Stimulus, where art thou?

Macro Drivers of China's Industrial Metals Demand – 25th January, 2019

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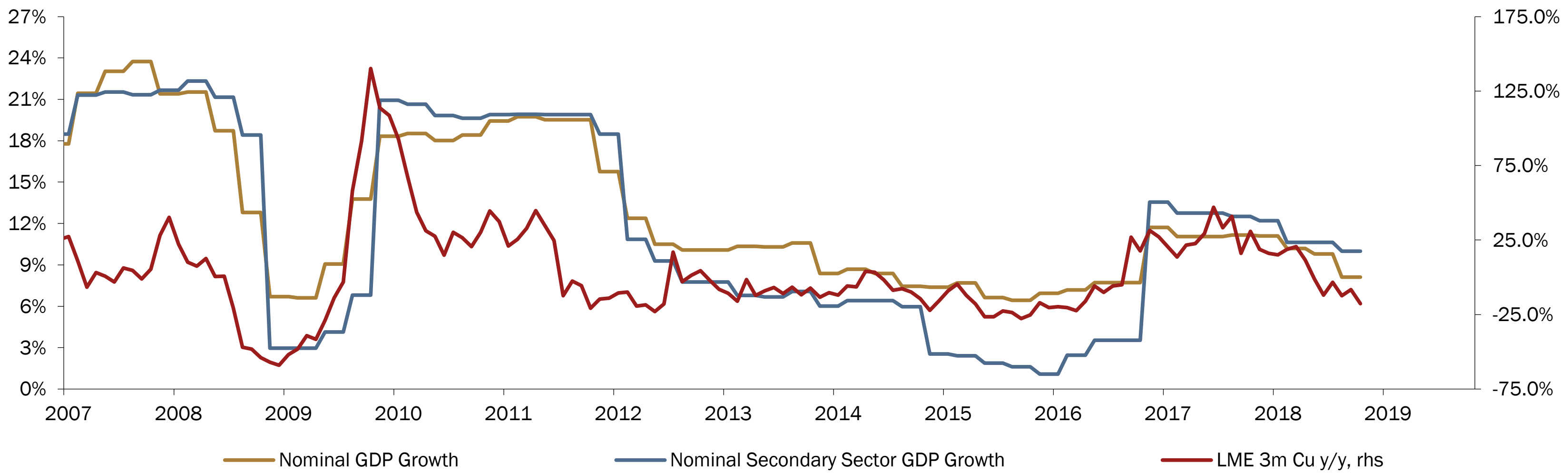
Stimulus, where art thou?

- Real GDP growth of 6.4% may be the slowest pace of expansion since the 1990s but nominal GDP growth of 8.1% remains well above 2008 and 2015 lows. Nevertheless, the slowdown in nominal GDP growth from Q1 2017's peak of 11.7% marks a material pull back.
- And, as we have argued previously, changes in the nominal figures have a much better correlation with changes in industrial commodities demand.
- Moreover, with nominal figures still above real, China is not currently experiencing the implicit deflation that occurred in both 2008 and 2015. It may be that significant stimulus will not be forthcoming unless or until growth slows to a level akin to these previous troughs.
- To date, the authorities have been more steadfast in their approach to deleveraging than we initially anticipated. Indeed, while FAI may have bottomed in Q4 it has not definitively turned higher. Likewise, money supply growth appears to be picking up but only slowly and from a historically low level.
- More than the trade war, we think the recent slowdown is due to the ongoing effect of non-bank deleveraging.
- So far, the market has only really questioned when rather than if stimulus will be forthcoming. With data distortions around lunar new year and the US trade negotiations' March 1st deadline coming into focus, Q1 could prove a test of investors' collective patience

Nominal GDP a better reflection of aggregate changes in underlying commodities demand



