Economic commentary

21/09/2018

Week Ahead Asia-Pacific Economic Preview

- **US Fed set to hike interest rates**
- **Caixin China PMI and industrial profits**
- **The Philippines, Taiwan and New Zealand central bank monetary policy meetings**
- **BOJ meeting minutes**
- **Special focus on US-China trade war**

Caixin manufacturing PMI data will provide an important steer into the health of China's economy at the end of the third quarter amid rising trade disputes, in a week that also sees the FOMC and a number of Asia Pacific central banks meet to set monetary policy. Other data highlights for Asia include Vietnam's third quarter GDP, China's industrial profits and a clutch of economic statistics for Japan and Taiwan.

Our special focus this week looks at the intensifying trade war between the US and China.

US Fed likely to hike

The key event of the week will be FOMC meeting, which is widely expected to result in US interest rates being nudged higher for the third time this year. While recent PMI numbers indicate that the third quarter is likely to see a slower growth momentum, it's clear that domestic demand remains strong, helping companies raise prices at a near-record rate.

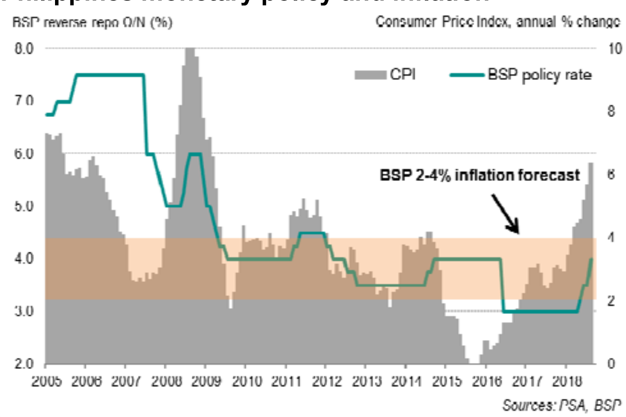
However, with a hike generally thought to be priced-in, it's the accompanying projections and press conference which will likely prove more interesting. Fed watchers will be scouring the so-called dot-plot graph to anticipate the likely speed of future tightening and seek clues from Powell's presser about the extent to which the Fed is worried about external factors and the impact of increasing trade frictions between the US and its key trade partners, particularly China.

China PMI

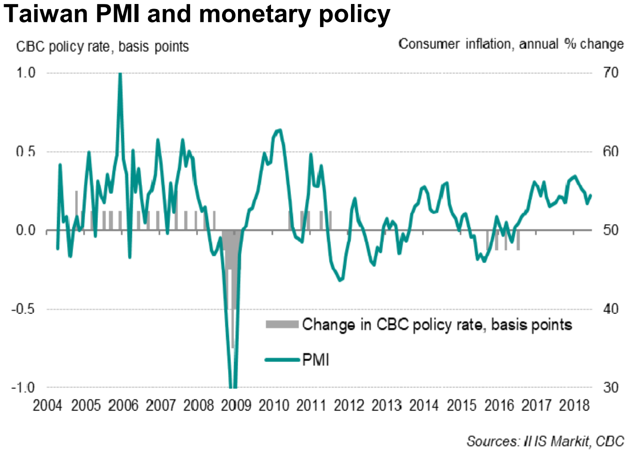
September Caixin China manufacturing PMI data, compiled by IHS Markit, will meanwhile provide early signals for economic activity in China at the end of the third quarter, with the trade aspects of the survey under particular scrutiny. Prior data had indicated softer growth momentum during August, with export sales falling for a fifth straight month.

China PMI: manufacturing & services

Philippines monetary policy and inflation



Taiwan PMI and monetary policy



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The Caixin survey revealed further evidence that escalating trade tensions were a key concern among Chinese firms. Meanwhile, official data on industrial profits could provide further insights into the performance of the industrial sector.

Monetary policy meetings

Next week will also see several central banks across the Asia Pacific region meeting to set monetary policy.

