Economic commentary

24/08/2018

Week Ahead Asia-Pacific Economic Preview

- **Bank of Korea policy meeting**
- **India second quarter GDP release**
- **Japan's production, retail and jobless data**
- **US GDP and price data updates**
- **Special focus on US-China trade war**

The coming week sees important updates to Japan's economic data flow, as well as second quarter economic growth for India. Policy action comes from South Korea. Other highlights include second quarter growth and price updates for the US, as well as inflation numbers for the Eurozone.

With policy decisions and economic trends likely to be influenced by on-going trade tensions, our special focus this week delves deeper into the escalating US trade spat with China.

Bank of Korea faces close policy call

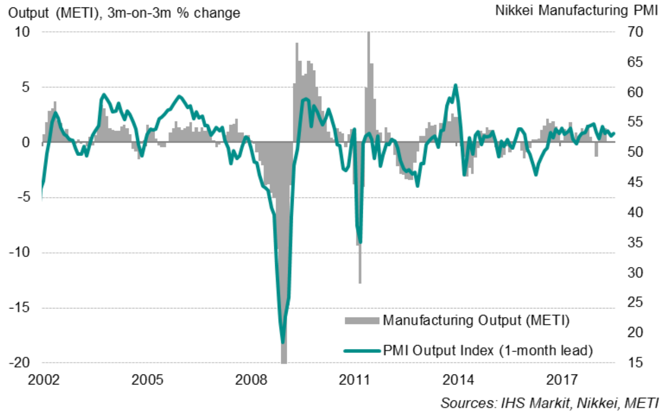
The Bank of Korea meets to decide on monetary policy, with analysts expecting a close call. The policy rate stands at 1.50%, with the last increase in November 2017. The central bank has frequently leaned towards a hawkish stance, with governor Lee Ju-yeol emphasising the need to create policy space by adjusting interest rates higher amid steady economic growth. However, signs of manufacturing weakness and a softening job market could convince policymakers to delay a rate hike until circumstances turn more favourable. According to Nikkei PMI data, South Korea's manufacturing sector business conditions deteriorated to the greatest extent for over one-and-a-half years in July, with factory employment levels falling for a fourth straight month.

Data on industrial production and retail sales, as well as consumer and business confidence surveys will provide further insights on the health of South Korea's economy.

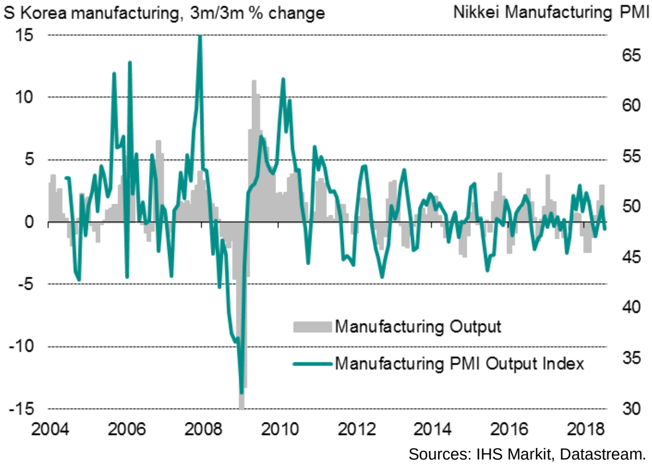
India's economy expected to slow

Second quarter GDP numbers are expected to show India's economy slowing to a 7.3% annual growth rate, down from 7.7% in the opening months of 2018. Better prospects could be in store for the third quarter. The Nikkei PMI surveys indicated that India enjoyed its strongest expansion for over one-and-a-half years during July, particularly supported by the service sector.

