# Good MornING Asia - 6 December 2019

After the Reserve Bank of Australia recently left rates unchanged, yesterday it was the turn of the Reserve Bank of India (RBI). We think the RBI definitely has more work to do, and the RBA probably does too

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India

## India: A central bank surprise

The Reserve Bank of India's on-hold policy decision comes as the central bank cut its growth outlook for the current fiscal year, the fifth cut so...

Philippines

## Philippines: November inflation at 1.3%, BSP likely on hold.. for now

Philippine inflation edged higher in November to 1.3% which should convince the data-dependent BSP Governor to refrain from rate hikes..for now

Opinion | 5 December 2019

# Central banks holding back

After the Reserve Bank of Australia recently left rates unchanged, yesterday it was the turn of the Reserve Bank of India (RBI). We think the RBI definitely has more work to do, and the RBA probably does too


Source: Shutterstock

There's no point denying we were a bit flummoxed by yesterday's "no change" decision by the RBI. Yes, inflation is rising, but that is largely a seasonal effect that will come and go. The deterioration of growth looks to have stronger underlying drivers, requiring further pushback by the authorities.

Markets responded with a stronger INR, but I wonder if that strength will hold. Yesterday's decision looks like one that will simply make the recovery of growth take longer, and as such, may require greater overall easing. I would think the more likely direction from here is for some depreciation.

Not one of the Bloomberg consensus expected "no change", and we don't think this is the last word on Indian easing. More looks likely next year. See the linked note by Prakash Sakpal for details. We think USDINR weakens to 73.0 by 1Q2020

## Data not running the RBA's way

It wasn't a good day for RBA hawks either, with the retail sales number for October coming in at zero month on month. It was forecast to rise by 0.3%.

Following its "no change" decision this month, the RBA has tied the future direction of its monetary actions to household spending, of which retail sales are a sizable portion.

The recent GDP disappointment challenged Governor Philip Lowe's notion of "gentle upturn". Couple that with last month's poor labour market data, and the backdrop is looking quite challenged. About the only thing that will stop us from adding a couple of rate cuts from the RBA into our forecasts for next year, would be a recovery in the 19 December labour data. In the meantime, the AUD is likely to remain pressured.

## Japan open's the spigot on fiscal spending

For some days, the news on Japan's fiscal stimulus has been churning, with the numbers getting bigger each time they are released. Japan was the first economy I ever covered in its entirety when I made the move to the dark-side from the UK Government Economic Service back in 1997, and if I learned anything in that time, it was this: Never change your forecast in the face of a Japanese stimulus package.

Why? Well if the government are throwing money at the economy, it usually means something is going wrong, and that means your original forecasts were too high. But the stimulus will largely offset that, leaving you roughly where you originally were.

Moreover, a fiscal stimulus isn't great news long term. As it shows that Abenomics is failing to make a meaningful difference to Japan's potential growth rates. It also means that the economy will be saddled with even more debt. But no one seems to care any more, and we suspect that ultimately, the portion of this debt that is held by the Bank of Japan, will be written off, in a sort of behind closed doors deficit monetisation.

## China trade comments

Iris Pang in HK SAR picked up a few Chinese comments on the Trade War from spokespeople. "Spokesmen from China's ministries reiterated that a tariff roll-back is a necessary condition for any phase-1 deal and that tariffs will ultimately hurt the interests of US consumers. It is getting closer to the next tariff imposition date, 15th December, which schedule 10% tariffs on around $160 billion that are mostly consumer goods. The US needs to decide if it wants to give concessions to China on tariff rollback in exchange for China's purchase of US agricultural products".

## OPEC decision still a bit murky

(Head of Commodities Strategy, Warren Patterson adds this on OPEC and oil): After a long day of meetings, it is still not 100% clear what OPEC+ have agreed to do, with OPEC deciding to skip the press conference, following closed-door meetings. Reports suggest that they will increase output cuts by 500Mbbls/d. However, it appears that this cut may just reflect formalisation of the over-compliance that we are already seeing from the group, rather than fresh cuts. Details should become clearer later today, with OPEC+ meetings set to get underway. The market so far seems somewhat unimpressed with the noise coming out of Vienna, with WTI trading somewhat lower this morning.

## Impeachment proceedings coming

US speaker of the House of Representatives, Nancy Pelosi, has asked leaders of the House committees that have been looking into allegations of Presidential wrongdoing relating to Ukraine, to draft articles of impeachment.

