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# Economic Acumen

Commentary by CEBI Research Team

## In Brief

- U.S. President Donald Trump announced that he would begin to revoke Hong Kong's (HK) preferential treatment as a separate customs and travel territory from the rest of China.
- The latest escalation of US-China tensions threatens HK as a global financial hub and as a critical business gateway between China and the U.S. As one of the most open and free economies in the world, HK is highly reliant on consumption, trade and investment flows from China and the rest of the world to maintain its economic strengths.
- We are of the view that the removal of HK's special privileges will shake business confidence and create pessimistic market sentiment in short run only.
- The continued complication of worldwide economic and political environment will push forward the rebalancing of HK economy, thus paving the way for a new era of development to ride out the economic storm as well as maintain the prosperity and stability.

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## The U.S. stripping away HK's preferential economic and trade status

U.S. President Donald Trump announced that he would begin to revoke Hong Kong's (HK) preferential treatment as a separate customs and travel territory from the rest of China. His action was in response to the National People's Congress (NPC) imposing national security law on HK in an attempt to prohibit acts of secession, subversion, terrorism or conspiring with foreign influences. The U.S. claims that the law erodes HK's autonomy and undermine "one country, two systems" framework. In sum, the latest escalation of US-China tensions threatens HK as a global financial hub and as a critical business gateway between China and the U.S. As one of the most open and free economies in the world, HK is highly reliant on consumption, trade and investment flows from China and the rest of the world to maintain its economic strengths. With a wealth of talent and professionals as well as financial, legal and professional services, HK plays a prime role in taking forward the economic development of China and the rest of the world supported by its business-friendly environment, low taxes, rule of law, free flow of capital, modern infrastructure, information technology capabilities, and robust intellectual property protection, thus backing enterprises and individuals to connect and excel in global economy. The punitive measures of the U.S. are compounding HK's economic woes, thus seriously jeopardizing HK's reputation as being a transparent and open economy. We are of the view that the removal of HK's special privileges will shake business confidence and create pessimistic market sentiment in short run only. The significance of China's role in global supply chain and continued opening of China's economy for foreign investment will further strengthen HK as an international financial and service center for the region. The continued complication of worldwide economic and political environment will push forward the rebalancing of HK economy, thus paving the way for a new era of development to ride out the economic storm as well as maintain the prosperity and stability.

### **Contraction of services trades curtailing economic momentum.**

In the wake of removing preferential status, HK no longer enjoys zero

tariffs. The impacts on HK may not be reflected in external merchandise trade figures as HK is mainly an entrepôt with which locally made products with exposure to tariffs just occupy less than 0.1% of total exports. In fact, re-exports are the main trading activities to generate trade in services including financial services, transport services, travel services, other business services and so on. Based on HK GDP account, the contribution of trade surplus to GDP stayed at an average of 2.8% between 2010 and 2019, with which trade surplus in services was large enough to cover merchandise trade deficit, reflecting the importance of trade in services for HK's economic growth. According to the office of the U.S. Trade Representative (USTR), U.S. exports to HK were USD \$50.1 bn and imports were USD\$ 16.8 bn, with total goods and service trade totaling USD \$66 bn. The U.S ranked second after China as the major service trade partner of HK. In sum, loss of special status and heightened tensions on trade disputes will reduce total trade between HK and the U.S, endangering the business of both local and U.S. service providers.

**The U.S. enterprises in HK suffering from the change of HK status.** Ending HK's special status is considered as a big blow for U.S. firms. There are more than 1,300 U.S. companies operating in HK, including most of the U.S. financial institutions. They are positioning for business in China's investment, financial services for capital markets, professional services offering for the U.S. enterprises, and so on. The U.S. actions against HK would have significant financial implications as the U.S. companies may choose to reduce the size of operation or remove the headquarters from HK or lower the investment in China to avoid the escalating business risks driven by heightened tensions between the U.S. and China.

**HK's IT sector development in jeopardy.** The U.S. treating HK the same as China in term of external trading activities will affect HK to source hi-tech products from the U.S. According to HK census and statistics department, the top imported items in HK are related to tech-based products with which the U.S. is the main area for sourcing. They include "electrical machinery, apparatus and appliances, and electrical parts", "telecommunications and sound recording and reproducing apparatus and equipment", "Office machines and automatic data processing machines" and so on. In sum, the U.S. actions on revoking HK's preferential status will impose sensitive technology transfer restrictions under the export control in HK, thus imposing barriers for HK to develop as a high-technology economy.

