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Daily Data Analysis and Assessment of the Global Economy
中国研究

Weekly Notes on China's Economy

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Persistent Trouble In The Engine Room

The latest output and demand indicators for China's economy show no sign of the economic recovery we have been waiting for. **Retail sales** did accelerate in August in value terms, to a 9.0% year-over-year rate of gain from 8.8%. However, **CPI** accelerated by 0.2 percentage points, too, so retail volume growth was pretty much unchanged at 6.7% year-over-year. **Industrial production** accelerated trivially, to a 6.1% year-over-year rate of increase from 6.0%. Fixed investment spending slowed again.

One can legitimately ask, what is wrong with economic growth in the neighborhood of 6-to-7%? The answer is that nothing is wrong with it—it is roughly triple what we expect U.S. economic growth to print on trend. However, growth at this pace falls short of the economy's demonstrated potential—sustainable—rate. That is nearer a 9-to-10% range, if history is any guide. The economy continues to create jobs, but modernization—lifting people from subsistence income jobs on the farms to middle-income jobs in the urban/industrial sector of the economy—is slower than desired.

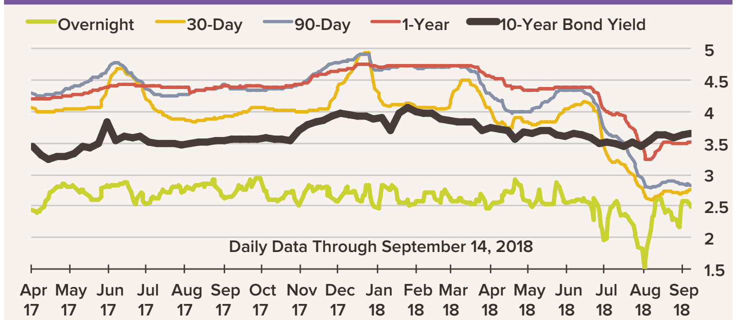
We can point to two key economic factors that may be restraining growth. First, bank lending is declining outright as the PBOC works to reel in decades of reckless lending. Nominal growth of the broad money aggregate, at 8.2%, is short of the potential growth rate of nominal GDP, around 11%. *Financial reform has its costs, eh?* Second, China continues to invest abroad, to the tune of about $600 billion per year in foreign acquisitions. China's companies are buying technology, or market share, or both. Were this money invested at home, the production possibility frontier would increase faster.

China's economy is not collapsing. We are not looking at a hard landing of any kind. We expect China's eight-year economic slowdown to end with a recovery above demonstrated trend growth. However, the latest data show that recovery has yet to begin.

Recent & Upcoming Economic Releases

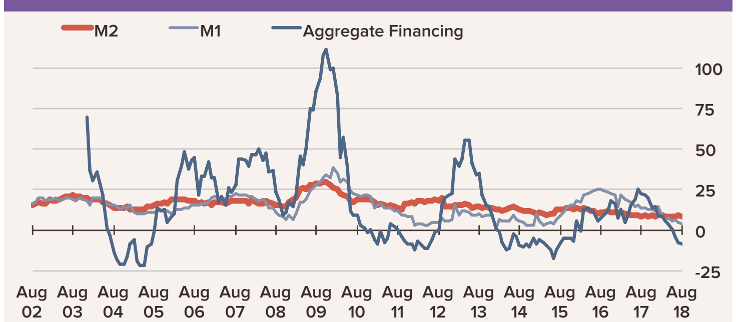
Date	Content	Expected/Actual	Prior
Jul 16	GDP (Q2) %chya	6.7%	6.8%
Aug 6	Current Account (Q2p) $billions	$5.8	-$34.1
Aug 31	CFLP PMI (8)	51.3	51.2
Sep 7	Foreign Exchange Reserves (8) $trillions	$3.110	$3.118
Sep 8	Trade Balance (8) RMB billions	179.8	177.0
Sep 8	Exports (8) RMB %chya	7.9%	6.0%
Sep 8	Imports (8) RMB %chya	18.8%	20.9%
Sep 10	CPI (8) %chya	2.3%	2.1%
Sep 10	PPI (8) %chya	4.1%	4.6%
Sep 12	M2 (8) %chya	8.2%	8.5%
Sep 12	M1 (8) %chya	3.9%	5.1%
Sep 12	Aggregate Financing (8) RMB millions	1520.0	1041.5
Sep 13	Foreign Direct Investment (8) %chya	1.9%	14.9%
Sep 14	Industrial Production (8) %chya	6.1%	6.0%
Sep 14	Retail Sales Value (8) %chya	9.0%	8.8%
Sep 14	Fixed Investment (8) %chya	5.3%	5.5%

