# Economics & Strategy Weekly

# Weekly: Orderly slowdown

**Economics/Strategy/Rates/FX/Credit**

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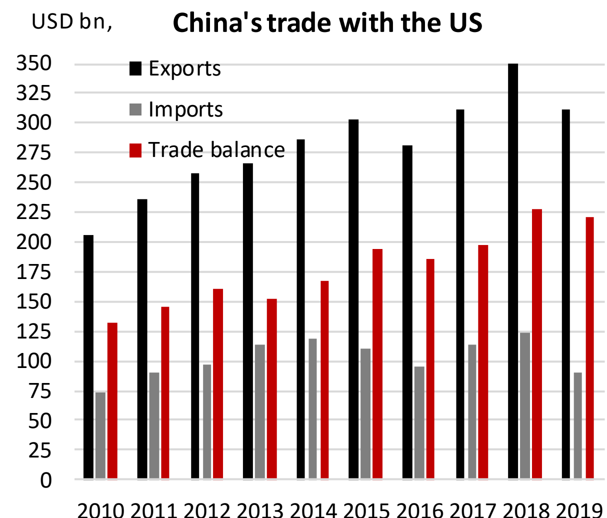
- *Backward looking data covering 3Q look rather weak, but PMIs and trade data suggest the worst of the global production and shipment cycle may be ending.*
- *2020 will see slow growth in the China and US, but the outturn will likely be no worse than seen in 2H2019.*
- *Emerging market economies will likely fare better, aided by low interest rates, flat energy prices, and stable currencies.*
- *Monetary policy worldwide will maintain dovish biases, but market moving policy traction will likely come from fiscal and structural policies.*

## Slowing, but a trough in the making

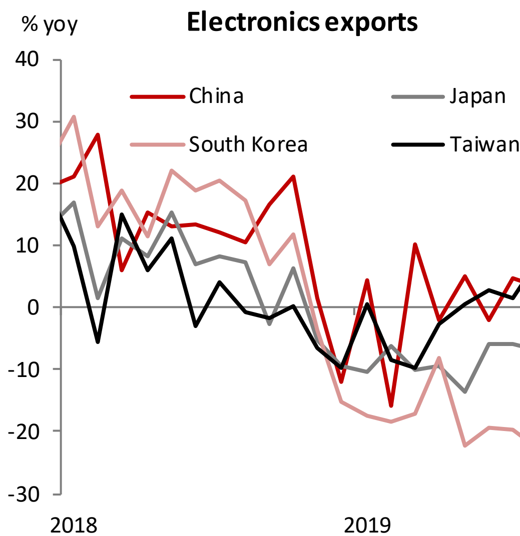
From a sub 2% 3Q US growth outturn to minus 3% growth in Hong Kong, the narrative of the worldwide growth slowdown remains intact. But financial markets are not in the mood to fret, with equity and bond prices remaining in constructive territory. Words of an interim China-US trade deal, hard-Brexit being taken off the table, rate cuts by the Fed, and no inflation worries have kept sentiments constructive, although their durability can be questioned.

On the trade war front, we would expect the White House keen to see a pick-up in China's purchase of agriculture products from the US. After all, despite the tariff war, the bilateral trade deficit has barely budged. Looking at data available through September, the ytd China-US trade balance stands at USD221bn, compared to USD 227bn last year during the same period, which should get the US to become more agreeable on the negotiating table, in our view.

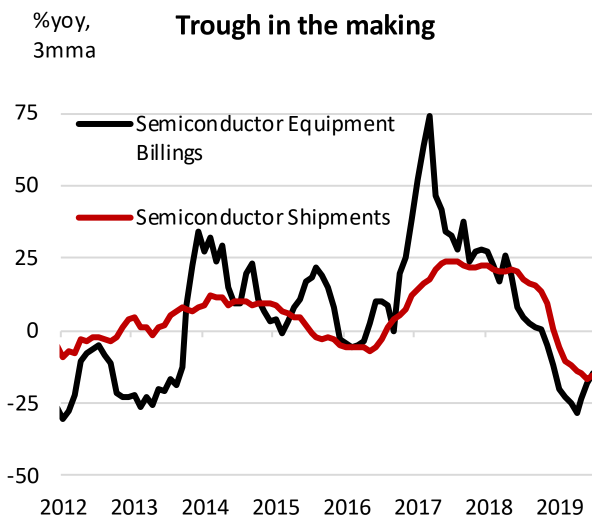



Source: CEIC, DBS. Data covers January-September of each year

Looking at mixed China PMI data and a surprisingly strong 3Q for Taiwan, we feel that the worst of Asian trade-related developments may be behind us. Electronics exports show signs of bottoming, especially when one examines leading indicators like semiconductor billing, which is presently suggesting that shipments are about the rise.

