

Good MornING Asia - 5 November 2018

Last week's trade inspired optimism in Asia looks short-lived as softer US stocks set the tone for the start of the week in Asia. US sanctions on Iranian oil exports are centre-stage today, with considerable speculation about which countries will manage to get exemptions, and on what the impact on benchmark crude prices will be

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By Robert Carnell



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Source: Shutterstock

Brent at \$72/bbl

The fall in benchmark crude oil prices is welcome. At \$72/bbl, Brent sits in what I feel is the sweet spot for oil, somewhere between \$65 and \$75. I like this area as it is sufficiently high that the crude producers who buy a lot of Asian manufactured goods, can afford to do so. But it is not so high that importing countries see their current accounts, inflation rates, or even fiscal policy exploded (for those who impose price controls). Those likely to benefit most in Asia are India, Indonesia, and the Philippines.

So that's all good, except that the new US sanctions that come into force on Iranian oil exports threaten to undo all of that. To limit the hit to crude oil from these sanctions, the US has apparently allowed certain countries temporary (180-day) exemptions from these restrictions. There are said to be eight of these countries. I believe the list contains India, South Korea, China, Japan, and Iraq, although I haven't seen any official list yet. That will no doubt dribble out over the course of the day.

BoJ Press conference today

Later today, the Bank of Japan Governor, Haruhiko Kuroda, will give a press conference in

Nagoya following the release of the last meeting's minutes. The meeting didn't deliver anything in terms of policy changes, downgraded growth and inflation and disappointed some who had been looking for the BoJ to start tweaking its policy guidance.

Relevant questions might include, "What are we to make of the decline in 10-Year Japanese government bond (JGB) yields to 0.114% currently when at the beginning of October, they were 0.15%?". Was this a policy move to stop yields drifting too far above their 0.1% target? Or was this just a market effect as global stocks plunged.

JGB yields are back up a bit today, though have not retraced all their losses for the month, unlike their US counterparts, which at 3.21%, are within a whisker of the 3.23% October-high. Let's see how stocks like this second time around...my guess, not much better than the first time.

And of course, let's not forget the Mid-terms

We can't escape some commentary about the US mid-terms today, especially as it is a public holiday in Singapore tomorrow, so we won't be writing again until Wednesday at the earliest. That is when, at about mid-day Singapore time, some of the results may start to come in.

The latest poll of polls published on [Five thirty-eight](#), puts the odds of the Democrat Party taking control of the House of Representatives at 6 in 7, though with only a 1 in 6 chance of taking the Senate. President Trump's net approval rating stood at a net -10.8% at the time of writing, though amongst registered voters, this was a less negative -9.2%.

I'm a little concerned that market volatility may spike up later in the week once the mid-terms are out of the way. A combination of policy uncertainty, political deadlock, Fed tightening and synchronized slowdown in global growth do not augur well for risk assets in the coming quarters.

China Expo - a way to stack the deck ahead of the G-20?

China's international Import Expo gets underway today, and comes with a speech by President Xi. As our Greater China Economist, Iris Pang, noted on our morning call today, opening up China market access for other countries imports makes China less reliant on US imports, and consequently improves their bargaining power as the talks scheduled for the G-20 meetings in Buenos Aires at the end of the month loom. This is important, and will be worth watching.

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International theme: US labor market fully on the mend but trade issues cloud outlook

- Equity markets saw directional trading on Friday with positive sentiment coming from an extremely strong jobs print which was promptly offset by conflicting reports on the actual status of the US-China trade negotiation status.

EM Space: Asian markets to move sideways, look to China's trade data for direction

- **General Asia:** Asian markets will likely digest the recent performance of Wall Street with markets still keenly watching developments on the trade negotiation front. Trade numbers out from China will also help drive sentiment throughout the week.
- **Malaysia:** In a significant fiscal derailment, the government estimates its budget deficit to spike to 3.7% of GDP in 2018 from 3% in the last year. The gap is projected to narrow to 3.4% in 2019. These projections rest on the GDP growth of 4.8% this year and 4.9% in the next. The wider budget deficit also comes as a significant fiscal impetus to the economy

amid elevated external risks. But weak public finances are negative for the MYR and we're reviewing our end-2018 USD/MYR forecast of 4.20 for upward revision.

