Good MornING Asia - 2 May 2019

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Opinion | 2 May 2019

Markets respond to patient Fed

"No strong arguments for a move either way" clips the US rate-doves' wings, pushing USD higher.

Source: Federal Reserve

2.35%

Interest rate on US Excess Reserves

down 5bp

Lower than expected

Technical changes show how little real liquidity there is

James Knightley has done his usual thorough job summing up last night's FOMC decision. Which can be characterized as highlighting the ongoing (though transitory) lack of inflation, whilst also flagging the better outlook for activity and the balance of risks.

2-Year Treasury notes responded to the cold water poured on rate-cut ideas by falling, with yields rising around 4bp, though it was a hairy ride, and they were at one point down 6bp.

The 10Y yield is almost unchanged at about 2.50%, resulting in a slightly flatter yield curve.

The technical adjustment to the interest rate on excess reserves (IOER) is interesting. With the Fed funds rate trading through the IOER recently, the Fed has acted to push the effective Fed funds rate back towards the centre of the 2.25-2.5% target range. The IOER was lowered to 2.35% from 2.4% following recent sessions in which the effective Fed funds rate has traded above it. The IOER was designed to act as a type of ceiling to the Fed's target range, but recent price action shows that by paying the banks a decent rate for doing absolutely nothing, the real liquidity in the overnight dollar market is set outside the banking system, by the much smaller liquidity source of the Federal Home Loan Banks, which don't get IOER and so are free to lend.

There is a good piece on Bloomberg today, their Bloomberg Reaction, "Fed tweaks IOER but no Repo Facility Innovation", which discusses the next moves. A Repo tool would make sense. When the Fed first normalized policy, it used a reverse-repo facility to ensure the effective rate would hold the floor of the target-range. Now a repo facility to ensure the ceiling is not breached seems a sensible addition.

USD stronger on Fed decision

The dollar index is stronger following the FOMC decision and testimony, no doubt bolstered by the damage caused to the rate-cut thesis. Two currencies in the Asia-Pacific region to watch are the AUD and NZD. Both have upcoming rate meetings. Both have growing reasons to cut, with poor NZ employment data most recently, and soft Australian inflation.

The AUD is trading just above the 0.70 level. And although I would say that this might be a bit weaker than fundamentals would suggest, in the short term, we still like a foray into the AUDUSD 0.69-something area. The NZD should follow it lower, though which currency weakens most, will probably reflect a horse race between the two central banks to see which can out-do the other with dovishness.

Elsewhere in Asia, the story on FX is a mixed one, some up, some down, some unchanged. This micro-shift in the Fed may take a little thinking about when there are other factors at work, both domestic (rate cut thoughts in some economies) and international (the impact of oil prices weakening - good for INR, not so good for MYR, for example).

Korean inflation - not as bad as feared

After a string of weak reports, Korean inflation for April was not as bad as expected, with the core rate remaining unchanged at 0.9%YoY and headline inflation nosing up to 0.6% from 0.4%. Ignoring historical base effects and focussing only on price levels of subcomponents, the better outcome seems to have been heavily food driven, though there was a small increase in furnishings too as well as transport, which, bolstered by small monthly increases in other components, has helped keep the April figure from sliding further.

That said, the rate of inflation is substantially below the Bank of Korea's (BoK's) target rate of 2.0%. with weak exports and domestic activity. The BoK is resisting calls for a cut, but we suspect it is only a matter of time before they reverse last November's hike with a 25bp cut later this quarter.

Thailand provides stimulus measures

(From Prakash Sakpal): The Thai government announced a THB 13.2bn economic stimulus directed at farmers and low-income people. This follows the downgrade earlier this week of the government’s GDP growth forecast for 2019 to 3.8% from 4.0%. At less than 0.1% of GDP, we doubt the package will be enough to shore up growth. The hawkish central bank and persistently large current account surplus sustain the potential for THB outperformance, though we maintain our view of the USD/THB rate hovering around 32 through 3Q19.

Asia Day ahead - more PMIs, HK GDP, Indon inflation

The rest of the day is a mopping up exercise for those countries in the region that have not yet released manufacturing PMI data, Most of the ASEAN plus Korea. We aren't expecting any surprises or much to celebrate in these figures.

Indonesian inflation could nose slightly higher but remains moderate. And with BI more fixated on the external balance, we don't expect this to change policy settings meaningfully.

And with China on vacation today, HK GDP figures may be our closest thing to a proxy release on the strength of the Chinese economy.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

ASEAN Morning Bytes

General market tone: Risk-off. Regional markets are likely to track Wall Street weakness as the Fed shoots down rate cut hopes.

