

## Good MornING Asia - 26 March 2018

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#### On a positive note...

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China

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## On a positive note...

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### Glass half full or half empty?

We will try to be positive this morning - for a change. And it will be a challenge. Not only is it easier to write about bad stuff, but it is more fun. China's newspaper, the Global Times, is suggesting that China teach Washington a lesson on trade, which seems to turn the volume up on what has been a very measured Chinese response up to now. But one thing that struck me as I ambled in to work this morning, was the latest suggestion by US Treasury Secretary Mnuchin that there was a way back from the \$50-60bn tariffs which sent equities into a tailspin last week. That was that the US was prepared to talk to see what could be done to avoid going down this route. Such a tactic would be entirely in keeping with the US Steel and Aluminium tariffs of recent weeks, whereby a global blanket tariff is imposed, and bit by bit, it is wound back until not much remains. We observe a similar tactic with the KORUS (Korea US ) free-trade deal, which was threatened with being ripped up, but where now apparently a deal is agreed and we expect announcements later today on just what South Korea has had to forgo in order to keep a free trade deal with the US.

So it looks as if maybe the US does not want to slap \$50-60bn of tariffs and quotas onto China after all and a climbdown is possible. What the US does want, is to knock \$100bn (which may turn out to be \$25-50bn) off China's bilateral trade surplus, something we don't believe China would have too much of a problem with. Especially if, for example, such a reduction came through higher

imports of US goods for which it actually has a use - namely LNG (not US autos). We know that China is looking to diversify its sources of this fuel, and the US is looking to export more. This could be a win-win solution for both countries. Smiles and hugs all round in Beijing and Washington?

## Day / Week ahead

For a full round-up of the week ahead in Asia, please read [this note](#) from Prakash Sakpal. Suffice it to say that in the G-7, it is really uneventful, and will be a shortened week this week and next for many countries due to the Easter holidays. The pick of the bunch will be US spending and incomes data on the 29th - which will provide a two-thirds picture of consumption spending in the first quarter of 2018, and thereby a tantalizing glimpse of 1Q GDP (maybe I sold this a little too strongly, but it is a quiet week).

For today, the G-7 is not worth watching, except on the political front, where in Italy, 5-Star and the Northern League seem to have managed to agree to work together to elect speakers for parliament, raising the prospect of a deal for governance. This could send jitters through markets if it happened.

On the Asian calendar today, Singapore's February industrial production data will likely flop, though mainly on Lunar New Year grounds. We will need to consider what Jan-Feb together look like to see what this means for output so far this year and if it vindicates our decision to throw in the towel on our long-standing MAS tightening decision at the end of last week.

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# China: losing patience on US trade protectionism

China has sent a strong message by announcing its own tariffs following the latest US\$60bn tariff plan from Washington. What are the implications?



Source: Shutterstock

The Ministry of Commerce of China has announced imports tariffs of 15% or 25% for a concrete list of items imported from the US.

Nuts and fruits, wine, modified ethanol, American ginseng and steel pipes will all face a 15% import tariff. Pork related items and scrapped aluminium will face a 25% import tariff. These items' export value in total was close to US\$3billion in 2017.

This reply to US trade tariffs sends a strong message to the US, even if the export value is relatively small.

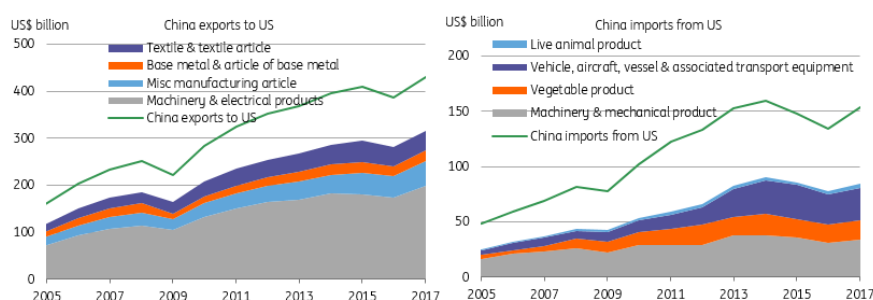
## Retaliation is on the cards

Compared to the US plans to put tariffs of US\$60billion of imports from China, the US\$3billion plan in China looks small, but it has big implications.

First, China indicates clearly that it can retaliate.

Second, the retaliation starts with tariffs on major export items namely: vegetable products, pork and scrap metal.

Third, China's embassy in the US has stated that China will fight these tariffs strongly, which implies that the list announced on 23 March may not be exhaustive and could be expanded if the US continues to impose tariffs on China's exports. This could include stopping US companies from operating in China.



Source: ING, CEIC, Bloomberg

## A trade war could ensue

Any further reaction by China will depend on what the US does now.

Let's assume the US targets the largest chunk of China exports to the US - machinery and electrical products. Then China could react similarly by imposing tariffs on the largest chunk of US exports to China (either machinery and mechanical products or transport equipment).

