

In case you missed it: Trading blows

Uncertainty over a potential tit-for-tat trade war dominated markets this week, with the US slapping tariffs on China and China reciprocating in kind. The trade tiff has raised questions about the outlook for global growth, central bank policy and the direction of financial markets. Here's everything we've been thinking about

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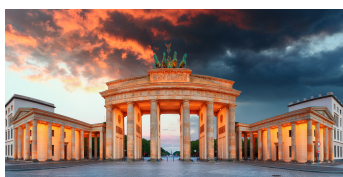


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Trade war: Trump will flex muscle until US elections

The world is about to enter into a real trade war. In our view, only significant protests among Trump voters or a quick surrender of US trade partners can prevent this. There are few signs this will happen anytime soon



Trade: the war is on

Things have changed. In our [analysis](#) at the end of March, there was a real possibility that various trade partners would be permanently exempted from higher US tariffs and that others would give in to Trump's demands under the threat of elevated tariffs, thereby avoiding a broad trade war. At first, this seemed to be the case. South Korea, Brazil, Argentina and especially China made considerable concessions.

But in the run-up to the G7 summit, Trump decided that his allies in Europe and his Nafta partners Mexico and Canada would no longer be exempt from steel and aluminium tariffs. He also decided that the concessions offered by the Chinese were not enough to put the trade conflict between the US and China on hold. Trump ruled that a 25% tariff on \$50 billion worth of imports from China- as a punishment for alleged theft of US intellectual property- would be implemented on 6 July. As a consequence, China, the EU, Canada and Mexico are hitting back.

And we fear there is more to come. China has threatened to impose its own tariffs on US products

on Friday, which the US has warned will lead to tariffs on an additional \$200 billion of Chinese export goods at a rate of 10%. Trump has already warned that if the Chinese retaliate again, another package of goods worth \$200 billion will be subject to higher tariffs as well.

In addition, the EU could see its car exports to the US hampered due to an import tax of 20% if the US Commerce Department's investigation concludes that imports of cars are a threat to national security. This measure could well be applied to other countries given that the current investigation encompasses imported cars from all countries (not just the EU). According to the Financial Times, the EU is considering a special deal with the US on cars, but many hurdles need to be overcome for this to become reality.

Trump overplays his hand

It is impossible to know how the trade war will evolve precisely from Friday onwards, so we consider three scenarios. One of the most important points to make here is that if President Trump steps up his protectionist measures afterwards, the US economy will join the rest of the world in suffering negative GDP effects (see figure 1). This is due to the fact that the positive effects of import substitution will no longer outweigh the negative effects that retaliation will have on US exports.

Figure 1

GDP impacts of trade war escalation, %					
	US	EU	China	World	
				GDP	Trade
6 July	0.06	-0.02	-0.18	-0.03	-0.35
Scenario 1	-0.05	-0.08	-0.27	-0.10	-0.67
Scenario 2	-0.16	-0.12	-0.36	-0.17	-0.90
Scenario 3	-1.99	-0.64	-0.97	-0.82	-2.60

Source: ING estimates

6 July: US steel and aluminium tariffs, plus 25 percentage point (pp) tariff increases on imports from China worth \$50bn. Both measures are retaliated against by trade partners.

Scenario 1: US increases tariffs on imports from China worth \$200bn by 10pp and on European cars by 20pp. China and the EU retaliate.

Scenario 2: US increases tariffs on a further \$200bn of imports from China by 10pp, and \$100bn of imports from the EU by 10pp. China and the EU retaliate.

Scenario 3: US increases tariffs by 20pp on all imports and all trade partners retaliate.

In the extreme third scenario, where the US charges an import tariff of 20% on imports from all countries and these countries do the same regarding their imports from the US, the American economy suffers a cumulative GDP loss that's three times as big as the rest of the world's within just 24 months. This is a consequence of the fact that US exporters would face a 20% tariff at the borders of all destination countries, while the rest of the world only face this tariff at the American border and trade among each other at prevailing tariffs.

The US economy and its trade balance would have been much better off if Trump had accepted the concessions that China offered during the negotiations. In particular, the offer to increase imports from the US by \$70 billion would have been a much better result. The tariffs on Chinese imports in, for example scenario 3, are probably not even high enough to reduce imports by more than \$70 billion and because American exports to China will decline due to Chinese retaliation, the net result in the bilateral trade balance will not even come close to \$70 billion.

The scenarios also show that China will be hurt more than the EU because the US exports more to the EU than to China. So in the EU, retaliation leads to more GDP growth caused by import substitution than in China.

The table also shows that world trade will suffer more than world GDP. An all-out trade war would drive down world trade growth by 2.6 percentage points in two years while the effect on world GDP would be -0.8 percentage points.

The most worrying aspect within this dispute is that Trump views his trade restricting measures as necessary to level the playing field for trade and he considers a response to retaliatory measures as unavoidable. This could mean a trade war escalates quickly.

When will this end?

When will Trump stop firing at his trade partners? To answer that question we need to know what his overall objective is. How many concessions from trade partners are needed for Trump to stop his war on trade? We don't know but Trump's attitude towards China indicates that he is aiming very high. He wants the bilateral trade deficit with China to be cut by more than half in two years. And the president seems reluctant to compromise, as seen by his refusal to accept China's offer to increase imports from the US by \$70 billion.

Trump's ambition reduces the chance that further negotiations with China will lead to a result any time soon. And his recent remark that the EU may be "as bad as China" when it comes to trading fairly with the US, signals a lack of flexibility in the emerging negotiations with the EU on bilateral trade in cars.

In our view, there are only two events that could bring this trade war to an end. First, trade partners give in to Trump's demands. Secondly, internal resistance in the US against trade policy becomes too much, especially if Trump voters start to protest on a large scale (see figure 2).

