

Good MornING Asia - 24 May 2019

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In this bundle



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By Robert Carnell



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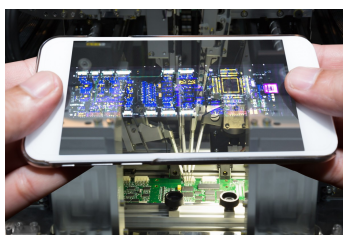
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Source: Shutterstock

Little things...big results

Yesterday was not a cataclysmic day for US data. The FOMC minutes were neutral and largely absorbed by markets without murmur. The manufacturing (and service sector) PMI data were down by 2 big figures. This was unexpected, but most analysts still focus on the old ISM indices rather than these new-fangled PMIs, so movements like this can usually be ignored. New home sales were weak. -6.9% Mom isn't good, but they rose 8.1% (revised up) the previous month, so actual home sales were within a whisker of where they were expected to be. In short, we can't blame Macro for this.

Stocks, on the other hand, look quite bad, so this is more likely a portfolio rebalancing story in the main. All main US indices were down more than 1%. The Tech indices fared worse. Europe largely did worse too. Asia will likely follow suit this morning by plunging into the red. India may briefly buck the trend on that following news of PM Modi's conclusive election victory. But that probably won't last.

Despite some more positive words on a possible trade deal from President Trump, most of the newswire headlines on the equity pages point the finger at trade war tensions for the latest drop. If correct, then a meaningful recovery might well require even more comforting sounds on a China

deal, or Chinese tech, which is a related, and equally important factor.

The US Treasury yield dip, and possibly President Trump's more optimistic trade comments have weighed on the USD, with EURUSD ticking up to 1.1183 as of writing. But the USD appreciation trend from January looks still firmly entrenched. Though we might need to see the tone on trade worsen again for 1.11 to be breached on the downside.

India - where next?

Prakash Sakpal has written [on the election victory separately](#), so all I would add is a question. Where do we go now? Most of the election was fought, less on policies, but on personalities. That may win votes, but it doesn't encourage investment. So what is going to happen in India over the next five years? The last five offered only some clues with the big and clunky policies of GST and Demonetisation together with a fairly clear knock to the independence of the Reserve Bank of India.

Goals for this term might well include tackling bad loans and recapitalization of the state-owned banks, reducing the budget deficit, and tackling the current account deficit - not by the current import substitution measures, but by productivity-enhancing structural reforms, and reduction in bureaucracy. These are harder steps to take, don't always deliver quick results, and often make things worse in the short term - awkward when unemployment is already high. Given this, and the looming presence of the political calendar, such measures are only likely to be implemented forcefully if they are implemented soon. The next few months will be important for India watchers.

CNY stable, again

The CNY fixed yesterday below 6.90 again, keeping it virtually flat at this level, and comments from the Central Bank Deputy Governor, Liu Guoqiang suggested that stability was the way forward. That contrasts with Dallas Fed President, Robert Kaplan, who warned that China may use currency depreciation to support economic growth in the face of trade tariffs.

Our take? If the latest tariff measures do weigh heavily on the economy and are not offset by other countervailing policy measures, then you can't rule out some currency depreciation from China, but it's clearly not their preferred option, and they have plenty of other tools at their disposal before they have to resort to that.

Asia Day ahead

About the only release on the Asian calendar today worth a look will be Singapore's April production data. Consensus looks for this to register a slightly less negative year on year figure of -3.7% from -4.8%YoY in March.

This looks to us to be more like a "statistical payback" forecast than a statement about production troughing. In other words, last month was bad, so this month will be a bit better. There isn't much more to it than that. Looking at the data in terms of levels, which can be a lot more instructive, the February, March, April deviations in production are always violent thanks to the Lunar New Year. Last month's year-on-year comparison, as a result, does not contain a lot of genuine signal amidst the substantial noise. Comparing this month's data to that figure is not a whole lot more instructive. Unless there is a substantial deviation from the consensus view, we can probably let

this one pass unremarked.