Source: ICBC Standard, Bloomberg, China NBS, LME

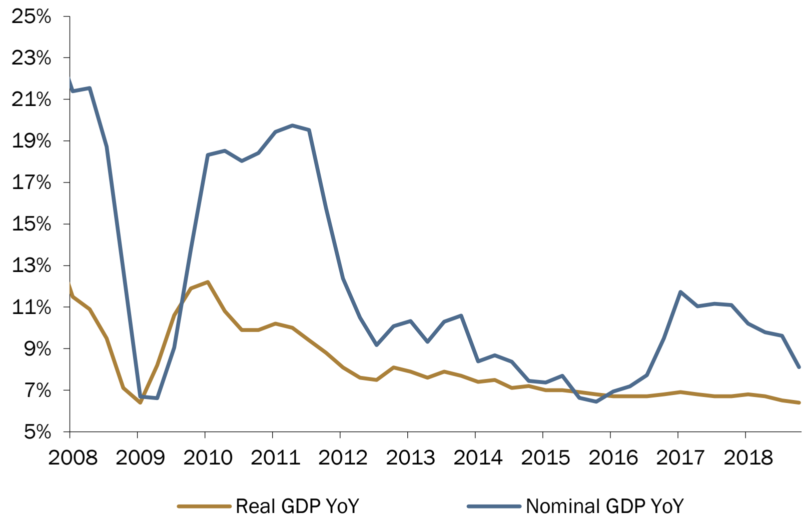
Growth slows in 2018 but the devil is in the detail

- Much has been made of China's Q4 real GDP growth at 6.4% y/y being the slowest since the 1990s. In our view, however, this is a red herring:
  - As commodity market performance indicates, growth is not as weak as it was during 2008/9 or 2015/16.
  - Yet, since Q1 2017, growth has slowed by more than the 0.4 p.p shown in the real GDP figures.

- As we have argued for some time[1], we prefer to focus on nominal GDP figures as a better reflection of aggregate changes in underlying economic activity.

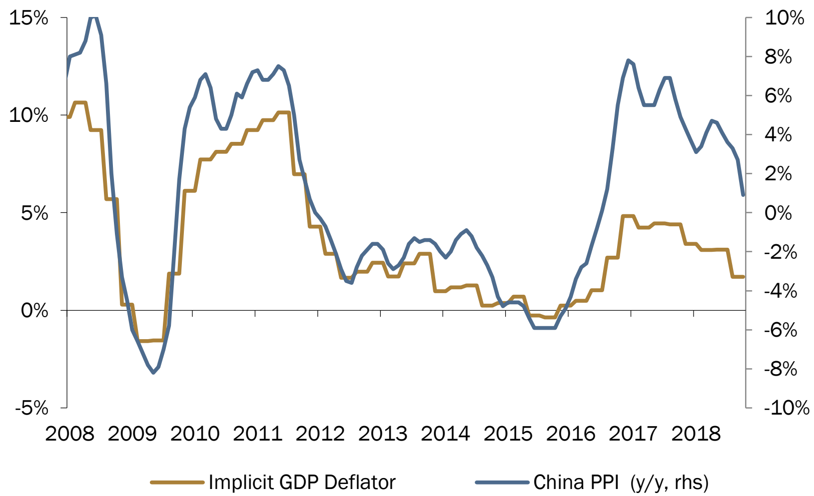
- Indeed, the nominal Q4 figure of +8.1% y/y is a material slowdown from Q1 2017's peak at 11.7%. But it is still above the 6.4% trough of Q4 2015. At that time, the implicit GDP deflator had turned negative and the secondary sector – construction and industry – was arguably in recession.

