

# China's state-capitalism model remains intact

By Gustavo Medeiros

Chinese stocks sold-off after the government announced regulatory measures to the educational sector and Shanghai hiked mortgage rates. Hungary hiked policy rates by a larger magnitude than expected. India's goods and services tax collections were better than expected in June. Economic data decelerated in South Korea. Brazilian current account surplus disappointed, while South Africa and Mexico's trade surplus and Thailand's current account deficit were better than expected. Russia's construction activity picked up, and the unemployment rate dropped in Russia and Chile. Turkey consumer confidence increased.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)	Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
MSCI EM	12.8	–	-2.49%	S&P 500	20.2	–	-0.35%
MSCI EM Small Cap	12.0	–	-0.79%	1-3yr UST	0.18%	–	0.05%
MSCI Frontier	11.7	–	1.87%	3-5yr UST	0.69%	–	0.12%
MSCI Asia	14.2	–	-3.22%	7-10yr UST	1.23%	–	0.44%
Shanghai Composite	11.3	–	-4.19%	10yr+ UST	1.91%	–	0.69%
Hong Kong Hang Seng	9.0	–	-6.16%	10yr+ Germany	-0.46%	–	0.78%
MSCI EMEA	9.9	–	2.06%	10yr+ Japan	0.64%	–	0.15%
MSCI Latam	9.3	–	-1.03%	US HY	3.88%	294 bps	0.06%
GBI-EM-GD	4.92%	–	0.73%	European HY	3.15%	357 bps	0.17%
China GBI-EM GD	2.94%	–	0.70%	Bloomberg-Barclays	0.99%	-24 bps	0.61%
ELMI+	2.91%	–	0.61%	VIX Index*	18.24	–	1.04%
EM FX spot	–	–	0.55%	DXI Index*	92.08	–	-0.57%
EMBI GD	4.88%	357 bps	0.00%	EURUSD	1.187	–	0.52%
EMBI GD IG	3.08%	171 bps	-0.09%	USDJPY	109.67	–	0.59%
EMBI GD HY	6.97%	571 bps	0.09%	CRY Index*	218.1	–	1.48%
CEMBI BD	4.27%	318 bps	-0.15%	Brent	74.5	–	-0.03%
CEMBI BD IG	2.91%	183 bps	0.00%	Gold	1,809	–	0.52%
CEMBI BD HY	5.91%	480 bps	-0.34%	Bitcoin	39,686	–	-1.12%

Note: Additional benchmark performance data is provided at the end of this document. \*See last page for index definitions.

## Emerging Markets

**China:** Chinese stocks came under pressure last week after Xinhua news reported that China banned for-profit tutoring in core school subjects and kept restrictive measures in the real estate sector. Mortgage rates for first-time buyers in Shanghai rose 35bps to 5.0% while second home mortgages rose 45bps to 5.7%. Higher mortgage rates are likely to be applied to other tier-one and tier-two cities. In the educational sector, China banned curriculum-based tutoring institutions from raising money in capital markets and receiving foreign investment. Last week's price-action in Chinese stocks suggests the market expects similar measures across other sectors, which is farfetched, in our view. Adjusting policy to fast-evolving strategic sectors does not mean that China's state-capitalist system has changed. The educational sector policies aim to reduce the financial burden for families and students while the higher mortgage rate aims to avoid exuberant valuations in the housing market. The regulations are coherent with China's policy objectives to promote sustainable and inclusive growth, reduce inequality as well as increase the birth rate (three-child policy) by lowering the cost of child-care, education and healthcare.

In other policy news, the Politburo of the communist party released a memo where it recognises that the global Covid-19 situation continues to evolve, complicating the external environment. The statement noticed domestic GDP growth recovery is no longer on solid ground. Therefore, the politburo pledged more fiscal policy stimulus (except for targeted sectors like property and high emission industries) via issuance or local government bonds to fund real projects. In economic news, industrial profits moderated to a two-year compound rate of growth of 20.6% in the first half of 2021, 1.1% lower than the January to May period. The official manufacturing and non-manufacturing purchasing manager index (PMI) fell 0.4 to 50.4 and 0.2 to 53.3 respectively, slightly below consensus expectations.

## Emerging Markets

**Hungary:** The central bank hiked both deposit and lending policy rates by 30bps to 0.25% and 1.20% respectively, 10bps higher than consensus. The statement following the decision was hawkish as the committee finds it reasonable “to keep policy rate increases, taking firm steps on a monthly basis to ensure price stability”. In other news, the unemployment rate rose by 0.1% in June to 4.0% while the yoy rate of wage growth declined 1.9% to 8.2%. Consumer confidence declined 2.4 to -16.9 while business confidence rose 2.3 to 4.4.

