

Good MornING Asia - 4 October 2019

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0.9% Philippines inflation in September

Lower than expected

EM Space: Asian central banks remain on easing path

- **General Asia:** The US economic data continues to unfold on a weaker side, adding to odds of the Fed accelerating its easing cycle by cutting rates again in October. While this will sustain most Asian central banks on the easing path, the Reserve Bank of India is getting far ahead of others with another policy rate cut today.
- **Malaysia:** August trade data is due with consensus looking for a pick-up in exports growth to 2.7% YoY from 1.7% in July. Electronics has been the source of surprising strength of Malaysian exports this year. While we believe it remained in play amid a seasonal smartphone launches during this summer. Firmer exports support our view of GDP growth staying near the top end of BNM's 4.3-4.8% forecast for 2019.
- **Thailand:** Prime Minister Prayuth Chan-Ocha warned trouble if the lawmakers fail to pass

the budget for the fiscal year 2020 (already started on 1 October) his government is due to present to the parliament this month. A weak coalition government with a slim majority in the lower house faces difficulty in getting its policies off the ground. The fate of the \$10 billion stimulus package announced in August hangs in balance. This is why we think the Bank of Thailand should cut policy rates sooner rather than later.

- **Philippines:** September CPI inflation came in below expected at 0.9% YoY (consensus 1.1%). A sharp dip from 1.7% in August was mainly from food and utility prices. We expect continued negative spells in the basket-heavy food component (-0.9% in September) to keep inflation below the BSP's 2-4% target in the months ahead, leaving the door open for further policy rate cuts while growth is likely to miss the target this year.
- **Indonesia:** President Jokowi clarified that Bank Indonesia (BI) remained independent and that he was confident Governor Warjiyo would know when and in what direction to move rates. Previously more neutral, Warjiyo has turned around to whip out three rate cuts to boost growth, in-line with Jokowi's policy directive to boost growth via investments. We expect BI to remain open for further cuts as growth seems to have displaced currency stability as a monetary policy driver.

What to look out for: RBI policy and US jobs data

- Reserve Bank of India meeting (4 Oct)
- Indonesia consumer confidence (4 Oct)
- Malaysia trade (4 Oct)
- Philippines inflation (4 Oct)
- US nonfarm payrolls (4 Oct)

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Asia week ahead: China-US trade talks resume

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Source: Shutterstock

➔ Trade talks – fingers crossed

After a breather of more than two months, Chinese and American trade representatives return to the negotiation table next week. While President Trump sees a 'good chance' of a trade deal 'sooner than you think', the news of Chinese companies starting to purchase US agricultural goods this week with a waiver from retaliatory import tariff bodes well for the upcoming talks.

Even so, caution is warranted given the breakdown of earlier negotiations. President Trump's on-and-off rhetoric against China's trade practices and the US now considering limiting financial flows

to China too means the risk of yet another negotiation round ending in vain still exists.

Aside from the trade developments, there is little on the Chinese calendar to drive markets after a week of pause in trading for the National Day holiday this week.

➔ Malaysia budget – growth comes first

Malaysia's finance minister Lim Guan Eng presents the 2020 Federal Budget to parliament on 11 October. Malaysia's export-driven economy is holding up well in the face of accelerating global economic slowdown due to the trade and tech war. With steady GDP growth, the finance minister is confident of achieving the target reduction in fiscal deficit to 3.4% of GDP this year from 3.7% in 2018, which seems fine for now.

However, the key question is whether these positive trends will be sustained into next year and beyond as the government aims to trim deficit under 3% in the near-term (2.8% by 2021). Indeed, it's going to be difficult for the economy to continue to outperform as global headwinds are getting stronger and this demands greater policy support. Without losing sight on continued fiscal consolidation, the government will need to pursue an expansionary fiscal policy to support growth. It's going to be a challenge.

We don't see them backtracking on the fiscal goals, though the planned 3% of GDP deficit for 2020 sounds optimistic for now.

➔ Trade figures – how's electronics doing?

Is the global electronics downturn near its trough yet? For answers, look out for trade reports from Taiwan and the Philippines next week. Electronics and electronic parts dominate exports in both of these countries, accounting for about a third of Taiwan's total exports, while that share is more than half in the Philippines.

