

China Research

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China – Trade Deficit Is Migrating; Talks, HK, Policy

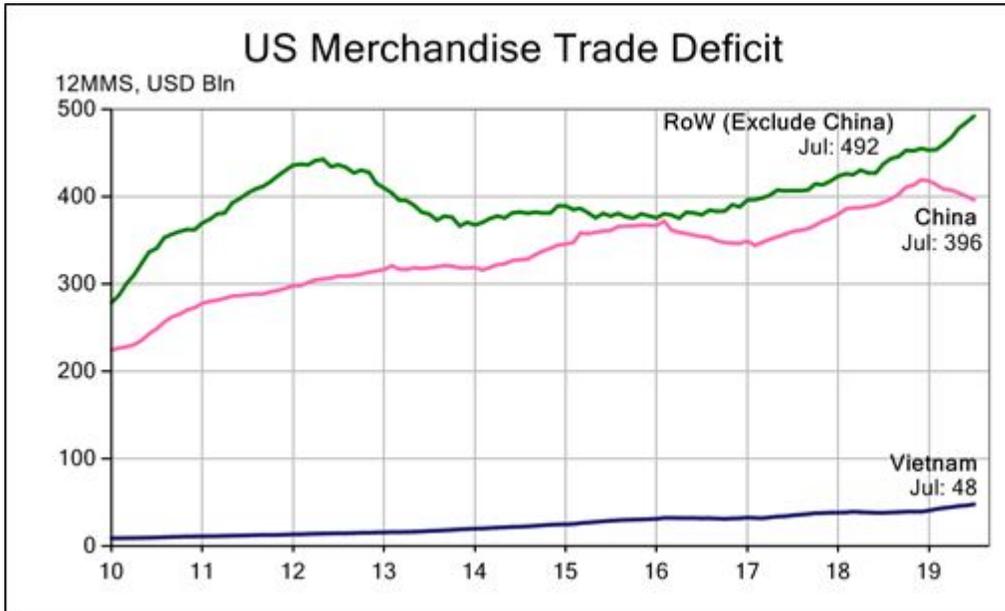


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Top Stories:
MoCom, USTR on US-China Trade Talks; Trump on China; Chief Lam on HK unrest; SAFE on Forex Trading.

Tariffs (taxes at the border) work. The US trade deficit with China has fallen from \$419 bln in Dec 2018 to \$396 bln in Jul 2019. A \$23 bln ‘gain’ from Washington’s perspective.

But also the US trade deficit with the ‘Rest of World’ has risen from \$455 bln in Dec 2018 to \$492 bln in Jul 2019. Maybe, only maybe a \$37 bln ‘loss’ from Washington’s perspective. **This process** will likely accelerate into 2020 as tariffs keep rising. Vietnam is a winner – alternative source.

Trade talks (both sides confirmed) face-to-face are planned, likely in Oct. Our view; no current sense of urgency; and no progress on key issues so far in 2019. Talks will happen. But at these talks, nothing will happen. More US tariffs Oct 1 & Dec 15.

Hong Kong. The extradition bill has been withdrawn but suffrage and other demands remain. Maybe less violence for a time, but HK’s future remains badly disabled.

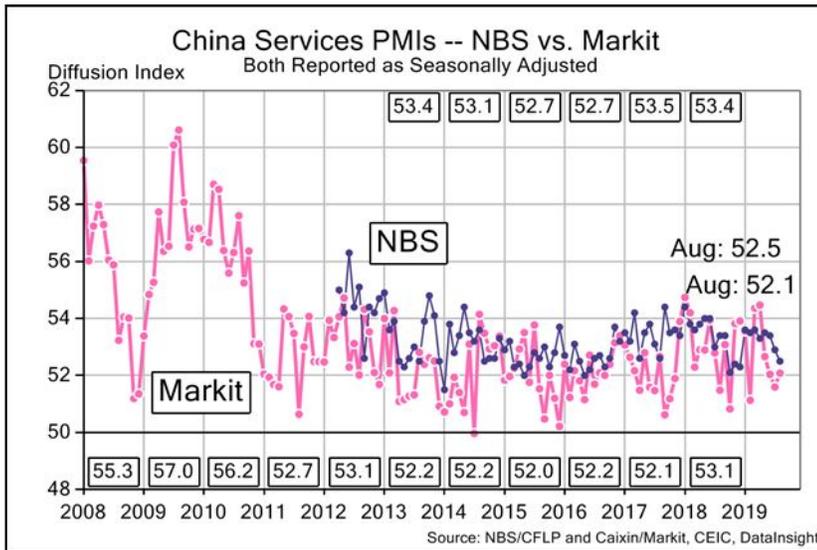
Monetary ease, fiscal stimulus. Likely RRR cut; two MLF rollovers Sep 7 and 17, before a lower LPR at monthly Sep 20 announcement. And fiscal also, more infrastructure support via Local Gov’t Bond financing. Maybe also tax cuts.

