

Good MornING Asia - 28 November 2019

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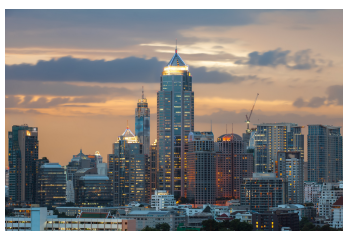
By Robert Carnell



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Signs of economic stabilisation

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Source: Shutterstock

Trump signs pro-democracy bill - USD CNH spikes up

I had been wondering if President Trump was just going to leave Congress' pro-democracy bill on his desk and pretend it had not arrived. I don't think he wants to inflame trade tensions. And I get the sense that he sees this as a problem for China and Hong Kong, and maybe is reluctant to get involved. He also knows that President Xi will not be impressed with this, and he has a lot of time for him.

Having said that, he has now just signed the bill, so any speculation over whether he would or not is now totally redundant. This is probably why USDCNH has spiked higher today - I can't see any other reason for this. but it already seems to be coming off again as I write.

[There is a pretty good article on this story in the Washington Post online](#), which sets out the background on these issues, and notes the potential for sanctions on officials in China and HK SAR. We aren't of the view that this changes a great deal, either on the trade front, or in terms of any potential for renewed protesting in HK, though Iris mentioned when chatting to her today that the

sources she follows indicate a return to protests shortly.

China special bonds quota front-loading

A newswire story today is running with the notion that China's Ministry of Finance brought forward CNY1tr of local government special bond quotas to this year. As I sat on the MRT into work this morning, I thought, I wonder if this signals concern that the trade deal won't happen? After all, it is these bonds that China uses to finance infrastructure projects and other fiscal stimulus programmes to offset the negative consequences of the trade war.

A quick call to Iris Pang puts this story into better perspective. Iris writes "China used CNY1 trillion 2020's quota of local government special bonds for the issuance in 2019 as reported by Bloomberg. This confirms our view that fiscal stimulus via infrastructure projects should reach CNY 3 trillion this year. The policy allows local governments to use quotas left by last year and quotas of next year, this preferential policy is valid until the end of 2021. So we expect local government to borrow quotas from 2021 for special bond issuance in 2020 to support infrastructure projects if the trade war continues without large enough rollback of tariffs".

In other words, this isn't exactly "news", and if China runs out of 2020 quotas, they can dip into 2021, and then later, 2022, etc.

Its grim down south

News out of Latam isn't looking very good right now. I'm clueless on the subject, so I leave commentary on that stuff to our Latam expert, Gustavo Rangel. [Check out what he has to say on our Think Latam page.](#)

But back in 2018, Argentina's woes, coupled with some other EM difficulties, caused problems nearer to home. In particular, the current account countries of Indonesia, Philippines and India, where local currencies took a battering.

Of the three, the Philippines has recently managed to turn its current account deficit into a surplus. Though that may owe more to the budget delay in government infrastructure spending, and this will need watching in coming months. Indonesia too seems to have at least stabilised the current account, and maybe even improved it a little. I'll reserve judgement on India. The recent figures have been quite erratic, and it is hard to draw any clear conclusions until we can see further evidence for a trend emerging. In any case, there seems to be no spillover contagion from any of Latam's woes - probably because they seem largely domestic/political, though that was also the case to a large extent last time, and that didn't stop it.

Data isn't bad, isn't good either

There is quite a lot of coverage about the revised 3Q19 GDP figures from the US overnight - not really clear why. A rounding error on the first release has led to a slight uptick in something that happened between 2 and five months ago, this doesn't much help me decide what is going on in that economy. But the Fed's Beige book released overnight was given a slight upgrade, business investment indicators weren't as bad as normal (though the three-month annualised core orders and shipments data still look very weak), and household income and spending figures show the household is not throwing in the towel on spending, even if incomes are not growing as strongly as they might be.

In short, there is nothing in the overnight run of economic data that should cause us to downgrade our view of the US economy or the Fed any further than it is already. OK, if you want an excuse, then the PCE deflator figures still show no inflation.

I am still entertained (sounds less curmudgeonly than "irritated"), by comments from Fed speakers (recently Brainard) that they might tweak their mandate by running inflation targeting on an "average" basis, implying that they might run it high after periods when it has undershot. If current policy is therefore not already doing that, then I shudder to think what financial distortions would follow from an attempt to run the economy "a little hot". Hasn't anyone been paying attention?

Happy Thanksgiving by the way (if you are celebrating it, then you probably aren't reading this!)

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China's industry profit data is scary, but look past the headlines

China's headline industrial profit numbers unexpectedly fell deeply on a yearly basis, despite the help of a low base effect. However, looking at the details, we see there's a significant divergence on profitability between infrastructure-related manufacturers and those related to trade. The picture reflects how China has grown its economy in 2019



Headline industrial profit data is so scary

Falling by 9.9%YoY in October after a 5.3% contraction in the previous month, China's headline industrial profit numbers look scary. It is the worst year-on-year growth since the data release began in 2011. It hints that manufacturers have been suffering a lot. But the details paint a different picture, some industries are earning big profits.

The promising industries

Infrastructure related industries are the most profitable:

- Mining of ferrous metals (+189.5%YoY YTD),
- Mining activities (+154.9%), and
- Railway, ship, aerospace and other transportation equipment manufacturing (+131.1%).

