Good MornING Asia - 30 April 2020

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Pills

Hands off Mr Spock

I was always more of a "Trekkie" than a Star Wars aficionado, which sets me at odds with the rest of my family on yet another score. So I'm a little uncomfortable with the appropriation of Star Trek terminology to describe the latest efforts to beat the coronavirus.

President Trump's "Operation Warp speed" goals are, however, admirable. He aims for the US to be in a position by next year not only to have found a vaccine but to be able to distribute large quantities of it to the population. That, and the coordinated nature of this programme, which will combine a great many trials under one umbrella, is helpful.

But once again, I think equity markets are getting ahead of themselves on a day when the run of news was actually pretty negative. Firstly, it is still worth bearing in mind that this virus may not lend itself to a vaccine. It is not a given. It's not simply a question of how much money is spent or just a question of time. It may not be possible, or it may offer only very limited protection. Above all, bear in mind that "warp-speed" is a concept of science fiction, and in direct conflict with Einstein's theory of General Relativity. Most physicists still agree that this is the best explanation of the universe we have, subject to the caveat that it delivers no Grand Unifying Theory of gravity linking to the standard model of quantum mechanics.

The other rather odd event yesterday was Dr Anthony Fauci going live with the positive results of a trial of the antiviral drug, Remdesivir before the trial had been peer-reviewed. The previous trial in China published in the Lancet had shown no statistically significant benefit to the drug. So if the US trial provides a completely different outcome, it is interesting, but also possibly means that the benefits are somewhat marginal. Fauci talks of a 4-day improvement in recovery speeds. I'll wait for the peer review before concluding if this is good science or not. Equity markets aren't so picky.

The peer-reviewed GDP numbers were horrible

In contrast to the possibly absinthe-fueled optimism of the equity market, the gin-soaked reality of the US 1Q GDP decline of 4.8% might well have delivered a different market result on a day when the Federal Reserve also met. Fed Chairman Powell delivered the sobering assessment that we may be looking at some long term damage to the economy from this pandemic and the mitigating measures taken to reduce its impact on the population.

In time, I think we will be faced with a nasty hangover from the equity market's constant sipping at the well of optimism.
Reality has a way of biting you when you least expect it. But for now, it's hard to push back at this stock recovery.

Still, remember, this is a long game. We have a full quarter of horrific data to endure. 1Q20 GDP will have been far less awful than the 2Q20 GDP data to come. And the Fed has basically done everything it can do, whilst Congressional stimulus is getting rapidly consumed.

My colleague James Knightley has been busy writing all this up - read this for his views on GDP and this, for his take on the Fed meeting.

Asian news

In terms of today's data releases in Asia, we get official PMIs this morning from China. Iris Pang writes "We expect China's PMIs to deliver a reading slightly below 50 reflecting lower input prices and more inventories. Taiwan will also publish its first-quarter GDP growth. We expect a small positive figure of 0.6% following Taiwan's successful early measures on preventing the spread of Covid-19, but weak consumption due to social distancing measures".

Iris also notes" China's Two Sessions will start on 21 May. The market is looking to see if an economic growth target will be announced. We believe that the description of GDP growth for 2020 will be rather fluid without mentioning any particular number. Instead, we expect the economic report to announce a concrete fiscal stimulus amount. Our estimate of the fiscal stimulus is 6% to 8% of GDP".

Prakash Sakpal also adds this on Singapore and Thailand:

"**Singapore:** A 2.4% unemployment rate in 1Q20 wasn't so bad (consensus 2.6%) but it was still an uptick from 2.3% in the previous quarter. More importantly, the 19.9k fall in jobs was the steepest since the SARS pandemic in 2003 and almost half of that was in services. The jobless rate hit a record of 4.8% during SARS. Hopes are pinned on the government's aggressive policy stimulus averting a retest of that level in the current crisis.

