

## Matthews Asia Perspective

### The Likely Trade War Fallout in Asia



**Sharat Shroff**  
Portfolio Manager  
Matthews Asia

The U.S. administration appears to be targeting export-oriented entities out of China. Exports are of little importance, however, to the Chinese economy. The largest and fastest-growing part remains Chinese companies selling goods and services domestically. This means that any impact of a trade war on these companies is likely to be modest. Still, a risk remains that as U.S.-China trade relations further deteriorate, the productivity gains accrued from more efficient manufacturing and global supply chains will start to unwind. In this case the consumer, globally, will have to bear at least part of the pain.

We have seen a partial shift in the financial institutions that exert their influence in Asia. Local regional entities are trying to create lending channels for various countries in the region. But there is not enough depth yet to fully offset traditional Western-backed institutions. If the availability of capital becomes challenging due to global monetary tightening, it may constrain the pace at which Asia's economies can grow.

A dichotomy exists, however, between what Asia's capital markets are telling us—which seem fearful of rising rates in the U.S. and potential trade wars—and what we are being told on the ground by companies and consumers. Not only are businesses across the region looking to invest, but they seem to have a reasonable degree of confidence about their future expectations.

Take India and Indonesia, two Asian countries that appear vulnerable to higher U.S. interest rates. After five years of disappointing economic growth, signs of life are creeping back into their respective investment cycles.

Following the taper tantrum in the U.S. in 2013, policy makers in India and Indonesia focused on the necessary structural reforms to set the stage for better future growth. With both countries reliant on outside capital, they addressed some of the inefficiencies within their economies, such as sticky inflation and wastage of subsidies, as well as long-term challenges to improve the business environment. This may alleviate tail risks of significant dislocations within these economies, but any changes in the availability of capital may constrain the nascent recovery in economic activity.

We believe both economies are starting to recover, albeit gradually. Low Indonesian equity valuations, when set against the backdrop of an improving earnings cycle, may offer opportunities. In India, on the other hand, valuations look more expensive compared with their recent history and will need to be underwritten by a sharp pickup in earnings.

*Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.*

---

#### Bull and Bear Cases for Asia's Markets

##### **Bull Case:**

- Improved fundamentals in Asia's economies
- Chinese domestic-oriented services sector is insulated from trade war impact
- Indonesian equity valuations appear attractive

##### **Bear Case:**

- Global monetary tightening might constrain the pace of growth in Asia
- Ripple effects from potential Chinese trade policy reaction

---

### Important Information

Matthews Asia is the brand for Matthews International Capital Management, LLC and its direct and indirect subsidiaries.

The information contained herein has been derived from sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Matthews Asia and its affiliates do not accept any liability for losses either direct or consequential caused by the use of this information. The views and information discussed herein are as of the date of publication, are subject to change and may not reflect current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles. This document does not constitute investment advice or an offer to provide investment advisory or investment management services, or the solicitation of an offer to provide investment advisory or investment management services, in any jurisdiction in which an offer or solicitation would be unlawful under the securities law of that jurisdiction. This document may not be reproduced in any form or transmitted to any person without authorization from the issuer.

**In the United States**, this document is issued by Matthews International Capital Management, LLC. **In Singapore**, this document is available to, and intended for Institutional Investors under Section 304 of the Securities and Futures Act ("SFA"), and to Relevant Persons pursuant to section 305 of the SFA, as those terms are used under the relevant law. It should not be circulated or distributed to the retail public in Singapore. **In Hong Kong**, this document is issued by Matthews Global Investors (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission in Hong Kong (SFC). **In the UK**, this document is issued by Matthews Global Investors (UK) Limited, which is authorised and regulated by the Financial Conduct Authority ("FCA"), FRN 667893. In the UK, this document is only made available to professional clients and eligible counterparties as defined by the FCA. Under no circumstances should this document be forwarded to anyone in the UK who is not a professional client or eligible counterparty as defined by the FCA. This document has not been reviewed by any regulatory authorities.