

# Macro + FX Strategy

## China: Slowdown In 3Q18 Manufacturing Growth Suggests Negative Impact From Trade Tensions Starting To Seep In

Friday, 19 October 2018

**Ho Woei Chen**

Economist

[Ho.WoeiChen@uobgroup.com](mailto:Ho.WoeiChen@uobgroup.com)

**Peter Chia**

Senior FX Strategist

[Peter.ChiaCS@uobgroup.com](mailto:Peter.ChiaCS@uobgroup.com)

- China reported a moderation in 3Q18 GDP growth to 6.5% (Bloomberg: 6.6%; UOB: 6.5%) from 6.7% in 2Q18. The slowdown in secondary industries growth in 3Q18 suggests that the negative impact from the trade tensions with US is starting to seep into the economy.
- Looking ahead, we expect China's GDP growth rate to moderate further to 6.4% y/y in 4Q18 and maintain our 2018 and 2019 growth forecasts for China at 6.6% and 6.3% respectively. Investment and private consumption may suffer a greater hit in the near-term even though exports remained supported due to factors including front-loading, depreciation in the CNY and the strength in the US economy.
- We maintain our call for the PBoC to keep the benchmark 1-year lending rate at 4.35% at least for the next 6 months even though the reserve requirement ratio (RRR) could be cut another time before the end of this year.
- Despite the muted response to the GDP miss, depreciation pressure on the CNY seems to be rebuilding. We maintain our view of gradual CNY weakness towards 6.95 by end-2018, 7.00 in 1Q19 and 7.10 in both 2Q and 3Q19.

### 3Q18 Growth Continues On Path Of Gradual Moderation

China reported a moderation in 3Q18 GDP growth to 6.5% (Bloomberg: 6.6%; UOB: 6.5%) from 6.7% in 2Q18. This is in line with our forecast though slightly missing market's expectation. The data today brings the YTD growth to 6.7% y/y, down from 6.9% in 2017. The q/q seasonally adjusted growth also moderated slightly to 1.6% from 1.7% in 2Q18.

Despite robust trade data in September (see our report [China: September Trade Data Continued To Paint A Mild Outlook](#)), the slowdown in manufacturing growth in 3Q18 suggests that the negative impact from the trade tensions with US is starting to seep into the economy. The secondary industries showed a sharp slowdown in growth rate to 5.3% y/y from 6.0% in 2Q18 while growth in the primary and tertiary industries picked up to 3.6% and 7.9% (from 3.2% and 7.8%) respectively as reported earlier for 2Q18.

China also released other September economic indicators today: industrial production moderated to 5.8% in September from 6.1% in August but retail sales and fixed asset investment (FAI) registered stronger growth of 9.2% y/y and 5.4% YTD y/y from previous 9.0% and 5.3% respectively. September surveyed jobless rate was marginally lower at 4.9% from 5.0% in August.

In the data release today, the National Bureau of Statistics said that the economic activities remained in a reasonable range and maintained overall stability in the first three quarters of 2018 but the increase in external challenges amid domestic restructuring have increased downside growth risks. It reiterated the government's commitment towards deepening reforms, expansion of effective demand, stabilization of financial system, trade, jobs market and investment.

Looking ahead, we expect China's GDP growth rate to moderate further to 6.4% y/y in 4Q18 and maintain our 2018 and 2019 growth forecast for China at 6.6% and 6.3% respectively. Investment and private consumption may suffer a greater hit in the near-term even though exports remained supported due to factors including front-loading, depreciation in the CNY and the strength in the US economy. This compares with the recently revised IMF's projection (in the October review) for China's 2018 and 2019 growth rates at 6.6% and 6.2% respectively.

### Policy Support To Be Maintained

As the data releases continue to point to growth slowdown in China, the domestic monetary and fiscal policies are expected to stay proactive to cushion further negative growth impact from the US-China trade conflict which may worsen next year as tariff measures are likely to be stepped up given no indication of a resolution yet. The tariff rate for the latest round of US\$200bn Chinese products is set to be increased to 25% in 2019 from current 10%. In addition, US President Trump has also threatened to expand the tariff to include all of Chinese products that are exported to the US.

