Good MornING Asia - 24 June 2020

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When should we worry about Covid-19 again?

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In search of direction

Asian markets were in need of some direction this morning, and finding this hard to gauge, with US markets finishing up the day before, but fading into the close. Asian equity futures were a mix of green and red before markets opened.

The US economy may have played a minor role in this market picture, with services and manufacturing sector PMI's undershooting expectations, and both remaining below 50. This indicates that marginally more firms see conditions getting worse than getting better. So converted into a diagram of activity, the line is levelling out, but is still falling.

Let's just be clear - following very big falls in previous months, this is not consistent with a V-shaped recovery. So far, it more resembles an L. If we are lucky, we will get an extended U or even Nike swoosh. This stuff seems to matter to some people Personally, I don't like this letter fetish, and it is subject to a lot of ambiguity and especially with respect to PMIs, to misreporting.

Covid-19 cases not helping sentiment

There was more bad news also from US new daily Covid-19 counts, with Texas, in particular, seeing new daily cases running above 5000.

The US Covid-19 experience is a microcosm of what is happening globally. In the chart below, we can see that in late March to early May, the number of new daily cases levelled out and ran flat at about 80,000 for over a month. Globally, this was when countries like China and Korea, and some of the early European countries, were tackling their outbreaks, but new countries were coming in and their numbers were picking up. The net result was a steady number of daily new cases, but made up of some rising trends and some falling ones.

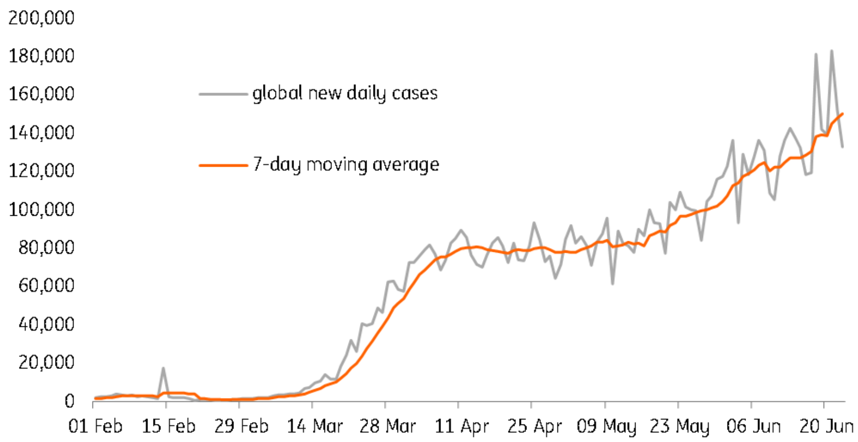
This is approximately the US experience now, as New York, New Jersey and Illinois hand the baton of daily new cases over to Texas, Florida, Arizona and others. Only California has been on an unbroken upward trend. What this is, is not a second wave, but the first wave taking off properly in states that lagged behind the front runners. Just like in the global picture. That's not to rule such a wave out, as new outbreaks in China seem to be related to a European strain of the virus re-entering Asia.

Globally, new cases are running at a 7-day moving average of about 150,000. The US and Brazil now make up nearly half of that. India lags a fair way behind at about 15,000 new cases daily, but I doubt they are capturing the full extent of their outbreak. Two weeks ago, the global new case 7-day moving average was only about 125,000, and two weeks before that, only about 100,000. Similarly, the US 7-day moving average is now a little below 30,000. The US peak 7-day trend, back around April 10, was about 32,000. On current trends, we will see that met or exceeded within a week.

While this is probably troubling markets, it seems unable to cause a substantial repricing, as they slowly get used to the worse news and accommodate it. The phrase "boiling a frog" is not a pleasant one, but it captures a little of what is going on right now.

I'm gradually leaning to the conclusion that it will take more than a slow grind higher in Daily new Covid-19 cases to deliver a meaningful market adjustment. And there are plenty of options open to countries like the US short of re-imposing lockdowns - enforced mask-wearing in all states would be one way to go that could make a big difference while leaving the economy largely intact.

