WEEKLY UPDATE

China – private enterprise with socialist characteristics

According to the International Monetary Fund, China overtook the United States in 2014 to become the world's largest economy in purchasing power parity terms. With China growing at twice the US pace today, it represents the largest single contribution to global growth. More recently, equity index provider MSCI announced a three-stage tripling in the weight given to Chinese domestic A shares in its indices. And then last weekend, Bloomberg confirmed that Chinese government bonds were soon to be included in its benchmark indices. China is already one of the largest, most liquid financial markets in the world. In coming years, it is set to become one of the key allocations in global portfolios. Increasingly, China matters. So what is going on?

Much recent commentary has focused on the damage wrought to Chinese output by the ongoing trade war with the United States. Here, recent news has been rather encouraging. Last week's talks in Beijing have been followed by a trip this week to Washington by a delegation led by Chinese vice-premier Liu He, who also met President Trump before leaving. Although we are sceptical that all tariffs imposed will be cancelled, the hope that the period of escalation might soon be over has bolstered risk appetite in global markets.

Given the trade-led slowdown, China has embarked on a number of policy easing initiatives. In the main, these have largely disappointed western investors perhaps hoping for the scale of policy response provided by China in the aftermath of the Great Recession of 2008-2009. On the contrary, we would argue that this should be viewed as positive news. The previous rounds of stimulus were heavily debt-financed – since 2007, Chinese corporate debt (mainly owed by SOE, or state-owned enterprises) has increased from 97.9% to 152.1% of GDP (source: IIF, Q4 2018).

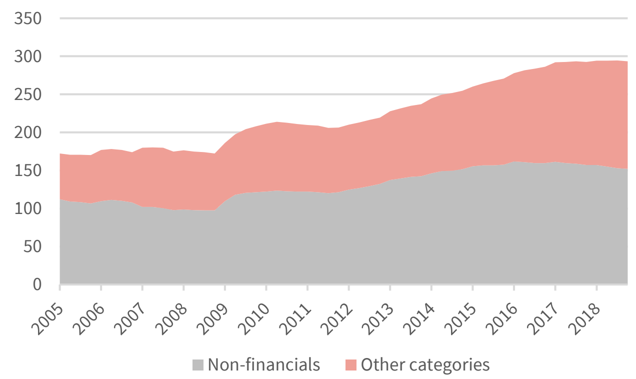
Chinese authorities have long been worried about the macro-prudential risks posed by over-dependence on debt and have decided that this round of stimulus should be different in nature. This time, China has focused its attention on the private sector. This makes sense – privately-owned companies account for some 90% of all exports, 80% of urban employment and over 60% of GDP. However, the private sector only represents around 23% of all types of corporate borrowing.

In terms of monetary policy, the People's Bank of China has made regular cuts to reserve ratio requirements for banks, targeting its efforts to free up new lending capacity for the private sector. And taxes have been cut, most recently value-added tax for manufacturing businesses (from 16% to 13%) and for transportation and construction (down 1 point to 9%). Given that private sector represents around 60% of VAT payments and that it is concentrated in higher-band activities, it stands to be the prime beneficiary of this year's cuts.

Bottom line. It is to be hoped that the private sector will prove to be a wise steward to the tax windfalls, with a focus on productive capital investment. In addition, state and local government stimulus looks set to be concentrated on infrastructure projects, again a long-term boost to growth potential. All in all, China's stimulus programmes should achieve three distinct goals – (1) mitigate the trade war drag on activity, (2) reduce the economy's over-dependence on SOE debt, and (3) foster greater reliance on private enterprise. Recent positive surprises in purchasing manager surveys suggest that the positive impact on the economy might soon be felt.

Rapid increase in SOE debt

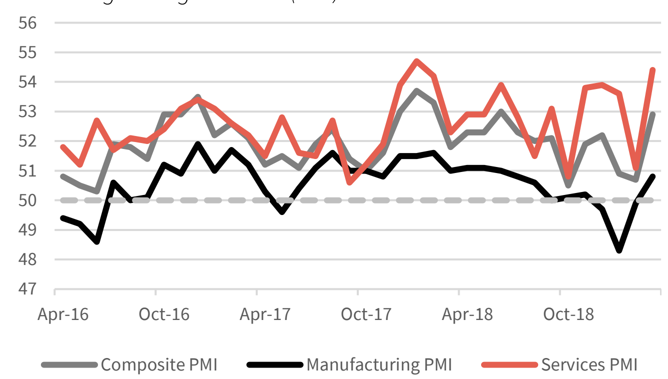
Debt in % of GDP



Source: Institute of International Finance, data as at Q4 2018

Signs of improvement in corporate confidence

Purchasing Manager's Index (PMI)



