

## Good MornING Asia - 31 March 2020

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South Korea

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By Robert Carnell



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China's central bank (PBoC) cut the 7D interest rate to avoid a financial crisis

# Lockdown is working

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## Better news for Europe, US, not so much

I've been on the gloomy side of this pandemic since, well, not day one, but since mid-January when I first started to write about it (and was politely told to shut up by some back then).

But it does feel as if there is a ray of light appearing. Europe's lockdown procedures are beginning to deliver positive (in other words, negative) effects, and the numbers of new cases are in almost all cases down. That includes the UK whose lockdown is relatively recent.

It does not include the US, where lockdown is regional, not national, and while the rate of increase of new cases there is slowing, rather than the numbers themselves, the risk of another region becoming a new hotspot makes it harder to be so optimistic.

## So is it time to become more optimistic in terms of markets?

If asked if it is now safe to dip your toes back in the water of risk assets, I think it might be. I still believe we have a long haul ahead, but if the numbers are right, and that remains a big if when testing has been so patchy, then we might be able to foresee an end to the lockdowns at the end of this month/beginning of May in Europe, later for the US on the assumption that they are lucky or that their lockdown is extended geographically.

An end to lockdown takes the pressure off businesses struggling to make earnings, on disrupted household incomes and on the financial architecture that has borne the strain of keeping all of this ticking along. So, if the pandemic news remains good, this might not be a bad time to explore risk again.

## Scope for error remains large

And it's worth throwing in the possibility that some countries looking to beat their neighbours back onto the economic growth escalator may relax restrictions too early, or that some seasonality may be lulling us into thinking that things are getting better when in fact it is just getting warmer (scientists simply don't seem to be able to agree on this). So there is still a chance that the news reverses and restrictions on movement have to be re-imposed. But right now, it's looking more hopeful than it has for some time.

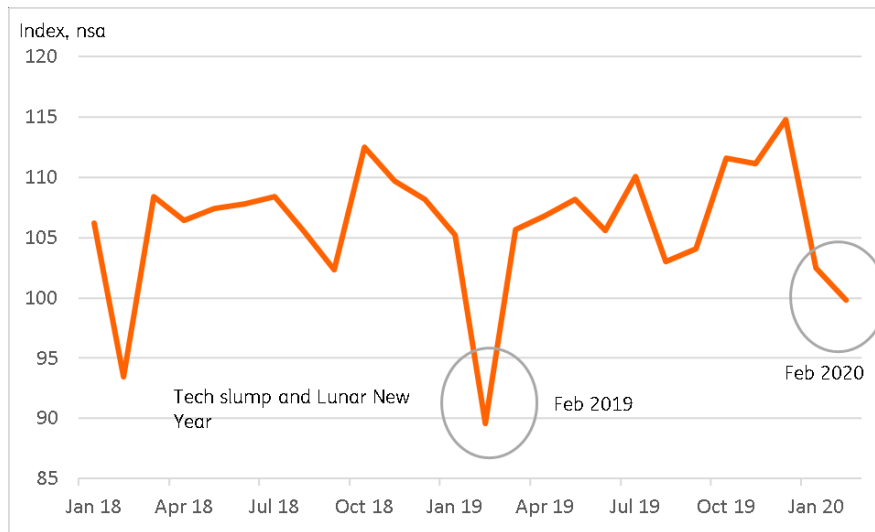
## Surprisingly good Korean production data

South Korea released February Industrial production data this morning, and it actually looks quite good. Production was up 11.4% year on year, despite a 3.8% month on month decline. What you need to know about these numbers is that February 2019 coincided with the absolute bottom of the tech slump, and of course is also bang in the middle of the Lunar New Year, which in 2019, landed in early Feb. So you couldn't have a weaker base for comparison. March data will be a lot more telling. But it could have been worse, so there is some cause for optimism in Korea too.

Prakash Sakpal adds on Thailand: "Following a three-week partial lockdown in Bangkok (started last week), Phuket island is now shut for the entire month of April. The government is planning a third stimulus package worth THB 500 billion in April to soften the impact of the Covid-19 virus on the economy. This will be in addition to two packages totalling THB 517 billion announced earlier this month, bringing total stimulus to worth about 6% of GDP. However, with the virus likely to keep tourists at bay for much of the year, the economic contraction this year seems inevitable".

Watch out also for the Chinese Purchasing Manager Index (PMI) data today. The consensus is widely split, which is not surprising. It also means we will have to interpret the result with care. A big increase may simply mean things are better, not that they are good. That is the difficulty with diffusion indices like PMIs.

