

## Good MornING Asia - 1 August 2018

Weak China PMI in July is a sign of trade war impact already kicking in, while the US is gearing up for the next round of tariffs on \$200bn of Chinese imports

### In this bundle



#### China

##### **China: Trade war impact begins to bite**

Both manufacturing and non-manufacturing PMI point to expectations of slower export-related activities, including logistics. Luckily, domestic services...



#### Japan

##### **Japan: Some policy tweaks but not a lot**

Has the Bank of Japan strengthened its commitment to reaching the 2% inflation target or conceded defeat in getting there anytime soon? Absent a departure...



#### South Korea

##### **Korea: Central bank policy stalemate**

Slower growth and rising inflation put the Bank of Korea's policy in limbo, supporting our forecast of no policy change through mid-2019



#### Taiwan

##### **Taiwan GDP surprises on the back of weaker imports**

Taiwan's GDP surpassed our expectations, which is why we marginally revise our annual forecast to 2.48%. But if the trade war continues to escalate,...



## Thailand

### **Thailand: Second quarter ends on positive note**

We revise our 2Q18 growth forecast to 4.5% from 4.0% but maintain our full-year growth forecast at 4.0%. Firmer GDP growth is positive for the Thai baht...

---

## China: Trade war impact begins to bite

Both manufacturing and non-manufacturing PMI point to expectations of slower export-related activities, including logistics. Luckily, domestic services...



Source: Shutterstock

### This is just the beginning of the downturn

Both manufacturing and non-manufacturing PMI point to concerns about the trade war impact on businesses. This is just the beginning of the trade war. If the 25% tariff on \$16 billion worth of goods starts on 1 August, it will only get worse for exporters and related businesses. We believe that this would make the yuan even weaker. Our USDCNY forecast is at 7.0 by the end of 2018.

# 49.8

Export orders manufacturing PMI

below key 50-level

### Both manufacturing and non-manufacturing PMI show trade war is starting to bite

Regarding manufacturing PMI, new export orders stayed at 49.8 in July, the same as June but imports fell to below 50 at 49.6 from June's 50.0. Although domestic orders are still holding up

steadily at 52.3, the figure is still lower than last month's 53.2. The survey indicates that worries of an escalating trade war have fed through export manufacturers to domestic manufacturers via the supply chain.

The non-manufacturing PMI also fell, from 54.0 to 53.0, mainly reflecting the fall in demand for production-related services and logistics, which fell by 1.9 and 5.7 points, respectively to 55.8 and 52.8. The steep fall in logistic services implies that exports and imports could slow down in the midst of a trade war.

Luckily, the domestic consumption related manufacturing PMI rose 0.6 points to 52.4, which indicates domestic consumption is still strong, and has yet to feel the heat of the trade war.

**-5.7 points**      Logistic service PMI at  
52.8%

Worse than expected

## Japan: Some policy tweaks but not a lot

Has the Bank of Japan strengthened its commitment to reaching the 2% inflation target or conceded defeat in getting there anytime soon? Absent a departure...



Source: Shutterstock

**-0.1%** BoJ policy rate  
No change

### BoJ maintains ultra-easier monetary policy stance

As widely expected, there was no change to the Bank of Japan's ultra-easier monetary policy stance, though today's policy meeting wasn't a complete non-event. There were some policy alterations aimed at enhancing the sustainability of its monetary policy, with more flexible market operations towards the price stability target of 2%. But the changes were subtle.

As we expected, the BoJ didn't abandon its inflation target nor was there any reduction in the asset purchases pace, both having grossly underperformed the 2% and JPY80 trillion targets, respectively.

## So what's changed today?

1. **Inflation:** the downgrade of its inflation forecast for FY2018 to 1.1% from 1.3%, and that for FY2019 and FY2020 to 1.5% and 1.6% respectively, from an earlier 1.8% forecast for both years. The statement noted that “it is likely to take more time than expected to achieve the price stability target of 2%”.
2. **Forward guidance (introduced for the first time):** the persistently low level of short- and long-term interest rates for an extended period of time, depending on uncertainty regarding economic activity and prices.
3. **JGB purchases:** some flexibility in the 10-year JGB yields around the 0% target, depending on economic activity and prices. A gradual reduction in the current account balances of financial institutions at the BoJ with the negative rate of 0.1%, from the current JPY 10 trillion.
4. **Asset purchases:** adjustment in the asset purchase amount depending on market conditions, and a shift in ETFs allocation towards Topix from Nikkei.