As such, it is appropriate for the policy makers to keep interest rates accommodative. We maintain our call for the PBoC to keep the benchmark 1-year lending rate at 4.35% at least for the next 6 months even though the [reserve requirement ratio \(RRR\)](#) could be cut another time before the end of this year.

Due to the measures to ease credit conditions including the four RRR cuts so far this year, domestic liquidity has eased as indicated by falling funding costs in the interbank market. In July, the benchmark 7-day repo rate traded in the interbank market had fallen below the 7-day reverse repo rate offered by the PBoC which is at 2.55%, for the first time since September 2015. The rate is currently hovering at around 2.60%.

Data on Wednesday showed that total social financing (TSF) had remained strong in September and continued to show increases in local currency loans in line with moves towards credit expansion to support domestic growth. On a YTD basis, despite the moderation in TSF compared to the same period last year due to deleveraging efforts, we noted that the local currency loans had actually increased. This is in line with the authorities' call for expansion of loans supply to the SMEs.

The ample market liquidity likely removes any immediate pressure on the PBoC to cut interest rates despite the weaker growth outlook. Moreover, the central bank has reiterated its prudent and neutral monetary policy stance and any shift to broad policy easing may accelerate capital outflows and place further downward pressure on the CNY. The US-China yield spreads have already been narrowing due to the divergence in interest rate movements.

Nonetheless, as pointed out by PBoC Governor Yi Gang, interest rate remains one of the monetary tools that the PBoC could use if the downside risks for the economy increase significantly.

### FX Outlook: USD/CNY Looks Set To Resume Its Up-move Towards Key 7.00 Level

Immediate reaction in the FX markets to the China GDP miss is surprisingly muted. USD/CNH spiked up 40 pips to 6.9440 before retreating to 6.9400, flat on the day. USD/CNY is also little changed at 6.9370 amid the PBoC setting its daily reference rate at the weakest levels since January 2017, at 6.9385 per dollar.

Depreciation pressure on the Chinese yuan seems to be rebuilding since early October. To that point, 3-month put options on the CNH are at now trading at the widest margin in 21 months against comparable call options. In addition, compared to mid-August where USD/CNH spot was around current levels (6.9400), there is a significant pickup in the option interest above the key 7.00 level. Given the keen interest in that level, we can reasonably expect authorities to step in as we approach 7.00 to smooth currency movements and keep devaluation pressures in check. Overall, we maintain our view of gradual CNY weakness towards 6.95 by end-2018, 7.00 in 1Q19 and 7.10 in both 2Q and 3Q19.

Please click on the link to access the [press release](#) from China National Bureau of Statistics

