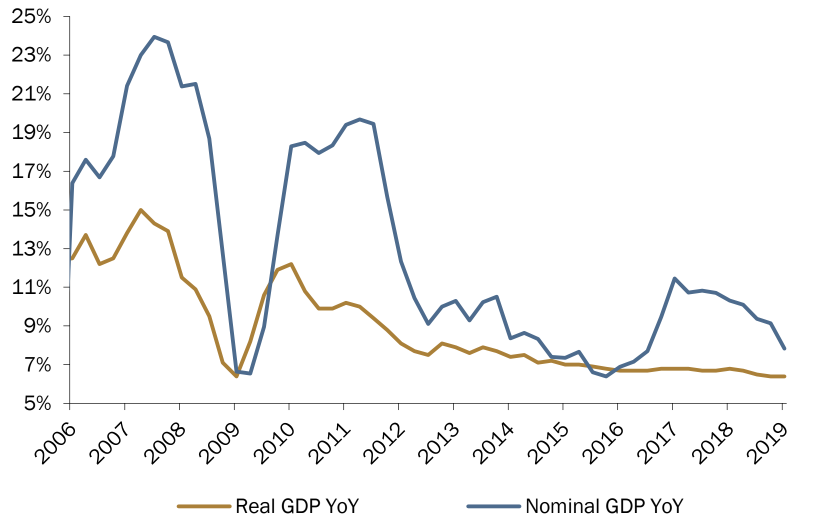
A spring in the step

Macro Drivers of China's Industrial Metals Demand – 17th April, 2019

Growth likely to have troughed early in Q1

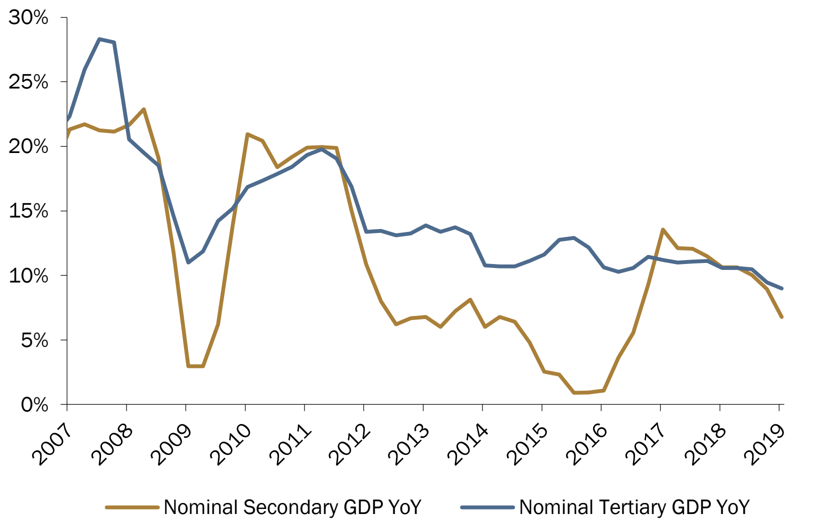
- A month ago, we argued that *Green Shoots*[1] were emerging amongst China's macro indicators of industrial metals demand and subsequent data has reinforced this view.
- In short, although activity was soft in Q1 – as reflected in micro demand indicators and nominal GDP growth – forward looking indicators continue to improve.
- Specifically, we note that money supply growth has turned up and credit growth has accelerated, with less pressure being placed on the shadow banking sector.
- Fixed asset investment (FAI) has also begun to accelerate, with infrastructure FAI recovering towards its prior trend.
- Furthermore, consumer confidence also appears to be improving, with property sales recovering, retail sales ticking up and auto sales showing signs of stabilisation.

