

## Good MornING Asia - 8 May 2019

The intensification of the trade war between the US and China sustain the negative spell on markets with Asian risk assets poised for another bad day today. Adding to the emerging market woes are political jitters in Turkey, South Africa, and Thailand

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# 1.75%

The Bank of Thailand's policy rate

No change expected today

### EM Space: The trade war and political risks weigh on investor sentiment

- **General Asia:** The escalation of US-China trade tensions with China considering retaliatory tariffs on US products dampens hopes of a trade deal even as Vice Premier Liu He continues negotiations this week. Asian central banks remain in the headlines. Australia's central bank left the policy on hold yesterday and those of New Zealand and Thailand are expected to follow suit today.
- **Indonesia:** Keeping up its verbal intervention amid ongoing market rout, a senior Bank Indonesia official warned about the central bank's intervention in both bonds and foreign exchange markets to ensure currency stability. BI also unveiled new regulations governing money and foreign exchange markets towards greater efficiency and transparency.

- **Malaysia:** As expected, the Bank Negara Malaysia cut the overnight policy rate by 25bp to 3.00%, citing increased external headwinds to growth. The cut still leaves BNM with a sufficient interest rate buffer if economic conditions deteriorate further. That may not be required though, as growth is likely to stay firmly within BNM's baseline of 4.3 - 4.8% for the year. That said, we revise our year-end USD/MYR forecast from 4.05 to 4.12.
- **Philippines:** April CPI inflation came in below consensus at 3.0% YoY. The slowdown from 3.3% in March was pretty much across the board but for the transport component. The trade data for March is due today and it's expected to show continued electronics-led export weakness. As for most Asian counterparts, we believe the central bank (BSP) will judge the current economic conditions warranting greater policy accommodation. Hence our forecast of a 25bp BSP policy rate cut tomorrow.
- **Thailand:** The Bank of Thailand is widely expected to stay pat today. The political uncertainty about the formation of the new government will continue to overshadow the economy. The Thaksin-linked Pheu Thai Party and military-backed Palang Pracharat Party emerged as main parties in the election held on 24 March, though both lacked a single-party majority to form the government. And the controversial electoral system is adding to the difficulty of coalition formation by either party. Yet, the balance of power remains tilted toward the PM Prayuth's Palang Pracharat party.

## What to look out for: Developments on US-China trade deal and central bank policies

- China exports (8 May)
- Philippines trade (8 May)
- The Bank of Thailand meeting (8 May)
- China CPI (9 May)
- Philippines 1Q19 GDP and BSP policy meeting (9 May)
- US trade balance and PPI (9 May)
- UK 1Q19 GDP (10 May)
- US CPI (10 May)

# Chinese foreign reserves edge lower but there were some inflows

Chinese foreign exchange reserves have fallen slightly, mainly as a result of the strong dollar. But this shouldn't mask the fact that there were some...



Source: iStockphoto

## The strong dollar is behind the drop in foreign reserves

According to central bank data, China's foreign exchange reserves fell by \$3.81 billion or 0.12% in April to \$3.095 trillion.

The small drop was mainly driven by the strong dollar that rose 1.17% in the month. The strong dollar has put a lower valuation on non-dollar assets in dollar terms.

## Don't ignore the inflows

From the foreign exchange reserves data, it seems there were net outflows from China, but as we've explained, this was masked by the strong dollar.

There were inflows into China's bond market and the stock market in April. For example, offshore institutions increased their holdings in China bonds by CNY 76.25 billion in the month - an increase of 4% on a monthly basis according to Bond Connect.

