China Leading Indicators
– It gets worse before it gets better

Chief Analyst, China
Allan von Mehren
+45 45 12 80 55
alvo@danskebank.dk

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Investment Research
www.danskemarketsequities.com

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Summary: it gets worse before it gets better

China outlook

- Leading indicators paint a mixed picture

  #1: Home sales to see lift from lower yields (p.3).

  #2: Commodity prices generally weak (p.4).

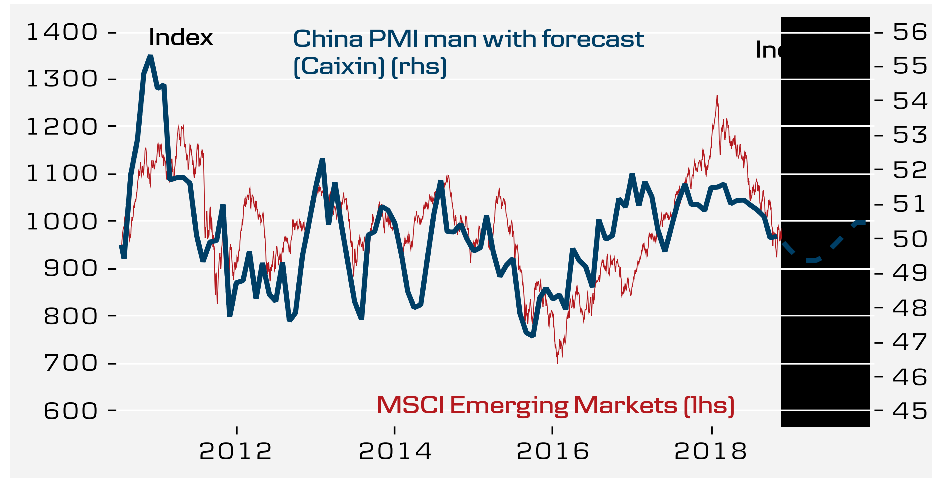
  #3: Credit impulse weak but ray of light in M1 (p.5).

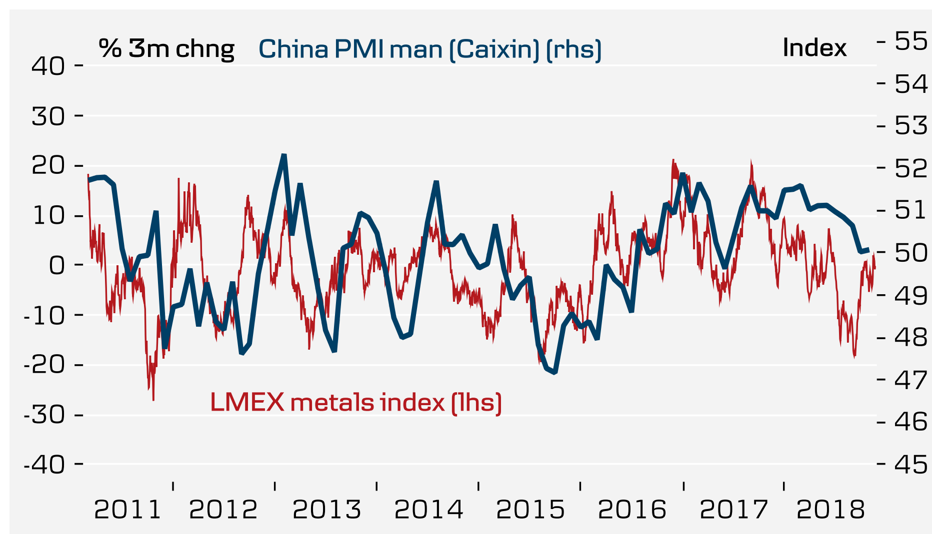
  #4: Export model bottoming – but the trade war is currently the main driver of exports.
- Our view: more weakness short term but moderate recovery from Q2 19.
- Trade war adds uncertainty to the outlook.

Financial implications

- Equities: still high volatility short term but outlook better when economy recovers from Q2 19.
- EM: more headwind short term but set to turn into a tailwind from Q2 (see top right chart).
- Global bonds: a weaker China cycle short term = disinflationary pressures and downward pressure on bond yields – all else being equal.
- Commodities: metals are set to be underpinned by Chinese stimulus, which benefits construction and infrastructure. Oil price sell-off overdone (p.16).

