

## Good MornING Asia - 25 June 2019

Geopolitics and trade remain in the driving seat for global and Asian markets ahead of the G20 meeting

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Asia Morning Bites

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General market tone: Wait and watch. Investors will likely remain in holding pattern awaiting the G20 meeting for direction.

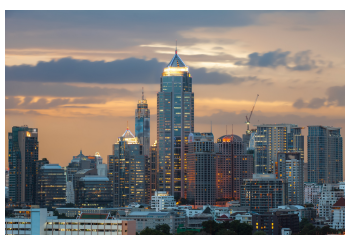


FX | New Zealand

#### New Zealand: August rate cut in view

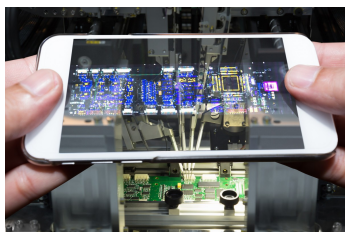
After Assistant Governor Christian Hawkesby dashed hopes for a rate cut in a speech last month, expectations for a move at this week's central bank...

By Francesco Pesole



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## ASEAN Morning Bytes

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### EM Space: Caution dominate amid US-Iran nuclear and US-China trade tensions

- **General Asia:** Regional markets will likely be in holding pattern with the fate of the US-China trade negotiations in the balance ahead of the G20 meeting later in the week. President Trump has also upped the ante on Iran with more tougher sanctions including the top leadership.
- **Malaysia:** Speaking at an event in Kuala Lumpur yesterday, IMF's managing director Christine Lagarde highlighted the need for a productivity boost to put Malaysia on the path to high-income status over the next decade. Meanwhile, she praised improved governance and anti-corruption policies, growing education investment, and efforts to encourage more women in the labor force. 4-5% GDP growth is our baseline for the Malaysian economy for the medium-term.
- **Indonesia:** Indonesia surprisingly posted a trade surplus of \$208 million for the month of May as a 17.7% YoY fall in imports far outweighed 9% fall in exports. Exports of non-oil products were down 8.2% as the ill effects of the trade war between the US and China bites while import weakness was across-the-board in consumer goods, raw and intermediate materials, and capital goods. The government has guided policies towards improving the external payments situation. However, the improvement in the trade surplus may come at a

cost less raw materials and capital imports for companies.

- **Thailand:** May manufacturing production data is due today. We share the consensus view that growth returned to negative territory in the last month after a one-off positive in April amid steeper export declines. Economic activity data has been supportive of our call of a 25bp BoT policy rate cut tomorrow, which is an outlier in the consensus view backing the stable policy. [Here](#) is more on why we think the BoT should ease the policy.

## What to look out for: Fed speakers and G20 meeting

- US consumer confidence (25 June)
- Hong Kong trade (25 June)
- Fed Bostic, Williams, Powell and Barkin speak (25 June)
- US durable goods (26 June)
- Bank of Thailand meeting (26 June)
- Singapore industrial production (26 June)
- Malaysia inflation (26 June)
- US 1Q GDP 3rd estimate (27 June)
- Bank of Korea (27 June)
- US Michigan sentiment (28 June)

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## New Zealand: August rate cut in view

After Assistant Governor Christian Hawkesby dashed hopes for a rate cut in a speech last month, expectations for a move at this week's central bank meeting are low. But a cut is probably not too far off



### Hawkesby says rates to stay "broadly" as they are

*Our central view is that New Zealand's interest rates will remain broadly around current levels for the foreseeable future.*

Although Hawkesby's use of the word "broadly" in his 30 May speech is clearly a get-out-of-jail-free card, to be drawn and played if conditions merit it, the assistant governor's recent remarks set quite a high bar for a rate cut at this meeting.

The question is, has anything changed since he delivered this speech in Tokyo?

The biggest change, of course, is what's happened at the Federal Reserve. While the US central bank hasn't taken any decisive action yet, and has only hinted at a small amount of easing, markets have frothed at the mouth at even the suggestion of a rate cut, pushing the US dollar lower, and virtually everything else higher, including the New Zealand dollar.