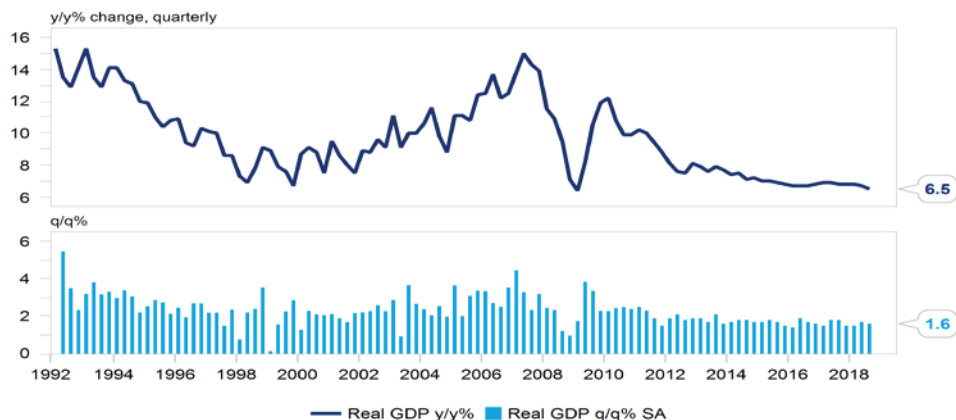
## China's Key Macro Data

Indicators	2015	2016	2017	1Q18			2Q18			3Q18		
Real GDP Growth %y/y	6.9	6.7	6.9	6.8			6.7			6.5		
Real GDP Growth %q/q SA	-	-	-	1.5			1.7			1.6		
%y/y change except noted	2015	2016	2017	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
Industrial Output	6.1	6.0	6.6	-	-	6.0	7.0	6.8	6.0	6.0	6.1	5.8
CFLP Manufacturing PMI	49.7	51.4	51.6	51.3	50.3	51.5	51.4	51.9	51.5	51.2	51.3	50.8
Caixin-Markit Manufacturing PMI	48.2	51.9	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0
CPI	1.4	2.0	1.6	1.5	2.9	2.1	1.8	1.8	1.9	2.1	2.3	2.5
PPI	-5.2	-1.4	6.3	4.3	3.7	3.1	3.4	4.1	4.7	4.6	4.1	3.6
Exports (USD terms)	-2.8	-7.7	7.9	11.1	44.5	-2.7	12.9	12.6	11.3	12.2	9.8	14.5
Imports (USD terms)	-14.1	-5.5	15.9	36.9	6.3	14.4	21.5	26.0	14.1	27.3	20.0	14.3
Trade Balance (US\$ bn)	603.0	547.1	435.3	20.3	33.8	-5.0	28.4	24.9	41.5	28.0	27.9	31.7
New Loans (RMB bn chg)	11,720.0	12,650.0	13,530.0	2,900.0	839.3	1,120.0	1,180.0	1,150.0	1,840.0	1,450.0	1,280.0	1,380.0
Aggregate Financing (RMB bn chg)	15,406.3	17,802.2	19,444.5	3,067.3	1,185.4	1,568.5	1,772.6	945.8	1,485.2	1,216.1	1,928.6	2,205.4
M2	13.3	11.3	8.2	8.6	8.8	8.2	8.3	8.3	8.0	8.5	8.2	8.3
Urban Fixed Asset Investment YTD	10.0	8.1	7.2	7.9	7.9	7.5	7.0	6.1	6.0	5.5	5.3	5.4
Retail Sales	10.7	10.4	10.2	-	-	10.1	9.4	8.5	9.0	8.8	9.0	9.2

Source: CEIC, Bloomberg, National Bureau of Statistics; UOB Global Economics & Markets Research estimates. All data for individual months except noted

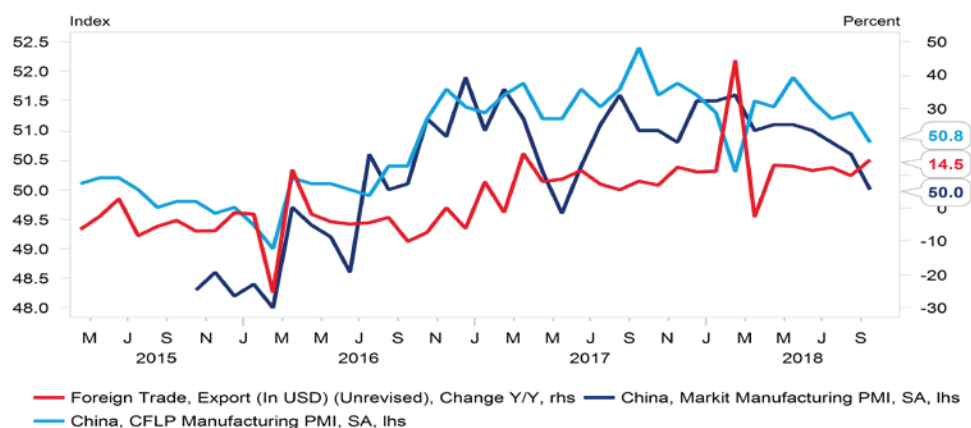
## China: Real GDP Growth Rate (Quarterly)

