Economics & Strategy Weekly

China's positive impulse to the global economy

DBS Group Research

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- *China's stimulus driven growth stabilisation narrative is taking hold. Our Nowcast model has steadily perked up in recent months with respect to China's growth momentum*
- *A steady decline in trend growth rate will likely remain part of the macro picture, but stabilisation measures can soften the impact.*
- *Emerging evidence of stimulus efficacy suggests that consumer expectation and investor confidence remain constructive*
- *Consumption, in particular, is amenable to responding to well-targeted measures, as seen in the recent rebound in loans and retail sales figures.*
- *China's demand may in fact be understated, given data seasonality. We expect another good GDP outcome in 2Q, which should further support the global growth picture.*

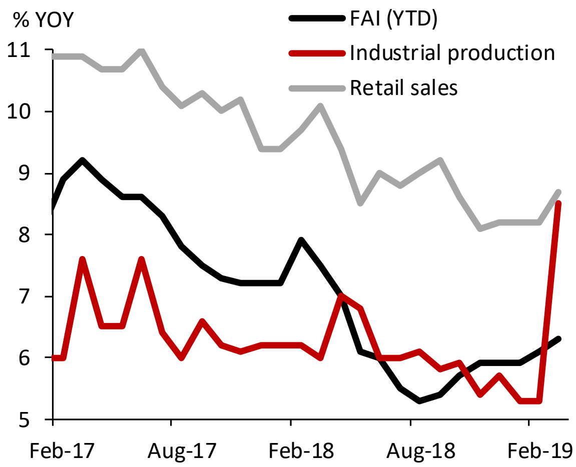
China's growth stabilisation is good news for all

We find China's 1Q GDP data to be in line with recent revival in consumption, loans, and production. Our Nowcast model, which considers high frequency data and calls the GDP of a given quarter long before the actual national accounts release, had steadily perked up in recent months. In late-November, the model was looking at sub-6% growth in 1Q, while by end-March the call had become 6.5%.

What drove this jump? First, a major caveat—China's first quarter data points tend to be very noisy due to Lunar New Year seasonality and gaps in some releases (sales and production, in particular). Keeping that in mind, our model began to pick up signs of life in long-deteriorating data series like loans, retail sales, and industrial production from February onward. As we stepped into April, we were reasonably confident that a decent GDP release was in the making.

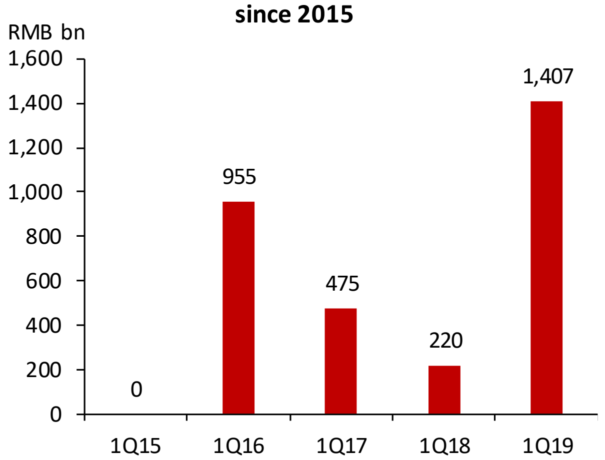
After the release of yesterday's data, we are beginning to wonder if the 1Q GDP growth number of 6.4% was in fact an understatement. As of now, our Nowcast model is now picking up a sharp rebound in activity going into 2Q.

FAI, Industrial production, and retail sales



Breakdown of data indicate that pro-growth policies have begun to through to the real economy. Growth in industrial value-added surged to 8.5% YoY in March from 5.3% in Jan-Feb as factories ramped up output in anticipation of more state-driven businesses. This was evidenced by the surge of fixed asset investment to 6.3% from 6.1% registered in Jan-Feb. Retail sales also expanded 8.7% (Jan-Feb: 8.2%) on the back of a surging equity market.

