

China: Expect faster activity growth after April's weak data

Investment, manufacturing and retail sales slowed in April. This could reflect that trade negotiations appeared to be progressing well in April, meaning the government could afford to slow down its stimulus measures. But this will change, as China needs faster domestic growth to compensate for slower exports



Slower than expected activity data in April as trade tensions eased

In 2019, the Chinese economy has mostly been driven by fiscal stimulus. But the government is wary about building up unnecessary capacity and debts and is likely to slow infrastructure projects if it sees signs of a breakthrough in the trade impasse with the US. This could have been the case back in April when trade negotiations seemed to be progressing well.

Industrial production and retail sales slowed for different reasons

- Fixed asset investments grew 6.1% year-on-year, year-to-date in April from 6.3% in March. This was probably hit by slower progress in completing investments in planned infrastructure projects and slow manufacturing investment as a result of the trade war. If the trade conflict continues to escalate, more factory owners will plan to move or expand production lines out of China, which will hurt investment and production.
- Industrial production slowed sharply to 5.4% YoY from 8.5% YoY. The slowdown is partly a result of the slower execution of infrastructure projects and partly the continuous disruption of ride-hailing apps on the production of automobiles. Automobile production fell 15.8% YoY in April from -11.8% in Jan-April.
- Retail sales growth dropped to 7.2% YoY from 8.7% YoY. The slower growth is broad-based. This is worrying as April was a month when China's stock market rose amid good progress in trade talks, so consumer sentiment should have been better. This is significant. We think it's likely that some consumers were worried about their job security or wage growth and so tightened their purse strings. This is also reflected in the sales of clothing falling to -1.1% YoY from 6.6%. When clothing sales shrink it signals consumers want to save rather than to spend.

If the slow down in the activity data continues in May and June, China's GDP growth could fall below 6.0% YoY in 2Q19.

But stimulus is on the way

We believe that the Chinese government will not wait for another set of data before it speeds up stimulus measures.

Premier Li mentioned recently that tax cuts needs to be implemented effectively. We believe an import-tax rebate for exporters could be possible. In addition, we expect that local governments, which control the speed of infrastructure project completions, will press contractors to speed up construction.

We also expect the People's Bank of China to have targeted liquidity injection measures in May or June so that smaller exporters and their suppliers can get credit at a lower interest rate from banks.

"The yuan is more of a political tool for the trade war than an economic tool."

Yuan is calm even with this set of data

The yuan is more of a political tool in the trade war than an economic tool. This is confirmed with today's data. Even though the data slowed unexpectedly, the USD/CNY fell slightly. In other words, the yuan has appreciated from yesterday's 6.8758 to the spot of 6.8726 (12:06 Hong Kong Time). The slight yuan appreciation is probably coming from the US's more optimistic tone on the trade negotiations.

We believe that both USD/CNY and USD/CNH will continue to move in tandem with sentiment on the trade war. If China and the US meet in the forthcoming G20 meeting in June then the yuan

should appreciate back to the 6.75 level. Ahead of that, however, expect volatility to be high.