



Economic Insight

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China economic outlook for 2019

ABCI Research

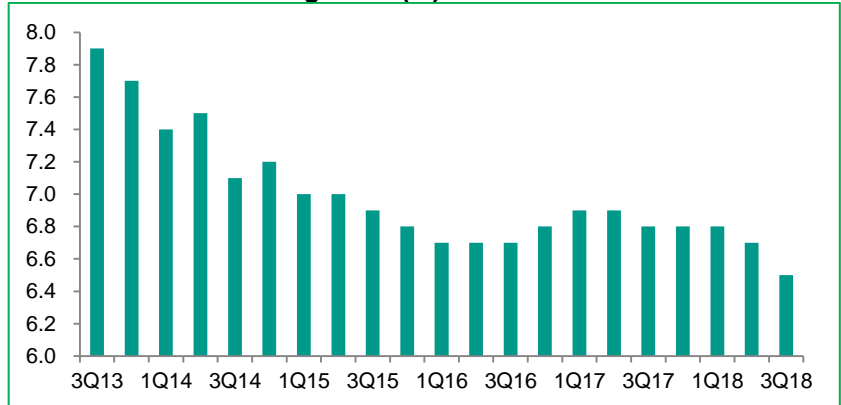
December 5, 2018

- China's economic growth has slowed slightly since the start of 2018 on weak domestic demand, tightening financial regulatory measures, and rising trade tensions with the US. Official figures show the world's second-largest economy has expanded by 6.7% in the first three quarters of 2018, down from 6.9% in the same period last year
- Looking ahead, we expect China's economic growth to slow in 2019 due to the ongoing Sino-US trade frictions, weakening consumption growth, housing market restrictions and rising credit defaults. However, a looser fiscal stance and a more accommodative monetary policy would prevent sharp economic downturn. We expect China's economy to grow by 6.3% for 2019E, slightly slower than the estimated 6.6% for 2018E
- PBOC is expected to maintain a neutral monetary policy with a loosening bias to support economic growth. It will keep liquidity abundant to support loan growth for private firms and SMEs. Targeted RRR would be slashed thrice or 2ppt in total in 2019E given the mild inflationary pressure and increasing economic slowdown
- The central government is expected to adopt a more proactive fiscal policy in 2019 to support economic growth through tax and fee reductions, funding support for private sectors, and infrastructure investment projects. We expect fiscal deficit ratio to approach to ~3.5% of GDP in 2019E

China's economic growth slowed slightly in 10M18

China economic growth has slowed slightly since the start of 2018 on weak domestic demand, tightening financial regulatory measures and rising trade tensions with the US. Official figures show the world's second-largest economy has expanded by 6.7%¹ in the first three quarters of 2018, down from 6.9% in the same period last year (Exhibit 1). A breakdown of the GDP components shows consumption was still the key growth driver, contributing to 5.2ppt to the economic growth in the first three quarters of 2018. Investment only added 2.1ppt to overall growth, while net exports of goods and services reduced growth by 0.6ppt.

Exhibit 1: China's GDP growth (%)



