# Good MornING Asia - 28 February 2019

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# Is Krugman right?

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## Global Recession possibility

Paul Krugman has been quoted recently as saying that there is some chance of a global recession late this year or next.

There is no widely accessible global recession indicator. But there are such indicators for the US, from which, most of the global business cycle usually starts and ends. One readily available indicator, the NY Fed index, has a recession in 12 months probability running at a 23.62%. That sounds a bit elevated, but not quite ringing alarm bells.

That said, this index has almost never risen from a lower level to reach this point, without then going on to register higher probabilities and in due course a recession. False signals are extremely rare. That is concerning.

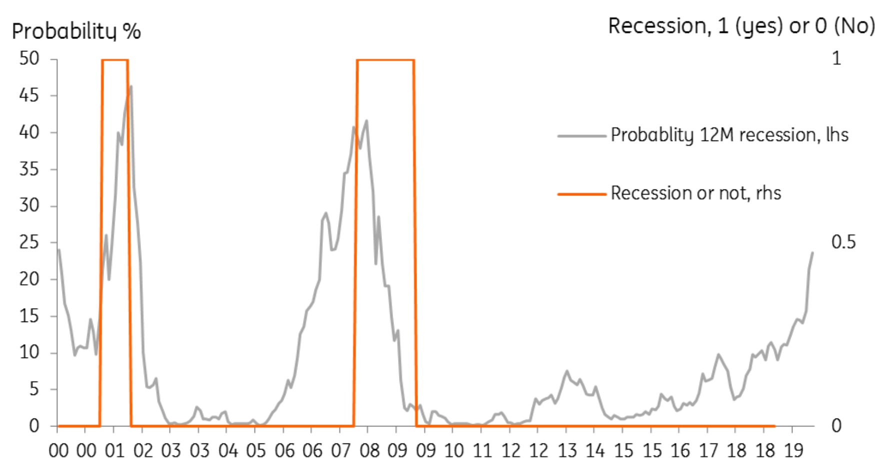
As for a global recession, this is harder to define, with no widely accepted definition. The IMF has a rather complicated definition, involving declining Purchasing Power Parity (PPP) based per-capita GDP backed up by one of seven other indicators including oil consumption and per capita consumption amongst others. But for most of us, lacking the resources of the IMF, this isn't really

all that helpful.

Perhaps a more accessible version is an older IMF definition, which backs out the global GDP growth rate from the per capita GDP cut-off, and suggests that a global recession happens when global growth falls below 3% per year. For the next several years, the IMF is forecasting global growth of just 3.6% to 3.7%. The buffer is small. Moreover, such forecasts tend to be a bit behind the curve. Have the IMF fully taken on board the effect of tariffs on China's exports and growth? Or the impact of the semiconductor cycle? US growth looks good for now, but some aspects of it suggest some slowdown this year and next, so is that baked firmly into the forecast? And Europe, it already looks slow and judging by business sentiment indicators, could slow further. India stands on the brink of a perilous standoff with Pakistan. Brexit may still happen badly (see here for latest). I could go on, but for the sake of brevity (and sanity), I won't.

In short, the 0.6% buffer does not look terribly large or very comforting.

## US recession probability indicator




## MAS MD, Menon, sounds relaxed about global prospects

Now before I describe what MAS Managing Director, Ravi Menon, had to say yesterday about the Singapore and Global economies, let's be clear about priorities. Mine, as a market / bank economist, are to look for things that are about to go horribly wrong, to provide a prior warning for our clients. Mr Menon's, are to preserve and foster economic and market confidence. We are bound to look at the world in a different way, and our conclusions, as a result, may differ widely for perfectly legitimate reasons.

Menon suggested, contrary to things we have said in this note, that there is no reason for (other) central banks (CBs) in Asia to ease rates, describing the hikes by some regional CB's last year as appropriate and sensible. I agree with the last bit, and the room for easing may be limited, and probably for later in the year, not now. But real rates in a number of Asian economies, Indonesia for one, Korea another, look high enough to offer domestic economies some support through possible future easing, and not just if external conditions worsen, as domestic conditions aren't looking too impressive in some economies either.

