise employment because SMEs are a big source of jobs for migrant workers. If migrant workers return to their home towns they can borrow from banks if they develop their own business in the agricultural sector.

However, if small factory owners cannot see a return of export orders, they may not be willing to

borrow. They may just wait for a month or two and then decide if they should close their business. On this front, fiscal stimulus is expected to play a role.

PBoC is expected to send a clear signal to the market

The market had been waiting for a rate cut after the government made a statement around two weeks ago that RRR cuts can support economic recovery. The message and its timing confused market expectations for monetary policy.

Better communication with the market is important to amplify the effectiveness of monetary policy.

USDCNY should not be responsive to the targeted rate cut

Since targeted rate cuts will only bring around CNY 1.5 trillion loans for this year, which is small compared to outstanding loans of CNY 232.3 trillion, the impact of the targeted rate cuts should not have much impact on interest rates in China.

We also believe that USDCNY will not be responsive to these targeted rate cuts. Our forecast of USDCNY for the end of 2020 is still at 7.05.

Philippines: BSP's extraordinary measures

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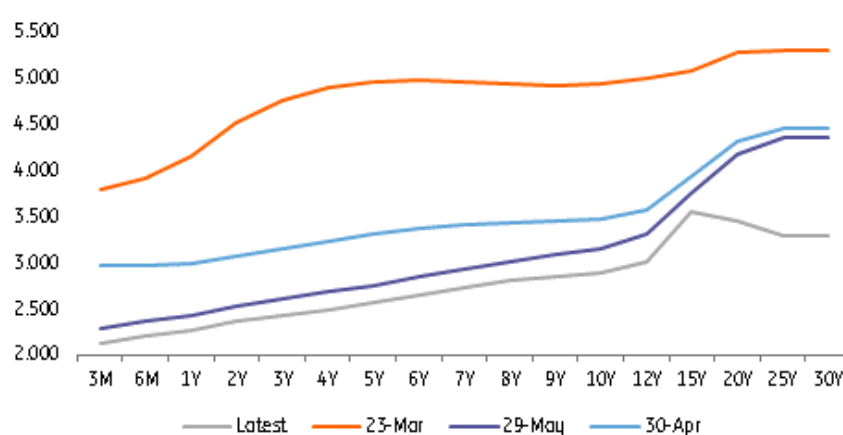
BSP uncorks extraordinary measures to combat Covid-19 fallout

The Bangko Sentral ng Pilipinas (BSP) has carried out “extraordinary” measures to shore up confidence and ensure that local financial markets remain functioning in response to the fallout associated with Covid-19 and the lockdowns that it brought. Financial markets were in disarray in March with global new infections surging and with the national government implementing strict lockdown measures to shut down the economy and slow the pace of infection. To support financial markets, on 24 March, the BSP announced it would be doing the following: a) reducing the policy rate window volume offering from Php320 billion to Php100 billion, b) a Php300 billion 3-month repurchase agreement with the Treasury and c) purchasing local government securities from the secondary market via a daily purchase 1-hour window.

Philippines' version of quantitative easing

The outright purchase of government securities from the secondary market is the Philippines' first attempt at carrying out quantitative easing to deal with the crisis the economy is facing. The BSP implemented the purchase window to reassure market participants of demand for government securities and to encourage participation in the bond market. And for the most part, the policy has worked, alongside recent aggressive policy rate cuts, to calm market nerves, resulting in lower borrowing costs. Bond yields hit a peak on 23 March before falling quickly in the weeks thereafter, due in large part to aggressive BSP rate cuts and liquidity infusions. On top of slashing policy rates and flooding the financial market with liquidity, the BSP began purchasing bonds in the secondary market, amplifying the transmission of the BSP's conventional monetary policy by preventing bond yields from drifting higher during any daily bouts of risk aversion.

Philippines local bond yield curve (various dates in 2020)



Source: PDEX

Local bond market on training wheels

BSP's bond purchase window was originally slated for operation from April to June or "until market conditions return to normal". With risks related to the Covid-19 pandemic and the impending economic recession remaining high, market conditions appear to be far from normal despite the recent improvement in sentiment from the lows seen in March. Thus we expect BSP to extend the operations of its bond purchase window possibly for at least another quarter as sentiment will likely remain fragile as the economy slowly reopens from its almost three month lockdown. With BSP implementing its bond purchase programme, the local bond market is in effect moving on "training wheels" with bond yields capped and any heavy sell-off averted.

BSP's bond purchase programme extended for now but for how much longer?

The presence of BSP in the secondary market caps any rise in yields for the time being, but it may also limit the ability of monetary authorities to gauge true market sentiment and the shape of the "true" yield curve. This predicament complicates the timing of the eventual removal of the "training wheels" with the central bank at some point having to remove this support from the market. BSP has indicated that the size of total purchases through the BSP's special window amounts to roughly 20% of total trading volume from March to June, with ING estimating roughly

Php400 to Php480 billion has been purchased so far. This shows that although BSP's purchases may not dominate trading, they constitute a sizable portion of trading volume and the Bank may eventually take quite a sizable amount of bonds onto its balance sheet. For now, however, BSP will be content to keep its purchase window open, helping guide market rates lower to aid the recovery. A careful look at an eventual exit strategy of the purchase programme may be warranted to ensure a full transition to normalcy.

Exit strategy?

BSP indicated that the bond purchase programme would remain in place until "market conditions return to normal" as this move helps complement its other traditional tools to keep monetary policy extremely accommodative during the economy's recovery. We can expect the central bank to retain this accommodative stance until the broader economy shows some signs of recovery and thus we can expect the bond purchase programme to remain in place likely until early next year. Given that the total amount amassed by BSP through its purchases may be significant, it may be difficult for the BSP to avoid some form of market sell-off in the future should they decide to actively wind down the balance sheet. Thus the best exit strategy for the central bank may simply be one where BSP holds on to them for the long haul.

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