

Good MornING Asia - 6 July 2020

Inflation, manufacturing and trade releases and central bank policy decisions in Australia and Malaysia will be driving the Asian markets this week besides the Covid-19 developments

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By Robert Carnell and Francesco Pesole



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The RBA looks comfortable with its current stance

[This speech by Reserve Bank of Australia's Deputy Governor, Guy Debelle, from 30 June](#) makes for nice background reading and is a nice summary of all the measures the RBA has put in place during this pandemic, and how successful they have been.

Whether this is intended to convey a message ahead of this week's rate meeting on 7 July is less clear, but if it is, then the message is a fairly clear one - nothing needed now, and maybe not for some time.

The following extract from Debelle's concluding remarks captures the essence of the RBA meeting this week:

"The cause of the decline this time is much different from those in the past. Many of the imbalances that exacerbated declines in

previous downturns are not present this time. But it is still quite likely that this decline will have a long-lived impact that will require considerable policy support for quite some time to come. While much of that support is likely to be on the fiscal side, the Bank will maintain current policies to keep borrowing costs low and credit available, and stands ready to do more as circumstances warrant".

In other words, it's all good now, but it is possible that conditions change, and then anything goes.

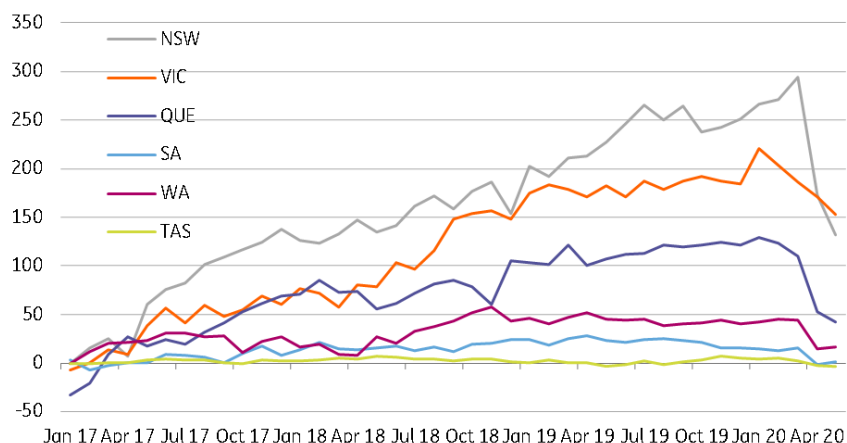
As the chart below shows, recent labour market figures show that the worst of the declines may have passed, and indeed in some states, employment began to creep tentatively higher again in May. More of this is likely in June everywhere except in Victoria, where restrictions remain in place.

The main concern for the central bank and the Australian government may be the strength of the Australian dollar, and it is possible that the upcoming rate meeting looks to talk up some of the possible downside risks to the economy and policy choices to keep the AUD from moving too much higher, though global market sentiment and appetite for the AUD and Australia's commodity exports could shortly turn for the worse if Covid-19 flare-ups in the US and elsewhere do not begin to turn back down again.

The Aussie dollar has been trading in the 0.68/0.70, following the stall in global market sentiment as indications of global recovery are being offset by second Covid-19 waves. As rightly pointed out by governor Lowe, there is no evidence that the AUD is overvalued - our in-house BEER estimates show an undervaluation of around 10%. However, the current global recessionary environment would surely warrant a much wider risk premium embedded into a quintessentially pro-cyclical currency such as AUD.

The role of a weaker AUD as a shock-absorber for the Australian economy is non-negligible, and the fact that neighbouring Reserve Bank of New Zealand is directly addressing a strong NZD as a hindrance to economic recovery is a case in point.

