

Good MornING Asia - 23 September 2019

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Another trio of Asian central banks meet next week

The next barrage of central bank policy decisions in the region will come from New Zealand, Philippines, and Thailand next week after Taiwan, Japan and Indonesia's central bank met this week. As was widely expected, the Bank of Japan and Taiwan's central bank left rates on hold but Bank Indonesia delivered its third rate cut for the year despite heightened market volatility making the Indonesian rupiah Asia's worst performer this week.

We anticipate more central bank action next week.

↓ Philippines central bank

Latest data from the Philippines shows a sharp slide in consumer price inflation in August below the central bank's 2-4% policy target which set another 25bp rate cut in stone - the third this year taking the BSP's overnight borrowing rate to 4.00%. This is one of the two Asian central banks (the other being Bank Indonesia) enjoying significant policy space from 175bp of rate hikes last year.

We don't think the BSP will need to use up all that policy leeway going forward unless pent-up government spending fails to revive GDP growth above 6% in the second half of 2019.

↓ Bank of Thailand

The Thai economy is among Asia's worst performers this year and is in need of greater policy support. The Bank of Thailand started cutting rates in August, albeit reluctantly judging from their hawkish stance, which made our view of a back-to-back 25bp policy rate cut to 1.25% next week looking rather difficult to materialise. However, economic data since the last meeting paints an increasingly weak economic outlook, while the political noise frustrates expectations of the recently announced fiscal stimulus kick-starting the economy anytime soon.

Making matters worse is the continued Thai baht appreciation, which is why we're having another out-of-consensus call on BoT policy, as we did in August.

→ Reserve Bank of New Zealand

After a double-barrel, 50 basis point rate cut just a month ago, leaving policy on hold seems to be the safest option for the Reserve Bank of New Zealand.

While the last rate cut preceded reports of strong labour market with 11-year low jobless rate, accelerated wage growth, and well-anchored inflation expectations in the middle of the 1-3% policy target, data since then hasn't been alarming. The economy outperformed expectations in the second quarter with 2.1% GDP growth and there has been little in the rates or the FX markets suggesting another rate cut just yet, which is why we don't think the RBNZ will jump the gun again next week.

And a barrage of data

China's industrial profits data will be an interesting watch as a deepened slump in output growth to a nearly two-decade low of 4.4% could dent profit growth back into the negative territory in August after a one-off positive in July. Elsewhere in the region, manufacturing in Singapore and Thailand remains under stress from weak electronics exports, while new smartphone launches are aiding recovery in Taiwan. The average July-August manufacturing growth will be a good guide to the third quarter GDP performance of these economies.

But inflation continues to be muted in much of Asia as we are likely to see that from the August data in Korea, Malaysia, and Singapore. Singapore's core CPI will be in focus ahead of the Monetary Authority of Singapore's (MAS) semi-annual policy adjustment in October. But with core inflation touching a three-year low of 0.8% in July, which is where it's likely to have stayed in August, and almost flat GDP growth, we expect the central bank to start easing next month.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Saturday 21 September					
Taiwan	-	Aug Money supply (M2) (YoY%)	3.4	-	3.4
Monday 23 September					
Philippines	-	Aug Budget balance (PHP bn)	-13.5	-	-75.3
Singapore	0600	Aug CPI (YoY%)	0.4	-	0.4
	0600	Aug CPI core (YoY%)	0.8	-	0.8
Taiwan	0900	Aug Industrial production (YoY%)	1.8	-	3.0
South Korea	2200	Aug PPI (YoY%)	-0.3	-	-0.3
Tuesday 24 September					
Thailand	0400	Aug Manufacturing index (YoY%)	-2.5	-	-3.2
Wednesday 25 September					
Malaysia	0500	Aug CPI (YoY%)	1.5	-	1.4
Thailand	0805	Benchmark Interest Rate	1.25	-	1.50
South Korea	2200	Sep BOK Consumer Sentiment Index	-	-	92.5
New Zealand	0300	Interest rate decision	1.00	1.00	1.00
Thursday 26 September					
Hong Kong SAR	0930	Aug Exports (YoY%)	-7.4	-	-5.7
	0930	Aug Imports (YoY%)	-10.7	-	-8.7
	0930	Aug Trade balance (HK\$ bn)	-34.2	-	-32.2
Philippines	0900	Overnight Borrowing Rate	4.00	-	4.25
Singapore	0600	Aug Industrial production (MoM/YoY%)	-2.0/-2.2	-/-	3.6/-0.4
Friday 27 September					
China	0230	Aug Industrial profits (YTD, YoY%)	0.0	-	2.6

