NOMURA

Asia Insights

ECONOMICS

China monthly: Rising pork prices a new risk, but the PBoC is unlikely to overreact

In this monthly, we update our views and forecasts on inflation. To a large extent, this can be viewed as a follow-up to our previous report on African Swine Fever (ASF; see *China: Inflation concerns seem overdone; watch African swine fever risk*, 16 September 2018). While Beijing's policymakers are trying to boost growth by ramping up monetary and fiscal stimulus, the last thing they want is a rapid rise in inflation. So far, so good, as CPI and PPI inflation dropped to 1.5% and 0.1% y-o-y, respectively, in February 2019 from 2.1% and 3.5% in 2018. However, pork prices are destined to be in the spotlight in the year of the pig. In general, pork prices tend to drop in days following the Lunar New Year (LNY) holidays, but this year they surged by 8.4%, based on data collected from 22 provinces by the China Animal Agriculture Association (CAAA). In fact, pork prices have already risen by 39.3% from the low in the week of 18 May 2018.

Considering the spreading of ASF, a sharp fall in the number of breeding sows, and the limited space for ramping up pork imports, we expect pork prices to peak at around RMB33/kg in January 2020 in this new hog cycle. China's monthly CPI inflation could rise towards 3.0% y-o-y at end-2019, and may reach approximately 3.3% y-o-y in January 2020, during which the LNY holidays will occur. That said, we believe the People's Bank of China (PBoC) is unlikely to overreact to the surge in pork prices, as a more experienced PBoC recognises that a rise in CPI inflation driven by cyclical pork prices is not a monetary phenomenon and will naturally decline without monetary tightening; thus it should not be treated as a real inflation risk.

March and Q1 forecasts

We have revised down our Q1 real GDP growth forecast to 6.2% y-o-y from 6.3% given signs of growth losing steam, as implied by sluggish activity data in January-February (see *China's growth slowdown worsened in the first two months of the year*, 14 March 2019). For the month of March, we expect industrial production growth to rise to 5.6% y-o-y in March from 5.3% in January-February, mainly due to last year's low base, which was partly due to the Lantern Festival occurring in March last year and partly due to the anti-pollution campaign ending in late March 2018. We believe it is likely that industrial production growth will moderate again in April and May.

Fixed asset investment growth likely continued to rise in March, supported by the pickup in infrastructure investment. One thing we would like to note is that the recovery in infrastructure investment growth could be moderate given limited room for local government finance, weighed on by contracting land sales and ongoing tax cuts.

We expect retail sales growth to remain unchanged at 8.2% y-o-y in March. The positive boost from higher CPI inflation and a booming stock market should have been offset by the high base last year (retail sales growth rose to 10.1% y-o-y in March 2018 from 9.7% in January-February, the highest print of the year) and lacklustre auto sales.

We expect export growth to rebound to -1.0% y-o-y in March from -20.7% in February, as the extended LNY holidays weighed on March exports last year but may help exports this March. We expect import growth to have edged up to -3.0% y-o-y from -5.2% in February, mainly supported by less oil price deflation. As a result, the trade balance could have turned to a deficit of USD2.1bn in March from a surplus of USD4.1bn in February.

Global Markets Research

28 March 2019

Visit Themes and Trades website for strategic cross asset ideas.

Research analysts

Asia Economics

Ting Lu - NIHK
ting.lu@nomura.com
+852 2252 1306

Wendy Chen - NIHK
wendy.chen@nomura.com
+86 21 6193 7237

Lisheng Wang - NIHK
lisheng.wang@nomura.com
+852 2252 2057

Jing Wang - NIHK
jing.wang@nomura.com
+852 2252 1011

Production Complete: 2019-03-28 06:06 UTC

Rising pork prices a new risk, but the PBoC is unlikely to overreact

While Beijing's policymakers are trying to boost growth by ramping up monetary and fiscal stimulus, the last thing they want is a rapid rise in inflation. So far, so good, as CPI and PPI inflation dropped to 1.5% and 0.1% y-o-y, respectively, in February 2019 from 2.1% and 3.5% in 2018. However, pork prices are destined to be in the spotlight in the year of the pig. In general, pork prices tend to drop in the days following the LNY holidays, but this year they surged by 8.4%,based on data collected from 22 provinces by CAAA. In fact, pork prices have already risen by 39.3% from the low in the week of 18 May 2018.

After considering the spreading of ASF, a sharp fall in the number of breeding sows, and the limited space for ramping up pork imports, we expect pork prices to peak at around RMB33/kg in January 2020 in this new hog cycle. China's monthly CPI inflation could rise towards 3.0% y-o-y at end-2019, and may reach approximately 3.3% y-o-y in January 2020. That said, we believe the PBoC is unlikely to overreact to the surge in pork prices, as a more experienced PBoC recognises that a rise in CPI inflation driven by cyclical pork prices is not a monetary phenomenon and will naturally decline without monetary tightening, thus it should not be treated as a real inflation risk.

