Economics

DBS Flash

China: Some relief but challenges remain

Economics/Growth/Monetary/Rates

DBS Group Research

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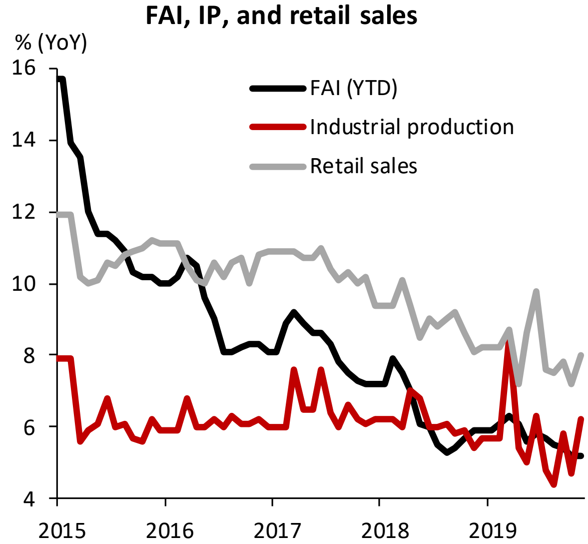
- *November data indicated a mild improvement in China's economy.*
- *Phase One trade negotiation between US and Chins was finally concluded and averted another round of US tariffs on Chinese goods.*
- ***Implication to our forecast:** Real GDP is likely to grow by 5.8% in 4Q19 and bring full-year growth at 6.1%.*
- ***Implication to our investor:** CNY will stabilize around 7 against USD with limited upside.*

Domestic activities pointed to a mild recovery in November.

- Industrial production rose by 6.2% YoY in November, up from 4.7% in October.
- Fixed asset investment growth YTD was flat at 5.2%. Private investment growth remained slower than that of SOEs.
- Retail sales growth improved to 8.0%, from 7.2% in October. But auto sales continued to fall by 1.8%.

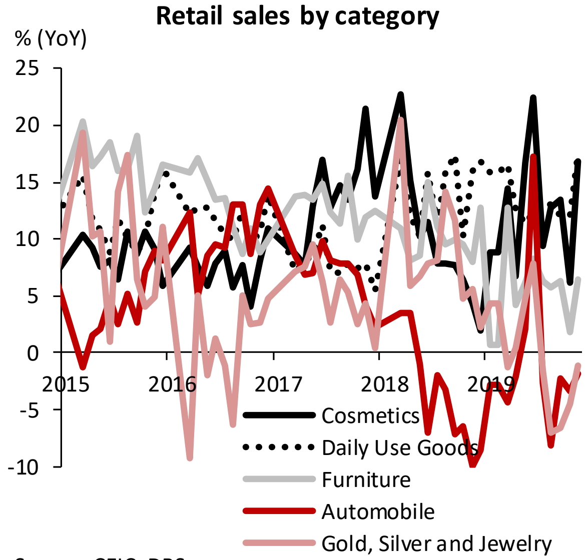
FAI, IP, and retail sales



Source: Bloomberg, DBS

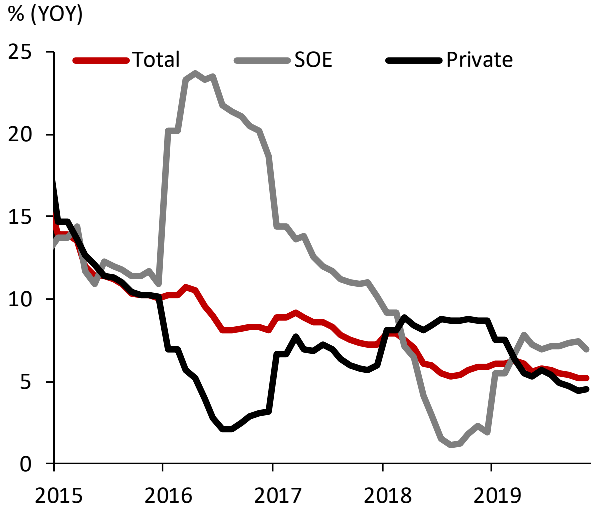
November data indicated some relative improvement in the economy. Headline Official Manufacturing PMI expanded again after contracting a 6th month to 50.2 in November from 49.3 in previous month. Production and new order sub-indices rose respectively to 52.6 and 51.3 from 50.8 and 49.6.

