

## Good MornING Asia - 9 March 2020

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### What is the "indifference" range for oil?

When I was a much younger economist, you would respond to swings in the price of oil by consulting one of the OECD "ready reckoners" printed in the back of the World Economic Outlook. This would tell you what a \$5/bbl increase/decrease in the price of a barrel of oil would mean for your GDP and inflation forecasts.

Back then, when the DM world dominated the global economy and most of them were both oil-intensive in production and typically net-oil consumers, it sort of made sense. But even then, it required you not to care what was happening to producer nations. A more sophisticated view of oil prices emerged as the world changed and EM economies started to dominate global GDP. This required you to think of oil as a zero-sum game, where oil producers benefited from a rise in the price of oil, and consumers form a fall and vice versa.

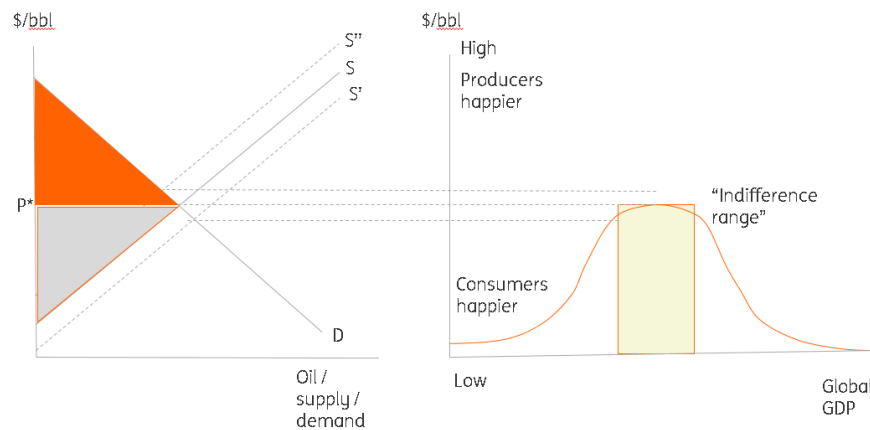
This sort of thinking still prevails in many forecasting circles, but even this is a gross simplification.

Let me explain with a simple 2-country model of the world. Here there are just two economies, and one produces and sells only oil, and the other produces and sells only chocolate. When the price of oil is very high, the chocolate producers can't afford to buy very much, and producers lose out, and when the price is very low, the chocolate producers can buy loads, but it doesn't earn enough for the producers, who then can't buy chocolate. There is a price of oil at which producers can buy

quite a lot of chocolate, and consumers can buy quite a lot of oil, both probably still grumble, which is why I refer to this as the "indifference range" for oil. Just by observation, and limited empirical analysis, I have viewed this range as about \$10/bbl either side of \$65/bbl.

Following the breakdown in OPEC+ negotiations at the end of last week, [which Warren Patterson has highlighted in this note](#), crude oil prices are down around \$36, and will almost certainly head lower in the days ahead unless someone changes their mind.

