

Good MornING Asia - 15 July 2019

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EM Space: Markets digest rate cut hopes and await China growth numbers

- **General Asia:** Investors will likely take their cue from China's 2Q GDP and other economic data today. The rest of the week will see them digesting recent dovish signals from the Fed Chair, while several other Fed officials add their voice to the noise. A slew of trade figures from around the region will continue to display downside growth risks, prompting two Asian central banks to ease their policies.
- **Thailand:** On Friday, the Bank of Thailand unveiled measures to curb THB appreciation. It cut the limit on outstanding balances in non-resident THB accounts, including those for securities, to 200 million from 300 million. In enhanced reporting requirement for non-residents' holding of debt securities issued in Thailand, the BoT also made the disclosure of end beneficiaries of such holdings mandatory. With large current surplus continuing to support the THB, these measures may not achieve their desired goal, at least not much in a weak USD environment. A policy rate cut may help though.
- **Malaysia:** Contrary to the consensus of a slowdown, industrial production growth was steady in May at the 4% YoY rate of April. And manufacturing sales growth of 6.7% also was

little changed over the same months. Activity data continues to support our view that GDP growth accelerated in 2Q19, allowing the central bank (BNM) to carry on with the stable policy rate of 3.0% through the rest of the year.

- **Indonesia:** President Jokowi pledged to implement a raft of reforms to help attract investments by slashing corporate taxes and relaxing both labor and foreign ownership laws. Jokowi is said to be looking to expand the list of industries open to foreign ownership as well as implement programs to improve worker skills. He is also looking to fast track infrastructure spending in a bid to boost growth, though such a move may limit the government's ability to contain the current account deficit. Overall, it may be a boost to growth but sustained demand for imports could offset potential foreign inflows and cap the probable gains of the IDR.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) Governor Diokno affirmed that the central bank was looking to slash policy rates in the 3Q as inflation continued to slide well into the target. Governor also indicated the plan of cutting policy rates ahead of any reductions in the reserve requirement ratio (RRR). We expect a rate cut at the August meeting and further reductions of RRR in a phased manner in the wake of the September meeting.

What to look out for: China GDP data

- China industrial production and GDP (15 July)
- Indonesia trade (15 July)
- Philippines remittances (15 July)
- Fed Williams speech (15 July)
- US retail sales (16 July)
- Fed Bostic and Bowman (16 July)
- Singapore non-oil exports (17 July)
- Fed Powell and Evans speeches (17 July)
- Hong Kong policy meeting (18 July)
- South Korea policy meeting (18 July)
- Fed Bostic speech (18 July)
- Bank Indonesia policy meeting (18 July)
- Fed Williams and Bullard speeches (19 July)

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China's trade future rests on its ability to sell tech abroad

The surge in shipments to avoid potentially higher tariffs has come to an end with Chinese exports shrinking on an annual basis in June. The tougher environment has had an impact on imports too. As things stand, it seems technology will be at the heart of the fate of China's exports in the future



Source: Shutterstock

G20 didn't really do much for China's trade problems

Even though the outcome of the sideline meeting between President Trump and President Xi at the G20 meeting was a so-called truce, Chinese exporters continued to export goods earlier than planned to avoid a possible further increase in tariffs.

But these front running export activities seem to have finally ended as exports fell 1.3% year on year in June after a small increase of 1.1% in May. It seems exporters have run out of goods to export to the US that could circumvent future tariffs. In June, China's exports to the US rose by a meagre 4.3% month on month after a 20% spike in May.

Given exporter's pessimistic outlook about future trading activities, imports contracted too - 7.3% YoY in June after falling by 8.5% a month ago - as exporters haven't imported many parts for future production. For 2H19, we believe exports and imports will continue to shrink.