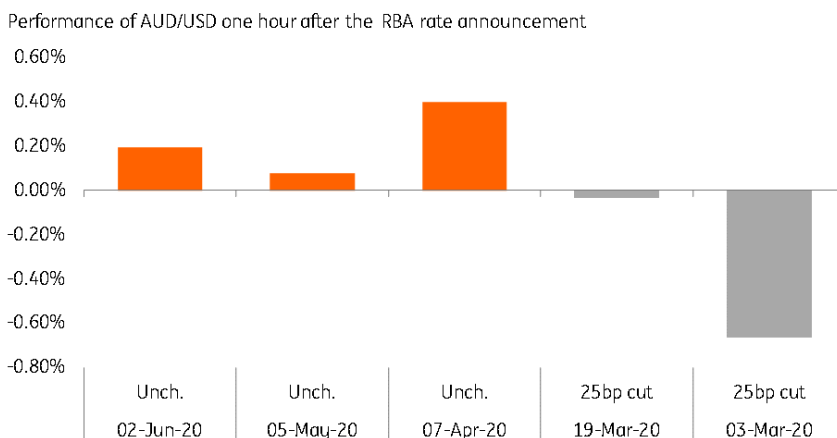
Cumulative employment growth - Australian states



Source: CEIC
AUS state employment growth

AUD reaction function depends on any currency comment

AUD has not faced very high volatility around the latest RBA meeting. The chart below analyses the impact on AUD/USD of the latest five RBA rate announcements: the AUD posted gains (although very marginal in May) in past three meetings, when rates were kept unchanged.



Source: ING, Bloomberg

This time, markets are likely pricing in very little surprise potential - as discussed above, the RBA appears to be comfortable with its current policy measures.

We suspect that most of the AUD reaction will be driven by whether and how the RBA will address the currency situation as there is a chance that Governor Lowe may want to implicitly walk back from the message that the RBA is quite relaxed about the current AUD levels.

If no mention of the currency is made and (as widely expected) there is no change in the policy stance/rhetoric, we expect a balanced or mildly positive impact on AUD.

If the AUD strength is mentioned, we think this would probably look similar to what the

RBNZ did: acknowledging that currency strength poses an obstacle to the economic recovery, but not going as far as hinting at any measures to counter more appreciation. In this case, we expect a negative impact on AUD, although relatively limited in size, in line with the reaction after the last few meetings.

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Why should Malaysia's central bank be cutting rates again?

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Source: shutterstock

1.50%

ING forecast

After 50bp cut next week

We're in the 50bp rate cut camp

Malaysia's central bank meets on Monday, 6 July and the decision is expected on Tuesday at 3 pm local time.

The central bank doubled up easing at the last meeting in early May, cutting the overnight policy rate by 50 basis points instead of the conventional 25bp move. This pushed the OPR down to the 2% low reached during the 2009 global financial crisis, after a cumulative 100bp easing thus far in 2020. The central bank also announced MYR 16 billion (about 1% of GDP) of liquidity-boosting measures at the same time.

The consensus for the upcoming meeting is split between more rate cuts staying on-hold outcome, and there is a further split within the rate-cut camp on a 25bp or a 50bp cut.

We believe another 50bp cut is on the table this time.

Our rationale for aggressive BNM easing

The nationwide Covid-19 movement control order (MCO) started in mid-March and has lasted for nearly three months, throwing the economy into the worst recession in decades.

Malaysia's GDP shrank in 1Q20 by 2% quarter-on-quarter (seasonally adjusted). Indeed, with near-standstill activity, it would be a far bigger fall in 2Q and we estimate -7.7% QoQ, pushing the yearly growth down to -8.3% - the worst since the 1998 Asian crisis (2Q GDP data won't be available until mid-August).

The relaxation of MCO since early May (Conditional MCO) may have helped sentiment but not real economic activity as such. The accelerated export decline to more than 25% YoY in May will have dragged manufacturing further down after the 32% YoY plunge in output in April (also look out for May industrial production data next week, 10 July).

Talking about sentiment, the improvement is seen from a rise in the manufacturing PMI above the 50 threshold for expansion in June (51.0 vs. 45.6 in May), which is probably why some forecasters expect no rate cuts next week. However, it only underscores some recovery from the dramatic manufacturing declines in the preceding months. In fact, barring occasional spikes above 50, the PMI has hovered below this level in recent years. With the key driver exports missing in action it's hard to imagine the PMI staying in the expansionary territory in the months ahead. Persistent weak manufacturing means GDP growth should stay negative throughout the second half of the year.