Source: ING, Bloomberg, *GMT

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China cuts rates via a new tool

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China cuts loan prime rate

The People's Bank of China cut the one-year loan prime rate (LPR) by five basis points to 4.2% while keeping the five-year LPR rate unchanged at 4.85%. The LPR is the new reference rate for banks and other financial assets, which can quote an interest rate linked to the LPR.

The last time the PBoC cut the one-year LPR was on 20 August, from 4.31% to 4.25%.

Here's how the interest rate works:

- the change in the LPR is an average of quotations from some banks;
- each rate change is a multiple of 5 bps;
- the LPR is linked to the medium lending facility (MLF) interest rate, i.e., $LPR = \pm MLF$;
- the MLF has not changed since 16 March 2018, when it rose 5 bps from 3.25% to 3.3%.

Why now?

We believe that the decision to cut the rate came from very weak August data released a few days ago. Industrial production grew just 4.4% year-on-year, the lowest level since February 2002, while fixed asset investments grew 5.5%, down from 5.7% previously, even with support from infrastructure stimulus.

A 5 bps cut in the one-year LPR will guide interest rates lower in bank loans and other financial assets, including local government special bonds which are used to fund infrastructure projects. This means that production costs and investment costs will be lowered slightly.

As the trade war is expected to continue for some time, this rate cut is clearly necessary.

Impact on the economy

A 5 bps cut in the LPR alone won't be enough to soothe the market or counter weak growth right now. This cut, together with last month's move, will be too small (in total 10 bps) to have an obvious impact on economic growth. But we shouldn't forget that the PBoC also cut reserve requirement ratios on 16 September, and there will be more targeted RRR cuts on 15 October and 15 November. Together, these should be able to suppress overall interest costs in the economy.

We want to emphasise the benefits of fiscal stimulus and monetary easing working together. This PBoC rate cut, along with RRR cuts and the issuance of local government special bonds to finance infrastructure projects, should create synergies, which may be magnified in the fourth quarter.

We expect another cut in October unless September data is very encouraging, which we think is unlikely. With more rate cuts, the Chinese economy should grow at 6% in 2019.

"Rate cut doesn't necessarily mean a weaker yuan"

Impact on the yuan

A rate cut doesn't necessarily mean a weaker yuan. There is very little arbitrage opportunity given that China's capital account is not fully open. Put simply, the theory that lower interest rates weaken the currency doesn't apply in China.

USD/CNY peaked at 7.1054 on Thursday then closed at 7.0965. After the rate cut today, the USD/CNY moved to 7.0903. That is, the yuan actually strengthened rather than weakened.

We expect a weaker yuan if the trade talks go poorly. Our USD/CNY forecast is 7.20 by the end of 2019.

MLF and LPR



Source: ING, Bloomberg

A \$20 billion tax boost to corporate India

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3.9%

ING's fiscal deficit forecast for FY2020

Revised up from 3.5%

Unexpectedly big tax boost

In a surprise move last Friday, Finance Minister, Nirmala Sitharaman, announced a significant tax reduction for domestic companies. The move is estimated to cost about \$20 billion to the government in lost revenue, includes a cut in the corporate tax rate to 22% from 30%, taking effect retrospectively from 1 April 2019, the start of the current financial year. This takes the effective tax rate after all additional levies to 25.2% from 25.9%.