Menon also takes a different view than Krugman saying that the global economy isn't heading for

a hard landing in 2019. Adding that China's slowdown is enabling it to reach a more sustainable growth rate. I tend to share his conclusion, but I would be far more cautious about the hard landing outlook, You see, to me, this still seems like something that *could* happen, even if on balance I don't think it will. But then as mentioned earlier, my job is to highlight risks, not to calm nerves.

As far as Singapore goes, Mr Menon was similarly upbeat, though there was just the hint of a door being opened for future changes in policy direction (next MAS meeting is in April) as he is quoted on Blomberg as saying that although there is no need for stimulus if the economy evolves as expected in line with MAS forecast ranges "two months is a long time, so we'll see how it looks like then". That may be the most significant comment of the lot.

The SGD is a little softer overnight. The MAS decision in April is unlikely to show a change in the NEER policy, but I would say the risks of an easing grew a very small amount following these remarks.

## Bank of Korea - probably won't ease, but should they?

A weak domestic economy, very low inflation, external headwinds  - all of these are ingredients for a rate cut from the Bank of Korea (BoK) today. Yet not a single economist in the Bloomberg consensus thinks there will be a cut. Why? Probably for similar reasons as Mr Menon cited earlier for other Asian central banks. Though that time may well come later this year. We all wait with bated breath on developments between the US and China on trade. The possibility of auto tariffs would also seriously affect Korea's stumbling economy. A rate cut later this year might well be on the cards and would be entirely warranted if it came under such circumstances, in my view.

## Asia Day ahead

From Prakash Sakpal:

India is the last Asian country to report GDP data for 4Q18 today. We expect it to join the majority of regional countries in posting slower growth, and consider consensus estimate of 6.8% YoY GDP growth subject to downside risk from a slowdown in exports and manufacturing (ING forecast 6.6%). The escalation of border tensions with Pakistan overshadows the economy and markets. The INR has depreciated 0.6% since the tensions started with the terror attack on 14 February and it is down 2.1% year-to-date, the most among Asian currencies. There are no reasons for the depreciation pressure to ease as the tensions will likely remain a burning issue going into elections in May.

Thailand's balance of payments data for January is expected to show a sharp negative swing in the current account balance, just like we saw from the customs-basis trade balance, which plunged to a deficit of $4 billion in the last month from $1.1 billion surplus in December. Having dropped to 7.5% of GDP in 2018 from 11% in the previous year, we forecast that the current surplus will shrink further to 4.5% in 2019. Yet it remains a strong support for the Thai baht, Asia's best-performer currency last year and remains so this year (see "Thailand: Steady economy amid political risk").

# ASEAN Morning Bytes

General market tone: Wait and see. The markets are likely to move sideways as players await fresh leads on trade and geopolitical concerns ebbing.

## EM Space: Testimonies from key US officials mixed, China data out later in the day

- **General Asia:** Fed Chair Powell's delivered a testimony again on Wednesday with little added save for some details on their plans for the balance sheet reduction. Comments from a trade official and President Trump's former lawyer failed to move markets convincingly.
- **Thailand:** The balance of payments data for January is expected to show a sharp negative swing in the current account balance, just as what we saw from the customs-basis trade balance, which plunged to a deficit of $4 billion in the last month from a $1.1 billion surplus in December. Having dropped to 7.5% of GDP in 2018 from 11% in the previous year, we forecast that the current surplus will shrink further to 4.5% in 2019. Yet its remains strong support for the Thai baht, Asia's best-performer currency last year and remains so this year.
- **Singapore:** Mr. Ravi Menon, the head of Singapore's central bank (MAS), views the current MAS policy stance as "appropriate" for the economy. The economy is off to a weak start in 2019 judging from the dismal NODX and manufacturing data for January. Having tightened twice in 2018 we believe the conditions are ripe for the MAS to leave the policy on hold in

April, though last year's tightening also provides wiggle room for the central bank to ease if things get really bad. "Two months is a long time, so we'll see how it looks like then", said Mr. Menon.

