DBS Flash

China: Sub-6% growth ahead

Economics/Growth/Monetary/Rates

DBS Group Research

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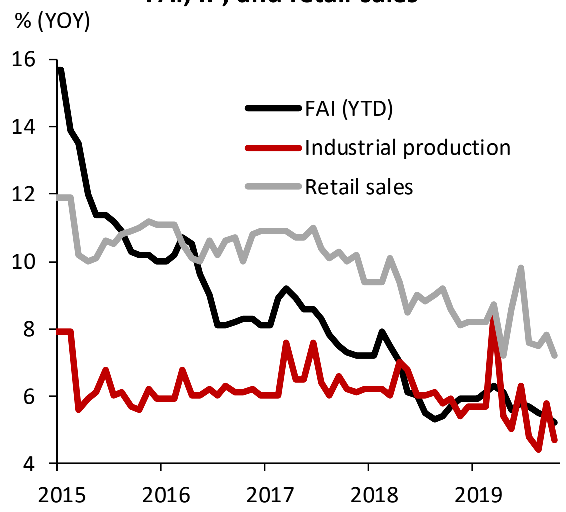
- *Domestic demand headed south in October.*
- *Retail sales hovered around the 20-year low of 7.2% on rising housing and food cost.*
- *Implication to our forecast: GDP will slow to 5.8% in 4Q.*
- *Implication to our investors: CNY will remain under pressure.*

Domestic activity continued to deteriorate into the 4th Quarter.

- Industrial production rose 4.7% YoY in October, down from 5.8% in September.
- Fixed asset investment rose 5.2% YTD, down from 5.4% previous month. Slowdown in private investment continues.
- Retail sales growth slowed to 7.2%, from 7.8% in September. Auto sales fell 3.3% after declining 2.2% previous month.

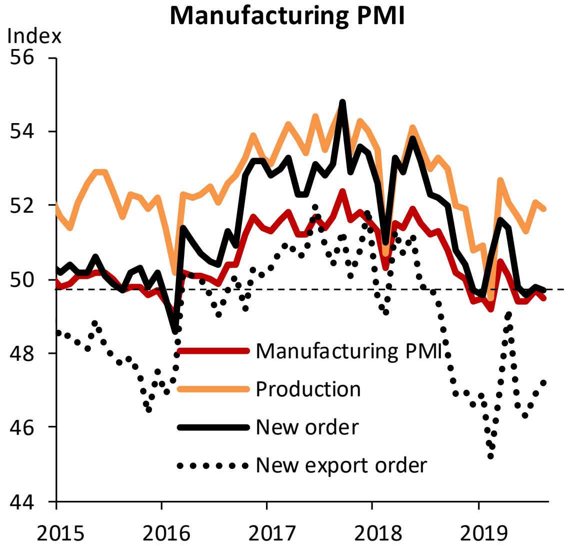
FAI, IP, and retail sales



Source: Bloomberg, DBS

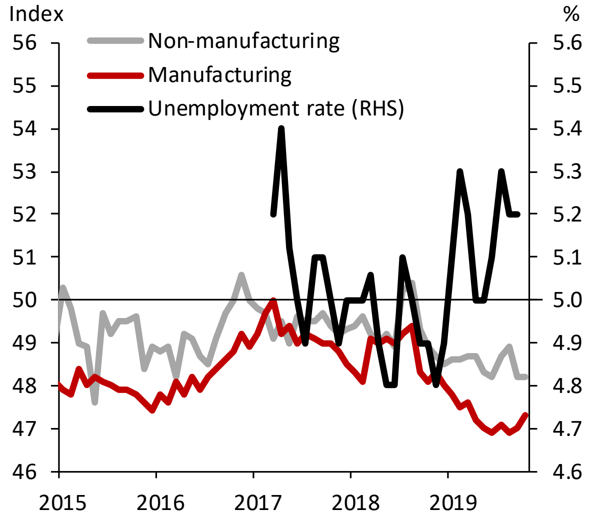
October data pointed to more weakness in the manufacturing sector. Headline PMIs contracted a 6th month to 49.3 in October from 49.8 in previous month. Production and new order sub-indices fell respectively to 50.8 and 49.6 from 52.3 and 50.5.

