Good MornING Asia - 13 May 2019

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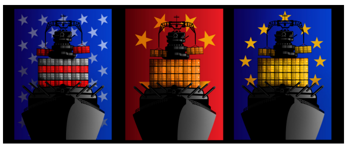

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By Robert Carnell

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The US-China trade stalemate continues to weigh on markets with all eyes now on how China retaliates to the last Friday's tariff hike by the US.

$7bn

Worse than expected

Indonesia current account deficit in 1Q19

$1.8bn wider than year ago

EM Space: The risk-off continues

- **General Asia:** Lack of activity data and public holidays in some countries will make it a slow start of the week for Asian markets. But the risk-off continues with the escalation of US-China trade war after last Friday's move by the US to raise tariffs on Chinese goods. All eyes are on China's retaliation.
- **Indonesia:** 1Q19 current account deficit came in at $7bn, beating the consensus estimate of $6.2bn deficit. A $1.8bn widening from a year ago sustains the Indonesian rupiah's vulnerability to the emerging market contagion. We believe Bank Indonesia will continue to train focus on market stability and leave policy on hold at the meeting this week (16 May).
- **Malaysia:** March industrial production surprised on the upside with 3.1% growth. However,

the average 2.7% IP growth in 1Q19 was a slowdown from 3.2% in the previous quarter and this should have dragged the GDP growth lower over the same quarters. Our forecast of a slowdown in 1Q19 GDP growth to 4.2% from 4.7% in 4Q18 remains on track. GDP data is due this week (16 May).
- **Philippines:** The markets are closed for the mid-term elections today, which is seen as a referendum on the Duterte regime. Meanwhile, the government is set to issue Panda or Chinese yuan (CNY)-denominated debt this week as part of its CNY 6bn issuance plan.

What to look out for: Lots of trade data from Asia

- China's April economic data (15 May)
- EU revised 1Q19 GDP (15 May)
- India April trade (15 May)
- Indonesia April trade (15 May)
- Philippines March OCW remittances (15 May)
- US April retail sales and industrial production (15 May)
- Bank Indonesia policy decision (16 May)
- Malaysia 1Q19 GDP and balance of payments (16 May)
- Singapore April NODX (17 May)

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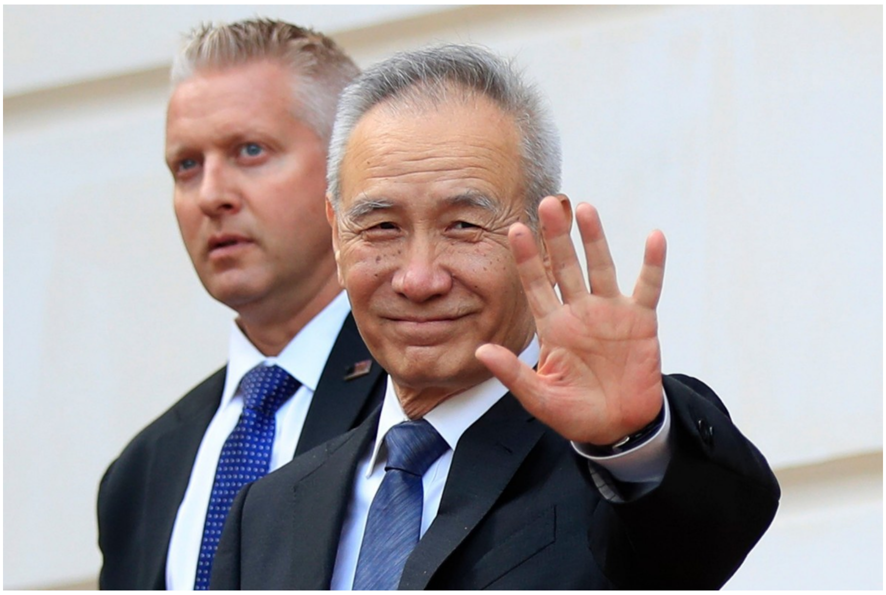
Article | 10 May 2019 **China**