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ASEAN Morning Bytes

General market tone: Risk-off. Trade tensions are seen to weigh on market sentiment again on Friday with Fed officials coy about moving.



EM Space: Beijing and Washington continue to trade barbs and possibly tariffs.

- **General Asia:** Sentiment overnight remained negative with Beijing and Washington trading barbs about the ongoing trade spat. Fed officials remained non-committal to acting on rates in either fashion with key officials preaching caution amidst the trade debacle. Oil prices took yet another tumble, this time on global growth fears.
- **Singapore:** April industrial production data is due. Yet another weak export reading in April, down 10% YoY, sustain the negative trend in manufacturing and GDP growth. Yesterday's CPI data was in line with the consensus estimate of 0.8% headline and 1.3% core inflation (vs. 0.6% and 1.4% respectively in March). Slowing growth and core inflation support a view of some easing in the MAS (Monetary Authority of Singapore) policy in October with a reduction in the SGD nominal effective exchange rate appreciation path in October.
- **Malaysia:** April CPI data is due today. The administered fuel price cut in January was partly reversed in March pushing inflation back into the positive territory after two consecutive months of negative. The base year effect could nudge it up in line with the consensus forecast to 0.4% YoY in April from 0.2% in March, though the risk remains tilted on the downside from the weakness of consumer spending seen in latest GDP figures.
- **Philippines:** The Bangko Sentral ng Pilipinas (BSP) reduced reserve requirements (RRR) for

smaller banks by 2% in phases. Similar to the cut in commercial banks in terms of schedule, the move would release roughly PHP 16bn into the system after all the reductions are carried out. The move shows dovish leaning of the current Governor who is expected to cut both policy rates and RRR further in 2019.

What to look out for: Trade developments

- Malaysia CPI and GIR (24 May)
- Singapore industrial production (24 May)
- Fed Kaplan (24 May)
- Taiwan GDP (24 May)

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Asia week ahead: Bank of Korea - will it, or won't it?

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Source: Shutterstock

➔ China: Trade war impact is coming through

The week kicks off with China's industrial profits for April. Keeping in line with the trend of slowing exports and production, industrial profits have been shrinking. As such, surprisingly strong 13.9% annual industrial profit growth in March appears to be an aberration from a weak trend, while the cumulative profits in the first three months were still down 3.3% from a year ago. Both exports and industrial production growth slowed sharply in April, pushing the profits growth back to negative territory.

China's economic downtrend will undoubtedly exacerbate further with the escalation of the trade tensions this month. The upcoming data on purchasing manager index for manufacturing and non-manufacturing sectors will shed light on this.

➔ Korea: Mixed market signals on BoK policy

The market isn't pricing a Bank of Korea rate cut next week and neither is the latest Bloomberg poll suggesting anything of sorts. But the Korean Won's (KRW) recent underperformance, with close to 5% depreciation against US dollar since the central bank's last meeting on 18 April, seems to suggest that a rate cut is just around the corner.

What this economy needs is some fiscal support, some economic reforms, and the end of the global tech slump. The BoK can't perform miracles. – Rob Carnell, ING Asia chief economist

We believe the poor trade environment and ongoing tech slump will continue to depress Korea's growth, making it difficult for the central bank to defy easing. The 1.8% YoY GDP growth in 1Q19 was the lowest since the global financial crisis. This combined with negligible inflation, running well below 1% currently, underpins our outlier view of a 25bp BoK rate cut.

➔ India: The best of election-related market rally is behind

The odds of prime minister Narendra Modi winning the elections in India cheered the markets this week. Indeed, his Bharatiya Janata Party is leading with an absolute majority in the vote count, still going on at the time of writing this piece, and it looks set to form the government with existing coalition partners. We believe the best of election rally is behind and the economy will be back to re-assert its influence on the markets - almost negatively amid prevailing risk-off sentiments globally.

India's economic slowdown gained speed in the final quarter of the financial year 2018-19 ended in March, for which GDP data is due next week (31 May). If true, our forecast of a slowdown of growth to 6.0% from 6.6% in the previous quarter will make it the slowest growth quarter in two years. While this will validate the Reserve Bank of India's two rate cuts this year, we expect the potentially higher inflation will keep it from easing again at the next meeting in early June.

