FORSYTH BARR

Economic Snapshot: China

Playing The Long Game

Kevin Stirrat
kevin.stirrat@forsythbarr.co.nz
+64 9 368 0069

China has come to the rescue of the global economy three times in the last decade. The first was immediately after the Global Financial Crisis in 2009, the second when the European Union was in crisis in 2012, and the third was when global energy prices collapsed in 2015. Each time, China flooded its economy with monetary and fiscal stimulus, boosting import demand and global activity. Due to rising debt imbalances, Beijing is now relying on currency devaluation to offset weaker growth. In a way, the trade war with the US is a useful distraction, and something to blame for softer activity. The growth in China's broad money supply, M2, has been slowing as policy makers rein in credit expansion and take tighter control of the property market (Figure 2). China's import demand has slowed accordingly and this is having a deflationary impact on global trade. The transition from investment led, to consumption led, growth is also having a marked impact on global trade. Consumption is increasingly services orientated, and less import-intensive. Major infrastructure projects have most likely peaked, which also means lower demand for commodities. The global economy needs to get used to China worrying about "China", with domestic politics and long-term economic stabilisation of more importance than major concessions in a trade agreement with the US.

Distrust in Trump remains high

Editorial's in the China Daily following conclusion of the trade talks last week highlight the "substantial progress" made in a wide range of fields including agriculture, intellectual property protection, exchange rates, financial services, trade cooperation, technology transfer and dispute settlement. But the articles also point out that the US still views China as a currency manipulator, retains high tariffs on most Chinese products, has imposed restrictions on business links of US companies with Chinese tech giant Huawei, imposed sanctions on individuals and companies associated with the imprisonment of Uyghur Muslims in Xinjian, and worse, the attitude of many US politicians towards China remains hostile. The level of confidence that Washington will adhere to any agreement reached is low, based on past records. Hence, it seems unlikely that Beijing will make any long-term concessions, particularly around structural changes in its economy or territorial aspirations. China will keep the channel of communications open but is likely buying time to see what comes out of next year's US elections. It is unlikely the 'Great Decoupling' will end soon.

NBA's off the court lesson for us all

Beijing's response to the Houston Rocket's general manager tweet in support of democracy protestors in Hong Kong underscores the complexity of any deals made with China. The response to ban NBA games from being broadcast in China, and the loss of all NBA's official partners in the Middle Kingdom, was both quick, and on the face of it, thin-skinned. But the message is: countries and companies must toe China's propaganda line, silence dissent and avoid hurting the feelings of the Chinese people. If not, the risk is exclusion from the world's second largest economy.

This example demonstrates the ability of Beijing to mobilise private Chinese companies to cut off dealing with foreign companies for as little as a tweet. It makes you wonder what would happen if Huawei was the dominant 5G provider for a country and politics or business sentiment soured between China and that country.

Key economic data (as at 14 October 2019)

Figure 1. Key economic data

Country	GDP (US$Bn)	GDP % (YoY)	GDP % (QoQ)	Cash Rate (%)	CPI % (YoY)	Jobless %	Govt Budget %	Govt Debt/GDP
China	13,608	6.20	1.60	4.20	2.80	3.6	-4.20	50.50

Source: Forsyth Barr analysis, Trading Economics

Recent economic releases

- China Caixin Manufacturing PMI rose to 51.4 in September
- China's official non-manufacturing PMI was steady at 53.7 in September
- China's exports fall the most in seven months, down -3.2% YoY to September
- China's inflation rate was +2.8% in August.

Caixin Manufacturing PMI unexpectedly rises in September

The Caixin China General Manufacturing PMI unexpectedly rose to 51.4 in September from 50.4 in August and above market expectations of 50.2. The latest reading points to the strongest pace of expansion in the manufacturing sector since February 2018, as output grew the most in over a year and new orders increased at the fastest pace since March 2018, despite a further reduction in overseas sales.

