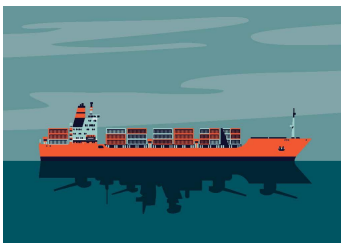


Good MornING Asia - 20 August 2018

This week, the US starts the public hearing into raising tariffs of 25%, not the originally suggested 10% on \$200bn of Chinese imports - US businesses will protest

In this bundle



China

Shock news: Businesses don't like tariffs

This week, the US starts the public hearing into raising tariffs of 25%, not the originally suggested 10% on \$200bn of Chinese imports - US businesses...

By Robert Carnell



China: Central bank closing outflow loopholes for further monetary easing

The People's Bank of China is actively closing possible capital outflow loopholes and this firewall building will allow it to lower interest rates and...



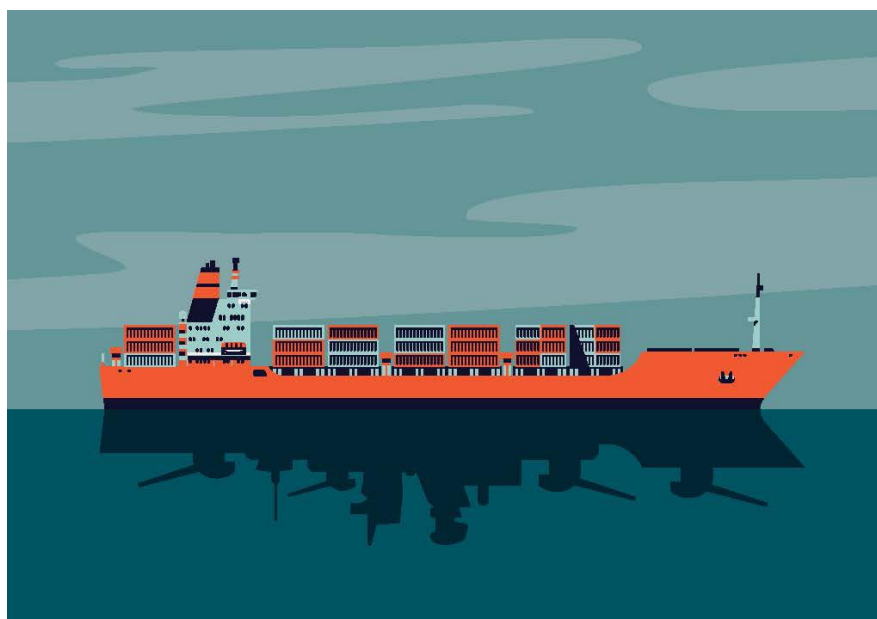
Malaysia

Malaysia: A huge downside GDP miss in the second quarter

We have cut our 2018 growth forecast to 4.5% from 5.2%. Slowing growth and low inflation reinforce our view that the central bank (BNM) will keep monetary...

Shock news: Businesses don't like tariffs

This week, the US starts the public hearing into raising tariffs of 25%, not the originally suggested 10% on \$200bn of Chinese imports - US businesses...



Source: London Publishing Partnership

Tariffs are a tax on imports, businesses rely on imports

The public hearing on whether the next wave of US tariffs on Chinese imports should be 10% or 25% is likely to hear an outpouring of anger from US businesses this week. Why? It's pretty simple. Businesses and consumers in the US import lots from China - about \$500bn (in approximate terms). And tariffs are a tax on those imports - they become more expensive. So business margins get squeezed and firms may invest a little less, and employ a few fewer employees. Consumers face not only higher prices, eating into their disposable incomes, but the central bank - the Federal Reserve, will likely carry on raising interest rates a little bit longer, taking them a little bit higher, causing the dollar to appreciate and hurting US business competitiveness.

Asking businesses whether tariffs should be raised 10% or 25% is a bit like asking them whether they want to be kicked in the foot or the face. Don't expect a polite reply.

Jackson Hole - Monetary policy in a changing economy

The title of Jerome Powell's Jackson Hole speech (see above) shouts out - "We are not going to give anything away about monetary policy". But just in case it does, I guess we should keep our eyes

and ears open. Indeed, the popular notion that Jackson Hole is a traditional venue for signaling changes in policy direction is not supported by history, even the alleged signaling of new rounds of stimulus from this were most likely [accidental](#).

What we can say almost for sure is that the Fed will hike rates again in September. And after that, we doubt even the Fed is that clear what comes next. That will be highly dependent on factors out of the Fed's control - the evolution of the trade war, developments in emerging market economies including China, where the dollar goes next... That said, a further hike from the Fed in 4Q is still looking a reasonable call, barring accidents. Powell won't make this any clearer.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Article | 17 August 2018

China: Central bank closing outflow loopholes for further monetary easing

The People's Bank of China is actively closing possible capital outflow loopholes and this firewall building will allow it to lower interest rates and...



