

Good MornING Asia - 20-Mar 2020

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Opinion | 18 March 2020

GFC 2.0

With Ted spreads blowing out and the US government mulling the resurrection of GFC-era policies, it is beginning to feel a bit like the GFC again - nostalgic times



Break out the powdered egg

I did something yesterday that I have not done for more than a decade. I looked at Ted spreads on Bloomberg. If you've forgotten, and I had to remind myself, these are the spreads between interbank rates and US Treasury bill yields. They were one of the indicators of financial stress that filled our days back in 2008/2009 during the global financial crisis. In normal times, there will be a small spread between these and interbank rates, reflecting counterparty risk. The Treasury bill is essentially risk-free government paper.

Such is the demand for cash and near-cash like Treasury bills, that 3m T-bills now have negative yields, and the Ted spread has widened out about 70bp to just over 110bp. I seem to remember it being much wider at times during GFC1.0. But we are on the way.

There is also talk of the US Fed resurrecting the Term Auction Facility, or TAF, which was also a GFC-era policy to provide liquidity. This was just one of a lexicon of policies, all designed to stem leakage in a particular aspect of the US and to some degree, global financial plumbing. Add to this list, there have also been some proposals to guarantee money market mutual funds. This is all about the danger of "breaking the buck". And if money market funds see fewer withdrawals, then this will

reduce pressure on them to restore liquidity by selling bonds, so seems a sensible direction of travel. All this stuff is interconnected, but it is a bit like a leaky garden hose - stem one leak, and the water spurts ever harder from other leaks.

Overnight, the bond sell-off we saw on Wednesday / Thursday seems to have started to abate. Moreover, the differentiation across bond markets in Europe that we observed a few days ago is much less evident. Possibly this is a reflection of the new EUR 750bn bond-buying programme unveiled by Christine Lagarde. This had helped to undo some of the damage from her unfortunate comment about the ECB and bond-spreads when she first took over.

This time, banks not to blame

A further observation as the GFC-era copybook is dusted off by the Fed and other central banks around the world, is that the terms of lending and attitudes to the collateral offered in exchange for cash are far more generous. I suppose this is because this time, there is no sense in which "banks are to blame". During GFC1.0, even as help was extended to the financial sector to prevent a wholesale meltdown, there was also a sense that banks and finance companies needed "punishing", so there was no free-lunch, no bailout without consequences.

This doesn't seem to be happening now. The assistance being offered seems to be with both hands, and with no hidden agenda. That, I think, is encouraging, when there are so few things to be upbeat about.

Is now the time for really radical thinking?

I did a CNBC interview earlier in the week, and the anchor, Sri Jegarajah, who is always a very thoughtful host, asked whether this was the time to start helicopter money drops? I admit I had not joined the dots to reach that conclusion at that time, but yes, now I think of it, it may well be.

Here's why: The coronavirus could lead to substantial layoffs, unemployment and income losses for households. They aren't likely to be in the market for a new car or flat-screen TV. But they still need to buy food, pay rent, utilities, medical bills. With estimates of up to 80% of populations getting the coronavirus on top of that, this lays the setting for utter global collapse if somehow, things aren't kept ticking along. US Treasury Secretary Mnuchin is urging Congress to pass a \$1tr stimulus package by Monday. That's extreme; helpful. But it may still be way too little.

Struggling firms now, but which have an underlying profitable model should not be lost in this crisis. If you lose them now, you lose them forever. A V-shaped recovery was never on the cards, but you do at least want some sort of recovery when this is all over. That requires government help in paying debts and keeping healthy workforces engaged, even if on a reduced wage. And without having yet done the sums, I suspect that the costs to governments are far more than are likely to be able to be achieved through normal means, even on the scale of that now being proposed by Mr Mnuchin.

And that is where some direct money-financed spending might be the only viable option. I will return to this in the coming days after I have dug a bit deeper into the scale that might be needed. But in the meantime, [can I commend the FT article](#). It helps to put all of this into some sort of perspective.

Asia today

There really isn't much going on in Asia today, or for that matter the G-7, apart from some PMIs in Europe which are guaranteed to plummet, the only interest will be to see how much they fall.

We do have some monetary policy action in China with the PBoC announcing its 1Y and 5Y Loan Prime rates. Iris Pang Writes: "The market largely expects a symbolic cut of 5bp, though the necessity of any cut is questionable, as liquidity in China is currently ample. It is also because the PBoC did not cut the 1Y Medium lending facility (MLF) a few days ago, and the MLF is part of the LPR formula. This improved liquidity position relative to some other markets reflects the semi-closed nature of the Chinese capital account, which limits outflows".

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klof
Senior Economist, Netherlands
marcel.klof@ing.com

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

RBA starts QE – AUD plummets

RBA Governor Lowe has described a series of measures to complement the government's fiscal stimulus and calm the financial system. This is a start, but probably not the end of measures the RBA will eventually have to undertake



A wide raft of measures

Australia's central bank, the Reserve Bank of Australia (RBA) has extended its support to the economy and financial system today. In a statement to the media, RBA Governor, Philip Lowe announced the following measures:

- Cash rate target would be reduced further to 0.25% from 0.50%.
- Cash rate will remain at this level or lower until progress is made towards full employment and inflation sustainably within its target 2-3% band (forward guidance).
- The 3Y Government bond yield would be targeted at around 0.25% through asset purchase in the secondary market (Quantitative Easing) across the yield curve and in government bonds and semi-government securities.
- Introduction of a term funding facility aimed at supporting SMEs. This is a 3Y facility for deposit-taking institutions at a fixed rate of 0.25% equivalent in size to 3% of outstanding credit, and at least AUD 90 billion.
- Increase of exchange settlement balances at the RBA to be remunerated at 10bp instead of zero as currently.
- Addition to the 1 and 3-month repo operations until further notice, and additional six-month

operations at least weekly until no longer necessary.