Nominal growth has pulled back from 2017 highs



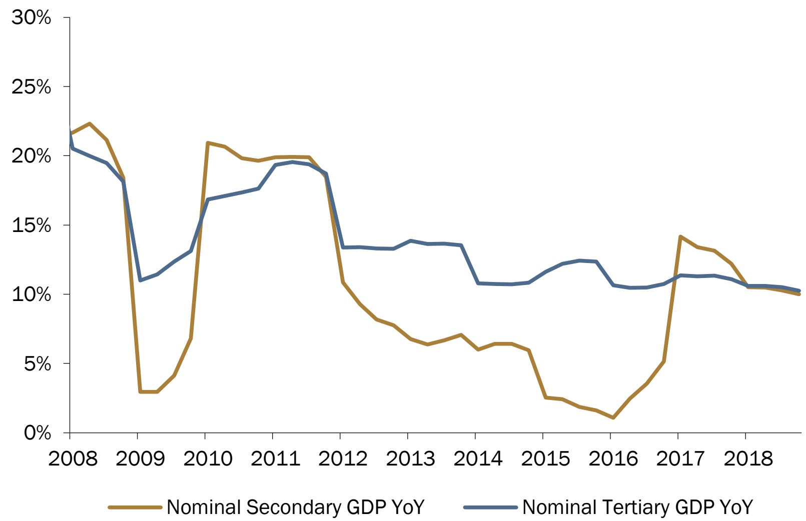
Source: ICBC Standard, Bloomberg, China NBS

But the implicit deflator remains comfortably in positive territory



Source: ICBC Standard, Bloomberg, China NBS

This is not yet a re-run of 2015's growth conditions



Source: ICBC Standard, Bloomberg, China NBS

1: See - https://www.icbcstandardbank.com/CorporateSite/ResearchStrategy/Reports

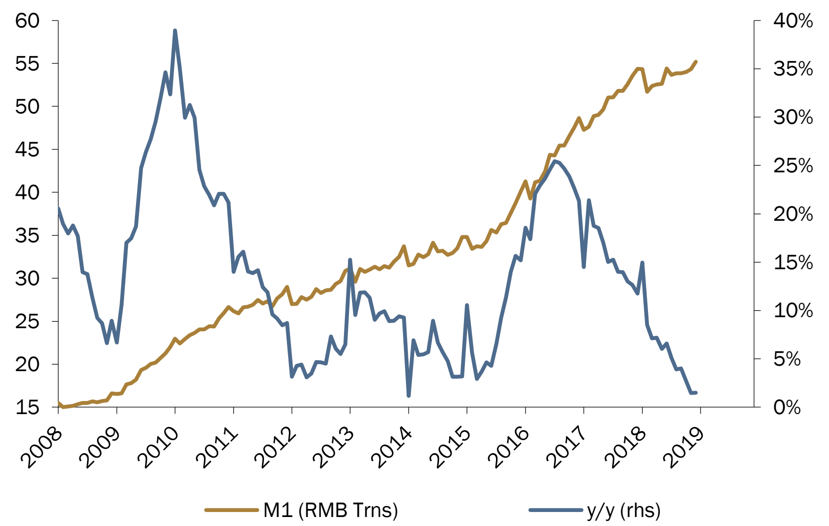
Non-bank deleveraging remains a significant headwind

- These nominal figures do not then gloss over the recent growth slowdown but rather bring it into clearer relief. Moreover, recent money supply data does not indicate that any kind of sharp recovery is yet in the offing. Specifically, M1 growth slowed to 1.5% y/y in November and December, having effectively oscillated around 0% annualised sequential growth since the end of 2017.

- On a single month basis, December's data looks like a potential turning point – it was the first month where the level of M1 made a new high since December 2017 – but that will need to be confirmed by Q1 data and any pick-up from here will have a lagged feed through to broader economic activity.

