Flash note
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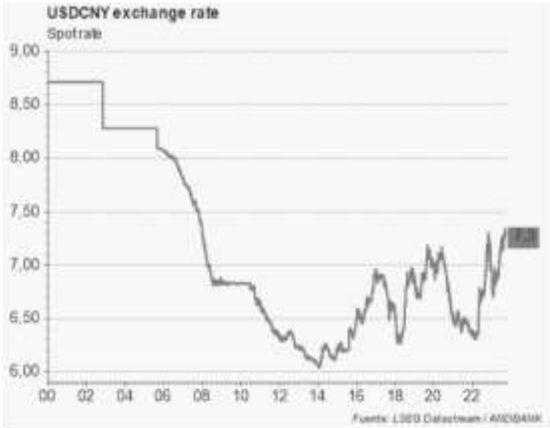
My Preferred Charts: Chinese stocks strongly underperform. Why? What's next?



FX: PBOC wants to drive yuan appreciation. SOEs are seen selling dollars + PBOC to scrutinize bulk dollar purchases by domestic companyies + China asks big banks not to square its Fx positions and keep Fx risk open (short dollar).

Chinese banks have been requested not to square their positions in the inter-bank foreign exchange markets after any U.S. dollar sales to clients, until their spot foreign exchange position hits a certain level. With this decision, banks would refrain from immediately squaring their foreign exchange positions in the market and will be forced to run open positions (open risk) for a while in order to alleviate downside pressure on the yuan. This means that some of the heavy dollar purchases by companies would be absorbed by banks. Banks were also told that companies requiring to purchase $50 million or more will need to seek the central bank's approval. Thus, PBOC is tightening scrutiny of bulk dollar purchases by domestic companies. Also, state-owned banks were seen selling dollars in both onshore and offshore markets and sources who received the directive said banks were also told to encourage their clients to hold off on dollar purchases. The effect could be just the opposite, as usually happens when there is a control (prohibition) on access to a strong currency which is a reserve currency. In fact, exporters are retaining their dollar earnings in deposits rather than convert them into Yuan.

What's next for the Yuan?

Two things are behind this year's decline in the yuan: a widening yield differentials with other major economies, particularly the United States, and a faltering domestic economy that causes the rate of return on marginal capital invested in China to remain lower than that of other places. As long as these two aspects remain unchanged, they will continue to negatively impact capital flows into the yuan regardless what the efforts of Beijing to avoid additional falls would be. In fact, In recent months, China has intensified its efforts to slow the rate of decline of the yuan by setting midpoints persistently stronger than expected, but it has not managed to stop the fall of its local currency, as can be seen in the attached graph 3. More recently, earlier this month authorities announced they would increase the supply of dollars by lowering the amount of foreign exchange that banks must set aside.

Chinese authorities "are simply smoothening the cycle. They want to avoid herding behavior. They want to avoid a scenario where the market feels that they might be losing control. They're just using different administrative tools to smoothen price action" aid Sid Mathur, head of Asia-Pacific macro strategy and emerging market research at BNP Paribas.

Equities: Beijing tries to support the equity market

Leveraged China equity positions saw their biggest daily increase in over three years on September 11, as new regulations took effect that lower deposit ratio for high-risk trades. Total outstanding amount of margin debt is now at CNY1.5T ($205B), still a 33% below 2015's peak.

Economics: Poll shows China GDP growth forecast cut to 5% in 2023, 4.5% in 2024

A Reuters poll shows China's economy will grow less than previously expected both in 2023 and 2024 amid a struggling property market. Latest forecast is 5% for 2023, down from 5.5% forecast in July. Some economists even cautioned government's growth target of around 5% for 2023 could be missed as drip-feed of policies would not be enough to stabilize economy. Majority of economists did not expect an aggressive economic stimulus package as local governments remain in heavy debt.

Trade: China hits back at Europe's EV probe as protectionist

Beijing quickly hit back at EU's investigation into China's EV subsidies. Ministry of Commerce said EU's investigation is "a naked protectionist act" that will disrupt and distort global automotive industry and supply chain and will harm China-EU economic and trade ties. Analysts expect China will take countermeasures if Brussels eventually levies duties against Chinese EV imports.

Property sector: Moody's cuts China property sector outlook

Moody's cut China's property sector's outlook from "stable" to "negative", citing economic growth challenges that would dampen sales despite slew of support measures from the government. Moody's expected contracted sales to fall by about 5% over next six to 12 months. Property investment have contracted ~8.9% yoy in first eight months. Moodis pointed that the impact of measures taken was likely to be short-lived and uneven.

Geopolitics

US National Security Council spokesperson said China's moves to expand a government ban on iPhones is "aggressive and inappropriate retaliation to US companies“. Biden administration has begun an official probe into made-in-China 7nm processor discovered within Huawei's latest smartphone Mate 60 Pro.

Norway's $1.4T sovereign wealth fund is closing its only office in China citing concerns about rising tensions between US and China. The fund held some $42B across 850 mainland China and HK companies by end-22, down from a peak of $47B in 2020.

Market outlook – Recommendations & Targets from fundamental analysis

Equities – SHANGHAI Idx: UNDERWEIGHT /// SHENZHEN Idx: UNDERWEIGHT

Bonds – Govies: UNDERWEIGHT

Forex – CNY/USD: UNDERWEIGHT (Target 7.50)