

Good MornING Asia - 30 April 2019

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South Korea

Second order improvement

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China

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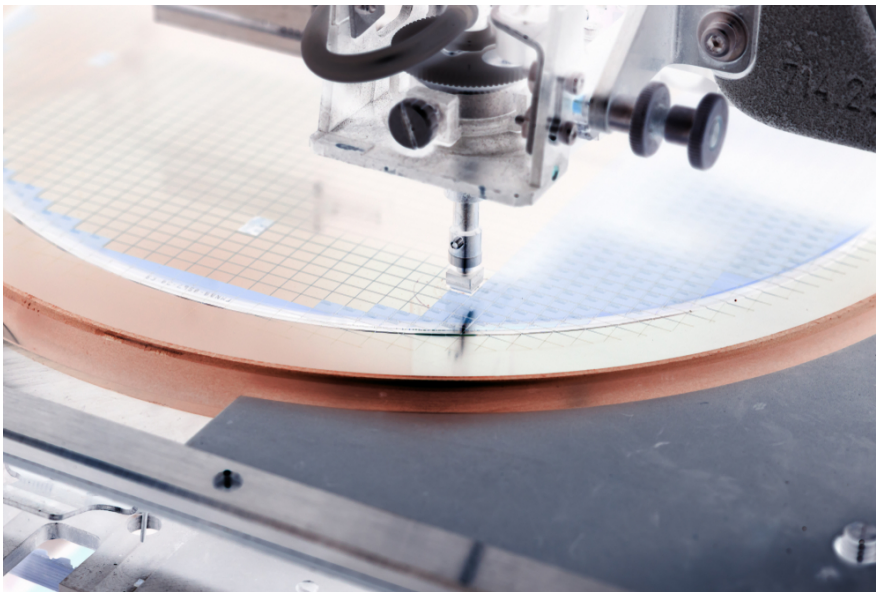
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Why sharp yuan appreciation or depreciation is unlikely in 2019

Since the central government described the Chinese yuan as a 'stable' currency, we have seen some structural changes in the movements of USD/CNY....

Second order improvement

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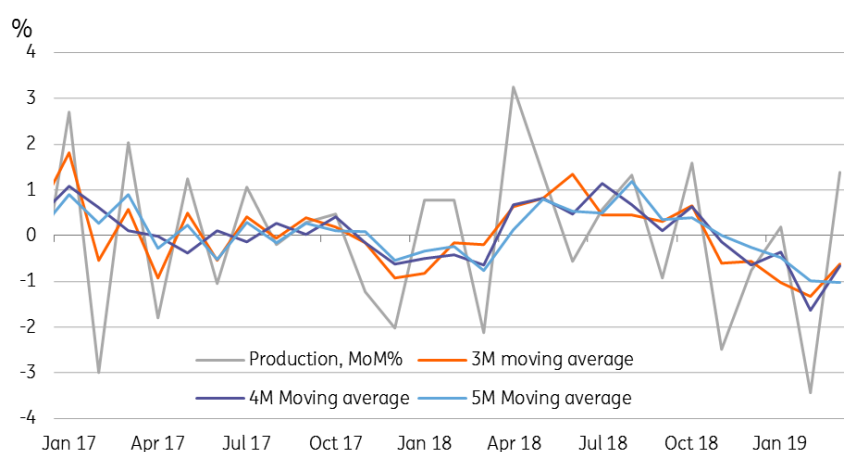
1.4%

March industrial production

MoM% (sa)

Better than expected

Korean Industrial production, MoM%



Month on month production was up 1.4%

While much of the business news industry has been fixated on the US-China trade war (which is topical today as trade talks resume in Beijing), we have been far more worried about the impacts of the global tech slump on the region. Korea, the global powerhouse for semiconductors and indeed most things electronic, has been particularly badly hit (Taiwan too - watch for moribund GDP data for 1Q today as a result).

So today's month-on-month increase in Korean production looks as if it is good news. Production bounced by 1.4%MoM, a shade higher than the 1.0% consensus expectation, but from a downward revised 3.4% decline in February.