At just a shade over 0.66, this is a decent bounce back from the 0.65 support level seen only a short while ago. This makes any additional rate cuts by the RBNZ easier, as the bank doesn't need to consider the impact on the currency as much as it would otherwise.

### Most of the data has been weak

Furthermore, with the exception of backward-looking 1Q GDP data, which delivered a better-than-

expected 2.5% year-on-year result, the run of data since 30 May has been universally poor. In a long list of weak data, we can name April building permits (-7.9%YoY), May consumer confidence (-3.2%) May House Prices (2.3% down from 2.7%), May credit card retail spending (-0.5%) and the Manufacturing PMI (50.2 down from 52.7).

About the only good news was another 1Q release (manufacturing activity) and the May service sector PMI.

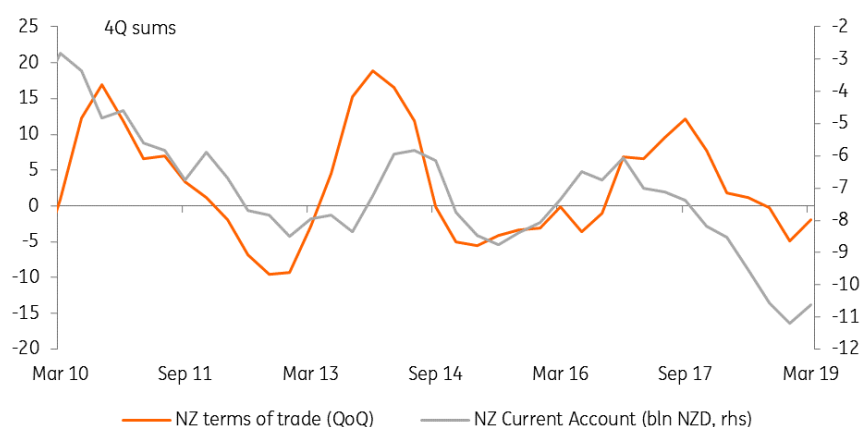
In short, if Hawkesby or Governor Adrian Orr want to play the "broadly" card and cut rates at this meeting, it would not be too surprising, although like the consensus, we're not expecting a move at this meeting. Still, we will be on the lookout for signs that another cut is coming soon.

## August looks like a good shout for the next cut

Assuming no action this week, the 7 August RBNZ meeting looks to be the first good opportunity for some further easing. By then, we will have more information on key variables such as CPI (2Q figure due on 16 July) and the labour market (2Q data due on 6 August, the day before the Official Cash Rate meeting). Home price data for July will be released the same day as the meeting. Weakness in one or more of these indices could provide the nudge needed for a further 25 basis point cut, taking the Official Cash Rate down to 1.25%. We think that is more than likely.

## NZD: beware of short-lived rallies

As the dollar fell across the board in the aftermath of Wednesday's Fed meeting, NZD (and AUD) performance was somewhat muted compared to its G10 peers. This is probably because a number of factors are keeping the balance of risks for NZD heavily tilted to the downside. Although markets have recently become more optimistic about a de-escalation of trade tensions following this week's G20 meeting, our trade team still expects the US to launch another round of tariffs this year. In addition, broadly weak data, along with a widening current account deficit and faltering terms of trade, continue to shed some doubt on the economic outlook.



Source: Statistics New Zealand, ING

Ahead of the RBNZ meeting, rates and FX markets are attaching a 20% probability to a rate cut. As we expect the central bank to keep rates on hold but to leave the door open for further stimulus, the short-term impact on the NZD may prove broadly limited. In the longer-term, OIS pricing shows 27bp of easing priced in for end-2019 and 35bp by June 2020, signalling market uncertainty about

whether the RBNZ will push rates below 1.25% in the coming quarters. All in all, the current dovish stance suggests that any NZD gains are likely to be fleeting, at least until the trade conflict is definitively resolved. We still expect NZD/USD to trade around 0.63 towards the end of 3Q, before gradually recovering throughout 2020.