The recent pick-up in the growth of electronics export from these countries stems from new smartphone launches. However, such seasonal boosts are quickly reversed, while weak economic prospects weighing on consumer confidence and deterring spending on more fancy gadgets is the added whammy this time around.

That said, the recent green shoots are hopeful signs of the electronics cycle close to its low. The recovery could be prolonged, though.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Saturday 5 October					
Taiwan	0900	Sep CPI (YoY%)	-	0.6	0.4
	0900	Sep WPI (YoY%)	-	-	-3.4
Monday 7 October					
China	-	Sep Forex Reserves (US\$bn)	-	-	3107
Malaysia	0800	Sep 30 Forex reserves- Month end (US\$bn)	-	-	103.5
Philippines	-	Sep Forex reserves (US\$bn)	86.3	-	86
S Korea	0000	Aug Current account (\$ bn)	6.8	-	6.9
Taiwan	0900	Sep Exports (YoY%)	-	-	2.6
	0900	Sep Imports (YoY%)	-	-	-2.7
Tuesday 8 October					
Hong Kong	-	Sep Forex Reserves (US\$bn)	-	-	432.8
Wednesday 9 October					
China	-	Sep Money supply (M2) (YoY%)	-	8.3	8.2
Thursday 10 October					
Philippines	0200	Aug Exports (YoY%)	1.2	-	3.5
	0200	Aug Imports (YoY%)	1.7	-	-4.2
	0200	Aug Trade balance (US\$mn)	-3687.6	-	-3393
Friday 11 October					
Mexico	1200	Aug Industrial Production (SA MoM/YoY%)	-/-	-	-0.4/-1.7
India	1300	Aug Industrial production (YoY%)	1.0	-	4.3
Malaysia	0500	Aug Industrial production (YoY%)	2.3	-/-	1.2
Malaysia	-	2020 Budget			
Singapore	0600	Aug Retail sales value (MoM/YoY%)	-1.1/-5.0	-/-	2.6/-1.8

Source: ING, Bloomberg, *GMT

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Asia FX Talking: Crest of a wave

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Source: Shutterstock

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China's not so happy 70th birthday

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Source: Shutterstock

70th anniversary of founding of People's Republic of China

The 70th anniversary of the People's Republic of China came against the difficult backdrop of the trade war protests in Hong Kong, swine fever and a struggling economy.

Policy tools are being tweaked continuously and the net result is that, so far, the economy as a whole continues to hang together. This is taking a lot of effort though and has brought the currency into play as a prominent, if not a very effective new policy lever.

Swine fever no laughing matter

Given the energy-sapping influence of the trade war and the political irritation of the Hong Kong protests, the very last thing that China needs right now is a food safety shock. But the swine fever is rampaging, not just through China, but across the region leading to the decimation of swine herds and soaring pork prices.

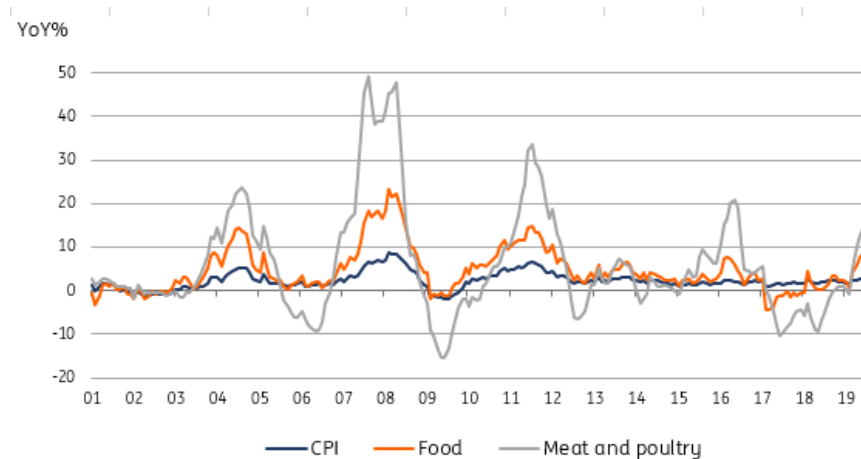
Inflation rising - a tax on households

Overall food price inflation has already soared to more than 12% as a result. And this is effectively

a tax on households, weighing on their ability and inclination to spend.

This would be bad enough in normal times. But right now, with authorities in China on a “war-footing” to prevent the trade war from derailing the economy – it is even more concerning.

