

Good MornING Asia - 21 April 2020

The impact of negative oil means different things for different Asian economies - but if you have to generalize, it isn't great news

In this bundle



What does negative oil mean for Asia?

The impact of negative oil means different things for different Asian economies - but if you have to generalise, it isn't great news

By Robert Carnell



FX | China

China: How many more rate cuts to come?

China cut the 1Y Loan Prime Rate (LPR) by 20bps today to 3.85%. We expect more rate cuts. The question is, at what level will the rate cuts stop as the...

Opinion | 21 April 2020

What does negative oil mean for Asia?

The impact of negative oil means different things for different Asian economies - but if you have to generalise, it isn't great news



Source: Shutterstock

-\$37.63/bbl WTI oil
May contract
Lower than expected

There are some winners and some losers, but mainly losers

I've covered this subject in some detail, not that long ago, so I won't labour these points too hard today.

WTI's May contract traded at minus (yes that's right) \$37 yesterday, and using some old and inappropriate yardsticks, we should all be revising our GDP forecasts higher. Right?

Wrong.

For starters, this is just the May contract, and it reflects inland storage problems in the US. More global oil indicators such as Brent or for some Asian oil importers, Dubai benchmarks, aren't trading so low - Brent is about \$26 and Dubai front-month contracts closer to \$21 (both positive). Our Head

of Global Commodities Strategy, Warren Patterson, [warns that](#) with this May contract expiring today, we may see the June contract coming under pressure. But we'll leave the intricacies of oil price dynamics for him to cover in his team's note later.

It's also the case that whenever something like this happens, you have to ask, "Why?" Yes, there's too much oil, but more importantly, there's way too much oil for the state of collapsed US and indeed global demand we currently have. These weak prices largely reflect the shutdown of the US economy, and so we should probably be revising our forecasts lower, to reflect this, not to mention the faster decline in US drilling activity and investment that we are likely to see as a result.

Then there is the main point that I made in one of my dailies not so long ago - that much lower oil is:

1. Not like a global tax cut as some often suggest;
2. It isn't even really a zero-sum game as others attest;
3. What it is, is a deviation from the optimal price of oil, the price at which producers and consumers are equally miserable/happy and the gains in one direction will always be less than the losses in the other direction like any other product in any other market and just as in any basic microeconomic textbook. We could be talking about jam or toothpaste...

What is a wonder is that institutions like the IMF peddled such nonsense as their ready-reckoners for oil for as long as they did.

To cut a long story short, there are some exceptions at the extremes where we can make glib generalisations - India is a big oil importer (normally) so in time, may see some benefit from much lower oil prices, and Malaysia is the region's only sizeable net oil exporter, so it doesn't help them. But for the rest of Asia, such a big negative deviation from the optimal price of oil (in the \$55-65 range in recent years) describes such a big terms-of-trade shock to the oil-producing nations, that it will likely weigh heavily on their demand for Asia's exports - that is assuming the Covid -19 pandemic moves on allowing exports and production to resume. And the hit from that will be bigger than any consumption benefit derived from these lower prices.

Moreover, right now, Covid-19 remains by far the bigger story, and you could file this oil development as a sub-story under the pandemic.

The news on the pandemic itself is generally looking a bit more positive, though Russia, and many Central and South American countries sound to be making heavy weather of it. And the US new case numbers remain stubbornly high, as states like Ohio see their daily case numbers triple in about a week. It only takes one of these states to blow up and you have a new New York.

This is another reason I worry about the race to re-open. But to follow these numbers, you *have* to look at the state-level figures (or deeper if you can get them). Looking at aggregates for the US now was as silly as it was to look at global new case counts in mid-February, as China got on top of its outbreak, only to see figures elsewhere begin to accelerate.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

China: How many more rate cuts to come?

China cut the 1Y Loan Prime Rate (LPR) by 20bps today to 3.85%. We expect more rate cuts. The question is, at what level will the rate cuts stop as the...



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

Rate cuts seen in the three policy interest rates altogether

China cut the 1Y Loan Prime Rate by 20bps today, which is the last part of the "set" of rate cuts, including recent 20bps cuts in the 7D reverse repo and 1Y Medium Lending Facility. These policy rates, namely, the 7D reverse repo, 1Y Medium Lending Facility (MLF) and 1Y Loan Prime Rate (LPR), are now at 2.2%, 2.95%, and 3.85%, respectively.

3.85% 1Y Loan Prime Rate
After 20 basis point cut today

Is there a bottom to PBoC policy rates?

The People's Bank of China has voiced that it does not agree with an ultra-low interest rate policy. As such, we do not expect the central bank to cut interest rates to a level that is ultra-low. But how low is ultra-low?

The 7D reverse repo has already gone beyond its previous historical low of 2.25% during 2016, and the same is true for the 1Y MLF, which was at 3% during 2016. The 1Y LPR is a new policy rate that replaces the benchmark lending rate. Even the old 1Y benchmark lending rate did not reach the current 1Y LPR's 3.85% level.

In other words, the current policy rates are at their lowest levels on record.

Assuming that each cut from now on to the end of Covid-19 is 20bp, and there is a cut each month, then the 7D reverse repo will reach 1% in September (the last cut of the 7D reverse repo was on 31 March). No one knows if the Covid-19 crisis will end completely by September, but it is almost certain that the damage to the economy will linger for another six months or so from now.

PBoC to rely more on RRR cuts

From the above assumption, September should mark the point when the PBoC hits the "ultra-low" interest rate level. After that, the PBoC may need to rely more on reserve requirement ratio (RRR) cuts than rate cuts. The PBoC may use RRR cuts more than rate cuts before September to delay its policy rates touching ultra-low levels.

We expect the trade war and the technology war to return after Covid-19 cases subside in the US. By then, the Chinese economy will need another round of monetary policy support. There is a strong argument for the PBoC to save some ammunition for further rate cuts. That would mean the central bank may not cut the 7D reverse repo all the way to 1% by September.

But there is a problem relying on RRR. The RRR for small deposit companies and the smallest banks is already low at 6%. It would not increase loan growth a lot by cutting the RRR for the smallest banks.

China's biggest banks face a RRR of 12.5%, which is still high. We believe that the central bank can cut the RRR of the big banks to release liquidity. If this were done together with fiscal support for government guarantees of SME loans, then SMEs and employment could stabilise.

Forecasts

By the end of 2020, the PBoC policy interest rates and RRR are projected at:

7D reverse repo 1.5%; 1Y Medium Lending Facility 2.45%; 1Y Loan Prime Rate 3.35%; RRR for the smallest banks 3.5% and RRR for the biggest banks 9.5%.

For USD/CNY forecasts, we have revised to 7.15, 7.0 and 6.9 by the end of 2Q, 3Q and 4Q20, respectively with the [downgrade of GDP forecasts](#).

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.