

## BREXIT on China

### *The aftermath of the UK's EU Referendum*

#### Background

UK 52% to 48% vote to leave the EU marked a major set-back of globalization. It even hinted rising populism globally and could have huge impact on geo-political landscape both in the EU and across the Atlantic. Though less direct, BREXIT's implication on China could be complicated and for years to come, namely in the following three facets.

- China Macro
- RMB
- Domestic Capital Markets

#### China Marco

China being one of the biggest beneficiaries of globalization in the past few decades may be hurt in terms of export and investment once globalization were to be put in the reverse gear. Precedents from the EU financial crisis in 2011-2012 point to immediate negative impact on export and GDP growth as well as longer-term and more severe damages as the contagion spreads. ([Exhibit 1](#))

Exhibit 1: China's export and GDP growth will be hurt by BREXIT

	Base Scenario	Risk Scenario	Spill Over Scenario
EU GDP Growth	-1%	-2%	
China's Export to EU	-5.50%	-11%	
China's Total Export	-1%	-2%	-5%
China GDP Growth	-0.20%	-0.40%	-1%

Source: CICC

China has strong ties with EU and UK in trades and capital flows.

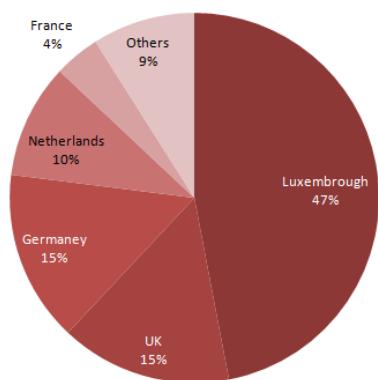
In 2014, China's outbound direct investment (ODI) in EU totaled 9.8 Billion USD (8% of China's total ODI), of which 1.5 Billion USD, or 1.5% of China's total ODI, went to UK.

On the inbound side, EU's 6.85 Billion FDI in China represented 5.7% of China's Total FDI, whereas UK represented 0.74 Billion USD, or 0.6% of total FDI. In 2015, China announced over 700 overseas M&As, of which 31 involved UK companies and 116 involved other EU countries. ([Exhibit 2](#))

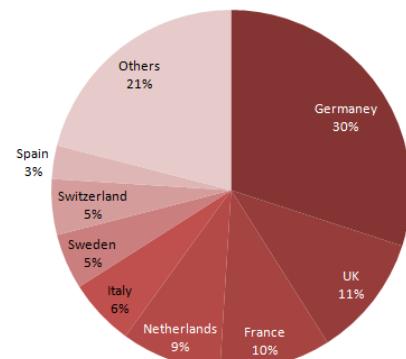
EU and UK are also strong footholds for the internationalization of RMB, with UK holding 80 Billion RQFII quota and the rest of EU holding a total of 260 Billion. Together they represent 1/3 of the total available RQFII quotas. With the breakup with EU, the UCITS scheme, under which many RQFII funds were raised and distributed in the Pan-Europe, may come under restructuring concerns.

Exhibit2: China's investment ties with EU and UK are strong

**China ODI to EU (9.8 Bln USD, 2014)**



**China FDI from EU (6.85 Bln USD, 2014)**

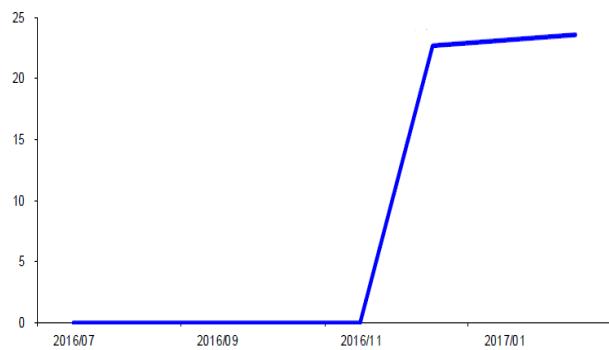


Source: CICC

## RMB

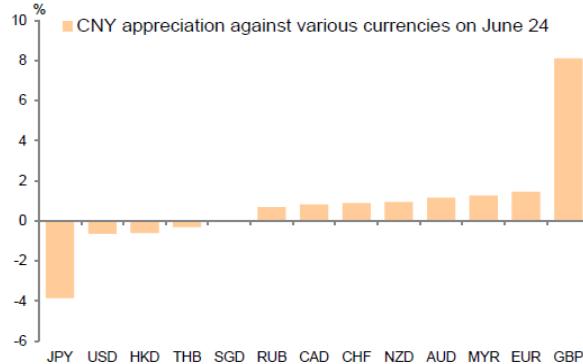
In longer term, the BREXIT result and the consequent British and EU economy deterioration could trigger another round of liquidity supply in Europe and even outside the continent, and the potential US Fed rate hike could also be delayed. ([Exhibit 3](#)) This could significantly ease the pressure of RMB depreciation in the longer term, making China less worried about imported inflation and therefore giving its central bank more room for monetary stimulation.

**Exhibit 3: Probability of US rate hike collapsed**



Source: Haitong Securities

**Exhibit 4: RMB performance on Jun 24th**



Source: CICC

In the short term, the sharp devaluation of GBP and EUR boosted USD index by 3.5%. RMB, which is declared to be pegged to a basket of major currencies, had fared steady on June 24<sup>th</sup>, except for against USD and JPY. ([Exhibit 4](#)) The rise of the USD index gives the PBoC an excuse to slightly depreciate RMB against USD, as is evidenced by the offshore USD/RMB jump from 6.58 to 6.68 in two days.

