Good MornING Asia - 9 July 2020

Risk sentiment remains supported with investors looking to China inflation data out later on Thursday for further direction

In this bundle

ASEAN Morning Bytes

China inflation data will be the highlight for Thursday

EM Space: Covid-19 cases continue to accelerate but tech shares lift sentiment

- **General Asia:** Asian markets are set to edge higher with technology shares climbing on hopes for a recovery as investors continue to look past the sustained pickup in fresh Covid-19 cases in the United States and new hot spots in other countries. US-China relations remain tense with US officials floating the idea of banning a popular China-based app and revoking student visas of Chinese nationals should classes shift to online platforms. Despite the risk of US-China relations worsening and the acceleration in Covid-19 cases, risk sentiment remains supported with investors looking to China inflation data out later on Thursday for further direction.
- **Malaysia:** May industrial production (IP) data is due today. Our forecast of a 30.0% YoY IP fall is slightly weaker than the consensus view of -29.0% and it follows an accelerated export decline (-25.5% vs. -24% in April). The relaxation of the Covid-19 lockdown in May provides some upside risk to this view. The combined April-May IP growth will shed light on GDP in 2Q20, which we see falling by 8.3% YoY - the most since the 1998 Asian crisis. This might be the trough for GDP. Although the sluggish recovery should keep the central bank (BNM) on an easing path in the months ahead. BNM scaled back easing to a 25bp policy rate cut to 1.75% earlier this week from 50bp cut at the last meeting in July. We expect at least one more rate cut in this cycle, probably in September.
- **Indonesia:** Indonesia’s retail sales contracted again, posting a 20.6% decline in May with

the pandemic and partial lockdowns hampering household consumption for the period. This is the 6th straight month of contraction and we expect the trend to continue in the coming months given slowing economic activity with new Covid-19 infections still accelerating. The sustained pickup in infections will likely keep consumer confidence and overall retail sales in the red, forcing overall GDP to contract in the coming quarters.

- **Philippines:** The Philippines recorded another record in terms of new daily Covid-19 infections on Wednesday with 2,539 new cases, bringing the total number of infected to 50,359. Despite the recent acceleration in infections and the apparent spread of the virus to areas outside the capital region, authorities continue to push for the economy to reopen given dire economic growth projections. President Duterte cautioned against reopening quickly to prevent a "relapse" but finance secretary Dominguez indicated that government must strike a balance between safeguarding public health and restarting the economy. We expect the surge in infections to continue although the government will likely refrain from total lockdowns but instead opt for localized shutdowns to limit transmission.

What to look out for: China inflation and Covid-19 developments

- China inflation (9 July)
- US initial jobless claims (9 July)
- Philippines trade (10 July)
- Malaysia industrial production (10 July)
- Thailand GIR (10 July)
- US PPI inflation (10 July)

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Article | 8 July 2020 Indonesia

Indonesia: Central bank's "burden-sharing" deal unlikely to stoke inflation

In a bid to limit financing costs for the Covid-19 response, Bank Indonesia (BI) will be buying up bonds in the primary market at discounted rates

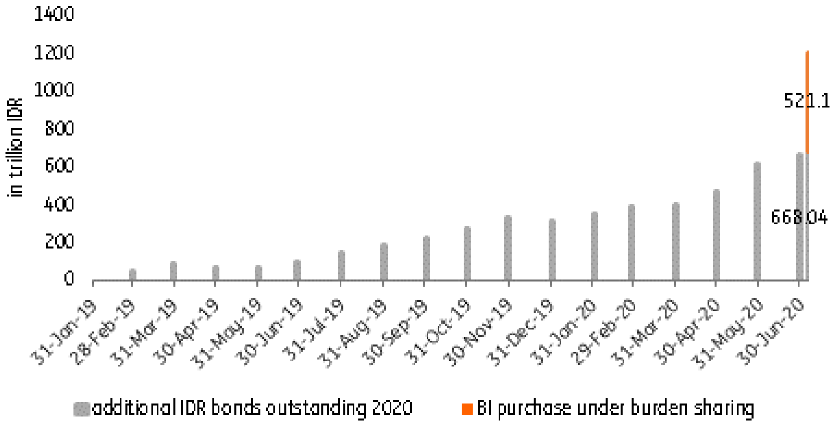
Source: Stenly Lam

Indonesia taps central bank to "ease the burden"