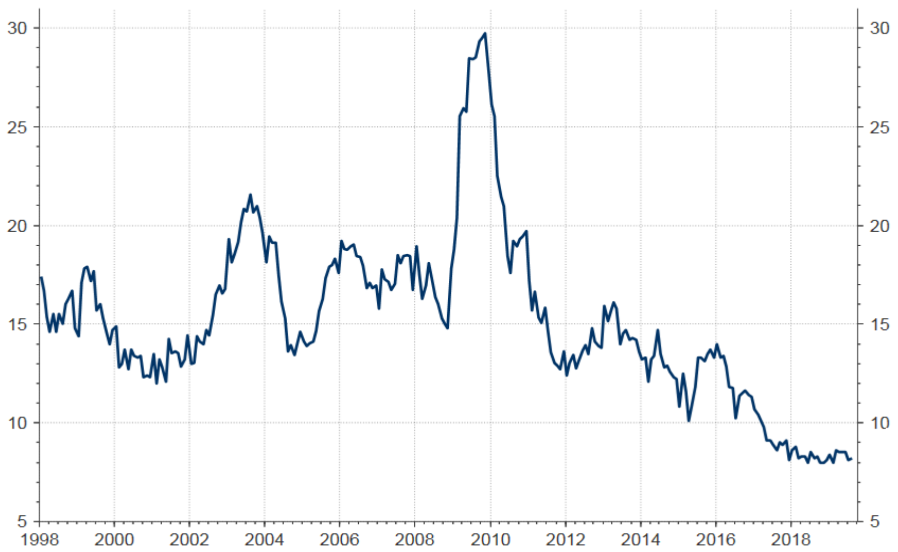
Employment was broadly unchanged, while backlogs of works went up at the steepest rate since early 2018. The lower exchange rate and the impact of higher tariffs pushed input prices up, while output prices were stable. This indicates a further squeezing of corporate profits. Sentiment remains weak amid declining profits and the ongoing worry of the US–China trade negotiations.

Non-manufacturing softer than expected

The official NBS Non-Manufacturing PMI came in at 53.7 in September, little changed from the previous month and below market forecasts of 54.2. New orders rose at a slightly faster pace, despite declining export orders, while employment continued to contract. On the price front, input cost inflation picked up while output charges were flat (margin contraction). Looking ahead, business confidence weakened to an eight-month low.

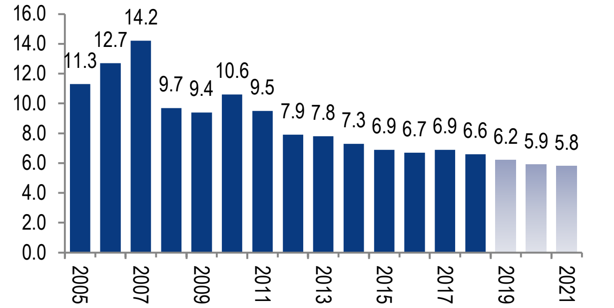
China's broad money supply growth continues to slow

Figure 2. China's M2, 12-month percent change



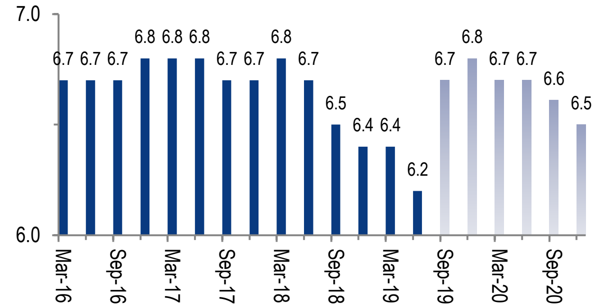
Source: Forsyth Barr analysis, Thomson Reuters DataStream

Figure 3. Real GDP (annual YoY %)



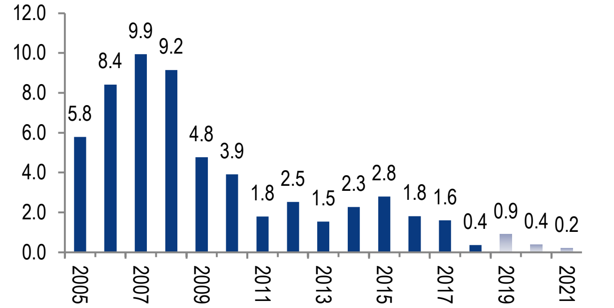
Source: Forsyth Barr analysis, Bloomberg

Figure 4. Real GDP (quarter YoY %)



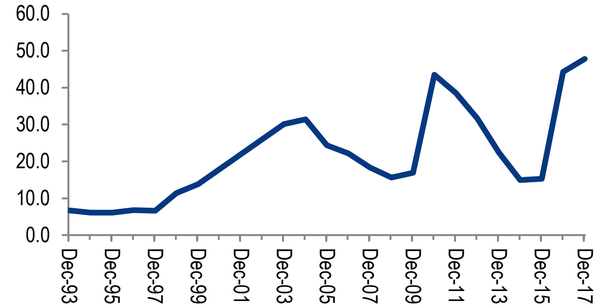
Source: Forsyth Barr analysis, Bloomberg

Figure 5. Current account balance (% of GDP)