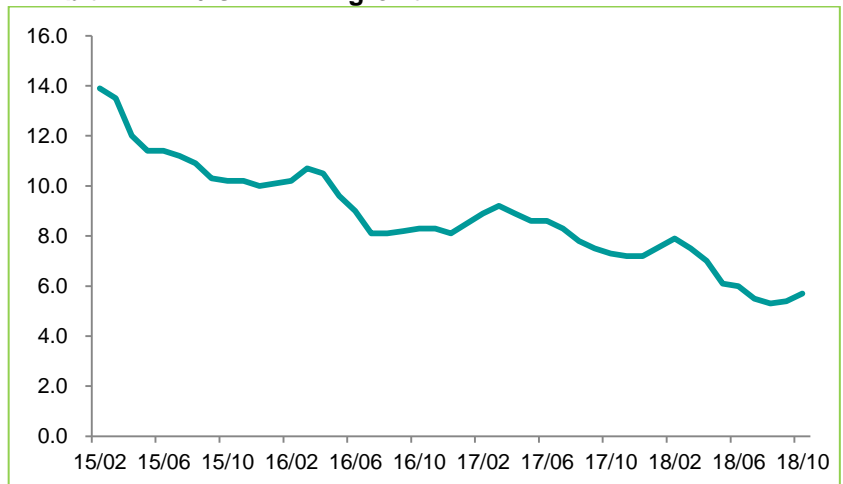
Source(s): NBS, ABCI Securities

¹ All growth rates are year-on-year except specified otherwise



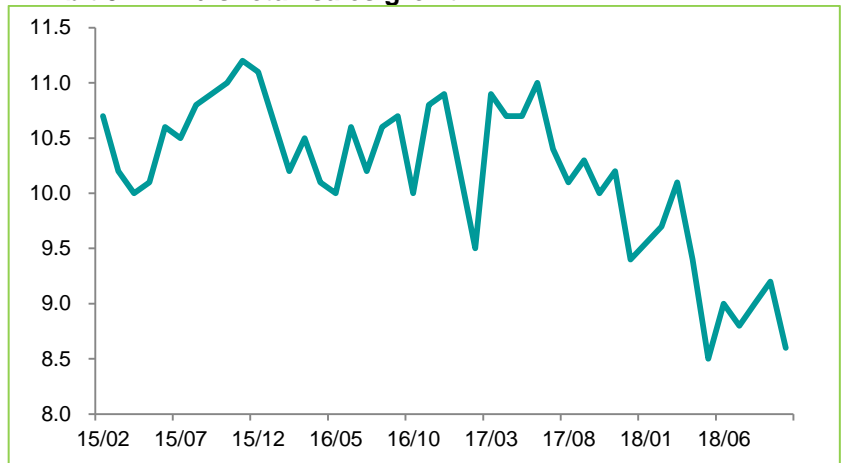
Compared with 2017, domestic demand showed weakness, with both investment and retail sales growth declining in 10M18. FAI growth in urban areas retracted to 5.7% in 10M18 from 7.2% in 2017, which we believe is a result of the slowdown in infrastructure investment amid tightened fiscal spending (Exhibit 2). Retail sales growth also decelerated to 9.2% in 10M18 from 10.2% in 2017, mainly attributable to consumption being squeezed by a surge in residential home loans and weak car sales due to tax rebate phasing out (Exhibit 3). On the production side, the real growth of industrial output slowed to 6.4% in 10M18, compared with 6.6% in 2017.

Exhibit 2: China's FAI YTD growth



Source(s): NBS, ABCI Securities

Exhibit 3: China's retail sales growth



Source(s): NBS, ABCI Securities

On the external front, both exports and imports rebounded significantly in 10M18 despite the Sino-US trade disputes since Mar 2018 (Exhibit 4). The USD value of China's exports grew by 12.6% in 10M18 on the back of RMB depreciation and export rush effect, well above the 7.9% increment in 2017. Imports climbed 20.3% in 10M18, compared with the 15.9% increase last year. With the substantial import growth, trade balance narrowed to US\$ 254.2bn in 10M18 from US\$ 334.8bn in 10M17.



Exhibit 4: China's export and import growth



Source(s): NBS, ABCI Securities

Inflation diverged in 10M18. CPI inched up to 2.1% in 10M18 from 1.6% in 2017, driven by risen food prices. However, PPI eased significantly to 3.9% in from 6.3% during the same period due to weak domestic demand and high base effect.

On the monetary front, PBOC has adopted a neutral monetary policy with a loosening bias since the start of 2018. It slashed targeted RRR four times in 10M18 to lower financing costs. We still expect to have another RRR cut before the end of 2018. Although the benchmark interest rates set by PBOC has stayed unchanged, yields of the government bonds and seven-day repurchase rate, which measures market interest rates, trended downwards. On the other hand, PBOC and CBIRC strengthened financial regulations, particularly in the area of shadow banking system. M2 growth decelerated to 8.0% in Oct 2018 from 8.8% in the same month last year, while new social financing, a comprehensive measure of all types of financing for the real economy, fell to RMB 14.6tn in 10M18 from RMB 16.8tn in 10M17.

Economic growth is set to slow for 2019

Looking ahead, we expect China's economic growth to slow in 2019 due to the ongoing Sino-US trade frictions, weakening consumption growth, housing market restrictions and rising credit defaults. In our view, a looser fiscal stance and a more accommodative monetary policy would prevent sharp economic downturn.

Domestically, infrastructure investment is expected to pick up in 2019 as the issuance pace of local government bonds quickens and fiscal spending accelerates. Property regulation will remain tight, and property investment is likely to fall back slightly as land auction failure has increased since July and property sales have slowed since 3Q18. Manufacturing investment will remain steady amid lower tax and financing costs. Overall, we predict total FAI growth to slow to 5.5% in 2019E from our estimated 5.8% in 2018E. Retail sales are expected to remain weak in 2019 on the sluggish income growth, though personal income tax reform would help underpin consumer spending. We expect retail sales growth to slow to 9.0% in 2019E from our estimated 9.2% in 2018E. Externally, frictions over trade between the US and China cast uncertainties on trade growth in 2019, though



leaders of both countries at the post-G20 Summit meeting agreed to put additional tariffs on hold for 90 days and intensify their further bilateral negotiations. We forecast the growth of exports and imports to ease to 7.0% and 12.0% in 2019E respectively from our estimated 12.0% and 20.0% in 2018E. On the whole, we expect China's economy to grow by 6.3% for 2019E, slightly slower than the estimated 6.6% for 2018E (Exhibit 5).

