CHINA: MOMENTUM REMAINS SOFT IN JANUARY AND FEBRUARY
EXPECT FURTHER DECELERATION BEFORE MODEST REBOUND IN H2

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SUMMARY
› Latest economic indicators show that Chinese growth momentum remained soft in January and February, consistent with our expectations.
› Industrial activity was especially weak, weighed by the mining and utility sectors. Growth in fixed asset investment (FAI) improved slightly, but was mainly driven by property investment, which may not be sustainable. Retail sales growth remained at low levels, indicating soft momentum in the consumer sector as well.
› Looking forward, we expect China’s growth momentum to continue to decelerate before staging a modest rebound in the second half of the year.

Latest economic indicators show that Chinese growth momentum remained soft in January and February, consistent with our expectations. Industrial activity was especially weak, weighed by the mining and utility sectors. Growth in fixed asset investment (FAI) improved slightly, mainly driven by the acceleration in property investment, but investment in the manufacturing sector declined. However, the strength in property investment is unlikely to be sustained given a deteriorating sales outlook. Retail sales growth remained sluggish, indicating soft momentum in the consumer sector as well.

Looking forward, our expectations of a continued slowdown in the Chinese economy in H1 2019 remains unchanged. We expect more liquidity injections in the coming months and implementation of the new fiscal stimulus measures announced during the National People’s Congress meeting, which jointly could lead to a stabilisation of the economy around the middle of the year before a modest rebound.

CHART 1: GROWTH IN CHINESE INDUSTRIAL PRODUCTION AND OFFICIAL MANUFACTURING PMI

Source: PWM - AA&MRI, National Bureau of Statistics of China
Below are some details of the data releases worth highlighting.

Growth in industrial production declined to 5.3% year-over-year (y-o-y) in the first two months of 2019 from 5.7% in December 2018. The sharp decline was mainly due to the mining sector (rising 0.3% y-o-y in January and February, down from 3.6% y-o-y in December) and the public utility sector (rising 6.8% y-o-y in January and February, compared to 9.6% y-o-y in December). The manufacturing sector remained fairly stable, although at low levels, in the first two months of this year. Output expanded by 5.6% y-o-y in January and February, compared to 5.5% in December and 5.7% in Q4 2018.

In our view, there could be further downside to the industrial sector in the coming months. The official manufacturing PMI for February released earlier this month came in at 49.2, close to the trough reached in early 2016 (Chart 1). The weakness was especially obvious in the external sector, where the new export orders sub-index collapsed to 45.2, the lowest reading since the global financial crisis. Hard data on exports growth has also plummeted (-16.6% y-o-y in February), with exports to the US contracting by nearly 29% y-o-y (Chart 2). Weak exports will likely continue weighing on China’s manufacturing sector throughout the first half of the year.

Headline growth in FAI looks better, rising 6.1% y-o-y in January and February, up from 5.9% in 2018. This was mainly driven by the acceleration in property investment, which rose by 11.6% y-o-y, up from 9.5% in 2018. Infrastructure investment was also up slightly (4.3% y-o-y, compared to 3.8% in 2018). However, investment in the manufacturing sector declined quite notably in the first two months of the year, dropping to 5.9% y-o-y from 9.5% in 2018 (Chart 3).
The strength in property investment, however, is unlikely to be sustained in our view. A broad range of leading indicators suggest that property construction may slow down in the coming months (Chart 4). First, growth in property sales declined to 2.8% y-o-y in January and February in value terms, down from 12.2% in 2018. In volume terms (gross floor area), growth is already negative (-3.6% y-o-y). As a result, developers are turning more cautious on future development. This is reflected in the sharp decline in the growth of new project starts (6.0% y-o-y in the first two months of 2019, down from 17.2% in 2018) and the collapse in land acquisition (-34.1% y-o-y, compared to 14.2% in 2018).

Source: Pictet Wealth Management, National Bureau of Statistics of China
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It also appears that developers are facing tighter financial constraints. Funds available to property developers rose by 2.1% y-o-y in January and February, significantly lower than 6.4% growth in 2018, despite fairly strong credit expansion (Chart 5). As a result, we are cautious about property investment in the coming months. While rising infrastructure investment may provide some cushion, total FAI will likely see more downside.

CHART 5: FUNDS AVAILABLE TO PROPERTY DEVELOPERS

On the consumer front, nominal retail sales growth remained flat at 8.2% y-o-y in the first two months of the year, almost the lowest rate since 2003 (when the epidemic of Severe Acute Respiratory Syndrome (SARS) hit China). In real terms, however, growth improved to 7.1% y-o-y from 6.6% in December 2018 (Chart 6).

Auto sales continued to be the main drag, with passenger car sales contracting by over 17% y-o-y in January and February, following a 15.8% decline in December. Other measures such as domestic tourists and movie box office revenue during the Chinese New Year golden week holidays also painted a downbeat picture.
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All in all, the latest round of macro data out of China generally point to continued slowdown in the economy. Despite the monetary easing started last year, there is no sign the economy is turning around yet. During the People’s National Congress meetings that took place in the past two weeks, the Chinese government announced a set of new measures to stimulate the economy, mainly on the fiscal front (cuts in value-added taxes and increase in issuance of local government bonds, for example). In our view, these policies are a step in the right direction. However, given that the tax cuts will only start to be implemented in Q2 and given the usual time lag between policy and change in growth momentum, we expect China’s growth momentum to continue to decelerate before stabilising around the middle of the year and staging a modest rebound in H2.
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