Economic commentary

05/10/2018

Week Ahead Asia-Pacific Economic Preview

- **Trade data from China, Taiwan, and the Philippines**
- **Other data from China include Caixin services PMI, new loans and credit, and FDI**
- **Singapore sets monetary policy and releases flash Q3 GDP**
- **US inflation**
- **Special focus on APAC's vulnerabilities to slower Chinese economic growth**

With worries over trade wars and tariffs dominating the political and economic agenda, the release of trade data from several key Asian countries in the coming week will provide important clues as to trade performance in the region, notably for China. An especially busy data calendar for China after the Golden Week also includes Caixin Services PMI plus data on credit, money supply and foreign direct investment.

The main central bank action comes from Singapore, where the monetary policy is accompanied by the advance estimate of third quarter GDP.

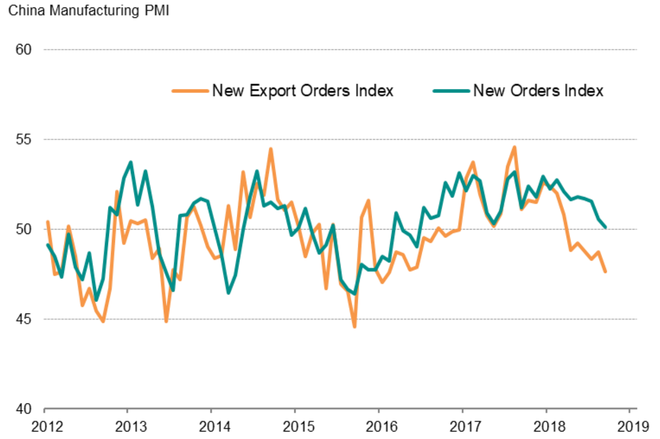
Other data highlights for Asia include Malaysia's industrial production numbers, South Korea's unemployment data, Japan's machinery orders and current account, Philippine and Taiwan trade data, plus India's inflation and industrial production figures. Elsewhere, UK monthly GDP data and US inflation numbers warrants close attention.

Our special focus this week looks at how trade tensions are weighing on an already-weakening rate of economic expansion in China, and the likely impact on the rest of the APAC region.

China data updates

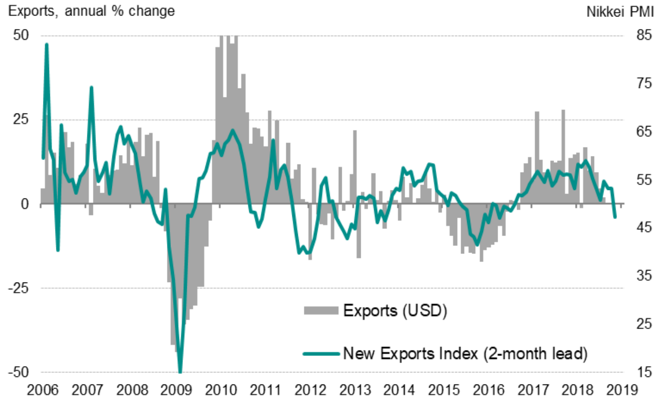
The coming week sees the first batch of Chinese data after the Golden Week celebrations, which include Caixin China services PMI, exports, credit, money supply and foreign direct investment. The September Caixin manufacturing PMI data, compiled by IHS Markit, indicated that manufacturing output continued to expand but only at a marginal rate. The survey also brought further signs of falling exports, with the steepest decline recorded for two-and-a-half years in September amid a number of reports that rising trade tensions and tariffs had impacted overseas sales.

China manufacturing PMI: new orders and exports



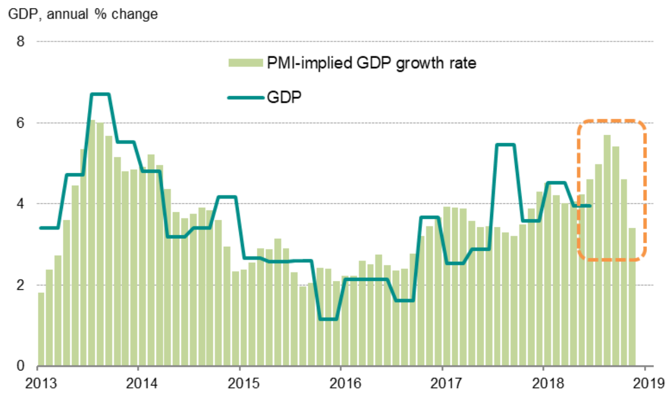
Sources: IHS Markit, Caixin

Taiwan PMI and exports



Source: IHS Markit, Nikkei, DGBAS

Singapore PMI-implied GDP growth rates



Note: Quarterly averages of PMI New Orders with two-month lead applied

Sources: IHS Markit, Nikkei, SingStat

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Taiwan trade

September export numbers are meanwhile expected to show Taiwanese goods shipments picking up to a 5.1% annual growth rate, up from 1.9% in August. Imports are also projected to show an accelerated growth.

