

Macro Weekly: Fed rate cut odds climb amid viral outbreaks outside China

This week's highlights

- **Production gradually bounces back in China**

In China, daily new confirmed and suspected COVID-19 cases dropped further. The new-confirmed cases outside Hubei increased only by single digits for a couple of days (Fig 1). According to the MIIT, the production resumption rate picked up by 3.2ppt to 32.8% on 26 Feb from four days ago. The NDRC noted that progress in coastal provinces was faster, with industrial production of above-scale producers exceeding 90% in Zhejiang, and over 70% in Jiangsu, Shandong, Fujian, Liaoning, Guangdong and Jiangxi. Among key sectors, steel production recovered to 67.4% of the previous level, while non-ferrous metal producers recorded a recovery rate of 86.3%. High-frequency data including coal consumption (Fig 2) and the Baidu migration index also showed that the work resumption rate is improving gradually. However, before COVID-2019 peaks, services sector activities will likely remain sluggish.

- **China PMIs dipped in Feb due to the virus outbreak**

China's manufacturing PMI dropped to 35.7 in Feb, the lowest reading in the data's history (since 2005). Production, new orders and purchase indexes all dropped below 30. Non-manufacturing PMI was hit harder, with the services index declining to 30.1 and construction PMI falling below 30. New orders in these two sectors both weakened sharply in Feb. Among the 21 services sectors, financial services remained in expansionary territory, while telecom and IT services sectors held better than others. In contrast, transportation, accommodation, catering, tourism and household services sectors saw their activities index dropping to below 20. The NBS said it is expecting the index to rebound in Mar as production resumption picks up. In Nov 2008, China's manufacturing PMI dropped to 38.8, then recovered to above 50 in four months. We expect the manufacturing PMI to rebound to over 40 in Mar. But given the slower recovery in the non-manufacturing sector, its PMI is likely to remain soft in Mar.

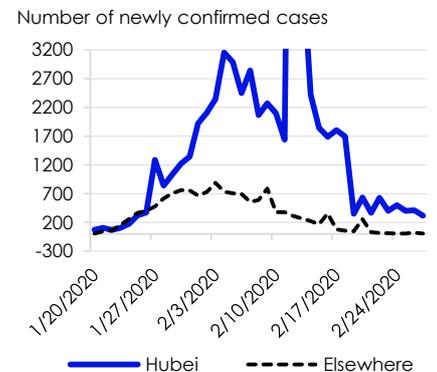
- **Fed sends dovish signal as the virus spreads outside of China**

The spreading of COVID-2019 outside China has accelerated. By Saturday, over 50 countries reported 6009 cases combined, with Korea, Japan, Italy and Iran recording more cases than elsewhere. Major stock indexes in the euro area and the US have declined by more than 10% over the past week. Credit spreads also widened. Fed Chairman Powell released a statement before market closure on Friday, saying that the central bank is closely monitoring developments of the coronavirus outbreak and will take appropriate measures to support the economy. After this remark, the 10-year UST yield sank to 1.15%. The dollar index retreated, and the RMB exchange rate strengthened slightly.

- **Chances of a Fed rate cut increases as market risks rise**

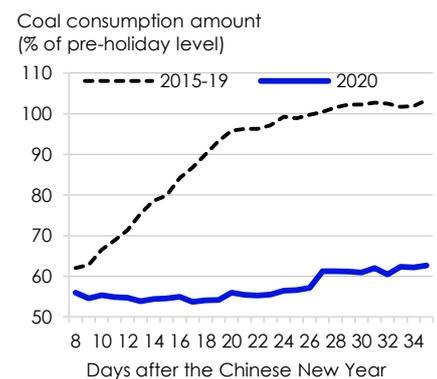
We expect the Fed to continue with its dovish message in the near-term and cut its policy rate by 25bp in Mar. Further rate cuts will depend on the evolution of the viral outbreak. In our baseline scenario, with more travel bans put in place in the US, market concerns of a pandemic risk will ease. Meanwhile, as China's production gradually normalizes, the hit to the global supply chain will be limited. The impact of the outbreak on US consumption and the labor market will likely be contained. In this scenario, we expect UST 10-year yield to rebound to around 1.5%, and rise further in 2H20F. However, if the outbreak expands and disrupts supply chains, the Fed will cut rates further, depressing the 10-year yield.

