



Weekly Notes on China's Economy

June 10, 2019. Worldwide Edition

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Imponderables

Everyone will be watching this week's flow of economic indicators for a glimpse at export performance under trade adversity. That adversity is a combination of reduced volumes of world trade overall and rising trade barriers with the United States. At the same time, domestic supply constraints are pushing up food prices: African swine fever is decimating pork supplies, pushing up prices of China's protein mainstay by 50% year-over-year. So we will see a pick-up in inflation metrics in this week's busy run of data—that bit of the picture we can understand. However, the current setting for trade is so far beyond the realm of experience of any China watcher that trying to predict the next reading for any of the trade metrics is pointless.

Let us be candid about this trade business: The scale of the escalation of tariff and non-tariff trade restrictions by the United States and China has never been seen before. Econometricians cannot pretend that the structure of the global trade regime has not been changed by this trade conflagration. *Therefore, they cannot use their models based on a legacy regime to predict the future.*

Because certain goods have been dutied but not others, the impact cannot be analyzed by looking at average price elasticities of imports in each country: Elasticities vary from product to product. Consider soybean and pork imports by China: Those import orders ceased at once when the United States announced new tariffs. Consider U.S. imports of electrical machinery from China: If a U.S. buyer needs a part for a gizmo, there many not be a source for it outside of China. So even smart econometricians who believe they have properly identified a price elasticity for U.S. imports from China—they probably have not, but that's a pointy-headed econometrics discussion that has no place here—there is no way to use an aggregate elasticity to analyze a complex program of tariffs on selected products.

When we shift to a discussion of non-tariff disruptions, we go off

Recent & Upcoming Economic Releases

| Date | Content | Expected/Actual | Prior |
|--------|---|-----------------|---------|
| Apr 17 | GDP (Q1) %chya | 6.4% | 6.4% |
| May 10 | Current Account (Q1) \$billions | \$58.6 | \$54.6 |
| May 31 | CFLP PMI (5) | 49.4 | 50.1 |
| Jun 12 | CPI (5) %chya | 3.1% | 2.5% |
| Jun 12 | PPI (5) %chya | 1.1% | 0.9% |
| Jun 14 | Industrial Production (5) %chya | 5.5% | 5.4% |
| Jun 14 | Retail Sales Value (5) %chya | 7.8% | 7.2% |
| Jun 14 | Fixed Investment (4) %chya | | 6.1% |
| Soon | Foreign Exchange Reserves (5) \$trillions | \$3.102 | \$3.095 |
| Soon | Trade Balance (5) RMB billions | 185.7 | 93.6 |
| Soon | Exports (5) RMB %chya | 4.3% | 3.1% |
| Soon | Imports (5) RMB %chya | 1.6% | 10.3% |
| Soon | M2 (5) %chya | 9.2% | 8.5% |
| Soon | M1 (5) %chya | 4.2% | 2.9% |
| Soon | Aggregate Financing (5) RMB billions | 2230.6 | 1359.2 |
| Soon | Foreign Direct Investment (4) %chya | | 6.3% |

Westpac Trade-Weighted Yuan Index

Monthly Data, Final Datapoint is June 7, 2019



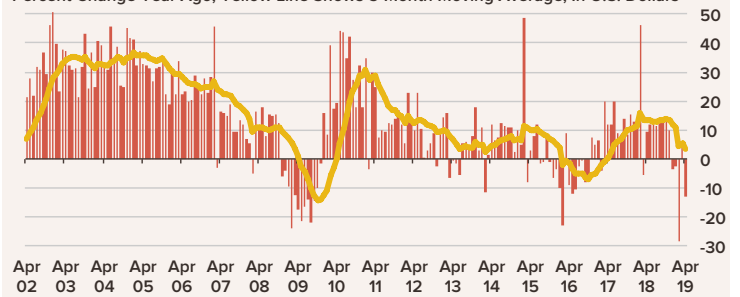
Yuan Per U.S. Dollar

Daily Data Through June 7, 2019



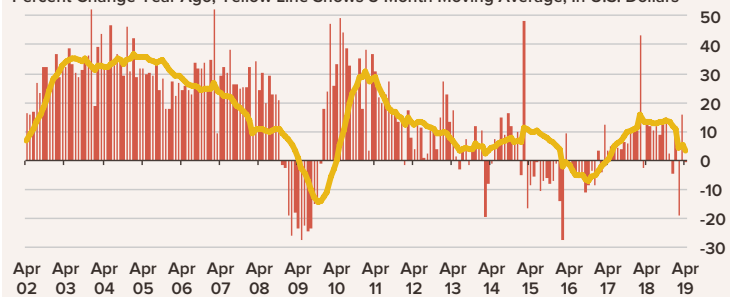
China: Monthly Exports To The United States

Percent Change Year Ago, Yellow Line Shows 5-Month Moving Average, In U.S. Dollars



China: Global Exports Excluding Sales To The United States

Percent Change Year Ago, Yellow Line Shows 5-Month Moving Average, In U.S. Dollars



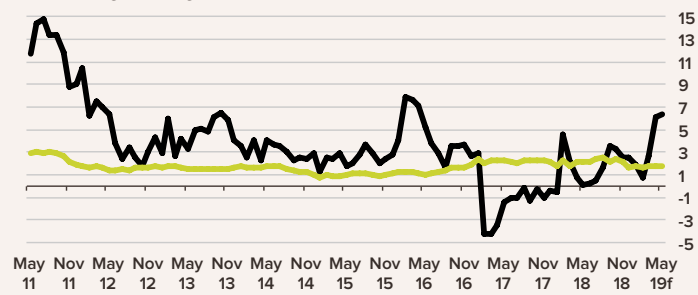
the rails altogether. No one we know can model the impact of the Huawei restrictions, the boycott of U.S. agricultural products or the harassment of Ford and FedEx in China because no one has any historical precedent to draw upon for guidance. Similarly, China's threat to withhold rare earth exports to the United States has unmeasurable effects on trade and on the economies.