In more incentives for new start-ups, for companies to be incorporated from 1 October 2019, the tax rate is set at 15%, down sharply from the existing 25%. Furthermore, reversing some of the tightening measures announced in this year's budget, the government rolled back surcharges introduced on capital gains from the sale of securities, including derivatives, and exempted companies from share buyback taxes for buybacks before July this year. Also announced on Friday

was a reduction in the Goods and Services Tax (GST) for some sectors.

Incessant stimulus

The latest round of fiscal boosts followed a slew of measures announced over the last month.

- **23 August:** Withdrawal of surcharge on long and short-term capital gains tax on foreign portfolio and domestic investors; \$9.8 billion (INR 700 billion) capital injection for public sector banks; lifting of curbs on new vehicle purchases by government departments.
- **29 August:** Easing of foreign investment regulation for retail, manufacturing and coal mining sectors. Relaxing local sourcing norms for foreign companies selling their own brand in India. Removal of caps on investment in commercial coal mining. Up to 26% investment permitted in digital media.
- **30 August:** Consolidating 10 public sector banks into four - A) Punjab National Bank, Oriental Bank of Commerce, and United Bank; B) Canara Bank and Syndicate Bank; C) Union Bank of India, Andhra Bank and Corporation Bank; and D) Allahabad Bank and Indian Bank.
- **14 September:** \$7 billion tax incentive for exporters. Measures to boost the real estate sector.
- **20 September:** \$20 billion corporate tax reduction for domestic companies (details as described at the onset). Reduction of GST on hotel rooms (18% from 28%) and catering services (5% from 18%), but a hike in that on caffeinated beverages (40% from 28%).

Near-term pain, long-term gain

The reduction in tax rate puts corporate India on par with Asian neighbours (standard rate of about 25% in most Asian countries, 17% in Singapore and Hong Kong), which is significantly positive for the economy over a longer-term.

Indeed, the latest measures should do what they are intended to – revive growth. But how quickly and effectively this will happen in the current climate of strong external risk remains to be seen. There is little that fiscal policy can do to overcome external hurdles to growth, in particular, the recent spike in global oil prices. With 80% of its energy requirement imported, India will have difficulty in keeping the oil price spike from affecting domestic fuel prices and overall inflation. On the domestic front, the still high level of personal income taxes of more than 30% and a decade-high unemployment rate are sapping the vigour of consumer spending – the key driver of GDP growth.

Where is the fiscal deficit headed?

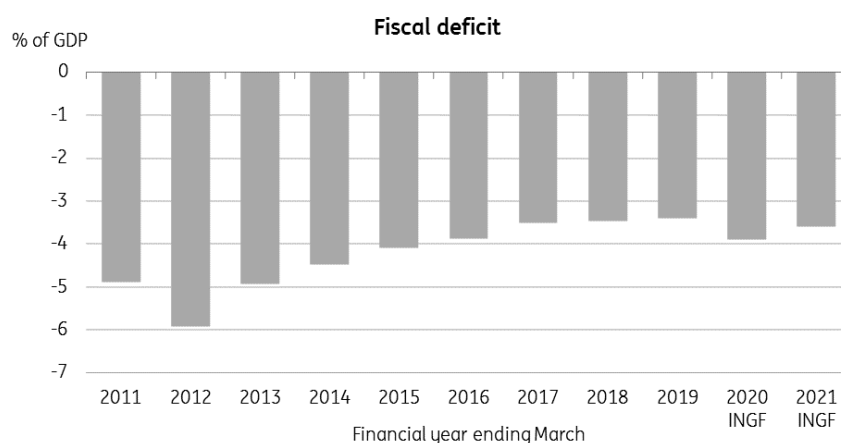
Moreover, the aggressive stimulus adds to the economy's long-term plight by further delaying fiscal consolidation. Certainly, the immediate implication will be a blowout of the fiscal deficit well above the government's 3.3% of GDP projection for the current fiscal year.

