Economics and Macro Strategy

Ten Economics Themes for 2020

Economics

Group Research

January 20, 2020

Taimur Baig
Chief Economist
taimurbaig@dbs.com

Nathan Chow
Strategist/Economist
nathanchow@dbs.com

Masyita Crystallin
Economist
masyita@dbs.com

Chris Leung
Economist
chrisleung@dbs.com

Ma Tieying
Economist
matieying@dbs.com

Radhika Rao
Economist
radhikarao@dbs.com

Irvin Seah
Economist
irvinseah@dbs.com

Samuel Tse
Economist
samueltse@dbs.com

Please direct distribution queries to
violetleeyh@dbs.com

Ample liquidity, low interest rates, trough in the electronics cycle, relaxed fiscal policy stance in the major economies, and a trade war détente have set conditions for a well-supported 2020. But plenty of other factors will weigh in on economies and markets, in our view, ranging from elections to civil unrest, cyber-attacks to pandemics, climate change to geopolitical tensions.

- *Theme 1: From recent elections in Taiwan to forthcoming elections in the US, China-US rivalry, civil unrest in several countries, and increasingly frequent natural disasters partly related to climate change, plenty of spoilers are in train to derail the comfortable macroeconomics environment.*
- *Theme 2: PBOC easing to fight all ills*
- *Theme 3: The worst for Hong Kong is over*
- *Theme 4: Electronics cycle bottoming out*
- *Theme 5: Japan's soft power and Tokyo Olympics*
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Theme 1: Elections, civil unrest, geopolitics

Markets are off to the races in early 2020, with recent trade, jobs, and spending data pointing to a decent end to 2019 for both China and the US. Ample liquidity, low interest rates, bottom in the electronics cycle, relaxed fiscal policy stance in the major economies, and a trade war détente have set conditions for a well-supported macro environment.

But plenty of other potentially destabilising factors will weigh in on economies and markets, in our view, ranging from elections to civil unrest, climate change to geopolitical tensions. From recent elections in Taiwan to forthcoming elections in the US, China-US rivalry, civil unrest in several countries, cyber-attack and pandemic risks, and increasingly frequent natural disasters partly related to climate change, plenty of spoilers are in train.

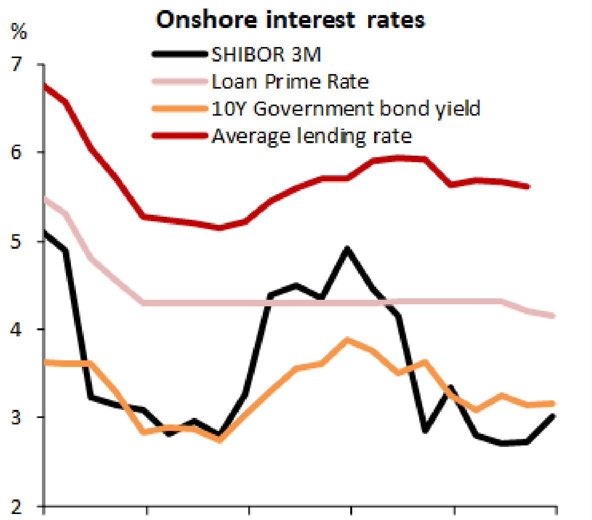
The US elections can not only create uncertainty about the coming environment for tax, regulation, and welfare, but if polls get tight, we are concerned that “wag the dog” type scenarios can materialize in the geopolitical sphere. Phase One trade deal notwithstanding, US will continue to push back China on tech dominance, human rights, and territorial matters, in our view. Such tensions will likely to continue to hurt the investment environment.

From the bushfire in Australia to incidences of floods here and drought there, climate-related costs and awareness are on the rise. We expect such matters to influence the policy agenda and the economic outlook increasingly, although markets are yet to price in such scenarios.

