

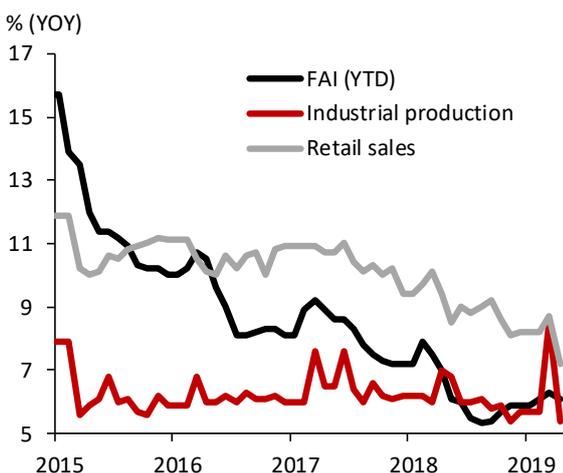
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- China's domestic demand saw broad-based easing in April.
- Advances of retail sales decelerated from 8.7% YoY in Mar to 7.2%, the slowest growth since 2003.
- Industrial production and investment fell to 5.4% and 6.1% (YoY YTD) from 8.5% and 6.3%.
- Implication for our forecast: USD/CNY heads toward 7 in the near-term.
- Implication for our investor: More targeted measures are on the cards.

Chart 1: FAI, Industrial production, and retail sales

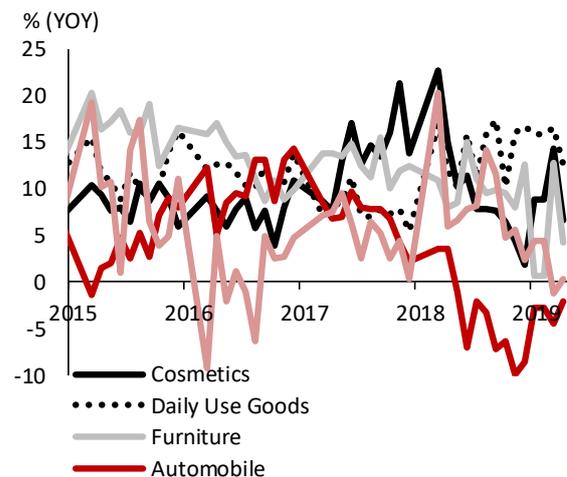


Source: Bloomberg, DBS Group Research

China's domestic demand saw broad-based easing in April.

The NBS Manufacturing PMI fell from 50.5 in March to 50.1 in April. Advances of retail sales decelerated from 8.7% YoY to 7.2%, the slowest growth since May 2003. Industrial value-added also fell to 5.4% in April from 8.5% in March. Fixed asset investment (FAI) moderated to 6.1% YoY YTD from 6.3% pending the effect of accelerated infrastructure spending to surface.

Chart 2: Retail sales by category



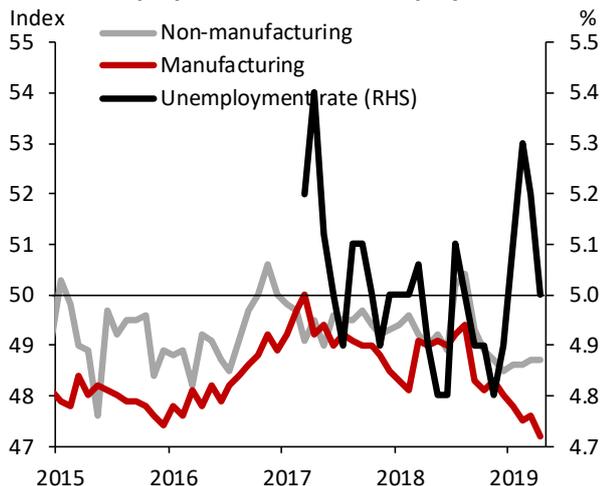
Source: CEIC, DBS Group Research

Private consumption sentiment has remained cautious.

Sales performance of cosmetic, furniture, and daily use goods decelerated noticeably. Non-necessity such as automobile registered on-year decline for 12th consecutive month. Supply of automobiles production also fell 15.8%, down significantly from -2.6% in March. Gold, silver and jewelry rebounded to positive territory modestly (Chart 2). Consumption sentiment was dampened by weaker expectation of future income growth alongside a weakening labour market.

The employment PMI for both manufacturing and the non-manufacturing had remained in contraction zone. Unemployment rate is standing above 5.0% for over 8 months despite mild retreat seen lately (Chart 3), exerting downward pressure on wage. Also, negative wealth effect from the slumping equity market is likely to weigh on spending power. CSI 300 fell from its 13 months high of 4,121 points to 3,680 of late (down 10.2%).

