China Macro

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Original Chinese Report

【广发首席经济学家观点】价格意外：谁是下一个？	2020-09-09

What will be the next price surprise?

Bigger-than-expected price fluctuations are a typical feature of economic turmoil Global asset prices have seen historic corrections this year, including the ten-year US Treasury yield, crude oil futures, the gold price and the spread between China's ten-year government bond yield and the ten-year US Treasury yield. Multiple indicators have fluctuated more drastically than expected, with some seeing swings bigger than during the 2008 global financial crisis.

Sluggish real economy and flood of global liquidity behind the surprises The COVID-19 pandemic has impacted the timing and magnitude of the global economic downturn. That said, the inversion of the US Treasury yield curve last year had already signaled the advent of a recession. The diminishing benefits brought about by technological advances and the absence of any new growth drivers have been fundamental reasons for the recessions in the US and elsewhere in the world. Sluggish demand and excess liquidity have led to low oil prices and a high gold price, which has depressed medium and long-term US Treasury yields, caused a depreciation of the US dollar, and prompted a bull-bear transition in the US stock market (a shift in the US stock market from a bull run to a bear market). In addition, the spread between interest rates in China and the US has widened and not been affected by the impact of the pandemic on China's economy, indicating the market is more bullish on China's economic growth outlook.

Global underlying inflation the next surprise
(1) Historically, a narrower gap between gold and crude oil prices has indicated that US inflation will rise. In other words, the US is currently experiencing deflation but is likely to face inflation going forward.

(2) China and the US are decoupling further, and insufficient capacity in the US and overcapacity in China will lead to inflation in the US and deflation in China.

(3) China's emphasis on self-reliance may exacerbate a food supply shortage and weak demand for non-food items, which should intensify food-driven inflation and non-food-induced deflation.

(4) Cost advantages from the "Made in China" era have gradually subsided, which together with a rise in the cost of producing labor-intensive products worldwide, should push up global underlying inflation.

Future price movements to hinge on global inflation and monetary policy Excess liquidity has caused the market to overlook the concern about fundamentals as market pricing has been based more on the post-pandemic policy-driven economic recovery. However, if the global economic recovery misses expectations, the accommodative liquidity conditions are likely to be continued, which should prompt a wider range of price surprises.

(Continued on next page…)

Asset allocation: beware of deeper-than-expected US dollar depreciation, higher-than-expected inflation and anther correction in the US stock market

(1) The US dollar may come under greater depreciation pressure. If there are no new growth drivers for the US economy, accommodative monetary policies in the US alone would lead to the depreciation of the US dollar against other currencies, as seen in Japan and the euro zone. This should benefit renminbi-denominated assets.

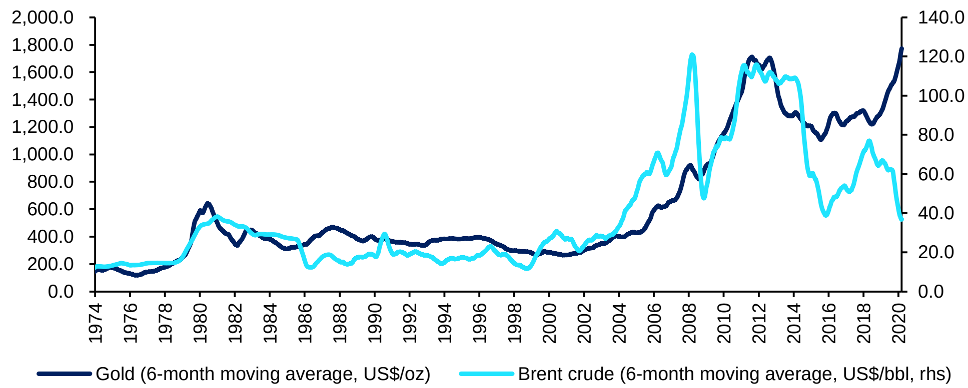
(2) Two major risks related to the bond market: (a) weaker-than-expected fundamentals or (b) higher-than-expected inflation. During economic recessions, the maturity of a large amount of high-yield bonds may heighten default risks.