One reason not to get too excited is that Korean production data exhibits what one might describe as a negatively autocorrelated process. Or in English, it "saw-tooths". Almost (though not quite) without exception, a good month is followed by a bad month. March was due a bounce. What is noteworthy, is that this seems (based on eyeballing a few moving average series), to be showing some slowdown in the rate of month-on-month decline.

Production is a function of exports - here the news is mixed

To build a stronger case for a leveling-out of production, we first need to see what is going on in the export markets, which is where most of Korean production ends up.

Here, the evidence is less compelling. March exports also fell a bit less than the February figures, down 8.2%YoY from an 11.4% fall in February. But looking at a series of moving average trends, it is less clear that this series is turning the corner. 20-day preliminary export data for April are also down 8.7%YoY, worse than at the same point in February, and suggest that the export picture remains difficult.

Recent company specific commentary on the electronics sector, in particular semiconductors, also remains very cautious. So on balance, I would say that the global tech slump and Korea's problems have further to run before we can begin to call the bottom.

One small glimmer of hope, Korean business surveys for May posted small 1-point increases for both manufacturing and non-manufacturing. Perhaps they are seeing something ahead of the

somewhat lagging economic data...?

Asia day ahead - Its PMI day

Across the region, PMIs will start to be released this morning. The releases include both official and Caixin PMIs for China, which will all be expected to register some positive response to the considerable stimulus that has been unleashed in recent months on the Chinese economy.

(And from Prakash Sakpal)...Thailand's March manufacturing index and balance of payments data due today will indicate the risks to our 1Q19 GDP growth forecast of 3.1%. The accelerated export decline in March leads us to expect much weaker manufacturing growth of -3.5% YoY (consensus -2.1%). And for the same reason, we expect the current account surplus to narrow to \$4.4bn in March from \$6.5bn in February. The finance ministry yesterday cut its GDP growth forecast for 2019 to 3.8% from 4.0% on a view of much slower export growth than previously expected (3.4% vs. 4.5%). Yet, the central bank's (BoT) persistent hawkish tone keeps us from expecting policy support with a rate cut this year.

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ASEAN Morning Bytes

General market tone: Slight risk-on. China's PMI data will set the tone for the markets ahead of the start of the FOMC meeting.



EM Space: Taking cue from China purchasing manager index

- **General Asia:** Positive sentiment from the solid report from the US may drive buying momentum although investors will also take a cue from China's manufacturing report. Meanwhile, trade talks between the US and China resume this week with Secretary Mnuchin hoping this round seals the deal.
- **Thailand:** March manufacturing index and balance of payments data due today will indicate the risks to our 1Q19 GDP growth forecast of 3.1%. The accelerated export decline in March leads us to expect a much weaker manufacturing growth of -3.5% YoY (consensus -2.1%). And for the same reason, we expect the current account surplus to narrow to \$4.4bn in March from \$6.5bn in February. The finance ministry yesterday cut its GDP growth forecast for 2019 to 3.8% from 4.0% on a view of much slower export growth than previously expected (3.4% vs. 4.5%). Yet, the central bank's (BoT) persistent hawkish tone keeps us from expecting policy support with a rate cut this year.
- **Philippines:** The Philippines is projected to grow by roughly 6% in 1Q19, according to Socioeconomic Planning Secretary Ernesto M. Pernia. This forecast is roughly in-line with the Bangko Sentral ng Pilipinas' assessment that demand conditions remain firm, which is one of the reasons why the central bank has refrained from cutting rates thus far to support growth.

What to look out for: China PMI, FOMC and NFP

- China PMI (30 April)
- Thailand trade (30 April)
- Philippines domestic liquidity (30 April)
- Taiwan GDP (30 April)
- Thailand inflation (1 May)
- US ADP PMI (1 May)
- China Caixin PMI (2 May)
- Hong Kong GDP (2 May)
- Indonesia inflation (2 May)
- FOMC (2 May)
- Malaysia trade (3 May)
- US NFP and PMI services (3 May)

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China: Strong industrial profits from credit growth

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Workers at an electronic factory in Eastern China

Industrial profits surged in March

Profits at China's industrial firms jumped by 13.9% year on year in March but was -3.3% in 1Q19, due to the drag from the 14% decline in the first two months of 2019.

