

Good MornING Asia - 15 April 2019

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EM Space: China trade data drives upbeat tone although global growth concerns persist

- **General Asia:** China reported better than expected data over the weekend which boosted risk taking behavior after decent US earnings. Meanwhile, oil prices continue to trend higher on supply disruptions and tightening supply with global leaders concerned about growth momentum.
- **Malaysia:** Once again Prime Minister Dr. Mahathir slammed the currency market speculators. Local media quoted him as saying, “Malaysia cannot allow the market and ringgit to decline and depreciate further due to attacks by currency speculators”. The renewed MYR weakness this month may have triggered the warning, though we don’t see this heralding yet another fixed exchange rate era under Dr. Mahathir. Despite the depreciation trend since the last year in line with the broad emerging market trend, the MYR remains a resilient Asian currency.
- **Indonesia:** March trade data are due today with the consensus expectations of a swing in the trade balance to \$177m deficit from \$330m surplus in February. However, Bank Indonesia (BI) expects the economy's external position to move into surplus with

improvement in the current account, according to Senior Deputy Governor Mirza Adityaswara. The current account deficit, which widened sharply in 2018 was one of the key reasons for IDR weakness and this forced BI for an aggressive rate hike by total 175 bps. The IDR should benefit from narrower current account deficit this year.

- **Philippines:** February overseas Filipino remittances data is due today with expectations centered on a 3.9% YoY growth. Bangko Sentral ng Pilipinas (BSP) Governor Diokno highlighted remittances as a stable source of inflows, which was a reason the BSP won't be "scared" of pressure on the Peso when it cuts rates later in the year.

What to look out for: China GDP data and Fed speakers

- Indonesia trade (15 April)
- Philippines remittances (15 April)
- US industrial production (16 April)
- Singapore exports (17 April)
- Fed Kaplan (17 April)
- China GDP (17 April)
- EU inflation (17 April)
- US retail sales (18 April)
- Korea BoK meeting (18 April)
- Fed Bullard and Harker speak (18 April)
- Fed Bostic (19 April)

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China: Exports rebound but maybe not for long

Exports jumped on seasonal factors while imports continued to shrink, with less demand for US goods compared to a year ago. In coming months, we expect modest export growth as the base effect fades. The yuan is more likely to depreciate due to its role as a negotiation tool in the trade talks



Exports bounce on base effects

Exports jumped 14.2% year-on-year in March after falling 20.8% YoY in February, mostly due to base effects. Imports continued to shrink further, falling 7.6% from a 5.2% drop a month ago, partly due to lower imports from the US compared to a year ago.

To minimise the seasonal effect, we prefer to look at the first three months as a whole. Exports in 1Q grew 1.4% YoY while imports shrank 4.8% YoY. Trade with the EU was 15.8% of total trade while the US was 11.6%. If there is a trade deal between China and the US, Chinese imports from the US will likely increase. But for 1Q19, imports from the US fell 8.5%.

Exports in coming month

Exports for the coming months don't seem to be as promising.

Early signs from China's official manufacturing PMI's export order showed an uptick in March to 47.1 from 45.2 in February, but the reading was still below 50, i.e. still shrinking, which suggests that exports will only improve slightly in the near future.

A potential trade deal with the US probably wouldn't help China's exports because the trade talks are focused more on the increase in China's imports from the US.

Meanwhile, global growth has been downgraded by the IMF and the World Trade Organization says the conflict over tariffs will hit global trade growth this year. This should be reflected in more moderate export growth from China in the coming months.

Imports will grow if there is a trade deal

A [report from Bloomberg](#) says China could buy an additional \$30 billion a year of US agricultural products, or 1.4% of total imports of \$2.1359 trillion in 2018.

We are aware there could be a substitution effect. If China imports more from the US, it could import less from other economies. But China may not want to upset those economies and so we think the net substitution effect could be insignificant.

There are another two large factors influencing import growth, one is value-add manufacturing activities that need imported parts, and another is retail sales that we believe could be a hurdle to imports.

- Manufacturing activities have been supported by fiscal stimulus and raw materials will need to be imported, while imported parts may be needed at a later stage. But we realise that mining activity within China has grown and this may reduce demand for commodity imports.
- Retail sales growth should stabilise with the fiscal stimulus in place. But consumers could still be cautious, and we expect big-ticket consumption items to experience soft growth as long as there is uncertainty about the future of trade talks. As long as the job market is stable, the Chinese government doesn't need to increase its fiscal stimulus from a total CNY4 trillion in 2019.
- For example, imports of automobiles and parts fell 15.9% YoY in 1Q19.

