# Good MornING Asia - 29 October 2018

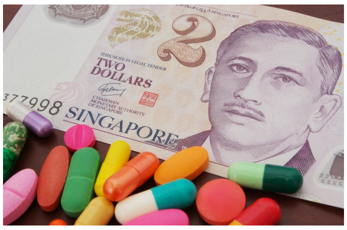
A further end-of-week drop in US stocks sets a poor tone to the start of the week in Asia. German politics adds to concern over the direction of Europe's leading economy, but signs of a mechanism to get Iranian oil back on the market could help keep local interest rates down.

### In this bundle








## Singapore production slows in September

After a good run in recent months, a decline in pharmaceuticals production of 11.1%YoY was not the only drag on Singapore's production growth in...

Opinion | 28 October 2018

# Unhappy Monday

A further end-of-week drop in US stocks sets a poor tone to the start of the week in Asia. German politics adds to concern over the direction of Europe's leading economy, but signs of a mechanism to get Iranian oil back on the market could help keep local interest rates down.

## Circumventing the dollar

A story that has got very little press, probably because it is happening behind closed doors, has received another breath of publicity today. Bloomberg reports that the EU is close to finalizing a deal that will allow Iranian exporters to sell their oil abroad, and buyers to bypass US sanctions. Exactly how this will work, we can't say. Conjecture is of a special purpose vehicle acting as a go-between and potentially using a system akin to barter to avoid settlement in US dollars. But more this we can't say.

What is worth pointing out is that before it began to top out, the primary driver for oil's recent rise was the loss of Iranian crude in the market (see also this from Warren Patterson), coupled with logistical bottlenecks for US shale. Adding back in the 400,000 barrels a day of Iranian crude that has been lost since June this year could see the Brent crude benchmark stabilize at or below $75/bbl. and in line with ING forecasts.

Whilst that is at the higher end of what I think consumers would like, in my view, it takes oil back into the global "sweet spot" where both consumers and producers are doing OK ($65-$75/bbl) - though in reality, both moaning equally (that's just human nature). In particular, this should help those Asian economies with a combination of energy price related current account difficulties, and inflation issues. Amongst others, IDR, INR and PHP stand to benefit.

As an aside, could this be an important crack developing in the USD's reserve currency status? That's a thorny issue and liable to get the sort of angry reaction that stems from writing about BitCoin, or gold prices. So I will just leave that thought dangling...anyone?

## EUR/USD lacking direction

News over the weekend does not seem to have left any clear direction for EUR/USD and consequently, leaves Asian FX somewhat directionless at the beginning of the week (with the exception of the CNY and Asian basket peggers, the equity backdrop seems to be having little effect on Asian FX).

Germany's political fragmentation continued over the weekend in the state of Hesse. And while we may have wondered about the long-term future of the USD as a reserve currency, I'm having difficulty imagining a Europe without the firm leadership of Angela Merkel at its centre. This has ramifications on subjects as diverse as the form of Brexit eventually that emerges, to the possibility of future European reform.

On the plus side, there does seem to be some slight movement on the Italian budget, though probably too little for the EU Commission. But every journey starts with a single step. The net result is EUR/USD still hovering just below 1.14.

## G-20 - will they won't they

As of today, President Xi and President Trump are scheduled to meet at the G-20 to discuss trade, this according to Larry Kudlow. This has been on and off for weeks now. But Kudlow also added that he didn't expect anything meaningful to come of the talks. I don't either. I'm also not sure that it is meaningful that they are even talking. From the US perspective, until China is prepared to talk about intellectual property transfers from joint ventures, there is little to discuss. And from China's perspective, until they have a firmer idea of what the US actually wants. there is not much point in starting talks.

## Asia week ahead

There will be a lot of focus on China data this week. September Industrial profits numbers released over the weekend were poor - showing a rise of only 4.1%YoY, and down from 9.2% in August. This week, we have official PMIs together with the Caixin PMI. The consensus is guessing no further move taking the index through the boom/bust 50 level it reached last month. On the back of the profits figures, this seems optimistic, and our Greater China Economist, Iris Pang, expects the level to be broken, with the Caixin PMI falling to 49.5.

