

Good MornING Asia - 2 November 2018

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China

The phone is mightier than the sword

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By Robert Carnell



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Donald J. Trump ✓

@realDonaldTrump

Following

Just had a long and very good conversation with President Xi Jinping of China. We talked about many subjects, with a heavy emphasis on Trade. Those discussions are moving along nicely with meetings being scheduled at the G-20 in Argentina. Also had good discussion on North Korea!

7:09 AM - 1 Nov 2018

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8.7K 17K 72K

280 characters cause big yuan rally

A single tweet from the US President following talks with President Xi ahead of the G-20, which were apparently heavily weighted towards trade, and which also were "moving along nicely" has been enough to take the yuan from the lower edge of USDCNY7.0 yesterday, to 6.92 today. I'm not entirely sure what to make of this. But it feels too big a change of direction following the Mike Pence speech some weeks ago to be taken literally. It certainly isn't in synch with the latest charge of a Chinese company for conspiring to steal trade secrets.

Is this wrapped up in some way with the mid-terms? Hard to say. Bashing China over trade has been a cross-party vote winner, so it seems odd timing if so. My gut instinct is to remain sceptical. US growth data remains strong, so the administration there doesn't need to make the first move. And while Chinese growth indicators have looked far more worrying, I can't see China moving sufficiently on issues like Intellectual property to satisfy the US. Perhaps Larry Kudlow is right, some middle ground can be found. I think it is more likely that this is just part of a process, rather than a meeting of minds. I'm unclear what the purpose is. Suggestions welcomed.

Easing on Iran? Easing on oil

The other big change happening right now is on oil, and for some Asian economies and currencies (IDR, PHP, INR) this is a big deal. The US has apparently softened its stance on India and Korea buying Iranian oil, helping the oil market to pull back from the highs of a few weeks ago. Brent crude is now only \$72.72/bbl, compared with over \$86 at the beginning of the month. This presages some much better (lower) inflation figures in the months ahead if it lasts, and some better (less negative) trade and current account figures too. President Trump has been berating OPEC to get oil prices down, but until Saudi Arabia started to really pump hard following the Jamal Khashoggi murder, this had failed to make much of a dent. Now, just ahead of renewed US sanctions on Iran, the softer approach on buying Iranian oil to allies of the US seems to be helping push oil lower still. Again, the messages are rather contradictory, and I'm struggling to figure out whether there is a new objective, or if this is also some temporary respite before the pressure on Iran steps up some more.

One other thought is that maybe there is some concern that the Iran sanctions were opening a can of worms on the dollar's role as the global reserve currency. It sounds as if some decent progress has been made by the EU on the special vehicle to enable countries to circumvent the US sanctions. The dollar isn't going to lose its reserve currency status overnight, but this could be the thin end of the wedge. I really doubt this is what this is all about though, even if it should be.

Don't get too comfortable, wages data later

Before coming to Asia 18 months ago, I spent 12 of the previous 13 years being disappointed by weak US wages data. Today offers a good chance for this saga of pain to end. Monthly wages growth in the US has been fairly steady at 0.3%, and a repeat of that today would take the wages growth rate to 3.2%, a level it has not seen since April 2009. And that [is indeed our house forecast](#).

Anecdotal evidence strongly supports the idea of higher wages. Our US Economist, James Knightley has recently referenced the extreme hiring issues faced by firms in the small firm NFIB survey. Surely at some stage, the levy must break and wages will rise?

You would think so, but years of disappointment have me looking for reasons why this may yet

disappoint. One is the tendency for the previous month's growth rate to be revised lower, which happens a lot. Another is that the seasonally adjusted data isn't, in fact, all that well adjusted, so last October's -0.2%MoM decline may not be the pure aberration it appeared to be and could see some vestige of a repeat today.

That notwithstanding, even a move to 3-something wages, could be enough to have markets doing a 180-degree turn in terms of their fed view. Having priced out a fair bit of 2019 tightening as the stock market fell, faster wages growth may encourage them to price it back in again, if so, the roller coaster on stocks, currencies and bond yields may start all over again - perhaps as early as today. Buckle up!

