

August 2, 2018

Economic Acumen

Commentary by CEBI Research Team

In Brief

- The U.S. Federal Reserve (the Fed) voted unanimously to leave target range of the Fed fund rates (FFR) unchanged, at 1.75% to 2.0%. The Fed pointed out that job creation, household spending, and business fixed investment grew strongly, keeping the unemployment rate at low level while both overall inflation and core inflation stayed at above 2% on a yearly basis, reflecting upswing in pricing pressures of the U.S. economy.
- Amid the Fed's optimistic assessment on the resilient growth momentum of the U.S. economy, we expect that there will be two more rate hikes in 2018, likely one in September and one in December.
- The increasing likelihood of rate hikes in coming months and the escalating trade tensions between China and the U.S. are posing downside risks to the global economy, which will further enhance market volatility and weaken market sentiment over investment.
- Market concerns over corporate earnings risks lead to a high risk premium for equity investments. For 2H2018, global equity markets will follow a much more volatile path due to rising protectionist sentiment in the U.S.

Banny Lam
Head of Research
Banny.lam@cebi.com.hk
(852)2916-9630

The Fed to keep rates on hold while hinting more rate hikes in 2018

At the conclusion of the fifth Federal Open Markets Committee (FOMC) policy meeting in 2018 on 1st August, the U.S. Federal Reserve (the Fed) voted unanimously to leave target range of the Fed fund rates (FFR) unchanged, at 1.75% to 2.0%. The Fed pointed out that job creation, household spending, and business fixed investment grew strongly, keeping the unemployment rate at low level while both overall inflation and core inflation stayed at above 2% on a yearly basis, reflecting upswing in pricing pressures of the U.S. economy. We believe that the Fed will launch further gradual rate hikes in order to maintain price stability and prevent U.S. economy from overheating. In our view, the U.S. economy is experiencing robust growth, with inflation continuously hitting the Fed's 2% target and unemployment rate standing at around 4% in recent months. Amid the Fed's optimistic assessment on the resilient growth momentum of the U.S. economy, we expect that there will be two more rate hikes in 2018, likely one in September and one in December. In general, the increasing likelihood of rate hikes in coming months as well as the escalating trade tensions between China and the U.S. are posing downside risks to the global economy, which will further enhance market volatility and weaken market sentiment over investment. Market concerns over corporate earnings risks lead to a high risk premium for equity investments. For 2H2018, global equity markets will follow a much more volatile path due to rising protectionist sentiment in the U.S.

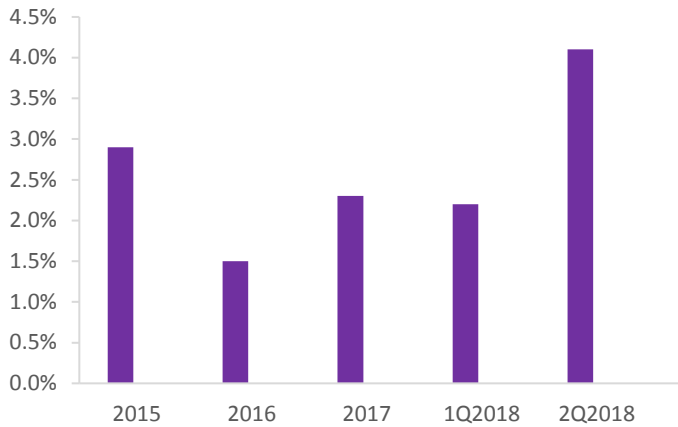
The U.S. economy to gain traction with upswing in inflation. The U.S. economy enjoyed a healthy spurt of growth with the economic fundamentals improving in varying degrees in 1H2018. The U.S. GDP grew at an annualized rate of 2.2% and 4.1% in the first quarter and second quarter of 2018, indicating that the recovery momentum is on track. Job creation surged as the unemployment rate stayed at low level of 4.0% in June. Although the FOMC meeting voted to leave target range of the FFR unchanged, latest wages and prices grew more than 2% YoY which has reached the Fed's 2% inflation target, indicating that inflation is trending upward and more rate hikes are likely in coming FOMC meetings. Looking forward, the Fed will launch gradual rate hikes and unwind the balance sheet in an

orderly manner to ensure a smooth transition to a normalized monetary policy by avoiding disruption of economic recovery and enhancement of market volatility. In our view, the U.S. economy is on a robust growth path, with employment and inflation staying on track.

