

Good MornING Asia - 15 January 2019

Yesterday's Chinese trade data provided a reality check to those who have been peddling a more upbeat trade story on the back of US-China talks. Current tariffs are already doing considerable damage, and merely not adding to that burden will not deliver a turnaround. Indonesian trade data due today will likely show how this is affecting Asia more broadly.

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By Robert Carnell



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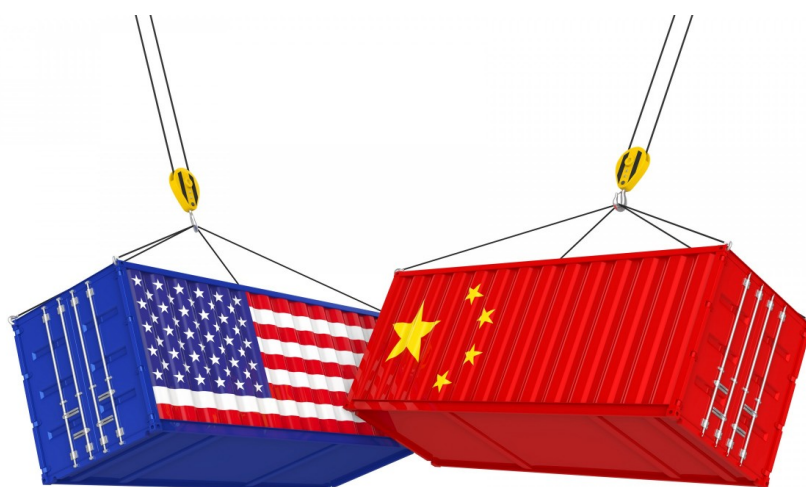
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To feed your Brexit cravings - click on following link

We are giving Brexit a break today - plenty of time for that tomorrow - if you want a good news story on what happens next, try [this](#) from BuzzFeed.

It's bad...

The negotiators may be making positive noises, especially from the US side, but we are taking nothing for granted in the trade talks between the US and China, and as yet, little concrete has been announced. There are no promises to roll back earlier tariffs. At best, talks have reduced the possibility of further, higher tariffs. And the Chinese concessions made seem relatively minor. China is pretty much an open door as far as exports of LNG - they have a structural energy shortage, so the more the better. Much the same is true of agricultural products, especially soy. And they need machinery, especially of the technological kind, to manufacture their higher value-added products. So their pledges to import more of all of these goods does almost nothing to shift China's basic position.

As for the US, some of the more unrealistic demands, the cessation of support for state-owned enterprises (you might as well ask China to abandon the one-party state) may be being scaled

back in favour of more achievable goals. Intellectual property remains a thorny issue. Some new Chinese laws to prevent the coerced transfer of technology seems unlikely to be sufficient to win further US concessions. And then there remains the issue of timing. Does the removal of tariffs, or prevention of additional ones depend on some time-dependent and subjective improvement of the trading position by the Chinese? That's unlikely to be an acceptable state of affairs by President Xi, so we remain rather concerned about this story, and as a result, haven't given up on some further dollar strength before the quarter-end.

...it could get worse...

The weakness of the Chinese December trade data are a historical fact now. The details and our view are contained in the [linked note](#) by our Greater China Economist, Iris Pang. Further economic stimulus measures will be needed. The authorities seem to be taking their time to deliver this, perhaps chastened by the overkill of their stimulus in the financial crisis. The eventual package may be very substantial. Its size will be contingent on just how bad the situation in China gets. And that is the nub of this question. What appears highly evident by the run of recent data is that the Chinese economy is already being hurt by these tariffs. We may not see the full effect of this reflected in official GDP figures. Those numbers still seem to be more of a political statement than an accurate reflection of what is happening on the ground. But the industrial profits numbers tell a different, more negative, and probably more accurate story of what is going on.

...and the currency could well be part of any fight back

All of which leads us to the thought that USDCNY 7.0 may have drifted away from traders sights, but over the coming months, the currency is likely to have to be used as well as all the other policy tools at the authorities' disposal, and it is probably too early to throw away those 7-plus forecasts for the yuan just yet.

