Good MornING Asia - 7 August 2018

China steps up retaliation to the US tariffs and takes measures to prevent capital outflows. Indonesia's GDP growth accelerates to a 5-year high pace in the second quarter

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China steps up retaliation and prevents capital outflows

China retaliates with the US raising tariffs from 10% to 25% on $200 billion of goods. At the same time, the central bank imposes 20% reserves on short yuan derivatives to prevent capital outflows from the escalating trade war

Source: Shutterstock

China's retaliation and shielding from capital outflows

As a retaliation for the US raising the tariff rate from 10% to 25% on $200 billion worth of goods imported from China, China reacts by imposing tariff rates from 5% to 25% on $60 billion imported US goods. The effective time will depend on the US' tariff effective time.

At the same time, the Chinese central bank (PBoC) adds 20% reserves on short yuan derivatives activities. This is to slow down the depreciation speed of the yuan against the dollar.

We see both actions by China as a "combo". On one side is retaliation on the US raising tariffs, on the other side, preventing capital outflows from the escalating trade war.

What's next is the more important question

We would like to see the next steps from China, and we ask the following questions:

1 Whether the 20% reserves would be enough to slow down yuan depreciation speed?

We believe the effect could be short-lived as the trade war escalation would mean a stronger dollar, which is a safe-haven currency. Then the next step would be that the PBoC would impose a "counter-cyclical factor" in the daily yuan fixing formula. The "factor" is like a blackbox to the market, so the fixing would be "determined" by the PBoC. We expect the PBoC would either fix steadily or even drive the fixing to appreciate slightly from the previous day if the yuan depreciates against the dollar quickly during the intraday.

2 What would China do to react to US tariffs on more Chinese goods?

Though the timing of US tariffs on $200 billion of goods is still uncertain, we expect that tariffs on $300 billion of imports from China are still possible. China would retaliate by increasing the tariff rates to 25% on all $60 billion imports from the US, as well as implement qualitative measures, which could limit US companies' operation activities and/or limit US companies' M&A activities.

We keep our USDCNY forecast by year end at 7.0

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Snap | 6 August 2018 Indonesia

Indonesia: GDP growth surprises on the upside

Household, government and business spending remained healthy in the second quarter and offset the more challenging net trade sector. The growth figures are in line with our 2018 growth forecast of 5.2%

Source: Shutterstock

5.27%

Higher than expected

2Q 2018 GDP growth rate

Stronger government and household spending

Low inflation and accelerated government support boost growth

Economic growth in the second quarter surprised on the upside and was faster than our 5.2% forecast and the consensus forecast of 5.1%.

- Government spending delivered a major upside surprise with growth rebounding to a 2Q growth of 5.3% from the contraction of -1.9% in 2Q 2017.
- Household spending provided a modest upside surprise with growth of 5.1%, mildly faster than from 2Q 2017's 5% growth and 1Q 2018 growth of 4.9%.

- Business spending moderated in 2Q to 5.9% from 1Q growth of 8% but was still slightly faster than 2Q 2017's pace of 5.3%.

These improvements offset the more challenging net trade. Import growth of 15.2% was almost twice as fast as export growth of 7.7%.

Outlook for second half

Government spending is likely to continue to post faster growth in the second half against the average 2H 2017 growth rate of 3.7%. Household spending growth should also remain high thanks to low inflation and an expanded energy subsidy from the government. Low inflation contributed to consumer spending in 2Q and will likely continue in the second half of the year. Average 2Q 2018 inflation was only 3.3%, slower than 2Q 2017 average of 4.3%.

Stabilisation efforts from Bank Indonesia, which raised policy rates by 100 basis points in the second quarter may keep business spending growth moderate in the second half. The risk-free 10-year yield in 2Q 2018 averaged 7.2%, around 10 basis points higher year-on-year. The yield on 10-year local government bonds in 3Q 2017 averaged 6.8%. The July 2018 10-year yield average is already 7.7%, almost 100 basis points higher than the 3Q 2017 average.

We expect the strong performance of household and government spending to bring overall economic growth to an average of 5.2% this year, mildly higher than 2017's growth of 5.1% and slightly below the consensus forecast of 5.3%.

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