Continued monetary normalization to favor the fast growth of the U.S. economy. The latest FOMC meeting stressed that the labor market continued to strengthen and the economic activities accelerated at a robust rate. The description of the economy changed from "solid" in the previous FOMC statement in June to "strong" now, indicating that the U.S. economy performed well as 2Q2018 GDP growth at 4.1% was the best in four years. In sum, the future stance of the U.S. monetary policy will remain accommodative that strikes a balance between solid economic growth and surging price level. The Fed has set the ultimate goal of restoring the normal path of monetary policy with which it will handle the rate hike cycle tactfully to sustain the economic growth.

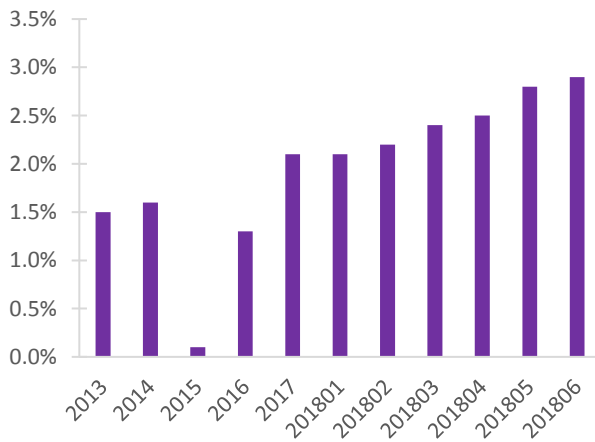
Gradual rate hikes and unwinding of balance sheet to continue in 2018 and 2019 amid stronger U.S dollar. The U.S. dollar Index has rebounded 3.1% against major currencies in 2018 on an upbeat U.S economic performance. The strengthening of U.S dollar indicates that economic momentum of the U.S. economy surges along with rising inflation. In sum, the U.S economy remains strong in 2018 and 2019 with recovery expanding to all sectors. Corporate profits surge with acceleration of investment and consumption. We believe pricing pressures will increase steadily, signaling the continuation of gradual rate hikes and balance sheet shrinkage in 2018 and 2019.

Fig. 1: US GDP (YoY)



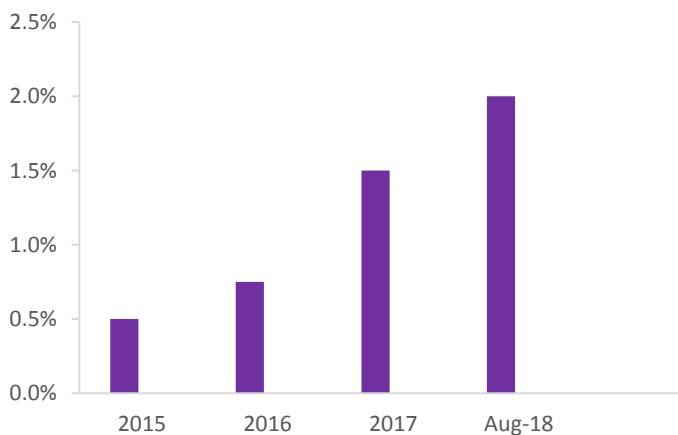
Source: Wind, Bloomberg and CEBI

Fig. 3: US CPI Inflation (YoY)