Figure 2

Trade war scenario	Trade partner's behaviour	+	Attitude of Trump voters	=	Result
1. Trump's gamble succeeds	Trade partners give in soon		Support for Trump continues		Short trade war
2. Trump's gamble fails	Trade partners keep retaliating		Support for Trump continues		Long trade war
3. Trump loses face	Trade partners keep retaliating		Voters oppose trade policy		Short trade war
4. trump gets lucky	Trade partners give in soon		Voters oppose trade policy		Short trade war

Right now, there is little reason to be optimistic about any of this happening soon. First of all, we don't see a lot of domestic resistance from Trump voters against his policy. Ratings on Trump's economic policies are actually improving. Recent events also teach us that Trump is unmoved by objections from business leaders. He criticised Harley Davidson for shifting some operations out of the US while the American steel association's plea to exempt Canada from tariffs fell on deaf ears. Maybe Congress can stop Trump, but that remains to be seen.

Second, US trade partners could decide to give in to Trump's demands, but the concessions from China thus far are already quite generous and it seems unlikely that they'll meet Trump's demand to lower the trade deficit by \$200 billion. And the EU? Well thus far, the bloc has been playing hardball with the US. The EU seems to be standing pretty firm in its defence of WTO rules.

Canada and Mexico are most dependent on demand from the US for their exports, making them the first likely candidates to acquiesce. But equally, it wouldn't make sense for an offshore El Dorado like Mexico to accept Trump's request for a sunset clause, which would scare away investors.

The world has to be prepared for an escalation of the trade conflict in the months to come. For

now, Trump's voters back his stance on trade, suggesting he's unlikely to back down, particularly ahead of the mid-term elections, where the Republicans will be fighting to hold onto a majority in the Senate. By the end of the year, the effect of the trade war on the US economy will become more visible, which might spark a rethink of his trade policy.

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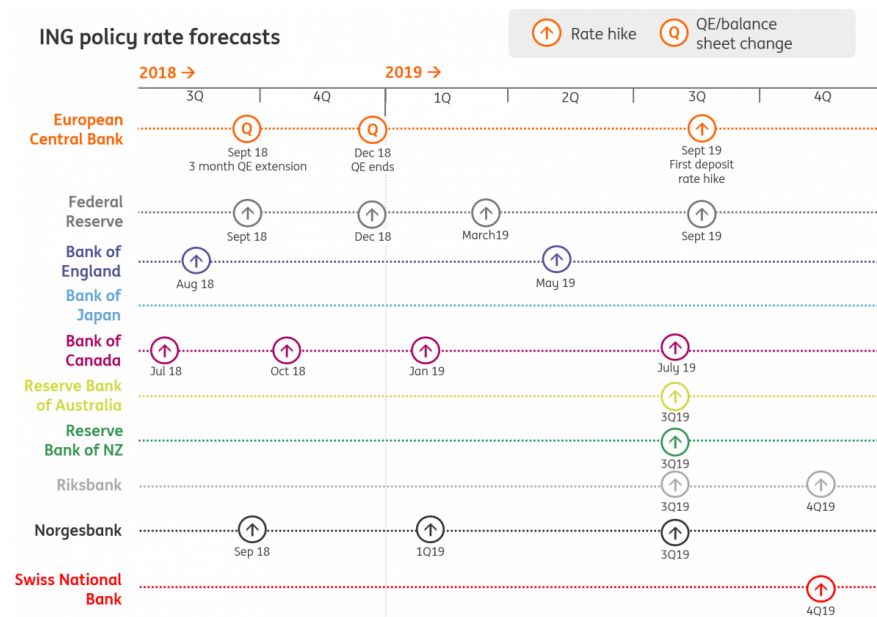
Where next for global central banks?

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Source: Federal Reserve, Bank of England, Shutterstock

Where next for central banks?



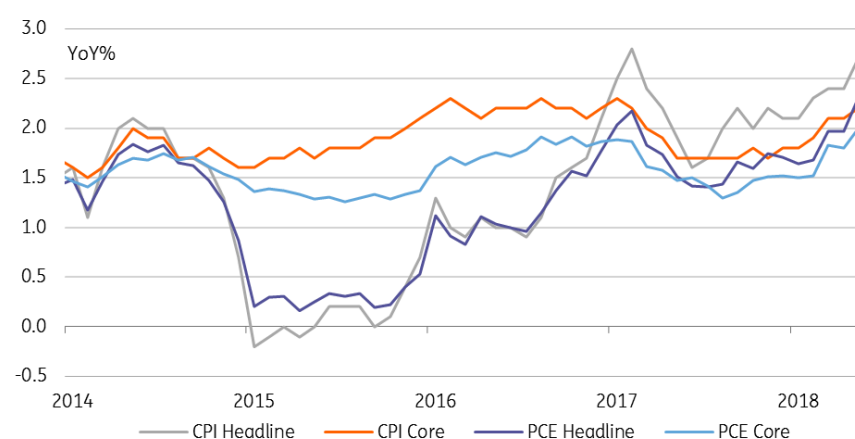
Federal Reserve: A steady climb

The Federal Reserve is sticking to its 'gradual' policy normalisation plan, which essentially means a rate hike every quarter. However in the near term, the balance of risks is skewed towards swifter action despite financial market pre-occupation over the potential for a tariff-led trade war.

The economy looks set to grow 4% annualised in 2Q18, buoyed by tax cuts, after a 'soft' 2% in 1Q18 while inflation continues to edge higher with headline CPI set to hit 3% YoY in the next couple of months. At the same time, employment growth is averaging 207,000 per month YTD in 2018 versus the 182,000 monthly average in 2017 and you have to go all the way back to December 1969 to find a lower unemployment rate.

For now, corporate America is sanguine on the trade situation. Business surveys are strong given robust demand, but should tensions escalate and trade barriers go up, growth may moderate. This could lead to a slower pace of interest rate hikes in 2019, but the process is unlikely to stop. The tightness in the labour market and rising pay pressures will continue to support both consumer demand and inflation.

