Global Economic Outlook 15 February, 2020

Tuan Hoang
Head of macro
Tuan.hoangcong@mbs.com.vn

Long Nguyen
Analyst
Long.nguyenphi@mbs.com.vn

Anh Nguyen, CFA
Analyst
Anh2.nguyenduc@mbs.com.vn

GLOBAL ECONOMIC OUTLOOK

Highlights:

Covid-19 virus suspended economic activities in China, resulting in a 15% drop in oil price in 3 weeks.

Inflation rate in China reached 5.4% yoy in January, the highest level in over 8 years. Food prices increased by 15% compared to January 2019. The US-China Phase 1 trade deal is likely to promote pork import into China, cooling down inflationary pressure.

Unemployment rate in developed countries is at its lowest in recent years.

Car sales figures in China is expected to reduce by 25%-30% yoy in January-February.

The United Kingdom officially leaves the EU and will negotiate trade deals during the transitional period.

PMI of major economies saw a slight recovery in January after the US-China Phase 1 deal was signed but Covid-19 might cause a disruption.

The US housing market is a bright spot as leverage declines substantially when household debt is at significantly lower than the 2007 peak while mortgage rate declines.

China's fiscal deficit will widen significantly in 2020 as the shock on the economy from the Corona epidemic will lower growth, projected to exceed 5% GDP this year.

Global bond yields have not stopped declining as investors rushed to increase their bond portfolio amid worries of Covid-19 impact on global growth outlook.

The US dollar surges 1.7% since the outbreak of the flu virus in China due to concerns of economic damages on the world's 2nd largest economy, which already has plenty of existing structural issues.

World Economic Updates

Crude oil

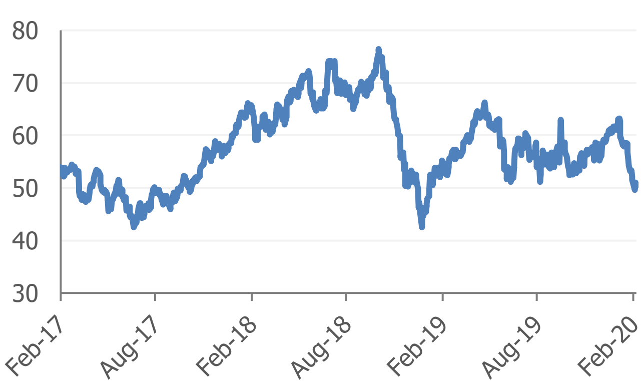
Covid-19 has caused some significant damages to the global economy, especially to the chinese growth outlook. As fear of the disease spreads, the Chinese government made a decision to extend the Lunar New Year by 10 days and lock down several cities in Hubei province. The disruption of manufacturing lowers the demand for production inputs, especially oil. Chinese refineries estimate oil consumption will reduce by 25% in February, an equivalent of 3% global consumption.

Oil price has been reacting accordingly. On 07/02, WTI has fallen by 14% during the extended Lunar New Year holiday, now trades at approximately USD 50/barrel. Brent has also dropped by 16% during this period, currently at USD 54.5/barrel.

To combat the downturn in price, OPEC+ analysts are recommending another cut of 600 thousand bpd in production until Q2/2020 and extend the 2.1 million bpd cut deadline from the end of Q1/2020 to the end of the year. However, one important member of the group, Russia, has not agreed with the recommendation, stating the need for more time to fully evaluate the impact of Covid-19. During the 3-month period from October 2019 to January 2020, OPEC has cut its output by 1.4 million bpd according to Bloomberg estimates. In its latest report, OPEC has also adjusted the growth of global oil consumption down by 50 thousand bpd, to 930 thousand bpd. With weaker consumption and impacts by the disease, WTI price in the coming times is expected to fluctuate around USD 50-60/barrel if OPEC and Russia cannot reach an agreement to cut production.

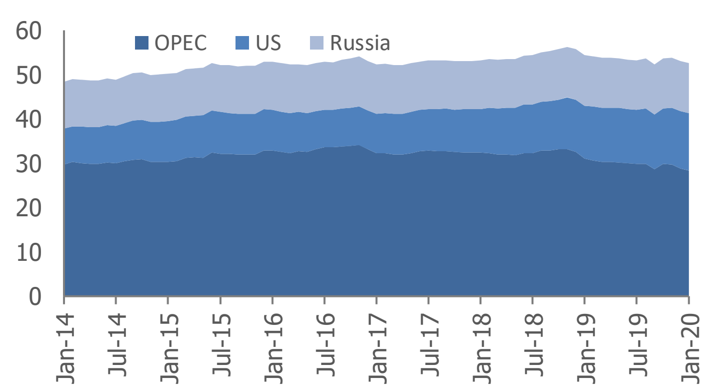
With a low fuel price, countries may have advantages to expand manufacturing, especially in countries with large oil consumption such as the US (20 million bpd) and China (13.6 million bpd). In addition, inflationary pressure will also cool down, avoiding the risk of central interest rates rising back up when central banks around the world are still employing expansionary monetary policies.