We believe that China will choose transport equipment, because if there were import tariffs on China's exports of machinery and electronic products to the US, then those imports from the US would also shrink (there is a complicated two-way supply chain in this sector). Taking this into account, the largest remaining import sector from the US is transport equipment.

Therefore a trade war is more likely to affect China's machinery and electronics sector and the US's transport equipment sector.

## Implications are complex

Would Chinese employment be hurt if US companies manufacturing in China decided to move their production lines to locations outside China? Yes. But this is not likely to happen overnight and may be more of a case of considering alternative locations for future Asian expansion.

Additionally, displaced workers could choose other jobs, likely in the service sector that is booming in China and has low skill requirements.

For transport equipment imports into China, there are always substitutes from Europe and elsewhere. So the overall impact on China may be predominantly through rising prices of these substitutes - this is likely to be considerably less than the US tariffs, however. In short, some increase in prices of transport equipment are likely.

## Usually there are alternatives

The analysis so far has been on from China-US trade and China-US-World trade, and from manufacturing of machinery and electronics to the service sector in China - there are substitutions for production location, trade partners and jobs.

If the US imposes restrictions on sectors that require a joint venture, it would also face the

consequences of investment decisions made by foreign companies.

There are so many alternatives in a globalized world when it comes to decision-making that we are very likely to have left out something critical in our analysis. And this is the point we would like to make - there are choices.

## **Even more complicated: Is this economics or politics?**

Eventually, we need to ask (or answer) the question, is all this protectionism an economic or a political issue? That would make a significant difference to the outcome. If it is the latter, it could get even more complicated.

And if it looks likely that it is the latter, then the US has helped Taiwan on tourism. China finds this as annoying as US hints that it does not agree on One-China policy.

All in all, trade protection actions imposed by the US may not be too damaging for China. We expect some loss of employment in manufacturing but this may be shifted to the service sector and result in higher prices of some imported goods. The more important point we would like to make is that trade protection actions will lead to changes in global production and trade, given today's globalised, complex supply chain.

## Singapore's CPI rises, a bit

We're not too excited by this stronger than expected inflation rise - much of it looks transitory - moreover, we're axing our MAS tightening call.



### Headline CPI inflation rises to 0.4% (YoY), MAS core rises to 1.7%

Singapore's February inflation rose a bit more than expected, with the headline rate now 0.5% (was zero in Jan 2018) and the MAS (Monetary Authority of Singapore) core measure (strips out housing) rising from 1.5 to 1.7%YoY. There is no strict inflation target for Singapore, though acceptable rates would likely be in the 2-3% area. So the headline looks way off, while the core looks to be closing in on a rate that would be just about right.

### Scratch below the surface, and this looks less impressive

If you take a look at narrower subcomponents of the inflation series, the overshoot of consensus looks less impressive. But most of the pick up in the YoY headline rate comes food, which is fickle, volatile and not a particularly good guide to domestic demand strength. In addition this month, there is a boost from recreation - in particular holidays. These were no doubt lifted by higher prices for holidays during the Lunar New Year. As such, this should drop back again in March as the holidays' end, so the positive contribution will become a negative one. and core and likely also headline inflation should drop back.

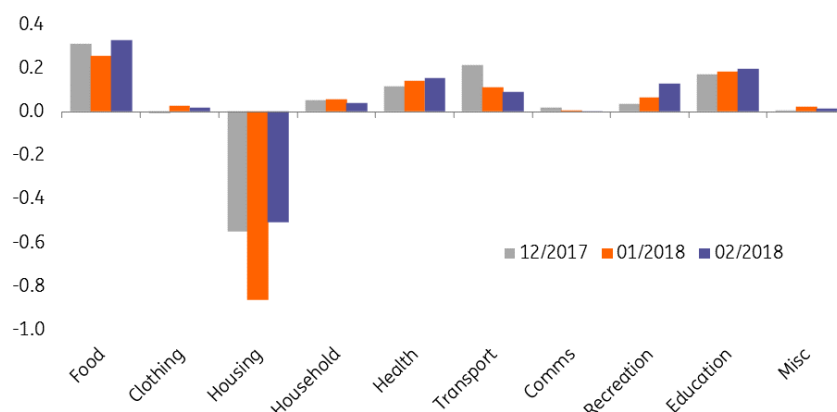
# 1.7% YoY

MAS core inflation measure

Approaching a level that looks broadly acceptable.

Better than expected

## Contributions to YoY inflation growth



## As for the MAS decision in April...

So although this February CPI improvement ought to make us a little more comfortable in our forecast for a very modest tightening by the MAS stance at their April meeting, the likely transitory nature of some of this month's rises don't comfort us much at all.

Moreover, with the US-China trade war likely to deliver at least some collateral damage to the Asian region, this seems like a very good time to pull the plug on this forecast. We now look for no change at the April MAS meeting,

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