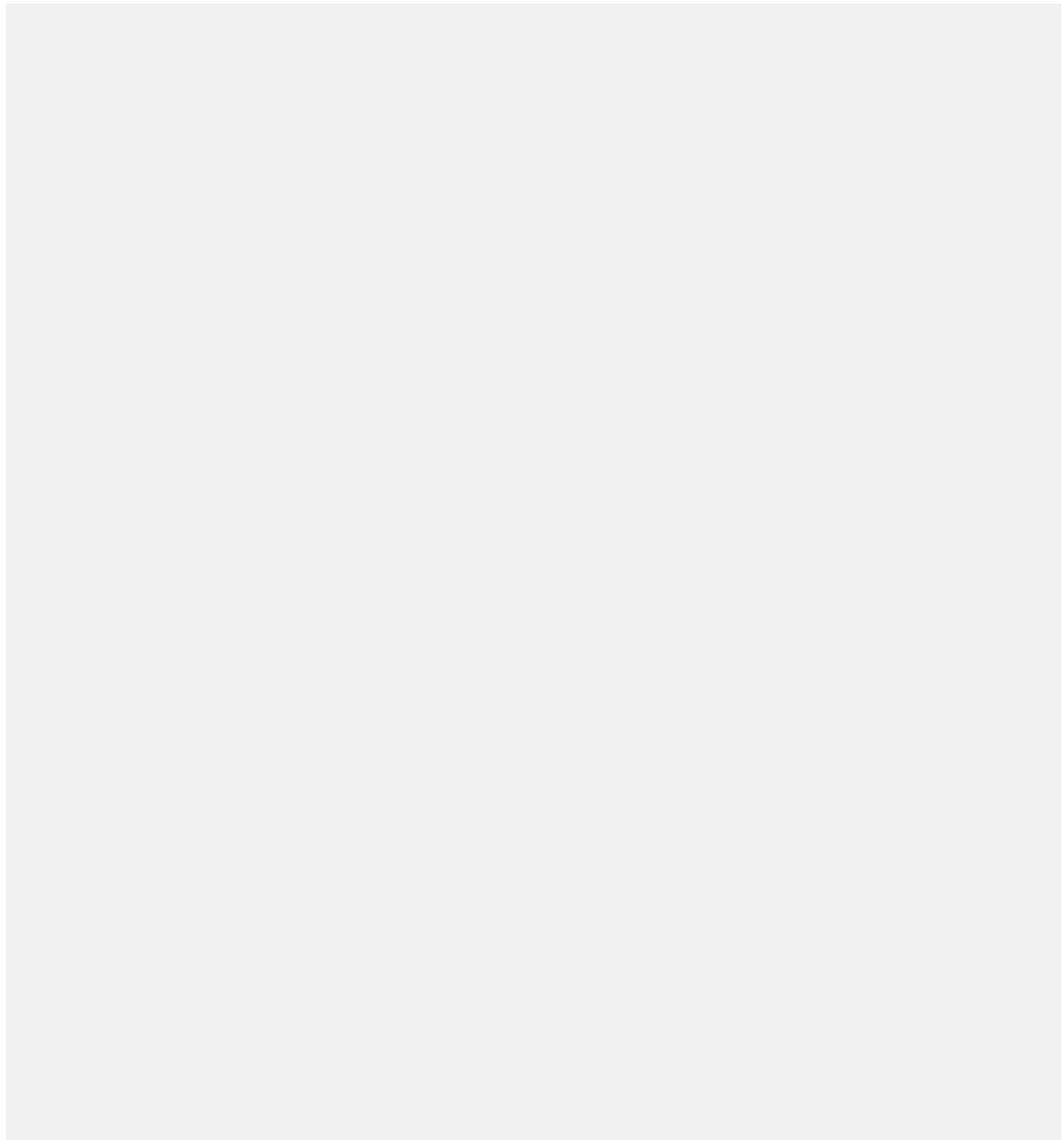
## Yuan to remain stable

If the trade war escalates, we expect the yuan to remain fairly stable.

We think the Chinese authorities would like to have a stable asset market, so they can concentrate their efforts and [focus on trade renegotiations with the US](#). Otherwise, a continuously depreciating yuan might increase the probability of capital flight, something the authorities would like to avoid.

We argue that a yuan appreciation during trade war renegotiation seems impossible, as that will be considered to be a weakness. The only option that we see remaining is a [slight softening of the yuan versus the dollar](#).