## What to look out for: China PMI and US data dump

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# Hong Kong: Hit by the trade war

Hong Kong 4Q18 GDP growth was weaker than expected. This was mainly a result of the trade war, which dampened exports, related jobs and therefore consumption and asset investment - especially investment in the residential property market. We expect economic weakness will continue in 1Q19 but will improve if trade tensions moderate.

Source: Shutterstock

## Hong Kong GDP growth was weak due to the trade war

Hong Kong GDP growth was weaker than expected at 3.0% for the whole of 2018 and 1.3%YoY in 4Q18.

This was mainly a result of the trade war, which dampened export activities and related jobs in Hong Kong and on the Mainland, with negative feedback into consumption in Hong Kong.

Due to the negative sentiment on job security, mortgagors have been reluctant to increase their investment in the residential property market. And this has a negative impact on the jobs of real estate agents.

Investment only grew by 2.2% in 2018, which was lower than the first three quarters' average of 4.5%YoY. We believe that this is also a result of the trade war, causing businesses to defer their investment decisions.

1.3%YoY

Hong Kong GDP growth in 4Q18

Worse than expected

## Economic condition in 2019 depends on the trade war

We expect the overall economic condition will not change in 1Q19. If there is any trade pact it should be finalized by end of March. GDP growth is expected at 1.8%YoY in 1Q19.

We believe that the trade talks are progressing positively. We forecast GDP growth of 2.5% for full-year 2019. Consequently, we project faster growth in 2H19 than 1H19. But there are still many uncertainties in agreeing on a trade pact, especially on some difficult topics like the yuan path and "forced" transfer of technology. These difficult topics may yet lead us to revise downward our GDP forecast for 2019.

## Long-term growth depends on integration with Mainland China

It is difficult for Hong Kong's economic activity to grow independently from Mainland China. In the long-run, Hong Kong's economic growth will partly depend on how it integrates with Mainland China.

The Finance Secretary stated in the 2019 budget that "the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area (Development Plan), promulgated last week, is a milestone, setting out the development directions for the Greater Bay Area up to 2035."

What we see is that it is not the Greater Bay Area design that would change the structure of the Hong Kong economy. We see this as a long term plan that could increase the degree of integration with Mainland China, and to tap the opportunities offered by Mainland China.

But before that is accomplished, Hong Kong's economic growth will be easily swayed by external economic and financial conditions.

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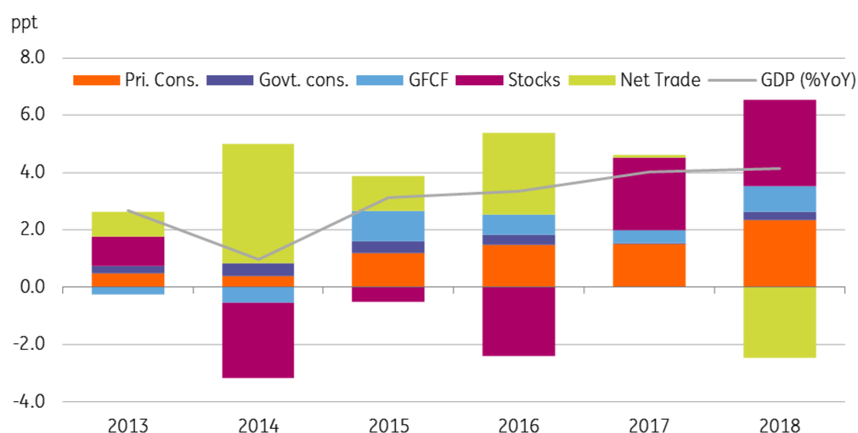
# Thailand: Steady economy amid political risks

Prime Minister Prayut Chan-o-cha is likely to remain in power at the general elections next month, though the transition to the new government under him may not be smooth. Absent a significant political shock, the economy will be on a steady 3-4% growth path and the currency will continue to be an Asian outperformer in the medium-term

