

## Good MornING Asia - 1 November, 2019

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By Robert Carnell

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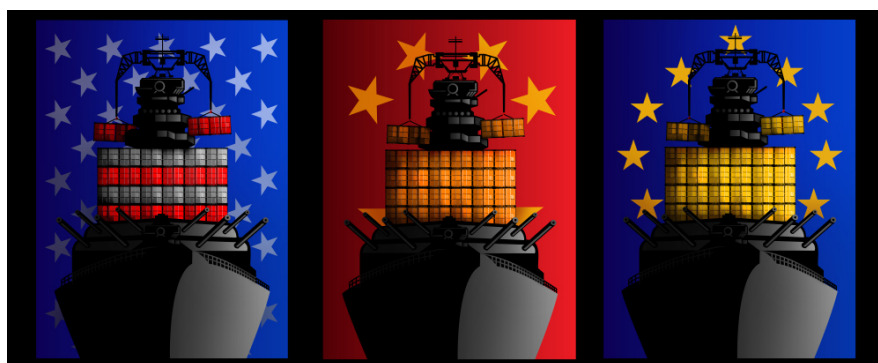
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## Down we go again

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Source: Shutterstock

### Trade comes back to bite our ankles

In spite of all the other stuff going on globally, trade and the trade war remain the biggest movers of financial markets, and yesterday saw Chinese officials pouring cold water on the prospects for any broader trade deal with the US, even as the mood has brightened on a phase-one, though probably not very significant constrained trade deal.

What does this tell us? Well possibly that China feels it is managing the downturn stemming from the ongoing tariffs relatively well. It may also feel emboldened to harden its position given what may appear to be some growing political weakness in the US - the impeachment inquiries - and economic weakness - recent sub-2% 3Q19 GDP figures.

If this mood lasts, it also suggests we may see bond yields trending lower again. In the last two days, 10Y US Treasury yields have fallen from 1.84% to 1.69%. The October/September low was 1.53%, the August low 1.46%.

### Can we make new lows?

Whether or not we will make new lows this time around, the direction seems a decent trend for now. Lower lows will require the recent disquiet from the Chinese on trade deals to broaden into something more unsettling. In the process, trade gloom, plus a further deterioration in the US economy that causes a rethink on the "Fed pause" hypothesis promoted by Jerome Powell earlier this week will likely need to happen.

Both seem eminently plausible. Indeed, later today, October US labour data could add to the sense of the gloom, though it is reasonably well understood that the numbers will be depressed by the GM strike and release of census workers. Nonetheless, a sub-100,000 figure coupled with a slight

upwards nudge in the unemployment rate, and moribund wages growth should add to the low inflation numbers released yesterday (core PCE 1.7%, headline 1.3%) and provide markets with the excuse to start pricing in further Fed cuts again. Don't expect market expectations to stop at just one cut.

## HK GDP woes

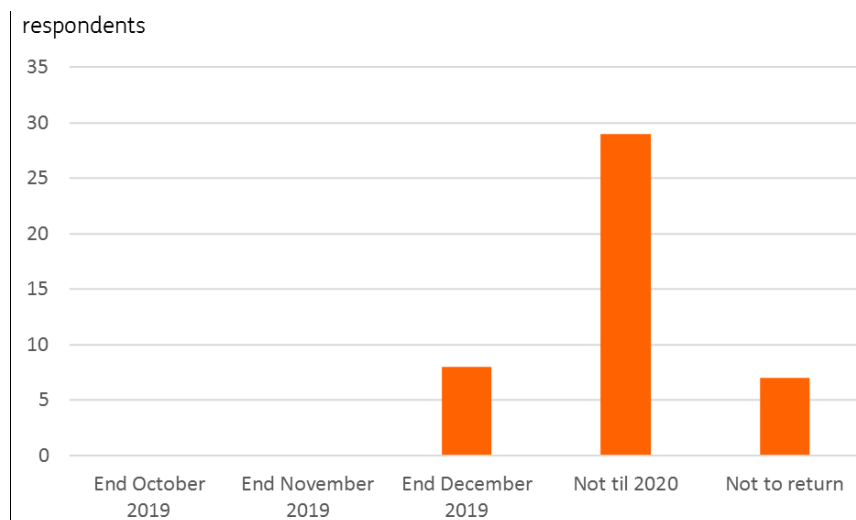
Iris Pang's note on yesterday's HK GDP data is attached in the bundled Good Morning Asia version of this note, but if you are reading this opinion daily as a standalone, [then here is a link](#).

Iris' expectation for HK GDP to decline in all quarters of 2020 is widely quoted in the financial press today. With much of the damage to the economy "self-inflicted", Iris' forecast is also in line with the expectations from a recent EMTA conference I moderated in HK, which asked participants to say when they expected calm to return. The chart below shows that few anticipate any restoration of peace until sometime in 2020.

Perhaps what is most interesting though about this number, is how the consensus, in spite of being able in many cases to see the impact of the protests on the economy first hand, came out with such a limp estimate of -0.4%QoQ, compared to the actual -3.2%QoQ outcome.