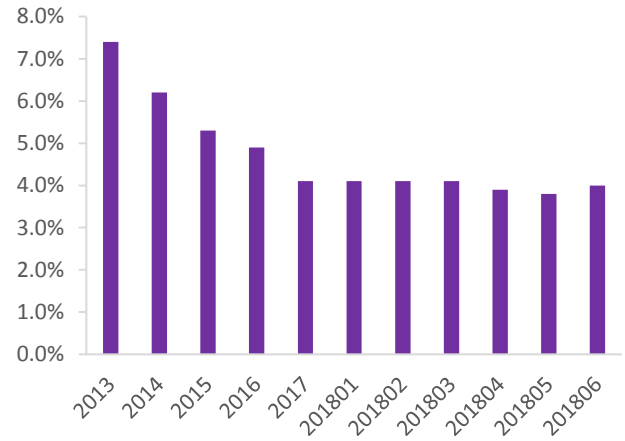
Source: Wind, Bloomberg and CEBI

Fig. 5: US Federal Funds Rate



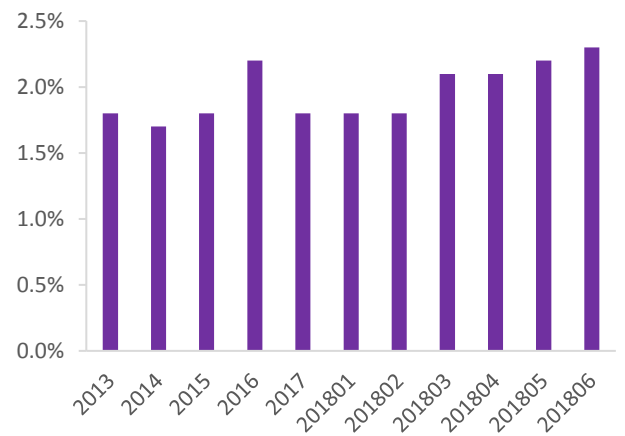
Source: Wind, Bloomberg and CEBI

Fig. 2: US Unemployment



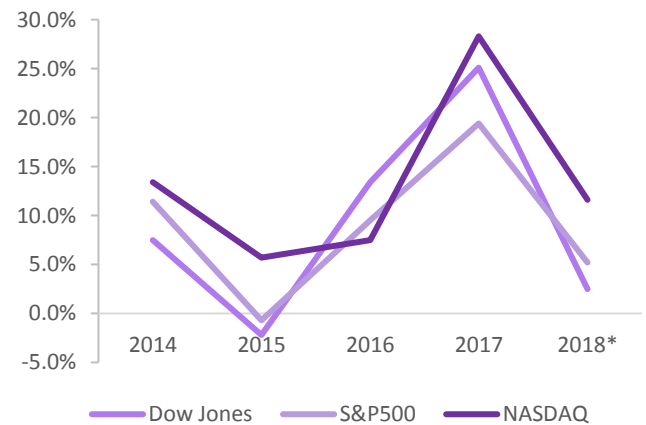
Source: Wind, Bloomberg and CEBI

Fig. 4: US Core CPI Inflation (YoY)



Source: Wind, Bloomberg and CEBI

Fig. 6: US Stock Market Performance (YoY)



Source: Wind, Bloomberg and CEBI

*1 August 2018

China Economic Indicators

	2014	2015	2016	2017	1Q2018	2Q2018	1H2018
Real GDP (YoY%)	7.3	6.9	6.7	6.9	6.8	6.7	6.8
PMI Manufacturing (%)	50.1	49.7	51.4	51.6	51.5	51.5	51.5
PMI Non-Manufacturing (%)	54.1	54.4	54.5	55.5	54.6	54.9	55.0
Exports (RMB YoY %)	4.9	(1.8)	(1.9)	10.8	7.4	3.2	4.9
Imports (RMB YoY %)	(0.6)	(13.2)	0.6	18.7	11.7	11.0	11.5
Trade Balance (RMB/bn)	2352.6	3686.5	3352.3	2871.6	313.6	598.08	901.32
Exports (USD YoY %)	6.0	(2.9)	(7.7)	7.9	13.9	12.1	12.8
Imports (USD YoY %)	0.4	(14.1)	(5.5)	15.9	19.1	20.4	19.9
Trade Balance (USD/bn)	383.1	593.9	510.7	422.5	46.5	94.8	139.7
CPI (YoY %)	2.0	1.4	2.0	1.6	2.2	1.8	2.0
PPI (YoY %)	(1.9)	(5.2)	(1.4)	6.3	3.1	4.1	3.9
FAI (YTD/ YOY %)	15.7	10.0	8.1	7.2	7.5	6.0	6.0
Real Estate Investment (YTD YoY %)	10.5	1.0	6.9	7.0	10.4	9.7	9.7
Industrial Production (YoY %)	8.3	6.1	6.0	6.6	6.8	6.8	6.7
Retail Sales (YoY%)	12.0	10.7	10.4	10.2	9.8	9.0	9.4
New Lending (RMB/bn)	9781.3	11719.9	12645.9	13523.1	4859.3	3510.0	8369.3
M2 (YoY %)	12.2	13.3	11.3	8.2	8.2	8.0	8.0
Aggregate Financing (RMB bn)	16457.1	15408.6	17802.2	19443.0	5580.0	3501.3	9084.0

