Good MornING Asia - 4 November 2020

Asian markets positioning for blue wave - stock futures up, bond yields up, Asian FX vs US up, oil up

In this bundle

Asian markets positioning for blue wave

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Polls barely closed but Asia is already taking a punt on the outcome

With most polls not even closed yet, Asian markets have kicked off this Wednesday by what looks like an expectation for a Biden Presidential victory, along with re-control of the Senate for the Democrats. EURUSD is up sharply and the USD has also weakened against the offshore renminbi, Indonesian rupiah and Australian and Singapore dollars to name just some of the region's key currencies.

Equities in the US were positive yesterday, after several days of on-off risk trading, and equity futures suggest this positive momentum, based on expectations of substantial fiscal support in early 2021 in the event of a Biden win, will carry over into today's trading.

The offset of this anticipated extra spending will be additional Treasury issuance to pay for it, and

US Treasury yields are pushing higher today, with the 10Y UST up 9 basis points from yesterday to 0.858 as of writing. This will likely be echoed in local currency bond yields today, with the Australian 10Y, an early trader, already matching UST yield moves higher, despite yesterday's rate cut and expanded QE program.

For the record, we suspect the result might be considerably closer than markets are implying today, and it is our profound hope that we have greater clarity when we look again tomorrow, though we are fully aware that this might not be the case.

Oil - following USD for now

The asset class which is not quite following the script is oil. The oil market has focussed on the Iran sanctions element of a Biden win to suggest that extra supply could weigh on crude, but the generic front month West Texas Intermediate future is pushing higher, probably dominated by the USD's weakness. Chatting to our US Chief Economist about this recently, he views the immediate concern for Biden (if he wins) as being domestic policy, so the Iran story may be a late player in 2021 rather than part of any immediate market knee-jerk over today and the rest of the week.

RBA's easing has short-lived impact

OK - we were the wrong side of the RBA on rates yesterday, though we did get the QE decision about right. There is a very good speech by Governor Lowe yesterday outlining the justification of the moves, though I'll be honest, none of it, especially the bit about the RBA still having monetary firepower, were terribly convincing. With the cash rate at 0.1%, together with the 3Y yield target, and the interest rate on Exchange Settlement balances at zero, there really is no further rates can go.

Usefully, Lowe noted that the RBA's view on negative rates has not changed. "*...the Board continues to view a negative policy rate in Australia as extraordinarily unlikely".*

More QE is probable from the RBA in due course than the AUD100bn over the next 6 months (5-10Y tenors) that has been promised. QE is not a very powerful policy tool and requires bucket-loads of asset buying to have much impact. This could quickly become a problem given the shallowness of the Australian Government bond market.

The Reserve Bank of New Zealand (RBNZ) has fewer qualms about negative rates. And this morning's news of a rise in the unemployment rate in 3Q20 from 4.0% to 5.3% provides a perfect excuse for the RBNZ's Governor Orr to match or exceed the RBA's easing yesterday. And given what has happened to both Australian and New Zealand bond yields overnight, and to their respective currencies (both stronger) Orr may see the arguments for a more aggressive move, including a foray into negative rates. In short, take care tracking the NZD higher ahead of the next meeting on November 11.

Its payrolls week still if anyone cares...?

I don't think there will be much interest, but in case anyone is still watching the macro releases, the ADP survey is out in the US later today, ahead of the Friday jobs report and all-important payrolls number. And US trade data is also out. When President Trump came to power in early 2017, the trade deficit averaged somewhere between $40 and $45bn per month. it now averages about $60-65bn. Of course, we don't know what the counterfactual would have been, so its not a clear cut verdict on US trade policies, but in case you were interested...

Philippine Trade data and China's remaining Caixin PMI surveys will probably not bother markets substantially in a day that will be dominated by election headlines. Have a very good day.

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Indonesia: Covid-19 to weigh on recovery

3Q GDP looks set to fall by 5.6%, with prospects for economic recovery weighed down by the pandemic

Source: Stenly Lam

Indonesia in recession as Covid-19 cases remain elevated

Indonesia's economy is in recession, with economic activity hampered by a recent spike in Covid-19 infections, forcing Jakarta and surrounding provinces to return to stricter lockdown measures in September. Indonesia currently has the highest number of Covid-19 cases in ASEAN, with new daily infections pushing north of 3,000. The return to stricter quarantine guidelines likely weighed on industrial activity in 3Q, with the latest PMI report reverting to contraction.

Prospects for the economic recovery rest on limiting the spread of the virus, with partial lockdown measures hobbling household consumption and weighing on overall sentiment. Consumer spending has slowed considerably, manifesting in below-target inflation and lacklustre retail sales while investments in durables such as road vehicles took a severe hit during the height of the lockdowns.