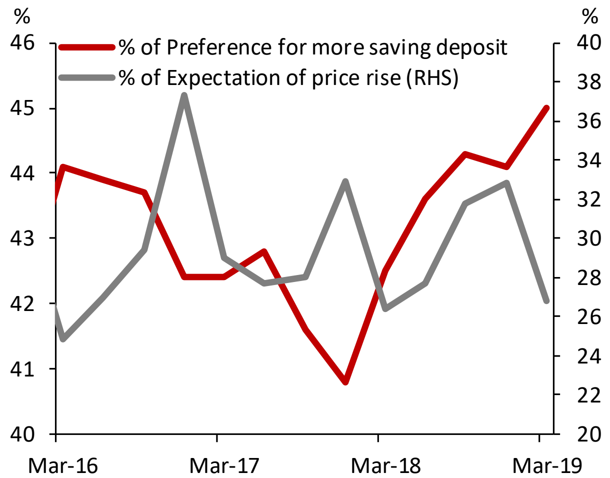
Local government bond issuance in 1Q since 2015



Looking forward, we expect continued recovery in industrial activities and infrastructure investment. According to Premier Li's work report, RMB800bn and RMB1.8tn will be invested in railway construction and road construction & waterway projects respectively this year. Other investments include intercity transportation, utilities, civil & general aviation as well as next-generation information infrastructure. Officials have approved a large number of projects since December 2018. And issuance of local government (LG) bond intended to fund infrastructure spending soared in 1Q19 to RMB1.4tn, up significantly from RMB0.2tn in 1Q18. Front-loading of debt allocation alleviates fiscal stress faced by local government. Local land sales, a primary source of LG funding, have come under pressure this year as the property market cools off. A VAT cut of up to Rmb2tn also depresses local tax revenues.

The PMI's employment component of the non-manufacturing sector – where the bulk of the workforce is employed – remained in the contractionary zone for seven consecutive months. Its manufacturing counterpart also hovered near the lowest level in 7 years. Weak labour market and tepid income growth have dampened consumer sentiment. According to the PBoC's Urban Depositor Survey, the proportion of respondents who intended to "save more" has, over a quarter, increased by 0.9ppt to 45% in 1Q19. Households were also less optimistic on the outlook for property prices. Home-related expenditure from furniture to electric & video appliances may remain lacklustre. Nonetheless, **we estimate that the recent increase in personal income tax threshold and expansion in deductibles should lift households' income by about 3%**. Consumer confidence should also get a lift from the buoyant stock markets.

Urban Depositor Survey



Exports jumped to five-month high last month, though the scale of the rebound was partly due to the different timing of Lunar New Year and hefty price increases. Specifically, export prices rose 4.4% in 1Q, contributing 66.3% of export growth.

Emerging evidence of stimulus efficacy suggests that consumer expectation and investor confidence remain constructive. Consumption, in particular, is amenable to responding to well-targeted measures, as seen in the recent rebound in loans and retail sales figures. This is a major source of comfort for China's outlook as growth trends lower. If growth deceleration becomes disorderly, the authorities will have the confidence that they have sufficient tools in their arsenal to stabilise the economy without having to sacrifice corporate deleveraging and associated moral hazard issue.

China's demand may in fact be understated, given data seasonality issues. Our Nowcast model is now signalling around 7% growth for 2Q, although we assign only modest confidence to that call given how early it is in the quarter. All in all, we expect another good GDP outcome in 2Q, which should offer further crucial support to the global growth picture.

Taimur Baig and Nathan Chow

FX: Asian currencies are still range-bound

USD/CNY fell below 6.70 on April 17 for the first time since March 20. China's growth did not slow as widely expected to 6.3% YoY in 1Q19. Instead, growth was unchanged for a second straight quarter at 6.4%, which in turn, affirmed that the policy stimulus and measures have stabilized growth against trade tensions. Yet, there are **no concrete signs that USD/CNY is about to move out of its 6.67-6.75 range** established since February 20. While US and China have been touting progress in trade talks, the timing of a finalized deal has remained elusive. An agreement as late as the G20 Summit in late June cannot be fully dismissed. Neither do we expect the Washington to pressure Beijing for a stronger yuan, now that America's trade deficit with China has shrunk 9.2% YoY in January-February.

