



Basis Points – August 30, 2022

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Above the Fold

China's Economy Continues to Slow, Banks and Real Estate in Focus

The communist nation is struggling to keep its economic growth going. Consensus estimates for the Chinese economy now project a modest expansion of just 3.5% this year, down from a previous forecast of 3.9%. In the second quarter of this year, China's grew just 0.4%, the worst since the pandemic hit in the first months of 2020, and less than half of consensus forecasts of 1%. Growth projections were also lowered for the first three quarters of 2023. In true Chinese style, the government still has a growth target of 5.5% for 2022, but many, including us, believe real growth is going to be closer to zero this year.

China's economy was driven in large part by a commercial, industrial and residential "real estate revolution," where the government heavily incentivized, encouraged, and essentially forced builders and developers to construct everything from infrastructure to high-rises. Wielding incredible power, the government is able to control and commoditize housing, restricting sales and thus manipulating prices. Two years ago, Business Insider estimated that China had roughly 65 million empty homes. But recent downturns in the economy as a whole, global growth slowdown and aggressive COVID-19-related lockdowns have all taken their toll on its housing market. There's also been a massive deleveraging campaign over the last two years that's stripped large swaths of liquidity out of the system. Declines in real estate values (that most Chinese didn't think could happen) is triggering systematic issues for the banking system. And prices have been declining for a year straight.

The private banks may have the most exposure, which is why two of the largest banks, Ping An Bank Co. and China Merchants Bank, have seen their share prices slashed by 25% and 33%, respectively, in 2022. It's hard to say how this will all shake out, but riskier assets and lenders with larger portfolios of lower-quality mortgages are likely to see more pain as "bad loan disposal" is likely to hit a record this year.

Three Things

LG and Honda to Build \$4.4 Billion Domestic Battery Factory

In a bid to increase the global capacity of electric vehicle (EV) batteries and meet the new tax credit requirements set out by the Inflation Reduction Act, Honda and LG Energy Solution Ltd. will join forces and construct a \$4.4 billion factory. The plant is likely to be located in Ohio, where Honda already has a large facility. The two companies expect the facility to produce roughly 40 gigawatt-hours of batteries per year, enough for 700,000 vehicles. Honda, like many competitors, is hastening its EV push as it plans to roll out 30 electric models by 2030. The car maker has planned collaborations in place with General Motors Co. and Sony Group Corp. to help develop the new models.

Your Starbucks Could Get More Expensive

The world's largest coffee producer is likely to deliver less than half the crop of high-end arabica coffee beans due to a combination of drought and frost. Farmers in Brazil are warning markets of a looming crisis related to their critical output. Arabica beans are on a two-year growth cycle, and the market is just off its all-time highs set in late 2021 and early 2022 after supply chain issues and

changes in consumer habits drove prices to more than \$2.50 per pound, more than 150% higher than where they were just a year prior. Rising demand may be a one-two punch for coffee drinkers as well, further pushing prices higher.

Jackson Hole Comments Rile Markets, Send Yields Higher

Following its annual conference in Jackson Hole, Wyoming, the Federal Reserve failed to offer investors reassurance that its aggressive tightening campaign is nearing an end. Fed Chairman Jerome Powell delivered some hawkish remarks stating that indications of slowing inflation still haven't given the central bank confidence to ease its tough stance against rising prices. He went on to say that [the central bank's job isn't yet done](#), and its progress "falls far short" of what the Fed "will need to see before we are confident that inflation is moving down." The two-year treasury note jumped from 3.372% on Thursday to 3.427% by Monday morning.

In the Know

2021 Was a Big Year for IPOs

One way for a company to raise money to expand and/or improve operations is through an initial public offering or IPO. Through the IPO process, the company sells a certain number of shares to investors and then lists its stock on a public exchange, like the NYSE or Nasdaq, to be traded. In 2021 alone, there were 1,035 IPOs in the U.S., more than double in the prior year. In the first six months of 2021, IPO proceeds totaled \$49.2 billion, as much as the entire previous year; the Nasdaq registered the highest global IPO proceeds. The 2014 IPO of Alibaba Group was the largest IPO in the U.S. ever, worth nearly \$22 billion.

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