Four observations on Chinese economy

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Highlights:

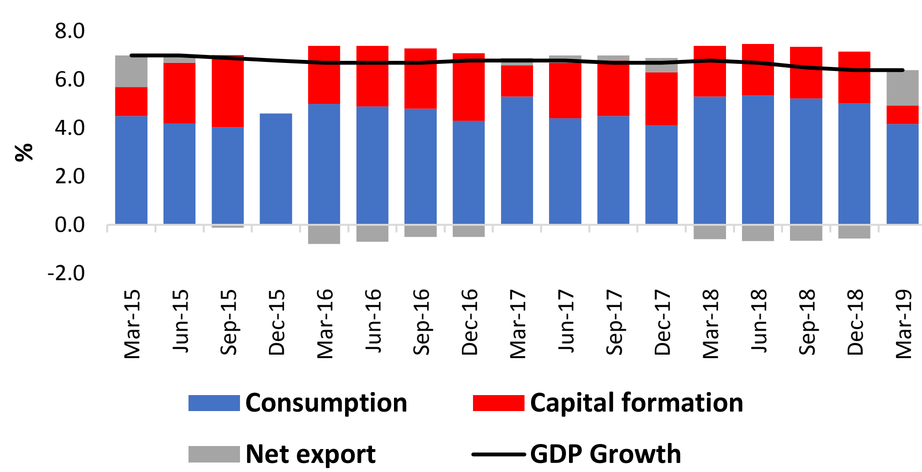
- **A strong turnaround story in March, but surprisingly net export is the key contributor to China's growth in 1Q.**
- **There is mismatch between supply story and demand story.**
- **Property market is not the weakest link in 2019**
- **More measures needed to boost domestic demand. Real income growth and wealth effect from equity rally are positive for consumption story.**
- **Infrastructure investment remains sluggish but may pick up soon.**
- **China is on track to grow at around 6.3% in 2019.**

The Chinese economy beat market expectation growing by 6.4% yoy in the first quarter of 2019, intact from growth in 4Q 2018. Despite a slow start in the first two months, the economy turned around strongly in March due to the fading of Chinese New Year effect as well as the positive response to China's easing fiscal and monetary policies.

China's industrial production grew by 8.5% yoy in March, much higher than the market consensus of 5.9%. Retail sales growth rebounded to 8.7% yoy in March while fixed asset investment reaccelerated to 6.3% yoy in 1Q from 6.1% yoy in the first two months of 2019.

Consumption remains a key driver to China's growth, contributing 65.1% to growth in 1Q. However, the share of consumption fell from 76.2% in 2018 as net export picked up strongly. 1.5% out of 6.4% came from net export. This was the highest number since China started to release the data from 2009.

Chart 1: 1Q GDP was supported by net export



Source: Wind, OCBC

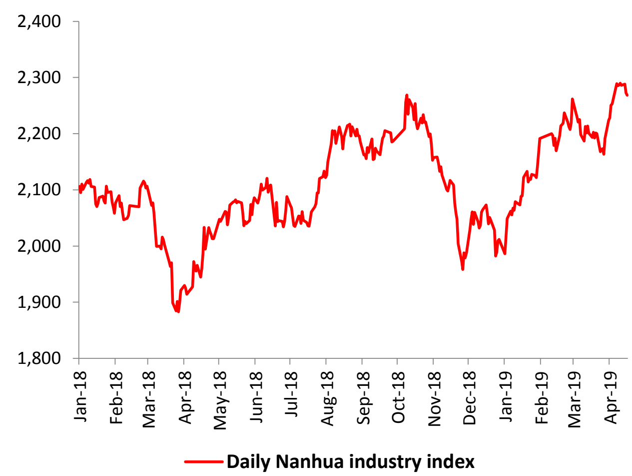
Observation 1: Mismatch between supply story and demand story
Among all the data released, the main surprise came from March industrial production. The 8.5% yoy growth is the level we haven't seen since July 2014. Clearly, the Chinese New Year effect played a part. After removing the Chinese New Year effect, China's industrial production increased by 6.5% yoy in the first quarter of 2019, reaccelerating from 6.2% in 2018.