More slowdown short term, but bottom likely in Q2



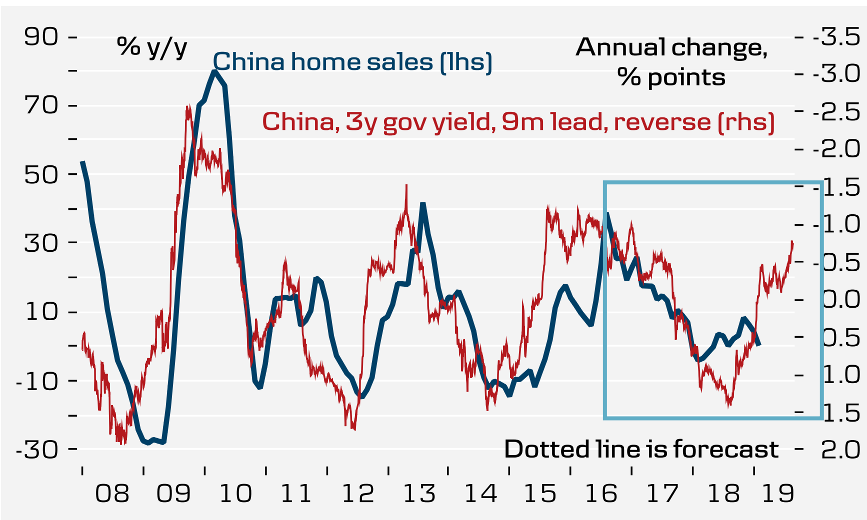


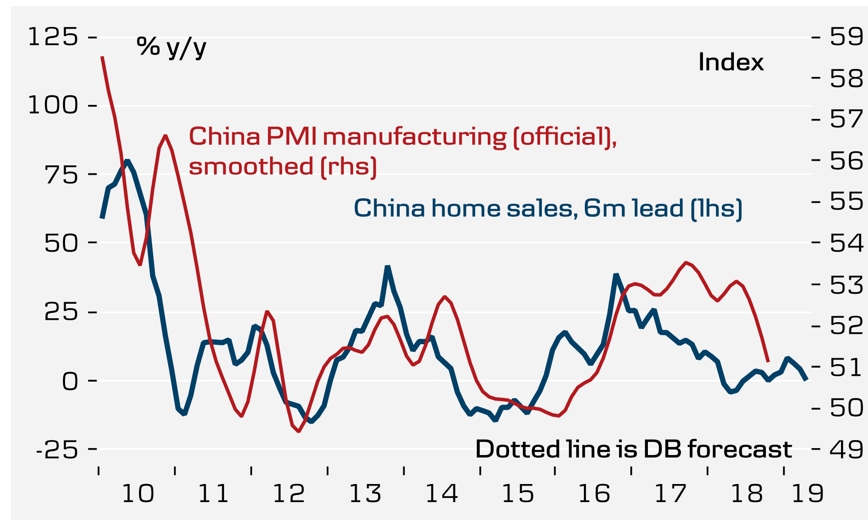
Source (both charts): Macrobond Financial, Markit, Danske Bank

#1 LEI - home sales: recovery in 2019

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

A weaker housing market has weighed on the Chinese economy due to the financial tighening campaign in H2 16 and 2017. A housing recovery in 2019 should underpin the overall economy

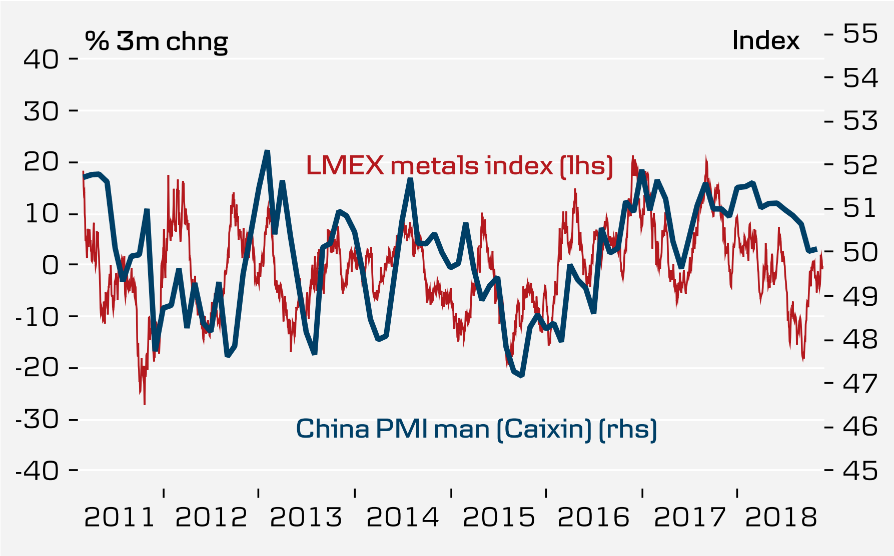




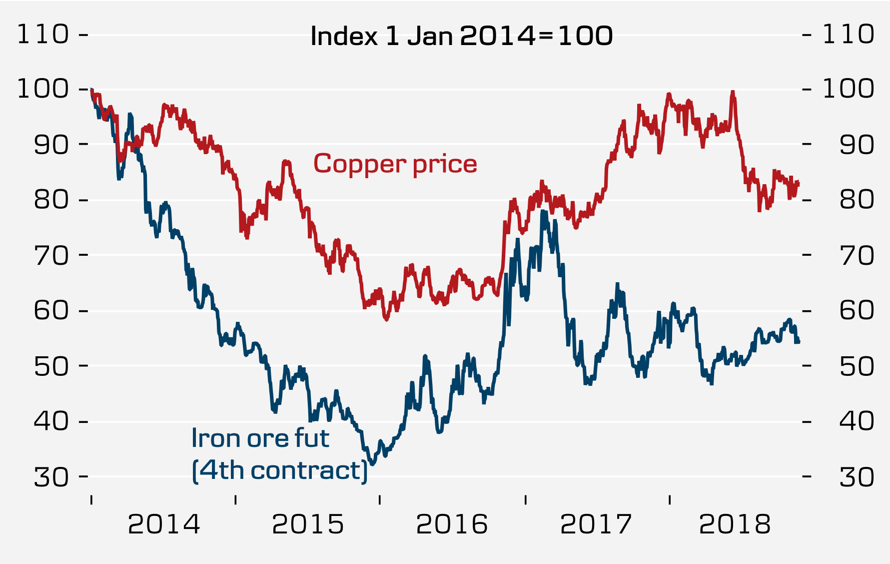
Source (both charts): Macrobond Financial, Danske Bank

#2 LEI - commodity prices: short-term weakness

Metal markets are a good real time indicator for China. **Decline still points to downside in PMI vs current levels**