We anticipate some recovery in 2021 though that's probably going to be very anaemic too.

A timely dose of easing, while there is room for it, will go some way in shoring up domestic demand.

The negative CPI inflation (-2.9% YoY in April and May), has left the real rate as one of the highest in Asia, offering scope for further cuts in the nominal rate. A timely dose of easing, while there is room for it, will go some way in shoring up domestic demand, though the overall recovery will still hinge on external factors, given the economy's reliance on exports and tourism.

The ongoing fiscal constraint is another reason why the monetary policy needs to do some heavy lifting. Although the government has unveiled about 19% of GDP stimulus so far, we estimate it equates to just 5.6% of real-spending GDP. And, scepticism about that actually flowing through to the economy is ample given the lingering political uncertainty.

Therefore, we see no reason why the central bank should take a pause next week. On the contrary, we believe its easing cycle has more room to run with our forecast of a total 100bp of rate cuts this quarter, including an additional 50bp cut we have pencilled in for the subsequent meeting in

September.

What this means for markets?

The markets don't seem to be pricing any more rate cuts. Both short-term interbank rates as well as long-term bond yields are firm at the levels since the last central bank policy move – 3M Klibor at 2.3% and 10-year MGS yield at 2.8% currently. Likewise the FX market, with USD/MYR firm in a narrow trading range of 4.25-4.30 since early June, though that's partly a broader emerging market strength recently.

Yet, we are convinced about our view of the central bank delivering a 50bp rate cut next week. If true, this will pull the floor under the bond yields and pressure the USD/MYR higher. We view the risk to our 31.30 USD/MYR forecast for end-3Q20 as tilted towards the upside (spot 4.29).

Singapore's May retail sales plunge 52%

As Singapore sees the worst drop ever recorded in retail sales, we foresee private consumption as the main expenditure-side source of 2Q20 GDP crash



Source: Shutterstock

52.1% May retail sales fall
Year-on-year

Worse than expected

Covid-19 circuit-breaker dents spending

Singapore's retail sales crashed by 52.1% year-on-year in May, bang on our -52.0% YoY forecast for the month while the consensus was -47%.

This is the worst drop ever recorded since the series started back in the mid-1980s and it comes on top of a more than 40% YoY decline in April. Month-on-month fall eased to 21.5% from 31.3% though.

The lockdown measures in place since early April to contain Covid-19 pandemic have been depressing spending. But sales of essential goods and services are spared from this slump;

supermarket and mini-mart sales continued to post strong gains, by 56.1% YoY and 9.1% respectively.

All non-essential spendings has been taking a strong beating instead. Big-ticket items like cars remained a dominant pull on the downside with an 86% YoY fall, which was consistent with more than a 90% fall in new vehicle registrations in May. Likewise, watches and jewellery suffered a 97% fall, department stores 93%, apparels and footwear 89%, and recreational goods 74%.

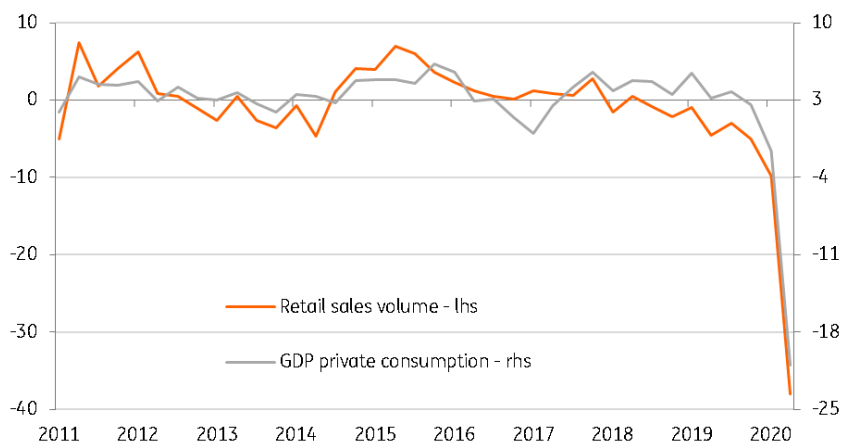
More weakness ahead

This brings the average April-May sales growth to -46%.

