



ASIA MACRO STRATEGY

China Market Outlook Amid Policy Easing

Report | 21 May 2019

For Professional Investors only in Hong Kong and Accredited Investors only in Singapore

With growing uncertainty around the Sino-US trade war and that relationship at a low ebb, investors are increasingly focusing on policy response to assess market outlook.

Some observers favour China over the US in policy easing speed and breadth, thanks to the former's highly centralised regime. Others argue that China's hands are increasingly tied due to high leverage, worsening credit quality and private sector growth. We believe that Beijing can afford to stretch out policy easing in 2019 to overcome the downside shock.

But if the drag gets amplified and protracted beyond 2020 (for example, if manufacturing migration or capital flight becomes more severe than currently envisaged), the stimulus game will be a much tougher play for China. Beijing will need to make alternative strategic alliances to boost production and attract foreign capital to make up the losses.

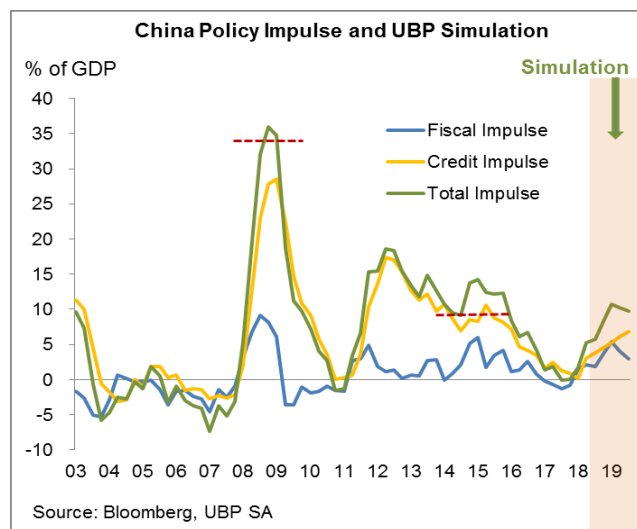
Overall, we remain constructive on Chinese assets in the next 6-9 months.

Policy Assessment

A worst-case scenario of 25% tariff on all Chinese exports to US will cut about 1.4% of China's GDP growth, including the multiplier effect. This means about RMB1.28trn or \$190bn in potential economic loss needs to be offset.

This resembles the 2015-16 policy response cycles, although it will be far less severe than the global financial crisis in 2008-09. That meltdown required a massive policy stimulus which China simply can't afford today.

Compared to the last three policy easing cycles of 2008-09, 2011-12, and 2015-16, China's current easing remains at a relatively early stage. Growth support will take priority over leverage concerns when fighting a trade war. We expect Beijing will ramp up policy impulse (which measures the extent of stimulus) to levels similar during 2015-16.



To pump \$190bn back to the economy, our simulation suggests that China's fiscal deficit will expand to around 6% of gross domestic product (GDP) on a four-quarter rolling sum basis. With an additional 100-150 basis points (bps) reduction in banks' reserve requirement ratio (RRR), credit impulse may resume to a 10%-15% growth rate from the current low single-digit level and add about 7% of GDP new debt stock to the already high level over 12-month horizon.

China Policy Easing Cycles and Policy Responses

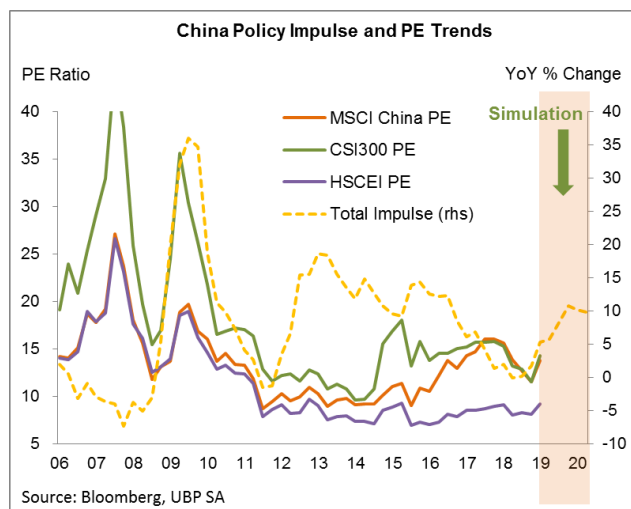
China Easing Cycles	RRR cut (bps)	Change in TSF/GDP ratio* (% pt of GDP)	Change in Fiscal Bal. (% pt of GDP)	Change in GDP growth (Peak to Trough) (% pt)
2008-09	-300	30.8	-2.8	-7.9
2011-12	-150	14.0	-0.5	-2.4
2015-16	-250	15.3	-1.7	-0.7
2018-1Q/19	-350	2.3	-0.9	-0.4
Present to 2020	-100 to -150	7.0	-1.5	-1.4

Based on our simulation of extend of policy easing that will need to offset 1.4% loss in GDP growth (assumed all Chinese exports to US are tariffed at 25%)
* TSF = Total Social Financing or Aggregate Credits
Source: Bloomberg, UBP SA

Market Assessment

Historically, China's policy easing tended to result in earnings recovery and price/earnings (P/E) multiples expansion in both A- and H-shares equity markets, as well as spread

compression in China's US dollar (USD) high-yield (HY) and investment grade (IG) credits.