China: Growth aids trade battle

Stronger-than-expected Chinese growth, coupled with fiscal and monetary firepower, will help authorities in trade negotiations as the tariff battle goes up a notch



The Chinese Vice Premier, Liu He, in Washington during trade talks between the United States and China

Stronger growth will help China, but trade isn't the only factor in US talks

Last month, we noted that China has enjoyed a recovery created by fiscal stimulus and monetary easing. This was demonstrated by the recent GDP figures, where first-quarter growth matched the 6.4% YoY pace seen in 4Q18. Stronger-than-expected economic growth should provide the Chinese government with extra chips when it comes to renegotiating the terms of a draft trade deal with the US.

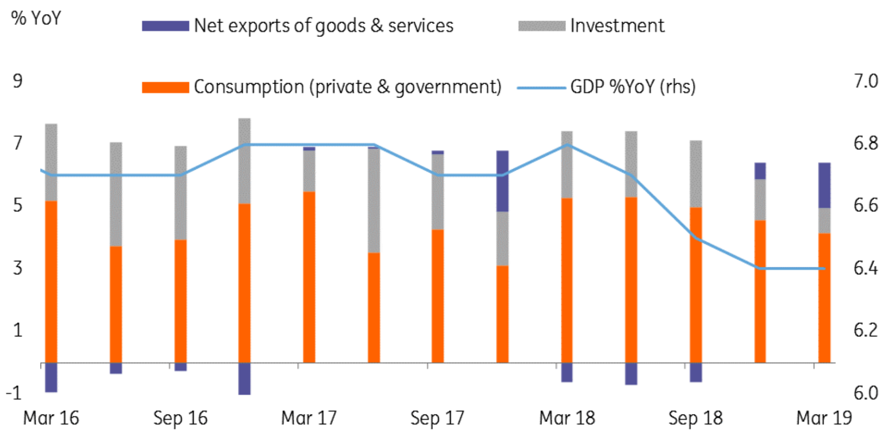
> *For China, the cost of confronting the US is more broad-based than trade*

The latest turning point in the trade negotiations appears to have been triggered by disagreements over a reciprocal penalty system. But for China, the cost of confronting the US is more broad-based than trade. The US, along with some of its allies, have aired concern over the use of Chinese-made 5G equipment. Equally, tensions have risen in the South China Sea. If China successfully renegotiates, then it has the potential to reduce some of these risks.

If China renegotiates successfully then the potential risks on 5G exports and geopolitical tension around the South China Sea will be reduced.

But let's not forget, China's negotiation chips come from fiscal stimulus and monetary easing. Domestic consumption, as reflected in retail sales, is not as bright as it seems. China may need even more fiscal stimulus and monetary easing to support a possible long-running renegotiation.

Chinese GDP is supported by "consumption" from government



Source: Bloomberg, ING

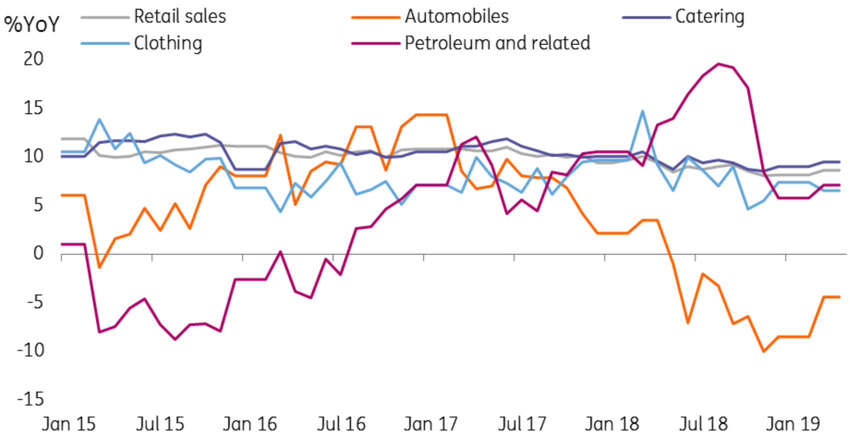
Recent actions show willingness of government to easy policy further

On the same day that the US revealed China has started renegotiating, the Chinese central bank, PBoC, restructured the system of required reserve ratios for small agricultural commercial banks. Though the extra liquidity released is a small drop of CNY280 billion out of an M2 money supply of CNY188,941 billion, it is a symbolic move that shows the willingness of the Chinese government to ease even further.

