

# *China Leading Indicators*

## *Darkest before dawn*

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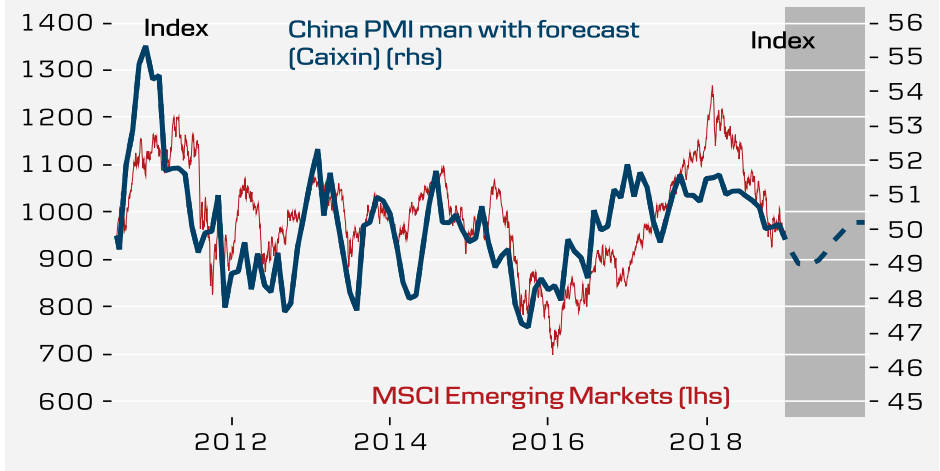
3 January 2019

# Summary: still worse before it gets better

## China outlook

- **Our view.** Still more weakness in the short term but moderate recovery from Q2 19.
- **Leading indicators paint a mixed picture**
  - #1: Home sales to see lift from lower yields (p.4).
  - #2: Commodity prices generally weak (p.5).
  - #3: Credit impulse weak but ray of light (p.6).
  - #4: Export model points to overshooting in exports (p.7).
- **Policy outlook**
  - We look for a US-China deal in the next three to six months to remove a key headwind.
  - We also expect further stimulus coming soon (big tax cut for both consumers and companies and one or more reductions in the reserve requirement ratio.)
- **Chinese market outlook**
  - We expect USD/CNY to stay around the current level (6.85) in the short term. A weaker USD is keeping a lid on USD/CNY despite the Chinese slowdown. A halt to CNY weakening is also likely to be part of a US-China trade deal.
  - We see more downside risk to stocks short term but higher from Q2 on stimulus and recovery.

PMI fell below 50 in December. We expect more downside short term but bottom in Q2



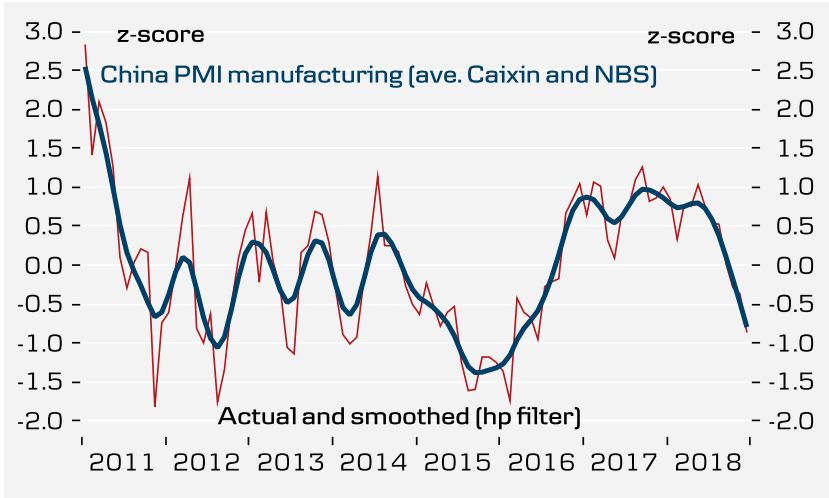
Source: Macrobond Financial, Markit, Danske Bank

## Global financial implications

- **Equities.** Short term still high volatility from weaker cycle. Outlook to improve when China recovers from Q2.
- **Emerging markets.** More headwind short term but turning to tailwind from Q2 (see chart above).
- **Global bonds.** A weaker China cycle short term = disinflationary pressure and downward pressure on bond yields - all else being equal.
- **Commodities.** Metals to be underpinned by Chinese stimulus, which benefits construction and infrastructure. Oil price sell-off overdone (p.15).

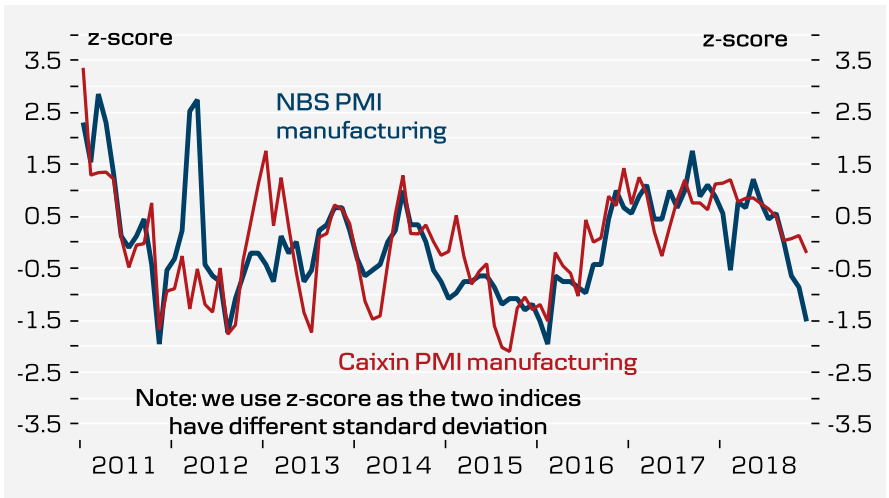
# Status on the cycle: both PMIs point to weakness

Our combined PMI indicator has fallen sharply in recent months pointing to a clear slowdown of the Chinese economy.



Source: Macrobond Financial, Markit, Danske Bank

Both the NBS and the Caixin PMI manufacturing point to weaker activity.