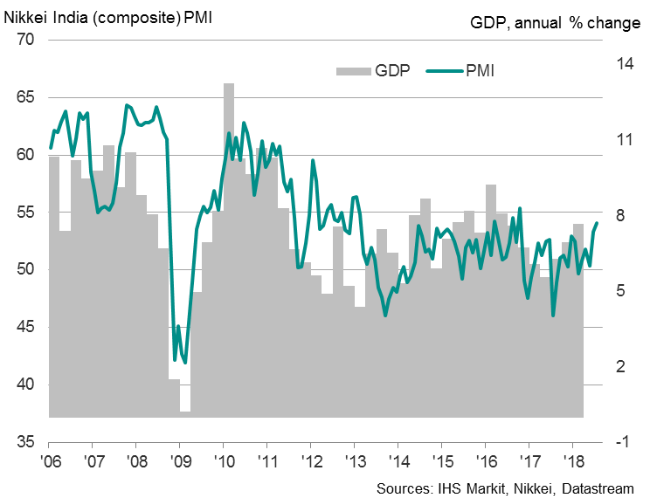
Japan manufacturing



South Korea manufacturing



India GDP



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The improvement in the services PMI in particular suggests the Indian economy has recovered from the adverse impact of de-monetisation and GST rollout. However, external factors, such as higher oil prices and a weaker rupee, are notable headwinds to future growth.

Japan data updates

A busy week of data releases for Japan include industrial production, manufacturing output and shipments, unemployment, consumer confidence, household spending and retail sales. The official figures come on the heels of August flash PMI data, which acts as a reliable advance indicator of official production and shipment numbers. The survey indicated that manufacturing output and order books continued to expand, boosting hopes of a further GDP rise in the third quarter. However, the survey also brought further signs of falling exports and sharply higher input prices. Factory job creation and business confidence were meanwhile the weakest since late-2016, adding to the gloomier outlook.

Other data

Other data highlights for Asia include industrial production numbers for Thailand as well as trade statistics for Hong Kong. Elsewhere, US second quarter GDP and personal consumer expenditure numbers, including closely-watched price indices, will be a focus of the week. Brazil and Canada also publish second quarter GDP numbers.

In Europe, Eurozone business sentiment surveys are accompanied by inflation numbers, the latter being especially important to gauge the ECB's appetite to rein-in its stimulus.

Monday 27 August

China industrial profits (YTD, Jul)

Hong Kong trade (Jul)

Germany Ifo surveys (Aug)

Turkey business confidence and capacity utilisation (Aug)

US Chicago Fed National Activity Index (Jul) and Dallas Fed Manufacturing Index (Aug)

Tuesday 28 August

South Korea and Taiwan consumer confidence (Aug)

Thailand industrial production (Jul)

France consumer confidence (Aug)

Italy business and consumer confidence (Aug)

US wholesale inventories (Jul) and S&P/Case-Shiller home price (Jun)

Wednesday 29 August

Japan consumer confidence (Aug)

Vietnam trade balance, industrial production and inflation (Aug)

Germany consumer confidence (Sep)

UK Nationwide housing prices (Aug)

France GDP (2nd est, Q2)

Turkey trade balance (Jul)

US GDP and PCE prices (2nd est, Q2)

US pending home sales (Jul)

Brazil consumer confidence (Aug)

Thursday 30 August

South Korea business confidence (Aug)

Japan household spending and retail sales (Jul)

Australia building permits (Jul) and private capex (Q2)

Germany and Spain inflation (flash, Aug)

Germany unemployment rate (Aug)

UK mortgage lending and BoE consumer credit (Jul)

Euro area business and economic confidence (Aug)

Brazil unemployment rate (Jul)

US PCE price index and personal income and spending (Jul)

Canada GDP (Q2)

Friday 31 August

South Korea industrial production and retail sales (Jul)

South Korea monetary policy decision

Japan unemployment rate and housing starts (Jul)

Japan industrial production (adv, Jul)

Australia private sector credit (Jul)

India GDP (Q2)

UK consumer confidence (Aug)

Germany retail sales (Jul)

Euro area, France and Italy inflation (flash, Aug)

Euro area and Italy unemployment rate (Jul)

Italy GDP (final, Q2)

Brazil GDP (Q2)

US Michigan consumer surveys and Chicago PMI (Aug)

Special Focus

The Impact of the Escalating US-China Trade War on the Asia-Pacific

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

Overview

The US-China trade war has escalated further in recent weeks, following new rounds of punitive tariff measures. The US government decided to impose punitive tariffs of 25% on USD 34 billion on Chinese products on July 6th. China immediately retaliated on July 6th with tariffs of 25% on an equivalent amount of USD 34 billion of imports from the US, targeting US agricultural products, including soybean, dairy and beef as well as US-made autos and parts.

On August 23rd, the US government imposed 25% tariffs on a further USD 16 billion of Chinese products. In retaliation, China has also imposed 25% tariffs on a further USD 16 billion of US products on 23rd August. This has occurred despite the re-commencement of bilateral trade negotiations between the US and China, with a Chinese delegation led by Vice Minister Wang Shouwen visiting the US in the week beginning 20th August for trade talks with US government counterparts.

