Economics

DBS Flash

China: Slowing growth; more stimulus to come

Economics/Strategy/Rates/FX

Group Research

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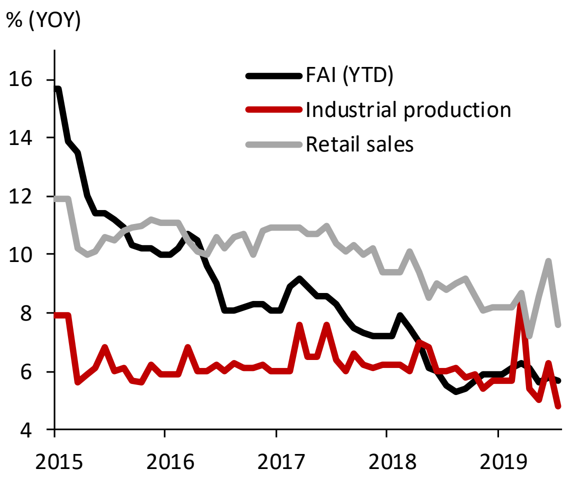
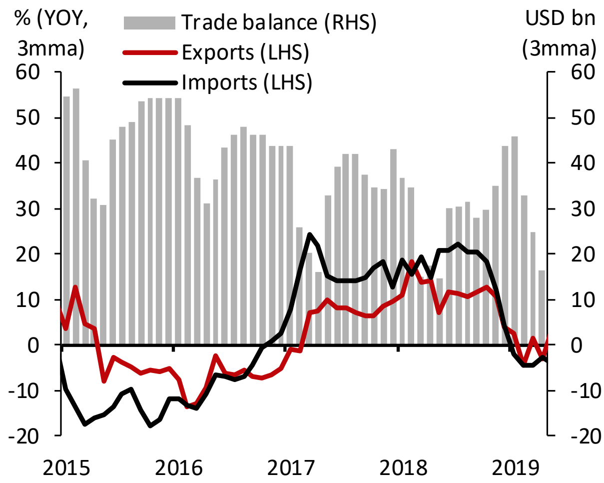
- *Most headline figures in July suggest persistent weakening of the economy.*
- *Industrial production growth slowed to a 17-year low of 4.8% in July. Moderation in retail sales was driven primarily by poor auto sales.*
- ***Implication for forecast**: our nowcasting model suggested the real GDP growth will slow to 6% in 3Q19.*
- ***Implication for investors**: the PBOC will cut benchmark interest rates and reserve requirement ratio.*

Chart 1: FAI, Industrial production, and retail sales



Source: Bloomberg and DBS Group Research

Chart 2: Merchandise trade

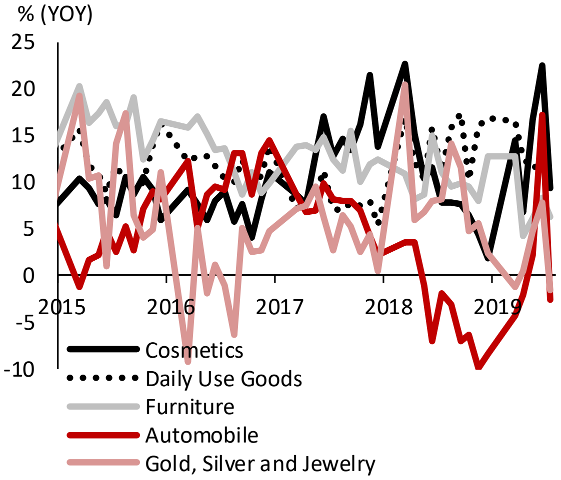


Source: CEIC and DBS Group Research

Most headline figures in July suggest persistent weakening of the economy (Chart 1). The deceleration of industrial production from 6.3% in Jun to a 17-year low of 4.8% reflects weak domestic demand and sluggish external trade. That corresponded with the notable 5.6% drop in imports alongside a meagre growth of infrastructure investment. On the bright side, export growth surprised on the upside at 3.3% amidst ongoing trade tension with the US (Chart 2). Also, fixed asset investment in high-tech manufacturing and services advanced 11.1% and 11.9% respectively YTD in July, higher than the headline FAI growth of 5.7%.

