Weekly: Asian central banks on the move

Economics/Strategy/Rates/FX/Equities

DBS Group Research July 19, 2019

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- *Rate cuts from Bank of Korea and Bank Indonesia this week have added to the policy easing narrative in Asia*
- *Central banks of China, India, and Malaysia, and the Philippines have been easing already*
- *We expect the Monetary Authority of Singapore to join the fray later this year. The Bank of Thailand is highly reluctant to cut, but an appreciating baht is exerting pressure on the central bank to act*
- *As the US Federal Reserve is unlikely to embark on an extended rate cut cycle, we expect only a few more cuts in Asia*
- *But the inclination to take defensive measures is widespread in the absence of inflation*

Asian policy makers are taking insurance cuts

Weak exports, uncertainty from trade wars, subdued inflation, and the US Fed signalling rate cuts are ample reasons for Asian central banks to ease policy presently. In recent months, central banks of China, India, Malaysia, and the Philippines have taken accommodating measures; this week South Korea and Indonesia joined the fray. The Monetary Authority of Singapore is not that far away, in our view.

BOK gravely concerned about the outlook

Bank of Korea's (BOK) rate cut on Thursday, which took the benchmark 7-day repo rate 1.50%, was the first cut since 2016. It was also a policy U-turn, with the rate cut coming less than one year after a hike. The BOK has expressed concerns about a swift rise in downside risks, revising down the 2019 GDP growth forecast to 2.2% from 2.5%, while lowering inflation forecast to 0.7% from 1.1%.

We are adding one more 25bps rate cut into our forecast for 2019 and expect the benchmark repo rate to fall to 1.25% in 4Q. To achieve the official forecast of 2.2% growth in 2019, real GDP will have to grow by more than 3.5% (QoQ saar) per quarter in 2Q-4Q. But there is little sign that the economy will stage such a strong rebound. High-frequency indicators like exports, PMI, industrial production, and consumer confidence weakened again in May/June after improvement in April.

In fact, both the South Korean manufacturing and construction sectors have entered a recession, driven by global demand weakness, tech sector downturn, property market slowdown, and US-China trade tensions. New headwinds come from the recent rise in Japan-Korea trade disputes. Japan's move of curbing the exports of high-tech materials to South Korea could disrupt the production activities among South Korean semiconductor and flat panel display companies, which highly rely on Japan for the supply of crucial materials.

We have been projecting real GDP to grow 2.1% this year, more conservative than the BOK's old (and new) forecast. We keep this estimate unchanged for the time being, but see risks tilted towards the downside.

Given the dovish Fed/ECB and the fall in DM yields into negative territory, the low yields of KRW assets are no longer a distinct disadvantage. In line with our forecast of two 25bps Fed rate cuts in 2H, we think the BOK also has the room to deliver one more cut towards the end of this year and bring the total magnitude of rate cuts to 50bps.

Conditions finally align for BI

Conditions have aligned for Bank Indonesia (BI) to embark on an easing cycle, with the first cut in this cycle coming on Thursday. With the rupiah performing well amid a dovish Fed and an improving trade balance, we think that BI could cut by a cumulative 75bps (25bps in 2019 and 50bps in 2020) over the coming quarters. Lacklustre growth could open up room for the 2020 cuts to be brought forward.

Inflation has been on the back burner, as a combination of slower economic activities, partly due to weaker commodity prices and better domestic rice supply management, have pushed inflation below 3%. We are revising down our inflation forecast to 3.2% in 2019 and 3.4% in 2020 from our previous forecast of 3.6%. Even if fuel and electricity prices adjustment need to be done this year, we do not think that inflation would swing too far from BI's median target of 3.5%.

The Rupiah has appreciated by 3.75% YTD, second highest after Thai Baht among Asian countries. IDR could stay resilient as interest rates are high compared to peers like India. It therefore makes sense for BI to take the opportunity to ease. Risks of a widening current account deficit and more volatile capital flows could close this window, so there is some motivation to front-load these prospective cuts, in our view. Moreover, Indonesia is among the few that hiked aggressively during the Fed hike cycle last year. With real rates still high, there is room for BI to cut further.

Outlook

As the US Federal Reserve is unlikely to embark on an extended rate cut cycle, we expect only a few more cuts in Asia this year. No more than 1-2 cuts can be expected from BI, RBI, BSP, and BOK, in our view. MAS policy easing, will also likely be modest. While trade headwinds are considerable, domestic demand is not particularly weak in most of Asia. Moreover, dataflow out of the US is rather sound, while China is showing signs of a trough, as per our Nowcasting model.

The inclination to take defensive measures is widespread in the absence of inflation. At the same time, we expect Asian policy makers to keep most of their powder dry for a possible global downturn in 2020-21.