Copper prices have stabilised following the sharp drop in the summer. Indicates some stabilisation – maybe because stimulus is starting to work



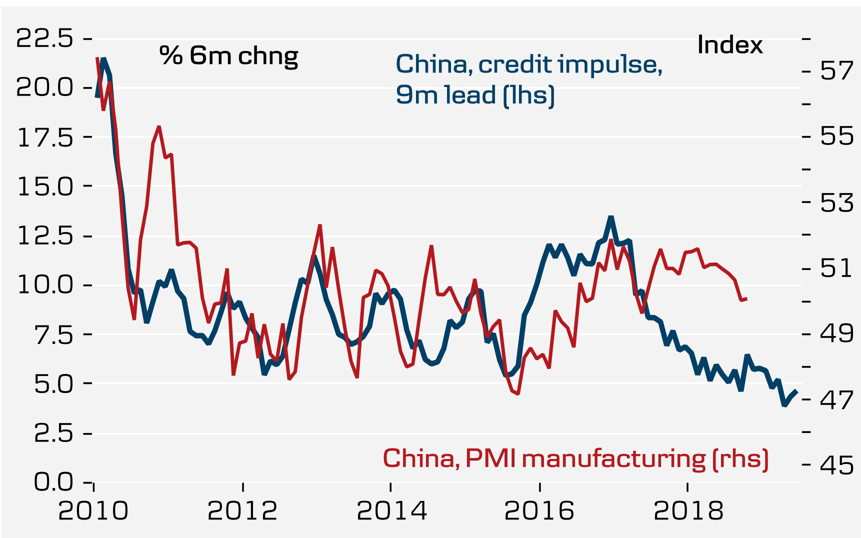
Source (both charts): Macrobond Financial, Markit, Danske Bank

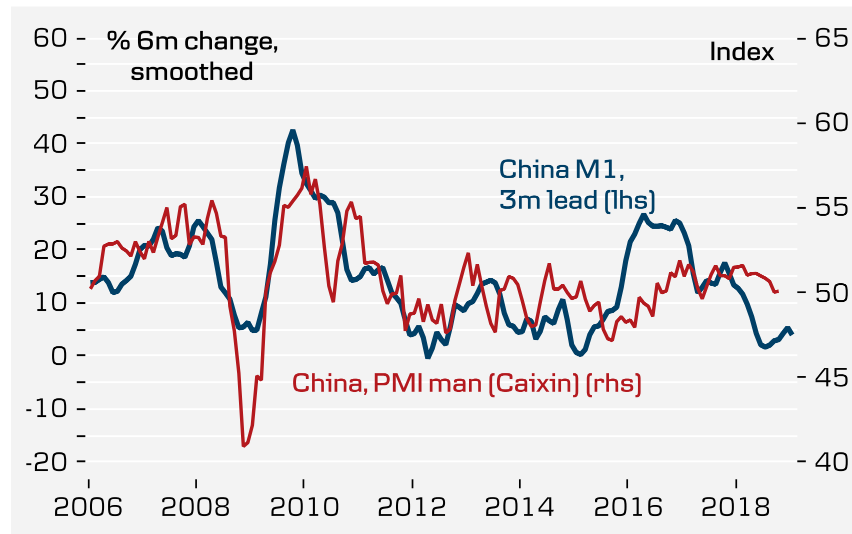
Note: as China consumes around 50% of global metals, metal prices tend to be a good indicator of Chinese demand

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

The **credit impulse has been weak for a long time.** The deleveraging campaign and crackdown on shadow finance has weighed on credit growth. Still one of the most negative growth indicators at the moment, pointing to downside risk in the short term

Money growth has also been weak for some time. However, the six-month rate has bottomed in recent months. While still at a low level, it indicates that monetary easing is starting to feed through





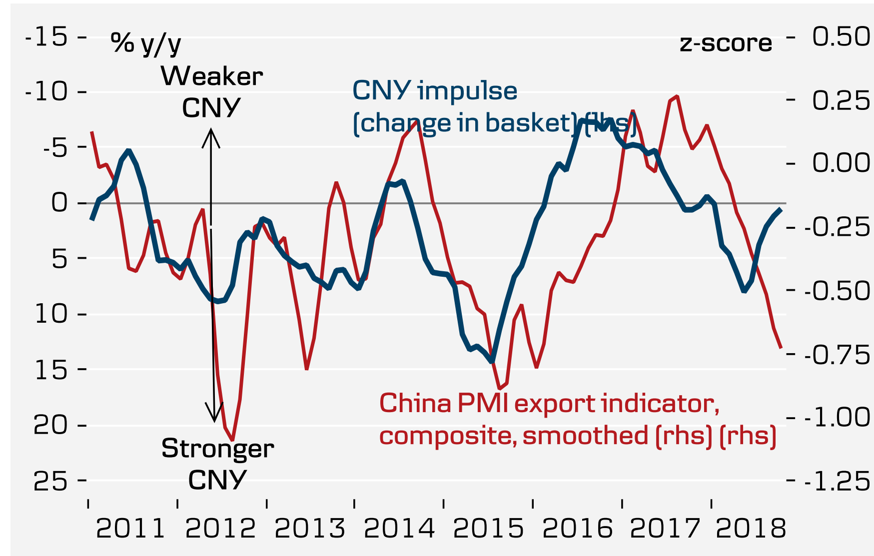
Source (both charts): Macrobond Financial, Markit, Danske Bank

Note: credit impulse is calculated as the 6M change in the annual flow of total bank claims

