

Good MornING Asia - 21 February 2020

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EM Space: Rising spread of Covid-19 weighs on sentiment

General Asia: Increasing spread of Covid-19 outside China is infecting investor sentiment, likely ending the trading week in Asia on a weaker note. Advanced releases today of G3 purchasing manager indexes (PMIs) for February will provide a sense of damage the disease is causing to these economies, while there is little on the economic calendar in Asia.

Malaysia: January CPI data is due today. Behind the consensus of a sharp rise in inflation to 1.7% YoY from 1.0% in December seems to be the low-base bounce in the transport component. Fuel prices play a key role here and the 20% fall in the global crude oil price in January speaks volumes about continued low transport inflation. This and weak demand due to the virus outbreak subjects the consensus forecast to downside risk (ING forecast 1%). With growth displacing inflation as the policy driver, we expect the central bank (BNM) to cut rates again at the next policy meeting in March.

Indonesia: Bank Indonesia (BI) cut policy rates on Thursday, opting to help give the economy a boost ahead of the impact from Covid-19. The central bank also lowered a threshold to help bolster bank lending activity as it lowered its growth outlook by 0.1 percentage point. Governor Warjiyo indicated that BI retained its accommodative stance and we expect further rate cuts in the near term should the economic impact become more severe.

What to lookout for: G3 PMIs

- G3 purchasing manager indexes (21 January)
- Malaysia inflation (21 February)
- US existing home sales (21 February)

Asia week ahead: Hong Kong to roll out big stimulus

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Source: Shutterstock

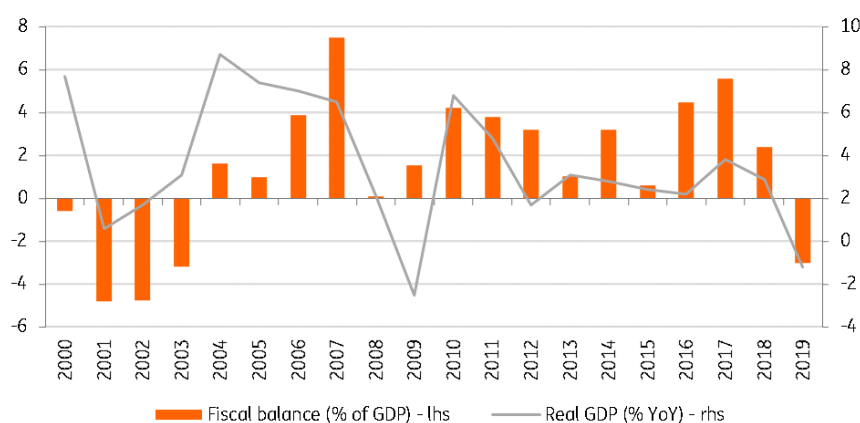
➔ Hong Kong SAR 2020 Budget – how big a stimulus?

Hong Kong's Financial Secretary Paul Chan will announce the budget for the fiscal year 2020 on 26 February. The pro-independence protests have already pushed the economy into a recession - GDP contracted for three consecutive quarters through the fourth quarter of 2019 (the final estimate of 4Q19 GDP is due on the same day as the budget) - and now there is Covid-19 dampening prospects further in 2020.

It is likely that the budget deficit for the new financial year [2020-21] will be the biggest ever – Financial Secretary Paul Chan

The markets are looking for a big, rather unprecedented, stimulus resulting in a very high fiscal deficit. Indeed, the Secretary has signalled a record deficit for 2020 on top of his estimate of about 3% of GDP deficit in the current fiscal year ending in March. Will this be enough to fix the economy's woes still remains to be seen.

Hong Kong: How big could the fiscal deficit be?



Source: CEIC, ING

➔ Korea central bank policy meeting – cut or no cut?

The key question of the week will be whether the Bank of Korea gets back on the easing path as the central bank easing in Asia gathered pace coming into 2020. Our house view is that the BoK stays on hold this year, assuming that fading trade war and improving tech demand makes it a more positive economic story this year than last.

