

# Asia Watch

Group Economics  
Emerging Markets Research

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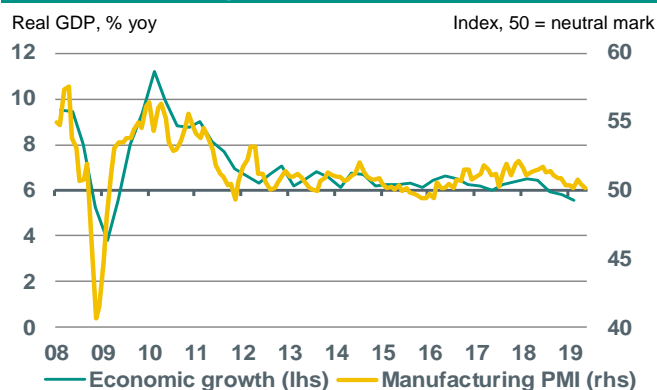
## Trade conflict hits Asian supply chains

- **US-China trade conflict is hitting supply chains, pushing down Asian trade,**
- **... with growth of Chinese imports from and exports to US having collapsed**
- **We have cut our regional economic growth forecasts for 2019 and 2020, ...**
- **... although monetary/fiscal easing will help keep regional slowdown gradual**
- **Downside risks stem from US-China tensions and other geopolitical factors,**
- **...while an improvement in US-China relations would pose 'upside risks'**
- **Upcoming G20 meeting Trump-Xi important litmus test in that respect**

### Regional slowdown continues, with US-China trade/tech conflict as key driver

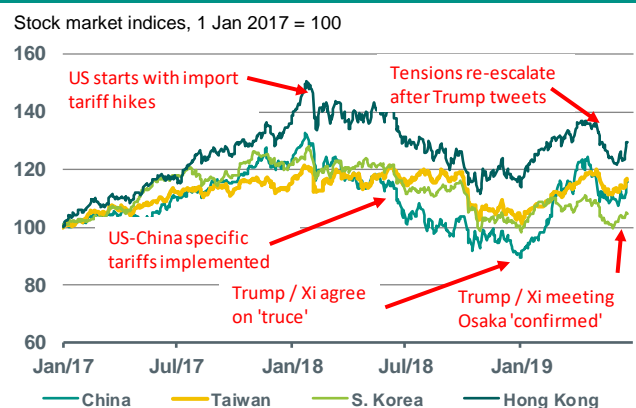
Real GDP growth in EM Asia slowed clearly over the past quarters, particularly since 2H18, falling from a cyclical high of 6.5% yoy in 1Q18 to just below 6% in 2H18 and to a post-global crisis low of 5.5% yoy in 1Q19. In our view, the main trigger for this slowdown is the escalation of the US-China trade/tech conflict since the spring of 2018, although initially effects of previous global monetary tightening also played a role. So far, the US and China implemented tariffs over USD 360 bn in bilateral trade. The US has also taken or threatened with protectionist measures versus other countries. These tensions have contributed to a global decline in cross-border investment in machinery and equipment, that went hand in hand with a slowdown in global trade. Not only China is feeling the impact of the conflict with the US, but also the rest of export-oriented Asia as the conflict has started to hit regional China-centered global supply chains. The conflict did not only have negative effects on actual trade flows, but also contributed to a region-wide drop in business confidence, asset market corrections and a tightening of financial conditions.

### Trade conflict hits growth and business confidence



Source: Bloomberg, Thomson Reuters Datastream, ABN AMRO Group Econ.

