

## Good MornING Asia - 22 June 2018

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### In this bundle



#### Hike to cut?

The Bank of England Monetary Policy Committee (BoE MPC) has opened the door wide open to an August rate hike. But given the uncertain Brexit outlook, does...



#### China | Indonesia

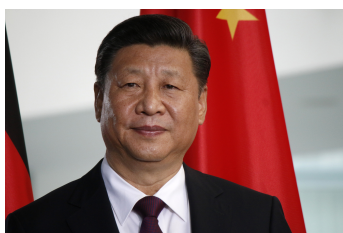
#### Asia week ahead: Spotlight on Indonesia's central bank

Expect Indonesia's central bank to hike rates by another 25bp to stem the rupiah's weakness. The other highlights include manufacturing releases...



#### China retaliation coming

A state-run newspaper in China has published an editorial saying the country could retaliate against US stocks if the trade war escalates



#### China policies to cushion potential trade war impact

China has started pre-emptive measures to buffer the negative impacts of rising trade and investment tensions between China and the US



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Opinion | 22 June 2018

## Hike to cut?

The Bank of England Monetary Policy Committee (BoE MPC) has opened the door wide open to an August rate hike. But given the uncertain Brexit outlook, does this make sense?



Source: iStockphoto

### Poised to hike - Bank of England Monetary policy Committee

With Bank of England chief economist Andy Haldane joining Ian McCafferty and Michael Saunders in voting for an immediate rate hike, the Bank of England seems to be giving itself every opportunity for an August hike. We've got further detail on this [in the attached note](#). But the underlying story remains this: The UK economy is currently fairly spotty, and it is really only wage inflation that provides any support for tighter policy. Meanwhile, the outlook for the economy has rarely seemed more uncertain, given the lack of progress on Brexit negotiations. So why hike now?

There are a couple of suggestions, none of which to my thinking are really satisfactory.

1. A hike now will give the BoE more room to manoeuvre if the economy really does not pick up, or the Brexit negotiations lead to the UK crashing out of the EU without a deal.
2. This is just another attempt to talk up the pound, and thereby, talk inflation down.

The problem with argument one is that it basically says that it makes sense for a central bank to hike rates so it can cut them. Say that aloud a few times to see how idiotic it sounds. That is as good a test for the sense of this idea as you can get, I think. That said, I do have some passing sympathy with the notion that it is not the level of rates that is important at very low levels, but the direction of change. So as a one-off, perhaps we can let this pass.

Argument two is not as stupid as it sounds, and there have been a number of occasions where

Governor Mark Carney has talked a hawkish story, only to back down. Is he really flip-flopping, as some of his critics aver? Or is this successful jawboning of the economy? If you can credibly talk up the currency to crimp imported inflation, then you never have to deliver in terms of actual policy. Maybe...but we are getting close to the point where the market will want the BoE to either 'put up or shut up'. This strategy does not have an infinite shelf-life.

6-3

No, not the England World cup score

MPC votes for rates on hold vs votes against.

Higher than expected

## Japan CPI 0.7% - OK unless you take the target seriously (no-one does)

May headline and ex-food and energy CPI in Japan came in at 0.7%YoY, (0.3%YoY for ex-fresh food and energy), which was a little higher than expected, but still so far below the 2% inflation target that the Bank of Japan is apparently striving to achieve, that it makes no difference.

That is unless you accept that 2% is the wrong number...the wrong target.

If the BoJ were aiming for a more credible and achievable 1%, then you would say, well done, almost there, and start looking for indications of an exit strategy from QQE. Personally, I think most central banks are targeting the wrong (too high) inflation target, and this is delivering excessively cheap credit driving down yields and driving down productivity growth. It also runs the risk of concentrating market risk - a problem if we ever see a rush to unwind positions.

Our base case is that the BoJ is still waiting for some more action from the ECB, under the cover of which it will try to extricate itself from its own qualitative and quantitative easing programme (QQE). But whilst the ECB has provided some more signals recently, it remains in low gear for any change, and this will keep the BoJ sidelined through the rest of this year at least.

