ABN·AMRO

Short Insight

Group Economics
Emerging Markets &
Commodity Research

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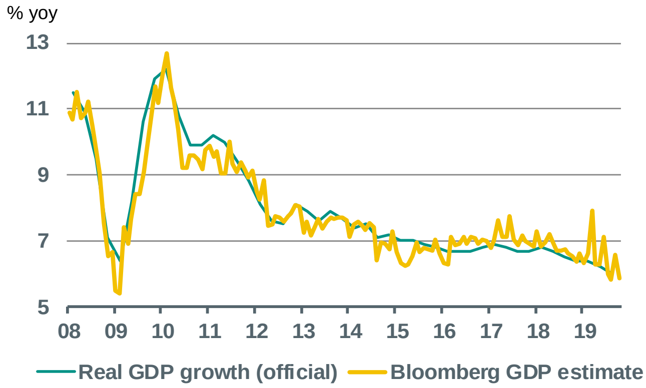
China - Wanted: trade deal and more stimulus

- **Hard data disappoint in October, remaining very volatile**
- **China also needs trade deal, next to more targeted stimulus, to stabilise growth**
- **Ongoing weakness foreign trade to large extent driven by US-China conflict**
- **Macro data suggest that China has an incentive to end the tariff tit-for-tat too**

1. Hard data disappoint in October, remaining very volatile

After showing improvement in September, the macro data for October published today were weaker again and below expectations. Industrial production growth fell back to 4.7% yoy (Sept: 5.8%, consensus: 5.4%), comparable to the lows seen in July/August. Growth of retail sales dropped to 7.2% yoy (Sept/consensus: 7.8%), the weakest pace since 1999. Fixed investment slowed to 5.2% yoy (Sept/consensus: 5.4%), the lowest number on record. The slowdown of investment is driven by private investment, which fell back to a three-year low of 4.4% yoy in October. State-led investment is holding up better, reflecting government measures directed at stimulating infrastructure investment by local governments. What is also striking is the extreme volatility of the macro data over the past couple of months. As far as business confidence is concerned, this could be partly explained by the many twists and turns in the US-China trade conflict next to the seasonal distortions that are typical for China. While its trend points to a gradual slowdown, though less shallow than GDP growth, Bloomberg's monthly GDP tracker has fluctuated in an unusually large range this year with a peak of 7.9% yoy in March) and a bottom of 5.8% yoy in August.

Activity data extremely volatile this year

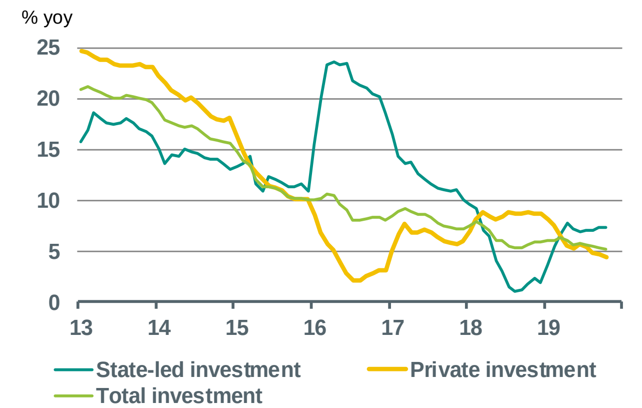


Source: Bloomberg

2. Trade deal and more stimulus needed to stabilise growth

The rise of Caixin's manufacturing PMI in recent months suggests that confidence amongst private firms is improving. That probably reflects targeted stimulus and rising hopes of a US-China deal. However, hard data show that this has not led to a pick-up in private investment (yet). All this implies that for the Chinese economy to stabilise a 'Phase one agreement' marking the end of the US-China tariff tit-for-tat would be welcome, as the escalation of this conflict has proven to be a clear headwind – on top of the effects of China's previous financial deleveraging campaign. It also shows that more stimulus is needed to support domestic demand. We continue to hold the view that Beijing will step up piecemeal stimulus. And we still expect them to refrain from aggressive easing given longer-term constraints such as the need to keep overall debt levels in check and to prevent a housing bubble. Recent measures lend support to this view. Following previous mini steps including further RRR cuts, in early November the PBoC cut the rate on its medium-term lending facility by 5 bps, to 3.25%. And this week, Beijing announced to lower capital requirements for certain infrastructural projects.