The reacceleration of industrial production in the first quarter is encouraging; however, it may not be matched by demand side story. On external demand, China's export rose by 1.4% in 1Q, down sharply from 9.9% yoy in 2018. On domestic demand, China's retail sales rose by 8.3% yoy in 1Q, down from 9% yoy in 2018. Despite slowdown in both external demand and domestic demand in 1Q, China's production reaccelerated. The mismatch between supply story and demand story could be distorted by the anticipation of value added tax cut effective from 1 April as smaller companies expanded their production preparing for the VAT cut.

Looking ahead, we think industrial production is likely to normalize in the coming months to about 6.5% range.

Chart 2: Industrial production reaccelerated

Chart 3: Industry commodity prices rebounded



Source: Wind, OCBC

Observation 2: Green shoots in property sector
Investment in property market remains strong with property investment grew by 11.8% yoy in 1Q, up from 11.6% yoy in the first two months. Meanwhile, the newly constructed gross floor area growth also reaccelerated to 11.9% yoy from 6%. The strong land acquisition in 2018 may continue to support property investment in the coming quarters. Meanwhile, as local governments have brought forward their bond issuances, the pickup of revamp of shanty town project may also provide support to property investment. As such, we reiterated our view that China's property market is unlikely to be the weakest link this year despite the uncertainty.

Chart 4: Property investment remains strong

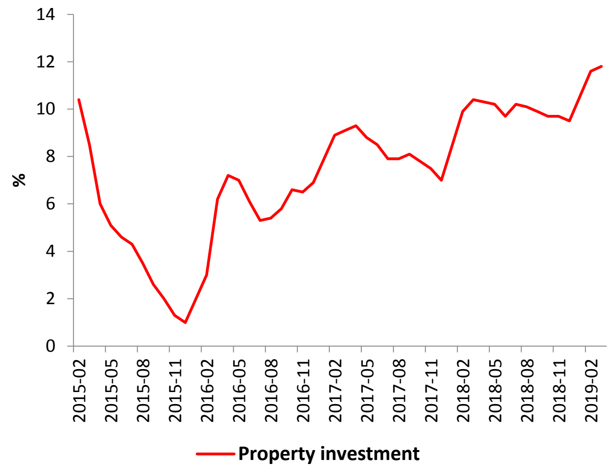
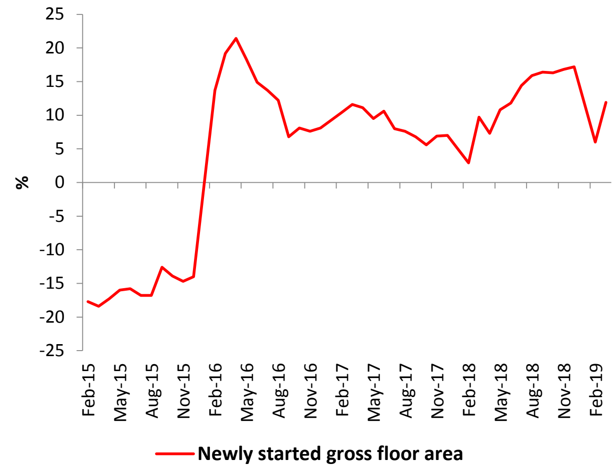


Chart 5: Newly started gross floor area



Source: Wind, OCBC

Observation 3: More support measures to boost domestic demand

The rebound of retail sales in March also caught us by surprise as we initially expect the retails sales to decelerate further due to weak car sales numbers. Noting that car sales account for 26.8% of China's total retail sales in 2018. The rebound of retails sales was mainly due to price effect as a result of higher petrol costs and food prices. Retail sales in food and oil related products reaccelerated to 4% and 3.6% yoy respectively in the first quarter.

On positive note, China's real earning grew by 6.8% yoy in 1Q, higher than 6.4% real GDP growth. The faster earning growth is supportive of consumption in the coming months.

Looking ahead, as China is likely to roll out more measures to support car sales. We expect car sales to rebound, providing support to retail sales in the coming months. Meanwhile, the positive wealth effect due to strong equity market strong real income growth may also support consumption.