If 2015-16 is a reasonably good yardstick to judge the current market outlook, both Chinese equities (P/E and earnings recovery) and USD credits (spread compression) are roughly half-way through their respective recovery cycles.

China Policy Easing Cycles and Market Impact

China Easing Cycles	Change in PE Multiples (x) (Trough to Peak)			Change in EPS (% chg) (Trough to Peak)			Change in USD Credit Spread (bps) (Peak to Trough)	
	CSI 300	MSCI China	HSCEI	CSI 300	MSCI China	HSCEI	China HY	China IG
2008-09	14.1	7.9	3.7	12.8	76.1	57.1	-279	-84
2011-12	1.2	2.3	1.9	15.5	15.0	28.3	-1257	-131
2015-16	2.5	2.5	2.2	7.7	39.4	25.2	-409	-98
2018-present	1.5	1.5	1.0	3.9	-0.8	12.4	-252	-42

Note - Trailing PE and EPS are used in the analysis
Source: Bloomberg, UBP SA

As stated before, Chinese equity valuation is not too stretched relative to its history and to the global index.

While China's credit spreads have tightened markedly since early 2019 and have stayed tight, HY spread has widened by a mere 8bps since Trump's new tariff imposition on May 10. IG spread has gapped up only 2bps while the upside cap remains significant from risk/reward perspective.

However, the credit market will be underpinned by monetary easing and delayed deleveraging and credit default risk. HY credits will get additional support from extended policy accommodation in the housing market as policy easing persists.

Anthony Chan
Chief Asia Investment Strategist

Disclaimer

This document is a marketing communication containing GENERAL INFORMATION on the financial services and/or financial instruments, and reflecting the sole opinion of Union Bancaire Privée, UBP SA and/or any entity of the UBP Group (hereinafter "UBP") as of the date of issue. It may contain generic recommendations but should not be deemed an offer nor a solicitation to buy, subscribe to, or sell any currency, product, or financial instrument, make any investment, or participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. This document is meant only to provide a broad overview for discussion purposes, in order to determine clients' interest. It does not replace a prospectus or any other legal document relating to any specific financial instrument, which may be obtained upon request free of charge from UBP or from the registered office of the fund concerned, where applicable. The opinions herein do not take into account individual clients' circumstances, objectives, or needs. In this document UBP makes no representation as to the suitability or appropriateness, for any particular client, of the financial instruments or services described, nor as to their future performances. Clients who wish to obtain more information about any specific financial instruments can request it from UBP and/or their Relationship Manager. Where an investment is considered, the information on the risks linked to each financial instrument shall be provided in good time by separate means before the investment decision is taken. In any case, each client must make his/her own independent decisions regarding any securities or financial instruments mentioned herein and regarding the merits or suitability of any investment. Before entering into any transaction, clients are invited to carefully read the risk warnings and the regulations set out in the prospectus or other legal documents and are urged to seek professional advice from their financial, legal, accounting and tax advisors with regard to their investment objectives, financial situation and specific needs. This generic information is therefore not independent from the proprietary interests of UBP or connected parties, which may conflict with the client's interests. UBP has policies governing cases of conflicts of interest. The investments mentioned herein may be subject to risks that are difficult to quantify and to integrate into the valuation of investments. Generally speaking, products with a high degree of risk, such as derivatives, structured products or alternative/non-traditional investments (such as hedge funds, private equity, real estate funds, etc.) are suitable only for clients who are capable of understanding and assuming the risks involved. The value of any capital investment may be at risk and some or all of the original capital may be lost. The investments are exposed to currency fluctuations and may increase or decrease in value. Fluctuations in exchange rates may cause increases or decreases in the client's returns and/or in the value of the portfolio. The client may be exposed to currency risks if a financial instrument or the underlying investment of a financial instrument is denominated in a currency different from the reference currency of the client's portfolio or from the currency of his/her country of residence. For more information on risks, the brochure called "Characteristics and risks of certain financial operations" should be consulted. The information contained in this document is the result neither of financial analysis within the meaning of the Swiss Banking Association's "Directives on the Independence of Financial Research" nor of independent investment research as per the EU's regulation on MiFID provisions. In principle, EU regulation does not govern relationships entered into with UBP entities located outside the EU, including but not limited to Union Bancaire Privée, UBP SA in Switzerland, which is subject to Swiss law and Swiss regulation, in Hong Kong, and in Singapore, and the subsidiary in Dubai. Reasonable efforts have been made to ensure that the content of this document is based on objective information and data obtained from reliable sources. However, UBP cannot guarantee that the information the Bank has gathered in good faith is accurate and complete. Circumstances may change and affect the data collected and the opinions expressed at the time of publication. Therefore information contained herein is subject to change at any time without prior notice. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein nor does it accept any liability whatsoever for any errors, omissions or misstatements in the document. UBP does not undertake to update this document or to correct any inaccuracies which may have become apparent after its publication. This document may refer to the past performance of financial instruments. Past performance is not a guide to current or future results. The value of financial instruments can fall as well as rise. All statements in this document, other than statements of past performance and historical fact, are "forward-looking statements". Forward-looking statements do not guarantee future performances. The financial projections included in this document do not represent forecasts or budgets, but are purely illustrative examples based on a series of current expectations and assumptions which may not happen as forecast. The actual performance, results, market value and prospects of a financial instrument may differ materially from those expressed or implied by the forward-looking statements in this document. The projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP also disclaims any obligation to update forward-looking statements, as a result of new information, future events or otherwise. Any performance data included in this document does not take into account fees, commissions, expenses charged on issuance and redemption of securities, or any other costs, nor any taxes that may be levied. The tax treatment of any investment depends on the client's individual circumstances and may be subject to change in the future. This document does not contain any tax advice issued by UBP and does not necessarily reflect the client's individual circumstances. This document is confidential and is intended to be used only by the person to whom it was delivered. This document may not be reproduced, either in whole or in part. UBP specifically prohibits the redistribution of this document, in whole or in part, without its written permission and accepts no liability whatsoever for the actions of third parties in this respect. This document is not intended for distribution in the US and/or to US Persons or in jurisdictions where its distribution by UBP would be restricted. UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority ("FINMA").