Taimur Baig

Theme 2: PBOC easing to fight all ills

The prime concern of PBOC is to ensure adequate liquidity in the system to alleviate rising credit risks. A record high of 4.9% of private issuers defaulted on onshore bond payments in 2019, up from 0.6% in 2014. As a result, the PBOC will likely cut RRR at least another 100bps in 1H20 to safeguard repercussions from potential defaults. Likewise, the Loan Prime Rate will fall 20bps to 3.95%. The Sino-US relationship also partially dictates the pace of monetary easing. Even though Phase 1 negotiation was concluded, challenges remains for Phase 2 involving state subsidies and IP protection etc. That will prompt PBOC to contemplate flooding the system, which in turn could reverse the ongoing RMB appreciation trend. Although the inverse correlation between GDP growth and interest rate have not held in recent years, asset prices have been reacting positively to laxer monetary that fuels liquidity. A combination of monetary policy and fiscal policy will nudge the economy to modest and orderly deceleration of real GDP to 5.8% in 2020 (from 6.1% in 2019).



Source: CEIC and DBS Group Research

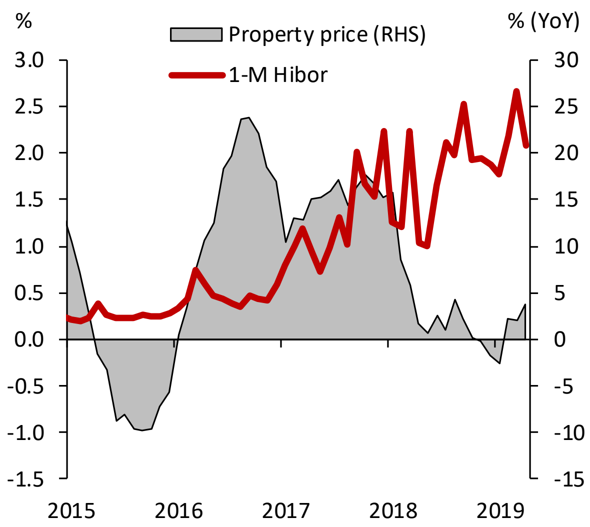
Chris Leung and Nathan Chow

Theme 3: The worst for Hong Kong is over

The de-escalation of social unrest and China-US trade war should warrant absence of a technical recession in 2H20. Retail sales may revive earlier than expectation due to positive wealth effect from equity market and a resilient labour market. Temporary rental adjustments for tenants could contain the risks of large-scale business closures and lay-off. There is room for a large-scale stimulus package to be announced in February. Fiscal stimulus amounted hitherto to 1.1% of the GDP, which is much smaller than that 3.4% during the financial crisis in 2009.

Thanks to the easing of global monetary easing conditions, property prices should remain resilient. It recorded 2.1% growth for FY19 despite recession. The Policy Address also allows potential homeowners to access the property market with higher leverage.

Property price and interest rate



Source: CEIC, DBS

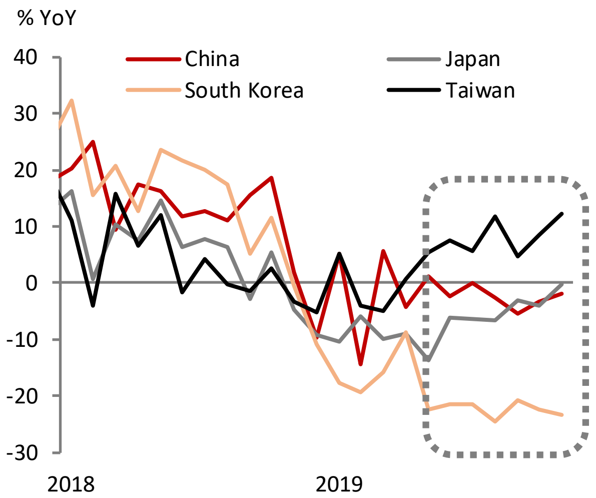
Samuel Tse

Theme 4: Electronics cycle bottoming out

Global electronics cycle is expected to bottom out this year, driven by 5G commercialisation, rising demand related to AI, automotive and other emerging applications. China turned on its 5G networks in end-2019, ahead of the initial 2020 schedule. It targets at 5G network coverage in all cities at prefecture level and above, starting from this year. Industry projections suggest that worldwide smartphone market will grow 1.5% in 2020 after shrinking for three consecutive years, with shipment volumes reaching 1.4bn. Shipments of 5G smartphones will surge to 190mn, or 14% of the total.

Taiwan's foundry industry should stand out to benefit and South Korea's memory chip exports are also likely to pick up, amid a rebound in DRAM prices. For China, the boosting impact is likely to be reflected in its domestic sales more than exports. The Chinese tech giant Huawei would still face challenges to expand outside of China, as it remains on the US's trade ban list.