Source: Macrobond Financial, Markit, Danske Bank

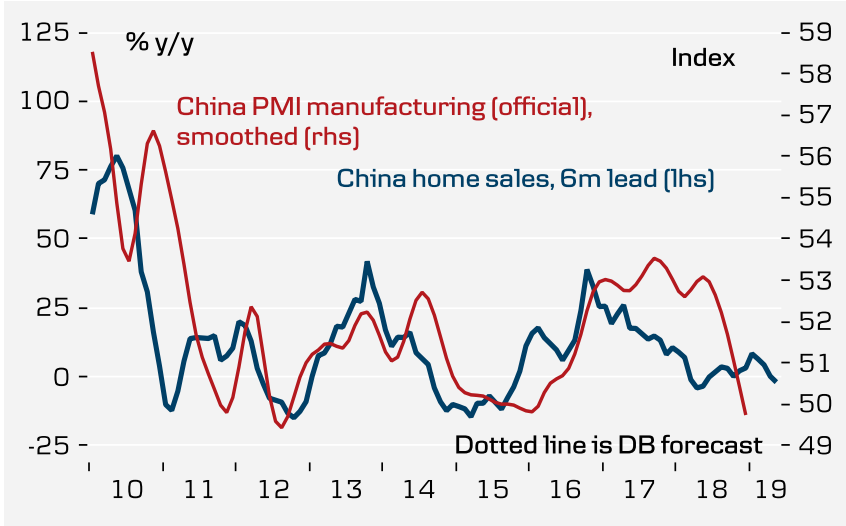
# #1 LEI - home sales: recovery in 2019

Home sales growth is set to recover in 2019, as the monetary policy easing is feeding through to lower financing costs. Bond yields have proven one of the best leading indicators for the housing market.



Source: Macrobond Financial, Danske Bank

The housing market has been one of the factors weighing on the Chinese economy. A recovery should underpin improvement in the overall economy.

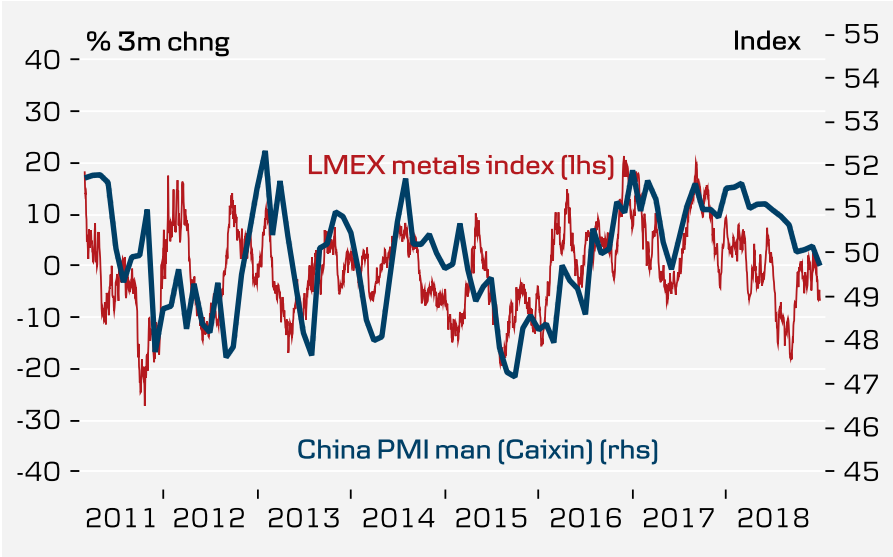


Source: Macrobond Financial, Danske Bank

# #2 LEI - commodity prices: short-term weakness

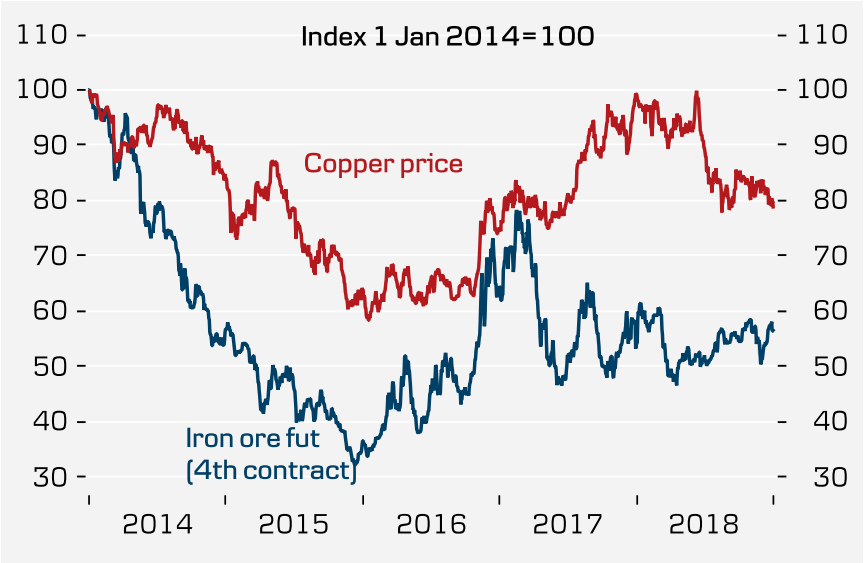
A good real time indicator for China is metal markets. **The decline still points to downside in Caixin PMI compared with current levels.**

**Copper prices have drifted lower lately but overall decline is less severe than over the summer after the trade war started. Iron ore prices are holding up.**



Note: As China consumes around 50% of global metals, metal prices tend to be a good indicator for Chinese demand

