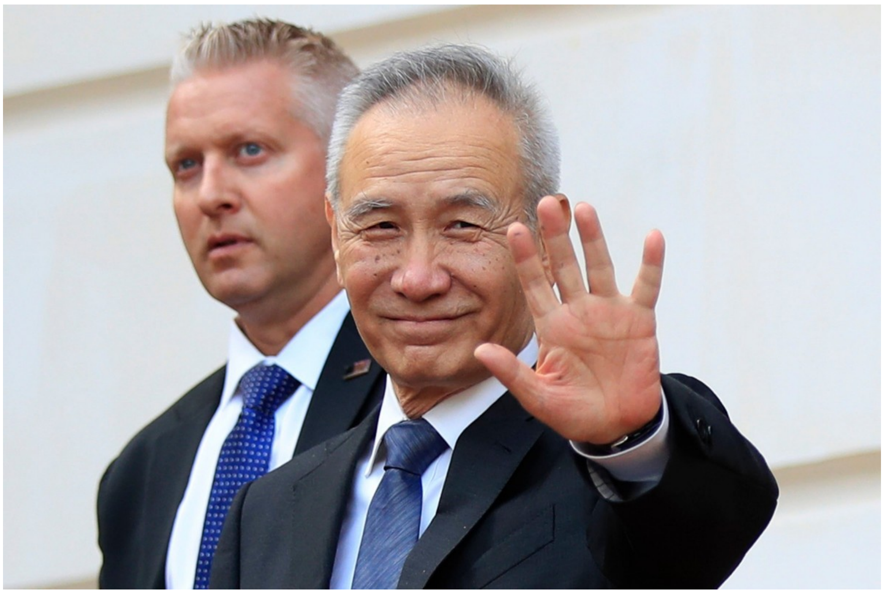
China: Growth aids trade battle

Stronger-than-expected Chinese growth, coupled with fiscal and monetary firepower, will help authorities in trade negotiations as the tariff battle goes up a notch



The Chinese Vice Premier, Liu He, in Washington during trade talks between the United States and China

Stronger growth will help China, but trade isn't the only factor in US talks

Last month, we noted that China has enjoyed a recovery created by fiscal stimulus and monetary easing. This was demonstrated by the recent GDP figures, where first-quarter growth matched the 6.4% YoY pace seen in 4Q18. Stronger-than-expected economic growth should provide the Chinese government with extra chips when it comes to renegotiating the terms of a draft trade deal with the US.

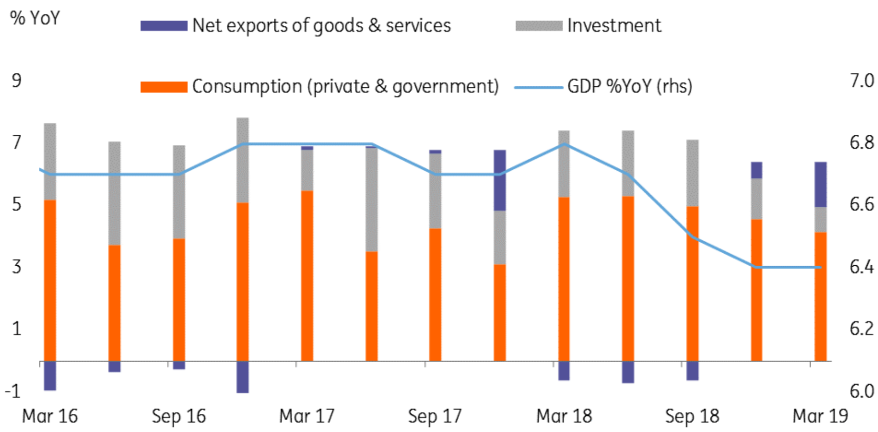
For China, the cost of confronting the US is more broad-based than trade

The latest turning point in the trade negotiations appears to have been triggered by disagreements over a reciprocal penalty system. But for China, the cost of confronting the US is more broad-based than trade. The US, along with some of its allies, have aired concern over the use of Chinese-made 5G equipment. Equally, tensions have risen in the South China Sea. If China successfully renegotiates, then it has the potential to reduce some of these risks.

If China renegotiates successfully then the potential risks on 5G exports and geopolitical tension around the South China Sea will be reduced.

But let's not forget, China's negotiation chips come from fiscal stimulus and monetary easing. Domestic consumption, as reflected in retail sales, is not as bright as it seems. China may need even more fiscal stimulus and monetary easing to support a possible long-running renegotiation.

Chinese GDP is supported by "consumption" from government



Source: Bloomberg, ING

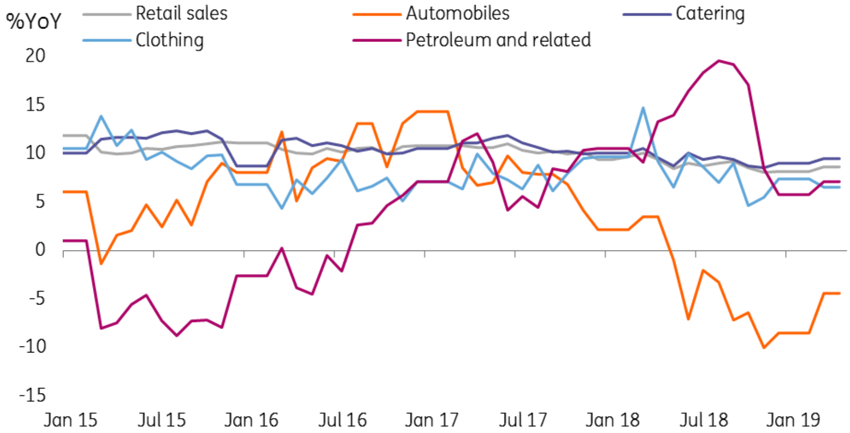
Recent actions show willingness of government to easy policy further

On the same day that the US revealed China has started renegotiating, the Chinese central bank, PBoC, restructured the system of required reserve ratios for small agricultural commercial banks. Though the extra liquidity released is a small drop of CNY280 billion out of an M2 money supply of CNY188,941 billion, it is a symbolic move that shows the willingness of the Chinese government to ease even further.

We keep our forecast for USD/CNY and USD/CNH at 6.75. But we have revised the 2Q and 3Q forecasts to 6.75 and 6.80 from 6.85. A big yuan depreciation when the trade war escalates could easily send an incorrect signal to the market that there are risks of capital flight. We have therefore kept our forecasts of USDCNY and USDCNH in a narrow range. We also keep GDP forecasts at 6.2%YoY in 2Q19 and 6.3% for 2019.

This article forms part of our Monthly Economic Update which you can find here

Consumers have been careful when it comes to spending



Source: Bloomberg, ING

Author

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com