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# Thailand: Why the central bank should ease policy this week

We don't mind being an outlier in the consensus view which solidly backs no policy change from the Bank of Thailand this week. We are convinced that the time is up for the central bank to cut rates now before the weak economic trend gets out of hand



Source: Shutterstock

**1.50%** ING forecast of BoT policy rate  
25 basis point cut

## ING, a consensus outlier

The Bank of Thailand's (BoT) Monetary Policy Committee meets this week to review the current policy setting. It will announce its policy decision on Wednesday, 26 June, around 2pm Bangkok time.

We don't mind being an outlier in the consensus view; 20 out of 21 participants in a Bloomberg survey are looking for no change from the Bank of Thailand this week. We, the only one in this

survey, are convinced that now is the time for the central bank to cut rates before the current economic weakness gets out of hand. Hence our forecast of a 25 basis point BoT policy rate cut to 1.50% this week.

## Weak domestic economic dynamics

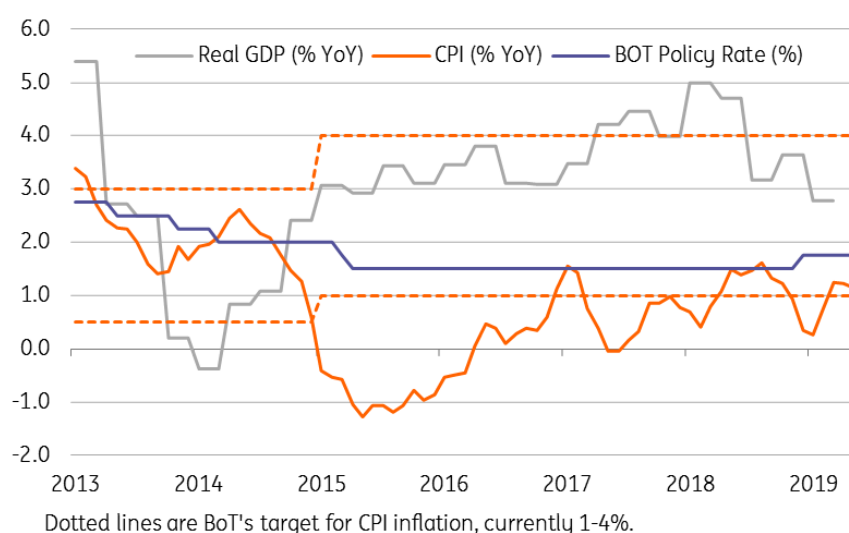
The BoT's last policy change was a 25 basis point increase in the 1-day repurchase rate, the policy rate, to 1.75% in December 2018. We thought that policy tightening wasn't required in the first place when the external economic headwinds were already getting stronger, GDP growth was petering out, and inflation was running under the BoT's 1-4% target for the policy.

Indeed, Thailand's economic environment hasn't got any better since the last policy move. Rather, it has deteriorated - an embarrassing outcome for policymakers. The export weakness, which has gathered steam, took a toll on GDP growth, driving it to a four-year low of 2.8% in the first quarter of 2019. Exports weren't the only thing to blame. Increased political risks surrounding general elections, which were finally held on 24 March after nearly five years of military rule, also weighed on domestic demand. Such a dismal report card for 1Q19 prompted a sharp cut to the official growth forecast for 2019 to 3.3% from 3.8%.

The negative fallout of the US-China trade war has also hit the tourism sector, the backbone of the Thai economy, evident from the slowdown in Chinese visitors underway since last year.

Meanwhile, inflation has remained subdued, rendering the last rate hike even more unnecessary. Average consumer price inflation of 0.9% year-on-year in the first five months of 2019 was unchanged from the same period last year. A spike in food inflation offset lower housing and transport costs. Core inflation, which strips out food and fuel prices from total CPI, has eased to 0.6% year-to-date from 0.7%.