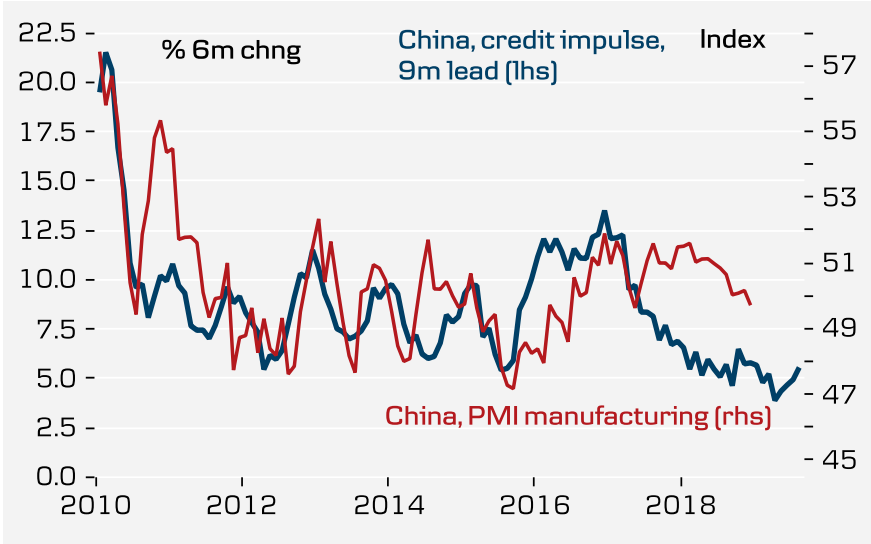
Source: Macrobond Financial, Markit, Danske Bank



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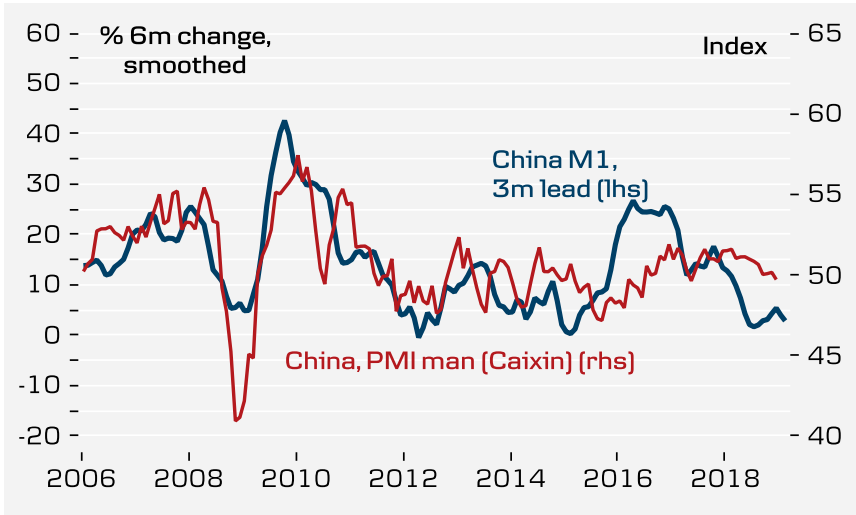
# #3 LEI - money and credit: negative but M1 growth stabilising

The **credit impulse has been weak for a long time**. The deleveraging campaign and crack-down on shadow finance has weighed on credit growth. The most recent data points to some stabilisation but still at a low level.



Note: Credit impulse is calculated as the 6M change in the annual flow of total bank claims  
 Source: Macrobond Financial, Markit, Danske Bank

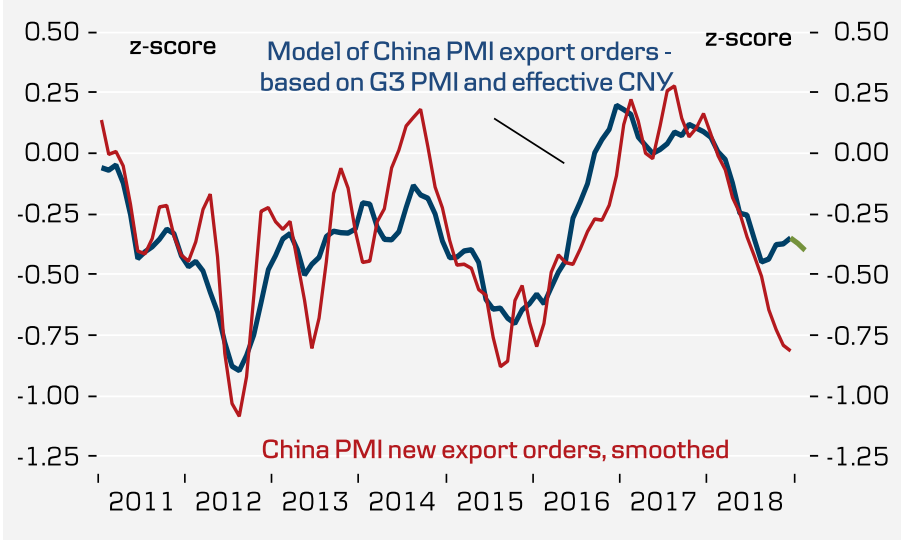
**Money growth has also been weak for some time.** The six-month growth rate is showing tentative signs of stabilisation, though.



Source: Macrobond Financial, Markit, Danske Bank

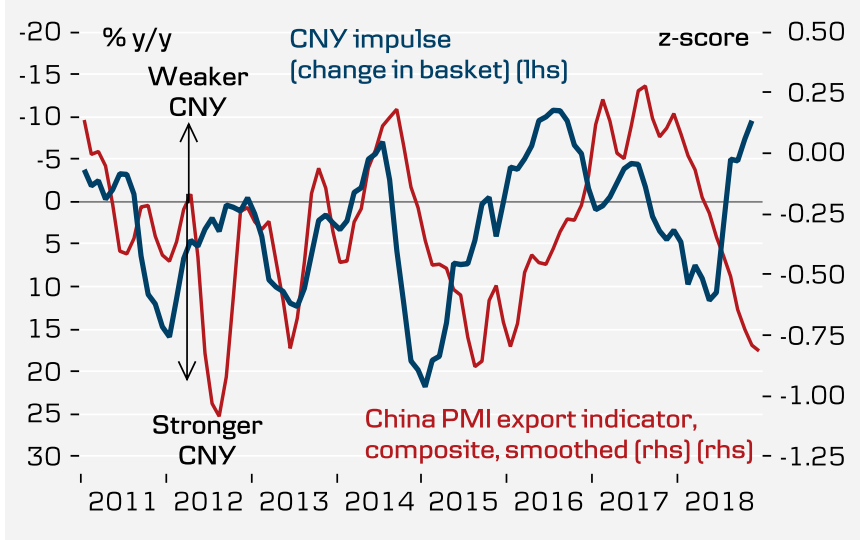
# #4 LEI - export model: deviation from model points to impact of trade war

Our export model has turned a bit lately, driven by the weakening of the CNY. However, PMI export orders continued lower in December, suggesting the trade war is having a clear negative impact.