Fig 1. Newly confirmed cases in China fall further



Source: CEIC, CCBIS

Fig 2. Coal consumption by major power plants recovers to c.60% of pre-CNY level



Source: CEIC, CCBIS

Li Cui

(852) 3911 8274
cui@ccbintl.com

Claire Huang

(852) 3911 8012
clairehuang@ccbintl.com

Ying Xue

(852) 3911 8013
xueying@ccbintl.com

What's next?

• Resilient US data expected in Feb

The latest US data, including regional Fed manufacturing survey reports and job claims, shows the overall economy has been little affected by the viral outbreak so far. The upcoming labor market report and ISM will be under the spotlight given the surging rate cut expectations. The consensus forecasts a small drop of ISM manufacturing index by 0.4 to 50.5, and non-farm payrolls to maintain a solid gain of nearly 200k. Oxford Economics forecasted an additional 0.2ppt slowdown of US growth in 2020F to 1.3% if the Asian pandemic continues, and that a global pandemic will lead to a recession in the US.

• China trade growth expected to turn negative in early 2020F

We expect China's export and imports growth to decline in Jan and Feb due to the viral outbreak. Global leading indicators, including PMIs in advanced economies and Korean exports, still point to improving external demand. However, risks of the coronavirus outbreak turning into a global pandemic could endanger the Asian supply chain, adding uncertainties to the trade recovery outlook.

Table 1: Upcoming data releases and events

Date	Time	Country*	Data release	Period	Bloomberg	CCBIS	Prior
2 Mar	9:45	CH	Caixin China PMI Mfg	Feb	46	--	51.1
2 Mar	23:00	US	ISM Manufacturing	Feb	50.5	--	50.9
3 Mar	18:00	EC	CPI Core YoY	Feb P	1.2%	--	1.1%
4 Mar	23:00	US	ISM Non-Manufacturing Index	Feb	55	--	55.5
6 Mar	21:30	US	Change in Nonfarm Payrolls	Feb	175k	--	225k
6 Mar	21:30	US	Unemployment Rate	Feb	3.6%	--	3.6%
6 Mar	21:30	US	Average Hourly Earnings YoY	Feb	3.0%	--	3.1%
7 Mar		CH	Exports YoY	Feb	-23.5%	-19%	--
7 Mar		CH	Imports YoY	Feb	-14.7%	-21%	--
7 Mar		CH	Trade Balance	Feb	\$12.75b	\$5.1b	--
7 Mar		CH	Foreign Reserves	Feb	--	--	\$3,115.5b

Date	HK time	Country	Central bank speaker/event
4 Mar	3:50	US	• Fed's Mester addresses UK Society of Professional Economists
4 Mar	5:30	US	• New York Fed's Logan discusses Ample Reserves Regime
4 Mar	7:30	US	• Fed's Evans to take part in moderated Q&A
5 Mar	7:30	US	• Bullard opening remarks
6 Mar	7:30	US	• Fed's Kaplan speaks at Chicago event
6 Mar	9:00	US	• Fed's Kashkari speaks at University of Minnesota
6 Mar	9:45	US	• Fed's Williams speaks at Foreign Policy Association Dinner
7 Mar	--	US	• Fed officials to address Shadow Open Market Committee

* CH = China, EC=Euro area

Source: Bloomberg, CCBIS estimates

Rating definitions:

Outperform (O) – expected return > 10% over the next twelve months
Neutral (N) – expected return between -10% and 10% over the next twelve months
Underperform (U) – expected return < -10% over the next twelve months

Analyst certification:

The author(s) of this document, hereby declare that: (i) all of the views expressed in this document accurately reflect his/her personal views about any and all of the subject securities or issuers and were prepared in an independent manner; (ii) no part of any of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this document; and (iii) he/she receives no insider information/non-public price-sensitive information in relation to the subject securities or issuers which may influence the recommendations made by him. The author(s) of this document further confirm that (i) neither he/she nor his/her respective associate(s) (as defined in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission issued by the Hong Kong Securities and Futures Commission) has dealt in/traded or will deal in /trade the securities covered in this document in a manner contrary to his/her outstanding recommendation, or neither he/she nor his/her respective associate(s) has dealt in or traded in the securities covered in this document within 30 calendar days prior to the date of issue of this document or will so deal in or trade such securities within 3 business days after the date of issue of this document; (ii) neither he/she nor his/her respective associate(s) serves as an officer of any of the companies covered in this document; and (iii) neither he/she nor his/her respective associate(s) has any financial interests in the securities covered in this document.