However, weaker prospects could be in store as Taiwan heads into the fourth quarter. The Nikkei PMI surveys indicated that export sales declined for the first time in over two years.

Singapore faces tight monetary policy call

The Monetary Authority of Singapore (MAS) holds its semi-annual meeting next week to decide on monetary policy, with analysts expecting a close call. Singapore uses a unique system to manage monetary policy, targeting the exchange rate instead of the more common inflation rate. In April, the MAS increased slightly the slope of the policy band from 0% to allow for a 'modest and gradual' appreciation of the Singapore dollar, representing the first tightening decision in six years. Mounting trade wars and tariffs, the recent malaise in emerging markets, and rising inflation are all factors the MAS will have to juggle in its decision.

In the same week, Singapore releases the advance estimate of third quarter GDP. While the latest PMI data signals deteriorating private sector operating conditions in September, the effects may only be evident in the official data towards the end of the year. The PMI's gauge of new orders exhibits a 77% correlation with official GDP annual rates when applying a two-month lead. The PMI-implied GDP growth rate signals an annual growth of 5.4% in the third quarter, before moderating towards 4% in the final quarter.

Monday 8 October

IHS Markit-Caixin China Services PMI (Sep)

Taiwan trade (Sep)

Germany industrial production (Aug)

Tuesday 9 October

Japan current account (Aug) and machine tool orders (Sep)

Australia business confidence (Sep)

Germany trade (Aug)

US IBD/TIPP economic optimism (Oct)

Wednesday 10 October

Australia consumer confidence (Oct)

Japan machinery orders (Aug)

Philippines trade (Aug)

Italy industrial production (Aug)

UK Halifax house price index: regional breakdown (Sep)

UK monthly GDP (Aug) and NIESR monthly GDP tracker (Q3)

UK industrial production, construction output and trade balance (Aug)

US PPI (Sep) and wholesale inventories (Aug)

ECB non-monetary policy meeting

Argentina interest rate decision

Thursday 11 October

Malaysia industrial production (Aug)

France and Spain inflation (final, Sep)

Brazil retail sales (Aug)

US inflation (Sep)

Friday 12 October

South Korea jobless rate (Sep)

Singapore GDP (adv, Q3) and retail sales (Aug)

Singapore monetary policy meeting

Australia home loans (Aug)

RBA financial stability review

China new yuan loans, total social financing, money supply, trade (Sep) and FDI (YTD, Sep)

India inflation (Sep) and industrial production (Aug)

Germany inflation (final, Sep)

US Michigan consumer surveys (Oct)

Special Focus

How Vulnerable is APAC to an Economic Slowdown in China?

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

The US-China trade war is exacerbating an existing slowdown of China's economy, with spill-over effects into other APAC countries. This article assesses the key areas of concern from the intensifying trade tensions and highlight which countries consequently face the greatest vulnerabilities from slower Chinese growth.

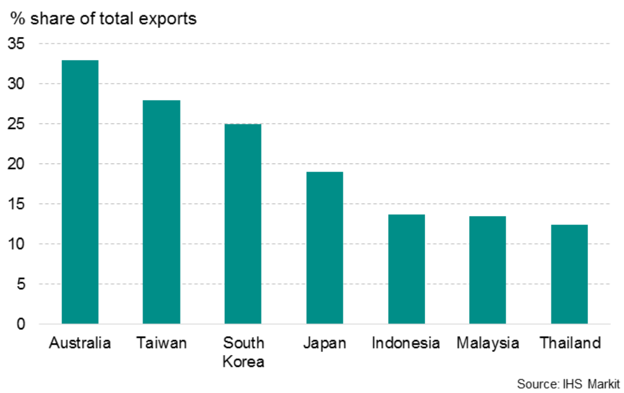
Overview

Over the past two decades, most of the major economies in the Asia-Pacific region have been lifted on China's rising economic tide. China's share of world GDP rose from 4.8% in 2005 to 15.2% in 2017. This represents a spectacular rise in China's share of the world economy within just over a decade. This considerable increase in China's economic importance in the global economy has also driven rapid growth in bilateral trade and investment flows between China and many Asia-Pacific countries. However, the economic ascendancy of China has become a double-edged sword for many APAC economies, creating new vulnerabilities to an economic slowdown or hard landing in China.

APAC's rising economic vulnerability to China

The sustained rapid growth of the Chinese economy has pushed China's share of APAC GDP to 40% by 2017, compared with just 24% in 2005. For many Asia-Pacific countries, China has become one of their most important export markets. For Australia, China has become the dominant export market, accounting for around 33% of total Australian merchandise exports in 2017. For South Korea, China has also become its largest export market, accounting for around 25% of total exports in 2017.