I mention this today as I can't really ignore such a big news story. However, I'm torn as I don't really think this has any financial market implications. As I see it, and I'm no political expert, this has no chance of making it through the Senate. It may not even affect President Trump's opinion poll ratings, at least not in the way you might expect. This is great news for the news industry. But beyond that, I'm not so sure what material impact it has.

## Market is calm...too calm

It all looks a bit too calm at the moment. Stocks rose yesterday - the absence of any bad news seemingly the catalyst, rather than any intrinsically good news. Tonight we get the US labour report. Following from the weak (+67K) ADP report earlier this week, there is some added risk of a disappointment here. The consensus payrolls expectation is +179K. Good luck and have a great weekend.

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# Asia week ahead: Another big data splurge

Activity releases from China, Japan and India, and central bank meeting in the Philippines dominate Asian economic calendar, making it another busy week for markets

Source: Shutterstock

## Trade news dominates

As the noise around 'phase one' US-China trade deal intensifies further as the mid-December deadline approaches, China's combined October-November activity growth will give some sense of the economy's performance in the current quarter. Judging from a rebound in manufacturing PMIs last month, things have stopped getting worse. We anticipate more evidence of this in the forthcoming data supporting our view of GDP growth gaining some traction in this quarter.

Japanese economic data should reinforce the continued weak state of the economy as the markets digest today's announcement by prime minister Shinzo Abe of $240 billion in fresh stimulus. The key item on the calendar is the Bank of Japan's quarterly manufacturing Tankan index with expectations of the lowest reading of large manufacturing Tankan in seven years. This comes as domestic spending is taking a hit from the consumption tax hike this quarter, while exports remain under pressure from the trade war.

Of all the Indian data next week, November consumer price inflation will be closely watched in light of surprise pause in RBI easing. Food prices are pushing inflation higher, taking prices above 5% in the last month, closer to the top end of the RBI's 2-4% policy target. Persistent downside growth risk will be revealed by another deeper fall in industrial production in October, we don't see inflation becoming a hurdle for more RBI easing.

Elsewhere, Taiwan's exports and Malaysia's manufacturing data should shed some light on the stage of the electronics cycle. We have seen signs of it bottomed out and would look for more evidence of the same.

Finally, the Philippines central bank policy meeting next Thursday (12 December) should be a non-event with higher November inflation likely to force a pause in rate cuts.

## Asia Economic Calendar

| Country | Time | Data/event | ING | Survey | Prev. |
|---|---|---|---|---|---|
| | | **Saturday 7 December** | | | |
| China | - | Nov Forex Reserves (US$bn) | 3115 | 3100 | 3105 |
| | | **Sunday 8 December** | | | |
| China | - | Nov Imports (YoY%) | -5.8 | -1.5 | -6.4 |
| | - | Nov Trade Balance (US$bn) | 52.0 | 45.2 | 42.8 |
| | - | Nov Exports (YoY%) | 0.0 | 0.7 | -0.9 |
| | | **Monday 9 December** | | | |
| China | - | Nov Money supply (M2) (YoY%) | 8.5 | 8.4 | 8.4 |
| | - | Nov Aggregate finance (CNY bn) | 1200 | 1485 | 619 |
| | - | Nov New yuan loans (CNY bn) | 1282 | 1200 | 661 |
| India | - | 3Q Current account balance (Q) (US$bn) | -6.8 | -5.7 | -14.3 |
| Taiwan | 0800 | Nov Exports (YoY%) | 2.4 | - | -1.5 |
| | 0800 | Nov Imports (YoY%) | -0.5 | - | -4.1 |
| | 0800 | Nov Trade balance (US$bn) | 5.5 | - | 4.0 |
| | | **Tuesday 10 December** | | | |
| China | 0130 | Nov CPI (YoY%) | 3.0 | 4.2 | 3.8 |
| | 0130 | Nov PPI (YoY%) | -1.7 | -1.4 | -1.6 |
| Philippines | 0100 | Oct Trade balance (US$mn) | -3703.0 | - | -3119.0 |
| | 0100 | Oct Exports (YoY%) | -2.8 | -1.0 | -2.6 |
| | 0100 | Oct Imports (YoY%) | 0.1 | -6.8 | -10.5 |
| Singapore | - | Oct Retail sales value (MoM SA/YoY%) | -1.5/-3.7 | -/- | 1.9/-2.2 |
| South Korea | 2300 | Nov Unemployment rate (% SA) | - | - | 3.5 |
| | | **Thursday 12 December** | | | |
| India | 1200 | Nov CPI (YoY%) | 5.0 | 5.3 | 4.6 |
| | 1200 | Oct Industrial production (YoY%) | -5.3 | -3.6 | -4.3 |
| | - | Nov Imports (YoY%) | -13.5 | - | -16.3 |
| | - | Nov Trade deficit (US$bn) | -13.1 | - | -11.0 |
| | - | Nov Exports (YoY%) | -5.0 | - | -1.1 |
| Malaysia | 0400 | Oct Industrial production (YoY%) | 2.3 | - | 1.7 |
| Philippines | 0800 | Overnight Borrowing Rate | 4.0 | - | 4.0 |