US inflation keeps the pressure on for Fed rate hikes



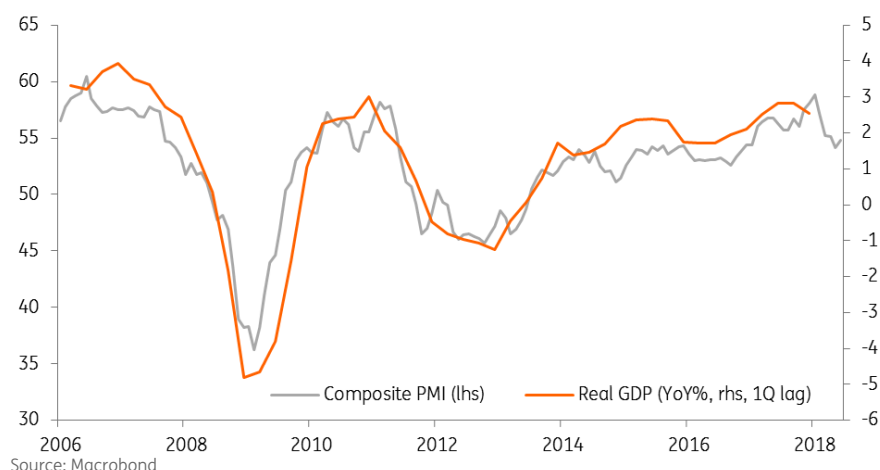
Source: Bloomberg

ECB: Dovish tapering

At its last meeting, the European Central Bank found a Solomon judgement to please both the doves and the hawks. A dovish tapering without creating a tantrum. The announcement that the ECB anticipates another reduction of the monthly quantitative easing purchases to €15 billion after September and an end of the net purchases by the end of the year was an elegant way to prepare markets. It would require a significant worsening of the economic situation over coming months, as well as an absence of any signs that core inflation is creeping upwards, for the ECB not to deliver.

However, the increased uncertainty on the back of trade tensions and political turbulence in the eurozone keep the door for a QE extension into 2019 slightly ajar. Once QE has ended, all eyes will be on the timing of a possible first rate hike. Here, ECB president Mario Draghi was very clear: interest rates will remain unchanged at least through the summer of 2019. This would give him two opportunities to hike rates before he leaves office: in early September and late October. In our view, he will use at least one of these two opportunities.

Eurozone data has softened



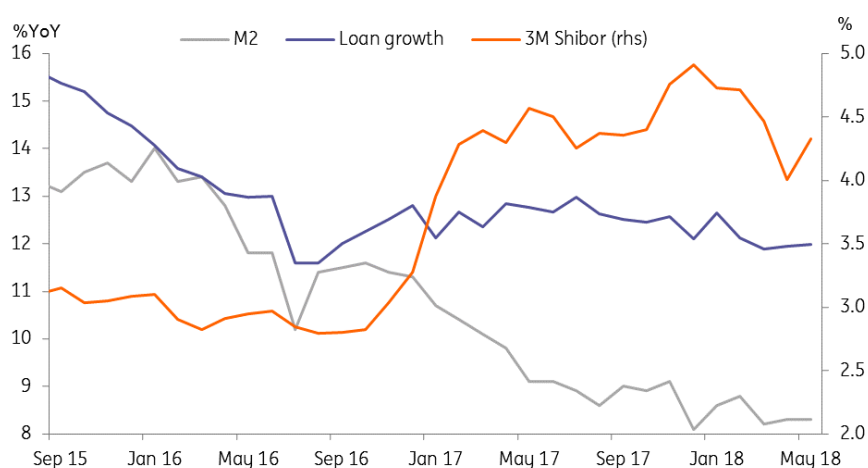
People's Bank of China: Safeguarding against trade wars

It is a tricky moment for the PBoC. On the one hand, it has to loosen monetary policy to safeguard against downside risks from trade, but it also has to tighten liquidity to fulfil its deleveraging target. The Chinese central bank (PBoC) has stopped following the Fed with rate hikes, and instead has cut the reserve requirement ratio and softened the yuan further to support SMEs through the current trade environment.

As the PBoC is now preparing to safeguard the economy from risks arising from trade and investment tensions, we don't expect the central bank to raise interest rates (7-day repo) in 2H18, but we would expect further RRR cuts at the beginning of each quarter, each of 0.5 percentage points. The RRR cuts, like previous moves, would predominantly release funds to SMEs, which are prone to export risks. As a result, we revise our USDCNY forecast to 7.0 for the end of 2018.

On the other hand, the PBoC will continue financial deleveraging reform by limiting issuance of wealth management products, and therefore restricting credit flowing into local government-related infrastructure projects. Daily liquidity management will remain tight as financial deleveraging reform continues.

China loan growth



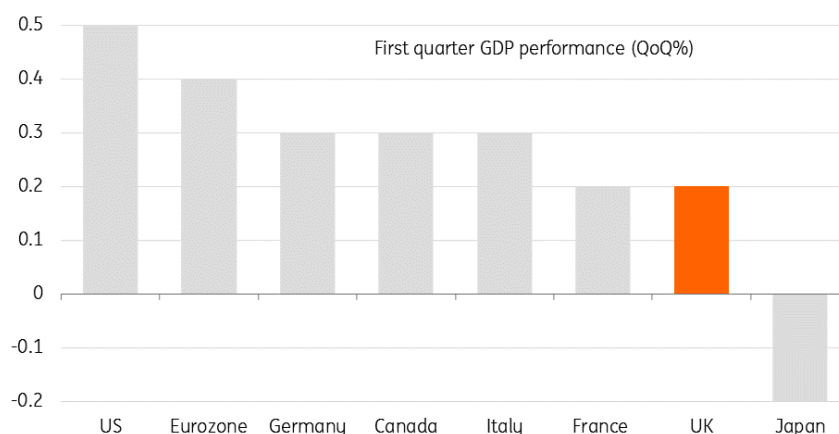
Source: Bloomberg, ING

Bank of England: Gearing up for an August hike, despite mixed data

The big question everyone is trying to answer in the UK is whether or not the economy has rebounded enough during the second quarter to justify an August rate hike. The Bank of England's recent commentary increasingly indicates they believe the answer to be "yes". Chief economist Andy Haldane joined two others to vote for an immediate hike at the June meeting. At face value, the latest data appears to support this. Retailers have had a better ride over recent weeks, while service sector activity has recovered somewhat. On this basis, we think policymakers are keen to hike rates if they can.

