

## Good MornING Asia - 13 August 2018

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### In this bundle

China | Singapore

#### **Rude awakening**

Back from two weeks of holiday - what's changed? Turkish Lira, EURUSD. Lower US Treasury yields

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#### **Asia week ahead: Bank Indonesia pauses tightening**

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#### **Hong Kong: Cutting GDP forecast on trade war woes**

Hong Kong GDP growth in 2Q was weaker than expected, which could be an early sign of the negative impact from the bilateral trade war between Mainland...

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## Rude awakening

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[https://think.ing.com/uploads/hero/140718-image-turkey\\_flag.jpg](https://think.ing.com/uploads/hero/140718-image-turkey_flag.jpg)

### Coming back from vacation is a bit like opening Christmas presents...not all desirable

Coming back from a two-week vacation, much of which was spent in wi-fi purdah, is a bit like opening Christmas presents - what am I going to find in bond market space? Oh, like the obligatory pair of socks - nothing too interesting here. 10Y Yields still below 3%, despite all the US inflation measures being over-target and the Fed still in tightening mode. 2Y US Treasury yields have dipped sharply (an unexpected but welcome jar of marmalade?).

But then open the FX wrapping paper, and whilst most of Asian FX seems to have stuck at levels reached some weeks ago (more socks?), the Turkish Lira continues to be under serious pressure, and some of this is now spilling into the EUR, due to the region's close trade linkages with Turkey (a tasteless sweater perhaps?). So much so, that this is even beginning to see EUR/GBP moving sharply in favour of the pound, despite Brexit seeming to have moved no further in a positive direction (some things never change).

OK - that's enough of this analogy, which was getting a bit stretched anyway (like the tasteless sweater - three sizes too small). But on the EUR/USD, relatively range-bound since June, one question is, should we really be treating US protectionism as a USD negative? Many big finance houses are doing so. But there are good reasons to think we should not.

Sure, past history has typically been unkind to the dollar during periods when it was being protectionist. But then how many occasions has this been? Is this really a statistically significant set of observations? Were economic conditions similar on those few occasions? The answers to these questions are, respectively, "Not many, no, and not really." At best, we should probably have approached this protectionism neutrally.

From a theoretical perspective, whenever the US administration slaps tariffs on other countries, it is improving its terms of trade (export prices relative to import prices) at the expense of other countries. If nothing else were changing, this ought to provide the USD with a boost. If it didn't, then protectionism would allow aggressor countries to have their cake and eat it too - they could improve their terms of trade with tariffs, and their currency would also move in a helpful direction.

In this respect, Turkey's currency is behaving as you might expect given that its terms of trade have been hurt by US tariffs, it is weakening to offset that damage. As we await a convincing response from the Central Bank and government, this will likely continue to be the case, and so too

will the spillovers we see today for example, in EUR/GBP. For now, this is not an Asian issue except in as much as the pressure for the USD to respond to its protectionism with some further appreciation remains. Ironically, this is probably exactly the opposite response President Trump would like to see, though he is being helped for the moment by the decline in yields in US bond markets. If this changes, then this ought to provide the USD with a further boost. Then, this might become an Asian problem.

## Asia day ahead

We've already had a slightly disappointing start to the day with Singapore 2Q18 GDP revisions coming in a little lower than the 4.1% consensus view (3.9% actual versus 3.8 preliminary). But the 1Q18 figures were revised higher to 4.5% (4.3% previously) mitigating some of the disappointment. And at this stage, we don't expect to have to respond to this data with any change to our 3.0% full-year GDP forecast. More important will be Friday's non-oil domestic export figures, which will set the scene for the second-half of the year.

Other than that, it is a quiet day - we may get some Chinese money supply figures, though these may not be out until Wednesday - we expect these to be strong, whenever these are released. Other than that, we are in wait-and-see mode ahead of China's activity data releases for July, released tomorrow.