Tariffs and trade. We do not see a break through before the US scheduled Oct 1 tariff hikes. Note that China has not announced any retaliation to those hikes (5% hike on over \$200 bln of imports. Do not be surprised. China has specified US tariff cuts are a necessary condition for a 'deal.'

Vietnam we noted above is a winner, an alternative source to China for US imports. It is contiguous to China, has a centrally-planned economic mindset in Hanoi, and is we believe a L/T winner in the US-China trade war. It is also relatively small and does not have the requisite infrastructure and skilled labor pool (not rising) to in any material sense replace China.

Global supply chain. The move out of China has been widely discussed. But it is exaggerated. When we look at trade flows, ASEAN is the dominant winner in any global supply-chain adjustment that is now going on. Note also that about 20% of China's goods exports go to the US, so 80% do not. Thus that 80% is not under threat. And we expect the second-best supplier of much production now in China will not be production moving to the US, but to other ASEAN nations continuing to amplify the US trade deficit migration – from China to other supplier countries. Trade-deficit migration; not trade-deficit reduction.

Aug 2019 NBS and Markit PMIs



Markit Services PMI: Aug 52.1, vs. Jul 51.6.

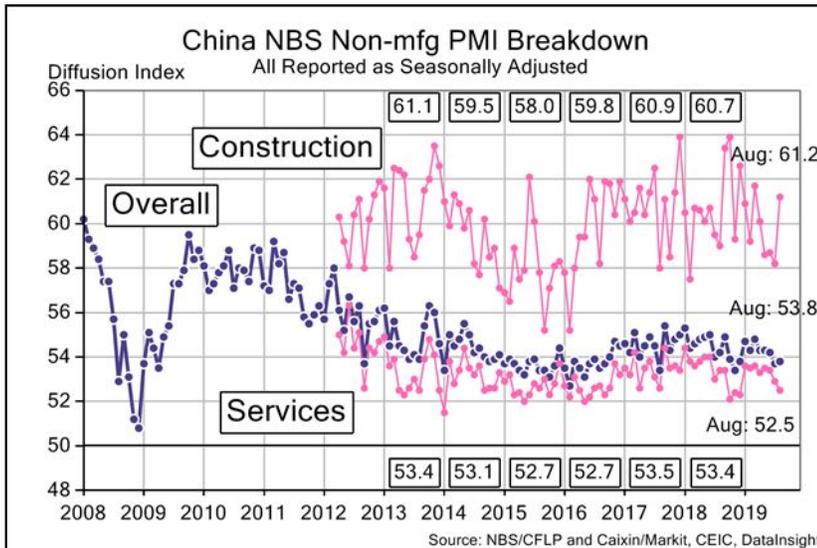
NBS Non-mfg PMI, two components; Construction Index and Service Index.
 Approx. weights, Services 78-85%. Construction 15-22%.

NBS Non-mfg PMI: Aug 53.8, vs. Jul 53.7, lowest since 53.4 in Nov 18.

- **NBS Services PMI: Aug 52.5**, lowest since 52.3 in Dec 18, vs. Jul 52.9.

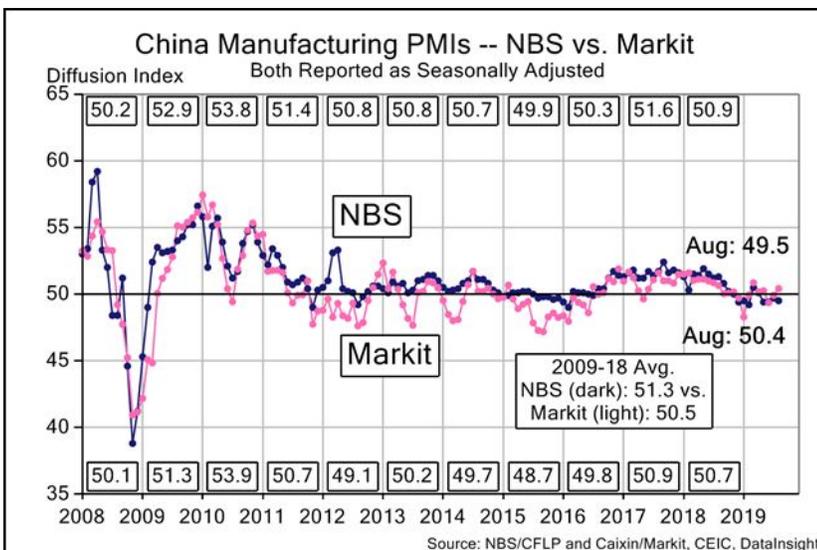
- **NBS Construction PMI: Aug 61.2**, a 5-month high, vs. Jun 58.2, the lowest since 57.5 in Feb 18.

