

China: Trade war vs 5G

While the US-China trade dispute is unlikely to be fully resolved next year, 5G infrastructure and services will be a new growth engine for China's economy in 2020



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Risks and opportunities in 2020

In 2020, we expect the risks associated with the trade war to be just as significant as the opportunities provided by 5G.

Trade war still the key risk

We believe that any trade agreement in November or December will be small, with most of the current tariffs likely to stay in force. Chinese exporters, and the related supply chains, will continue to be affected.

In 2020, there will still be a lot of uncertainty over the signing of trade deals and questions about whether these might be later overturned, by both sides.

The impact of the dispute so far has been significant. In the five months to September, China's

exports showed negative yearly growth. The value of exports and imports declined by CNY566 billion in the first nine months of 2019 compared to the same period of the previous year. This may look relatively small but that's just the trade value; manufacturing activity has not been counted. In the eight months to October, the manufacturing PMI fell below 50, signalling a contraction in the sector. This has been reflected in slower economic growth overall despite sizeable fiscal stimulus.

We believe the trade war situation will continue to pose a threat to exports and manufacturing activity in 2020.

5G is the biggest opportunity

That said, 5G presents opportunities. Semiconductor sales have increased on a monthly basis since June 2019, and as we stated in [our electronics report](#), we think this is due to 5G.

China is in the process of building 5G infrastructure in its home country and is exporting to other economies, too, which will likely be the growth engine for semiconductor sales.

There will be more than [130,000 5G base stations by the end 2019](#) to support the 5G network. It is estimated that China will have [170 million 5G subscribers by 2020](#). This only covers 12% of the 1.4 billion population, so we'll inevitably see more 5G stations being built.

Meanwhile, Chinese smartphone brands have already entered the 5G smartphone market. We expect most consumers in the big cities to upgrade their 4G phones to 5G. This means that 5G applications will probably surge. The market is already anticipating new smartphone games, new video streaming services and most importantly the "internet of things".

It is estimated that 5G will stimulate [growth in China by 15 trillion yuan over the next five years](#). On average, it should contribute nearly 3% of nominal GDP each year (using the estimate of nominal GDP at 99 trillion yuan).

Big fiscal stimulus still needed?

For 2020, it is key that the government avoids piling up unnecessary debt after a surge in issuance in 2019.

As trade deals are unlikely to be fully completed, we believe that the central government will extend the tax and fee cuts for another year, which were worth around CNY2 trillion in 2019.

Most of the stimulus money for infrastructure projects came from the issuance of local government special bonds. For reference, the local government special bond quota for 2019 was 2.15 trillion yuan. Railway investments increased by 13.6% year-on-year on average in the first nine months of 2019.

Total fiscal stimulus is estimated to be in the range of CNY2 trillion to CNY3 trillion in 2020.

Will monetary policy go in tandem with fiscal stimulus?

The central bank seems to have been reluctant to flood the market with liquidity, seeking to avoid a repeat of 2009 when liquidity boosted speculation in various assets, including the real estate market.

As such, we think the PBoC will cut interest rates and the Reserve Requirement Ratio only when interbank rates are high, which could be measured by 3M SHIBOR over 3% on a consistent basis. Thus we expect the bank to cut interest rates once, by five basis points, and the RRR twice, each by 0.5 percentage points, in 2020.

Where is the yuan heading?

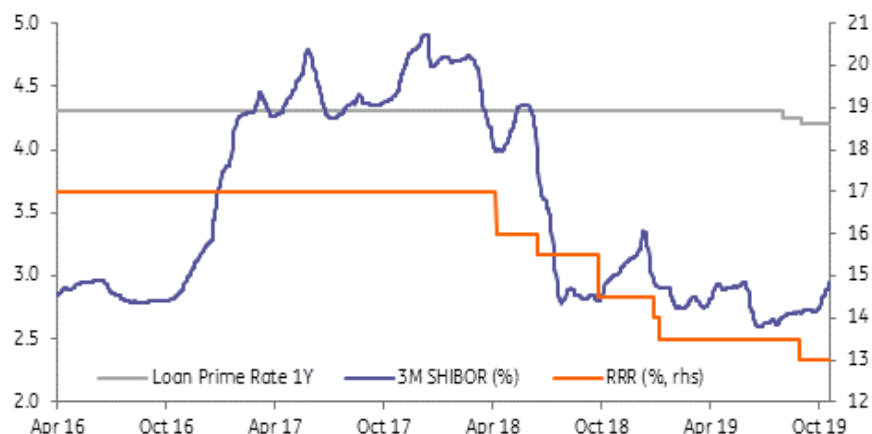
Both China and the US seem to be more willing to work out a deal than we previously expected. Though we don't think the September tariffs will be rolled back in phase one of the trade deal, this could still happen as we move closer to the US presidential election, which would support the yuan.

Our revised forecasts on USD/CNY are 7.00 and 6.85 for the end of 2019 and 2020, respectively. This strengthening is based on expectations of some progress in trade talks.

We would like to highlight that uncertainty about a trade deal is high and USD/CNY is likely to remain volatile.

GDP forecast

We expect the Chinese government to call for GDP growth in 2020 of "around 6.0%" when this is announced in March. Our forecast is for 5.9% growth next year. But this forecast depends a lot on the progress of trade talks.



Source: ING, Bloomberg

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com