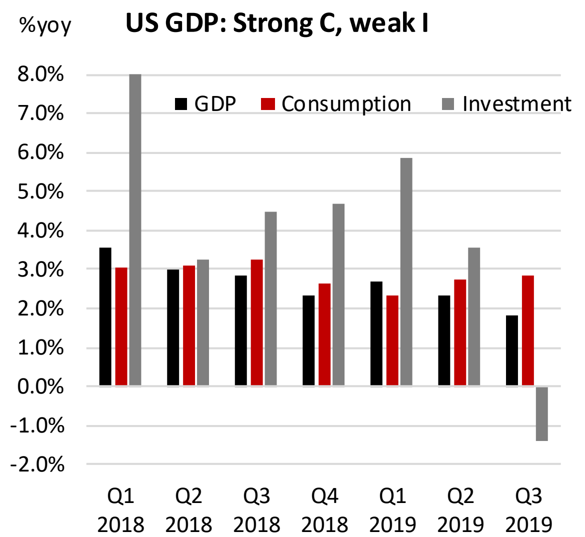


Source: CEIC, DBS. Data through Sept 2019

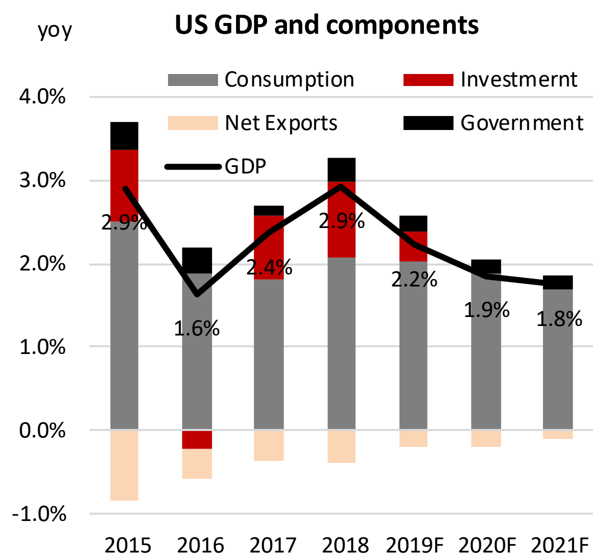


Source: CEIC, DBS

Against this backdrop, the latest Fed rate cut looks close to the terminal rate in this cycle, although we will be rash to ignore the downside risks. Our forecasts are for sub 2% growth in the US in both 2020 and 2021, although growth momentum may remain the same as that of 2H2019. There is a chance that the Fed would cut one more time in the first of half of 2020, considering the 100bps slowdown in nominal GDP growth rate, but largely we agree with the FOMC that the combination of around 2% growth and 2% inflation in the forecasting horizon is consistent with the present monetary policy stance.



Source: CEIC, DBS



Source: CEIC, DBS

*Taimur Baig*

## Taiwan: From underperformer to outperformer

GDP growth rose 2.9% YoY in 3Q, faster than the 2.4% in 2Q and beating the consensus / our forecast of about 2.5%. With growth averaging 2.4% in 1Q-3Q, Taiwan clearly outperformed its regional peers including South Korea (1.9%), Singapore (0.4%), and Hong Kong (-0.6%) so far this year.

The economy may have started to benefit from the trade diversion and investment repatriation effects of the China-US trade war. Exports of goods and services grew 4.2% YoY in 3Q, the second consecutive quarter of solid gains. And the rise was mainly driven by exports to the US market (18.0%, in nominal terms).

Cyclically, the electronics sector has showed some signs of bottoming-out. The rise in goods exports in 3Q was largely driven by electronic components (3.9% YoY, in nominal terms). It was reported that orders from the Apple supply chain have started to pick up, as the new iPhone 11 products received better-than-expected demand worldwide. Meanwhile, Taiwan's TSMC recently announced to increase its capex plan for 2019, citing stronger-than-expected growth in the 5G smartphone market.

