Economics & Strategy Weekly

Global investment and trade wars

DBS Group Research   May 10, 2019

Taimur Baig
Chief Economist
taimurbaig@dbs.com

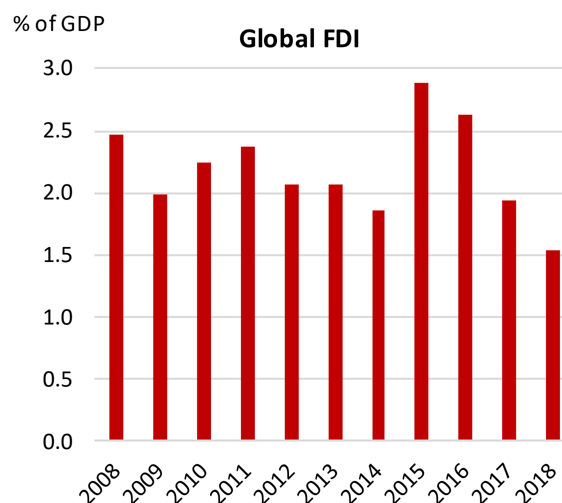
Nathan Chow
Strategist/Economist
nathanchow@dbs.com

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *Foreign direct investments have weakened worldwide over the past decade. Indeed, as a share of GDP, global FDI fell to 1.5% of GDP last year, lowest seen in decades.*
- *Unsurprisingly, the country with the most robust net FDI track record has been China, although as Chinese companies have begun investing outside, the net figure has declined.*
- *Inward FDI to China, contrary to conventional wisdom, shows no sign of weakening*
- *Net FDI to the US has begun to improve, while remaining weak for EU*
- *However, despite historic tax cuts and incentives, inward FDI to the US has weakened the last two years.*
- *Tariff and non-tariff barriers are unlikely to change these trends, in our view.*

Investment and trade wars

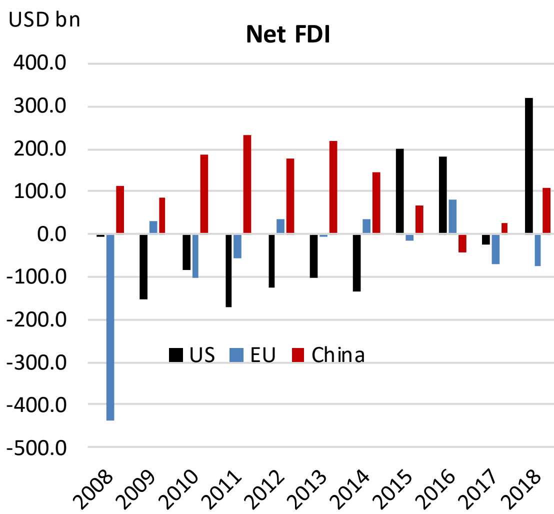
As we end a week full of drama around China-US trade frictions, the scenario of a world full of trade frictions is solidifying. As trade barriers go up, not only do the flow of goods across borders gets affected, outward investments suffer too, thank to associated uncertainty and costs. That this is taking place at a juncture when global investments flows are weak in any case is particularly worrisome. Looking at UNCTAD's global investment data, we see that global FDI fell to 1.5% of GDP last year, lowest seen in decades. A weakening tech cycle, lowering of growth expectations in the G3, and a rise in economic nationalism may all have contributed to this trend. The ongoing China-US trade frictions will likely exacerbate this trend.