Nominal GDP growth has continued to slow



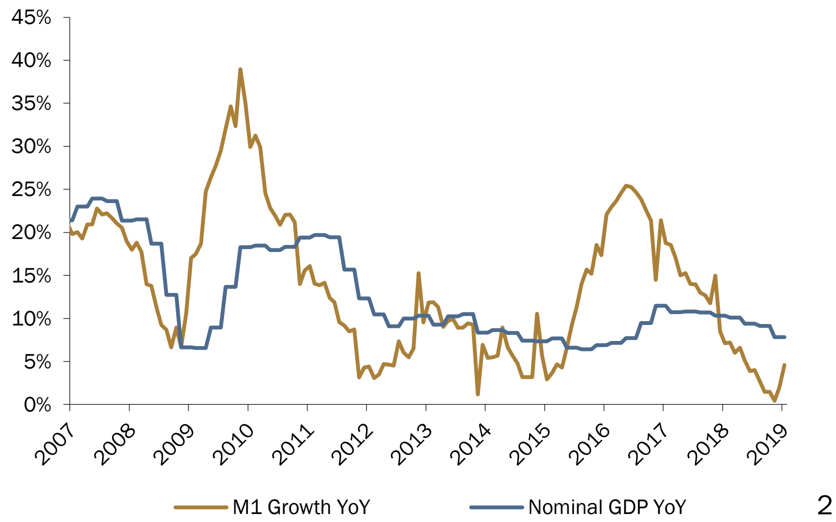
Source: ICBC Standard, Bloomberg, China NBS

With the secondary sector a major drag



Source: ICBC Standard, Bloomberg, China NBS

But leading indicators, like M1 growth, appear to have turned



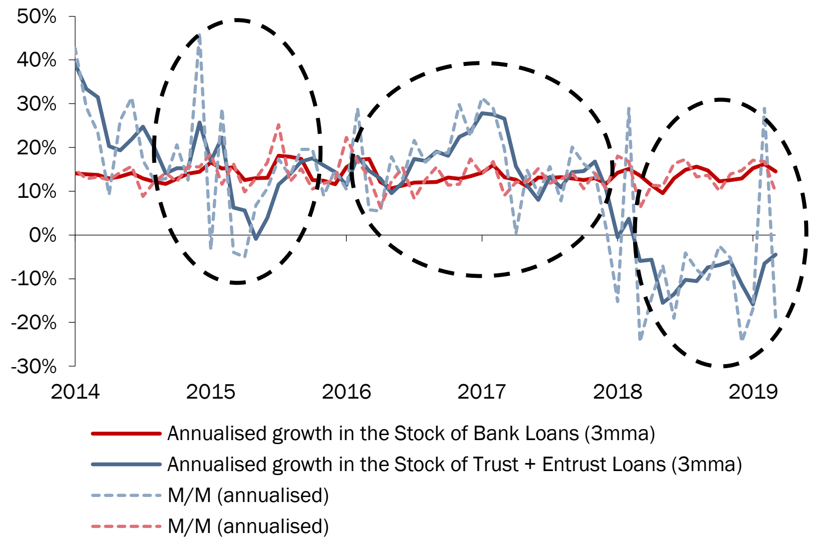
Source: ICBC Standard, Bloomberg, China NBS, PBoC

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

Credit conditions shifting from headwind to tailwind

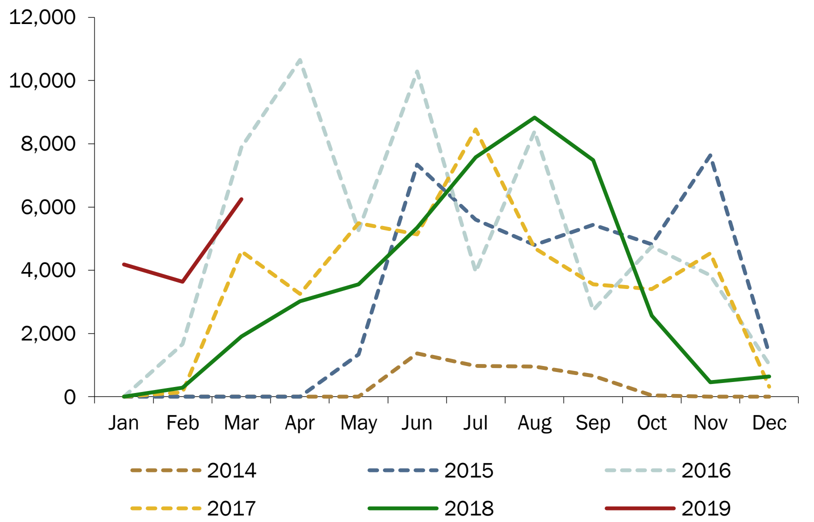
- To reiterate a point made in recent notes, we do not view current policy as a classic bout of "stimulus" but do think that policy is being loosened meaningfully, from what were actually contractionary conditions last year.
- Primarily because non-bank lending, while not surging, is no longer contracting at the pace it was during much of 2018. Coupling this to steady growth in bank lending and corporate bond issuance is allowing for a material increase in the overall pace of credit growth.
- Furthermore, local government bond issuance was very strong in Q1, up 227% y/y on Q1 2018's tepid level of issuance. This is unlikely to sustain and we expect front loading to mean growth is given back in H2 but is still supportive of upcoming infra FAI.
- To date, however, non-financial equity issuance has been subdued. We would view it as a positive development if companies took advantage of a rising stock market to increase their equity funding.

