

Good MornING Asia - 7 October 2019

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By Robert Carnell



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A narrow deal?

It looks as if we are back to considering the merits of a narrow trade deal today, as news stories break suggesting that China is not looking to make a broader trade deal along the lines it is reported the US is seeking.

I'm intrigued by this, as from a strategic point of view, I would have thought that the US would have the most to gain from a partial deal, not China.

1. The US economy remains in fairly good shape, but recent data show that this position is being undermined, in particular by trade-war-affected manufacturing;
2. The US economy has further to fall, and perhaps has fewer stimulus policies up its sleeve
3. The benefits of fighting China on trade may now be being outweighed by the short term hit to the economy, in terms of popular support and potential votes for President Trump at next year's Presidential election
4. Given the points above, China may see it as advantageous to keep the trade war alive, but under control pending political developments in the US.

What may undermine these strategic considerations in the short term is the impact that swine fever is having on pork-supply in China and the need for other agricultural goods such as soy. Even if the strategic points above are correct, feeding the nation clearly will always come first, so this

may be the dominant thinking this week.

A mutual olive branch from the US could be further delaying the implementation of the most recently announced tariffs.

Against this, the US has indicated that it wants a broad-based deal. Nothing is yet in the bag, and optimism on trade has proved time and again to be misplaced.

US data - supports Fed cut, but could have been worse

As James Knightley (JK) [writes in the linked note](#), the US jobs data last Friday raise the prospects of a further Fed rate cut (house view is another at the 31 Oct meeting and then again in December). But the data could have been considerably worse, at least from a risk asset perspective.

One of the things JK has been highlighting recently is the sharp pick up in wages and core CPI. On an annualized basis, this has been looking particularly worrying. But if we have learned anything about US wages (indeed wages globally) since the financial crisis, it is that just as they begin to look worrying, they are either revised lower or simply fall back. This seems to be the world we live in. It doesn't matter how tight the labour market gets, how low the unemployment falls (now only 3.5%), we just don't seem to get wages blowing out. Before moving to Asia, I spent years wrongly worrying that we were on the verge of US wages finally bursting up. Almost three years later, they still haven't. I'm not sure now that they ever will.

But this is potentially not as bad as it looks. Face it, had wages been hurtling higher, as growth stagnated, it would have tied the Fed's hands to respond. At least this way, there is little to stand in their way on 31 October. And that should provide a modicum of comfort to equity investors.

One brief aside, in terms of US labour tightness, I had two weeks of marketing in the US recently. My unofficial benchmark for how tight the US labour market is has for many years been based on the quality of service in fast-food outlets. The relationship is inverse. If you get your order rapidly, and accurately, there is slack in the labour market. The Fed has ample room to move. If your order is completely wrong, and given to you with an accompanying "Killer accent dude!", it is tight, and the central bank in question has limited room.

My observation: It is tight, very tight...

Brexit - election first! After which...?

There seems little chance that PM Johnson's "compromise" offer to the EU on the Irish Backstop has a hope of being passed, or even that it will form a broad "landing pad" for an EU counter-offer. There is some chat about a further offer from the UK before this Friday. That would indicate that the current government is actually serious about getting a deal. This is not clear.

[James Smith covers this all in great detail here](#). Note, the Brexit deadline is 31 October, but 19 October is the effective deadline, after which, according to the Benn bill passed in September, the PM will have to ask the EU for an extension to article 50.

And then, and probably only then, we may expect a vote of no confidence and a General Election.

What happens then is anyone's guess. A variety of polls indicate that a second referendum would narrowly be won by "remain". But to get a referendum, we would need a broad coalition of Labour

and Liberal Democrats and probably others to form a government. At the moment, the Conservative Party is ahead in the polls. If they campaigned on a "no-deal" ticket, forcing out the Brexit Party, then they could possibly win a majority under the UK's first-past-the-post system, which would mean that the UK might still be leaving, and without a deal.

It's probably time for me to contact the British Consulate and arrange for my postal vote (though I often worried that most of these ended up in the bottom of the Regent Canal).

In the meantime, expect GBP to swing widely.

