

Flash Note 06/07/2018

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Commercial spat. Here we go!

Market reaction

- Greater China benchmarks closed higher yesterday, with Shanghai up 0.49%, Shenzhen up 0.48% and Hang Seng up 0.47%.
- Here is the awkward question that I propose today: Why Chinese markets rise right when the US tariffs went into effect?

Our follow-up on the level and decibels of the threatening rhetoric.

- Despite some disturbing headlines in some Chinese newspapers (Xinhua) citing a Ministry of Commerce statement that "having vowed not to fire the first shot, China is forced to stage counter-attacks to protect the core national interests", we prefer to emphasize other interventions and assessments made from other government sources, and that point to a much more measured and pragmatic reaction.
- In that regard, I would like to underline what I've read last night in the South China Morning Post. According to this newspaper, China President Xi Jinping would have told Chinese officials that the country must pick its battles carefully amid the increasing trade tensions to ensure that nothing derails the country's process of reform and opening up. (see link below)
- Another economic magazine underlined that Xi has repeatedly reminded aides that while US President Donald Trump's provocations mean Beijing must retaliate, "we must try to contain the damage to prevent the stand-off from compromising its chosen path".
- This makes me think that perhaps, and I stress that perhaps, we were right when saying that China had neither incentives nor effective answers to enter this ring and start a fight.

Outlook

- Time will tell whether or not we were right in advancing a measured and pragmatic response from Beijing.

- If this scenario of contention in the Chinese responses (an approach we have been defending so far) ends up materializing, then we could see markets trading in a normal environment again.
- While the tensions will not disappear completely, we could recover that scenario of "two steps forward, one backward" that makes up our central proposal for the second half of the year.
- What about the CNY? Our expectation is for a yuan that will not reverse June's losses against the dollar any time soon. The yuan was trading around 6.64 per dollar and could remain well around the same level for a while. At year-end, however, the yuan could strengthen to 6.50 and then go stronger to 6.25-6.50.

Best