Economics

DBS Flash

China: Economy still fragile despite stabilisation policies

Group Research

April 30, 2019

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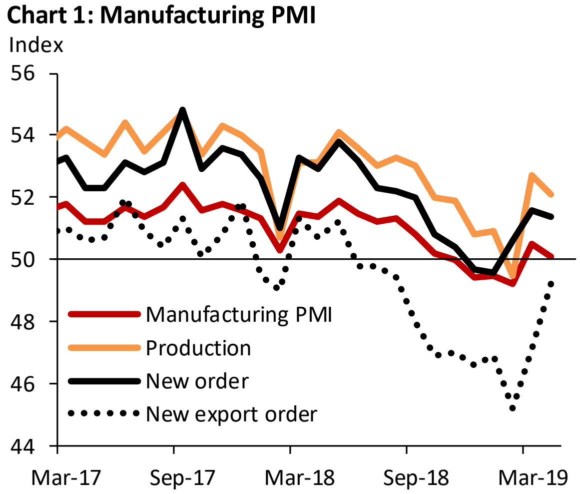
- *Economic stabilisation seen in 1Q has proven to be fragile, with NBS manufacturing PMI dipped to 50.1 in April from 50.5 in March*
- *Both production and new orders moderated but remained in expansionary zone. New export orders stayed in contractionary territory for the 11th month*
- *Implication for our forecast: We maintain our GDP forecast of 6.3% for 2Q19*
- *Implication for investors: Today's print heightens the risk that investors may sell shares and the Chinese yuan to cut risk*

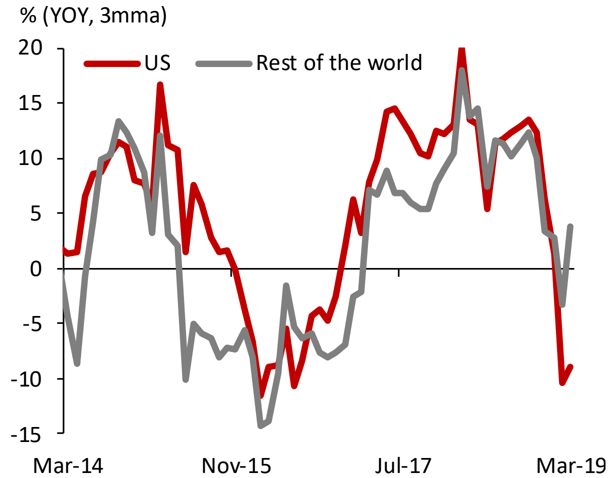
Chart 1: Manufacturing PMI



Source: CEIC, DBS

The National Bureau of Statistics (NBS) PMI came in at 50.1 in April, down from 50.5 previous month (Chart 1). The softening was broad-based. Production index fell to 52.1 from 52.7 in March. New orders index edged down to 51.4 from 51.6. Meanwhile, the input prices index eased to 53.1 from 53.5 previously, ending a two-month rising streak. The fall could partly be attributed to correction in commodity prices such as copper and zinc (down 0.8% and 5.6% in April respectively). **Risk of dis-inflation at the producer level remains.**

Chart 2: Exports to US and rest of the world

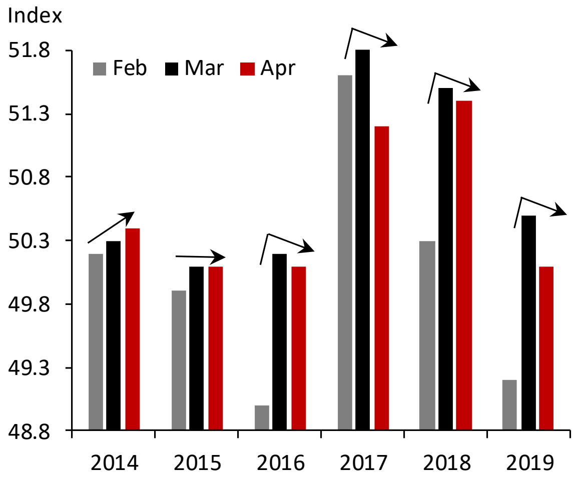


Source: CEIC, DBS

Although new export orders recovered from 47.1 to 49.2, they remain in contractionary zone (11th consecutive month). It indicates downward pressure on the external front is still strong. A return to rapid growth is unlikely given the faltering momentum amongst China's top export destinations. Aside from the seasonal spike last month, shipment to the US and the rest of the world have decelerated sharply since late last year (Chart 2). Global trade volumes fell in February, marking the fourth drop in six months.