The big difference of profit growth between March and 1Q19 is probably because of the strong yuan loan growth in March at 51%YoY, especially loans for small private firms, which is a policy objective directed from the central government.

But account receivables still look concerning

Account receivables rose 6.5%YoY at the end of March. This means there are manufacturers that still cannot fulfil their payments, and this remains a key risk in the manufacturing sector as a whole. This is because the financial chain among manufacturers is fragile, and can be easily broken when some manufacturers miss their payments persistently.

Credit growth should continue to support smaller manufacturers

We think the government probably sees this risk too, and therefore is likely to continue to use strong credit growth to support small private manufacturers. Having said that, we don't think the 51%YoY loan growth, as seen in March will be seen again in April. Instead, we think credit is likely to grow at a speed of 10%YoY.

The government is still pushing fiscal stimulus

For light industries such as textiles, shoes, toys, it may be good news that the central government is pushing to upgrade home electrical appliances in some rural areas. This policy was used in 2009-2010 and was successful. Though we don't think the same degree of positive effect will repeat itself in 2019, as rural households' living standards have improved, but at least this policy should be of some help.

For the automobile industry, the same scheme is being pushed to upgrade combustion cars to electric cars, but this is slightly more difficult as electric cars charging infrastructure in rural areas may need to considerably improve before there is a substantial increase in demand for such cars.

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Why sharp yuan appreciation or depreciation is unlikely in 2019

Since the central government described the Chinese yuan as a 'stable' currency, we have seen some structural changes in the movements of USD/CNY. This is why we're revising our forecasts of USD/CNY and USD/CNH



Source: Shutterstock

The 'two sessions' structurally changed yuan movements

After the 'two sessions' in March, the USD/CNY and USD/CNH have traded in narrow ranges as yuan stability is one of the big focuses of the Chinese government. And now, it is beginning to look clearer that yuan stability means the central bank manages the yuan movements in a narrow range.

Onshore yuan depreciated 0.2% against the dollar in March, and so far has dropped 0.3% in April (until 29/4/2019). These narrow range bounds are very different from the movements observed in the first two months of 2019 when the yuan appreciated 2.45% against the dollar.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and

1.16% year to date appreciation

It's important to note that not only has the range narrowed, but the direction has also changed from yuan appreciation to yuan depreciation.

We believe the change in direction, albeit small in substance, is a way for China to show that its yuan policy is independent from the influence of other countries. We think this is a snub to the Trump administration who said that the yuan cannot depreciate if there is a US-China trade deal.

Where is the yuan headed after a trade deal is finalised?

Even though we have few clues about when a trade deal between the US and China will be signed, we need to think about the path of the yuan when it eventually is. We think the narrow range bound may not change even after there is a deal.

China will probably want market stability at the beginning of the trade deal, and not add more uncertainty when both sides begin with the implementation. Moreover, we don't think the execution of the trade deal will be smooth, also noting that the US is pressurising its allies to refrain from using China's 5G equipment.

We don't think a sharp yuan appreciation or depreciation is likely for the political environment in 2019

We're ruling out a sharp yuan appreciation because we believe that will be interpreted as appeasing the US, which is probably politically incorrect from Beijing's point of view and we think a substantial yuan depreciation would only be possible if China wants to pick a fight with the US, at the cost of increasing market concern about capital flight from the country and this seems highly unlikely.

So, neither a sharp yuan appreciation nor depreciation is likely for the political environment in 2019.

Revising USD/CNY and USD/CNH forecasts

At the time of writing this article, USD/CNY spot was near 6.73 and has depreciated from 6.71 since the end of 1Q19.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and 1.16% year to date appreciation, respectively. Our previous forecasts for 2Q and 3Q were 6.85.

We maintain our 4Q19 forecast at 6.75, which suggests the yuan is going to appreciate by 2.62% in 2019.

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