China: weak start of the Year of the Pig

Economic Comment
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- **Based on the first monthly figures and our expectations, economic momentum will weaken further this year**
- **There are positive signals about a looming trade deal with the United States, although a summit between Presidents Trump and Xi seems unlikely in the weeks ahead**
- **We can learn from the National People's Congress that Chinese policymakers will put emphasis this year on securing stability on several fronts, but there have been contradicting announcements in terms of stimulus policies, risk mitigation and growth**
- **On balance, we expect that the gradual slowdown of the Chinese economy to continue, leading GDP growth to fall from 6.6% in 2018 to 6.3% this year, and 6% in 2020**

Mixed, but generally weak start of 2019

The first months of the Year of the Pig show a mixed picture as far as economic activity is concerned. After real GDP growth slowed down further to 6.4% in the fourth quarter of 2018 compared to the same quarter in 2017, it appears that this slowdown will continue in 2019Q1. On the domestic side, industrial production in particular was disappointing, having its weakest year start since 2009. Retail sales performance remained stable and fixed asset investments even rebounded somewhat compared to late 2018 (Table 1). China's National Bureau of Statistics (NBS) publishes combined figures for these domestic indicators for January and February each year, because of volatility related to Chinese New Year. Looking ahead, sentiment indicators for the industry and services sector also show a mixed picture. The level of the industry purchasing managers' index (PMI) is still below the neutral level of 50, which indicates less manufacturing activity in the period ahead. The Caixin services PMI is currently still above that neutral level, although it fell considerably in February (Figure 1).

Table 1: Domestic indicators point to weak start of 2019

	Jan-Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-Feb-19
Retail sales												
Nominal	9.4	10.1	9.4	8.5	9	8.8	9	9.2	8.6	8.1	8.2	8.2
Fixed asset investments												
Total	7.9	7.5	7.0	6.1	6	5.5	5.3	5.4	5.7	5.9	5.9	6.1
Private	8.1	8.9	8.4	8.1	8.4	8.8	8.7	8.7	8.8	8.7	8.7	7.5
SOEs	9.2	7.1	6.5	4.1	3	1.5	1.1	1.2	1.8	2.3	1.9	5.5
Industrial production												
Total	6.2	6.0	7.0	6.8	6	6	6.1	5.8	5.9	5.4	5.7	5.3
SOEs	N/A	5.7	7.7	8.1	6.1	6.2	5.6	5.6	4.6	3.9	3.6	N/A

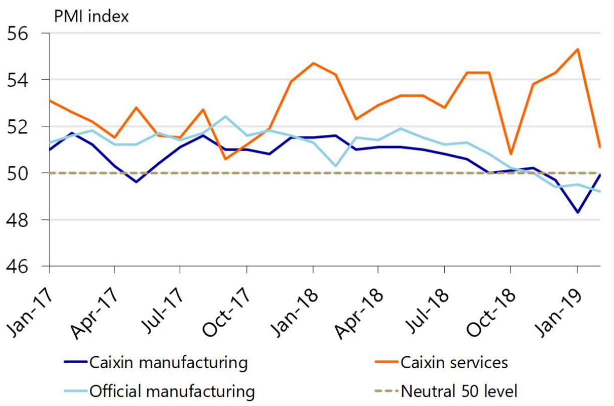
Source: NBS, Macrobond.

Note: there is no data available yet on industrial production by state-owned enterprises (SOEs) and retail sales in real terms for Jan-Feb 2019