An emergency situation warrants an emergency prescription – President Moon Jae-in

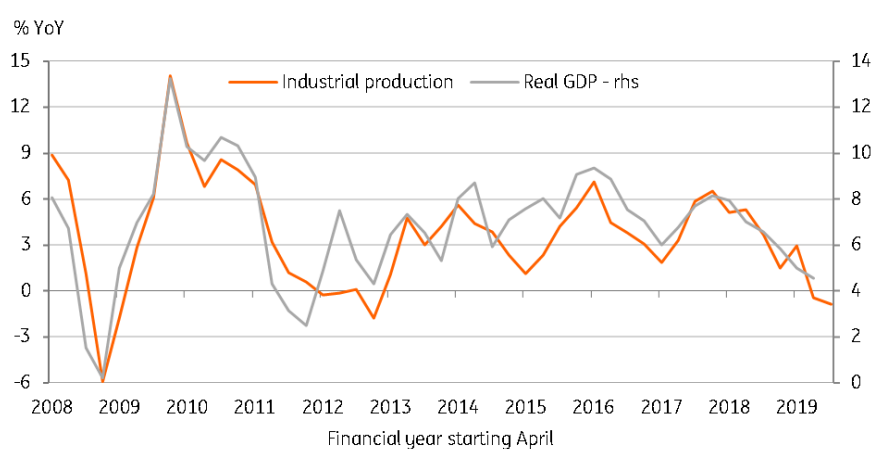
Of course, Korea isn't immune to the virus that's undoubtedly going to hinder the recovery from a sharp growth slowdown last year. And just as I was writing this note, there were reports of the country moving up to the rank of most affected one outside China, overtaking Japan (excluding Diamond Princess), as the number of infections more than doubled to over 100 in just one day with first death in the country. President Moon has declared the spread of the virus as an emergency demanding extraordinary steps to minimise the impact. All this could tip the balance of risk for the BoK policy towards easing next week.

➔ India 4Q19 GDP report – has growth bottomed?

We expect India's GDP report for the October-December 2019 quarter to show improvement in growth over the 4.5% year-on-year rate posted in the previous quarter. The consensus view about a month ago was 4.9% 4Q19 growth in the last quarter. And our bit longer-held than consensus view is 5.2% assuming a massive fiscal and monetary stimulus of in the early parts of 2019 would have started to revive demand, while the low base year effects also drove it higher.

The high-frequency data hasn't been fully supportive of acceleration in GDP growth though, imparting a downside risk to our GDP forecast. That said, we believe the expansionary macro policy in India has run its course amid imminent inflation risk ahead.

India: Persistent slowdown



Source: CEIC, ING

➔ Lots of manufacturing data

The economic data has been overshadowed by the Covid-19 outbreak and the barrage of manufacturing data coming out next week will be no exception either.

Moreover, January data is also distorted by the timing of the Lunar New Year (which in 2019 fell in February but this year was in January), which makes the usual year-on-year growth rates more of a noise rather than a clear trend. The tendency is to read combined January-February growth, though now these will also be impacted adversely by an extended slump in the economic activity due to the virus outbreak after the new year.

We believe economic data will remain just a watching brief for at least a couple more months before it provides a good gauge of the economic impact of evolving developments on the Covid-19 front.

Asia Economic Calendar

Country	Time Data/event	ING	Survey	Prev.
Monday 24 February				
Singapore	0500 Jan CPI (YoY%)	0.8	-	0.8
	0500 Jan CPI core (YoY%)	0.8	-	0.7
Taiwan	0800 Jan Industrial production (YoY%)	-4.9	-3.2	6.0
	0820 Jan Money supply (M2) (YoY%)	4.2	-	4.1
Thailand	0330 Jan Exports (Cust est, YoY%)	-4.5	-	-1.3
	0330 Jan Imports (Cust est, YoY%)	-20	-	2.5
	0330 Jan Trade balance (\$m)	-255	-	596
South Korea	2100 Feb BOK Consumer Sentiment Index	100.3	-	104.2
Tuesday 25 February				
Hong Kong	0830 Jan Trade balance (HK\$ bn)	-12.5	-	-32.5
	0830 Jan Imports (YoY%)	-15.4	-	-1.9
	0830 Jan Exports (YoY%)	-16.4	-	3.3
Philippines	- Dec Budget balance (PHP bn)	-144.2	-	-60.9
Thailand	- Jan Manufacturing index (YoY%)	-4.8	-	-4.3
South Korea	2100 Mar BOK Business Survey Index, non-mfg	72.9	-	74
	2100 Mar BOK Business Survey Index, mfg	74.2	-	77
Wednesday 26 February				
Hong Kong	0830 4Q F GDP (Q) (YoY%)	-3.0	-	-2.9
	0830 4Q F GDP (Q) (QoQ% SA)	-	-	-0.4
Singapore	0500 Jan Industrial production (MoM%/YoY%)	-3.7/-8.5	-/-	4.1/-0.7
Thursday 27 February				
South Korea	2300 Jan Industrial production (MoM%/YoY%)	0.0/6.7	-/-	3.5/4.2
	- 7-Day Repo Rate	1.25	-	1.25
Friday 28 February				
India	1200 4Q GDP (Q) (YoY%)	5.2	-	4.5
	1200 2020 GDP annual (YoY%)	-	-	6.1
	- Jan Fiscal deficit (INR crore bn)	-	-	1.2
Thailand	- Jan Current account balance (\$bn)	1.1	-	4.1