But this is not guaranteed. Looking beyond the weather, consumers remain very cautious when it comes to big-ticket purchases. This, combined with higher business rates and rising minimum wage costs, is continuing to lead large high street firms into difficulties. And while the recent overall wage growth trend has been better this year, momentum has begun to slow a little. Based on what policymakers have been saying recently, we still suspect the Bank is gearing up for an August rate hike. But the risks of a rapid succession of hikes beyond then remain low, particularly as Brexit noise ratchets up in the autumn.

UK 1Q growth was poor relative to the rest of the world



Source: Macrobond

Bank of Japan: Taper plans bogged down by trade & ECB

Not a lot has changed for the BoJ since our last update. It continues to pass up on regular bond purchases on occasion, no doubt viewing this as a good way to prevent a premature exhaustion of available instruments when bond yields are behaving themselves anyway. More of this in the future seems likely, even to the point where we cease to think of the BoJ's purchases as regular, and begin to view them more as reactive, depending on market conditions.

As such, the notion of a stealth taper remains one we like. But the cover for doing this has been reduced as the ECB has made its own taper a very drawn out and slow affair. With limited distraction from them, the BoJ's own attempts to return to something closer to normality are getting bogged down.

On top of which, with the trade environment globally, and particularly in Asia turning more negative, China beginning to look a little more concerning, and Japan's own data flow losing some momentum, the BoJ's own policy intentions have most likely been postponed until later in 2019, at the earliest.

Bank of Canada: Twists and turns

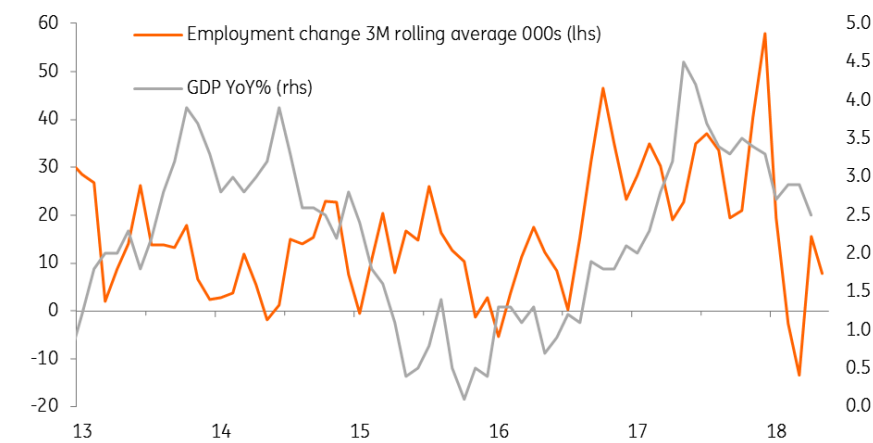
The market had been all set for an 11 July rate hike from the Bank of Canada, but comments from governor Stephen Poloz have muddied the water in recent days. Poloz cited a "litany of things we simply do not know" and the uncertainty over Trump's trade tariffs as an issue that would "figure prominently in our upcoming deliberations". This led to markets pricing in the odds of a hike this month at just 50:50.

However, the following day he adopted a more hawkish stance saying that "we're in a situation where the economy will warrant higher interest rates". He added "we're data dependent, not headline dependent. We're not going to make policy on the basis of political rhetoric". This suggests he felt markets may have over-interpreted his previous statement. As such, should the numbers come in OK between now and 11 July, we are probably going to get a rate rise.

The outcome hinges on Friday's Labour report. If employment rebounds strongly after two consecutive falls we'll get a hike. Assuming the trade rhetoric calms as we predict - note Nafta

talks are ongoing – then this can pave the way for a further rate rise in 4Q given inflation is broadly in line with target and the economy remains set to grow close to trend this year.

A rebound in Canadian employment could help unlock a rate hike



Source: Bloomberg

Riksbank: Still waiting for Godot

The outlook for the Riksbank remains challenging. While the Swedish economy continues to grow at a solid pace (3.3% YoY in 1Q) and headline inflation has reached 2%, growth momentum is slowing down and the underlying trend in inflation remains subdued.

In addition, Sweden's export-oriented economy is highly vulnerable to escalating trade tensions driven by the US's aggressive stance, and the domestic housing market remains under pressure.

At its policy meeting on 3 July, the Riksbank left rates and the interest rate path unchanged (indicating the first hike towards the end of 2018).

In the longer term, our view remains that weak domestic inflation pressures and the very gradual tightening of ECB policy means the Swedish central bank is unlikely to deliver its first rate hike until mid-2019. We believe the Riksbank's policy stance will start to shift slowly in that direction as the year goes on.

Norges Bank: Getting ready to hike

At its latest meeting in June, Norges Bank confirmed its intention to raise interest rates by 25 basis points to 0.75% in September and also raised its interest rate forecast further out. With a strengthening domestic recovery and buoyant oil prices supporting the growth outlook, we think the Bank will stick to the September hike. At this point, it would take a major setback for the Norwegian economy in the next three months to force the NB to change course.

The June decision reinforces our view that the Norwegian central bank is in a more hawkish mode than its fellow central banks in western Europe. While the ECB, BoE, SNB, and the Riksbank have all pushed back rate expectations in the first half of this year, the NB has been going the other way, raising the expected path of interest rates in March and June.

So long as the recovery in the domestic economy stays on track and oil prices hold up, the NB is likely to remain in tightening mode.

Reserve Bank of Australia: On hold as trade uncertainty builds

The Reserve Bank of Australia met on 3 July and held interest rates steady at 1.5%. Although there was [a subtle shift in tone](#) to a more negative outlook, it wasn't enough to change our view that the next move for the RBA will be to tighten. We note that inflation could pick up over the coming quarters, and the main reason why policy remains unchanged – stagnant wages growth, is at odds with an improving labour market and rising GDP growth and inflation.

Perhaps the main reason for not tightening is simply an absence of necessity, though this is a bit backward looking. The lack of central bank action is also partly a reflection of the ongoing increase in Australian household debt, which at 190.1% of household incomes, means that any rate hike will have a proportionately greater dampening effect on household spending than it would have done when debt ratios were only 100%. This is becoming a bit chicken and egg though, and debt will not stop rising if rates remain low for an extended period.

