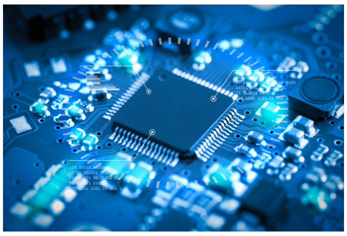
Good MornING Asia - 26 April 2019

Dollar strength is evident across FX space, with notable gains against the KRW and AUD. Strong US data combines with weakness in Asia exports to amplify the effect

In this bundle



Dollar strength dominates

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Asia Morning Bites

ASEAN Morning Bytes

General market tone: Risk-off. Investors will likely stay defensive ahead of the release of US 1Q GDP data later on Friday.

Asia week ahead: Is a technical recession lurking?

Some Asian economies are already showing signs that a 'technical recession' may be around the corner, but low inflation gives central banks some...

South Korea

Korea: From bad to worse

1Q19 GDP growth fell 0.3%QoQ. Another negative quarter in 2Q19 and therefore "technical recession" is quite plausible.

Indonesia

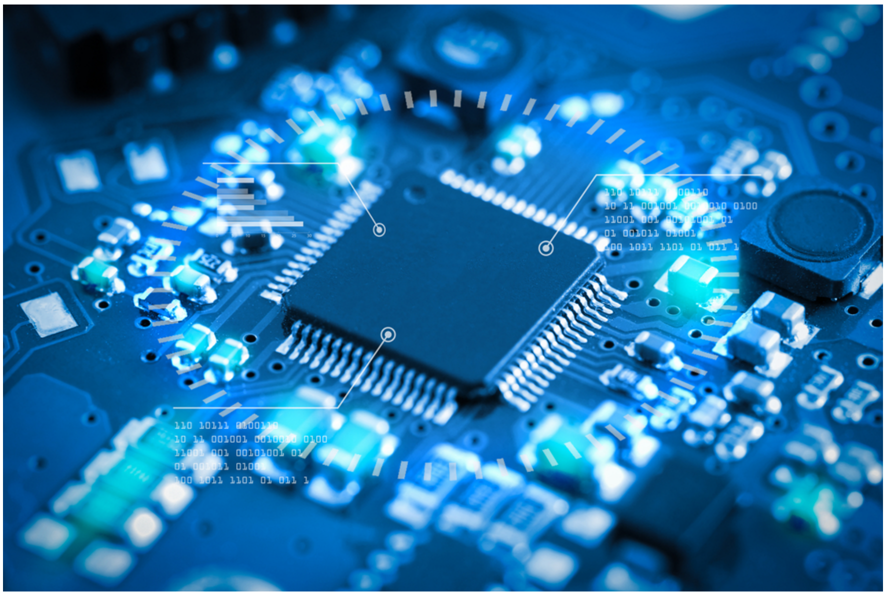
Indonesia: Central bank cautious but looks to support growth

Bank Indonesia (BI) kept its main policy rate unchanged as it looks to further strengthen its external position

Opinion | 26 April 2019

Dollar strength dominates

Dollar strength is evident across FX space, with notable gains against the KRW and AUD. Strong US data combines with weakness in Asia exports to amplify the effect.



Tech weakness still weighing on Asia

My journey into work each day involves sitting on public transport reading the daily summary of economic and market views from one of the big providers. I'll leave you to guess which. We don't get paid for advertising.

Today, I counted three specific company references to weak semiconductor/tech earnings expectations or demand, which tells you that the global tech slump is still a force to be reckoned with. For sure, there may be some activity going on in China related to the 5G rollout. Our Iris Pang referred to this in a recent industrial production note. But foreign firms exposed to China are not seeing any strength in tech demand, which either means it is all being sourced locally (doubtful, though in time that may become more likely as China pushes forwards its self-sufficiency in tech) or the big boost in China 5G activity is more infrastructure-related - laying of cables, transmitting stations etc. It doesn't mean we are on the verge of a technological breakthrough that will see Asian economies fly again. Though that day will come eventually.

Engineers I have spoken to recently in Singapore tell me that there are still fundamental problems with making 5G work, and suggest 2022 is a more likely blast off date to have at the back of your mind. So it's great that Chinese data is looking strong again, but what is good for China, isn't necessarily going to have a very big impact on the rest of the region whilst this tech weakness prevails. Singapore's industrial production data for March due out later this morning will, I think, back up this gloomy prognosis.

