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Market Update: 2nd January 2020

Stocks Surge on Fresh Chinese Stimulus

Global stocks surged into the new year after an earlier than expected cash injection from the Chinese central bank spurred expectations for further government support in 2020, while optimism grows that trade ties with the US will improve over the year. With key risks facing the global economy in 2019 now abating, the focus is expected to turn to the health of the global economy, with the fragile Chinese outlook likely to remain in the spotlight.

Cash Injection

The People's Bank of China (PBoC) kicked off the new year by injecting fresh stimulus into the ailing Chinese economy this week, providing a fresh boost to global stocks. As key risks weighing on the global economy continue to abate, markets have started the year on an optimistic note, with stocks gaining on the announcement of fresh Chinese stimulus and optimism over a US-China trade deal, with the phase one deal now expected to be signed later this month.

In a bid to boost the Chinese economy, the PBoC is set to lower its reserve requirement ratios by 50 basis points on 6th January, aiming to boost growth and reduce borrowing costs. The move, which essentially cuts the amount of money banks are required to have on hand, is expected to release around 800 billion yuan into the economy for lending purposes, boosting the economy ahead of the Lunar New Year that falls on 25th January. In the lead up to China's most important annual holiday, companies and individuals typically require more cash to pay bonuses, clear debts and cover other expenses. While the cut was expected, the early announcement suggests that policymakers may add more liquidity in the coming weeks to meet cash demands ahead of the holiday period.

The most recent action by the central bank adds to a series of other measures taken over the last year to support growth, including cuts in key loan prime rates and reverse repo rates, and raises optimism that more targeted cuts could be on the way. During the announcement, the PBoC reinforced that it will continue to pursue a prudent and flexible monetary policy, but markets are now expecting an easier monetary policy stance in 2020. As a result, Asian and European stocks have been lifted, with US futures also pointing to a positive start to the new year.

New Direction for Markets

After months of uncertainty, markets appear to have found a new sense of direction, however analysts will be keen to see whether this will have fed through to December and January data, with mixed data and high large cap valuations still prompting the need for caution in markets. As it stands, markets appear to have priced in the majority of the good news, therefore although stock prices may continue to climb, risks remain in the large cap markets.

Going into the new year, with key risks regarding Brexit and US-China trade abating, the focus now shifts to the year ahead. Today's Chinese manufacturing data provided the first look into the health of the

Chinese economy, with the Caixin PMI dipping slightly from its November level, while remaining well in the expansionary zone. As it stands, the outlook remains fragile, with key economic indicators remaining mixed. Today's PMI data showed slowing new order growth over December while output expansion remained strong overall. Business sentiment remained weak due to concerns over trade tensions, environmental protection policies and intense market competition. In the coming months, markets are likely to remain sensitive to new data as we continue to assess the underlying health of the Chinese economy, as well as the effectiveness of government stimulus in boosting economic growth.

Despite ringing in the new year with tear gas, fires, vandalism and roadblocks, stocks in Hong Kong also started 2020 with a gain, owing to optimism over an improvement in Sino-American relations after President Trump announced that he will sign the phase one trade deal on 15th January. Pro-democracy protests are expected to continue into this year, however further progress in US-China relations would provide a boost to Hong Kong trade. The date is yet to be confirmed by the Chinese side, so there is a risk that this date could alter, however after the breakthrough in talks in December, it is expected that the phase one deal will now go ahead, making way for optimism over what a second phase deal may look like and when we can expect further progress in the negotiations.

Default Risks

After years of ramping up debt levels, Chinese companies have faced a reality check in the recent years. A de-leveraging campaign that President Xi Jinping began in 2016 to curb risks in financial markets has led to a crackdown in unregulated lending (shadow banking) and tighter rules on asset management. That made it harder for some companies to raise funds to repay existing debt, leading to a record level of bond defaults in 2018 and 2019 as economic growth slowed. Recent cuts to reserve rates have helped to manage the risk of defaults, but there are concerns over whether the stimulus measures will continue to keep default risks at bay going forward.

Positioning

While recent stimulus from the Chinese central bank has worked to improve sentiment and boost global stocks, it is clear that risks remain in the Chinese economy, therefore we would wait for further clarity on China's economic health before allocating directly to Chinese stocks. With a 6% growth target for 2020, policy is likely to remain supportive over the year to spur investment, however data suggests that economic growth continues to slow. Further progress towards a trade deal with the US will be vital to shoring up the Chinese economy, however with tariffs now being rolled back, less restrictive trade conditions and fresh stimulus should provide some much-needed reprieve for global trade and the Chinese economy.