The best argument for inaction now is uncertainty about the global trading environment. Although it has not yet hit the commodity space, we expect it to do so in the quarters ahead, which would likely weigh heavily on Australian terms of trade and growth.

Reserve Bank of New Zealand: Dovish rethink has pushed AUD/NZD higher

The Reserve Bank of New Zealand took a much more dovish stance at its latest policy meeting, and signalled that rates could move down as well as up. This has caused a rethink in the forecasting community, which had been assuming that rates would remain on hold for the foreseeable future, like its larger neighbour. Our base case remains that the Bank will stay on hold, eventually followed by some modest tightening. But a more damaging trade environment would provide a suitable catalyst for NZ rates to converge on Australian rates, which are currently 25 basis points lower at 1.5%.

This latest dovish swing from the RBNZ has enabled AUD/NZD to push above 1.09, but we doubt that it could move past 1.13 without a further catalyst specific to the New Zealand economy.

Swiss National Bank: Wait and see

At its June meeting, the Swiss National Bank left its main policy rates unchanged: the target range for the 3-month Libor was maintained between -1.25% and -0.25% and the interest rate on sight deposits with the SNB remained set at -0.75%. Moreover, the SNB reiterated its willingness to intervene if needed in the foreign exchange markets to prevent an appreciation of the Swiss franc. The SNB still believes the Swiss franc is “highly valued” and still believes it is considered a safe-haven asset.

Given the higher than expected inflation during the first few months of 2018, the SNB revised its conditional inflation anticipation (i.e. based on the assumption of no change in monetary policy) upwards for 2018, to 0.9% from 0.6% estimated in March. However, it didn't revise its forecast for 2019 (0.9%), recognising that higher inflation is due to temporary factors. Moreover, it revised its inflation forecast for 2020 downwards, from 1.9% to 1.6% which signals a rather dovish

monetary policy over the coming years.

We believe the SNB won't change its policy anytime soon. Given that the central bank's worst nightmare is a strong appreciation of the franc, we believe it'll wait on the ECB to start raising rates. The ECB announcement that it'll stop bond buying in December isn't enough on its own to make the SNB change its policy. Given that the ECB is not expecting to hike before the end of summer 2019, we think the SNB will hold off raising rates before December 2019.

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Asian foreign exchange in tariff tantrum

The near-term outlook for Asian currencies is unambiguously negative – further out, the scope for some recovery remains



Source: Shutterstock

Trade war is upon us

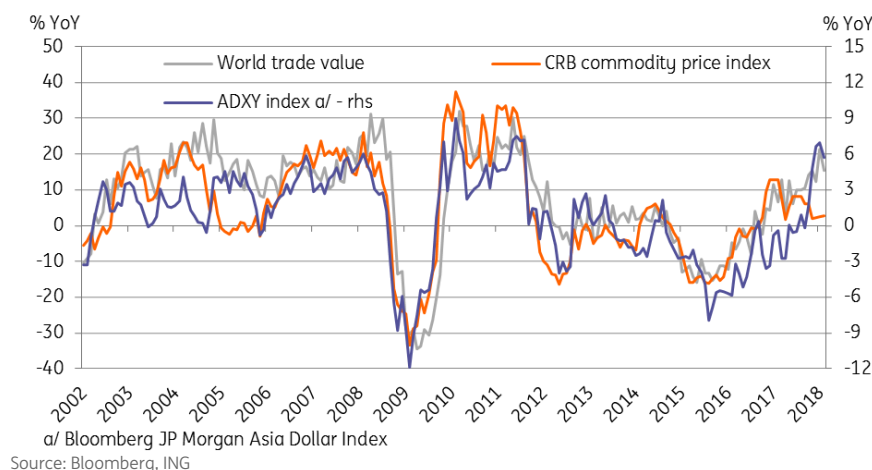
It seems as if we've been talking about trade wars for months now yet until this week, no tariffs had actually been levied, and some still hold out hope that a trade war can be averted.

We think it's getting too late for that. We sense that the Trump administration feels the global trade environment is unfair, that tariffs can help redress the balance in the US' favour and that it can win a trade war. We disagree with both the premise and the solution - but that doesn't change anything. Tariffs are coming, and some have already arrived.

With tariffs we expect global trade growth to worsen. This is going to be important in terms of local Asian currency (FX) strength, but exactly how much and for how long is a more complicated story.

Let's start by considering the relationship between global trade and Asian currency strength. The figure below shows world trade in USD plotted against both the ADXY index (index of nominal Asia ex-Japan currencies) and the headline CRB commodity index.

World Trade, Commodity Prices and Asian Currencies



The measure of global trade we have used is from Bloomberg, which derives it from IMF data. Trade is calculated from imports, not exports, as these are viewed as the least distorted of the two series. In contrast to the Dutch Trade statistics, which are sometimes used, this data is more timely and is available more frequently, making for easier comparison with real-time indicators like foreign exchange.

What strikes us particularly, is that while so many of the relationships that held before the global financial crisis have either weakened or been utterly destroyed, the relationships shown in the figure above holds firm before, during and after the global financial crisis.

We believe the trade environment for Asia will continue to deteriorate through the rest of 2018. But there is a chance that the outlook after that will be less threatening

Given that Asia accounts for about a third of all global trade, Europe for about 40% and North America, only about 10% and the logic of this becomes hard to refute. A negative shock to global trade will hurt the growth potential of one of the most trade focussed regions in the world. Moreover, relative to GDP, trade is even more important for Asian growth despite accounting for a slightly smaller share of the world trade total than Europe. Hit this trade outlook with a negative shock like tariffs, and local Asian currencies are going to suffer.

So what are we really looking at in terms of the trade outlook? In the short term, the prognosis isn't good. Tariffs, retaliatory tariffs, and retaliation to that retaliation describes the situation between the US and China so far. But globally, the picture is even worse. The US/EU trade theatre of war is almost as ugly as the US/China campaign, and let's not get started on NAFTA.