Source: Shutterstock

Interest rate stabilises from further downward pressure, for now at least

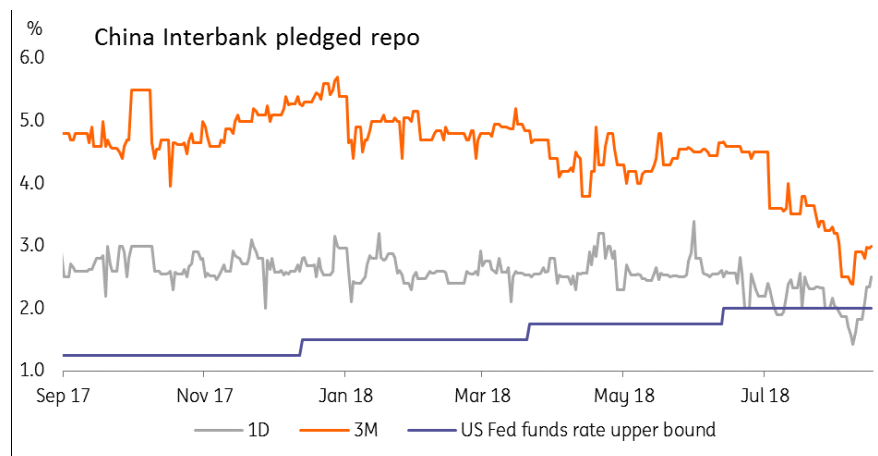
The People's Bank of China would like to lower the interest rate to cushion against potential adverse impacts from the escalating trade war and unwind some harsh damages (e.g. bonds defaults) caused by financial deleveraging reforms in 1H18. However, when the 1D interbank pledged repo and overnight SHIBOR fell below 2% - which is the level of the US's Fed funds rate upper bound - it triggered capital outflow concerns from the inverted China-US interest rate spread.

This could be the reason the central bank has guided the interbank interest rates higher than the 2% level after a sharp fall in the first week of August. The central bank also guided the interest rate on 3M government deposit auction stable at 3.7% in August, the same as July after a sharp fall from 4.73% in June.

As we [expect another rate hike](#) from the Federal Reserve in September, China's interest rate could

be lower than the US again by then. PBoC will have to live with this negative spread because the economy needs lower interest rates to support investments and economic growth in this ongoing trade spat.

Chinese interest rate dipped below the Fed funds rate recently



Source: ING, Bloomberg

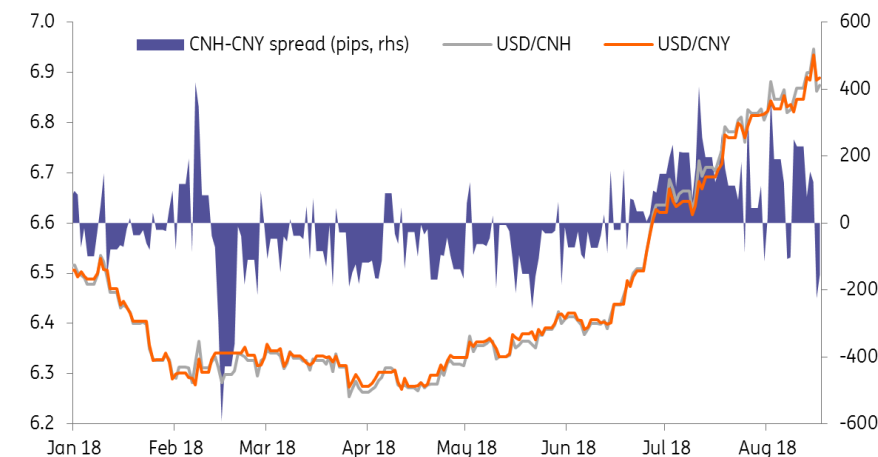
Closing outflows loopholes allows for more monetary easing

The Chinese central bank should have known if it shut down cross-border capital flow channels, then the chance of substantial capital outflows would be small even it guides interest rates lower, and the yuan weakens further due to the strong dollar.

This could be the reason behind the policy to stop capital outflows via interbank accounts set up in the Shanghai Free Trade Zone [as reported by the media](#) on 17th August 2018. We see this as a firewall to prevent capital outflows, give more room for a lower interest rate and a weaker yuan in the coming months when the trade war escalates.

USDCNH may not fully reflect the offshore market reaction of this policy, but USDCNY movements would be more indicative than the USDCNH from here onwards, and we believe the PBoC would allow USDCNY to follow the dollar trend broadly. Once the Fed hikes, the dollar should maintain its strength even after the recent emerging market situation stabilises.

CNH not as indicative as CNY after outflows via free trade zone stop



Source: ING, Bloomberg

We believe the US has invited China to a fresh round of trade negotiations but the low official ranking of representative from both sides signals the chance of a positive result, or of any result, from this negotiation is small.

Given that China isn't going to give way if the US doesn't scale back its tariffs, we think the trade war will escalate, and the yuan would weaken against the backdrop of a strong dollar index. As USDCNY touched 6.9348 on 15th August 2018, passing 7.0 in 2018 looks increasingly likely.