Note: G3 here is US, Euro area and Japan  
Source: Macrobond Financial, Markit, Danske Bank

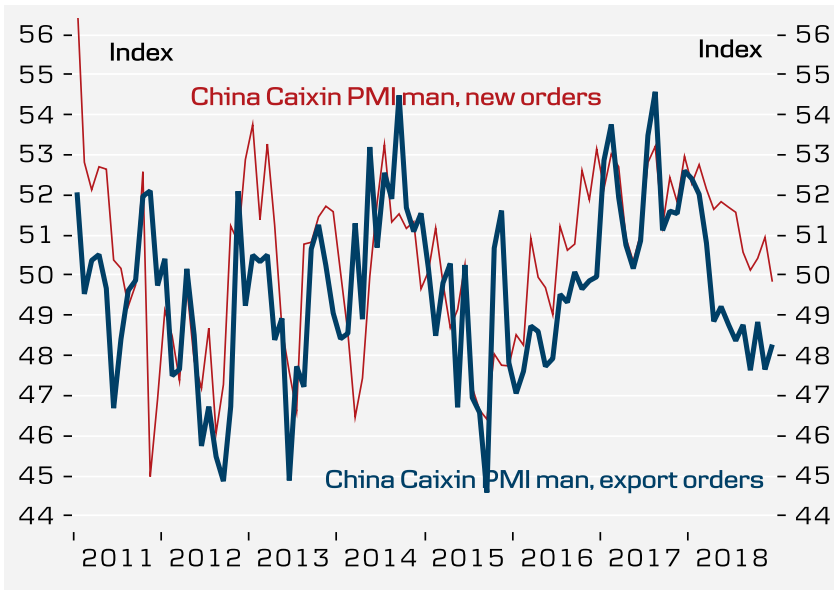
The CNY impulse has turned from a headwind into a tailwind following the recent depreciation of the CNY basket.



Source: Macrobond Financial, Markit, Danske Bank

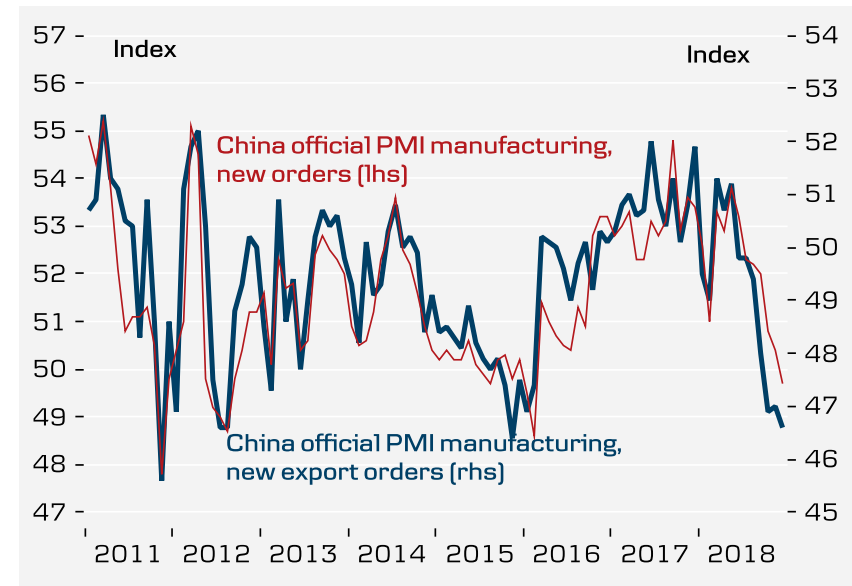
# Export orders the weakest link in the economy

Caixin PMI new orders have clearly been pulled lower by export orders.



Source: Macrobond Financial, Markit, Danske Bank

The same is the case for official PMI where export orders are now as weak as the low in late 2015.



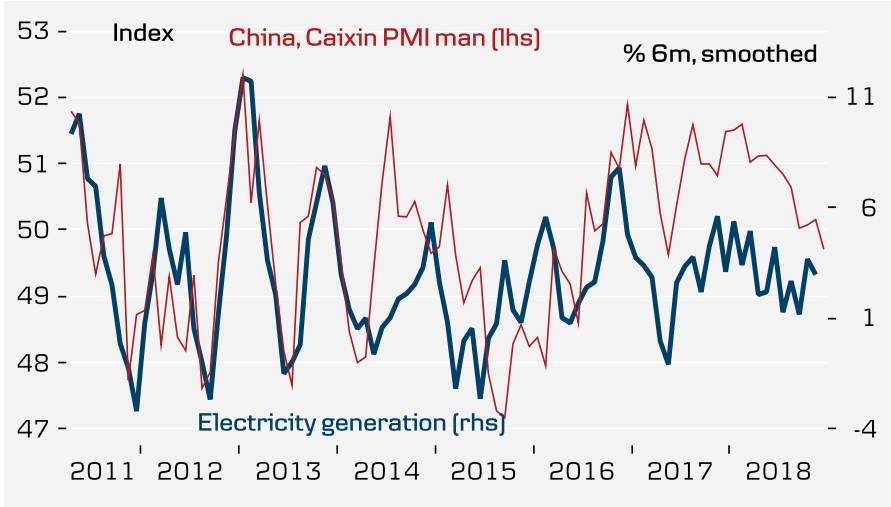
Source: Macrobond Financial, Markit, Danske Bank