Data out of the US this week in advance of Friday's jobs report will have to do the talking as the US Federal Reserve is in the blackout period ahead of the 9 November rate meeting. Markets are beginning to doubt the 2019 hiking story again given the equity backdrop. But I don't think the Fed is ready to change course yet,

And from Prakash Sakpal: The Pakatan Harapan coalition government is due to unveil the 2019 Federal Budget this week (2 November). Significant policy changes such as the elimination of

Goods and Services Tax have derailed a decade-long fiscal consolidation. We expect this to push the fiscal deficit above 3% of GDP in 2018 and keep it there in the coming years. Yet, with the expectation of continued monetary policy accommodation for a prolonged period, the macro policy mix still remains healthy.

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# ASEAN Morning Bytes

General market tone: Risk-off Risk off tone continued to dominate as global growth concerns trumped still robust growth numbers out from the United States


## International theme: Risk assets backpedaled further with earnings failing to inspire

- Despite reporting a better-than-expected growth print in the US, risk assets were hit as investors continue to fret over a weaker outlook in the coming months.

## EM Space: Asia seen to slide as tech rout persists

- **General Asia:** Asian equity markets will likely remain rattled on Monday with investors reacting to the sell-off on Wall Street with tech shares pressured. Persistent fears of a slowdown in global growth hurt risk appetite with the outlook on earnings turning less optimistic despite the decent earnings season.
- **Malaysia:** The government unveils the 2019 Federal Budget this week (2 November). Significant policy changes such as the elimination of goods and services tax have derailed a decade-long fiscal consolidation. We expect this to push the fiscal deficit above 3% of GDP in 2018 and keep it there in the coming years. Yet, with the expectation of continued monetary policy accommodation for a prolonged period, the macro policy mix still remains healthy.

- **Indonesia:** Bank Indonesia (BI) expects growth to slow with GDP now expected to slip below 5.2% by year-end. Meanwhile, inflation is seen to remain stable with full-year projections at 3.5% while the current account deficit is expected to settle below 3% by the end of the year. BI is also reiterated its tightening stance to safeguard the economy from risks emanating from trade tensions, global geopolitics, and the Fed rate hike cycle.
- **Philippines:** Pump prices were rolled back for a third straight week on Monday with signs pointing to our expectations that inflation had peaked in September. Gasoline prices are seen to fall PHP1.5 while diesel will drop by PHP 0.6 to reflect the sustained dip in crude oil. The sentiment appears to be echoed by BSP's Governor Espenilla who indicated that perhaps only a “moderate” rate hike was needed for the balance of the year to anchor inflation expectations. Thus we continue to expect only a 25 bps rate hike, most likely at the December meeting to anchor expectations going into 2019.
- **Philippines:** Although food prices have begun to normalize in recent weeks after augmentation to supply of fresh fruits, vegetables, and rice, another super typhoon barrels down on the northern portion of the Philippines which could cause renewed crop damage and disrupt supply chains further to stall the recent downtrend in food prices and inflation. This supports our view that although inflation is seen to decelerate, it may be a gradual slide in price pressures but we continue to believe that inflation had peaked in 3Q.

## What to look out for: trade war traces with global export numbers due

- US core PCE (29 October)
- EZ 3Q GDP (30 October)
- US consumer confidence (30 October)
- AU CPI inflation (31 October)
- CH PMI manufacturing and services (31 October)
- TH trade balance (31 October)
- EZ core inflation (31 October)
- US ADP employment (31 October)
- BoJ policy meeting (31 October)
- SK CPI inflation (1 November)
- SK trade balance (1 November)
- AU trade balance (1 November)
- TH CPI inflation (1 November)
- ID CPI inflation (1 November)
- BoE policy meeting (1 November)
- US PMI manufacturing (1 November)
- MY 2019 Budget (2 November)
- US Non-farm payrolls (2 November)

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# Malaysia 2019 Budget Preview – A derailed fiscal consolidation

