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CNY – "*Upbeat*" trade outlook with headwinds

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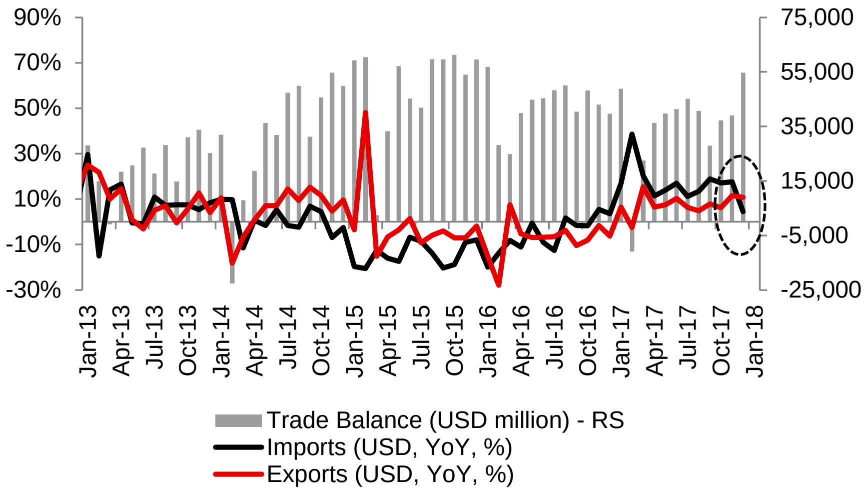
Key Points:

- **China's exports and imports achieved a double-digit growth in yuan terms last year, which would unlikely repeat this year, even though the outlook is upbeat**
- **Sharp deceleration in import growth in December caught our attention, giving an early signal of possibly softening domestic demand**
- **Headwinds might originate from rising tensions with the US**
- **Growth acceleration last year is unlikely to persist this year**

China released trade figures for December today, with an unexpected modest import growth, while export growth came broadly in line with expectations.

STEADY EXPORT GROWTH, ALBEIT WITH SOFTENING IMPORT GROWTH



Source: CEIC, MUFG Bank

China's softening growth for imports is worth monitoring

Sharp deceleration in import growth in December caught our attention

Yuan-denominated import growth decelerated sharply to only 0.9%YoY in December, the slowest pace in 17 months, far below consensus expectations of 11.8%, from a downwardly revised 15.4%YoY in November. In dollar terms, import growth also slowed to a 12-month low of 4.5%YoY in December (also far below consensus of 15.1%YoY) from 17.6%YoY in November.

Taking out of the seasonality, import growth also moderated sharply to a 12-month low of 8.7%YoY in December from 17.8%YoY in November. Taking out of the effect of the rather volatile prices, **imports in volume terms declined 2.0%YoY in December, the first decline in 17 months**, after rising 5.4%YoY in November. **Domestic demand for commodities appeared to weaken somewhat**, with a broad-based softening demand in coal (in volume terms: 6.1%YoY YTD < last 8.5%), iron ore (5.0% < last 6.0%), fuel oil (16.1% < last16.4%) and copper (-5.2% < last -5.0%), while import demand for steel products remained muted (0.6% = last). The softening import growth in China is worth monitoring, possibly **giving some early signals of softening domestic demand**; though other cyclical indicators have yet to raise similar concerns.

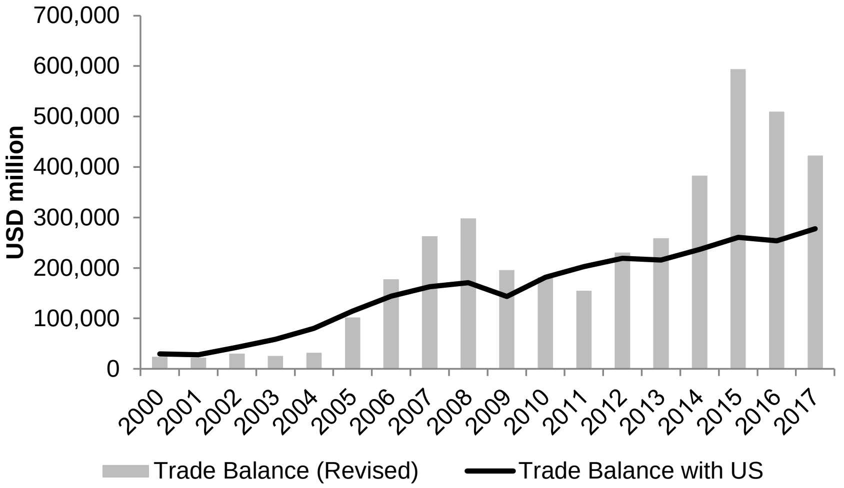
Export figures confirmed firm external demand

Firm external demand helped lift China's export growth last year. In December, China's exports in both yuan and USD terms exceeded consensus expectations (10.9%YoY and 7.4%YoY > consensus 10.8% and 6.7% < last 11.5% and 9.5%, respectively), outweighing the high base effect which should have started to kick in since November. **In volume terms, exports surged 30.8%YoY in December, the fastest since December 2015**, after jumping 13.5%YoY in November.