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## Asia week ahead: Bank Indonesia pauses tightening

So far so good, not much of an impact of the China-US trade war on Asian exports in July. But that's no reason to relax just yet - the trade war has just started. It will take a while for the impact to trickle down to the real economy and Asia won't be immune to this



# 6.4%

## China industrial production growth

ING forecast for July, up from 6.0% in June

### ➔ More Chinese economic data for July

As expected, China's July trade data showed little impact from the US-China trade war in the initial phase of \$34bn of tariffs. The remaining economic data for July - industrial production, retail sales, fixed asset investment, and monetary indicators - is likely to reinforce the same message.

We increase our industrial production growth forecast to 6.4% year on year for July from the 6% in June on the back of firmer exports. Investment and monetary data will shed light on whether recent liberalisation measures in areas of financial securitisation and asset management have started showing results.

# 5.25%

## BI policy rate

ING forecast, no change from current level

### ➔ Indonesian central bank tightening cycle isn't over just yet

Indonesia's central bank will hold its policy meeting next Thursday (16 August). After a cumulative 100 basis point of policy interest rate hikes in May and June, Bank Indonesia paused tightening at the July meeting. We aren't looking for any policy moves next week, and Indonesian economic data since the July meeting supports our call. However, this doesn't mean that the Indonesia tightening cycle is over just yet.

Most of the policy tightening so far was aimed at curbing the weakness of the Indonesia rupiah, while inflation has been running in the lower half of 2.5 - 4.5% policy target. A likely swing in the trade balance to a deficit in July from a surplus in June could reignite the currency pressure.

July trade data is also due next week (15 August). The rupiah will come under pressure once the trade war begins to hurt exports. Moreover, higher tariffs together with the currency weakness will pressure inflation higher. and we continue to expect one more 25 basis point hike later this year.

# 5.2%

## Malaysia 2Q GDP growth

ING forecast, down from 5.4% in 1Q

### ➔ Singapore and Malaysia report second quarter GDP

Singapore reports revised GDP figures for the second quarter. The advance estimate released in July revealed a slowdown in GDP growth to 3.8% YoY from 4.3% in the first quarter. But the subsequent data showed strong industrial production growth which leads us to revise upwards our second quarter growth to 4.0%.

But that's not important. We think the non-oil domestic exports figure for July - the first hard activity data for the current quarter will be more significant for GDP growth amid growing global trade tensions. June NODX was exceptionally weak with 11% month on month fall (seasonally adjusted), so we expect some clawback in July.

As for Malaysia, we forecast a slowdown to 5.2% YoY in the second quarter from 5.4% in the previous quarter - which is still among the strong growth economies in Asia. We infer from widening external trade surplus that net exports, which displaced domestic demand as GDP growth driver in the first quarter, remained in the driving seat.

We think the best of GDP growth in Asian economies is over and the global trade war is going to depress growth going forward.

# 4.8%

## India CPI inflation

ING forecast for July, down from 5.0% in June

### ➔ Inflation and trade figures matter for India's central bank

India's consumer prices and trade data for July are due. A likely dip in CPI inflation below 5% may come as a relief for the central bank's tightening policy. However, this tells us more about what happened a year ago than what's happening now - the high-base year effect.

We don't expect any moderation in key CPI drivers of food, fuel and transport prices. Typically, July is the month with a sharp month-on-month rise in the food components in the year.

On the trade side, the widening trade deficit trend underway since February this year looks set to remain in place. We forecast a further widening of the trade deficit to \$16.9bn in July from \$16.6bn in June as a result of slower export and faster import growth. Oil contributes to almost half of the trade deficit.

We don't expect overhang on the Indian rupee from widening trade deficit and elevated inflation to lift anytime soon. Hence our forecast of continued central bank policy tightening ahead.

## Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
<b>Friday 10 August</b>					
China	-	Jul Money supply (M2) (YoY%)	8.2	8.2	8
	1000	Jul Aggregate Finance	1380	-	1180
	1000	Jul Total Loan Growth	12.75	-	12.73
	1010	Jul Financial Institution Loans (Yuan bn)	2040	-	1840
India	1300	Jun Industrial Production (YoY%)	6.5	-	3.2
Hong Kong	0930	2Q GDP (QoQ, SA/YoY%)	4.5	-/-	2.2/4.7
Malaysia	0500	Jun Industrial Production (YoY%)	3.9	3.5	1.5
Singapore	0600	Jun Retail Sales Value (MoM/YoY%)	-/-	-/1.2	0.1/0.1
<b>Sunday 12 August</b>					
India	-	Jul Trade Deficit (US\$bn)	-16900	-	-16600
	-	Jul Exports (YoY%)	15	-	17.57
	-	Jul Imports (YoY%)	26	-	21.31
<b>Monday 13 August</b>					
India	1300	Jul CPI (YoY%)	4.8	-	5
Singapore	0100	2Q F GDP (QoQ/YoY%)	-/-	-/-	1/3.8
<b>Tuesday 14 August</b>					
China	0300	Jul Retail Sales (YoY%)	9.4	9.1	9
	0300	Jul Industrial Production (YoY%)	6.4	6.3	6
	0300	Jul Fixed Asset Investment (YTD, YoY%)	6.5	6	6
India	0730	Jul WPI (YoY%)	5	-	5.77
<b>Wednesday 15 August</b>					
Indonesia	0500	Jul Imports (YoY%)	17	-	12.66
	0500	Jul Exports (YoY%)	15.1	-	11.47
	0500	Jul Trade balance (US\$m)	-580	-	1742.6
	-	BI Policy Decision (7-day reverse repo, %)	5.25	-	5.25
Philippines	-	Jun OCW Remittances (YoY%)	5.3	-	6.9
<b>Thursday 16 August</b>					
Malaysia	0500	2Q GDP (QoQ, SA/YoY%)	-/5.2	-/-	1.4/5.4
	0500	2Q Current Account (Q) (MYR bn)	-	-	15000
<b>Friday 17 August</b>					
Singapore	0130	Jul Non-oil Domestic Exports (MoM/YoY%)	4.4/11.8	-/-	-10.8/1.1
Taiwan	1000	2Q F GDP (YoY%)	3.3	-	3.29
South Korea	0000	Jul Unemployment Rate (% SA)	3.7	-	3.7

Source: ING, Bloomberg

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## Hong Kong: Cutting GDP forecast on trade war woes

Hong Kong GDP growth in 2Q was weaker than expected, which could be an early sign of the negative impact from the bilateral trade war between Mainland China and the US. The linked exchange rate system adds further pressure and the government must spend its big fiscal surplus to cushion the impact



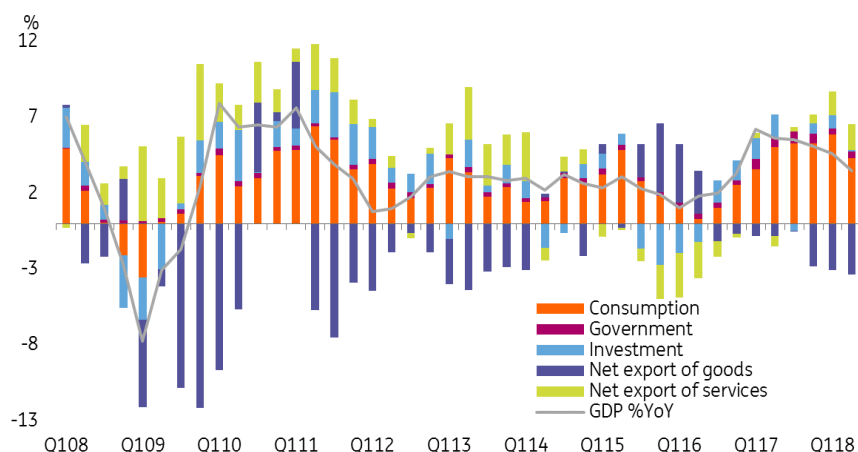
Source: Shutterstock

### **GDP grew 3.5% YoY in 2Q18, as expected**

The moderate but slower than expected growth in 2Q18, at 3.5% YoY in 2Q from 4.6% in 1Q, mainly came from consumption, which contributed 4.3 percentage points to growth- offset by the net trade deficit.

Investment was weak, growing only 0.4% YoY, indicating that high house prices have deterred further real estate development.

