

CCBI Securities | Research

Economic Update

How will the Coronavirus affect the US bond yield?

Some downside pressure on China and the world due to the coronavirus is unavoidable in the near-term. Our base case for China is that growth will weaken 1 ppt to 5.0% YoY in 1Q20F and by 0.4 ppt to 5.7% in 2020F. If containment of the virus takes longer than expected (i.e. beyond 1Q) growth could ease to 4.0% in 1Q and 5.4% in 2020F. Developments so far suggest our base case is the more likely outcome.

Global economic impact will be relatively mild and short-lived, with travel and manufacturing supply chain the main impacted areas, reducing global growth by 0.3 ppt in 1Q20F and 0.1 ppt in 2020F. We expect the global manufacturing recovery to be delayed but not derailed, even though the auto sector may experience some disruption in the near-term due to delayed factory operations in Hubei.

We do not expect the Fed to cut rates due to the virus. It is rare for epidemics to affect Fed monetary policy decisions unless their spread has direct bearing on the economy. The impact of the coronavirus on US growth will be comparatively smaller than the rest of the world.

We expect the 10-year UST in 1Q20F to hover around 1.5-1.8% due in part to concerns about the virus' spread. Once the outbreak is contained, we would expect the rate market to focus on fundamentals that support a modest recovery in the manufacturing sector and a slight pickup in inflation. We lower our average 10-year UST yield forecast for 1Q20F to 1.8% from 2.0%, but continue to expect a gradual rise in rates throughout the remainder of the year. Please refer to [Table 1](#) (page 5) for detailed forecasts.

Claire Huang

(852) 3911 8012
clairehuang@ccbintl.com

Li Cui

(852) 3911 8274
cui.li@ccbintl.com

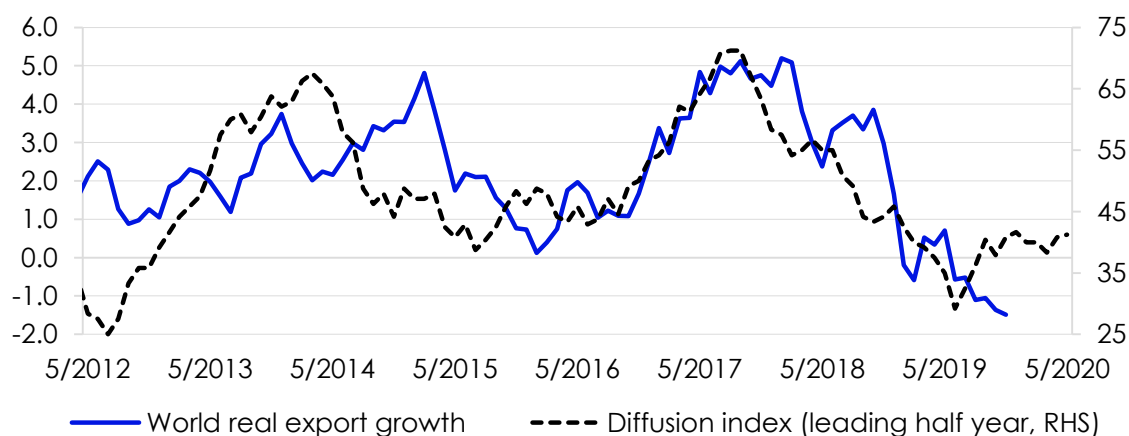
Ying Xue

(852) 3911 8013
xueying@ccbintl.com

Economic development early in the year was largely in-line with our forecasts: global manufacturing and trade picked up since 4Q19 led by the auto and IT sectors. Although the latest PMI reports from across the world and our global trade leading indicator mainly reflect data prior to the virus outbreak, they point to further improvement in global trade and manufacturing sentiment in coming months (Fig 1).

The spread of the coronavirus has heightened near-term downside risk to the global economy. Our base case for China is that growth will weaken 1 ppt to 5.0% YoY in 1Q20F and by 0.4 ppt to 5.7% in 2020F. Developments so far continue to support this relatively optimistic view. However, we remain wary of the possibility of a prolonged outbreak, with the number of new cases peaking in early 2Q20 instead of in 1Q20 as in our base case. In the event of a prolonged outbreak, we estimate growth in China would decelerate to 4.5% YoY in 1Q20F before beginning a slow recovery to around 5.0% in 2Q20, which would drag full-year growth down to 5.4%.