Despite the positive spillover from the Chinese yuan, 1M **implied volatility for most Asian currencies have not deviated far from the year's low**. For example, USD/SGD has been nestled within its 1.3450-1.3620 (1.3%-wide) range since January 7. Currencies have also been stable and well-behaved in countries that held or are holding elections this year. Since March, the Thai baht has not traded out of 31.4-32.0 while the Indian rupee kept to a 68.3-70.0 range. Neither was there a victory dance for the Indonesian rupiah (still in a 13900-14340 range since January 7) when early results showed incumbent President Joko Widodo headed for a second term. The South Korean won, for the first time since October, made a second failed attempt to depreciate out of its 1110-1140 range of the past ten months. USD/MYR, however, did push into a higher 4.10-4.15 range from 4.05-4.10 seen during February to mid-April.

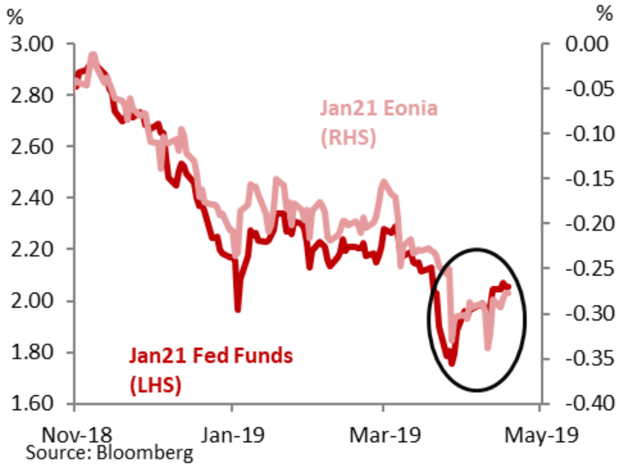
The return of risk appetite has yet to undermine the US dollar. Benchmark stock indices have recovered close to the record highs from which they fell in 4Q18. In turn, the US 10Y bond yield has returned above the Fed Funds Rate to 2.60%. This has eased US recession worries and led markets to price out a Fed cut this year. If the yield reaches 2.75%, debate will return to Fed hikes. This will keep the USD firm against the euro, which is the not only largest component in the USD Index (DXY), but also struggling against Eurozone's very weak growth outlook.

Philip Wee

Rates: Asia high-yielders to compress against low-yielders

Green shoots in China and Eurozone economic data have greatly improved growth sentiments and led some parts of markets to believe that the we may have seen the bottom of the mild synchronized global slowdown. Dovish pricing of major central bank policy outlooks is beginning to reverse, whether its Fed cuts or further-into-the-future ECB and BOJ policy lift-offs. 10Y USTs, Bunds and JGBs should continue to reprice modestly higher (5-20bps). The risks of sharper re-pricings appear to be low. The Fed is taking a patient approach. The probability of ECB and BOJ turning more dovish and staying "lower for longer" seems to be rising with talks of additional easing. Besides, G3 inflation has been muted and inflation expectations low. There does not seem to be much impetus for markets to price for higher inflation break-evens (i.e. upward repricing would largely be driven by real yields).

Dovish pricing of Fed and ECB policy outlook has reversed considerably.

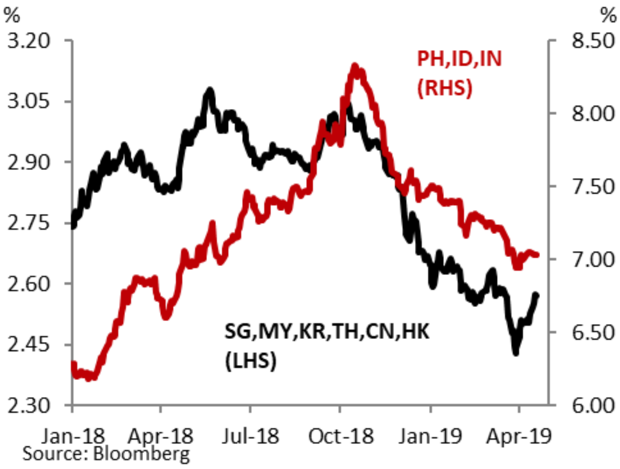


Source: Bloomberg

Against such a macro backdrop, EM Asia's high-yielders ("HY", group of Indonesia, India and Philippines) are well-placed to outperform low-yielders ("LY", group of Singapore, Thailand, South Korea, China, Hong Kong and Malaysia). We see spread compression of HY against LY.