Global Daily New Cases and 7-day moving average



Source: World Health Organization

Global Covid

Asia-Pacific day ahead

New Zealand: The RBNZ delivers their verdict on monetary policy at 10am SGT today. I wrote a bit about this with my FX colleague Francesco Pesole yesterday. Our conclusion was that the RBNZ may wish to dampen enthusiasm for the NZD before too long, as it is otherwise poised to appreciate further. That may simply involve some clever talking, such as mentioning the possibility of negative rates - this never actually has to be implemented. More likely would be an expansion of QE, should they feel the need to do something concrete. But today, we expect very little.

Prakash Sakpal picks up some events elsewhere in the region

Singapore: Prime Minister Lee Hsien Loong yesterday called a snap election to be held on 10 July, 10 months ahead of schedule. He expects the polls to clear the decks and provide the government with a fresh five-year mandate to focus on the national agenda and the difficult decisions it will have to take and implement. The government achieved 69.9% of the popular vote in the 2015 election.

Malaysia: May CPI inflation data is due. Behind the consensus view of a slight improvement in inflation to -2.8% YoY from -2.9% in April lies the Ramadan-related pick-up in demand, while easing of Covid-19 movement restrictions from early May should have released some pent-up spending. But housing and transport prices continued to be a big drag on headline inflation. Negative inflation has opened the door for more Bank Negara Malaysia policy rate cuts. We continue to expect an additional 100bp of rate cuts over the coming quarter.

Thailand: It's decision day for the Bank of Thailand. It's most likely to pass as a non-event though, with a solid consensus of no change to the policy rate, currently at an all-time low of 0.50%. Also due today are trade figures for May, which should underscore a weak state of the economy. The case for further monetary easing remains strong but there is not much easing space left for the Bank of Thailand, which is why I consider the BoT's current easing cycle to be over (read more here).

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ASEAN Morning Bytes

Asian markets could see muted gains as caution caps enthusiasm on lingering concerns about Covid-19

EM Space: Covid-19 infections on the rise in select US states

- **General Asia:** Focus is slowly shifting back to Covid-19 with new daily infections on the rise for states in the US that had moved quickly to remove lockdown restrictions. The recent acceleration in infections has rekindled concern that governments will be forced to shut down their economies once again, squandering the chance for the much-hoped-for economic bounce back. The concerning trends on the virus front may overshadow improving PMI reports from major markets with market sentiment possibly driven by Covid-19 developments on Wednesday.
- **Singapore:** Prime Minister Lee Hsien Loong yesterday called a snap election to be held on 10 July, 10 months ahead of schedule. He expects the polls to clear the decks and provide the government with a fresh five-year mandate to focus on the national agenda and the difficult decisions it will have to take and implement. The government achieved 69.9% of the popular vote in the 2015 election.
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- **Indonesia:** Finance minister Indrawati has reported that government officials are discussing expanding the role of Bank Indonesia (BI) in "sharing the burden" in terms of financing the Covid-19 recovery efforts. Previously, the central bank was granted authority to purchase government bonds in the primary market to help stabilize the bond market. Indrawati indicated discussions are in the early stages and that officials are determining what capacity and which instruments may be used to allow BI to help finance the widening deficit.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) reported another record high for gross international reserves, hitting $93.3 bn for May. The rise in dollar reserves was likely driven by financial account inflows related to government borrowings from multilateral institutions to help combat Covid-19. Meanwhile, import compression helped offset slowing overseas Filipino remittance flows with the current account also likely swinging back into surplus resulting in a balance of payments surplus. Financial account inflows have helped support the resilient peso despite several rate cuts by the BSP although we expect a reversal for the PHP in the coming months as import demand returns at a time when remittances are set to contract with the pandemic hitting job prospects for millions of Filipinos based abroad.