Local factors overlay on USD strength

The USD is strong, but let's not get too bogged down with the USD, some Asia/Pac currencies are actually "weak", in their own right, and for good reason. The AUD took a bath this week on low inflation. We can argue about the timing of the RBA response - there is the small matter of the election on May 18 to deal with, which may postpone any easing until June (May 21 minutes could provide a big clue) - but the ultimate direction of travel now seems clear.

And despite their protestations, the Bank of Korea (BoK) must surely also soon have to throw in the towel and concede that all the official BoK and government forecasts for growth this year are grossly optimistic, and require some additional assistance to supplement the insufficient budget stimulus penciled in so far. We have one cut forecast for this quarter. But to be honest, that may not be enough.

Japan at a crossroads

Yesterday saw the Governor of the BoJ admit his frustration with the BoJ's inability to meet its 2% inflation goal. This came with an increasingly fierce pushback on what he was terming "Modern Monetary Theory" or MMT, which is shorthand for saying that ultra-low interest rates don't work. Personally, although I hate the MMT monicker, I think there is a more than a grain of truth in some of this critique of ultra-low rates, which I have written about repeatedly in this note. Kuroda's gift to the markets this time was to change the wording on the BoJ statement, which replaced "extended period" for describing how long low rates would be in place, to "around Spring 2020".

To paraphrase his explanation, he suggested that the market was misinterpreting "extended period" and was anticipating rate hikes much sooner than was probable. Governor Kuroda almost certainly doesn't read this note, but if he did, I would have to respectfully suggest that this assessment is completely without substance. Not only does the market not believe that the BoJ will meet their inflation target over the BoJ's forecasting horizon, but many of us also don't believe they will meet it, ever (notwithstanding some slightly better Tokyo CPI figures today). A tweak to forward guidance as delivered yesterday is as meaningless as it is irrelevant, and markets shrugged it off as they should have done.

I am more interested in a Japan story running today that backs up our current forecast that the Consumption Tax hike, planned for October, will be delayed again this year. Isabel Reynolds on Bloomberg (OK, I've told you now), runs through four factors to watch out for, which will indicate whether or not we are right to have ditched this tax hike from our forecasts. These include a turn in public opinion, evidenced from the July Upper House elections, a further decline in the June Tankan, the summoning of renowned economists (I won't be on that list, sadly), and a worsening in the global outlook. This seems like a good list to me.

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ASEAN Morning Bytes

General market tone: Risk-off. Investors will likely stay defensive ahead of the release of US 1Q GDP data later on Friday.

-4.6%

Consensus on Singapore March industrial production growth

Year-on-year

EM Space: Wall Street and crude oil pull back with US GDP in focus

- **General Asia:** The US equity markets succumbed to profit-taking after poor earnings reports from a select manufacturing firm. This sets the Asian markets for a weak start today with investors looking to 1Q19 GDP reports from the US for direction.
- **Singapore:** March industrial production due today will inform on the direction of revision to the 1.3% preliminary estimate of GDP growth in 1Q19. Exceptionally weak exports, down 12% YoY in March, imparts upside risk to the consensus of 4.6% YoY fall in IP. And therefore, GDP is prone to downside revision. 1Q19 labor report is also due today. Against a backdrop of a slowing economy, we think the consensus view of an unchanged unemployment rate at 2.2% is optimistic.
- **Thailand:** Bloomberg quoted the Bank of Thailand's deputy governor Paiboon

Kittisrikangwan saying that the monetary policy was focused on long-term economic stability rather than short-term volatility and that central bank would carefully use the limited policy space to preserve it as a tool for future volatility. Our baseline is no change to the BoT policy this year.

- **Indonesia:** Bank Indonesia (BI) kept policy rates unchanged with the 7-day reverse repo rate at 6.0% for the 5th straight meeting. With inflation now running at the lower end of BI's 2.5-4.5% policy target range, the IDR relatively more stable, and reserves replenished after the 3Q 2018 siege on EM currencies, there is room for policy easing. While Governor Warjiyo retained his hawkish rhetoric on the back of prevailing external risks, he did hint at easing in the form of liquidity infusion to support growth.
- **Philippines:** The government budget deficit in March came in at PHP 58.4bn, much lower than target as the budget passage delay hampered spending efforts while revenue collections remained on track. This brings the 1Q19 deficit to PHP 90.2bn, down from PHP 152.2bn posted in 1Q18. Delayed public spending would have been a drag on GDP growth in the last quarter.