Source: ING, Bloomberg, *GMT

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# Japan: Smoothly does it

So far, Japan's consumption tax hike seems to have gone down far more smoothly than its previous equivalents in terms of both GDP growth and inflation. Though the coming months could still see some fallout even if the front-loading was smothered by inventory fluctuations

Source: Shutterstock
Japanese Prime Minister Shinzo Abe

## 3Q19 GDP rises only 0.1% QoQ

Japan is now in the midst of an adjustment phase following on from its consumption tax hike from 8% to 10% in October. So far, this has gone far more smoothly than the previous episodes of this tax hike. The 3Q19 GDP result was only 0.1% QoQ, or 0.2% annualised, down from the previous quarter despite front-loading of consumer spending in September on some items affected by the hike.

The GDP figures were also negatively affected by a big drawdown in inventories. The QoQ contribution of private inventories was -0.3%. That was enough to totally offset the growth in private consumption. Net exports stripped a further 0.2pp from the total, with the result that the front loading of residential and non-residential investment, which in any case was fairly subdued, was totally offset.

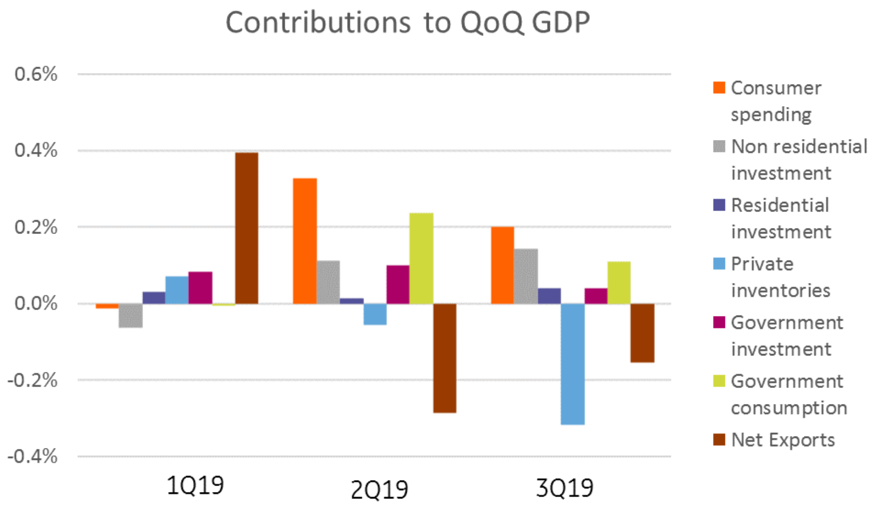
# 0.1% QoQ

Lower than expected

3Q19 GDP

0.3% saar

## Contributions to QoQ GDP growth




Source: CEIC, ING

Contributions to QoQ GDP growth %

## Front-loading buried, but a big drop still probable

But if the front-loading was denatured, does that mean that 4Q19 figures will escape the big drop that usually follows the front loading? In our view, probably not.

For one thing, it seems a stretch to rebuild inventories against a known background of likely weak 4Q19 demand. Sure, if it were involuntary, then it could happen, but it is not as if a weak quarter of demand in 4Q19 is likely to be a surprise. More probable, inventories will be roughly unchanged rather than fall sharply as they did in 3Q19. Their contribution might rise to something closer to zero, so it gives 4Q19 GDP a better starting point. But that is likely to be offset by falling household consumption and falling investment.

Retail sales for October fell by 17.4%YoY, having risen by 11.0%YoY in September. Compared to 2014, this means that sales rose slightly less just ahead of the tax hike, and have also fallen slightly less too immediately afterwards. So perhaps the 4Q19 collapse will not be as abrupt.

