Good MornING Asia - 30 March 2020

The MAS eased policy in line with expectations this morning. Recent global market ebullience seems to be ebbing as stimulus measures are absorbed, but the virus data keep getting worse - this week we get the release of some potentially market-moving US data. This pattern of brief spells of optimism followed by lengthy spells of gloom is likely to persist

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In for the long haul

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Source: Shutterstock

MAS eases policy

The Monetary Authority of Singapore (MAS) has grabbed centre stage on a quiet day for data releases today: Prakash Sakpal writes on this: "Consistent with their previous response to crises, MAS policy has moved to a neutral stance implied by zero appreciation of the S$-NEER policy band, albeit shifting the midpoint to the prevailing lower level. There is no change in the width of the band, estimated +/-2% from the mid-point. The statement reinforced a dismal growth and inflation outlook; growth projected between -4% to -1% and inflation between -1% to 0%. But, the central bank also emphasized “the primary role of fiscal policy in mitigating the economic impact of COVID-19”. However, a record stimulus of about 11% of GDP is only good once the Covid-19 threat to economy ends. Meanwhile, recession is unavoidable. A steeper than expected fall in 1Q GDP prompted a further cut to our 2020 growth forecast to -2.6% from -0.8%".

How will markets cope with months of train-wreck numbers?

Other central banks and governments have grabbed the headlines in recent weeks with their actions, just as the MAS has done today. But this pandemic is going to be a long haul. Have markets the stamina to remain buoyant over the coming months and the inevitable train-wreck of economic data coming down the tracks?

I think the answer is pretty obviously no. Last Thursday and Friday's market action seems to suggest that the positive impact of the $2tr US stimulus announcement has already begun to wear thin. To test this theory, this week, the US provides us with a wealth of potentially market-moving data, both sets of ISM numbers and the all-important non-farm payrolls figures on Friday. The consensus there is for a 100K decline in jobs. But the spread is wild, with the low at -1 million jobs, presumably encouraged by the recent initial claims figures. I'd like to see the market rally in the face of that.

Markets behaving more normally, but still some stress signs

We have begun to see some more normal bond/equity trading in recent days too, which is indicative of some of the Fed's financial plumbing actions beginning to work more normally. Bond yields are down to the mid-60s for the 10Y US Treasury now, declining along with equities. But the 3M Ted spread continues to widen, so there are still signs of financial stress evident. The Fed's work is not yet done.

Put that all together, and the medium-term trend for bond yields should be to resume its downward path, but that does not remove the possibility of occasional liquidity and loss-covering spikes, as we have seen at times in recent weeks.

Other Asian developments

(From Prakash Sakpal)

Malaysia: "The government's $58 billion (17% of GDP) stimulus package dwarfs those of most other countries given their sizes in terms of GDP. We expect Bank Negara Malaysia to waste no more time in announcing emergency rate cuts of the order of 50-100 basis points. However, as for most other economies in the region and the world, the stimulus should position the economy for a bounce-back once the pandemic ends, but in the meantime, it guarantees no lasting relief from the market sell-off.

India: Complementing the $22.6 billion (0.8% of GDP) fiscal stimulus package, the Reserve Bank of India on Friday announced emergency monetary easing via a 75 basis point reduction in the policy rate, 100 bp cut in the banks' reserve requirement, and $50 billion worth of liquidity support including targeted long-term repo operations and a three-month loan moratorium for banks and shadow banks. This may bring the economy back to its feet once the lockdown lifts in mid-April. Yet, the persistent gloom until and well after the end of Covid-19 is likely to be dragging the economy to its worst contraction ever and this is keeping markets and the INR under constant selling pressure".

And from Iris Pang on **China**, "It is reported that China is going to increase its fiscal deficit target in the coming Two Sessions. That is widely expected as the norm of that number is 3% to 3.5%, which is too low to offset the damage from Covid-19, and also was too low for 2019 due to costs to the economy from the trade war. From various official data, we estimate that the fiscal stimulus is 6.5% of nominal GDP for 2020, and it could increase to 8%-10% if there is a second wave of infection from imported cases".