Fig 1: Global leading indicator suggests trade recovery is on track

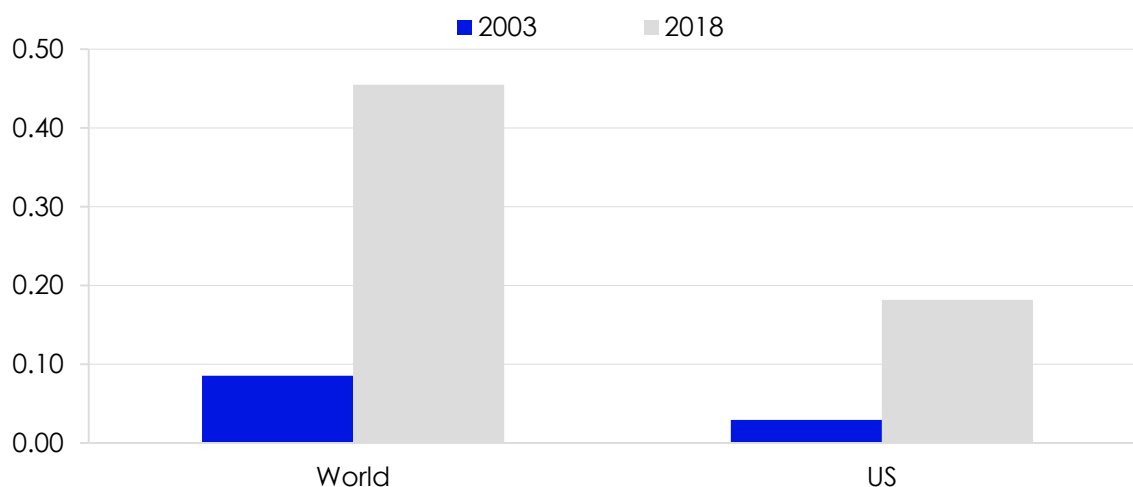


Source: CPB, CEIC, CCBIS

Global travel feels the brunt

The two main implications of the coronavirus for the world economy are a sharp decline in global travel and tourism, a delayed recovery in the manufacturing sector which could lead to disruptions in global supply chains, especially in the case of Chinese-made components, which may not be easily substituted in the short-term. We examine these implications in turn.

- Effect of the virus on transport and travel services is significant.** China's transport and travel services imports from the rest of the world account for 0.45% of global GDP, five times higher than during the SARS outbreak. US services exports to China also increased significantly since 2003, with US transport and travel services to China together representing nearly 0.2% of US GDP (Fig 2). In the wake of the coronavirus outbreak, cancelled flights and broad-scale travel bans will likely lead to a dramatic reduction in global travel flows in 1Q. Considering Chinese international travels might nosedive in Feb and start to recover somewhat in Mar, we estimate a 50% decline in Chinese travel on its own will reduce global and US growth by 0.2 ppt and 0.1 ppt, respectively, in 1Q20F, but would have a more moderate impact on annual growth were travel to recover in subsequent quarters.

Fig 2: Global and US transportation and travel services exports to China, % of GDP