Source: UNCTAD, DBS

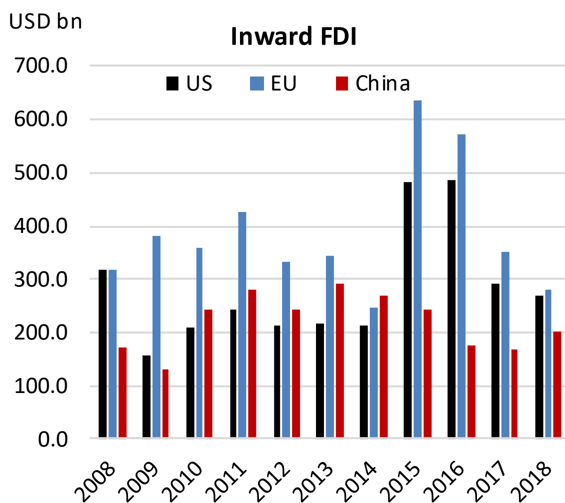
Beyond the overall global trend, the picture becomes more nuanced when the data from the US, EU, and China are examined. Unsurprisingly, the country with the most robust net FDI track record has been China, although as Chinese companies have begun investing outside, the net figure has declined. In contrast, net FDI to EU has been virtually non-existent, with inward FDI's almost always being exceeded by outward investment flows. The US has also had an ordinary net FDI track record, although there has been some improvement in the trend since 2015.

Refer to important disclosures at the end of the report



Source: UNCTAD, DBS

The picture is most interesting when the data are isolated to gross inward flows. This series reveals the sentiment of foreign investors toward an economy. This again underscores robust flows to China in more than a decade. Strikingly, despite historic tax cuts and incentives, inward FDI to the US has weakened the last two years.



Source: UNCTAD, DBS

As tariffs spike and trade wars rage, it is unlikely that we will see a revival in the global investment downtrend. However, given China's scale and competitiveness, global investment flows are unlikely to shy away, in our view. The US may also receive flows if growth continues to remain healthy and the investment environment is open. We are not as optimistic about EU though, given its myriad of cyclical and structural headwinds.

Taimur Baig

China: Stimulus is working; more coming

Earlier this week, the PboC cut reserve requirement ratio (RRR) releasing RMB 280bn for small to medium size banks. Banks with assets lower than RMB 10bn will be subject to RRR of 8%. About 1,000 small banks will benefit. The latest cut will put downward pressure on the 7-day repo rate, and subsequently drive down average lending rates. Looking ahead, a broad-based easing is likely given persistent trade tensions.

Monetary condition tightened somewhat last month. M2 growth inched down from 8.6% to 8.5% in April. Outstanding aggregate financing growth also eased back from 10.7% to 10.4%. Bank loan also drop from 13.7% to 13.5%. The corporate loan as percentage of total loan shrank, thereby suggesting a weak borrowing demand. Premature policy normalization could risk choking off growth momentum (see: "Economy still fragile despite stabilization policies", April 30). The escalated trade tension with US also warrants accommodative stance on monetary policy to stay.

The outlook of the external environment is cloudy due to lingering trade tension with the US. Exports to the US in April dropped 13.1%, compared to the 3.7% advance in March. Yet, the trade balance increased from USD20.5bn from USD21.0bn due to slumping import (-25.7%) from the US. Total imports growth was 4.0% in April on the back of gradually improving domestic demand. Headline NBS Manufacturing PMI was above 50 for the second time since Nov18, with the import component improved from 48.7 to 49.7. In fact, the industrial production and fixed asset investment surge to 8.5% and 6.3% in March from 5.3% and 6.1% registered in Jan-Feb respectively due to large-scale stimulus policy. These increased the demand for commodities such as oil, copper and coal. The respective import volumes increased by 10.8%, 6.6% and 13.5%. Meanwhile, the China-US trade deal also boosted soybeans import. The inward shipment soared by 10.4% in volume terms/2.9% in value terms due to the decrease of value-added tax for the product effective in April. This is the first YoY increase since Nov18.

Samuel Tse

Philippines: BSP cuts rates, more to come

BSP announced a 25bps rate cut on the back of sharp growth slowdown, joining India and Malaysia's central bank which has cut earlier this quarter. Philippines GDP data shows lowest growth in four years, down to 5.6% from 6.3% in 4Q18. BSP also cut their inflation forecast for this year to 2.9% and hike next year to 3.1%. BSP also sees that risk continue to lean toward the downside in 2020 and seems determine to support growth. We think this will not be the last rate cuts as growth might continue to face more headwinds ahead while inflation is likely to remain benign. We reiterate our forecast of 50bps policy rate cuts this year.