### US-China trade conflict drives Asian stock markets

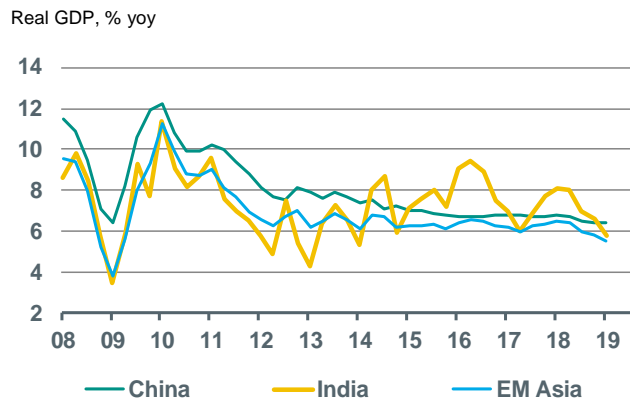


Source: ABN AMRO Group Economics, Bloomberg

**Regional slowdown broad-based**

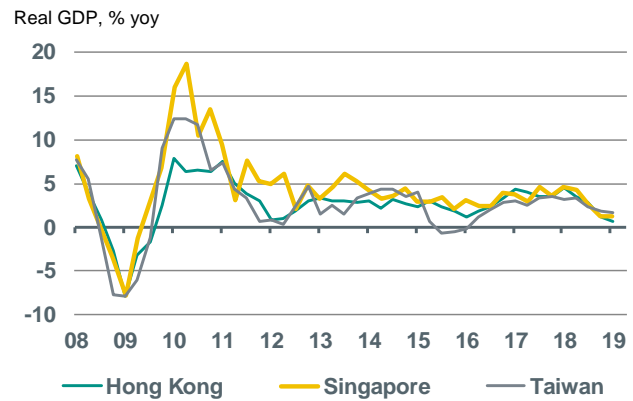
The regional slowdown has been broad-based, with GDP growth coming down in almost all but a few countries in EM Asia. Although the downturn in China's industrial and trade activity has been significant over the past months, the drop in official GDP growth has been moderate partly reflecting Beijing's switch from financial deleveraging to targeted easing. Growth in India, EM Asia's second-largest economy, has come down much more quickly (from around 8% yoy in early 2018 to a five-year low of 5.8% yoy in Q1-2019), driven by a weakening of domestic demand.

**Growth has slowed in China and India ...**



Source: ABN AMRO Group Economics, Bloomberg

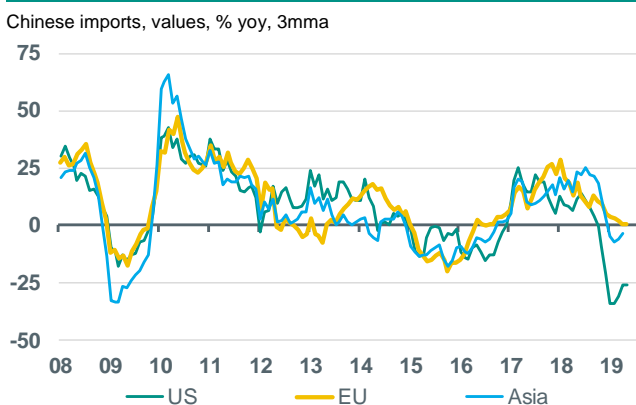
**... as well as in Asia's global bellwethers**



Source: ABN AMRO Group Economics, Bloomberg

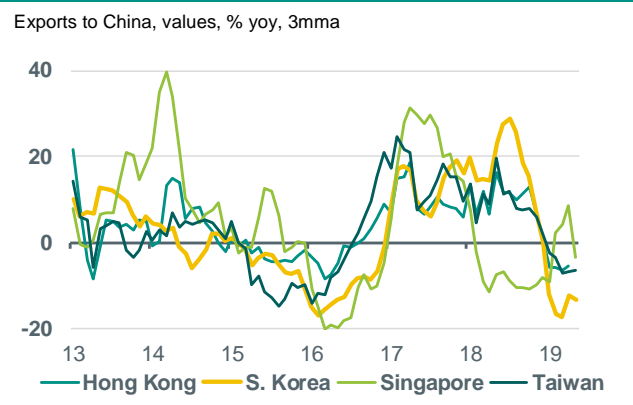
Not surprisingly, the sharpest growth slowdown was visible in trade/tech hubs like Hong Kong, Singapore and Taiwan. Growth in export oriented South Korea peaked in Q4-2018 (3.1% yoy), but fell back to a post-global financial crisis low of 1.7% yoy in Q1-2019. Main exceptions to the rule are Indonesia (where growth continues to hover around 5% since 2014 despite all kinds of external shocks) and Vietnam (that shows the region's highest growth rates, profiting from a gradual shift of global supply chains).

**US-China conflict is hitting supply chains**



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

**Global bellwether's exports to China under pressure**



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

**US-China conflict is hitting supply chains, pushing down trade**

A common factor driving growth down in export-oriented EM Asia is the deceleration in global trade, particularly since late 2018. That partly reflects a natural correction after global trade growth accelerated in 2017 and early 2018, after years of weakness. However, this correction

was aggravated by effects from the trade conflict, partly reflecting payback from frontloading of trade flows in autumn 2019. This conflict seems to have started hitting China-US centered supply chains. Chinese imports from the US have collapsed in recent months, and so have Chinese exports to the US. All this is affecting foreign trade developments in other Asian countries as well. Exports to China of global bellwethers Hong Kong, Singapore, South Korea and Taiwan have weakened recently, although swings in the global tech cycle likely also do play a role here.

### We have cut our regional growth forecasts for 2019-20 ...

We have recently become more negative about the development of trade tensions between the US and key trade partners and the impact thereof on the global economy. As a result, we have lowered our growth forecasts for a wide range of advanced and emerging economies, while expecting a global easing cycle to cushion the blow. We have also cut our growth forecasts for the highly export-oriented region emerging Asia, as higher US-China tariffs have left its mark on supply chains, on business confidence and financial conditions while external demand is soft.