**India:** The collection of goods and services tax rose 25% in July to INR 1.6trn, despite a patch of soft economic data due to mobility restrictions imposed by Covid-19. Better mobility should allow for higher tax collections ahead. A Bloomberg survey with 40 economists expects real GDP growth at 9.2% in fiscal year 2022 (March 2021 to March 2022), 20bps higher than previous week, which represents the first rate of improvement since the second wave of Covid-19 virus.

**South Korea:** Real GDP growth slowed to 0.7% qoq in Q2 2021 from 2.0% qoq in Q1 2021. Consumer confidence dropped to 103.2 in July from 110.3 in June, while manufacturing confidence survey dropped to 92 in August from 99 in July. Industrial production rose 2.2% in June after declining 1.0% in May, better than expectation. In other news, the trade surplus narrowed to USD 2.2bn in June from USD 4.1bn on average in May as exports declined 2.7% mom and imports were stable from the previous month.

**Brazil:** The current account surplus moderated to USD 2.8bn in June from USD 3.1bn in May and foreign direct investment dropped to USD 0.2bn from USD 1.2bn over the same period. The primary deficit widened to BRL 65.5bn in June, from BRL 15.5bn in May as the net debt to GDP ratio rose 1.2% to 60.9% over the same period. The labour market improved faster than expected with 309k jobs created in June from 281k in May, as the unemployment rate declined 0.1% to 14.6%. The yoy rate of producer price inflation (PPI) declined 2.0% to 33.8% in July.

**South Africa:** The trade surplus improved to ZAR 57.7bn in June from ZAR 54.6bn in May while the budget balance improved to ZAR 63.1bn surplus from ZAR 5.4bn deficit over the same period, the best result for the month in 17 years. The government reached a deal with trade unions representing most public servants to increase salaries by 1.5%, slightly above the 1.2% expected in the budget. The yoy rate of PPI inflation rose to 7.7% in June from 7.4% yoy in May, 0.4% higher than expectation.

**Mexico:** The trade surplus rose to USD 762m in June from USD 340m in May while the budget deficit deteriorated to MXN 231bn from MXN 113bn over the same period (in line with seasonal patterns). The yoy rate of economic activity growth measured by the Indicador Global de Actividade Economica (IGAE) rose to 25.2% in May from 22.3% yoy in April. Unemployment rate was unchanged at 4.0% in June.

**Thailand:** The current account deficit improved to USD 1.3bn in June from USD 2.6bn in May, as the trade surplus rose to USD 3.9bn from 3.4bn over the same period, both better than expected. Manufacturing production declined to a yoy growth rate of 17.6% in June from 25.7% yoy in May, lower than expectations.

**Russia:** The yoy rate of construction contracts surged 15.7% in June from 7.7% yoy in May while the yoy real growth rate of retail sales declined to 10.9% from 27.2% yoy over the same period. The unemployment rate inched 0.1% down to 4.8% in June. Wage inflation decelerated to a yoy rate of 3.3% in May from 7.8% yoy in April.

**Chile:** The unemployment rate dropped 0.5% to 9.5% in June. The yoy rate of retail sales slowed to 65.6% in June from 72.1% yoy in May while manufacturing improved to 14.6% yoy from 8.9% yoy and industrial production rose to 6.0% yoy from 3.5% yoy over the same period. A Bloomberg survey of 19 economists expected real GDP growth at 8.0% in 2021 from 6.9% prior and CPI inflation at 3.6% from 3.5% prior.

**Turkey:** The Economic Confidence Index rose to 100.1 in July from 97.8 in June. The trade deficit was unchanged at USD 4.1bn in June, which was wider than USD 2.9bn consensus expectations. In geopolitical news, thousands of Afghans are crossing the border to Turkey every week seeking refuge from the Taliban, which seized large parts of countryside territory ahead of the deadline for the withdrawal of US troops on 31 August.

### Snippets:

- **Angola:** Foreign exchange (FX) reserves rose to USD 8.3bn in June from USD 8.0bn in May.
- **Argentina:** Consumer confidence rose 3.3 points to 37.9, still below the last 10-year average of 44.2.
- **Colombia:** The central bank kept the policy rate unchanged at 1.75%, but two out of seven monetary policy committee members voted for a 25bps hike. Policymakers upgraded the 2021 GDP growth forecast to 7.5% from 6.5%.
- **Czech Republic:** Consumer and business confidence declined to 8.4 in July from 13.0 in June. The yoy rate of real GDP growth rose 7.8% in Q2 2021 from -2.4% yoy in Q1 2021, which was 1.4% higher than consensus expectations.
- **Egypt:** The primary surplus improved to 1.4% of GDP in fiscal year 2020-21, 0.5% higher than the government target.
- **Ghana:** The central bank kept its policy rate unchanged at 13.5%, in line with consensus.

