

July 5, 2018

# Economic Acumen

Commentary by CEBI Research Team

## In Brief

- The second quarter of 2018 was dominated by the escalation of trade tensions between China and the U.S., a period when the performance of Hong Kong (HK) equities were suppressed by growing worries over the spillover effects of full-blown trade war on global economic recovery in 2H2018. HK stock market experienced increasing global and local risks with uncertainty and falling liquidity which led to correction of 3.8% in 2Q2018.
- For 2H2018, HK market will follow a much more volatile path due to rising protectionist sentiment in the U.S. However, HK equity market remains attractive on strong growth of corporate earnings growth and investors take advantage of dips in the market to accumulate equities.
- Investors will shift their investment interest to China for higher returns. The concerns over trade war's impact on the China's growth will fade gradually as it is already well-priced by the market. We estimate the HangSeng Index (HSI) and Hang Seng China Enterprises Index (HSCEI) to reach 31,000 and 12,300 by end-2018E, equivalent to a 12.0x and 8.9x 2018E P/E.

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## Surging market volatility to reign over Hong Kong stock market in 2H2018

The second quarter of 2018 was dominated by the escalation of trade tensions between China and the U.S., a period when the performance of Hong Kong (HK) equities were suppressed by growing worries over the spillover effects of full-blown trade war on global economic recovery in 2H2018. Along with surging HIBOR amid the U.S. rate hike cycle, HK stock market experienced increasing global and local risks with uncertainty and falling liquidity which led to correction of 3.8% in 2Q2018. The scale of damage to the global economic growth from the trade war is huge and uncertain, which may further enhance market volatility and weaken market sentiment over investment. This situation has been caused mainly by excessive market concerns over corporate earnings risks, which led to a high risk premium for stock investments. For 2H2018, HK market will follow a much more volatile path due to rising protectionist sentiment in the U.S. However, HK equity market remains attractive on strong growth of corporate earnings and investors take advantage of dips in the market to accumulate equities. In addition, China is likely to fine-tune its economic policies in line with economic conditions, along with China's structural reforms, offsetting the impacts of the U.S. rate hikes and trade disputes. Investors may shift their investment interest to China for higher returns. The concerns over trade war's impact on the China's growth will fade gradually as it is already well-priced by the market. We estimate the HangSeng Index (HSI) and Hang Seng China Enterprises Index (HSCEI) to reach 31,000 and 12,300 by end-2018E, equivalent to a 12.0x and 8.9x 2018E P/E.

**Pessimistic outlook impacted by Trump's policy uncertainty to cloud investment sentiment.** A possible full-blown trade war will do no good for global economic recovery. Risk appetite measures, VIX index, was up 46% in 1H2018, indicating that macroeconomic uncertainty is building up from the punitive tariffs placed by the U.S. and China on their trading products with the result of board HK market sell-off in June. As President Trump aims at using foreign trade policies to secure the victory of the U.S. midterm election in coming November, we expect his "America First" stance will continue to trigger more volatility in global markets in 2H2018.

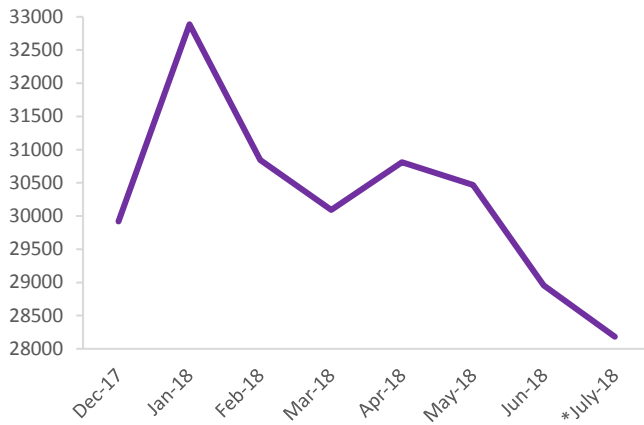
**Acceleration of China's structural shift in the economy in sight to undermine the impacts of tariffs.** China's economy performs robustly in 1H2018, with domestic demand and external trade growing steadily at varying degree. However, the escalation of trade tensions triggered by the U.S to impose tariffs on Chinese goods endangers China's growth momentum, thus leading to month-to-month depreciation of renminbi at 5.5% in June and 1H2018's depreciation of 1.8%. In order to resist the impacts of tariffs on the economy, the PBOC demonstrated strong capabilities to handle economic fluctuations by launching RRR cut in 5 July with which liquidity will flow into the real economy to support economic recovery. Domestic demand remains as key growth driver in which consumer spending and fixed asset investment will play a bigger economic role in 2H2018. We forecast the PBOC would lower RRR again and RRR cuts will be deployed as the principal tool to strengthen the growth momentum of real economy.