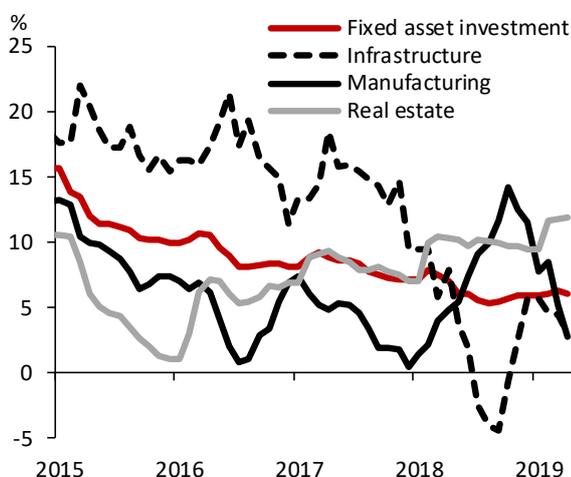
Chart 3: Employment PMI and unemployment rate



Source: CEIC, DBS Group Research

Industrial production has already weakened in tandem with sluggish export performance. It fell 2.7% in April, down from an increase of 13.8% in March. China decided to retaliate on USD60bn US imported goods over the weekend. The US is also planning to raise tariffs to 25% for the rest (USD325bn) of the Chinese shipments (mainly consumer goods), which will be an unambiguous negative for exports. Deterioration in industrial activities will weigh on GDP growth. According to our estimation, 25% tariffs on USD 200bn Chinese exports would shave 1.0ppt on GDP growth this year. Tariffs impositions on all of China's exports to the US would impact about 1.5 ppt (see "[RRR cut signals PBoC still supportive](#)").

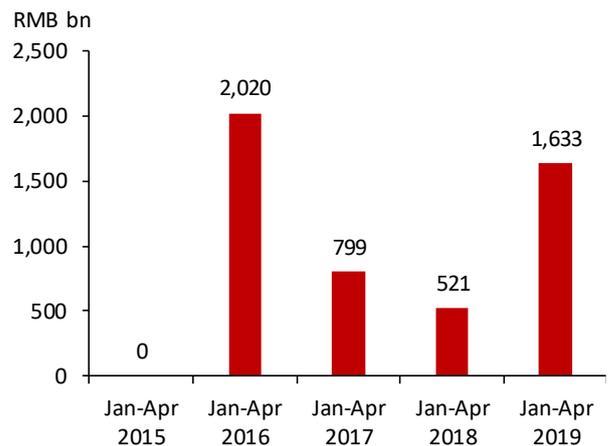
Chart 4: Fixed asset investment (YTD)



Source: Bloomberg, DBS Group Research

Hence more pro-growth policy is expected. Meanwhile, the impact from VAT cut effective in April (RMB800bn corporate tax saving) and social security fee cut effective in May (>300RMB) will feed through into growth momentum.

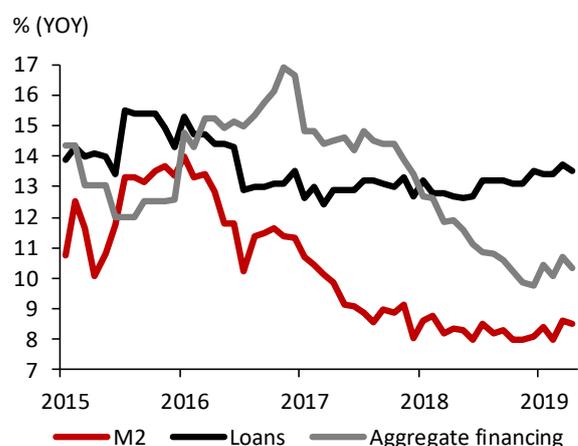
Chart 5: Local government bond issuance in 1Q since 2015