#4 LEI - export model: rebound but trade war is the joker in the pack

Our export model has turned a bit recently driven by the weakening of the CNY. However, PMI export orders have continued lower, suggesting that the trade war is having a clearly negative impact

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

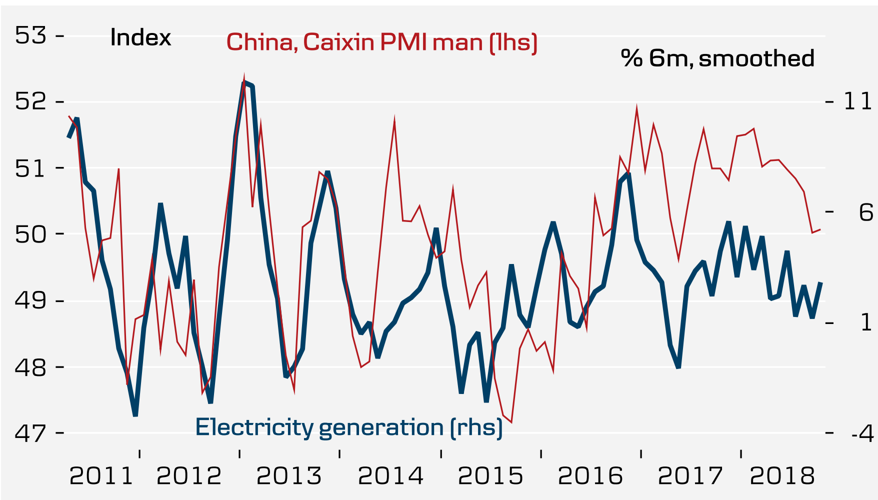


Note: G3 here is the US, Euro area and Japan
Source (both charts): Macrobond Financial, Markit, Danske Bank

Output indicators

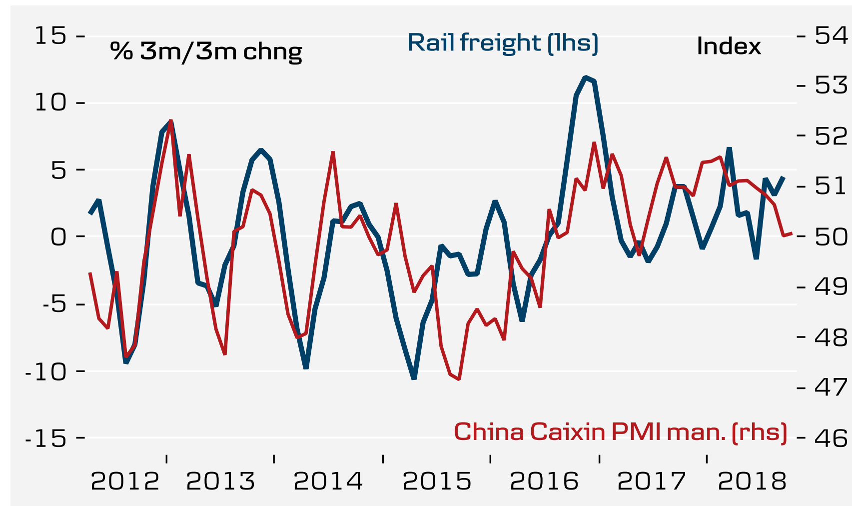
Electricity and freight soft but does not point to hard landing

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



Source (both charts): Macrobond Financial, Markit, Danske Bank

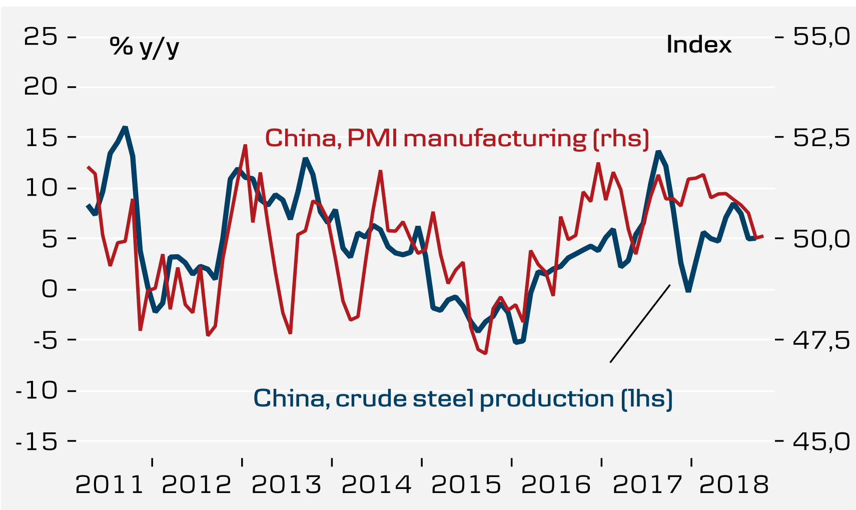
Rail freight is another good cross-check for activity. **It doesn't point to a hard landing either.** It is actually holding up better than other indicators.