**Escalating trade tensions to become a shock to renminbi.** Starting in the beginning of 2018, China's economic fundamentals and growth looked robust which supported steady appreciation of renminbi at 3.6% in 1Q2018. However, surging trade tensions between the U.S. and China placed renminbi into a weakening territory with depreciation of 5.5% in 2Q2018 with which June suffered month-to-month depreciation of 3.3%. On one hand, growing expectation of renminbi depreciation indicates that it may be an effective tool to offset the impacts of the U.S. tariffs. On the other hand, the weakening of renminbi may have negative impact on corporate earnings of China's enterprises, especially those with high level of USD debt. In sum, fluctuations of renminbi act as the major headwinds to stability of financial markets.

**Sectors to avoid in volatile external trade and renminbi environment.** Export sector is likely to suffer the most in trade war while weak renminbi along with surging volatility hits hard on sectors such as China properties and airlines as depreciation of renminbi increases interest expenses to finance their huge amount of USD debt, thus decelerating their growth of earnings in 2H2018. Investors should take underweight positions in these sectors.

**Sectors to take overweight positions in 2H2018.** China's economic policies will point towards boosting domestic demand to offset the negative economic impacts from the U.S. tariffs. The latest RRR cut will inject new long-term capital into the economy to stimulate the growth in consumption and investment. As HK stock market faced correction of 3.2% in 1H2018, investors should take advantage of dips in the market to accumulate equities in sectors including China banks, HK banks, insurance, consumer discretionary, infrastructure, oil, technology and education in 2H2018 on the back of stronger earnings growth.