**USD-HKD peg remaining stable despite the withdrawal of special status.** The mounting tensions between China and the U.S. cause negative market sentiment, thus fueling economic risks of HK economy. Nonetheless, there are no signs of capital outflow as the aggregate balance of banking liquidity maintains at HK \$94 billion against HK \$84 billion in April and HK \$54 billion in March as well as USD-HKD exchange rate stays at the strong side of trading range,

thus signaling strong liquidity conditions under the pegged exchange rate system. In sum, the size of foreign exchange reserves was USD \$441 billion in April, twice the size of HK's monetary base, thus representing a solid support for the stability of the peg. In addition, HK's financial markets are fueled by liquidity from different countries. Even though there are concerns about less liquidity flowing into HK from the U.S., USD-HKD peg is fully backed by USD and HK still has strong capabilities to attract liquidity from the rest of the world, thus pursuing proper financial stability and shoring up its status as an international financial hub.

**Status of international financial center remaining intact.** The main purpose of imposing the national security law in HK is to ensure proper national security that protects China and HK. This is one of the basic building blocks of an international financial center as stability of society is of paramount importance in generating business activities and enhancing prosperity. HK has long casted itself as the business, trading and services hub for China and the world. A strong and well-regulated financial sector, a free press, the free flow of capital and information, low taxes and a simple taxation system, a pool of managerial talent with international experience, ease of access, proximity to major markets, and a dense network of services firms are among the strengths and advantages of doing business in HK. We are of the view that China's presence at the core of the global supply chain reflects its influence in global economy. With further opening for foreign investment along with substantial investment in 'New Economy' infrastructure and strengthening of domestic demand, China will maintain sustainable growth and engage in more economic activities with the rest of the world. Despite the downgrade of HK's economic role by the U.S., HK remains at the forefront of business gateway for global investors, thus further strengthening HK's role as an international financial center.

## China economic indicators

	2017	2018	1Q2019	2Q2019	3Q2019	4Q2019	2019	1Q2020
Real GDP (YoY%)	6.8	6.6	6.4	6.2	6.0	6.0	6.1	(6.8)
PMI								
Manufacturing (%)	51.6	49.4	49.7	49.6	49.7	49.9	50.2	45.9
Non-Manufacturing (%)	55.5	53.2	54.6	54.3	53.7	53.6	53.5	45.3
Exports (RMB YoY %)	10.8	7.1	6.7	5.6	3.9	4.0	5.0	(11.4)
Imports (RMB YoY %)	18.9	12.9	0.3	2.8	(2.5)	5.4	1.6	(0.7)
Trade Balance (RMB/bn)	2852.0	2324.7	506.8	700.7	812.4	895.1	2917.7	98.6
Exports (USD YoY %)	7.9	9.9	1.4	(1.0)	(0.3)	1.8	0.5	(13.3)
Imports (USD YoY %)	16.1	15.8	(4.1)	(3.7)	(6.2)	3.2	(2.7)	(2.9)
Trade Balance (USD/bn)	419.6	350.9	72.9	103.9	117.7	127.4	421.9	13.1
CPI (YoY %)	1.6	2.1	1.8	2.6	2.9	4.3	2.9	4.9
PPI (YoY %)	6.3	3.5	0.2	0.5	(0.8)	(1.2)	(0.3)	(0.6)
FAI (YTD/ YOY %)	7.2	5.9	6.3	5.8	5.4	5.4	5.4	(16.1)
Real Estate Investment (YTD YoY %)	7.0	9.5	11.8	10.9	10.5	9.9	9.9	(7.7)
Industrial Production (YoY %)	6.6	6.2	6.5	5.6	5.0	5.9	5.7	(8.4)
Retail Sales (YoY%)	10.2	9.0	8.3	8.6	7.6	7.8	8.0	(19.0)
New Lending (RMB/bn)	12174.9	16173.6	5809.1	3863.4	3955.6	3187.6	16817.5	7096.6
M2 (YoY %)	8.1	8.1	8.6	8.5	8.4	8.7	8.7	10.1
Aggregate Financing (RMB bn)	26153.6	22492.0	8605.9	6007.7	5997.0	4964.7	25575.2	11076.7