## Emerging Markets

- **Greece:** The unemployment rate declined to 15.9% in May from 17.1% in April.
- **Indonesia:** The yoy rate of CPI inflation rose 0.2% to 1.5% in July, while core CPI declined 0.1% to 1.4% yoy, both in line with consensus expectations.
- **Malaysia:** The trade surplus improved to MYR 22.2bn in June from MYR 13.7bn in May as exports and imports rose by a yoy rate of 27.2% and 32.1%, significantly higher than consensus expectations.
- **Nigeria:** The central bank kept its policy rate unchanged at 11.5%, as expected
- **Pakistan:** The central bank kept its policy rate unchanged at 7.0%, in line with consensus.
- **Peru:** President Pedro Castillo appointed Pedro Francke as Finance Minister after not including him in the original cabinet announcement. The rest of the cabinet was less centrist than expected with Guido Bellindo, a member of the Marxist Party, appointed as Prime Minister.
- **Philippines:** The fiscal deficit improved to PHP 150bn in June from PHP 200bn in May while the balance of payments narrowed to a USD 0.3bn deficit from USD 1.4bn over the same period.
- **Poland:** The cumulative budget surplus rose to PLN 28.0bn in June from 9.4bn in May, better than the last 5-year seasonal pattern. The yoy rate of CPI inflation rose to 5.0% in July from 4.4% in June, 0.3% higher than consensus expectations.
- **Qatar:** The trade surplus rose USD 0.1bn to USD 16.7bn in June.
- **Romania:** The unemployment rate dropped 0.2% to 5.2% in June.
- **Taiwan:** The yoy rate of real GDP growth slowed to 7.5% in Q2 2021 from 8.9% yoy in Q1 2021, higher than consensus expectations.
- **Uruguay:** The unemployment rate declined to 9.4% in June from 10.2% in May while the yoy rate of PPI inflation dropped to 14.1% in July from 15.5% yoy in June.

## Global backdrop

**Coronavirus:** The number of Covid-19 cases declined sharply in the United Kingdom (UK) from 703 cases per million people on a 7-day moving average (7d ma) on 20 July to 397 cases per million on 31 July. Importantly, the number of deaths per million only rose to 1.1 on a 7d ma on 31 July, much lower than 18 deaths per million at the peak of the second wave in January 2021. In contrast, the number of cases per million on a 7d ma is rising fast in the United States (US) to 237 on 31 July from only 38 cases per million on 30 June. The rise in cases is concerning as the US has vaccinated a smaller share of its population (57% of which 49% fully vaccinated) than the UK (69% of which 56% with two jabs).

In EM, Covid-19 cases continued to decline across Latin America (except for Mexico where cases are creeping up from a low basis) and remained at very low levels across Eastern Europe. Within Asia, cases started to decline in Indonesia and stabilised at a low plateau around 30 cases per million (7d ma) in India and the Philippines at 60 cases per million (7d ma). Cases are rising fast in Malaysia to 516 cases per million on a 7d ma, more than twice the level of the second wave at the end of May 2021 whereas cases seem to be stabilising in Vietnam after restrictive mobility measures adopted by the country. EM is still accelerating its vaccination pace with 50% of the Brazilian population inoculated with at least one jab, while Indonesia pledged to vaccinate 2.5 million per day (c. 1% of population) in August and September.

**United States:** Economic activity data surprised to the downside as the Citibank Economic Surprise index declined to -13.8 on the 30 July from +8.7 in the previous week. Initial jobless claims declined only 24k to 400k in the week of 24 July while continuing claims were unchanged at 3.3 million in the week ending on 17 July. The yoy rate of real GDP growth rose 0.2% to 6.5% in Q2 2021, which was 1.9% below consensus expectations. Surveys of economic activity were only marginally higher in July as the University of Michigan rose 0.4 to 81.2, the Conference Board consumer confidence inched 0.2 higher to 129.1 and the Richmond Fed manufacturing survey went up by 1 point to 27. Durable goods orders rose 0.8% in June after increasing 3.2% in May. Housing market data was mixed as pending home sales declined 1.9% (vs. unchanged estimates) and new home sales declined 6.6% in June (vs. +3.5% expected), but mortgage applications rose 5.7% in the week of 23 July after declining 4.0% in the previous week.

In other news, the Federal Reserve (Fed) kept the policy rate and the pace of quantitative easing (QE) unchanged. The statement following the meeting had a slightly hawkish angle, signalling the 22 September meeting is 'live' for tapering QE, but Chairman Jay Powell struck a more dovish tone when answering questions from the press.