Malaysia: A huge downside GDP miss in the second quarter

We have cut our 2018 growth forecast to 4.5% from 5.2%. Slowing growth and low inflation reinforce our view that the central bank (BNM) will keep monetary...



Source: Pexels

4.5% GDP growth in 2Q

Lower than expected

Net exports dent GDP growth in 2Q18

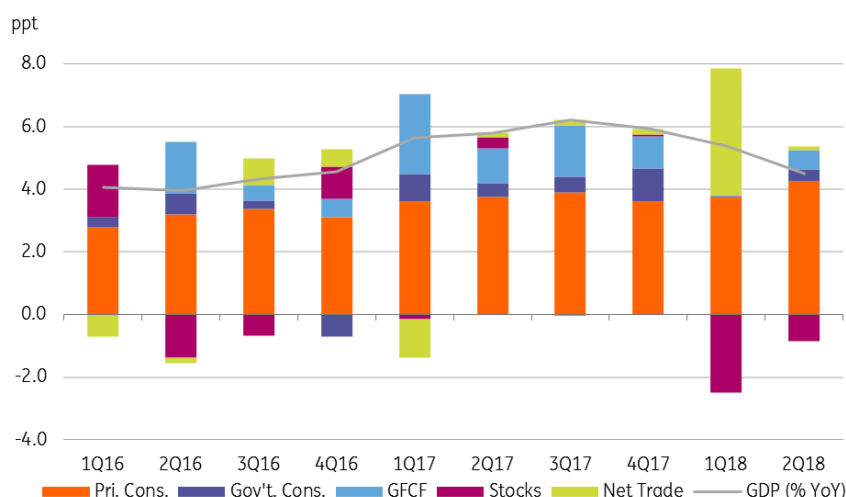
Malaysia's GDP growth slowed sharply to 4.5% year-on-year in the second quarter from 5.4% in the first. We expected 5.2%, only a modest decline and in line with consensus.

Looking at the breakdown, weak net exports were the main source of downside GDP surprise, contributing only 0.1 percentage point (ppt) to GDP growth as against 4ppt contribution in the previous quarter (see figure). As such, domestic demand returned to the driving seat, led by a 4.3ppt private consumption contribution, up from 3.7ppt in 1Q, while government consumption

and fixed capital formation also contributed more than in the previous quarter. This left inventory as a net drag on GDP growth of 0.9ppt.

On the industry side, strong exports supported manufacturing growth, but services remained the main force behind GDP growth. Finance Minister Lim Guan Eng sees 2018 GDP growth at about 5%. The central bank (BNM) cut its forecast today to 5.0% from 5.5-6.0%.

Sources of year-on-year GDP growth



Source: Bloomberg, CEIC, ING

Downgrade of 2018 growth forecast

The weak 2Q GDP report dents our full-year growth forecast. A month ago we revised it to 5.2% from 5.5%. We are now revising it still further to 4.5% as the global trade war will weigh on exports for the rest of the year, and the tight fiscal stance will limit government spending. On the flip side, the GST removal, low inflation, and improved real incomes of households should support consumer spending.

MYR 3.9bn

Current surplus in 2Q

Down from MYR8.8bn a year ago

Weakening external payments

Reinforcing the weak external sector contribution to GDP growth, the balance of payments data for 2Q (also released alongside GDP data today) showed a significant narrowing in the current account surplus to MYR 3.9bn from MYR 8.8bn a year ago. The goods trade surplus remained strong though, as was evident from the monthly customs trade data. We have also cut our current account surplus forecast for the year to 2% of GDP from 3.5%, which will be a narrowing from 3% in 2017.

Policy implications

Slowing growth and low inflation reinforce our view that the central bank (BNM) will keep monetary policy on hold over the remainder of the year. Things are turning sour for the Malaysian ringgit (MYR), Asia's outperforming currency so far. The contagion-effect of the US-China trade war is behind our view of the USD/MYR rate rising up to 4.35 by end-2018 (spot 4.10). Until today we were uncomfortable about our view due to continued MYR outperformance in the recent emerging market currency rout. But today's data raises our confidence in our forecast.

Economic forecast summary

Malaysia	2017	1Q18	2Q18F	3Q18F	4Q18F	2018F	2019F
Real GDP (% YoY)	5.9	5.4	4.5	4.1	4.0	4.5	4.8
CPI (% YoY)	3.9	1.8	1.3	1.8	1.9	1.8	2.3
BNM o/n policy rate (% eop)	3.00	3.25	3.25	3.25	3.25	3.25	3.50
3M interbank rate (% eop)	3.44	3.70	3.69	3.70	3.80	3.80	3.95
10Y govt. bond yield (% eop)	3.91	3.95	4.20	4.25	4.30	4.30	4.30
MYR per USD (eop)	4.05	3.86	4.04	4.20	4.35	4.35	4.05

Source: Bloomberg, CEIC, ING

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.