Sweeping policy changes under the Malaysian government's drive to improve people's standard of living and drive out political corruption have strained public finances. We expect this to push the fiscal deficit above 3% and keep it there through 2019

Malaysian Prime Minister, Mahathir Mohamad

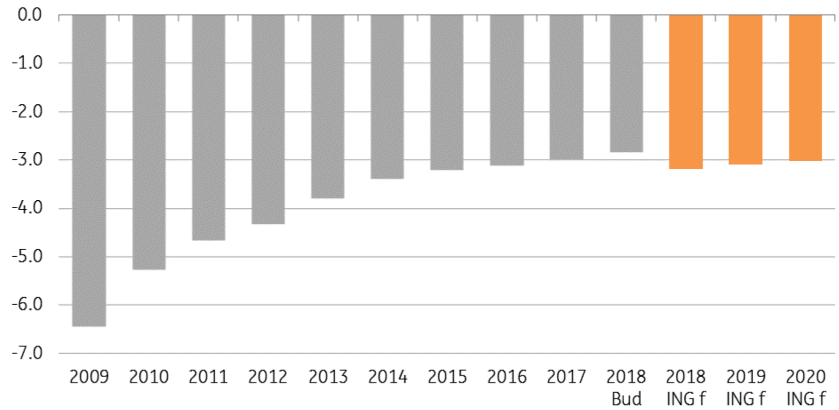
## Long-term inclusive growth, sustained development

The Mid-term Review of the 11th Malaysia Plan 2016-2020 (11MP) unveiled by Prime Minister Mahathir earlier this month (18 October) sets a clear tone for the upcoming Federal Budget for 2019 – a derailed fiscal consolidation. The first budget of the Pakatan Harapan [Alliance of Hope] coalition government will be presented to the parliament by Finance Minister Lim Guan Eng on Friday next week, 2 November.

As per the 11MP review, the fiscal policy by the new administration will be driven by objectives of an 'inclusive growth and sustained development'. As tighter fiscal stance and risk from global trade tension slam the breaks on the economy, the government has downgraded GDP growth target for the remaining plan period, 2018-2020, by half a percentage point, from 5-6% in the original plan to 4.5-5.5%. The target for inflation is also revised slightly from 2.5-3% to 2-3%. And, contrary to the earlier target of a balanced budget by 2020, the fiscal deficit is now projected at 3% of GDP over the plan period.

Notwithstanding its drive to rein in high public debt the focus remains on continued fiscal consolidation. Yet the year 2018 will see the trend of steadily falling fiscal deficit underway since 2009 coming to an end; the deficit hit a record 6.7% of GDP in 2009 and has more than halved to 3% by 2007 (see below). The initial budget for 2018 under the previous administration had projected a further fall in the deficit to 2.8% this year. That's not going to materialise.

## A decade-long fiscal consolidation coming to end - fiscal deficit (% of GDP)




Source: CEIC, ING

## Sweeping policy changes – elimination of GST and more

The economic policies took a significant turn, either for good or bad, after Dr Mahathir's coalition took over the helm in May this year. Keeping with its election agenda of boosting people's standard of living and cleaning the corrupt political machinery, the new administration launched sweeping policy changes. The most prominent among these are elimination of Goods and Services Tax (GST), replacement of GST with SST (Sales and Services Tax), and suspension of mega investment projects undertaken by the previous government in collaboration with foreign governments (China, Singapore, etc.). These policies certainly will have an adverse bearing on the fiscal situation in the current year and beyond.

The Finance Minister, Lim Guan Eng, is on record as saying that it would be "foolish" for the current government, which took power in May, to abide by "unrealistic" fiscal targets set by the previous administration. The policy shift makes the target of limiting the deficit at 3% a challenging task for the government as heightened global economic risks – the trade war, geopolitics, and emerging market routs – will undermine Malaysia's economic performance. As can be conjectured from the 11MP ditching of the balanced budget target, and holding a 3% line on the deficit over the remaining plan period, the fiscal deficit will have surged past the 3% mark in the current financial year itself and will likely prevail above that level in the medium-term.

