Good MornING Asia - 20 April 2020

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Boredom

Today, I will be mainly talking about the pandemic, again

I have to write a message to my Dad in the UK today, he has a birthday coming up. And like this note, it is going to be a struggle to write. I'd normally fill it up with newsy stuff about what the family has been doing, places we've visited, nice meals out, people we've seen. Chuck in a couple of photos opf the kids. Of course, I have none of that to offer today, having been nowhere, seen no-one, and done nothing.

And it is much the same with work too. There really is still only one game in town - the pandemic and how it is shaping up in various geographies. In Europe, real progress does seem to be being made, and as I noted last week, pioneers in the re-opening field, Austria and Denmark, are illustrating how it could go. Austria's new case numbers are still trending lower, so it looks good so far. Denmark's are holding up between 150 and 200, but their active cases are falling, so if they consider the capacity of their health service to cope as a key metric for re-opening, then it is stll on track.

The arguments for opening up states in the US is turning uglier, with Governors on both sides of the political divide noting the inadequacy of testing as a major constraint for them when it comes to re-opening. You could still probably argue that new cases in the US look to have peaked, which should mean the daily death tally should also soon begin to ease back, but the decline is still pretty marginal, and looks highly vulnerable to policy mistakes.

The UK is also having to deal with an increasingly tetchy public, with rebuttals of claims that a re-opening may occur as soon as May 11, and of newspaper criticisms of early UK policy towards the virus outbreak.

Here in Asia, there is no one-size-fits-all remark that can be levied on how it is going. China is having to respond to new outbreaks in Heilongjiang with lockdowns in the town of Suifenhe, according to the FInancial Times. And of course, we are still digesting last week's negaitve GDP figures. Korea gets to show how it has coped under the crisis, with its GDP release this week. The consensus is for a relatively modest 1.5%QoQ decline in GDP, which would be a remarkably good outcome if it is close to the mark. This could show what could have been done when testing capacity is aggressivly ramped up early on in a pandemic - Korea has not had any *mandatory* lockdowns (Daegu was volunrtary, though well followed). That said, it is a bit like showing losing contestants on a TV game-show what they could have won if they hadn't gambled their paltry winnings on the big prize.

Increasingly, we will turn back again to economic data like this to see how badly lockdowns have affected our countries, and to throw into the hat alongside clinical and epidemiological requirements for any re-opening. Like it or not, there will be a trade-off between the state of an economy and the lives of its citizens that politicians will implicitly, and often behind closed-doors, explicitly be making. And the worse the economic numbers, the greater the pressure on them to bow to public demands for a relaxation of controls. So there is still a purpose to being an economist, even if it hasn't felt like that for many weeks.

Asia today

Later this morning, the PBOC will release its new figures for the Loan Prime Rate: Iris Pang in Hong Kong writes, "The PBoC is widely expected to cut 1Y LPR by 20 bps. A smaller or deeper cut will surprise the market. The next question is then how many more cuts can the PBoC perform given that it does not agree with ultra-low interest rate policy. We believe that there will be hints on this question from the PBoC Q&A or statement".

And we've already had 1Q20 New Zealand CPI, which at 2.5%YoY (+0.8%QoQ), has exceeded the midpoint of its inflation target mandate (1-3%). Its a bit ironic now they've cut policy rates to their effective lower bound and started Quantitaitve Easing - but much of the increase appears to be related to indirect taxes, and the biggest rises from a year ago are cigarettes and alcohol. The coming quarters will almost certainly pare back these increases taking inflation back below or close to its midpoint. But the message here may be, NZ could be one of the first countries to start normalising policies as it exits its own very successful lockdown programme.

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Economy contraction worse than 1967

GDP contracted 6.8% year-on-year in 1Q20, the last time we saw such a big contraction was back in 1967 when China saw the economy shrink -5.8% during the Cultural Revolution, according to data from the World Bank. The contraction this time is a result of city lockdowns and strict social distancing measures but the comparison provides us with a sense of how big an impact Covid-19 has had.

Investment was up in March it can't be described as a recovery

Fixed asset investments contracted 16.1%YoY in 1Q20 but rose 6.05%MoM in March.

