China’s trade future rests on its ability to sell tech abroad

The surge in shipments to avoid potentially higher tariffs has come to an end with Chinese exports shrinking on an annual basis in June. The tougher environment has had an impact on imports too. As things stand, it seems technology will be at the heart of the fate of China's exports in the future

Source: Shutterstock

G20 didn't really do much for China's trade problems

Even though the outcome of the sideline meeting between President Trump and President Xi at the G20 meeting was a so-called truce, Chinese exporters continued to export goods earlier than planned to avoid a possible further increase in tariffs.

But these front running export activities seem to have finally ended as exports fell 1.3% year on year in June after a small increase of 1.1% in May. It seems exporters have run out of goods to export to the US that could circumvent future tariffs. In June, China's exports to the US rose by a meagre 4.3% month on month after a 20% spike in May.

Given exporter's pessimistic outlook about future trading activities, imports contracted too - 7.3% YoY in June after falling by 8.5% a month ago - as exporters haven't imported many parts for future production. For 2H19, we believe exports and imports will continue to shrink.

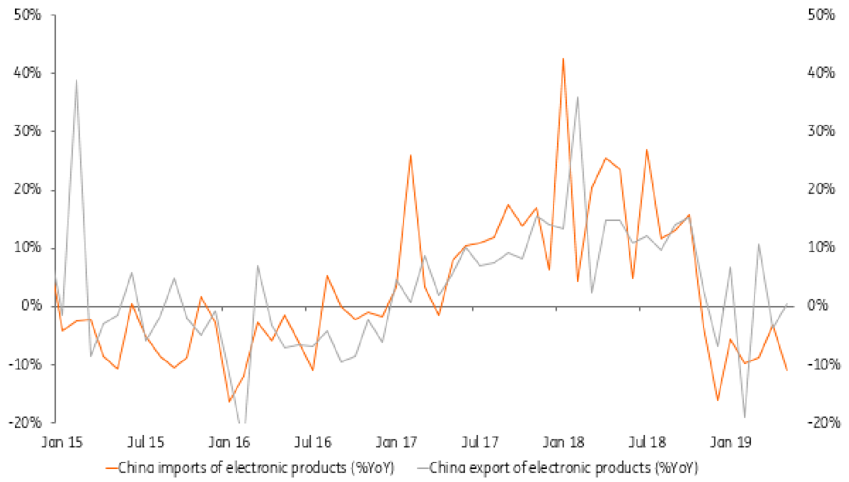
The tech war could have a long-term impact on China's exports

Between January to June 2019, mechanical and electronic products made up around 55% to 60% of China's exports, which means the tech war will hurt China's export significantly.

Post the G20 meeting, Huawei's CEO said, "very little has materially changed as Chinese tech firms still face quite a few problems in doing business with the US even with the changed US policies" and we tend to agree. But nowadays technology usually has dual-use, which means it can be used both by the military and ordinary people. So, in our view, this apparent relaxation is nothing more than a political gambit.

This may also explain why China hasn't yet increased US agricultural produce imports. This month alone, soybean imports fell by 15%MoM, which implies that China is still yet to import more agricultural products from the US. Moreover, there are other countries blocking Chinese companies from engaging in the 5G infrastructure set up, so we expect this tech war to continue for a while.

But all of this means that technology products and parts export from China will diminish after this wave of front running (tariff avoiding) activities.



Source: ING, Bloomberg

Government stimulus to fill GDP growth gap

As we've explained before, depreciating the yuan won't help exporters who are concerned about 25% tariffs, as such a large spike in tariffs will mean they forego export orders altogether, and then the exchange rate movements will no longer be a concern for them.

Therefore, China is likely to rely on government stimulus measures to fill the gap of loss of export activities, which means infrastructure investments and related manufacturing activities will have to continue to support GDP growth to prevent it falling below the 6% lower bound target set by the government.

In our view, China's trade activities will need to bounce back considerably to avoid more fiscal stimulus and achieve above 6% GDP growth.

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