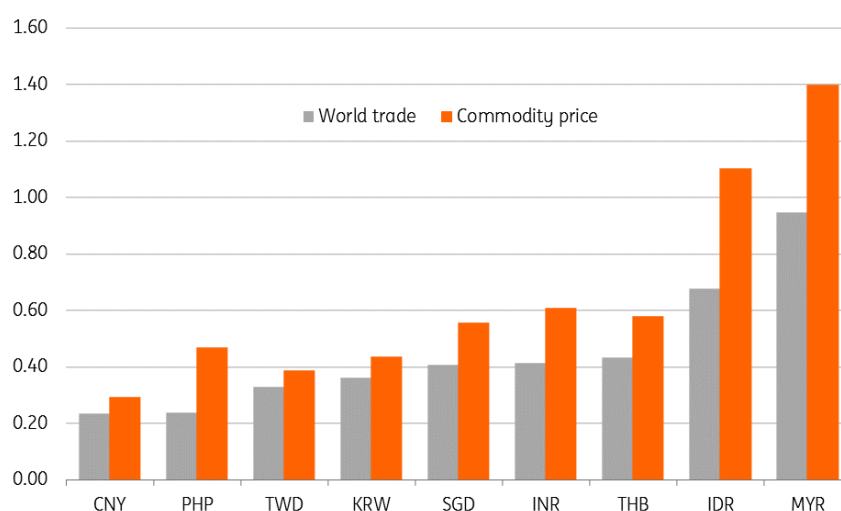
So as a risk scenario, we are considering a temporary 20% decline in global dollar trade values. That is not as big a drop as during the global financial crisis. But it could still result in a decline of the Asian FX index of about 6%-7%.

Currency sensitivity to trade and commodity prices

But the story doesn't end there, because a fall in global trade of this magnitude is likely to weigh on commodity prices. China is the world's marginal consumer of most commodities, so anything which hurts China's purchasing power is also likely to weigh on commodities, and this could be the second leg of a looming global trade shock.

The figure below presents elasticities of each of Asia ex-Japan currencies to both trade and commodity prices derived from the simple regression analysis.

Asian currency elasticity to world trade and commodity prices



Source: Bloomberg, ING

The Chinese yuan is the least sensitive of all currencies, but then it is not a free float, so that isn't too surprising. At the other end of the spectrum is the Malaysian ringgit (MYR) and the Indonesian rupiah (IDR). These currencies are much more sensitive to commodity prices.

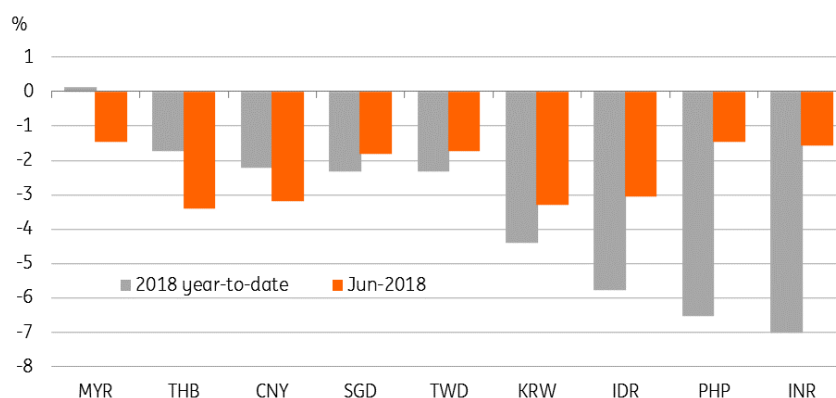
The impact of a trade shock will also vary depending on the hit to individual economies via their external payments situations. That is to say that currencies of countries with trade and current account deficits – India, Indonesia, and the Philippines – will be more vulnerable than those of surplus countries like – Thailand, Korea, Taiwan, Malaysia, and Singapore.

The level of economic openness and currency management system are other determinants of the magnitude of any shock on individual economies. Less open economies or those with heavily managed currencies should be less vulnerable to external trade shocks.

CNY takes the brunt of the impact

In contrast to the analysis above, President Trump's announcement of \$50bn tariff plan on 16 June has swung the fortunes of the Chinese yuan (CNY). This has swung from being Asia's most resilient currency earlier in the year to one of the worst performers in the recent sell-off. Over 3% CNY depreciation against the USD since the beginning of June is reminiscent of the devaluation in August 2015.

Asia ex-Japan currency performance year-to-date



Note: In descending order of year-to-date performance.

Source: Bloomberg, ING

This raises the question of whether a weaker currency could be one of China's weapons in the current trade war. Our Greater China Economist, Iris Pang, [doesn't think so](#).

Some of the other biggest underperformers in the region in the most recent sell-off are neither current account deficit countries, nor commodity producers, but instead, are heavily engaged in technology, for example, the Korean won. For them, the recent currency weakness is partly a reflection of tech stock anxiety, and the US sanctions on ZTE have no doubt played a part. Though in time, a technology embargo by the US on Chinese producers simply plays into the hands of the likes of Korea and Taiwan, who can pick up that market share. What we are seeing is merely short-run disruption.

Moreover, what we are seeing with the Korean won could also simply reflect that it is one of the bigger more liquid currencies in the region. When foreign investors pull out of Asian FX, they probably have bigger exposures to Korea than many other currencies. That is what they sell first, even though on most fundamental grounds, Korea is one of the most attractive investment propositions in the region.

Though further weakness cannot be ruled out, we sense that the following phases of Asian FX weakness will be kinder to the tech-heavy currencies than either the commodity-producing economies including the Indonesian rupiah and the Malaysian ringgit or the current account deficit countries such as the Indian rupee, Philippine peso and the Indonesian rupiah.

Indeed, the recent aggressive rate increases from Bank Indonesia seem to show a degree of prescience, as they appear on both of our 'at risk' watch lists. Central bank action can offset what is coming, but at the expense of domestic demand, and will be more effective combined with a reining back of some of the fiscal expansion that has played a large part in creating the external imbalances in these economies (that doesn't look likely anywhere).

[Read China policies to cushion potential trade war impact](#)

Recession or not?