Looking ahead, investment repatriation and trade diversion are likely to continue next year, amid the lingering uncertainties in China-US relations. Whether the electronics sector can sustain a recovery is a bigger question mark, given that the overall global demand outlook remains weak. **We are revising up the 2019-20 GDP growth forecasts modestly, to 2.3% (vs 1.9%) and 2.0% (vs 1.8%), respectively**.

*Ma Tieying*

## Hong Kong: Economy in muddy water

**We have downgraded the GDP growth forecasts to -1.7% from 0% for 2019.** Due to the low base comparison this year, we have revised up our forecast for 2020 from 0.5% to 1.5%. Advance estimates on the 3Q real GDP growth was -2.9%. On a sequential basis, it contracted by 3.2% after recording a 0.5% drop in 2Q. Hong Kong has entered technical recession.

3Q performance was dragged by the subdued consumption sentiment. Private consumption expenditure plunged by 3.5% amid political uncertainties. Retail sales also dropped by 23% in August. Visitor arrivals slumped by over 30% in August and September.

The outlook remains clouded by the lingering trade tensions between China and the US. Merchandise exports have contracted 11 straight months. A shrinking trade finance pointed to a weak business confidence in the external sector. Export of services recorded double-digit drop of -13.7%.

The pessimistic investment sentiment (-16.3%) indicated to a weak business expectation. The property market consolidation (-5.1%) also dragged the investment performance. Yet, there will be a rebound despite economic recession. The global monetary easing condition, the latest Prime Rate cut, and recent relaxation in mortgage requirements will render some support to the asset prices.

CPI inflation edged down from 3.5% in August to 3.2% YoY in September. Yet, stagflation risks remained amid a jump in food price (13.1%).

*Samuel Tse*

## Japan: BOJ revises forward guidance

The Bank of Japan (BOJ) kept policy unchanged at the October 31 meeting but revised the forward guidance. **The BOJ now expects short- and long-term interest rates to remain at "the present or lower levels" as long as it is necessary to pay close attention to the possibility that the momentum towards achieving the price stability target would be lost.** This is in contrast to the earlier guidance – the Bank will maintain "the current extremely low levels" of short- and long-term interest rates for an extended period of time, at least through around spring 2020.

During the quarterly economic outlook report, the BOJ further downgraded growth and inflation forecasts for FY19-21, by 0.1-0.3ppt. The Bank also issued an assessment report to say that it is necessary to pay close attention to the risk that the momentum towards achieving the price stability target would be lost, because uncertainties over the output gap and inflation expectations are significant.

**BOJ's growth and inflation forecasts**

| | | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| GDP growth (%) | New | 0.6 | 0.7 | 1.0 |
| | Old | (0.7) | (0.9) | (1.1) |
| Core CPI (excl. sales tax, %) | New | 0.5 | 1.0 | 1.5 |
| | Old | (0.8) | (1.2) | (1.6) |

The revision of the forward guidance is a stronger signal about monetary easing, in our view. The concerns about inflation losing momentum will likely grow bigger in the coming months, putting greater pressure on the BOJ to take policy actions. Core CPI has fallen notably to 0.3% YoY in September from the peak of 0.9% in April. This week's data showed that Tokyo core CPI remained flat at 0.5% in October even after the 2ppt sales tax hike took effect, as the impact of tax increase was offset by that of a free pre-school education program introduced by the government.

The output gap is deteriorating. Judging from the pattern of rush demand before the October sales tax hike, the post-tax hike decline in consumption growth may not be much smaller than that during 2014. Retail sales and department store sales jumped 9.0% YoY and 22.8% respectively in Sep19, a similar pace as that during Mar14 (11.1%, 25.2%). Consumer confidence plunged by 5ppt in the Apr-Sep19 period, also similar as during Oct13-Mar14.

It doesn't help that the external sector remains sluggish. Exports contracted -5.2% YoY in September vs -4.9% in July-August. Exports to South Korea fell as much as -15.9%, as the impact of the bilateral trade disputes emerged. Given the unresolved trade tensions (Japan-South Korea, China-US) and the slowdown in global growth, a significant turnaround in exports cycle appears unlikely in the near term.

**We continue to expect a 10bps cut in the short-term policy rate in 4Q (likely at the next meeting in December).** Meanwhile, **we are revising down the full-year CPI inflation forecasts, to 0.5% (vs 0.8%) for 2019 and 0.7% (vs 1.3%) for 2020.**

*Ma Tieying*

## FX: October rally could be a head fake

October ended on a mixed note with optimism giving way to caution again. China and the US are still working towards sealing a mini trade deal in November with no assurances that trade tensions won't flare up again anytime soon. China growth has slowed in 3Q19 to the floor of this year's 6-6.5% target and see falling below 6% in 2020. UK has averted a no-deal Brexit on October 31 but is headed towards a snap election on December 12 that is likely to produce a majority government to resolve Brexit. The EU is less willing to extend a third extension beyond the new Brexit Day set on January 31, 2020.