Service sector -- growing in importance. Beijing wants more jobs here with lingering trade war woe, capacity cuts, and economy restructuring.



Markit Mfg PMI: Aug 50.4, vs. Jul 49.9, Jun 49.4, May 50.2, Apr 50.2, Mar 50.8. a 8-month high then, Feb 49.9, and Jan 48.3, a 3-year low then.

NBS Mfg PMI: Aug 49.5, vs. Jul 49.7, Jun 49.4, May 49.4, Apr 50.1, Mar 50.5. a 6-month high then, **Feb 49.2, a 3-year low then**, and Jan 49.5. (Sep 2017 was 52.4, the highest since Apr 2012, May 2018 was 51.9, second highest.)



NBS' sample biased toward state-owned and bigger companies. 310-473-4051 9/5/2019

News Tracker – Sep 5, 2019

Yuan per USD (On vs. Off in basis point)

Rate	CP Fixing	On-shore	Off-shore	On vs. Off
9/5/2019	7.0852	7.1459	7.1434	25
vs. Trump	-4.3%	-5.0%	-4.8%	
vs. Brexit	-7.2%	-7.9%	-7.8%	
vs. 8/10/15	-13.7%	-13.1%	-13.0%	
1D Ago	7.0878	7.1460	7.1471	-11
2D Ago	7.0884	7.1789	7.1780	9
3D Ago	7.0883	7.1720	7.1940	-220
4D Ago	7.0879	7.1565	7.1623	-58
5D Ago	7.0879	7.1445	7.1439	6
1M Ago	6.9225	7.0507	7.0987	-480
3M Ago	6.8903	6.9089	6.9282	-193
6M Ago	6.6998	6.7076	6.7051	25
1Y Ago	6.8266	6.8300	6.8422	-122
End-2017	6.5342	6.5068	6.5143	-75
2Y Ago	6.5370	6.5388	6.5408	-20
3Y Ago	6.6873	6.6771	6.6915	-144
4Y Ago	6.3619	6.3559	6.4669	-1110
5Y Ago	6.1707	6.1411	6.1412	-1

Source: Bloomberg

CURRENCY & EXCHANGE RATE

SAFE said it will let Citic Securities, Huatai Securities and China Merchants Securities buy and sell foreign exchange for clients or themselves under a pilot program, the brokerages are also allowed to participate in interbank forex market trading, and that this move is intended to facilitate the development of Chinese brokerages' yuan and foreign exchange businesses. --- *BBG, Sep 5*

DEBT & FIXED-INCOME MARKET

It is said that there's no planned start date for China's new interbank bond repurchase clearing service, which was supposed to launch last month. --- *BBG, Sep 5*

FOREIGN RELATIONS

Trump on China: US stocks would be much higher if he hadn't levied tariffs on Chinese imports. To me, this is much more important than the economy. Somebody had to do this, we had to do it with China, had to be done, and I'm not even talking about purely economically, I'm talking about in other ways also. It was out of control and they were out of control. --- *BBG, Sep 4*

MoCom: Vice Premier Liu He held a phone call with Lighthizer and Mnuchin Thursday, upon US invitation. China, the U.S. will hold trade talks early Oct in Washington. Work-level negotiations will be held mid-Sept. to get prepared for senior trade talks early Oct. The two sides agreed to make joint efforts, take actions to create sound conditions for the negotiation. --- *Xinhua, BBG, Sep 5*

USTR on US-China trade talk: They agreed to hold meetings at the ministerial level in Washington in the coming weeks. In advance of these discussions, deputy-level meetings will take place in mid-September to lay the ground work for meaningful progress. --- *BBG, Sep 5*

MoCom: China's strong opposed to further escalation of the trade war. No more information to offer on the talks other than what was in the announcement. The two sides had a good phone call and will try to make real progress. No information on the question of whether the talks with the US would cover pork imports by China and whether China would lower import tariffs on US pork. --- *BBG, Sep 5*

Trudeau named Dominic Barton as Canada's ambassador to Beijing on Wed. --- *BBG, Sep 5*