## 2018 wasn't all that bad with firmer growth

Thailand's economy grew by 4.1% in 2018, the best performance in the last six years. However, it was not much of an improvement from the 4% growth rate recorded in the previous year and underlying drivers of growth weren't very impressive either. As in 2017, a large contribution to growth came from inventory re-stocking, which isn't a healthy sign as the potential inventory overhang is likely to keep future output growth subdued. There was some improvement in domestic demand but the all-important investment demand continued to be anaemic and lacked a material boost from public investment. Meanwhile, narrowing external trade surpluses held headline GDP growth down.

## Sources of GDP growth



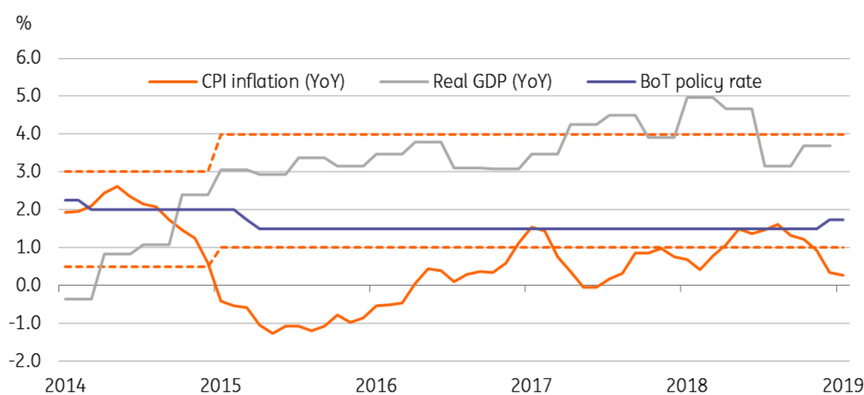

Source: CEIC, ING

The strong currency and lack of demand-side pressure have kept consumer prices subdued. The Bank of Thailand's (BoT) 1-4% policy inflation target has barely been achieved on a sustained basis in recent years. Last year was no different. Even though average CPI inflation of 1.1% in 2018 was the most in four years, after a brief return to the target level, inflation slid closer to zero toward the year-end. Apart from the pass-through of higher global oil prices to domestic fuel prices, which kept the CPI transport component elevated, and higher "sin taxes" on alcohol and tobacco products, there was no inflation in most other CPI components, not even in food prices, which have been the main driver historically, due to their 36% CPI weight.

On the external side, the current account surplus equivalent to 7.5% of GDP in 2018 represented a sharp narrowing from 11% recorded in the previous two years. Yet this remained the main source of currency (THB) strength. The Thai baht was unscathed and retained its top spot among Asian currencies during bouts of emerging market volatility owing to the trade war and contagion from the crisis in Argentina and Turkey.

Indeed, persistently low inflation was an argument against the Bank of Thailand following the US Federal Reserve in tightening. Even so, the BoT stepped up its hawkish rhetoric and moved policy with a 25 basis point interest rate hike in December. The first BoT rate hike in seven years was aimed at gaining policy space for the future. Meanwhile, fiscal policy remained expansionary with close to a 3% of GDP budget deficit.

## Growth, inflation, and central bank policy




Note: Dotted lines are BoT's inflation target, currently 1 to 4%.

Source: Bloomberg, CEIC, ING

## Could 2019 be ugly as politics overtakes the economy?

After frequent rescheduling, general elections are (hopefully finally) set to take place on 24 March 2019. Hopes rest on this ending the long-standing political uncertainty about establishing a civilian government after the military grabbed power in May 2014. That coup overthrew the last elected government of Yingluck Shinawatra (2011-14), the sister of the former Prime Minister Thaksin Shinawatra (2001-06). General Prayut Chan-o-cha initially promised elections within a year of the coup but has pushed out the timing until this latest rescheduling.

