Good MornING Asia - 31 October 2018

In a slew of weak manufacturing reports from Asia recently, Thailand yesterday reported a steeper than expected manufacturing fall for September and Korea joined in today with even more dismal industrial production figure. China manufacturing PMI is an important release for the markets today

In this bundle

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ASEAN Morning Bytes

General market tone: Wait and see. Risk markets bounced back on Tuesday in reaction to comments from the White House and positive economic data but traders remained cautious with Europe missing its growth projections.

International theme: US expresses optimism over trade talks with China

- The US equities managed to rebound on Tuesday with market players picking up bargains amid an upbeat consumer confidence data. Tech shares also bounced after a bluechip player unveiled new hardware models.

EM Space: Asian markets may track the Wall Street rebound

- **General Asia:** Asian equity markets may track the rebound on Wednesday with bargain hunting in session. Manufacturing PMI data out from China may point to possible ill effects of the trade tariffs and will likely dictate whether the rally continues.
- **Thailand:** The Bank of Thailand reports September balance of payments data today. The swing in the customs-basis trade balance to surplus in September from deficits in the previous two months will have translated into a wider current account surplus of about $1.2bn than $753m in August. Slower tourism receipts are the key risk to this data. Although wider current surplus is positive for the currency, the THB is ending October as Asia's worst

performing currency.
- **Thailand:** The Thai cabinet gave an in-principle approval to THB 600bn (3.9% of 2017 GDP) worth of infrastructure projects, part of THB 1.7tr Eastern Economic Corridor initiative. Following weak September manufacturing data, we have cut our 3Q18 GDP growth forecast to 3.7% from 4.1%, and full-year 2018 growth forecast to 4.2% from 4.3%. Recent data weakness not only undermines the government's optimism on the economy's growth this year but also dampens the prospects of the central bank tightening policy anytime soon (read more here).
- **Malaysia:** The MYR weakened to a one-year low of 4.1807 against the USD yesterday. However, unlike the THB, this currency has not lost its luster as Asia's outperformer in the sell-off this month. The government is considering a legislation against economic sabotage (the 'Economic Sabotage Act'), preventing businesses from selling their secured projects and approved permits for immediate gains.
- **Philippines:** Prices for important crops continue to trend lower, albeit at a modest pace with the cost of regular-milled rice showing a 0.13% fall from the previous week. Other vegetable items also posted sharp declines, which could help limit the year on year rise in food inflation, which accounts for 38% of the headline. The BSP has indicated that they would only enact a "moderate" rate hike before the year-end if inflation begins to show any deceleration.
- **Philippines:** The government has kick-started rehabilitation efforts of the southern city of Marawi, which was devastated after a protracted conflict in 2017. The estimate for the reconstruction efforts is pegged at Php80 bn over the next three years, with the government indicating a potential Php50 bn offering in 4Q 2018, subject to market conditions. The timing for the issuance of the reconstruction bond will be key as the Bureau of the Treasury is also looking to float retail bonds before the end of the year.

What to look out for: US job data and ASEAN inflation

- 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 Federal Budget (2 November)
- US Non-farm payrolls (2 November)

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Snap | 30 October 2018

China PMI will continue to drop but remain above 50

We expect that China's manufacturing PMI and non-manufacturing PMI will continue to drop but show that activity is still expanding, thanks to tax cuts and other stimulus measures.

Source: Shutterstock

Manufacturing activity could expand more slowly

We expect the manufacturing PMI to fall from 50.8 last month to 50.3 in October.

The main reason for this is that the trade war will be hurting manufacturing activity as tariffs imposed by the US are too costly for Chinese exporters to fully absorb. But we still expect the reading to be above 50 because we think that stimulus measures (e.g. export tax rebates) and salary and corporate tax cutting measures should support domestic consumption for the time being. Therefore manufacturing activity for the domestic market should continue to rise.

Services will continue to expand, but again more slowly

We expect the non-manufacturing PMI will also fall from 54.9 to 54.5 in October.

Real estate activity will be the main drag on the non-manufacturing PMI. But this may not last long because if home prices start to fall across the whole country, some local governments will have to re-think their attitude to mortgage borrowing. We expect that some locations may ease housing constraints a bit to avoid home price falling steeply. This would help real estate's sub-index in the non-manufacturing PMI.

Banking activities slowed in October. This may be reversed in November as we expect a rise in financial activity as easing measures boost bank lending to SMEs and other private-owned entities.

Domestic demand is now crucial to support the economy

With an escalating trade war between China and the US, the Chinese government is using both fiscal and monetary stimulus measures to support local demand.

