Bundle | 21 May 2020

Good MornING Asia - 21 May 2020

No news is good news for now but Thursday's rally could be tempered by the economic outlook

In this bundle

ASEAN Morning Bytes

No news is good news for now but Thursday's rally could be tempered by the economic outlook

EM Space: Fed speakers on deck as investors monitor Covid-19 developments

- **General Asia:** Asian markets may bounce back with the focus shifting to how economies are slowly reopening after lockdowns although gains may be limited given the dour outlook on the economic front. Minutes from the most recent Fed meeting coupled with recent testimonies by FOMC officials point to a possibly drawn-out economic downturn which could be amplified should a second wave hit. Investors will continue to take their cue from developments on the virus front with authorities watching out for signs of a second wave after lockdown measures have been lifted in respective states and countries.
- **Malaysia:** April CPI inflation posted its steepest decline since the GFC falling to -2.9% YoY. Lower food, housing and transport prices were responsible. The weak data prompted a further cut to our full-year 2020 inflation forecast to -2.5% from -1.0%. We have also added another 50bp of easing to our forecast of central bank (BNM) policy rates this year, taking rates to an all-time low of 1.00% (read more here).
- **Thailand:** A 25bp Bank of Thailand rate cut yesterday takes the policy rate to a record low of 0.50%. With the economy already in a recession that's going to be deeper and more prolonged than any in recent history, we won't rule out further BoT rate cuts in this cycle. And, as the easing option via this conventional route is about to be exhausted, talk of

unconventional easing may well gain some momentum.

- **Indonesia:** Indonesia recorded a current account deficit to GDP ratio of 1.4% for 1Q 2020 with the trade in goods balance staying in surplus. Import compression on the back of slowing economic activity was the main reason for the improvement from the -2.8% balance in 4Q 2019 and we expect this trend to continue. Bank Indonesia's (BI) estimates the current account to GDP ratio slipping below -2.0% for the year. Despite the improvement in the current account, IDR has been vulnerable to depreciation, highlighted by the swoon to 16,500 in March with IDR's fate influenced more by financial account flows in 2020. The DR has steadied since its March weakness as investor sentiment has improved as BI monitors the stability of the currency for policy cues.

What to look out for: Fed speakers and Covid-19 developments

- Fed's Bostic, Williams and Bullard speak (21 May)
- US initial jobless claims and existing home sales (21 May)
- Thailand trade (21 May)
- Malaysia, Thailand, Philippines GIR (22 May)
- Fed's Clarida and Powell speak (22 May)

China: a pause from the PBoC

The PBoC did not cut interest rates this month. This is despite deleting the description of a prudent monetary policy stance, which created a market...

Source: Shutterstock

PBoC's pause creates some doubts

China's central bank, the PBoC, did not cut any policy interest rates or reserve requirement ratios (RRR) in May. Open market operations so far for this month have been for a net withdrawal of liquidity.

This has created some doubt over whether the central bank has changed course now that the economy has begun to recover.

Has the PBoC changed stance?

We believe that the PBoC has not changed its rate-cutting trend.

1. There is a risk of more shutdowns of SMEs in China, especially factories, which need help from not only fiscal measures buy also preferential monetary policies.
2. The timing is somehow embarrassing for the PBoC if it wants to change its monetary policy stance to a tighter one. The Two Sessions will start this week. It is possible that the PBoC has to wait for the approval of the government work report, which will include the monetary policy stance for the rest of 2020, before it can act further.

3. The monetary policy stance in the last monetary policy report deleted the strong wording of "no aggressive liquidity injection". This should imply a more aggressive policy stance rather than changing to tighter monetary policy.

Our expectation on monetary policy

As such, we expect the PBoC could ease during the Two Sessions when the government work report is approved. This should include an interest rate cut and a RRR cut of 0.5 to 1.0 percentage point.

Article | 20 May 2020 Malaysia

Malaysia: Falling prices call for more interest rate cuts

Deep negative inflation in Malaysia has driven the real interest rate to one of the highest in Asia – not a good thing for the post-Covid-19...

-2.9%

April CPI inflation

Year-on-year

Worse than expected

Movement control dents inflation

Released today, Malaysia's consumer price index for April posted a steeper than expected fall, by 2.9% from a year ago, beating the previous low of -2.4% at the height of the global financial crisis in 2009. This was a significant disappointment for the consensus of -1.6% YoY and our -1.8% forecast.

Core inflation stayed in positive territory in April and was also unchanged from a 1.3% rate in March, meaning most of the fall in the headline was due to food and oil-related CPI components. This isn't a surprise though. Food prices typically rise during the month of Ramadan. This year they were weak because restrictions on movement dented the usual festive season demand. Still, despite two straight months of decline in this component, the yearly increase was unchanged at 1.2%.