Could it spread?

Today, Indonesian trade data will shed some light on whether China's trade problems are being transmitted elsewhere in the region. Indonesian trade growth (YoY) has been in a trend decline since mid-2017, and last month's November data punched down through zero to register a year-on-year contraction. The more recent weakness seems to show a steepening of the downward slope, so it already looks as if Indonesia is being affected by China's trade problems. We'll see how much later today.

Korean December trade price data did not make for particularly pleasant reading today either. In year on year terms, the prices of exports are falling (-0.6%), whilst import prices are still growing, (3.2%YoY). So Korea's terms of trade are deteriorating, and not surprisingly, the KRW is looking softer as a result.

China's Money supply and Philippines OFW remittances

Today's remaining data includes Chinese Money supply and new loans data, which always take quite a lot of interpreting as policy measures shunt funds from one area to another. Philippines OFW remittances are usually strongest in December. Today's November number may give us some clues as to how strong that is going to be, and how much of a boost to the PHP.

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International theme: Trump hopeful for a deal with China

- President Trump's remarks that "we are going to be able to do a deal with China" raise hope for some progress on the trade front even as his standoff with the Democrats continues.

EM Space: Markets likely to remain in defensive mode

- **General Asia:** Emerging markets took a hit on Monday after China reported disappointing trade numbers. Defensive theme looks to be intact today with investors worried about slowing global growth while geopolitical concerns remain lurking in the background given the US shutdown and UK Prime Minister May's struggles.
- **Indonesia:** Trade data for December is due today. Analysts' expectations are centered on a narrower trade deficit due to slower import growth of 7.7% as against 11.7% in the previous month, while exports likely recovering to post 1.0% growth after a 3.3% contraction. The government has been active in carrying out measures to lower the current account deficit to GDP ratio from an estimated 3% in 2018. Bank Indonesia's Governor Warjiyo sees the current account deficit in 2019 equivalent to 2.5% of GDP as the government clamps down on imports.

- **Philippines:** Bangko Sentral ng Pilipinas (BSP) reports data on overseas Filipino remittances for November, an important source of foreign currency to finance wide trade deficit. The consensus estimate of 8.3% YoY rise in inflows follows 8.7% growth in October.

What to look out for: Fed speakers

- Indonesia trade (15 January)
- Philippines OCW remittances (15 January)
- Fed Kashkari, Kaplan and George speak (16 January)
- Bank Indonesia policy meeting (17 January)
- Fed Quarles speaks (17 January)
- Thailand reserves (18 January)
- US consumer sentiment, industrial production, trade and retail sales (14-18 January pending shutdown)
- Fed Williams speaks (18 January)

China: exports and imports contracted in December

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Shrinking exports and imports in December - especially in the electronic sector

China's exports and imports shrank 4.4%YoY and 7.6%YoY in December 2018, respectively, which was considerably down from our already downbeat forecasts of +2.5%YoY and 0.0%YoY, respectively.

Exports fell for commodity energy goods like coal and crude oil. But there were also declines in some electronic related parts and goods and auto-related parts.

It was a similar story for imports, but with even greater reductions in electronic-related parts and goods.

Trade of electronics will continue to shrink

We believe that the fall in electronic imports and exports is related to the lack of demand for upgrading smartphones, and also the start of foreign companies avoiding using China-made

electronic components.

With regard to the possible shunning of China-made electronics by foreign firms, China could rely more on domestic demand as external demand fades. But exports and imports of electronic parts and goods will still likely continue to shrink in 2019.

