

Good MornING Asia - 3 September 2018

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By Robert Carnell



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Source: Shutterstock

Reporting undermines Canada negotiations

Off the record comments made by President Trump to Bloomberg suggested that any deal with Canada would be "totally on our terms" and with Canada's auto exports to the US a key sticking point for the President, he added, "Canada's working their ass off. And every time we have a problem with a point, I just put up a picture of a Chevrolet Impala".

The leak, which the US President himself reportedly admitted was accurate, has scuppered negotiations to bring Canada into the deal brokered with Mexico for a re-vamped Nafta, though of course, that name has now been consigned to history.

Fortunately, Chrystia Freeland, the Canadian negotiator, seems to be made of tough stuff and believes the US delegation, led by Robert Lighthizer, is, in fact, negotiating in good faith. The negotiations recommence this Wednesday. The leak certainly hampers the chances of a deal being struck, and significant gaps remain. But if there is room for any movement by the US (in total contrast to what the President has indicated), then a deal could be possible by the end of September.

US needs Canada for a trade deal

Without Canada, the bilateral deal between the US and Mexico would stand almost no chance of making it through Congress, as it would need a two-thirds majority. With Canada on board, a tripartite deal would be able to fast-track through with only a majority deal. Which all begs the question, does President Trump really want to get this through and build on the deal with Mexico, or do we put more weight on another of his tweets?

"There is no political necessity to keep Canada in the new NAFTA deal. If we don't make a fair deal for the U.S. after decades of abuse, Canada will be out. Congress should not interfere w/ these negotiations or I will simply terminate NAFTA entirely & we will be far better off...".

USDCAD is about 1.3064 right now, weaker than the 1.2960 levels at the end of last week when there was still an air of optimism.

Asia Day ahead

Its been a good start to the day in Asia, where both Japanese capital spending for 2Q18 and corporate profits are adding to the consumer strength lent by rising wages and promising a better 2Q18 GDP figure than we had been penciling in. We were already looking for a 2.4% rebound after the -0.9% disappointment of 1Q18. Upside risk to this could take the annualized QoQ growth figure closer to 3.0%.

South Korea also posted a reasonable print on August exports over the weekend, with the 8.7%YoY gain missing consensus on the downside, but beating the July growth figure. This still leaves the smoothed trend of this choppy series slightly down from the previous month. Though on a longer basis, the trend growth of exports seems to have bottomed out at about a 5% rate. We see this trend growth rate being maintained over coming months, barring any further substantial changes to what we already know about the difficult global trade backdrop.

We have also already had most of the day's manufacturing PMI data. There are no clear trends.

- Recording increases: South Korea, Malaysia, Indonesia, Philippines.
- Recording no change: Japan.
- Recording declines: Taiwan, Thailand.

Later today, we also have the Caixin China PMI. We are in line with the consensus looking for a small decline from 50.8 to 50.7 for this survey in contrast to the better numbers of the less export-oriented official PMI last week.

Inflation data from Thailand and Indonesia for August complete the day. Currency weakness in both economies (though more so in Indonesia) could see headline inflation measures nudge up in both economies.

And this from my colleague Prakash Sakpal on India:

In an outstanding performance, the Indian economy grew by 8.2% year-on-year in 1QFY2019, beating the consensus estimate of 7.6%. This [stunning economic performance despite all woes](#) raise two key questions: Will strong GDP growth help to stimulate foreign investors' confidence in the Indian economy and prevent a free-fall of the INR? Also, will it open the door for more

aggressive RBI policy tightening to stem currency weakness and keep inflation in check? We are skeptical of the first; the INR isn't quite out of trouble from adverse domestic economic factors, let alone external contagion. But we are hopeful on the second.

We maintain our view of the RBI hiking rates again at the next scheduled meeting in early October, possibly a double-up (50 basis point) hike or even an inter-meeting hike if the ongoing external contagion drags the currency even weaker. That said, we continue to see more upside than downside risk to our USD/INR 71.5 end-year forecast. But for today, we can expect some knee-jerk strengthening of the currency, as markets have had no chance to respond to the data released after the close of trading on Friday.

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China: Fiscal stimulus has arrived

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Source: Shutterstock

PMIs are upbeat

China's manufacturing and non-manufacturing PMIs both beat consensus.

The Manufacturing PMI rose to 51.3 from the previous' 51.2. The main reason behind this better outlook is the government's push for fiscal stimulus on infrastructure projects that boost production activity and have pushed up raw material prices.

Non-manufacturing activity was pushed up by tourism, reflected in air transportation, and banking activity, which is a result of more relaxed asset management policies.

The future - even faster PMIs

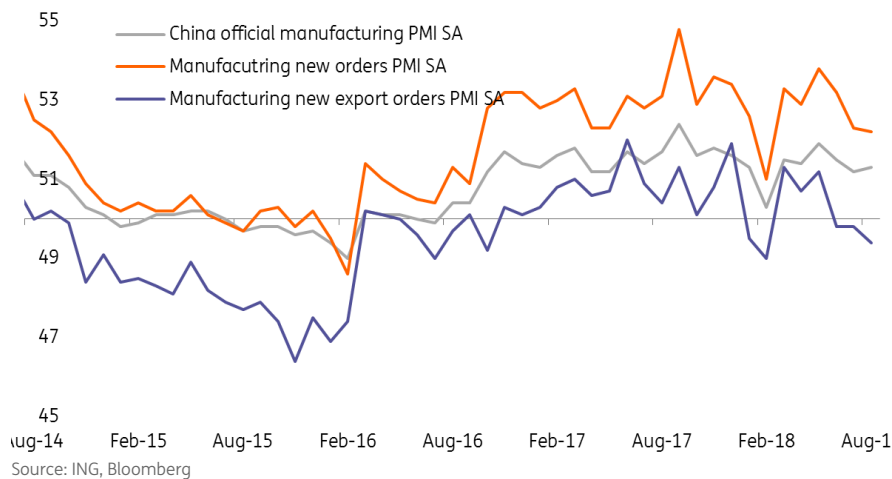
We expect even faster PMIs in the coming few months.