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ASEAN Morning Bytes

Emerging markets may be in for a rough start on Monday with the IMF indicating the global economy is in a recession

EM Space: Governments resort to stiff "lockdown" measures to flatten curve

- **General Asia:** With the global outlook dimming further as the fatality count refuses to flatten out, the International Monetary Fund declared a global recession as it readied its capability to respond to the crisis. Meanwhile, the US is extending its social distancing guidelines for a month while Indonesia and Japan mull more enhanced measures to restrict mobility. With the world going into quarantine, commodity prices have tanked with risk assets also likely vulnerable this week as the virus continues to spread. Regional PMI numbers are likely to drop while non-farm payroll numbers from the US on Friday will likely take its cue from last week's surge in unemployment claims.
- **Singapore:** Consistent with their previous response to crises, MAS policy has moved to a neutral stance implied by zero appreciation of the S$-NEER policy band, albeit shifting the midpoint to the prevailing lower level. There is no change in the width of the band, estimated +/-2% from the mid-point. The statement reinforced a dismal growth and inflation outlook; growth projected between -4% to -1% and inflation between -1% to 0%. But, the central bank also emphasized "the primary role of fiscal policy in mitigating the economic impact of COVID-19". However, a record stimulus of about 11% of GDP is only good once the Covid-19 threat to economy ends. Meanwhile, recession is unavoidable. A

steeper than expected fall in 1Q GDP prompted a further cut to our 2020 growth forecast to -2.6% from -0.8%
- **Malaysia:** The government's $58 billion (17% of GDP) stimulus package dwarfs those of most other countries given their sizes in terms of GDP. We expect Bank Negara Malaysia to waste no more time in announcing emergency rate cuts of the order of 50-100 basis points. However, as for most other economies in the region and the world, the stimulus should position the economy for a bounce-back once the pandemic ends, but in the meantime, it guarantees no lasting relief from the market sell-off.
- **Indonesia:** Indonesia is finally considering administering more enhanced measures to restrict mobility as Jokowi had previously not been in favour of initiating a "total lockdown" of the capital Jakarta or the rest of the country. Calls for more stringent measures to stem the tide of the virus have escalated as fatalities and infections are on the rise with ministers readying plans to implement regional quarantines which would knock out a sizable chunk of growth in 2020 should it be implemented.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno vowed to carry out further easing if needed to help the economy avoid a recession in 2020. Diokno reiterated that he had the provisional authority to reduce reserve requirements by another 300 bps if needed and that he could resort to cutting policy rates further. BSP projects a possible 3% GDP growth in 1Q but a possible contraction in both 2Q and 3Q should the lockdown be extended. BSP has done much of the heavy lifting but until the fiscal package is approved and released the economy may sputter considerably with more than half of the country under quarantine.

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

- US pending home sales (30 March)
- China manufacturing and non-manufacturing PMI (31 March)
- Thailand trade (31 March)
- Hong Kong retail sales (31 March)
- Philippines bank lending (31 March)
- US consumer confidence (31 March)
- Japan Tankan survey (1 April)
- Regional PMI (1 April)
- US ADP employment and ISM PMI manufacturing (1 April)
- US trade and factory orders (2 April)
- Hong Kong PMI (3 April)
- China Caixin PMI services (3 April)
- Singapore retail sales (3 April)
- US non-farm payrolls (3 April)

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China: Worst-ever profit data for factories

Industrial profits fell sharply in China's state-owned and privately-owned enterprises in January and February. What can we expect for March and April?

Workers at en electronic factory in Eastern China

-38.3%

The worst industrial profits on record

YoY YTD in February

Profits of factories plunged in the first two months

Industrial profits fell 38.3% year-on-year, year-to-date in February from -3.30% YoY YTD in December. This is the worst data on record.

The plunge spanned state-owned (-32.9%YoYYTD) and privately-owned (-36.6% YoY YTD) manufacturers. But manufacturers in Mainland China who are funded by Hong Kong, Macau and Taiwan suffered the most serious falls in profits, at 53.6% YoY YTD.

Credit should deteriorate as account receivables lengthen

There is a risk that the profit squeeze leads to a credit event, especially among smaller manufacturers, as the number of days of account receivables has increased to 71.3 days from December's 53.7 days. Again, Hong Kong, Macau and Taiwan-funded factories are at a higher risk. The number of days of account receivables they faced is 89.4.

When account receivables lengthen, the risk of a cash flow problem is higher. The risk of being unable to pay an invoice then goes up, which can turn a liquidity risk into a credit risk.

Some manufacturers are also suppliers. If their upstream manufacturers cannot pay them back in time, they will have difficulty paying their downstream suppliers. The chain effect has been seen in previous difficult times. This is no different.