We don't think June growth to drift far off from this rate. The reopening of the economy should have provided some relief to spending in June, though we don't think all pent-up demand has returned just yet given continued caution on the pandemic. This suggests that private consumption was the main expenditure-side source of GDP collapse in 2Q20. Our -9.2% YoY GDP growth forecast for 2Q is on track.

We expect consumer demand to continue to lack vigour throughout the rest of the year, and well beyond, as persistent economic strain and rising job losses are likely to deter non-essential spending.

Consumer spending under duress (% year-on-year)



Source: CEIC, ING

Note: Quarterly data. ING forecast for 2Q20.

Thailand: Has inflation bottomed?

We don't think the price gains seen in June will be durable enough to bring inflation back into positive territory for the rest of the year



Source: Shutterstock

-1.6% June CPI inflation

Better than expected

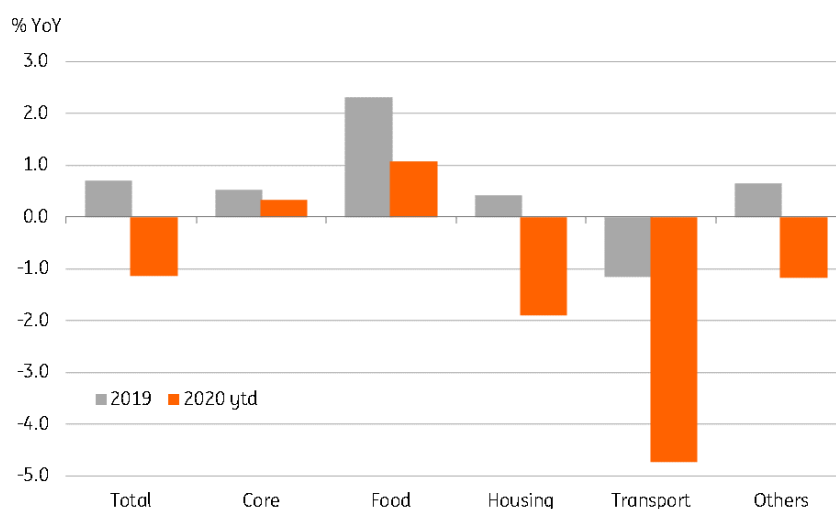
An upside inflation surprise

Thailand's consumer price inflation remained in negative territory for a fourth straight month in June, though a rate of -1.6% year-on-year was a significant recovery from the post-global financial crisis low of -3.4% reached in May. The consensus median was for a modest improvement to -3.1% (ING forecast was -3.3%).

The relaxation of the Covid-19 lockdown should have brought back some pent-up demand. However, a sharp recovery in inflation appears to be largely a supply-side phenomenon instead, explained by the surge in utilities and transport prices. Utilities and transport components suffered the most at the start of the lockdown with month-on-month plunges of 21% and 4.3%, respectively in April. Both returned with 24% and 2.6% surges in June as the lockdown ended.

Inflation in most other CPI components was little changed from May. And so was core inflation, which remained close to zero, indicating a lack of demand-side pull on prices.

What's driving CPI inflation?



Source: CEIC, ING

Has inflation bottomed?

The economy is facing a continued downdrift ahead as the key drivers of exports and tourism remain missing in action, and weakness from external sectors has broadened out to domestic demand. Consumer confidence has been at a record low and the threat of rising job losses offers little hope of it coming back to the pre-Covid level anytime soon.

For now, inflation appears to have bottomed. But we don't think the extent of price gains observed in June will be durable enough to bring inflation back into positive territory in the rest of the year. However, it is enough to provide a boost to our annual inflation forecast. If it does not worsen from here, we see inflation staying near June's pace for the rest of 2020. We revise our annual inflation forecast to -1.5% from -2.3%.

While persistent negative inflation calls for further monetary easing, there isn't any easing space left for the Bank of Thailand in this cycle.

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