	Apr 19	May 19	Jun 19	July 19	Aug 19	Sept 19	Oct 19	Nov 19	Dec 19	Jan 20	Feb 20	Mar 20	Apr 20
Real GDP (YoY%)	-	-	6.2	-	-	6.0	-	-	6.0	-	-	(6.8)	-
PMI													
- Manufacturing %	50.1	49.4	49.4	49.7	49.5	49.8	49.3	50.2	50.2	50.0	35.7	52.0	50.8
- Non-manufacturing%	54.3	54.3	54.2	53.7	53.8	53.7	52.8	54.4	53.5	54.1	29.6	52.3	53.2
Exports (RMB YoY %)	3.2	7.7	5.9	10.4	2.6	(0.7)	2.1	1.1	9.0	-	(15.9)	(3.5)	8.2
Imports (RMB YoY %)	10.8	(2.2)	0.2	1.1	(2.5)	(5.9)	(3.3)	3.0	17.7	-	(2.4)	2.4	(10.2)
Trade Balance (RMB/bn)	88.1	276.1	335.7	303.4	238.9	270.8	298.2	264.4	332.1	-	(41.1)	139.6	318.2
Export (USD YoY %)	(2.7)	1.1	(1.5)	3.4	(1.0)	(3.2)	(0.8)	(1.3)	7.9	-	(17.2)	(6.6)	3.5
Import (USD YoY %)	4.5	(8.2)	(6.8)	(4.9)	(5.5)	(8.2)	(6.2)	0.8	16.5	-	(4.0)	(1.0)	(14.2)
Trade Balance (USD/bn)	13.0	41.2	49.6	44.0	34.7	39.0	42.4	37.3	47.2	-	(6.9)	19.9	45.3
CPI (YoY %)	2.5	2.7	2.7	2.8	2.8	3.0	3.8	4.5	4.5	5.4	5.2	4.3	3.3
PPI (YoY %)	0.9	0.6	0.0	(0.3)	(0.8)	(1.2)	(1.6)	(1.4)	(0.5)	0.1	(0.4)	(1.5)	(3.1)
FAI (YTD/ YOY %)	6.1	5.6	5.8	5.7	5.5	5.4	5.2	5.2	5.4	-	(24.5)	(16.1)	(10.3)
Real Estate Investment (YTD/ YoY %)	11.9	11.2	10.9	10.6	10.5	10.5	10.3	10.2	9.9	-	(16.3)	(7.7)	(3.3)
Industrial Production (YoY %)	5.4	5.0	6.3	4.8	4.4	5.8	4.7	6.2	6.9	-	(13.5)	(1.1)	3.9
Retail Sales (YoY%)	7.2	8.6	9.8	7.6	7.5	7.8	7.2	8.0	8.0	-	(20.5)	(15.8)	(7.5)
New Lending (RMB/bn)	1016.0	1183.7	1663.6	1055.8	1208.9	1691.0	661.3	1388.1	1138.2	337.5	905.7	2853.4	1700.0
M2 (YoY %)	8.5	8.5	8.5	8.1	8.2	8.4	8.4	8.2	8.7	8.4	8.8	10.1	11.1
Aggregate Financing (RMB bn)	1671.0	1712.4	2624.3	1287.2	2195.6	2514.2	868.0	1993.7	2103.0	5069.7	857.8	5149.2	3090.0
Urban Unemployment Rate (%)	5.0	5.0	5.1	5.3	5.2	5.2	5.1	5.1	5.2	-	6.2	5.9	6.0
Urban Unemployment Rate in 31 major cities (%)	5.0	5.0	5.0	5.2	5.2	5.2	5.1	5.1	5.2	-	5.7	5.7	5.8

## World Economic/Financial Indicators

Global Indices			
Index	Closing Price	P/E	One Week chg(%)
<b>U.S.</b>			
DJIA	25,383.11	18.82	3.71
S&P 500	3,044.31	21.18	3.25
NASDAQ	9,489.87	37.60	2.21
<b>EUR</b>			
FTSE 100	6,076.60	21.31	1.02
DAX	11,586.85	21.86	4.63
CAC40S	4,695.44	18.66	5.64
STOXX EUR 600	350.36	17.88	3.00
<b>Asia</b>			
HSI	22,961.47	9.55	0.14
HSCEI	9,561.03	7.86	1.42
CSI300	3,867.02	14.48	1.12
SSE Composite	2,852.35	14.50	1.37
SZSE Composite	1,786.51	42.41	1.95
NIKKEI 225	21,877.89	25.46	7.31
KOSPI	2,029.60	23.39	3.02
TWSE	10,942.16	18.58	1.21
S&P/ASX 200	5,755.69	18.73	4.71
<b>MSCI Index</b>			
MSCI WORLD	2,147.88	20.89	3.67
MSCI DEVELOPED	509.47	19.90	3.56
MSCI EMERGING	930.35	14.55	2.77
MSCI US	2,918.45	21.97	3.31
MSCI UK	1,722.12	21.68	0.93
MSCI France	136.29	18.31	5.49
MSCI Germany	132.96	21.33	4.48
MSCI China	80.68	13.88	2.14
MSCI Hong Kong	12,141.89	11.15	(0.69)
MSCI Japan	945.53	19.04	6.09