Growth slowdown is mainly caused by budget impasse. 2019 budget was just approved in mid-April, two months after operating under a re-enacted budget in which new infrastructure projects could not be started. This has caused construction sector growth to slow, only growing at 3.9% YoY from 20% in 4Q18. From the expenditure side, government spending was down to 7.4% from 12.6% in 4Q18.

Inflation has decelerated for sixth straight month last April resulting in YTD average of 3.6% from a recent high of 6.7% in Sep-Oct18. Core inflation has softened as well indicating softer domestic demand. We see inflation to remain within BSP target limit this year, we revise our CPI forecast to 3.1% both in 2019 and 2020.

Growth is likely to rebound, especially in 2H19 when government consumption is fully up to speed and consumption stable. We think that growth could remain above 6% this year and next (DBSf: 6.1% in 2019 and 2020).

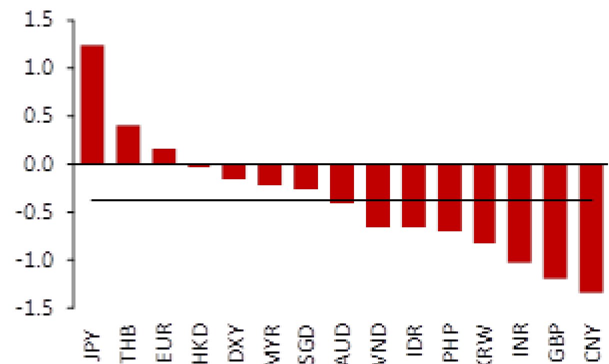
Masyita Crystallin

FX: High noon for China-US trade talks

There has been no panic selling in the currency markets even as the US increased tariffs to 25% (from 10%) on USD200bn worth of Chinese exports. USD/CNY has held near the 6.80 on hopes of averting a full-blown trade war.

Currency sell-off on higher US tariff fears this week

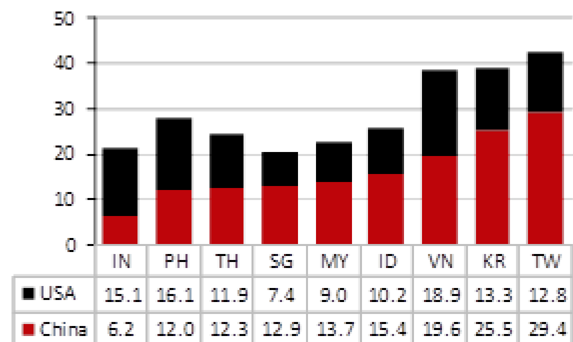
% change vs USD, May 9 vs May 3



The worst-case scenario a full-blown trade war, based on our analysis of the effective link between US tariffs and the CNY, could lift USD/CNY above 7. The resulting spillover into Emerging Asian currencies would be considerable. Other than the USD, market participants could also seek safety in the Japanese yen. The Emerging Asian countries that send around 40% of their exports to the US and China are Taiwan, South Korea, and Vietnam.

Who is most vulnerable in a US-China trade war?

% share of total exports in 2018 (ranked by China)



	IN	PH	TH	SG	MY	ID	VN	KR	TW
USA	15.1	16.1	11.9	7.4	9.0	10.2	18.9	13.3	12.8
China	6.2	12.0	12.3	12.9	13.7	15.4	19.6	25.5	29.4

Sources: DBS Economics & Strategy, Bloomberg data

Philip Wee

Equities: Focus on domestic sectors and valuation

The development on the US-China trade negotiation is undoubtedly a negative surprise to the market, which has been pricing in a trade war resolution. While markets' pricing on the development of the trade talks are still tentative, we believe the correction this time round should be shallower and shorter than last year. The advantage we have now is that economic slowdown and earnings growth downgrades are at their bottom, when compared to last year, they were coming off from the peak. Policies from the Fed and China are also seen to be more supportive and prepared in cushioning downside global risks.

In China / Hong Kong, Hong Kong's Hang Seng Index and China's CSI300 Index fell by near 6% and 8% respectively this week till Thursday, while the RMB also dropped by more than 1% after months of relative strength. We expect the sell-off to be the greatest for companies and sectors that have outperformed recently, namely Macau gaming, insurance, education, software & games and F&B. Once the dust settles, however, we think the market will return to focusing on sectors which are not directly impacted by the trade war.