China: Daily SHIBOR Vs 10-Year Bond Yield, Percent

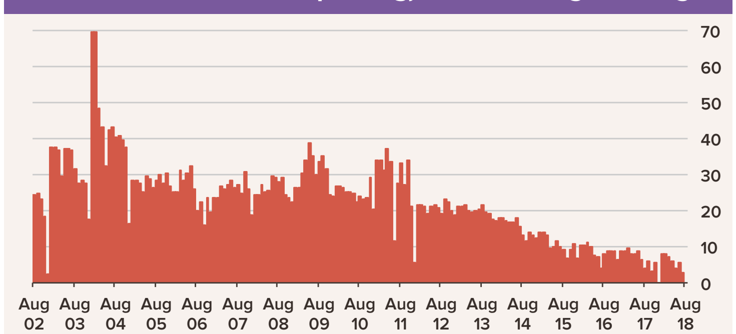


Westpac Trade-Weighted Yuan Index

China: Money And Credit, Percent Change Year Ago



China: Fixed Investment Spending, Percent Change Year Ago



Talk Is Cheap

U.S. Treasury Secretary Mnuchin has extended an invitation to China's Minister of Commerce Zhong to resume talks to end the growing trade dispute between the world's two biggest economies. Undermining that initiative, President Trump was reported to have authorized his team to proceed with new tariffs affecting approximately $200 billion worth of additional goods imported from China. The president is moving ahead despite advice from U.S. industrial leaders, labor unions and consumer groups that business will be harmed. The tariffs are unlikely to succeed in bringing about the desired changes in China's trade and investment practices that reduce U.S. companies' reach into China's huge domestic market. China, on its part, is not dropping its WTO complaint against the United States that its unilateral tariffs on $38 billion worth of imports from China violate WTO rules.

The *People's Daily* yesterday reported no particular positive or negative response from the Commerce Ministry, although it did confirm the invitation. A spokesperson told the official Communist Party newspaper, "This practice of blackmail and pressure does not work on China and will not help solve the problem." Press reports yesterday said the ministry is considering rejecting the invitation in response to the latest Trump tariffs and additional threats of tariffs on another $267 billion worth of imports from China.

As the U.S. Trade Representative has made very clear, the objective of all these tariffs is to coerce China into shelving its Made In China 2025 initiative. The Trump team sees this initiative as a threat to U.S. domination in key industrial sectors. China sees it as its industrial development plan. Our estimate is that China will gain about $1 trillion per year by achieving its MIC2025 objectives. In comparison, the losses of exports are likely to be small from the Trump tariffs, since most assembled-in-China goods have no made-somewhere-else substitutes. **For goods whose elasticity of demand is low or zero, the incidence of a U.S. tariff falls entirely on the U.S. consumer: The Trump tariffs are a tax on U.S. companies and consumers, not on China's industry.** Someone in the White House had better figure that out. For U.S. voters in November's midterm elections, new iPhones and Apple watches will be that much more expensive because of these tariffs.