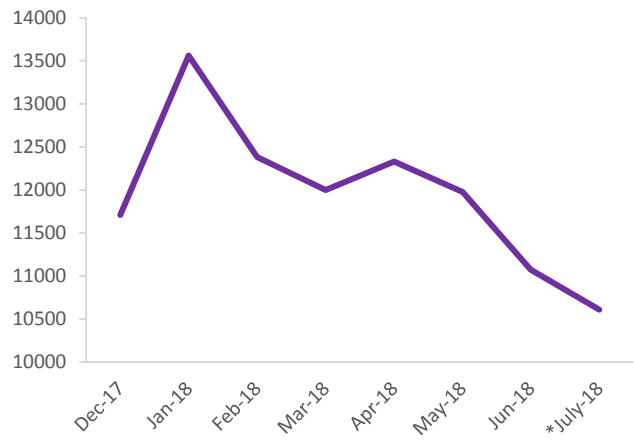
**Fig. 1: HangSeng Index**



\*5th July 2018

Source: Wind, Bloomberg and CEBI

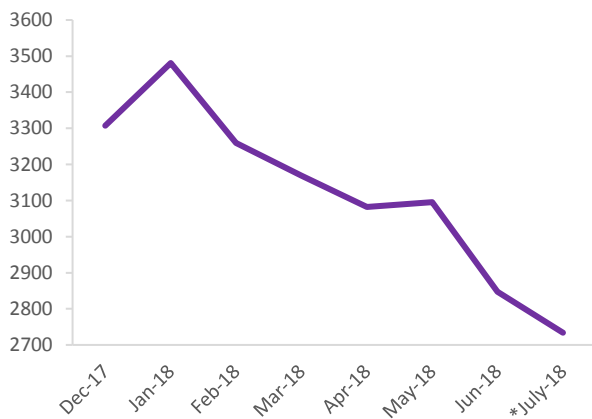
**Fig. 2: HSCEI Index**



\*5th July 2018

Source: Wind, Bloomberg and CEBI

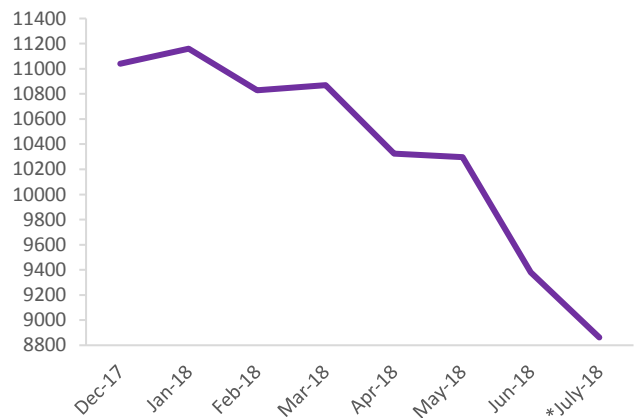
**Fig. 3: Shanghai Composite Index**



\*5th July 2018

Source: Wind, Bloomberg and CEBI

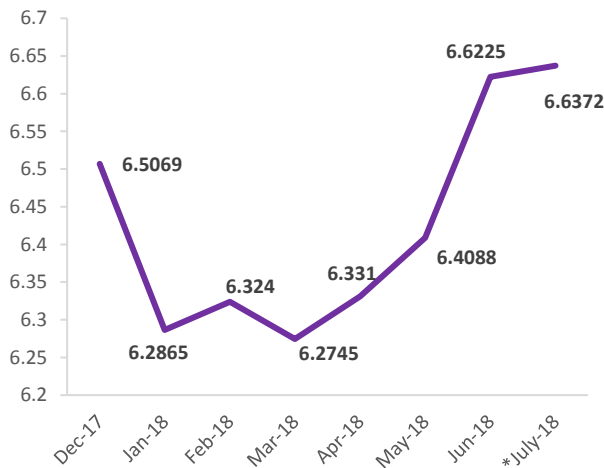
**Fig. 4: Shenzhen Component Index**



\*5th July 2018

Source: Wind, Bloomberg and CEBI

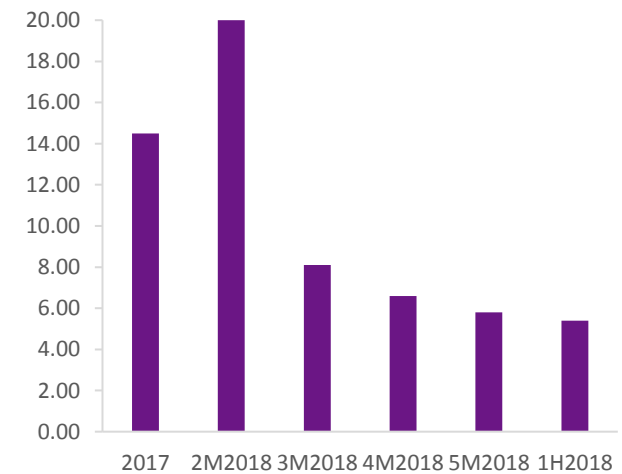
**Fig. 5: USD/CNY**



\*5th July 2018

Source: Wind, Bloomberg and CEBI

**Fig. 6: China's exports to the U.S (YoY%)**



Source: Wind, Bloomberg and CEBI

## China Economic Indicators

	2016	1Q2017	2Q2017	3Q2017	4Q2017	2017	1Q2018
Real GDP	6.7	6.9	6.9	6.8	6.8	6.9	6.8
PMI Manufacturing (%)	51.4	51.8	51.7	52.4	51.6	51.6	51.5
PMI Non-Manufacturing (%)	54.5	55.1	54.9	55.4	55.5	55.5	54.6
Exports (RMB YoY %)	(1.9)	13.7	11.3	7.1	7.1	10.8	7.2
Imports (RMB YoY %)	0.6	31.3	20.3	16.5	9.7	18.7	11.9
Trade Balance (RMB/bn)	3352.3	419.0	809.5	777.5	865.6	2871.6	345.2
Exports (USD YoY %)	(7.7)	7.2	8.2	6.4	9.7	7.9	13.9
Imports (USD YoY %)	(5.5)	24.3	14.1	14.6	12.5	15.9	19.1
Trade Balance (USD/bn)	510.7	60.38	117.4	113.8	130.9	422.5	46.5
CPI (YoY %)	2.0	1.4	1.4	1.6	1.8	1.6	2.2
PPI (YoY %)	(1.4)	7.4	5.8	6.2	5.9	6.3	3.1
FAI (YTD/ YOY %)	8.1	9.2	8.6	7.5	7.2	7.2	7.5
Real Estate Investment (YTD YoY %)	6.9	9.1	8.5	8.1	7.0	7.0	10.4
Industrial Production (YoY %)	6.0	6.8	6.9	6.3	6.2	6.6	6.8
Retail Sales (YoY%)	10.4	10.0	10.8	10.3	9.9	10.2	9.8
New Lending (RMB/bn)	12645.9	4220.0	3750.0	3785.5	2367.6	13523.1	4859.3
M2 (YoY %)	11.3	10.6	9.4	9.2	8.2	8.2	8.2
Aggregate Financing (RMB bn)	17802.2	6906.4	4222.9	4518.6	3795.1	19443.0	5580.0