-14.9% YoY

Imports of advanced technology products in December

Headline imports -7.6%YoY

Worse than expected

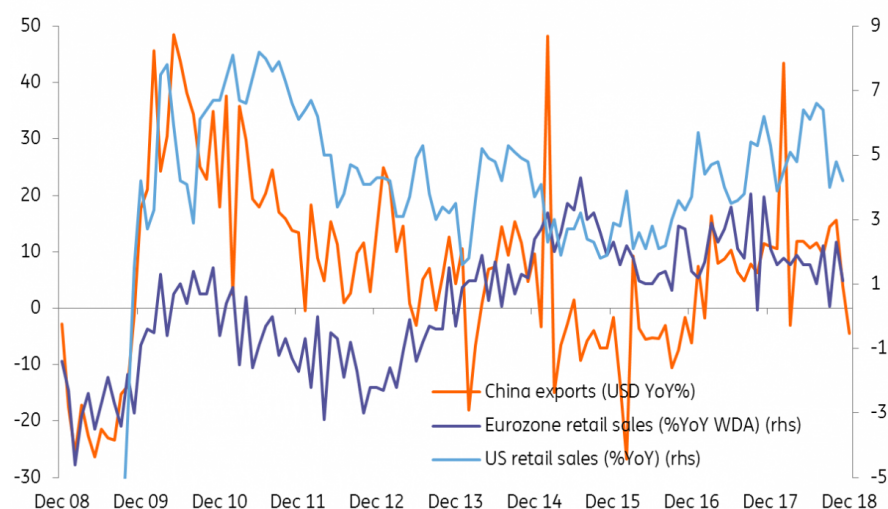
2018 trade balance signals solid consumption growth

For the full year, exports and imports rose by 9.9% and 15.8% in 2018 respectively, which resulted in an annual trade surplus of \$351.8 billion. This was down from \$509.7 billion in 2017, due to faster growth of imports relative to exports. The 31% decline in the trade balance also implies that China's consumption growth was reasonably solid in 2018.

Global growth in the first part of 2018 grew faster than expected, especially in the US, which boosted China's exports and imports (imports from inputs for subsequent export).

However, we doubt the same can be repeated in 2019. The US will likely experience a slowdown later in the year due to a combination of weakening fiscal stimulus and higher prices of inputs stemming from tariffs. The government shutdown does not help matters currently, but it is hard to see this persisting beyond the immediate future. Major European countries are also struggling to maintain growth and combined with a weaker US, provides a challenging external demand backdrop for China's exports in 2019.

Weakening foreign demand affects China's exports



Source: ING, Bloomberg

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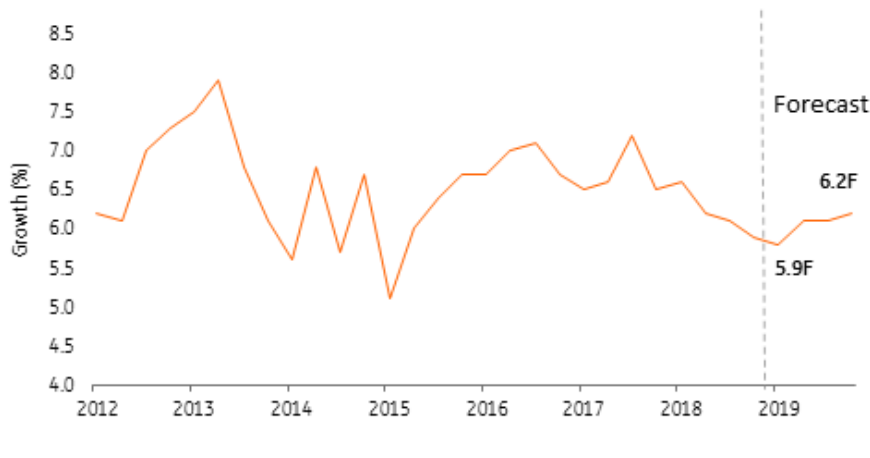
Source: Shutterstock

Recent Growth and outlook: Robust but speed bumps ahead

The Philippines continued to post growth above 6% as of the 3Q of 2018 with year-to-date growth at roughly 6.3% and almost all sectors of the economy contributing to that figure. In the past, the economy was heavily reliant on household consumption but in recent years we've seen a steady contribution from both capital formation and government spending as well. On the other hand, net exports have continued to act as a drag on economic growth as the Philippines runs a chronic trade deficit. This has become more pronounced in recent months with imports surging at a time when exports have struggled.