Thailand: Manufacturing output plunged by 11% YoY in March- more than expected. We now see as much as a 5% YoY GDP contraction in 1Q20, steeper than our earlier view of a 2.2% fall. Two months of a state of emergency means an even deeper GDP fall in 2Q, by over 8%. We also revise our full-year 2020 growth forecast to -5.4% from -4.3%. We see no reasons why the Bank of Thailand's policy rate shouldn't fall further, at least by another 50bp from 0.75% currently, as inflation has also moved into negative territory and is likely to stay there for a long time to come".

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ASEAN Morning Bytes

Fed warns of unprecedented slump in 2Q, calls for more aid to bolster the economy.

EM Space: China PMI data could give market more direction after sobering US GDP report

- **General Asia:** Fed Chair Powell warned of an even deeper 2Q GDP drop after 1Q GDP data showed the US economy contracted by 4.8% as he called for more fiscal stimulus to help offset the economic slump. Despite the dismal economic numbers, market players may opt to react to earnings reports and developments on the Covid-19 front although upcoming economic data should remind investors of the economic gloom ahead. China PMI numbers should give trading additional direction on Thursday with attention also focused on virus testing capability, which will be crucial for states and countries to determine the pace of reopening after lockdowns.
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- **Philippines:** Finance Secretary Dominguez flagged a tax collection shortfall of Php300bn as economic activity fades significantly in 2020 but expressed confidence in the government's ability to source Peso funding to make up the shortfall. Meanwhile, Dominguez pushed back on bailing out businesses using state funds indicating he favoured offering support to banks to help businesses get through the crisis. The government has touted its infrastructure program and tax reform agenda as integral to the Covid-19 response efforts but has been shy about upsizing the budget for fiscal stimulus to offset the economic downturn.
- **Indonesia**: Bank Indonesia (BI) Governor Warjiyo indicated that bond yields continued to be too high and that the IDR remained undervalued, reiterating that IDR would close the year at the 15,000 level. The central bank stepped up support for the IDR via its triple intervention while also utilizing its ability to purchase government bonds in the primary market. Warjiyo also indicated that he does not think that inflation will be a problem in 2020 but we maintain that BI will not have ample scope to cut policy rates further until IDR stabilizes.

What to look out for: China PMI and Covid-19 developments

- Philippines remittances and GIR (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)

RBNZ: Keeping it positive

Markets seem to be getting ahead of themselves, as expectations have risen for a move to zero or even negative rates at the Reserve Bank of New...

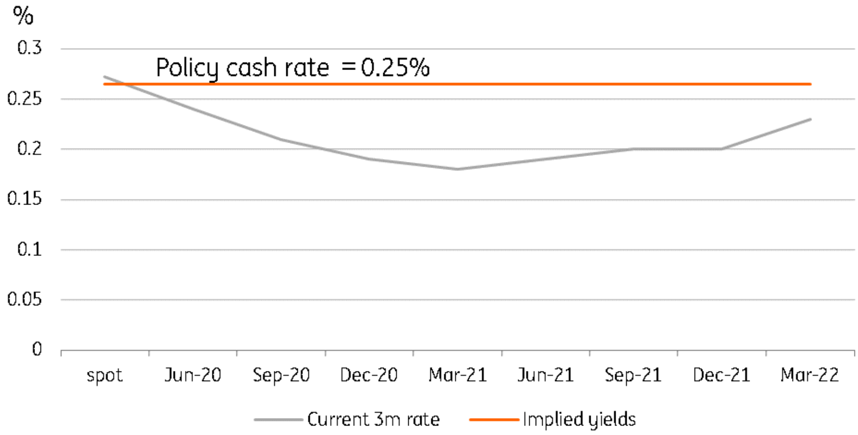
RBNZ Governor, Adrian Orr

Markets don't like inaction

Bank bill futures in New Zealand have dropped precipitously in the last month, taking them well below the 25 basis point official cash rate set by the RBNZ at their 16 March meeting, when they cut rates by 75bp. Back then, the end of year implied rate from bank bill futures was 0.77%, so not much term premium over the official cash rate, but basically in line with it, plus a small spread of a few basis points.