According to the National Bureau of Statistics, there were many items that experienced a slower contraction in Jan-Mar compared to in Jan-Feb. That means there are signs of some growth in investment in March. But it is still too soon to gauge the effectiveness of stimulus measures on investment.

The central government is now pushing the "New infra" plan, which currently consists of 5G infrastructure, big-data centres, AI, Industrial internet of things, ultra-high voltage connectors and e-vehicle chargers. The contents of the plan are quite fluid and more items have been added to it since January.

But we believe the speed of putting money into projects and turning this into measurable production will take much longer than it would do without social distancing in place. In short, recovery will be a long road.

Factories were the least affected

Industrial production shrank 8.4%YoY in 1Q20 but shows signs of heading back to recovery in March as the shrinkage narrowed to 1.1%YoY during that month.

Automobiles and related parts were heavily impacted by the lockdown. Automobile production shrank 43%YoY and new energy cars fell 43.9%YoY.

This positive note was mainly a result of the need to fight against Covid-19, e.g. non-woven textiles (masks and protective wear) +6.1%YoY, medicines +4.5%YoY. Other positive notes include the push for the “New Infra” projects by the central government. Computation and telecommunication rose 9.9%YoY and robot production also increased at 12.9%YoY in March.

Exports are expected to be dismal due to the Covid-19 situation in Europe and the US. This could last until June-July.

Retail sales were the most hit

Retail sales in March fell 15.8%YoY after falling 19.0%YoY in Jan-Feb. Retail sales show some improvement in terms of the variety of spending. It was not just food and medicine as in Jan-Feb, but also telecommunication equipment (+6.5%YoY), which is most likely purchases of smartphones.

But there was still a deep contraction in many retail sales items, e.g. clothing (-34.8%YoY), furniture (-22.7%YoY) and automobiles (-18.4%YoY).

As mentioned earlier, as long as there are strict social distancing measures, the recovery of activity will be very slow, and this will be reflected in consumption.

Policy expectation

Monetary easing and fiscal stimulus will certainly continue.

We expect a 20bp cut in the 1Y Loan Prime Rate on 20 April. Apart from that, there will be more targeted RRR cuts, which should focus on inclusive finance so that SMEs, which are employers of many workers, can get loans from banks.

Another policy expectation is the combination of monetary and fiscal policy of government guarantee loans for SMEs if banks continue to be reluctant to lend to SMEs.

To further stabilise the jobs market, the central government will push harder on the “New infra” plan, to make sure that the local government special bonds issued so far this year at CNY1.1 trillion can be put into projects as soon as possible. But the difficulty is still that even getting enough capital, the projects need to run smoothly without strict social distancing measures, which we don't think will be relaxed any time soon.

Revision of GDP forecasts

We have downgraded China' GDP growth further to -3.1%YoY in 2Q20, -0.5%YoY in 3Q20 and 4.5%YoY in 4Q20. 2020 full-year growth is projected at -1.5%.

USD/CNY has been affected by the changes of cases and death tolls of Covid-19 globally. We are revising the yuan to depreciate less than in our previous forecasts to USD/CNY at 7.15, 7.0 and 6.9 by end of 2Q, 3Q and 4Q20, respectively.

Article | 17 April 2020 **India**

Reserve Bank of India's "whatever it takes"

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Source: Shutterstock

Whatever it takes...

The Reserve Bank of India's Governor Shaktikanta Das announced an additional set of liquidity-boosting measures in an unscheduled press conference held today, topping up about $50 billion worth of measures unveiled less than a month ago on 27 March. Today's announcement includes:

Policy rates: A 25 basis point cut in the reverse repo rate to 3.75%. No change to the repo rate of 4.40%. The move discourages banks from depositing funds with the central bank instead of lending them out.

TLTRO 2.0: A targeted long-term repo operation INR 500 billion to start with, and in tranches thereafter, to support liquidity for small and medium-sized non-bank finance companies (NBFC). Banks are mandated to deploy the same amount of funds within one month and 50% of these are assigned for mid-sized NBFCs and microfinance institutions (MFIs).