Week ahead

In the week ahead in Asia, Prakash Sakpal writes: "Malaysia's 2020 Budget due on Friday is expected to focus on growth. The Malaysian economy will find it increasingly tough to continue to outperform the global slowdown as external headwinds from trade and the tech war are gaining strength. As such, we expect the budget to include some growth-boosting measures, keeping the deficit above 3%." (For more, see our [Asia Week ahead publication](#))

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India's central bank gets further ahead of the easing curve

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Source: Shutterstock

5.15% RBI repurchase rate
After 25 basis point cut today

As expected

Getting ahead of the easing curve

In line with the solid consensus, the Reserve Bank of India (RBI) delivered yet another 25bp policy rate cut at its bi-monthly policy review concluded today. It was also a unanimous decision by all six Monetary Policy Committee (MPC) members, while one of them wanted an even deeper cut of 40bp.

Today's move takes the RBI's repurchase rate to 5.15% and the reverse repurchase rate to 4.90%, putting the central bank further ahead of Asian and most global peers in the current easing

cycle, with a cumulative 135bp rate cut year-to-date.

What the policymakers say

The [policy statement](#) noted no change to the 'accommodative' stance. And supporting this position, there was a further downgrade of the RBI's economic outlook for the current fiscal year, with growth now projected at 6.1% against the 6.9% projection at the August meeting (which itself was cut from 7.0%). Here, hopes have been pinned on the monetary policy easing so far this year gradually feeding into the real economy and boosting demand.

Meanwhile, the central bank sees inflation continuing under the 4% target (mid-point of 2-6% target zone), though it did nudge up the expectation for the July-September quarter from 3.1% to 3.4%. It pointed to subdued food price pressure and weak demand conditions, but also admitted "upside risk to the inflation outlook" from crude oil prices amid geopolitical uncertainties.

Are we at the end of it yet?

The continued 'accommodative' policy bias, downgrade of growth forecast, and stable inflation expectations – all point to more RBI easing ahead. The question is: how much more?

We think they have done enough easing and, given a considerable policy transmission lag, which the RBI policymakers acknowledge too, they should now pause and allow the rate cuts so far to work their way through the real economy before taking any further action. Otherwise, they run the risk of aggressive stimulus, via both monetary and fiscal channels, eventually transmitting into higher inflation.

*Monetary transmission has remained staggered and incomplete.
- RBI statement.*

However, judging by the all-dovish rhetoric, with some MPC members even calling for a rate cut in excess of 25bp, we don't think we are at the end of it. Reluctantly though, we retain our view of one more 25bp rate cut at the next meeting in December.

What this means for the markets

As well-flagged by Governor Shaktikanta Das and unanimously anticipated by economists, today's RBI policy adjustment should have little-to-no market impact.

Yet, there is no end in sight to the unfriendly policy backdrop for the Indian rupee (INR) as at least one more 25bp rate cut looks more certain than not at the next RBI meeting in December. We maintain our end-2019 USD/INR forecast at 73.50. Government bonds have been under selling pressure from a worsening fiscal deficit. Lower interest rates should be some relief to that market, though it's unlikely to be a lasting one.

And, after a knee-jerk positive reaction to corporate tax cuts late last month, investors in stocks seem to have retrained their focus back on weak growth prospects ahead, both globally and domestically. We don't see RBI easing as a positive here, and indeed, this

was evident today with the Sensex down 300 points as of this writing.

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Source: shutterstock

-0.8%

August export growth

Year-on-year

Worse than expected

Palm oil exports saved the day

Malaysia's export growth surprisingly swung back to negative territory in August. A 0.8% year-on-year export contraction was below consensus estimates, which not only foresaw growth staying in positive territory but actually accelerating to 2.7% YoY from 1.7% in the preceding month.

Yet, the latest underperformance isn't a complete shocker -- denominated in local currency (Malaysian ringgit, or MYR), export growth has been flipping between low single-digit positives and negatives this year.

