No urgency for China to change its modest policy stance

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- **China's property market was more resilient than initial expectation.**
- **Manufacturing sector may find its bottom soon.**
- **Reacceleration of infrastructure investment is positive.**
- **Together with the favourable base effect, we expect China's growth to maintain at 6% yoy in 4Q.**
- **Disinflationary and inflationary pressures coexist. The jump of headline CPI above government's target created a more complicated backdrop for monetary policy.**
- **The positive factors such as the trade truce, low base effect, stabilization of manufacturing sector and pickup of infrastructure investment may give PBoC more reason to take a wait and see approach.**

China's 3Q economic growth decelerated further to 6%, slightly below market expectation. However, China's three key economic indicators stabilized in September. Retail sales rebounded slightly to 7.8% yoy from 7.5% yoy in line with expectation though fixed asset investment decelerated slightly to 5.4% yoy in the first three quarters from 5.5% yoy in the first eight months. Industrial production rebounded strongly to 5.8% yoy from 4.4% yoy. This is encouraging when some factories were closed prior to the mega celebration of 70th National Day on 1 Oct.

We have three takeaways from today's data.

First, property market was more resilient than initial expectation. China's property investment grew by 10.5% yoy in the first three quarters intact from previous month's reading despite tightening measures and falling land acquisition. Given land acquisition (Chart 1) usually led China's property investment by 6-12 months, we still expect property investment to slow down further. Nevertheless, the rising investment in central and western China partially offset the decelerating investment growth in highly regulated eastern area. (Chart 2)

Meanwhile, China's medium to long term loan to household sector rose by CNY494 billion, highest since January 2019. The strong loan demand from household sector shows that demand for property market remained resilient.

Chart 1: Land acquisition remained weak despite improving

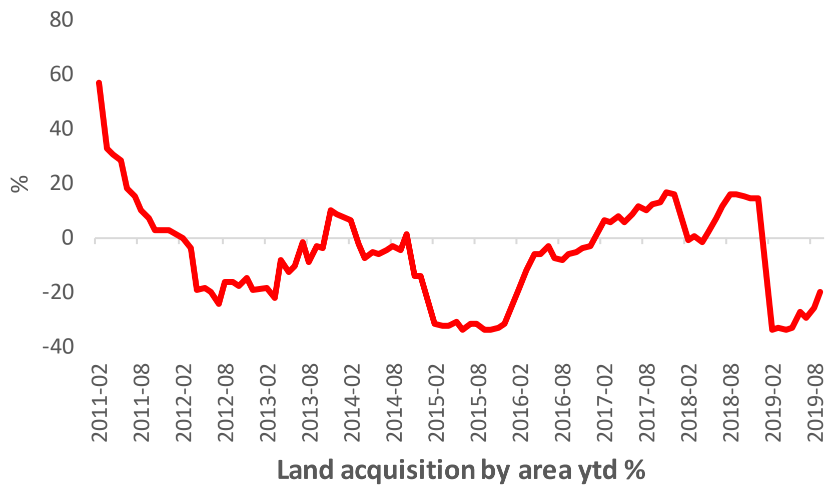
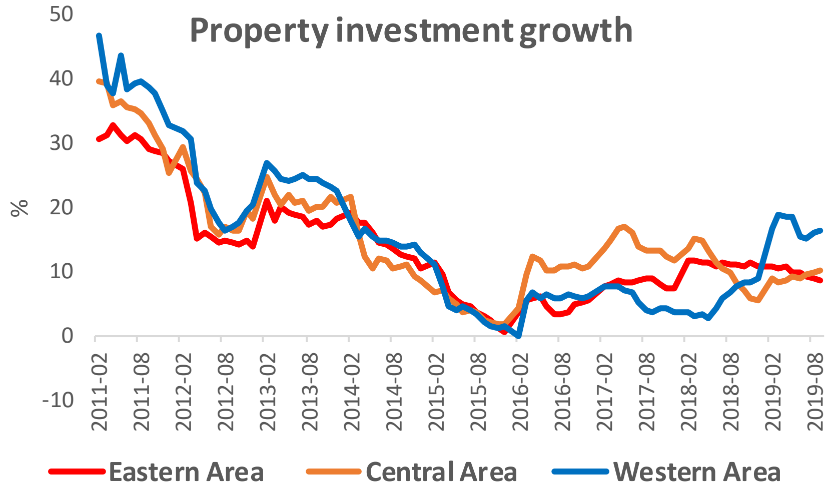