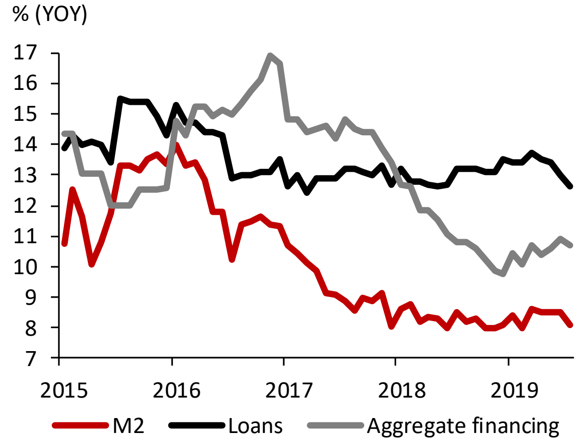
Moderation is equally apparent in private consumption, driven primarily by poor auto sales (Chart 3). The auto sector weakness could well be a one-off phenomenon due to more stringent regulatory requirement on emission standard, forcing automakers to liquate old models with deep discounts.

Chart 3: Retail sales by category



Source: CEIC and DBS Group Research

Chart 5: M2, loans, and aggregarate financing (outstanding)

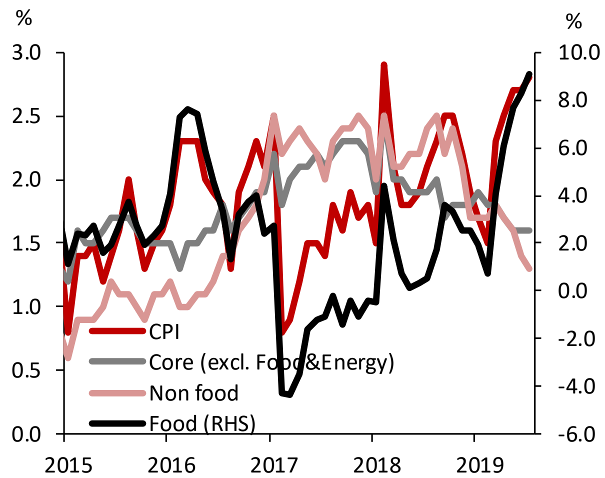


Source: CEIC and DBS Group Research

CPI inflation was broadly stable at 2.8% in Jul (Chart 4). The food component of the CPI index jumped 9.1% on year due to soaring pork prices (27% jump) amidst the spread of African swine fever. To compare, the index would have only surge 1.3% on year should food prices are excluded. At the supplier level, the decline of the producer price index accelerated to 0.3%, which is the first negative reading in 3 years. If the trend develops further, the looming risks of deflation will potentially elevate interest rate in real terms.

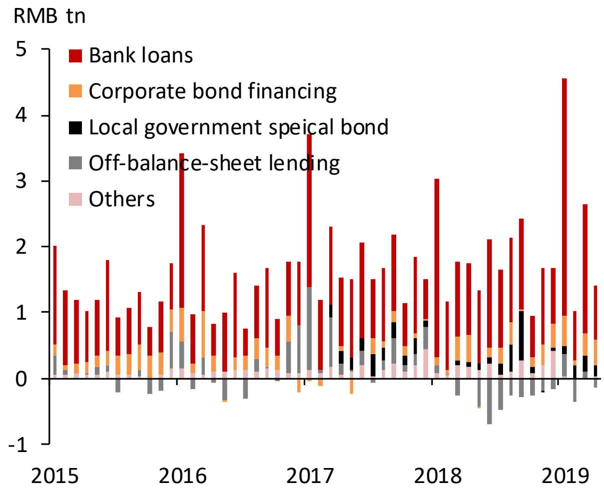
Loan growth in July was surprisingly weak. New loans only amounted to CNY1.06trn, down almost 27% on year from CNY1.45trn in Jul 18. Outstanding loan growth also decelerated to 12.6% from 13% in June. Total social financing, which includes all off-balance sheet financing channels, also slowed to 10.7% in Jul from 10.9%. As such, the aggregate financing also slowed (Chart 5). In response to weakening loan demand, M2 decelerated to 8.1% from 8.5% during the same period (Chart 6).