Market response mixed

Australian longer dated (10Y) bond yields spiked higher on the announcement, which was probably not the intended outcome, even if the 3Y government bond yield declined slightly. We anticipate finessing of the policy goals later to deliver a decline in yields across the curve, though a slight steepening would not be unwelcome for the banking sector.

The Australian dollar has fallen sharply on the announcement, in line with previous announcements of QE around the world. The 0.5569 current level is its weakest since 2002 and takes the AUD down close to parity with the NZD.

As with most central banks, we don't consider this the end for the RBA, but more likely the beginning in a series of measures to provide support for the government's fiscal policy, and to help maintain the functioning of the Australian financial system. The RBA will want to see longer dated bond yields come down too, so any further finessing of the policy package may move more in that direction.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havlant

Chief Economist, Czech Republic

420 770 321 486

david.havlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Deputy Global Head of Editorial and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klokk

Senior Economist, Netherlands

marcel.klokk@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Taiwan's central bank cuts rates too

Taiwan has cut rates to 1.125% but we think more is to come. The fiscal stimulus should look to help the economy more directly rather than its current scattergun approach as the impact of the coronavirus has turned into a global demand issue that is likely to hurt the economy even post-Covid-19. As a result, we've lowered our TWD and GDP forecasts



Source: istock

Taiwan cuts rates for the first time since 2016

Taiwan's central bank cut policy rates more aggressively than the market expected. The rate cut to 1.125% from 1.375% was deep, but not unusual compared to what other central banks are doing around the world. This is the first move since 2016, and lower than the 1.25% we saw during the global financial crisis.

For the first time, the central bank has introduced a TWD 200 billion lending pool for small-medium enterprises for six months, which aims to help SMEs surf through the tide of Covid-19's damage on operations, which should, in turn, stabilise the job market. In our view, this should be more effective than the fiscal stimulus planned by the government so far.

But, we think the assumption that Taiwan needs low interest rate funding for a period of six months is quite optimistic.

Global demand has been hit, the recovery may be gradual if the job market is dismal even after Covid-19 subsides which will subsequently lower demand for electronic products, e.g. smartphones, which are more of a luxury item than a necessity. Taiwan's manufacturing and export demand will also be hit but this relief lending pool should help.

To prevent tight liquidity conditions, a liquidity injection of up to 180 days funding now includes banks, bills, postal, security firms, insurance companies.

Fiscal stimulus could help SMEs

Taiwan has scaled up its fiscal stimulus from TWD60 billion discussed on 27 February, to TWD100 billion on 18 March 2020. This is now equivalent to 0.5% of nominal GDP estimated by the government for 2020, up from 0.3% in late February. But the scale of this package is still smaller compared to other economies' stimulus, which is generally 2% or above GDP.

The smaller scale of fiscal stimulus could be explained by the unaffected manufacturing and export sector. But if we look ahead, many manufacturing economies are still battling with Covid-19, as their factory operations remain suspended.

Revising USD/TWD forecast

Even though Taiwan is not slashing rates like the Federal Reserve, the TWD is going to be weaker against the USD because of the flight to safety to US Treasuries, and capital outflows from Taiwan's stock market.

We believe this flight to safety behaviour will last until Covid-19 subsides in the US and Europe and in the meantime, we hope this does not lead to a global financial crisis that turns liquidity risks into credit risks.

Based on the above assumptions we revise our USD/TWD forecasts for the end of 1Q20 to 4Q20. These are 30.5, 31.00, 30.50 and 30.00 respectively.

Another downgrade to Taiwan's GDP

We are a lot less optimistic than the government or the central bank on Taiwan's GDP growth in 2020. This rapid spread of Covid-19 will hit global demand for electronic products, which is Taiwan's main export item.

More, the fiscal stimulus is too small to help SMEs and the job market if the global demand for electronic goods like smartphones continues to be persistently weak.

Therefore, we downgrade our forecast for Taiwan's GDP growth to -0.4% from 0.8% for 2020.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Snap | 19 March 2020

Indonesia: Bank Indonesia trims policy rate to 4.5%

With coronavirus cases on the rise, BI cuts policy rates despite IDR woes.



4.5% BI policy rate

As expected

Bank Indonesia cuts policy rate by 25 bps as growth prospects dip

With prospects of weaker economic output given the Covid-19 outbreak, Bank Indonesia (BI) has cut policy rates by 25 bps to help bolster sagging growth momentum. BI has lowered its growth forecast for 2020 to 4.2-4.6% (previously 5.0-5.4%) with inflation seen as broadly stable for the next two years and reflecting depressed energy prices. Governor Warjiyo indicated that the central bank would retain its accommodative stance, given the need to stimulate growth, but also vowed to step up his “triple intervention” to stabilize the IDR alongside fundamentals. In the meantime we expect the central bank to continue its intervention to support the currency and to assure ample liquidity in the financial system. We do not think they will be able to cut rates in the near term.

IDR to remain pressured

The BI move was expected by most analysts, particularly given the need to bolster the economy as the number of Covid-19 cases have risen of late. Foreign selling was noted in Indonesian bond and equity markets and this will likely continue to weigh on the currency. The resultant risk-off tone induced by the virus has left the IDR pressured - we can expect the currency to remain threatened after the policy rate cut and until market sentiment improves.

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

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