FOREIGN TRADE

MoCom: Started Sept. 2, China allows imports of sugar beet pulp, soybean meal, rapeseed meal and sunflower meal from Russia. --- *BBG, Sep 5*

HONG KONG

HK Chief Executive Lam said her decision to scrap extradition legislation was only the first step to addressing HK's unrest, but resisted protesters' calls to immediately meet the rest of their demands. --- *BBG, Sep 5*

MONETARY POLICY & INTEREST RATES

PBoC skipped reverse repo for a 6th day, saying the current banking liquidity is at a reasonably ample level after absorbing impacts of gov't bond sales and banks' reserve requirement payment. --- *BBG, Sep 4*

News Tracker – Sep 4, 2019

AGRICULTURE

MoF and MoARA: China will increase incentives to counties with bigger hog production in a move to boost supplies and ensure economic stability amid a swine fever epidemic that has ravaged China's pork output. Both central and local gov'ts will subsidize mandatory culling of pigs sick with African swine fever. --- *BBG, Sep 4*

CURRENCY & EXCHANGE RATE

Duterte on online casino: I decide that we need it. Many jobs will be lost. Anyway, it's gov't-controlled. --- *BBG, Sep 4*

DEBT & FIXED-INCOME MARKET

JPMorgan will start a phased inclusion of Chinese gov't debt into its benchmark emerging-market indexes. China's weight will be capped at 10% of the GBI-EM global diversified and narrow diversified indexes, and the inclusion will begin Feb 28, 2020. --- *BBG, Sep 4*

ENVIRONMENT -- AIR POLLUTION

MoEE said in a statement that it welcomes reports from public on local authorities conducting blanket cuts, as there have been instances of officials indiscriminately forcing all companies to shut down or cut production, to deal with environmental issues. --- *BBG, Sep 4*

FINANCIAL MARKET

China will include P2P platforms in financial credit system. All online lending information will be included in the financial credit information database by PBoC and credit company led by the national Internet finance association. The move aims to prevent risks from bad debt and in the financial system. --- *Financial News, BBG, Sep 4*

FISCAL, TAXATION & GOV'T FINANCE

State Council called for an acceleration of the issuance of special bonds by local gov'ts. The bonds are mostly used to pay for infrastructure spending, and will lend support to the economy which faces downward pressure from the complex external environment. Funds raised via local gov't special bond sales can be invested in sectors including transport, energy, agriculture and forestry, vocational education and medical care in 2020, while projects such as land reserve and property will be prohibited. --- *BBG, Sep 4*

FOREIGN BUSINESSES IN CHINA

FedEx on said it correctly handled a package containing restricted types of knives that was bound for HK after Xinhua reported the package was suspected of being handled illegally. --- *Reuters, Sep 4*

FOREIGN RELATIONS

Liu He met US Senator Daines, and said that China firmly opposes a trade war as it is not good for China, the U.S. and the world, that China hoped the two sides seek common ground while setting aside difference, and that they can appropriately resolve the issue on the basis of equality and mutual respect. --- *Xinhua, Reuters, Sep 4*

Duterte said that he and Xi had long agreed on a 60-40 revenue-sharing arrangement that would favor the Philippines should joint oil and gas exploration in the South China Sea proceed, and that territorial dispute between the two nations will remain a problem after Xi insisted that China doesn't recognize Manila's victory in an arbitration case. --- *BBG, Sep 4*

FOREIGN TRADE

Chinese health inspectors are said to start evaluating four Brazilian beef plants on as part of a push to approve new meat exporters amid an outbreak of swine fever. --- *Reuters, Sep 4*

HONG KONG

HK Chief Executive Lam formally withdrew legislation to allow extraditions to China, pledged an independent study of the gov't's performance, reaffirmed her commitment to reviewing the police actions, but said that she couldn't accept other protester demands such as dropping rioting charges against demonstrators. --- *BBG, Sep 4*

HK Lam was quoted by saying HK gov't won't set up an independent commission of inquiry for recent events. --- *BBG, Sep 4*

Foreign Ministry spokesman declined to comment on reports that HK Lam plans to formally withdraw legislation that would've allowed extraditions to China. --- *BBG, Sep 4*

MONETARY POLICY & INTEREST RATES

State Council called for the timely use of tools including broad and targeted reserve-ratio cuts to support the economy. --- *BBG, Sep 4*

CSJ front-page report: PBoC is likely to cut rates on medium-term lending facilities around the middle of this month to boost liquidity support. --- *BBG, Sep 4*

PBoC skipped reverse repo for a 5th day, saying the current banking liquidity is able to absorb impact of reverse repo maturities. --- *BBG, Sep 4*

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