The Fed delivered its third rate cut on October 30 and signalled that it may be done with its mid-cycle adjustment for the year. US growth surprised on the upside; it slipped marginally to 1.9% QoQ saar (vs 1.6% consensus) in 3Q19 from 2.0% in the previous quarter. This may be negative for emerging market Asian currencies because global uncertainties have remained high despite some easing in trade and Brexit worries. The Hong Kong economy reported a technical recession in 3Q19. Singapore remains vigilant against downside growth risks and is ready to ease its SGD policy again if the trade war spill-over from the export/manufacturing into domestic demand and services. The currency appreciation in October is unsustainable because there are still no signs that the synchronized global slowdown this year would turn into a broad-based recovery with US underperforming the rest of the world next year.

*Philip Wee*

## Rates: Fed is done with insurance cuts

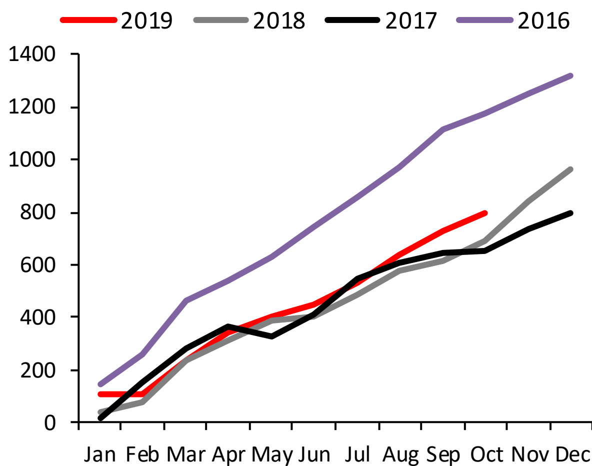
**The US Federal Reserve's Open Market Committee delivered the third rate cut for the year, taking the Fed Funds rate upper bound to 1.75%, and signaled that a prolonged pause is likely.** This episode of policy easing mirrors the two instances seen in the 1990s (see here). In both cases, the Fed took precautionary measures and pre-emptively cut by 75bps before pausing. If global economic conditions improve, it is quite conceivable that the next Fed move may be up, rather than down. However, the hurdle for further Fed action appears to be set relatively high. With downside risks stemming from hard Brexit and China-US trade war seemingly diminished, there should be no urgency for further rate cuts. Moreover, the US economy is still generally firm. However, the Fed will probably be more comfortable with hikes only if economic numbers (especially global manufacturing) start to show closer signs of bottoming out.

**We still see 10Y US Treasury yields in the 1.5-2.0% range for now.** Worries about negative rates across the DM space has receded somewhat as major central banks push back against overly low rates and overly flat curves. Importantly, 10Y German yields (at-0.36%) are now some 35bps above the nadir registered in August. The amount of negative yielding bonds has also dipped below USD 13tn, from a peak of USD 17tn in late August. **With the odds of a cyclical uplift improving and a likely end (or close to the end) of the monetary easing cycles in the DM space, we see room for US yields to grind higher in the coming months. 10Y yields could push above 2% in 2020.**

*Eugene Leow*

## Credit: China's bond financing stays moderate

Amidst a recent flurry of Chinese new corporate issuance in the credit market, investors could ask if there has been a significant growth in Chinese bond financing this year. We estimate that **China's 2019 full-year net corporate issuance** (less maturing debt) **could match the 2018 quantum, but it is not likely to surpass previous records** for either the onshore or offshore market.