What to look out for: US GDP

- Singapore industrial production (26 April)
- US GDP and core PCE (26 April)

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Article | 25 April 2019

Asia week ahead: Is a technical recession lurking?

Some Asian economies are already showing signs that a 'technical recession' may be around the corner, but low inflation gives central banks some room to avert one. But aside from that, April economic data should provide a glimpse of where GDP growth and inflation are headed in the second quarter

Source: Shutterstock

Is a 'technical recession' lurking?

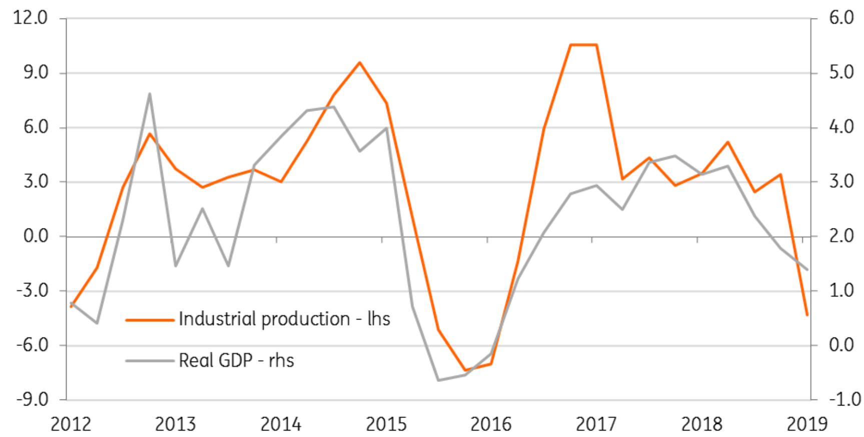
1Q19 GDP reporting season is catching up with more Asian countries reporting data next week.

Aside from China, the slowdown in Asian economies gained traction in the first quarter of the year. China's GDP growth was steady, thanks to the fiscal stimulus, but Korea and Singapore posted sharp growth slowdowns in 1Q19, and the countries reporting next week – Hong Kong and Taiwan – are likely to join this camp too.

The critical question is whether a recession is around the corner. Korea was the first in Asia to report quarterly GDP contraction in 1Q19. Taiwan could follow suit, judging by a steep fall in its manufacturing in the last quarter. As things stand now, we can't rule out another quarter of GDP contraction in 2Q, and after today's GDP numbers from Korea, we think a 'technical recession' is quite plausible.

Read why the biggest quarterly contraction in Korea GDP is bad news

Taiwan's manufacturing is dragging GDP lower (% YoY)



Source: Bloomberg, ING

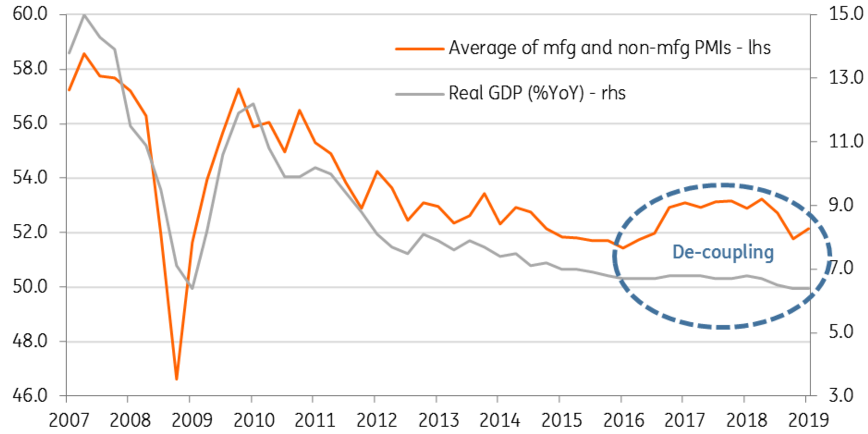
April data should give a glimpse of 2Q growth

April trade data and purchasing managers' index should provide a glimpse of where GDP growth is headed in 2Q. Preliminary manufacturing PMIs from developed countries bode well for those due from Asia next week. The export order components of PMI will be judged for the trade story, which doesn't seem to be getting any better though.