3.2% Average Hourly wages growth

ING House view

Higher than expected

Malaysian budget

(And this from Prakash Sakpal): It's [budget day in Malaysia](#). The inaugural budget of the new government of Prime Minister Mahathir is widely expected to be a tough balancing act in the government's drive to rein in large public debt (estimated at about 80% of GDP) and at the same time sustain the economy on a strong growth path. The key headwinds to this strategy are the already weak revenue structure now exacerbated by consumption tax reforms and high operating expenditures.

PM Mahathir has signaled new taxes and curbs on development spending. Yet the fiscal deficit is poised to rise above the 3% mark in the current year (ING forecast 3.2%) and remain there through 2020. The tighter fiscal policy stance combined with sustained external risk suggest Malaysia's GDP growth will remain under pressure in 2019, more likely staying close to the low end of 4.5-5.5% target.

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Source: Shutterstock

➔ China slowdown concerns downplayed

China's October data dump started this week on a mixed note.

The official manufacturing purchasing manager's index fell in October, but its Caixin counterpart rose, but both indexes remained in the expansionary territory - a figure above 50. However, what is striking is the seventh consecutive fall in the PMI new export orders component, a sign of the trade war impact slowly coming through.

However, the hard data paints a positive picture. The average 12% year on year growth of China's export in the first nine months of this year was twice as fast as a year ago and based on our house forecast of 23% YoY growth in October, the strength persisted into the final quarter of the year, even as the US tariffs on \$260bn of Chinese goods took effect. Likewise, a 23% surge in Korea's exports in October reinforces the message.

But Beijing isn't quite as relaxed. This week China's Politburo signalled timely measures to counter the slowdown, and the State Council announced a stimulus plan but stopped short of revealing the total amount. We suspect the details must be in the making and will drive the markets as soon as they hit the newswires over the coming weeks.

23% China's October export growth
ING forecast

➔ Indonesia and Philippines on steady growth path

It wasn't all bad for Indonesia and the Philippines - the two Asian economies hit hardest by the emerging market contagion in the third quarter. At least that's what the consensus 3Q GDP growth forecasts for the duo suggest.

Despite the aggressive tightening by respective central banks, the 5.2% consensus estimate for Indonesia is hardly a slowdown from the 5.3% pace of the previous quarter, while the Philippines' growth rate sped to 6.4% from 6.0%.

Firmer growth also means greater resolve by central banks to tighten the policies if emerging market contagion hits again as external risks loom large. But with the inflation pressure in both economies starting to subside and currencies stabilised, the tightening pressure also appears to have eased. Inflation in Indonesia remains anchored at the 3% level and is expected to recede from the 6.7% peak reached in September in the Philippines. That said, we still expect one more 25bp policy rate hikes by Bank Indonesia and the Bangko Sentral ng Pilipinas before the end of the year.

6.3% Philippines 3Q GDP growth
ING forecast - Up from 6% in 2Q

➔ Malaysia's central bank to stay on hold

[Malaysia's 2019 budget](#), due to be released tomorrow will set the tone for local markets for the week in which the country's central bank also announces its monetary policy decision. Coming just ahead of the meeting, September data on trade and industrial production will be key inputs for the Bank. We expect the Bank to remain on hold and leave the policy rate at 3.25%. And we aren't alone; there is a solid consensus behind this view.

The activity data will reinforce a sustained slowdown in Malaysia's GDP growth. This warrants

continued monetary policy accommodation to the economy, especially when weak public finances are squeezing the fiscal support. The government budget deficit is poised to rise above the 3% mark in the current year (ING forecast 3.2%) and remain there through 2020.