WTI price (USD/barrel)



Source: Bloomberg.

OPEC, US, Russia oil output (million barrels/day)



Source: Bloomberg.

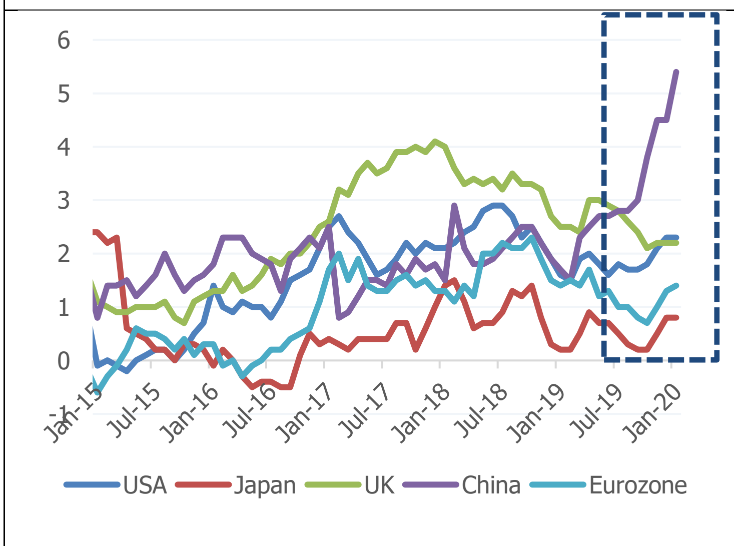
Inflation

China recorded an increase in its January CPI of 5.4% yoy, the fastest rise since October 2011. The biggest contributor is food price in general and pork price in particular. According to National Bureau of Statistics, compared to January 2019, pork price has increased by 116%, contributing 2.76% into this month CPI increase. Other food categories also saw a price rise due to the fact that Lunar New Year came earlier than last year and people were hoarding neccessities because of Covid-19 outbreak. Under impact from Covid-19, we expect inflation in China will still be above 4% in the first half of 2020 when citizens are still hoarding essential products and the supply chain in China is disrupted. However, there are some bright spots such as low inflationary pressure from fuel price, and the Phase 1 deal between the US and China, which requires China to purchase an additional USD 200bn of goods from the US, will promote pork imports, driving down the inflationary pressure from this key product.

Inflation in developed economies reach its 2019 bottom at the end of Q3 has since recovered slightly. The US and UK are having an inflation rate of 2.2-2.3%, slightly above the 2% target. Meanwhile, Eurozone inflation is at 1.4% in January 2020, quite a climb from the 0.7% level in October 2019. Japan's current inflation rate is at 0.8%, highest since April 2019.

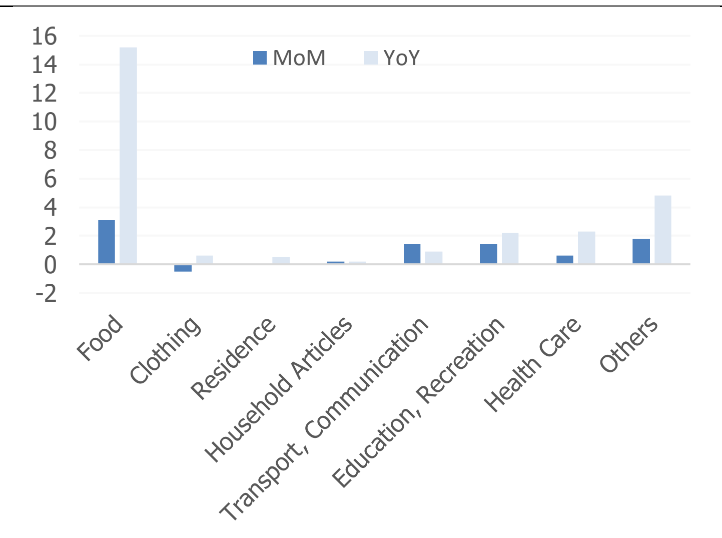
Inflation rate in these countries are expected to be on the rise because major central banks such as Fed and ECB continue to maintain the current interest rate level after cutting rates in 2019, as well as injecting money into the financial system (Fed injecting USD 60bn/month, ECB injecting EUR 20bn/month)

Major economies inflation rate (% yoy)



Source: Bloomberg.