Chinese data will be under scrutiny to see if the economy's better-than-expected performance in the first quarter was a blip and if the slowdown has been delayed. This may be hard to judge from soft data like PMIs, given its de-coupling from real GDP growth in recent years. But it's still a key sentiment driver for markets. A slight improvement as implied by consensus forecasts for both manufacturing and non-manufacturing PMI will be good enough to put a positive spin on China's growth story.

Korea is the first economy in the region, and probably the world, to release trade figures for April, and should prove to be a good guide to trade from the rest of the region. We see no respite from the falling trend in Korean exports which have been reeling under the global tech slump.

China: De-coupling of PMI and GDP growth



Source: Bloomberg, ING

Low inflation allows for more policy support

Korea also reports consumer price data for April along with Indonesia and Thailand.

Aside from the upward pressure on global oil prices, there is nothing to worry about inflation in Asia. And an oil-driven rise in inflation isn't something we expect to see in an environment of slowing growth. But the current low level of inflation across the region does give central banks the scope if needed to ease policies to support growth.

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
		Saturday 27 April			
China	0230	Mar Industrial Profits (YoY%, YTD)	-	-	-1.9
		Monday 29 April			
Hong Kong	0930	Mar Exports (YoY%)	-2.6	-	-6.9
	0930	Mar Imports (YoY%)	-1.4	-	-3.8
	0930	Mar Trade Balance (HK$ bn)	-58.5	-	-48.8
Thailand	-	Mar Manufacturing Index (YoY%)	-3.5	-	-1.6
South Korea	2200	May BOK Business Survey Index, mfg	74.0	-	76.0
	2200	May BOK Business Survey Index, non-mfg	75.0	-	76.0
		Tuesday 30 April			
China	0200	Apr Non-manufacturing PMI	55.0	55	54.8
	0200	Apr Manufacturing PMI	50.5	50.8	50.5
Taiwan	0900	1Q P GDP (YoY%)	1.4	-	1.8
Thailand	0730	Mar Current Account Balance (US$bn)	4.4	-	6.5
South Korea	0000	Mar Industrial production (MoM, SA/YoY%)	-1.7/2.5	-/-0.6	-2.6/-2.7
		Wednesday 1 May			
Thailand	0500	Apr CPI (YoY%)	1.2	-	1.2
	0500	Apr Core CPI (YoY%)	0.6	-	0.6
South Korea	0100	Apr Exports (YoY%)	-7.2	-	-8.2
	0100	Apr Imports (YoY%)	-6.8	-	-6.7
	0100	Apr Trade Balance (US$mn)	5543.0	-	5206.0
		Thursday 2 May			
China	0245	Apr Caixin Manufacturing PMI	51.0	51.0	50.8
India	0600	Apr Nikkei Manufacturing PMI	53.2	-	52.6
Hong Kong	0930	1Q GDP (Q) (QoQ, SA/YoY%)	-/-	-/-	-0.3/1.3
Indonesia	-	Apr CPI (YoY%)	2.5	-	2.5
	-	Apr Core CPI (YoY%)	-	-	3.0
Malaysia	0030	Apr Nikkei Manufacturing PMI	47.7	-	47.2
Taiwan	0130	Apr Nikkei Manufacturing PMI	49.5	-	49.0
Thailand	0030	Apr Nikkei Manufacturing PMI	49.9	-	50.3
South Korea	0000	Apr CPI (YoY%)	0.3	-	0.4
	0000	Apr Core CPI (YoY%)	0.7	-	0.9
	0130	Apr Nikkei Manufacturing PMI	48.2	-	48.8
		Friday 3 May			
Hong Kong	0930	Mar Retail Sales Value (YoY%)	-	-	-10.1
	0930	Mar Retail Sales Volume (YoY%)	-	-	-10.4
Malaysia	0500	Mar Exports (YoY%)	1.0	-	-5.3
	0500	Mar Imports (YoY%)	-2.0	-	-9.4
	0500	Mar Trade Balance (RM bn)	16.9	-	11.1
Singapore	1400	Apr PMI	50.5	-	50.8

Source: ING, Bloomberg, *GMT

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Snap | 25 April 2019 **South Korea**

Korea: From bad to worse

1Q19 GDP growth fell 0.3%QoQ. Another negative quarter in 2Q19 and therefore "technical recession" is quite plausible.