The controls on movement and unusually weak Ramadan demand also depressed transport costs, which had already been dragged down by lower gasoline prices. A 21.5% YoY fall here surpasses the 20% fall during the GFC. Adding to these negative forces was housing, with a sharp swing from +1.6% YoY in March to -2.2% in April, which has not been seen in the last two decades.

Entrenched deflationary streak

We recently cut our full-year inflation forecast for 2020 to -1% from -0.2%. This now appears to be optimistic given today's price report. Indeed, it would take a significant demand recovery for inflation pressure to return – something that's unlikely to happen at least throughout the rest of this year, with the lingering impact of the disease and persistently weak economic outlook.

We anticipate a deeper fall in prices ahead, as much as 4%, leading to a further downgrade to our annual inflation forecast, to -2.5%.

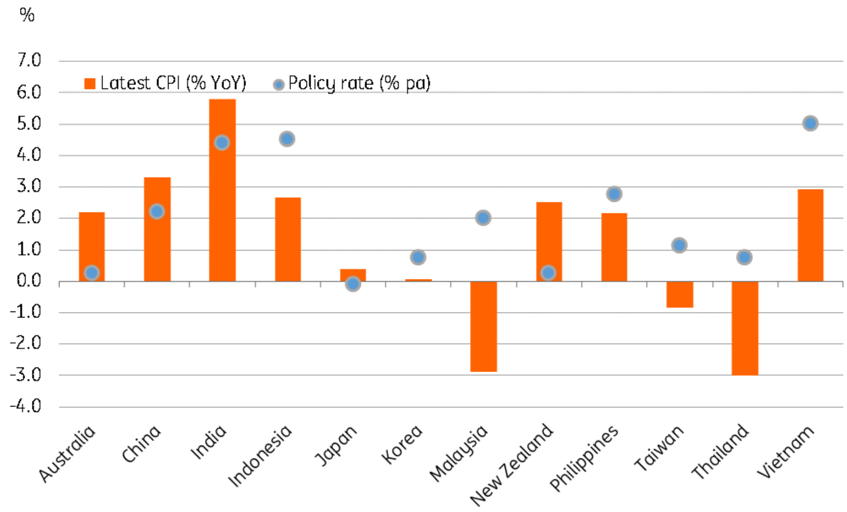
More central bank rate cuts

Malaysia's central bank doesn't particularly target inflation in setting monetary policy. But the economy, staring at a deep downturn ahead, is demanding more policy accommodation. Cutting interest rates remains an important option at the central bank's disposal, while there is space to do so.

The BNM has cut the overnight policy rate by a total 100 basis point so far this year, including a 50 basis point cut earlier this month (5 May), taking the overnight policy rate to 2.0%. We have an additional 50bp cut forecast for the next meeting in early July. However, with -3% inflation pushing the real interest rate much higher- at 5.0% it is the highest among Asian countries- we don't see any reason why the BNM policy rate couldn't fall further.

We now add another 50bp cut to our BNM policy forecast, driving the OPR to an all-time low of 1.00% by the end of 2020.

Inflation and central bank policy rates in Asia



Source: CEIC, ING

Article | 20 May 2020 FX | **Philippines**

Philippines: Missing the remittance cushion

The Philippines relies heavily on overseas Filipino workers remittances, but with Covid-19, we expect remittances to fall by up to 6.9% in 2020. As the...

Source: Shutterstock

-6.9% Projected OFW remittance growth

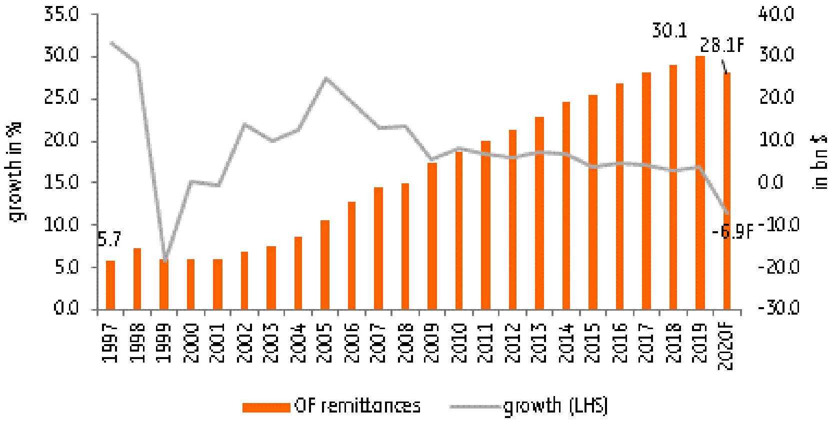
In 2020

The current account records the flow of goods, services and transfers between residents and non-residents.

