

Good MornING Asia - 23 March 2018

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Trade crusade

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New tariffs on China

Having given so many exemptions to the steel and aluminium tariffs that it was beginning to look like a China tariff after all, the Trump administration has announced a further \$50bn of tariffs on Chinese goods. We don't know what these are yet but should have a better idea within 15 days, when US Trade Representative, Robert Lighthizer, will provide a list. What is being reported currently is that it will be aimed at aerospace, information and communication, machinery - basically technology on which the US accuses China of having infringed intellectual property rights (IPR).

Without taking sides on the IPR dispute, we don't believe tariffs are likely to deliver a positive global outcome, and the 3% decline in US stocks overnight suggests that markets agree.

If the tariffs go ahead as planned, then we believe China will retaliate. It is impossible to imagine that they cannot. And then we expect the US to retaliate further etc. This can turn ugly on a global scale very quickly. And synchronous global growth or not, markets are right to be pricing in a more subdued outlook. The JPY is one barometer of global risk concerns and looks strong today.

Although this trade dispute is largely a US / China one, it has the potential to embroil much of the Asian region. Although trade growth figures are generally positive, we have been concerned for some time that they are narrowly focussed, with much of the gains coming from one source alone

- semiconductors. Even here, trade flows appear to have topped out for some countries. Asian export growth is not so strong that they can just shrug off any spillover effects from tariffs on China. We are concerned.

Japanese inflation - there still isn't any

Yes, National CPI inflation in Japan has risen to 1.5%, and the core rate has risen to 1.0%, but before you rush to congratulate BoJ Governor, Kuroda on getting halfway to his inflation target, stop for a brief moment to note that the broader core, which excludes all food and energy prices, is only 0.3%YoY. LNG prices across Asia are rising as China seeks to battle emissions and pollution and use cleaner gas (instead of coal) to fire its power plants. With little other option following its nuclear disasters, Japan is in a seller's market for LNG, having to accept the world price, whatever that is with little option to substitute into other fuels. This is not "good" inflation driven by demand. This is a negative supply shock. Nothing for the BoJ to cheer here.

Day ahead

Inflation in Singapore is also conspicuous by its absence, though the core figures continue to run well above the headline, mainly because these strip out the effects of the weak property market. The effects of this are beginning to ease off, so we should begin to see headline inflation nudging ever so slightly higher, perhaps even with today's release of figures for February. Core prices might also rise a little. With the MAS decision on policy stance next month, this helps the case for tighter policy, which has been our low-conviction call since October last year. But a lot of other data has been very mixed for Singapore, and rising inflation does not make us that much more comfortable with our forecast.

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Asia week ahead: Manufacturing data crowds calendar

The global trade war threatens Asia's export-driven growth, which so far has been on a firm footing and we expect next week's manufacturing data to confirm that



Source: Shutterstock

Global trade war- a threat to Asia's export-driven growth

The Asian markets will remain under pressure from the global trade war.

Media reports as of writing this article suggest an intensified trade war with the US set to slap \$50bn worth of tariffs targeting hundreds of Chinese export goods. Beijing has so far responded with a conciliatory approach by further opening up the economy for foreign competition, but retaliatory measures can't be ruled out.

An intensified trade war will be a threat to Asia's export-driven growth, but for now, the manufacturing data from the region is likely to show that growth has so far remained strong this year.

51.5 China manufacturing PMI in March
ING forecast

China - Manufacturing points to steady GDP growth

China's manufacturing Purchasing Managers' Index (PMI) data for March will be watched closely.

Recovery from the Lunar New Year-related slack in activity underlies ING's forecast of a rise in PMI to 51.5 in March from 50.3 in February.

This is no big deal because the PMI has been bouncing around the 51 level since mid-2011, but markets are still sensitive to the soft data. The hard data showed an acceleration in manufacturing growth; industrial production growth of 7.2% year-on-year in the first two months of 2018 was up from 6.6% average in the fourth quarter of 2017.

This leads us to forecast steady GDP growth in 1Q18 around the 6.8% YoY pace of 4Q17, contrary to the consensus of a slowdown to 6.6%.

Singapore - Should the MAS tighten or not?

February industrial production data is due from Korea, Singapore and Thailand.

Singapore should be the most significant as weak non-oil domestic exports in the first two months of the year undermine the view of the Monetary Authority of Singapore (MAS) moving to tightening in April. As of now, the consensus is tilted toward tightening despite the dismal NODX in February. However, manufacturing data could nudge the bias towards an on-hold MAS policy.

Thailand - BoT policy, steady as it goes

The growth of exports from Korea and Thailand along with manufacturing growth accelerated as we began 2018. We think the markets will rather focus on the forward-looking Korean activity data on consumer and business confidence indicators.

In Thailand, better activity data could provide a further lift to the Bank of Thailand's growth optimism on March 28. But we are still unable to find strong reasons to change our view of no change to the BoT policy throughout 2018.

Headline economic growth has improved, but underlying fundamentals continue to be dogged by weak domestic spending that's also evident in perennial low inflation.

India - Headwinds to INR appreciation

In India, budget figures for February will be under scrutiny to see the extent of the deficit overshoot in FY17-18 (April-March).

In the first ten months of the current fiscal year, the deficit at INR 6.8tr, was 20% wider on the year, imparting upside risk to the government's revised forecast of INR 5.9tr or 3.6% of GDP fiscal deficit for the full-year. We expect fiscal slippages to remain among main headwinds for the INR appreciation this year. Other headwinds will be high inflation and widening external trade deficit.