Chart 6: Food and petrol sales rebounded

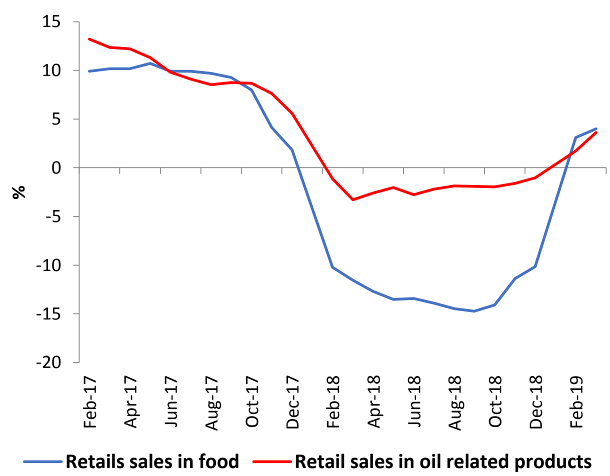
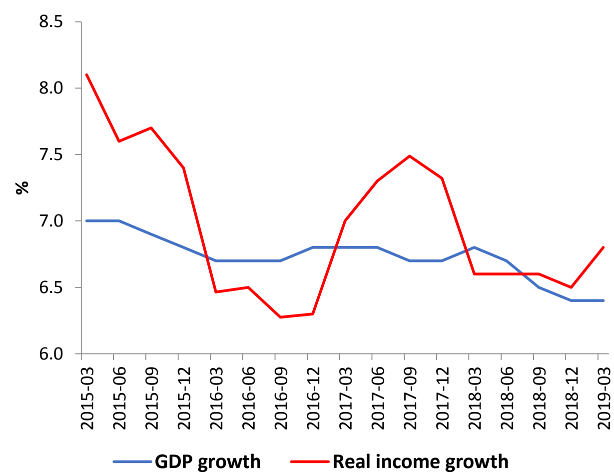


Chart 7: Real income grew faster than GDP



Source: Wind, OCBC

Observation 4: Infrastructure investment yet to pick up

China's infrastructure investment grew by 4.4% yoy in 1Q, up slightly from 3.8% yoy in 2018. Despite the pickup, the pace of recovery is still slow in our view. Nevertheless, given the successful issuance of local government bonds in the first quarter, we expect China's infrastructure investment to accelerate further to 5-10% in the coming quarters.

Chart 8: Infrastructure investment remains sluggish

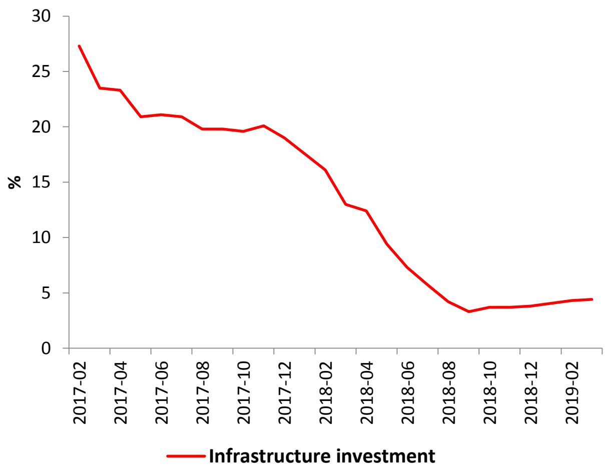
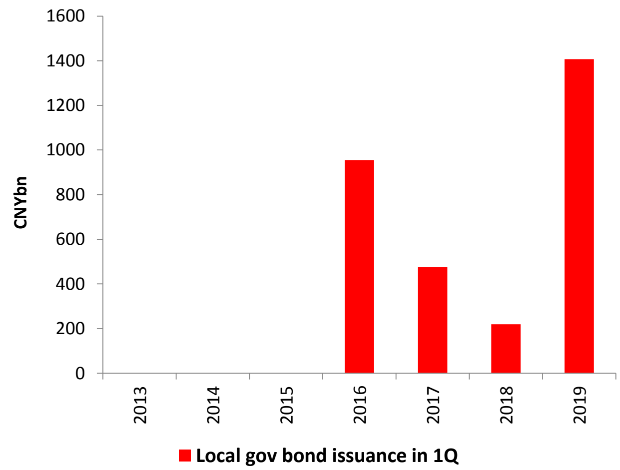


Chart 9: local gov brough forward their funding



Source: Wind, OCBC

To conclude, there are green shoots in recent China data such as strong property investment. Nevertheless, uncertainties remain on demand side. On the positive note, the possible new stimulus measures to car sale, positive wealth effect from strong equity market and strong real income growth in 1Q may be supportive of consumption story in the coming quarters. Meanwhile, we also expect China's infrastructure investment to pick up further as local governments have successfully brought forward their funding. As such, we believe China is on track to grow at around 6.3% in 2019.

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