Source: CEIC, IMF, CCBIS

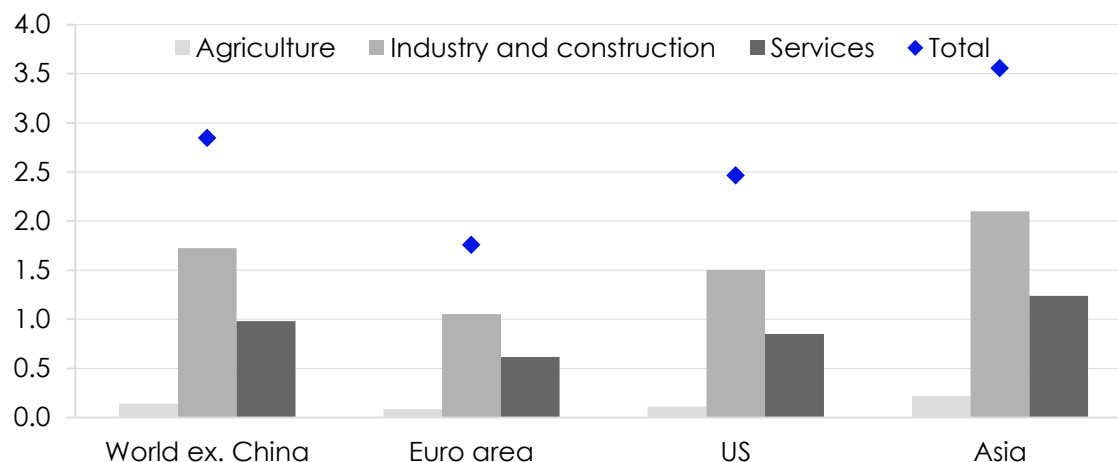
- Manufacturing sector will see a delayed but not derailed recovery.** Reduced working days and difficulties returning to work is causing partial suspension of manufacturing and construction activities in China. Under our baseline scenario, a timely containment of the coronavirus will see economic activity bounce back as early as Mar. The progress of production recovery after the Lantern Festival will be critical. Anecdotal evidence suggests major high tech firms and capital-intensive sectors have been able to weather the supply disruptions so far while maintaining production of key parts and components.¹ The auto sector (for which Hubei is a key production center), may suffer more from disruptions to production, even under our baseline scenario, but it is not expected derail the recovery.

We also expect the rest of the world to refrain from imposing large-scale trade restrictions on China in addition to the travel bans already in place². Thus, the impact on merchandise trade is likely to be confined to 1Q20F.

On net, small global impact on a full-year basis. We estimate a 1 ppt decline in growth for China in 1Q20F and a 0.3 ppt decline in 2020F would chip 0.3 ppt away from global growth in 1Q20F and 0.1 ppt in 2020F. We estimate the impact on US growth would be smaller, at 0.2 ppt in 1Q20F and less than 0.1 ppt for the full year due to the US' relatively low exposure to China final demand (Fig 3). The just-signed phase-one trade deal should also mitigate the negative impact on growth for the full-year.

¹ Most smartphone producers are based outside of Hubei

² Macro Weekly: [Chinese production to gradually resume after the Lantern Festival](#) (9 Feb 2020)

Fig 3: Sector breakdown of value-added exposure to China**Value-added share in China's final demand**

Source: OECD TiVA, CCBIS

Global rates expected to climb back up as Fed remains calm

Latest US data indicates solid domestic consumption and healthy job picture. ISM indexes and most regional surveys point to a strong rebound in sentiment surrounding the manufacturing sector in Jan. For example, the Manufacturing ISM New Order Index recently recorded its strongest reading since mid-2019, indicating solid domestic demand. Meanwhile, job market data remained buoyant in Jan, supporting private consumption and moderate wage expansion and inflation. In short, the US economy is well positioned for forthcoming downside shocks from the coronavirus should they arise.

We do not expect the Fed to cut the rate this year. At the end of Jan, market risk aversion pushed up policy rate cut expectations in the rates futures market. Based on previous experience, an epidemic or other health scare rarely directly affects Fed actions unless the risks had spread to the US economy. For instance, though the H1N1 flu of 2009 had a much more severe impact on the US population than has the coronavirus, the Fed at the time nevertheless held rates unchanged. During the SARS epidemic the Fed cut rates in Jun 2003 when the virus was already petering out, and the Fed did so because of domestic low inflation, not because of SARS.

Fundamentals support yields to increase again. Fear has played a major role in the recent decline in rates, evident in the fact that long-term yields mirrored the movements in overnight rate futures. We expect the Fed to stay on hold this year, but the rate market to keep a rate cut pricing until the outbreak is under control. We would expect the rate market to turn its focus back to the fundamentals once the outbreak is contained. A modest recovery in the manufacturing sector and a slight pickup in inflation will lend supports to an increase of bond yields throughout the rest of the year.

Table 1: US economic assumptions and forecasts

	3Q19	4Q19	1Q20F	2Q20F	3Q20F	4Q20F
US Fed fund target range (EOP %)	1.75-2.00	1.50-1.75	1.50-1.75	1.50-1.75	1.50-1.75	1.50-1.75
US 10-year bond yield (avg %)	1.7	1.8	1.8	1.9	2.0	2.1

Source: Bloomberg, CEIC, 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