Rising prices mean the Bangko Sentral ng Pilipinas is under pressure to raise interest rates further. Recent sharp rises in inflation prompted the bank's governor to pledge strong monetary action and even consider scheduling an off-cycle meeting. Consumer inflation surged to an annual rate of 6.4% in August, the highest for over nine years. The BSP has hiked rates by a total of 100 basis points since May to address above-target inflation. August PMI surveys indicated that prices remained elevated, sending a hawkish message to policymakers.

Taiwan's central bank is meanwhile expected to maintain interest rates steady in its third quarterly policy meeting, although the next move is widely anticipated to be a rate hike. Historical comparison of PMI data and changes in policy rate suggests that policymakers appear to be falling behind the curve on normalising interest rates.

The Reserve Bank of New Zealand also meets to set monetary policy. While the consensus is for a rate hold, the central bank has not ruled out monetary easing. In August, RBNZ said the odds of a rate cut had increased amid softer economic growth.

Japan

A busy week for Japan will provides further clues as to economic activity and policymaking. Markets will look to data on industrial production, retail sales, housing starts, construction output and jobless rate. The Bank of Japan will also release its July meeting minutes, seeking more clues as to the central bank's thinking as it grapples between the need to sustaining its stimulus and its desire to start normalising policy, especially in the bond markets, as soon as conditions will allow.

Monday 24 September

Singapore inflation (Aug)

BOJ meeting minutes

Germany IFO surveys (Sep)

US Chicago Fed National Activity Index (Aug) and Dallas Fed manufacturing index (Sep)

Tuesday 25 September

Thailand industrial production (Aug)

Taiwan industrial production, retail sales and jobless rate (Aug)

Taiwan interest rate decision

US Case-Shiller home prices (Jul) and consumer confidence (Sep)

Wednesday 26 September

New Zealand trade (Aug)

Singapore industrial production (Aug)

US new home sales (Aug)

Thursday 27 September

FOMC and release of quarterly economic projections

New Zealand interest rate decision (Sep)

China industrial profits (Aug)

Philippines interest rate decision

Hong Kong trade (Aug)

Germany inflation (flash, Sep)

UK nationwide housing prices (Sep)

Euro area business and consumer confidence (Sep)

Euro area economic and industrial sentiment (Sep)

US durable goods orders, pending home sales (Aug) and PCE prices (final, Q2)

Friday 28 September

IHS Markit/Caixin China manufacturing PMI (Sep)

South Korea consumer confidence (Sep)

New Zealand building permits (Aug)

Japan unemployment rate, retail sales and industrial production (Aug)

Japan construction orders and housing starts (Aug)

Australia private sector credit (Aug)

Malaysia PPI (Aug)

Vietnam GDP (Q3) and inflation (Sep)

UK GDP, business investment (final, Q2) and consumer confidence (Sep)

Germany jobless rate (Aug)

Spain and France inflation (flash, Sep)

Spain GDP (final, Q2)

Euro area inflation (flash, Sep)

Brazil unemployment rate (Aug) and consumer confidence (Sep)

US core price index, personal income and personal spending (Aug)

US Chicago PMI and Michigan surveys (Sep)

Special Focus

US-China Trade War Battlefront 2: Gunsmoke and Mirrors?

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

The announcement of additional US tariffs on Chinese goods has raised the stakes in the trade war, but the effects will likely not be limited to China, as other Asian economies may also suffer. However, some countries may benefit amid shifting global supply chains.