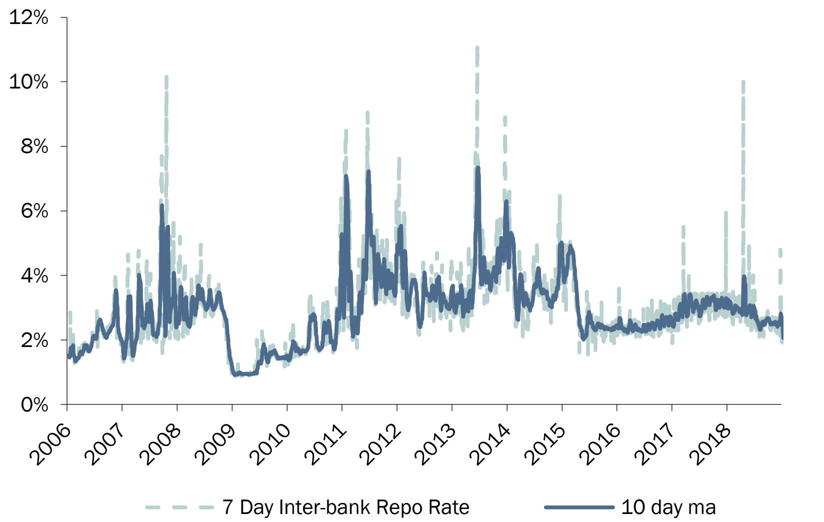
- This issue of anaemic M1 growth does not stem from liquidity problems in the banking sector – note how repo rates remain subdued – but, in our view, is a function of continued non-bank financial sector deleveraging.

M1 growth tentatively bottoming out



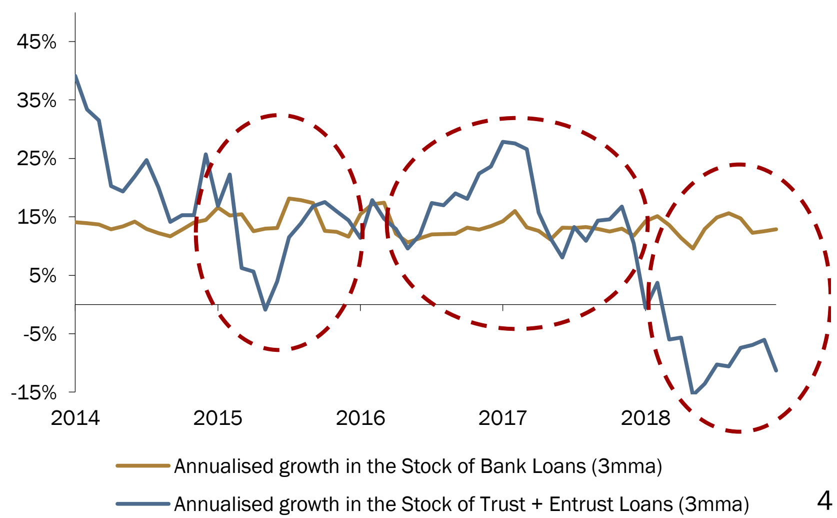
Source: ICBC Standard, Bloomberg, China NBS