UK: UBP is authorised in the United Kingdom by the Prudential Regulation Authority, and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority (PRA).

Dubai: This marketing material has been communicated by Union Bancaire Privée (Middle East) Limited, a company regulated by the Dubai Financial Services Authority ("DFSA"). It is intended for professional clients and/or market counterparties only and no other person should act upon it. The financial products or services to which this material relates will only be made available to a client who meets the professional client and/or market counterparty requirements. This information is provided for information purposes only. It is not to be construed as an offer to buy or sell, or a solicitation for an offer to buy or sell any financial instruments, or to participate in any particular trading strategy in any jurisdiction.

Hong Kong: UBP is a licensed bank regulated by the Hong Kong Monetary Authority (HKMA) and a registered institution regulated by the Securities and Futures Commission (SFC) for Type 1, 4 & 9 activities only in Hong Kong. The securities may only be offered or sold in Hong Kong by means of documents that (i) are addressed to "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO"); or (ii) are defined as "prospectuses" within the meaning of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (the "CO") or constitute offers to the public within the meaning of the CO. Unless permitted to do so under the laws of Hong Kong, no person may issue or have in his/her possession for the purpose of issuing, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the securities, directed at, or likely to be accessed or read by, the public in Hong Kong, except where the securities are intended to be disposed of only to persons outside Hong Kong, or only to "professional investors" within the meaning of the SFO.

Singapore: UBP is a bank regulated by the Monetary Authority of Singapore (MAS), is an exempt financial adviser under the Financial Advisers Act (Cap. 110 of Singapore) to provide certain financial advisory services, and is exempt under section 99(1) of the Securities and Futures Act (Cap. 289 of Singapore) to conduct certain regulated activities. This document has not been registered as a prospectus with the MAS. Accordingly, this document and any other document or material in connection with generic recommendations may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) to institutional investors under Section 274 of the Securities and Futures Act (Cap. 289) of Singapore ("SFA"), (ii) to relevant persons pursuant to Section 275(1), or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This advertisement has not been reviewed by the Monetary Authority of Singapore.

Luxembourg: UBP is registered by the Luxembourg supervisory authority the Commission de Surveillance du Secteur Financier (CSSF).

Italy: Union Bancaire Privée (Europe) S.A., Succursale di Milano, operates in Italy in accordance with the European passport – held by its parent company, Union Bancaire Privée (Europe) S.A. – which is valid across the entire European Union. The branch is therefore authorised to provide services and conduct business for which its parent company, Union Bancaire Privée (Europe) S.A., has been authorised in Luxembourg, where it is regulated by the Luxembourg financial supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF).

Monaco: This document is not intended to constitute a public offering or a comparable solicitation under the Principality of Monaco's laws, but might be made available for information purposes to clients of Union Bancaire Privée, UBP SA, Monaco Branch, a regulated bank under the supervision of the Autorité de Contrôle Prudentiel et de Résolution (ACPR) for banking activities and under the supervision of the Commission de Contrôle des Activités Financières for financial activities.

© UBP SA 2019. All rights reserved.

Union Bancaire Privée, UBP SA
Singapore Branch
Level 38 | One Raffles Quay | North Tower
Singapore 048583
T +65 6730 8088 | F +65 6730 8068

Hong Kong Branch
26/F AIA Central | 1 Connaught Road Central
Hong Kong
T +852 3701 9688 | F +852 3701 9668