The \$20 billion worth of revenue loss from corporate tax measures (leaving aside other stimulus

efforts announced over last one month) itself amounts to 0.7% of GDP, which on its own will swell the deficit to 4% of GDP. While some of this revenue loss will be shared by state governments and the central government may count on improved tax compliance due to lower rates as an offset, an additional whammy from slower GDP growth depressing revenue cannot be ruled out.

We are revising our deficit forecast for the current fiscal year from 3.5% to 3.9%, wiping out nearly all the deficit reduction over the last three years.

Derailed fiscal consolidation



What about financing?

There is no clarity about how the government will be financing this wider deficit. The \$24 billion payouts from the RBI's coffers won't be enough, nor can the government continue to rely on such monetization of the deficit.

The prospect of turning to global debt markets for financing remains clouded amid the prevailing uncertain market environment, more so now as the global investors will, in all likelihood, be viewing excessive fiscal loosening negatively. S&P has left no time in warning of the negative implications of recent fiscal actions. This is a further blow to the government's plan to borrow overseas, which, in turn, means a greater strain on domestic debt markets where excessive government borrowing leads to crowding out of private investment demand – a recipe for continued sluggish GDP growth ahead. A vicious cycle could go on.

And RBI is ready to do more

The Reserve Bank of India's (RBI) aggressive monetary easing with a total 110 basis point (bp) policy rate cuts implemented in four policy meetings so far this year has failed to arrest the growth slowdown. Last week Governor Shaktikanta Das assured markets of continued monetary stimulus for the economy through more policy interest rate cuts ahead. This makes another 25bp rate cut at the next bi-monthly policy review in early October almost certain. And there could be even more with our forecast of a further 25bp of cuts in December.

We identified growth as our highest priority in August. We have

also maintained that it cannot be business usual now and the economy needs something more. Therefore, we went for 35 basis points cut in August. - RBI Governor Shaktikanta Das.

All this is potentially inflationary. But nothing matters beyond growth, at least while inflation is running below the RBI's 4% target.

Bottom line

Whether this helps to kick-start the economy is still to be seen. For now, the negative consequences of derailed fiscal consolidation on India's external creditworthiness keeps up weakening pressure on local financial assets. While more RBI easing is positive for the bond market, the negative from the supply overhang from a wider fiscal deficit is likely to outweigh this, and bond yields will remain under continued upward pressure. Last Friday's market reaction with a strong rally in the stocks but a huge selloff of government bonds speaks for itself.

The INR did gain some ground amidst the positive swing in sentiment towards the equity market, though we don't think this will persist given that currency will likely be undermined by weakening public finances, the renewed threat of higher oil prices leading to higher domestic inflation, and the persistently wide current account deficit.

We retain our end-2019 USD/INR forecast at 73.50 (spot 70.95).

India: Key economic indicators and ING forecasts

India (FY ending March)	FY2016	FY2017	FY2018	FY2019	FY2020 f	FY2021 f
Real GDP (% YoY)	8.0	8.2	7.2	6.8	6.1	7.0
CPI (% YoY)	4.9	4.5	3.6	3.4	4.0	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.4	-3.9	-3.6
Public debt (% of GDP)	69.9	69.0	69.8	72.5	73.0	72.0
Current account (% of GDP)	-1.1	-0.6	-1.8	-2.1	-2.5	-2.4
FX reserves (mth of imports)	10.2	10.6	10.2	8.7	7.8	7.2
External debt (% of GDP)	182.1	168.2	171.3	165.3	174.2	178.0
RBI repo rate (% eop)	6.75	6.25	6.00	6.25	4.90	5.15
3M T-bill rate (% eop)	7.27	5.82	6.09	6.14	5.10	5.50
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.35	7.10	7.30
INR per USD (eop)	66.33	64.84	65.18	69.16	73.80	69.80

Sources: Bloomberg, CEIC, ING forecasts

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