Asia 4: Electronics exports



Sources: CEIC, DBS

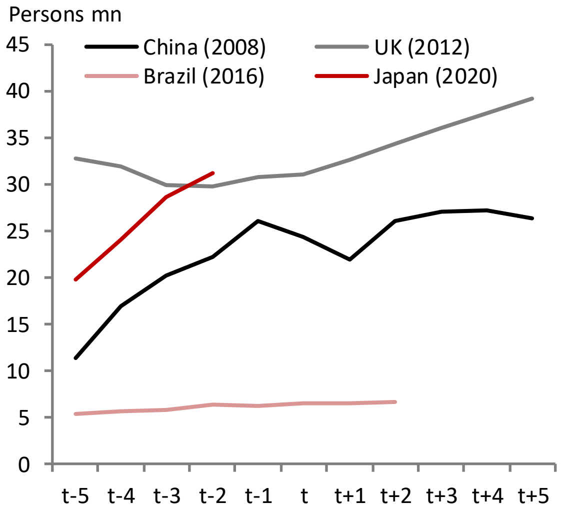
Ma Tieying

Theme 5: Japan's soft power and Tokyo Olympics

The 2020 Summer Olympic Games, which will be held in Tokyo from July 24 to August 9, are likely to strengthen Japan's soft power. An important concept of the Games is sustainability. Initiatives include producing medals from recycled electronic devices, producing uniforms using recycled plastic bottles, providing zero-emission vehicles, supplying electricity based on renewable sources, among others. The cutting-edge technologies to be used in the Games will also include robots, AI-powered athlete tracking, VR training, cloud-based broadcasting, etc.

The positive effect on the economy is expected to be largely reflected in tourism – the number of visitor arrivals is on track to achieve 35mn this year. The risk of a post-Olympics economic slump is limited, given that 1) the Olympics-related business cycle fluctuation is relatively modest in developed economies, and 2) Abe's government has prepared a JPY13tn stimulus package to create new demand in 2020.

Olympic host countries: Visitor arrivals



Sources: CEIC, DBS

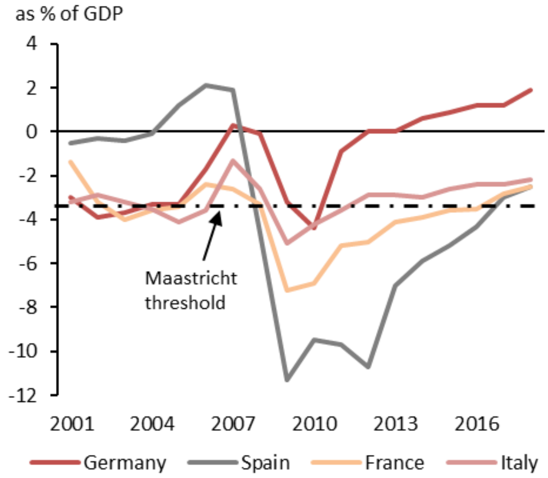
Ma Tieying

Theme 6: Brexit finale

In the UK, attention has shifted beyond the Brexit deadline (presuming this is a done deal) on end-Jan to the challenge of negotiating and arriving at a post-Brexit trade relationship between the EU and the UK. Early indications are that the EU might subject the UK to stricter terms vs its other trading partners; e.g. non-lowering of labour/ environmental safeguards in a bid to attract investments and trade etc. The UK is expected to counter-argue that trade deals and terms with EU's other partners should be used as a precedent. Arriving at a consensus by end-2020 will be an uphill task.

Apart from spillover concerns from Brexit, the Eurozone will continue to look for green shoots of recovery. Any further slowdown could put pressure on new ECB President Lagarde. Additional monetary stimulus is unlikely after the outgoing chief resumed QE and pushed benchmark rates deeper into red. With banks facing pressure from low-to-negative rates, pressure to utilise fiscal stimulus will gain traction this year. Markets are likely to take fiscal slippage risks in their stride.