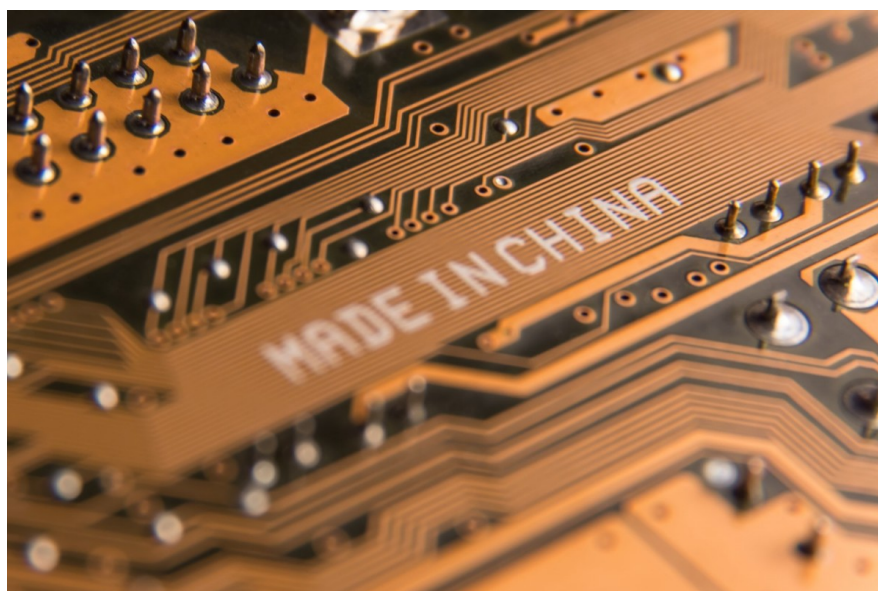
Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
Monday 27 May					
China	0230	Apr Industrial Profits (YoY%, YTD)	-3.3	-	13.9
Hong Kong	0930	Apr Exports (YoY%)	-1.5	-	-1.2
	0930	Apr Imports (YoY%)	-0.5	-	-0.1
	0930	Apr Trade Balance (HK\$ bn)	-50.0	-	-59.2
South Korea	2200	May BOK Consumer Sentiment Index	102.4	-	101.6
Tuesday 28 May					
South Korea	2200	Jun BOK Business Survey Index, Mfg	76.0	-	77.0
	2200	Jun BOK Business Survey Index, Non-mfg	76.0	-	77.0
Thursday 30 May					
Thailand	-	Apr Manufacturing Index (YoY%)	-1.5	-	-2.5
Friday 31 May					
China	0200	May Manufacturing PMI	50.2	-	50.1
	0200	May Non-manufacturing PMI	50.1	-	54.3
India	1300	1Q GDP (Q) (YoY%)	6.0	-	6.6
	1300	2019 GDP Annual (YoY%)	7.0	-	7.0
-	-	Mar Fiscal Deficit (INR crore)	-	-	80654.0
Hong Kong	0930	Apr Retail sales Value (YoY%)	-0.5	-	-0.2
	0930	Apr Retail sales Volume (YoY%)	-1.2	-	-0.8
South Korea	0000	Apr Industrial Production (MoM, SA/YoY%)	1.0/-2.8	-/-	1.4/-2.8
	-	7-Day Repo Rate	1.5	-	1.75
Thailand	0730	Apr Current Account Balance (US\$bn)	2.2	-	6.1

Source: ING, Bloomberg, *GMT

China's response to US tech war could be aggressive

Japan and Europe seem to be standing with the US to prevent the rise of Chinese technology. But China could retaliate in ways that could prove very damaging



Source: Shutterstock

US adds allies to curb China's tech rise

The United States seems to have persuaded Japan and some European countries not to use Chinese technology products or sell tech to Chinese companies. This is reflected in the asset market, where sentiment towards the Chinese tech industry is negative.

The purpose of these actions is to prevent China from becoming a world tech giant in the short term, but China isn't wholly unprepared for this.