	May 17	Jun 17	July 17	Aug 17	Sep 17	Oct 17	Nov 17	Dec 17	Jan 17	Feb 18	Mar 18	Apr 18	May 18
Real GDP	-	6.9	-	-	6.8	-	-	6.8	-	-	6.8	-	-
PMI – Manufacturing %	51.2	51.7	51.4	51.7	52.4	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9
PMI- Non-manufacturing%	54.5	54.9	54.5	53.4	55.4	54.3	54.8	55.5	55.3	54.4	54.6	54.8	54.9
Exports (RMB YoY %)	16.3	10.3	6.3	8.9	5.5	9.5	7.4	16.3	5.7	35.4	(9.9)	3.5	3.2
Imports (RMB YoY %)	22.9	14.8	14.5	19.6	15.8	15.4	0.9	22.9	30.6	(0.2)	5.9	11.6	15.6
Trade Balance (RMB/bn)	274.6	284.6	310.0	277.9	189.6	248.2	255.4	362.0	127.2	218.0	(31.6)	179.71	156.51
Export (USD YoY %)	7.6	10.3	6.4	4.9	7.9	6.3	11.5	10.9	10.8	43.7	(2.9)	12.6	12.6
Import (USD YoY %)	14	16.9	11.1	13.4	18.9	17.1	17.6	4.5	37.3	6.3	14.4	21.5	26.0
Trade Balance (USD/bn)	39.8	41.4	45.1	40.7	28.0	37.2	39.0	54.7	19.1	32.7	(5.3)	28.3	24.9
CPI (YoY %)	1.5	1.5	1.4	1.8	1.6	1.9	1.7	1.8	1.5	2.9	2.1	1.8	1.8
PPI (YoY %)	5.5	5.5	5.5	6.3	6.9	6.9	5.8	4.9	4.3	3.7	3.1	3.4	4.1
FAI (YTD/ YOY %)	8.6	8.6	8.3	7.8	7.5	7.3	7.2	7.2	-	7.9	7.5	7.0	6.1
Real Estate Investment (YTD/ YoY %)	8.8	8.5	7.9	7.9	8.1	7.8	7.5	7.0	-	9.9	10.4	10.3	10.2
Industrial Production (YoY %)	6.5	7.6	6.4	6.0	6.6	6.2	6.1	6.2	-	7.2	6.0	7.0	6.8
Retail Sales (YoY%)	10.7	11.0	10.4	10.1	10.3	10.0	10.2	9.4	-	9.7	10.1	9.4	8.5
New Lending (RMB/bn)	1110.0	1540.0	825.5	1090.0	1270.0	663.2	1120.0	584.4	2900.0	839.3	1120.0	1180.0	1150.0
M2 (YoY %)	9.6	9.4	9.2	8.9	9.2	8.8	9.1	8.2	8.6	8.8	8.2	8.3	8.3
Aggregate Financing (RMB bn)	1063.1	1771.8	1195.6	1489.5	1833.5	1035.7	1619.6	1139.8	3061.0	1167.2	1354.6	1560.5	760.8
Urban Unemployment Rate (%)	-	-	-	-	-	-	-	-	5.0	5.0	5.1	4.9	4.8
Urban Unemployment Rate in 31 major cities (%)	-	-	-	-	-	-	-	-	4.8	4.9	4.9	4.7	4.7

## World Economic/Financial Indicators

Global Indices			
Index	Closing Price	P/E	One Week chg(%)
<b>U.S.</b>			
DJIA	24,174.82	18.03	-0.45
S&P 500	2,713.22	20.68	-0.36
NASDAQ	7,502.67	25.55	-0.78
<b>EUR</b>			
FTSE 100	7,573.09	13.54	-0.64
DAX	12,317.61	13.71	-0.25
CAC40S	5,320.50	16.76	-0.13
STOXX EUR 600	380.05	16.01	0.02
<b>Asia</b>			
HSI	28,182.09	11.29	-0.61
HSCEI	10,608.06	8.18	-2.49
CSI300	3,342.44	12.77	-2.37
SSE Composite	2,733.88	13.45	-1.90
SZSE Composite	1,528.67	25.48	-1.81
NIKKEI 225	21,546.99	16.63	-3.25
KOSPI	2,257.55	10.83	-2.45
TWSE	10,611.81	14.53	-0.40
S&P/ASX 200	6,215.52	18.29	0.00
<b>MSCI Index</b>			
MSCI WORLD	2,082.17	18.45	0.28
MSCI DEVELOPED	502.94	17.65	0.29
MSCI EMERGING	1,056.07	13.24	0.38
MSCI US	2,589.18	21.11	-0.37
MSCI UK	2,188.35	13.62	-0.59
MSCI France	153.96	16.97	-0.12
MSCI Germany	149.05	14.53	-0.46
MSCI China	84.86	14.30	-0.56
MSCI Hong Kong	15,081.66	10.21	-0.58
MSCI Japan	1,004.85	13.63	-1.98