(3) US stocks are riskier than A-shares. Weaker-than-expected earnings, low interest rates, the high gold-to-oil ratio and a weak dollar are set to hamper US stocks. In contrast, the widening spread between interest rates in China and the US and earnings recoveries should be tailwinds for A-shares.

(4) We suggest increasing holdings of inflation-friendly commodities, sectors that are on a rising trend (consumer spending, biopharmaceuticals, tech, non-bank finance) and cyclical sectors that are underpinned by supply (import substitution).

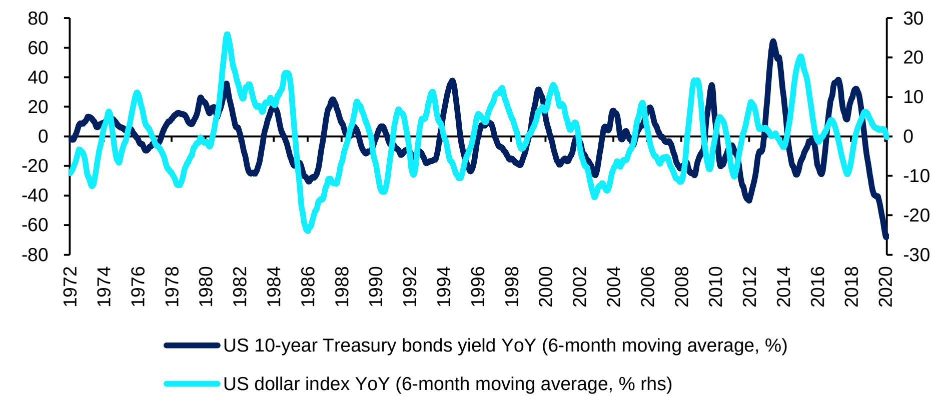
Risks: Faster-than-expected US economic recovery; earlier-than-expected end to the Fed's accommodative policies; changes in domestic property policies exceed expectations.

Figure 1: Gold and crude price six-month moving averages



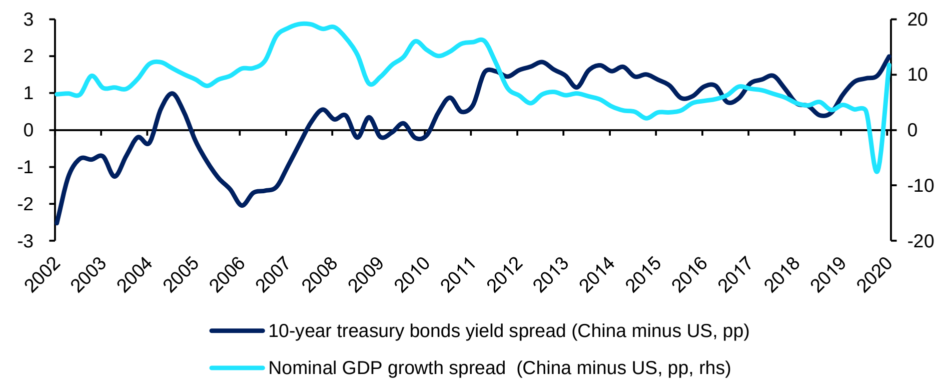
Source: Bloomberg, Wind, GF Securities Development & Research Center