Today, the end of year implied rate is 19bp, fully 6bp below the official cash rate. Should we be pricing in a cut in rates to zero or even negative rates?

Implied rates and current 3m rates



Source: Bloomberg, ING

Maybe, but probably not

The arguments in favour of such a change in policy boil down to Governor Adrian Orr's open-minded attitude to all manner of policy responses.

He has said that he will not rule out negative rates. He has also said that he would not totally dismiss direct monetisation of the deficit. Markets seem to be viewing this as a signal of policy direction.

But it looks to us as if, and not for the first time, the market is caught up with its own momentum, and has lost sight of the drivers of RBNZ policy.

NZ outlook is one of the best in APAC

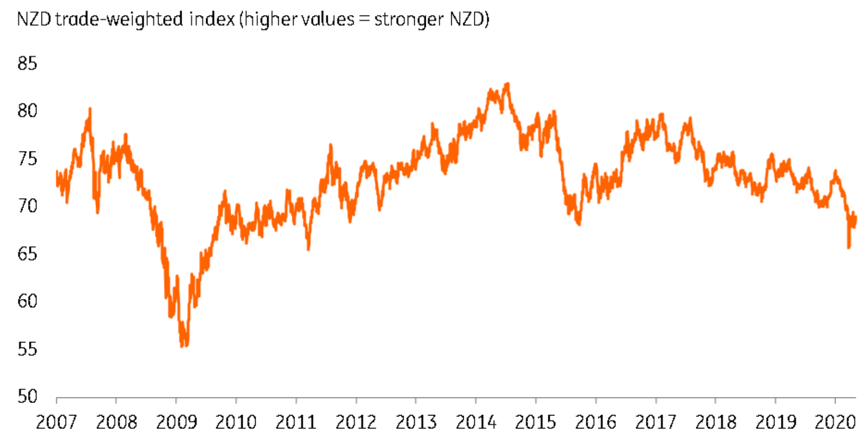
Recent RBNZ policy has been all about responding to the Covid-19 outbreak. Certainly, the NZ lockdown will have hurt economic activity, but as of 28 April, the lockdown ended. New cases are very low and their sources well understood. This isn't to rule out a second wave, but for now, it does look as if the country has managed to deliver a way out of lockdown with minimum economic disruption, and a return to growth in 2Q now looks very likely.

So given that the macro outlook has clearly improved, the macroeconomic rationale for adopting either negative rates or direct monetisation looks extremely weak. But could there be a currency argument?

NZD: Weak, but not weak enough

The RBNZ does not openly mention the exchange rate as part of its objectives. Indeed, as the currency normally depreciates during global economic downturns, it works as an automatic shock-absorber to the export-oriented economy.

This time, however, things are a bit different. While it is true that the NZD has lost around 5% on a trade-weighted basis (chart below) since the Covid-19 outbreak became public (late January), the RBNZ may be worrying about the faster than expected rebound in its currency. In 2008, the NZD depreciated by some 30% on a trade-weighted basis and did not rebound until early 2009.



Source: RBNZ, ING

The Bank may not be comfortable with a recovery in the NZD just yet, as they recognise its role in keeping exports attractive in global markets, as the New Zealand economy tries to work its way out of the sharp downturn. Whether this currency-related concern (which would still likely remain implicit) will be enough to make a somewhat risky move into negative rates, is a different question. In our view, it is more likely – if anything – that the Bank will maintain some sort of ambiguity about additional easing, hoping it will be enough to slow the recovery in the currency.

Crossing the event horizon

Even if there were a stronger argument for easing policy further, which looks questionable, negative rates or direct monetisation are two policies that come with considerable baggage. As Orr himself remarks, direct monetisation is a good way to lose market credibility. So yes, you might "win" on a weaker currency, but you may well "lose" on your government bond market.

As for negative rates, Europe is perhaps the best advertisement for NOT going down this route. Closer to home, Australia has in fact ruled them out, noting not only that they may do more harm than good, but also how difficult it seems to be to undo them once in place. This "event horizon" feature of negative rates seems as good a reason as any for not doing something which a) seems patently unnecessary at this time, especially when b) other alternatives remain available.