## Day ahead - desk tidying - long lunch, home early

Its super quiet in terms of the data calendar today, with a motley bunch of second/third tier releases in the Asia-Pacific region. Watch out for some further commentary on trade, as the US' Wilbur Ross has been quite critical (some would say rude) about Chinese claims of openness. A war of words may ensue, which won't help thoughts of a trade deal, though there is also chatter of last-ditch attempts to come up with something on both sides of the Pacific. In my opinion, I don't think the US wants a trade deal. If I'm right, then tariffs will beget more tariffs and the global order will get a significant shake-up. Buckle up, helmets on.

Preliminary June PMI data from Europe provide the main G-7 interest today - this will probably soften a bit further (Composite PMI for May expected 53.9 from 54.1). That is a substantial slowdown from 58.8 in January but would indicate some bottoming out at a still reasonable level, and leave ECB taper plans intact (to the relief of the BoJ no doubt).

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# Asia week ahead: Spotlight on Indonesia's central bank

Expect Indonesia's central bank to hike rates by another 25bp to stem the rupiah's weakness. The other highlights include manufacturing releases for May from Korea, Singapore, Taiwan and Thailand



5%

ING forecast of BI policy rate

Up by 25 basis points

## ➔ Bank Indonesia to tighten policy ... again

Bank Indonesia's monetary policy meeting is the key highlight of the week ahead.

Financial stability will be the main focus of the meeting as an escalation of global trade tensions keep domestic financial assets and the rupiah (IDR) under a weakening pressure. Following its Philippine counterpart, BI moved to tighten policy in May and raised interest rates by a total 50bp, two 25bp moves taking the main policy rate to 4.75%. Alas, the hikes did little to stem the

currency weakness in both countries. Philippine's central bank raised rates by another 25bp this week, and we expect Bank Indonesia to follow suit next week.

On a positive note, however, Indonesia's trade data for May due next week is likely to show a swing in the trade balance to surplus from a deficit. A swing to about \$1bn surplus in May from \$1.6bn deficit in the previous month is what we anticipate, should bring some life into the currency.

**52.3** China manufacturing PMI  
ING forecast

### ➔ Trade tension weighs on China's manufacturing

The soft data on China manufacturing PMI for June may not capture the impact of trade war just yet. At least that's what appears from our house forecast of a rise in PMI to 52.3 in June from 51.9 in May. However, we aren't ruling out a downside risk.

The manufacturing PMI has been bouncing around 51 over the past two years, the level associated with about 6% year on year industrial production growth. Any dent in trading from tariffs will also dent manufacturing.

The good news is that China has started pre-emptive [measures to cushion potential trade war impact](#).

### ➔ So far so good, exports still supporting manufacturing elsewhere

The industrial production releases for May from Korea, Singapore, Taiwan, and Thailand should benefit from firmer exports from these countries. Apart from Thailand, the growth of exports from other economies reporting industrial production data accelerated in May, led by firmer electronics exports.

Industrial production growth closely tracks real GDP growth in most Asian economies, and the combined April-May data will offer a good insight into GDP growth in the current quarter.

## Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
<b>Monday 25 June</b>					
Indonesia	0500	May Imports (YoY%)	11.4	-	34.68
	0500	May Exports (YoY%)	14.5	-	9.01
	0500	May Trade balance (US\$mn)	1034	-	-1629.3
Philippines	-	May Budget balance (PHP bn)	-	-	46.3
Singapore	0600	May CPI (YoY%)	0.3	-	0.1
	0600	May CPI core (YoY%)	1.5	-	1.3
Taiwan	0900	May Industrial production (YoY%)	6.5	5.8	8.53
	0920	May Money supply (M2) (YoY%)	3.1	-	3.59
South Korea	2200	Jun BOK Consumer Sentiment Index	-	-	107.9
<b>Tuesday 26 June</b>					
Hong Kong	0930	May Exports (YoY%)	8.5	-	8.1
	0930	May Imports (YoY%)	11.3	-	11.1
	0930	May Trade balance (HK\$ bn)	-48.2	-	-46.9
Singapore	0600	May Industrial production (MoM/YoY%)	2.0/13.0	-/-	0.2/9.1
<b>Wednesday 27 June</b>					
China	0230	May Industrial profits (YTD, YoY%)	17	-	21.9
<b>Thursday 28 June</b>					
Indonesia	-	BI policy decision (7-day reverse repo, %)	5	-	4.75
Thailand	-	May Manufacturing index (YoY%)	3.1	-	4
South Korea	2200	Jul BOK Business Survey Index, mfg	-	-	80
	2200	Jul BOK Business Survey Index, non-mfg	-	-	82
<b>Friday 29 June</b>					
India	1200	May Fiscal deficit (INR crore)	-	-	151967
South Korea	0000	May Industrial production (MoM/YoY%)	2.0/1.9	-/-	3.4/0.9
<b>Saturday 30 June</b>					
China	0900	Jun Official manufacturing PMI	52.3	-	51.9
	0900	Jun Official non-manufacturing PMI	55	-	54.9