Fiscal stimulus and monetary easing will facilitate faster production activity from infrastructure investment projects and their financing. We expect new orders will continue to stay above 52.0, and new export orders continue to lie below 50 due to the trade war.

Real estate activity could offset some of this growth, as more cities tighten purchase and

mortgage policies. Having said that, we do not expect the housing market to derail the whole economy. Tightening measures on housing will be flexible, not aggressive.

New orders would continue to surpass export orders during trade war



As a result, GDP growth in 3Q18 will still hold up. We are forecasting 6.5%YoY and 6.3%YoY in 3Q and 4Q, respectively from 6.75% in 1H18. Depending on the speed of fiscal stimulus and its scale to offset the looming tariffs on up to \$200 billion of Chinese exports, GDP growth in 4Q18 could surprise on the upside.

Yuan weakening would continue as trade tensions escalate again. We retain our forecast of USDCNY at 7.0 by end of 2018.

India: A stunning economic performance despite all woes

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Source: Shutterstock

8.2%

GDP growth in 1QFY19

Probably the fastest in the world

Higher than expected

An astonishing GDP performance in 1QFY19

Conventional wisdom falls apart when an economy with many difficulties – persistently high inflation, lingering adverse effects of twin shocks of cash bans and consumption tax, widening twin-deficits (trade and fiscal), ongoing banking troubles and a battered currency – grows at such an astounding pace.

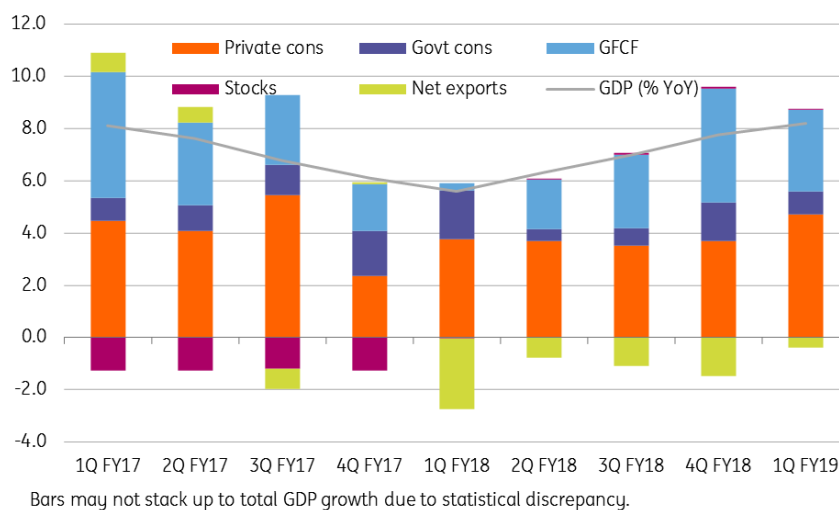
Contrary to the consensus of a slowdown, India's GDP growth accelerated to 8.2% year-on-year in 1QFY19 from 7.7% in the previous quarter. This is the fastest rate in more than two years and

probably the fastest rate in the world currently. The outcome was far better than the consensus centred on a 7.6% figure, and our 7.0% estimate.

Private consumption was the main driver with an improved contribution of 4.7 percentage points of total GDP growth (up from 3.7ppt in the previous quarter, see figure below). This is the highest contribution since 4QFY17 when de-monetisation hit consumers hard and was at odds with persistently high inflation and complicated consumption tax reforms. The firmer private consumption more than offset the slowdown in government consumption and fixed capital formation. Net exports remained a drag on GDP growth for the fifth straight quarter, though smaller than before. On the industry side, manufacturing powered the GDP.

On the statistical factors, we can give some credit to the low base-year effect in boosting the year-on-year growth; the late-2016 de-monetisation depressed GDP growth to a four-year low of 5.6% in the year-ago quarter. However, the high base-year effect will be at work to depress GDP growth in the remainder of the year. We forecast full-year FY19 growth of 7.2%, below the central bank's (RBI) 7.4% and the government's 7.5% forecasts.

Expenditure-side sources of GDP growth



Source: CEIC, ING

And yet deteriorating public finances

Also released at the same time as GDP data late Friday, the government budget deficit widened to INR1.1tr in July from INR835bn in the previous month. The highest July deficit on record, up 76% from the same month last year, took the cumulative deficit in the first four months of the fiscal year to 87% of the full-year budget target.

The derailed fiscal consolidation last year is unlikely to be back on track this year, justifying the warning by rating agencies of another overshoot of the deficit above the 3.3% of GDP target. And there are more reasons to expect this as looming elections will move the ruling administration to spend more.

What this means for central bank policy, and the INR?

We think two key questions the latest data pose are: Will strong GDP growth help to stimulate

foreign investors' confidence in the Indian economy and halt a free-fall of the INR? And, will this also open the door for more aggressive RBI policy tightening to stem the currency weakness and keep inflation in check? We are skeptical of the first; INR isn't quite out of trouble from adverse domestic economic factors, let alone external contagion. But we are hopeful about the second.

We maintain our view of the RBI hiking rates again at the next scheduled meeting in early October, possibly a double-up (50 basis point) hike or even an inter-meeting hike if the ongoing external contagion drags the currency for even more depreciation. That said, we continue to see more upside than downside risk to our USD/INR 71.5 end-year forecast. But for today, we can expect some knee-jerk strengthening of the currency, as markets had no chance to respond to the data released after the close of trading on Friday.

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