China's long-term plan to deal with tech warfare

1. It's clear that China will attempt to minimise its reliance on foreign countries to provide critical hardware and software. Facing severe headwinds from the US, China will aim to develop as many technologies as possible domestically. And with more resources being ploughed into the sector, it's possible that China's technology will become more advanced than that of the US and its allies in the future, especially in 5G and the military.

2. China is also expected to explore the “Belt and Road” market to export its 5G infrastructure technology and related equipment. In the short term, these markets may not be able to replace the markets of Western economies, but they may become fairly large, and China has a first-mover advantage to open them up.

It is more difficult to end a technology war than a bilateral trade war. Technology warfare involves companies from more countries, each with unique technology. This makes the process a long and difficult one for China, which is why President Xi called it the "Long March".

China's short term reaction could be aggressive

The Chinese government may be patient during this "Long March" but only up to a point. Eventually, it could react more aggressively to stop the US from piling pressure on Chinese companies. Here are the possible responses from China:

1. An export ban on rare earth elements to the US. During 2014-2017, the US received [80% of its rare earth imports from China](#). Rare earth metals and alloys are used in many electronic goods and parts and a ban would slow down US manufacturing activities, which the current US administration wants to promote. An export ban could be temporary in order to give the US the option to return to the negotiating table.
2. China holds fewer US Treasuries. A recent fall in US Treasury holdings is likely the result of a decline in China's FX reserves, rather than a direct response to the trade war. China can only buy more US Treasuries if its foreign reserves rise again when the trade war tension eases.
3. Additional tax cuts. The Chinese government has already announced extra tax cuts for integrated circuit design and software development companies from 25% to 0% for the first two years and thereafter 12.5% for three years. These tax cuts are on top of the value-added tax cuts. We see this as a short-term solution for the "Long March" plan.

The yuan is not a weapon in the short or long term

1. An exporter losing export orders because of higher tariffs, or because there are too few business opportunities in the US and elsewhere, wouldn't benefit from a depreciation of the yuan.
2. If the USD/CNY depreciates to cross the key 7.0 mark, it could create disruption in the A-share stock market, as USD/CNY and the A-share market move together. The experience of 2015, which saw a sharp depreciation of the yuan and a collapse of the A-share market will be avoided by the central bank.
3. Allowing the yuan to cross 7.0 could also give the US an excuse to label China as a currency manipulator, though the chance is small as China's current account is almost balanced (1.05% of GDP), which does not fulfil one of the currency manipulator requirements of having a large currency account surplus.
4. Over the past four days (from 20 May to 23 May), the fixing of USD/CNY has barely changed (around 6.8990). This signals that the People's Bank of China has tried to stabilise the onshore yuan via the daily fixing. And the Chinese government is going to raise more yuan funds from offshore markets, which is a support for the offshore yuan exchange rate.