Source: Macrobond, UOB Global Economics & Markets Research



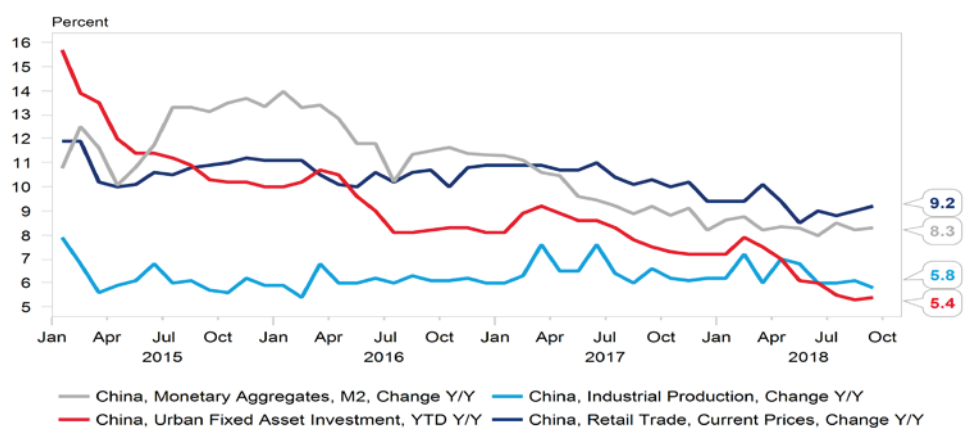
## China Export Growth & Manufacturing PMIs