For the Philippines, an economy that routinely posts trade deficits, the current account is largely dependent on secondary income, which is supplied by remittances sent home by Filipinos working outside the country. Overseas Filipino Worker (OFW) remittance flows have been a steady source of foreign exchange and purchasing power for the Philippines over the past few decades.

From a mere $5.7 bn back in 1997, OFW remittances have grown at an average rate of 9.3% over a span of 22 years while registering 18 straight years of growth since 2002.

Philippine remittances (volume and growth rate)



Overseas Filipino population is as big as Austria's

Official records vary but we estimate that c.9.2m Filipinos are based overseas, roughly equal to the population of Austria.

On average, each Filipino sends home $267 a month with cash remittance flows totalling $30.1bn in 2019. Of the 9.2m, only 2.4m are registered with the government with the balance classified as non-registered OFWs or as Filipinos who may have established permanent residence in another country but continue to send remittances to their families.

Filipinos are everywhere (pretty much)

Filipinos live across the globe with remittances sent from Europe, the Americas, the Middle East, Oceania and even Africa.

> *Philippines remittance flows continued to expand even during severe economic downturns such as the global financial crisis in 2008*

This broad-based deployment forms a natural hedge against specific regional recessions in the past, with weak remittance flows from affected areas compensated by remittances from less affected parts of the world. The consistency of remittance flows has also been tagged to the altruistic nature of these transfers, with Filipinos sending home money to finance daily consumption, housing payments or tuition costs and reported to take on extra work just to make ends meet.

These factors were believed to be the reason why remittance flows continued to expand even during severe economic downturns such as the global financial crisis in 2008 or the Federal Reserve taper tantrum in 2013.

But Covid-19 has been a game changer

The Covid-19 pandemic has changed dynamics substantially, with the virus forcing economies around the world to implement strict lockdown measures to help mitigate the spread of infection. This development has undoubtedly threatened employment for scores of OFWs, with more than 230,000 Filipinos recently seeking aid from Philippine authorities as lockdowns were implemented across the globe.

We believe the initial figures reported by the government don't capture the full extent of OFW job losses, with many Filipino workers facing economic hardship in the coming quarters.

Slowdown in remittances to be widespread as lockdowns bite

Although remittances are sourced from almost every country (remittances from even North Korea hit $6m in 2019), the bulk of remittance flows are sourced from the top 11 host countries, all of which are facing at least a partial lockdown or border control measures. Lockdowns have grounded economies across the globe, resulting in widespread unemployment and contracting GDP.

> *The bulk of remittance flows are sourced from the top 11 host countries, all of which are facing at least a partial lockdown or border control measures*

Oil exporters from the Middle East are top sources of remittances and, with crude prices currently subdued, we expect jobs prospects for the c.1.3 m OFWs in the region to be challenged even further. The United States, which is another big remittance provide recently reported more than 20m jobs losses for the month of April alone with OFWs likely joining the scores of unemployed.

Overall, economic projections for these countries are bleak and all are expected to be in recession this year, threatening job prospects for millions of OFWs based abroad.

Prospects for recovery don’t look good even after lockdown ends

Meanwhile, job prospects for OFWs remain bleak even after lockdowns are lifted as the majority of OFWs are employed in sectors that are expected to struggle in a world of social distancing. Based on a survey conducted for registered OFWs, 37.6% of OFWs are employed in “elementary occupations”, which include domestic helpers and hotel/restaurant cleaning staff while 18% work in services and sales sectors.

This suggests that OFWs are likely to continue struggling to find employment as sectors such as hotel and restaurants take longer to recover quickly due to social distancing, leading to less remittance flows for OFWs based in these professions.

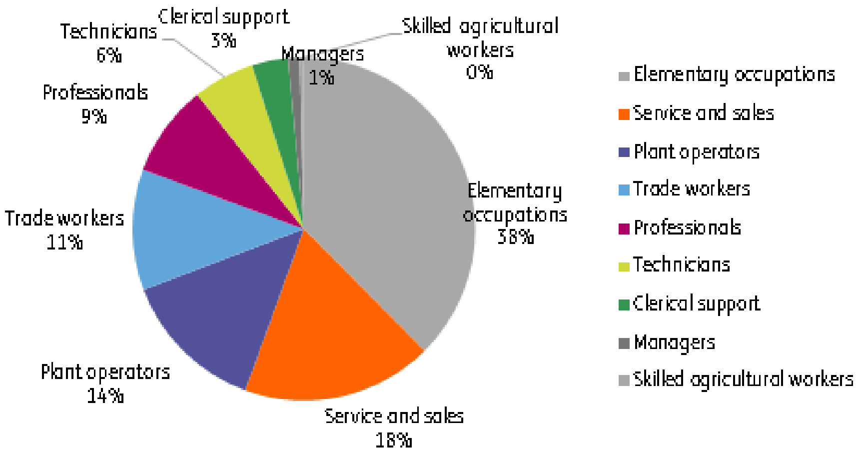
Given these dire prospects, we now expect OFW remittances to fall by up to 6.9% in 2020, the first contraction since 2001.

