Economics & Strategy Weekly

Weekly: A zero-sum trade deal

Economics/Strategy/Rates/FX/Equities

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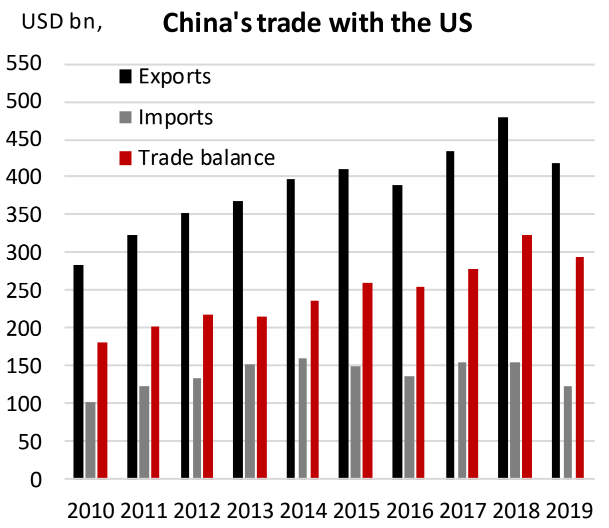
- *Phase 1 trade deal allows US President Trump to assert gains from a zero-sum approach*
- *China's pledge to buy more US goods, provide American firms more market access, and enforce tighter protection for intellectual property, while most tariffs imposed since 2018 remain in place may seem like a capitulation.*
- *But such reforms were already in train, and the purchase commitments are much smaller than the original deficit reduction targets of the US.*
- *Going forward, US will continue to push back China on many areas, including access to technology, human rights, and territorial disputes. Great power rivalry will continue to simmer in 2020, in our view.*

Trade deal and superpower rivalry

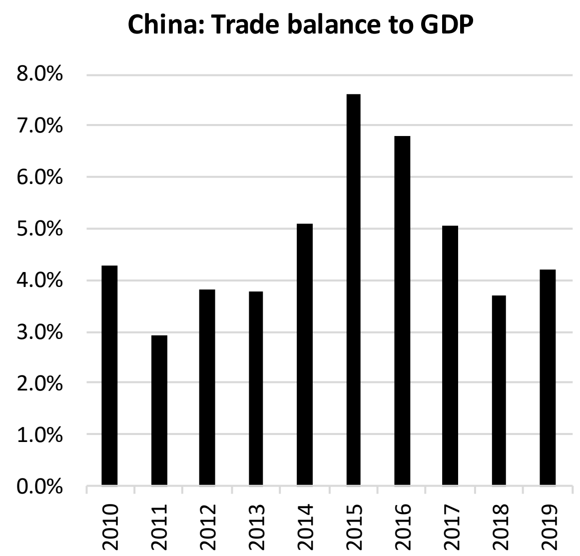
Starting the year with a high-profile assassination of an Iranian general while dealing with impeachment proceedings at home, US president Donald Trump added to the headlines by signing the Phase 1 trade deal with China this week. The agreement allows Mr. Trump to assert gains from what he sees as a zero-sum negotiation.

Indeed, China's pledge to buy more US goods, provide American firms more market access, and enforce tighter protection for intellectual property, while most tariffs imposed since 2018 remain in place may seem like a capitulation. But compared to the demands with which the US started the trade war (USD200bn in bilateral trade deficit reduction in 2019, major changes to subsidy for industries, dealing with cyber security), phase 1 barely scratches the surface.



Source: CEIC, DBS.

In fact, many of the market reforms in the deal were already in train (some in fact got delayed by the trade war), and the purchase commitments (USD200bn over two years) are much smaller than what would be needed under the original deficit reduction targets. Note that China's trade surplus vis-à-vis the US in 2019 was only 9% lower than in 2018 (and 6% higher than in 2017). Also, the point of fixating on bilateral deficits looks hollow when one takes into account the fact that China's overall trade balance vis-à-vis the world improved in 2019, while the same for the US has barely changed (despite a surge in energy exports).