3.25% BNM policy rate
To be unchanged through 2019

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Monday 5 November					
India	0500	Oct Nikkei Services PMI	51.0	-	50.9
Korea	2300	Sep Current A/C Balance (US\$m)	6245	-	8439.8
Malaysia	0400	Sep Exports (YoY%)	6.5	-	-0.3
	0400	Sep Imports (YoY%)	11	-	11.2
	0400	Sep Trade Balance (RM bn)	5.6	-	1.6
Indonesia	-	3Q GDP (QoQ/YoY%)	-/5.2	3.1/5.2	4.2/5.3
Tuesday 6 November					
Philippines	0100	Oct CPI (YoY%)	6.5	-	6.7
Taiwan	0800	Oct CPI (YoY%)	2.0	-	1.7
	0800	Oct WPI (YoY%)	6.7	-	6.6
Wednesday 7 November					
China	-	Oct Forex Reserves (US\$bn)	3062	-	3087.03
Malaysia	0700	Oct 31 Forex reserves- Month end (US\$bn)	-	-	102.8
Philippines	0100	Sep Exports (YoY%)	4.5	-	3.1
	0100	Sep Imports (YoY%)	20.6	-	11.0
	0100	Sep Trade Balance (US\$m)	-3100	-	-3513
-	-	Oct Forex Reserves (US\$bn)	-	-	74938.8
Taiwan	0800	Oct Exports (YoY%)	10.0	-	2.6
	0800	Oct Imports (YoY%)	17.7	-	13.9
Thursday 8 November					
China	-	Oct Trade Balance (US\$bn)	34.7	-	31.7
	-	Oct Imports (YoY%)	30.5	-	14.3
	-	Oct Exports (YoY%)	23.0	-	14.5
Malaysia	0700	Overnight Policy Rate	3.25	-	3.25
Philippines	0200	3Q GDP (SA, QoQ/YoY%)	-/6.3	-/-	1.3/6.0
Friday 9 November					
China	0130	Oct PPI (YoY%)	4	-	3.6
	0130	Oct CPI (YoY%)	2.8	-	2.5
Indonesia	1000	3Q Current Account Balance (US\$bn)	-8.5	-	-8.03
Malaysia	0400	Sep Industrial Production (YoY%)	2.0	-	2.2

Source: ING, Bloomberg

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Xi highlights external forces as drag on economy

President Xi emphasised that external forces have hit the economy, which we believe is a reference to the bilateral trade dispute between China and the US. The nature of the trade war has become clearer over time: as a technology war (the US avoids using China's technology, and avoids technology being transferred to China), an investment war (US imposes penalties on Chinese tech company in the US), and an additional geopolitical element (naval standoff in South China Sea and military sales to Taiwan).

Xi's message implies that the chance of getting a positive result from trade negotiations between China and the US is small. That means that the possibility of the trade war escalating and continuing to drag on the Chinese economy is high.

Relying on infrastructure, again

This explains why, on the same day as Xi's comment, the National Council announced a stimulus package, most of which comprises infrastructure investment.

Infrastructure should be the fastest way to boost economic growth. We categorise the package

into three parts:

1. Hardware investments, which include railway, highway, waterway, airports. This would increase the demand for building materials and labour. So even if the housing market continues to cool, building materials and labour could be diverted to infrastructure construction projects. These projects should have positive cash flow after completion, so the burden on fiscal support should be temporary. This seems to comfort the market in terms of the risk to local government finances.
2. Environmental protection. These projects include water management and pollution controls. We would describe these as the "software of the economy." It is uncertain to us how local governments could generate a future stream of revenue from these projects aimed at a clearer sky and cleaner air. But they are goals worth pursuing anyway.
3. Social benefits in the form of improving rural living standards, medical care and schooling. These again are software of an economy. The benefits are a higher quality future labour force. But it is difficult to measure if local governments will overspend.

A lot of money needed but how much?

The stimulus package does not mention a monetary amount. We expect that it would be comparable to the 2009 package, but as GDP has more than doubled, the stimulus amount will also increase. We believe the total package will be around CNY 9 to 10 trillion.

The National Council requests that local governments issue bonds to finance the stimulus, and asks banks to lend to these projects. We expect some local governments will once again depend on local government financial vehicles to fund some of the projects. And we expect banks will lend to projects that are operated by state-owned enterprises. We believe that private enterprises may be involved in some of the smaller projects.

This announcement could increase the risk of higher non-performing loans or defaults in the future. But the authorities clearly believe that the more pressing need is for immediate stimulus now.

Revising yuan weaker in 2019

The government requests a pool of future infrastructure projects. This means the government is prepared to dig in for a longer-term fight in the trade war with the US. This also implies that the Chinese government might depend on investment to support the economy for a longer time.

Our GDP forecasts are still intact as we consider the government's fiscal stimulus sufficient to provide support as trade tension escalates. We project GDP growth at 6.3%YoY in 4Q18, 6.2%YoY in 1H19, and 6.3%YoY in 2H19.

But we do expect USDCNY to continue to weaken if the trade war continues. We are keeping our forecast of USDCNY and USDCNH at 7.0 by end of 2018, but have weakened the yuan pairs to 7.30 by end of 2019 (previously at 6.50).

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