Like all humans, economists are bad at predicting outside their comfort range. This has less to do with the accuracy of their models, and more to do with psychology. As Iris points out, you probably have to go back to the SARS epidemic in 2003 to get something comparable. That means that most forecasters need to have been in work at that time, some 16 years ago to have experienced anything similar. Anyone under the age of 40 can therefore likely be excused missing this forecast.

## When do you expect calm to return to HK SAR?



Source: EMTA HK 2019, ING

## Day ahead - busy

If today's note seems a little rushed - it is - I have to dash off to do some media-stuff. But besides the US labour market stuff due out tonight, which I've already mentioned, there is a full calendar in Asia today too. Before I forget though, [here is a link to the note on the global technology slump that is affecting Asia, written by myself and my team. Give it a read if you think that sounds](#)

interesting.

Inflation figures from Korea (already out and better than expected at 0.0%YoY), Indonesia, and Thailand provide one side of the equation today. Nothing too pivotal to flip central bank policy expectations one way or another in all likelihood. And PMIs from Taiwan, Malaysia, Japan, Korea, Indonesia, Vietnam and of course China's Caixin manufacturing PMI index deliver the bulk of the other side.

Expectations for the Caixin PMI are a little lower than the 51.4 reading from September. The wonder is that this index is above 50 at all, given that this sector should be the most impacted by the trade war. I see little merit in obsessing over a few tenths of a point for an index like this. If the consensus is correct, then the right interpretation will be that China's private manufacturers continue to show weak growth. That isn't a bad result in the circumstances, and a big improvement from the 48.3 reading back in January this year.

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# Hong Kong: More than just a technical recession

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Anti-government protests continue in Hong Kong

## GDP falls again on a quarterly basis

Hong Kong's economy contracted by 3.2% quarter-on-quarter in the third quarter of this year and is now in a technical recession. That's defined by two consecutive quarters of negative growth. It was widely expected due to the damage done by the trade war and anti-government protests. The economy shrank by 2.9% year-on-year in the third quarter after positive growth of 0.5% YoY in 2Q19.

## More than a technical recession

As the trade war is expected to linger well into 2020, and there seems to be no end to the violent protests, for the time being, Hong Kong's economy will continue to suffer from negative quarterly growth going into 2020. More companies will close, leading to a deterioration in employment. Without the protests, those affected by the trade stand-off might be expected to find jobs in the retail sector. But retailers are suffering too given the demonstrations, with redundancies and no paid leave commonplace.

The downturn in the jobs market will put extra pressure on retail sales which are already under pressure because of the loss of tourism and a decline in local consumption. We're expecting, therefore, negative quarterly growth for each quarter of 2020. And that's a real recession, not just a technical one.

## As bad as the SARS epidemic?

We believe it is more appropriate to compare the current situation with what happened with the SARS epidemic in the early 2000s than with financial crises, as the nature of the damage is more on consumption and tourism than on financial activities. What we're seeing is not worse than SARS, in the sense that people mostly stayed at home during the crisis in an attempt to avoid the deadly virus.

The difference is time-scale. The protests could inflict more damage to Hong Kong's GDP as they're likely to last longer than the acute SARS outbreak.

- Tourists will only return to Hong Kong when they see things have settled. However, we can't see yet how the protests will end. Mainland tourist arrivals decreased by 35%YoY, while overall tourist arrivals have declined by more than a third in September.
- Locals will continue to spend but only in their local areas to avoid not just the protestors but the traffic jams. Retail sales were down 23%YoY in August.

## Why more stimulus could be coming

The Hong Kong government has been employing stimulus measures of some HKD21 billion (USD 2.7bn) in two tranches. That's not, however, expected to be a useful boost to GDP; the money has not been targeted at the most affected businesses. We think there's more stimulus to come, but some of the relief measures need to pass through the Legislative Council. And that might not be as easy as it once was so we're not expecting any quick fix.

## Fewer concerns over the HKD peg

The most talked-about topic given all this pressure is the HKD peg. Some market participants worry the peg could be under pressure if Hong Kong is no longer a place for tourists and expats. But so far, it seems that mainly only trade services and the retail sector are impacted. Financial services remain intact.

There is speculation that some people will emigrate. But let's face the fact that Hong Kong has a low tax regime. Even if some people do move away, their money is very likely to stay in Hong Kong. In short, we don't expect large capital outflows from Hong Kong.

This is an important reason why we see the HKD-linked exchange rate system as being solid, and USD/HKD will remain in the range of 7.75-7.85.

## Revising our forecasts downwards

We've revised our Hong Kong GDP forecasts to reflect the contraction of the economy. The last time Hong Kong suffered full-year negative GDP growth was back in 2009 when it declined by -2.5%. We expect Hong Kong GDP to be in negative quarterly growth for 4Q19 right through to the last quarter of 2020.

GDP growth on a yearly basis is forecasted to be -5%YoY in 4Q19, and full-year growth will be -2.2% in 2019, which is close in scale to 2009's recession. Our GDP growth forecast for 2020 is -5.8%, assuming that the violent protests last the whole year.

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