Economics & Strategy Weekly

What will cause global trade to bottom?

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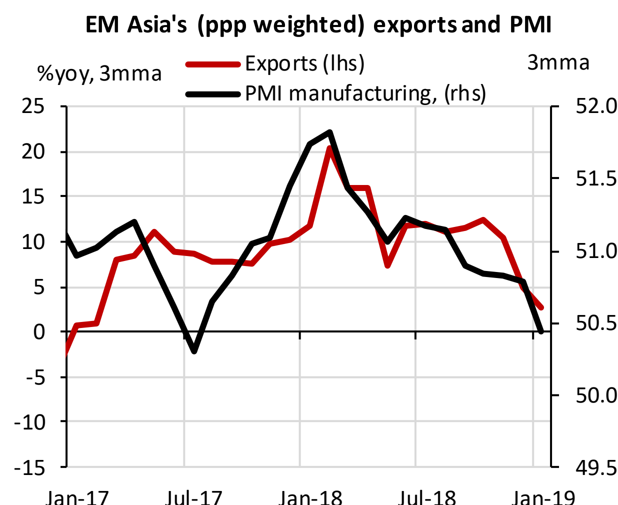
- *Despite a better-than-expected 4Q GDP print out of the US, market pleasing data remain elusive. Assets continue to rally though, ignoring the dataflow.*
- *The ongoing slowdown in trade is not a novel development; just two years ago Asia was reporting negative year-on-year exports growth. Trade wars and China slowdown are dampeners without doubt, but there are other, more normal, cyclical components at play as well, particularly with respect to electronics.*
- *What could cause the trade narrative to reverse? We highlight five factors: (i) impact of China stimulus on commodity demand; (ii) easing of China-US trade tensions; (iii) a modest rebound in oil prices; (iv) revival in tech demand around 5G rollout and new cell phone models; (v) bottoming of the global auto cycle, helped purchase by consumer incentives being rolled out in China, and dissipation of US-EU trade tension around auto tariffs.*

Is trade bottoming?

January trade figures have been uniformly disappointing, notwithstanding the data being clouded by Lunar New Year holidays. Considering that 2018 had begun with nearly 20%yoy exports growth for Asia, the base effect is daunting to begin with it; and on top of that there are multiple sources of drag—China slowdown, trade wars, and a decidedly soft patch in global electronics demand. Poor trade figures are therefore here to stay for a few months to come, even though the fact that US non-residential investment is showing signs of picking up could be helpful to the trade narrative, on the margin.



Source: CEIC, DBS Group Research

Below we examine five factors that could help the waning trade cycle to bottom. Even if three out of five of the following play out favourably, 2019 will turn out to be one more year of decent expansion:

China stimulus

There are many doubters of the efficacy of a policy stimulus when there is so much debt overhang, but China has some formidable firepower to lifts its own, and by extension, global demand. Corporate tax reform, rebates for white goods purchase, liquidity easing measures to facilitate debt servicing and restructuring, reform measures to boost investment, and targeted boost in infrastructure spending are all on the cards. We believe that a large part of the recent stock market rally is built

around these likely measures. We expect policy stimulus to prop up growth to around 6% in 2019.

China's demand revival (or at least stabilisation) will have a salutary impact on the demand for commodities and a range of goods and services. Note that China is the world's largest market for consumer goods, with retail sales slated to cross USD5trln this year. Whether it is autos or luxury goods, even a mild turnaround in China's demand will be a considerable boost to sales worldwide. Along with consumer demand, if business friendly measures and infrastructure spending pick up, commodities will benefit as well.

Easing of China-US trade tensions

We don't expect any magic bullet out of ongoing trade talks between China and the US, but with the markets pricing in considerable doom and gloom, and multinational companies decidedly uncertain and on the side-line, we wonder if the worst news has already been priced in. Even if tech wars continue, cessation of tariffs in some areas would help both trade and sentiments. A brewing and complicating factor is the incipient tension between the US and EU on autos, but our view is that the potential upside from China-US negotiations is greater than the potential downside from the EU-US tussle.

Rebound in oil

Since the beginning of this year, oil is up about 25%, reversing some of the sharp declines that took place in 4Q. We see the USD50-60/barrel range as a sweet spot, sufficient to support the exports and public finances of oil exporting economies, but not so high to undermine to the external balance or inflation outlook of oil importing economies. As long the prices remain in a 10%± range-around the USD55/barrel mark, an orderly global movement of commodities and a fairly-constructive supply-demand dynamic can be expected. We saw global freight rates fall sharply in January, but there have been signs of those rates bottoming out in the past month or so. A turnaround in the value of an index like the Baltic Dry Freight will a positive marker for us.

Revival In electronics demand

Both the mobile phone and semiconductor cycles are going through a soft patch, as seen in the published earnings and forward guidance provided by tech companies. The world is however not about to run out of innovation. Roll-out of 5G network and devices to take advantage of that, and new range of mobile phones from the market leaders in South Korea and China, may well boost tech demand modestly in the second half of the year, in our view.