Source: ING, Bloomberg, *GMT

Chinese loan growth sees big jump

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Source: Shutterstock

Soaring credit growth

In January, Chinese yuan loan growth increased by CNY 3.49 trillion - a 12.1%YoY increase. This number is pretty big, but not massively different from our expectations of CNY3.22 trillion, as it is usual for Chinese banks to see their loan books swell in the early months of the year.

Aggregate financing increased by CNY5.07 trillion - the highest since the current data series started. This is considerably larger than our expectations of CNY4.14 trillion.

The big difference lies in the net issuance of government bonds of CNY761.3 billion - an increase of CNY591.3 billion year-on-year. These issuances could have been used to provide support to the already battered economy suffering from the trade and technology war.

Things could look similar in February

The People's Bank of China has set up a special re-lending programme, which offers low-interest-rate loans to corporates that have directly been impacted by coronavirus since the beginning of February. This means loan growth is likely to increase more than usual after the Chinese New Year.

However, this alone won't be enough. The government will continue to issue bonds to support stimulus for individuals that are out of work and corporates that are facing cash flow problems. Therefore, we think aggregate finance in February will grow by a similar amount as in January.

More monetary easing on the way

We expect that if Covid-19 continues to spread for another quarter, the central bank will need to ease again by a 0.5 percentage point cut in the reserve ratio requirement and 10 basis point cut in 7D reverse repo, 1-year medium-term lending facility and 1-year loan prime rate.

However, if there is no increase in the rate of new cases, expect more broad-based policy support from the government and the central bank

China: cautious interest rate cuts

China's central bank, PBoC, cut rates today, but cautiously. The central bank could have some reservations about interest rate cuts for long-term...



Source: istock

Rate cuts as expected but by a smaller step

The PBoC cut the 1Y Loan Prime Rate by 10 basis points to 4.05% as expected, following cuts of 10 basis points in the 7D reverse repo and 1Y MLF rates.

What is unexpected is that the central bank cut the 5Y Loan Prime Rate by only 5 basis points to 4.75%, not by 10 basis points.

Smaller interest rate cuts could be positive for the economy

We believe that the smaller interest rate cut for 5Y loans can be viewed positively.

The objective of interest-rate cuts at this time is to help corporates and individuals with their interest service costs during the covid-19 epidemic. There is also a rough consensus that this epidemic will end sometime in 2020.

So cutting the 5Y loan rate to a lesser extent is logical as the rate-cut needs for longer-term loans should not be mixed with critical short-term cash-flow needs.

Moreover, there is history in China that when money is too cheap, it increasingly flows into

speculative assets, e.g. during 2009 and 2010. We think this also explains why the central bank is cautious when cutting the 5Y Loan Prime Rate.

More monetary easing expected in 2Q20 but fiscal stimulus is the key

We expect that there will be more monetary policy easing in 2Q20 to support the economy to recover from the ongoing epidemic.

Our projection is a 0.5 percentage point RRR cut and 10 basis points cuts in 7D reverse repo rates, 1Y MLF and 1Y Loan Prime Rates, respectively. The objective, as said, will be to help the economy to recover. As such the cuts will be more broad-based if the epidemic is over.

The main support during the covid-19 epidemic and the recovery from its aftermath will primarily fall on fiscal measures. We expect a fiscal stimulus of 4.5% of GDP in 2020.

Yuan has weakened after the rate cut

USDCNY has gone from around 7.0000 to 7.0170 at 10:38 HKT on the back of today's rate decision. This reaction was not particularly big compared to the currency's movements in response to new cases of covid-19 since 20th January 2020.