"The yuan has a new role as a tool for trade negotiations with the US. During the recent rounds of trade talks, the yuan depreciated slightly "

Yuan has a new role in politics

We don't think the yuan will help to support net exports if new export orders are falling. In fact, we don't think the yuan will be used this way in 2019.

Our view of the USD/CNY largely following the dollar index is still valid. But we believe the yuan has a new role as a tool for trade negotiations with the US. During recent rounds of trade talks, the yuan depreciated slightly, defying President Trump who said the yuan should not be allowed to

depreciate if an agreement on trade is struck. We think this will continue at least in the early stages of implementing a trade deal.

Our forecast remains at 6.75 for the USDCNY by the end of 2019.

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China: RRR cut needed to sustain credit growth

China's aggregate financing, which includes loans and other credit channels, amounted to CNY2.86 trillion in March alone. Loans comprised only a part of this, with the rest coming from the debt market. The central bank wants credit creation to support the economy. We believe a cut in the reserve requirement ratio is needed to maintain strong credit growth



Source: Shutterstock

A very high credit growth

Aggregate financing at CNY2.86 trillion, as a measure of China's credit growth, was up 80.28% YoY in March. 1Q19 total credit created was near CNY8.20 trillion, up 40.% from 1Q18.

Though it is usual to have high credit growth in the first quarter of the year in China, the growth is surprisingly high and a clear sign to us that this is to support the economy. Another sign that the central bank is supporting the economy is that the interest rate bid has remained low, as shown by 3M SHIBOR.



Source: ING, Bloomberg

Yuan loans likely went to small exporters

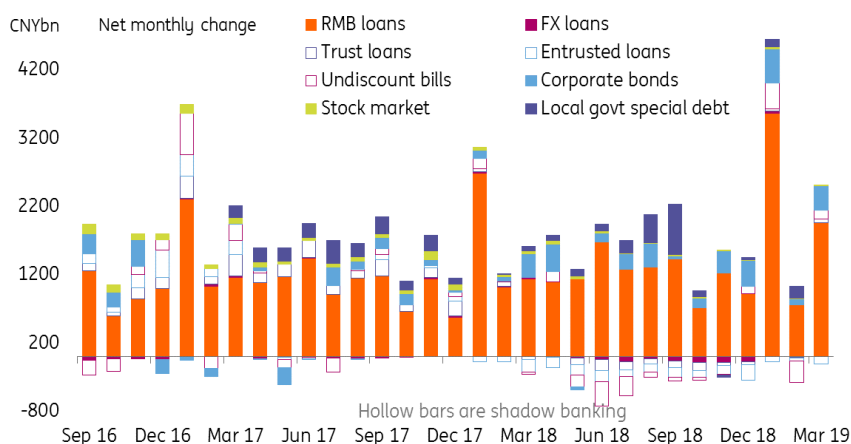
RMB loans from banks are still the largest contribution of total credit for the economy.

This is likely the result of central bank efforts to help small private firms to get funding from banks. Some of these private firms have been hurt by the trade war. As such, the credit diversion to small private firms should reduce the risk of a slump in the job market. We are not sure how these funds will be used if small exporters face weaker global growth.

Debt market serviced local government infrastructure projects

The second largest credit creator was the debt market, facilitating fundraising for infrastructure through the issue of local government special bonds.

This funding will go directly into project finance, and so boost the mining, commodities, energy and transportation sectors. Most of the infrastructure spending is for new metro lines, new toll roads and water management systems.



Source: ING, Bloomberg

Rapid yuan loan growth means an RRR cut is needed

As trade war uncertainties linger on, there is a need to keep the fast yuan loan growth to help small private firms survive. An RRR cut is needed to facilitate fast credit growth.

China may not need such fast ongoing credit injection into small private firms. That said, we believe that the central government will allow speedy credit growth to continue for some time, at least until it is satisfied that the job market is stable.

RRR cut in April still on the cards

Liquidity seems to be ample, as shown by 3M SHIBOR. However, by 17 April a sizeable liquidity injection expires and there will be tax payments around mid-April. Usually, this would create some tightness in the interbank market. This should allow the central bank to cut RRR by 0.5 percentage points to 13.0%.

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