Taimur Baig

FX: Struggling in a monetary policy easing environment

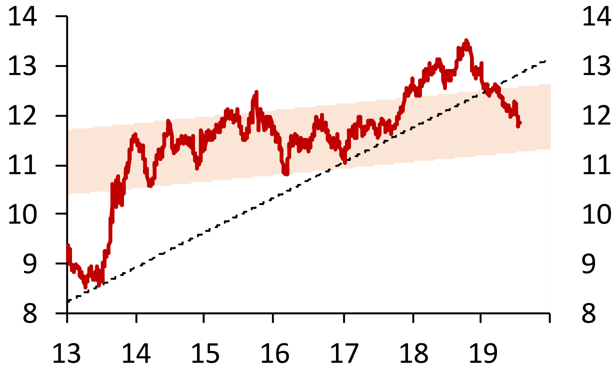
Developed market currencies are struggling against each other in a convergent monetary policy easing environment. The US dollar is not tanking ahead of the 25 bps Fed cut expected at the FOMC meeting on July 31. Advance estimate for US GDP (1.8% QoQ consensus vs 3.1% previous) on July 26 could vindicate the Fed for looking past the recent upside surprises in US data. On the other hand, the Fed views the cuts as insurance against global headwinds from trade tensions. Until this changes, the US 10Y bond yield should stay supported around the Fed's 2% inflation target. The USD Index (DXY) has been hovering around 97, the mid-point of its 96-98 range established since February.

The euro has found some support around 1.12 but could not break free of the weakness in the Eurozone economy. The German ZEW current situation index has turned negative in July for the first time since June 2010. This was well below the levels when the European Central Bank launched its quantitative easing programme in March 2015. Hence, pay close attention to the governing council meeting on July 25. The ECB may signal its readiness to resume, if needed, asset purchases. More importantly, ECB President Mario Draghi is expected to pave the way for a rate cut in September before his term ends in October. Former IMF Managing Director Christine Lagarde, who has been nominated to lead the ECB, is considered a dove.

The Indonesian rupiah continues to be favoured over the South Korean won after their rate cuts on July 18. The Bank of Korea's decision to lop 25 bps off its 7D repo rate to 1.50% came earlier-than-expected but Bank Indonesia's 25bps cut to 5.75% was considered a long-awaited event. Our economist expects one more cut by BOK in 4Q19 and the next BI cut in 2020. The BOK's decision to downgrade its 2019-2020 growth and inflation outlook underscored the need to cushion growth against risks posed by Japan's export ban on key components needed by its semiconductor industry. BI is looking for the Fed's upcoming insurance cuts to provide a benign US dollar environment for more easing to lift growth. The KRWIDR cross rate, last at 11.86, has scope to fall to 11.30.

There is still room for KRW to fall against IDR

IDR per KRW



Sources: DBS Research, Bloomberg data

Philip Wee

Rates: Asia to ease further

The Bank of Korea (BoK) and Bank Indonesia (BI) joined the easing bandwagon, cutting their respective policy rates by 25bps this week. The BoK and BI joins the ranks of other Asia central banks (India, the Philippines and Malaysia) in taking steps to cushion economic growth amid persistent growth challenges. More importantly, the U-turn from the Fed and the European Central Bank (ECB) over the course of the past year has led to much more benign global financial conditions. As developed market rates push lower, it provides increasing leeway for Asia central banks to cut rates. This is especially true for economies with twin deficits.

We think that the wave of easing has further to go and this should be supportive of Asia govvies in general. Over the coming few quarters, we can expect more rate cuts from India, Indonesia, Malaysia, the Philippines and South Korea. Thailand and Taiwan buck the trend, but we suspect that pressure to loosen policy could build in the coming months. Similarly, expectations for slope flattening from the Monetary Authority of Singapore (MAS) in October have spiked after the weak non-oil domestic export (NODX) figures dashed hopes for an upward revision in already dismal 2Q GDP numbers. Lastly, we think that China govvies are attractive and have probably not factored in the likely measured easing ahead.

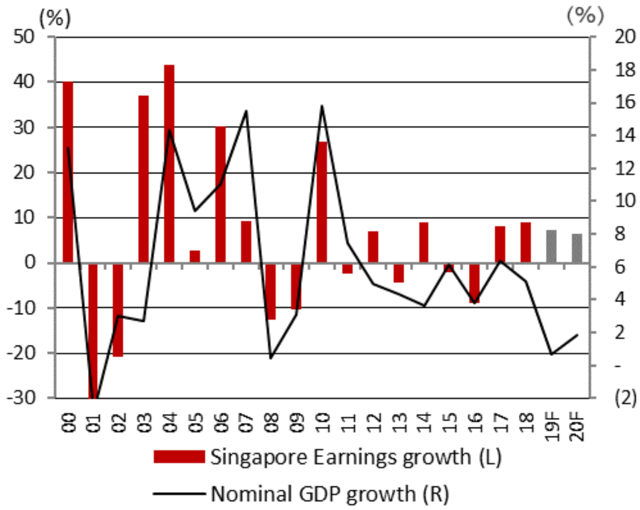
Eugene Leow

Equities: Singapore, the new defensive market

Singapore's economic growth momentum lost steam in Q2, prompting our economist to downgrade his 2019 GDP growth forecasts to 0.7% for this year and 1.8% for 2020. This will be the worst growth since the financial crisis.

