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Flash note
15/03/2022

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China's stocks fell sharply amid fears they could be hit by US sanctions, surging covid and PBOC ending cut rates

China locks down more than 45M people.

The sell-off that started on Monday gathered pace Tuesday afternoon despite the release of strong economic data earlier in the day. Later on Monday, authorities placed Jilin province in lockdown. Also, the southern city of Shenzhen was placed under lockdown for at least a week late on Sunday. The restrictions will last until at least 20-Mar and include halting of bus and subway services in the city, a work-from-home order, and shutting of factories including at its important tech hub, prompting manufacturers such as Apple suppliers Foxconn and Unimicron Technology Corp to halt operations. The financial hub of Shanghai locked down some office compounds. "China's economy could be severely hit again," said Nomura analysts in a note. "With the much-worsening pandemic and Beijing's resolution in maintaining its zero-COVID strategy, we believe China's 'around 5.5%' GDP growth target this year is becoming increasingly unrealistic." The visible economic cost could be near 1% of GDP.

PBOC – Rates & liquidity. Why the PBOC kept the key rate unchanged.

PBOC decided to keep its one-year medium-term lending facility rates unchanged at 2.85% from the previous operation, defying expectations for a cut. The market selling came despite data showing China's economy perked up in the first two months of the 2022, with key indicators all exceeding analysts' expectations. The data shows the government's supportive policies have started to help the economy, although the macro-outlook in the next few months remains challenging.

On the liquidity side, the PBOC opened liquidity gates as headwinds to growth strengthen. The central bank injected CNY100B into the financial system Tuesday morning, saying it comes just as Covid cases and lockdowns rise, and the property market slump shows no sign of abating. The injection was higher than consensus and came after it kept rates steady at 2.85% versus expectations for a 5-10 bp cut. Looking ahead, influential economist says PBOC will cut rates to stabilize economy. China Securities Journal carried an article saying the PBOC will cut rates to stabilize the economy, downplaying concerns that a narrowing China-US yield spread would be an obstacle.

Economy: Jan-Feb industrial output, retail sales and investments beat forecasts.

January-February industrial production +7.5% y/y vs consensus +3.9% and +4.3% in prior month. Retail sales +6.7% y/y vs consensus +3.0% and +1.7% in prior month. Fixed asset investment (YTD) +12.2% vs consensus +5.0% y/y vs +4.9% in prior month. On the negative side, real estate sector growth continued to decelerate to 3.7% from 4.4%, with total sales dropping 19.3% and construction starts in all three major segments falling by double digits. Trucking operations across China continue being delayed by more stringent testing requirements for drivers, leading to operational efficiency of trucking services at major port cities to be significantly reduced. Shipper AP Moller-Maersk noted even inland ports would be affected.

Beijing says it wants to avoid US sanctions over Russia's war.

Bloomberg reported Comments from China's foreign minister Wang Yi, who said China wants to avoid being impacted by US sanctions over Russia's war. "China is not party to the crisis“. Beijing is likely to encourage its larger banks to abide by US sanctions and "tread carefully" in helping Moscow navigate export controls on key technologies so long as US can credibly threaten secondary sanctions. US national security advisor Jake Sullivan and top China diplomat Yang Jiechi, meet in a seven-hour long meeting the US described as "intense". The meeting did not led to specific outcomes. Sullivan warned Beijing of the isolation it would face if it supported Russia. A day earlier, US officials believed Moscow has asked Beijing for military equipment to support its invasion of Ukraine as there were indications Russia was running out of certain kinds of weapons and suggested that “China was preparing to help”. The Chinese embassy in Washington said it was unaware of any suggestions of help. Some Beijing-backed news outlets had repeated claims that the US is trying to spread pathogens through animals via a Ukrainian bio-lab.

Regulator, Tech sector crackdown and US delistings of Chinese firms

The Cyberspace Administration of China has said companies engaged in online gaming, livestreaming, audio and video should set up a "youth mode" to protect minors. Platforms should also cap daily spending amount for minors and conduct regular assessments on protection to provide a "clean environment" on the internet. JPMorgan Chase & Co. downgraded 28 Chinese stocks listed in the United States and Hong Kong on Monday, sending the Nasdaq Golden Dragon China Index down nearly 12% overnight. “We find China Internet unattractive on a 6-12 month view with an unpredictable share price outlook, depending on the market perception of China’s geopolitical risks, macro recovery and Internet regulation risk”. The Hang Seng Tech Index has lost roughly 17% since last Friday, as the SEC identified Chinese companies that will be delisted if they do not provide access to audit documents.

Market outlook – Recommendations & Targets from fundamental analysis: Pending an in-depth discussion on this and other markets in our global banking and investment committee (CIGA), the current market declines coincided with an EPS consensus upward revision (for both the Shanghai index and the of Shenzhen). . Therefore, the recent declines put this market at an attractive valuation point. Although, it must be made clear that the political factor and the ambiguity of the Chinese government regarding the crisis in Ukraine greatly depress investor appetite. Everything depends on the attitude and position of Beijing in relation to the war.

Equities – SHANGHAI Idx: OVERWEIGHT (Cheap)

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Bonds – Govies: OVERWEIGHT (10Y Yield target 2.4%)

Forex – CNY/USD: MW (Target 6.35)