What to look out for: Covid-19 developments

- Thailand trade (24 June)
- Bank of Thailand meeting (24 June)
- Bangko Sentral ng Pilipinas meeting (25 June)
- US durable goods orders, initial jobless claims, 1Q GDP (25 June)
- Singapore industrial production (26 June)
- US personal spending and consumer sentiment (26 June)

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Taiwan Quarterly: Semiconductors take charge

Taiwan, like other Asian economies, faces weaker demand for export orders even as Covid-19 starts to subside in many countries. But the technology war between the US and Mainland China has benefited Taiwan's semiconductor sector

Xinyi District in downtown Taipei, Taiwan

Preventative measures for Covid-19 don't offset weak demand

Taiwan has been very successful at implementing measures to contain the spread of Covid-19 and its economic situation is a bit better than other Asian economies, which have all been hit by domestic and external factors.

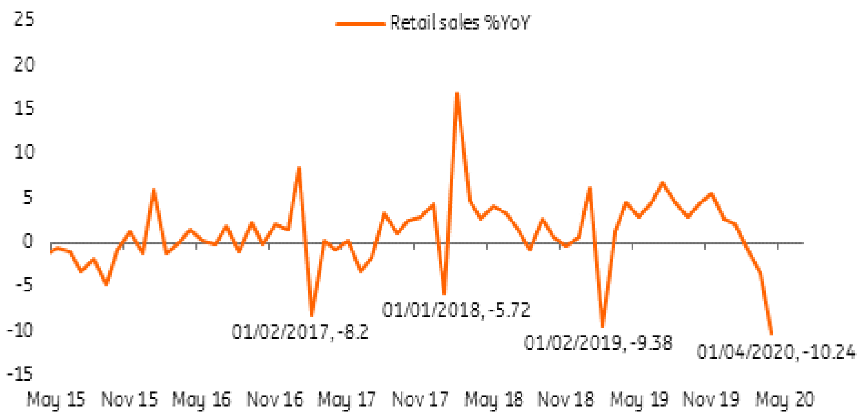
But despite positive GDP growth of 1.59% year on year in 1Q20, Taiwan's retail sales have fallen, and global demand for its products has been very weak.

Consumption has been hit, even though there was no lockdown in Taiwan

Let’s start by looking at the domestic economy because Taiwan has been very good at preventing Covid-19 infections. But does this protect it from the economic damage associated with this pandemic?

Retail sales have a seasonal pattern in Taiwan because some shops close during the Chinese New Year holidays. Covid-19 has resulted in retail sales contracting even more than they usually do on average during the Chinese New Year holiday. Although shops have not been forced to close by the government, sales have been few and far between.

Retail sales in May were even worse than during the Chinese New Year



Source: National Statistics of Taiwan, ING

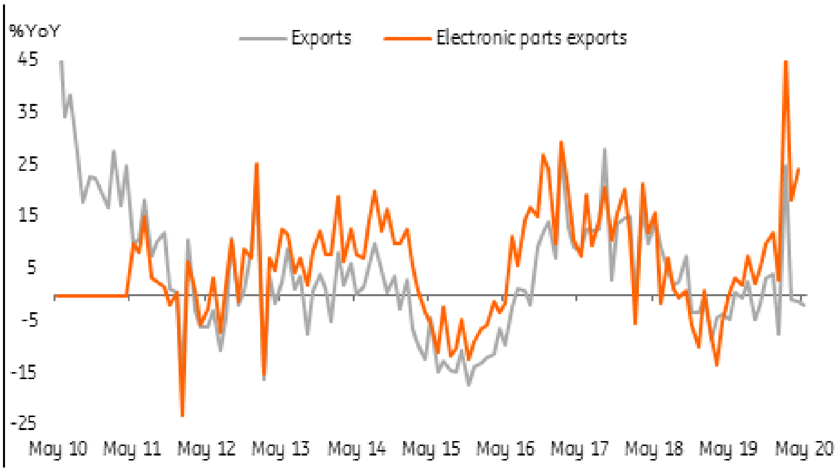
Exports have been hurt by weak global demand

Exports have contracted since March, though electronic exports continued to outperform the average. Growth in electronic parts exports is mainly due to the growth in exports to Mainland China. Chinese companies have had to find substitutes for US advanced semiconductor chips, and Taiwan semiconductor companies have helped to fill the void.