We do not know where this is going. China has threatened to retaliate against U.S. tariffs, but it is running out of imports to duty in response to U.S. actions. ***China has a multitude of non-tariff measures it can use to retaliate against the U.S. levies.*** Boycotts of U.S. products and brands in China can cost U.S. companies a big share of their global profits: For instance, a quarter of GM's global profits come from its two direct investments and 11 joint ventures that make and sell cars in China. A boycott could be catastrophic to profits. Also, China has yet to begin to explore measures like export taxes on made-in-China goods sent to the United States. *This could get very nasty very fast! Watch out!*

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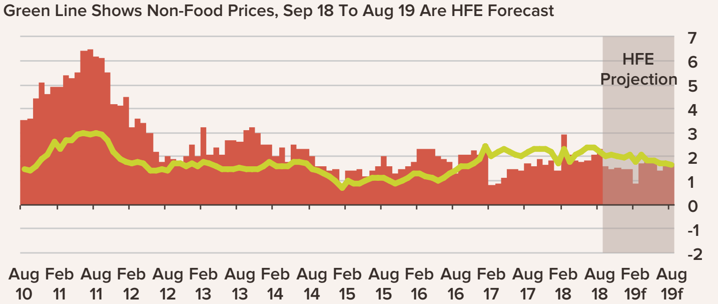
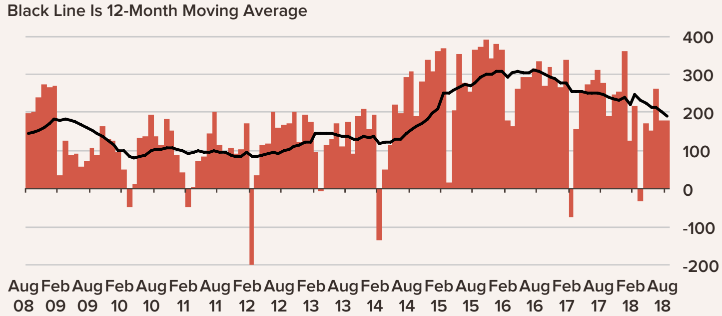
China: Consumer Price Index, Percent Change Year Ago

Green Line Shows Non-Food Prices, Sep 18 To Aug 19 Are HFE Forecast



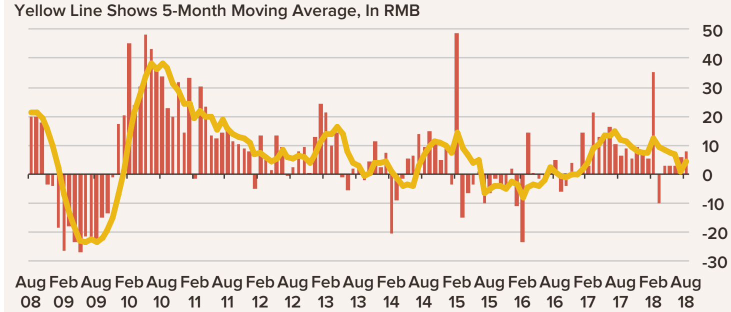
China: Trade Balance, Seasonally Adjusted, RMB Billions

Black Line Is 12-Month Moving Average



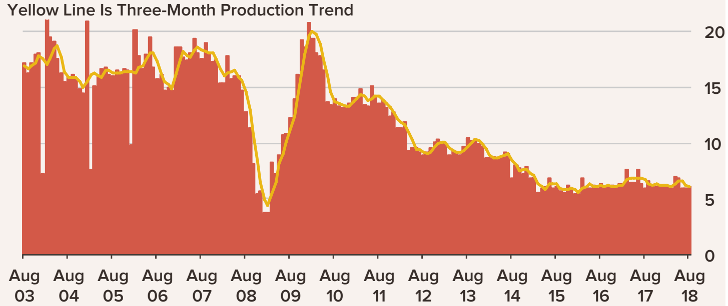
China: Exports, Percent Change Year Ago

Yellow Line Shows 5-Month Moving Average, In RMB



China: Industrial Production, Percent Change Year Ago

Yellow Line Is Three-Month Production Trend



China: Retail Sales, Percent Change Year Ago

Green Line Shows CPI-Adjusted Sales