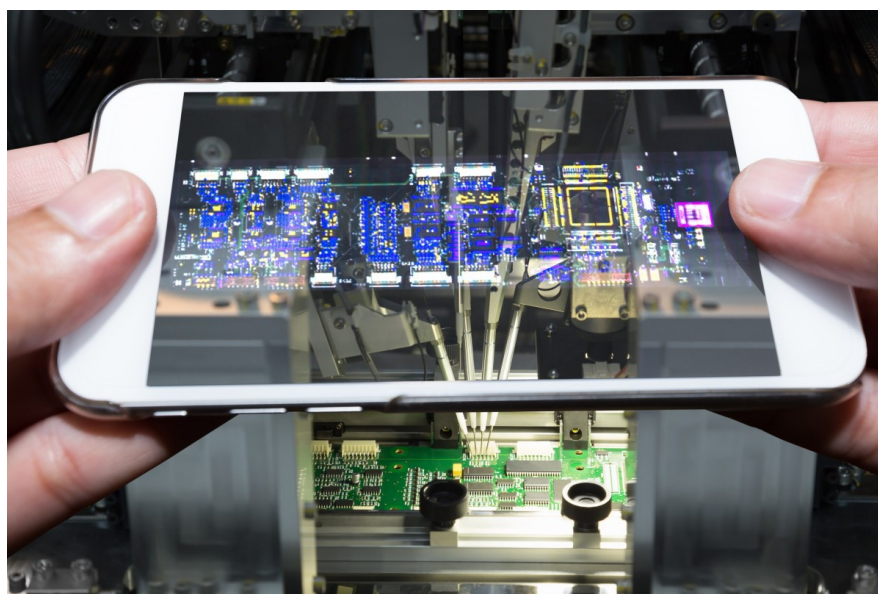
Impact on GDP

It is still too soon to estimate the damage that a technology war could inflict on China's GDP, as this is still at an early stage.

But we believe that the Chinese government will keep using fiscal stimulus and liquidity easing measures to offset any negative impacts. So keeping GDP growth at or above 6.0% in 2019 should not be an issue unless there are fewer supportive measures than we have expected.

Taiwan's manufacturing rebound could prove to be short-lived

Taiwan's industrial production rebounds to positive territory from almost -10% in March. This positive surprise could prove to be short term because...



Source: Shutterstock

Industrial production surprises on the upside

We are surprised by Taiwan's industrial production bouncing back to positive growth (0.9%YoY) from -9.88%YoY a month ago. It seems this was mostly the result of a big jump in the production of computers/optics category (35.63%YoY) but electronic parts continued to suffer negative growth (-3.27%YoY).

The big jump in production of computers/optics is probably the result of new smartphones that have numerous built-in cameras. We doubt this will carry-on as smart devices cannot continue to increase sales just by adding more cameras. For example, one may upgrade their smartphone to a new model that has six cameras, but after that, there would be very little additional value in upgrading to a phone with nine built-in cameras. Put simply, the creativity or technology value-added from a new smartphone is diminishing before the kick-off of 5G mobile phone networks.

Electronic parts are a better barometer

Electronic parts manufactured by Taiwan are a better barometer for the manufacturing sector as they don't have a strong seasonal element, and are widely used in many electronic products. However, this category has been displaying negative growth since December 2018.

We believe Taiwan's overall manufacturing sector will continue to suffer from low growth or single-digit negative growth throughout 2019 until trade war tensions soften.

We'll continue to monitor Taiwan's GDP

The technology war that Mainland China is facing will hurt the demand for smart devices and therefore electronic parts, and subsequently, add extra pressure to Taiwan's manufacturing sector, and this is likely to become a negative factor for Taiwan's GDP.

We will continue to monitor Taiwan's data to see if we need to revise our GDP forecast downwards from the 1.4%YoY pencilled in for 2Q19.

India: Way forward under Prime Minister Modi

Prime Minister Modi's General Election win puts to rest long-standing political uncertainty for markets. After a strong rally this week,...



Source: Shutterstock

~300

Parliamentary seats for BJP out of 543

A landslide win

Higher than expected

Surprisingly strong voter mandate for Modi

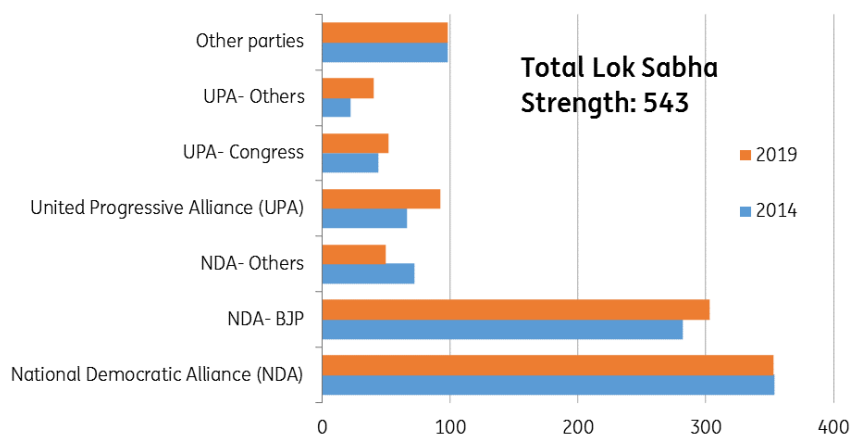
Prime Minister Narendra Modi's Bharatiya Janata Party (BJP) swept back to power, stronger than before. The vote counting yesterday kicked off with a strong, 300-seat lead for the BJP in the 543 seat Lok Sabha (lower house of parliament). The final tally due any time now, is expected to put the BJP ahead with over 300 seats, surpassing the 282-seat majority in the 2014 election and absolutely on course to form the government single-handedly. The result contrasts with the pre-election polls predicting the BJP's return with a significantly thinner margin.