We keep our forecast for USD/CNY and USD/CNH at 6.75. But we have revised the 2Q and 3Q forecasts to 6.75 and 6.80 from 6.85. A big yuan depreciation when the trade war escalates could easily send an incorrect signal to the market that there are risks of capital flight. We have therefore kept our forecasts of USDCNY and USDCNH in a narrow range. We also keep GDP forecasts at 6.2%YoY in 2Q19 and 6.3% for 2019.

This article forms part of our Monthly Economic Update which you can find here

Consumers have been careful when it comes to spending



Source: Bloomberg, ING

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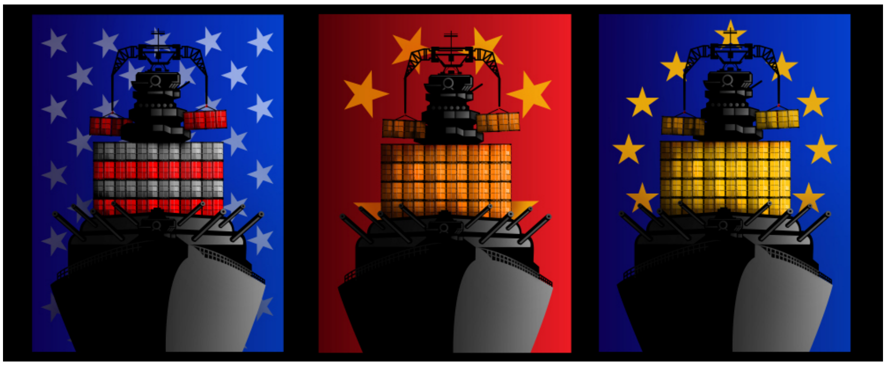
China likely to retaliate to US tariff increase

The US increased tariffs on $200 billion of Chinese goods to 25% on Friday. We believe that China will retaliate in kind, with $30 billion worth of tariffs on US goods. This could happen either today or tomorrow. But it will become increasingly difficult for China to respond to a further round of tariff hikes



Source: Shutterstock

Retaliation from China is highly expected

We believe China will retaliate in kind, with $30 billion worth of tariffs on US goods, the amount that the US has increased tariffs on Chinese goods today. This could be announced during a regular media briefing in the afternoon. China could also delay this tariff until Vice Premier Liu He returns to China tomorrow. In any event, this will happen very soon.

But how can China retaliate in kind if US imposes 25% tariffs on remaining goods

It is very difficult for China to retaliate in kind if the US imposes 25% tariffs on the remaining goods (about $289.5 billion, according to US data).

What we expect is that China will apply a mix of tools to penalise the US:

- First, it will impose higher tariffs on most US goods shipped to China. But this won't make up the whole amount of tariffs imposed by the US on Chinese goods.
- Second, it will make life more difficult for US companies operating in China, possibly by stepping into M&A deals in China

However, we do not expect China to sell US Treasuries. This is a tool that China will save as a last resort, and it may not even be used in the unlikely event of a breakdown in the trade negotiations.

USDCNY is less affected but USDCNH more volatile

The yuan will be little affected by this, as the news has been expected for a few days and has already digested by the market.

In fact, the volatility decreased after the US imposed the additional tariffs on China.

We believe the yuan, USD/CNY, will continue to remain calm while USD/CNH could be more volatile. We expect that both yuan exchange rates will head to 6.75 by the end of 1H19.