Exhibit 5: Economic forecasts

Economic indicators	2017	2018E	2019E
Real GDP growth, %	6.9	6.6	6.3
FAI growth, %	7.2	5.8	5.5
Retail Sales growth, %	10.2	9.2	9.0
Export growth in USD terms, %	7.9	12.0	7.0
Import growth in USD terms, %	15.9	20.0	12.0
Industrial Production growth, %	6.6	6.5	6.2
CPI, %	1.6	2.2	2.0
PPI, %	6.3	3.5	2.5
M2 growth, %	8.2	8.5	8.5
Aggregate Financing, RMB bn	22,397	18,000	20,000
New Yuan Loans, RMB bn	13,523	15,500	17,000
Spot CNY per USD, End-year	6.5068	6.9000	7.0000

Source(s): NBS, PBOC, ABCI Securities estimates

CPI inflation is expected to ease slightly to 2.0% in 2019E from the estimated 2.2% in 2018E due to lower oil price and easing property price. We forecast PPI inflation to ease to 2.5% in 2019E from the 3.5% for 2018E with commodity prices moderating and domestic demand softening. We believe the establishment of macro policy will not be constrained by inflation in 2019.

On the monetary front, PBOC is expected to maintain a neutral monetary policy with a loosening bias to support economic growth. PBOC is likely to keep liquidity abundant to support loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to increase by 9.7% and 11.1% to ~RMB 17.0tr and ~RMB 20.0tr respectively in 2019E. Meanwhile, we expect the authority to lower interest rates of open market operations and various instruments such as SLF, MLF and more, though it will keep the benchmark interest rates steady in 2019E. Targeted RRR would be slashed thrice in 2019E given the mild inflationary pressure and increasing economic slowdown. We expect RRR for large financial institutions to be 12.0% and RRR for medium and small financial institutions to be 10.0% for end-2019E. Broad money supply (M2) is set to grow by about 8.5% in 2019E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 7.0000 by end-2019E with the rising US interest rates, as compared to the estimated 6.9000 for end-2018E.

The central government is expected to adopt a more proactive fiscal policy in 2019 to support economic growth through tax and fee reductions, funding support for private sectors, and infrastructure investment projects acceleration. The Minister of Finance released a detailed draft plan for personal income tax cuts, while the enterprise income tax and VAT cuts are on the cards in 2019. The State Council



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issued a policy report requesting support for reasonable financing requirements for infrastructure investment. We expect faster growth in fiscal expenditure than fiscal revenue to result in another fiscal deficit in 2019, with the headline ratio approaching to about 3.5% of GDP.



China Economic Indicators

	2017						2018							
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Real GDP (YoY %)	---	---	6.8	---	---	6.8	---	---	6.7	---	---	6.5	---	---
Export Growth (USD, YoY %)	6.9	12.3	10.9	11.1	44.5	-2.7	12.9	12.6	11.3	12.2	9.8	14.5	15.6	---
Import Growth (USD, YoY %)	17.2	17.7	4.5	36.9	6.3	14.4	21.5	26.0	14.1	27.3	27.0	14.3	21.4	---
Trade Balance (USD bn)	38.2	40.2	54.7	20.3	33.7	-5.0	28.8	24.9	41.6	28.1	27.9	31.7	34.0	---
Retail Sales Growth (YoY %)	10.0	10.2	9.4	9.7	9.7	10.1	9.4	8.5	9.0	8.8	9.0	9.2	8.6	---
Industrial Production (YoY %)	6.2	6.1	6.2	7.2	7.2	6.0	7.0	6.8	6.0	6.0	6.1	5.8	5.9	---
PMI - Manufacturing (%)	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9	51.5	51.2	51.3	50.8	50.2	50.0
PMI - Non-manufacturing (%)	54.3	54.8	55.0	55.3	54.4	54.6	54.8	54.9	55.0	54.0	54.2	54.9	53.9	53.4
FAI (YTD) (YoY %)	7.3	7.2	7.2	7.9	7.9	7.5	7.0	6.1	6.0	5.5	5.3	5.4	5.7	---
CPI (YoY %)	1.9	1.7	1.8	1.5	2.9	2.1	1.8	1.8	1.9	2.1	2.3	2.5	2.5	---
PPI (YoY %)	6.9	5.8	4.9	4.3	3.7	3.1	3.4	4.1	4.7	4.6	4.1	3.6	3.3	---
M2 (YoY %)	8.8	9.1	8.2	8.6	8.8	8.2	8.3	8.3	8.0	8.5	8.2	8.3	8.0	---
New Lending (RMB bn)	663	1120	584	2900	839	1120	1180	1150	1840	1450	1280	1380	697	---
Aggregate Financing (RMB bn)	1040	1600	1140	3060	1170	1330	1560	761	1180	1040	1520	2210	729	---