*Limiting the deficit at 3% will be challenging*

A strong run for the economy in 2017, with close to 6% of GDP growth, and through the first quarter of this year and a boost to petroleum revenue from higher oil price might have supported total government revenue in the current year. Indeed, the 10% year-on-year revenue growth in the first half of 2018 compares with 0.8% growth in the same period last year. The growth of operating government spending also accelerated to 6% from 1.5% over the same period, though it was offset by slower development spending to -0.7% from 1.9%. This left the fiscal deficit at 4.5% of GDP in the first half of the year, not unusual for the period yet raising the risk of an overshoot in the full-year deficit.

However, the real hit to the budget will have started after the removal of the GST in June, while the overall economic performance also started to weaken from the second quarter of the year - a double whammy to government revenue. The launch of the SST in September will make up for some of the GST revenue loss, but not all.

On the spending side, PM Mahathir has assured steady operating expenditure in a drive to fulfil election promises. The suspension of public investment projects will have kept development expenditure well under MYR 46bn planned in the original budget, of which only less than half was incurred in the first half of the year. While the revenue loss from consumer tax reforms will far outweigh saving on development spending, weak investment will further compound GDP growth slowdown and pressure the deficit in relation to GDP higher.

With this backdrop, we anticipate fiscal deficit in the current year rising to 3.2% of GDP from 3.0% in 2017.

## What's in store from the 2019 Budget?

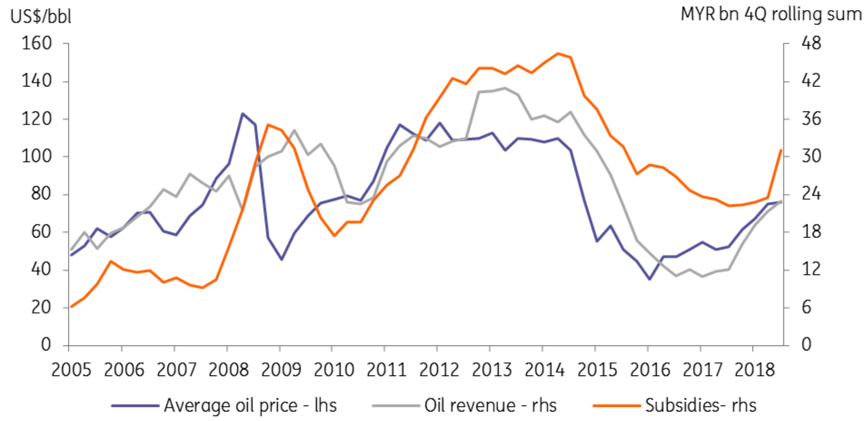
The forthcoming budget will set the course for the fiscal policy in the coming years. And, in all likelihood, it will be a tightening rather than easing. Here are some of the revenue and spending side factors deserving attention in the 2019 budget formulation:

- The tighter fiscal policy stance combined with sustained external risk suggests Malaysia's GDP growth will remain under pressure in 2019, more likely staying close to the low end of 4.5-5.5% target.
- Slower GDP growth will be associated with a continued slowdown in government revenue in 2019, while the MYR 23bn revenue gap left consumer tax reforms – MYR 44bn loss from the elimination of the GST as against MYR 21bn revenue from SST – will need to be plugged. However, the loss to the government is gain to the people. And the increase in household disposable income will sustain private consumption as a strong driver of GDP growth in the next year.
- Just a few weeks ago PM Mahathir signalled introduction of new taxes as well as the sale of assets to boost the revenue and curb the debt. However, media reports suggest some of the widely talked new taxes -- capital gains and inheritance taxes, as well as an extension of SST net to online business (digital tax) – might not be part of the 2019 budget. Indeed, they will need a thorough public consultation before implementation.
- Higher oil price will be the key positive for the economy and the public finances. It will not only soften the impact of the global trade war on Malaysian exports but also will increase the petroleum revenue to the government (see below). But a high oil price also means higher government expenditure on fuel subsidies to the public. The reports of $70 per barrel oil price assumption for the 2019 Budget may be an understatement in view of the current

level of about $80 per barrel, and the likelihood of geopolitics keeping it on the upward pressure in 2019.