Bank lending has held firm, while non-bank is stabilising



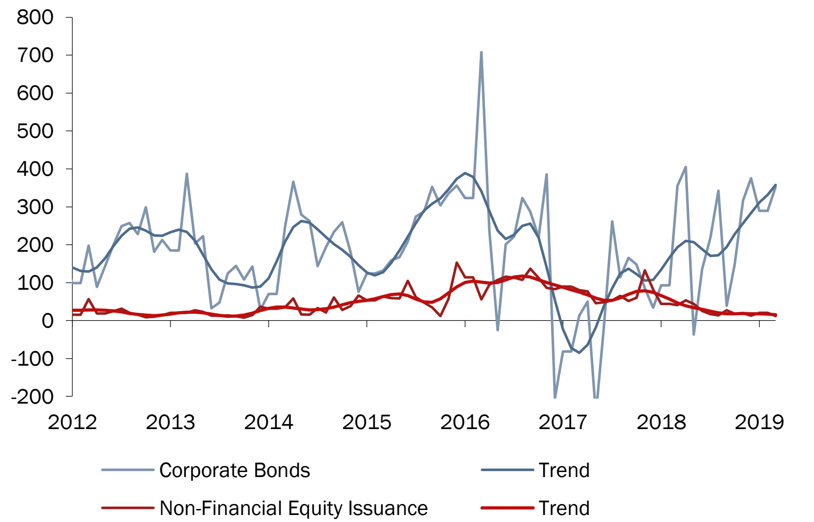
Source: ICBC Standard, Bloomberg, China NBS, PBoC

LGB issuance up 227% y/y but not quite a return to 2016 levels



Source: ICBC Standard, Bloomberg, China NBS, PBoC, Chinabond

Bond issuance on the rise but equity issuance still subdued



Source: ICBC Standard, Bloomberg, China NBS, PBoC

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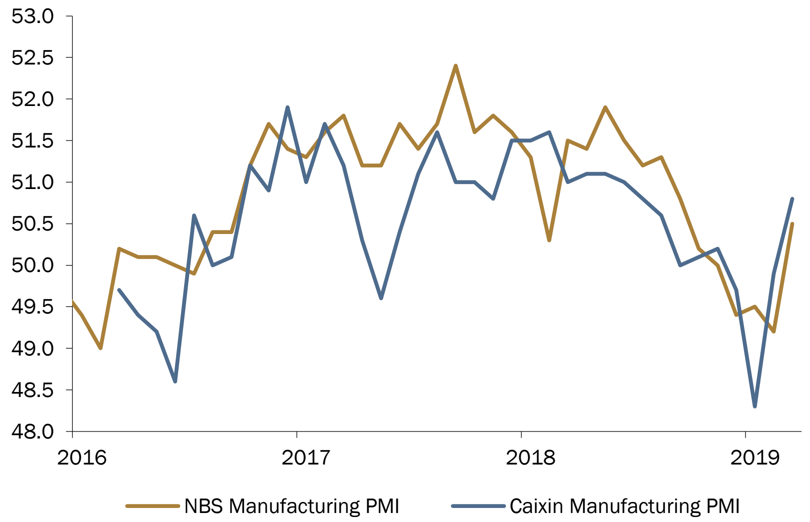
PMIs indicate improving demand and easier financial conditions

- The recent headline uptick in China's PMI surveys follows an improvement in the sub-components which we flagged a month ago. In particular, the finished goods sub-index has been falling, declining from 48.6 in November to 46.4 in February. This indicates the produces are destocking, due to demand running above the level of production.

- In March, output finally bounced back, rising from 49.5 to 52.7. As a result the spread between output and finished stocks expanded to 5.7, from a trough of 2.6 in December. We take this as a proxy for demand having turned, with producers now responding accordingly.

