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Growth slows to 6% in Q3, monthly data improve

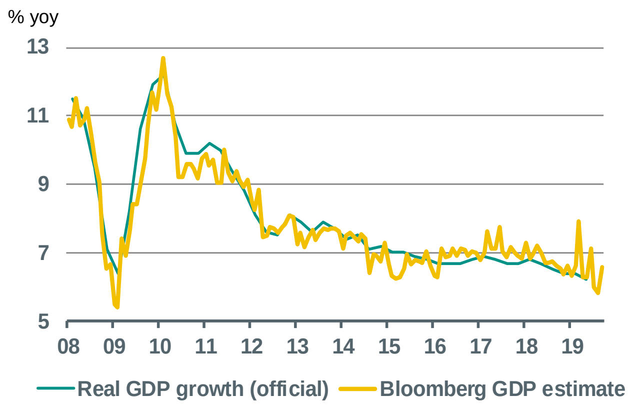
Arjen van Dijkhuizen
Senior Economist
Tel: +31 20 628 8052
arjen.van.dijkhuizen@nl.abnamro.com

- **Growth drops to 6.0% yoy in Q3, driven by industrial weakness …**
- **… but macro data for September improve compared to July/August …**
- **… although US-China conflict remains drag on foreign trade growth**
- **Policy easing still moderate and only slowly filtering trough**

1. Growth drops to 6.0% yoy in Q3 driven by industrial weakness …

Real GDP growth in Q3 came in marginally lower than expected, at 6.0% yoy (consensus/our expectation: 6.1%; Q2: 6.2%). This reflects the lowest pace of growth in three decades and is at the bottom of the government's growth target for 2019 (6.0-6.5%). Quarterly growth fell marginally to 1.5% qoq (Q2: 1.6%). The slowdown was driven by weakness in the industrial sectors. Growth of industry and construction slowed to 5.2% yoy (Q2: 5.6%). This was partially offset by a mild acceleration in services, from 7.0% yoy in Q2 to 7.2% in Q3. The weakness in industry fits within the global picture, as the escalation of the US-China trade/tech conflict has proven a serious drag for worldwide business confidence, manufacturing activity, investment and trade. All in all, these numbers are in line with our base scenario of an ongoing gradual slowdown. We expect annual growth to drop from 6.6% in 2018 to 6.2% in 2019 and for next year we expect growth to slide further and fall below 6%. Our annual growth forecast for 2020 is 5.8%, which is slightly below consensus (but consensus is moving our way).

Official GDP growth drops to 6,0% in Q3 …

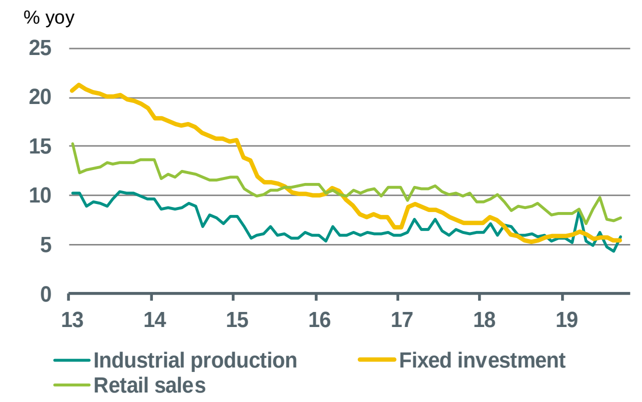


Source: Bloomberg

2. … but macro data September improve compared to July/August

Notwithstanding the ongoing growth slowdown in Q3, the monthly activity data for September clearly improved compared to the two previous months. Industrial production growth bounced back to 5.8% yoy, from a weak 4.5% yoy in July/August. Growth of retail sales edged up to 7.8% yoy (around 7.5% in July/August). Over the past months, retail sales growth has been quite volatile due to specific developments in car sales, with a peak in June (driven by inventory adjustments related to the introduction of new emission standards) followed by payback in subsequent months. Fixed investment dropped back marginally to 5.4% yoy (August: 5.5%) and has failed to gain momentum in the course of this year. That is mainly due to ongoing weakness in private investment growth, while state-led investment growth has picked up on the back of fiscal stimulus (although falling back a bit in August). Earlier this month, the manufacturing PMIs (particularly Caixin's index) showed improvement, while the services PMIs were slightly weaker. Overall, Bloomberg's monthly GDP estimate improved sharply in September, to 6.6% yoy, up from the relatively weak numbers in July (6.0%) and August (5.8%).