## The "indifference range" for oil



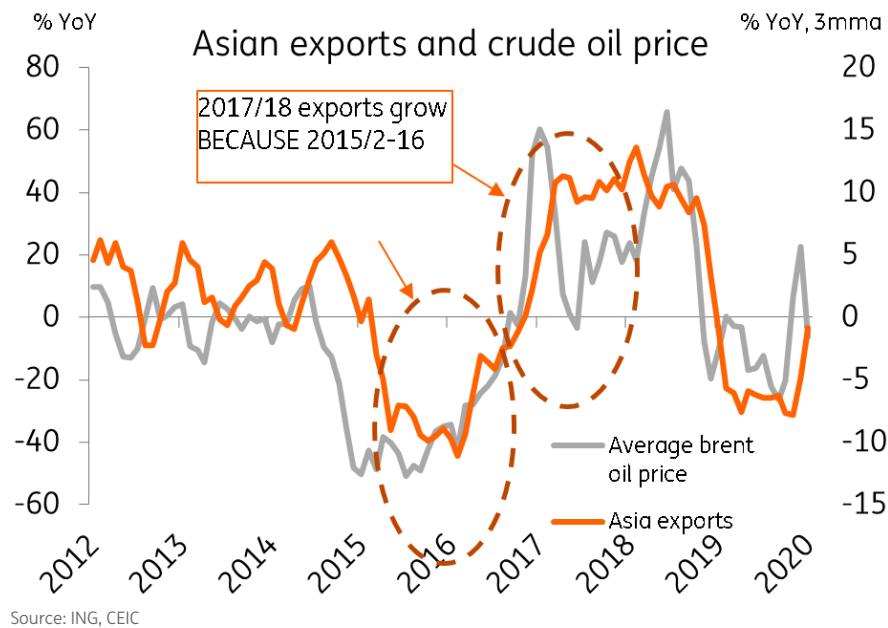
Source: ING

## Crude oil price and Asian exports in practice

Well, that is so much for the theory, how about the practice? The chart below shows how swings in crude oil prices have preceded swings in Asian export growth, with the most notable plunge in recent history being 2015/16, which led to a big fall in Asian export growth, and then as oil firmed through 2017/18, helped their recovery. The chart is specified in terms of year-on-year changes, but it also works in levels (\$/bbl) against the percentage change in exports. Oil prices are now plunging, following the breakdown of OPEC+ talks.

It is hard to see how this sort of shock could have come at a worse time for Asia. Even India, where we would normally expect an oil price decline to provide some support to the rupee, is unlikely to see much benefit, as it is embroiled in its own financial sector problems, with the collapse of a private bank at the end of last week. The MYR stands to lose too as the region's most notable oil exporter.

## Oil swings and Asian exports ("indifference range" in practice)



## Don't write off China's GDP after this quarter

Iris Pang provides some hope for Chinese GDP after what looks like it will be a horrific 1Q20 [judging by the trade data released over the weekend](#).

Iris writes, "China has issued more than CNY 1 trillion of local government special bonds recently to finance infrastructure investment. The "new infrastructure investment" mentioned by the media, includes 5G investment, electric car charging facilities, electricity infrastructure. These are all planned infrastructure. The name "new infrastructure" highlights that this investment will not include property, which is in trouble from high leverage. We believe front-loading of planned "new investment" will support the recovery of the economy from 2Q20".

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Article | 9 March 2020

# The OPEC+ break-up: It's not you, it's me

OPEC+ knew they had to surprise the market, and that is what they did. Although the surprise was failing to come to a deal, rather than cutting more than...



Source: Shutterstock

## From Russia with no love

It was a risky move from OPEC, and it clearly was a gamble that did not pay off. Following the conclusion of the OPEC ministerial meeting on Thursday, the group agreed to recommend to the wider OPEC+ group additional cuts of 1.5MMbbls/d through until the end of 2020, whilst also extending current cuts of 2.1MMbbls/d through until year-end. The key was to ensure that Russia was on board.

The outcome of the wider meeting on Friday was pretty clear - no deal. Russia was not willing to cut any more, and starting on the 1 April, members would be free to pump as much as they wanted. ICE Brent settled almost 10% lower on the day, and given the scale of the surplus about to hit the market, there is still significant downside to prices.

For the Russians, giving up market share to the US was the key factor behind not making deeper cuts. Russia can weather a lower price environment better than some of the OPEC members. The Russians have a fiscal breakeven oil price of below US\$50/bbl, while the Saudis need around US\$80/bbl. But clearly the expected downside to prices will be a growing concern for the Russians, especially if we see a prolonged period of weakness.



## Surplus times ahead

We have revised lower our price forecasts for ICE Brent. For 2Q20, we are now expecting prices to average US\$33/bbl vs. US\$56/bbl previously. Given the scale of the surplus over 2Q20, we would not be surprised to see ICE Brent testing the lows seen in early 2016. Over the second half of 2020, we are assuming prices to average US\$43/bbl.

While lower prices will likely have an impact on output, particularly from the US, this will likely only feed through to the market later in the year, and into 2021. Furthermore, inventory builds over 1H20 will likely mean only limited upside to prices over 2H20. The key assumption to our forecast is that OPEC+ do not have a change of heart, and agree to further cuts down the road.

The end of the deal risks bringing 2.1MMbbls/d of supply back to the market, and it is also not unrealistic to think that Libyan output may return to normal in the coming months, bringing a further 1MMbbls/d of supply to the market. This 3.1MMbbls/d of additional supply would come at a time when the market was already set to be in surplus over 2Q20, while the demand picture remains uncertain, but clearly fragile due to Covid-19. indeed, there are growing expectations that we will actually see a contraction in consumption this year, rather than just a slowing in consumption growth as Covid-19 spreads. For now, though, we are still assuming modest consumption growth over the year.