All these are highly related to the production stage of infrastructure projects. We will continue to see these industries being particularly profitable when compared to others as more infrastructure projects have moved from the investment to the production stage.

The dismal industries

Trade-related manufacturers have suffered from the trade war. Not surprisingly, their profits have been heavily squeezed.

- Chemical fibre manufacturing (-26.3%YoY YTD),
- The paper industry (-17.0%),
- Automotive (-14.7%), and
- The textile industry (-6.4%).

As we expect the trade war will continue even if there is a 'Phase 1' deal, these industries will continue to suffer from shrinking profits.

The degree of damage depends a lot on whether there will be a tariff rollback. Not only that, such a rollback could alleviate the burden shared by Chinese exporters and manufacturers. US consumers too would share less of the tariff burden and would recover some of the lost consumption demand.

The in-between businesses

The above mainly touch on the trade war's impact on Chinese manufacturers from the angle of fiscal stimulus and export damage. Domestic demand is in between the two.

Domestic demand should hold up quite well as shown from the profitability of consumer goods manufacturing industries:

- Beverages (+17.6%),
- Sports and entertainment (+10.8%), and
- Pharmaceuticals (+10.6%)

These reflect the fact that domestic demand has continued to enjoy double-digit growth even though the trade war has affected some employees' salary and job security.

This could be a sign that the supportive effect from fiscal stimulus is working, and the trade war has not had too much impact on the consumer services industry in China.

Divergence will stay

This divergence of profitability among different industries will remain until there are big improvements in the trade negotiations. And we will gauge this on the degree of tariff rollbacks.

If those are significant, for instance taking us back to the situation in May 2019, then exporters should be able to win more export orders and trade-related manufacturing activities will obviously increase. At the same time, the government can slow down the pace of infrastructure investment.

That could significantly paint a completely different picture regarding industrial profitability. However, it is too early to make such a call. And I'm afraid we remain sceptical about the prospects of any significant progress on tariff rollbacks.

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Thailand: Weak manufacturing opens door for more BoT easing

But we don't think the Bank of Thailand will deliver a back-to-back rate cut in December, especially now that the government has just unveiled more stimulus



Source: Shutterstock

-8.5%

Worse than expected

October manufacturing growth

Worst in six years

Blame it on weak domestic demand

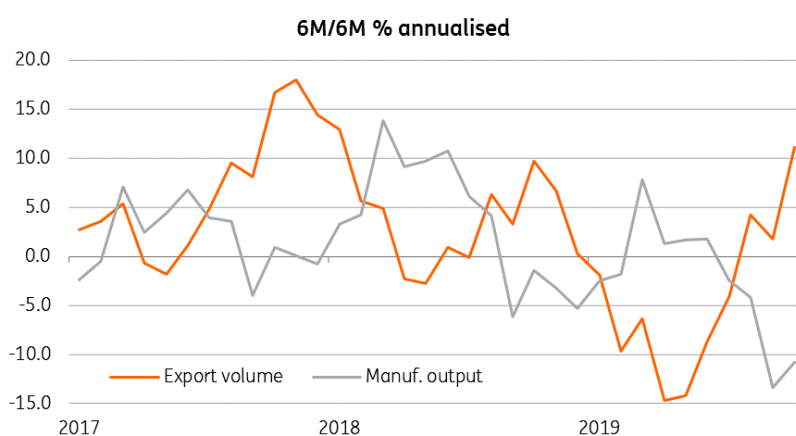
Thailand's manufacturing output plunged 8.5% in October from a year ago, more disappointing than the consensus expectation for a 5.1% fall. It's also the worst reading since January 2014.

Weak manufacturing growth may appear consistent with more weak exports growth in October (-4.5% YoY vs. -1.4% in September). But there is more to it than that. Despite the steeper year-on-year export fall in October, the underlying trend has been improving as is evident from six month annualised growth figures. This drives the blame for the manufacturing decline from exports to

weak domestic demand. This is also reflected by a double-digit decline in car sales in recent months. And probably adding to these woes is the strong currency (THB) depressing tourism spending.

This data points to continued sluggish GDP growth in the current quarter. Our view of a slowdown in GDP growth to 2.0% YoY in 4Q from 2.4% in 3Q remains on track.

Decoupling of exports and manufacturing



Source: Bloomberg, CEIC, ING

Will more stimulus help?

The government is addressing its weak domestic demand problem with some fiscal stimulus. Just yesterday it unveiled additional stimulus worth \$3.3 billion (0.6% of 2018 GDP) to support growth, almost all of which is directed toward additional support to farmers. This comes on top of the \$10 billion stimulus provided in August, which clearly hasn't helped the economy much yet. Headline GDP growth got some lift in 3Q from low base effects but the underlying growth drivers were still missing. We are sceptical about how far the additional stimulus will go in shoring up demand.

The Bank of Thailand (BoT) also cut its policy rate earlier this month by 25 basis points, the second cut this year taking policy rates to a record low of 1.25%. Governor Veerathai Santiprabhob has recently flagged more policy easing "if needed". Today's data provides a strong reason for another rate cut at the December policy meeting. However, we don't think the BoT will deliver a back-to-back cut, especially now that the government has unveiled more stimulus.

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