## All boils down to inflation

However, everything boils down to achieving the price stability target. And after downgrading its inflation forecast for this and the next two years, the key question is: has the central bank conceded defeat on the objective of raising inflation to the 2% target level? Or just as today's statement notes at the outset, is the Bank actually strengthening its commitment to achieving this target? Only time will tell.

Even with the planned consumption tax in 2019, meeting the inflation target by next year remains a far cry, not only from the BoJ forecast but also from the consensus view. So is the unwinding of stimulus. While inflation so far this year is on track to meet our 0.9% annual forecast, we are reviewing our 1.8% inflation forecast for 2019 as well as the forecast timing of the start of tapering by the end of next year. But for now, absent a significant departure from an ultra-easy monetary policy stance, the 10-year JGB yield giving back its recent spike seems to be a reasonable expectation.

# Korea: Central bank policy stalemate

Slower growth and rising inflation put the Bank of Korea's policy in limbo, supporting our forecast of no policy change through mid-2019



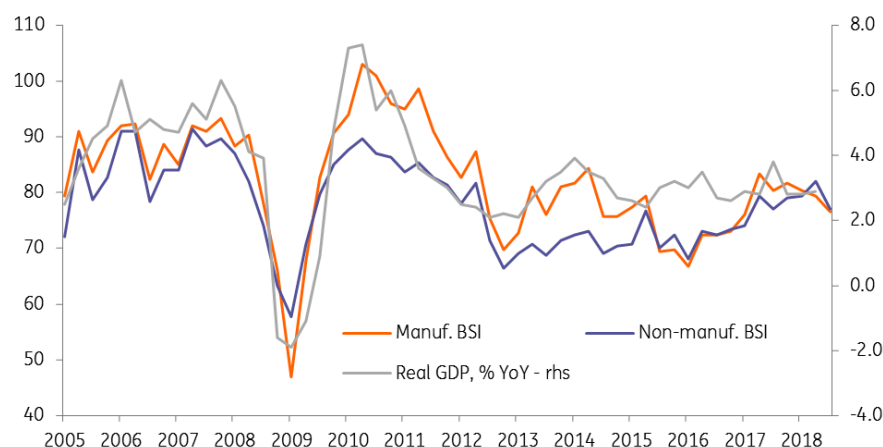
Source: Shutterstock

Forward-looking Korean confidence indicators paint a picture of dim growth for the coming months, while inflation continues on an uptrend. These developments put the central bank's policy in limbo. We aren't forecasting any change to the 1.50% BoK policy rate through mid-2019.

## Weakening business confidence

The BoK released its manufacturing and non-manufacturing business survey indexes (BSI) for July. The focus typically is on the forecasts of these indicators for the upcoming month, in this case, August. And they posted their steepest decline in three years, from the point of 80 for both in July to 73 for manufacturing and 74 for non-manufacturing in August. These indexes indicate the continued tapering in GDP growth in the period ahead (see figure).

## Weakening business confidence point to slower GDP growth



Source: Bloomberg, ING

## Evolving growth-inflation dynamics

Besides this, the releases tomorrow of trade and inflation data for July will shed more light on evolving growth-inflation dynamics of the Korean economy. We consider consensus forecasts of 7.4% YoY export growth and 17.0% import growth- implying a significant improvement over -0.1% and 10.7% in June- to be optimistic. We anticipate a contraction on the order of 2.6% YoY in exports and 1.3% in imports, which will be associated with a near-halving of the trade surplus to \$3.2 billion in July from \$6.2 billion in the previous month.

Our 1.7% YoY July inflation is in line with the consensus. Inflation bottomed at 1% at the start of the year in January and has since accelerated to 1.5% by June as a result of the double-whammy from firmer global oil prices and a weaker Korean won (KRW). While these factors will remain in play through the rest of the year, the higher trade tariffs and the low base effect will also add to the upward inflation pressure.



## Taiwan GDP surprises on the back of weaker imports

Taiwan's GDP surpassed our expectations, which is why we marginally revise our annual forecast to 2.48%. But if the trade war continues to escalate,...