**Eurozone:** Consumer confidence was unchanged at -4.4 in July while economic confidence improved to 119.0 from 117.9 in June, better than expectations. The yoy rate of core CPI inflation declined to 0.7% in July from 0.9% in June, in line with consensus. The unemployment rate declined to 7.7% in June from 8.0% in May, 0.2% better than consensus. In Germany, the IFO Expectations survey declined to 101.2 in July from 103.7 in June while IFO Business Climate declined 0.9 to 100.8 over the same period.

**Japan:** The yoy rate of industrial production rose to 22.6% in June from 21.1% in May, better than consensus expectations. Retail sales rose 3.1% in June after declining 0.4% in May.

## Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-6.69%	-6.69%	0.28%	20.97%	8.28%	10.73%
MSCI EM Small Cap	-1.29%	-1.29%	18.33%	48.23%	11.65%	10.89%
MSCI Frontier	-0.26%	-0.26%	14.70%	39.18%	7.56%	9.08%
MSCI Asia	-7.47%	-7.47%	-1.55%	19.36%	9.32%	11.95%
Shanghai Composite	-4.56%	-4.56%	-0.33%	4.80%	8.17%	5.00%
Hong Kong Hang Seng	-12.79%	-12.79%	-12.20%	-5.54%	-2.48%	4.26%
MSCI EMEA	0.12%	0.12%	16.32%	33.68%	4.47%	6.41%
MSCI Latam	-4.05%	-4.05%	4.63%	25.63%	0.92%	4.21%
GBI-EM-GD	-0.43%	-0.43%	-3.79%	3.00%	3.32%	3.03%
China GBI-EM GD	1.68%	1.68%	4.83%	12.27%	na	na
ELMI+	-0.51%	-0.51%	-1.11%	4.39%	1.64%	2.15%
EM FX spot	-1.16%	-1.16%	-2.71%	1.50%	-3.74%	-3.01%
EMBI GD	0.42%	0.42%	-0.25%	4.11%	5.96%	4.57%
EMBI GD IG	0.48%	0.48%	-1.99%	-0.66%	7.51%	4.92%
EMBI GD HY	0.35%	0.35%	1.77%	10.06%	4.20%	4.12%
CEMBI BD	0.22%	0.22%	1.50%	6.44%	7.07%	5.50%
CEMBI BD IG	0.55%	0.55%	0.41%	3.45%	6.89%	4.76%
CEMBI BD HY	-0.22%	-0.22%	2.97%	10.67%	7.28%	6.63%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	2.38%	2.38%	17.98%	36.43%	18.14%	17.31%
1-3yr UST	0.17%	0.17%	0.08%	0.13%	2.78%	1.64%
3-5yr UST	0.72%	0.72%	-0.33%	-0.47%	4.51%	2.20%
7-10yr UST	2.01%	2.01%	-1.44%	-3.30%	6.78%	2.63%
10yr+ UST	3.65%	3.65%	-4.56%	-11.08%	9.83%	3.48%
10yr+ Germany	4.64%	4.64%	-2.46%	-1.56%	6.15%	2.01%
10yr+ Japan	1.03%	1.03%	0.72%	0.29%	1.46%	-0.01%
US HY	0.38%	0.38%	4.01%	10.62%	7.19%	6.98%
European HY	0.41%	0.41%	3.90%	10.87%	4.12%	4.35%
Bloomberg-Barclays Agg	1.33%	1.33%	-1.92%	0.78%	4.74%	2.45%
VIX Index*	0.00%	15.22%	-19.82%	-25.43%	49.63%	36.42%
DXY Index*	-0.10%	-0.38%	2.39%	-1.36%	-3.24%	-3.14%
CRY Index*	0.00%	2.20%	29.97%	51.77%	13.20%	22.99%
EURUSD	0.03%	0.20%	-2.88%	1.06%	2.27%	5.79%
USDJPY	0.05%	1.29%	-5.81%	-3.26%	1.78%	-8.12%
Brent	-2.42%	-0.87%	43.78%	72.01%	1.40%	78.18%
Gold	-0.29%	2.07%	-4.51%	-8.21%	49.06%	32.53%
Bitcoin	-3.93%	16.26%	38.82%	254.03%	424.26%	6,533.60%

\*VIX Index = Chicago Board Options Exchange SPX Volatility Index. \*DXY Index = The Dollar Index. \*CRY Index = Thomson Reuters / CoreCommodity CRM Commodity Index.

Source: Bloomberg, JP Morgan, Barclays, Merrill Lynch, Chicago Board Options Exchange, Thomson Reuters, MSCI, total returns.

Figures for more than one year are annualised other than in the case of currencies, commodities and the VIX, DX Y and CRY which are shown as percentage change.

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