Good MornING Asia - 28 April 2020

Markets rise on another "whatever it takes" - this time from the Bank of Japan. But is there any room for more?

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BoJ’s “whatever it takes”

Markets rise on another "whatever it takes" - this time from the Bank of Japan. But is there any room for more?

Source: istock

Glass half empty, cracked, with a dead spider in it

OK, I'm not known for my sunny disposition, but even I can see that yesterday's Bank of Japan (BoJ) "Whatever it takes" announcement could be viewed positively by investors in risk assets. That basically makes it all the big central banks. Smaller central banks also all seem to be doing about as much as they can, with a few more rate cuts from some still to come, and a bit more liquidity from RRR cuts mixed with a bit of financial forbearance on things like leverage ratios for banks (Bank of England's latest). But basically, the monetary spigots are wide open.

Just to briefly re-cap on yesterday's BoJ pledges. These amount to the following (my views in parentheses)

1. The current Japanese Government Bond (JGB) target of JPY80tr per year of outright purchases to be replaced by "unlimited" JGB purchases (yet the BoJ were not even needing to buy that amount in order to hit their zero % yield target for the 10Y JGB - so surely this is the removal of a non-binding constraint?)
2. A quadrupling of their corporate bond purchases (this is a bit more meaningful)
3. Enhance the "special funds" supplying operation. This includes:a) expanding the range of eligible collateral b) increase the number of eligible counterparties and c) apply a positive interest rate of 0.1% on balances held by banks corresponding to loans extended through

this operation.

For more detail, here is the BoJ's own account of its enhanced measures.

The final measure seems a bit of a hybrid of the Bank of England's funding for lending scheme, mixed with the Fed's Interest on Excess Reserves, and should help with corporate liquidity problems.

But, and I think it is worth returning to this, the BoJ's outlook for growth for 2020 is -3 to -5% (ING f -4.9% towards the bottom of this range) and the outlook for inflation is -0.7% to -0.3%. The outlooks for fiscal 2021 look fanciful and overly optimistic at 2.8% to 3.9% - basically saying that 2021 returns all the lost growth on top of the underlying growth rate for a net "no loss" position. That is basically nonsense. See the BoJ's argument and make your own mind up.

The BoJ's forecasts, I think, encapsulate what a lot of market participants are assuming about this crisis, which makes them blind to current bad news, but celebrate every positive policy response. And I struggle with this. I think they are assuming:

1. It will basically all be over by Jan 1 2021 (there's a lot of optimism in a vaccine)...
2. ...and no second wave, despite some questionable opening ups in some parts of the world, and still worsening case counts in others.
3. It will have left no residual damage, so output lost will be restored with pent up demand returning us to more or less where we would have been before

In short, a nasty, but temporary interlude from the prevailing growth trend.

All of these assumptions seem highly questionable to me. I would prefer a base pricing model that assumed the following:

- Some permanent and perhaps substantial loss of potential output due to business failures, in spite of Central banks best efforts
- Jan 2021 is not "business as usual, but some social distancing measures remain. International travel remains a shadow of its former self, consumer spending on services remains dampened, and manufacturing adopts new, clunkier and probably less efficient and less profitable (but safer) supply chains.
- This may also be wrapped up with a more nationalistic policy on supply, possibly tied around a flaring up of trade war issues once more.

So as I said, I can't blame the market for reacting positively to news like this, or indeed the continued progress towards re-opening. But for me, the present value of the future I see, does not warrant these levels. I'm not a buyer.

Asia today

There's not much else going on today: Prakash Sakpal writes this on Thailand: "The Thai government is planning to extend its state of emergency by a month until 31 May. Meanwhile, the country's tourism authority has dashed hopes of a near-term economic recovery as it expects a 60% plunge in tourist arrivals this year with this, in turn, denting tourism income by at least half. All this adds to the downside risk to our view of a 7.7% YoY GDP fall in 2Q20 and full-year contraction of 4.3%. We expect an additional 50 basis point central bank (BoT) rate cut this quarter, taking rates to a record low of 0.25%, fueling the need for unconventional easing after that".

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ASEAN Morning Bytes

Hopeful trends emerge on the Covid-19 front but growth data later in the week should remind investors of the downturn ahead.

EM Space: Central bank meetings and GDP data to give cues for trading

- **General Asia:** Investor sentiment will take its cue from economic data reports from major markets in the coming week even as previous virus hotspots rollout plans to gradually reopen their economies. GDP data and meetings of key central banks will be the focus for the coming days while hopeful trends on the virus front will likely be countered by rounds of expectedly poor economic data and the continued rise in new Covid-19 cases in other jurisdictions.
- **Thailand:** The Thai government is planning to extend its state of emergency by a month until 31 May. Meanwhile, the country's tourism authority has dashed hopes of a near-term economic recovery as it expects a 60% plunge in tourist arrivals this year with this, in turn, denting tourism income by at least half. All this adds to the downside risk to our view of a 7.7% YoY GDP fall in 2Q20 and full-year contraction of 4.3%. We expect an additional 50 basis point central bank (BoT) rate cut this quarter, taking rates to a record low of 0.25%, fueling the need for unconventional easing after that.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) predicts GDP growth to slip to -0.2% in 2020 as Governor Diokno pledged additional stimulus to help stave off an impending economic downturn. Diokno indicated that he was open to cutting rates further and reducing reserve

requirements but we believe he may be running out of conventional policy space after committing several rounds of rate cuts to date. Meanwhile, the Treasury announced a fresh round of Dollar-denominated borrowing with the Philippines set to issue $1bn worth of bonds likely split between the 10-year and 25-year tenors. The issuance should help bolster the PHP in the near term but reports that up to 90,000 migrant Filipinos are now unemployed should limit the Peso's gains.