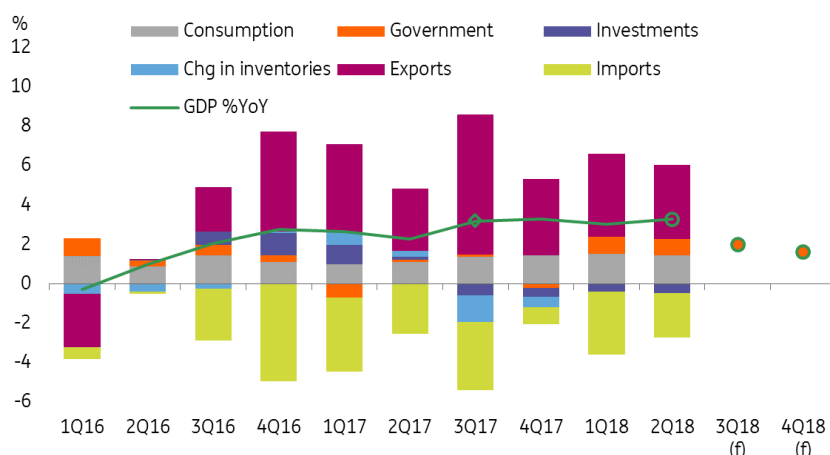
Source: Shutterstock

Taiwan's GDP came in at 3.29% year on year in 2Q18, surprisingly up from 3.02% in 1Q, surpassing our forecast of 2.8% and consensus 2.9%. However, the surprising growth doesn't imply a strong economy in fact, quite the opposite.

The main reason for the higher GDP growth was simply that import growth was smaller which reflects that exporters were cautious to import materials for manufacturing and therefore export growth should slow down too in the coming months. The cautious behaviour is probably due to rising concerns about the bilateral trade war between Mainland China and the US.

Due to the strong 2Q GDP growth, we revise our 2018 GDP growth to 2.48% from 2.4%.

## Taiwan GDP growth higher due to weaker imports



Source: ING, Bloomberg

## Not a single component tells a positive story

Every component in the GDP breakdown experienced slower growth than in 1Q18, but due to the negative nature of imports, the headline numbers look good. Consumption, government spending and exports all exhibited slower growth, and investment continued to shrink even more negatively than in the first quarter.

The interest rate is already at a low level of 1.375%, so there is little room for the central bank to cut rates any further. The slower government spending shows that fiscal stimulus, if any, would be small.

So, given that business owners cannot rely on fiscal or monetary policies, Taiwan's manufacturers have to find a way to save themselves - better to manufacture substitute goods for Chinese exporters. But this won't be easy either, especially when the trade war escalates to the extent that it affects the job market and global demand and inflation.

In short, Taiwan's economy looks somewhat shaky at the time of this bilateral trade war between China and the US.

[Why we've also revised our USD/TWD forecast lower too](#)

## Thailand: Second quarter ends on positive note

We revise our 2Q18 growth forecast to 4.5% from 4.0% but maintain our full-year growth forecast at 4.0%. Firmer GDP growth is positive for the Thai baht...



Source: Shutterstock

Thailand's activity data for the second quarter of 2018- the June manufacturing and current account balance- surprised on the upside, signalling that it was a better quarter for GDP growth than we expected. While the government agencies, the finance ministry, and the central bank, have been upgrading their growth forecasts for 2018, we retain our 4% forecast for this year. Absent central bank (BoT) policy support, and with weakening external payments, the Thai baht (THB) should continue its depreciation trend for the rest of the year, although with some stabilisation in July.