Emerging Asia: Economic growth (forecasts)							
% yoy	Q3-18	Q4-18	Q1-19	2017	2018	2019*	2020*
China	6.5	6.4	6.4	6.8	6.6	6.2 ↓	5.8 ↓
Hong Kong	2.8	1.2	0.6	3.8	3.0	2.0 ↓	2.0 ↓
India <sup>^</sup>	7.0	6.6	5.8	7.2	6.9	7.0 ↓	7.0 ↓
Indonesia	5.2	5.2	5.1	5.1	5.2	5.0 ↓	5.0 ↓
Malaysia	4.4	4.7	4.5	5.7	4.7	4.0 ↓	4.0 ↓
Singapore	2.6	1.3	1.2	3.7	3.2	2.0 ↓	2.0 ↓
South Korea	2.0	3.1	1.7	3.1	2.7	2.0 ↓	2.0 ↓
Taiwan	2.4	1.8	1.7	3.1	2.6	2.0 ↓	2.0 ↓
Thailand	3.2	3.6	2.8	4.0	4.1	3.0 ↓	3.0 ↓
Regional average	5.9	5.8	5.5	6.3	6.1	5.7 ↓	5.5 ↓

Source: ABN AMRO Group Economics, Bloomberg, EIU. Arrows point to changes compared to previous report.  
\* Forecasts 2019-20 rounded except for China ^ India: fiscal years

### ... although offsetting policies will help to keep the regional slowdown quite gradual

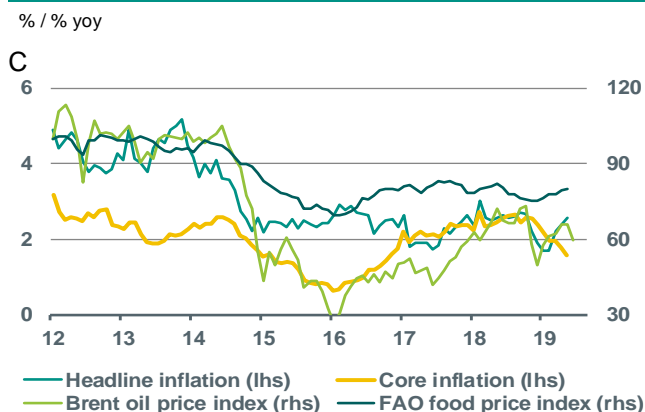
We cut our growth forecasts for China only modestly: for 2019 from 6.3% to 6.2% and for 2020 from 6.0% to 5.8%. That reflects our expectation of more support to offset the larger drag from trade (see more for background our latest [China Watch, Growth forecasts down a bit on trade/tech conflict](#)). These revisions should be taken in the context of the relative stability of China's official growth figures and imply more weakness in trade and manufacturing. For the majority of other EM Asian countries we follow, we cut our 2019 and 2020 growth forecasts by 0.5 ppt since our previous Asia Watch published in April. For Thailand, we have cut our 2019-20 by a full ppt, to 3.0%. As a result of these revisions, we now expect regional growth to slow from 6.1% in 2018 to 5.7% (down from 6.0%) in 2019 and to 5.5% (down from 5.8%) in 2020. Despite these downgrades, this implies that the slowdown in regional growth remains quite gradual (partly thanks to offsetting policies), with EM Asia remaining a key engine of global growth.

### Monetary easing to continue, with core inflation low and Fed more dovish

After having fallen sharply in late 2018/early 2019, regional headline inflation has picked up in recent months, from 1.7% yoy in February to 2.6% in May. In the same period, China's CPI inflation rose from 1.5% yoy in February to 2.7%, largely caused by the swine flu driving up pork prices. Still, CPI inflation in countries like India, Indonesia and Taiwan has also risen sharply

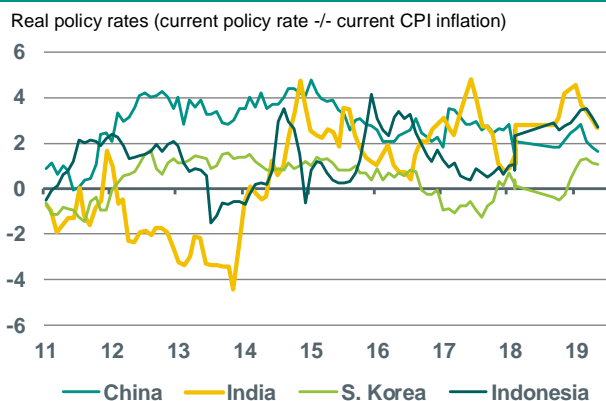
recently. However, taking out the impact of higher food and energy prices, our regional index for core inflation has fallen to 1.6% yoy in May, the lowest level since October 2016.