Asian Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Friday 23 March					
Singapore	0500	Feb CPI (YoY%)	0.6	0.4	0
	0500	Feb CPI core (YoY%)	1.6	1.6	1.4
Taiwan	0800	Feb Industrial production (YoY%)	3	1.7	10.86
	0820	Feb Money supply (M2) (YoY%)	3.5	-	3.42
Monday 26 March					
Singapore	0600	Feb Industrial production (MoM/YoY% SA)	-8.4/1	-11.1/1	6.7/17.9
South Korea	2200	Mar BOK Consumer Sentiment Index	108.5	-	108.2
Tuesday 27 March					
Hong Kong	0815	Feb Exports (YoY%)	11	-	18.1
	0815	Feb Imports (YoY%)	10.7	-	23.8
	0815	Feb Trade balance (HK\$ bn)	-59.9	-	-31.9
Wednesday 28 March					
China	0200	People's Bank of China Deputy Governor Pan Gongsheng speaks			
India	1200	Feb Fiscal deficit (INR crore)	41000	-	55610
Thailand	0805	Benchmark Interest Rate	1.5	-	1.5
South Korea	0000	4Q F GDP (QoQ/YoY%)	-0.2/3	-/-	-0.2/3
	2200	Apr BOK Business Survey Index, mfg	83	-	82
	2200	Apr BOK Business Survey Index, non-mfg	80.7	-	82
Thursday 29 March					
Thailand	-	Feb Manufacturing index (YoY%)	4.3	-	3.4
Friday 30 March					
South Korea	0000	Feb Industrial production (MoM/YoY%)	-0.5/-	-/-	0.98/4.6

Source: ING, Bloomberg

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PBoC follows the Fed by 5 basis points, what's next

The PBoC raised the 7D open market rate by 5 basis points this morning. This has been expected. Would it extend it to other interest rate tools like last time? How would trade tensions affect interest rates and the exchange rate path?



Source: istock

Demonstrating policy continuity

As expected, the People's Bank of China (PBoC) raised the 7D reverse repo open market rate today by 5 basis points from 2.50% to 2.55%. [We wrote on 21st March that this is our view. This shows that there is policy continuity in the central bank in terms of interest rate policy.](#)

The objective of raising 5 basis points is to stabilise China-US short term interest rate as raising 25 basis points would be overdone as the central bank has tightened liquidity through daily open market operations. Short-term rates have already gone up. That explains why PBoC raised rate by 5 basis points.

However, we expect more than that.

We are looking at other short-term interest rates to rise 5 basis points as well, so that the interbank rate curve would move up in parallel by 5 basis points. The interest rate tools that we expect to

move up by 5 basis points are the Medium Lending Facilities (MLF) and the Short-term Liquidity Operation (SLO).

If these do not move up, then the short-term interest rate curve would be flattening, which we think is not the objective of the central bank.

For the rest of the year, PBoC would still follow the Fed by 5 basis points as financial deleveraging would mean tighter open market operations and would continue to push up short end rates in China.

Future interest path depends on risks from trade tension

How China reacts to US trade protection actions would affect not only trade but also US companies operating in China.

Overall, trade protection actions affect the supply chain of US and China goods as well as consumer and production prices of the goods. This means the impact is not just limited to the two economies, but to the rest of the world as well.

Goods produced in China ship to many countries, and companies in China could look for markets outside the US to reduce the risk of trade tension. We believe that the Belt and Road initiative may help China exporters to diversify, but results are still to be seen.

This explains why we are not particularly concerned the yuan exchange rate would be affected. But this would affect the interest rate path if economic growth is largely impacted by trade protection actions.

All in all, PBoC shows policy continuity, and we expect future Fed rate hikes to be followed by 5 basis points hikes by the Chinese central banks to avoid overdoing the tightening, which is already in every day's open market operations. If there is anything that would slow down interest rate hikes that would be increasing negative impact on economic growth from trade tension.

The dollar has been largely weak when there has been trade protection actions from the US government, and the trade tensions from the US on China is escalating, so we expect a stronger yuan against the dollar. This is in line with our yuan forecasts. We keep our view that USD/CNY could reach 6.1 by the end of 2018.

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Taiwan central bank stays put at 1.375%

Taiwan has kept rates on hold for seven consecutive quarters but the economy now faces risk from trade protectionism as it sits between the supply chain of goods traded between China and the US



Source: Shutterstock

Rates on hold since July 2016

As expected, Taiwan's central bank kept the interest rate on hold at 1.375%, which has remained unchanged since July 2016.

Taiwan's new central bank governor, Yang Chin-long said the Bank's main task is to keep inflation stable rather than solve the structural problems of the economy.

Since 2016, inflation has fluctuated between 0% to around 2%, and as we forecast it to move between 1% to 1.5% in 2018, we expect the central bank to continue to stay put.

But risks from trade tension are rising

With the help of the US on tourism, and the electronics sector doing well the economy is in good shape, and we expect it to grow at 3.2% in 2018, which is above the consensus of 2.7%. But the risks are rising as tensions between the US and China escalate over trade.

Nowadays, the supply chain is complex, and Taiwan falls between the supply chain of electronic goods traded between China and the US. Increasing trade protectionism would ultimately hurt

Taiwan's trade volume and profits.

If trade protection actions become visibly negative for Taiwan's economy, then we may need to revise our GDP forecast and the policy rate.

Expect the TWD to appreciate along the soft USD

As trade tensions escalate, the US dollar would be weaker against major currencies. We expect USD/TWD to reach 28.00 by the end of the year and so far our forecast is on track. The spot is 29.149 against our first quarter forecast of 29.00.

Again, if US trade tensions intensify further, we may need to revise USD/TWD downward. But for now, we keep them unchanged.

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