

## A weak Chinese economy

Chinese industrial output reaches a 17-year low, echoing the recent slow credit growth. It's the result of the government opting for stability rather than speedy growth. But it also shows that without the right stimulus, low consumer demand will reflect lower production. Even President Trump's tariff delays offer little help



People crossing a Shanghai road

### Stable growth, but industrial production hit hard

Chinese fixed asset investments grew by 5.7%YoY in July, slowing slightly from 5.8% a month ago with infrastructure projects still the main driver of investments.

But industrial production was hit hard and grew by only 4.8%YoY from 6.3% previously. This kind of growth was last seen in January 2002, which effectively means the current manufacturing situation is worse than it was during the global financial crisis.

- The main cause is the contraction of cars and related manufacturing parts, which has led to very weak headline industrial production growth.
- Infrastructure projects have begun to enter the construction phase after projects received funding from local government special bonds. But the details show their contribution to industrial production was quite small compared to the negative impact of car-making on overall production.

Retail sales have slowed down to 7.6%YoY from 9.8% in June. Consumption sentiment hasn't been helped by tax and fee cuts, as consumers tend to save the additional income rather than spend

during challenging times. We see that spending on luxury items such as jewellery and cars declined while spending on essential items grew steadily.

# 4.8%

## Chinese industrial production

The weakest since Jan 2002

### China needs to speed up stimulus

The stability picture echoes the recent slower credit growth and a shrinking in shadow banking activities and implies that the government prefers stable quality growth over exponential growth.

But it's also time to consider whether the Chinese economy needs more stimulus. It's now divided into two parts; one is stimulus driven, another is regular activities. When regular activities face headwinds, there is a need for stimulus to keep the economy running to avoid rising unemployment.

To keep GDP growth above 6%, infrastructure projects that have received funding from local government special bonds should increase their pace, which in turn should help industrial production. At the same time, fiscal stimulus should be accompanied by easing monetary policy to divert liquidity to targeted borrowers, especially exporters.

Target required reserve ratio (RRR) cuts of 50 bps, together with targeted short-term interest rate cuts of 5 bps are expected in 3Q as well as 4Q.

### Tariff delays provide temporary respite, but tech firms to suffer longer

The US administration has delayed imposing the additional 10% of tariffs on some of the \$300 billion goods to 15 December, originally due to come into effect on 1 September.

So Chinese exporters and manufacturers don't need to front load shipments for the American holiday season, but unless the demand from the US is very strong, we don't expect this temporary delay to cheer up Chinese exporters.

China has not claimed victory on this tariff delay, and it should not, as the US administration could add other hurdles for Chinese companies, especially technology companies. American companies continue to be banned from doing businesses with Chinese technology companies that have been included in the US' entity list.

It is not all bad for China's future. We have argued this will force China to innovate its own hardware such as chips and its own operating system, for instance. Even though this may take a few years, China's threat to the US will not disappear. China realises this, and will continuously pour in more resources to achieve technology independence.

### USD/CNY has followed its own orbit

After crossing the 7 handle, USD/CNY seems to have its own orbit. Overnight, even the US

dollar jumped on the back of the tariff delay announcement while the offshore yuan strengthened from 7.10 to 7.04 at the time of writing this note.

Crossing that 7 line is a mere gesture on China's part to show its discontent with the progress of the trade talks. But this is not really a solution for exporters when they face high tariffs and fewer export orders.

So the activity data and the delay of tariffs doesn't change our forecast of USD/CNY at 7.10 by the end of 2019.

### **Upcoming trade and stimulus plans may help**

The activity data in July was weaker than our expectations but we need to see if there will be more stimulus coming to speed up the growth slightly so that it won't touch the 6% target line in 3Q. Infrastructure projects should help too.

Upcoming trade talks and stimulus plans will help us decided if we need to revise our GDP forecast for 3Q and 4Q, but for now, we maintain them at 6.3% for 3Q and 4Q, respectively.