Overview

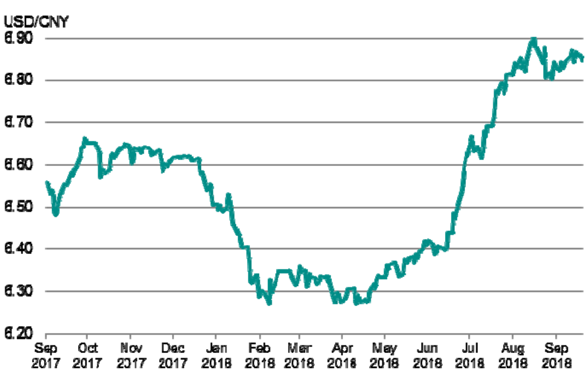
New broadsides of tariff measures have been fired in recent days by both sides in the escalating US-China trade war. The Trump Administration has announced a second tranche of tariffs on China, with a 10% tariff on an additional USD 200 billion of Chinese products to be imposed from 24th September 2018. These measures have been taken as part of the US government's Section 301 investigation of the impact on US firms of China's intellectual property and technology practices. The tariff rate will ramp up to 25% on 1st January 2019.

In response, China immediately announced that it would impose tariffs ranging from 5% to 10% on USD 60 billion of US products, with the new Chinese tariffs also to be implemented from 24th September.,

Yuan Depreciation Shields Chinese Exporters from Near-term Impact

The immediate impact of the 10% tariff rate imposed by the US will be limited, since the depreciation of the Chinese yuan against the USD since February 2018 has largely offset the effect of the tariff on Chinese exporters. The Chinese yuan has depreciated from 6.27 against the USD on 8th February 2018 to 6.87 on 17th September 2018, which has shielded Chinese exporters almost entirely from the impact of the 10% tariff.

The depreciating yuan



The retaliatory Chinese tariff measures to be applied to US products are also relatively mild, at a rate of only 5% to 10% from 24th September.

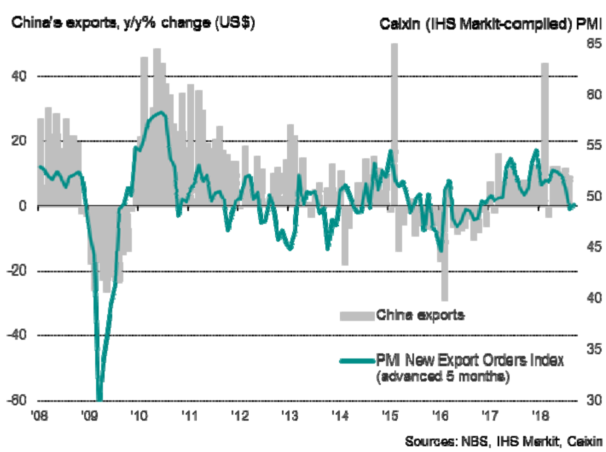
With the disruptive effects to bilateral trade from this second tranche of tariff broadsides by both nations still relatively limited in impact, the focus will now turn to whether high-level bilateral trade talks between China and the US will resume in earnest despite the escalating tariff actions.

If sufficient progress in negotiations can be made in the relatively short time window until the end of 2018, this could avert a further much more damaging escalation of tariff measures. A key political milestone will be the US mid-term elections in November, particularly if there are any significant shifts in the composition of either the House of Representatives or the Senate.

However, if no US-China trade deal can be reached by the end of 2018, and the US tariff rate escalates to 25% on this second tranche of USD 200 billion of Chinese products, the impact on China's export sector will be far more significant.

The latest Caixin General Manufacturing Purchasing Managers' Index (PMI) for August showed that escalating US-China trade frictions had weighed on demand for Chinese manufactures, with new export orders having contracted for the fifth consecutive month. The escalating US-China trade war will be likely to further weigh on Chinese export orders and business sentiment, particularly if no trade deal can be reached by the end of 2018.

China's exports



Collateral Damage and Trade Diversion Effects for Asian Supply Chains

A 25% tariff rate on USD 200 billion of Chinese products would also cause significant collateral damage to other Asian economies that are part of the East Asian manufacturing supply chain. Around one-third of the value added in Chinese exports consists of imported foreign raw materials and intermediate goods, much of which is sourced from East Asian economies.

However, there will also be some trade diversion effects away from China which may benefit some Asian exporting nations such as Vietnam and Malaysia. Vietnam produces low-cost electrical and electronic goods as well as garments and textiles that US importers could source as substitutes for some Chinese products, while Malaysia is a significant exporter of electrical and electronic goods globally.