But even strong export growth of electronic parts cannot prevent overall exports from shrinking on a yearly basis. We believe this is because global demand has weakened considerably during this pandemic and will continue to be weak, with social distancing measures lingering even as economies begin to reopen.

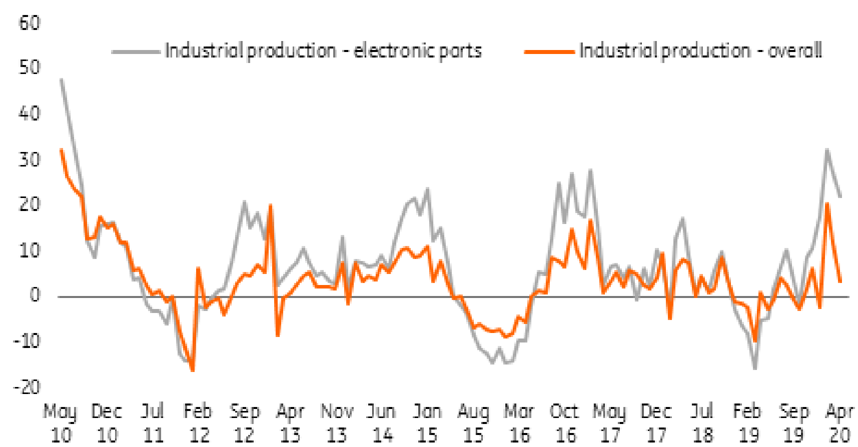
Weak exports have resulted in weaker industrial production, though again, electronics have helped overall industrial production to look better than it otherwise would.

Taiwan overall export growth has been mainly led by electronics



Source: National Statistics of Taiwan

Industrial production growth has been led by electronics



Source: National Statistics of Taiwan

Unemployment and negative inflation paint a weak economic picture

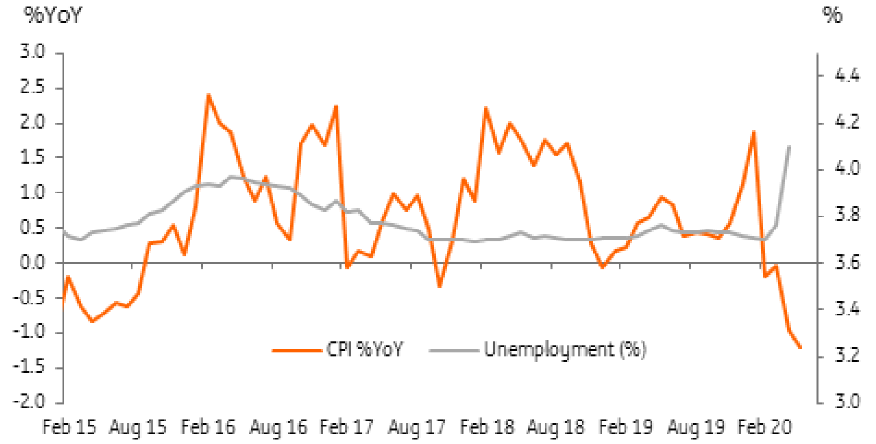
Taiwan's unemployment and low inflation have become an increasingly serious problem since the Covid-19 outbreak.

The unemployment rate - 4.16% in May has not been this high since December 2013. The situation is better now than it was in 2009 because Taiwan's semiconductor companies have been able to sell more chips to Mainland China.

Negative inflation has risen quickly due to the lack of consumer demand, even though there has been no lockdown or forced closure of retail businesses to limit the spread of Covid-19.

With contracting retail sales and exports overall, the job market is likely to remain in a dismal state. The unemployment rate is expected to continue to edge up and is therefore likely to put additional pressure on retail sales. Negative rates of inflation could linger.

Taiwan unemployment rises with deflation



Source: National Statistics of Taiwan, ING

Some government stimulus policies work. Others don't

Government attempts to stimulate consumption do not seem to be working. This ineffectiveness was widely expected within Taiwan because most of the stimulus comes from consumption coupons. With more people unemployed, consumers are likely to use these coupons simply as a substitute for spending they would have done ordinarily. It won't encourage them to spend more.