With the government's response to the ongoing pandemic ballooning to IDR 695.2 trillion, Finance Minister Sri Mulyani Indrawati tapped the central bank to help ease financing costs, with Bank Indonesia (BI) asked to purchase bonds in the primary market at discounted rates. BI had previously received provisional authority from the President to purchase bonds directly from the primary market to help rein in borrowing costs at the height of the risk-off episode in April. The recent "burden-sharing" arrangement between BI and the Ministry of Finance goes a step further, with the central bank buying IDR 397 trillion worth of bonds to fund social spending at BI's policy rate. BI will also participate in the purchase of a second bond worth IDR 123 trillion, which would fund loans for small and medium-sized enterprises with the central bank also taking on a portion of financing costs. All interest earned would however eventually be returned to the government with the central bank monetising government debt.

Additional outstanding IDR bond issuance 2020

Level of outstanding IDR bonds at end 2019: IDR2,437 trillion



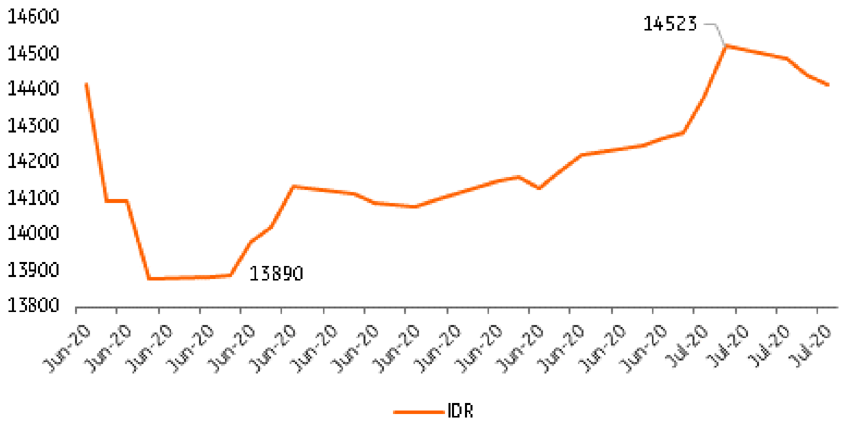
Source: Ministry of Finance

Outstanding level of IDR bonds at end 2019: IDR 2,437 trillion

Market players initially spooked by new arrangement

Sentiment soured somewhat on Indonesia in the past week with investors turning increasingly wary about the much-anticipated BI-finance burden-sharing arrangement, with the Indonesian rupiah knocked back by 1.6% in early July ahead of the announcement. Concerns about the new scheme centred on central bank independence with BI's profitability taking the direct hit from the agreement. Furthermore, the resulting infusion of liquidity from the bond purchases was expected to stoke inflationary pressure and spark IDR depreciation. Authorities moved to allay concerns, assuring investors that the scheme would be in place only for 2020 due to the pandemic and that both the central bank and government would "maintain fiscal and monetary prudence to ensure macroeconomic credibility".

IDR movement June - 7 July 2020



Bank Indonesia

BI's bond purchase arrangement not likely to stoke inflation but IDR will come under some pressure

Indonesian authorities have sidestepped concerns about the burden-sharing arrangement setting a precedent for future debt monetisation for now, but investors will be wary if the scheme is extended beyond 2020. The profitability of the central bank will definitely take a hit, but given the circumstances, and with other global central banks unloading unconventional monetary policies, investors will likely give the central bank the benefit of the doubt for now. In the near term, price pressure from the imminent infusion of liquidity will likely be marginal given the depressed state of economic activity, with inflation currently at the lower end of the central bank's target of 2-4%. Economic growth will contract in 2Q and remain subdued for the balance of the year and consequently, we agree with BI Governor Perry Warjiyo that inflation will likely settle within target in 2020 even with the liquidity infusion from the burden-sharing bond purchases. We do, however, expect the IDR to come under some depreciation pressure in the near term which will likely be offset by a sustained triple intervention by the central bank. A renewed weakening bias for the IDR may mean Governor Wariyo shelves plans for a further rate cut for now.

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