Chart 4: CPI by category



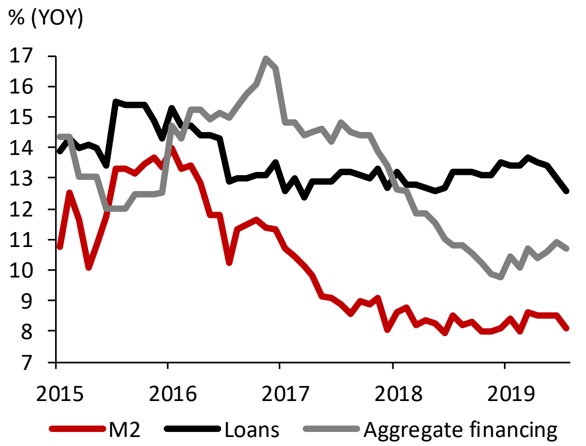
Source: CEIC and DBS Group Research

Chart 5: Total social financing (new increase)



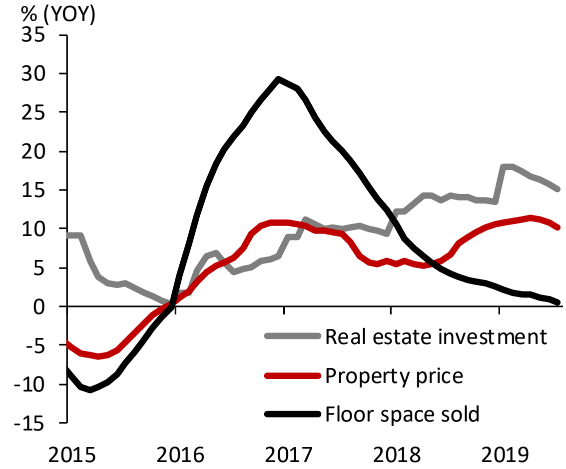
Source: CEIC and DBS Group Research

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



Source: CEIC and DBS Group Research

Chart 7: Residential housing growth



Source: Bloomberg, CEIC and DBS Group Research

The macroeconomy is clearly still trending downward though much of the slowdown observed hitherto is within expectation. The headwinds going forward remain strong. Relocation of manufacturers to South East Asia has already become a fashion. Negative impact of trade war will continue to inflict Southern China the most given the relative higher export to GDP ratio than in the inner part of the country. Foreign direct investment is already slowing down as well. The confluence of such factors in turn negatively impact consumer/investment confidence before consequentially translating into lower property and equity prices.

MoM growth of new home price of the 70 major cities slowed to 0.59% in July from 0.66% in June. On a YoY basis, it also peaked out to 10.09% from 11.3% in Mar (Chart 7). Likewise, real estate investment fell from its year high of 18% in Feb to 15.1% in Jul. The average sell-through rates in Tier 1 and 2 cities, which can reach 95%, fell to 58% in late-July. The red-hot property market has started to cool down.

At this juncture, the current macroeconomic situation is increasingly a case of retreating aggregate demand. It is important to buttress domestic demand by investment. Fiscal policy must be much more proactive with deep considerations for the long haul emphasizing on technological renovations and productivity enhancement. The aim is to generate sustainable new growth areas. On the other hand, the central bank will have to cut benchmark interest rates and reserve requirement ratio to preempt the escalating risks of deflation. Our Nowcasting model shows growth will slow to 6% in 3Q19. This is driven by the easing industrial production, loans, and retail sales growth.

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