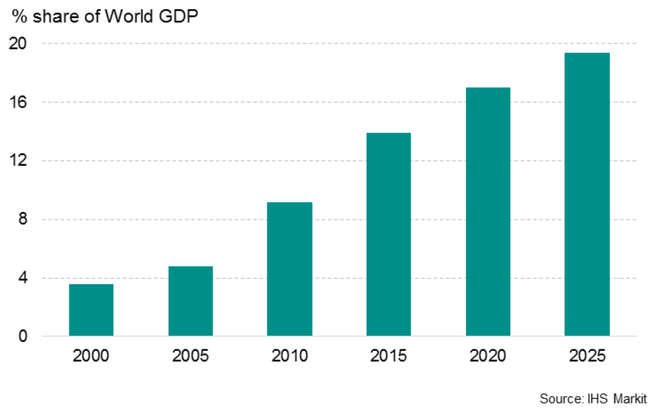
APAC exports to China, 2017



For ASEAN countries, China has likewise been a fast-growing export market over the past decade, accounting for 13.7% of Indonesian merchandise exports, 13.5% of Malaysian exports and 12.4% of Thai exports in 2017. Although the US had been the largest export market for Vietnam for the past 15 years, Vietnamese exports to China in 2017 rose by 60%, making China the largest export market for Vietnam.

The massive Chinese stimulus package during the Global Financial Crisis and subsequent rapid Chinese economic growth helped Asia to weather the storm of the crisis with relatively limited negative effects from the recessions in the US and EU. However, Asia's rising dependency on the Chinese growth engine has increased the vulnerability of the region to contagion from a Chinese economic downturn through trade and investment flows, as well as through financial shocks via international equity, debt and currency markets.

China's share of World GDP



China's economic slowdown

China's two key growth engines from 1980-2008 were fixed investment and exports, but both have slowed significantly in recent years, with the US-China trade war now putting further downwards pressure on export orders. Although China's economic growth momentum has been very resilient during 2016-18, supported by strong growth in consumer spending, the pace of Chinese economic growth is expected to moderate from around 6.7% in 2018 to slightly above 6% in 2019, with the impact of tariff measures already announced in the US-China trade war expected to dent growth momentum. While this is likely to have some negative transmission effects on economic growth and trade in other major Asian economies, the APAC region is expected to be resilient to a slight moderation in Chinese economic growth.

However, a further escalation of the trade war is possible in coming months, with rising China-US military tensions in the South China Sea in recent weeks adding to the acrimony in bilateral relations. President Trump has signalled the possibility of extending US tariff measures to a further USD 267 billion of Chinese exports, which would result in another negative shock for China's export sector. Consequently, a further slowdown in the Chinese economy in 2019 remains a risk to the outlook. The latest Caixin China General Manufacturing PMI survey data for September show that manufacturing export orders fell at their fastest rate since early 2016, as the impact of US tariff measures began to bite.

Chinese small to medium enterprises that are part of China's manufacturing export supply chain are being hit by the impact of sharply higher US tariffs on Chinese products, which is eroding their competitiveness compared with suppliers from other low-cost manufacturing hubs such as Vietnam and Cambodia. Chinese SMEs have already faced rising cost pressures which have steadily eroded their global competitiveness for low-cost manufacturing exports, notably from rapidly rising manufacturing wages in coastal provinces such as Guangdong. This has already put increasing pressures on profit margins of Chinese SME manufacturing exporters, with the US tariffs exacerbating the squeeze on profit margins. As multinationals readjust their supply chains, switching production of exports to the US market to hubs outside of China, Chinese manufacturing SMEs are facing weakening inflows of new orders and job losses. Chinese provinces such as Guangdong and Fujian have responded by rolling out packages of relief measures for exporters, such as lower corporate taxes and subsidised electricity prices to mitigate the burden of costs.

Risks to the APAC economic outlook

While the near-term APAC economic outlook remains one of robust GDP growth for the region of 5.0% in 2018, moderating slightly to 4.8% in 2019, there are downside risks from the US-China trade war to the regional outlook.

Macroeconomic modelling of a global protectionism scenario, using the IHS Markit Global Link Model of the world economy, indicates that APAC is the most vulnerable region of the global economy to rising global protectionism, driven at the core by an escalating US-China trade war. For the APAC region, the negative impact of a China slowdown on the East Asian manufacturing supply chain remains an important downside risk to Asian emerging markets.

South Korea, Taiwan, Singapore, Malaysia, Vietnam, Thailand and the Philippines are among the most vulnerable economies to the shock waves of a trade war.

Furthermore, the APAC region has become increasingly vulnerable to the downside risk of a China hard landing scenario due to the rising importance of China as the largest economy in the region. The ratio of credit to China's non-financial private sector as a share of GDP has risen sharply from around 110% of GDP in 2010 to 210% by 2017, highlighting the risks from rising leverage and a credit bubble.

The Chinese government is acutely aware of the risks from a credit bubble, and has implemented measures to reduce speculation and leverage in the financial system. As a result, credit growth has shown signs of stabilization with some recent moderation in shadow banking credit and the pace of growth of total social financing. While a China hard landing still remains a low probability scenario, if it did in fact occur, it would unleash a tsunami of contagion across the APAC region through negative shocks to regional trade and investment flows and turmoil in regional financial markets.

For further information:

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