Bottoming of the global auto cycle

Car sales have been weak worldwide, but we believe that the worst numbers could be behind us. A still-strong labour market and strong wage growth in the US, likely auto-purchase incentive in China, and oil prices in a benign range are three factors that could help global auto demand to bottom this year, in our view.

We are therefore not inclined to see the ongoing slowdown in global trade as a harbinger for recessionary tendencies around the horizon. Global growth may not be as strong as last year, but we are not about to head into a sharply slower patch either.

Taimur Baig

Strategy

FX: USD is as resilient as the US economy

The resilient US economy remains an important support for the US dollar amidst a weakened global economy. US real GDP growth came in at 2.6% QoQ saar in 4Q18, well above the 2.2% consensus. More importantly, non-residential business investment surged by 6.2%, suggesting that the US expansion is likely to hold up better and longer than expected. This not only contrasted sharply with the weaker investment outlook in the Eurozone and Japan but also supports our view for more Fed hikes later this year. EUR/USD attempted and failed to break above 1.14 while USD/JPY punched above 111.

The Chinese yuan is unlikely to appreciate further even as the US and China move closer towards a trade deal. China is said to have agreed to report its interventions on the yuan. This should erode the case that yuan will be led higher. We believe that the yuan has become more market-determined and will be fluctuating more with the currencies of its major trading partners. Put simply, we don't expect the yuan to buck any depreciation pressure when the USD becomes strong again globally. If the USD index (DXY) rises towards 100, we see USD/CNY returning higher to 6.90.

We remain mindful that the euro has struggled after the US-EU trade truce last July which did not stop the Eurozone growth slowdown. China is expected to announce a slower 6-6.5% growth target at its National People's Congress next week on March 5. The US trade deficit did not improve with the EU, and this has prompted America to consider imposing tariffs on automobiles and auto parts imported into America. Until the US's trade deficit with China improves, any US-China trade deal is unlikely to roll back but only hold off further tariff increases. For now, US President Trump and China President Xi still need to meet and seal the seal first at a summit said to take place around mid-March.

Philip Wee

Rates: Brace for USD curve steepening

The sharp rally in USTs over the past four months have spooked short sellers. From a record net short of almost 1.9mn contracts (across the 2Y, 5Y and 10Y tenors) last October, these positions have since whittled down to 0.7mn contracts. The paring of positions was acute for the longer-tenors (5Y and 10Y) and surprisingly, despite the very flat curve, there remains relatively greater interest to short the 2Y tenor. The well-telegraphed Fed pause and market turbulence in late 2018 appears to have a lasting impact on USTs. Despite the bounce in risky assets since the start of the year, UST yields refused to grind meaningfully higher. To put things into context, the S&P 500 has already recoupled about 75% of the losses. Comparatively, 10Y yields recovered about 24% of the drop from peak.

We are somewhat more optimistic and retain our steepening bias for the UST curve. Overnight, 10Y yields poked above 2.70% as 4Q GDP numbers came in stronger than expected (actual: 2.6% QoQ saar, consensus: 2.2%). We think the rise is not done and see 10Y yields heading towards 3% in the coming months. The belly of the curve is still inverted (2Y/3Y), but that might not be the case for long.

Asia rates should be able to handle modestly higher USD rates. **However steepening pressures across Asia curves would be inevitable if 10Y US yields grind higher as we expect.** The environment would then be slightly less conducive than what we saw in the first two months of the year (when USD rates were pinned down). Accordingly, **shorter-duration govvies will probably do better.** We have also pivoted in our China and India rates strategy. **We are now are reluctant to chase China govvie yields lower**, noting that the rise in equity markets has stalled the decline in yields. **For India, our steepening call has played out and we no longer see favourable risk-to-reward for this trade**.

Running ideas:
-long 3Y Indo govvie (7th Jan)
-short Dec-2019 Fed funds futures (7th Jan)

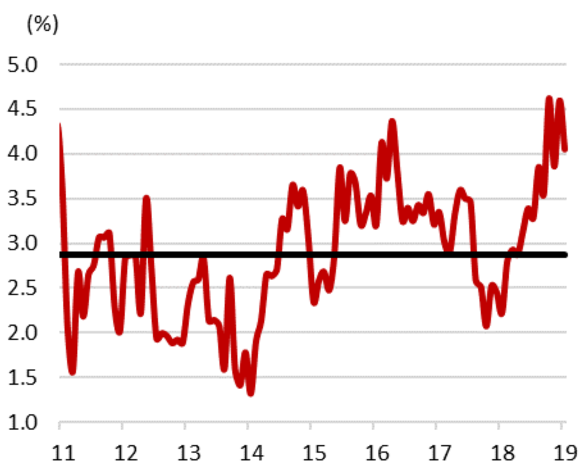
Eugene Leow

Equities: Cash levels in Asia ex-Japan still sceptically high

Cash levels in Asia ex-Japan funds are still at above-average levels, suggesting that despite easing Fed headwinds, positioning has yet to support the bullish view. We believe the concerns are valid as markets still need to climb a wall of worry of trade tensions, currencies, Brexit, European political risks, US politics, and growth downgrades. Meanwhile, markets have been pushed to oversold technical levels and VIX is hovering at low levels, suggesting that short-term reversals may be imminent.