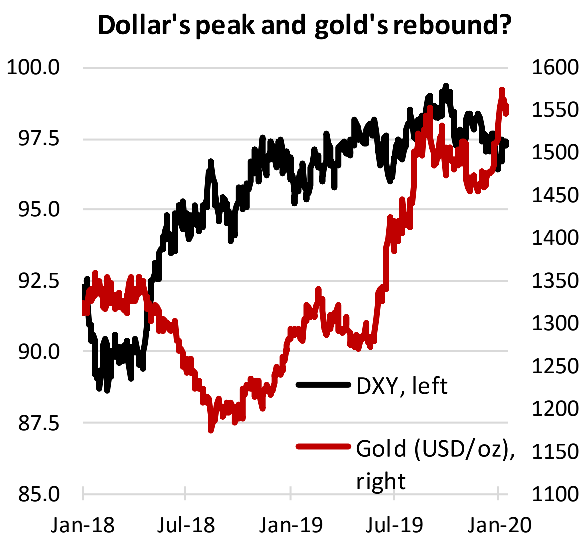
Source: CEIC, DBS.

We are sure that regardless of the course of the US economy or the political calendar, the White House will continue to push back China on many areas this year, including access to technology, human rights, and territorial disputes. Great power rivalry will continue to simmer in 2020 and beyond, in our view.

Along the way, there are two critical considerations for us. First, among the various players in Washington, we see three camps in the trade war—(i) focus on lowering the trade deficit (Trump), (ii) promotion of corporate America's interest (Trade representative Robert Lighthizer), and (iii) pure antagonism (Trade advisor Peter Navarro). Among these three lines of attack, (i) and (ii) may rest for a while, but (iii) is likely to persist.

Second, with the US fixated on the zero-sum nature of the conflict, China may end up reducing certain agriculture purchases from other countries to show that they are buying more from the US. Similarly, goods that are cleared in the port of Hong Kong may now be diverted to mainland China so that they show up officially as Chinese imports. These are types of distortions one can expect in the prevailing environment, we're afraid.

Clearly the prospect of a cessation of tit-for-tat tariffs at least for this year is helpful to market sentiments. We have noted a reflation rally keen to get going, in the form of curve steepening and commodity price (gold and oil, in particular) jumps. It is just a matter of time, in our view.



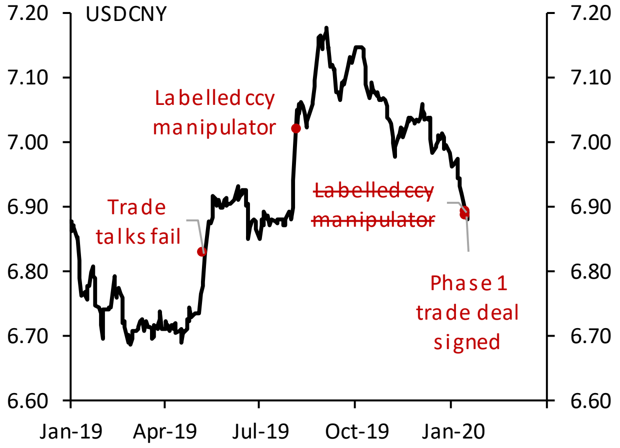
Source: Bloomberg, DBS

Taimur Baig

FX: Phasing in some post-deal relief rally

The Phase 1 trade deal signed on January 15 has rolled back some US tariffs and reversed China's designation as a currency manipulator. **The Chinese yuan has recovered most of the depreciation incurred after** US President Donald Trump called off trade talks in **May 2019** and initiated another tariff war. Without a Phase 2 deal to rollback more tariffs before the November US elections, **USDCNY may stabilize into a 6.80-7.00 range** to assess if Phase 1 can deliver the desired tangible results and avoid another relapse in the trade war.