… but montly data improve in September

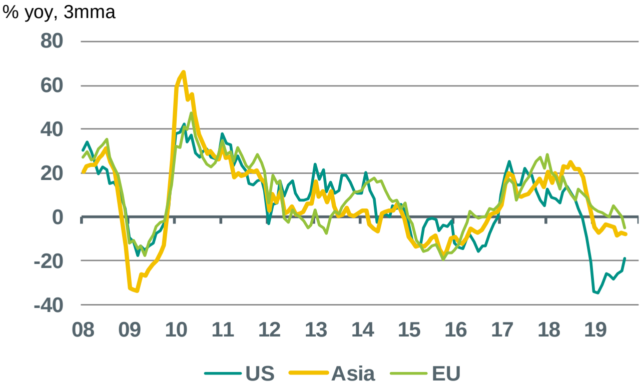


Source: Thomson Reuters Datastream

3. … although US-China conflict remains drag on foreign trade growth

Despite the uptick in momentum in September, Chinese foreign trade data deteriorated further. Exports in dollars contracted by 3.2% yoy (August: -1.0%, consensus: -2.8%). Imports in dollars contracted by 8.5% yoy (August: -5.6%, consensus: -6.0%). This weakness is primarily the result from the trade-conflict related collapse of US-China bilateral trade, although broader weakness in external and domestic demand also plays a role. Chinese imports from the US so far this year have been on average 25% lower than during the same period in 2018 (Chinese exports to the US also dropped, but less dramatically). Growth of Chinese imports from Asia and Europe has also slowed, but not as aggressively. All in all, the tariff war has proven a clear drag for US-China bilateral trade, and is indicating some decoupling between the world's two largest economies. The recent 'Phase One' agreement between the US and China does little to change the macro scenario, although that could change over time if this 'handshake deal' would mark the end of the tit for tat tariff spat (but 'seeing is believing'). That said, even in case Trump and Xi would sign an agreement in November, strategic tensions between the US and China will likely linger, particularly on the technology front (also see our Asia Watch published last week here).

US-China conflict still drag on foreign trade growth

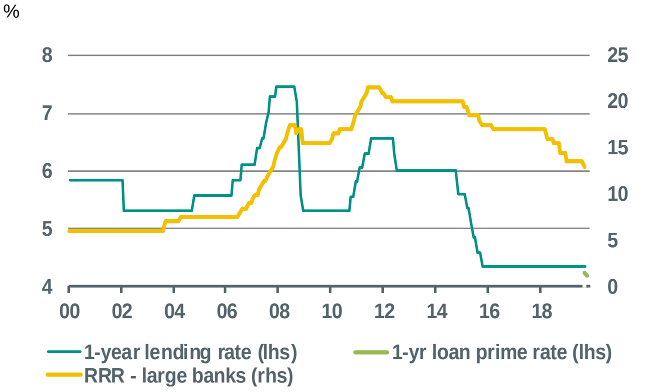


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

4. Policy easing still moderate, and only slowly filtering through

In line with our view, the Chinese authorities have been cautious so far with policy easing, as they are constrained by the desire to keep overall debt levels in check. Moreover, ongoing resilience of the real estate markets also takes away some of the urgency. True, as the drag from the US-China has conflict has risen, Beijing has shifted its policy stance from targeted tightening/financial leveraging to piecemeal monetary and fiscal easing. That said, the stimulus provided so far is still limited compared to previous episodes of easing, such as in 2015-16 and 2008-09, and the pick-up in lending growth is much smaller now. In recent months, the PBoC has modified its interest rate toolkit, with the 1-year loan prime rate now seen as a new benchmark rate. So far, the PBoC has only cut this rate very modestly (a 5 bp cut in September, no change in October). The PBoC has also continued cutting banks' RRRs (by a cumulative 150 bp this year), with additional cuts provided for certain city commercial banks that lend a lot to private firms/SMEs. Given the ongoing drags on growth, we expect the authorities to continue with adding piecemeal monetary and fiscal stimulus.

Monetary easing limited compared to previous episodes



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