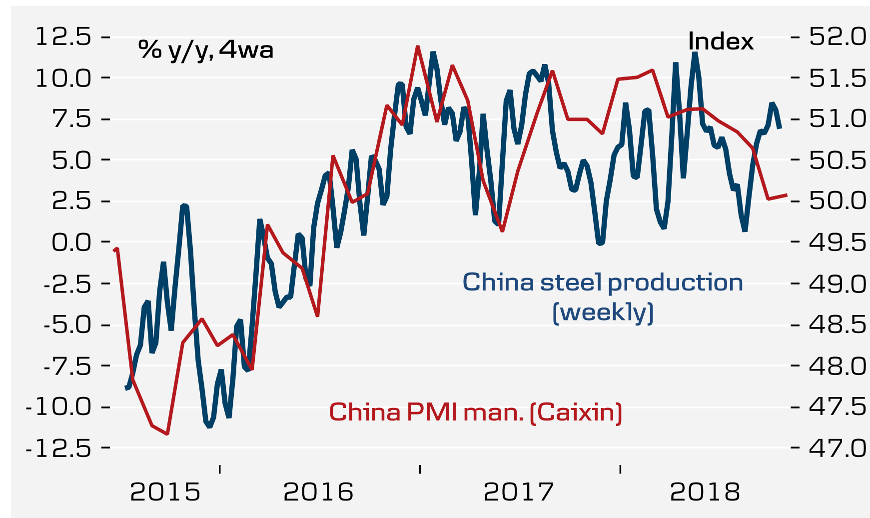


Steel production holding up on robust construction

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 through higher infrastructure spending, which is underpinning steel consumption

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

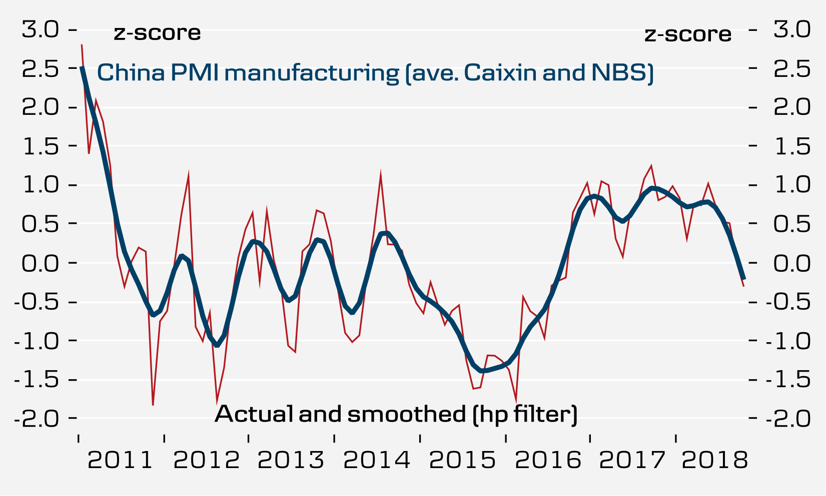




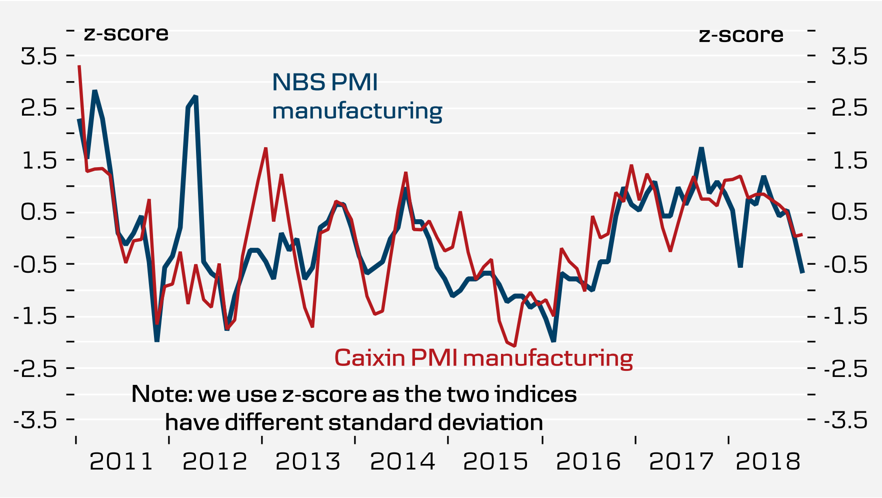
Source (both charts): Macrobond Financial, Markit, Danske Bank

Both PMIs point to short-term weakness

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



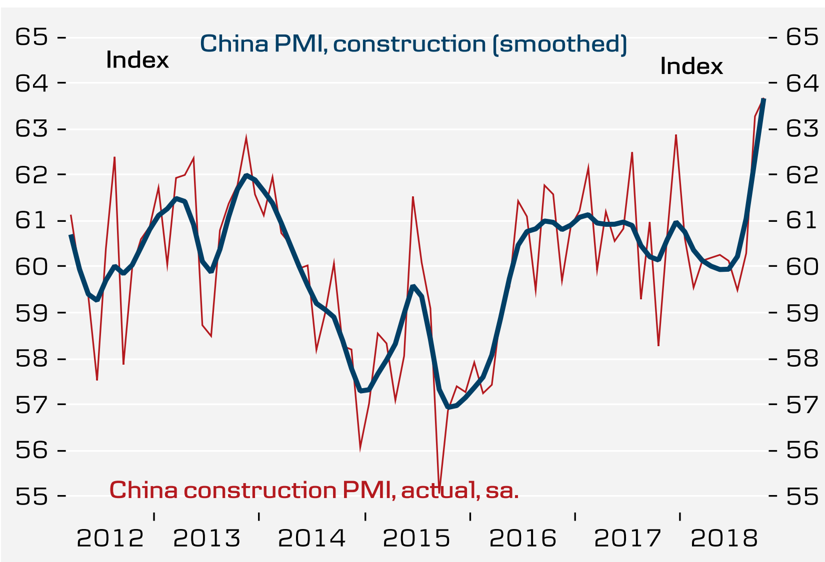
Both the NBS as well as the Caixin PMI manufacturing point to weaker activity