## ING oil price forecasts

New Forecasts	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
ICE Brent (US\$/bbl)	53	33	40	45	50	60	60	63
NYMEX WTI (US\$/bbl)	48	28	35	40	44	54	54	57
Previous Forecasts								
ICE Brent (US\$/bbl)	55	56	60	65	64	70	70	68
NYMEX WTI (US\$/bbl)	50	50	53	58	57	63	63	61

Source: ING Research

## Let the price war begin

The failure to reach a deal means that we are set to see a price war, and the Saudis have reacted quickly, already throwing down the gauntlet by cutting the April official selling price (OSP) for its crude oil significantly. The Light Arab crude's official selling price (OSP) into Asia was reportedly slashed by US\$6/bbl, to a discount of US\$3.10/bbl to the benchmark. While into Europe, the OSP for most Saudi grades was reportedly cut by US\$8/bbl. This sees Arab Light into Europe over April at a US\$10.25 discount - levels not seen at least since May 2002. Will these severe OSP cuts from the Saudis be enough to make the Russians reconsider? Only time will tell.

The aim of the Russians is to put pressure on the US oil industry, and while this may work in the medium term, it is less certain what the longer-term impact will be. When OPEC tried this last time around, the US oil industry bounced back stronger and more efficient than before. Projections prior to the OPEC+ meeting were that US supply would grow by 960Mbbbls/d this year and just 350Mbbbls/d in 2021. Clearly weaker prices moving ahead means only further downside to these numbers.

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# Asia week ahead: Gleaning the trade impact

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Source: Shutterstock

## → China

A sharp plunge in China's manufacturing and non-manufacturing purchasing manager indexes in February means hard activity data is set to reveal the impact of Covid-19 on the economy starting with trade figures over the weekend, followed by inflation and monetary indicators over the course of next week.

We agree with the consensus of a double-digit trade contraction in the first two months of the year in comparison to the same period last year, and inflation above 5%. Meanwhile, market

expectations of a sharp slowdown in new yuan loans and aggregate financing in February stems from virtually stalled economic activity, though we're not ruling out the risk of these indicators surprising on the upside as a result of the recent monetary stimulus.

The rate of new infections is abating and factories are gradually re-opening, which is good news for the economy. However, markets are unlikely to relax just yet, as the data might show recent exceptional weakness in economic activity persists for months before it gets better.

## ➔ Taiwan, Korea, Malaysia and India

Trade reports also are due in Taiwan and the Philippines, while Korea releases its jobs report and Malaysia its manufacturing data – all will be under scrutiny for the Covid-19 impact. However, data may not provide a good sense of the impact as the epidemic rapidly began to spread beyond China only in the second half of February.

Lastly, India's elevated consumer price inflation above 7% will continue to be the main headwind for central bank easing amid the rising threat of the virus to GDP growth. Making matters worse is the latest acceleration currency depreciation, which saw the Indian rupee weakening above 74 against the US dollar this week.

It's going to be a challenge for Governor Shaktikanta Das as he struck a dovish chord after the Fed's surprise rate cut.

## Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
<b>Saturday 7 March</b>					
China	0300	Jan-Feb Exports (YoY%)	-14.1	-17	7.9
	0300	Jan-Feb Imports (YoY%)	-28.8	-15	16.5
	0300	Jan-Feb Trade Balance (US\$bn)	64.4	29.9	47.21
	0200	Feb Forex Reserves (US\$bn)	3110	3105	3115.5
India	1200	4Q19 Current account balance (US\$bn)	-	-	-6.3
<b>Monday 9 March</b>					
Taiwan	0800	Feb Exports (YoY%)	-	-	-7.6
	0800	Feb Imports (YoY%)	-	-	-17.7
Indonesia	1000	Feb BI consumer confidence index	119.6	-	121.7
Taiwan	1600	Feb Exports (YoY%)	-25.8	-	-7.6
	1600	Feb Imports (YoY%)	-33.8	-	-17.7
	1600	Feb Trade balance (US\$bn)	5.0	-	3.5
<b>Tuesday 10 March</b>					
China	0130	Feb PPI (YoY%)	-0.3	-0.3	0.1
	0130	Feb CPI (YoY%)	5.5	5.2	5.4
	0200	Feb Money supply (M2) (YoY%)	8.4	8.45	8.4
	0200	Feb Aggregate finance (Yuan bn)	5000	-	5070
	0200	Feb Financial institution loans (Yuan bn)	3400	-	3340
India	-	Holi Festival - Market holiday			
Philippines	0100	Jan Trade balance (US\$bn)	-	-2.9	-2.5
	0100	Jan Exports (YoY%)	-	4.1	21.4
	0100	Jan Imports (YoY%)	-	-5	-7.6
South Korea	2300	Feb Unemployment rate (SA%)	-	-	4
<b>Wednesday 11 March</b>					
Korea	2300	Feb Unemployment Rate (SA%)	4.2	-	4.0
<b>Thursday 12 March</b>					
India	1200	Feb CPI (YoY%)	7.3	-	7.59
	1200	Jan Industrial production (YoY%)	-1.7	-	-0.3
	-	Feb Trade deficit (US\$bn)	-	-	-15170
	-	Feb Exports (YoY%)	-	-	-1.66
	-	Feb Imports (YoY%)	-	-	-0.75
Singapore	0500	Jan Retail sales value (MoM SA/YoY%)	-/-	-/-	-1./-3.4
<b>Friday 13 March</b>					
Malaysia	0400	Jan Industrial production (YoY%)	-	-	1.3
	0900	Jan Exports (YoY%)	1.4	-	21.4
	0900	Jan Imports (YoY%)	-1.2	-	-7.6
	0900	Jan Trade balance (US\$m)	3744.2	-	-2478
Philippines	-	Jan Budget balance (PHP bn)	-	-	-251.1

Source: ING, Bloomberg, \*GMT

# China posts first trade deficit in two years

China's exports fell in February, as expected. But imports were not as negative as predicted, as imports of medical-related supplies surged. That...



Source: Shutterstock

## China in trade deficit

In China, exports were smaller than imports in January and February, which resulted in a trade deficit of US\$7.1 billion. The last time that China had a trade deficit was in March 2018, at the start of the trade war with the US, when it was nearly US\$5.8bn.

## A lot of imports of medical supplies

Imports fell only 4% year-on-year year-to-date in February. This is a surprisingly low negative growth figure.

In January and February, China imported an increased value of medical-related supplies, e.g. raw materials to produce masks, which falls into the category of textiles and rubber, and latex for hospital beds. Part of this was from donations from the rest of the world. Imports from donations increased by more than 4000% YoY YTD, to fight Covid-19.

## Exports were bad, as expected

Exports fell 17.2% YoY YTD in February, as expected. Factories were closed for most of January and February due to the Chinese New Year holidays and the coronavirus, and thus we could hardly

expect positive growth here.

## Things should be different in March

We do not expect a V-shape rebound in production and exports in March, but we also think that China is unlikely to receive more donations from the rest of the world. On the contrary, we expect China to export some medical supplies to other countries that need help to fight the coronavirus. As such, we believe that even though China's trade could be negative on a yearly basis in March, the trade balance should turn positive.

## The negative trade balance is a risk to our GDP growth forecast, again

We have revised our first quarter GDP forecasts for China to 4.4% year-on-year. Our forecast is now at risk as we did not expect a trade deficit in the first two months of the first quarter. But we have seen increasingly more fiscal stimulus from the central government, which is also ahead of our expectations. For the time being, we maintain our forecasts at 4.4% YoY for the first quarter.

## USD/CNY to follow the dollar index

We do not think that the People's Bank of China is going to weaken the yuan to boost exports as what we have seen so far is that the USD/CNY has moved in tandem with the dollar index. So the yuan, in fact, has strengthened to 6.93 on 6 March from the weakest level this year at 7.03 per dollar on 24 February. If the dollar gets stronger due to a flight-to-safety, the yuan could weaken to 7.05 by the end of March.

# China: The supply chain is still broken

The spread of the coronavirus in China seems to be slowing down, but the global supply chain remains broken. As a result, we've revised our growth...



