Short Insight

Group Economics
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Tweets and twists in the trade/tech war

- **Tweets and twists in US-China conflict: fresh tariffs, delays and currency turmoil**
- **We expect a stepwise, 'orderly' yuan depreciation, no freefall**
- **China's weak July data build the case for more support**
- **Hong Kong economy is feeling the heat from rising social unrest**

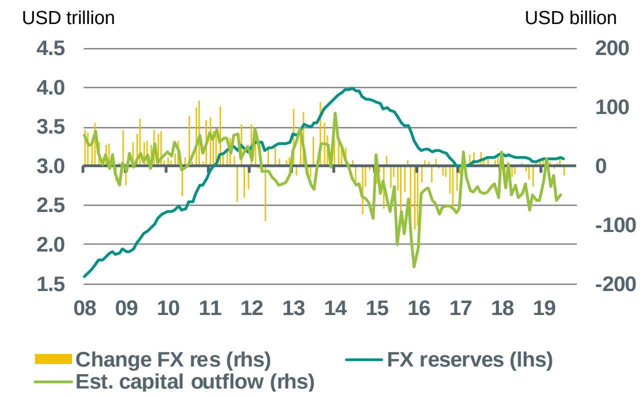
1. Tweets and twists: fresh tariffs, delays and currency turmoil
Last month, we pointed to the 2nd truce in the US-China conflict agreed in late June. One month later, we all know this had an amazingly short life. On 1 July, Trump tweeted that China was (amongst other things) not fast enough with stepping up agricultural imports from the US and announced fresh 10% tariffs on the remaining USD 300bn of imports from China (on top of the 25% tariffs over USD 250 bn already in place). China did not seem to be very impressed and instead has hardened its position. Beijing has responded by announcing they would reduce – not boost – agricultural imports from the US. What is more, they have tolerated the yuan to depreciate below the level of 7 CNY per USD, for the first time since 2008, with a 2% depreciation or so on Monday 5 August alone. In response, on the same day, the US declared China a 'currency manipulator', for the first time since 1994. Meanwhile, illustrative for the turns and twists in the trade war so far, yesterday the US announced that some of the 10% tariffs scheduled for 1 September will be delayed to 15 December.

PBoC allows USD-CNY to break the 7 level

Source: ABN AMRO Group Economics, Bloomberg

2. We expect a stepwise, 'orderly' yuan depreciation, no freefall
Following recent developments, we revised our USD-CNY forecasts higher. We had been of the view, like many investors, that the PBoC would be cautious with breaking the USD-CNY level of 7, as it learned lessons the hard way during the 2015-16 turbulence when capital outflows surged on sharp depreciation expectations and FX reserves lost 25%. Still, we pointed to the risk of the 7 level to be broken in case of a severe escalation of the trade conflict. Remember that we had seen a 10% depreciation mid 2018 in the run-up to higher US tariffs, while in the spring of 2019 the CNY moved quickly from 6.70-6.75 to just above 6.90 after negotiations broke down in May. We still think that the authorities will keep managing the yuan cautiously, with lessons from the 2015-16 capital outflows in mind. We expect the PBoC will tolerate some more yuan weakness to preserve China's competitiveness in the wake of higher tariffs, but will keep the depreciation modest. Note that the PBoC today - after the US delayed some tariffs – set the USD-CNY fixing stronger for the first time since late July. All in all, we have adjusted our USD-CNY forecasts for end-2019 and end-2010 to 7.20 (from 6.90) and 7.50 (from 6.70).