Chinese yuan rolls back trade war risks



Sources: DBS Research, Bloomberg data

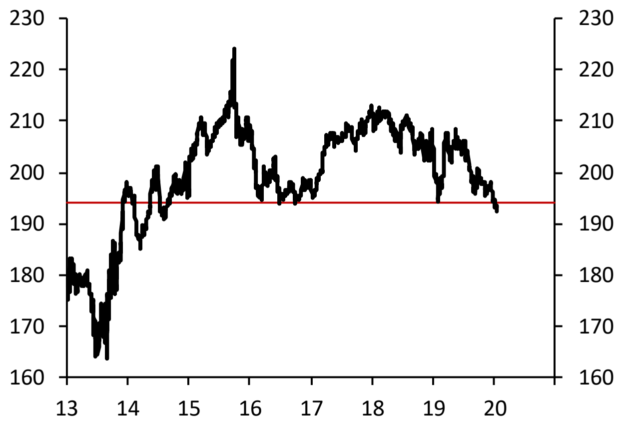
Until then, the post-deal caution is unlikely to hold investors back from positioning for a relief rally. **Risk appetite will be reflected by higher yen crosses** such as AUDJPY and GBPJPY. Do look out for short term volatility from the dovish monetary policy biases in Australia (bushfires crisis) and the UK (weak economy, low inflation). Like China on trade, "Getting Brexit Done" will be partially done. UK will exit the EU on January 31 as scheduled, but struggle to finalize its future relations with the EU at the end of its transition period on December 31.

Within Emerging Asia, **the Indonesian rupiah has overtaken the Chinese yuan as the top beneficiary of the trade truce**. Technically, USDIDR has broken below 13900 in January, its key support for most of 2019. With the Fed not looking to take back last year's three rate cuts during the US election year, the rupiah will remain an attractive carry trade.

With inflation slower at 2.7% YoY and growth steady around 5%, **Indonesia does not suffer from stagflation in India**. Indonesia's relative strength here is best reflected by the INR's new five-year low against the IDR below 194.

INR vs IDR cross rate

Fresh break at major support around 194



Sources: DBS Research, Bloomberg data

India's CPI inflation has surged to 7.35% YoY in December, which was not only above the official 2-6% target range, but also its 4.5% GDP growth rate in the September quarter. The Reserve Bank of India is likely to be caught between a rock and hard place at its next policy meeting on February 6. Hence, **USDINR is likely to have bottomed around the floor of its five-month range between 70.5 and 72.0**.

Philip Wee

Rates: Phase 1 deal signed and priced

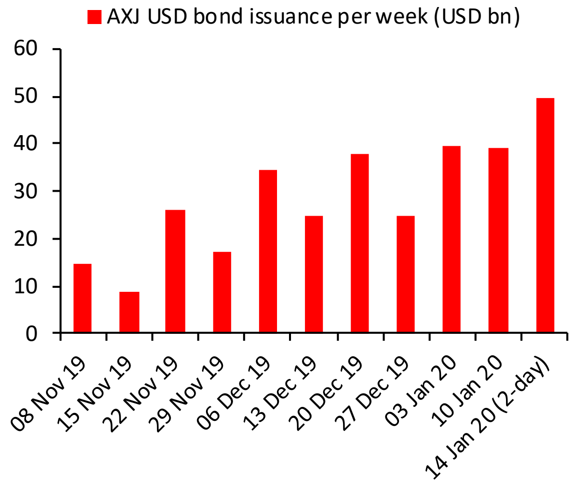
The phase 1 China-US trade deal was signed this week. The broad outlines have been well known for several weeks – China to enhance intellectual property protection, prevent forced technological transfers, purchase more US goods and services, open up the financial services sector to foreign players and refrain from keeping the currency undervalued. We reckon that **a lot of the optimism on this front has already been priced in.** Notably, the S&P 500 is up by 5.6% since end-November, tracking further tightness in USD credit spreads. **The bond market is clearly the least impressed with the trade deal as 10Y yields still hovering around 1.80%,** broadly unchanged over the past six weeks.

With China-US trade tensions likely to be in the backburner for a while, market participants will have to shift focus. US corporate earnings, macro data, Trump impeachment proceedings (charges have been delivered to the Senate) and upcoming US elections will probably capture the market's attention. **For USD rates, we expect range trading for the short term.** US data, while firm, appears to be coming off the boil. Payrolls (last week), CPI and PPI figures have come in short of consensus estimates but retail sales was firm. In any case, we think that the Fed will be firmly on hold and expect USD rates to shrug off any strong US data in the immediate few months. **We see 10Y yields in the 1.7-1.95% range.**

Eugene Leow

Credit: Surge in Asian USD bond issuance

EM Asian USD bond issuance surged this week



Source: Bloomberg, DBS

USD bond issuance by Asian corporates has been extremely strong, with announced numbers for the first two days of this week already outpacing typical full-week issuance.