## Consumption continued to be the main growth driver



Source: ING, Bloomberg

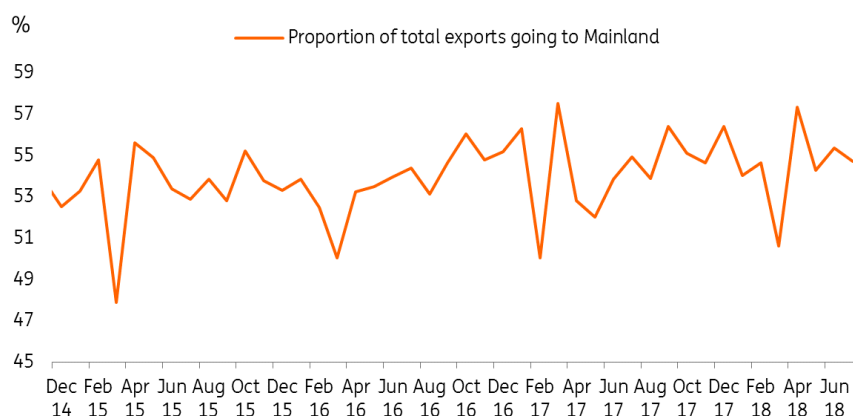
## Future growth could be weaker amid trade war

Over 50% of trade in Hong Kong is related to Mainland China so a bilateral trade war between China and the US will negatively affect Hong Kong's trade, logistics and ports.

From [the Statistics Department of Hong Kong](#), employment in trade and logistics was near 20% of total employment in 2016. Even accounting for a slowdown in the sector, as competition from the Mainland has been fierce, we believe that the proportion is still at least 15%. These workers face the possibility of lower salaries or even losing their jobs. And while the overall labour market is currently solid, with unemployment at 2.8%, employees in this sector could turn to low skilled work, which would put at risk the salary trend of low-income labour.

This, in turn, could reduce consumption demand, which has been the main growth driver of the economy.

## Over 50% of Hong Kong exports shipped to Mainland



Source: ING, Bloomberg

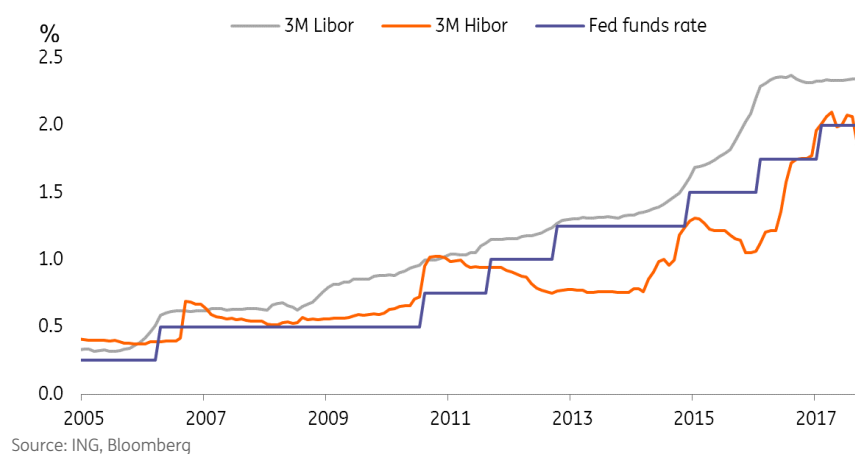
## Linked exchange rate means interest rates go up even in bad times

In the face of an expected economic downturn, monetary policy will be ineffective because:

1. Hong Kong does not have its own independence to drive interest rates lower. Quite the reverse, interest rates will go up in order to align with US dollar rates, under the linked rate system. Recently, more banks have revised their lending rates upward.
2. The HK dollar is already near its weak bound of 7.85, it can't be weaker, so the exchange rate couldn't help the economy.

The linked exchange rate system delivers a sucker punch to Hong Kong in the Mainland China-US bilateral trade war.