EM Space: Fed shoots down rate cut expectations

General Asia: Risk markets will likely track the weakness seen on Wall Street with the Fed signaling that they would remain on hold and refrain from moving in either direction. Economic data appears to support this stance with manufacturing ISM down but still in expansionary territory. Meanwhile, US-China trade talks resume with Secretary Mnuchin hoping that this would be the last chapter before a deal is struck.

Thailand: The headline and core CPI inflation in April were steady at March's 1.2% and 0.6% rates respectively. The manufacturing PMI and consumer and business confidence indexes for April due today are likely to reinforce the balance of economic risks as tilted toward growth. The government announced THB 13.2bn economic stimulus directed at farmers and low-income people. This follows the downgrade earlier this week of government's GDP growth forecast for 2019 to 3.8% from 4.0%. Less than 0.1% of GDP, we doubt the package will be enough to shore up growth.

Indonesia: Foreign direct investments into Indonesia contracted by 0.9% but local investment looked to offset the slowdown in foreign inflow and the total investment rose by 5.3% in the 1Q of 2019. This undermines the government drive to have a solid external position.

Philippines: The Philippines bagged a credit rating upgrade from S&P ahead of the labor day holiday on the back of solid growth momentum and external payments position. S&P did hint that further upgrades could be in the offing should legislative reform continue but it also flagged a possible downgrade should debt metrics get out of hand. For the time being, debt and external metrics remain relatively in check although the recent investment boom has pressured current account.

What to look out for: NFP

- China Caixin PMI (2 May)
- Hong Kong GDP (2 May)
- Indonesia inflation (2 May)
- FOMC (2 May)
- Malaysia trade (3 May)
- US NFP and PMI services (3 May)

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

China: softer PMI to keep stimulus in place

The lower than expected manufacturing PMIs show new orders continuing to increase. By contrast, new export orders continued to shrink although at a slower...

Official manufacturing PMI lower than expected

The China official manufacturing PMI was 50.1 in April, lower than last month's 50.5 (also the consensus expectation for April). Another measure of PMI, Caixin manufacturing PMI, confirms that Chinese manufacturing growth softened slightly to 50.2 in April from 50.8 previously.

We highlight that new orders from the official PMI report. These represent growth indomestic demand for industrial products and parts and were solid at 51.4, although softer than the 51.6 a month ago.

New export demand, however, shows foreign demand for Chinese made manufacturing products still shrinking at 49.7, although better than the 48.7 in March.

The two diverging orders signal that China is still facing external headwinds but fiscal stimulus and monetary easing have supported the domestic economy.

High-tech production PMI at 52.9

According to the Statistics Bureau, high-tech manufacturing PMI was 52.9, up for 4 straight months. Here new orders rose to 56.2, a 10-month high. The report didn't mention high-tech export orders and this could signal that high-tech parts and goods produced in China face external headwinds .

This may be due to the fact that the economic fundamentals of foreign economies are not fundamentally strong, but at least the US economy is growing solidly. In addition, political concerns mean that high-tech goods produced in China are not a preferred import for some foreign economies.

Fiscal stimulus and monetary easing will be in place

High-tech product headwinds remind us of uncertainties from external demand, which include:

- exports of 5G related parts and goods, especially to the west,
- when the trade deal between China and US will be signed, and
- how the two sides implement the trade deal.

These uncertainties make us strongly believe that the Chinese government will continue its fiscal stimulus to support industrial sectors through infrastructure stimulus, and will provide enough credits to smaller private firms to keep them running and so stabilise the job market.