Will the transition from military to publicly-elected government be smooth, without any political turmoil? Maybe not, judging by Thailand's political history which has been marred by frequent unrest, military interventions, and short-lived governments. A glimpse of this came earlier this month when a Thaksin-linked Thai Raksha Chart Party announced Princess Ubolratana Rajakanya, the elder sister of King Maha Vrjiralongkorn, as its prime ministerial candidate for upcoming elections. A spike in political risk ensued with a public outcry against the move deemed unconstitutional and disrespectful to the royal family. The sell-off in local financial markets was associated with the steepest single-day depreciation of the THB since last October.

The King denounced the Thai Raksha Chart's move as unconstitutional, and the party now faces dissolution by the constitutional court on the grounds of violating election laws. This nipped in the bud Thaksin's bid to reacquire his grip on Thai politics via a royal family member and also bolstered the odds of Prayut holding on to power.

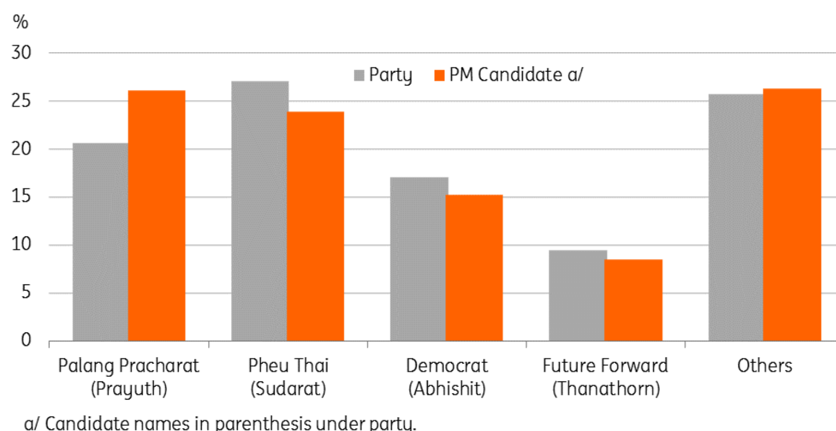
There are 68 prime ministerial candidates in the ring, including Prayut contesting from the military-backed Phalang Pracharat Party and former Prime Minister Abhisit Vejjajiva (2008-11) from the Democrat Party. Thaksin's Pheu Thai Party is also fielding three prime ministerial candidates, while the fourth major party in the fray is the newly-formed Future Forward Party led by Thanathorn Juangroongruangkit.

Moreover, the new constitution adopted in 2017 allows the military to retain its decisive role in future governments. The upcoming elections will be for the 500-seat lower house of parliament,

but the 250-seat upper house, or Senate, is the non-partisan body of appointees from the Royal Thai Military. As such, the balance of power remains tilted toward Prayut. Yet, the passage to the new government may not be without any political gridlock or public unrest.

## What pre-election opinion polls point to?

Average results of various opinion polls held since December 2018.



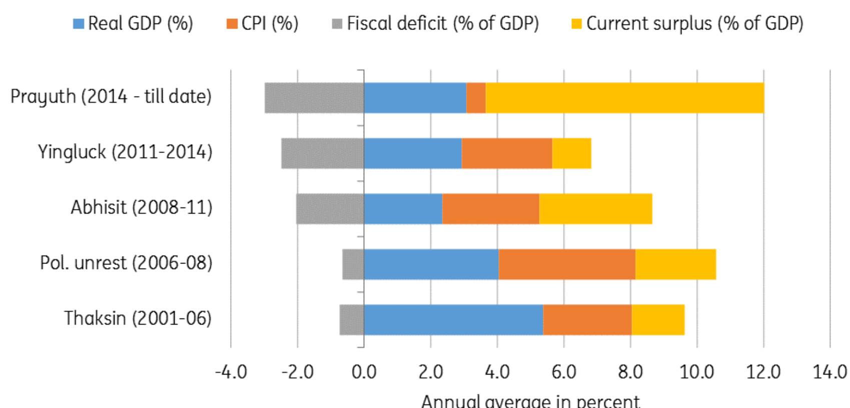

Source: Wikipedia, ING

## Economic case for Prayut's re-election

Let's take a look at Thailand's economic performance under the current and previous regimes to assess Prayut's chances of continuing as prime minister.

