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Briefing note: 18th April 2019

China's Q1 GDP growth holds up, but what does this mean?

After China posted Q1 GDP growth of 6.4% yesterday (just beating the 6.3% estimate), some analysts have quickly branded the upswing in data as a rebound, as a potential resolution of trade tensions with the US combined with government stimulus appears to be driving an improvement in sentiment and trade. When we look into the detail however, it is clear that the headline data may not telling the whole story.

As the media reports on a potential rebound in Chinese data, it is worth reminding ourselves that China is currently growing at its weakest pace in around three decades, and the repercussions of this are expected to continue to feed into the global economy for the rest of 2019. While slightly above estimates, growth of 6.4% in Q1 matches the previous quarter for the weakest growth since 2009, despite a significant amount of stimulus from the Chinese government.

In a bid to stem the decline in growth, the Chinese government has been trying to promote the narrative that the Chinese economy remains stable on the back of stock market gains, large flows of credit and tax cuts for consumers. This week's GDP data appears to back this up, with a rebound in retail sales and factory output in Q1, however underneath the headline, the story appears to be more complex with weak domestic demand which could compound the existing weakness in economic growth. Our key concerns in the data are:

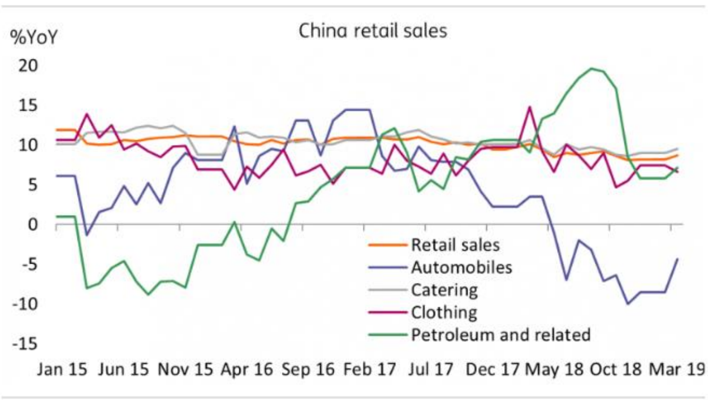
A Rapid Expansion of Credit

Beijing has been flooding the market with credit, with total source funding rising by 40% so far this year. The source of the funds is a cause for concern, as the data suggests that the funding is expanding beyond the banks, indicating an increase in shadow activity, which is already a significant problem for China. This indicates that the increase in credit is unlikely to boost the real economy, therefore this could be misleading.

Weak Domestic Consumption

On the consumer side, Q1 data suggests that the Chinese consumer is beginning to feel the effects of weaker growth, as the consumption contribution to GDP has fallen from 79% in Q4 to 65% in Q1. Sales of clothing and big-ticket items are typically used as a proxy of consumption in China, as these are the aspects that consumers cut back on when confidence in the economy starts to decline. When we look at this data, clothing sales declined from 7.4% in Feb to 6.6% in March, and although auto sales increased somewhat in March following an exceptionally poor January and February, auto sales fell by 11% over Q1. The component performances of retail sales can be seen in the following chart:

China retail sales by selected items

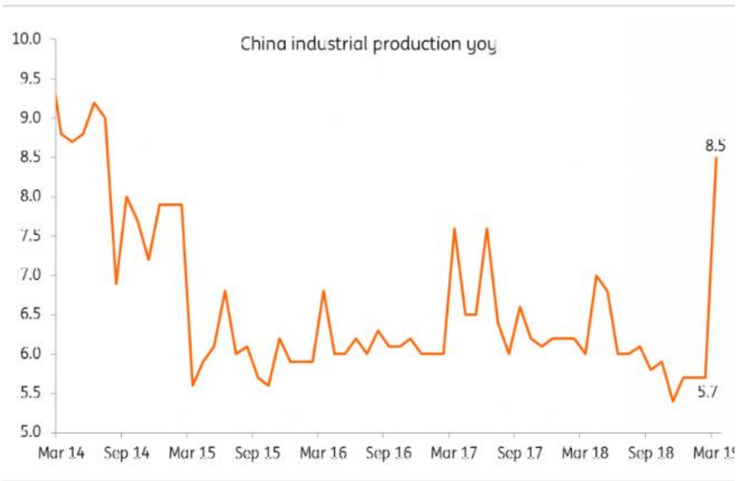


Source: ING, Bloomberg

In addition to the main reported sales categories, the data suggests that the Chinese consumer is ordering less takeaways via delivery apps and seeing less films at the cinema. Mobile phone shipments also fell 12%, compounding a 26% decline last year. Data also suggests that shoppers are using credit cards more, with balances up 23% in Q4 2018 on a year on year comparison basis. This all paints a picture of a weaker Chinese consumer, despite the headline increase in retail sales.

Industrial Production

Another key component of the rebound story reported in the media is the rise in Industrial production to 8.5% in March from 5.7% a month before. This jump was driven by infrastructure projects (influenced by government stimulus) and 5G production. The impact of the stimulus can be seen in the production of cement, which grew from 0.5% in Feb to 22.2% in March, telecommunications production which grew from 7.8% to 10.2% and transportation equipment, which grew from 10.9% to 13.6% over the month.



Source: ING, Bloomberg

While the stimulus is beginning to provide a boost to headline industrial production, external and domestic demand remains weak, and this level of stimulus is unlikely to be sustainable over the long term.

History & Sentiment

It appears that government stimulus is beginning to feed through into some aspects of the Chinese economy, however whether this will stem the underlying slowing of the economy is debatable, as the measures are likely to have a smaller impact on consumption and corporates than hoped. A long history of credit 'binges' in the Chinese economy serves as a reminder that the Chinese government could end up spending a lot to accomplish very little.

Unrealistic Growth Expectations

Total inflation is currently sitting at around 1% compared with 2.9% at the end of 2018, and a decline in nominal growth would likely push leverage higher in 2019. The Chinese government has abandoned specific growth targets, however even its current range of growth expectations may be unachievable. Attempting to maintain 6+% real economic growth in an economy struggling with debt and excess capacity is unrealistic, particularly given a reducing current account surplus which has boosted growth in the past.

Market Expectations

In response to the Chinese data, equity markets remained relatively muted in yesterday's trade, indicating that the China result had already been priced in. As a result, markets have instead focused on corporate earnings and European data. A risk off tone dominates markets, with volumes remaining low.

US-China Trade Deal

A China-US trade deal is still yet to be confirmed, with an announcement now expected in May, however fresh concerns have emerged this week that the deal could have the potential to hit US companies through the reciprocal enforcement mechanism, which makes sure that either party faces consequences if it doesn't live up to its promises. The deal would see both sides agree to forego their right to retaliate or challenge enforcement action by the other at the WTO. Additionally, international officials have expressed concern that the tensions could be ongoing even after a trade deal is made, as the dispute appears to go deeper than just trade, and is likely to resonate given the enforcement challenges.

Overall

Looking at the Chinese economy, it appears that the recent improvement in headline data is more of a sentiment-driven impulse following government stimulus, rather than a material uptick. Weaknesses remain within the Chinese economy, and it is clear that stimulus needs to be targeted at the right areas in order to deliver a stabilisation of growth. The outlook remains uncertain, and we are unconvinced that there has been any material improvement in the economy, despite the headline GDP being above the expectation. For now, our expectations are unchanged as we await further data.