Source: ING, Bloomberg

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Snap | 21 June 2018

## China retaliation coming

A state-run newspaper in China has published an editorial saying the country could retaliate against US stocks if the trade war escalates



Source: Shutterstock

### Retaliation directly on US companies

Even China couldn't match the US's threat of imposing as much as \$450 billion worth of tariffs on Chinese imports, as the US only exports about \$130 billion to China. In recent days, China said it could retaliate "qualitatively". Now, we're clear what "qualitative" means; China could target US stocks.

The [official newspaper's editorial](#) emphasised that China could hurt US companies listed on the Dow Jones industrial average if the trade war were to escalate. The editorial wrote, "The 30 companies that make up the Dow Jones average may be some of the first to bear the brunt of China's countermeasures".

### How to "hurt US stocks"?

We believe that China may impose administrative hurdles on US companies operating in China, which would then have an impact on stock prices. The practice could be similar to the administrative measures on South Korea's Lotte Department Stores in China, which involve an examination of goods before they can be shelved.

We don't expect China to short stocks in financial markets because affecting business operations of US companies operating in China is more controllable by the Chinese government than doing this



through the stock market.

## Would this end the trade war?

No, we don't expect this would end the trade dispute. Quite the reverse, we expect some tough talk between the US and China to follow, though this could be effective in delaying the process of a trade war.

For the time being, US companies could lobby the US government intensively and extensively to avoid a further rise in trade tensions. As the editorial mentioned, the risk of a fall in the Dow Jones goes up with these measures, potentially hurting retirement funds and therefore prompting more lobbying on the US government.

## China's other weapon

China's other weapon could be to sell US Treasuries. This isn't a remote possibility if the US administration insists on imposing more tariffs on China.

## Impact on markets, production and trade, globally

Given that the supply chains of US companies are likely to be sourced globally, the impact is not limited to the stock market. If China were to affect business operations of US companies operating in China, we would expect production, sales, and trade to be affected globally, not just in China and the US. Investment decisions by these US companies and their supply chains will also be disturbed. World economic growth will slow, not just China and US.

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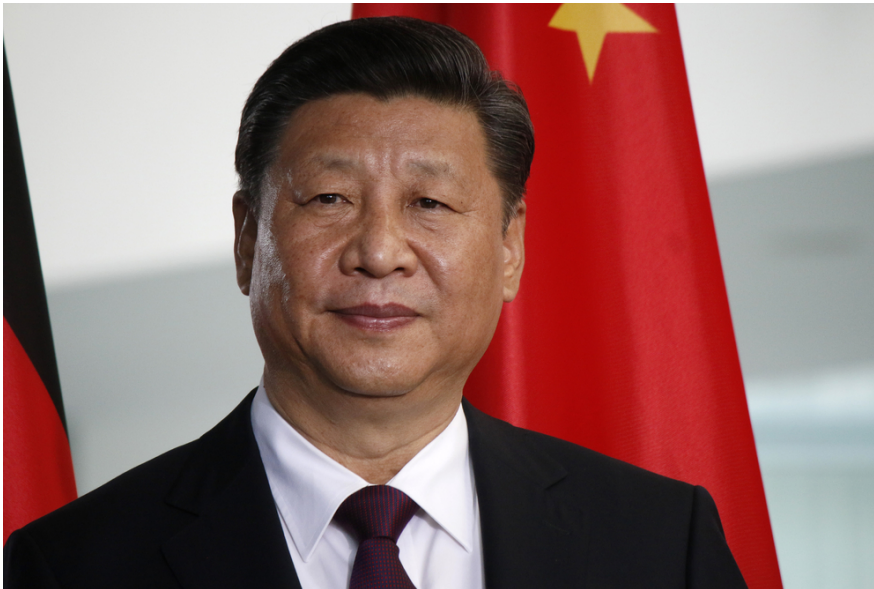
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Article | 21 June 2018