7 day repo rates remain subdued



Source: ICBC Standard, Bloomberg, PBoC

Steady bank lending insufficient to offset non-bank contraction

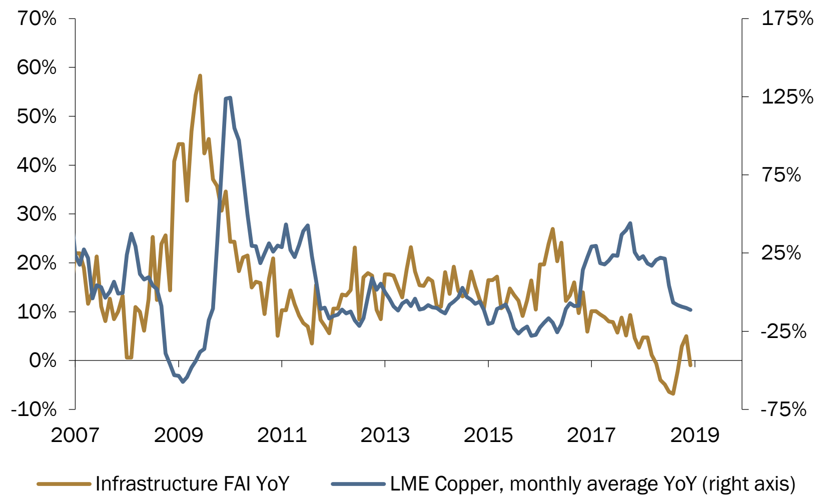


Source: ICBC Standard, Bloomberg, PBoC

FAI tentatively bottoming but broad loosening notable by its absence

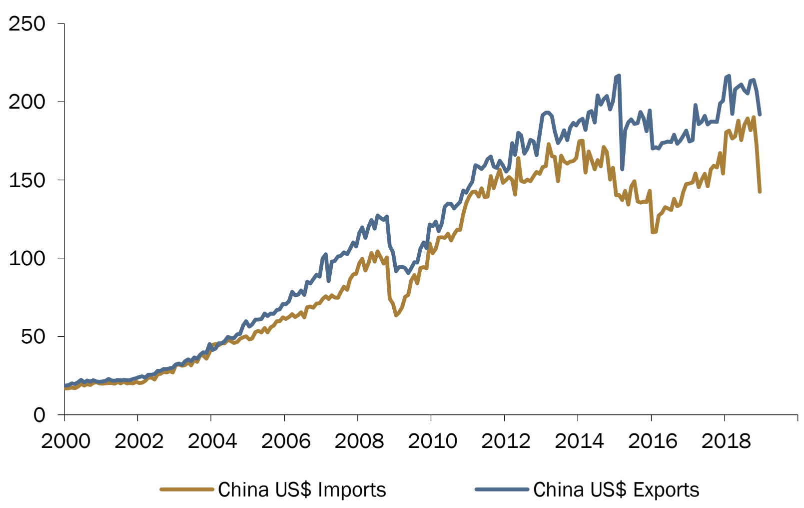
- Although the government rhetoric around domestic de-leveraging has been dialled down, the data does not yet show any signs of aggressive stimulus.
- Taking a glass half-full view, in addition to the potential trough in M1 growth, one could argue that public fixed asset investment did bottom in Q4 2018 – thus indicating that growth should bottom in Q1 2019 – but neither has yet turned definitively.
- More than the "trade war", which only hit December's data and even then on the import more than export side, the fact that domestic policy is not clearly out of contractionary territory – let alone indicating full blown stimulus – is what explains the recent deterioration in market and consumer sentiment.
- This is also illustrated in real estate, where the percentage of purchasers' mortgage finance acts as a proxy for restrictions that force buyers to use equity or seek other sources of finance.

Infrastructure FAI off its lows but not surging higher, yet



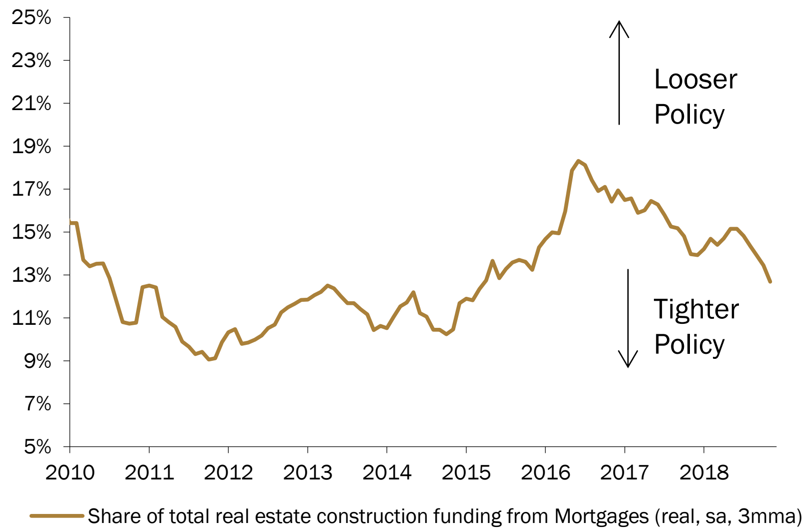
Source: ICBC Standard, Bloomberg, China NBS, LME

Trade data had been steady until December



Source: ICBC Standard, Bloomberg, China NBS, China Customs

Falling share of mortgage financing reflect policy tightness



Source: ICBC Standard, Bloomberg, China NBS, PBoC

Consumer confidence still fragile

- Fitting this, total construction sales expanded by just 1.3% y/y in 2018, with growth heavily weighted to H1. The paradox in construction, however, is that new project starts have so far held-up in the face of this – rising 17% y/y in 2018.

