

# Short Insight

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## China: After the truce

- **A truce without a deal yet, but at least a truce**
- **Another truce, another rebound in PMIs?**
- **Swine flu drives up CPI; PPI is approaching deflationary territory**
- **Foreign reserves rise to 14-month high**

### 1. A truce without a deal yet, but at least a truce

Recently, we cut our 2019-20 growth forecasts for a wide number of advanced and emerging economies (including China, see our June China Watch [here](#)), due to a more negative view on the impact of trade tensions as much of the damage on the global economy has already been done. The escalation of trade tensions since early 2018 has negatively affected global business confidence, investment, trade and growth. Given the unexpected twists and turns in the trade/tech war so far (with an unexpected re-escalation of US-China tensions in May, Trump's threat to sanction Mexico for non-trade related reasons, and a recurrent threat to tariff cars and/or other imports from the EU), we think that on a global scale firms will remain cautious for the time being. For the Chinese economy, direct effects from tariffs on trade flows are significant. Total Chinese exports and imports have slowed, but bilateral trade with the US has collapsed since late 2018 (trade figures for June will be published later this week). The (second) truce in the US-China trade/tech conflict agreed in late June at the margins of a G20 summit in Osaka, implies that the potential drag from tariffs will be lower, at least for now. Indeed, despite all damage done already, it does make a difference whether USD 250 bn of exports to the US is levied by 25% tariffs (current reality) or more than double that amount (threat).

### 2. Another truce, another rebound in PMIs?

China's PMIs for June published in early July pointed to a softening of momentum. For the first time since February, both the manufacturing indices from Caixin and NBS are back below the neutral 50 mark. The US-China trade/tech conflict seems to have had a material impact on China's manufacturing PMIs over the past one and a half year (beside other factors like shifts in the policy stance). Obviously, that is most visible in the PMI export and import subindices. Particularly since the US started to announce China-specific tariffs in the spring of 2018, export and import PMIs have fallen sharply below the neutral 50 mark. However, after the first truce agreed between Trump and Xi in late 2018, these indices showed a significant recovery, climbing back towards the 50 mark until April. Not surprisingly, after the unexpected re-escalation of US-China tensions in May, these indices got hammered again. All this suggests that purchasing managers' expectations on export and import flows are at least in part shaped by the state of play in US-China negotiations. With a second truce agreed between Trump and Xi in late June, that could lead to some improvement again, even though the Osaka meeting did not shed much light on whether the two sides will be able to reach some sort of a deal later on.

### US-China trade has collapsed

Chinese import values, % yoy, 3mma



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

### Imports/exports expectations driven by trade conflict

China, PMI export and import sub-indices, 50 = neutral mark

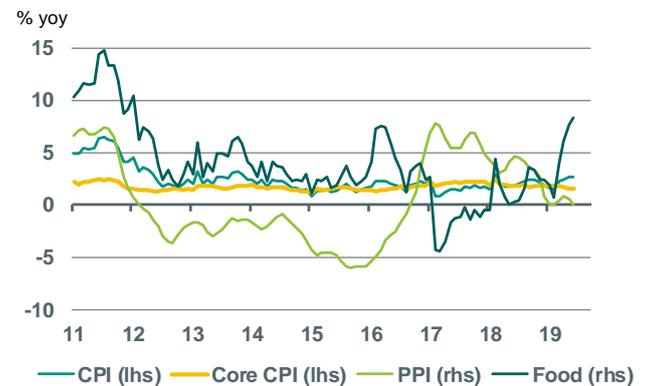


Source: ABN AMRO Group Economics, Thomson Reuters Datastream

**3. Swine flu drives up CPI; PPI is approaching deflationary territory**

CPI inflation in China was stable at 2.7% yoy in June, and still below the 3% 'target'. That followed a pick-up in preceding months driven by swine flu effects on food prices. Food price inflation jumped from 0.7% yoy in February to 8.3% in June, the highest level since January 2012. Core inflation has been quite stable, coming in unchanged at 1.6% yoy in June. Meanwhile, producer price inflation has fallen back again, to 0.0% yoy in June, after a short-lived pick-up in March/April. That is putting downward pressure on industrial profits and leads to higher debt repayment pressures. Falling producer prices in China also have the potential to spark global deflation fears. We should add that the current levels are not at all comparable with the sharply negative PPI numbers in 2012-2016 (during the commodity slump). All in all, we think that the latest inflation figures are in line with our view that the PBoC will continue with easing monetary policy through (significant) RRR cuts and (modest) rate cuts as well as through targeted measures to support bank liquidity and bank lending, particularly to the private sector.

**Swine flu drives up CPI, PPI comes down again**

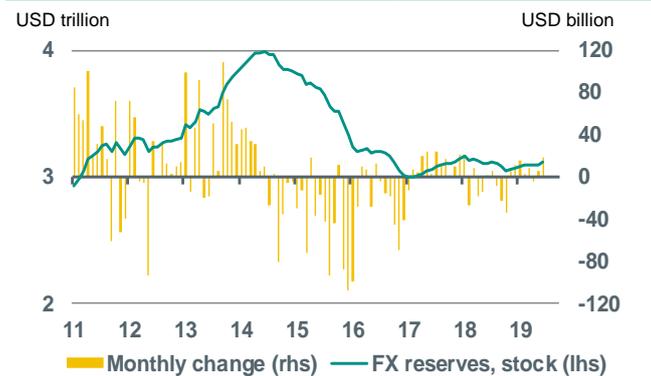


Source: ABN AMRO Group Economics, Thomson Reuters Datastream

**4. Foreign reserves rise to 14-month high**

On Monday, China's FX reserves for June were reported at USD 3.12 tn, up by USD 18bn compared to May and also higher than consensus expectations. FX reserves are now back at the highest level in fourteen months. According to the State Administration of Foreign Exchange (SAFE), the rise of FX reserves was partly driven by valuation effects. Seen over a slightly longer term, the 25% drop witnessed in 2015-16 (when yuan devaluation fears fed capital outflows) is clearly behind us. Since January 2017, FX reserves have risen by 4%. That partly reflects a fading of yuan depreciation fears: even a 10% CNY depreciation versus USD last year on escalating US-China tensions did not cause renewed pressures on FX reserves. Off course, the tightening of capital restrictions in 2016 is an important factor in this respect. Last but not least, the ongoing inclusion of certain Chinese equity and bonds in global indices is a structural factor supporting portfolio inflows from abroad. According to Bloomberg estimates, foreign investors bought at least USD 75bn of Chinese bonds in June (with foreign investors now owning 8.3% of total government bonds).

**FX reserves reach a 14 month high**



Source: ABN AMRO Group Economics, Thomson Reuters Datastream

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**Key forecasts for the economy of China**

	2016	2017	2018e	2019e	2020e
GDP (% yoy)	6.7	6.8	6.6	6.2	5.8
CPI inflation (% yoy)	2.1	1.5	1.9	2.5	2.5
Budget balance (% GDP)	-3.8	-3.8	-4.2	-4.5	-4.5
Government debt (% GDP)	16	17	19	22	25
Current account (% GDP)	1.8	1.6	0.4	0.0	0.0
Gross fixed investment (% GDP)	42.7	42.9	44.4	43.3	42.3
Gross national savings (% GDP)	45.9	46.3	45.1	43.7	42.3
USD/CNY (eop)	7.0	6.5	6.9	6.9	6.7
EUR/CNY (eop)	7.3	7.8	7.8	7.7	8.0

*Economic growth, budget balance, current account balance for 2019 and 2020 are rounded figures*

*Source: EIU, ABN AMRO Group Economics*