

Good MornING Asia - 14 January 2020

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By Robert Carnell



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December Trade data for China

Not getting carried away is the theme of today's note. China's export and import data for December are likely to show slight increases. The consensus has a 2.9% and 9.6%YoY increase in CNY terms. But bear in mind that this data largely predates the reduction in the tariffs that took place as part of the phase 1 trade deal. Also, remember that the effective tariff reduction from that deal is fairly small, so any bounce in exports may not be terribly exciting even once the tariff reductions are playing a more meaningful impact on the data in the months to come.

Bottom line, China's trade circumstances are still relatively weak, and the tariffs much higher than they were 18 months ago. We should not expect miracles.

Trade War and CNY

Market sentiment on the trade war is such a dominant driver of the fortunes of the CNY, that it is worth pondering under what circumstances the recent rally could reverse. Such a reversal may already be baked into the phase-one deal, which we believe will contain measures to monitor

compliance with criteria such as intellectual property rights and market access. It could also be that once the immediate pork and swine shortage is addressed, China's need for US agricultural products will abate, and the US may also find that market access for banks and credit card companies is not quite what it had thought in a market which is already quite mature.

Moreover, the political pressure for taking a tough line on trade will grow as we approach the US Presidential Election (to be balanced with whatever effect this has on the stock market). So it's all smiles and CNY appreciation now, but from the middle of the year, things may begin to look rather different.

Aggregate financing data due

We're still due the Chinese aggregate financing data for December, though it probably won't be too instructive. Consensus expects the numbers to dip as banks run out of capacity to lend in the last month of the year, having pushed loans out aggressively earlier. M2 money supply at 8.3%YoY would be a fair bit lower than nominal GDP growth assuming the underlying GDP numbers are accurate, which would come in at a little over 10% adding real GDP of about 6% to CPI inflation (as a proxy for the GDP deflator) of about 4.5%.

But the current spike in inflation is, of course, all food-related and should ease off, taking CPI back to its prior 2-2.5% range, which would leave current M2 growth about in line with nominal GDP assuming that remains steady. There's nothing abnormal going on here.

Indian CPI - high

Indian inflation exceeded the consensus estimate of 6.7% in December, climbing to 7.35% (let's call it 7.4% - 2 decimal places for inflation or any other economic data assumes a degree of accuracy in measurement that is frankly unrealistic).

This takes inflation outside the RBI's 2-6% target range, and by quite a bit. We anticipate the next meeting will see the RBI adjust its language to indicate a neutral monetary stance from it's the previously accommodative position.

The increase was mainly a food price phenomenon. Food price inflation was 12.2%, with vegetable prices up more than 60%YoY. Most other components showed inflation running well within the RBI's target band, though there was some upward movement in fuel and lighting, and transport and communication reflecting higher energy and telecoms prices. Nonetheless, Indian inflation will come down from these highs, just maybe not to a level that will enable the RBI to provide further easing anytime soon.

Could rising inflation pull the rug from under markets? Probably not.

In other data releases today, US inflation for December is due, which will likely show headline CPI coming in at 2.4%YoY, and the core rate at 2.3%. If these increases are reflected in the policy-important PCE indices, then we should see December headline and core PCE inflation rising to 1.8%YoY and 1.6%YoY respectively. That doesn't provide any excuse for the Fed to do anything in any direction with policy any time soon. That is a distinctly neutral setting, as opposed to an outright hostile one, so it doesn't threaten current market ebullience particularly.

For now, the trend is your friend.

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Taiwan: Tsai re-election adds to Mainland China's tech war woes

Tsai Ing-wen won a landslide victory in Taiwan's presidential election. The re-election will be a barrier to Mainland China's technological advancement, and it may not offer any immediate relief to Taiwan's economy



Taiwan's President Tsai Ing-wen, centre, celebrates with her supporters

Tsai re-elected thanks to protests in Hong Kong

The re-election of Tsai Ing-wen was widely expected. She and her party, the Democratic Progressive Party, oppose closer ties to Mainland China, a stance which proved increasingly popular following the Hong Kong protests, which triggered worries about Taiwan's own potential loss of autonomy in the future.

What's next after the election - for Mainland China?

There are two obvious impacts from this election, one on Mainland China and one on Taiwan.

The most significant consequence is that Tsai will continue to make it difficult for Chinese technology companies to do business with Taiwan tech firms on the most advanced semiconductor products. This will force China to approach other countries which have that advanced technology, including Japan.

Another consequence is that Mainland China will likely exercise more soft power in Taiwan, perhaps by forging stronger business ties with Taiwanese companies that have no connections to Tsai's party.

What's next after the election - for Taiwan?

As Tsai was re-elected based on political sentiment, she may not consider the economy - which has done poorly under her presidency - a top priority. In fact, her main policy on Taiwan is "return investment to Taiwan", in other words, to encourage Taiwanese manufacturers who have production lines in Mainland China to move their factories back to Taiwan. Her policy has only seen investments on paper with no reports about the actual use of funds.

Headline PMI rose in December to 50.8 from 49.8 in November, mostly because the inventories PMI climbed to 52.2 from 47. This signals that the investment policy, which began in 2018, has not been successful in inducing production. It has, however, encouraged land purchases. Investors are hoping that land will be needed for factory plants. We have doubted the success of this investment policy for several months and are still sceptical of its effectiveness in supporting the Taiwan economy.

Separately, Mainland China will continue to limit the number of tourists going to Taiwan in a bid to put pressure on the economy which, in turn, could dampen Tsai's approval rating.

No change in forecasts from this election result

As this election result was expected, we maintain our forecast on Taiwan.

GDP growth for Taiwan is expected to soften to 1.6% in 2020 from 2.5% in 2019. The main reason for this is the ineffectiveness of the government's policy to support the economy, as well as the higher inflation rate.

We also expect no change in monetary policy rate in 2020, which is currently at 1.375%.

Regarding the currency, we forecast that the USD/TWD could go from 30.2 at the end of 2019 to 30.00 by the end of 2020, as a continuation of the trade war could mean more capital inflows into the Taiwan asset market, which is not directly affected by the conflict.

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