[Renegotiating trade from a China perspective](#)



## Renegotiating trade from a China perspective

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Source: Shutterstock

Donald Trump, Xi Jinping. President Donald Trump, right, with China's President Xi Jinping, left

### There is a reason why China wants to renegotiate

We have long believed that the trade war is more than about trade, it is about technology. And during the last couple of months, the US has urged its Western allies not to use China's 5G products as the US believes that there is a security concern.

Since then the Chinese government has tried to have more of a say in the trade negotiations. For example, China has made the penalty system of any trade deal reciprocal, which means the US could be penalised if it does not comply with a signed deal. That was the beginning of China trying to move into the driver's seat of the trade negotiation.

### The Chinese economy backs up renegotiation

The Chinese economy has been supported by fiscal stimulus and monetary easing. It is due to these stimulations that the economy grew at 6.4% year on year in 1Q19, the same speed as in 4Q18. This gives China more chips on the trade negotiation table.

China is prepared to use more stimulus and monetary easing to support this trade renegotiation.

On the same day that the US announces a possible increase of tariffs this Friday (10 May), the Chinese central bank, PBoC, cut the required reserve ratio (RRR) of smaller banks to divert even more liquidity to small, private companies.

We see this easing as part of the back-up for the economy and that the Chinese government is prepared for a long negotiation process.

[Our trade research specialist Raoul Leering has a note on US raising tariffs.](#)

[https://think.ing.com/snaps/trump-the-tariff-man-strikes-again/?utm\\_campaign=May-06\\_trump-the-tariff-man-strikes-again&utm\\_medium=email&utm\\_source=emailing\\_snap](https://think.ing.com/snaps/trump-the-tariff-man-strikes-again/?utm_campaign=May-06_trump-the-tariff-man-strikes-again&utm_medium=email&utm_source=emailing_snap)

## What to watch for in the coming months

1. We would want to see if Liu He, the head of the trade negotiators from China, will join the upcoming trip to the US for further negotiations. This will signal how serious China is and indicates that China and the US are going to talk further.
2. Whether China will speed up fiscal stimulus and continue with more monetary easings. These will become signs as to whether China plans a tougher stance and therefore longer negotiations with the US.
3. The higher tariffs do not only affect Chinese exporters but also US consumers unless the US can find substitutes for Chinese goods in a short period of time. The US policy response will also be a variable in the trade negotiation.

## We are less worried about yuan volatility

We believe that USDCNY and USDCNH will become less volatile compared to yesterday's rollercoaster ride. The fixing mechanism should help to stabilise the yuan, and strict implementation of capital outflow policies will help the yuan not to depreciate too fast to create a worrying sentiment of capital flight.

These are the major reasons we keep our USDCNY forecast at 6.75 by the end of 2019.



## Malaysia's central bank cuts policy rate by 25 basis points

Today's rate cut still leaves Malaysia's central bank with a sufficient interest rate buffer if economic conditions deteriorate further. That...



Source: Shutterstock

Governor of the Central Bank of Malaysia Nor Shamsiah Mohd Yunus

**3.00%** Policy rate  
After a 25bp cut today

As expected

### No policy surprise, so little market impact

Malaysia's central bank cut the overnight policy rate by 25 basis point to 3.00% at their meeting today. This was in line with our forecast as well as the consensus median estimate, though the consensus was fairly skewed as nine out of 23 analysts in the Bloomberg survey expected no policy change.

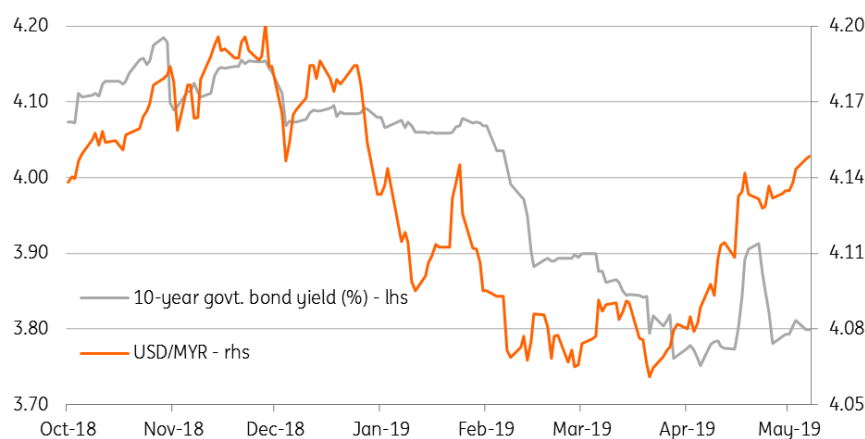
*We're revising our USD/MYR year-end forecast higher to*