We look for growth downgrades to end by March after the earnings season and also details of trade deal to revive sentiments. From a half-full market perspective, high cash levels imply that there are bullets for the markets to recover after this soft patch. A trade deal which includes a withdrawal of some past import tariffs could be hugely positive for markets. Meanwhile, China's top legislature, the 13th National People's Congress, will hold its second annual session in Beijing in early March. We expect policy guidelines to emphasise on growth-supporting measures. An outright corporate or personal tax cut will be hugely positive for the Chinese market sentiments, in our view.

Cash levels among Asia ex-Japan funds



Source: EPFR, DBS. Latest data as of Jan 19. Horizontal line refers to period average.

Joanne Goh

Credit: Consolidation mode

Asian credit markets were largely in consolidation mode. With valuations beginning to now look rich, market participants look for direction for the next move. While current assumptions were reinforced during the week, there was no new catalyst to move markets in either direction. Fed Chair Jerome Powell reinforced market expectations of a dovish Fed, which has been a key driver of the improved sentiment this year. In his testimony before the Senate Banking Committee on 26 February, Mr. Powell said, "with our policy rate in the range of neutral, with muted inflation pressures and with some of the downside risks we have talked about, this is a good time to be patient and watch and wait and see how the situation evolves." With no surprise from the Fed, we believe markets will find support for now although any potential change in Fed policy will be key to monitor.

Two key stories this week were 1. around Indian credits with a flare up in tension between India and Pakistan. 2. A delayed coupon by a Chinese LGFV on its USD bond.

As we wrote in the Macro Strategy dated 28 February, we do not see the risk of a material sell off in Indian credits unless the situation escalates to a military conflict. This is not our base case now. Given the lack of meaningful supply of Indian bonds and challenges in diversifying portfolios away from China, any big sell off should bring in buying interest, which will limit the extent of the downside. That said, we view Indian bond valuations as generally expensive, and the latest developments / price action have not changed this view.

Meanwhile, the delayed coupon by a Chinese LGFV was a reminder of downside risks in high yield Chinese credits. Recent price moves in several weak credits may also suggest some degree of complacency towards credit quality. In this case, it was potentially the assumption that local government support would be timely. While sentiment has improved over the past eight weeks, fundamentals do not change so fast. The rally in single B and weaker credits is an opportunity for investors to reassess positions and potentially exit positions, in our view.

Neel Gopalakrishnan

Highlights of the week:

India's economy and markets around elections

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	7.1	6.7	7.1	7.4	4.5	3.6	4.0	4.2
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.6	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	2.5	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.2	3.9	3.8
Singapore	3.6	3.4	3.0	2.8	0.6	0.4	1.8	1.5
South Korea	3.1	2.7	2.6	2.4	1.9	1.5	1.7	1.6
Taiwan	3.1	2.6	1.9	1.8	0.6	1.4	1.0	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.4	1.5
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	3.0	2.5	1.5	2.1	2.6	2.5	2.5

* refers to year ending March ** new CPI series *** eop for CPI inflation

Policy interest rates, eop

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.80	2.05	2.30	2.30	2.30	2.30	2.30	2.30
South Korea	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00
United States	2.50	2.50	2.75	3.00	3.00	3.00	3.00	3.00

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

Exchange rates, eop

	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
China	6.90	7.00	7.10	7.05	7.00	6.95	6.90	6.85
Hong Kong	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
India	72.0	73.0	74.0	73.5	73.0	72.5	72.0	71.5
Indonesia	14200	14600	14800	14700	14600	14500	14400	14300
Malaysia	4.10	4.20	4.30	4.25	4.20	4.15	4.10	4.05
Philippines	53.0	54.0	55.0	54.5	54.0	53.5	53.0	52.5
Singapore	1.38	1.40	1.42	1.41	1.40	1.39	1.38	1.37
South Korea	1140	1160	1180	1170	1160	1150	1140	1130
Thailand	32.0	33.0	34.0	33.5	33.0	32.5	32.0	31.5
Vietnam	23200	23300	23400	23350	23300	23250	23200	23150
Australia	0.70	0.68	0.66	0.67	0.68	0.69	0.70	0.71
Eurozone	1.10	1.08	1.06	1.07	1.08	1.09	1.10	1.11
Japan	111	113	115	114	113	112	111	110
United Kingdom	1.26	1.24	1.22	1.23	1.24	1.25	1.26	1.27

Australia, Eurozone and United Kingdom are direct quotes

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