We see domestic demand as a crucial factor to support the whole economy as it will avoid massive job losses and drive activity from export demand to local demand. As we have claimed before, the current Chinese economy is now advanced enough to absorb goods that are designed for export, which is very different from 10 years ago, when exported goods did not match local market demand due to big differences in purchasing power.

We keep our forecast of USDCNY at 7.0 by end 2018

Tariff news will continue to weaken the yuan, and USDCNY is heading towards 7.0. We believe that USDCNY will hit 7.0 a few times before crossing over, so it will not create any surprise to the market when it happens.

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Korean production for September - Weak

Production in Korea fell 2.5% from the previous month to land 8.4% lower than a year ago. Expectations weren't strong, but this is a particularly weak reading. Any remaining BoK hawks must surely change their views.

Source: Shutterstock

More than just volatility

Month on month production growth in Korea is a volatile series, with all sorts of seasonal aberrations to contend with, so at first glance, the 2.5%MoM decline in industrial output (most of it from a 2.1% decline in manufacturing) might be written off as statistical noise. But a lot of that noise disappears when you examine the year on year growth. At -8.9% in September, you have to go back to 2009 and the aftermath of the global financial crisis to find weaker production data. This is no aberration.

The weakness wasn't confined to industrial production either. Construction activity also dropped for a second consecutive month and is running at -16.6%YoY. Even public administration (government) which you might have expected to be bucking this trend thanks to increased hires in the public sector, registered both a month on month and a year on year decline. In short, the Korean economy looks in bad shape currently.

-8.4%

Korean September industrial Production

YoY%

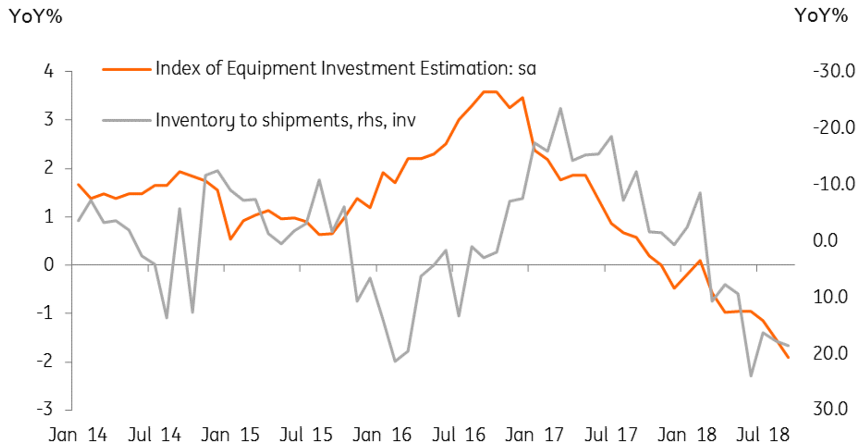
Worse than expected

An inventory cycle is part of the explanation

An old-fashioned inventory cycle is at least part of the explanation for the current weakness. Manufacturing production plotted against inventory to shipment ratios (inverted) shows that inventory ratios have risen sharply, requiring production to be cut back sharply in the near term. The same negative relationship holds for inventory ratios and equipment investment, shown below.

What isn't explained is why demand for the output is so slack that these inventories have risen so much. Looking at the components of production, it is actually a whole batch of old-economy products that are looking particularly weak. ELectronics isn't growing strongly, but it at least registers a positive sign for growth.

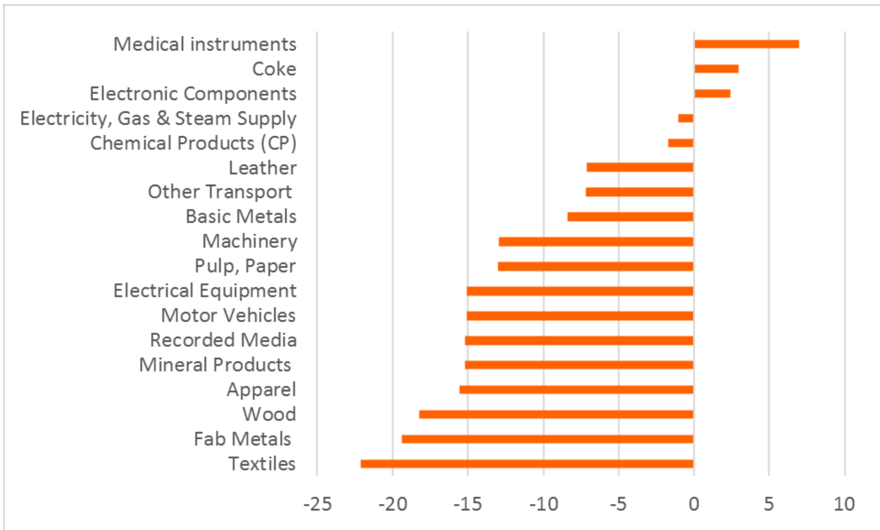
Korean inventory shipments ratio and equipment investment



Is this a trade war effect?