Sources: Macrobond, IHS Markit, data as at 03/04/2019

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All data taken from Bloomberg, Macrobond (05/04/2019).
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OUR MACRO-COMMENTS

This week and next

EUROZONE

- March *Manufacturing* PMI fell from 49.3 to 47.5, hitting a 6-year low according to final data. New orders saw their biggest monthly decline since late-2012. Even if *Services* PMI rose from 52.8 to 53.3, the *Composite* reading declined from 51.9 to 51.6.
- Both flash headline (1.4% YoY) and core inflation (0.8% YoY) slowed and printed below expectations in March. Meanwhile, producer prices rose from 2.9% YoY to 3.0%, indicating few signs of inflationary pressures.
- The unemployment remained steady in February at 7.8% – a decade low.
- Retail sales rebounded from 2.2% YoY to 2.8% in February against expectations for 2.3% – their best pace in more than a year.

Next week's key events		*Per.*	*Prev.*	*Cons.*
8 Apr	Sentix investors sentiment	Apr	-2.2	-1.7
10 Apr	ECB meeting (Refi. Rate)	--	0.0%	0.0%
12 Apr	Industrial production YoY	Feb	-1.1%	-1.0%

UNITED KINGDOM

- *Manufacturing* PMI surged 3 points to 55.1 in March (13-month high) whereas expectations were for a decline to 51.2. The report highlighted the fact that *Stocks* of inputs and finished goods rose at record rates.
- Against expectations for 50.9, *Services* PMI slipped from 51.3 to 48.9 – below the 50.0 no-change mark for the first time since July 2016. *New orders* fell for the third straight month while prices charged rose at their slowest pace since June 2017 given clients delay spending decisions over political worries.
- *Construction* PMI saw little improvement, up from 49.5 to 49.7, slightly below expectations, and commercial construction remained weak with projects on hold.

Next week's key events		*Per.*	*Prev.*	*Cons.*
10 Apr	BRC retail sales YoY	Mar	-0.1%	--
10 Apr	GDP MoM	Feb	0.5%	0.0%
10 Apr	Industrial output YoY	Feb	-0.9%	-0.8%

UNITED STATES

- Retail sales slowed down from 0.7% MoM to -0.2% in February.
- March ISM *Manufacturing* PMI rebounded from 54.2 to 55.3 with *New orders*, *Production* and *Employment* components expanding. Economic activity in the *Non-Manufacturing* sector expanded for the 110th consecutive month but at a slower rate, from 59.7 to 56.1. The survey concluded that respondents remain mostly optimistic about overall business conditions but still have underlying concerns over employment resources and capacity constraints.
- Ex-transport durables goods new orders rose 0.1% MoM in February after -0.1%.
- Total nonfarm private employment rose 129k in March after 197k, according to the ADP survey.

Next week's key events		*Per.*	*Prev.*	*Cons.*
10 Apr	Core inflation YoY	Mar	2.1%	2.1%
10 Apr	Headline inflation YoY	Mar	1.5%	1.8%
11 Apr	Initial jobless claims	1 Apr	202k	--

ASIA & EMERGING COUNTRIES

- China's official *Manufacturing* PMI rebounded from 49.2 to 50.5 in March (a 6-month high), outperforming expectations for 49.5. The Caixin/Markit *Manufacturing* PMI ticked up from 49.9 to 50.8, against expectations for no changes.
- Japanese *Manufacturing* PMI rose from 48.9 to 49.2 in March while the *Services* PMI declined from 52.3 to 52.0.
- The Japanese Q1 Tankan survey on large manufacturing firms indicated current conditions have worsened (from 19 to 12) while forecasts also pointed to less optimism (from 15 to 8). Non-manufacturing firms are less pessimistic with current conditions falling from 24 to 21 and forecasts unchanged at 20.
- As expected, India cut its benchmark repo rate by 25 bp to 6.0%.

Next week's key events		*Per.*	*Prev.*	*Cons.*
10 Apr	Japan: Machinery orders YoY	Feb	-2.9%	-5.2%
10 Apr	China: Total social financing (CNY bn)	Mar	703	1850
11 Apr	China: Headline inflation YoY	Mar	1.5%	2.3%

Sources: DataStream, Bloomberg, 5 April 2019. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Manager's Index.