## Growth-inflation dynamic calls for a rate cut



Source: Bloomberg, CEIC, ING

## Strengthening external headwinds

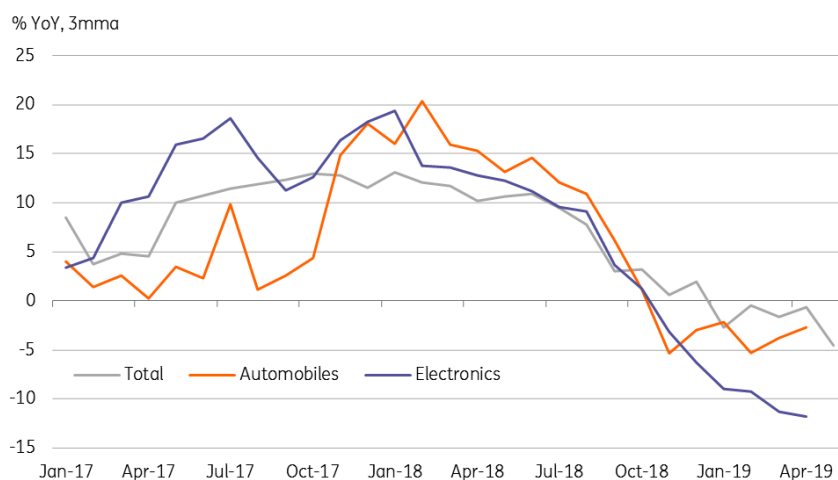
While domestic economic risks remain tilted towards growth, external risks are on the rise. Exports



of electronics and automobiles, together accounting for 30% of Thailand’s total exports, have been on a downward grind. The slump in the global tech sector is compounding the higher US tariffs on the auto sector.

A 2.7% YoY export fall in the year through May is a significant negative swing from 12% growth a year ago. The swing is much worst for imports, - 1.0% YTD from +16%, which underscores domestic economic weakness. This is associated with a (just slightly) narrower trade and current account surplus than a year ago. The potential negative impact on the tourism dollar could mean that the surplus narrows even further, though we think the current surplus should continue to be a significant support to the currency compared with other Asian economies.

## Slumping autos and electronics exports



Source: CEIC, ING

## Runaway currency appreciation

Further depressing export demand is runaway currency appreciation. The baht (THB) continues to be among the best performing emerging market currencies this year. Nearly half of the 5.8% THB appreciation against the USD so far this year occurred in the current month, taking the exchange rate to a six-year high of 30.78, as of this writing. This was despite heightened global economic and geopolitical uncertainty.

The authorities are worried about excessive currency strength aggravating the export weakness. It also makes visits to Thailand increasingly expensive, removing its lustre as a cheap tourist destination in Asia and perhaps the world. All this has prompted the BoT to closely monitor the foreign exchange market for speculative interests. A rate cut might help in the process.

## Surging portfolio inflows boosting bonds and currency



Source: Bloomberg, ING

## A reversal of December hike, not much

Just last week, BoT policymaker Somchai Jitsuchon signalled that monetary policy would be data-dependent, with the fallout from the US-China trade war on the local economy leaving the bank “open to all possibilities”. This being the case, it’s hard to imagine the BoT ignoring the latest activity data, which offers no hope of recovery in economic growth in the period ahead.

We believe the case is strong for a BoT rate cut this week, even if it merely reverses the December 2018 rate hike and there is no accommodation in a real sense just yet. The economy will need more policy support for a recovery in GDP growth towards the 4% average rate of the last two years. Given persistently low inflation, there is enough policy space for more rate cuts, in line with the global easing cycle.

### What this means for markets?

We think that a rate cut this week will pass without hurting local financial markets too much. In keeping with the recent global pattern, both equities and government bonds stand to benefit from lower interest rates, without causing too much impact for the currency, which is benefiting from a strong external payments position.

The question is, whether local government bond yields offer enough of a risk premium over their US counterparts for investment in an economy with weaker fundamentals. Currently, at just 10 basis points on a 10-year local yield (2.15% vs. 2.05% on UST), we don’t think it’s worth the risk.