	July 17	Aug 17	Sep 17	Oct 17	Nov 17	Dec 17	Jan 17	Feb 18	Mar 18	Apr 18	May 18	Jun 18	July18
Real GDP (YoY%)	-	-	6.8	-	-	6.8	-	-	6.8	-	-	6.7	-
PMI – Manufacturing %	51.4	51.7	52.4	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9	51.5	51.2
PMI- Non-manufacturing%	54.5	53.4	55.4	54.3	54.8	55.5	55.3	54.4	54.6	54.8	54.9	55.0	54.0
Exports (RMB YoY %)	6.3	8.9	5.5	9.5	7.4	16.3	5.7	35.4	(9.9)	3.5	3.2	3.1	-
Imports (RMB YoY %)	14.5	19.6	15.8	15.4	0.9	22.9	30.6	(0.2)	5.9	11.6	15.6	6.0	-
Trade Balance (RMB/bn)	310.0	277.9	189.6	248.2	255.4	362.0	127.2	218.0	(31.6)	179.71	156.51	261.9	-
Export (USD YoY %)	6.4	4.9	7.9	6.3	11.5	10.9	10.8	43.7	(2.9)	12.6	12.6	11.3	-
Import (USD YoY %)	11.1	13.4	18.9	17.1	17.6	4.5	37.3	6.3	14.4	21.5	26.0	14.1	-
Trade Balance (USD/bn)	45.1	40.7	28.0	37.2	39.0	54.7	19.1	32.7	(5.3)	28.3	24.9	41.6	-
CPI (YoY %)	1.4	1.8	1.6	1.9	1.7	1.8	1.5	2.9	2.1	1.8	1.8	1.9	-
PPI (YoY %)	5.5	6.3	6.9	6.9	5.8	4.9	4.3	3.7	3.1	3.4	4.1	4.7	-
FAI (YTD/ YOY %)	8.3	7.8	7.5	7.3	7.2	7.2	-	7.9	7.5	7.0	6.1	6.0	-
Real Estate Investment (YTD/ YoY %)	7.9	7.9	8.1	7.8	7.5	7.0	-	9.9	10.4	10.3	10.2	9.7	-
Industrial Production (YoY %)	6.4	6.0	6.6	6.2	6.1	6.2	-	7.2	6.0	7.0	6.8	6.0	-
Retail Sales (YoY%)	10.4	10.1	10.3	10.0	10.2	9.4	-	9.7	10.1	9.4	8.5	9.0	-
New Lending (RMB/bn)	825.5	1090.0	1270.0	663.2	1120.0	584.4	2900.0	839.3	1120.0	1180.0	1150.0	1840.0	-
M2 (YoY %)	9.2	8.9	9.2	8.8	9.1	8.2	8.6	8.8	8.2	8.3	8.3	8.0	-
Aggregate Financing (RMB bn)	1195.6	1489.5	1833.5	1035.7	1619.6	1139.8	3061.0	1167.2	1354.6	1560.5	760.8	1180.0	-
Urban Unemployment Rate (%)	-	-	-	-	-	-	5.0	5.0	5.1	4.9	4.8	4.8	-
Urban Unemployment Rate in 31 major cities (%)	-	-	-	-	-	-	4.8	4.9	4.9	4.7	4.7	4.7	-