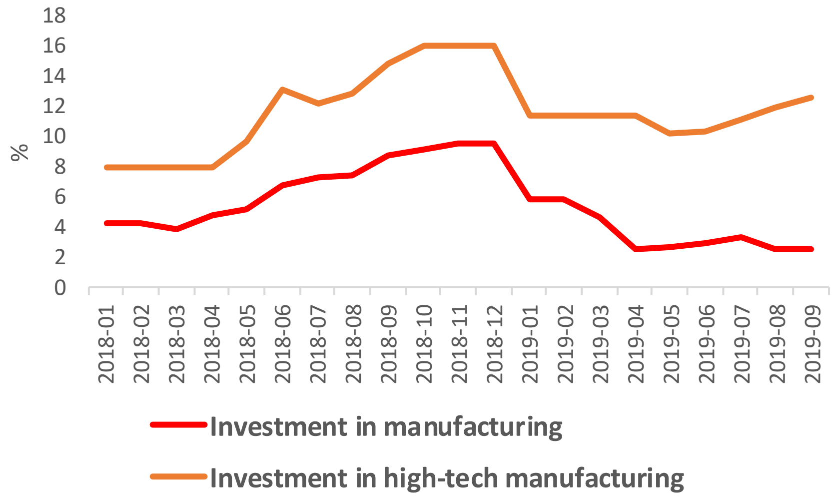
Chart 2: Property investment in Central and Western China remained strong



Second, manufacturing sector may find its bottom soon. China's manufacturing output rebounded from 4.3% yoy in August to 5.6% yoy in September. This is in line with the surprise rebound of September manufacturing PMI. We think the recent stabilization in China's manufacturing sector was mainly the result of supportive tax cuts and rebate.

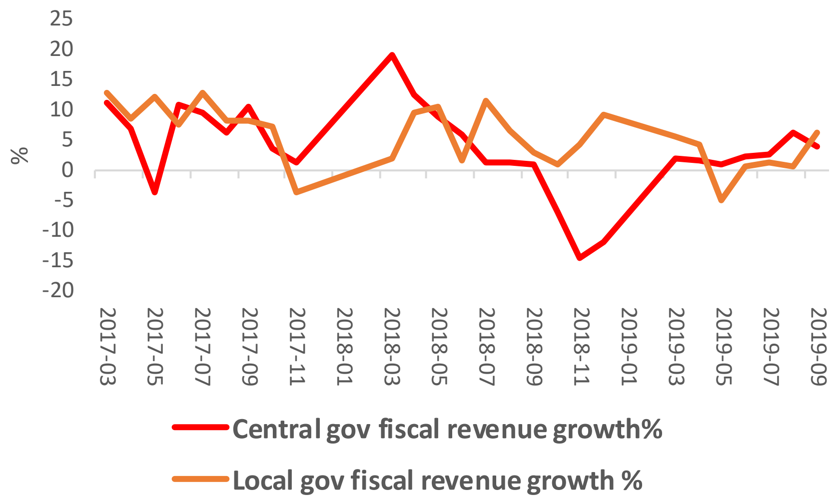
However, investments in China's manufacturing sector remained weak. For the first three quarters, fixed asset investment in manufacturing slowed down further to 2.5% yoy from 2.6% yoy, lowest since China started to publish the data from 2004. This weak investment sentiment could be mainly attributable to uncertain outlook on US-China trade war. However, the investments in high-tech manufacturing sector remained strong up by 12.6% yoy in the first three quarters. We expect the investments in high-tech manufacturing to keep its momentum in the coming months regardless the progress of the trade talk as profits of those high-tech companies are less sensitive to the global slowdown and trade war. As such, we expect manufacturing sector to bottom out soon.

Chart 3: Investments in high-tech manufacturing remained strong, which may help manufacturing sector to find bottom



Third, China's infrastructure investment growth reaccelerated to 4.5% yoy in the first three quarters from 4.2% yoy, a sign that China's fiscal policy started to take effect. We have no doubt about China's commitment to support growth via fiscal policy. However, the key question hinges on China's capacity to roll out more fiscal policy, especially at local government level. On the positive news, China has unveiled more measures to allocate more revenue to local government. For example, the latest reform plan to redistribute the tax revenue between central and local governments will give local government more room to manoeuvre against the backdrop of economic slowdown and decline of land sales.

Chart 4: Re-acceleration of fiscal revenue growth at local level



Looking ahead, the slower than expected deceleration of property investment, bottoming out of manufacturing sector and reacceleration of infrastructure investment may provide some buffer to counter the impact of external uncertainties on Chinese economy. Together with the favourable base effect, we expect China's growth to maintain at 6% yoy in 4Q.

Disinflationary and inflationary pressures coexist

China's CPI hit 3% in September for the first time since November 2013. China is facing structural inflation problem as the rise of CPI was mainly the result of surging pork prices. Core inflation, which excludes food prices and energy prices, only rose by 1.5% yoy in September, no change from August reading. This is also the lowest reading since April 2016. In addition, service CPI fell by 0.1% mom in September despite the higher than expected headline reading. Together with the deeper negative reading of PPI, it seems disinflationary pressure and inflationary pressure coexists in China.

Policy reaction may remain modest

The slower than expected GDP may argue for further easing from China amid the restart of global easing cycle. Nevertheless, the jump of headline CPI above government's target created a more complicated backdrop for monetary policy. In addition, the positive factors such as the trade truce, low base effect, stabilization of manufacturing sector and pickup of infrastructure investment may give PBoC more reason to take a wait and see approach. As such, expect China's policy reaction to remain modest with low probability of cut of MLF rates.

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