As argued so far, the direction for Asian FX is clear, but the timing and extent of the weakness for individual currencies is less certain and subject to many more moving parts than would be ideal.

A valid question linked to this debate is whether this could be the source of the next global, or at least Asian recession - a theorem that has begun to attract some vocal followers in recent weeks. In our view, it is certainly possible. Though some factors provide a little comfort.

We're currently dealing mainly with protectionism, not weak global demand. Though of course, the former could well lead to the latter. Moreover, at the moment, the situation is best described as the US against the rest of the world, not a multilateral trade conflict. It is possible to imagine a proliferation of trade deals between the rest of the world in this environment, but which exclude the US (for example the Regional Comprehensive Economic Partnership - RCEP), which might even deliver a global net trade boost - a sort of "My enemy's trade enemy is my friend" situation.

A financial crisis was at the root of the 2008-09 recession, - with contagion from the US to the global financial system. That's not the case today. Though there is growing concern about a possible Chinese credit crunch. So far, this is contained.

Tighter monetary policies before the 2008-09 crisis, subsequent regulatory clamp down and fiscal austerity made a bad situation worse. Monetary policies are still relatively loose today in both emerging and developed countries, despite some withdrawal of accommodation by the Federal Reserve since last year. Fiscal policies are not particularly loose except in the US and don't look likely to be reversed imminently.

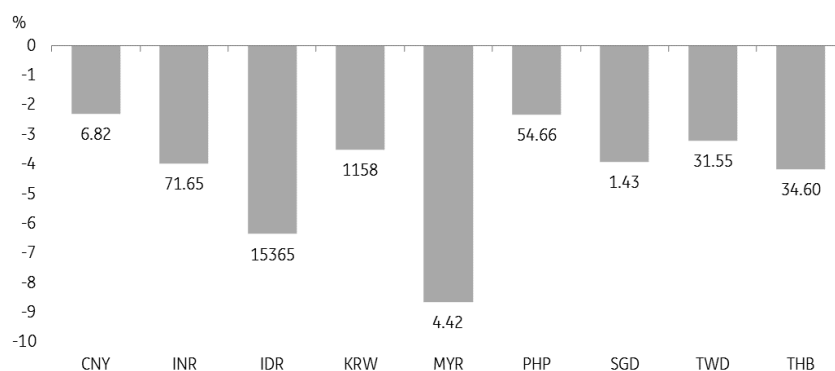
The domestic-demand-driven growth in most Asian economies could cushion some of any negative trade impact, though how long this would hold out if the trade sectors begin to crumble is debatable.

In short, there are some mitigating factors, but none are hugely comforting. A worst-case scenario might not be as bad as the global financial crisis, but it might still be pretty bad.

Expect a moderately negative trade impact

We believe the trade environment for Asia will continue to deteriorate through the rest of 2018. But there is a chance that the outlook after that will be less threatening. In our worst-case scenario, global trade falls by only about 10-to-20% (similar to that witnessed during the 2014-15 oil slump - and about half that during the global financial crisis). Subject to the caveats of our earlier analysis, that implies a 2-8% downside risk for regional currencies.

Impact on Asian currencies of 10% fall in world trade



Note: Figures along bars are worst-case exchange rates vs. USD

Source: ING

Some hope

We believe the US public is the main intended audience of recent US trade policy actions. It doesn't appear to be US business, who on the whole, take an orthodox view of the benefits of trade, no doubt knowing first-hand the benefits that trade brings.

This motivation is likely to run strong ahead of the US mid-term elections. But if Republicans come out of the mid-terms poorly, and there is a chance that they lose the House of Representatives, then they may be less willing to support the President's protectionist leanings.

Though, this has to be viewed against the possibility that the forthcoming nomination to the Supreme Court may help Trump rebut any attempt by a less friendly Congress to overturn some of his recent security based trade policies as unconstitutional. As stated – this stuff isn't simple.

Along with political developments, the outlook for the USD, in major FX pairs, and by extension for Asian FX, will also be determined by the pace and degree to which the European Central Bank moves towards removing its negative deposit rates. That, in turn, will also be influenced by the global trade outlook.

In short, there are too many moving parts to this story to do anything more than highlight the scenarios. But what is clear, the outlook for Asian FX is negative, and we have shifted our near-term forecasts accordingly. The latest [Asian FX TalkING](#) details the recent steps taken in this direction. But a continuous negative watch on our current Asian currency forecasts remains the order of the day.

Proposed Asian currency forecast revisions for end-2018

	CNY	INR	IDR	KRW	MYR	PHP	SGD	TWD	THB
Spot vs. USD (2-Jul-18)	6.67	68.80	14390	1118	4.04	53.39	1.37	30.54	33.17
Latest forecast for end-2018	7.00	71.50	14320	1180	4.35	54.81	1.43	30.60	35.00
Proposed revision	7.00	71.50	15300	1180	4.35	54.80	1.43	31.50	35.00

Source: Bloomberg, ING

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Germany's digital scoreboard

Sound fundamentals, low-interest rates, and record high employment currently bode well for the German economy, but to tackle long-term challenges such as ageing and digitalisation, Germany urgently needs to step up its game, both in terms of investments and structural reforms. Our digital dashboard highlights the pain points and the opportunities



Source: Shutterstock

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Soybeans: Chinese tariff fully priced in

As the clock hit 12.01am on Friday, US tariffs on \$34 billion worth of imports from China came into effect, and it did not take long for China to retaliate by imposing tariffs on a number of US goods, including a 25% import tariff on US soybeans. We believe the tariff impact is fully priced in already, and therefore do not expect further pressure on CBOT soybeans



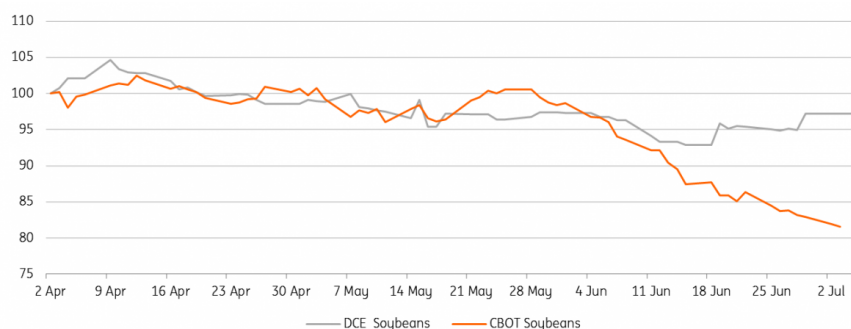
What has happened to soybean prices since the initial announcement?