The three hog cycles in the 2006-2018 period

Hog cycles describe cyclical pork price movements. Pork prices rise when the demand exceeds the supply. In response to rising pork prices, pig farmers may raise more hogs, but too much new supply will, in turn, dampen pork prices. Hog cycles are especially evident in China where pig farming is dominated by numerous small farms that are not sophisticated enough to predict prices. Since it takes several months from increasing the number of breeding sows to adding the number of hogs, hog cycles in China usually last about four years. Based on the time from one trough of pork prices to the next, China experienced three hog cycles over the period from 2006 to 2018: cycle one in 2006-10, cycle two in 2010-14, and cycle three in 2014-18 (Figure 1).

Understanding China's hog cycles is important, as pork accounts for around 75% of total meat consumption and 12.5% of food consumption in China. Pork's weighting in China's CPI basket used to be higher at around 3.3% but, as a result of a shift in consumer preference towards a more diversified diet, it weighting has declined over time to the current level of 2.5%. Due partially to pork's declining weighting in the CPI basket, the once-high correlation between changes in pork prices and CPI inflation has moderated to some extent in recent years (Figure 2). However, pork prices still play quite an important role in CPI inflation. Below, we briefly discuss the last three hog cycles.

Cycle one in 2006-10

The breakout of Blue Ear Disease and other diseases reduced pork supply and caused pork prices to surge in 2007, and the extremely cold weather in early 2008 dealt another blow to hog-raising businesses, as small pig farmers were not equipped to handle the abnormally cold winter. Pork prices jumped to a high of RMB22.6/kg in August 2007 and quickly retreated to RMB20.3/kg in October, but then rebounded to a new high of RMB25.9/kg in March 2008. After that, pork prices were largely on a downcycle, bottoming at RMB15.2/kg in June 2010.

Cycle two in 2010-14

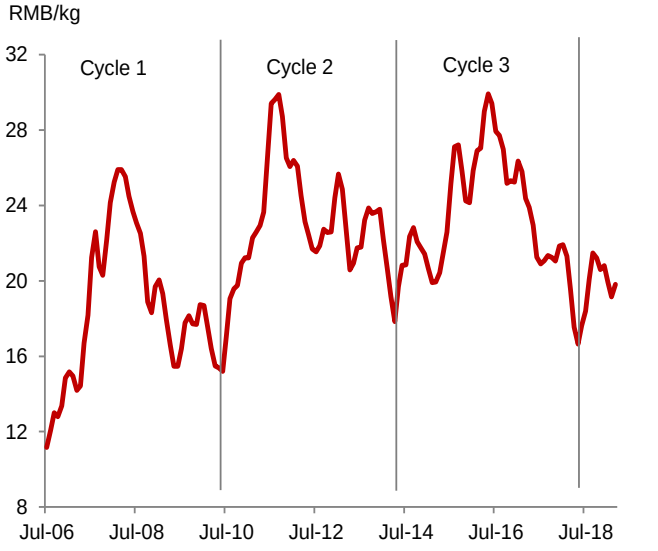
The sharp fall in pork prices in 2008-09 significantly dampened the incentive to pig farmers and reduced hog stock. The breakout of diseases such as the swine foot-and-mouth disease in 2010 exerted further downside pressure on hog supply. The falling supply of pork, plus an economic growth recovery driven by a colossal stimulus in response to the global financial crisis, started to drive up pork prices in the second half of 2010. Pork prices rapidly rose to the peak of this cycle at RMB29.9/kg in September 2011, followed by rising supply and falling prices. The cycle bottomed at RMB17.8/kg in April 2014.

Cycle three in 2014-18

One key driver of this cycle was the anti-pollution campaign, which set much stricter environmental requirements for pig farms. As a result, many small pig farms exited the pig farming business. For instance, there are areas defined as restricted for pig farming and farms located within those areas were forced to either closed or relocate. According

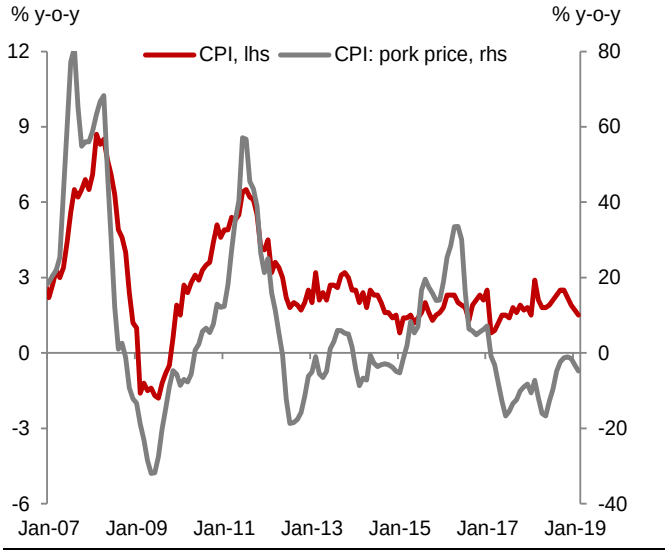
to data from CAAA, the number of small pig farms (with annual hog production below 500 head) fell by 18% from 2013 to 2016 (2016 is the latest data point available). During this cycle, pork prices peaked at RMB29.9/kg in May 2016 and then bottomed at RMB16.7/kg in May 2018.