### Headline inflation up, core inflation down



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

### Still room for further monetary easing



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

Given subdued core inflation and a more dovish Fed and other central banks, monetary policy in EM Asia has eased. The Chinese authorities shifted from financial deleveraging to targeted easing. Recently, the PBoC steered money market rates down, after the failure of a smaller regional bank caused liquidity pressures. Elsewhere in the region, we have seen recent policy rate cuts in India, Malaysia and the Philippines. Going forward, we expect more easing measures throughout the region. We expect more targeted easing in China and also some general measures (cuts in 1-year lending rate, further RRR cuts). We also expect further rate cuts in countries like Korea and Taiwan, and possibly India. There is also still room to add fiscal stimulus in most countries, given that public finance indicators in Asia (ex Japan) are relatively strong.

### Finally, there are downside risks to our growth forecasts ...

While we have cut our 2019-20 growth forecasts on trade tensions, we expect the regional slowdown in EM Asia to stay quite gradual and the region to remain a key engine of global growth. That said, downside risks stem from a further escalation of trade and tech tensions, particularly between the US and China, although some countries (like Vietnam) are profiting from the shifting of supply chains while the strengthening of regional trade arrangements would mitigate risks from global protectionism over time. Other (geopolitical) risks relate to the situation on the Korean peninsula, the relationship between Hong Kong and Taiwan and mainland China and China's attempts to secure control in the South China Sea. While we do not expect serious escalation, risks of policy failures and accidents remain.

### ... but also 'upside risks': coming G20 *rendez-vous* Trump-Xi important litmus test

'Upside risks' to our outlook would stem from a meaningful improvement in the US-China relationship, with for instance further tariffs being put on hold and possibly some revokement of tariffs over time. The Trump-Xi summit scheduled in Osaka coming weekend is a key litmus test in that respect. Major question will be whether the two presidents will show a willingness to compromise on sensitive issues and succeed in getting the US and China back to the negotiation table. Possibly, an agreement could come in the form of another 'truce', similar to what was reached at the G20 meeting in Buenos Aires in late 2018) Still, even in case of such a positive outcome, tensions on the tech front will likely not be solved easily and may linger on for longer.

## Main economic indicators/forecasts

<b>GDP growth (%)</b>	<b>2017</b>	<b>2018e</b>	<b>2019e</b>	<b>2020e</b>	<b>Inflation (%)</b>	<b>2017</b>	<b>2018e</b>	<b>2019e</b>	<b>2020e</b>
Emerging Asia	6.3	6.1	5.7	5.5	Emerging Asia	2.3	2.6	2.9	3.0
Emerging Europe	4.1	3.3	1.5	2.2	Emerging Europe	5.4	6.3	7.0	5.3
Latin America	1.0	0.6	1.0	2.1	Latin America**	6.9	7.5	8.7	7.3
<b>Emerging markets total</b>	<b>4.8</b>	<b>4.5</b>	<b>4.0</b>	<b>4.2</b>	<b>Emerging markets total</b>	<b>3.8</b>	<b>4.3</b>	<b>5.5</b>	<b>4.5</b>
Eurozone	2.5	1.8	0.7	0.9	Eurozone	1.5	1.7	1.1	1.0
US	2.3	3.0	2.2	1.5	US	2.1	2.4	1.6	2.0
World	3.8	3.6	2.9	3.0	World	3.0	3.4	3.8	3.4

<b>Budget balance (%GDP)</b>	<b>2017</b>	<b>2018e</b>	<b>2019e</b>	<b>2020e</b>	<b>Current account (%GDP)</b>	<b>2017</b>	<b>2018e</b>	<b>2019e</b>	<b>2020e</b>
Emerging Asia	-3.2	-3.5	-3.5	-3.5	Emerging Asia	1.4	0.3	0.5	0.5
Emerging Europe	-1.3	0.4	-0.5	-0.5	Emerging Europe	-0.5	1.6	2.5	1.5
Latin America	-5.3	-4.9	-4.0	-3.5	Latin America	-1.5	-1.7	-1.5	-2.0
Eurozone	-1.0	-0.5	-1.2	-1.4	Eurozone	3.9	3.4	3.0	2.8
US	-3.5	-4.1	-5.2	-5.0	US	-2.6	-2.4	-3.0	-3.0

Source: EIU, ABN AMRO Group Economics

\* figures Emerging Markets regions are rounded

\*\*Inflation Latin America and World without Venezuela

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