## HIBOR would follow the next Fed hike



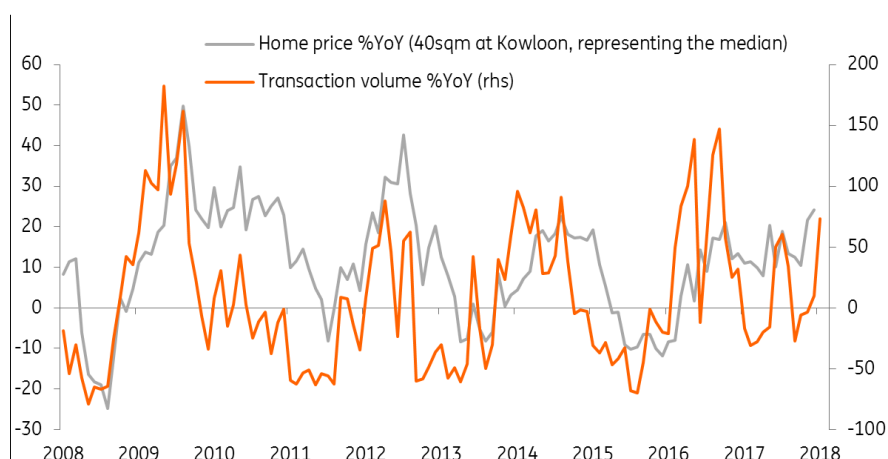
## Risks rising

Risks from the linked exchange rate system could emerge in the fourth quarter when the trade war escalates further with tariffs on another \$200 billion of goods.

We can think of at least two areas of the economy that will be hurt:

1. The business sector. A high lending rate would deter investment for future growth and increase the existing interest cost of businesses.
2. The housing sector, which has been booming partly due to the low interest rate environment. The regulatory maximum debt-income ratio is 50%. But when interest rates go up and the economy weakens, incomes can fall and unemployment can rise. Monthly repayments could also rise with interest rates and the debt-income ratio at the loan's inception would mask the risk of repayment difficulty or even default. Though we don't expect a housing market crash now, it is increasingly possible in one to two years' time when the job market deteriorates from a trade war.

## Housing boom is a hidden risk



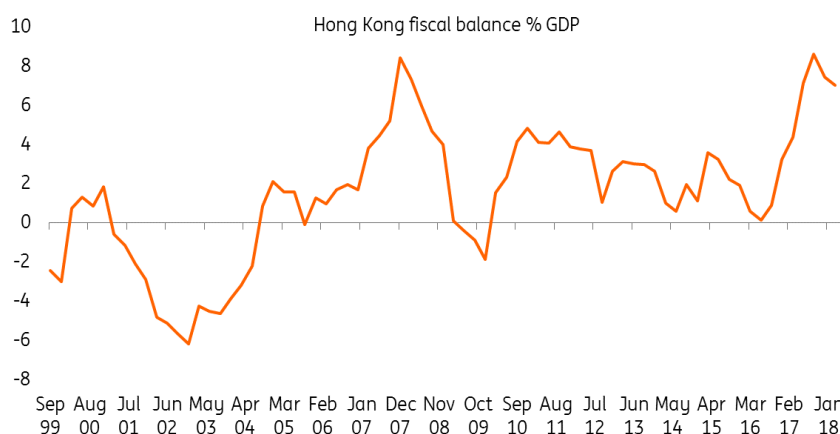
Source: ING, Bloomberg

## Fiscal stimulus could be big, as surplus near historical high

The good news is that the fiscal surplus is significant, at 7.05% of GDP in 1Q18. History tells us that the government could use this surplus to boost the economy during bad times. We think this time will be no different.

We expect a tax cut on salary earners and corporates and cash handouts to residents. This could alleviate the fall in consumption. We also believe that the government could emulate the Mainland's strategy of boosting investments on infrastructure projects.

## Fiscal stimulus to cushion downturn



Source: ING, Bloomberg

## Revising downward GDP forecast for 2018

We are revising our GDP forecast downward to 3.6% in 2018 from 4.9% due to the escalating China-US trade war and weaker than expected 2Q growth. The linked exchange rate system could bring higher interest rates even during bad times, though we expect the government to use aggressive fiscal stimulus to offset part of the damage.

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