Source: Macrobond, UOB Global Economics & Markets Research



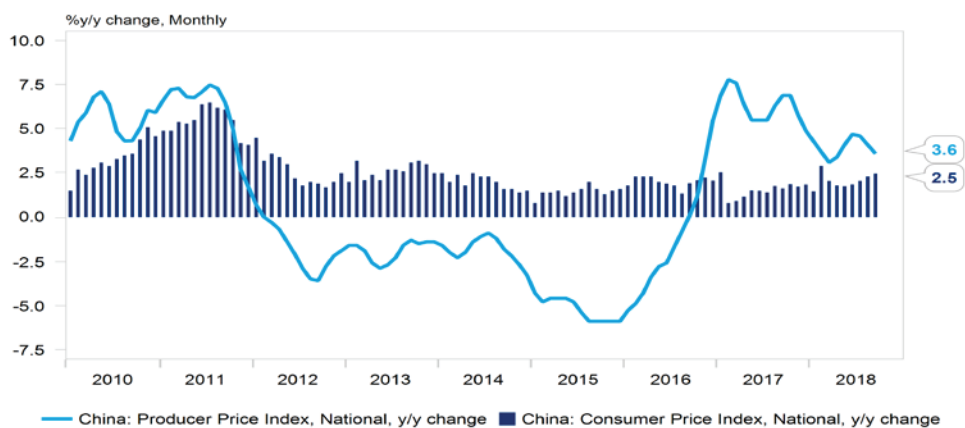
## China: Domestic Growth Indicators

Source: Macrobond, UOB Global Economics & Markets Research



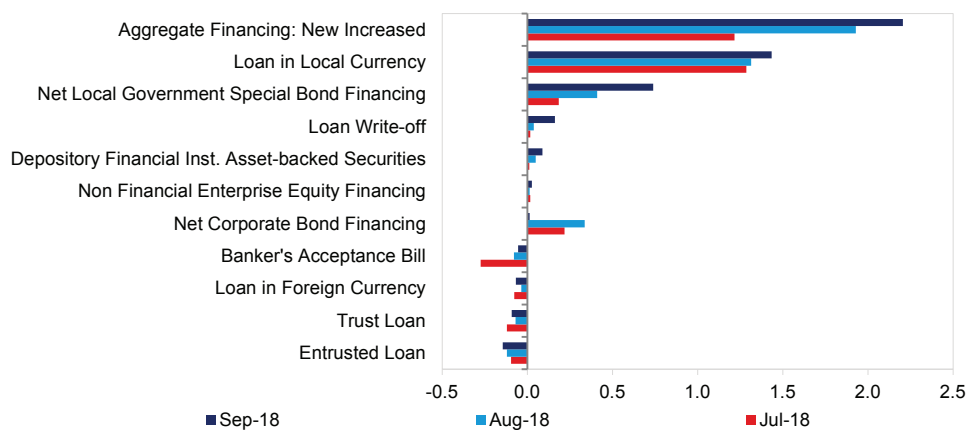
## China: CPI and PPI

Source: Macrobond, UOB Global Economics & Markets Research



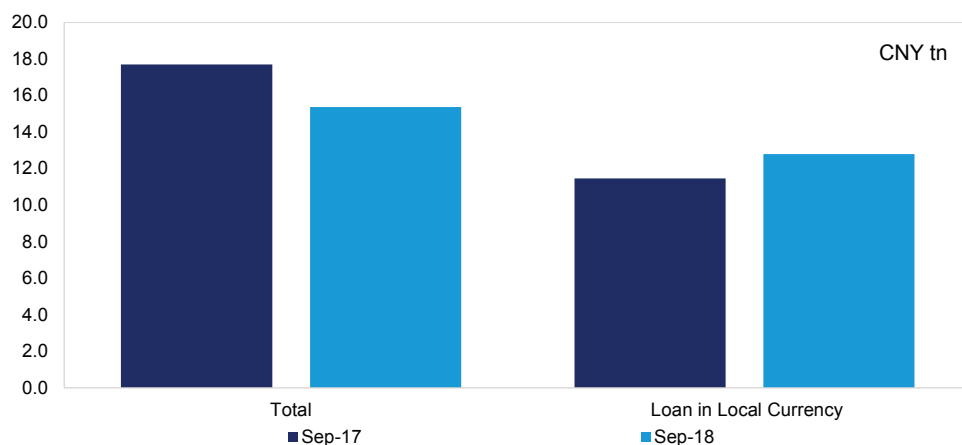
### China: Total Social Financing (CNY Trillion)

Source: CEIC, UOB Global Economics & Markets Research



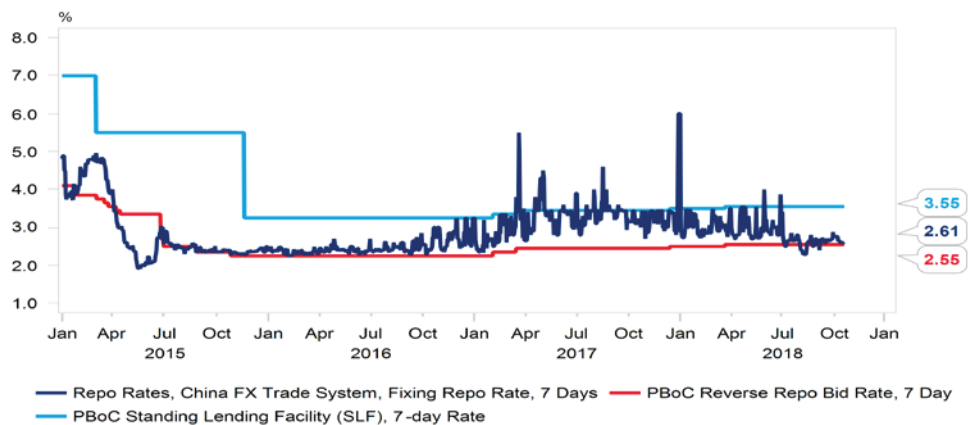
### China: Aggregate Financing, New Increase YTD