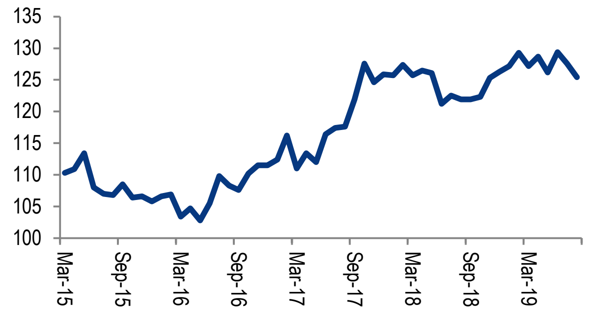
Source: Forsyth Barr analysis, Bloomberg

Figure 6. Government debt to GDP (%)



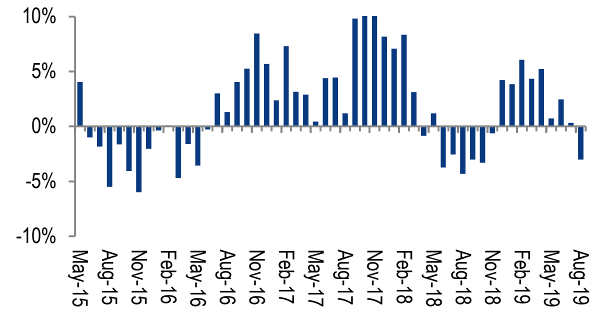
Source: Forsyth Barr analysis, Bloomberg

Figure 7. Westpac MNI China consumer sentiment



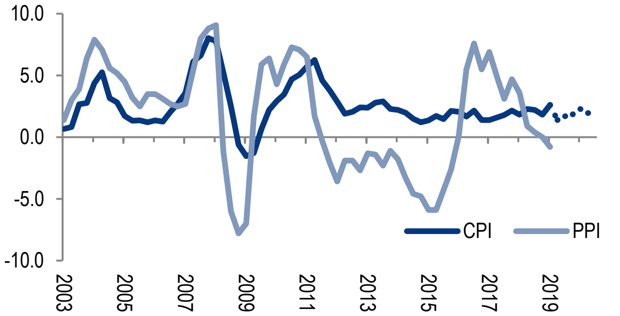
Source: Forsyth Barr analysis, Bloomberg

Figure 8. Change in consumer confidence (rolling six months)



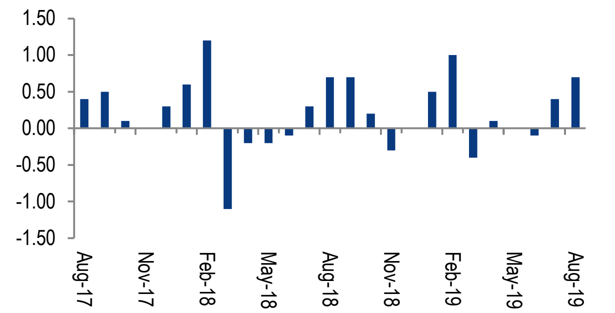
Source: Forsyth Barr analysis, Bloomberg

Figure 9. CPI and PPI (YoY%)



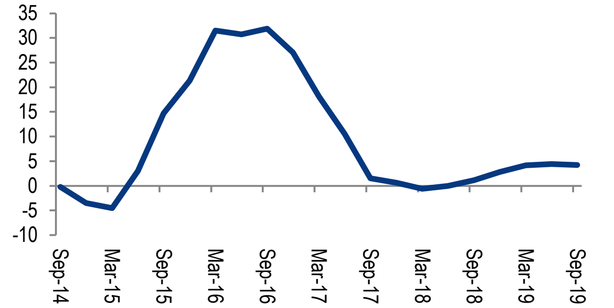
Source: Forsyth Barr analysis, Bloomberg

Figure 10. CPI momentum (MoM%)



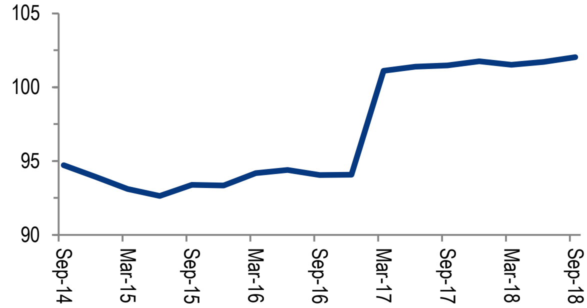
Source: Forsyth Barr analysis, Bloomberg

Figure 11. First tier cities new residential buildings prices (YoY%)