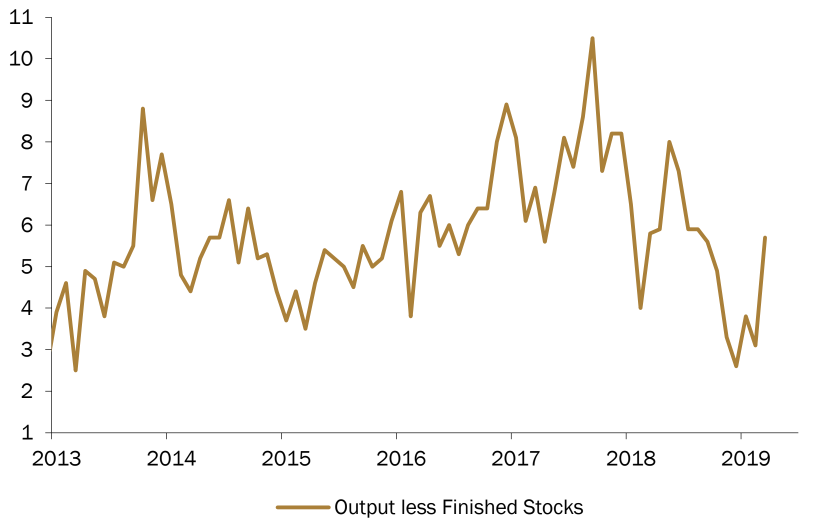
- Finally, for the official PMI, we note that the readings for small and medium sized companies both bounced in March. Given smaller, particularly private, companies have struggled in the face of tighter credit conditions, this supports the case that increased credit growth is starting to feed through to the real economy.

Both Caixin and official PMI turn up



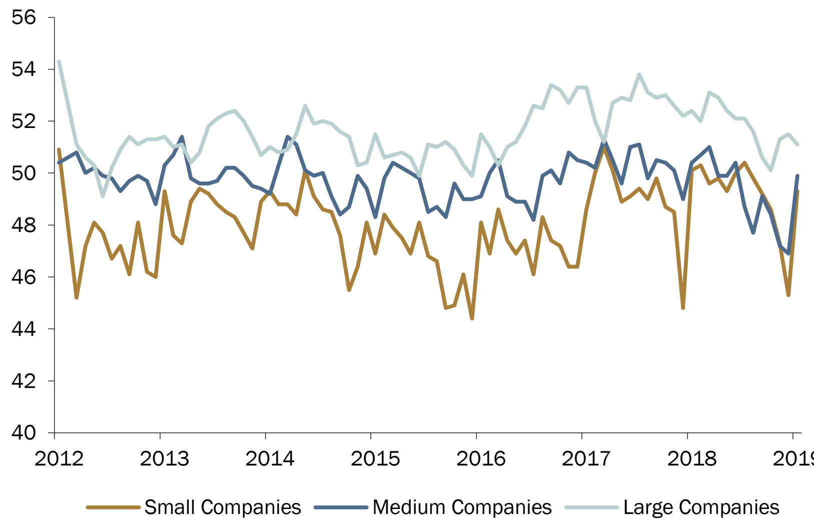
Source: ICBC Standard, Bloomberg, China NBS, Caixin

As producers appear to have destocked



Source: ICBC Standard, Bloomberg, China NBS

And small + medium size companies are showing signs of life



Source: ICBC Standard, Bloomberg, China NBS

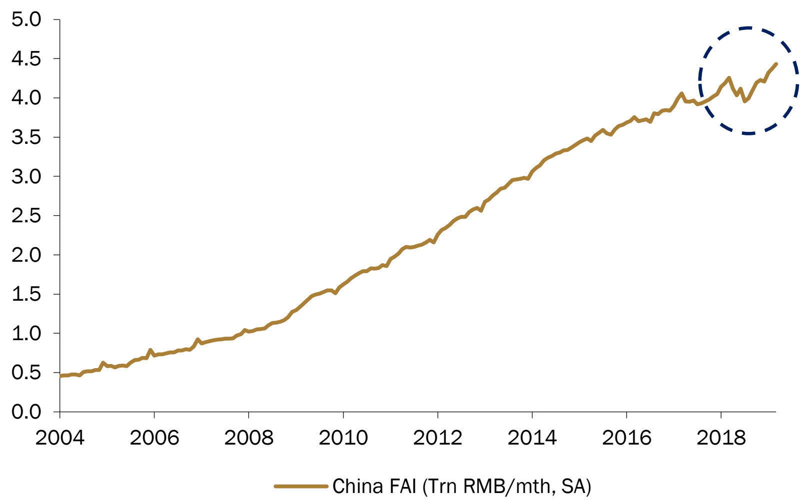
Fixed asset investment and construction to spur increased demand

- Following the strong start to the year for LGB issuance, FAI appears to be reaccelerating, with infra FAI specifically having turned the corner. As per our view on credit loosening, however, this should not be misconstrued as aggressive stimulus.