# *Output indicators*

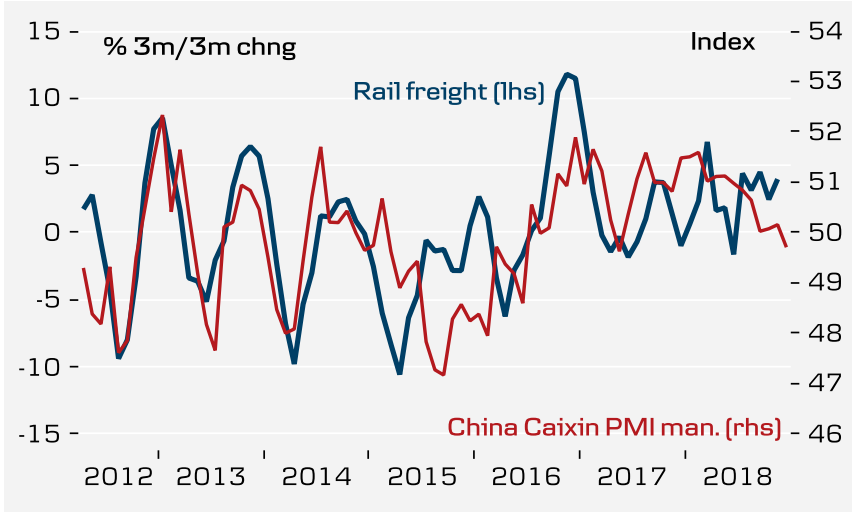
# Electricity and freight soft but they do not point to a hard landing

Electricity generation has weakened but it is not pointing to a sharp downturn.



Source: Macrobond Financial, Markit, Danske Bank

Rail freight is another good cross-check for activity. It is also not pointing to a hard landing. It is actually still holding up better than other indicators.

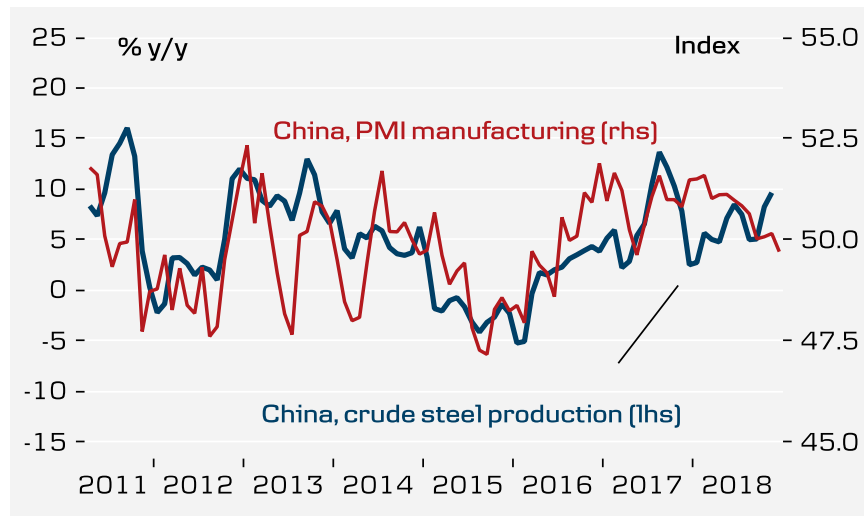


Source: Macrobond Financial, Markit, Danske Bank

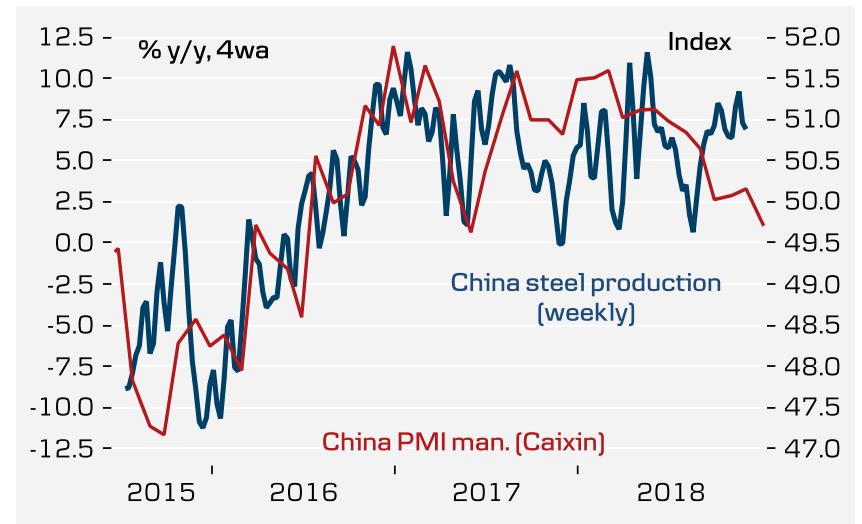
# Steel production holding up on robust construction

While the anti-pollution measures on steel production have given somewhat more volatility, the **overall impression is that steel production is holding up well**. Fiscal stimulus has been boosted by higher infrastructure spending, which is underpinning steel consumption.

The weekly steel production numbers confirm a picture of decent construction activity.



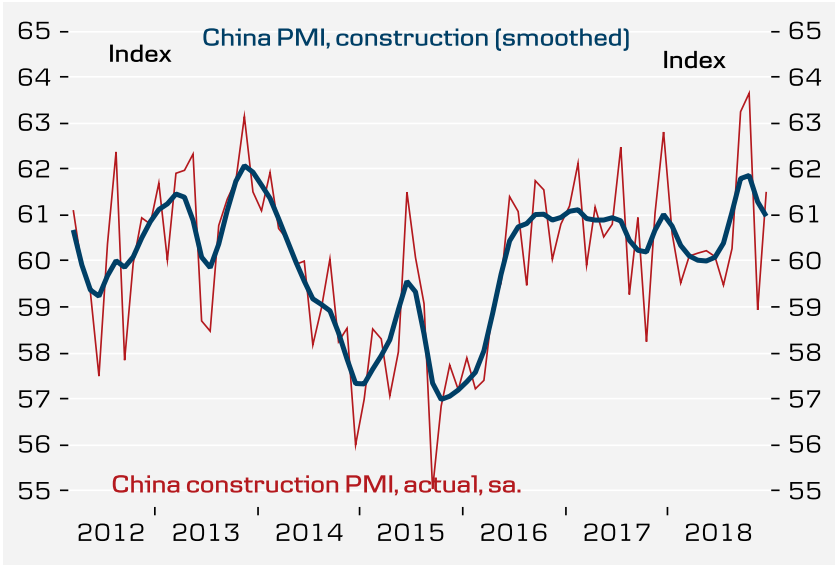
Source: Macrobond Financial, Markit, Danske Bank