January price change in China (%)



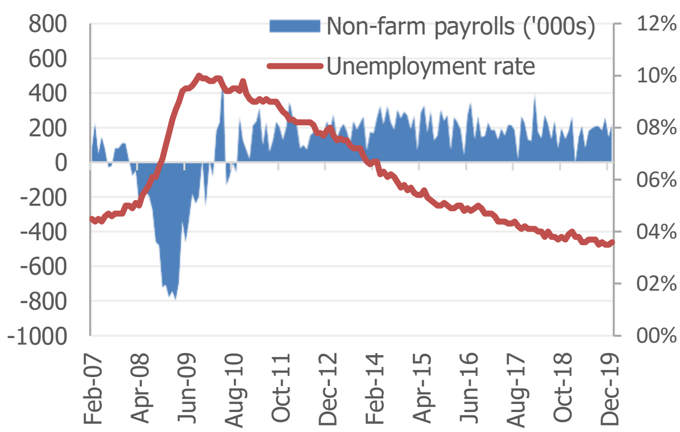
Source: Bloomberg.

Labor market

The labor market in developed economies is still operating positively. American unemployment rate in January is at 3.6%, a minor increase of 0.1% compared to December but still around the lowest level in 50 years. There are 225 thousand new jobs in the non-farm sector, 50% higher than the December figure of 147,000 jobs.

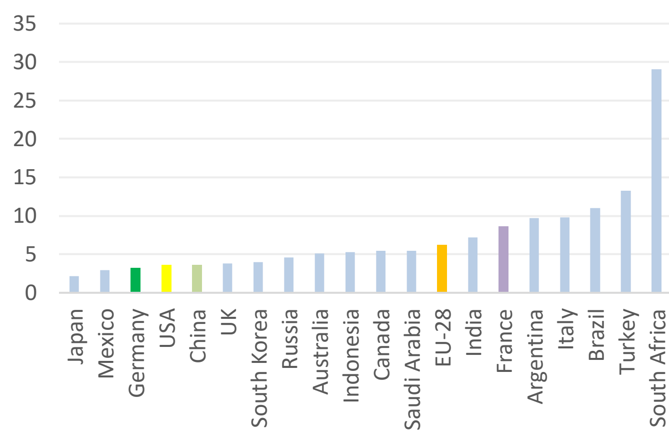
The average unemployment rate in the EU is 6.2%, of which the countries with low unemployment rate are Germany (3.2%), Netherlands (3.2%), Czechia (2%), whereas some major economies such as France, Italy and Spain are suffering from above average unemployment rate, which is 8.4%, 9.8% and 13.7% respectively. In 2019, 21 out of 28 EU member countries managed to reduce their unemployment rate, of which Greece has been the most prolific, from 18.5% in October 2018 to 16.6% in October 2019.

Employment in the US



Source: Bloomberg.

Unemployment rate in G20 economies (%)



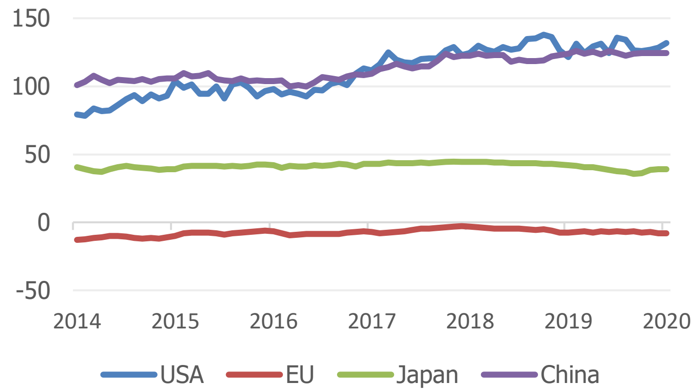
Source: Bloomberg.

Consumption

Automobile sector in China is experiencing challenges after challenges. Car sales in China in the first two months of 2020 is projected to reduce by up to 25-30% due to Covid-19. However, it may recover after this because Chinese citizens may refrain from public transport and switch to personal vehicles to avoid the virus spreading. In Japan, private consumption may suffer in Q4/2019 due to the consumption tax hike from 8% to 10% in October. Some estimate that Japan comsumption drop by 7.8% in Q4, resulting in a reduction in business investment.