Fiscal support has been significant, with authorities allocating IDR 695 trillion (4.4% of GDP) to Covid-19 relief efforts, although bureaucratic delays have led to delays in disbursement. The budget deficit to GDP ratio rose to 4.2% as of September, prodding the authorities to enter in a "burden sharing" agreement with Bank Indonesia (BI). The agreement is for IDR575 trillion worth of deficit financing, with the central bank absorbing the financing costs to help limit the impact of increased spending on debt metrics.

Despite stimulus measures, GDP momentum remains subdued especially with Covid-19 cases hitting at least 3,000 daily, which will limit consumption momentum in the near term. One recent development that could offset the Covid-19 handicap is the recent passage of the Omnibus law, which is designed to attract foreign investments by simplifying investment rules and regulations. An influx of foreign investors could help stabilize IDR and generate employment, which will be crucial in the recovery period. Should the implementing rules and regulation be drafted quickly, we could see growth prospects improve considerably, however a return to pre-pandemic GDP level will likely take at least 2 years with consumption, the main driver of the economy, still downbeat.

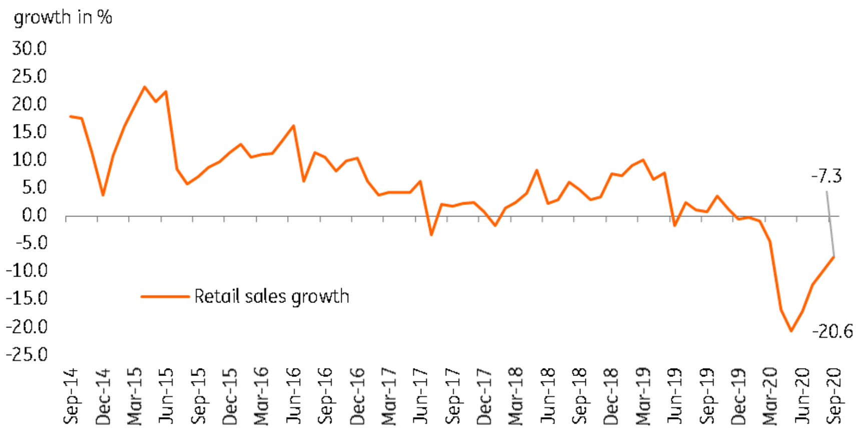
Covid-19 weighing on overall economic momentum

Indonesia's economy slipped into recession, with economic momentum still hampered by elevated daily infections from Covid-19. Several indicators point to subdued economic activity with anxiety over the virus weighing on overall consumer sentiment. Consumer sentiment hit a low of 77.8 in May, rebounding slightly in July and August before dipping again in September as Jakarta returned to more stringent lockdowns.

Poor sentiment has been reflected in anaemic household spending and a pullback in capital outlays for durable goods such as road vehicles. Retail sales have improved from the lows (reported in June) but weak consumer sentiment and uncertainty could be affecting consumption patterns with households likely setting aside more funds for savings in case things turn for the worse.

We can expect household spending, the main driver of overall economic activity, to remain downbeat until Covid-19 cases dissipate or when effective treatments and vaccines are readily available to the public. As a result, we expect consumer price inflation to dip below the central bank's inflation target of 2-4% for 2020.

Indonesia retail sales



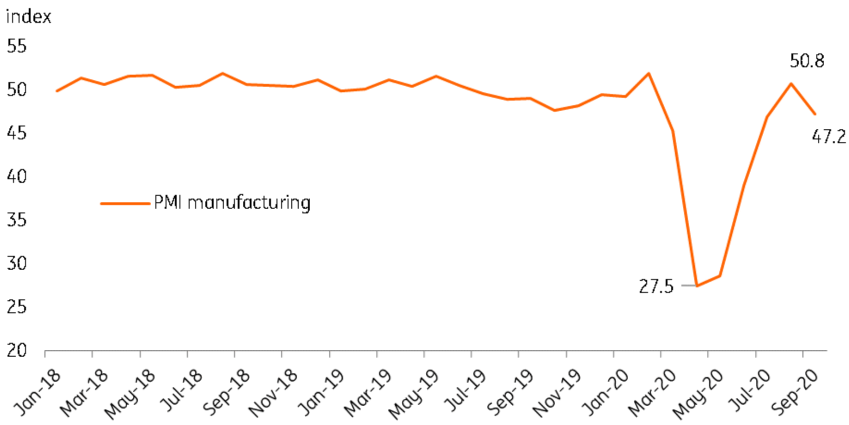
Source: Bank Indonesia

Restrictions matter

Suppressing the spread of Covid-19 is likely the most important factor in jumpstarting the economic engine as a virus under control translates into improved consumer sentiment and robust household consumption. Indonesia has refrained from implementing full lockdown measures to date, opting instead for partial lockdowns to help mitigate the spread of infection. Authorities had been gradually relaxing mobility curbs before a recent spike in cases forced government officials to reinstate more stringent lockdown measures in Jakarta and surrounding regions last September. The impact on manufacturing was significant enough to force PMI manufacturing activity back into contraction after stringing together consecutive months of improvement since June.