Growth improved from a low of 1% in 2014 (the year of the military coup) to about 4% in the last two years, though the 3% average over these years was hardly an improvement over previous administrations. The economy enjoyed lower inflation under Prayut than previous regimes though this is more a result of weak demand and lower commodity prices.

## How did the economy fared under recent governments?



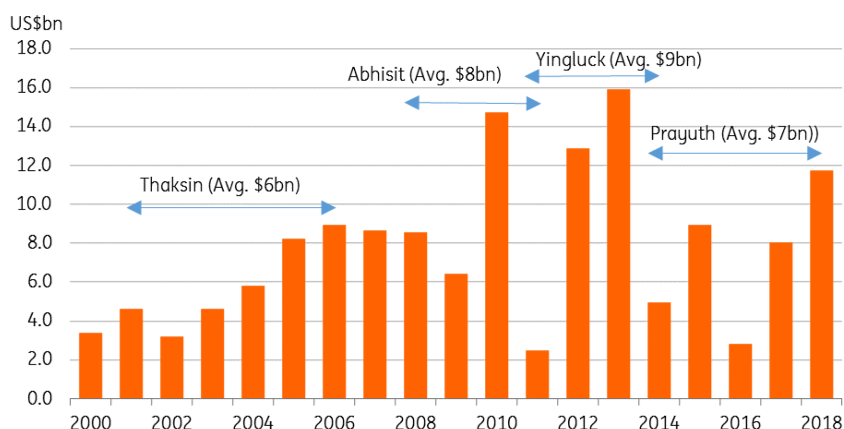

Source: Bloomberg, CEIC, ING

## External situation - great, but thanks to weak demand

Of course, the external payments position had never been as strong as it was under Prayut, supported by a lumpy current account surplus and swelling foreign exchange reserves. However, a large current account surplus also reflects a gross economic imbalance, which has failed to correct despite expansionary macroeconomic policies. Having slashed policy rates by 200 basis points to 1.5% from late 2011 to early 2015, the BoT held policy stable until the latest hike in December 2018. The fiscal deficit averaged about 3% of GDP in the years from 2014, more than the previous administrations.

Foreigners have been pouring funds into local stocks and bond markets in recent years, thanks to the comfort of healthy external payments boosting the currency. And direct investment inflows also gained traction in the last two years. But real investment growth continued to be depressed under military rule (there is also a structural aspect to this as discussed in the next section).

## Net foreign direct investment inflows



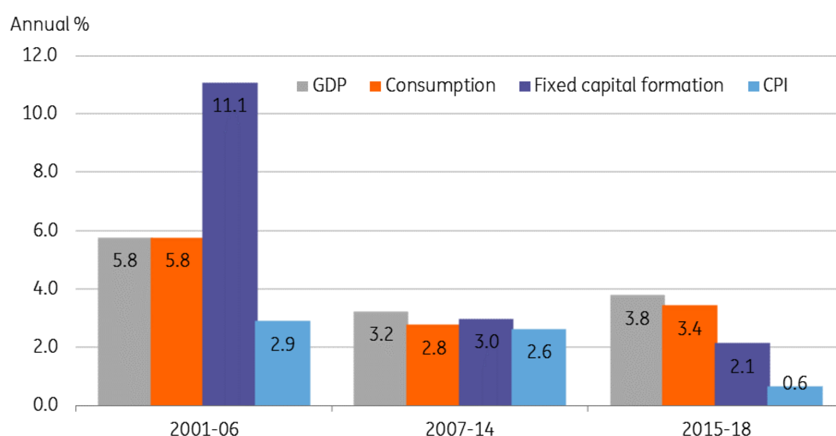

Source: CEIC, ING

## Structural trends – plenty of slack in the economy

The post-Thaksin era was marked by a significant surge in political uncertainty taking a toll on the economy. This is evident from the almost permanent shock to growth via weak investment demand. Once an Asian tiger, Thailand's economy has struggled to grow in recent years with a steady slowdown from an annual average rate of 5.8% in 2000-06 (Thaksin era) to 3.2% in 2007-14 (years of heightened political turmoil). A slight improvement in recent years (military government) can be characterised as lopsided – persistent weak domestic demand – without stoking any inflation.