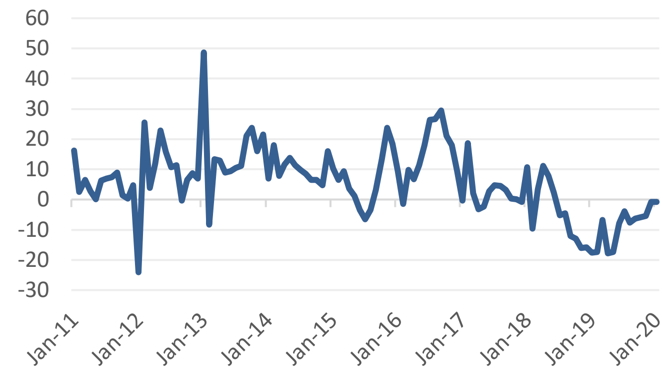
in January 2020 reached 131.6, an increase of 3 points compared to December 2019. Meanwhile, this index in the EU is on a downward trend in Q4/2019 after the ECB announced to cut interest rates to -0.5% and pump EUR 20bn/month.

Consumer confidence index



Source: Bloomberg.

China car sales growth (% yoy)



Source: Bloomberg.

Trade

On January 15, 2020, after a long period of trade tensions between the two largest economies in the world, trade representatives of the US and China signed the Phase 1 trade deal. Some agreements were reached as follows:

- In the next 2 years, China pledged to buy an addition of at least USD 200bn of US goods compared to 2017 imports, including USD 52.4bn in energy, USD 32bn in agricultural products, USD 77.7bn of manufactured goods, USD 37.9bn of services. The two countries also agreed that the purchase of goods could continue until 2025 but there are no specific provisions. However, Deputy Prime Minister Liu He said that Chinese enterprises will import US goods based on the needs of the domestic market, so it is likely that the USD 200bn is not locked in.

- China also agreed to loosen some regulations on the standards of agricultural products being used to prevent US agricultural products from entering China. Some main agricultural products include milk, meat, cattle, seafood, and animal feed.

- This agreement also aims to protect intellectual property rights, genuine goods. The US wants China to take measures to protect the copyrights of US businesses doing business in China, as well as stop requiring US companies to transfer technology if they want to operate in China.

- The two sides also set up a committee to settle complaints in practice, instead of giving it to a third party for consideration. In the event of a dispute that cannot be resolved, one party may take action on its own (eg, impose a tax) and the other party may not retaliate if it deems it is justified. If retaliated, both parties can withdraw from this agreement.

- China is committed to loosening the rules for financial companies operating in China (Banking, Credit Ratings, Electronic Payments, Insurance, Securities ...)

- China also committed not to lower its currency to compete.

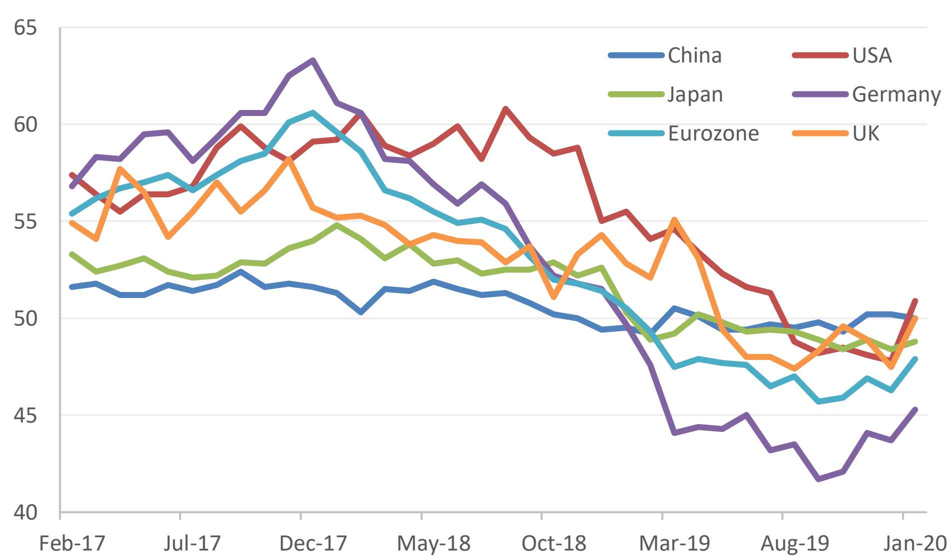
- Other issues such as cybersecurity, Chinese government's subsidy to domestic enterprises in some industries such as steel and solar power have not been mentioned in this agreement. The tax imposed by the US on USD 360bn of Chinese goods remains at least until the Phase 2 deal.