\* As of 5/7/2018 closing for Asian markets, 3/7/2018 closing for American markets.

Global Commodities			
	Unit	Price	One Week chg(%)
<b>Energy</b>			
NYMEX WTI	USD/bbl	74.12	1.87
ICE Brent Oil	USD/bbl	77.83	-0.03
NYMEX NatGas	USD/MMBtu	2.84	-5.14
<b>Basic Metals</b>			
LME Alum.Cash	USD/MT	2,115.00	-3.27
CMX Cop.Active	USD/lb.	287.20	-4.51
LME Steel Rebar	USD/MT	548.00	-1.26
LME Lead Cash	USD/MT	2,318.00	-4.53
<b>Precious Metals</b>			
CMX Gold	USD/KRW	1,253.51	0.04
Gold Futures	USD/KRW	1,254.50	-0.13
CMX Silverbn	USD/KRW	15.99	-0.78
NYMEX Platinum	USD/T. oz	841.02	-1.70
<b>Agri, Products</b>			
CBOT Corn	USD/bu	364.25	-2.41
CBOT Wheat	USD/bu	491.00	1.66
NYB-ICE Sugar	USD/lb.	11.50	-4.56
CBOT Soybeans	USD/bu.	864.25	-2.62

Money market		
	Yield (%)	One Week chg(%)
US Fed Fund Rate	2.00	0.00
US Prime Rate	5.00	0.00
US Discount Window	2.50	0.00
ECB Rate (Refinancing)	0.00	0.00
BOJ Policy Rate	-0.10	0.00
US Treasury (1 Mth)	1.90	0.15
US Treasury (1 Yr)	2.31	0.00
US Treasury (5 Yr)	2.75	0.03
US Treasury (10 Yr)	2.86	0.02
US Treasury (30 Yr)	2.98	0.01
1-Month LIBOR	2.09	-0.02
3 Month LIBOR	2.34	0.00
Japan 1-Yr Gov. Bond	-0.13	0.00
Japan 10-Yr Gov. Bond	0.04	0.00
German 1-Yr Gov. Bond	-0.63	0.02
German 10-Yr Gov. Bond	0.33	0.02
China Benchmark Interest	4.35	0.00
China 1-Yr Gov. Bond	3.11	-0.19
China 5-Yr Gov. Bond	3.33	-0.09
China 10-Yr Gov. Bond	3.52	-0.06
O/N SHIBOR	2.13	-0.16
1-mth SHIBOR	3.57	-0.49
HK Base rate	1.12	-0.14
O/N HIBOR	1.12	-0.14
1-mth HIBOR	1.97	-0.05
O/N CNH HIBOR	1.87	-0.90
1-mth CNH HIBOR	3.57	-0.69
<b>Corporate Bonds (Moody's)</b>		
Aaa	3.93	-0.05
Baa	4.84	-0.02

Currency market		
	Spot Rate	One Week chg(%)
US Dollar Index	94.38	-0.98
Euro/USD	1.17	0.83
GBP/USD	1.32	1.00
AUD/USD	0.74	0.44
USD/CAD	1.31	-1.08
USD/JPY	110.61	0.38
USD/CHF	0.99	-0.33
USD/CNY Midpoint	6.62	0.33
USD/CNY	6.64	0.15
<b>USD/CNY NDF</b>		
12-mth Spot pr.	6.72	-0.22
USD/CNH	6.65	0.35
USD/HKD	7.85	-0.01
CNY/HKD	1.18	-0.16
CNH/HKD	1.18	-0.35
USD/KRW	1,118.50	-0.49
USD/TWD	30.53	-0.15
USD/SGD	1.36	-0.18
USD/INR	68.84	0.07

All data sources: Bloomberg, CEBI, NBS

## Disclosures

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