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Article | 29 April 2020 Thailand

Thailand: Further downgrade to GDP growth forecasts

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Source: Shutterstock

11.3%

March manufacturing fall

Year-on-year

Worse than expected

Dismal March manufacturing data

Manufacturing output contracted by 11.3% in March from a year ago, a steeper fall than the consensus estimate of -6.7%. The sharp fall can be explained by the high base effect, as output rose 2.9% on the month.

The recovery from the Lunar New Year-related slack in the first two months of the year and some front-loading ahead of the Thai New Year (Songkran) holiday in April generally make March a strong growth month, with double-digit month-on-month surges. It was less strong this year with only a 2.9% MoM rise, much of which could be traced to firmer exports rather than domestic demand. The Covid-19 outbreak has virtually halted tourism, the backbone of the economy, and through that, domestic spending.

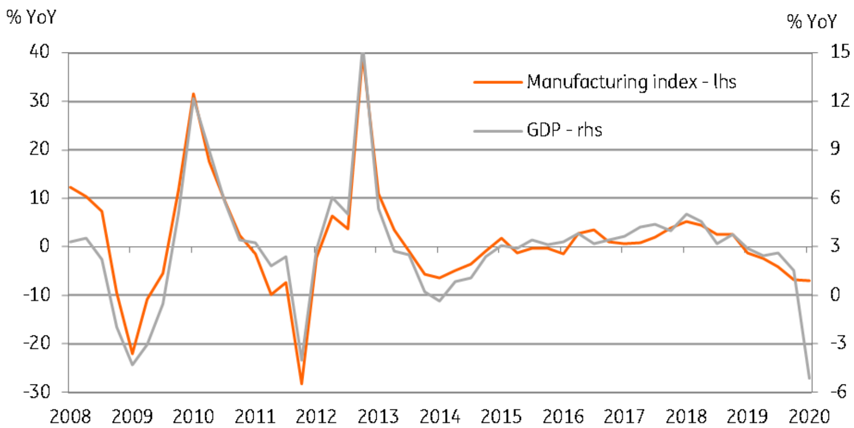
The sector breakdown was not available at the time of writing, though we think autos and parts remained the weak spot, judging from the over 40% YoY crash in vehicle sales in the last month. Press reports also point to sugar and refinery productions as drags.

It means deeper GDP contraction

The March fall brings the cumulative 1Q20 manufacturing fall to 6.9% YoY. While this is little changed from the rate of fall in 4Q19, a significant dent to services activity likely pushed overall GDP growth into negative territory in the last quarter. Or rather, more deeply into negative terrain than we had thought earlier. We now estimate that GDP contracted as much as 5% YoY in 1Q, more than double our previous view of -2.2% (data due in mid-May).

This is the steepest GDP fall in almost a decade, since the last quarter of 2011 when the severe floods hit the economy hard with a 4% YoY GDP fall. It's going to be worse in the current quarter as two months of a state of emergency, until the end of May, will prove to be a much bigger dent to activity in both manufacturing and services. We expect the GDP decline to accelerate to -8.3% in 2Q20 and the full-year decline to be -5.4% in 2020, downgraded from our earlier forecasts of -7.7% and -4.3%, respectively.

Manufacturing-GDP growth disconnect



Source: CEIC, ING

Quarterly data. ING estimates for 1Q20.

And, demands more policy support

Fiscal policy has taken the lead with over 8% of GDP in real spending aimed at softening the Covid-19 impact. Monetary policy isn't far behind with an increased thrust on soft loans, market stabilisation funds, and other support measures. But the latest data, including a return to a negative inflation trend, also screams out for more central bank easing. We expect the Bank of Thailand to top it up with an additional 50 basis point rate cut this quarter, taking the policy rate to an all-time low of 0.25%.

However, the increasing policy support comes against a backdrop of record low consumer and business confidence, keeping the economy on course for a deep slump this year.

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