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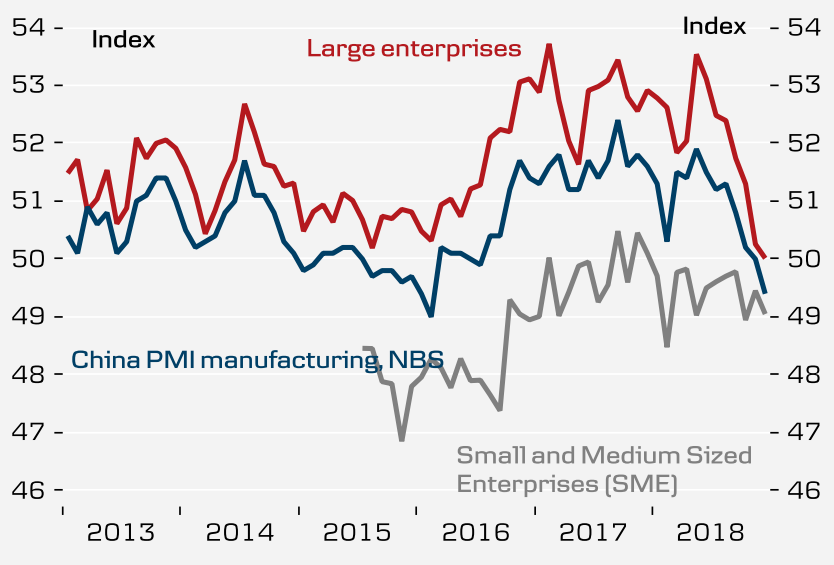
# Construction sector getting a boost

**Construction PMI still at robust levels.** This supports a picture of infrastructure and residential construction spending.



Source: Macrobond Financial, Danske Bank

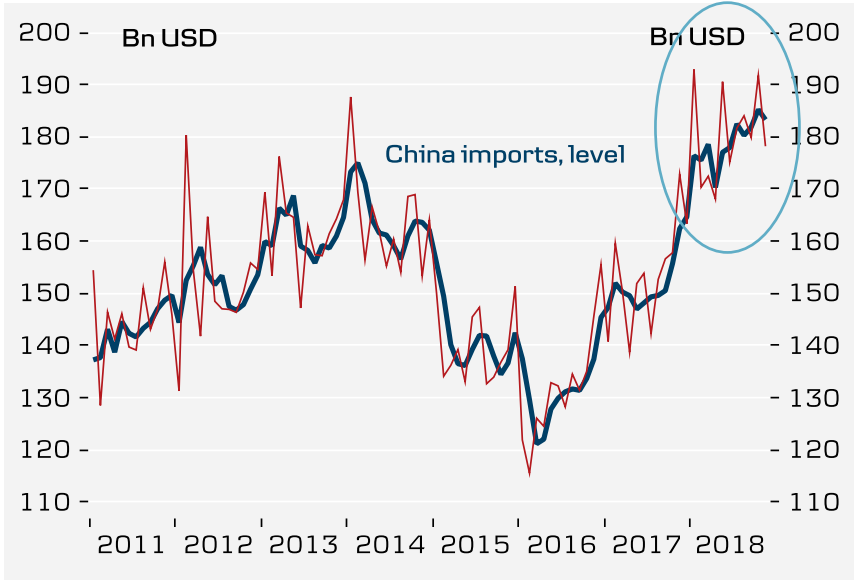
The official PMI manufacturing has details on the size of companies. It **shows declines across company sizes but more pronounced declines for large enterprises.** This is a bit puzzling, as we would expect more export companies in the SME segment.



Source: Macrobond Financial, Danske Bank

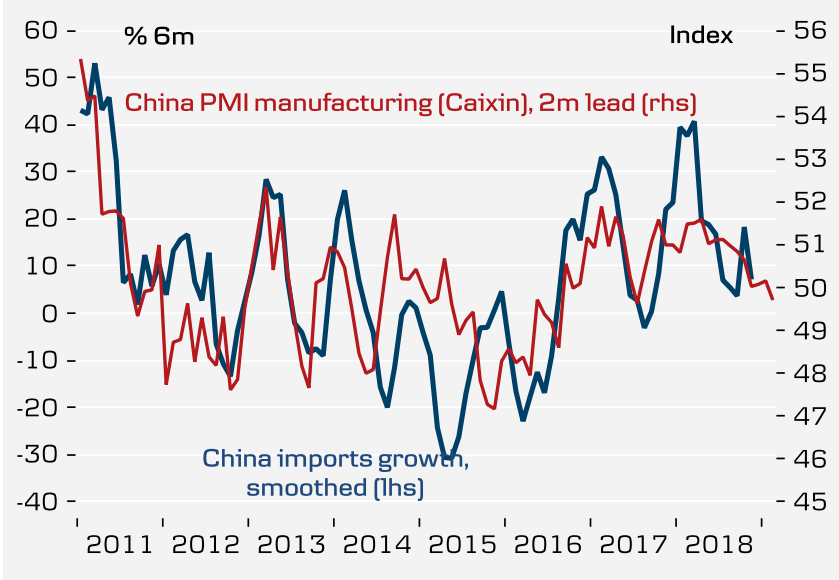
# Imports still decent – but distorted by the trade war

The *level* of imports has been robust in recent months. However, this may be related to the dynamics of the trade war. Some exports to the US have been pushed forward to avoid a potentially higher tariff on 1 January. As exports have a high import content, this also lifts imports.



