

Opinion | 29 May 2020

CHINA INDIA

Markets await Trump verdict on HK

President Trump is due to comment on the China-Hong-Kong situation later today...markets to tread water in the meantime



Mass protests in Hong Kong are having an economic impact

HKD Q&A

It feels an anticlimactic end to the week here in Asia after all the noise about China and Hong Kong earlier, though this is a show that will likely run and run, and President Trump is apparently due to make a statement later today about this. Following the comments by Mike Pompeo earlier this week, it is possible that President Trump will use the occasion to announce some sanctions, which as we noted previously, will likely not include tariffs at this time, but could target individuals and impose visa requirements for travel to the US.

There is, as there often is at these times, renewed speculation about the HKD, and 12M forward points have risen substantially over the week, though they are down to about +600 from a high of about +800 a few days ago.

I'm taking the opportunity to re-run some comments from Iris Pang who was asked about this earlier this week (but then I lost her email), so to give them the light they should have already had, here are some HKD Q&As from Iris:

Q: Could the HKD peg be reset to other currencies apart from the USD (CNY for example)?

THINK economic and financial analysis

A: Yes, but setting the HKD peg to other currencies or at other levels is not wise when economic and financial risks are rising, as they are now. So it is possible, but the timing is bad. Moreover, even if the HKMA wanted to change the peg, pegging it to a not-fully convertible currency (in practice CNY is not widely used internationally) would dampen HK's financial market severely. Changing to a basket of currencies, similar to that used for the CNY might be an option, though again, the timing is wrong.

Q: Instead of re-pegging, could the HKMA re-set the upper part of the band to a higher level?

A: Resetting the band would only be a viable option when financial markets were calm, otherwise it would be something similar to Russia in the past.

Q: If the US adopted negative interest rates, could this be another reason for the HKMA to reconsider the USD peg?

A: The risk premium on HK assets should be high enough to avoid negative interest rates even if the Fed adopted such an approach, which we think unlikely. So it shouldn't undermine the HKD.

So perhaps not quite the outright rejection of any possibility of a change to the HKD currency regime that may historically have been the usual response. But plenty of reasons for thinking that it will not happen, at least not imminently, but perhaps only if markets calm down, and even then, probably a much more nuanced approach than simply pegging to the CNY. Tense times though.

Rest of Asia

We've already had plenty of data out from South Korea, following yesterday's slightly uneventful BoK rate meeting (yes, they did cut rates another 25bp, but this appears to be it for rate policy and there isn't much evidence that QE is in the pipeline either - [see here for more](#)). Today's releases of April industrial production -6.0%MoM (-4.5%YoY), weaken the trend but don't overturn the verdict that there is still a weak production recovery going on.

Japanese data were fairly bad, with retail sales for April registering a 13.7%YoY decline, and industrial production down 14.4%YoY. Both figures were bad and worse than expected, but it's all various shades of dreadful these days, so nothing to get too anxious about. And the Tokyo inflation numbers suggest that national inflation will pick up by 0.3pp when May data is released, so some signs of supply disruption causing some relative price shocks. This isn't inflation, but a price level shock. Don't start saying deflation is coming, or you will get a long lecture from me, [or I will force you to read this note](#).

We've also got Indian GDP later today. Prakash Sakpal writes: "India: The 1Q20 GDP report card arrives today. The consensus is for 1.6% YoY growth, down from 4.7% in 4Q19. We are a bit more bearish at 1.1%. The downside risk to the consensus is based on the sharp fall in activity

in March (-35% YoY in exports and -17% in manufacturing). The nationwide Covid-19 lockdown that started, in late March, and is still in place in some of the worst affected states, spells disaster for the current quarter, and will probably deliver a much steeper GDP fall than our -5% forecast. It looks as if India's central bank (the RBI) might be having similar thoughts, given the second emergency rate cut by 40bp just a week ago. India is Asia's epicentre of the pandemic currently and the 9th worst-affected by it in the world based on official data. We expect significant demand destruction keeping GDP growth well into negative territory over the rest of the year".

And also on Thailand: "Balance of payments data for April are expected to show a sharp swing taking the current account to a deficit of about \$750 million from a \$697 million surplus in March. This swing stems from net outflows on the services side, while the trade balance continued to post a strong surplus in April (\$2.5 billion on customs basis). Despite all this, the THB has been performing strongly since April and is already back to being Asia's top currency this month. Covid-19 is under control currently in Thailand, but the hit to the current account from weak exports and tourism remains a headwind for THB appreciation ahead".

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