71.3 Account receivable days

Chinese manufacturers

So far no sign of stress in the market

The good news is that the market in Mainland China so far has not seen any sign of a liquidity crunch or credit crunch. Interbank interest rates have been low, and we have not seen any spikes- that is there is no stress in the market in general. 7D to 3M interest rates have been below 2%, while the People's Bank of China 7D policy rate is currently at 2.4%.

But small manufacturers' problems may not be reflected in the interbank market as they have difficulty borrowing from banks.

According to the PBoC website, the central bank's re-lending programme to support the resumption of SME operations has released CNY130 billion, which is only a fraction of the CNY500 billion re-lending programme.

It is expected that some SMEs may close their businesses, which will affect the stability of the job market, and therefore will slow down the recovery of domestic consumption. This will put further pressure on SMEs.

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Article | 27 March 2020 FX | New Zealand

What the Kiwi 'bazooka' means for NZD

The Reserve Bank of New Zealand has joined major central banks in starting quantitative easing and will buy NZD 30bn (around 10% of GDP) worth of New Zealand government bonds over the next 12 months. With the central bank not bucking the ultra-dovish trend, the pro-cyclical NZD is left without any solid floor and may converge lower in the next few weeks

New Zealand's central bank goes big

After an initial sanguine reaction to the Covid-19 outbreak, the Reserve Bank of New Zealand delivered an emergency 75 basis point rate cut on 16 March.

On 23 March, as the Monetary Policy Committee of the RBNZ acknowledged how downside risks to the economy had highly intensified, it announced a Large Scale Asset Purchase Program (LSAP). Over the next 12-months, the Bank will buy up to NZD 30bn of New Zealand government bonds in the secondary market across different maturities to "provide further support to the economy, build confidence, and keep interest rates on government bonds low". The statement highlights the possibility of further adjustments to the programme if necessary.

The RBNZ's asset purchase programme is worth around 10% of New Zealand's GDP

This move by the central bank is in line with the jump into unorthodox monetary policy in many developed countries and, in particular, by the two key reference central banks, namely the Reserve Bank of Australia and the Federal Reserve. While RBNZ LSAP is largely similar to "standard" quantitative easing implemented by the Fed (although the latter recently made it practically unlimited), it differs quite significantly from the Australian case. The RBA opted for a Japanese-style yield-curve control scheme, aiming at keeping the 3-year yield at 0.25% (which equals the Cash Rate). On the contrary, the LSAP is mostly aimed at keeping the long-end of the curve pressured.

In terms of the size of the purchase scheme, the RBNZ has surely gone big: the asset purchase programme is worth around 10% of New Zealand's GDP. The Fed's initial announcement on QE – before announcing a practically unlimited scheme – was worth only around 2% of domestic GDP, the ECB's EUR 750 bn new bond-buying was roughly 6% of the Euro Area GDP, while the Bank of England's GBP 200 bn scheme equals approximately 9% of GDP.

Full lockdown warrants extra stimulus

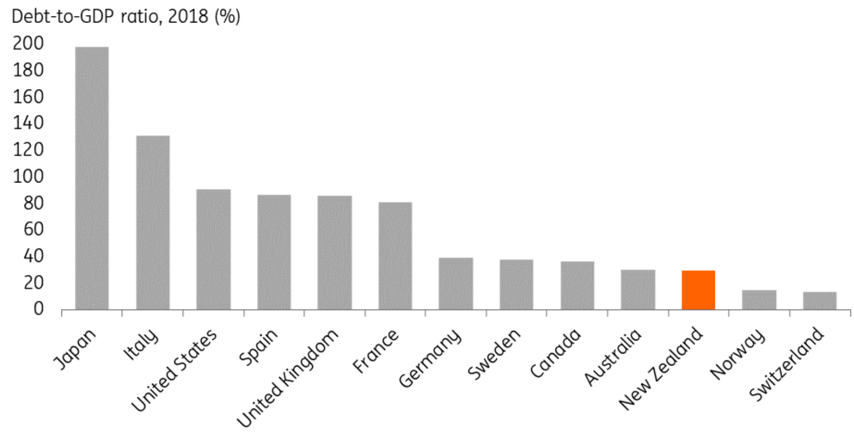
Assessing the impact of Covid-19 on the New Zealand economy has mostly been concentrated on external factors: above all, a slowdown in Chinese demand along with shrinking global trade flows and a fall in tourism. However, the impact is now obviously seen covering a wider share of economic activity and, like in other countries, private consumption – that makes some 57% of NZ GDP – is what concerns authorities the most.