Thus, effective control of Covid-19 should help to bolster the economic recovery, in terms of restoring household spending coupled with a recovery for manufacturing activity. However, given still elevated daily new infections, we expect growth momentum to struggle in the near term although we do note a recent modest deceleration in fresh cases as well as efforts by the authorities to prepare for eventual vaccine deployment.

Indonesia PMI manufacturing



Source: Markit

Omnibus law could offset Covid-19 impact somewhat

Despite the downbeat assessment for growth, one development that could offset the negative impact of Covid-19 on the economy could be the recent passage of the Omnibus law. President Jokowi hoped to pass the landmark bill at the beginning of his second term but the pandemic pushed back passage to last month. Investor optimism rebounded sharply with the new law expected to streamline the investment process and help attract foreign investors to Indonesia. The authorities are now drafting implementing rules and regulations with market players awaiting details on the said bill. The Omnibus law is reported to cover the following:

a. Improves ease of doing business in Indonesia by amending more than 75 different laws to streamline and simplify opening a business in Indonesia

b. Amendments to the power, mining, forestry, postal and healthcare sectors

c. Simplifies environmental assessment requirements and licensing

d. Amendments to the current labour law with regard to overtime, outsourcing, minimum wages, worker termination and social security to protect workers and employers

e. Amendments to the tax code to increase ease of doing business and help attract foreign investors

f. Inception of the Indonesian Sovereign wealth fund

g. Incentives for micro and small enterprises and simplified application process

Should the Omnibus law deliver as promised, it could usher in an influx of investments that could bolster growth prospects and generate more employment to combat the recession.

Bank Indonesia focuses on IDR stability

Bank Indonesia (BI) paused at its last meeting with Governor Warjiyo focusing on currency stability while refraining from cutting policy rates to bolster growth. IDR has been under pressure in recent months as investors remain anxious over questions on central bank independence and more importantly growth prospects.

The currency has managed to find its footing of late, with investor sentiment improving somewhat with the Omnibus law. Unless IDR rallies sharply to close out the year, BI may be constrained from easing policy further, resorting to liquidity infusions to help keep borrowing costs pressured lower.

Constrained from cutting rates, BI has opted to take the unconventional monetary policy route to ensure market stability and even help finance the sizable fiscal response of the government. BI currently carries out quantitative easing to infuse liquidity into the financial system while conducting debt monetization with their "burden sharing" agreement with fiscal authorities.

Covid-19 to weigh on growth

Indonesia's growth momentum has been impaired by still elevated Covid-19 infections, weighing on domestic consumption, the main driver of economic growth. With retail sales and consumer confidence stalling, we forecast GDP growth to remain in negative y-o-y territory until 1Q 2021 as Indonesia hopes to curb the virus. Should authorities struggle to contain Covid-19, we would be inclined to downgrade our projections further. The authorities are banking on the Omnibus law for a boost but as long as daily Covid-19 infections remain elevated, growth momentum will remain subdued with inflation slipping below the 2-4% BI target, reflecting poor domestic demand. Meanwhile, BI will likely keep policy rates untouched for the rest of 2020, opting to undertake unconventional monetary policy to ensure financial market stability.

	3Q20	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Real GDP (% YoY)	-5.6F	-6.1	-4.5	2.7	2.9	3.0
CPI (% YoY)	1.4	1.9	3.3	3.5	3.6	3.5
BI policy rate (%, eop)	4.00	4.00	3.75	3.75	3.50	3.50
3M rate (%, eop)	4.30	4.40	4.28	4.35	4.34	4.46
10Y govt. bond yield (%, eop)	6.93	6.78	6.69	6.49	6.52	6.59
Budget deficit to GDP (%, eop)	4.20	6.10	6.2	5.8	6.0	5.60
Current account deficit to GDP (%, eop)	2.0	1.6	1.7	1.9	2.3	2.4
IDR per USD (eop)	14880	14823	14841	14899	14910	14777

Source: ING estimates

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