Disclaimers:

This document is prepared by CCB International Securities Limited. CCB International Securities Limited is a wholly-owned subsidiary of CCB International (Holdings) Limited ("CCBIH") and China Construction Bank Corporation ("CCB"). Information herein has been obtained from sources believed to be reliable but CCB International Securities Limited, its affiliates and/or subsidiaries (collectively "CCBIS") do not guarantee, represent and warrant (either express or implied) its completeness or accuracy or appropriateness for any purpose or any person whatsoever. Opinions and estimates constitute our judgment as of the date of this document and are subject to change without notice. CCBIS seeks to update its research as appropriate, but various regulations may prevent it from doing so. Besides certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate according to the analyst's judgment. Forecasts, projections and valuations are inherently speculative in nature and may be based on a number of contingencies. Readers should not regard the inclusion of any forecasts, projections and valuations in this document as a representation or warranty by or on behalf of CCBIS that these forecasts, projections or valuations or their underlying assumptions will be achieved. Investment involves risk and past performance is not indicative of future results. Information in this document is not intended to constitute or be construed as legal, financial, accounting, business, investment, tax or any professional advice for any prospective investors and should not be relied upon in that regard. This document is for informational purposes only and should not be treated as an offer or solicitation for the purchase or sale of any products, investments, securities, trading strategies or financial instruments of any kind in any jurisdiction. CCBIS makes no representations on the availability of the securities covered in this document (or related investment) to the recipients. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Neither CCBIS nor any other persons accept any liability whatsoever for any loss or damages (whether direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential) arising from any use of this document or its contents or otherwise arising in connection therewith. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. The opinions and recommendations herein do not take into account prospective investors' financial circumstances, investment objectives, or particular needs and are not intended as recommendations of particular securities, financial instruments or strategies to any prospective investors. The recipients of this document should consider this document as only a single factor in making their investment decision and shall be solely responsible for making their own independent investigation of the business, financial condition and prospects of companies referred to in this document. Readers are cautioned that (i) the price and value of securities referred to in this document and the income derived from them may fluctuate; (ii) past performance is not a guide to future performance; (iii) any analysis, ratings and recommendations made in this document are intended for long-term (at least for 12 months) and is not linked to a near-term assessment of the likely performance of the securities or companies in question. In any event, future actual results may differ materially from those set forth in any forward-looking statements herein; (iv) future returns are not guaranteed, and a loss of original capital may occur; and (v) fluctuations in exchange rates may adversely affect the value, price or income of any security or related instrument referred to in this document. It should be noted that this document covers only those securities or companies as specified herein and does not extend to any derivative instruments thereof, the value of which may be affected by many factors and may not correspond with the value of the underlying securities. Trading in these instruments is considered risky and are not suitable for all investors. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forward-looking statements, opinions and expectations contained herein are based on fair and reasonable assumptions, CCBIS has not been able to verify independently such facts or assumptions and CCBIS shall not be liable for the accuracy, completeness or correctness thereof and no representation or warranty is made, express or implied, in this regard. All pricing referred to in this document is as of the close of local market for the securities discussed, unless otherwise stated and for information purposes only. There is no representation that any transaction can or could have been effected at those prices, and any prices do not necessarily reflect CCBIS' internal books and records or theoretical model-based valuations and may be based on certain assumptions. Different assumptions could result in substantially different results.

Any statements which may be contained herein attributed to a third-party represent CCBIS' interpretation of the data, information and/or opinions provided by that third party either publicly or through a subscription service, and such use and interpretation have not been reviewed or endorsed by the third party. Reproduction and distribution of these third party contents in any form is prohibited except with the prior written consent of such third party. The recipients must make their own assessments of the relevance, accuracy and adequacy of the information contained in this document and make such independent investigation as they may consider necessary or appropriate for such purpose. Recipients should seek independent legal, financial, accounting, business, investment and/or tax advice if they have any doubt about the contents of this document and satisfy themselves prior to making any investment decision that such investment is in line with their own investment objectives and horizons. Use of hyperlinks to other internet sites or resources (if any) as referred to in this document is at users' own risk. They are provided solely for the purpose of convenience and