On January 31, 2020, the UK officially left the EU after nearly 4 years since the people voted. During the transition until December 31, 2020, the UK and the EU will negotiate future relations. At the same time, the UK will also negotiate trade agreements with other countries such as the US, China and Japan. The Boris Johnson administration has been adamant by declaring that the UK will not accept EU requirements, while the EU has warned that it will impose tariffs on UK exports if the two sides do not reach an agreement. However, time is of the essence, Boris Johnson will most likely accept some EU requests to reach an agreement.

Manufacturing

US-China trade tensions and declining global trade growth has weakened global manufacturing in 2019. However, after the two countries reached the Phase 1 deal, the industry has shown some positive signs. Manufacturing PMI index of most major economies increased in January, though still at a relatively low level. The manufacturing PMI of the US and UK is only approximately 50, while the German and Japanese are at 48.8 and 45.3 respectively. European manufacturing, notably Germany, has struggled for over a year due to a trade war between two of its largest import-export partners, which is expected to continue on the upward momentum 2020. The recovery of production is hindered by the complicated development of the Covid-19 epidemic that disrupted production in China, an important link in the global supply chain. It is expected that the disease can only be controlled after April, so the global production will be affected at least until the end of the second quarter of this year.

Manufacturing PMI

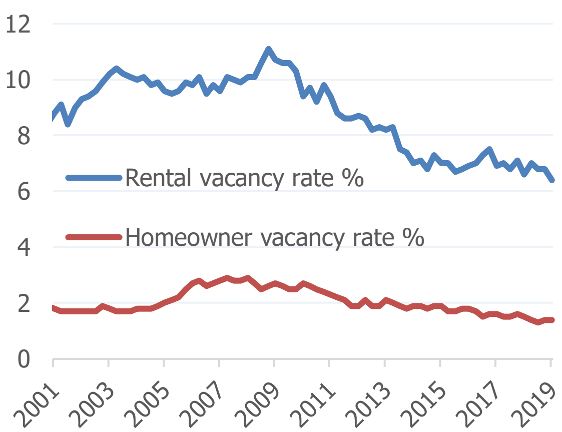


Source: Bloomberg.

The housing market

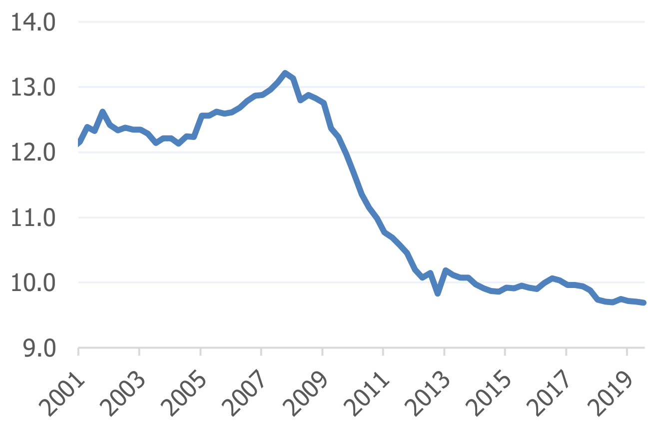
The culprit of the 2008 financial crisis was the risky mortgage lending activities of the US housing market, however, at the moment, housing market in the United States is one of the positive factors in the US economy. Before the crisis, US household debt has spiked from 104% of household income in 2000 to 144% in 2007, pushing property price to increase more than 50% after adjusting for inflation. Currently, US household debt has decreased to 110% income, while service debt payment as share of personal income also falls from the peak 12 years ago from 13.2% to under 10% in 2019, which shows a substantial decline of the leverage in the US residential housing market. Mortgage rate falling in 2019 has increased the household's ability to pay, rental and homeowner vancancy rate significantly drops while excessed supply post-crisis has been absorbed will be factors supporting house price in the U.S. this year.

Rental and homeowner vacancy rate (%)



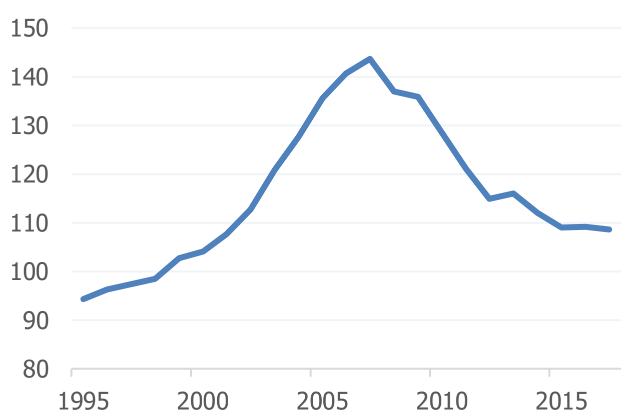
Source: US Census.