Growth, however, is expected to hit a speedbump in the next two quarters with still-elevated levels of inflation and higher borrowing expected to sap both consumption and investment momentum somewhat. Meanwhile, government spending may decelerate sharply as the administration is running on a re-enacted budget following Congress's failure to pass the 2019 spending plan.

Philippines gross domestic product and forecasts (until end 2019)



Source: Bloomberg and ING
base year 2012

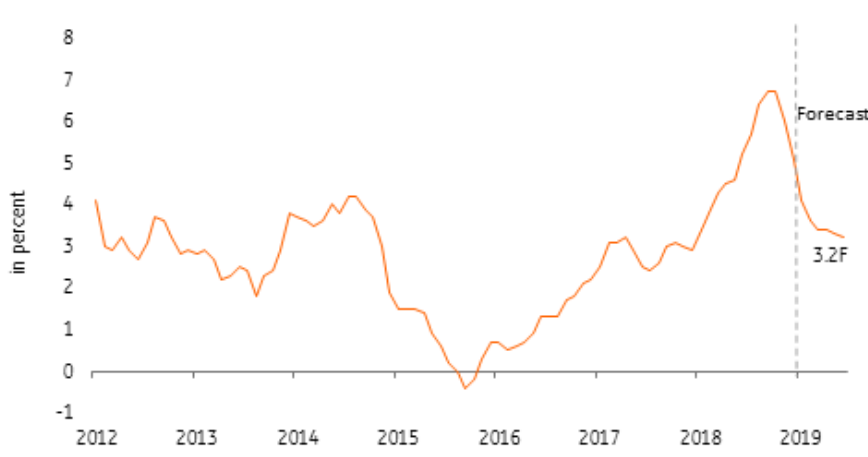
Inflation and outlook: Multi-year peak but expected to decelerate

Price pressures resurfaced in 2018 with a confluence of events pushing inflation to multi-year highs. Excise taxes on fuel, tobacco, alcohol and select food items piled on to pressures emanating from supply bottlenecks caused by adverse weather while crude oil prices jumped more than 40% for the year. Given these developments, inflation peaked at 6.7% in 3Q but has since shown signs of a stark deceleration with the December 2018 number stalling at 5.1%.

With Congress passing a key legislative measure to help improve supply of the all-important rice grain and oil prices sliding from a peak in 2018, BSP is now expecting inflation to slow to below 4% as early as 1Q 2019.

Philippine inflation

2016=100



Source: Bloomberg and ING

Monetary policy and interest rates: BSP hiked but likely to reverse in 2019

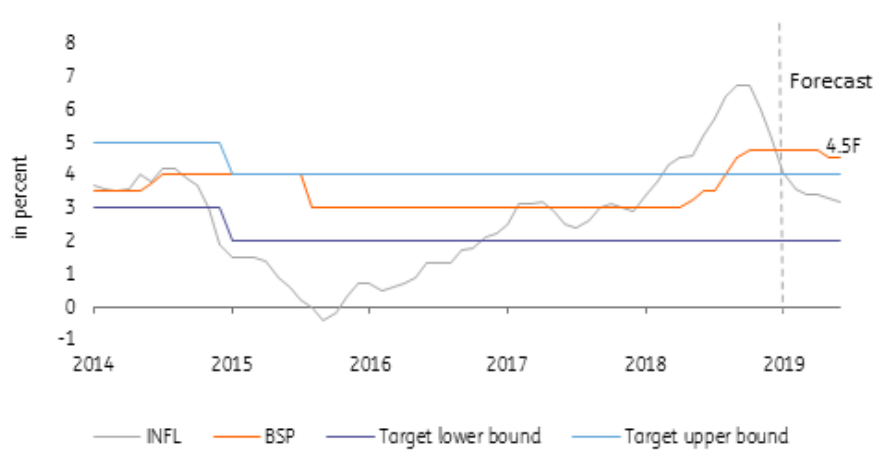
With inflation zooming past the BSP's 2-4% inflation target, monetary authorities unloaded a string of policy rate hikes throughout the year, bringing the cumulative increase to 175 basis points for 2018. With inflation pushing higher and the BSP hiking rates, secondary market rates jumped as well with three-month paper up to 6.149% by year-end from 3.164% at the start of the year.