- While the plan to significantly cut down on public debt, estimated over MYR 1 trillion (80% of GDP), over next two years faces headwinds from slower revenue growth, the cancellation costs of some of the infrastructure projects undertaken with other countries could blunt the debt reduction efforts. Moreover, the drive to cut down on development spending also bodes ill for the overall economic outlook.

## Higher oil price raise government revenue but also lift spending on subsidies




Source: Bloomberg, CEIC, ING

## Still, a healthy policy balance overall

We think the pressure to bring public finances back on track to consolidation without hampering economic prospects, especially in an environment of elevated external economics risks, will be a challenging task for policymakers in the near-term. We expect the budget deficit to remain elevated above 3% in coming years, with our forecast of 3.1% of GDP for 2019 and 3% for 2020.

*Hopes are also pinned on higher oil prices*

The downside risk to our deficit forecast stems from a significant reduction in development spending, though that also means a greater downside GDP growth risk. The hopes also are pinned on higher oil price providing positive terms of trade shock to Malaysia's net oil exporting economy, while the economy continues to be largely driven by domestic demand that will get further support from consumer-friendly tax reforms as well current low level of inflation. We maintain our 4.5% GDP growth forecast for this year and revise the forecast for the next year slightly downward to 4.6% from 4.8%.

We believe the lower inflation allows for some policy balance, by letting the central bank (Bank Negara Malaysia) to maintain an accommodative monetary policy stance as the government has now embarked on a fiscal tightening to rein in the large public debt burden. We expect inflation to average around 1% this year and to come in at the low end of the 2-3% official medium-term target in 2019.

The MYR has weakened to almost a year-low level against the USD of 4.18 on growing fiscal jitters ahead of the 2019 budget presentation next week. However, with sufficiently positive real interest rates the MYR should retain its year-to-date Asian outperformer position over the rest of the year. We consider our end-2018 USD/MYR forecast of 4.20 subject to upside risk, while we expect the pair to hover around that level through most of 2019.

## Malaysia - Key economic forecasts

| Malaysia | 2015 | 2016 | 2017 | 2018F | 2019F | 2020F |
|---|---|---|---|---|---|---|
| Real GDP (% YoY) | 5.1 | 4.2 | 5.9 | 4.5 | 4.6 | 5.0 |
| CPI (% YoY) | 2.1 | 2.1 | 3.8 | 1.0 | 2.0 | 1.9 |
| Fiscal deficit (% of GDP) | -3.2 | -3.1 | -3.0 | -3.2 | -3.1 | -3.0 |
| Current account (% of GDP) | 3.0 | 2.4 | 3.0 | 2.1 | 1.8 | 1.6 |
| BNM o/n policy rate (%, eop) | 3.25 | 3.00 | 3.00 | 3.25 | 3.25 | 3.50 |
| 3M interbank rate (%, eop) | 3.84 | 3.41 | 3.44 | 3.70 | 3.80 | 3.90 |
| 10Y govt. bond yield (%, eop) | 4.19 | 4.23 | 3.91 | 4.30 | 4.30 | 4.00 |
| MYR per USD (eop) | 4.29 | 4.49 | 4.05 | 4.20 | 4.18 | 4.05 |

Sources: CEIC, Bloomberg, ING forecasts

Source: Bloomberg, CEIC, ING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Snap | 26 October 2018

Malaysia

# Malaysia: A negligible sales and service tax impact on inflation

Persistent low inflation allows for some policy balance, by letting the central bank (BNM) maintain an accommodative monetary policy stance as the government has now embarked on fiscal tightening to rein in the large public debt burden


Source: Shutterstock

Low inflation, increased downside growth risks and yet an outperforming Malaysian ringgit (MYR) have been the factors behind our view that the central bank (Bank Negara Malaysia) will be under no urgency to change monetary policy anytime soon.