## South Korean Industrial production. non-seasonally adjusted, index



Source: CEIC  
Korean Production, index, nsa

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## ASEAN Morning Bytes

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### EM Space: Asia to take its cue from rebound in US as experts rush to produce vaccine

- **General Asia:** Tuesdays' highlight will be China's PMI report with analysts' expectations varying substantially with a low of 38.0 versus a high of 59.1. Sentiment on Tuesday, however, may take its cue from abroad with investors gaining some confidence from reports of improved case numbers from Europe. Other economic reports for today are Thailand's trade and Hong Kong retail sales which could continue to show signs of how badly the Covid-19 outbreak is hurting respective economies.
- **Indonesia:** President Jokowi has called for even stricter measures to curb the movement of citizens as the number of infections continues to rise in Indonesia. Jokowi has continued to resist placing Indonesia under full lockdown with the central bank admitting that growth will likely take a substantial hit. Growth projections for Indonesia have been scaled down given likely weaker export performance and depressed household spending due to the strict regulations to restrict movement and a full lockdown will push the economy closer to the zero growth projection by Finance Minister Indrawati. Until sentiment improves, we expect IDR to remain pressured with the central bank busy supporting both the bond and spot market.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno shared that he is open to

upsizing the budget for the planned repurchase arrangement to Php500 bn with the Bureau of the Treasury (BTr). Previously the BSP had announced a Php300 bn bond purchase scheme to help the national government fund a recovery bill while keeping a lid on rising bond yields. Diokno has reiterated his commitment to wielding the full might of the BSP with a likely increase in the repurchase plan to be carried out in the near term as the BTr struggles to secure funding with the T-bill failing for a 3rd straight week as investors demand higher yields.

- **Thailand:** Following a three-week partial lockdown in Bangkok (started last week), Phuket island is now shut for the entire month of April. The government is planning a third stimulus package worth THB 500 billion in April to soften the impact of the Covid-19 virus on the economy. This will be in addition to two packages totalling THB 517 billion announced earlier this month, bringing total stimulus to worth about 6% of GDP. However, with the virus likely to keep tourists at bay for much of the year, the economic contraction this year seems inevitable.

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

- 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)

# China: PBoC surprise rate cut to avoid financial crisis

China's central bank (PBoC) cut the 7D interest rate to avoid a financial crisis



Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

## PBoC unexpectedly cut 7D rate

China's central bank (People's Bank of China) cut the 7D reverse repo from 2.4% to 2.2% when it injected CNY50 billion into the interbank market this morning. The cut is deeper than the 5bp reductions usually seen in the past and also the previous cut of 10bp.

This rate cut was unexpected. But the liquidity injection was even more of a surprise. The PBoC has not only stopped injecting any liquidity into the system since the 16 March but even withdrew CNY 33 billion of liquidity on 28 March, just one working day before this injection.

## Pre-emptive move to avoid a financial crisis

We see this rate cut as a move to avoid a financial crisis because liquidity has been ample in the Chinese interbank market. The concern falls along the following two lines:

1. Though China's financial system is quite isolated from the global financial system due to its

- semi-closed capital account, it is impossible to completely insulate it from global financial market volatility.
2. Domestically, part of the jobs market is affected by the lockdown of many cities within China as the Covid-19 spread from January to March. It is reported that there is an increase in "past-due" payments in consumer finance.

Even though we think the chances are extremely small, these global and domestic sources of volatility could potentially turn into a financial crisis in China. We believe that the central bank is trying to keep this probability as low as possible by cutting the 7D rate pre-emptively.

## More cuts are coming

With the cut in 7D reverse repo rates, we expect that there could be a cut in the 1Y Medium Lending Facility on or before 20 April and the 1Y Loan Prime Rate on 20 April so that the whole lending curve shifts downwards.

We do not expect any cut in the benchmark deposit interest rate, which is a retail interest rate, as this would be a backward move in interest rate liberalisation. This is not the time to protect bank profitability.

Instead, regulators could be thinking about protecting financial institutions by increasing bank's capital buffers.

## USD/CNY forecast at 7.25 by end of 2Q20

Directly, the rate cut should have little impact on the USD/CNY exchange rate. But the underlying concerns driving the cut (i.e. financial crisis), could move the dollar higher due to flight to safety, and therefore the yuan weaker.

We forecast the USD/CNY at 7.25 by the end of 2Q20.



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