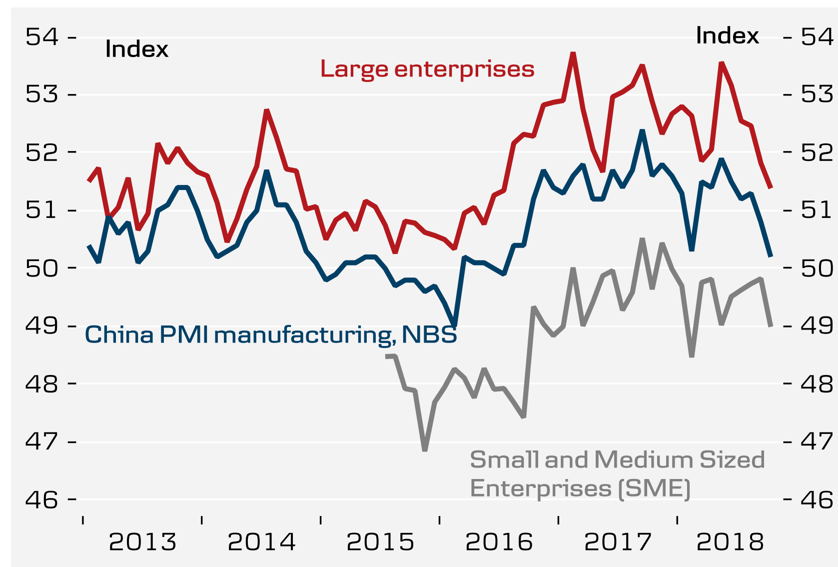
Source (both charts): Macrobond Financial, Markit, Danske Bank

Construction sector getting a boost

Construction PMI has increased sharply in recent months. It may be related to the pickup in infrastructure spending



Official PMI manufacturing has details on the size of companies. It shows declines across company sizes but is a little more pronounced for large enterprises. Not sure of the reason for this, as you would expect SME exporters to be hit the most by the trade war

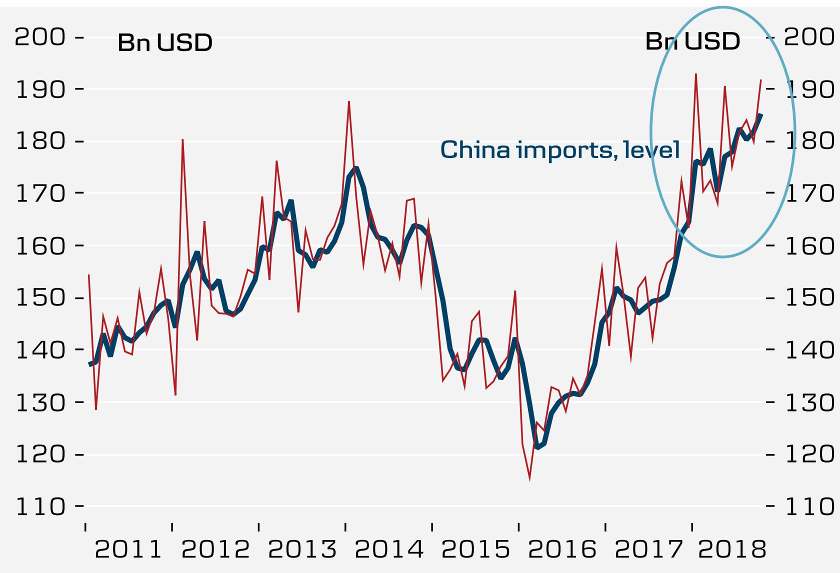


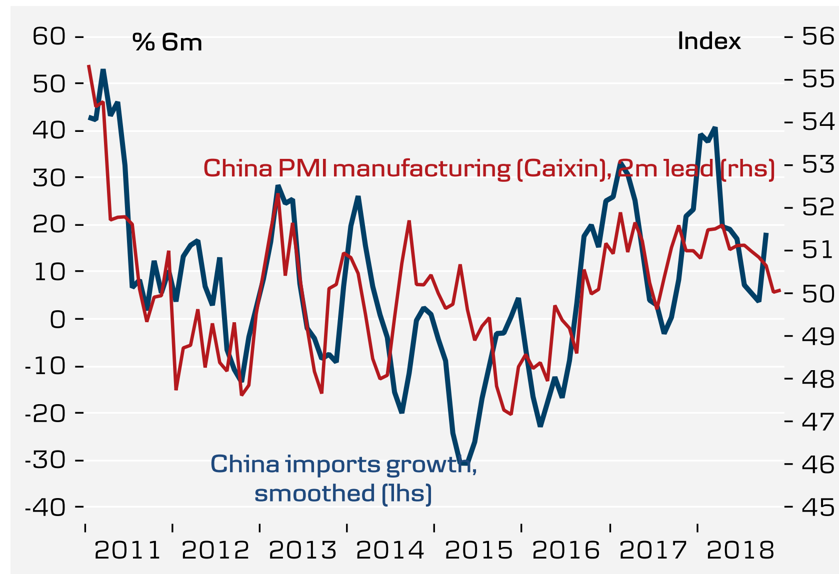
Source (both charts): Macrobond Financial, Danske Bank

Imports still decent – but distorted by the trade war

The *level* of imports has been robust in recent months. However, it 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 is also lifting imports