Fig. 1: The hog cycles over 2006-2018



Source: WIND and Nomura Global Economics.

Fig. 2: CPI inflation: headline vs pork price



Source: CEIC and Nomura Global Economics.

A new hog cycle started in mid-2018

We believe a new hog cycle has started after the average of 22-province pork prices bottomed in May 2018 at just over half of the cycle peak price of RMB29.9/kg in May 2016. However, the ASF outbreak in China in mid-2018 distorted markets. In the beginning of the ASF outbreak, although some hogs were killed by ASF, pork supply actually increased, as concerns over the disease spreading pushed pig farmers to slaughter hogs early to avoid potential losses from the disease. Pork prices moderated to RMB18.5/kg during the LNY holidays in early February 2019, against a normal pattern of rising food prices during the LNY holidays, but then surged to RMB22.1/kg during the week of 22 March. We expect pork prices to rise further on the following factors.

Falling hog stock and hog-to-corn price ratio

Hog stock, which indicates the supply in the pipeline, fell to 428mn head in 2018, according to the data from the National Bureau of Statistics, its lowest since 2006 and marking a 10.9% contraction from the peak of 480mn head in 2012. Furthermore, the NBS data show per capita pork consumption by Chinese households has remained relatively stable at around 20kg per year from 2013 to 2017. We expect the falling supply in the pipeline, combined with stable demand, to exert inflationary pressure on pork prices.

The major driver of falling hog stock is the declining hog-to-corn price ratio[1], which dipped below the breakeven level of 6x and averaged just 5.5x over the four months of March to June in 2018. When the ratio is below 6, it suggests the hog-raising business has become unprofitable and usually drives farmers to reduce breeding sows. At the start of previous two cycles (the 2010 and 2014 episodes; no data are available prior to September 2006), we noticed the occurrence of sub-6 ratios (averaged at 5.2x for six months, and at 5.4x for 17 months, respectively) during each episode.

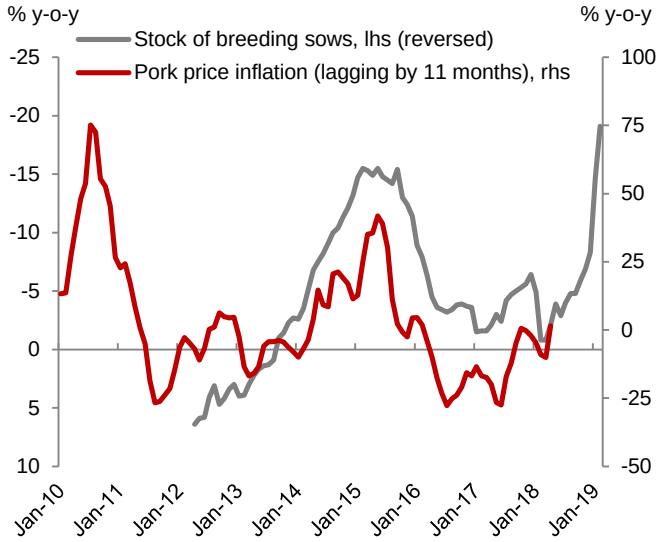
Falling stock of breeding sows

The number of breeding sows dropped sharply from around 50.0mn in mid-2013 to just 27.4mn in February 2019, according to the data from the Ministry of Agriculture and Rural Affairs (MARA). The stock of breeding sows used to be a very reliable leading indicator of pork prices with a 1% change in the stock of breeding sows leading to a 5% change in pork prices in the inverse direction (with a lead time of around 11 months; Figure 3). Thanks to the improved efficiency, this link has weakened slightly over the past

[1] The hog-to-corn price ratio is the ratio of hog prices to feeding costs, with the producers' breakeven point at 6x. Here we use the hog-to-corn price ratio of 22 provinces.