Yuan is more like a political tool to

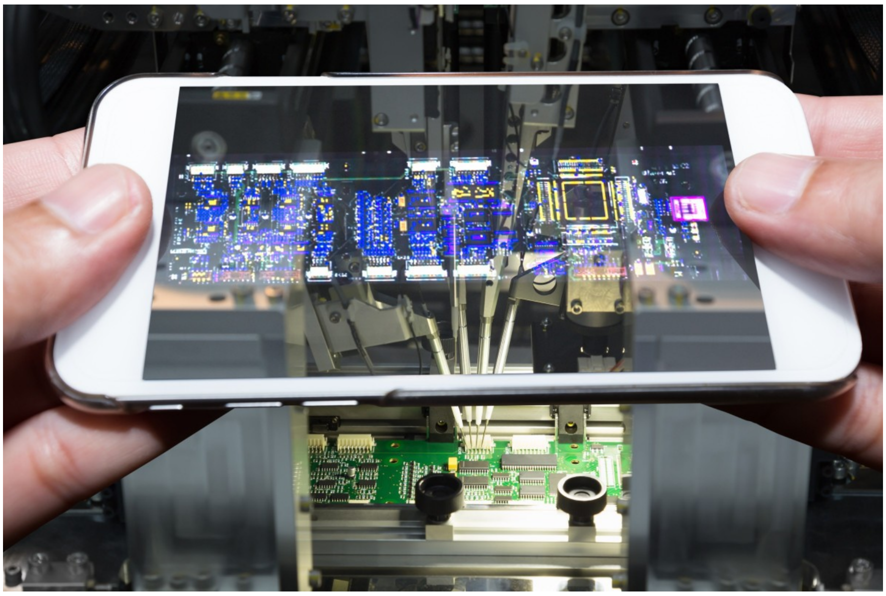
We have revised our USD/CNY and USD/CNH forecasts to reflect that yuan movements are now more a tool for politics. The "Two Sessions" have directed the yuan to be moving in a narrow range and when there were trade talks between China and US, the yuan has been more likely to depreciate than appreciate.

These changes in yuan movements mean that we revise our 2Q19 and 3Q19 forecasts for USD/CNY and USD/CNH to 6.75 and 6.80 and keep 6.75 by the end of 4Q19.

Snap | 30 April 2019 FX | Taiwan

Taiwan: GDP growth edges lower amid shrinking exports

Taiwan 1Q19 GDP growth was 1.7% year-on-year, down from 1.8% in 4Q18. Most of the growth engines contracted. Looking forward, producing 5G equipment could...



Source: Shutterstock

Can government spending and 5G support the whole economy?

GDP growth was 1.7% YoY in 1Q19, edging down from 1.8% in 4Q18. Exports, industrial production, and retail sales exhibited negative growth in the first quarter.

- Export growth dropped to -4.2% in 1Q19 in comparison to 0.0% in 4Q18.
- Industrial production fell 9.88% YoY in March.
- Retail sales edged up only by 0.62% YoY in the same month.

This activity data demonstrates that most engines on the private side of the economy have been a drag on growth.

The government is trying to stabilise the economy, with plans to spend nearly TWD 2 trillion in 2019, or around 11% of nominal GDP. This spending has taken the form of investment, which contributed almost 1.4 percentage points to GDP growth of 1.7% YoY. Unlike in big economies, it is difficult to rely on government spending to support growth in smaller economies for an extended period of time.

There will be a technical recovery in 2H19 because of the lower base of last year. But there won't be a fundamental recovery in 2019 unless there are many new smart-devices going to market or a popular device that needs parts from Taiwan.

Though 5G equipment manufacturing is growing, this is unlikely to boost industrial production, let alone the whole economy this year. Instead, we see 5G manufacturing as a long term growth prospect for Taiwan because 5G will create demand, from parts to final products, in the coming few years.

Moderate impact even if factory owners move production back to Taiwan from Mainland

The Taiwan government has proposed that factory owners who have production lines in Mainland China move production back to Taiwan. This is one result of the China-US trade war; if Taiwan manufacturers affected by tariffs continue to stay in Mainland China, it will increase the cost of doing business. Taiwan media has reported that the amount of approved investment so far is TWD200 billion, which is around 1% of GDP. But we don’t expect all the approved amount to be invested.

Still, we believe that the upside of this policy is limited for the economy as a whole:

- First, "tariff-saving" applies to Taiwan manufacturers affected by US tariffs imposed on China. If they are not affected, there is little reason for them to move back to Taiwan.
- These manufacturers are also limited by Taiwan's smaller supply of factory workers. If there is a big labour requirement, wage growth will increase, which will offset the attractiveness of moving production back to Taiwan. Still, some companies could add production capacity in Taiwan whilst continuing to produce in the Mainland to please the Taiwan government though we believe these activities are unlikely to be large enough to move the GDP needle significantly.

We are watching the pre-election

The current government's stance of going against the Mainland Chinese government has created a growth hurdle to the economy. For example, the number of Mainland China visitors to Taiwan has fallen by more than 35% from 2015- the year before Tsai took office- to 2018.