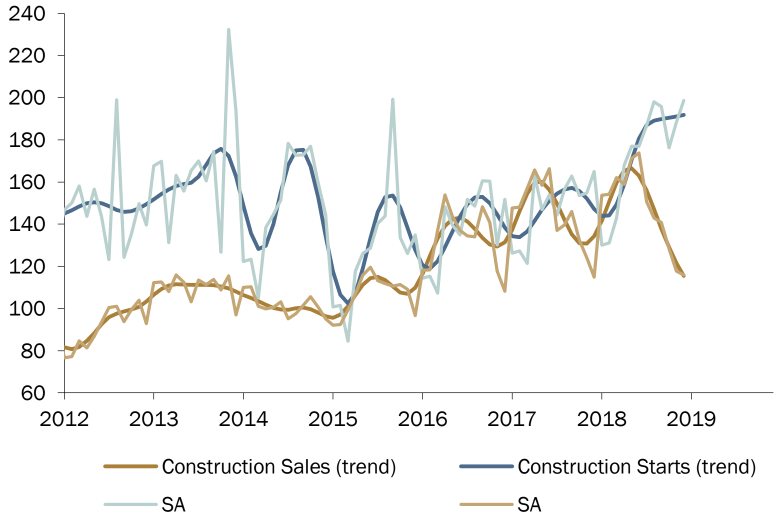
- Unless policy turns much more expansionary, spurring a sharp recovery in sales, developers will either need to slow activity or risk building up unsold inventory, as they did in 2014/15.

- This weakness is also being replicated in the auto sector – discussed in detail here[2] – where total sales declined 3.1% y/y in 2018.

- In aggregate, the note of caution sounded in our November report – *Faltering consumer confidence, as credit conditions bite* – still rings true, "non-bank deleveraging may need to at least pause for a period, if sentiment is to improve, growth to be supported and a sharper than previously forecast Q1 slowdown to be avoided"[3].

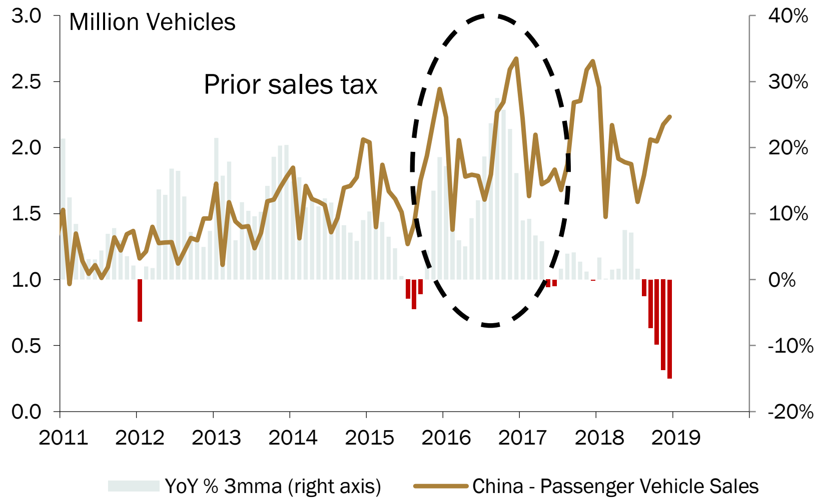
- There have been further signs of a shift since then but the data is yet to turn definitively. So far, the market has only really questioned when rather than if stimulus will be forthcoming. With data distortions around lunar new year and the US trade negotiations' March 1st deadline coming into focus, Q1 could prove a test of investors' collective patience.

Housing sales roll over but new starts holding up



Source: ICBC Standard, Bloomberg, China NBS

Falling auto sales raise the question of another tax cut



Source: ICBC Standard, Bloomberg, China NBS, CAAM

2 & 3: See - https://www.icbcstandardbank.com/CorporateSite/ResearchStrategy/Reports

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