The other hope is for a bigger decline in imports and recovery in exports. That is not impossible. Though exports are still likely to struggle against a weak global demand backdrop, some softer imports may at least soften the blow of weak domestic demand.

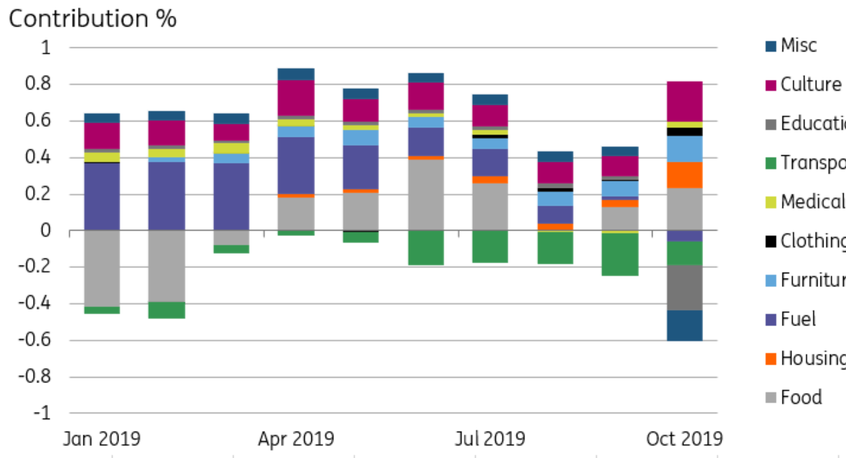
## The JPY 13 trillion support package arrives

Looking beyond the immediate period of economic disruption, prime minister Shinzo Abe launched a fiscal package of JPY13.2tr ($121bn). That is about two to three per cent of GDP, though we expect the effective element of this will be far smaller in terms of 2020 GDP as it is to be spent over 15 months, and will likely contain some spending already accounted for, or include soft loans, not real spending.

The spending could help Japan get over another hump – namely the end of construction investment following the conclusion of next year's Olympic Games. Exactly what the package will entail is not yet public knowledge, but it will likely contain a number of natural disaster protection elements, (flood defences etc) as well as infrastructure.

Typically, it is not a good idea to bump up GDP forecasts in response to stimulus packages such as this, though they also tend to provide very lumpy support and it may well be that 2020 is every bit as bumpy as we thought 2019 would be.

## Japanese inflation dampened by education




Source: CEIC

## Inflation unchanged - or is it?

The other big change to our forecasts for 2020 is in terms of inflation.

Our previous forecast treated the consumption tax in the same was as previous hikes, which led to a 12-month price spike and raised inflation that then dissipated. This time, there has been no such price spike – well there has – but it has been almost totally offset by the impact of pre-school childcare, which has been made free. So in October, alongside a rise in clothing and footwear costs of 1.6% (on top of 4.1% the previous month), a 0.9%MoM medical care spike, 2.2%MoM entertainment increase and 1.1% increase in transport and communication costs, education prices fell 8.4%.

*The other big change to our forecasts for 2020 is in terms of inflation*

From the previous month, national CPI inflation remained unchanged in October. And we have had to drop our inflation profile for next year substantially to reflect this offsetting price reduction. Saying that there was no change in Japan's price level in October is a bit of a simplification though. Considering how few people in Japan have children of pre-school age, for most households, prices have risen quite a lot without any offsetting declines.

In other words, the lack of movement in Japan's price level is a statistical simplification for the majority of households.

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Article | 5 December 2019 China

# China: How alarming is the default risk?

We have seen default cases rising in China's bond market. But is it really a bad thing?


Source: Shutterstock

## Is this a fall off the cliff or a healthy clean up?

As always defaults are eye-catching and bad news for investors, issuers and the market.

For the economy, if poor credits can access funding to cover existing debts, and rollover "forever" then accumulating these debts, without defaults, isn't a great situation as it has the potential to create a default time bomb.

Therefore, the question is if the recent round of defaults is a large scale fall-off-the-cliff event that will rock the market or just a cleanup of bad credits.

