

Good MornING Asia - 26 August 2019

The trading week in Asia is likely to kick off with a significant risk-aversion as the US-China trade tensions move up a notch with both sides preparing for even higher import tariffs.

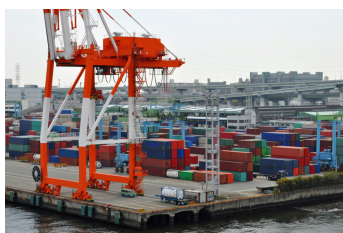
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ASEAN Morning Bytes

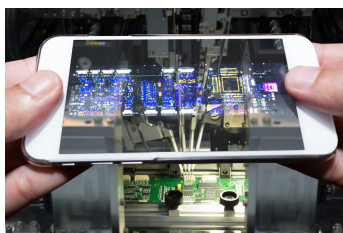
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China

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-5.8%

Consensus on Singapore July
manufacturing growth

YoY

EM Space:: The US-China trade tensions moves up a notch

- **General Asia:** The US-China trade tensions moves up a notch with China announcing new tariffs on \$75 billion of US goods and the latter retaliating with a hike in the existing and proposed new tariff rates by 5%. The next event risk seems to be President Trump invoking emergency trade powers banning US companies from doing business in China. As such the trading week in Asia looks to kick off with a risk-off sentiment.
- **Indonesia:** Bank Indonesia (BI) Governor Perry Warjiyo told media that foreign investment inflows worth IDR 177.9 trillion in the local bonds and stocks so far this year underscored strong investor confidence in the economy amid escalating trade tensions. Meanwhile, the IDR exchange rate was little affected from the central bank's decision to cut the policy interest rates by 25bp at the meeting last week, which undermines the argument of the IDR

volatility being a hurdle for rate cuts. If so, we don't quite rule out more BI rate cuts to support growth in the rest of the year as the central bank may use a huge policy buffer created by aggressive tightening in 2018.

- **Malaysia:** Released last week, the latest Bloomberg survey of the Malaysian economy revealed a steady consensus growth forecast for the current year at 4.5%, though that for 2020 is ticked down to 4.3% from 4.4% and for 2021 to 4.5% from 4.6%. Based on the year-to-date track record we see scope for growth continuing to surpass expectations going forward (see "[How is Malaysia bucking the global slowdown?](#)").
- **Singapore:** July industrial production data today will provide a glimpse of direction GDP growth is heading in the current quarter. The consensus forecast is -5.8% YoY (-1.6% MoM SA) IP growth. Released on Friday, July CPI surprised on the downside with headline inflation of 0.4% YoY and core inflation of 0.8% as against consensus of 0.5% and 1.0% respectively (0.6% and 1.2% in June). The balance of economic risks remains tilted toward growth and this is expected to force the MAS for easier policy at the next semi-annual statement in October.
- **Philippines:** The government budget posted PHP 75.3 billion deficit in July, well under our PHP 115 billion deficit forecast. The PHP 117.9 billion deficit in the first seven months of the year was down from PHP 279.4 billion deficit in the same period of 2018 as the year-to-July revenue grew by 9.6% YoY while spending was little changed from year ago. We expect the authorities to use the increased fiscal leeway to revive GDP growth above 6% in the second half of the year. Local markets are close for the public holiday today.
- **Thailand:** The key economic ministers are due to meet this week (30 August) to discuss steps to attract foreign direct investment as the country positions itself for supply chain relocations opportunities arising out of the trade war. More than that, we also believe the economy needs a significant fiscal and monetary pump-priming to boost growth.

What to look out for: Lots of US activity data

- Hong Kong Foreign trade (26 August)
- Singapore Industrial production (26 August)
- US Durable goods orders (26 August)
- China Industrial profits (27 August)
- Korea Business Survey (29 August)
- Thailand manufacturing (29 August)
- US revised 2Q GDP (29 August)
- EU CPI (30 August)
- India 2Q19 GDP (30 August)
- Bank of Korea policy meeting (30 August)
- Thailand balance of payments (30 August)
- US Core PCE deflator (30 August)

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China hits back with surprise tariffs

China has eventually retaliated with tariffs but this retaliation is far from the last. Very soon, we expect American companies to be included in China's "unreliable entity list". If the trade talks in September don't make much progress, we think USD/CNY to move closer to 7.10 level or even cross 7.10 briefly



Source: Shutterstock

An unexpected Friday afternoon retaliation

China has just announced it will impose 5% to 10% tariffs on \$75 billion of goods (including frozen pork and nuts) along with resuming the 25% duty on US automobiles and auto parts from 15th December. Some tariffs will come into effect on 1 September while others will kick in around 15 December.

What's interesting to note here is that the market was not expecting this tariff retaliation given that China did not immediately react to the 10% US tariffs on \$300 billion goods and President Trump's unexpected tariff delays to 15 December.

But even though China's tariffs are smaller than what the US has imposed, the sudden surprise element of it all should cause a risk-off to asset markets globally.

But there will be more

But tariffs aren't the only tool China has to retaliate against President Trump's tariffs.

China has said a few times that it has its own 'unreliable entity list' ready. The market has speculated that the first company to be included in that list is likely to be American, and we think that's when the war of 'entity list' will kick-off. This will be another risk-off factor for asset markets.

Yuan could be weaker

As China has allowed USD/CNY to cross 7.0, we think it is possible that this tactic is reused to weaken the yuan further to surprise the market again.

We expect USD/CNY to move closer to 7.10 level or even cross 7.10 briefly if the trade talks in September don't make any progress like the last round.

Over to the US

The unanticipated Chinese move to impose more tariffs on the US has caught the market off guard and has put the Trump administration in a position who is likely to retaliate but in an unprepared way.