# 4.7% June industrial production growth

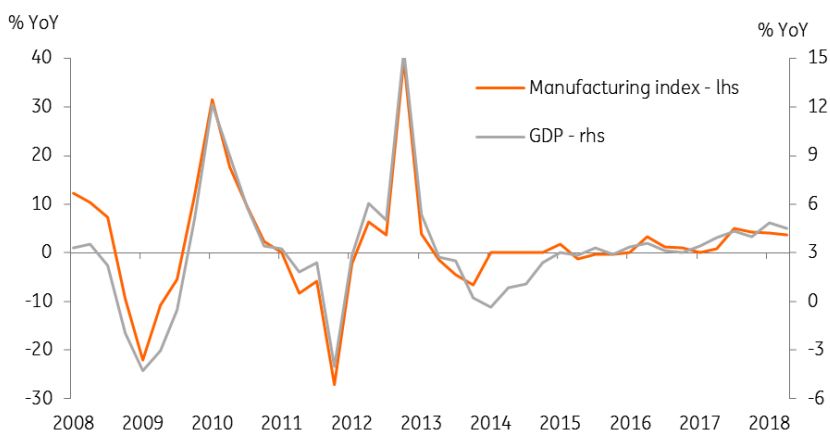
Higher than expected

## Manufacturing indicates better-than-expected 2Q GDP growth

June industrial production (IP) growth came in at 4.7% year-on-year, well above the consensus forecast of 3.1% and up from 2.9% in May, although growth in the previous month was revised from the 3.2% initial estimate. The low base effect and firmer export growth explain the better manufacturing performance in June. This puts average IP growth in 2Q18 at 3.2% YoY, a modest slowdown from 3.7% in 1Q18.

IP growth closely tracks real GDP growth (see figure). We now estimate 2Q GDP growth of 4.5%, up from our previous forecast of 4.0%. Data for 2Q GDP is due on 20 August. We maintain our full-year 2018 growth forecast of 4.0%, as evolving risks of the global trade war will weigh on exports and GDP growth in the remainder of the year. Earlier this week, the finance ministry lifted its growth forecast for 2018 to 4.5% from 4.2%. The central bank's forecast is 4.4%, recently revised from 4.1%.

## Manufacturing drives GDP growth



Source: Bloomberg, ING

# \$4.1bn Current account surplus in June

Higher than expected

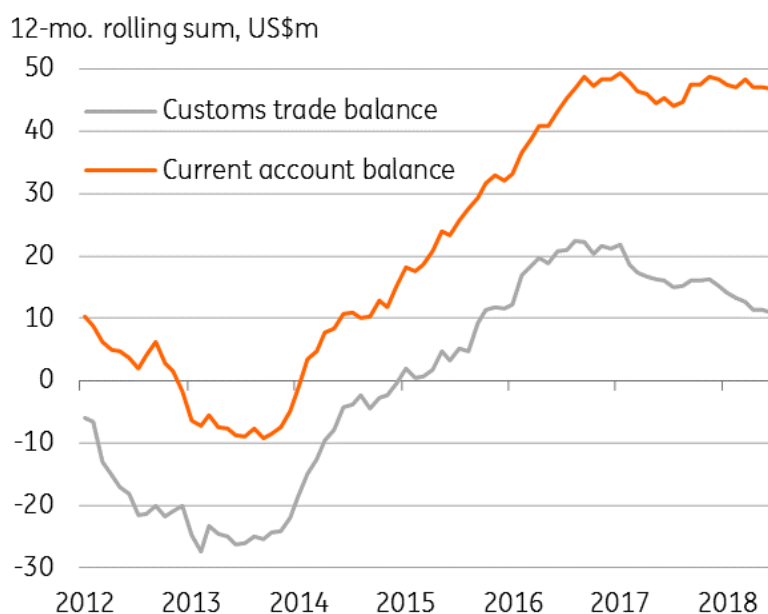
## Weakening external payments, weaker THB

The balance of payments data for June showed a bounce in the current account surplus to \$4.1

billion from \$958 million in May. Most of the bounce was from the services trade, especially tourism-related income, while the goods trade balance was only slightly better at \$2.9 billion than \$2.7 billion in May. A large positive swing in the current account was accompanied by the opposite in the capital account, dragging the overall payments balance to a \$5.3 billion deficit from a \$54 million surplus over the same months. No wonder the Thai baht depreciation accelerated in June.

While some in the markets are anticipating that the Bank of Thailand will start tightening monetary policy this year to support the currency, the authorities have been signalling their preference for stable policy. We continue to expect no change to the 1.5% BoT policy interest rate this year. Firmer growth is positive for the THB but a weakening external payments position is negative. While recent USD/THB stability around 33.3 undermines our confidence in our forecast of the pair trading toward 35.0 by end of the year, we don't expect the THB to return to its status as an outperformer.

## Narrowing external surpluses



Source: Bloomberg, ING

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.