The MYR has weakened to almost a year-low level against the USD of 4.18 on growing fiscal jitters ahead of the 2019 budget presentation next week. However, with sufficiently positive real interest rates the MYR should retain its year-to-date Asian outperformer position over the rest of the year. We consider our end-2018 USD/MYR forecast of 4.20 subject to upside risk.

# 0.3%

September CPI inflation

Lower than expected

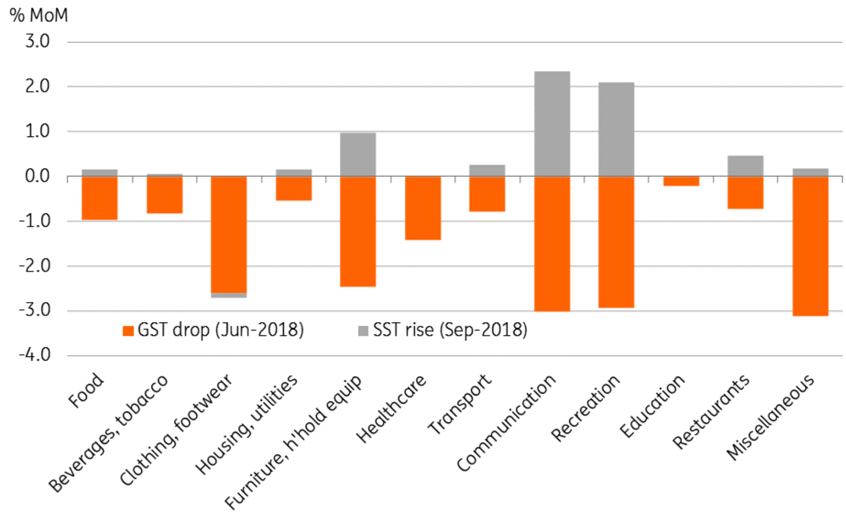
## Little sales tax impact on consumer prices

The launch of the Sales and Services Tax (SST) in the last month in place of the Goods and Services Tax (GST) that was repealed in June didn't come as a big push to consumer price inflation. Inflation of 0.3% year-on-year in September was only a tiny uptick from August's 0.2% print, and below our estimate of 0.5% and that of consensus of 0.5%.

As the chart below shows the SST impact was negligible across most CPI components, except communication and recreation though these also failed to offset the GST related dip in June and the year-on-year increase in both these components continued to be negative.

Among other things keeping inflation subdued are the high base effects in the key CPI components of food and transport prices. Year-on-year food inflation is running at its lowest level in almost two decades, 0.5%, while transport inflation dipped to 0.3% in September from 2.1% in August. At 0.3%, core CPI inflation remained converged on the headline inflation.

## Impacts of GST removal and SST implementation by CPI component




Source: Bloomberg, ING

## Continued benign inflation outlook through 2019

The year-to-date inflation rate of 1.2% YoY is a significant deceleration from 3.9% a year ago. Inflation may have bottomed, though there isn't going to be an upward thrust emerging until the consumption tax impact moves out of the base of comparison. That's unlikely to happen until after mid-2019.

We consider our 1.0% full-year 2018 inflation forecast at risk of a downside miss. And we expect inflation in 2019 to remain close to the low end of the 2-3% official medium-term forecast. Persistent low inflation allows for some policy balance, by letting the central bank (BNM) maintain an accommodative monetary policy stance, as the government has now embarked on fiscal tightening to rein in the large public debt burden