Private investment growth at three-year low



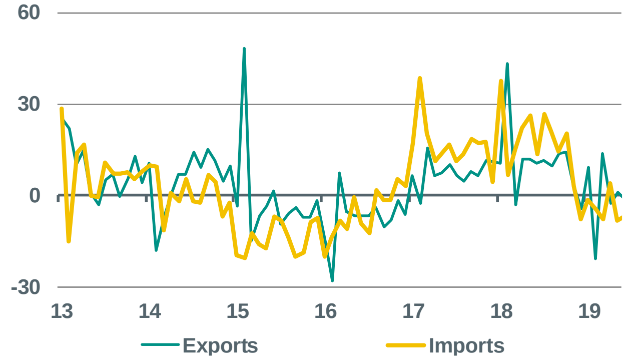
Source: Thomson Reuters Datastream

3. Foreign trade data driven down by collapse bilateral US-China trade

Chinese foreign trade growth for October remained in negative territory. That said, both export and import numbers came in slightly better than in September and above consensus expectations. Exports in USD terms contracted by -0.9% yoy (Sept: -3.2%, consensus: -3.9%). Imports in USD terms contracted by -6.4% yoy (Sept: -8.5%, consensus: -7.8%). We should add that the weakness in foreign trade data is still to a large extent dominated by the US-China trade/tech conflict. Chinese exports to the US were down 16.2% yoy in October and 11.6% yoy in the first ten months of this year. Chinese imports from the US were down 14.3% yoy in October and 25.4% yoy in the first ten months of this year. Imports from the EU were down -3.0% yoy in October, but are stable in January-October. Imports from Germany contracted by almost 12% yoy in October and by almost 3% in January-October. All this suggests that the US-China trade conflict is still the dominant factor in explaining China's weak foreign trade growth numbers. This not only reflects the collapse of bilateral trade, but also the impact of the conflict on global growth and trade. Regarding imports, the weakening of domestic demand has been a drag as well.

US-China conflict key drag on foreign trade growth

Chinese foreign trade, Values, USD, % yoy



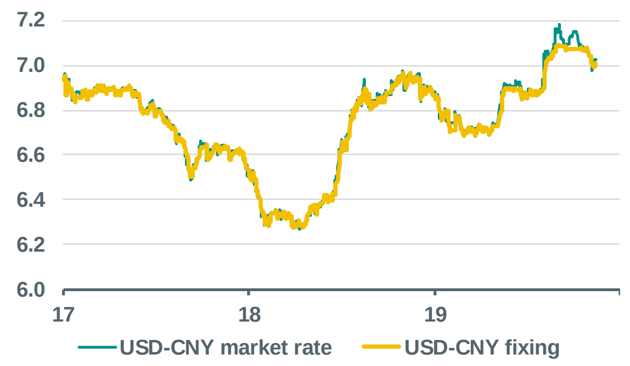
Source: Thomson Reuters Datastream

4. Macro data suggest China has incentive to end tariff tit-for-tat too

After a re-escalation of the US-China trade/tech conflict last May, over the past months we have seen tentative signs of de-escalation. That suggests some shift of political calculus in both Washington and Beijing, with US presidential elections looming in November next year. Both countries have granted tariff exemptions to each other. Last month, US president Trump announced a so-called 'Phase one-deal'. That entailed the US from refraining from further tariff hikes and China to step up agricultural imports from the US. This partial trade deal allegedly should be signed by Trump and Xi later this year, on a time and place still to be announced. The mid November APEC summit in Chile, where both gentlemen were supposed to meet, was cancelled for domestic reasons. The latest macro data suggest that not only the US but also China has a clear incentive to at least put an end to the tariff tit-for-tat, with new US tariffs due on 15 December without a short-term deal. Uncertainties remain however, for instance on how much rollback on existing tariffs could be agreed on and under what conditions (such as an enforcement mechanism). Given that both parties remain wide apart on some fundamental issues, a comprehensive deal still looks out of sight for now and strategic tensions between the two will likely linger.

CNY regained somewhat vs USD on trade deal optimism

CNY per USD



Source: Bloomberg

Key forecasts for the economy of China

	2016	2017	2018	2019e	2020e
GDP (% yoy)	6.7	6.8	6.6	6.2	5.8
CPI inflation (% yoy)	2.1	1.5	1.9	2.5	2.5
Budget balance (% GDP)	-3.8	-3.8	-4.2	-4.5	-4.5
Government debt (% GDP)	16	17	15	19	22
Current account (% GDP)	1.8	1.6	0.4	0.5	0.5
Gross fixed investment (% GDP)	42.7	42.9	43.1	42.4	41.8
Gross national savings (% GDP)	45.9	46.3	45.2	44.5	43.4
USD/CNY (eop)	7.0	6.5	6.9	7.2	7.5
EUR/CNY (eop)	7.3	7.8	7.8	8.1	8.6

Economic growth, budget balance, current account balance for 2019 and 2020 are rounded figures
Source: EIU, ABN AMRO Group Economics