Remittances to contract 6.9% as job market remains challenged

The projected pullback in these once robust inflows spells likely economic hardship for recipients of OFW remittances.

Our current GDP forecast for 2020: -2.9%, factors in a drop off in consumption and investment activity as up to $2.1bn worth of remittances are lost due to the pandemic. On top of the economic impact of foregone remittances, the slowdown of these income transfers will also be reflected in the deterioration in the Philippines' external position.

OFW employment per sector



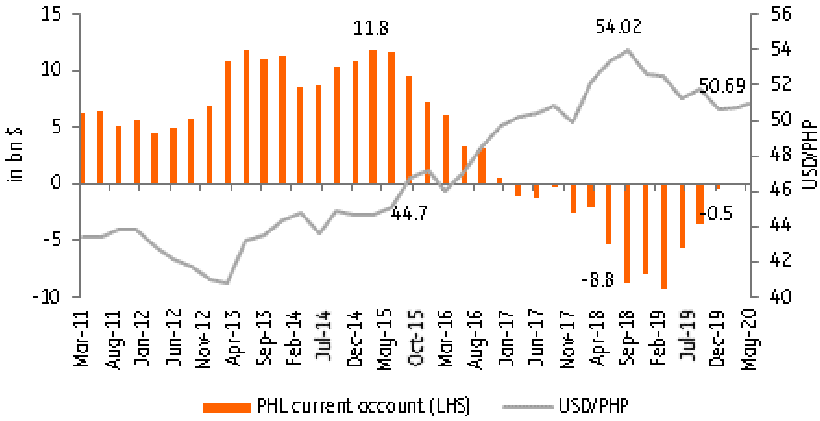
Source: PSA

PHP performance tied to current account balance

Over the last five years, remittance flows alongside trade in services (business process outsourcing receipts) grew at averages of 5.7% and 12.2%, supporting the current account by offsetting the chronic trade deficit.

However, in 2018 the current account deficit swelled to -$8.8bn, driven mainly by a surge in imports, forcing PHP to depreciate by 5.3% for the year. A year later, PHP would swing into appreciation, strengthening by 3.7% as the external position improved, with the current account deficit narrowing to -$460m.

Philippine current account balance and PHP



Source: Bangko Sentral ng Pilipinas

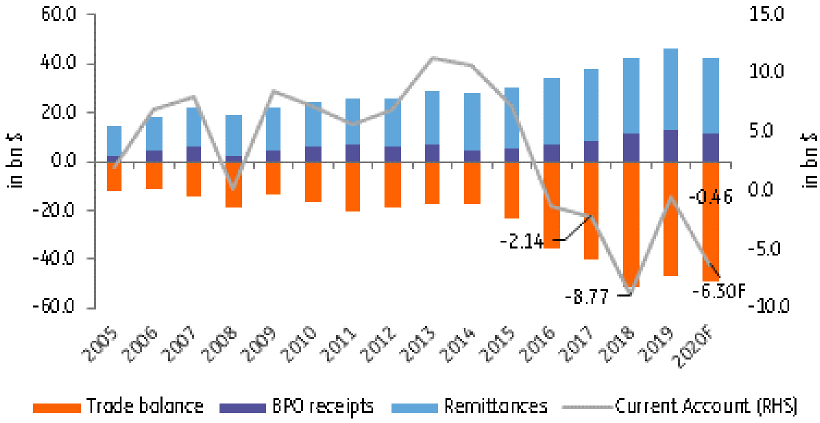
Without remittances, currency to weaken as deficit widens

Due to the pandemic, we expect remittance flows to contract by 6.9% in 2020, therefore we believe the current account is likely to be pushed deeper into deficit as remittances dip by c.$2.1 bn. In addition, we expect import demand to pick up substantially in the coming months as authorities seek to stimulate the economy by resuming large scale, import-intensive construction projects.

Given the projected sudden reversal in remittances and the government's plans to resume import-intensive infrastructure programmes, we expect the current account deficit to widen substantially in 2020 to $6.3 bn from -$460m last year. The sudden swelling of the current account deficit will in turn force PHP back on its heels with the currency expected to weaken to 52.19 by the end of the year.

Given that job prospects for OFWs will remain constrained until the global economy heals, we expect current account woes to continue for the Philippines with the peso losing its footing after its recent outperformance in early 2020.

Philippine current account and components



Source: Bangko Sentral ng Pilipinas

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