We expect that USDCNY will reach 7.0500 by the end of 1Q20 when more workers will be back to work. If the numbers of new confirmed cases begin to increase again, then the yuan will be even weaker against the dollar.

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JPY: Three drivers behind the fall

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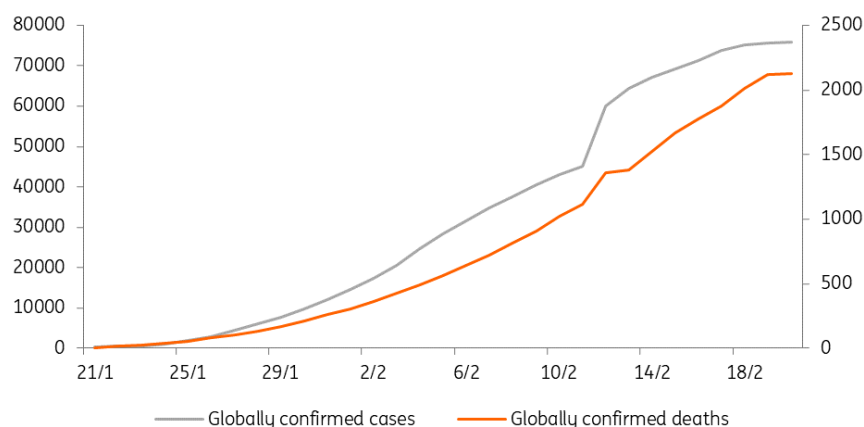
Source: Shutterstock

USD/JPY has just hit the 112.00 mark, moving towards levels last seen in December 2018. Along with a generalised strong-dollar environment, the yen has been the target of markets selling interest in the last few days, triggered by three main drivers.

1 Shifting from short-term to longer-term Covid-19 fears

Firstly, fears around the Covid-19 virus seem to have partly eased. Figure 1 shows the number of globally confirmed cases and deaths, which seem to have decreased their rate of growth, or if anything, have not accelerated further.

Figure 1 - Is Covid-19 spread slowing?



The feeling is that markets are shifting their worries from the short-term (i.e. an escalation of the outbreak to a fully-fledged pandemic) to the longer-term (i.e. the economic slowdown in China). This is likely why the two key China proxy-currencies, both AUD and NZD have fallen along with the yen.

All three countries - Japan, Australia and New Zealand have high exposure to the Chinese economy, and as markets price out the immediate risks, they are pricing in the impact on these economies of a slowdown in Chinese activity.

In contrast, the higher beta, commodity exposed CAD and NOK outperformed the three G10 Asian currencies. Particularly for NOK, such outperformance during risk-off days has not previously been the case, with the krone being one of the worst-hit in days like these.

2 Japanese economy from bad to worse

The impact of the virus is related to the second driver of JPY underperformance, which is the quickly deteriorating Japanese economic outlook.

Latest data – [as highlighted by our Asian economist](#) – showed a worse than expected -6.3% QoQ slump in GDP for 4Q19. Covid-19 is likely to weigh heavily on 1Q20 growth numbers, and at this point, a recession seems all but inevitable. We forecast full-year GDP growth for 2020 at -1.1%.

Accordingly, markets are starting to speculate about the Bank of Japan's actions in terms of monetary stimulus, which is contributing to an even less attractive rate environment for the yen. We find it hard to foresee any policy response by the short-handed (in monetary ammunition terms) BoJ, but for now, the market dovish sentiment seems to be on the rise.

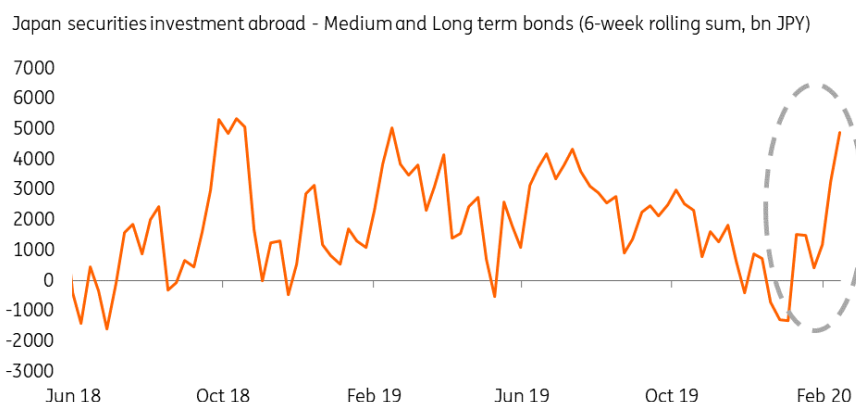
3 Search for a decent yield suggest large outflows

The last key driver of the recent JPY weakness is likely related to the mounting speculation around Japanese investment funds re-allocating their positions towards foreign securities as we approach the end of the Japanese financial year (March).