Outlook

The immediate effect of the second tranche of tariff measures being implemented by the US and China is expected to be relatively modest until the end of 2018. However, if no bilateral trade deal is agreed by that time, then a more punitive US tariff rate of 25% will kick in on USD 200 billion of Chinese products. This would put further downward pressure on Chinese export orders and would also likely dampen Chinese economic growth until a trade deal can be reached.

The Trump Administration has also indicated that a third tranche of US tariff measures could be imposed on up to USD 267 billion of Chinese products, which would then bring almost all Chinese exports to the US under the US tariff measures and would result in a further deterioration of the Chinese export sector outlook for 2019.

With considerable uncertainty clouding the outlook for bilateral trade flows between the US and China, there is anecdotal evidence that some multinationals are already adjusting their global supply chains to reduce exports of products made in China to the US market, while also increasing their exports to the US from other low-cost Asian manufacturing hubs such as Vietnam.

The escalating US-China trade war during 2018 has therefore created a new driver for multinationals to reposition their global supply chains and reduce their vulnerability to Chinese production. Rising US tariffs on Chinese products could significantly improve the relative competitiveness of several ASEAN countries as manufacturing hubs compared with China, notably for Vietnam, which is likely to be a significant winner from the US-China trade war.

For further information:

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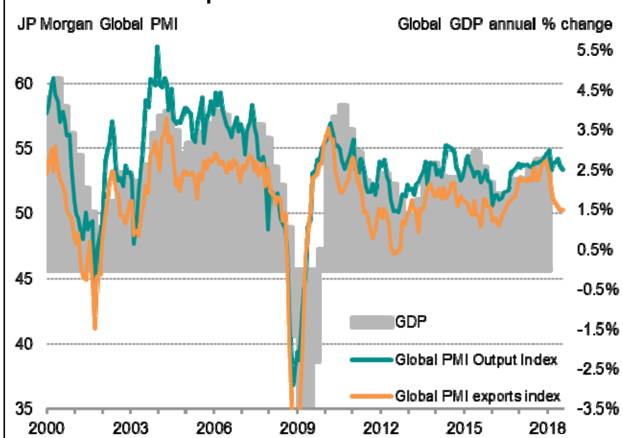
Monitoring export trends

The global PMI surveys, complied by IHS Markit, track business conditions in all major developed and emerging markets, providing the first available monthly indication of changing economic conditions each month. The surveys collect factual information on metrics such as output, order books, employment, price trends and inventory levels. The surveys also track export orders.

Our chart plots the headline global output index from the PMI surveys against official GDP growth (collected from various national statistical offices), with the PMI export orders index also overlaid. Any PMI reading above 50 signals an increase in the prior month while readings below 50 signal a decline. Having struck a near seven-year high of 54.1 in January, the Global PMI Export Orders Index reading was a mere 50.3 in August, highlighting the rapid erosion of trade growth since the start of the year to near-stagnation.

Global PMI and export orders



Sources: IHS Markit, JPMorgan, Datastream.

Slower export growth has been commonly attributed by PMI respondents to rising concerns regarding tariffs and trade wars. Stagnant or falling exports are currently being recorded in the US, China, Japan and the UK, with only modest growth seen in the Eurozone.

The impact of tariffs on prices and worsening supply availability is also becoming apparent. Average prices charged for goods and services rose globally at the fastest rate since the global financial crisis in July, according to the PMIs, easing only modestly in August.

Tariffs and trade wars were also commonly cited as factors encouraging companies to build safety stocks of inputs to ensure supply, or lock-in lower prices, exacerbating supply shortages and driving prices even higher. The problem appears to be particularly acute in the US, where almost two-thirds (64%) of US companies reporting higher input prices in August explicitly blamed tariffs as the cause of increase costs. Almost one-in-three went on to cite tariffs as the cause of having to hike prices to customers.

For more information on the PMI surveys contact economics@ihsmarkit.com.