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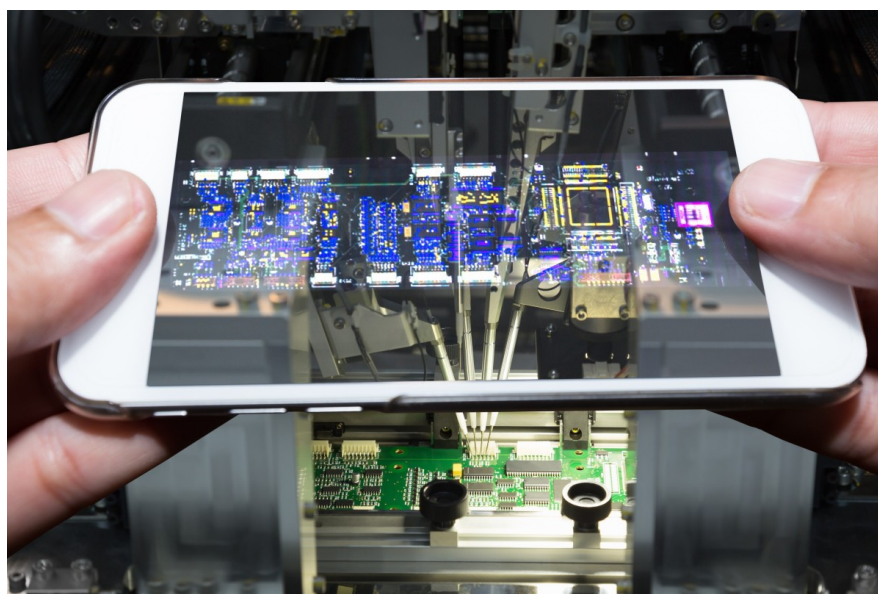
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## Taiwan: Industrial production shrinks again

Industrial production shrank again in May after a brief period of positive growth in April. A contraction is firmly in place, especially for LED panels, which are used in smart devices



Source: Shutterstock

### Taiwan's industrial production shrank again

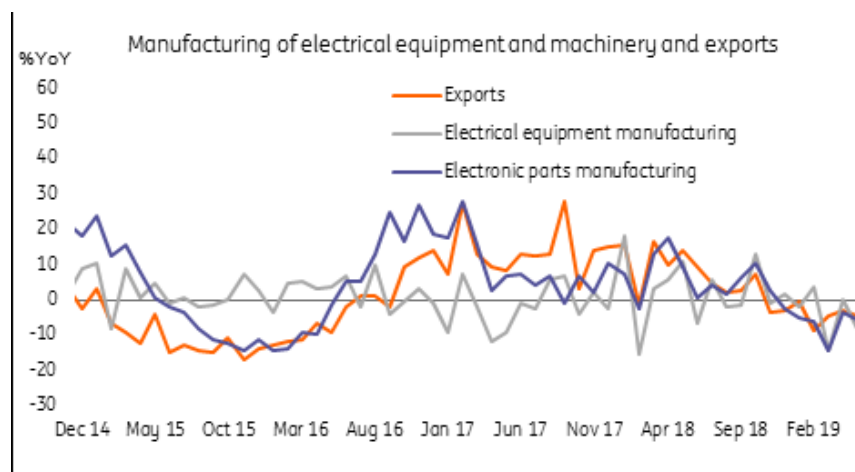
Industrial production fell 3.01% year-on-year in May, continuing the negative trend seen between December 2018 and March 2019, following a brief respite in April where output grew 1.41%.

The end of the smart device product cycle has reduced demand for integrated circuits, which fell 5.83%, and other parts for the production of smart devices, e.g. LED panels, which fell 11.27% YoY in May.

### 5G equipment brings some hope

Production of 5G-related computer parts and equipment rose 23.30% YoY but the amount is not large enough to cover the loss of production of 4G devices. Unless 5G equipment becomes the major wireless technology globally, Taiwan's industrial production may have a significant growth problem.

## Taiwan's manufacturing of electric parts and their relationship with exports



Source: ING, Bloomberg

### There is little the government can do

To combat falling production and exports, the government has encouraged manufacturers to move their Mainland China production lines to Taiwan. It is aiming for TWD 500 billion (around 2.7% of nominal GDP in 2018) of investments to be moved from Mainland China to Taiwan, which may increase investment in factory sites and demand for factory workers.

But as we have seen from the industrial production data, manufacturing activities have shrunk. Even if more production is moved, these production lines may not run at their full capacity without increased demand for upgrading smart devices.

Eventually, Taiwan needs demand for products to keep these factories running, and the current trade war between Mainland China and the US is not helping.

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