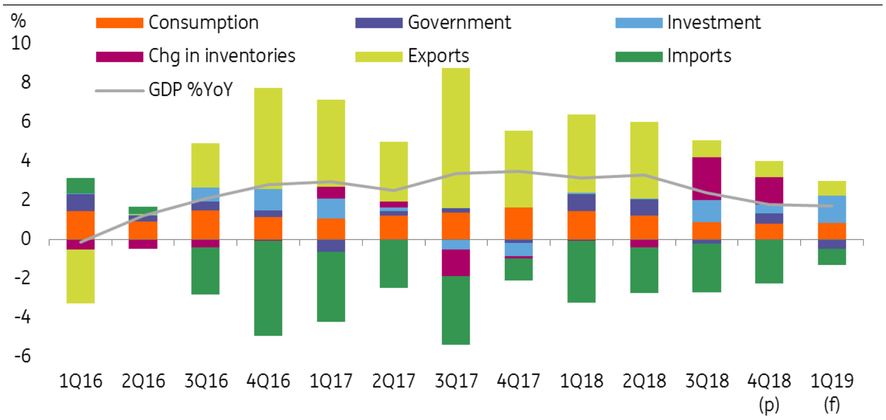
Currently, some political parties are starting to prepare for the 2020 presidential election. If the KMT party takes office in 2020, Taiwan's economy is very likely to receive "economic gifts" from the Mainland, which could help GDP growth return to the 10-year average of 2.92%.

Forecasts on GDP, policy rate and exchange rate

We expect 1.4% YoY, 2.0% YoY and 2.2% YoY GDP growth for 2Q, 3Q and 4Q, respectively. The whole year GDP forecast remains at 1.8%. As mentioned above, higher GDP growth in 2H19 should be due to a technical recovery from a low base last year.

According to our GDP forecasts, we do not expect any recession in 2019, which means the central bank can sit back and refrain from cutting the policy interest rate, which is now at 1.375%. As we don't expect a strong fundamental rebound in the economy or accompanying increase in inflation, there will be no need for rate increases either.

The currency is sensitive to corporate earnings because there is a substantial flow of foreign investments into the stock market. We are concerned that any missing sales targets of smart devices could put downward pressure on the Taiwan dollar against the US dollar. As such, we've revised our TWD forecast in March from 30.40 to 30.95 by the end of 2019.



Source: ING, Bloomberg

Snap | 30 April 2019 **Philippines**

Philippines: April inflation to be right on target at 3.0%

Inflation continues to decelerate rapidly and is expected to be within target for a third straight month, with the Philippines central bank (BSP)...

Source: Shutterstock

-0.90% price change for regular milled rice

y-o-y change

BSP's Research Department sees inflation between 2.7-3.5%

Philippine inflation continues to slide with the April reading expected to dip to 3.0% after the 3.3% print in March. With rice prices (a hefty 9% weight in the CPI basket) declining year-on-year, we can expect headline inflation to remain subdued. Utility rates, on the other hand, may have increased month-on-month but may likely be a touch lower compared to the same period in 2018. The downward trend in inflation comes despite a 31.6% year-to-date increase in Dubai crude prices as well a 24.6% jump in domestic diesel prices, showing that the deceleration in food inflation, which constitutes roughly 34% of CPI, will be more than enough to offset the effects of an energy price spike.

Three and counting, BSP to be forward looking?

The April reading would mark the third month in a row that inflation is back within the central bank's target, as supply chains continue to normalise after last year, which saw inflation breach the upper end of the BSP's target band. Given the supply side nature of last year's breach, inflation has plunged back to earth quickly, with the latest BSP inflation forecast at 3.0% for both 2019 and 2020. Meanwhile, inflation expectations remain well anchored with the latest BSP survey among private sector forecasters pointing to inflation settling at 3.3% for the year.

BSP has vowed to remain data-dependent in its actions and will have three months' worth of within-target inflation prints to consider. Furthermore, given the forward-looking nature of inflation targeting, inflation expectations and forecasts both point to inflation remaining within target for the next two years. Given BSP Governor Diokno's recent remarks hinting at a rate cut (and RRR reduction) within the year, we expect that we are getting closer to the central bank finally reversing its previous ultra-aggressive stance.

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Article | 30 April 2019 Thailand