Source: Shutterstock

1Q19 GDP was bad

The biggest quarterly contraction in Korean GDP since the global financial crisis hit in 4Q 2008 has to be bad news. Year-on-year growth of 1.8% doesn't look too bad, but the components of GDP weakness don't bode well for the quarter ahead. It isn't hard to come up with a set of figures for 2Q19 that would deliver a further decline and as a result, a technical recession.

-0.3%QoQ

Korean GDP

1Q19

Worse than expected

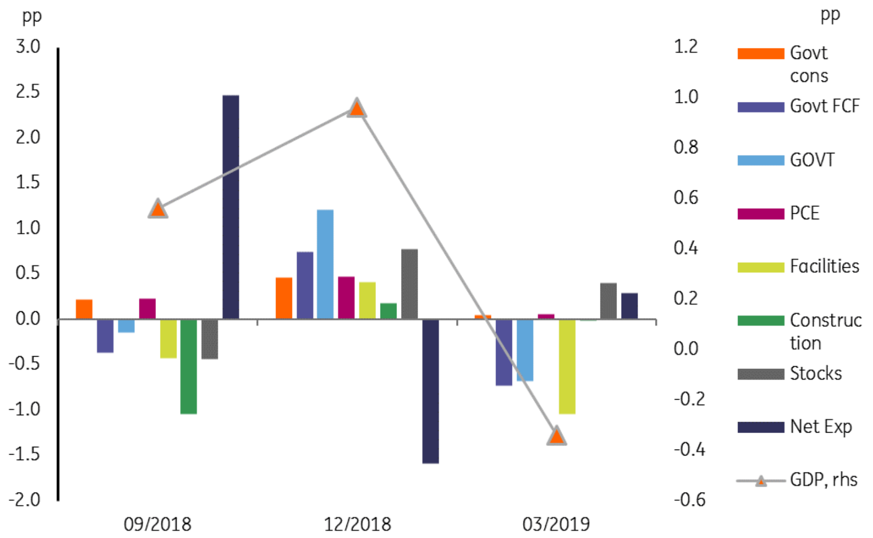
How is 2Q19 shaping up?

It is early days to be calling the second quarter GDP estimates. For the most part. We don't even have any hard data for April yet. But GDP components tend to exhibit both trend persistence, mean reversion and negative cross-correlation and we can tweak some hypothetical figures to see how sensitive the current GDP numbers are to a further downturn. The answer, it turns out, is that a further decline in 2Q19 is quite easy to achieve.

Big components of GDP, like personal consumption expenditure (PCE) are not particularly volatile. That said, the 0.1% QoQ growth of PCE in 1Q19 was a sharp fall from 1.0% in 4Q18. That 4Q18 figure was itself a bit of a fluke. Though based on a relatively sombre assessment of the Korean labour market - employment and wages - we reckon something like 0.3% QoQ would be a reasonable starting point for PCE in any quarterly GDP calculation.

Gross fixed capital formation (GFCF) is more volatile. But the private elements of this, which fell 0.3% in 1Q19, could easily fall further in 2Q19 without some pick up in demand for global technology (semiconductors). We aren't seeing that yet, so another -0.3% figure in 2Q19 seems like a fair guess. Public capital formation fell 15% QoQ in 1Q19. The government has a KRW 6.7tr stimulus package ready for implementation. They say it could be worth 0.1pp of GDP. That seems about twice as much as is likely, but nonetheless, we can reverse the 1Q19 public GFCF decline in its entirety, with an expectation of further public sector support in 3Q and 4Q19.

Contribution to QoQ GDP growth by expenditure component (pp)



Inventories and net exports could pull 2Q19 down

The biggest risks to growth in 2Q19 come from the inventory and net export terms. There is usually some negative correlation here, such that a terrible inventory figure will be partially offset by better net export figures and vice versa. In 1Q19, inventories added to GDP to the tune of about KRW 3.1tr. That was up about KRW1.5tr from the previous quarter and added 0.4pp to GDP after a very helpful 0.8pp in 4Q18.