With inflationary pressures abating, we do expect interest rates to slowly edge lower especially at the long-end of the curve. We do not expect rates on shorter-dated securities to return to levels seen at the start of 2018 given BSP's recent 175 bps hike as well as relatively tight liquidity conditions, as evidenced by a third straight month of single-digit growth in the money supply.

Given decelerating inflation, tight liquidity conditions and slowing growth, we expect the BSP to walk back its recent aggressive rate hike cycle by carrying out a two-pronged easing; slashing reserve requirement ratios (RRR) as early as 1Q and reducing its main policy rate by 2Q to bolster flagging growth momentum.

Philippines inflation, BSP policy rate and inflation target

2016=100



Source: Bloomberg and ING

Country specific highlight: twin budget and current account deficits

The Philippines is experiencing 'twin deficits' in the form of a targeted widening budget deficit of up to 3.2% of GDP and a current account deficit expected to hit 2.3% of GDP. In many ways, the twin deficits are two sides of the same coin as the government's aggressive infrastructure push has fomented increased borrowing by the national government while at the same time driven import demand for capital goods and raw materials. Government officials continue to assert the need for such an aggressive drive in borrowing and importation in order to improve the overall quality of infrastructure to usher in President Rodrigo Duterte's 'golden age of infrastructure'.

We expect the country to remain in this situation in 2019 with the current account remaining in deficit due to surging imports while the government runs a budget deficit to finance its aggressive

infrastructure build up. As long as the government hovers close to its targets for the year, we do not foresee this worrying credit rating agencies.

Currency movement: Weakened on C/A woes but 2019 may be different

The Philippine peso weakened for most of 2018 in large part due to concerns about the country's widening current account deficit. Investors also pointed to the central bank being 'behind the curve' as it postponed hiking rates even after inflation zoomed past its target. Risk sentiment improved considerably when inflation slowed sharply in the 4Q of 2018 as oil prices plunged and the food supply bottlenecks were mitigated.

The peso is expected to enjoy some short-term appreciation given the risk-on tone and as investors have looked kindly on high-yielding currencies as the Fed suddenly turned dovish. In the medium-term, look for the peso to face renewed headwinds as the current account remains in the red and with the BSP expected to switch to an easing stance as early as 1Q 2019.

Summary: Speed bump in 1H, rebound in 2H

The Philippine economy continues to post respectable growth despite the recent flare-up in inflation and borrowing costs in 2018. Speed bumps are directly ahead though with economic growth expected to slip slightly below 6% as higher borrowing costs and still above-target inflation sap consumption and investment momentum. Government spending, which has recently been a key source of growth, is expected to struggle in 1H 2019 with an election ban preventing fresh projects and a delay in passing the budget likely to halt last year's strong growth. But with inflation expected to slip back within target in 1H and the BSP expected to ease, GDP growth momentum may be rekindled to close out the year.

ING Philippine forecasts

	2018F	1Q19F	2Q19F	3Q19F	4Q19F	1Q20F	2020F
Real GDP (% YoY)	6.2	5.8	6.1	6.1	6.2	6.3	6.4
CPI (% YoY)	5.2	3.9	4.8	6.3	5.9	3.2	3.4
BSP o/n borrowing rate (% eop)	4.75	4.50	4.50	4.25	4.25	4.25	4.13
BSP reserve requirement ratio (% eop)	18	17	17	16	16	16	14
3M T-bill rate (% eop)	6.15	5.60	5.35	5.40	5.25	5.2	5.15
10Y govt. bond yield (% eop)	7.07	6.35	6.10	6.15	6.00	6.1	6.05
Budget deficit to GDP (% eop)	3.0	2.70	3.00	3.40	3.20	3.0	3.00
Current account deficit to GDP (% eop)	1.9	2.1	2.0	2.1	2.3	2.1	2.0
Unemployment (%)	5.30	5.20	5.10	5.30	5.10	5.0	5.20
PHP per USD (eop)	52.58	52.20	53.34	54.03	52.56	54.7	54.64

Sources: CEIC, Bloomberg, ING forecast

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