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





Source (both charts): Macrobond Financial, Markit Danske Bank

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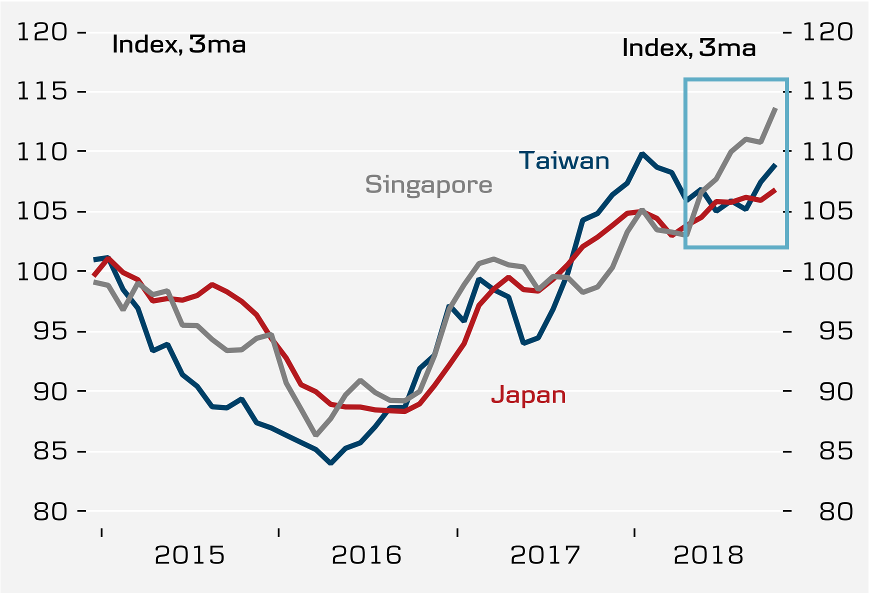
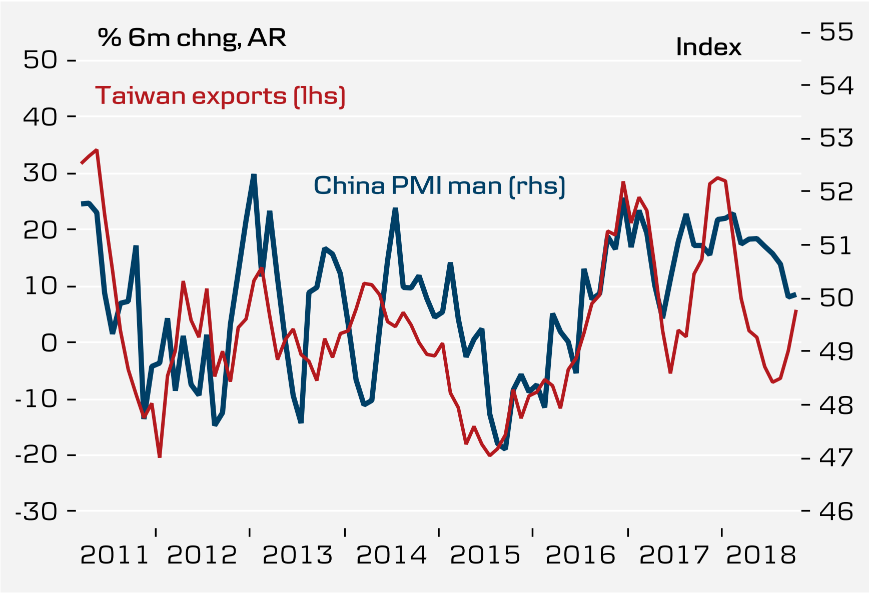
Asia exports to China decent – but also distorted by trade war

Another **good cross-check of Chinese activity are other Asian countries exports,** as China is their main export market. It shows some improvement in recent months – but the same caveat holds as with Chinese imports. It may be related to trade war dynamics



Taiwan export growth in line with weaker Chinese PMI



Source (both charts): Macrobond Financial, Markit Danske Bank

China's global inflation impulse

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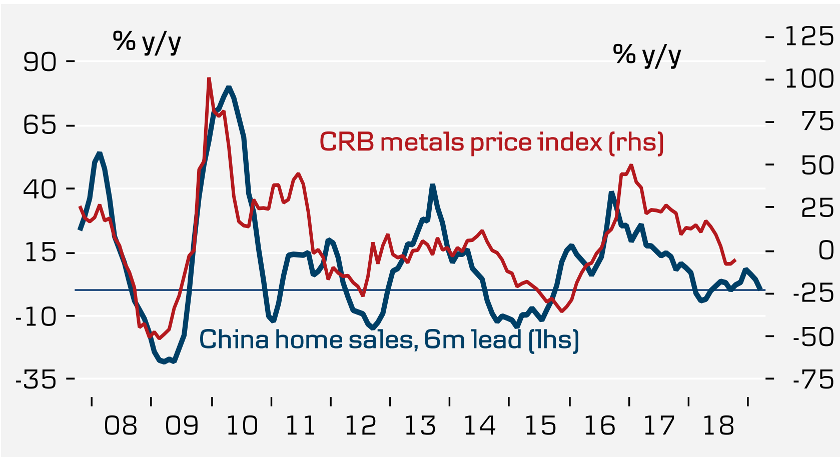
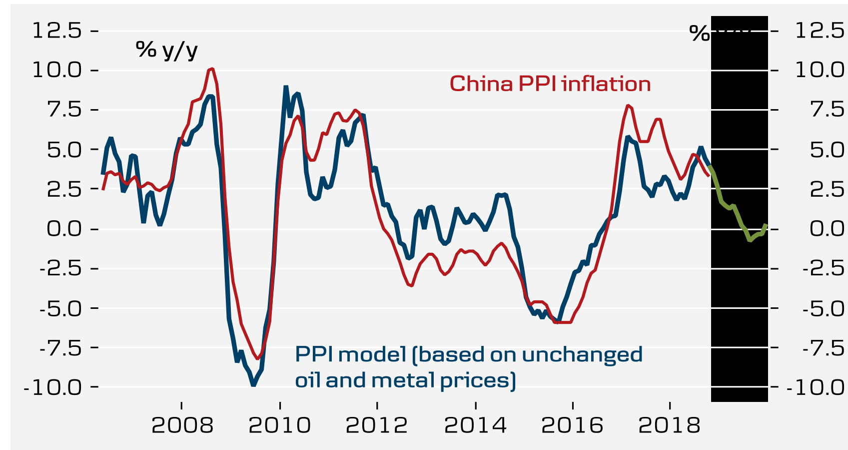
China again a disinflationary force