## China policies to cushion potential trade war impact

China has started pre-emptive measures to buffer the negative impacts of rising trade and investment tensions between China and the US



Source: Shutterstock

### China adopts measures to soften the impact of a potential trade war

China will not passively sit back if a trade war is unleashed. Indeed, it is already implementing policies to temper any effect. We look at some of the more important ones below.

#### Fiscal support on high-tech sector

Government expenditures on science and technology in China rose by 18.5% year-on-year, year-to-date in May, considerably faster than overall government spending growth of 8.1%.

This is a direct response to sanctions on a Chinese company operating in semiconductor and smartphone operating systems. China intends to invest in its own advanced technologies.

We expect fiscal spending in this sector to increase and be matched by rising funding from private companies to achieve President Xi Jinping's objective of a bigger domestic advanced technology

sector.

## Monetary policies to assist SMEs

SMEs will likely be hit hard by a trade-war. Consequently, the government has established an SME Working Committee to help small companies navigate through any trade storm.

Even before we see any tangible evidence of the damage the trade war is having, China's strategy is to put in place policies designed to cushion any negative trade spillovers.

At its meeting on 20 June, the central government emphasised lowering the interest costs of SMEs, and including some SME loans as collateral for the Medium Lending Facility (MLF), a loan taken by banks from the central bank.

The meeting also mentioned that targeted cuts in the reserve requirement ratio could help small and medium-sized enterprises.

We expect the central bank to implement the targeted RRR cut in July. And like the previous cut, any cash released could be used to repay high-cost MLF funds borrowed from the central bank. This could avoid cash released by RRR leaking into asset markets.

The reason we don't expect targeted RRR cuts in June is that it might confuse the market into thinking that the RRR cut was a measure to relieve quarter-end liquidity tightness. However, this is a longer-term policy tool, which should not be interpreted in this way.

### Would a trade war stop reforms in China?

It really looks as if the central bank (PBoC) is loosening monetary policy to prepare for an escalating trade war and investment tension. But, at the same time, the PBoC is managing liquidity quite tightly to achieve financial deleveraging reform.

Could a trade war slow down or even stop the PBoC's financial deleveraging reform?

We don't believe that, at the current stage, the PBoC will slow its efforts to clamp down on shadow banking activity - the focus of financial deleveraging reform. But if a trade war escalates and weighs on investment, then the central bank may have to step back on reforms and focus instead on supporting the economy by loosening monetary policy.

## Policies to ease inflows reducing yuan impact on outflows

During this period of escalating protectionism and rising investment tension between China and the US, the market usually reacts to bad news by causing the US dollar to appreciate against other major currencies. This would also tend to weaken the yuan against the dollar.

If the yuan maintains its weakening trend, this could lead to capital outflows. To avoid a repeat of the quick loss of foreign exchange reserves that occurred between mid-2014 and 2016, the central government has made it easier for foreign companies to do businesses in China.

For example, commencing from 1 July, foreign direct investment into China will follow a negative

list control. So business areas not in the negative list could invest in China without restrictions.

Another example is the recent relaxation of QFII and RQFII outflow restrictions, which is to ease worries of foreign investors so that China can attract more inflows ([you can read the note here](#)).

We believe more measures to open up the market and attract inflows will be unveiled in the near future. This is important to offset outflows induced by an expected weaker yuan. Without more measures to attract inflows, the central bank could easily become trapped by a fall in foreign exchange reserves and may be forced to strengthen the yuan even if it's not in line with economic conditions.

We expect USDCNY to go to 6.60 by end of 2018 ([our note on USDCNY forecast revision is here](#)).

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