Manufacturing PMI



Source: CEIC, DBS

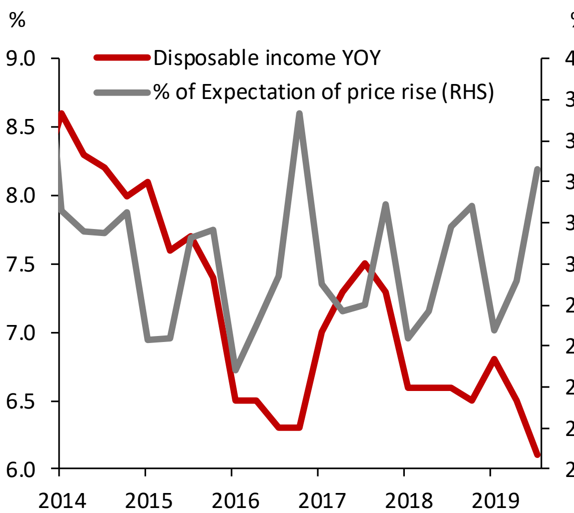
Employment PMIs and unemployment rate



Source: CEIC, DBS

Trade negotiations between Washington and Beijing have remained inconclusive. It is unlikely for the US to remove the tariffs. The Phase 1 trade deal has centred on agricultural products which will benefit both China (seeking relief from the swine fever) and the US (by appeasing farmers). Core disputes such as forced technology transfer and greater financial market accessibility remain unsolved. Therefore, the relative improvement of exports in October (the drop narrowed to -0.9% from -3.2%) partly reflected front-loading activities to avoid potential tariffs hike in December.

Disposable income and inflation expectation



Source: CEIC, DBS

Meanwhile, global demand in advanced economies (e.g. Japan: -7.9%) has decelerated and weighed on China's factory performance. Export-led industrial production will remain under pressure.

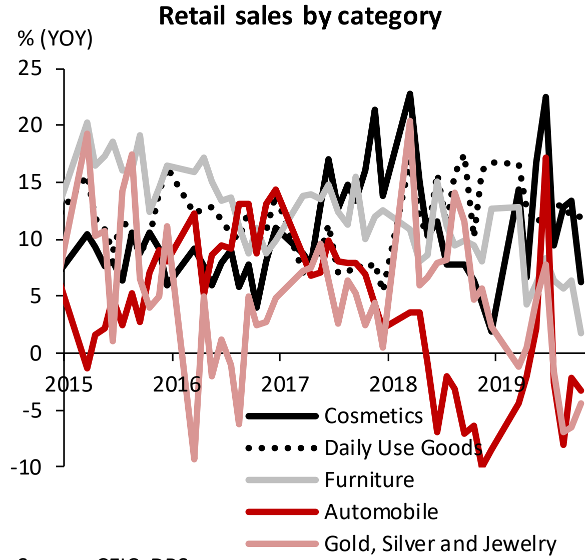
Softening industrial sector has eventually translated into more joblessness. Surveyed unemployment rate in urban areas stayed above 5% for 9 months in a row. Hiring sentiment remains weak; employment PMIs have contracted pro-longed period.

Rising housing cost and food price have also cut into real income and constrained spending. Average prices of new homes have risen, for the 53rd straight month, in September.

CPI accelerated for 8 months and reached 3.8% in October. As pork price skyrocketed 101.3%, the search for substitutes led beef and lamb prices to jump 20.4% and 16.1% respectively.

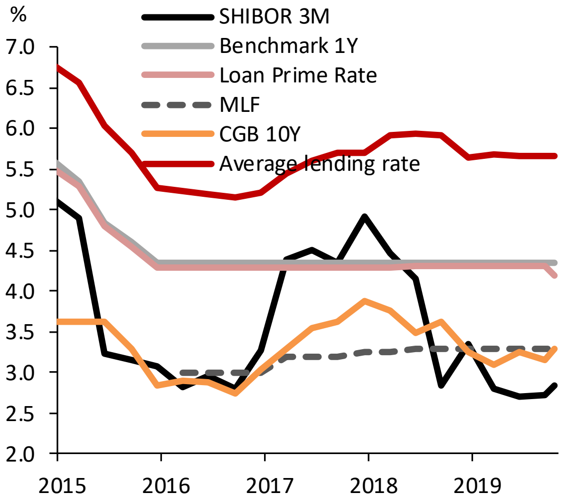
Even so, sluggish spending sentiment is better reflected by core inflation (excludes food and energy) which remained moderate at 1.5%. In fact, sales have deteriorated broadly and cut across cosmetics, daily use goods and furniture in varying degrees.