Source: Shutterstock

## What we know so far

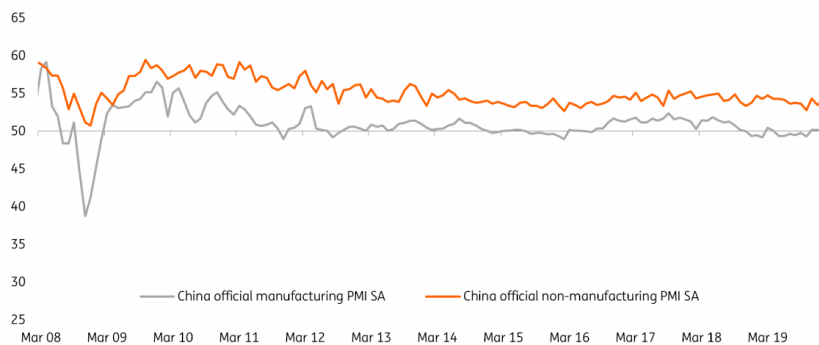
The market expects Chinese activity data from January to February to be fairly disappointing.

China has postponed trade data release for January, so the upcoming data release will be year-to-date February figures, but that won't help much. For most of January and February, exports and imports are likely to be almost negligible.

There wasn't much activity in the manufacturing and retail sector, which was reflected by the PMI. Manufacturing PMI dived to 35.8 and non-manufacturing PMI dived even deeper to 29.6 - both were the poorest reading since the data has been compiled.

We expect industrial production and retail sales to move to the negative territory but fixed-asset investment could experience some growth as two new hospitals have been built to combat coronavirus.

## China's worst PMI in history



## Factories trying to get back to normalcy

Some reports suggest, 85.6% of larger factories resumed operation as of 25 February, but others suggest this figure might be overestimated.

As local governments received resumption quotas from the central government, they are eager to show factories in their cities are operating as usual again.

Therefore officials are closely monitoring the reopening of factories. Although well-intentioned, as officials could in theory help workers travel to factory locations from their hometowns, but, in reality, there is little they can do. The main issue is traffic, which has been very congested as many workers move from rural to factory hubs.

As a result, some factories, which are trying to circumvent officials' visit, have switched on machinery, despite the lack of workers to inflate electricity usage, which often is a production indicator.

## Not much will change in March

A few things we need to note on [the development of the coronavirus](#) for March:

- Imported coronavirus cases increase, but the number is still below 100 as of 4 March 2020.
- Some patients after being discharged from the hospital have tested positive again.

This means the peak of confirmed cases might not be behind us. As more countries report new cases daily, factories in these locations could also temporarily halt production, and this can always lead to the entire supply chain being disrupted.

With expected hurdles in factory production in March, and most consumers too wary to go shopping malls and dine out, and little business investment demand, the prospect of economic growth is still unclear.

We don't think March data will do any wonders.

## More fiscal stimulus to the rescue

When activity levels are low, the Chinese government usually delivers a fiscal stimulus to support the economy. There is already a policy in place that waives social security contribution for staff,



worth around CNY 1 trillion. More fiscal stimulus is likely to follow if cities confirm they have been able to reduce confirmed Covid-19 cases.

Last month, the Chinese government announced more stimulus measures. Therefore, we revise our projection of fiscal stimulus from around CNY 3.5 trillion to CNY 4 trillion, which is equivalent to 4% of nominal GDP in 2020, and this could be increased if more is required to boost economic growth.

## Monetary easing beyond rate cut

We maintain our forecast that the People's Bank of China is going to cut 10 bps on 7D reverse repo, 1-year medium lending facility and 1-year loan prime rate. The loan prime rate cut should be on 20 March.

There will also be a focused RRR cut of 0.5 percentage points for banks to channel liquidity to companies affected by Covid-19.

More than these, the central bank is allowing companies suffering from cash flow problems to request deferred loan repayments. The positive side is that affected companies can concentrate on the resumption of work and not worry about repayment. The negative side is that only banks that have capital buffers can participate in this scheme.

## The global supply chain remains broken

As most economic activities have been muted in January and February, we're not expecting a V-shape rebound in March, even though more fiscal stimulus and monetary easing is on the way.

Therefore, we scale down our forecast for China's GDP in 1Q20 from 5.0%YoY to 4.4%YoY and 5.2% from 5.4% for the full-year.

# Japan: In search of a paddle

Last month, we pre-emptively took an axe to our growth forecasts - looking back on it, we may still have work to do



Source: Shutterstock

## Recession looking all but inevitable

Last month, in response to the blossoming Covid-19 outbreak in Asia, we decided to take some fairly hefty cuts to our existing mediocre growth forecast for 2020. We did this in anticipation that the covid-19 outbreak would get worse and spread. And that is indeed what is happening.

