Good MornING Asia - 30 July 2020

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By Robert Carnell

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Manufacturing index

BoK survey (August)

BoK's business survey rises strongly

Korea's strong handling of the Covid-19 pandemic and avoidance of widescale lockdowns has given it an advantage in the recovery race, allowing domestic demand to bounce back more strongly than its restricted regional peers. But the latest ("August") business survey from the Bank of Korea suggests that the good news is now more broadly spread, with exporters also seeing an improvement.

The headline index for manufacturing firms (non-seasonally adjusted) rose to 57 from 51 the previous month, and sub-indices for exporters show the index at a punchy 68, up from 60. We don't have a sector breakdown of this, and my guess is that this is dominated by semiconductor firms. But still, a rise is better than a fall.

Strength in the survey was evident across most indices, with sales, production and new orders all rising, and inventories marginally declining (suggests production gains are sustainable). There was even some suggestion of a return of pricing power, as the sales price index rose fractionally more than the purchase price index. Cash flow indices also improved. The only fly in the ointment was a small decline in the employment index.

Non-manufacturing firms also registered gains, but having been ahead of the manufacturing sector in this recovery, the gains were more muted, even though the level of the index is higher (60, up 1 from 59 the previous month - non seasonally adjusted).

We had already concluded that the BoK was done with easing this cycle. It is still far to soon to start thinking about any reversal of monetary easing, but the improved data could set up the KRW for a renewed push through 1190 for a run at 1180, which is a level it last saw back in early March.

The economy is ruined - buy stocks!

James Knightley has written up the latest FOMC meeting here, and all I want to add is my own irreverent take on the proceedings.

Chair Powell gave a pretty downbeat assessment of the economy and noted the mounting risks to growth. The implication from all of this is that policy will remain very accommodative for a long time. But we knew that, and the warning from Powell that markets are still expecting too smooth a recovery, rather than injecting a note of caution into their behaviour, seems simply to have provided another excuse for them to rally on the notion that the gravy-train of free money will be around for years.

Let's be clear, there is no hint of ***more*** easing unless you are focussing on the circus of new fiscal stimulus spending. But as I noted yesterday, if you are currently in receipt of supplemental unemployment benefits in the US, what you are really facing is a pay cut, not a pay rise, the only questions remaining to be answered are, when, and how big? That doesn't sound particularly "risk-on" to me.

We also got no change in the Fed's overall strategy - so all the talk of price-level targeting and running inflation "a little hot", can wait for another day. The received wisdom is that we will hear more about this in September. This remains, in my view, an irrelevant discussion about an unattainable target. If we can't hit 2% inflation with the current stance, then we certainly won't be able to exceed it. And I suppose If they are seriously going to try (I don't think they should), then that does suggest we ought to consider the possibility of even more extreme policy measures including negative rates in due course. Remind me to buy some more physical gold this weekend...

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Hong Kong: Revising GDP down further

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Source: Shutterstock

Economy was still bad in 2Q20

GDP contracted 9.0% year-on-year in 2Q20 after a revised fall of 9.1% YoY in 1Q20. The contraction was mainly due to weak consumption from Covid-19 and social distancing measures, and that triggered a drop in investment due to a worsening economic outlook.

- Due to Covid-19, consumption contracted 14.5% YoY in 2Q20 after -10.6% YoY in 1Q20.
- Investment shrank 20.6% YoY in 2Q20 after a 15.8% contraction in 1Q20.
- Exports of goods shrank 2.1% YoY in 2Q20 less than the contraction of 9.7% to 1Q20.
- But exports and imports of services, which are mostly tourism-related services, fell 46.6% YoY and 43.5% YoY, respectively. Both were worse than the contraction of 37.4% YoY and 24.5% YoY in 1Q20, respectively.
- Government spending increased 9.8% YoY 2Q20 after an 8.8% rise in 1Q20.

Expect another bad quarter in 3Q20

Covid-19 cases have increased in Hong Kong, and there could be many sources that are hard to trace. The government has tightened further social distancing measures again since the outbreak, which the health department claimed could be due to the previous relaxation of social distancing measures.

Focusing first on the most recent social distancing measures, the number of people that can gather together is two, and all restaurants can only serve takeaways, i.e. there is no dining-in allowed and all people have to wear a mask in public areas, both outdoors and indoors.

The direct impact is a big hit to catering businesses, especially the small ones that have little flexibility when it comes to takeaways. Even if restaurants are able to arrange food deliveries, they still have to pay high rents. Construction work could also slow down until October as wearing masks outside in Hong Kong's hot summer temperatures means that workers will likely need to rotate shifts more to allow for periods of rest.

The indirect impact is that, with more cautious sentiment, consumers in general are now more reluctant to go shopping in streets and malls, and more have chosen to stay at home. This will hit most consumer-based services, e.g. hairdressing, and many physical stores though shopping online and using online food delivery services will be more common. Investment by businesses will also be very weak due to the lack of demand locally. As mentioned above, construction activities will be slow and therefore real estate investment will continue to be very weak.

With the number of Covid-19 cases continuing to rise or stay at high levels, it is very difficult to see the restart of outbound tourism activities to and from Hong Kong. Airlines, travel agencies, hotel accommodation will continue to remain in bad shape.

Re-exports and imports will continue to grow with external demand in 3Q20. But the uncertainty lies in the number of Covid-19 cases in the rest of the world.

The economy could be even worse if there is no further help from the government, as the unemployment rate is expected to rise.

Revising forecasts downward

We expect Hong Kong GDP growth to be -10% in 3Q20, -5% in 4Q20 and -8.3% for the full-year, assuming that the tight social distancing measures continue to stay in place. This assumption is based on the lesson learned from the previous relaxation of social distancing measures, which suggests that Covid-19 could spread rapidly.

The unemployment rate is expected to rise to 8% in 3Q20 from the latest 6.2% for April-June 2020 period.

The Hong Kong dollar has continued to be strong due to more capital inflows to the Mainland stock market via stock-connect and also to the Hong Kong stock market. The spot of HKD is 7.7501, on the stronger side of the HKMA's set level of 7.7500.

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