Amidst the escalating “tit-for-tat” tariff measures, concerns are increasing amongst Asian governments and multinationals about the collateral damage to regional trade from this escalating US-China trade war. This reflects China’s significantly increased importance over the past decade as a key export market for many Asian nations, as well as the potential vulnerability of the East Asian manufacturing supply chain to a slowdown in Chinese manufacturing exports.

In addition to the escalating US-China trade war, the US has also taken significant new measures that impact on investment flows relating to technology. New legislation that strengthens the powers of the Committee on Foreign Investment in the United States (CFIUS) was passed by US Congress on 1st August and was signed into law on 13th August by President Trump. The scope of transactions that CFIUS will cover will be significantly enhanced, with a strong focus on defence and security implications relating to sensitive US technology.

Proposed Major Escalation of US Tariff Measures on China

On 10th July, the Office of the United States Trade Representative (USTR) announced that US President Trump had ordered the USTR to begin the process of imposing tariffs of 10 per cent on an additional USD 200 billion of Chinese imports.

However, the significant depreciation of the Chinese yuan against the USD from around CNY 6.28 in mid-February to CNY 6.84 on 22nd August did provide some offset to the loss in export competitiveness arising from the higher US tariffs on Chinese exporters.

In response to the recent depreciation of the yuan against the USD, President Trump has instructed the Office of the US Trade Representative (USTR) to consider the option of lifting the proposed 10% tariff on an additional USD 200 billion of Chinese products to a rate of 25%. As total Chinese merchandise exports to the US reached USD 505 billion in 2017, the extent of US punitive tariffs of 25% could hit around 50% of total Chinese exports of goods to the US if the US Administration proceeds to implement the next round of tariff measures.

US Investment Regulatory Reforms: The new Foreign Investment Risk Review Modernization Act of 2018 (FIRMMA) that is incorporated in the National Defense Authorization Act for fiscal 2019 was signed into law by President Trump on August 13th. The new legislation will strengthen the powers of the CFIUS to investigate foreign investment into the US involving critical US technology and infrastructure. The new legislation will also task CFIUS with considering a broad range of national security issues when considering such foreign investment transactions.

Chinese outbound M&A investments into the US reached a peak estimated at around USD 60 billion in 2016, but slowed sharply to around USD 11 billion in 2017. This has reflected both Chinese government measures to slow outbound M&A outflows, as well as actions by foreign governments, including the US, to tighten review procedures for foreign investment in technology industries.

The US had also applied crippling sanctions on Chinese technology firm ZTE, which manufactures telecoms equipment, following breaches of the US embargo on trade with Iran. Following a settlement involving a large fine of USD 1 billion, the US Department of Commerce lifted the ban on US companies selling equipment to ZTE on July 13th.

The tightening US scrutiny of foreign investment is occurring at the same time as European countries are also tightening regulations for foreign investment into sensitive technology. The German government tightened regulatory oversight for foreign investments in 2017, with the UK government also considering tighter approval processes, especially for sensitive technologies.

Collateral damage to APAC economies: The US punitive tariffs on China will also have transmission effects to the rest of the Asia-Pacific economies. Many other APAC economies will be hit by collateral damage from the escalating US-China trade war due to the integrated East Asian manufacturing supply chain providing raw materials and intermediate manufactures to China, given the importance of China as an export market for other APAC economies.

The East Asian electronics industry supply chain is particularly vulnerable to the US tariff measures. Electrical and electronic manufacturing exports are among the key Chinese exports targeted on the new US list of USD 200 billion of Chinese products. Significant intermediate inputs for Chinese production of these goods are sourced from East Asian economies, such as Singapore, Malaysia and South Korea. For example, China is the most important export market for South Korea, accounting for 25% of total exports, while 13.5% of Malaysia's merchandise exports go to China. Around one-third of the total value of China's exports comprises foreign value-added. Since a significant share of Chinese exports are manufactured by foreign multinationals, US and other foreign multinational corporations (MNCs) from countries such as Japan and South Korea that are manufacturing products in China for export to the US, will also be hit by these measures.

US Section 232 Investigation into Autos Imports

In May 2018, the US Department of Commerce also initiated an investigation under Section 232 of the Trade Expansion Act of 1962 to determine whether imports of automobiles, including SUVs, vans and light trucks, and automotive parts threaten to impair US national security.