## 4.12 from 4.05

But the markets had priced in a cut, judging from the 30bp year-to-date fall in the 10-year government bond yield and by 0.3% depreciation of the Malaysian ringgit. As we expected, the bonds recouped from their recent sell-off, after the FTSE Russell dropped them from its global bond index. But the currency isn't immune to the broader weakening pressure on emerging market currencies. We are revising our end-2019 USD/MYR forecast higher to 4.12 from 4.05.

[Read Malaysia: What's happening to ringgit?](#)

## Markets are priced for a rate cut



Source: Bloomberg, ING

## Increased external headwinds to growth

The 'unresolved trade tensions', the key source of risk that BNM's previous policy statement in March cited at the outset, have indeed materialised to pack the punch of policy easing today.

[Today's statement](#) noted, "Considerable downside risk to global growth remain, stemming from unresolved trade tensions and prolonged country-specific weaknesses in the major economies". On the domestic side, it cited 'stable labour market conditions and capacity expansion in key sectors as supporting consumption and investment spending going forward, and (GDP) growth staying within the BNM's baseline of 4.3 - 4.8% for this year. However, it also pointed to heightened external headwind to growth from the trade tensions and extended commodity market weakness.

Thanks to the absence of strong demand pressure, inflation isn't perceived as a major concern this year and the central bank's forecast is 0.7-1.7%.

## Possibly one-and-done move for the year

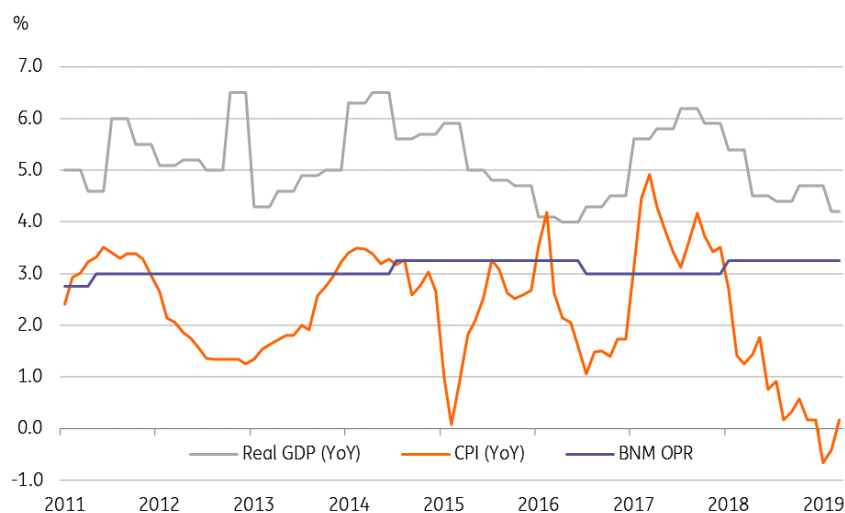
Today's rate cut still leaves the central bank with a sufficient interest rate buffer if economic conditions deteriorate further, but this may not be required.

Although the GDP slowdown intensified coming into 2019 – our estimate of 4.2% growth in the first quarter puts it below the BNM's forecast range for the year. We expect the timely policy boost together with the favourable base effect to shore up growth in the rest of the year towards the top end of the forecast range.

Inflation returned to the positive territory in March after two consecutive months of being negative. With inflation likely to remain close to the low end of the BNM's forecast range, the central bank has room to maintain the current level of policy accommodation going forward.

Our full-year 2019 growth and inflation forecasts remain at 4.6% and 1.0% respectively.

## BNM has sufficient policy buffer



Source: Bloomberg, CEIC, ING

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