Current consensus earnings growth of 7.2% this year will be put to the test in the upcoming reporting season. However, we do note that Singapore's earnings growth is becoming less sensitive to GDP growth, and has been more stable in the past few years. We believe this is due to the more diversified sources of revenue by geography. We estimate that only 18% of aggregate revenue is derived domestically.

Singapore earnings growth vs GDP growth

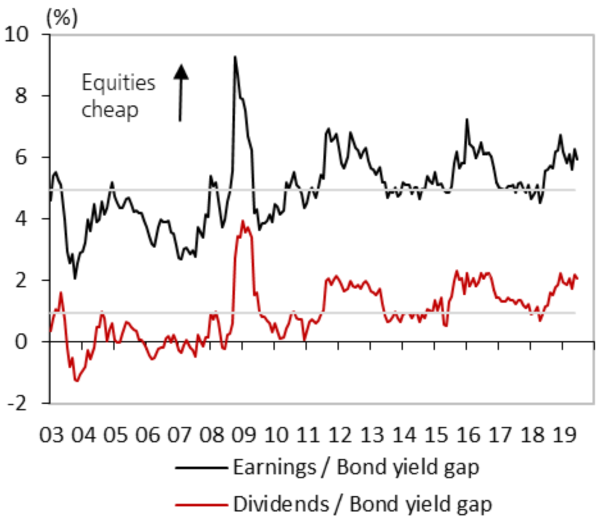


Source: IBES, Thomson Reuters, DBS

And unlike the economy, earnings are almost entirely independent of the electronics cycle except for one company among the STI stocks. Sector wise, the Banks are contributing the bulk of earnings growth. In light of the weakening GDP growth and declining interest rates, the worry is that Banks could surprise on the downside. However, we reckon that loan growth is becoming less correlated to the economy, and the NIM has fallen to such a low point over the years that it is no longer a critical factor for driving share prices. Non-interest income, NPLs, provision charges, shape of yield curve are equally important, which all depend on how the Banks are run. Singapore Banks, in general, are well capitalised, and have a low price-to-book ratio and high dividend yields. We believe the Banks should not disappointment in a big way.

One of the valuation measures we watch most closely — the yield gaps vs bond yields, are near their post-GFC high, suggesting that the equity market is attractively valued versus bond yields. Given that global interest rates are likely to stay low for some time, we believe that Singapore, as a high-yielding market, should be attractive to yield-seeking investors.

Singapore dividends and earnings yield gap vs bonds



Source: IBES, Thomson Reuters, DBS

Near-term drivers for the market include policy stimulus such as monetary easing and an increase in government spending on subsidies. We believe that cheap valuations and lower interest rates could drive M&A and share buy-back activities, which is positive for overall market sentiments.

We reiterate our Overweight stance on the Singapore market in an Asia ex-Japan context. Cheaper valuations, high dividend yield, resilient earnings and government policy flexibility, should make it a relatively defensive market in this challenging environment.

Joanne Goh

Highlights of the week:

South Korea: First rate cut since 2016; more to come
Indonesia: Rate cuts in the horizon
India: External borrowing to fund budget; good or bad?
Asian bonds in demand: catalysts and upside
China: Slowing growth along with signs of stabilization
SGD rates: The liquidity conundrum
Downgrading Singapore's growth forecast
Chart of the Week: US growth data don't justify deflation fears

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018	2019f	2020f	2017	2018	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	6.8	6.8	4.5	3.6	3.4	3.8
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.2	3.4
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	0.9	1.6
Philippines**	6.7	6.2	6.1	6.1	2.9	5.2	3.1	3.1
Singapore	3.9	3.2	0.7	1.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	0.5	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.4	3.5	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	1.7	1.6

* 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	5.50	5.25	5.25	5.25	5.25	5.25
Indonesia	6.00	6.00	5.75	5.75	5.75	5.50	5.50	5.25
Malaysia	3.25	3.00	3.00	2.75	2.75	2.75	2.75	2.75
Philippines	4.75	4.50	4.25	4.25	4.25	4.25	4.25	4.25
Singapore**	1.95	1.95	1.80	1.60	1.60	1.60	1.60	1.60
South Korea	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.25
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	2.25	2.00	2.00	2.00	2.00	2.00

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

	Exchange rates, eop							
	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.87	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.81	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.2	69.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14243	14126	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.13	4.25	4.23	4.21	4.19	4.17	4.15
USD/PHP	52.6	51.3	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.35	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1135	1155	1180	1170	1165	1160	1155	1150
USD/THB	31.7	31.0	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23189	23301	23500	23450	23400	23350	23300	23250
AUD/USD	0.71	0.70	0.64	0.66	0.68	0.70	0.72	0.74
EUR/USD	1.12	1.14	1.08	1.09	1.10	1.11	1.12	1.13
USD/JPY	111	108	112	111	110	109	108	107
GBP/USD	1.30	1.27	1.22	1.24	1.26	1.28	1.30	1.32

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).