Source: CEIC, UOB Global Economics & Markets Research



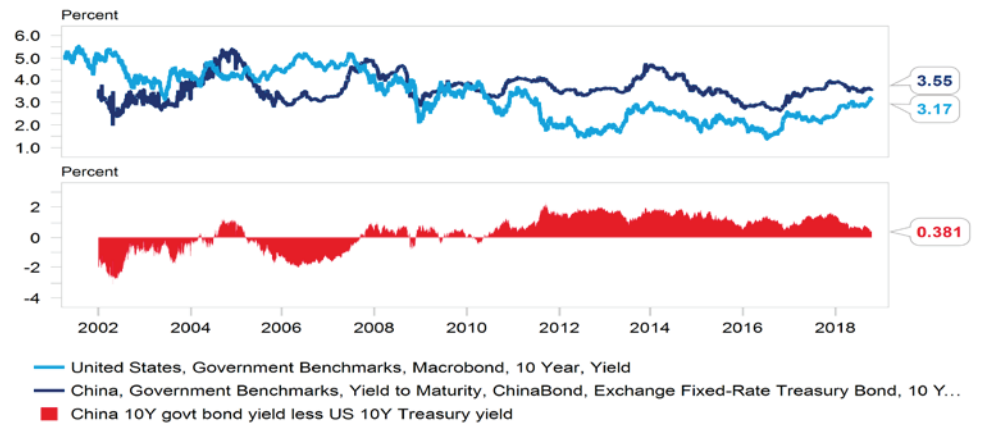
### China: 7D Interbank Rates & Policy Rates

Source: Macrobond, UOB Global Economics & Markets Research



## US and China 10Y Govt Bond Yields

Source: Macrobond, UOB Global Economics & Markets Research



## China, FX Reserves

Source: Macrobond, UOB Global Economics & Markets Research



## CNH Put Options Trading At The Widest Margin To Call Options Since January 2017

Source: Bloomberg, UOB Global Economics & Markets Research



## Recent Publications

[Malaysia: 11th Malaysia Plan Mid-Term Review - Resets Growth And Fiscal Deficit Targets](#), 18 October 2018

[US Treasury Oct 2018 FX Report: China Not Named Manipulator But Remains The Center of Attention](#), 18 October 2018

[South Korea: BOK On Hold But Rate Hike Looming As It Pays More Attention To Financial Stability Risk](#), 18 October 2018

[Euro Area Inflation Rises In September](#), 18 October 2018

[UK Inflation Cools: GBP Remains Lower](#), 18 October 2018

[US Sep FOMC Minutes: Optimistic Fed Keeps To Gradual Hikes](#), 18 October 2018

[Australia's Unemployment Rate Falls Sharply](#), 18 October 2018

[Singapore: Sep NODX Suggests Shifting Profile Of Export Destination](#), 17 October 2018

[UK Wage Growth At Strongest Level In Nearly A Decade](#), 17 October 2018

[China: Mild Inflation Outlook, Reiterating Our Call For Steady Policy Rate](#), 16 October 2018



Scan the QR Code for a list of all our reports

## Disclaimer

This publication is strictly for informational purposes only and shall not be transmitted, disclosed, copied or relied upon by any person for whatever purpose, and is also not intended for distribution to, or use by, any person in any country where such distribution or use would be contrary to its laws or regulations. This publication is not an offer, recommendation, solicitation or advice to buy or sell any investment product/securities/instruments. Nothing in this publication constitutes accounting, legal, regulatory, tax, financial or other advice. Please consult your own professional advisors about the suitability of any investment product/securities/ instruments for your investment objectives, financial situation and particular needs.

The information contained in this publication is based on certain assumptions and analysis of publicly available information and reflects prevailing conditions as of the date of the publication. Any opinions, projections and other forward-looking statements regarding future events or performance of, including but not limited to, countries, markets or companies are not necessarily indicative of, and may differ from actual events or results. The views expressed within this publication are solely those of the author's and are independent of the actual trading positions of United Overseas Bank Limited, its subsidiaries, affiliates, directors, officers and employees ("UOB Group"). Views expressed reflect the author's judgment as at the date of this publication and are subject to change.

UOB Group may have positions or other interests in, and may effect transactions in the securities/instruments mentioned in the publication. UOB Group may have also issued other reports, publications or documents expressing views which are different from those stated in this publication. Although every reasonable care has been taken to ensure the accuracy, completeness and objectivity of the information contained in this publication, UOB Group makes no representation or warranty, whether express or implied, as to its accuracy, completeness and objectivity and accept no responsibility or liability relating to any losses or damages howsoever suffered by any person arising from any reliance on the views expressed or information in this publication.