## Domestic Capital Markets

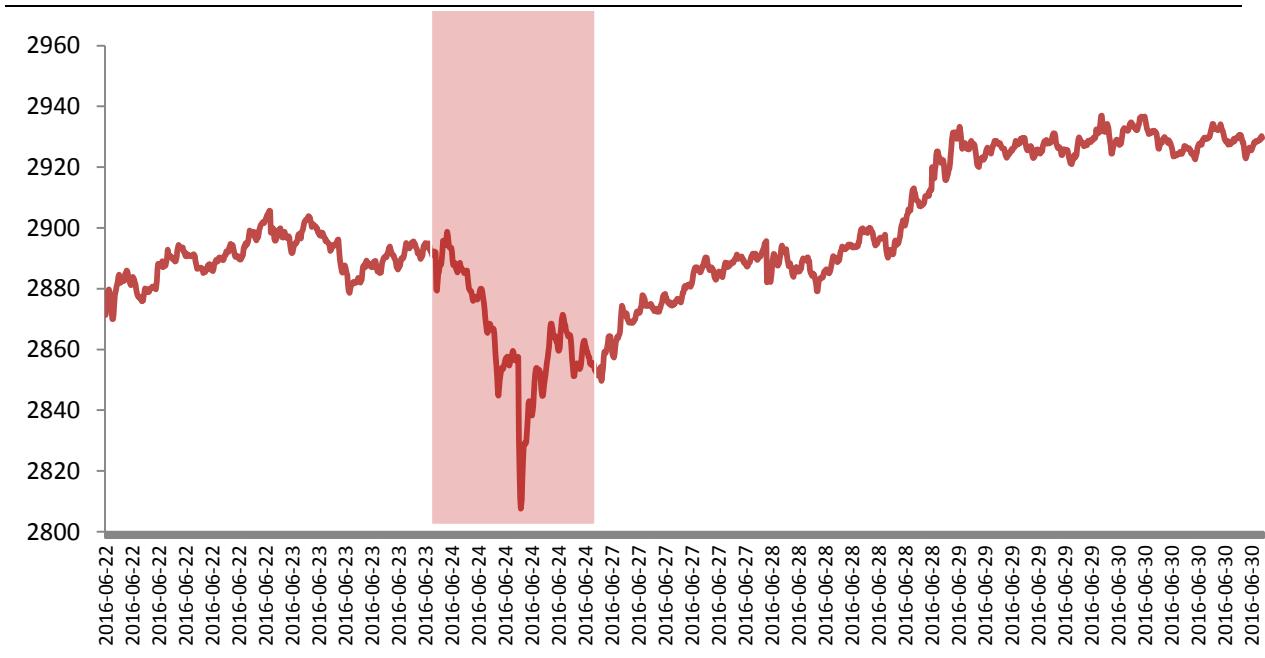
BREXIT's impact on China's domestic market is mixed coupled with a great level of uncertainty. The only certainty among all is the elevated risk aversion in the short term, which will boost the domestic bond market as investors take refuge.

Rising expectation for accommodative fiscal as well as monetary policies to weather expected external

shocks is also benefiting the bond market at least in the short term. However, with the domestic yields already quite low and out of fear of putting additional pressure on the currency, the medium-term picture of the bond market is a bit vague at this moment.

On the equity side, domestic risk aversion sentiment went full-blown on the day of the BREXIT, yet it seemed to be short-lived. The Shanghai Composite index since then went on a four-day rising streak, reflecting the spooked domestic investors finding comfort in their home markets. ([Exhibit 5](#))

Exhibit 5: SHCOMP Performance (Jun 22-30)



Source: Wind, ChinaAMC

The strategy we have been implementing so far this year has focused on value and consistency between valuation and earnings growth. With this philosophy, we believe that the downside risk is well managed even after the shock of BREXIT.

We will overweight stocks with steady performance and visible prospects in the future, such as Consumer Staples, and will keep performance of current portfolio holdings in close check, and will cut underperformed positions as we see fit.

We still see structural opportunities existing in the A-share market and will keep looking for investment opportunities in the emerging industries, including semiconductor and new-energy vehicles. In cases of a market correction, we will view it as an opportunity to pick up additional names whose valuations are in our comfort zone.

## **Disclaimer**

### **Important Information**

This report is intended only for the use of our clients and prospects. Neither this report nor any of its contents may be reproduced or published for any other purpose without the prior written consent of China Asset Management Co. Ltd ("ChinaAMC"). All the investment strategy illustrated in this report was made on a preliminary basis only, no representation or warranty is made as to the efficacy of any particular strategy or the actual returns that may be achieved.

The information in this report reflects prevailing market conditions and our judgment as of this date, which are subject to change. In preparing this report, we have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources. We consider the information in this report to be reliable, but we do not represent that it is complete or accurate. ChinaAMC, its affiliates, directors, officers or employees accept no liability for any errors or omissions relating to information available in this report, and will not be liable for any damages or costs arising out of or in any way connected with the use of the information provided in this report.

Any information given or representation made by any dealer, salesman or other person and (in either case) not contained herein should be regarded as unauthorized and, accordingly, should not be relied upon. Accordingly, no person receiving a copy of this report in any territory may treat the same as constituting an invitation to him to purchase or subscribe for the participating shares of the Fund nor should he in any event use the Fund's subscription agreement unless in the relevant jurisdiction such invitation and distribution is lawfully made.

---

### **Contact Information**

China Asset Management Co. Ltd.

8F, Tower 7, One Yuetan Street South, Xicheng District, Beijing 100045, China

[IB@ChinaAMC.com](mailto:IB@ChinaAMC.com)

Tel: +86 10 8806 6688/ Fax: +86 10 8806 6330

---

