

Good Morning Asia - 21 November 2019

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Here we go...

US Treasury yields have been falling slowly for some days, and the Reuters story mentioned in the summary has probably only served to give them a push in a direction they were already willing to travel. The obvious question now is how far do they fall?

There are some technical and some fundamental factors to take into account when answering this question. The first is to note the rising yield lows since Aug 30, which would suggest it won't be plain sailing all the way back to the September 1.458% low. Regulations prevent me from saying much more than this, but you can draw your own chart and add appropriate support and resistance lines and draw your own conclusions.

Fundamentally, the key fact here is that from December 15, unless the Schedule 4B tariffs are suspended (I suppose that is possible pending a new-year deal) then we really ought to consider quite a big break by both equity and bond markets. Those tariffs, if implemented would take us into new territory for this trade war, and, moreover, threaten the US consumer, the main support for the US economy right now.

The rest is all politics

I'm oddly glad that there was this trade story to talk about today, as it is at least tangentially to do with economics. Virtually all the other news in my newspaper this morning was market-relevant but political. For example, the Congressional vote on the HK protestors (doesn't help get a trade deal done admittedly), impeachment proceedings and testimonies, UK election hustings, Democrat nomination debates.

The Fed minutes were one of the few other bits of economic news out there overnight, and the gist of these seems to support where the market was already going, as most members still saw more downside than upside risks. We also had one Fed speaker, Lael Brainard, who seemed content that the Fed is done with easing for the time being, but also seemed to indicate that there was some further easing possibility in the future.

Iris Pang in Hong Kong SAR notes another political, but trade-related story, namely that the "...US has approved several licences for US companies to do business with Huawei. And it is also reported that US President Trump is looking to exempt Apple from tariffs. These steps could be the answer from the US to China's request to roll tariffs back to the situation in May. But we do not expect China will accept these as a replacement for lifting tariffs, as these company level exemptions will not be written as a clause in any trade agreement. The exemptions also hint that the US is finding it difficult to accept China's request for tariff rollback". She notes also that the yuan is expected to weaken, which I would agree with though it seems fairly steady right now, as do most Asian currencies.

Not really feeding into the trade story, but nonetheless on a downbeat market note, is the European Commission's (EC) castigation of Italy, France and Spain for not tackling their government debt effectively. While the rest of the world, including the European Central Bank (ECB), is calling for fiscal expansion, the EC is calling for more austerity it seems. No comment from me. You can guess what I think.

Asia today

There is a bit more on the Asian calendar today than there has been recently, including a Bank Indonesia (BI) BI is a central bank that definitely still has some ammunition left should it decide it is needed. We don't think they will move today though, although we still think we have a further 50bp of easing from them, probably in the first half of next year, data permitting of course.

We've also had 3Q19 Singapore GDP data, revised up, a little more than expected to 0.5%QoQ, and taking Singapore a bit further away from recession risk.

20-day November Korean export figures were also out, declining 9.6%YoY, a less dismal reading than the 19.5% decline in October, and providing some further evidence that the worst of the export slump has passed (as we noted yesterday also for Japan).

And Thai trade data for October are also released later this morning. The key expectation here is for some narrowing of the trade surplus on a weak export picture. The surplus will remain large though, and we don't see this result denting THB strength particularly.

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ASEAN Morning Bytes

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EM Space: Further delay in trade deal

- **General Asia:** A Reuters story that any phase-one trade deal may not now be signed until next year has set markets off again. Bond yields are lower, though they had been falling anyway, Asian stock futures are mainly in the red following on from declines in US and European equity markets overnight. USDCNY looks steady for now, but this would normally push CNY weaker.
- **Thailand:** October trade figures due today are likely to show a narrower trade surplus (consensus \$419 million vs. \$1.3 billion in September). This is because October typically is a strong month for imports, while exports continue on a weak growth path. We don't see this report carrying much market impact, especially that on the Thai baht (THB). The Bank of Thailand (BoT) policy minutes yesterday expressed worries about strong THB hurting exports and the overall economy. The currency has clawed back all of the loss it suffered in the aftermath of the BoT policy rate cut and more measures to curb the THB strength announced earlier this month. There is little more the BoT could do about large current account surplus sustaining THB as a refuge for investors during heightened global uncertainty.
- **Singapore:** The Ministry of Trade and Industry confirmed 3Q19 GDP growth at 0.5% YoY (2.1% QoQ SAAR), an upward revision from 0.1% (0.6%) advance estimate. Manufacturing was the main source of the upward revision. However, the outlook continues to be clouded

by weak external demand. In yet another downgrade, the official NODX growth forecast for this year is now revised to a deeper contraction by 9.5-10% than 8-9% contraction earlier, with the negative trend likely to continue through 2020 with at least 2% fall.

- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno indicated that the central bank was in no rush to reduce reserve requirements (RRR) in the near term after a total 400 bps of cuts so far this year. Funds released by the recent RRR reductions have not fed into bank lending. Governor would like to see the liquidity infusion find its way to bank lending before easing further. We expect BSP to remain on hold, both on policy rates as well as RRR reductions until the first quarter of 2020.
- **Indonesia:** Bank Indonesia (BI) is widely expected to leave the policy on hold today after cutting the policy rates four straight times this year. Given that the Fed has taken a neutral stance of late, BI would wait to gauge the impact of its recent easing cycle. A patient pause will afford BI scope to ease further in 2020 should global headwinds to growth pick up, while inflation is likely to stay within target.

What to look out for: Trade tensions

- Thailand trade (21 November)
- Hong Kong inflation* (21 November)
- US existing home sales (21 November)
- Bank Indonesia (21 November)
- Thailand GIR (22 November)
- Malaysia GIR (22 November)
- US consumer sentiment (22 November)

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China: Three rate cuts, one adjustment

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Source: Shutterstock

So many rate cuts but they amount to just one

The People's Bank of China has cut interest rates three times this month:

- 5 November: One-year Medium-Term Lending Rate cut by five basis points to 3.25%.
- 18 November: 7D reverse repo cut by five basis points to 2.50%.
- 20 November: 1Y and 5Y Loan Prime Rate also cut by five basis points to 4.15% and 4.80%, respectively.

However, we should really see all these cuts as just one cut of five basis points. The policy implication is that the interest rate curve from the short rate to the five-year rate should reflect these cuts.

Why the PBoC needs to control so many interest rates

The methodology by the PBoC to move almost the whole interest rate curve by cutting interest rates of various maturities means that the interest rate transmission mechanism in China does not function very well.

We expect the PBoC to live with this until the MLF rate is truly market-based, at which point the PBoC can leave the MLF rate and the LPR to the market. By then, the policy interest rate will be the short-term interest rate alone.

Rate cuts will be data dependent

"Data-dependent" monetary policy is quite unusual in China because most of the time, the PBoC seems to have an interest rate path in mind for the year ahead. But the trade war has changed how the central bank projects its policy.

A positive outcome from the trade war would mean the central bank can stay put on monetary policy, but the reverse will mean it needs to loosen further. The trade war has also resulted in massive infrastructure investments, which should enter into the production stage from the investment stage in the coming months. This will also affect how the PBoC manages monetary policy.

As such, we expect the central bank to be more data-dependent than in the past.

RRR cut is still an important policy tool

Aside from its interest rate policy, the PBoC also has a policy of managing liquidity. Cutting the reserve requirement ratio is a major tool here. Others include the injection or absorption of cash in the interbank market via the MLF and daily open market operations.

After the RRR cut in September which injected CNY800 billion into banks, there were further targeted RRR cuts, which released CNY100 billion on 15 October and 15 November. Additionally, net liquidity injections between September and 20 November amounted to CNY55 billion. The total was an injection of CNY955 billion over just three months.

This highlights that liquidity management is an important tool to guide interest rates lower.

Impact on yuan

As we've said before, there is no direct relationship between the interest rate and the exchange rate in China.

- The capital account is not fully open and there are only small arbitrage opportunities on interest rate differentials between China and the rest of the world.
- The yuan exchange rate is guided by the daily fixing rate, which may not reflect the PBoC's looser monetary policy. For example, after the PBoC announced the five basis point cuts in the 1Y and 5Y LPR, the yuan strengthened from 7.0336 to 7.0305, as of this writing.

The yuan's path is tied more to news on trade talks and will continue to do so until there is a complete trade agreement.

We confirm our view that the USD/CNY will reach 7.0 by the end of 2019.

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