Weekly data on foreign buying of bonds by Japanese investors suggest such a process may have

started, as shown in Figure 2.

Figure 2 - Japanese investments abroad rising in February



Source: Bloomberg, ING

With yields in Japan remaining highly unattractive it would not be surprising to see Japanese funds turning to higher-yielding options, and such a shift would prompt those funds to sell JPY and buy foreign currencies.

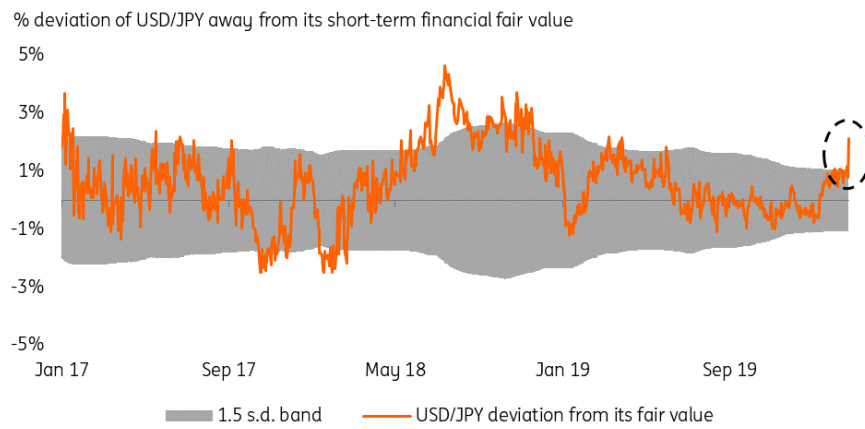
The FX markets are inevitably sensing these dynamics, thus contributing to the yen decline.

... but the JPY fall now looks stretched

The question that comes naturally is whether this move in USD/JPY is sustainable. Our short-term financial fair value model highlights how the pair has moved into overvalued territory, breaking above the 1.5 s.d. band (Figure 3).

This suggests the move may be somewhat overdone at this point and possibly makes a case for some stabilisation.

Figure 3 - The move looks overdone from a fair-value perspective



Source: ING

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Snap | 20 February 2020

Indonesia: Central bank trims policy rate ahead of virus impact

With inflation well within target and growth momentum fading, Bank Indonesia cut its 7-day rate by 25 basis points to shield the economy from the...



Source: Stenly Lam

Central bank looks to shield economy via monetary easing

Bank Indonesia (BI) moved quickly to shield the economy from the impending economic slowdown induced by COVID-19, slashing its 7-day policy rate to 4.75%. The move was anticipated by a majority of analysts as growth momentum stalled at the end of 2019 with fourth quarter GDP slipping below 5% and full year growth well below the government's target of 5.3%. The central bank lowered its growth forecast for the year to 5.0-5.4% from 5.1-5.5% as the coronavirus will undoubtedly slow tourist arrivals and hit Indonesia's export sector in the coming months. On top of trimming its policy rate, BI also lowered the macroprudential intermediary ratio rule, a sign that monetary authorities would like to support sluggish bank lending activity.

More easing down the line?

BI Governor Perry Warjiyo indicated that the central bank remained committed to keeping the Indonesian rupiah stable, as evidenced by the Bank's "triple intervention" to steady the currency while the central bank's stance remains "accommodative". Warjiyo also indicated that the Bank's baseline scenario takes into account up to two months of travel restrictions from China and a pullback in foreign tourist arrivals for another six months. Meanwhile, BI expects the Federal Reserve to keep policy rates unchanged although Warjiyo did admit that the chances for a Fed rate cut in September may be increasing. If the economic fallout from the coronavirus becomes more evident or the Fed is indeed pressured to continue its rate cutting cycle, we believe BI will be open to easing policy rates further to help support the economy in light of President Jokowi's 5.3%

growth aspiration.

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