Focus on Asia – The Impact of Trade Tensions on the Region

Oct 25, 2018

John Greenwood,
Chief Economist

Q1) Trade tension between the US and China has already played out for more than 6 months, what are the observable impacts so far in the Asia region / Asian countries?

Dr Greenwood: So far the US has imposed tariffs on US$ 235 billion of Chinese imports coming into the US. This amounts to 44% of Chinese exports to the US, and 8% of total US imports in 2017. The impact on the US so far has been small, in part because the US$ has strengthened (lowering import prices), but the impact will surely intensify. For example, although the prices of all US imports from China had increased by only 0.4% in September, overall import prices had risen by 4.0% in July, while spot industrial metal prices have declined by 4% over the past year.

Nevertheless, the imposition of tariffs is bad news for the US consumer. In January the Trump administration imposed a 20% tariff on imported laundry equipment (such as washing machines) until a quota of 1.2 million per year was reached, and then 50% after that. The result was that in the three months April to June, US laundry equipment prices within the US CPI increased by 19.9% -- by far the largest monthly price increase of any of the 300 individual CPI categories or sub-categories -- and domestic makers like Whirlpool have been able to raise their prices.

On the Asian side the observable results in the published data are very small to non-existent, but the PMI measure for new export orders – an indicator of future trade volumes -- fell to its lowest level in two years.

China's total exports increased by 14.5% year-on-year to US$ 226.7 billion in September 2018, after a 9.8% rise in July, defying market expectations of a slowdown. It was the fastest growth in outbound shipments since February, though some might be due to front-loading of exports to the US before tariffs are raised to 25%. Despite intense trade tensions with the US, strengthening global demand and a lower yuan have helped fuel a record Chinese trade surplus with the US of $34.1 billion in September. In addition, raw aluminium and aluminium product exports surged 37% year-on-year to 507,000 tonnes despite the 25% tariffs on Chinese steel imports and 10% on aluminium imports since March 23rd.

Two things are already clear: first, the makers of the targeted goods are looking for alternative places to do the manufacturing of the lower value-added items. Thus Vietnam has benefitted from the transfer of numerous garment makers from China. Second, the tariffs will encourage China to shift more rapidly into higher value-added activities where profit margins are higher. This is what happened in Japan when the US imposed quotas and other restrictions on Japanese goods coming into the US in the 1970s and 1980s.

Q2) CNY/CNH has been one of the worst performing Asian currencies in the region in the past 6 months. In your opinion, how would this impact on other countries in the region? What is your outlook on Asian currencies?

Dr Greenwood: All the Asian economies have been affected by rising US interest rates and the strengthening US dollar, but the CNY has been additionally affected by the imposition of tariffs on the country's exports to the US. In my view the US dollar will likely strengthen further against Asian currencies while US interest rates are being raised, but will then stabilize – probably in mid or late 2019. However, the recent US Treasury report on "currency manipulation", while not labelling China a "currency manipulator" makes it clear that the US government will not tolerate much more CNY depreciation, so it seems unlikely that the CNY will depreciate much more against other Asian currencies.

The impact of currency change is only one of the factors driving export and import growth. Changes in the volume of demand in the target markets are equally important. Normally it takes up to two years for these price (or currency depreciation) effects and volume effects to be fully reflected in exports and imports. It is therefore too early to see the full consequences of the recent currency changes. Meantime, while China has done better than other Asian exporters in 2018, the steady strengthening of global activity has helped non-China Asian exports recover modestly over the past year.

Q3) Recently, China has taken certain actions in terms of monetary policy, e.g. cut RRR and weaken its currencies. What is your outlook on the People's Bank of China (PBOC) monetary policy going forward and how will that impact on the economy?

Dr Greenwood: In my view China's priority remains the deleveraging of the economy due to the build-up of excessive debt since 2008-09. This has meant that M2 growth, bank lending growth and total social financing have all slowed down since the start of 2017. For example, outstanding total social financing increased only 10.6% in September from a year earlier compared with growth of 13-15% just two years ago. Inevitably this has been reflected in some slowing of Chinese domestic spending, slower growth of fixed asset investment, a pause in house price increases in Tier 1 cities, and it was almost certainly behind the slower growth of real GDP in 2018 Q3 (6.5% or 6.0% annualized).

To counter the slowdown and ensure that the downturn in domestic spending does not intensify, the PBOC, China's central bank, has cut the RRR and lowered interest rates. However, these moves should be seen as counter-balancing the monetary and credit slowdown, not the start of a new stimulus programme. I therefore forecast that the gradual slowing in China's real GDP will continue, and furthermore, that inflation will remain very low in 2018 and 2019.

Important Information

This document has been prepared only for those persons to whom Invesco has provided it for informational purposes only. This document is not an offering of a financial product and is not intended for and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any person without the consent of Invesco is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements", which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

The information in this document has been prepared without taking into account any investor's investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs. You should note that this information:

- may contain references to amounts which are not in local currencies;
- may contain financial information which is not prepared in accordance with the laws or practices of your country of residence;
- may not address risks associated with investment in foreign currency denominated investments; and
- does not address local tax issues.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.