What is driving this frenetic pace of issuance? On the suppy side, there were two big issuers in Asia. PT Pertamina issued USD3bn of long tenor bonds, while POSCO also marketed USD1.88bn of 3y-5y bonds. On top of these, we also have significant issuance by Chinese banks.

On the demand side, tighter pricing is also conducive. As an exmaple, the new POSCO 3y bond has zero new issue premium compared to the existing POSCO 3y. In fact, Asian credit spreads have continued to narrow, despite the sharp jump in supply.

We have previously alluded to the possibility of a renewed search for yield, and this is seeemingly driving Asian IG demand. HY issuance has been much smaller, suggesting that investors are still selective amidst risks.

Chang Wei Liang

Highlights of the week:

Top-10 macro investment strategies for 1H2020

Chart of the Week: Rising auto and credit card loan delinquencies in the US

SGD rates: Flush liquidity

Thailand: Stabilisation at moderate levels

India Budget Preview: Loosening the purse

China: More PBOC cash injection ahead

Indonesia: Government bonds with high quality carry

China-US trade deal: Neutral impact on Taiwan

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2018	2019f	2020f	2021f	2018	2019f	2020f	2021f
China	6.6	6.1	5.8	5.6	2.1	2.6	2.3	2.5
Hong Kong	3.0	-1.7	1.5	1.5	2.4	2.7	2.5	2.5
India	7.4	5.0	5.8	6.4	4.0	3.5	4.2	4.5
*India (FY basis)**	*7.1*	*6.8*	*5.0*	*5.8*	*3.6*	*3.4*	*3.9*	*4.2*
Indonesia	5.2	5.0	5.0	5.1	3.2	3.1	3.4	3.2
Malaysia	4.7	4.5	4.6	4.6	1.0	0.9	1.6	1.8
Philippines**	6.2	5.9	6.3	6.3	5.2	2.8	3.5	3.3
Singapore	3.1	0.7	1.4	1.8	0.4	0.6	1.1	1.5
South Korea	2.7	2.1	2.4	2.3	1.5	0.5	1.5	1.3
Taiwan	2.7	2.3	2.0	2.2	1.3	0.6	1.0	1.1
Thailand	4.1	2.5	3.0	3.2	1.1	0.8	1.2	1.3
Vietnam	7.1	7.0	6.8	6.7	3.5	2.8	2.9	3.0
Eurozone	1.9	1.2	1.3	1.5	1.8	1.2	1.2	1.3
Japan	0.8	0.7	0.5	0.9	1.0	0.5	0.7	0.6
United States***	2.9	2.2	1.9	1.8	2.0	1.7	1.7	2.0

* refers to year ending March i.e. 2020 represents FY20 - year ending March 2020 ** new CPI series *** eop for CPI inflation

Policy interest rates, eop

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	5.15	5.15	5.15	5.15	5.15	5.15	5.15	5.15
Indonesia	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Singapore**	1.60	1.60	1.60	1.60	1.60	1.60	1.60	1.60
South Korea	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Vietnam***	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20
United States	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75

* 1-yr lending rate; ** 3M SOR ; *** prime rate

Exchange rates, eop

	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
USD/CNY	7.20	7.15	7.10	7.05	7.00	6.95	6.90	6.85
USD/HKD	7.85	7.84	7.84	7.83	7.82	7.81	7.80	7.80
USD/INR	72.0	72.5	73.5	74.0	73.5	73.0	72.5	72.0
USD/IDR	14200	14300	14400	14500	14450	14400	14350	14300
USD/MYR	4.20	4.18	4.16	4.14	4.13	4.12	4.11	4.10
USD/PHP	52.0	51.5	51.0	50.5	50.4	50.3	50.2	50.1
USD/SGD	1.40	1.39	1.38	1.37	1.36	1.36	1.35	1.35
USD/KRW	1180	1175	1170	1165	1160	1155	1150	1145
USD/THB	31.0	30.8	30.6	30.4	30.3	30.2	30.1	30.0
USD/VND	23300	23300	23300	23300	23300	23300	23300	23300
AUD/USD	0.64	0.65	0.66	0.67	0.68	0.69	0.70	0.71
EUR/USD	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	110	109	107	106	105	105	104	104
GBP/USD	1.20	1.21	1.22	1.23	1.24	1.25	1.26	1.27

Australia, Eurozone and United Kingdom are direct quotes

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).