Thailand's economy ends first quarter of 2019 on weaker note

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Source: Shutterstock

-2.5% March manufacturing growth

Worse than expected

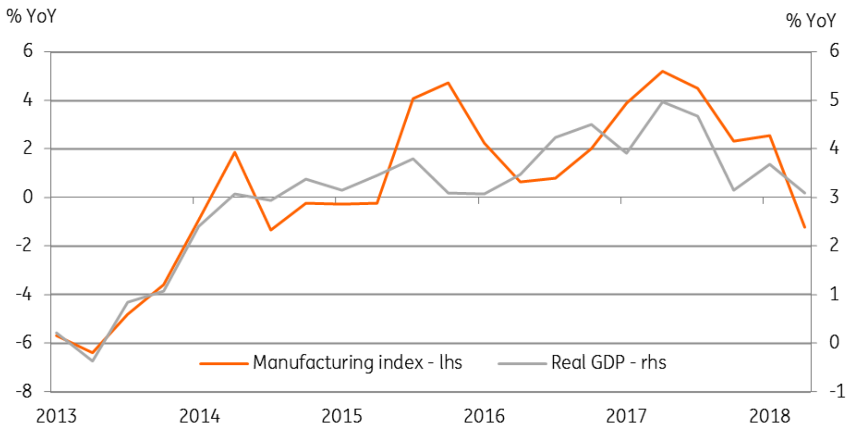
Increased downside growth risk

As widely expected, Thailand's manufacturing decline accelerated to 2.5% year-on-year in March from 1.6% in February, a steeper drop than the consensus estimate of 2.1%. Our even more bearish forecast of a 3.5% fall rested on an accelerated decline in exports in March. By sectors, electronics have been a stand-out source of weakness in both exports and manufacturing. Weakness in steel and rubber were an added drag in March.

But it's not just an export-led slowdown. We think domestic demand also weighed on output as a spike in political risks surrounding the general election gripped the economy. A dip in consumer confidence index, a slowdown in motor vehicle sales, and a fall in tourist arrivals speak to this.

Cumulative manufacturing output fell by 1.2% YoY in the first quarter of 2019, a sharp negative swing from the 2.5% growth in the previous quarter. This will have almost certainly dragged GDP growth lower. We consider our 3.1% GDP growth forecast for 1Q19 as having an asymmetric downside risk. The finance ministry has just announced a cut in its GDP growth forecast for 2019 to 3.8% from 4.0% on a view of much slower export growth than previously expected (3.4% vs. 4.5%).

Weak manufacturing, weak GDP



Source: Bloomberg, CEIC, ING

$6.1bn

March current account surplus

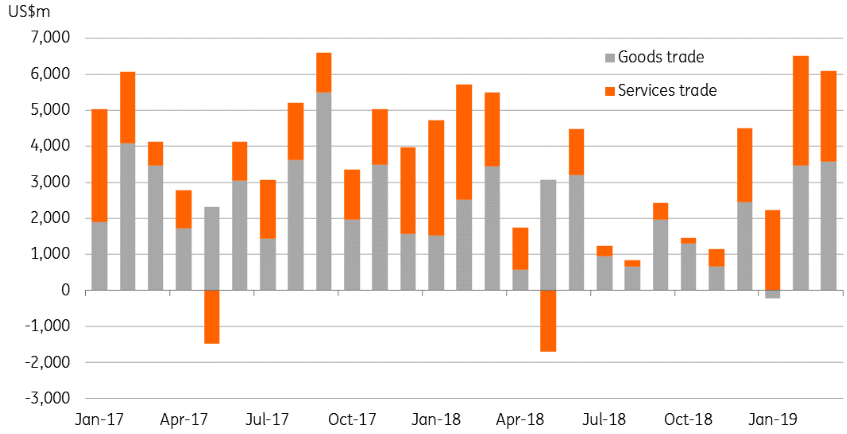
Higher than expected

Persistent large current surplus

Also released today, balance-of-payments data for March revealed a current account surplus of $6.1bn in the month, barely a narrowing from $6.5bn surplus in February which was the third largest monthly surplus on record. Expectations were centered on a significant narrowing in line with the customs basis trade surplus. In the event, the surplus from goods trade was steady at $3.5bn, while that from services trade fell only slightly.

The cumulative current surplus of $14.6bn in the first quarter more than doubled from the $7.1bn inflow in the previous quarter, which is a hopeful sign of an improved net trade contribution holding a floor under GDP growth.

Current account surplus



Source: Bloomberg, CEIC, ING

And yet a hawkish central bank

Despite slowing growth (and persistently low inflation) the Bank of Thailand's persistent hawkish tone keeps us from expecting policy support with a rate cut this year. Our baseline is no change to the BoT policy this year.

The elevated political uncertainty explains depreciation pressure on the Thai baht (THB) since February, paring strong gains made in the first month of the year. Yet, with a 1.8% year-to-date appreciation it's still the second-best Asian currency (after Chinese Renminbi, or CNY). The hawkish central bank and large current surplus should sustain the potential for THB to outperform in the rest of the year. That said, we maintain our view of the USD/THB rate hovering around 32 through 3Q19. Our year-end forecast remains at 31.80 (spot 31.96).

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