



ECONOMIC COMMENTARY

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RARE EARTH CONTROLS, HONG KONG MARKET SURGE, AND US POLICY TURBULENCE

China's rare earth export controls tighten global supply chains

China's newly enforced export controls on rare earth elements have begun to disrupt global supply chains significantly. Since introducing the controls in April, exporters must now obtain licences from China's Ministry of Commerce before shipping seven targeted rare earths or permanent magnets used in sectors ranging from electric vehicles and robotics to renewable energy and military aviation.

So far, the pace of licence approvals has been slow. Some shipments to Europe have resumed, including those for Volkswagen, but industry groups like the Federation of German Industries warn that Europe is close to a production crunch. Tesla, Ford, and Lockheed Martin have expressed concerns over delays, and uncertainty remains as to whether any shipments to the United States (US) have been authorised. Executives on the ground cite disorganisation, with one European official calling the situation "untenable". Elon Musk disclosed that Chinese regulators asked Tesla to ensure that magnets imported from China would not be used for military purposes. A supplier in Chengdu confirmed that, while non-military shipments may still be permitted, applications with even potential military links are being rejected outright.

This tightening of controls followed sweeping tariffs imposed by President Donald Trump and demonstrates China's intent to weaponise its dominance in rare earth processing. Though companies like Yantai Zhenghai Magnetic Material have resumed taking orders, it is clear that the flow of rare earths will remain unpredictable. This situation has intensified Western interest in reducing reliance on Chinese mineral supplies. As global demand for green technologies surges, countries may accelerate domestic mining, invest in recycling, and establish strategic reserves.

Hong Kong stocks outperform amid AI optimism and trade relief

While Beijing grapples with geopolitical tension and a domestic slowdown, Hong Kong's markets have rallied. The Hang Seng Index has jumped 16.4% year-to-date, marking the largest performance gap relative to the mainland's CSI 300 Index since 2008. This divergence reflects both a sectoral difference and investor sentiment. A major driver is capital flow from mainland investors seeking refuge from economic uncertainty, and investing in artificial intelligence (AI) and tech-heavy sectors listed in Hong Kong. Chinese firms like Tencent and Alibaba, unavailable on mainland exchanges until recently, are among the biggest beneficiaries.

The AI momentum, sparked by DeepSeek's technological breakthroughs, combined with de-escalation in the US-China tariff war and the Federal Reserve's (Fed's) dovish stance, has attracted speculative and institutional investors alike. Yet, much of this influx appears short term. Hedge funds dominate the recent inflow, and long-only investors remain cautious, still scarred by previous volatility in China-linked equities. BNP Paribas analysts note that Hong Kong's heavier weighting in global-facing sectors makes it more responsive to international policy shifts. The Hang Seng is also poised to benefit from potential reallocations away from overvalued US equities and expected Fed rate cuts in the second half of 2025.

US sentiment weakens despite trade pause

Despite a temporary easing in trade tensions with China, US economic sentiment remains fragile. Moody's downgraded America's credit rating owing to ballooning debt levels, while consumer sentiment (as measured by a survey by the University of Michigan) fell to its second-lowest reading on record. One-year inflation expectations have surged to 7.3%, the highest level recorded in the survey since 1981. While producer prices are falling, businesses are absorbing more of the cost burden, especially in tariff-exposed sectors. Retailers have warned of rising consumer prices even with the partial rollback of tariffs on Chinese goods. Trump's flagship tax bill, which includes an extension of his 2017 tax cuts and deep spending reductions, suffered a blow as fiscal conservatives and moderate Republicans clashed. This legislative gridlock, combined with deteriorating sentiment and inflation concerns, has led to mounting uncertainty in both bond and equity markets.

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