Narrow fiscal deficits to be tapped



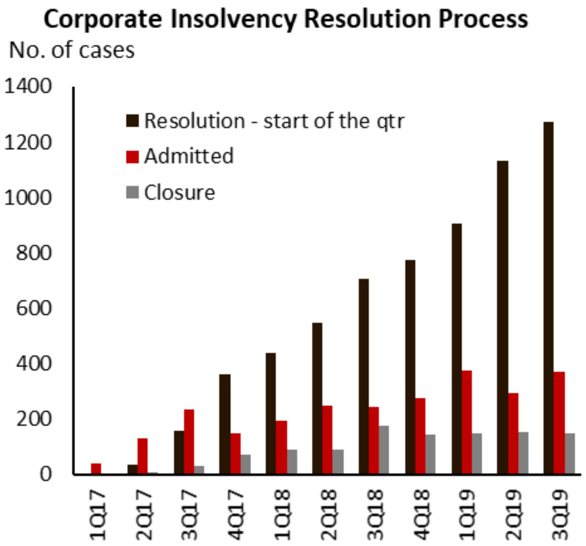
Source: Bloomberg, DBS

Radhika Rao

Theme 7: India's financial sector vulnerabilities

Reviving India's financial sector will be a key 2020 priority. With the sector being a key lubricant for the economy, conditions need to be conducive to support recovery. Banks were capitalised to the tune of INR700bn last year, complemented by mergers amongst public sector banks. Towards non-banks, efforts were to ensure business-worthy firms received adequate funding – through external commercial borrowings, banks' loan securitisation etc. – to prevent liquidity paucity to morph into solvency or systemic risks.

More are likely: a) Feb20's budget may allocate more recap funds to enable mergers, b) tighten checks on ALM mismatches in non-banks; c) feasibility of introducing a Special Purpose Vehicle (SPV) or US-TARP like arrangement to purchase stressed assets. In the medium-term i) fixing governance lapses, ii) asset quality review (AQR) and SPV-lite structures to free assets; iii) better recovery of past NPAs through the IBC process (vs slow progress presently).



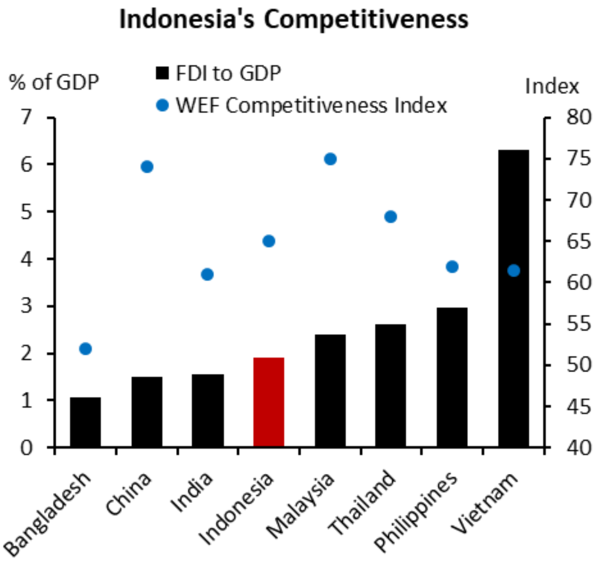
Source: IBBI, DBS

Radhika Rao

Theme 8: Post-election Indonesia – off to a good start

President Jokowi's second period is off to a good start for continuing reform with strong political support (coalition government controls 74% seats in the parliament and contender Prabowo joining the cabinet as Ministers of Defence). Several important reforms including the politically challenging labour law, are Jokowi's key priority in 2020 in a bid to improve the country's competitiveness and investment.

Reforms in the pipeline this year are: 1) Omnibus bill on labour creation, which revoke 1,244 articles and 79 laws, will improve labour market competitiveness compare to peers 2) The bill will also include the establishment of Indonesia's Sovereign Wealth Fund with the potential to attract USD20bn inflows. 3) Omnibus law on taxation are set to slash corporate income tax from 25% to 20% until 2023 with additional tax cut for companies that are go public for the first time in 2021 onwards, eliminate dividend income tax and lower income tax on interest.