When we look at the charts on page one, we see that China's economy has bigger problems than just trade with the United States. China's exports to the world outside the United States—representing 85% of its exports—are fading just as fast as exports to the United States. This is a consequence of the slowdown in global trade that we discuss today in our *Weekly Notes on the Global Economy*. A one-percent drop in exports to the rest of the world is more than five times more important to China's economy than a similar percentage point drop in exports to the United States. *We have no good explanation for the decline in global trade yet.*

We can admit that we see a lot of negative factors building up around China's trade prospects. What we cannot tell is how important they are going to be. We cannot model any of them.

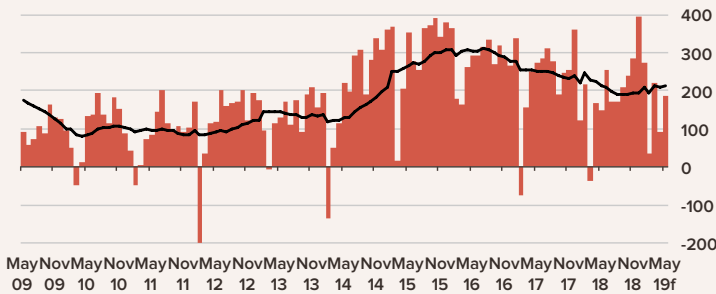
China: Consumer Price Index, Food Vs Non-Food Elements

Percent Change Year Ago, Green Line Shows Non-Food Prices, Black Line Is Food



China: Trade Balance, Seasonally Adjusted, RMB Billions

Black Line Is 12-Month Moving Average



Pork Crisis Pushes Inflation Metrics Up

The acceleration of headline CPI is all about food prices: Swine fever is devastating the hog population. Pork is a staple in China's diet—the primary source of protein for most residents. NBS' statisticians report that a typical Chinese resident eats his or her weight in pork every year. The 50% jump in pork prices is therefore a true supply shock, passing very quickly into CPI metrics. Since people in China have to buy food at any price, the elasticity of substitution is quite low and the impact on household spending is equal to the reduction in incomes. So this pork supply problem reduces the real disposable income that households have to spend after they have paid their food bill. The price hike is like a tax on consumers, and it is a regressive tax because it hits poorer households—which spend a higher portion of their budgets on food—harder than wealthier households.

The impact will appear in this week's retail sales report for May. Nominal retail sales likely accelerated, but CPI-adjusted measures of sales volumes should slow. *Note that "accelerate" and "slow" describe rates of change.* Retail sales in China are not falling. They were rising at a 7.8% year-over-year rate in May, we figure, better than the 7.2% pace reported for April. However, CPI was up 3.1% year-over-year in May, by our estimate, following a 2.5% pace in April. That means volumes were up just 4.2% yearly after 4.7% in April.

There will be a lot of chatter around the trade figures this week, especially with Presidents Xi and Trump expected to encounter each other at the G-20 Summit on June 28 and 29. *One can hope for detente from the trade skirmishes, but you never know when you are dealing with a mercurial U.S. president pitted against a Chinese leader willing to talk but not willing to fold on key issues.*

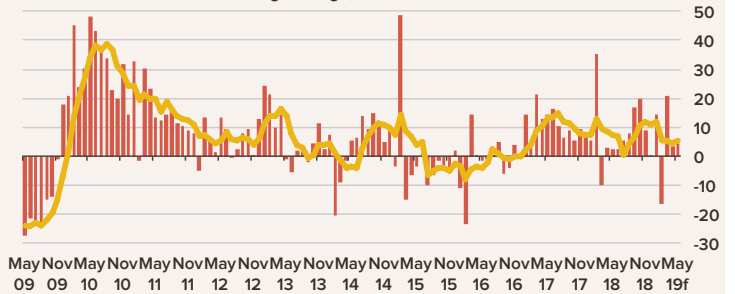
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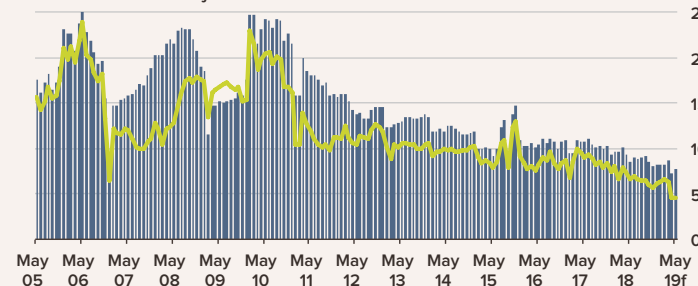
China: Exports, Percent Change Year Ago

Yellow Line Shows 5-Month Moving Average, In RMB



China: Retail Sales, Percent Change Year Ago

Green Line Shows CPI-Adjusted Sales



China: Industrial Production, Percent Change Year Ago

Yellow Line Is Three-Month Production Trend

