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China – The current state of the nation & Outlook

Trade tensions: Trump ready to move ahead with next round of tariffs.

President Trump wants to proceed with a plan to impose tariffs on $200B. While he could potentially announce the tariffs next week, they will be implemented at a later date. Meanwhile, China's foreign minister hits back at Trump's 'irresponsible' North Korea remarks accusing Beijing of pressuring North Korea..

Reform agenda: Xi reiterates reform commitment

Taxes - The State Council unveiled new tax cuts to boost the real economy while working to ensure full implementation of all existing tax reduction measures. The incentives are expected to cut the corporate tax burden by more than CNY45B this year. The plan includes tax relief for companies under restructuring plans.

Trade - President Xi Jinping told UN Secretary-General Antonio Guterres that "China is still determined to reform and wants to work with all parties to build an open world economy". Xi made no direct mention of the trade tensions with the US, referring instead to "unilateralism and protectionism rearing its head".

Supply side reforms - China will put brakes on auto investment to ease capacity glut. Officials of the National Development and Reform Commission (NDRC) said that China will curb automakers' ability to invest in new production capacity as soon as this year. Automakers hoping to add capacity would need to have utilized factories at a higher rate than the industry average for the prior two years, and new-energy vehicles (NEV) would have to make up more of their output than the industry average.

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Economic activity: Major Banks vow to boost lending in H2.

PMI Manufacturing rose to 51.3 in August (from 51.2 in prior month). PMI Non-manufacturing also rose to 54.2 from 54.0. Although today's Caixin PMI manufacturing came in slightly below expectation (to 50.6).

Rail freight growth accelerates: According to the National Bureau of Statistics, China's railway freight volume rose 7.9% y/y in Jan-Jul period (a touch higher than the 7.7% y/y seen in June).

Banks to increase loans: According to interim reports of 26 A-share listed banks, most of the major lenders have vowed to boost lending to smaller firms and to support infrastructure investment in H2.

Q2 GDP was +6.7% y/y vs +6.8% in prior quarter.

H1 corporate profits: Broadly firmer

Listed companies in Shanghai and Shenzhen recorded an increase of 22% y/y in aggregate net profits in H1 (Wind Data). 65.6% of Chinese listed companies posted higher net profits.

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Traditional sectors such as steel, construction materials and non-ferrous metals recorded significant net profit growth of 128%, 92% and 40% respectively as a result of ongoing supply-side reforms. However, China's tech sector, profitability was sluggish as it seems unable to leverage Beijing's push to modernize the sector as government subsidies in the targeted fields begin to dry up. The electronics sector logged a 1% decline. Bank's profits rose 6.5% y/y in H1.

Financial Markets - Outlook

Debt – Foreign institutions increased their holdings for yuan-denominated bonds by CNY66.5B in July to CNY 1,612.3B, marking the 17th straight rise. However growth waned from the CNY 110.4B increase in June. Many experts expect inflows to continue unaffected by near term volatility in interest rates and currency. Meanwhile, local government bond issuance reaches two-year high (CNY882.97B in August), marking the highest since July 2016. Bond sales will remain at peak levels in September, feeding infrastructure investment, which is expected to stabilize in H2. **Outlook stable**

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Equities – Corporate profits are growing at a 22% y/y pace (on track to reach our originally projected FY 2018 19% growth). However, there has been a very strong contraction in the multiples of the Chinese indices, due to the threat of a trade war with the USA, which has led the PE ratio to levels of 11x for the Shanghai (from 14.4x in January), and 17.5x for the Shenzhen (from 25x in January). Given the circumstances in the international arena we do not think that a sudden recovery in multiples could eventually happen before December. We keep stable our projected PE for Shanghai index at 12x (target price stable at 2,977. Current market price at 2,751), but we cut our PE estimate for Shenzhen index to 18.5x (new target price is 1,552. Current market price at 1,466).