If the US retaliates harshly, then we expect China to really kick off its unreliable entity list. But if it doesn't, it will be on the back foot during the upcoming trade negotiations in September - and given President Trump's latest tweets, that seems improbable.

In our view, one thing is for certain, this is a lose-lose situation for both China and the US in this trade and technology war.

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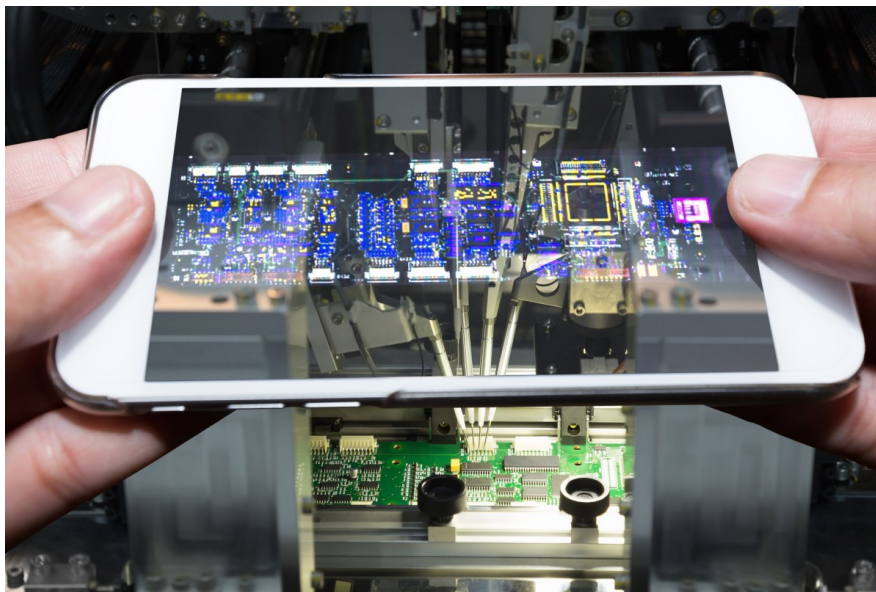
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Taiwan's industrial production surprises us all

The surprisingly good Taiwanese industrial production numbers in July are probably due to the upcoming smartphone release, which will help exports too. But we expect the economy to return to a state of low or even negative manufacturing growth, once this shipment is on its way



Source: Shutterstock

Smartphones to the rescue

Taiwan's industrial production rebounded to positive territory, growing by 3.03% year on year in July from a negative growth rate of 0.49% in June. This is good news for Taiwan given the ongoing global trade and technology war; at least the release of new smartphone models is able to help Taiwan's economy.

Growth mainly came from manufacturing products related to smartphone production. Computers and related products grew by 34.82%YoY while the integrated circuits component grew by 12.39%. These are astonishing growth figures but given that headline growth is just 3.03%, inevitably there are some items that saw negative growth. The most prominent contraction was seen in LCD panel production, which contracted by 14.6%YoY and machinery, which shrank by 13.98%.

Exports should be upbeat

The production growth of new smartphones will help exports, which is why we expect shipments to be strong in August and September even though there are doubts about sales but that is a concern for fourth-quarter production.

Good exports should marginally support GDP growth in 3Q19, which is why we think our GDP forecast for 3Q at 2.0%YoY is still within a reasonable range.

Can this positive manufacturing growth continue?

We doubt Taiwan's manufacturing growth will continue after the first batch of new smartphone sales. Most consumers are looking to upgrade to 5G phones, which should become available in a few locations from 2020. Therefore, we don't expect smartphone sales to be very strong this year, which makes it unlikely that companies will place extra orders

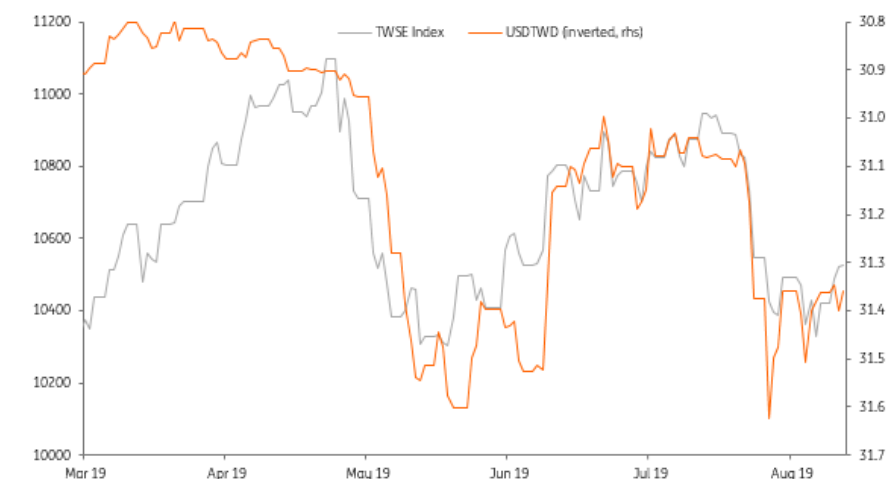
We think it unlikely that the positive industrial production growth will become a rising trend. It'll probably only last for one quarter, and will then fall with the sales of smartphones, if no more orders are placed.

USD/TWD forecast

The capital inflows into Taiwan's stock market have strengthened the Taiwanese dollar since the beginning of August. But these inflows and outflows will be more frequent if investors find Taiwan's industrial production growth for smartphone unsustainable in 4Q19, which will affect USD/TWD directly.

We expect TWD to weaken from the current level of 31.39 to 31.50 by the end of the year. We may revise our forecast of TWD to a weaker level if industrial production growth flips back to the negative territory.

USD/TWD and Taiwan stock market



Source: ING, Bloomberg

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