Retail sales by category



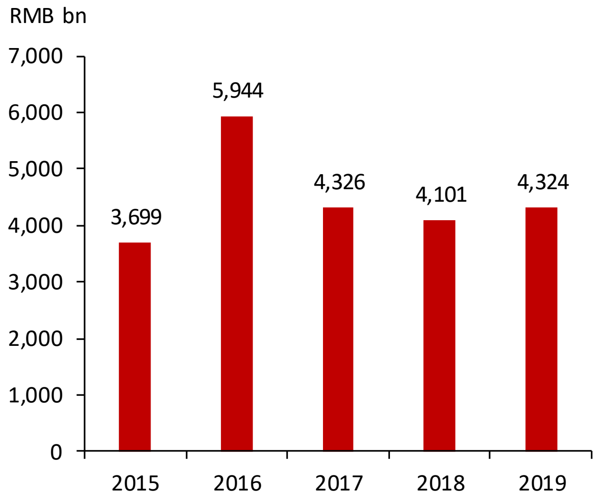
Source: CEIC, DBS

Fixed asset investment (YTD)



Source: CEIC, DBS

Local government bond issuance (Jan-Nov)



Source: Bloomberg, DBS

China and the US concluded Phase One trade negotiations. The US tariffs scheduled for December 15 were delayed. 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). However, core disputes such as intellectual property protection and greater financial market openness remain unresolved and left to Phase 2 talks. Meanwhile, the recovery in global demand from advanced economies (e.g. Japan: -7.8%, EU: -0.2%) has been weak. Export-led industrial production will remain under pressure.

Softening industrial sector has eventually led to more joblessness. Surveyed unemployment rate in urban areas stayed above 5% for 10 months in a row. Hiring sentiment remains weak as evidenced by the persistent contraction of the employment PMIs.

Although some uptick in retail sales was apparent this month, rising housing and food costs reduce real income growth. Property price has risen for the 54th straight month in October.

CPI inflation accelerated further to 4.5% YoY in November from 3.8% last month, the fastest pace since 2011. Widespread swine fever ramped up pork prices by 110.2% while substitutes such as beef and mutton also jumped 22.2% and 14.3% respectively. Core inflation (which exclude food and energy) fell to 1.4% from 1.5%, below 2% for the 15th consecutive. This indicated weak consumer sentiment. Looking ahead, headline CPI will likely approach 5% into the Lunar New Year holiday.

Given the subdued core inflation, PBoC is likely to sustain its pro-growth policies in 2020. Growth in total social financing and loan were on par against October at 10.8% and 12.4% in November respectively. M2 also fell to 8.2% from 8.4%. Headline investment growth was mainly driven by SOEs. Private sector investment edged up to 4.5% from 4.4% (lowest since end-2016) but was much slower than that of SOEs (6.9%). As such, the PBoC lowered the Loan Prime Rate to 4.15% in November from 4.2% in October and injected RMB300bn into the market through the medium-term lending facility (MLF) at an interest rate of 3.25% today. Monetary policy easing through a combination of the reserve requirement ratio and interest rate cuts is warranted.

Infrastructure investment is likely to improve as indicated by the improving commodity imports such as crude oil (up 17.1%) and copper (up 22.0%). The Ministry of Finance announced that it will bring forward RMB1trn of its 2020 local government special bond issuance quota this year. As of November, local government bonds issuance increased 5.4% YoY.

That said, the CNY exchange rate could stabilize amid positive trade negotiation, but upward pressure is expected to be limited. We forecast the USD/CNY will consolidate around 7. Real GDP is likely to grow by 5.8% in 4Q19 and bring full-year growth to 6.1%.

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