> *The good news for New Zealand is that it has ample room for additional spending, given its small debt-to-GDP ratio (around 29%) compared to other developed economies*

New Zealand has just entered a full lockdown phase, that will last at least four weeks. People have been asked to stay at home and all non-necessary businesses, schools and universities have been closed. So far, there are 338 confirmed cases in New Zealand, although authorities expect the number to increase sharply in the next few days.

On the fiscal side, the government announced a NZD 12.1 bn (4% of GDP) stimulus last week, with 5 bn for wage subsidies for businesses, 2.8 bn for income support, the same amount as tax relief and around 600 m to help the airline industry. All in all, the fiscal stimulus package seems quite heavy, although more may well be required to offset the dramatic consequences of Covid-19.

In this context, the good news for New Zealand is that it has ample room for additional spending, given its small debt-to-GDP ratio (around 29%) compared to other developed economies (as shown in the chart below).



Source: IMF, ING

NZD: A fragile recovery

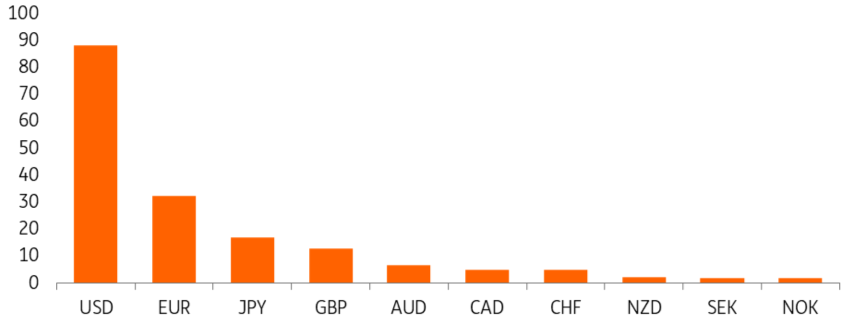
The Kiwi dollar is, indeed, part of the equation. Like in Australia, the pro-cyclical nature of the currency makes it a natural shock-absorber in times of economic downturns, given the export-oriented nature of the economy.

It's worth highlighting that NZD is one of the least liquid currencies in G10, and another liquidity drop in the markets bears the risk of NZD underperforming most of its G10 peers

The recent price action in NZD/USD has, however, followed mostly those of the USD (strictly linked to USD funding fears), and almost no mark of the RBNZ bazooka was left in the FX market. The easing of USD funding concerns may mean, however, that the period of large indiscriminate moves may be over, leaving more space to fundamentals. Naturally, this is also translating into USD weakness and a more sanguine global risk sentiment, all to the benefit of NZD/USD upside.

However, we suspect that the RBNZ's quite aggressive dovish stance makes the recovery in NZD hardly sustainable in the next few weeks, especially in the crosses. Also, it is worth highlighting that NZD is one of the least liquid currencies in G10, and another liquidity drop in the markets bears the risk of NZD underperforming most of its G10 peers (as shown in the chart below).

% G10 FX turnover. As two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%, BIS data



Source: BIS, ING

Looking at the AUD/NZD case, the QE in New Zealand appears substantially deeper than in Australia for now (in relative terms).

If nothing else, this represents an obstacle for AUD/NZD to trade sustainably at parity. The key notion that likely allowed the pair to briefly touch 1.00 earlier in March was that the RBNZ was lagging the RBA in terms of easing. Clearly, this is not the case anymore. Even if the RBA ramps up its QE scheme, exceeding the RBNZ LSAP in terms of relative size will be quite hard, and we need to bear in mind that the RBNZ has also left the door open for additional QE.

We expect the pair to stabilize around the 1.02/1.03 area in the next quarter.

Any additional NZD weakness may also be channelled against safe-havens such as the yen. As highlighted in a recent publication, we think the yen could face recovery in the next months ahead as a deep global recession unfolds. This could mean that NZD/JPY could re-approach the 62 low.

Looking at NZD/USD, we could see some additional support from USD weakening in the very short term, but we suspect the pair may be close to the bottom of the range. Looking beyond the near-term, the pro-cyclical nature of NZD in a global recessionary environment and the ultra-dovish stance by the RBNZ should prevent any sustained recovery above 0.60 before 2Q20.

Any possibility of additional fiscal stimulus by the Kiwi government may bode well for the economy but may only have time-limited impact on the currency, given the highly unsupportive rate environment.

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