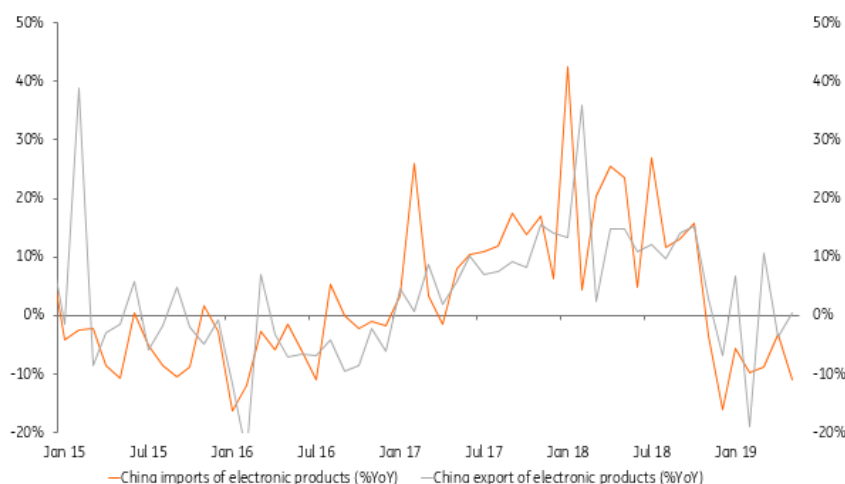
The tech war could have a long-term impact on China's exports

Between January to June 2019, mechanical and electronic products made up around 55% to 60% of China's exports, which means the tech war will hurt China's export significantly.

Post the G20 meeting, Huawei's CEO said, "very little has materially changed as Chinese tech firms still face quite a few problems in doing business with the US even with the changed US policies" and we tend to agree. But nowadays technology usually has dual-use, which means it can be used both by the military and ordinary people. So, in our view, this apparent relaxation is nothing more than a political gambit.

This may also explain why China hasn't yet increased US agricultural produce imports. This month alone, soybean imports fell by 15%MoM, which implies that China is still yet to import more agricultural products from the US. Moreover, there are other countries blocking Chinese companies from engaging in the 5G infrastructure set up, so we expect this tech war to continue for a while.

But all of this means that technology products and parts export from China will diminish after this wave of front running (tariff avoiding) activities.



Source: ING, Bloomberg

Government stimulus to fill GDP growth gap

As we've explained before, depreciating the yuan won't help exporters who are concerned about 25% tariffs, as such a large spike in tariffs will mean they forego export orders altogether, and then the exchange rate movements will no longer be a concern for them.

Therefore, China is likely to rely on government stimulus measures to fill the gap of loss of export activities, which means infrastructure investments and related manufacturing activities will have to continue to support GDP growth to prevent it falling below the 6% lower bound target set by the government.

In our view, China's trade activities will need to bounce back considerably to avoid more fiscal stimulus and achieve above 6% GDP growth.

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China: Soaring loan growth is a worrying signal

Credit grew at an exceptionally fast pace in June mainly due to financing for infrastructure projects. The implication is that if there were no fiscal stimulus, the economy would be deteriorating. The key question is, can the central bank keep interest rates capped given such enormous demand for infrastructure loans?



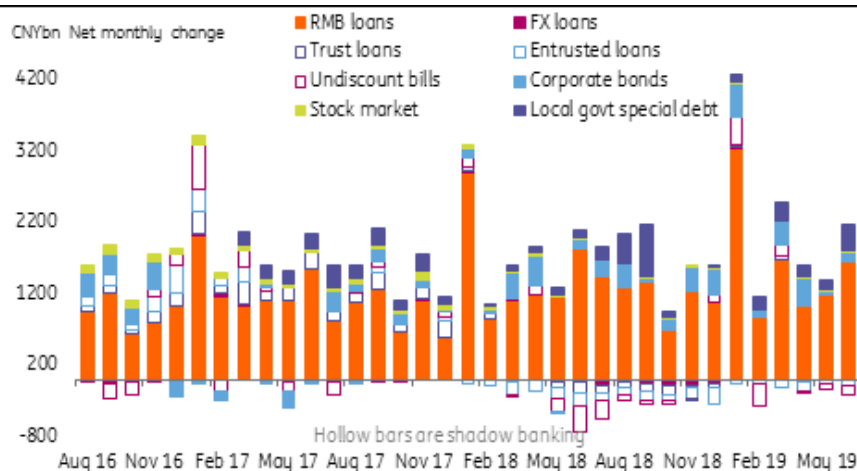
Source: Shutterstock

Credit growth too strong, not a good sign

Total financing increased by CNY2.26 trillion in June, with yuan loans increasing by CNY1.66 trillion.