Regarding investment stimulus policy, since late 2018-2019, the government has asked Taiwanese manufacturers to move factories from Mainland China or build additional factories in Taiwan. Some Taiwanese have bought land as a result, pushing prices higher. This has raised the cost of investment and has made the policy less effective than expected. Another reason that this policy is not effective is that most manufacturers who “registered” an investment amount have held back their investment plans because of Covid-19. So even though some Taiwanese started to invest in Taiwan in 2019, the contribution of investment to GDP is not expected to be big in 2020.

Still, we expect investments from semiconductors and related equipment factories to increase, as they have orders from Mainland China to support the expansion of their operations. This could be the major economic growth engine for Taiwan in 2020.

Expect one more rate cut from central bank

The central bank kept policy rates on hold in June, mainly because some other central banks also adopted the wait-and-see approach. This was the first reason stated in the central bank's decision. It expects a quick economic recovery from Covid-19 - a view which we do not share.

As such, we think a rate cut of 12.5 basis points is still on the cards for the rest of 2020 (i.e. one more rate cut).

TWD has strengthened but weakening factors exist

USD/TWD has increased due to foreign capital flowing into the Taiwan stock market (mostly into semiconductor companies).

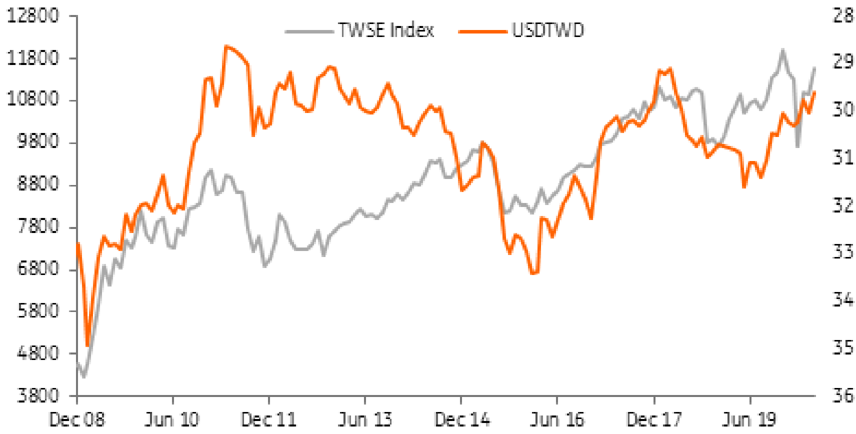
This is expected to continue until:

1. Mainland China is self-reliant on developing the most advanced semiconductor chips, which is impossible this year;
2. The US stops targeting Chinese technology companies (also hard to imagine in 2020);
3. Fund managers reallocate funds to other stock markets that regain momentum when Covid-19 subsides, which is possible by 4Q20.

But the Taiwan dollar could weaken if the economic situation deteriorates, particularly if exports continue to contract, which is likely given the weakness of global demand. The central bank would then be expected to cut rates once more in 2020.

Combining all the factors, we have revised downward USD/TWD slightly to 29.6 by the end of 2020 from 29.7.

TWD has been affected by capital flows into the stock market



Source: CEIC

Summary

The main bright spot for Taiwan comes from its semiconductor companies filling the gap left by US companies (which can't do business with Mainland Chinese companies included in US entity list).

Put simply, Taiwan has been affected by Covid-19 like other economies and faces weak global demand for its products (think of the delayed new iPhone release, fewer upgrades to new smartphones and other consumer electronic gadgets).

But it also has additional business with Mainland Chinese technology companies because the US has slapped sanctions on Chinese companies and placed several firms on its so-called 'entity list', which are essentially blacklisted companies on national security grounds.

Forecasts

	2019	2020F	2021F	2022F
Real GDP (YoY%, period average)	2.7	-0.4	2.8	2.3
CPI (YoY%, period average)	0.6	0.3	1.3	0.9
Central bank policy rates (%, end period)	1.375	1.00	1.00	1.00
FX Forecasts (end period)	29.99	29.70	29.00	28.60

Source: ING

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