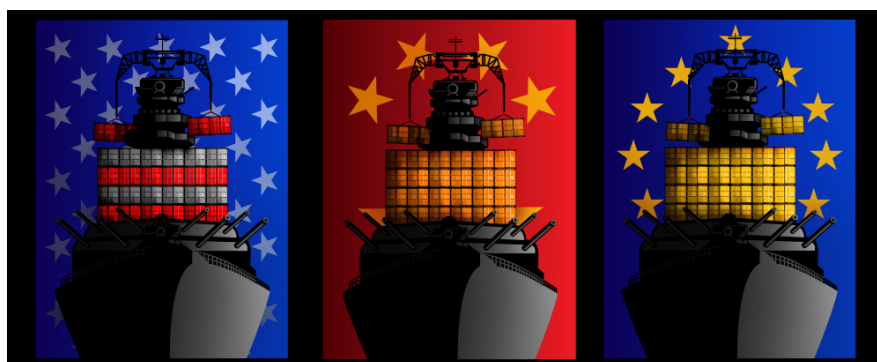
- **Thailand:** Somchai Jitsuchon, member of the Bank of Thailand's Monetary Policy Committee, signaled increased downside growth risk in 2019 from slower exports and persistent low agriculture product prices pressuring farmers. Among other headwinds to growth is slowing tourist arrivals from China. On our forecast, GDP growth dips below the 4% level in 3Q18 (data due 19 November) and remains there through most of 2019. This also means the BoT leaves policy on hold for a prolonged period.
- **Indonesia:** 3Q GDP numbers will be reported on Monday with the market looking at a print of 5.18%, slightly slower than the 5.27% print in 2Q but faster than the same quarter in 2017. Indonesia's growth will likely come from healthy government expenditures as well as a sustained push from the household sector with inflation remaining well within target. The Rupiah's recovery in recent sessions will take some pressure off from Bank of Indonesia but the central bank may still need to adjust monetary policy before year-end to help the IDR find a more convincing rally.
- **Philippines:** Important data reports will be released in the coming sessions with October inflation reported on Tuesday (6 November), trade data released on Wednesday (7 November) and 3Q GDP out on Thursday (8 November). Inflation is expected to come off its peak, albeit still at an elevated level, the trade deficit forecasted to remain wide at more than \$3 bn while growth will see an above 6% print on strong government spending.
- **Philippines:** The Philippine Peso had outperformed the region but Philippine markets have been shuttered in the past few sessions, with the Peso likely to see some moderate catch down after traders return from the holiday. Pent-up remittance flows over the extended holiday, coupled with some slight risk on tone will help PHP appreciate slightly with inflation and still strong growth seen to support.
- **Philippines:** Government officials had sounded off in the recent weeks that a Dollar-denominated bond issuance was in the works and would likely be floated in November and when market conditions improved. With the slight risk on tone emanating from possible improved relations between the US and China creeping in the past sessions, the government may look to issue in the next few weeks, which should support the Peso.

What to look out for: China trade data and FOMC decision

- CH Caixin PMI services (5 November)
- TH consumer confidence (5 November)
- MY trade (5 November)
- US PMI services (5 November)
- ID 3Q GDP (5 November)
- PH CPI inflation (6 November)
- US JOLTS (6 November)
- PH trade (7 November)
- ID GIR (7 November)
- PH GIR (7 November)
- CH GIR (7 November)
- PH 3Q GDP (8 November)
- CH trade (8 November)
- US FOMC (9 November)
- US consumer sentiment (9 November)

China: Trade war and geopolitics

Trade war and geopolitical tensions continue to escalate between the US and China, but increasing concerns around Taiwan could risk intensifying the...