- Rather, following the 2016-17 stimulus, 2018 marked a significant slowdown, which now appears to be being reversed. Indeed, infrastructure FAI was up 4% m/m after seasonal adjustment and should be a material contributor to marginal industrial metals demand over the coming quarter.

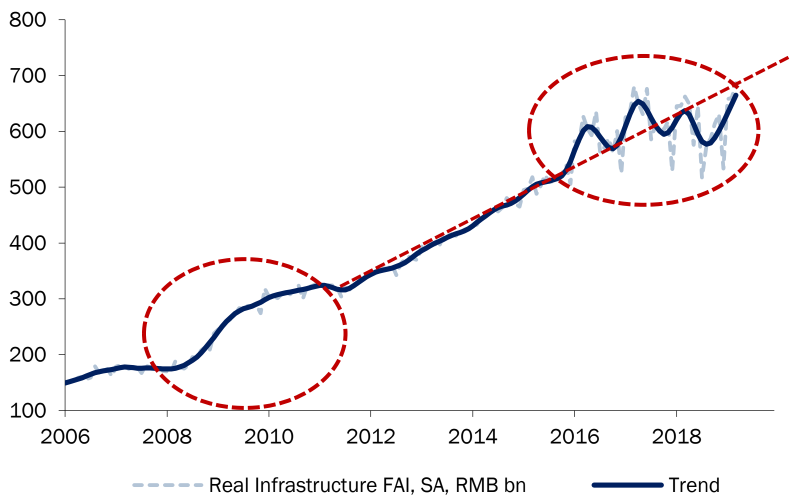
- Construction activity also appears to be bottoming out sequentially, following a rebound in sales over the course of Q1, with support coming from increased mortgage lending and marginal relaxation of purchasing restrictions.

Fixed asset investment bouncing back



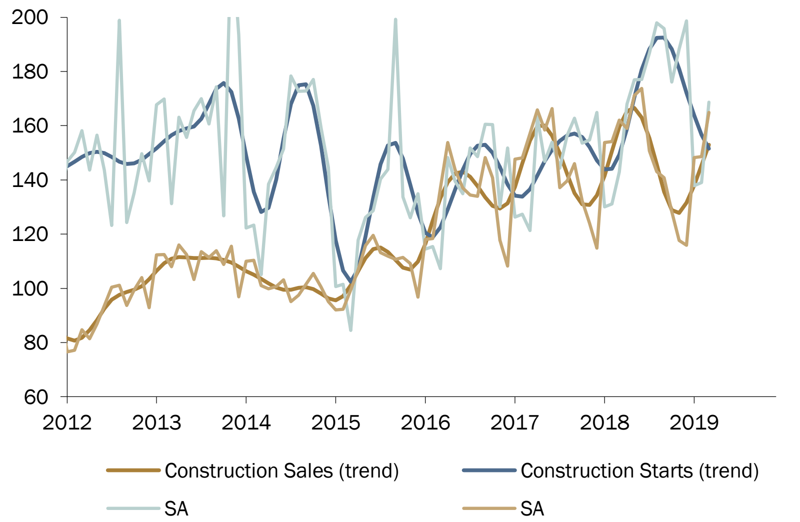
Source: ICBC Standard, Bloomberg, China NBS