World Economic/Financial Indicators

Global Indices			
Index	Closing Price	P/E	One Week chg(%)
U.S.			
DJIA	25,333.82	18.06	-0.32
S&P 500	2,813.36	20.58	-1.15
NASDAQ	7,707.29	57.14	-2.84
EUR			
FTSE 100	7,652.91	13.05	-0.07
DAX	12,737.05	14.06	1.25
CAC40S	5,498.37	16.99	1.33
STOXX EUR 600	389.84	16.08	0.69
Asia			
HSI	27,714.56	11.33	-3.71
HSCEI	10,733.19	8.42	-2.61
CSI300	3,370.96	13.14	-4.67
SSE Composite	2,768.02	13.73	-3.96
SZSE Composite	1,512.05	25.37	-6.07
NIKKEI 225	22,512.53	16.94	-0.33
KOSPI	2,270.20	11.04	-0.82
TWSE	10,929.77	14.69	-0.73
S&P/ASX 200	6,240.86	18.48	-0.06
MSCI Index			
MSCI WORLD	2,149.36	18.38	-0.57
MSCI DEVELOPED	518.99	17.67	-0.53
MSCI EMERGING	1,086.87	13.61	-0.18
MSCI US	2,681.40	20.94	-1.18
MSCI UK	2,211.70	13.12	-0.01
MSCI France	158.87	17.36	1.09
MSCI Germany	154.45	14.93	1.13
MSCI China	83.92	14.20	-3.99
MSCI Hong Kong	15,407.98	10.86	-1.23
MSCI Japan	1,050.78	14.14	0.86

* As of 2/8/2018 closing for Asian markets, previous date for other markets.

Global Commodities			
	Unit	Price	One Week chg(%)
Energy			
NYMEX WTI	USD/bbl	67.61	-2.87
ICE Brent Oil	USD/bbl	72.40	-2.87
NYMEX NatGas	USD/MMBtu	2.75	-1.22
Basic Metals			
LME Alum.Cash	USD/MT	2,030.00	-0.51
CMX Cop.Active	USD/lb.	274.80	-2.48
LME Steel Rebar	USD/MT	544.00	1.49
LME Lead Cash	USD/MT	2,112.50	-0.98
Precious Metals			
CMX Gold	USD/KRW	1,217.85	-0.86
Gold Futures	USD/KRW	1,226.60	-0.70
CMX Silverbn	USD/KRW	15.44	-0.70
NYMEX Platinum	USD/T. oz	817.90	-2.72
Agri, Products			
CBOT Corn	USD/bu	380.50	1.26
CBOT Wheat	USD/bu	562.50	4.85
NYB-ICE Sugar	USD/lb.	10.49	-4.90
CBOT Soybeans	USD/bu.	894.50	2.11

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)	1.92	0.04
US Treasury (1 Yr)	2.43	0.02
US Treasury (5 Yr)	2.87	0.01
US Treasury (10 Yr)	3.00	0.02
US Treasury (30 Yr)	3.12	0.02
1-Month LIBOR	2.08	0.01
3 Month LIBOR	2.35	0.01
Japan 1-Yr Gov. Bond	-0.10	0.02
Japan 10-Yr Gov. Bond	0.13	0.03
German 1-Yr Gov. Bond	-0.62	0.04
German 10-Yr Gov. Bond	0.48	0.07
China Benchmark Interest	4.35	0.00
China 1-Yr Gov. Bond	2.82	-0.21
China 5-Yr Gov. Bond	3.17	-0.11
China 10-Yr Gov. Bond	3.47	-0.10
O/N SHIBOR	1.97	-0.35
1-mth SHIBOR	2.88	-0.19
HK Base rate	0.57	0.25
O/N HIBOR	0.57	0.25
1-mth HIBOR	1.51	-0.39
O/N CNH HIBOR	2.03	0.11
1-mth CNH HIBOR	2.87	-0.10
Corporate Bonds (Moody's)		
Aaa	3.89	-0.02
Baa	4.79	-0.04

Currency market		
	Spot Rate	One Week chg(%)
US Dollar Index	94.91	0.13
Euro/USD	1.16	-0.78
GBP/USD	1.31	-0.76
AUD/USD	0.74	-0.75
USD/CAD	1.30	-0.05
USD/JPY	111.55	0.65
USD/CHF	0.99	0.17
USD/CNY Midpoint	6.79	0.41
USD/CNY	6.84	0.63
USD/CNY NDF		
12-mth Spot pr.	6.88	0.68
USD/CNH	6.85	0.88
USD/HKD	7.85	0.02
CNY/HKD	1.15	-0.61
CNH/HKD	1.15	-0.86
USD/KRW	1,126.10	0.59
USD/TWD	30.68	0.38
USD/SGD	1.37	0.37
USD/INR	68.56	-0.15

All data sources: Bloomberg, CEBI, NBS

Disclosures

Analyst Certification

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**Office address: CEB International Capital Corporation Limited, 22/F AIA Central, 1 Connaught Road Central, Hong Kong.
Tel: (852) 2916 9600**