But although imports will most likely feed into that inventory measurement, imports actually fell in 1Q19, and by considerably more than exports, providing an additional boost to GDP (imports are a drag on GDP, so falling imports represent a GDP boost) of about 0.3%QoQ. Exports don't look likely to show any substantial near term improvement, but even if imports remain weak in 2Q19, after their recent dismal performance, they may decline somewhat less relative to exports in 2Q19. The positive net trade contribution of 1Q19 (imports fall more than exports) could revert to neutrality or even a slight drag in 2Q19. As for inventories themselves, after two-quarters of unwanted build, we would look for them to be drawn down in the second quarter.

Whilst this is more of a sensitivity exercise than a strict forecast, tweaking next quarters figures in this way shows that is is quite easy to generate a further small contraction in overall GDP, and thereby a technical recession. And this is why we think the BoK will be forced to cut, maybe more than once.

What does this mean for the BoK?

The last Bank of Korea policy meeting just over a week ago left rates unchanged at 1.75%. The last change in BoK policy was as recent as November 2018, when they raised rates by 25bp, based on a not terribly convincing argument of high Seoul house prices and high household debt. The most recent meeting trimmed GDP growth forecasts for 2019 slightly to a "mid-2%" level from 2.6% at the January projection. To come even close to this will need (non-annualised) QoQ growth of more than 1% in every quarter until the year-end. In our view, that is simply not going to happen. In response to these latest figures, we think GDP growth for 2019 will do well to exceed 1.5%, which is our new full-year forecast and one that comes pre-loaded with plenty of downside risk.

The BoK's inflation forecasts are somewhat more realistic, in our opinion, than their growth numbers, with inflation expected to remain below 1% for some time. This is also a downward projection from January, but the forecast recovery to low to mid-1% in 2H19 again seems questionable and probably stems from unrealistic growth assumptions.

While the BoK may be relying on government stimulus to do the heavy lifting of combatting the current gloom, the current budget package seems insufficient for the task. We believe the BoK will have to provide some additional support with a rate cut this quarter. Moreover, further fiscal stimulus will also be needed before too long. Korea's good public finances make this an easy choice. Even so, we would not rule out the BoK having to step in to provide further support with another cut later in the year if the hoped-for 2H recovery does not take hold or is weaker than projected.

And the KRW?

Our 2Q19 forecast of USDKRW 1150 has now been smashed with 1160 reached today. We had a 3Q forecast of 1150 too. Both now seem too optimistic, though these forecasts were already at the very gloomiest end of consensus until recently. USD/KRW 1180 seems like a sensible mid-term target for the time being, and we will come up with a more thoughtful quarterly profile shortly.

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Indonesia: Central bank cautious but looks to support growth

Bank Indonesia (BI) kept its main policy rate unchanged as it looks to further strengthen its external position

Source: IMF/Flickr
Perry Warjiyo, Governor of Bank Indonesia

Bank Indonesia on hold for 5th meeting

Bank Indonesia (BI) opted to keep its 7-day reverse repo rate at 6.0%, unchanged for a fifth time, as the rupiah has been under less pressure with global sentiment much improved compared to the 3Q of 2018. Although down year-to-date, the IDR has recovered significantly from the lows seen in 2018, up roughly 7% from the height of the emerging market rout of last year. With the Fed now seemingly on hold for the rest of the year and the US and China making headway, pressure on emerging market currencies has reversed, with foreign funds flooding the region and boosting currencies in turn. The reversal in flows has helped regional central banks shore up reserves after drawing from their stock pile at the height of the 2018 turbulence. Indonesia has seen reserves rise roughly $10 billion in the last few months with gross international reserves now at $124.5 billion.

6.0%

7-day reverse repurchase rate

Unchanged

As expected

Warjiyo stays cautious but looks to support growth momentum

Governor Perry Warjiyo has shot down expectations of a reversal in BI's policy stance, citing external risks for the need to retain the attractiveness of Indonesian financial assets. Despite retaining his hawkish stance, Warjiyo, however, does appear to be supportive of growth, indicating a possible infusion of liquidity to help shore up growth momentum as President Jokowi looks poised to secure a second term. However, if the IDR remains stable and the central bank is able to build up reserves further, we do expect a possible reversal in the current stance sometime in the 3Q, as long as the Federal Reserve remains on hold until then.

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