If this were a spillover from the trade war between the US and China, you would expect the production weakness to be mirrored in weakness of Korean exports to Asia. It isn't. Export growth to China is about 7.66%YoY. Where growth is particularly weak is to SE Asia (Singapore, Philippines, Thailand, Vietnam, Malaysia bucks the trend), and some of the frontier economies, Bangladesh, Pakistan. Exports to Taiwan are extremely robust. So it looks hard to pin this weakness on the trade war, or on some electronics-based product cycle. in short, this is puzzling, but nonetheless worrying.

Korean production by type YoY%



Market response

Markets are responding appropriately to this economic weakness. Korean 2Y bond yields are now down to 1.877%, from a little over 2.0% earlier this month, as any thoughts of BoK tightening in November are swept away by bad data. The KRW is also looking weaker. We expect it to reach 1145 before the end of the year. We will also be revising down our GDP forecasts for Korea in the light of this weakness.

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Thailand: Weak activity leads GDP forecast downgrade

Following weak September manufacturing activity, we have cut our 3Q18 GDP growth forecast to 3.7% from 4.1%, and full-year 2018 growth forecast to 4.2% from 4.3%. Recent data weakness not only undermines the government's optimism on the economy's growth this year but also dampens the prospects of the central bank tightening policy anytime soon

Source: Shutterstock

-2.6% September manufacturing growth

Worse than expected

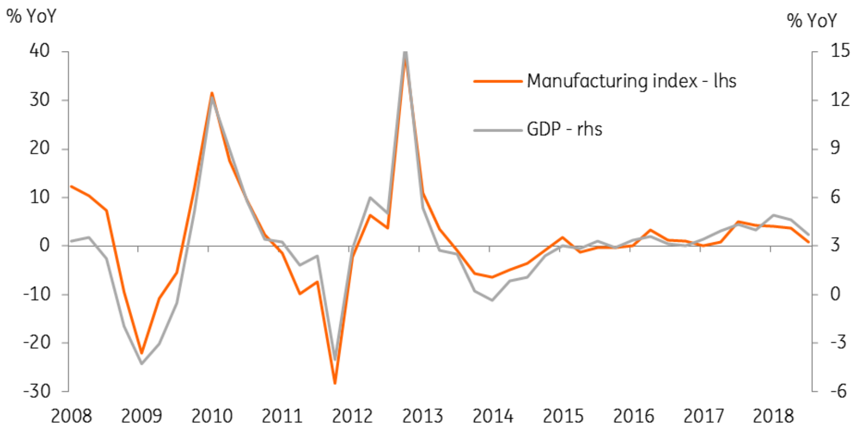
Exports dent manufacturing

Consistent with the consensus view, manufacturing output contracted on a year-on-year basis in September. However, the 2.6% fall was much steeper than the consensus median of only a 0.5%

fall. Coming on the heels of unexpectedly weak exports (-5.2% YoY), the steeper manufacturing fall isn't a complete surprise.

The decline in exports and manufacturing in recent months has been partly the result of high base effects; growth was accelerating during the same period of 2017. A sharp slowdown in manufacturing in 3Q18 to 0.9% YoY from 3.7% in 2Q18, will have undoubtedly pulled GDP growth lower (see figure). It's not only manufacturing though. Service sector activity has also started to take a hit from falling tourist arrivals, especially visitors from China.

Manufacturing drives GDP



Source: Bloomberg, CEIC, ING

GDP forecast downgrade

We now estimate 3Q18 GDP growth of 3.7%, slower than our earlier 4.1% estimate and down from 4.6% in 2Q (Bloomberg consensus 4.2%, data due on 19th November). This pushes our full-year growth forecast down to 4.2% from 4.3%. The fourth quarter is typically a strong growth quarter, which will soften the impact on full-year growth.

Yesterday the finance ministry reaffirmed its 2018 GDP growth forecast of 4.5% but cut its export growth forecast to 8% from 9.7% projected three months ago, citing the US-China trade conflict as the reason for the cut. We consider the official projection optimistic. With 8.1% growth in the first nine months, exports will have to continue growing at this pace over the remainder of the year. The risk is squarely on the downside, with export growth likely remaining negative in the final three months. The ministry also revised its forecast of tourism revenue this year to 2.01tr Thai baht from 2.08tr.

However, we agree with the finance ministry's view that there will be no change in Bank of Thailand policy in the rest of the year. The BoT policy rhetoric lately has been flitting between dovish and hawkish, driven by factors of potential downside growth risks and the need to create policy space for the future. The latest data empowers the doves.

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