Unsurprisingly, CBOT soybeans came under significant pressure following the initial announcement from China back in April that it would retaliate to any US tariffs. CBOT soybean prices have fallen by a little over 21% since mid-April, trading below \$8.50/bu, levels last seen back in 2008. In fact, CBOT has traded down to levels where, even if we take into consideration the 25% import tariff, US soybeans are still workable into the Chinese market. At the moment, we estimate that import parity is around \$8.70/bu, compared to the CBOT November 2018 contract trading at around \$8.56/bu.

Meanwhile, the Chinese domestic soybean futures market has strangely also traded lower, falling by around 7% since mid-April. If we look at the move in the domestic market in USD terms, prices have fallen by almost 12%, reflecting the depreciation that we have seen in the CNY recently. It

appears that the domestic market started pricing in these tariffs earlier in the year, with domestic futures rallying strongly over 1Q18.

CBOT and Dalian normalised soybean price

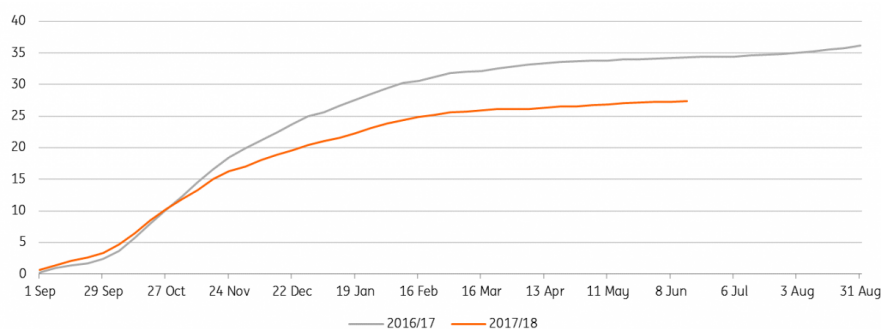


Source: Bloomberg, ING Research

Has there been an impact on US soybean flows yet?

The US exported 36.16mt of soybeans to China last season, making up 39% of total Chinese soybean imports. Meanwhile, China made up 62% of total US export demand. Looking at US export sales over the current marketing year does show that exports to China have fallen well behind last season. The latest data shows that cumulative sales to China are down 20% YoY. However, it's important to point out that exports started falling behind last season prior to the escalation in the trade spat. There are about 1.14mt of outstanding sales in the current marketing year, which shows China as the destination. Given the introduction of the tariff, we are likely to see these sales cancelled, or at least the destination changed, with an incentive for Chinese buyers to source Brazilian soybeans, a situation which will keep Brazilian farmers happy.

US soybean export sales to China (m tonnes)



Source: USDA, ING Research

US loss is Brazil's gain

Brazil is on course to harvest a record soybean crop this season, with it estimated to total 118mt, up 3.5% YoY, putting the country on par with the US when it comes to soybean production. So Chinese tariffs on US soybeans have come at a great time for Brazilian farmers. Cash values for Brazilian soybeans have rallied over CBOT, a sign of growing demand for Brazilian product. However, we are in a period where Chinese buyers seasonally rely on Brazilian supply. It will be interesting to see how the purchase of US soybeans evolves as new crop supply hits the market

later in the year.

Brazil soybean cash value over CBOT soybeans (Usc/bu)



Source: Commodity3, Bloomberg

What does this mean for prices?

While Chinese buyers will be keen to buy soybeans from origins that do not attract a 25% import tariff, we believe that China will still need to rely on the US to help meet domestic demand. In order for flows from the US to China to make sense, we either need to see domestic prices rally, a weakening in CBOT soybeans, or a combination of the two. Clearly what the market has seen so far is weakness in CBOT prices.

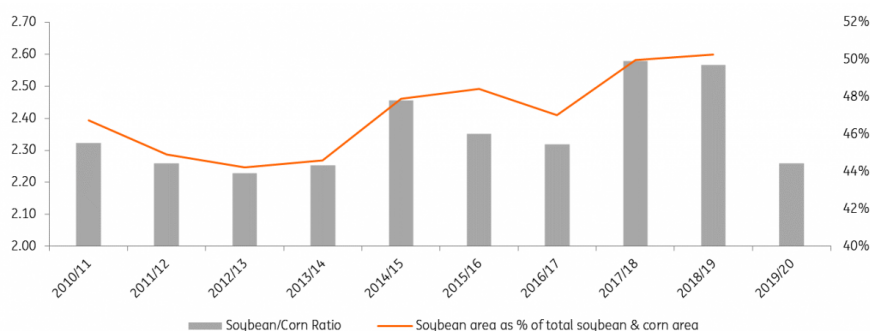
As mentioned previously, CBOT has traded down to levels where imports of US soybeans into China are workable with the 25% import tariff. Therefore we don't believe that there should be much further weakness in CBOT, with prices likely trading largely between \$8.00-8.70/bu over the next 12 months.

The knock-on effect from weaker soybean prices

The weakness that we have seen in the soybeans market has also had an impact on other agri commodities, with CBOT corn prices falling by more than 12% since mid-April. While it is too late for US farmers to adjust their 2018 plantings, it is likely that for 2019 farmers will make a significant adjustment, with them looking to plant more corn at the expense of soybeans. The soybean/corn ratio is already sending this signal to farmers, with it currently standing at 2.26. Therefore assuming normal weather conditions and yields over 2019, the market could expect to see significantly more US corn supply than it was initially anticipating.

However, the underlying fundamentals for the corn market remain constructive, and we believe the market needs this additional supply in order to meet demand moving forward.

US soybean/corn ratio weakens



Source: USDA, Bloomberg, ING Research

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