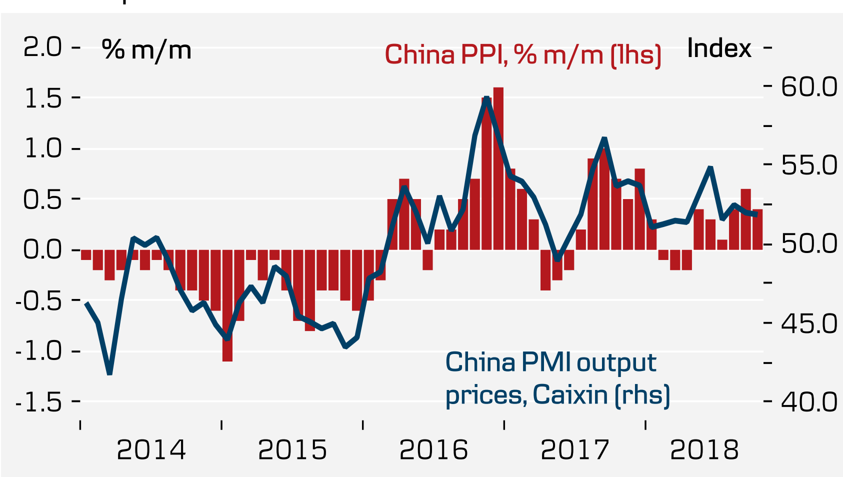
Slower housing tends to feed into metal prices



PPI inflation to move lower from here



PMI output in line with moderate PPI momentum



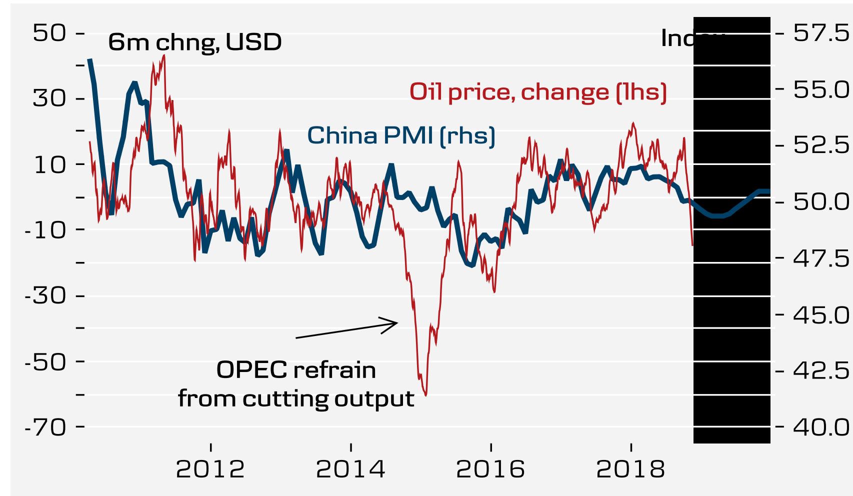
M1 growth also points to lower inflation pressure

Source (all charts): Macrobond Financial, Markit, Danske Bank

China slowdown weighs on global cycle and caps inflation

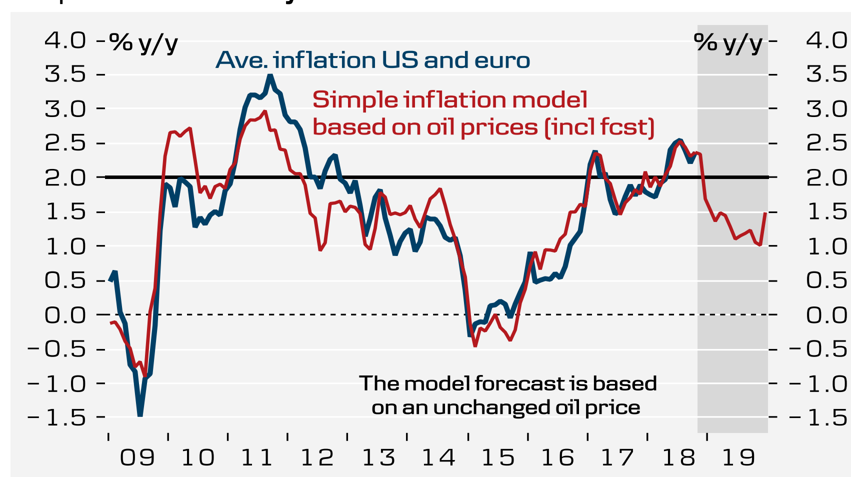
China export price inflation weighs on global inflation

Slowdown underpins lower oil price but move looks overdone



China slowdown **in tandem with global business cycle**

Oil prices are a **key driver for inflation**



Source (all charts): Macrobond Financial, Markit, Danske Bank

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Date of first publication
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