Trade War 2.0

Comments from Mike Pompeo about the origin of the coronavirus, together with a suggestion from President Trump that he will impose tariffs on China because of the outbreak, are not helping risk sentiment and are pushing USD/CNY higher

Source: Shutterstock

USD/CNY rising

Our Economist for Greater China, Iris Pang, like most of us, is obliged to produce spot forecasts on a range of market indicators, as well as the usual macro numbers. It is one of those parts of the job that carries little upside. And the standing USD/CNY 7.25 forecast for end 2Q20 has not been criticism-free.

But the recent rhetoric from the US is beginning to make it look quite a promising call.

For a few weeks now, mutterings and criticism from the US administration about the origins of the Covid-19 outbreak have been growing. These reached a crescendo at the end of last week, with President Trump reported in Bloomberg to have threatened to impose tariffs on China in retaliation for the Covid-19 outbreak and US Secretary of State, Mike Pompeo, talking of the "enormous evidence" linking the outbreak to the Wuhan virus laboratory.

We haven't seen or heard any of the evidence referred to, so we can't comment on that. But it does look as if one of the underpinnings of the 7.25 call - namely a return to trade tension - is turning into reality. If this continues, then a 7.25 end 2Q20 USD/CNY result will suit our forecasts very well.

For those of you who can still remember the trade war, one of the key results of enhanced trade tension was - stronger USD (so weaker everything else, but especially CNY), and a drop in risk appetite. It is possible that the US administration feels emboldened to restart the trade rhetoric given the rally stocks have undergone in recent weeks. If so, Friday's S&P 500 sell-off comes as a reminder that the underlying drivers for markets have not changed. And given the incredibly weak backdrop, a return to trade war really has the potential to be even more damaging (to both sides) than it was under version 1.0. This needs close watching.

Shape of things to come

South Korea posted April CPI data showing a hefty 0.6% month-on-month drop (0.1% year-on-year). The full release shows, as one might expect, most of the damage coming through the transport component, which fell 3.5% MoM reflecting the collapse in global crude oil prices. Clothing and footwear fell 1.5% on dampened demand, and education costs also fell sharply.

The release tells us two things:

1. It provides a benchmark for other upcoming CPI releases in the region (they could be substantial) and
2. It suggests that the Bank of Korea will cut rates a further 25bp from their current 0.75% at the 28 May meeting.

Asia today

Just to reinforce my earlier comments on China and the Trade War, Iris Pang also writes today, "USD/CNH jumped to 7.13 during the May holiday from 7.06 on Friday, which should be a market reaction to the possible restart of the trade war and technology war as US President Trump has warned of a possible increase in tariffs on Chinese goods. The market will continue to react to any news on the trade and technology war as this will put pressure on both Chinese and US economies".

Iris also adds, "On data, today we will have the Taiwan Markit manufacturing PMI which should come in at only 42.2 due to the deferred release of a new model of smartphone. We will also have Hong Kong GDP growth for 1Q20, where we expect a -10%YoY reading, while the government expects a range of -4% to -7%YoY for the whole of 2020".

And ASEAN news from Prakash Sakpal:

Malaysia: March trade figures are due today. Firmer exports from most Asian economies in March impart some upside risk to the -8.3% YoY consensus on Malaysia's exports. However, underlying the weak consensus is the dent to activity due to the Covid-19 lockdown started in mid-March. Trade is the last piece of economic data for the central bank (BNM) beginning its two-day policy meeting today. We expect a 50bp cut in the overnight policy rate to 2.00%.

Singapore: The April manufacturing PMI is due today, with expectations centred on a drop in the index to an all-time low of 40.0 from 45.4 in March. The extended circuit-breaker measures mean the surprising manufacturing strength shown in the first quarter is poised to be reversed in the current quarter, leaving GDP on a path to a record contraction.

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