Liquidity Coverage Ratio: Freeing up more cash for scheduled commercial banks, with a cut to 80% from 100% in the proportion of liquid assets they are required to be set aside to cover shortterm obligations. The cut will be rolled back in two phases in October 2020 and April 2021.

All-India Financial Institutions: A special financial facility of INR 500 billion at the repo rate to NABARD, SIDBI, and NHB, the national lenders to the agriculture sector, small-scale industries, and housing sector, respectively.

Easing lending guidelines: Extension of the loan-repayment moratorium for three months though with additional provisioning of 10% to be fully reversed back in two quarters once the situation is normalised. Easier restructuring of loans to the real estate sector.

More funding for states: Increase in the ways and means advance (WMA) limit for states by 60% until 30 September, 2020.

… but no quantitative easing

The announcement was, however, a disappointment for the markets, which expected aggressive easing via unconventional routes such as debt purchases, as well as monetisation of the fiscal deficit. As the government is embarking on a record domestic borrowing spree to finance the budget gap and this supply-overhang is driving yields higher, the markets were hoping that the central bank would absorb this debt in the secondary market and keep yields from going higher.

Alas, that's not going to happen. Our reasoning for this is that, unlike developed economies where exceptionally low inflation and interest rates have forced central banks on the quantitative easing path, the RBI still has room to ease by cutting policy interest rates. Admittedly, the policy transmission has been weak and the RBI's Operation Twist since December (buying of long-dated government bonds and simultaneously selling short-dated ones) has worked well in keeping yields low.

Governor Das did point out that the potentially low inflation rate allows for further rate cuts. At 5.9% year-on-year in March, inflation is just back within the RBI's 2-6% policy target range. We expect it to fall below 5% within this quarter.

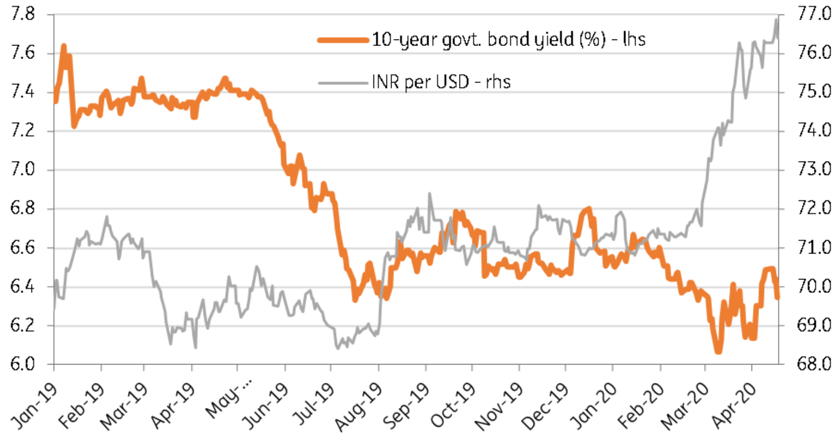
What's ahead?

Today's liquidity-boosting measures of INR 1 trillion combined with those worth INR 3.74 trillion announced on 27 March amount to about 2.4% of GDP monetary stimulus so far. Add to this 1.3% of GDP fiscal thrust, including the imminent second package said to be worth INR 1 trillion, and this still doesn't put India among the ranks of the more aggressive, 10-20% of GDP, aggregate policy thrusts seen elsewhere in Asia.

We don't consider economic stimulus as strong enough to position the economy for a speedy recovery once the pandemic ends. Stretched public finances have constrained fiscal stimulus and this has forced the RBI to do all the heavy lifting. However, liquidity-boosting efforts may not be much help to corporate and household cash flows, at least not until confidence returns, which is too difficult to time given the unprecedented nature of the current crisis.

Meanwhile, the markets will continue to ponder the depth of the economic downturn ahead of us and the length of the recovery after that. The extended lockdown until early May adds further downside risk to our view of a 5% YoY GDP fall in the current quarter, the worst ever. No doubt Indian government bonds and the rupee will remain under pressure in the near-term. Our end-2Q20 USD/INR forecast is 79.0 (spot 76.4).

Under weakening pressure



Source: Bloomberg, ING

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