What to look out for: GDP data, central bank meetings and Covid-19 developments

- Philippines remittances and GIR (28 April)
- US wholesale inventories and consumer expectations (28 April)
- Singapore unemployment (29 April)
- US GDP and pending home sales (29 April)
- FOMC meeting (30 April)
- China PMI manufacturing and non-manufacturing (30 April)
- Thailand trade (30 April)
- Taiwan GDP (30 April)
- ECB meeting (30 April)
- US personal spending and core PCE (30 April)
- US ISM PMI manufacturing (1 May)

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China: Industrial profits continued nosedive

China's industrial profits growth has kept falling sharply. External demand has shrunk and is having a feedback effect on China's domestic demand. We expect a combination of fiscal and monetary policy to keep SMEs and jobs stable.

Source: Shutterstock

Another deep fall in industrial profits

Industrial profits fell 34.9%YoY in March after falling 38.3%YoY in January to February.

The continued deep fall in industrial profits shows that China has faced a continued fall in demand for goods from foreign economies due to Covid-19's impact on those economies' job markets and wages growth.

-34.9% China industrial profits

%YoY in March

Profits may not come back as lockdowns relax

The re-opening of a few European and US cities does not mean a meaningful rebound of activity and demand for goods and services even in these places. Unemployment rates are rising, and even those hanging on to jobs could face a fall in wages.

This means that the demand for goods in a large part of the world will be weaker than in pre-Covid-19 times. As such manufacturing and exports from China will continue to face difficulties.

Industrial profits will have to rely more on domestic demand. But conditions are not much better in China. With the shrinkage in demand from overseas, factories are receiving fewer export orders, and they too need fewer employees or may need to cut wages. There will be also challenges from domestic demand.

In need of a combined fiscal and monetary policy

Interest rates and RRR cuts are still necessary as these will lower interest rates for the whole economy.

But there are limitations on monetary policy tools. Smaller firms are more at risk as they are less likely to get loans from banks due to their weak credit profile.

So fiscal policy will fill the gaps, and It is expected that the government will help those SMEs with guarantees so that banks can be confident to approve their loans.

We expect 4 more rate cuts and 6 more RRR cuts. But these monetary policies will really only be effective if there is matching fiscal support. We expect the Two Sessions will reveal more fiscal stimulus. For now, we estimate the size of fiscal stimulus at 6% to 8% of GDP.

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Philippines: Lockdown extension all but knocks out chances for growth in 2Q

Covid-19 is kryptonite to the Philippine economy, with GDP expected to contract for the first time since 1998

Source: Shutterstock

Consumption machine

In the wake of the Asian Financial Crisis (AFC), the Philippines entered a recession but subsequently posted what will likely be 85 straight quarters of positive growth. Riding a wave of stable consumption from a burgeoning population, the Philippine economy rode out every crisis since 1998, with domestic incomes augmented by overseas Filipino remittances. More recently, the Philippines had posted a sterling run of growth above 6% with a combination of robust household consumption, capital formation and government spending. The streak of positive growth however may come to an end in 2020.

Kryptonite to the economic engine

Pre Covid-19, the Philippines was enjoying a nice growth spurt helped along by the demographic dividend and supported by remittances sent home by migrant Filipino workers. Remittances have been a big part of the economic resilience, providing both dollar liquidity and peso purchasing power with remittance growth sustained even during economic downturns. The natural hedge of Filipinos based in almost every corner of the globe meant that region specific recessions could be offset by remittances sent from other countries. 2020 and the Covid-19 pandemic however changes the equation for the Philippine economy, knocking out heavyweight household consumption (lockdown measures) and negating the boon of remittances.

Government signals technical recession

Government officials signalled the possibility for the economy to enter a technical recession beginning in 2Q 2020 with Secretary Carlos Dominguez flagging a best case 0% growth for the economy. We expect a sharp deceleration in growth momentum for both 2Q and 3Q with a marginal recovery by the end of the year. The extension of the lockdown for a whole month (ends 15 May), coupled with a modest response from the fiscal sector all but scuttles hopes for growth in 2Q with the lockdown period extending deep into the quarter. Meanwhile, 3Q output may also contract as consumer and business sentiment will likely stay impaired significantly even after the lockdown is lifted.

U-shaped recovery

We have likened Covid-19 to kryptonite to the once robust economy and we now expect a deep drop in performance as the virus knocks out the Philippines' greatest strengths. The Philippines will be missing the support from remittance flows, which will take the wind out of consumption momentum with up to 90,000 migrant Filipinos losing their jobs due to the virus. Onshore, the services-oriented economy is not likely to jump out of the gates after the lockdown as social distancing curtails businesses where human interaction is unavoidable. To date, the fiscal response has remained modest even as the lockdown was extended a full month and as it remains meagre we expect GDP to contract by 2.2% in 2020 with negative growth in both 2Q and 3Q.

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