Source: Worldbank, WEF

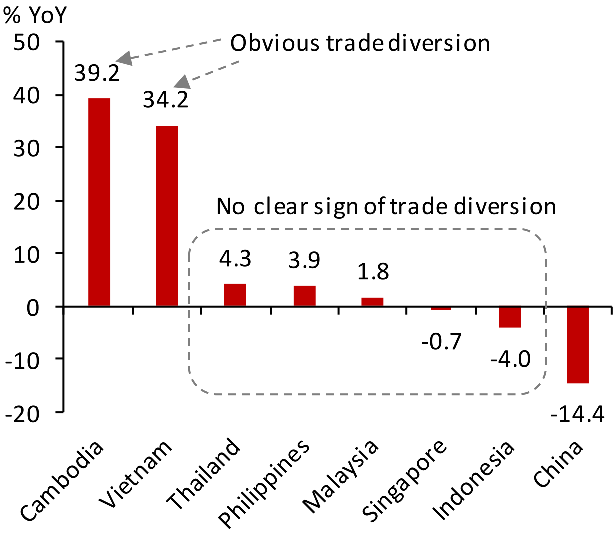
Masyita Crystallin

Theme 9: Vietnam, the rising star

The economy reported GDP growth of 7.0% in 2019, and this is likely to be the fastest amongst key Asia economies. Such phenomenon will most certainly repeat in 2020. Expect Vietnam to continue to dominate the headlines this year with robust economic expansion, driven by trade diversion from the ongoing disputes between the US and China, as well as strong FDI flows into the country.

Indeed, Vietnam is a key beneficiary of the ongoing trade war. The country is well-positioned as an alternative to China for US importers seeking new sources, and for both global and Chinese companies looking to reshuffle their supply chains to a new low-cost destination. Such value proposition to investors implies continued strong FDI flows. However, while many of the regional peers are struggling with weak demand, the key challenge for Vietnam is containing growth. Policymakers will continue to focus on economic stability and sustainability.

US imports from key Asian economies, Jan-Oct19



Source: CEIC

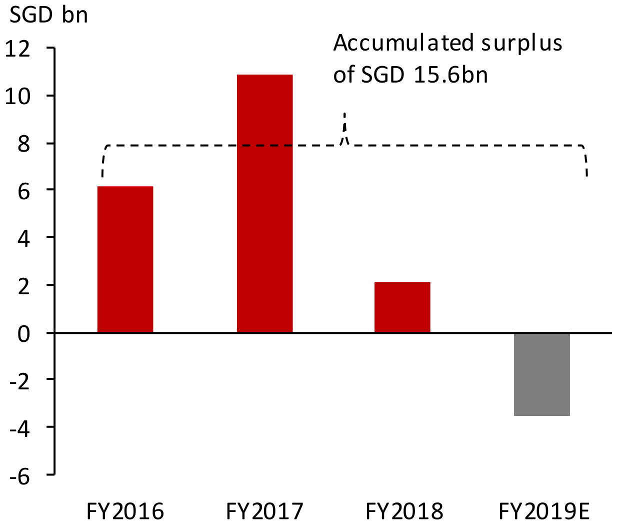
Irvin Seah

Theme 10: Singapore pivotal budget 2020

Budget 2020 will be significant. This will likely be the final fiscal budget for the current term of government, and possibly an election budget. An outsized accumulated surplus of about SGD 15.6bn has raised expectation. However, we reckon that the government would maintain fiscal prudence and focus on fiscal sustainability. Nevertheless, this budget would provide a glimpse of the policy direction of the 4G leadership in the years to come.

There will be measures to address near term concerns amid the cloudy economic climate. Tax rebates, subsidies, cash grants and handouts will be announced to share the fruit of growth and provide some relief for people. There is also the need to persevere with economic transformation and mitigate against future challenges. Deepening enterprise capabilities, upskilling of workers and helping companies internationalise will remain in focus. Budget 2020 will be a highly expansionary budget, but not an excessively generous one.

An outsized accumulated surplus



Sources: CEIC, DOS, DBS

Irvin Seah

Group Research - Economics & Macro Strategy Team

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Chang Wei Liang
Macro Strategist
+65 6878-2072 weiliangchang@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia-
+65 6878-2842 eugeneleow@dbs.com

Duncan Tan
Rates Strategist - ASEAN
+65 6878-2140 duncantan@dbs.com

Nathan Chow
Economist/Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Masyita Crystallin
Economist - Indonesia, & Philippines
+62 21 2988-4003 masyita@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Radhika Rao
Economist – Eurozone, Thailand & India
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia & Vietnam
+65 6878-6727 irvinseah@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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