World Economic/Financial Indicators

Equity Indices				Global Commodities				Bond Yields & Key Rates				
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Volume (5-Day avg.)		Yield (%)	Chg. WTD (Bps)		
U.S.				Energy				US Fed Fund Rate				
DJIA	25,027.07	(2.00)	16.69	NYMEX WTI	USD/bbl.	52.45	2.98	787,453		2.25	0.00	
S&P 500	2,700.06	(2.18)	18.47	ICE Brent Oil	USD/bbl	61.18	4.21	168,917	US Prime Rate	5.25	0.00	
NASDAQ	7,158.43	(2.35)	40.55	NYMEX Natural Gas	USD/MMBtu	4.55	(1.43)	145,566	US Discount Window	2.75	0.00	
MSCI US	2,567.52	(2.15)	18.70	China Qinhuangdao Port Thermal Coal ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (1 Yr)	2.3095	0.46	
Europe				Basic Metals				US Treasury (5Yr)				
FTSE 100	7,022.76	0.61	15.94	LME Aluminum Cash	USD/MT	1,972.50	0.78	17,535	US Treasury (10 Yr)	2.9136	(7.43)	
DAX	11,335.32	0.69	12.42	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,974.00	0.82	36,059	Japan 10-Yr Gov. Bond	0.0690	(2.30)	
CAC40	5,012.66	0.17	15.48	CMX Copper Active	USD/lb.	6,220.50	(0.10)	21,070	China 10-Yr Gov. Bond	3.3190	(6.10)	
IBEX 35	9,061.70	(0.17)	13.04	LME Copper 3- mth Rolling Fwd.	USD/MT	6,209.00	0.18	40,332	ECB Rate (Refinancing)	0.00	0.00	
FTSE MIB	19,353.43	0.86	10.89	Precious Metals				1-Month LIBOR				
Stoxx 600	358.43	0.26	16.03	CMX Gold	USD/T. oz	1,239.80	1.13	218,953	3 Month LIBOR	2.7513	1.51	
MSCI UK	2,035.12	0.63	16.12	CMX Silver	USD/T. oz	14.50	1.96	78,095	O/N SHIBOR	2.2670	(37.5)	
MSCI France	145.16	0.03	15.73	NYMEX Platinum	USD/T. oz	797.40	(0.30)	21,994	1-mth SHIBOR	2.7820	8.10	
Asia				Agricultural Products				3-mth HIBOR				
NIKKEI 225	21,919.33	(1.93)	15.15	CBOT Corn	USD/bu	383.75	1.59	218,422	Corporate Bonds (Moody's)			
S&P/ASX 200	5,668.35	0.02	15.62	CBOT Wheat	USD/bu	520.25	0.87	60,316	Aaa	4.17	(5.00)	
HSI	26,821.17	1.19	10.16	NYB-ICE Sugar	USD/lb.	12.75	(0.70)	56,995	Baa	5.24	(4.00)	
HSCEI	10,764.26	1.34	8.07	CBOT Soybeans	USD/bu.	911.00	1.82	118,642	Note:			
CSI300	3,252.00	2.50	12.00	1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)								
SSE Composite	2,649.81	2.38	12.34	2. The price is Coal 5500 kcal/kg FOB Spot Price								
SZSE Composite	1,380.78	3.22	22.30									
MSCI China	77.24	1.95	12.40									
MSCI Hong Kong	14,737.61	3.21	10.52									
MSCI Japan	983.84	(1.00)	12.57									

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1330	1.2686	0.7298	113.09	0.9995	6.8654	7.8049	6.9168
Chg. WTD (%)	0.11	(0.49)	(0.11)	0.42	(0.16)	1.39	0.24	1.41



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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate $<$ Market return rate (+10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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