## China bonds default cases have increased

We think there are three reasons why the number of defaults in China has increased:

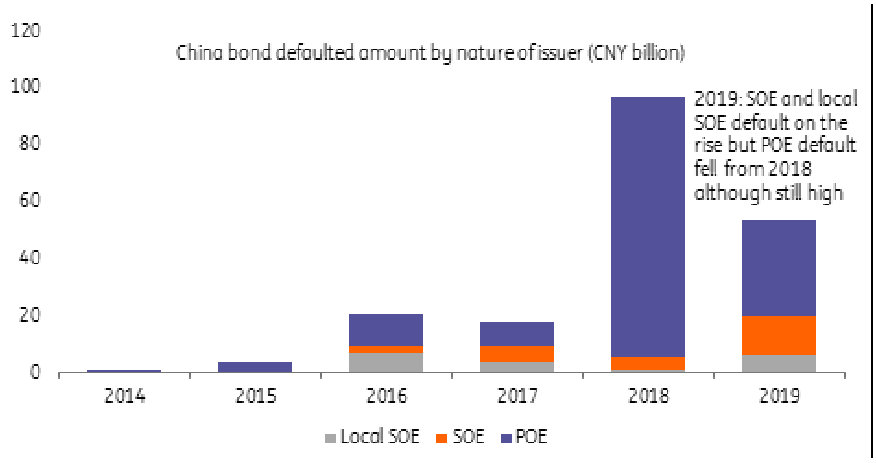
1. Lots of local government special bonds - around CNY2.5-3 trillion - have been issued in 2019 to support infrastructure projects. The market has started to question if this influx could generate a series of defaults, which would be on what are by nature corporate bonds and therefore not guaranteed by the local government.
2. Land sales revenue for some local governments has been small while relief measures have increased due to the trade war. The combined effect of these factors impacts local

governments' ability to pay. Default from local SOEs jumped from nearly zero in 1Q18 to more than CNY6 billion in 3Q19.

3. Defaults on bonds issued by privately-owned enterprises have been high though these have fallen since 2018. Then, the government aimed to clean up POE bonds after the cleanup of SOE loans in 2016-2017. The issue with POE is more complicated as major shareholders usually pledge their shares as collateral for loans. Should the company be unable to repay the loan, the stock market then reflects this through a lower share price, in turn making repayment more difficult.

## China bond default on the rise

Data as of 4th December 2019 from Bloomberg do not include private placements.




Source: ING, Bloomberg

## Shadow banking is shrinking at the same time

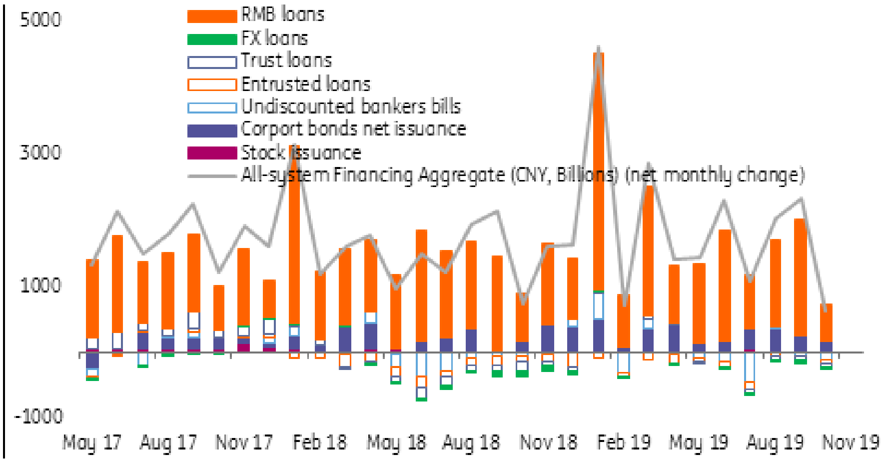
This view is confirmed by shrinking shadow banking activities.

Shadow banking activities have been shrinking since early 2018, thanks to the efforts of the central government to restrict these. In 2019, the shadow banking activities most affected have been peer-to-peer (P2P) lending platforms, which accepted loans drawn by mostly smaller firms that were facing difficulties. Trust companies then packaged the P2P loans and sold these to investors seeking yields.

In 2019, the central government has driven most P2P activities out of business. The Chinese central bank has increased incentives for banks to lend to smaller firms.

## Shadow banking has been shirnking

Hollow bars are shadow banking activities




Source: ING, Bloomberg

## More defaults to come in 2020

We expect more local state-owned enterprises to default in 2020 - land sales will be limited by restrictive housing measures and the credit ratings of local governments will continue to be diverse.

Local government special bond issuance has increased since late 2018. Usually, these bonds have maturity of five to 10 years. The concern isn't about these credits defaulting in 2020, but rather in 2023. By that time infrastructure projects should be completed and should begin to generate cash flows to repay the debts. In 2019, the rate of local state-owned company defaults has been faster than in 2018, also reflecting the government's intention to stop overlending at the local government level.