Service debt payment as share of personal income US (%)



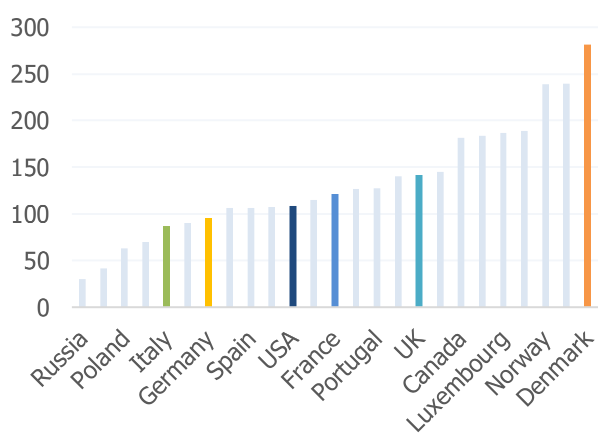
Source: Fred St Louis.

US Household debt as share of income (%)



Source: IMF.

World's household debt as share of income (%)



Source: OECD.

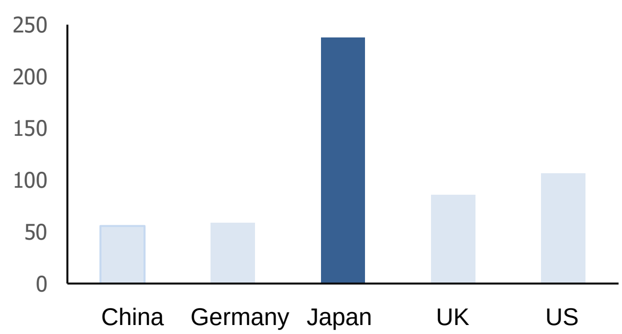
Policy

US Federal budget deficit approximates US$1 trillion in 2019, equivalent of 4.7% GDP, a significant rise from the 3.8% in 2018 and 3.5% in 2017, due to agressive spending policies of the Trump's administration. The deficit is projected to increase above the 5% level in 2020 as revenue drops as an impact of the tax cut in 2017. At 78% of GDP, US public debt is at high level, according CBO (US Congress Budget Office), at this rate, US public debt will rise to 98% GDP by 2030, near the historic high of 1947. Unless there is a spending cut in pension, healthcare, nursery for old people or a tax hike, the budget deficit will continue to rise with the public debt. However, with declining government bond yields and near zero interest rate, US nominal GDP growth above the interest rate might help maintain a controllable deficit, as long as the interest stays at low level.

Meanwhile in China, under the national health emergency of Covid-19, the chinese government has to abandon their prudent approach to monetary and fiscal policies in the previous periods, by giving out stimulus packages such as delaying deadline for tax submission and social security contribution for firms and companies impacted by the epidemic. The government also increases expediture on infrastructure such as building hospitals to combat Covid-19, as well as provides subsidies to discretionary goods to assure the supply of medical equipment and food.

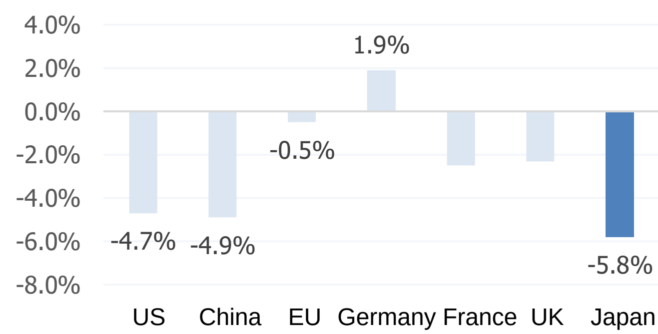
At the same time, PBOC, the central bank of China also requires commercial banks to lower lending interest rate and extend debt obligations for firms impacted by the epidemic when cities are quarantined and firms have to shut down temporarily, by injecting substantial liquidity into the banking system. The gloom-ridden impact of the external shock on the Chinese economic growth outlook forces Xi's goverment to swiftly reverse the prudent policies earlier. China's fiscal deficit in 2019 is 4.9% of GDP and is expected to widen to above 5% this year in the face of shrinking revenue while expenditure soars.

Public debt of selected economies (% GDP)



Source: IMF.