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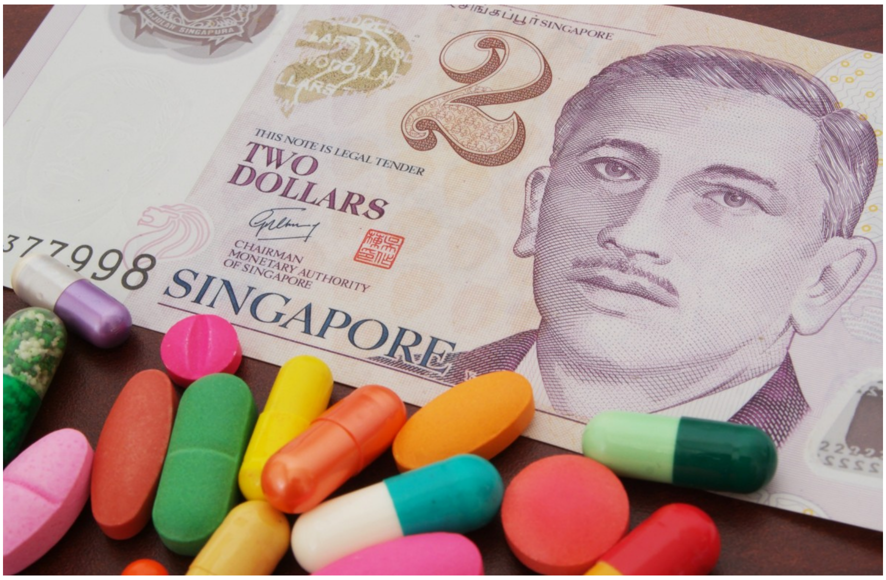
Snap | 26 October 2018

# Singapore production slows in September

After a good run in recent months, a decline in pharmaceuticals production of 11.1%YoY was not the only drag on Singapore's production growth in September. Semiconductor production also fell (the broader electronics category also registered falls), and petrochemicals fell 14.3%YoY worsening a 2.3% fall in August.

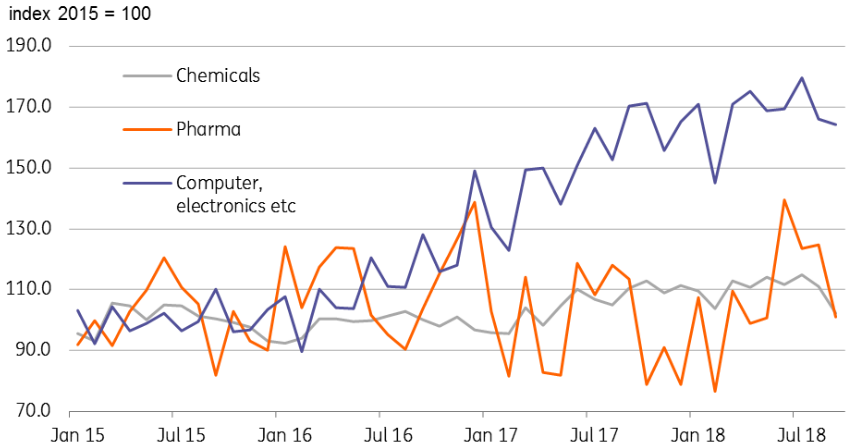



## Across the board declines spell a downgrade to GDP growth

The breadth of the weakness in September 2018 industrial production is surprising mainly in that it hasn't happened earlier. There have been clear signs of a slowdown in many production sectors in recent months, but until now, there has usually been one sector, or sometimes two, that put in a heroic performance and kept the overall index from slumping on the month.

But not this month. The big change was pharmaceuticals. This has been the clear outperformer this year, but it has finally dipped sharply. With few other sectors picking up the slack (a massive percentage leap in marine engineering is unfortunately too small in absolute terms to overturn the outcome) the result was a disappointing 4.9%MoM decline for a -0.2%YoY growth rate.

## Singapore industrial production by major group



Singapore Production by major group

## Consensus overestimated - now GDP will be revised lower

The consensus estimate for this figure had been a 3.5%YoY increase. Our own forecast was closer to the mark (ING f -1.0%YoY) which derived from the earlier softness of non-oil domestic exports, which provides an unreliable, but in this case accurate lead over the production figures.

Plugging in the new production data into our GDP estimates, we now think that the preliminary 2.6%YoY estimate for 3Q18 GDP will be revised down to 2.4%. Assuming that Singapore grows at a similar pace in 4Q18, we now see full-year growth of 3.3%, consistent with the MAS' forecast of growth for 2018 in the top half of a 2.5% to 3.5% range. However, next year, we anticipate growth slowing to only 2.2% as trade frictions bite.

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