Smallest overall trade surplus in three years but record high trade surplus with the US

For the full year 2017, exports jumped 7.9% and imports surged 15.9% in dollar terms, while both exports and imports achieved a double-digit growth in yuan terms, by 10.8% and 18.7%, respectively. The overall trade surplus for 2017 was USD422.5 billion, the smallest in 3 years, implying shrinking current account surplus (as of % of GDP). Yet, **China's trade surplus with the US widened to the record high of USD 277.97 billion**, representing a two-third of the overall.

CHINA'S SMALLER OVERALL TRADE SURPLUS IS UNLIKELY TO IMPRESS TRUMP



Source: CEIC, MUFG Bank

Rising tensions with US

US might impose some more aggressive trade actions

US President Trump is unlikely to be happy with China's shrinking overall trade surplus, despite the launch of some investigations last year, such as targeting Chinese steel and aluminum in April, intellectual property and technology transfer policies in August, in addition to some other anti-dumping cases. **It's hard to rule out the possibility for the US to roll out some more aggressive trade actions against China, while China is unlikely to remain silent.**

China tried to break the silence

China's Ministry of Commerce updated its trade openness briefly in a regular press conference yesterday (11 January 2018) that "*more than 8000 items are subject to zero tariffs*" and "*at present, China has signed a total of 16 free trade agreements with 24 countries and regions, covering Asia, Europe, the Americas and Oceania. From the already signed free trade agreement, the level of liberalization of trade in goods between our country and free trade partners is generally high, and the final zero-tariff product accounts for more than 90% of* *the total.*"

Earlier the day, China's State Administration of Foreign Exchange (SAFE) said the media reports that China is considering slowing or halting purchases of US Treasuries could be based on wrong information or perhaps might be false news.

All in all, the Chinese proverb "***If the wind comes from an empty cave, it's not without a reason***" (空穴来风, 未必无因) might be a good wrap.

China's trade outlook

Moderating export growth is expected, even without an increase in US protectionism.

China's Customs spokesperson, Huang Songping, said, *it will be hard for China's foreign trade growth to remain in the double digits this year, albeit with upbeat trade outlook*. Huang's claims came in line with World Trade Organization (WTO)'s forecasts that the spectacular world trade export growth last year is set to normalize this year. The wide range of the world trade growth forecast from WTO also indicates headwinds this year, in particular the China-US relations. As such, we maintain our views that China's dollar-denominated export growth is expected to moderate to about 4.5% this year, while an increase in US trade protectionism and unexpected real effective exchange rate appreciation (2017 + 1.3%) would probably pose downside risks to our forecast.

WORLD TRADE GROWTH TO MODERATE IN 2018

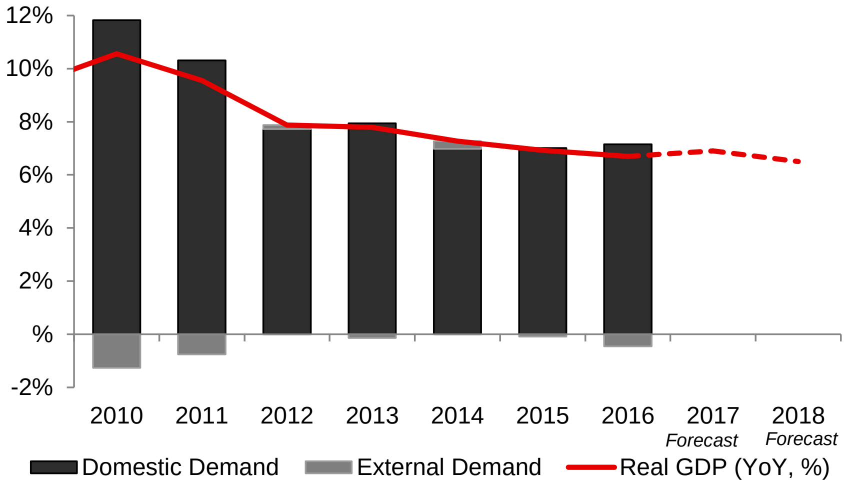
Annual % change	2013	2014	2015	2016	2017f	2018f
World Mechandise Trade: Volume	2.4	2.7	2.6	1.3	3.6 (3.2 – 3.9)	3.2 (1.4 – 4.4)
Exports						
North America	2.7	4.2	0.7	0.5	4.2 (2.5 – 5.3)	3.8 (0.8 – 6.0)
South and Central America	1.7	-2.2	2.5	2.0	0.5 (-1.9 – 2.4)	1.3 (-1.5 – 3.0)
Europe	1.7	2.0	3.6	1.4	2.5 (1.6 – 3.3)	2.5 (1.3 – 3.3)
Asia	5.4	4.3	1.1	1.8	6.4 (5.9 – 7.2)	4.0 (1.3 – 6.2)
Other regions	0.5	0.9	4.3	0.3	0.5 (-1.4 – 2.7)	2.1 (1.2 – 2.8)

Remarks: f: forecasts, world trade is average of exports and imports

Source: WTO Secretariat (Last update on 21 September 2017)

All in all, the strong external demand should have bolstered China's economic growth in the final quarter last year (which will be released on 18 January), which China is expected to report its first annual GDP growth acceleration in seven years. That said, we maintain our views that such growth acceleration is unlikely to persist and reiterate our views for **growth moderation this year**, against the backdrop of normalizing world trade growth, cooling property markets and rising financial costs.

CHINA'S GROWTH ACCELERATION IS UNLIKELY TO PERSIST



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