Budget deficits of major economies (% GDP)



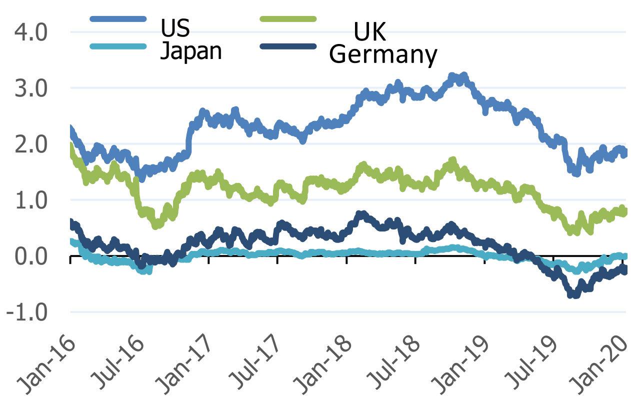
Source: IMF, Eurostat.

Bond Market

Government bond yields of many countries have fallen into negative territory as investors seek safe assets in a rising uncertainty environment globally, from the trade war to the current epidemic in China. According to calculation by Bloomberg, a quarter of government and corporate bonds outstanding has negative yields. Pension funds, insurance firms as well as creditors will face substantial drawdown in their bond portfolio if these US$15 trillion negative yield bonds are held til maturity.

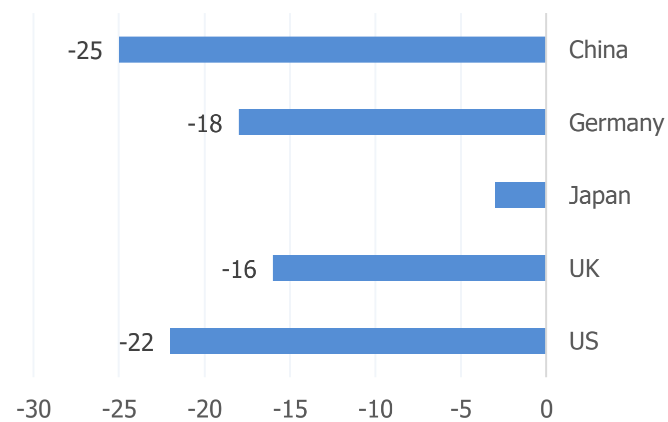
Eurozone countries, especially those with large fiscal surplus such as Germany, Netherlands and Austria all have 10y G-bond yield at negative rate. In other countries with deficit like France, Belgium and Ireland, yields also decline to negative. Yields of countries with budget crisis like Italy, Spain and Greece have also approached 0. Weak economic growth outlook of the EU causes the ECB to lower the interest rate and carry out bond-purchase program of the member states, causing yields to further decline. Meanwhile, the EUR 5y5y Forward Swap, market's inflation expectation indicator widely used by central banks and investors is currently at 1.22%, indicating that inflation expectation continues to stay at low level, reducing the demanded future cashflow from their bonds holding, thus intensify the falling spiral of bond yields.

10Y yields of selected countries



Source: Bloomberg.

Change in 10Y G-bond yields since the outbreak of COVID-19 in China (Jan 10, 2020) *basis points



Source: Bloomberg.

Exchange rate

The USD surges 2.7% YTD with the DXY index rises to 99 points, the highest level in 4 months as the United States and China reached a partial agreement on trade issues on Jan 15. The greenback is expected to appreciate in the short-run as the chinese economy faces sharp decline due to Covid-19 and growth outlook in the eurozone remains foggy. However, with Fed keeping rates low and a weakening US economic growth in 2020, downward pressures on the USD will be maintained til the rest of the year.

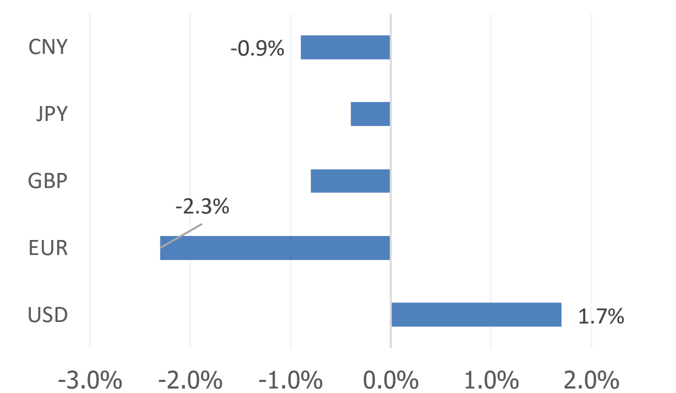
The Euro drops sharply 2.3% against the dollar to 1.08 USD/EUR in 1 month after the corona epidemic broke out in China, Europe's 2nd largest export market after the United States, disrupting Europe's supply chain in China. Germany is largely impacted, German automotive supply chain in China with over 315 locations are severely disrupted as many facilities are shutdown in order to control the Covid-19. Besides, Europe's tourism and luxury industry also face immense difficulties as European streets lack Chinese tourists. In France, chinese tourists spend on average 1,000 EUR/day, highest among international tourists in the country of Eiffel tower, and according to statistics from Bank of France, Chinese tourists purchase EUR 4bn worth of goods when traveling in France every year. The epidemic will make growth in the Eurozone falls negative (q-o-q) in Q1/2020.