Source: Macrobond Financial, Markit, Danske Bank

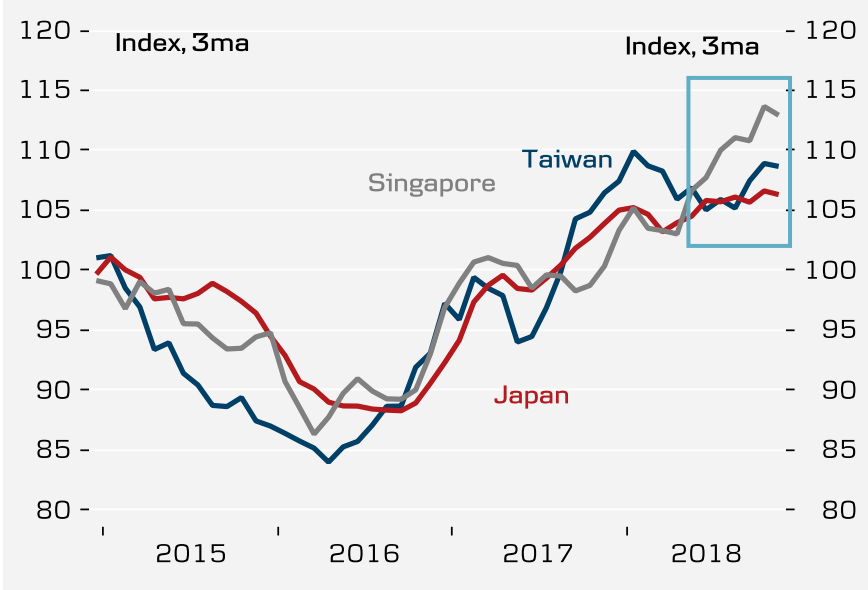
Decent correlation with PMI – but PMI leads by a couple of months. Hence imports tend to be more a cross-check than a forward-looking indicator.



Source: Macrobond Financial, Markit, Danske Bank

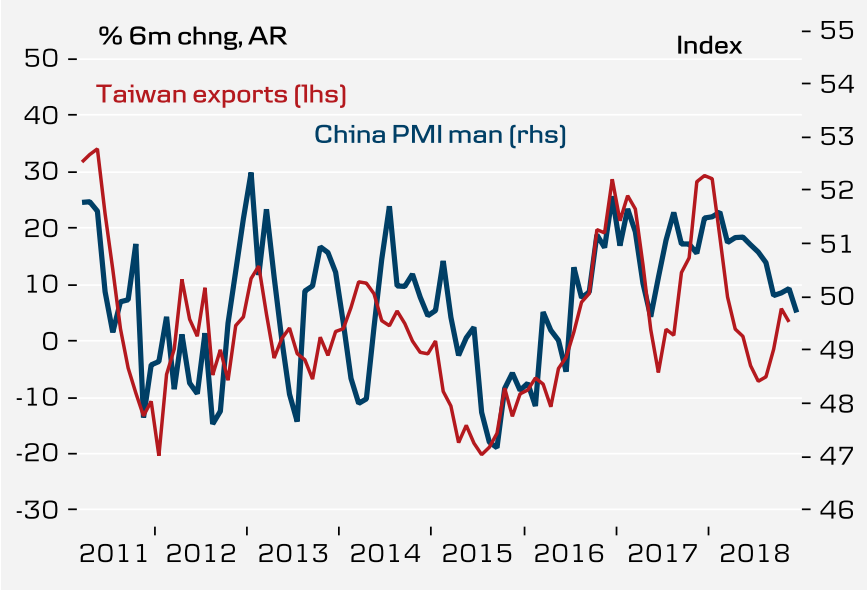
# Asia exports to China decent – but also distorted by trade war

Another **good cross-check of Chinese activity** is **other Asian countries' exports**, as China is their main export market. Numbers are also distorted by trade war effects, though.



Source: Macrobond Financial, Markit Danske Bank

**Taiwan export growth in line with weaker Chinese PMI.**

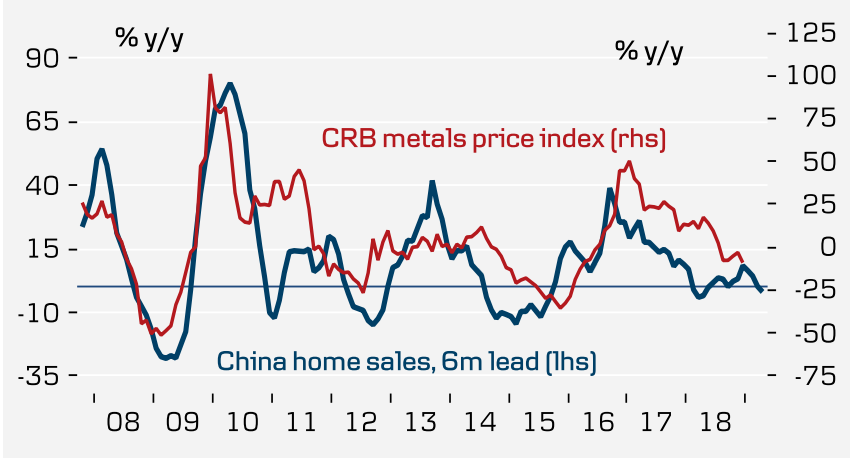


Source: Macrobond Financial, Markit Danske Bank

# *China's global inflation impulse*

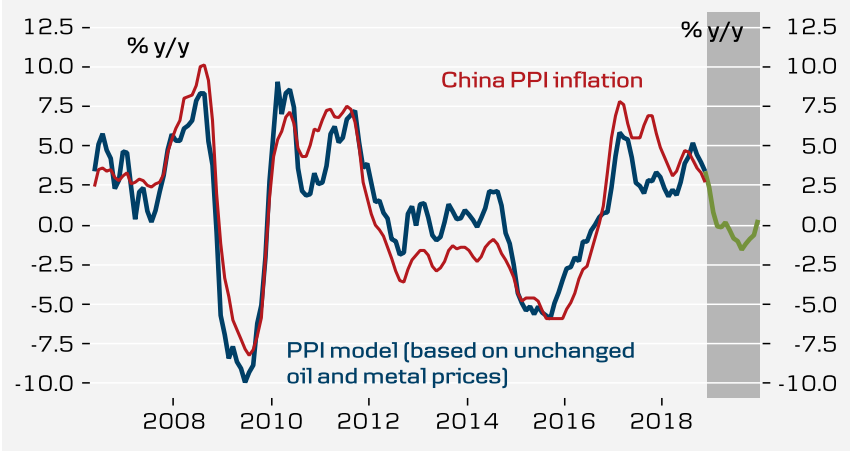
# China again a disinflationary force

Slower housing generally feeds into metal prices.