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.12	1.11
GBP/USD	1.31	1.32
EUR/CHF	1.12	1.11
USD/JPY	111.7	110
Brent	$69.7	$68
Gold (oz.)	$1288	$1250

No change to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

MARKET PERFORMANCE

Past performance should not be seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	0 bp	→	0 bp	-1 bp	-1 bp
3mth Euribor (EUR)	-31 bp	0 bp	→	0 bp	0 bp	2 bp
3mth Libor (USD)	259 bp	0 bp	→	-22 bp	-22 bp	26 bp
3mth Libor (GBP)	83 bp	0 bp	→	-8 bp	-8 bp	9 bp
10-year US Treasury bond	251 bp	12 bp	↑	-15 bp	-18 bp	-28 bp
10-year German bond	-1 bp	7 bp	↑	-21 bp	-25 bp	-51 bp
10-year French bond	37 bp	6 bp	↑	-33 bp	-34 bp	-36 bp
10-year UK bond	109 bp	9 bp	↑	-19 bp	-18 bp	-28 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0,1%	→	3,3 %	3,2 %	2,3 %
BAML EURO Corp HY	0,8%	↑	6,5 %	5,9 %	2,6 %
BAML GBP Corp IG	-0,3%	↓	4,4 %	4,6 %	3,9 %
BAML US IG	-0,5%	↓	4,5 %	4,6 %	4,8 %
BAML US HY	0,6%	↑	6,4 %	7,8 %	6,4 %
BAML Global EM Sov. External Plus	0,5%	↑	5,0 %	6,0 %	1,6 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,12	0,0 %	→	-1,5 %	-2,2 %	-8,6%
EUR/CHF	1,12	0,3 %	↑	-0,2 %	-0,4 %	-4,9%
GBP/USD	1,31	0,3 %	↑	2,7 %	2,5 %	-7,1%
USD/JPY	111,7	0,9 %	↑	2,9 %	1,9 %	4,6%
USD/BRL	3,86	-1,1 %	↓	3,9 %	-0,6 %	15,9%
USD/CNY	6,72	-0,3 %	↓	-2,2 %	-2,3 %	6,5%
USD/RUB	65,4	0,7 %	↑	-3,3 %	-6,2 %	13,9%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	-0,5 %	↓	1,3 %	1,5 %	4,1 %
United Kingdom (3-7yr)	-0,2 %	↓	0,8 %	0,8 %	2,5 %
Germany (3-7yr)	-0,1 %	↓	0,5 %	0,6 %	1,6 %
Japan (3-7yr)	-0,2 %	↓	-0,1 %	0,1 %	0,2 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	517	2,5 %	↑	13,2 %	14,3 %	5,4 %
Eurostoxx 50	3 442	3,8 %	↑	13,8 %	15,3 %	7,0 %
DAX	11 988	4,9 %	↑	11,3 %	13,5 %	0,3 %
CAC 40	5 464	3,2 %	↑	15,6 %	15,8 %	9,8 %
S&P 500	2 879	2,3 %	↑	14,3 %	15,5 %	11,1 %
FTSE 100	7 402	2,5 %	↑	9,7 %	11,5 %	10,0 %
SMI	9 564	1,8 %	↑	12,6 %	14,9 %	15,4 %
Topix	1 620	2,4 %	↑	11,4 %	9,7 %	-2,8 %
IBOV Brazil	96 313	2,0 %	↑	4,9 %	9,6 %	14,2 %
MICEX Russia *	2 536	1,7 %	↑	5,4 %	7,5 %	11,9 %
MSCI EM	1 081	3,4 %	↑	12,4 %	12,3 %	-3,8 %
SENSEX 30 India	38 685	0,4 %	↑	8,6 %	7,5 %	18,6 %
Hang Seng (H-K)	29 936	4,1 %	↑	17,3 %	16,3 %	5,0 %
Shanghaï Composite	3 247	8,4 %	↑	29,1 %	30,2 %	3,7 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$69,7	3,8 %	↑	22,5 %	31,3 %	2,9 %
Gold	$1 288	-0,2 %	↓	0,4 %	0,5 %	-3,7 %
Copper	$6 437	1,2 %	↑	9,2 %	8,2 %	-3,8 %

Source: DataStream, on 4 April 2019.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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