Amid weak growth outlook, the risk of policy uncertainties and debt crisis may increase the threat of the dissolution of the single-currency European area. Heightened risk of members leaving the EU, following Brexit, especially countries with high debt level such as Italy, Spain and Greece, as well as populism continues to rise in Europe, will raise the EUR volatility in 2020.

DXY Index

Source: Bloomberg.

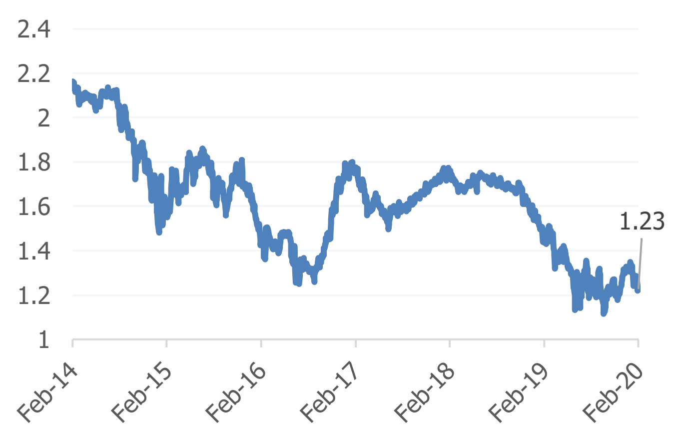
Currencies movement against USD since Jan 10,2020 as Covid-19 broke out in China



Source: Bloomberg.

USD/EUR Exchange rate

EUR 5y5y Forward Swap (%)



Countries	GDP (% yoy)			CPI (% yoy)			Unemployment rate (%)
	2019	2020F	2021F	2019	2020F	2021F	2019
USA	2.3	2.1	1.7	2.2	2.4	2.4	3.7
EU	1.0	1.4	1.4	1.3	1.3	1.7	7.7
Germany	0.5	1.2	1.4	1.8	1.7	1.8	3.2
France	0.8	1.3	1.3	1.0	1.4	1.5	8.6
Italy	0.0	0.5	0.8	0.7	1.0	1.1	10.3
Spain	1.8	1.8	1.7	0.7	1.1	1.6	13.9
Britain	1.2	1.4	1.5	1.6	2.1	2.0	3.8
Japan	0.9	0.5	0.5	1.6	0.2	1.4	2.4
China	6.0	5.8	5.9	2.2	2.4	2.8	3.8
Russia	1.1	1.9	2.0	3.8	3.7	4.0	4.6
Developed Markets (DM)	1.7	1.7	1.6	1.7	1.7	1.9	4.9
Emerging Markets (EM)	3.9	4.6	4.8	4.7	4.6	4.5	
World	2.5	2.7	2.8	3.5	3.4	3.5	

Countries	GDP (% q-o-q)		CPI (% yoy)		Unemployment rate (%)	
	Latest		Latest		Latest	
US	0.5	Q4	2.5	Jan	3.5	Dec
EU	0.1	Q4	1.4	Jan	7.4	Dec
Germany	0.1	Q3	1.7	Jan	3.2	Dec
France	-0.1	Q4	1.5	Jan	8.4	Dec
Italy	-0.3	Q4	0.6	Jan	9.8	Dec
Spain	0.5	Q4	1.1	Jan	13.7	Dec
Britain	0.02	Q4	1.3	Dec	3.8	Q3
Japan	0.5	Q3	0.8	Dec	2.2	Dec
China	1.5	Q4	5.4	Jan	3.6	Q4
Russia	0.8	Q3	3.0	Dec	4.6	Dec

Source: OECD.

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MBS HEAD OFFICE
MB Building, 3 Lieu Giai, Ba Dinh, Hanoi
Tel: + 8424 3726 2600 - Fax: +8424 3726 2601
Website: www.mbs.com.vn