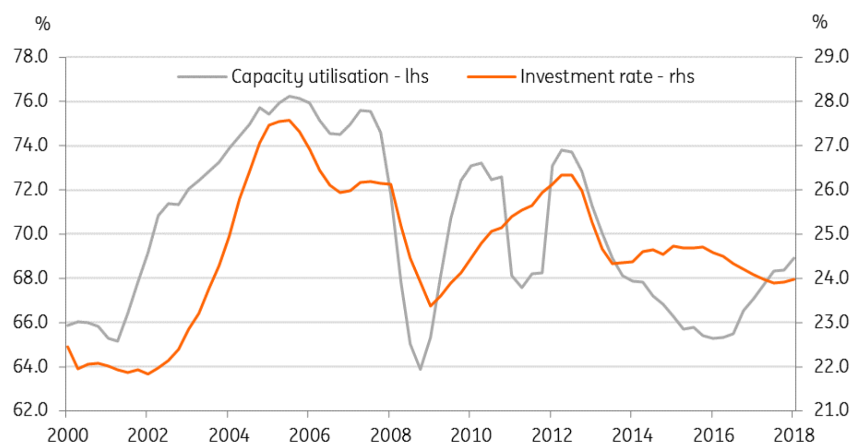
There is plenty of slack in the Thai economy as underscored by factories running at about two-thirds of their capacity. The elevated manufacturing inventory-to-shipment ratio points to the same feature. And this has dampened the investment rate (ratio of fixed capital formation to GDP), which has failed to reach the Thaksin-era highs, while politics has been a constant overhang on investor sentiment.

## Years of political uncertainty has shocked growth lower




Source: CEIC, ING

## Unused capacity weighs down investment




Source: CEIC, ING

## Steady as it goes into the medium term …

We expect the broad economic trends described above to remain in place in the medium term. Absent significant political risk, we see no reason for Thailand's GDP growth to break out of the 3-4% range that it's seen in recent years. The National Economic and Social Development Council (NESDC) projects 3.5-4.5% growth in 2019, as election spending is likely to provide upside to consumer spending. But with the prevailing external risks from the global trade war, GDP growth will likely be closer to the low end of the NESDC's forecast range.

Investment will persist as a weak spot. Hope rests on the continuation of the Eastern Economic Corridor Plan undertaken by the current administration under the new government. This is a long-term plan to develop three coastal regions into a special economic zone with airports, deep sea ports, and high-speed rail, and spanning a multitude of industries. Thailand is also seen among the destinations for potential supply chain relocation resulting from the US-China trade dispute, but is still not as attractive a destination as Cambodia, Vietnam, Myanmar or Laos – all up-and-coming countries with relatively cheap labour.

We see external trade imbalances narrowing gradually. A significant negative swing in the trade balance in January to a deficit of $4 billion from a surplus of $1.1 billion in the previous month heralds this trend. We forecast that the current surplus will shrink further to 4.5% in 2019, providing continued strong support for the currency's appreciation.