The BJP retained its stronghold in the states – Gujarat, Madhya Pradesh, Rajasthan, Karnataka, and

Chhattisgarh – despite its poor showing in assembly elections there. It gained some ground against dominant local parties in some other states – Assam, though failed to make in-roads in the southern states -- Kerala and Tamil Nadu. The BJP’s main rival, the Congress Party, improved on its 2014 performance slightly but is nowhere close to being a threat to the incumbents.

As things stand, close to the final results, the BJP-led National Democratic Alliance (NDA) looks set to win about 350 seats, the Congress-led United Progressive Alliance about 90, and other parties taking the remaining parliamentary seats.

Yet another landslide victory for BJP



Source: Wikipedia, Election Commission of India, Local media, ING

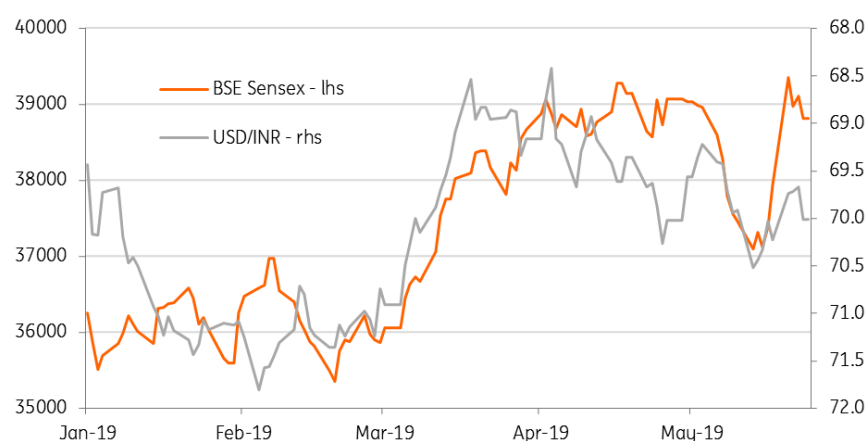
Best of election-related market rally is behind

The odds of Prime Minister Modi winning the elections with an absolute majority cheered markets most of this week. We believe markets had factored in Modi’s win but not yet another landslide surge back to power.

The BJP’s strong lead right at the start of vote counting came as an added boost for markets in the early hours of trading yesterday. However, as the initial euphoria died down, the profit-taking ensued and most gains were pared off towards the end of the trading session. Pretty much the same can be expected about trading today.

We believe the best of the election rally is behind us, and the economy will be back to re-assert its influence on the markets - mainly negatively amid the prevailing risk-off sentiment globally.

Markets likely to be back in profit-taking mode



Source: Bloomberg, ING

Near-term economic reality remains grim

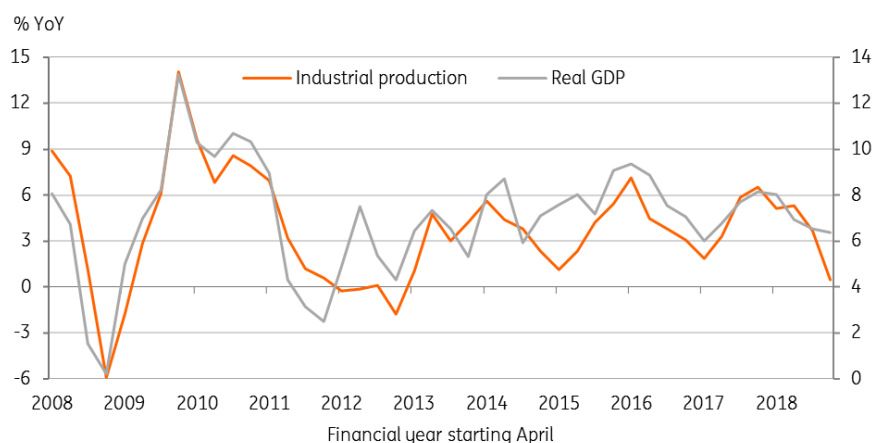
The forthcoming activity data should reinforce that despite its relatively small export base, the Indian economy isn't fully shielded from the potential global slump stemming from the trade war.