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Article | 10 May 2019 **Japan**

Japan: Mixed messages

In Japan, the macro picture paints a bit of a muddy picture. Both investment and net trade don't really help us much with the outlook for the rest of the year, and we aren't particularly sure whether the anticipated 1Q19 GDP (around 1%) would be a good or bad result

No questions answered

From a purely macro perspective, the last month has answered no questions about the trajectory of Japan's economy. Indeed, to the contrary, the picture is less clear than it has been for some time.

We are approaching the release of 1Q19 GDP data, which means that we have near-complete, and semi-complete high-frequency data for most of the subcomponents of GDP, as well as for inflation. The story is as follows:

1Q19 GDP may not look too bad at first glance; we are looking for something around 1.1% at a seasonally adjusted annualised rate. That would follow a 1.9% rate in 4Q18, so looks decent, albeit perhaps indicative of a slight moderation in pace.

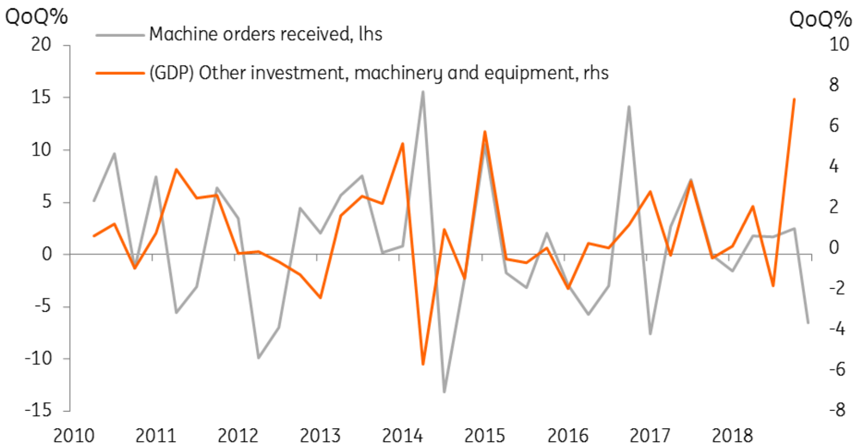
But Japanese GDP can't really be taken so literally, and is also prone to huge revisions, so aside from saying it is likely to be slower in 1Q19 than 4Q18, we can't confidently say much more at this stage.

Many mixed signals

Within this total are some real "head-scratchers". For example, private consumer spending looks as if it could register a healthy 2% pace. But cash earnings, which had been providing some lift to the household sector, have recently crashed to low sub-1% levels, and this does not look sustainable.

On the investment side, residential investment seems to be undergoing something of a boom, prompting questions about the Bank of Japan's purchasing of real estate investment trusts (JREITS). Business investment in plant, machinery and non-residential construction looks terrible in contrast, so the net investment picture will be determined by a largely unforecastable horse race between these two components.

Business investment (in GDP) and machine orders



Source: CEIC, ING

Don't expect any big economic rebound

Net trade is another source of considerable uncertainty. We know that exports have been badly hit by the slowdown in global trade, the US-China trade war and the global tech slump, not to mention the slump in the auto sector. What we can't say with any precision is how this plays off against what also looks to have been a very weak quarter for imports, and whether this has led to a surge in inventories, or has been accompanied by destocking from previous inventory accumulation. We have opted for the latter, but inventories are often calculated residually by statistical agencies, so we have no confidence that this will actually turn out as forecast.

> *Exports are very weak, but net trade is harder to call, or how this impacts inventories*

Putting this all together, it is very hard to characterise whether 1.1% is a good or a bad result for Japan, even if this is close to the figure that eventually gets published. It certainly doesn't set the economy up for a big rebound in 2Q19, but it isn't particularly worrying either.

Inflation did nudge a little higher in March, though this coincided with a further tweak to Bank of

Japan (BoJ) forward guidance that to paraphrase, guarantees no tightening of policy until at least Spring 2020, and probably not then either. This, according to BoJ was to offset misperceptions about their intentions. We don't believe there were any. But in any case, it won't help the BoJ achieve their inflation target, and even they seem to have given up on it if recent economic projections are to be taken at face value.

This article forms part of our Monthly Economic Update which you can find here

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