Figure 2: US 10-year Treasury yield YoY & US dollar index YoY



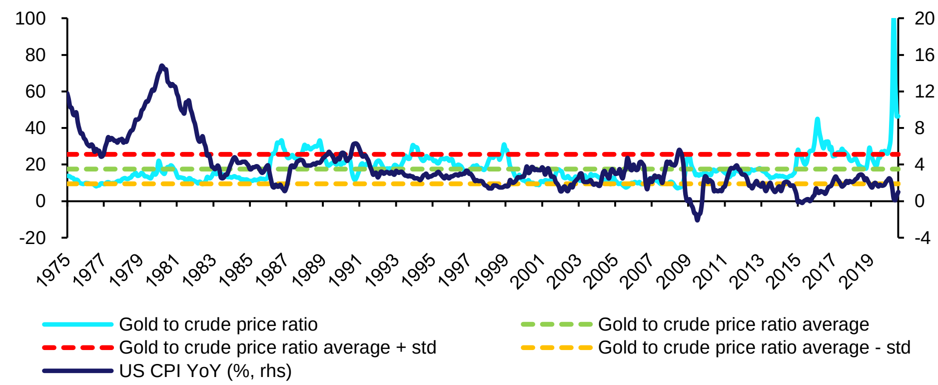
Source: Bloomberg, GF Securities Development & Research Center

Figure 3: Long-term interest spread & nominal GDP growth spread between China and US



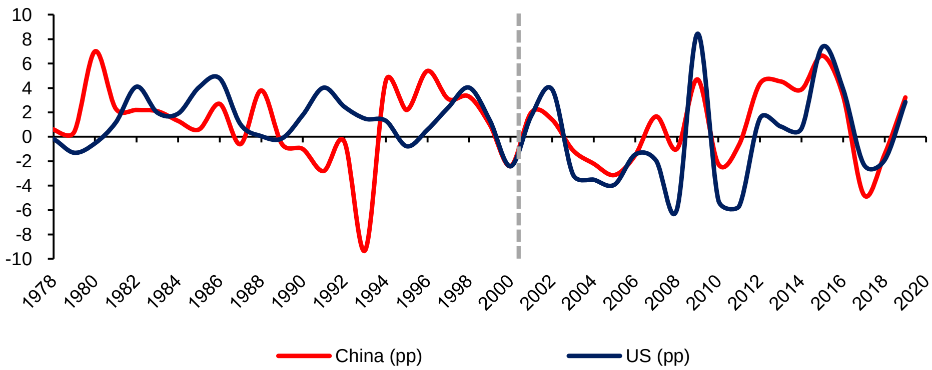
Source: Wind, GF Securities Development & Research Center

Figure 4: Gold to crude price ratio & US CPI YoY change



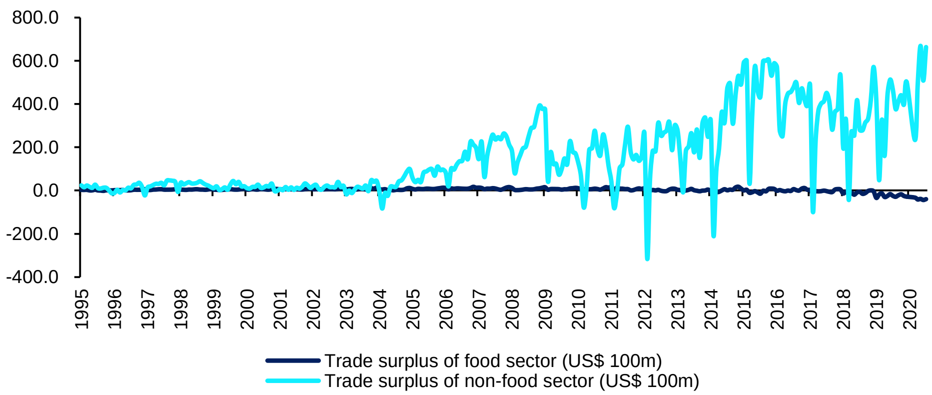
Source: Wind, GF Securities Development & Research Center

Figure 5: Inflation spread between supply and demand (CPI YoY change minus PPI YoY change) for China & the US



Source: CEIC, GF Securities Development & Research Center

Figure 6: Trade surplus between China and the US (food & non-food sectors)



Source: Wind, GF Securities Development & Research Center

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Company ratings	
Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings	
Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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