## Key economic indicators and ING's forecasts

| Thailand | 2015 | 2016 | 2017 | 2018 | FY2019 f | FY2020 f |
|---|---|---|---|---|---|---|
| Real GDP (% YoY) | 3.1 | 3.4 | 4.0 | 4.1 | 3.8 | 4.0 |
| CPI (% YoY) | -0.9 | 0.2 | 0.7 | 1.1 | 1.0 | 1.4 |
| Unemployment rate (%) | 0.9 | 1.0 | 1.2 | 1.1 | 1.2 | 1.1 |
| Fiscal balance (% of GDP) | -2.9 | -2.7 | -3.5 | -3.0 | -3.2 | -2.9 |
| Public debt (% of GDP) | 42.1 | 41.1 | 41.2 | 42.4 | 43.7 | 46.9 |
| Current account (% of GDP) | 8.0 | 11.7 | 11.0 | 7.5 | 4.5 | 3.4 |
| FX reserves (US$bn) | 156.5 | 171.9 | 202.6 | 205.6 | 220.0 | 230.0 |
| External debt (% of GDP) | 32.7 | 32.0 | 34.1 | 31.3 | 32.0 | 33.0 |
| Central bank policy rate | 1.50 | 1.50 | 1.50 | 1.75 | 1.75 | 1.75 |
| 3M interbank rate (%, eop) | 1.63 | 1.59 | 1.57 | 1.86 | 1.85 | 1.85 |
| 10Y govt. bond yield (%, eop) | 2.50 | 2.65 | 2.32 | 2.48 | 2.60 | 2.80 |
| THB per USD (eop) | 36.08 | 35.84 | 32.58 | 32.33 | 31.80 | 31.50 |

Source: Bloomberg, CEIC, ING

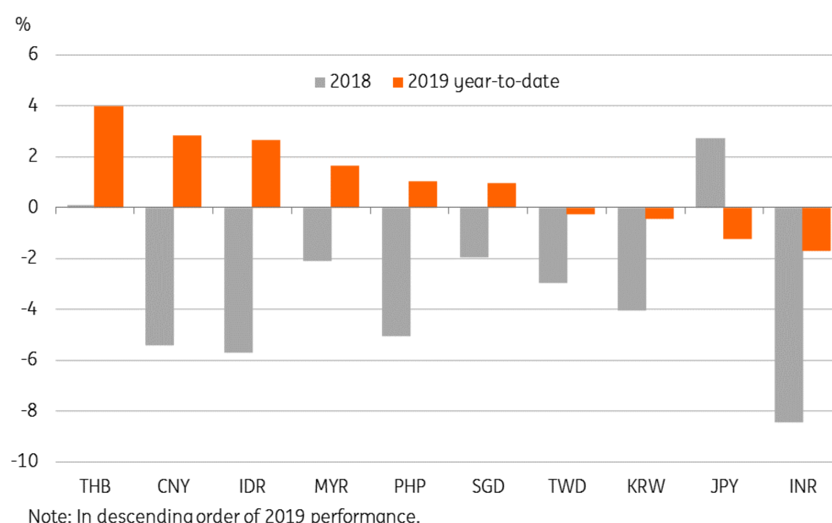
## … thanks to continued policy accommodation

We aren't anticipating a near-term departure of monetary or fiscal policy from the current accommodative stances. Despite the sustained hawkish tone, the BoT has flagged policy to be data-dependent and yet likely maintaining an 'accommodative' bias for this year. We don't see anything significant in the data to cause another rate hike this year, nor do we expect any easing. This view of policy status quo hinges on our forecasts of growth slipping below 4% and inflation hovering around 1% in the current year.

Fiscal policy will remain accommodative, too. The state budget for the current financial year ending September 2019 is set to produce a deficit equivalent to about 2.6% of GDP, a consolidation from 3% in FY2018. But slower GDP growth will likely depress revenue, and together with the surge in election spending, this will see a wider budget gap than projected. However, we don't see anything here threatening the country's investment-grade sovereign credit rating underpinned by still sound external payments.

Still, there are more reasons for the authorities to be worried about the ongoing currency strength, which is detrimental to exports in the current environment of rising global trade protectionism. The BoT views recent THB appreciation as consistent with broader emerging currency trends supported by a dovish turn in US Fed policy and softer US dollar. Moreover, we think the reason for the currency's 4% year-to-date appreciation probably lies in investor confidence about the military Junta maintaining its grip on the government, and thus ensuring political as well as economic stability. Although we aren't ruling out some weakness in the run-up to March elections, the THB will remain investors' darling for the rest of the year.

## THB remains top-performing Asian currency




Source: Bloomberg, ING

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