We stand by our Overweight ratings on education, property management, Hong Kong property, Hong Kong REITs, and the Internet sectors, with the exception being the insurance sector which has benefitted from the strong performance of the equities market. Any policy responses from China in view of the challenging trade and currency conditions may offer the market some support. Sectors which are typically supported by the government may fall under the spotlight, including sectors such as rail, infrastructure and cement.

In Singapore, we see the Straits Times Index trading between 3190 – 3370 in the short term, depending if the trade tension worsens or eases. We think there is enough valuation cushion to support the Singapore market, even if US tariffs rise, provided US-China trade talks continue. Singapore REITS is still our favoured sector as it stands to benefit from lower bond yields.

Joanne Goh

Rates: USTs look expensive

The market had a difficult time digesting the myriad of possibilities that opened up the moment Trump threatened additional tariffs on Chinese imports. Just last week, a China-US trade deal looked like a foregone conclusion and the market was priced accordingly. While a last-minute deal is still a possible, the market has to factor in other scenarios (no deal and tariffs go up, the possibility of a delayed deal), however, none of them are as good as what market participants were expecting (a deal by this week).

The reaction in US and Chinese markets have been relatively orderly compared to what we saw in 4Q last year. The S&P 500 is down by barely 2.5% from last week's close while 10Y UST yields are down by 7bps. The reactions are more sizable in the Chinese markets with the Shanghai Composite down by over 7% and 10Y govvie yields lower by 10bps. **Clearly, things could get worse if the tariffs hit and there are zero positive news flow on further trade negotiations.**

Without making a call on the trade talks (we think it's mostly noise anyway), we should note that the global economy appears to be in a better spot (tentative signs of stabilization in China and generally supportive monetary policy stances) compared to late last year. Financial conditions are still benign and US data has stayed firm. **Accordingly, US Treasuries look expensive at current levels.** To be sure, there would be further yield downside if trade talks unravel, but with the market already pricing in 1-2 cuts by end-2020, it would take a sizable shock to drive the Fed to even more aggressively. **Reaching for duration makes little sense and we reiterate that the front of the curve (<1Y) may be the safest bet at this point.**

Eugene Leow

Highlights of the week:

Philippines: BSP to cut rates soon
China: RRR cut signals PBoC still supportive
Macro Insights video on Sing Dollar - What's it all about?
Hong Kong chart book - Gradual improvement in the making
Chart of the Week: Trade recovery hostage to US-China trade talks

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018	2019f	2020f	2017	2018	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*	8.2	7.2	7.0	7.0	4.5	3.6	3.4	3.8
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	1.7	1.6
Philippines**	6.7	6.2	6.1	6.1	2.9	5.2	3.1	3.1
Singapore	3.9	3.2	2.6	2.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	1.1	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.0	1.3
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	2.9	2.5	1.5	2.1	2.4	1.7	1.6

* 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	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	4.75	4.50	4.25	4.25	4.25	4.25	4.25	4.25
Singapore**	1.95	1.95	1.95	1.95	1.95	1.95	1.95	1.95
South Korea	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
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	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50

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

Exchange rates, eop

	Mar 29	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.85	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.4	70.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14248	14300	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.10	4.20	4.25	4.20	4.15	4.10	4.05
USD/PHP	52.7	54.0	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.37	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1137	1170	1180	1170	1165	1160	1155	1150
USD/THB	31.7	32.5	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23201	23250	23300	23280	23300	23250	23200	23150
AUD/USD	0.71	0.70	0.68	0.68	0.68	0.69	0.70	0.71
EUR/USD	1.12	1.12	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	111	113	115	114	113	112	111	110
GBP/USD	1.31	1.30	1.28	1.29	1.30	1.31	1.32	1.33

Australia, Eurozone and United Kingdom are direct quotes

Group Research

Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying, CFA
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Duncan Tan
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

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

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the “DBS Group”). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.
DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.
PT Bank DBS Indonesia, DBS Bank Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000. Company Registration No. 09.03.1.64.96422.