The 2015-16 turbulence still in PBoC's mind

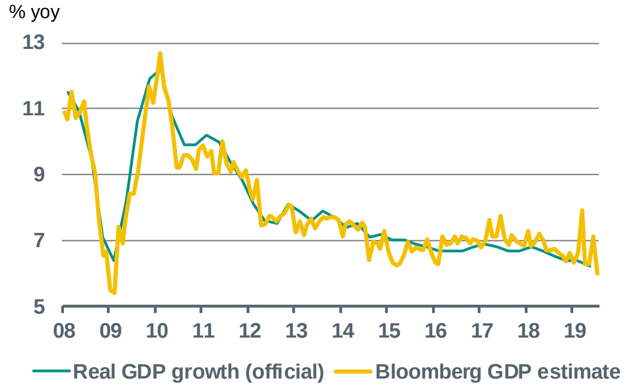


Source: ABN AMRO Group Econ, Thomson Reuters Datastream, Bloomberg

3. Chinese data for July weak, building the case for more support

The activity data for July published today were weak, certainly in comparison to the stronger than expected June data. Industrial production slowed to 4.8% yoy (June: 6.3%, consensus: 6.0%), the weakest pace in 17 years. Retail sales slowed to 7.6% yoy (June: 9.8%, consensus: 8.6%). Fixed investment growth was marginally lower in July (5.7% yoy ytd) compared to June. Lending data for July were also weaker than expected, although some seasonal factors play a role here. By contrast, the export and import data and the manufacturing PMIs published earlier this month were a bit better than expected. CPI inflation edged up further to 2.8% yoy driven by the ongoing – swine flu related – spike in food prices, but producer price inflation (-0.3% yoy) was back in negative territory for the first time in three years. Bloomberg's monthly GDP estimate dropped sharply to a post global financial crisis low of 6.01% yoy, from June's spike of 7.11%. All in all, the Chinese economy is not out of the woods yet and we expect the authorities to step up fiscal and monetary easing in the coming quarters (including RRR and interest rate cuts) to stabilise growth.

Bloomberg GDP estimate for July lowest in 10 years

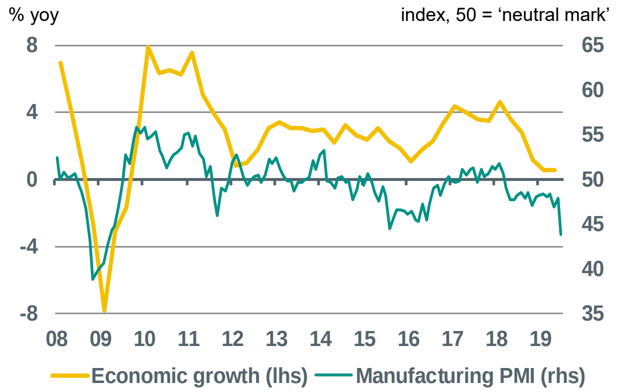


Source: Bloomberg

4. Hong Kong economy is feeling the heat from social unrest

In Hong Kong, social protests have become more intense (with the airport being a new target). Chief Executive Carrie Lam warned the city might slide into an 'abyss'. Mainland China stepped up its rhetoric, referring to signs of terrorism. The world will watch closely how developments will evolve. What is sure is that the rise of political turbulence is not helping the Hong Kong economy. Hong Kong is highly export oriented, so economic growth has slowed materially as escalating trade tensions between the US and China (in particular) have caused a global slowdown in manufacturing, (cross-border) investment and trade. Economic growth has slowed from 4.6% yoy in Q1-18 to 0.6% yoy in Q1 and Q2 2019. Quarterly growth over Q2-2019 was negative (-0.3% qoq), and Hong Kong could well slip into recession in Q3. Monthly activity indicators show that the social unrest is contributing to this slowdown due to the impact on confidence, consumer and business spending and tourist arrivals, as well as the disruptive impact on public transport and daily business activities. Hong Kong's manufacturing PMI nosedived in July falling to 43.8, the weakest level (4since the global financial crisis). Retail sales have slowed sharply (June: -6.7% yoy). Hong Kong's Hang Seng stock index has lost 15% since mid April.

Social unrest adds to Hong Kong growth slowdown



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

Key forecasts for the economy of China

	2016	2017	2018e	2019e	2020e
GDP (% yoy)	6.7	6.8	6.6	6.2	5.8
CPI inflation (% yoy)	2.1	1.5	1.9	2.5	2.5
Budget balance (% GDP)	-3.8	-3.8	-4.2	-4.5	-4.5
Government debt (% GDP)	16	17	19	22	25
Current account (% GDP)	1.8	1.6	0.4	0.0	0.0
Gross fixed investment (% GDP)	42.7	42.9	44.4	43.3	42.3
Gross national savings (% GDP)	45.9	46.3	45.1	43.7	42.3
USD/CNY (eop)	7.0	6.5	6.9	6.9	6.7
EUR/CNY (eop)	7.3	7.8	7.8	7.7	8.0

Economic growth, budget balance, current account balance for 2019 and 2020 are rounded figures
Source: EIU, ABN AMRO Group Economics