Since then, we have also had to deal with the fact that fourth quarter GDP was in fact already abysmal, with the aftermath of the consumption tax hike resulting in an annualised decline in growth of 6.3% quarter-on-quarter. It seems hard to imagine any other alternative now than that this big decline in the fourth quarter is followed by a further substantial decline in the first three months of the year, and no guarantee that there is any recovery in the next three.

Indeed, even if Covid-19 does burn itself out in the Northern Hemisphere summer as some have argued, this is not necessarily a precursor to a sharp bounce in the second half of the year. Talk of V-shaped recoveries is, in our view, totally misplaced.

## Olympics may be a victim

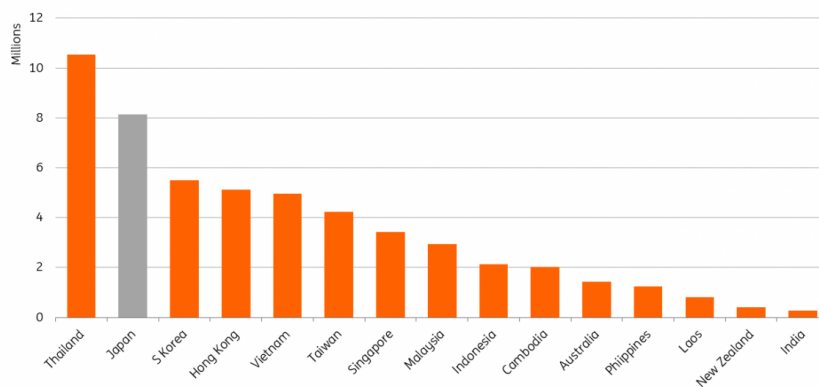
Prime Minister Shinzo Abe recently called on the nation to halt, scale back or suspend large public events. Schools have been closed. And one can't help remembering that Japan is due to hold the Olympic Games in Tokyo at the end of July and early August this year. Should the Covid-19

epidemic still be rampaging, it is certainly possible that the timing of the games could be altered to later in the year or even next year. They may be cancelled altogether.

Even if they do go ahead, it seems extremely likely that they will be shunned by overseas visitors, and that many top athletes will also stay away. Although such sporting events have a history of making no financial profit, to do the investment and then not hold the games, or hold them but with massively reduced ticket and ancillary sales looks like a formula for substantial losses.

Japan's tourism industry was already headed for a tough summer. After Thailand, Japan is the second most popular destination for Chinese tourists. They won't be coming this year. And with Japan towards the top end of the Covid-19 confirmed cases table, it's possible no one else will either.

## Visitors arrivals from mainland China (2018)



Source: See below

## Policy dearth

Curiously, one of the Bank of Japan's (BoJ) most dovish members, Goushi Kataoka, who has been consistently calling for more easing to enable the BoJ to meet its improbable 2% inflation target, has argued against Japan easing rates because of the virus. In his view, the virus is not enough on its own to spur a rate cut whilst the spread of the disease and its effect is highly uncertain. Until recently, these views were partly shared by BoJ Governor Kuroda. He had said that the BoJ is ready to act, but that he didn't believe any action was needed now. Kuroda added that the BoJ stands ready to take appropriate measures as needed and won't hesitate to act if the need arises. This view has undergone some revision. The version that followed the Fed's Jerome Powell comments runs "The BOJ will monitor developments carefully, and strive to stabilise markets and offer sufficient liquidity via market operations and asset purchases." In short, the BoJ will invest in ETF's to try to limit any equity market rout. It won't prevent it, but it may slow a violent drop.

Kuroda also added that he thought it likely that the virus would hit exports, supply chains and tourism (see chart). The strong-sounding words in the face of the virus mask a chronic lack of any effective policy tools in Japan to counter the additional negative shock of the outbreak on the economy following the consumption tax hike. The only consolation here is that this lack of credibility is very old news. And fortunately, neither the currency nor the Japanese government bond or equity markets are particularly reliant on foreign investors for support.