As infrastructure FAI returns to trend growth



Source: ICBC Standard, Bloomberg, China NBS

Improving sales to lead recovery in construction starts

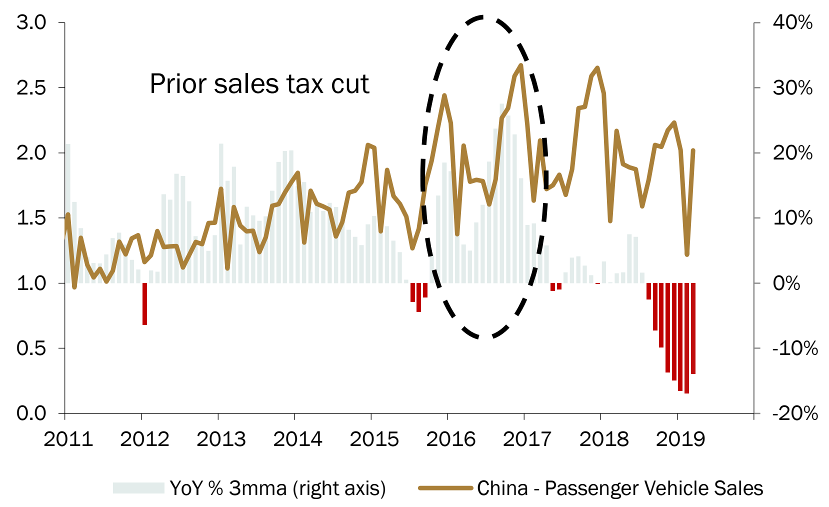


Source: ICBC Standard, Bloomberg, China NBS

Autos sector the laggard but signs of a bottom emerge

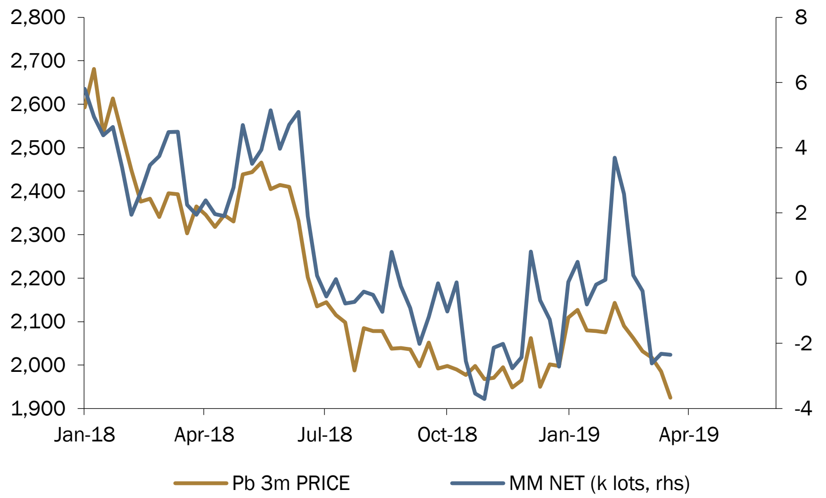
- Despite this, the auto-sector continues to underperform, as sales contracted 5% y/y in March.
- Nevertheless, the pace of contraction appears to be slowing. During January/February, sales fell 15% y/y and, after seasonal adjustment look to have expanded 12% m/m in March. The distortion of Chinese new year makes this difficult to interpret but the auto sector may also be approaching a turning point
- Following the points we made about positioning in *What's in the price*[1], any improvement in the autos sector would present an important change for both lead and palladium.
- The former is the only metal which we estimate to have a material short from systematic funds – on account of recently weak momentum – while the latter should have seen a significant clean up of residual length over the course of its recent correction. Meaning that positioning could be a tailwind to any moves higher.

Auto sales negative y/y but stabilising sequentially



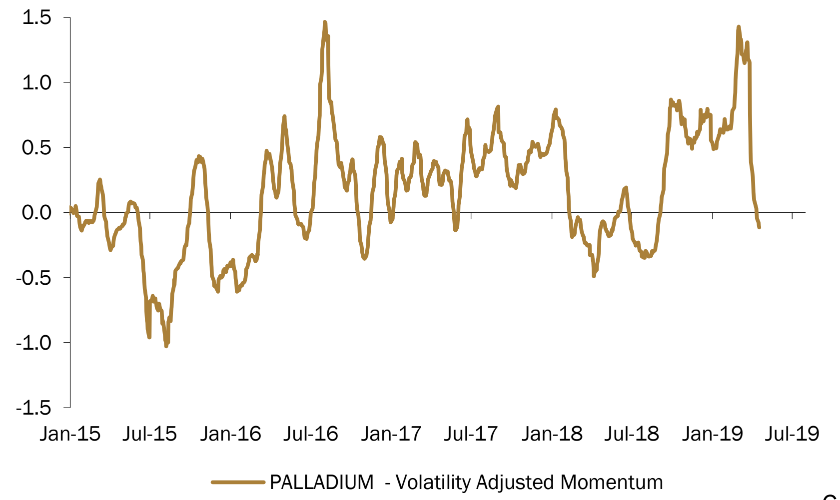
Source: ICBC Standard, Bloomberg, China NBS, CAAM

LME lead shows an investor short on the COTR



Source: ICBC Standard, Bloomberg, LME

Palladium's dramatic correction likely to have cleaned positions



Source: ICBC Standard, Bloomberg, CME

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