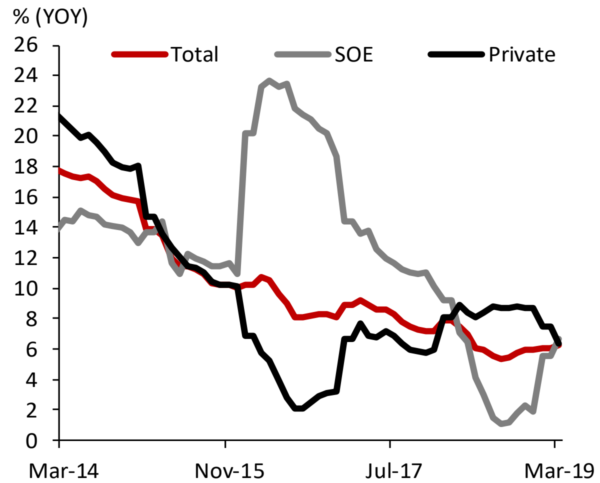
Despite the moderation, April's PMI was still 0.4 and 0.2 percentage points higher than 1Q19 and 4Q18 respectively. Seasonal factor was at play. PMI usually decelerates in April after a rebound in March (Chart 3). Improving credit growth should boost Q2 business activities. Specifically, the share of long-term corporate

Chart 3: NBS Manufacturing PMI



Source: CEIC, DBS

Chart 5: Fixed asset investment (Ytd)

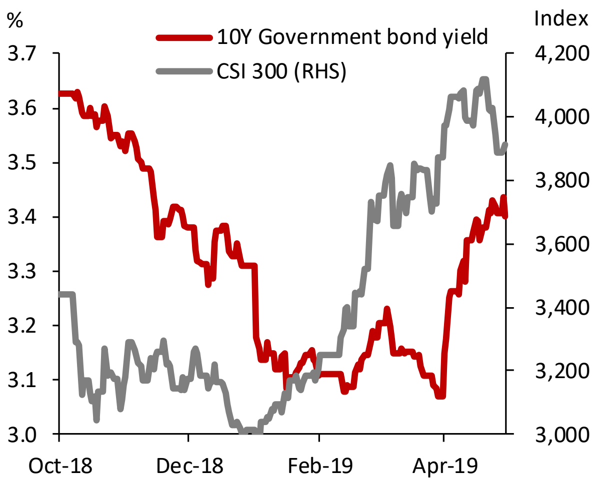


Source: CEIC, DBS

loans to total loans has increased to 44.1% in 1Q19 from 22.1% in 4Q18. The cut in value-added tax effective his month ought to buttress the manufacturing and industrial sectors, in our view.

The latest print reinforces our view that the recovery is fragile and sustained accommodative policy support is warranted. Better than expected in 1Q GDP growth may offer some comfort, but the recent Politburo meeting further emphasized the insistence to deleverage. Comments made last week by Premier Li Keqiang also struck a less dovish tone subsequently driving markets down. The Shanghai Composite Index drop 5.6% last week, the largest weekly decline since October 2018. The yield curve abruptly steepened, with the 10Y yield jumping 37 basis points this month (Chart 4).

Chart 4: Government bond yields and CSI 300



Source: Bloomberg, DBS

Premature policy normalization could risk choking off growth momentum. Data volatility resulting from the Lunar New Year holidays has created considerable uncertainty about the underlying strength of the economy. For instance, while industrial profits (released over the weekend) soared 13.9% YoY in March, it declined 3.3% in 1Q. Private investment also slowed further in 1Q despite accelerating headline FAI growth (Chart 5).

TMLF injection last week underscored PBoC's persistent supportive stance. The authority has injected RMB110bn longer-term liquidity to the banking sector in April. TMLF is not simply an operation to smooth short-term liquidity, which can be achieved via 7-day or 14-day reverse repos. It also injects long-term funds, giving banks more leeway to extend credit. **Looking forward, more targeted measures are expected to keep the recovery momentum steady.**

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).