\*\* As of 29/05/2020 closing for all markets.

Global Commodities			
	Unit	Price	One Week chg(%)
<b>Energy</b>			
NYMEX WTI	USD/bbl	35.49	4.63
ICE Brent Oil	USD/bbl	35.33	0.57
NYMEX Natural	USD/MMBtu	1.85	8.13
<b>Basic Metals</b>			
LME Aluminum	USD/MT	1,526.25	2.11
CMX Copper	USD/lb.	242.55	(0.27)
LME Steel Rebar	USD/MT	421.00	(0.36)
LME Lead Cash	USD/MT	1,655.00	0.88
<b>Precious Metals</b>			
CMX Gold	USD/T. oz	1,730.27	(0.25)
Gold Futures	USD/T. oz	1,751.70	0.85
CMX Silver	USD/T. oz	17.87	3.79
NYMEX Platinum	USD/T. oz	837.97	0.27
<b>Agricultural</b>			
CBOT Corn	USD/bu	325.75	2.52
CBOT Wheat	USD/bu	520.75	0.92
NYB-ICE Sugar	USD/lb.	10.91	(0.64)
CBOT Soybeans	USD/bu.	840.75	0.69

Money market		
	Yield (%)	One Week chg(%)
US Fed Fund Rate	0.25	0.00
US Prime Rate	3.25	0.00
US Discount Window	0.25	0.00
ECB Rate (Refinancing)	0.00	0.00
BOJ Policy Rate	(0.10)	0.00
US Treasury (1 Mth)	0.11	0.03
US Treasury (1 Yr)	0.16	0.01
US Treasury (5 Yr)	0.30	(0.03)
US Treasury (10 Yr)	0.65	(0.01)
US Treasury (30 Yr)	1.41	0.04
1-Month LIBOR	0.18	(0.01)
3 Month LIBOR	0.34	(0.02)
Japan 1-Yr Gov. Bond	(0.15)	0.01
Japan 10-Yr Gov. Bond	0.01	0.01
German 1-Yr Gov. Bond	(0.57)	(0.00)
German 10-Yr Gov. Bond	(0.45)	0.04
China LPR (1-year)	3.85	0.00
China 1-Yr Gov. Bond	1.56	0.20
China 5-Yr Gov. Bond	2.21	0.16
China 10-Yr Gov. Bond	2.69	0.11
O/N SHIBOR	2.10	1.00
1-mth SHIBOR	1.43	0.12
HK Base rate	0.31	(0.03)
O/N HIBOR	0.31	(0.03)
1-mth HIBOR	1.05	0.03
O/N CNH HIBOR	2.16	0.01
1-mth CNH HIBOR	2.56	0.30
<b>Corporate Bonds (Moody's)</b>		
Aaa	2.41	(0.04)
Baa	3.80	(0.06)

Currency market		
	Spot Rate	One Week chg(%)
US Dollar Index	98.34	(1.52)
Euro/USD	1.1101	1.83
GBP/USD	1.2343	1.40
AUD/USD	0.6667	1.99
USD/CAD	1.3780	(1.54)
USD/JPY	107.83	0.18
USD/CHF	0.9616	(0.99)
USD/CNY Midpoint	7.1316	0.53
USD/CNY	7.1372	0.01
12-mth Spot pr.	7.2386	(0.09)
USD/CNH	7.1332	(0.21)
USD/HKD	7.7512	(0.06)
CNY/HKD	1.0863	(0.15)
CNH/HKD	1.0866	0.16
USD/KRW	1,238.35	0.11
USD/TWD	30.022	0.10
USD/SGD	1.4135	(0.80)
USD/INR	75.618	0.00

All data sources: Bloomberg

## Disclosures

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