ASIA MACRO STRATEGY

Post-G20: US-Sino future still uncertain beyond relieved market rally

Report | 2 July 2019

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

Anticipated but with positive surprises …

Financial markets enjoyed a relieved rally yesterday as the G20 outcomes was in line with expectations of a trade war truce. No timeline has been given for the next round of negotiations, and a lifeline has been extended to Huawei – allowing US firms to continue their sales to the Chinese tech firm.

News of the latter has caused equity sector rotation back to the tech and semiconductor sectors, while the truce resulted in a firmer yuan versus US dollar (CNY/USD) and credit spreads staying tight.

US President Donald Trump has taken a conciliatory approach to Huawei, allowing the sale of US components to continue (excluding items with national security concerns) while reviewing the export control measures.

We think the 90-day review period for Huawei with the deadline on August 19 is likely to be extended as trade talks resume. Alternatively, a true de-listing of Huawei from the 'entity list' (Trump hinted at this possibility in a post-G20 interview with the Financial Times) would represent a more solid de-escalation of the trade war.

…But lack of details means uncertainty remains

The Trump-Xi meeting looked more like a personal intervention by the two leaders to prevent an escalation of economic tension. But the announcement lacked substance – this will continue to overshadow market concerns on the ongoing trade conflict.

Prior to his meeting with Trump, China's President Xi Jinping has said that the lifting of the Huawei ban was a fundamental ground for continued trade negotiation.

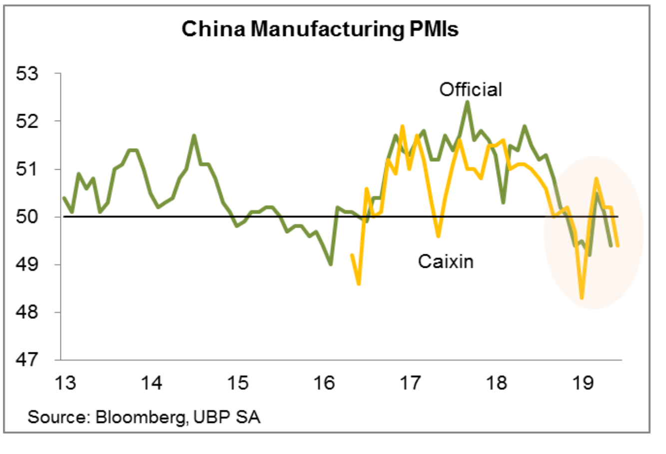
Trump has conceded, at least partially, and his only announcement on China's concession was its intention to step up soybean imports from US farmers. This is directly aimed at his own constituency of supporters in the US. Increased US imports is always the relatively easier measure for Beijing to smooth over trade conflicts.

Other than that, the crucial issues did not get a mention. This included China's demand for tariff removal, and the US' demand for China's state subsidy reform, increased market access, changes in China's foreign investment law to prevent forced technology transfers as well as the establishment of a US-China monitoring system on China's reform promises

The above suggests that, while the Xi-Trump meeting may provide some negotiating flexibility at the top, the gap for trade negotiation remains huge and trade talks will likely remain a drawn-out process.

Continue to favour China's domestic sector

Beyond the relieved rally of the G20 outcome, we continue to favour China's domestic demand sectors – consumer discretionary, infrastructure, internet gaming, education, and financials – based on expectations of China's 'policy easing 2.0' and still-attractive equity market valuation as our core investment themes (see Asia Macro Strategy: Weak Data To Reinvigorate China's Policy Easing, 18 June, 2019).



Indeed, latest key indicator such as the Caixin manufacturing purchasing managers index (PMI) has slipped further to 49.4 in June (below 50 goes into contractionary phase) from 50.2 in the previous month. This reinforces expectation for a marked softening of the economy with the new tariff impositions as well as waning consumer and investment sentiments.

Tariff removal key to export earnings

On tech, US White House economic advisor Larry Kudlow, in a post-G20 media interview, stressed that the temporary concession to Huawei referred merely to general merchandise sales and did not mean the firm is not posing a national security threat to the US. This makes many investors sceptical of any imminent resolution to the Huawei saga.

In our view, a more confident sector rotation back to export manufacturing and technology sectors requires meaningful tariff removals so as to revive exporters' profit margins and earnings outlook. Based on existing information, the Trump administration remains fixed on maintaining the tariffs on China's tech sector with the strategic objective of curbing its ambitious China 2025 program.

RMB and Hong Kong market outlook

With regards to the RMB, CNY/USD largely stayed firm at around 6.84-6.85 on the news. We expect near-term stability to be maintained (not breaking out from 7.00) as trade talk resumes, but trading flexibility will depend on trade talk progress as well as overall consideration of capital outflow risk.

Despite the constructive G20 news, there is idiosyncratic factor of Hong Kong that may impact market performance. Another massive demonstration yesterday against the proposed extradition bill has overshadowed investors' confidence in the city as a global business and financial centre.

The controversial extradition law has already aroused international attention. It lands at the height of the Sino-US trade war where the US may consider withdrawing its US-Hong Kong Policy Act that has treated Hong Kong with full autonomy on economic and trade matters from China's rule.

Although the Hang Seng Index (HSI) has rebounded on the Hong Kong SAR Government's earlier suspension of the bill in response to two earlier massive protests, the latest saga may reinvigorate international business' concern of the city's stability and its role in China's long-term development.

This may discount any potential upside of HSI from the G20 news as long as the extradition bill is not officially withdrawn and protests in the city continue to linger.

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