information and the content of these internet sites or resources does not in any way form part of this document. The contents, accuracy, opinion expressed, and other links provided at these sites are not investigated, verified, monitored, or endorsed by CCBIS. CCBIS expressly disclaims any responsibility for and does not guarantee, represent and warrant (either express or implied) the completeness, accuracy, appropriateness, availability or security of information found on these websites. Users of these websites are solely responsible for making all enquiries, investigation and risk assessment before proceeding with any online or offline access or transaction with any of these third parties. All activities conducted by users via or at these websites are at their own risk. CCBIS does not guarantee the security of any information users may forward or be requested to provide to any third parties via these websites. Users are deemed to have irrevocably waived any claims against CCBIS for any loss or damage suffered as a result of any access to or interaction with any of these websites. Upon request CCBIS may provide specialized research products or services to certain customers focusing on the prospects for specific securities as compared with other covered securities over varying time horizons or under differing market conditions. While the views expressed in these situations may not always be directionally consistent with the long-term views expressed in the analyst's published research, CCBIS has procedures in place to prevent selective disclosure and will update the relevant readers when our views has changed. CCBIS also has procedures in place to identify and manage potential conflicts of interest that may arise in connection with its research business and services. Chinese Wall procedures are also in place to ensure that any confidential and/or price sensitive information is properly handled. CCBIS will use its best endeavors to comply with the relevant laws and regulations in this respect. Nevertheless, the recipients should be aware that CCB, CCBIS, their affiliates and/or their officers, directors and employees may do business with the issuer(s) of the securities covered in this document, including investment banking business or direct investment business or may hold interest in (and/or later add or dispose) such securities (or in any related investment) for themselves and/or on behalf of their clients from time to time. As a result, investors should be aware that CCBIS may have a conflict of interest that could affect the objectivity of this document and CCBIS will not assume any responsibility in respect thereof. Further, the information contained herein may differ or be contrary to opinions expressed by other associates of CCBIS or other members of the CCB or CCBIH group of companies. Where this document refers to any products, investments, securities, financial instruments or industry sectors, this is for the information of the institutional and professional customers of CCBIS only and this document should not be distributed to retail customers. This document is not directed at you if CCBIS is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that CCBIS is permitted to provide research material concerning investments to you and that you are permitted and entitled to receive and read the document under relevant legislation and regulations.

In particular, this document is only distributed to certain US Persons to whom CCBIS is permitted to distribute according to US securities laws, but cannot otherwise be distributed or transmitted, whether directly or indirectly, into the US or to any other US person. Any US person (as defined under the Exchange Act or the U.S. Internal Revenue Code of 1986, as amended) who is a recipient of this material wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided herein should direct such transaction exclusively to and such transaction shall be effected only through CCB International Overseas (USA), Inc. This document also cannot be distributed or transmitted, whether directly or indirectly, into Japan and Canada and not to the general public in the People's Republic of China (for the purpose of this document, excluding Hong Kong, Macau and Taiwan) unless under applicable laws. Any unauthorized reproduction or redistribution by any means to any persons, in whole or in part of this document is strictly prohibited and CCBIS accepts no liability whatsoever for the actions of third parties in distributing this research report. If this document has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. CCBIS therefore does not accept liability for any errors or omissions in the contents of this document, which may arise as a result of electronic transmission. The disclosures contained in this document prepared by CCBIS shall be governed by and construed in accordance with the laws of Hong Kong.

Distribution in Singapore: The information/research herein is prepared by CCB International Securities Limited ("CCBIS"), a foreign affiliate of CCB International (Singapore) Pte Ltd ("CCBISG") (Co. Reg. No. 201531408W). CCBISG holds a capital markets services license from the Monetary Authority of Singapore for fund management, dealing in capital market products (specifically securities and collective investment schemes) and providing custodial services, and is an Exempt Financial Adviser under the Financial Advisers Act in respect of advising others by issuing or promulgating research analysis or research reports. CCBIS may distribute information/research pursuant to an arrangement with CCBISG under Regulation 32C of the Financial Advisers Regulations. CCBIS is licensed in Hong Kong to provide such information/research reports. Singapore recipients should contact CCBISG at +65-68071880 for matters arising from, or in connection with the information distributed.

Copyright 2020 CCBIS. The signs, logos and insignia used in this research report and the company name "CCB International Securities Limited" are the registered and unregistered trademarks of CCB, CCBIH and/or CCBIS. All rights are hereby reserved. All material presented in this document, unless indicated otherwise, is under copyright to CCBIS. This document or any portion hereof may not be reproduced, sold or redistributed without the written consent of CCBIS.

CCB International Securities Limited
12/F, CCB Tower, 3 Connaught Road, Central, Hong Kong
Tel: (852) 3911 8000 / Fax: (852) 2537 0097