Depending on the eventual outcome of the Section 232 investigation, if significant US tariffs are imposed on imported autos and components, this could have a substantial negative impact on the Asian auto industry. The auto sectors in Japan, South Korea, China, India and Thailand potentially vulnerable to such US tariff measures. More than 30% of Japan's and South Korea's automotive exports, and nearly 20% of China's, are sent to the United States. Taiwan, primarily a supplier of components, sends more than 25% of its automotive exports to the US market. Latest scenario analysis using the IHS Markit Global Link Macro-Industry Model to assess the potential sectoral and macroeconomic impacts of proposed tariffs on US automotive imports finds that an incremental 25% tariff on US imports of automotive vehicles and parts would have significant influence on global economic activity. If imposed on all trading partners, the level of world real GDP would decline 0.3% in 2019 and 0.5% in 2020–21, compared with our baseline forecast. (See IHS Markit Global Economics report entitled "Global economic impacts of the Trump administration's proposed tariffs on automotive imports", 22 August 2018).

Outlook

Although the APAC region has shown continued strong growth momentum during H1 2018, the impact of the US-China trade war and other global trade frictions are creating increasing downside risks to regional trade flows in H2 2018 and for 2019. Many APAC economies are particularly vulnerable to the escalating US-China trade war as their manufacturing sectors are integrated into China's manufacturing supply chain, with around one-third of China's manufacturing output comprising foreign inputs. If higher US tariffs on auto imports are imposed following the Section 232 investigation, this could also hit Asian auto exporters, with Japan, South Korea, China and Taiwan particularly vulnerable.

With no early end appearing to be in sight for the escalating 'tit-for-tat' world trade frictions and rising trade protectionism, global trade wars have become one of the key downside risks to world growth and trade in the second half of 2018 and for 2019.

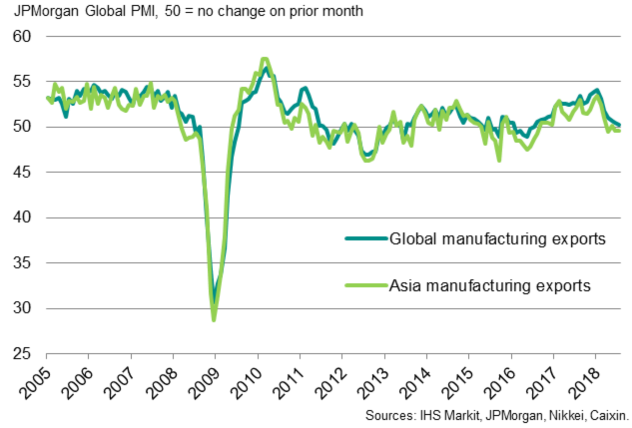
Monitoring export trends

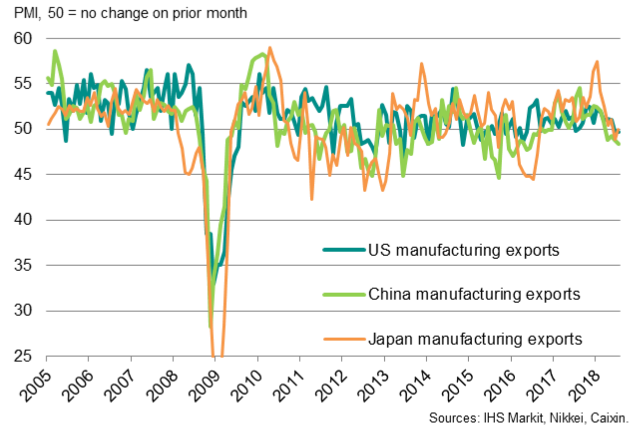
The latest indications of export trends around the world are provided by IHS Markit's PMI survey data, which cover over 30 countries. The latest available global data showed worldwide goods exports barely growing in June and July, posting the worst performance for two years.

The near-stagnation of trade contrasts markedly with strong growth at the start of the year, which saw export growth reach a seven-year peak.

Exports from Asian manufacturers have fared especially badly in recent months, falling for the third time in four months in July. China's exports fell for a fourth successive month. However, US exports also declined for a second straight month.

PMI manufacturing export orders survey data





August PMI data are available on 3rd September.

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

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