Chinese inflation



Source: CEIC

More fiscal and monetary tools being used

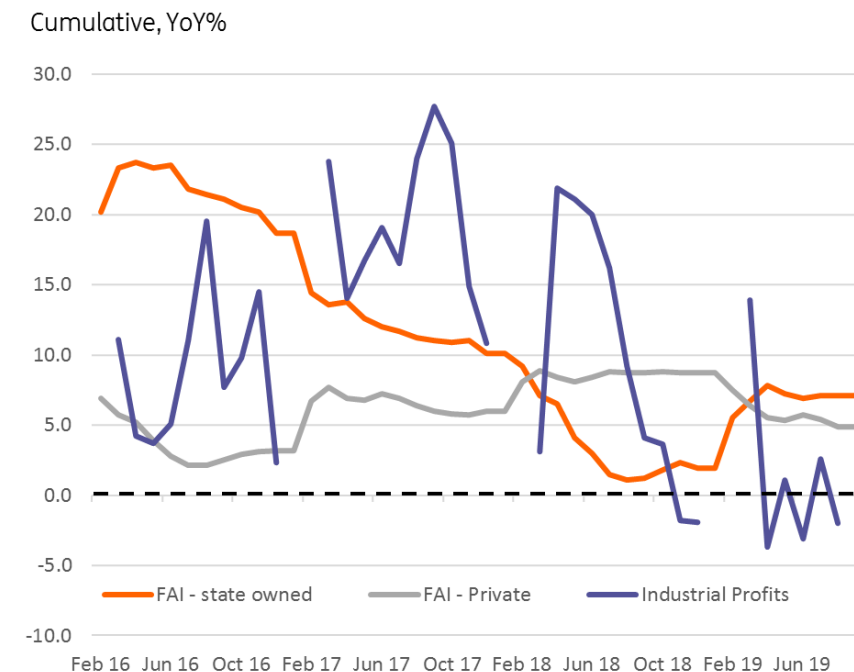
Fiscal tools have already been activated, including tax cuts and subsidies, as well as infrastructure spending financed by local government bond issuance. Monetary policy levers have also been added and incremental nudges to policy accommodation are ongoing, as we saw this month with the further [downward push to the loan prime rate by 5 basis points, and cuts to required reserve ratios](#).

[Why China has cut the one-year loan prime rate and what that means for the economy](#)

The trade war is hurting China

All this may help in time, though lags make it hard to judge the efficacy of measures already undertaken. In the meantime, the run of data has been mixed to poor. Hard data – fixed asset investment, industrial profits and industrial production have come in substantially weaker than expectations recently. Softer survey data, PMIs, and others have been more mixed with some recent upside surprises. The net conclusion, though, remains that the trade war is hurting China’s economy, and it is taking a substantial policy effort to keep things moving forward.

Hard data has been mainly bad



Further stimulus likely

Additional policy efforts look pretty much like a done deal. China's strategic pork reserves have been utilised to try to keep food prices down. But further direct support measures for households will likely become necessary. Additional purchases of US pork will also likely be necessary, weakening the Chinese position in the trade war, though this can be presented as a favourable shift to foster trade dialogue, as it has been recently.

The yuan is now a policy lever in its own right

One additional policy lever that can be brought to bear is the yuan. For a long time, this was left out of the policy arsenal as being either too political or too prone to negative side effects such as capital outflows. The firming of China's capital account restrictions has plugged the outflow problem, while ironically, the decision to label China a currency manipulator in early August and escalate tariffs, removed the disincentive for a more activist currency policy.

A weaker CNY doesn't do much to shield China from tariffs, but it does serve as a clear snub to any US escalation, and we would anticipate this forming a part of any future retaliation. Recent movements of USD/CNY seem to have mirrored market sentiment about a possible trade deal, and recent CNY behaviour has appeared to be more market-driven than at any recent juncture.

Our forecast for USD/CNY for the end of 2020 is predicated on further trade trouble ahead and remains at 7.30.

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Japan: Trying times

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Source: Shutterstock
Japanese Prime Minister Shinzo Abe

10%

New consumption tax rate

Up from 8%

As expected

Fiscal consolidation in Japan

Japan's public finances are the worst in the developed world. Measures of gross debt to GDP top 240% on some measures (OECD), and even netting out the considerable amount owned by the government itself, is far in excess of 120%. At this scale, the exact numbers lose a lot of their meaning. Government debt is huge, and it does not seem unreasonable to try to bring this under some control.