Retail sales by category



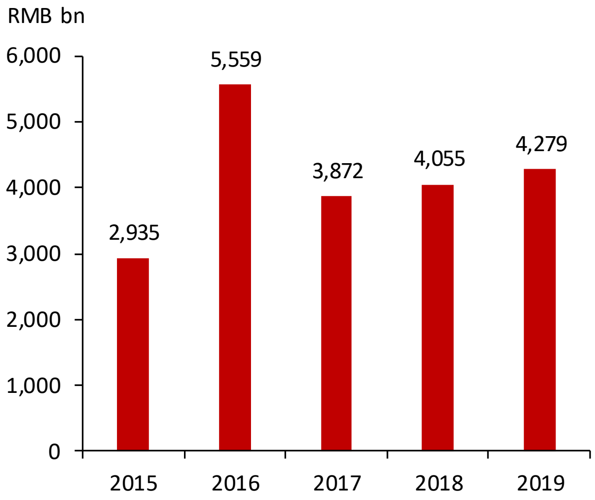
Source: CEIC, DBS

Onshore interest rates



Source: Bloomberg, CEIC, DBS

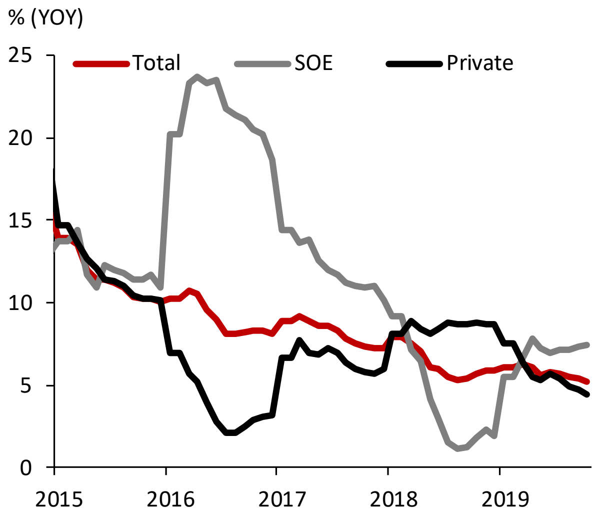
Local government bond issuance (Jan-Oct)



Source: Bloomberg, DBS

Against this backdrop, demand for credit and investment has been lacklustre. Growth in total social financing edged down to 10.7% in October from 10.8% in the previous month. Loan growth retreated by 0.1pp to 12.4%. Private sector investment fell further to 4.4% (lowest since end-2016) from 4.7%. In fact, the impact of previous targeted policy easing on rates has so far been limited. The weighted average lending rates have remained broadly unchanged around 5.65-5.69% in the past three quarters ending a2 2019. M2 also stayed low at 8.4%.

Fixed asset investment (YTD)



Source: CEIC, DBS

In line with our expectations, PBoC injected RMB400bn of medium-term lending facility (MLF) into the interbank market last week. It also lowered the 1Y MLF rate by 5bp to 3.25%. The move paves the way for a cutting loan prime rate on November 20.

On the fiscal front, increments of project approvals and local government bond issuance in recent months should translate into more infrastructure spending ahead. As of October, local governments bonds issuance increased 5.5% YoY and used up more than 90% of their new debt quotas for 2019. An early assessment on the 2020's quota is already in progress.

As such, downward pressure on the Chinese yuan exchange rate shall persist. The CNY has depreciated 12% against the USD since the start of trade war in 2018. We expect it will reach 7.10 by end of this year. **GDP growth will slow further to 5.8% in 4Q19 and result in a full-year of 6.1% this year.**

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