As investors become more confident that recession risks are low and global monetary stance would stay broadly dovish, the current goldilocks carry environment could continue to hold. A comparison of current yield levels relative to 12 months ago show that HY yields have retraced ~60% of 2018's spike while LY yields have fallen way below early-2018 levels. On both points, there certainly seems to be more room for HY risk premiums to compress. If G3 yields reprice modestly higher as we expect, HY should be well buffered by their large yield spreads and thus be resilient. On the contrary, LY could be quite vulnerable, considering that four out of six members have nominal yields lower than USTs.

Asian Gov Bonds - Low yielding vs High yielding



Source: Bloomberg

HY were most aggressive in tightening in 2018, combining for 400bps of rate hikes. With inflation presently contained and their currencies more than holding up well (outperforming many EM and DM currencies), their central banks would have more room (relative to LY) to cut rates to support growth in 2019.

For investors, there are a couple of key risks to our view. Much higher oil prices would hurt HY more than LY, particularly India and Philippines. Intensifying stress in rates and currencies of Brazil, Argentina and Turkey could spillover to the region via financial market linkages, disproportionately impacting the more risk-sensitive HY.

Duncan Tan

Equities: Maintaining overweight Jakarta on elections

Early results suggest that incumbent President Jokowi may he headed for second five-year term after the Indonesian elections held on April 17. During his new term, we would expect stability and continuity in his polices, thus removing a major overhang for the market. Investors would know what to expect based on Jokowi's track record in his first term. Infrastructure development will continue, with plans to focus more on the human resource development. Another emphasis is the distribution of wealth and the development of rural areas outside of Java. He also intends to continue with the bureaucratic reform and attract more investments into manufacturing to reduce dependency on resources and minerals.

We believe investors' reaction to the elections results will be positive. During his tenure, Indonesia obtained a sovereign ratings upgrade to investment grade, and steered through a mini emerging markets currency crisis in 2018 without much negative impact on growth as well as the financial system. Indeed, the JCI has been re-rated during Jokowi's term and further improvement is possible in our view.

We reiterate our Overweight on Indonesia and raise our year-end JCI target from 6500 to 6900 based on 16x 12-month forward PE. Sectors that would benefit during Jokowi's new term would include infrastructure related sectors such as construction, toll roads and cement. We are also positive on the industrial property sector, assuming Jokowi can boost investments and manufacturing. State-owned companies such as those in the energy and banking sectors would also continue to benefit from on-going reforms in these two sectors.

Joanne Goh

Highlights of the week:

China: Stable signs, slower growth
Singapore's GDP: Expect a better 2H19
India: Tempering growth expectations

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	8.2	7.2	7.0	7.0	4.5	3.6	3.4	3.8
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.6	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	1.7	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.2	3.9	3.8
Singapore	3.9	3.2	2.6	2.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.6	2.4	1.9	1.5	1.1	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.5	1.5

* refers to year ending March ** new CPI series *** eop for CPI inflation

	Policy interest rates, eop							
	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.95	1.95	1.95	1.95	1.95	1.95	1.95	1.95
South Korea	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50

* 1-yr lending rate; ** 3M SOR ; *** prime rate

	Exchange rates, eop							
	Mar 29	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.85	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.4	70.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14248	14300	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.10	4.20	4.25	4.20	4.15	4.10	4.05
USD/PHP	52.7	54.0	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.37	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1137	1135	1145	1140	1135	1130	1125	1120
USD/THB	31.7	32.5	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23201	23250	23300	23280	23300	23250	23200	23150
AUD/USD	0.71	0.70	0.68	0.68	0.68	0.69	0.70	0.71
EUR/USD	1.12	1.12	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	111	113	115	114	113	112	111	110
GBP/USD	1.31	1.30	1.28	1.29	1.30	1.31	1.32	1.33

Australia, Eurozone and United Kingdom are direct quotes

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