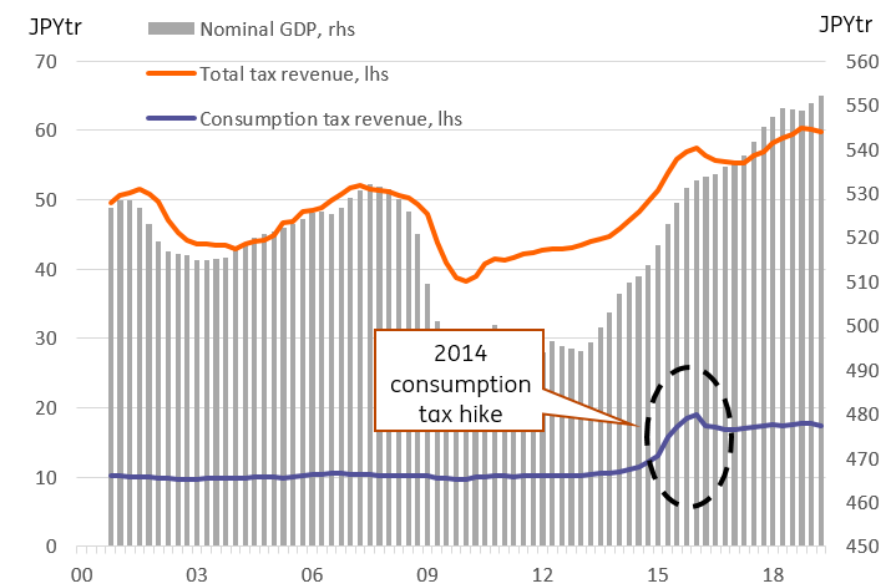
Is this the right thing to be doing?

That said, there may be better ways of Japan going about this than a consumption tax hike. Especially when most of its peer group is belatedly coming to understand that monetary policy has lost most, if not all, of its potency and fiscal policy is the only way to give growth a helping hand.

Consumption tax revenues static

The chart below shows total tax revenues on an annualised basis and nominal GDP. Total tax revenues track nominal GDP more or less. But consumption tax revenues are virtually a constant, with the exception of the bump in revenues following the 2014 April consumption tax hike.

Tax revenues and nominal GDP



Source: CEIC

A lot of distortion for not much fiscal benefit

A two percentage point increase in this tax would add about JPY 5.4 trillion annually to total tax revenues (about 1% of GDP) though the total effect on the budget deficit will be considerably less than this, due to the numerous offsetting measures that have been put in place to mitigate the impact of the tax on activity, and the numerous opt-outs that mean the full 2ppt increase will never be brought to bear.

Some front-running, but not much

In the short-run, the biggest impact of the tax hike will be to distort spending and inflation data. We don't have much to go on, but the front running so far seems fairly muted. August retail sales spiked up 4.8% month-on-month, and we can expect an elevated figure for September, too before the October figures drop sharply back. In 2014, they fell far more than they rose, though they fairly quickly returned to the pre-hike trend.

BoJ to buy more short tenor, fewer long tenor bonds

Japan's bond yields have retreated from the -0.3% level they reached at the end of August and were on the way to returning towards in the latter part of September. The 10-year yield now sits at about -0.164%.

BoJ schedule for outright bond purchases

	August	September	Difference
< 1y	100-1000	100-1000	0
> 1 ≤ 3	2500-5000	3000-5500	500
> 3 ≤ 5	2500-5000	200-4500	-500
> 5 ≤ 10	2500-5500	2000-5000	-500
> 10 ≤ 25	1000-2500	500-2000	-500
> 25	100-1000	0-500	-500
Inflation indexed	250	250	0
Floating rate bonds	1000	1000	0
Max total	<u>21250</u>	<u>19750</u>	<u>-2500</u>

Source: Bank of Japan

Reverse Twist

The central bank has refrained from changing its official policy stance, but the announced bond purchases suggest the Bank is engaging in a sort of reverse twist operation, buying more shorter-dated assets, and fewer longer-dated ones. Along with an announcement by the Government Pension Investment Fund that currency-hedged foreign bonds could be viewed as similar to domestic government bonds, this has added to the yield curve steepening, and given the currency a little upwards push too.

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