UNION BANCAIRE PRIVÉE

ASIA MACRO STRATEGY

Watch For China's Bounce

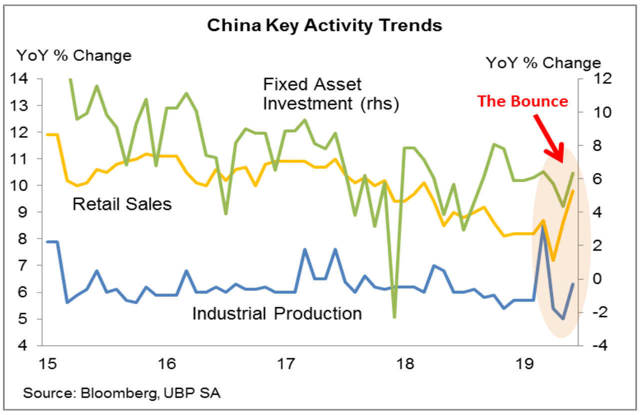
Report | 16 July 2019

China's reported gross domestic product (GDP) showed a modest deceleration to 6.2% year-on-year (yoy) in the second quarter of 2019 (2Q/19) from 6.4% in the previous two quarters.

This is in line with our and the market's expectations for a softer quarter after a firm start of the year. We maintain our full-year 2019 GDP forecast at 6.2%.

Surprise bounce

The real story in the latest data releases is the surprise significant bounce in most domestic activities in June. Reported numbers from industrial production to retail sales and fixed asset investment were buoyed by increased total credit expansion last month.



Source: Bloomberg, UBP SA

Our credit impulse indicator has revived to a meaningful level. We think that the results of a more effective stimulus are starting to show – this should have positive earnings implication ahead.

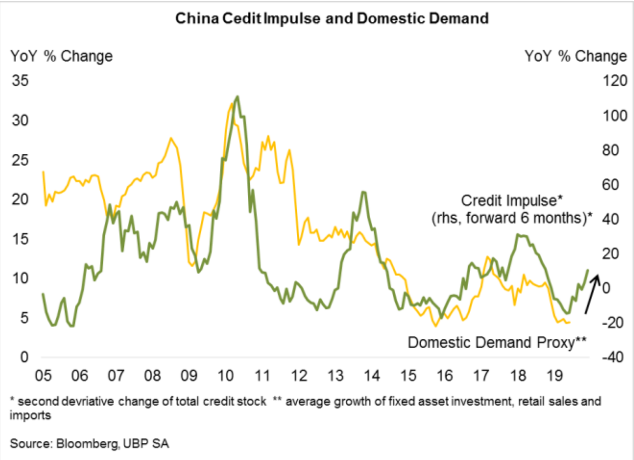
Against the mild contraction in China's June export growth (-1.3% yoy), the picture is clear. Beijing's effort to counteract the trade war's impact by buttressing domestic demand is showing renewed effect after some slippages in early 2Q.

In particular, the recent relapse of infrastructure growth (down to a mere 1.5% yoy in May) was quite disappointing given all the efforts to boost the sector's financing support by stepped-up special bond issues. However, June saw growth revived to a more solid 5.4% growth, aided partly by low-base effect.

Real estate investment and new housing growth continued to stay robust at around 10% yoy. This is despite local reports of the government restricting some shaky trust loan lending for mortgage purposes.

The weakest link remains in manufacturing investment – understandably, the sector is still directly affected by the trade war.

Reinforced optimism



* second deviative change of total credit stock ** average growth of fixed asset investment, retail sales and imports

Source: Bloomberg, UBP SA

The credit numbers have reinforced our near-term optimism:

- Our China's credit impulse measurement has rebounded markedly to double-digit expansion in June (up 10.5% yoy) for the first time since October 2018. This acceleration has reinforced our earlier argument that China needs a policy stimulus similar to the scale in 2015-16 and it seems to be moving to this direction

- Given the strong lead-lag relationship between credit impulse and domestic demand growth in China, our analysis suggests a noticeable revival of the latter in 2H/19 as the cumulative liquidity effect filters through (see chart below).

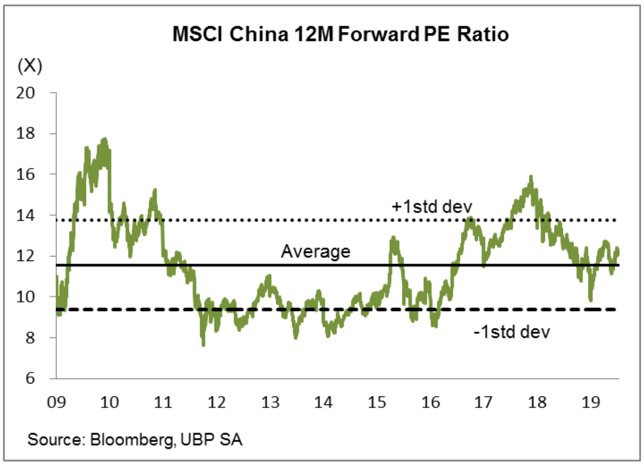
- Total social financing (TSF) flow accelerated noticeably reaching some RMB2.26trn ($328bn) in June. This was driven largely by short-term loans (to support private sector and SMEs), local government bond issues (to support infrastructure projects), and mortgages (to support the backbone of China's domestic economy amid the trade war).

Good omens

Overall, the strong rebound in economic activities will bode well for growth and earnings expectation in 2H/19.

This should support China's equity market valuation which has rebounded to marginally over mean level currently for MSCI China. The index is at about 12.2x forward price-to-earnings (P/E) from recent low of 11.0x in May with about 14-15% 2019 earnings per share (EPS) growth forecast.

We think investors will continue to focus on China's policy stimulus theme. Domestic and new economy plays will be the beneficiary of the lingering trade war saga.



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