Trade is disappointing as well

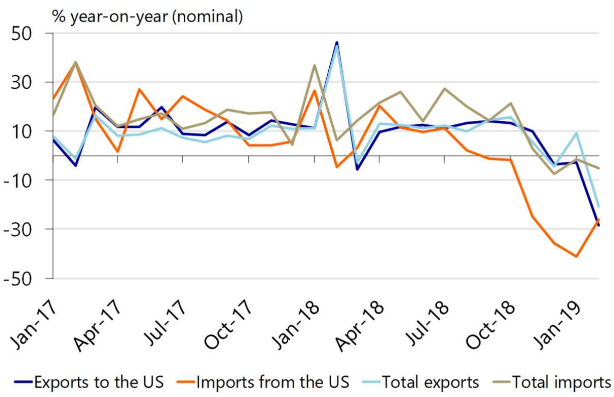
Next to the domestic figures, the most recent data on external trade are also disappointing. Exports are suffering from falling global demand and the trade tensions with the United States (US), while lower imports correspond to cooling of domestic economic activity (Figure 2). The effect of the US-China trade war is clearly visible. For example, in January-February Chinese imports from the US fell in nominal USD terms on average by 33.6%, while exports from China to the US on average lowered by 15.7%. It is important to emphasize that these figures are in nominal terms. This means that any export subsidy policies by the Chinese government could in turn have led to lower export prices in relative terms, which means that the decline could be less in real or volume terms. It should, however, be noted that China's General Administration of Customs already released trade data for the first nine days of March (+39.9% year-on-year), which clearly signals efforts to alter the negative momentum in terms of confidence.

Figure 1: Sentiment has become more negative



Source: Macrobond

Figure 2: Trade activity loses further momentum



Source: Macrobond

Can we expect a deal between the US and China soon?

Although the latest news is that any meeting between China's President Xi Jinping and US President Trump will not take place before the end of March, there are signals that a deal on trade is likely to be struck sooner or later. As a result, tariffs would not be raised from 10% to 25%. There is even a chance that the US lowers the current protectionist packages in the short run, in case China shows progress on the implementation of higher import pledges. However, we think that these tariff packages will not be lifted completely and many of the already installed tariffs will remain in place as part of an enforcement mechanism. In the medium term, we deem it not realistic that China follows up on more complicated demands, such as an opening up of certain parts of the economy, forced transfer of technology, excessive support of SOEs. As a result, we think that an overall deal will break down in the end, resulting in renewed tensions over trade. Giving China's cooling domestic economic momentum and challenges in terms of financial and economic stability, the country seems to be more in need of a short-term deal than the US.

National People's Congress of stability and contradictions

This year's National People's Congress (NPC) of the Chinese Communist Party ended on March 15. During the NPC Prime Minister Li Keqiang outlined that Beijing is expecting 'a difficult time ahead' and stated that the country must be prepared for a 'tough struggle'. As a result, the majority of announcements that have been made focused on emphasizing to safeguard stability. That is a clear difference compared to the announcements that were made at the NPC in 2018. Back then, the focus of policymakers shifted increasingly to the so-called quality of economic growth, with more attention being paid to environmental pollution, income inequality and financial stability. A question raised in the aftermath of that NPC was what would happen in case economic growth would slow down faster than anticipated, for example due to lower domestic activity, more instability or a further escalation of trade tensions with the US. As an answer, China's fiscal and monetary policymakers have decided fired up the stimulus engine again.

In general, this year's targets related to economic growth and the (central) government deficit are largely in line with earlier expectations. For example, next to several other announcements, a GDP growth target between 6 and 6.5 percent has been set for 2019 and the central government deficit target was raised from 2.6% to 2.8% of GDP. It however seems that many of the communicated policy targets are at odds with each other. For example, the announced stimulus package through tax cuts worth 2% of GDP (298bn USD) do not correspond with a 0.2%-points increase of the central fiscal deficit target, as there were no significant corresponding tightening measures announced. In addition, monetary policymakers pledged to pursue a 'prudent' policy stance this year. Plans were announced for further cuts in the required reserve ratio for banks and to speed up lending to small- and micro firms, while stating that they want to keep the debt-to-GDP ratio stable. Giving that nominal GDP growth is expected to be lower this year, there is also a clear contradiction on the side of monetary stimulus and goals. As a result, this year's NPC was one of emphasizing stability combined with contradictory goals.

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