Just as in other Asian countries, the economic slowdown here has accelerated in the final quarter of the financial year 2018-19 (ended in March), for which GDP data arrives next week (31 May). If true, our forecast of a slowdown of growth to 6.0% from 6.6% in the previous quarter will make it the slowest quarterly growth in two years. We continue to expect GDP growth staying at this level in the current quarter before the pre-election boost to government spending boosts the economy.

But with growing global headwinds from weak exports and higher oil prices, sustaining growth at or above 7% will be a challenge in the current financial year (ING forecast 6.8% average for the year). Adding to the cyclical economic woes are the structural bottlenecks of persistent twin deficits (the current account and budget deficit) weighing on investor sentiment.

While the cyclical growth slowdown validates the Reserve Bank of India's two rate cuts this year, we believe the risk of potentially higher inflation will keep the central bank from easing again at the next meeting in early June. With this, we consider the RBI easing cycle over for now.

Weak manufacturing, weak GDP



Source: CEIC, ING

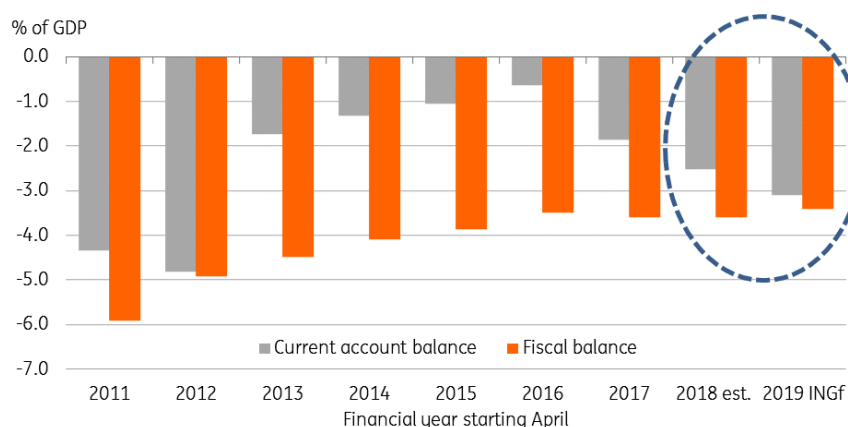
What to expect in Modi's second term

The return of the Modi government assures investors of economic policy continuity in the foreseeable future. Moreover, the strong mandate reinforces voters' confidence in the current policies. That said, this is also a chance for the government to mend discontent instilled in people by the harsh policy steps of demonetization, and alleviate concerns about the prevailing high level of unemployment.

We think the government's focus will continue on sustaining the "Make in India" theme of boosting growth. Further structural reforms towards curbing the currently wide budget and current account deficits and consolidating the beleaguered public sector banks will likely gain prominence. This is important for attracting more foreign investment, especially now that the intensified US-China trade war might accelerate supply chain re-location away from the "conflict zone". Capitalizing this fully will require further labour market reforms, easier land acquisition policies for companies and reduced red-tape.

Such a reform thrust ought to enable the Indian economy to achieve a 7-8% pace of growth. But with the likelihood that the global economic environment will continue to be marred by more and higher barriers to trade, such measures will probably only allow for GDP growth around 7%, while keeping consumer price inflation in check around 4%.

The twin-deficit - a key structural headwind to economy



Source: Bloomberg, CEIC, ING

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