We also expect the default of private-owned enterprise bonds to continue at a high level of around CNY35 billion in 2020, similar to the level expected in 2019. Critical here is that shareholders pledge shares to get loans, which in turn has the potential to increase risk correlation between the share prices and the loan and bond markets.

China's sovereign bonds will remain intact as these are seldom affected by state-owned players' default situations.

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# India: A central bank surprise

The Reserve Bank of India's on-hold policy decision comes as the central bank cut its growth outlook for the current fiscal year, the fifth cut so far, and also raised its inflation forecast. We expect one more 25 basis point rate cut in the current cycle

Source: Shutterstock

5.15%

RBI repurchase rate

No change today

Higher than expected

## Stable policy

Confounding the broad consensus of one more 25 basis point rate cut, and our more bearish 40 basis point cut forecast, the Reserve Bank of India decided to leave the repurchase and reverse repurchase rates unchanged at 5.15% and 4.90%, respectively. There was also no change to the 4.0% cash reserve ratio for banks.

It was a unanimous decision by all six policy committee members. The statement noted that the policy stance would remain accommodative “as long as it is necessary to revive growth while ensuring that inflation remains within the target”. This is despite continued inflation risks ahead from higher food prices going into 2020 amid rising inflation expectations. The RBI now sees inflation rising above 5% in the second half of the current fiscal year (FY2019 started in April), against an earlier forecast in October of under 4% inflation. It also cut its growth forecast for this year to 5.0% from 6.1%, the fifth cut so far.

## End of easing? Not yet..

The policy pause comes after 135 basis points of rate cuts earlier in the year did little to revive the economy while rising inflation has also started to reduce the policy space.

While inflation isn't going to be a hurdle to further RBI easing if needed, we do believe that the downward growth cycle has reached a trough. However, against a backdrop of rapid easing earlier this year and persistent downside growth risks ahead, we think the easing cycle might have a bit further to run. We maintain our forecast of a 25bp rate cut at the February 2020 meeting, which we expect to be the last cut in this cycle.

## Good for INR, but not great

The RBI's decision was a disappointment for the markets which, we think, had priced in a 25bp rate cut. But it's positive for the Indian rupee (INR), Asia's underperforming currency this year, partly due to aggressive rate cuts.

The INR lost some ground today in trading until the RBI's decision. Its reaction to the decision was positive, though not enough to offset weakness before the decision. We don't think the worst is over for the beleaguered currency, not least from a policy perspective, and maintain our view of USD/INR rate at 73.00 by end-March 2020.

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# Philippines: November inflation at 1.3%, BSP likely on hold.. for now

Philippine inflation edged higher in November to 1.3% which should convince the data-dependent BSP Governor to refrain from rate hikes..for now

Source: Shutterstock

**1.3%**

Higher than expected

November CPI inflation

ING forecast at 1.3%

## Philippine November inflation rises to 1.3%

After dipping to 0.8% in the previous month, inflation for November settled at 1.3% with price gains in the top three subsectors remaining subdued. This was slightly faster than the market expectation for a 1.2% increase and should be enough to persuade the central bank to pause at its next meeting.

Food inflation was flat on the back of improved supply conditions and ample rice supply thanks to legislation that removed quotas on rice imports. Relatively stable global crude oil prices also helped both utility (1.2%) and transport costs (-2.4%) to keep headline inflation below the lower-end of the Bangko Sentral ng Pilipinas' (BSP) 2-4% inflation target. Taken together, food, utilities and transport account for 68% of the CPI basket.

## Bounce and settle: Inflation to trend higher from hereon

With base effects from last year's inflation spike fading quickly, we expect the acceleration in inflation to continue into 2020 and settle at around 3% throughout most of next year. For as long as supply conditions remain favourable, we can expect inflation to remain in-check, though we are unlikely to re-visit sub-2% inflation for at least the next 12 months.

## November headline inflation to convince BSP to pause

Given the higher than expected inflation, we expect BSP Governor Diokno to refrain from reducing policy rates at the 12 December 2019 meeting, Diokno has indicated that his policy decisions remain data-dependent with inflation being the primary consideration for rate adjustments. Given his dovish leaning, Diokno could resume his rate cut cycle as early as 1Q 2020 to chase a higher growth target (6.5-7.5%). The Peso may receive some near-term support as faster inflation means that a BSP rate cut is off the table for now.

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