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Flash Note
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Trump asks to identify and additional US$200bn of Chinese exports for tariffs. Final decission on late August

Latest developements

- After having had a few solid trading sessions, Chinese equities fell yesterday as Washington suggested that it is moving ahead with tariffs on a further US$200bn of imports from China.
- After Friday's mutual imposition by the US and China of 25% tariffs on US$34bn of each other's goods, some local media in China pointed that there might not be immediate moves to further escalate the trade dispute. But on Tuesday, the proposed list (that President Donald Trump asked his trade representative in order to identify an additional US$200bn of Chinese exports for 10% tariffs, in retaliation for China's retaliatory tariffs), was finally published.
- The final decision to impose tariffs is likely to come in August 20-23 (after public hearings), but as some independent sources suggested me that investors -and specially authorities in Beijing-, should take Trump's threats on trade seriously.
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Why then Chinese stocks rallied in the last three days?

- Chinese local news reports suggested late last week that strict new rules on wealth management products, which are a major channel for retail investor funds in the stock market, will be delayed. Those news were likely behind Monday's 2.8% surge in Chinese stocks.
- However the delay is really a temporary respite, not a change in policy. A powerful financial regulatory commission, chaired by top economic policymaker Liu He, met last week to approve a plan for financial de-risking in China through 2020.
- This is a long-term campaign with long-term positive consequences, but could weight in stock prices the short-term.
- Growth in the shadow finance sector on which marginal borrowers depend has slowed sharply, and net new issuance of shadow finance actually turned negative in May. Of course, fears about firms' inability to refinance have sent credit spreads soaring.
- The de-risking campaign is not new in China, and didn't stop the stock market from rising in 2017 because regulators were good at limiting the impact on growth. But my impression is that investors will keep trying to

find reasons to worry that the slowdown (likely to be seen in 2H18) has not been priced in.

Outlook

- Obviously we could see regulators stepping back in their tougher regulation and de-risking policy, and could cut official rates or reduce required reserve ratios, as happened in 2014-2015, but our local sources suggest that the slowdown in growth is not likely to be bad enough to force policymakers to give up on financial de-risking and actively try to reaccelerate credit growth. As a result, it seems as if Chinese equity indices will continue to struggle.
- The confluence of factors that have been pushing Chinese stocks down – tougher financial regulation, de-risking & deleveraging campaign from Beijing, and now the conflict with the US-, will persist, and none of these factors is turning positive in the short term.
- Chinese markets remain fundamentally policy-driven, and with the trade conflict running hot and domestic financial policy staying tough, the best move could be to stay on the sidelines.

Best