Source: CEIC, DBS Group Research

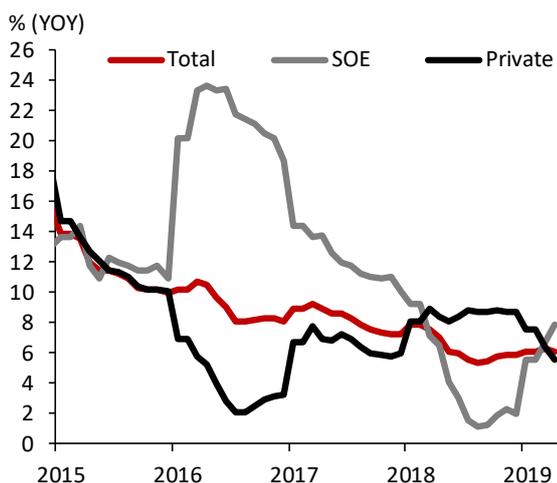
More large-scale domestic stimulus is also needed to boost the industrial activities. On a positive note, real estate investment went up by 2.4ppt to 11.9% YTD. Yet, investment appetite in manufacturing sector remained particularly conservative (Chart 4). Infrastructure investment decelerated further since early 2019. The downtrend may reverse course ahead. More projects will be rolled out by NDRC. In fact, there was appreciable improvements in commodities imports such as oil, copper and coal due to increased demand from infrastructure projects (see "[Stimulus is working: more coming](#)"). Local government bond, as main source of funding for infrastructure, has been rising steadily (Chart 5). Its cumulative issuance jumped 16.1% from March.

Chart 6: M2, loans, and aggregate financing (outstanding)



Source: CEIC, DBS Group Research

Chart 7: Fixed asset investment (YTD)

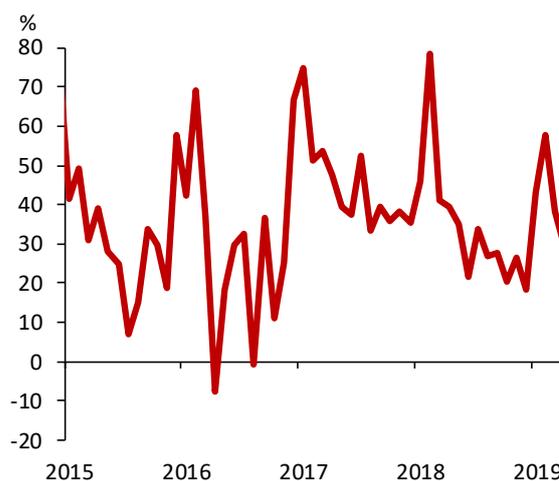


Source: CEIC, DBS Group Research

Premature policy normalization could risk choking off growth momentum. **Tightening monetary condition seen in April, is therefore not likely to sustain** (Chart 6). FAI should rebound down the road. Currently, FAI was mainly driven by state-owned enterprises (SOEs) (Chart 7). The authority will continue to impose targeted measure to unclog funding channels to private enterprises (POEs) who are more affected by the China-US trade war.

In fact, bank loan dropped from 13.7% to 13.5% in April. The corporate loan as percentage of total loan shrank (Chart 8) mirroring weakening loan demand. Therefore, PBoC extended CNY267.4 bn to commercial banks in April via its targeted medium-term lending facility (TMLF). Reserve requirement ratio (RRR) cut will release RMB280bn for small to medium size banks, exerting downward pressure on interest rates. Yield of 10-year government bonds dropped from 12.4bps from a year-high of 3.435% to 3.311% of late.

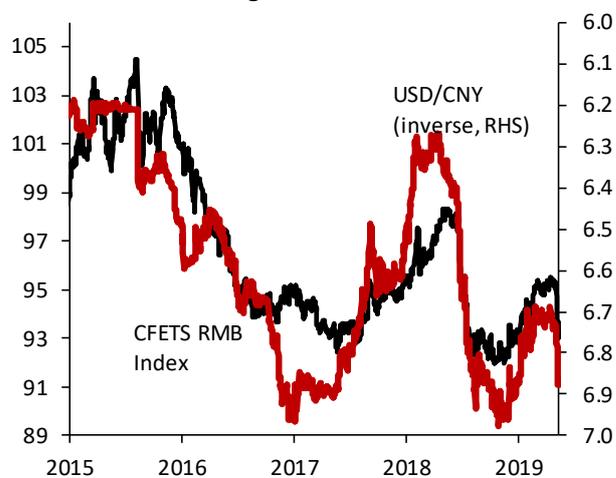
Chart 8: Corp. long term loan/total loan



Source: CEIC, DBS Group Research

Re-leveraging will eventually add downward pressure to CNY exchange rate. CNY has depreciated towards 6.9 from 6.7 against the USD (Chart 9). Our back-of-the-envelope calculations showed that if the US increased tariffs to 25% from 10% on USD 200bn of China's goods, USD/CNY could rise to 7.30. A full-blown trade war which entails a 25% US tariff on the rest of China's goods could propel USD/CNY to 8 (see "[Effective link between tariffs and CNY](#)", December 13, 2018). A relatively strong US economy may dissipate the dovish stance of Fed, thereby also adding downward pressure on CNY.

Chart 9: RMB exchange rates



Source: Bloomberg, DBS Group Research

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

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