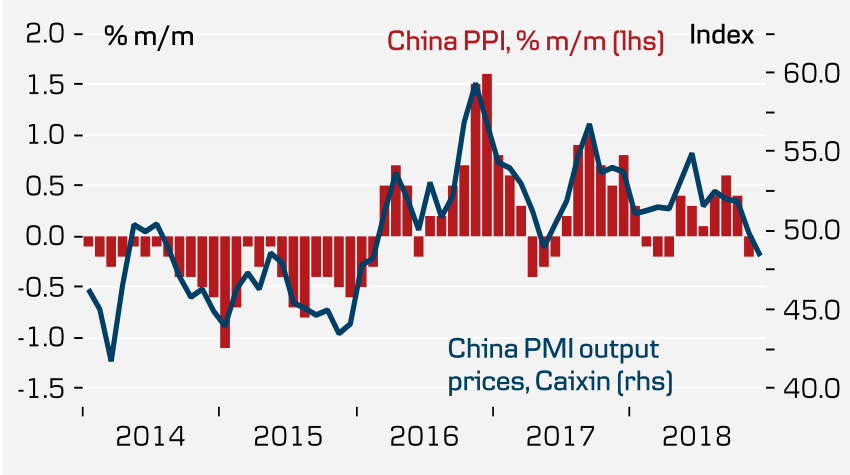
Source: Macrobond Financial, Markit, Danske Bank

PPI inflation set to move sharply lower from here.



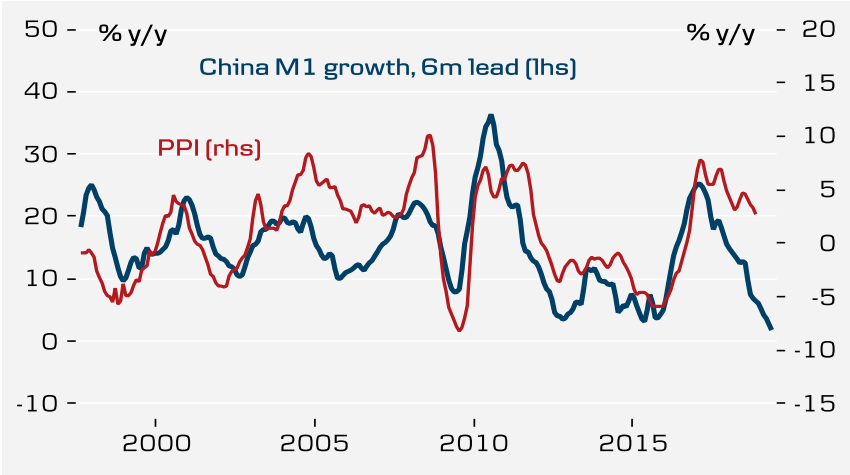
Source: Macrobond Financial, Markit, Danske Bank

PMI output in line with weaker PPI momentum.



Source: Macrobond Financial, Markit, Danske Bank

M1 growth also points to lower inflation pressure.



Source: Macrobond Financial, Markit, Danske Bank



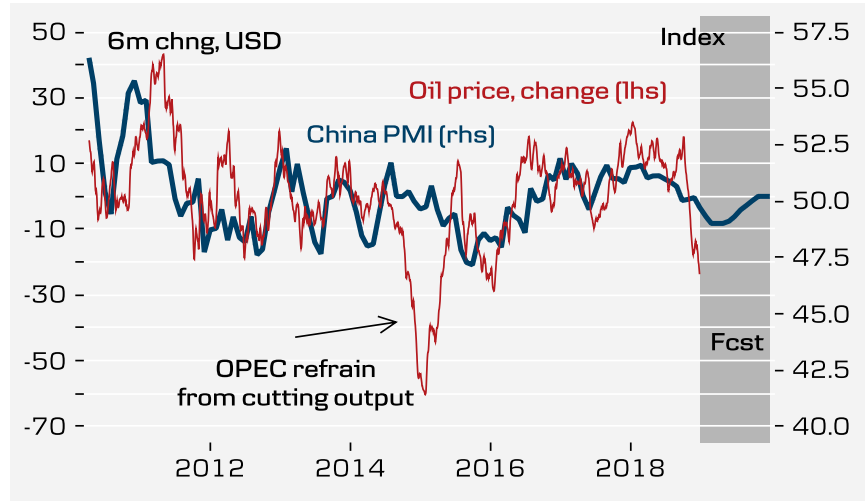
# China slowdown weighs on global cycle and caps inflation

China export price inflation higher lately - but should come down soon on weaker commodity prices.



Source: Macrobond Financial, Markit, Danske Bank

Slowdown underpins lower oil price - but move looks overdone.



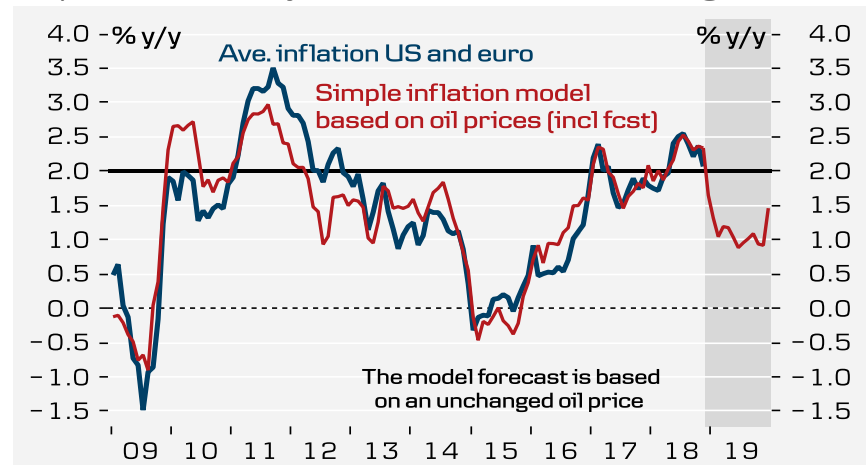
Source: Macrobond Financial, Markit, Danske Bank

China slowdown in tandem with global business cycle.



Source: Macrobond Financial, Markit, Danske Bank

Oil prices are a key driver of inflation. Heading down.



Source: Macrobond Financial, Markit, Danske Bank

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