## It's not just the BoJ that is out of bullets

We have written in recent months about the Japanese government's fiscal efforts to smooth over the impact of both the consumption tax hike and the end of construction associated with the Olympics. The net result of the huge packages promised, when compared in terms of primary budget deficits, was precisely zero. In other words, all the money earmarked for spending in 2020/21 would exactly offset the additional tax revenue supposedly drained out of the economy by the consumption tax hike for no net economic impact whatsoever.

Now it is very clear that the efforts to contain the consumption tax hike have either missed in terms of their timing or in terms of their quantity. Moreover, with the outlook for the Olympics now highly questionable, you'd struggle not to draw the conclusion that either more fiscal easing will be needed, which raises even bigger questions about what happens in 2021, or that the amounts dedicated to propping up the economy in the second half of the year will fall well short of what was intended, requiring us to take the axe to the second half figures too.

In other words, the forecast slashing is probably still not yet over. We currently forecast full-year 2020 GDP to fall by 1.2%.

### Sources

[Korea Tourism Organization](#), [Japan Tourism Statistics](#), [Tourism Australia](#), [PartnerNet](#), [India Ministry of Tourism](#), [Association of Southeast Asian Nations](#), [Stats NZ](#)

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# Taiwan: Negative inflation reflects damage from coronavirus

Taiwan's Consumer Price index and Wholesale Price Index were both negative on a yearly basis. This reflects the hit to consumers and manufacturers...



Xinyi District in downtown Taipei, Taiwan

## Negative inflation rates

The CPI was -2.1% year-on-year in February while the WPI was -4.47 YoY. It is quite rare for Taiwan to see negative CPI inflation, though the WPI measure has been in negative territory since May 2019.

## Not deflation, yet

The negative CPI reading in February is just one data point so it's too early to talk about deflation. The last time Taiwan recorded a negative CPI inflation rate was back in December 2018, when it was -0.06%YoY.

## Damage from coronavirus confirmed

The data reflects the damage done to the economy by the coronavirus. When consumers are not working, they're spending most of their time at home, which has had a severe impact on retailers.

This will likely continue until the number of new confirmed cases ends, which could possibly take another couple of months.

## But the central bank is not going to cut rates

We do not expect Taiwan's central bank to cut the policy interest rate, which is now at 1.375% and has not moved since June 2016.

The main reason is that an interest rate cut will do nothing to combat the actual health emergency. The government has already planned to deliver consumption coupons to consumers and tourists after the epidemic ends. This may help struggling retailers a little, but could also make the central bank comfortable in its current policy position.

## Capital inflows support TWD

There have been inflows of capital to Taiwan, which is another reason that we don't think a rate cut is likely given that there is more money in the system.

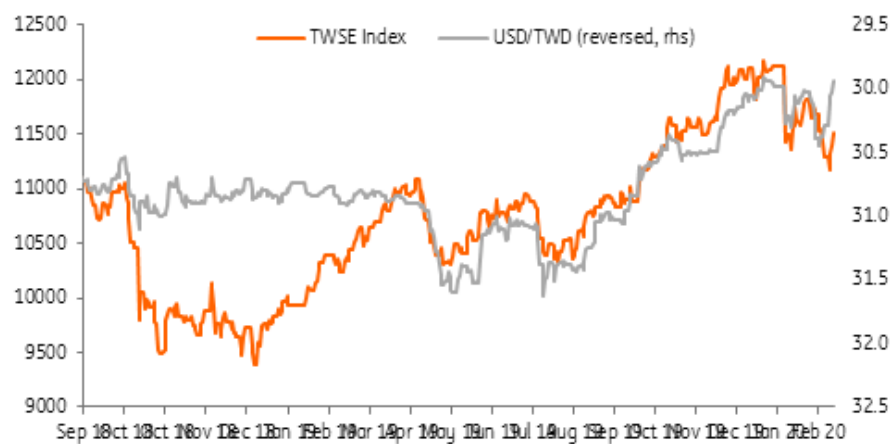
As inflows continue, USD/TWD has strengthened to around 30.00 from 30.45 on 24 February 2020.

### We forecast a weaker TWD by end of 1Q20

But the Taiwan dollar strength could be temporary.

As the global supply chain is increasingly at risk from further disruption in South Korea, Japan, Europe and the US, production in Taiwan could be affected even if Mainland China's factories try to resume operations.

We, therefore, forecast that USD/TWD could reach 30.20 by the end of 1Q20.



Source: ING, Bloomberg

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