While they were a source of Malaysia's export strength for much of this year, electrical and

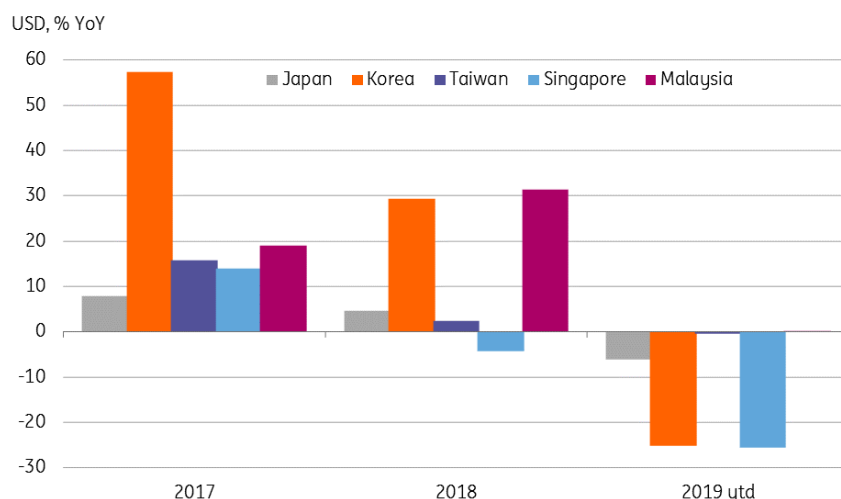
electronics exports were a source of weak headline growth in August. There was a sharp slump in these exports to -7.4% YoY from +4.5% in July. Undoubtedly, much of this was from semiconductors (-5.9% vs. +10.3% in July). Oil and related exports continued to be weak (-12% vs. -6.5% in July), though other commodity exports like palm oil, with a 17% surge, saved the day.

Is electronics strength fading?

Malaysia's semiconductor exports have performed far better this year in the face of a global technology slump. Heavy-weights in the field, Korea and Singapore, have seen their exports plunge as much as 30% YoY in recent months.

The year-to-date performance puts Malaysia closer to Taiwan than other Asian exporters, though part of the recent improvement in Taiwan's electronics exports was seasonal, a boost from new smartphone launches in summer. If anything, we sense Malaysia's relative strength as a move up the electronics value chain. And if so, the outperformance should continue even if recent strength wears off in an entrenched global downturn.

Asian semiconductor exports



Source: Bloomberg, CEIC, ING

Strong external payments

Import growth of -12.5% YoY in August was far weaker than expected (consensus -8.0) and it reflects weak domestic demand. But a narrower August trade surplus of MYR 10 billion than July's MYR 14.3 billion was in line with consensus.

The MYR 92.5 billion trade surplus in the first eight months of 2019 was \$20.6 billion wider than a year ago, which, in turn, will translate to a wider current account surplus. Our forecast for a 2019 current surplus equivalent to 2.8% of GDP, up from 2.1% in 2018, remains on track. Furthermore, a wider current surplus also means a continued positive net trade contribution to GDP growth this year, supporting it at the 4.7% rate of 2018, at least.

More policy support

However, today's weak export data does reinforce the view that 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.

While we maintain our view of one more 25 basis point rate cut by Bank Negara Malaysia in the current quarter, we also expect some policy support coming through in the 2020 Budget to be announced a week from today (11 October).

Philippine inflation slips to 0.9%

Headline inflation dropped to 0.9% with benign inflation providing the BSP scope to cut policy rates further



Source: Shutterstock

Food inflation now in deflation

Philippine inflation continued to fall as base effects hit home. Mirroring last year's inflation peak of 6.7%, the September print dropped to 0.9% with the index-heavy food basket weighing on headline inflation as it fell into deflation of 0.9%. Only alcoholic beverages saw higher price gains for the month - mainly due to legislation - while all other subcomponents posted lower or flat inflation prints. Last year's inflation spike was supply-slide oriented and and, with bottlenecks addressed, inflation has decelerated quickly all the more after the BSP's 175bp in rate hikes.

Supply “slide” inflation affords BSP scope to ease further

Inflation to rebound but stay within target. Inflation will likely revert to target once base effects fade. Price pressures appear to be benign as food prices are expected to be more stable given new legislation and the government's openness to importing foodstuffs. With this environment the BSP has scope to ease policy rates further should other data points warrant it but for the most part the price objective remains well in hand.

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