Credit growth was exceptionally strong and this worries us. It means the Chinese economy needs a lot of funds to keep infrastructure investment growing at a level that can maintain GDP growth above 6% at a time when manufacturing PMIs and export growth are negative.

Local government special bonds support credit growth but yuan loans still the main financing channel



Source: ING, Bloomberg

There will still be big funding needs in 2H19, expect RRR cuts

There will still be big funding needs in China in 2H19, as we expect infrastructure projects to double from 2 trillion yuan to 4 trillion yuan.

These projects will raise funds from local government special bonds (net issuance of these bonds amounted to 1.19 trillion yuan), but at a later stage, when there are manufacturing activities from these projects, there will be sizeable demand for loans from manufacturers.

The central bank is expected to divert targeted liquidity to smaller manufacturers. We therefore expect two targeted RRR (required reserve ratio) cuts, one in 3Q and one in 4Q, each at 0.5 percentage points.

If the economy needs further credit, we expect these targeted measures could become broad-based, although this is not as likely as targeted RRR cuts.

PBoC doesn't like very low interest rates, but we expect two rate cuts in 2H19

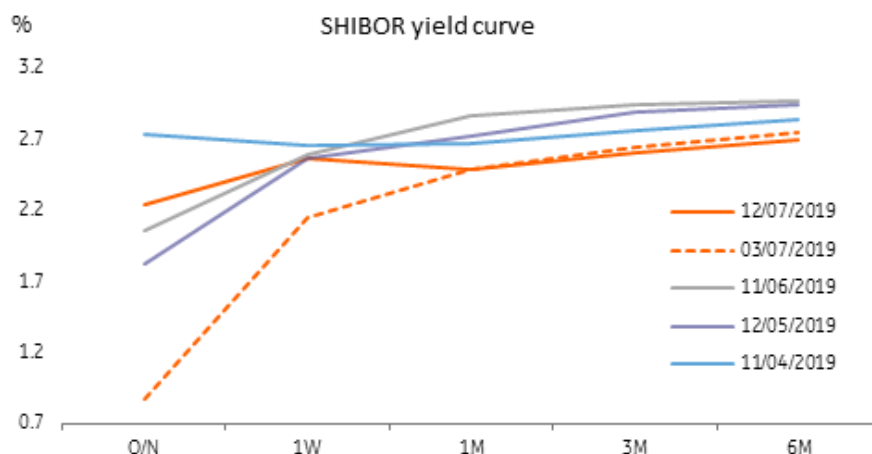
Overnight SHIBOR dropped to around 1% from the end of June to early July from a level of about 1.5%. This was driven by tight liquidity as the central bank took control of a small-sized bank. This is very likely related to a corruption case, which should be an isolated incident. The central bank has since absorbed liquidity from the system and interest rates have rebounded to around 2%.

Our views on interest rate policy are:

1. From this case, we deduce that the central bank does not like a very low interest rate environment. This is understandable because other major central banks that have very low interest rates have fallen into a liquidity trap where lowering interest rates further has failed to bring about even marginal loan growth.
2. Nevertheless, we still believe there is a high chance the PBoC will cut the 7-day policy rate

- twice by 5bp each in 3Q and 4Q to reinforce the impact of targeted RRR cuts. This is not to create a low interest rate environment but to avoid interest rates coming under upward pressure due to the high demand for credit to fund infrastructure projects.
3. It's even more important for the central bank to suppress high interest rates faced by micro and small firms.
 4. We think if the overnight SHIBOR surpasses 2% and/or 3-month SHIBOR breaks 3%, the PBoC will cut rates.

Overnight SHIBOR has an invisible bottom of 1%



Source: ING, Bloomberg

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