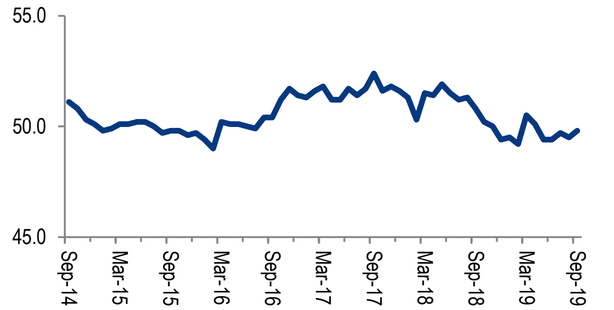
Source: Forsyth Barr analysis, Bloomberg

Figure 12. Real estate climate survey



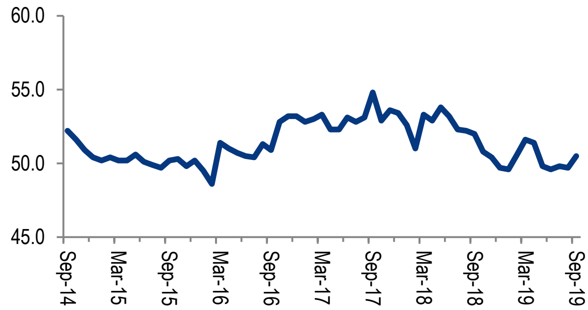
Source: Forsyth Barr analysis, Bloomberg

Figure 13. China manufacturing PMI



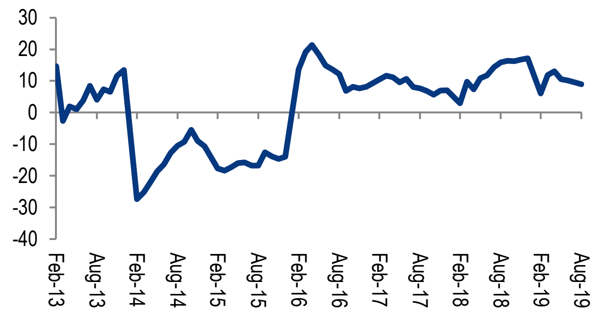
Source: Forsyth Barr analysis, China Federation of Logistic and Purchasing

Figure 14. PMI new orders



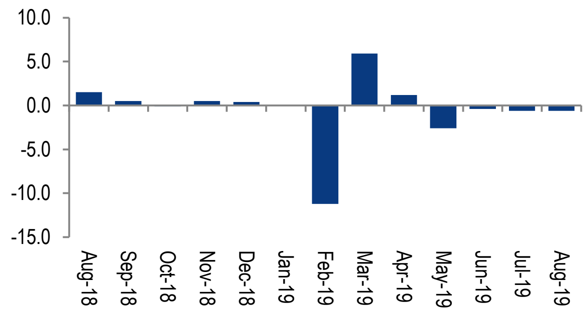
Source: Forsyth Barr analysis, Bloomberg

Figure 15. Private housing authorized by building permits (YoY%)



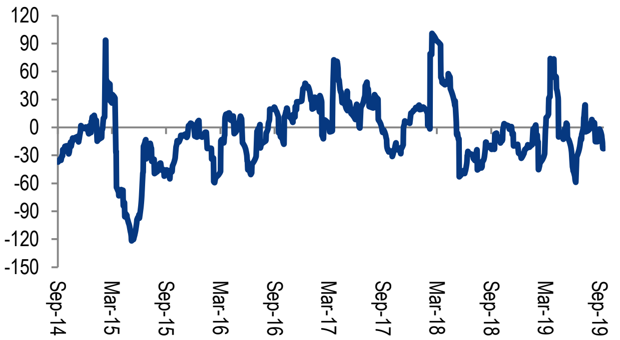
Source: Forsyth Barr analysis, Bloomberg

Figure 16. Monthly change in the YoY% of building permits*



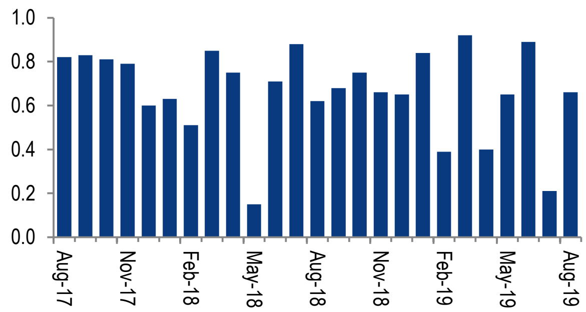
Source: Forsyth Barr analysis, Bloomberg

Figure 17. Citigroup economic surprise index



Source: Forsyth Barr analysis, Bloomberg

Figure 18. China retail sales value (MoM%)



Source: Forsyth Barr analysis, Bloomberg