Source: Shutterstock

The US administration has threatened China that if there is no constructive outcome from the Xi-Trump meeting in the upcoming G20 gathering, then the US would expand tariffs on Chinese imports to a total of \$505 billion, though it has not mentioned the tariffs rate yet.

In terms of what we already know on future tariffs, from 2019, the tariff rates on \$200 billion of Chinese imported goods is set to increase to 25% from 10%. We expect China to reciprocate on imports from the US, (i.e., to 25% as announced earlier in August). [See our trade teams piece](#) on the impact the US-China trade conflict could have on world trade next year.

Xi-Trump meeting is likely to be a stalemate

It seems that the US would like to get some concessions from China during the Xi-Trump meeting. But this will be primarily determined if the two sides insist on their points on trade such as:

If the US continues to emphasise that Chinese imports are the driver of the US trade deficit, but China reckons narrowing the deficit won't really help. Or if the US continues to express displeasure at how it doesn't like how China gets its technology from business partners but China insists that is just business. And finally, if the US continues to send military vessels around Taiwan, then China is bound to lose its patience after a while.

Trade war has damaged the Chinese economy



Source: ING, Bloomberg

Using the Taiwan card could prove to be foolhardy

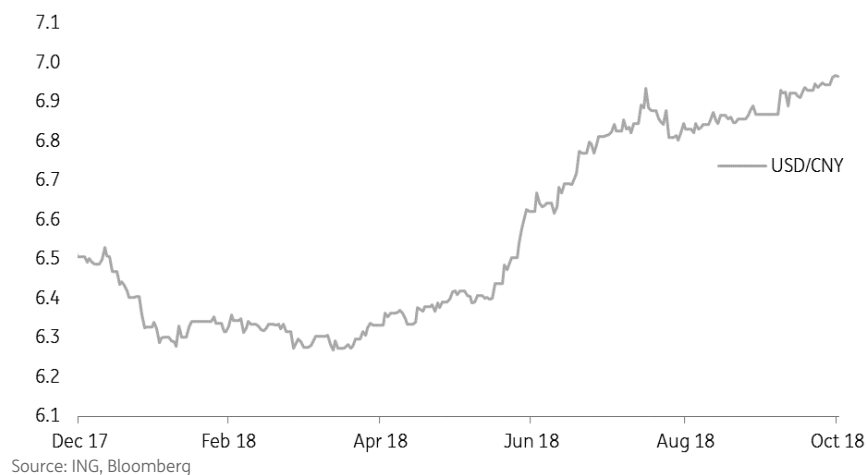
As we have emphasised, the trade war doesn't end with just tariffs and is now increasingly tied to geopolitical tension.

The US is increasing hurdles for its trade allies including Mexico and Canada to sign trade agreements with China. Moreover, two US warships sailed through the Taiwan Strait providing military arms sales to Taiwan.

According to the Chinese media, Xi has ordered the military to be prepared for [war](#) and we think [this](#) should be considered with caution. The One China principle means Taiwan is part of China, and this is a foundation stone for China's Taiwan policy.

The US administration could end up in a pickle if it uses the Taiwan card to get more chips for negotiation as we think China is very unlikely to give any concessions on trade if the US continues to send military forces around Taiwan.

After the yuan cross the 7.0 handle it will continue to depreciate slowly



USDCNH crossing the 7.0 handle is a high probability

If the outcome of Xi-Trump meeting yields no improvement, then we see the yuan edging lower and USDCNY crossing the seven handle won't be a surprise. Recently, the central bank has allowed the USDCNH to test the 7.0 mark. This would increase market expectation that USDCNH could cross 7.0 anytime soon.

After crossing 7.0, the yuan would continue to depreciate slowly. The yuan has slowed down in its depreciation speed. The fastest depreciation happened in June (3.28%) followed by July (2.96%), and has moderated since then to around 1.43% in October. But crossing the 7.0 mark doesn't imply a fast depreciation will follow.

The claim that if the yuan passes the 7.0 handle, then there will be massive capital outflows doesn't add up because if that were the case, then the regulator could tighten capital outflows as the yuan continues to weaken.

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