Sources: Bloomberg, DBS

The onshore RMB bond market has seen new issuance coming in slightly above 2017 and 2018 levels, with nearly $800bn raised by end October. However, there is little chance of closing to the 2016 record, which saw over $1.3trn of RMB bond issuance. **Given that corporate leverage is still elevated in general, China could maintain a measured pace of corporate issuance into next year, seeking to lower debt burdens to more comfortable levels.**

*Chang Wei Liang*

**Highlights of the week:**

India: Personal income tax cuts likely in the pipeline
Chart of the Week: China and India's rise in "Doing Business" survey

# 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 | -1.7 | 1.5 | 1.5 | 2.5 | 2.7 | 2.5 |
| **India*** | 8.2 | 7.2 | 6.8 | 6.2 | 4.5 | 3.6 | 3.4 | 3.6 |
| **Indonesia** | 5.1 | 5.2 | 5.0 | 5.1 | 3.8 | 3.2 | 3.2 | 3.4 |
| **Malaysia** | 5.9 | 4.7 | 4.5 | 4.6 | 3.8 | 1.0 | 0.9 | 1.6 |
| **Philippines**** | 6.7 | 6.2 | 5.7 | 6.1 | 2.9 | 5.2 | 3.1 | 3.1 |
| **Singapore** | 3.9 | 3.1 | 0.6 | 1.4 | 0.6 | 0.4 | 0.5 | 1.1 |
| **South Korea** | 3.1 | 2.7 | 2.1 | 2.4 | 1.9 | 1.5 | 0.5 | 1.5 |
| **Taiwan** | 3.1 | 2.6 | 2.3 | 2.0 | 0.6 | 1.3 | 0.7 | 1.0 |
| **Thailand** | 3.3 | 4.1 | 3.0 | 3.2 | 0.7 | 1.1 | 1.0 | 1.3 |
| **Vietnam** | 6.8 | 7.1 | 6.6 | 6.3 | 3.5 | 3.5 | 2.8 | 3.4 |
| **Eurozone** | 2.5 | 1.9 | 1.0 | 1.1 | 1.5 | 1.8 | 1.2 | 1.3 |
| **Japan** | 1.9 | 0.8 | 0.7 | 0.5 | 0.5 | 1.0 | 0.5 | 0.7 |
| **United States***** | 2.3 | 2.9 | 2.2 | 1.9 | 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 | 5.40 | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 |
| **Indonesia** | 6.00 | 6.00 | 5.25 | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 |
| **Malaysia** | 3.25 | 3.00 | 3.00 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 |
| **Philippines** | 4.75 | 4.50 | 4.25 | 3.75 | 3.50 | 3.50 | 3.50 | 3.50 |
| **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 | 1.50 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 |
| **Vietnam***** | 6.25 | 6.25 | 6.00 | 6.00 | 5.75 | 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 | -0.20 | -0.20 | -0.20 | -0.20 | -0.20 |
| **United States** | 2.50 | 2.50 | 2.00 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 |

* 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 | 7.15 | 7.20 | 7.15 | 7.10 | 7.05 | 7.00 |
| **USD/HKD** | 7.85 | 7.81 | 7.84 | 7.85 | 7.85 | 7.84 | 7.84 | 7.83 |
| **USD/INR** | 69.2 | 69.0 | 70.9 | 71.5 | 72.0 | 72.5 | 73.5 | 74.0 |
| **USD/IDR** | 14243 | 14126 | 14195 | 14500 | 14550 | 14600 | 14650 | 14700 |
| **USD/MYR** | 4.08 | 4.13 | 4.19 | 4.25 | 4.24 | 4.23 | 4.22 | 4.21 |
| **USD/PHP** | 52.6 | 51.3 | 51.8 | 53.6 | 53.9 | 54.2 | 54.5 | 54.7 |
| **USD/SGD** | 1.36 | 1.35 | 1.38 | 1.42 | 1.41 | 1.41 | 1.40 | 1.40 |
| **USD/KRW** | 1135 | 1155 | 1196 | 1250 | 1240 | 1230 | 1220 | 1210 |
| **USD/THB** | 31.7 | 31.0 | 30.6 | 32.0 | 31.8 | 31.6 | 31.4 | 31.2 |
| **USD/VND** | 23189 | 23301 | 23203 | 23220 | 23250 | 23270 | 23300 | 23330 |
| **AUD/USD** | 0.71 | 0.70 | 0.68 | 0.64 | 0.65 | 0.65 | 0.66 | 0.66 |
| **EUR/USD** | 1.12 | 1.14 | 1.09 | 1.08 | 1.09 | 1.09 | 1.10 | 1.10 |
| **USD/JPY** | 111 | 108 | 108 | 109 | 109 | 108 | 108 | 107 |
| **GBP/USD** | 1.30 | 1.27 | 1.23 | 1.16 | 1.17 | 1.18 | 1.19 | 1.20 |

Australia, Eurozone and United Kingdom are direct quotes

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