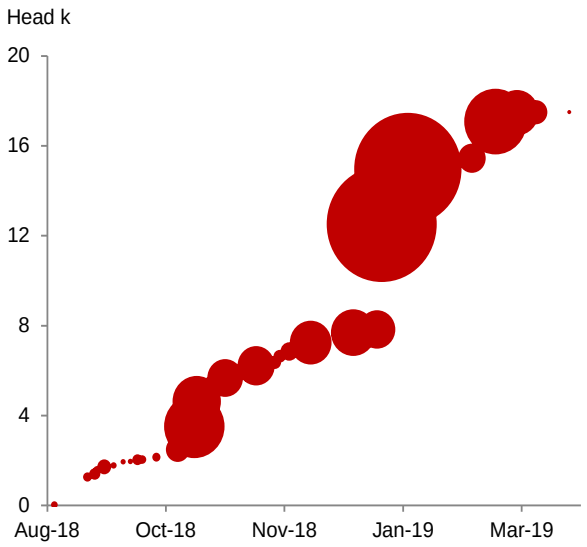
decade, although the stock of breeding sows still serves as a good indicator. In February 2019, the year-on-year change of stock of breeding sows worsened to -19.1% from -8.3% in 2018. Assuming a lead time of 11 months, an elasticity of about four times and the year-on-year change of breeding sow stock now near the bottom implies the year-on-year change in pork prices could surge to around 65% in January 2020 (or at around RMB33/kg), higher than the previous peak of RMB29.9/kg in May 2016.

Fig. 3: Changes of breeding sows stock vs pork inflation



Source: WIND and Nomura Global Economics.

Fig. 4: The cumulative number of hog infected by ASF



Note: The size of bubbles reflects the stock of pig farms and slaughterhouses reporting the disease breakout. Source: The website of the Ministry of Agriculture and Rural Affairs and Nomura Global Economics.

Why could peak pork prices exceed previous hog cycles? The credit goes to ASF

China reported its first ASF outbreak in Liaoning province in August 2018, which was also the first reported case in East Asia. As China accounts for around half of the world's pork production, and as pork is the country's principal source of dietary protein, the spread of ASF represents a major threat to China's food security. ASF has two major impacts on the current hog cycle. First, it kills hogs and reduces pork supply. Second, despite the rise in pork prices, pig farmers may be reluctant to increase hog stock on concerns about ASF. In this regard, the upturn of the hog cycle could last longer and drive pork prices higher than in previous hog cycles.

An update on ASF

According to the MARA, so far 28 provinces have reported a breakout of ASF disease, with only three exceptions (Hainan, Xinjiang and Tibet) in the mainland. Based on data collected from MARA's website, around 18k hogs have been infected (Figure 4), 12k hogs have died from the disease and, in total, 323k hogs have been affected by the ASF (including pig farms and slaughterhouses, which reported the disease breakout), which equates to ~0.08% of total hog stock. Although the portion looks tiny, the pervasive breakout across the country has alarmed pig farmers and led to a dramatic contraction of hog in stock in January (-12.6% y-o-y) and February (-16.6%) this year.

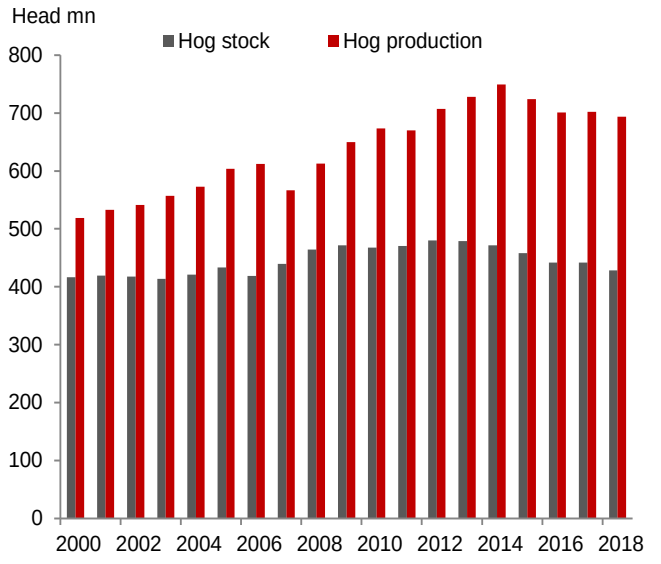
The spread of the outbreak seems to have slowed somewhat into 2019. In March 2019 so far, only three outbreaks of ASF have been reported on the MARA website, with one being the transportation of infected swine in Sichuan Province and just two new outbreaks of the disease. There were seven new outbreaks reported in February 2019 and only five in January, down from 21 new outbreaks reported in December 2018. However, the damage seems to have increased this year, as some big corporate pig farms were hit. On 1 January 2019, a corporate pig farm with 73,000 head in Heilongjiang province reported 4,686 infected hogs, of which 3,766 died. On 12 January, two other pig farms owned by one company in Jiangsu province, with a total of 68,969 head reported that 2,452 hogs were infected and 1,369 had died. On 18 February, a pig farm in Guangxi, with 23,555 head reported that 1,629 hogs were infected and 924 had died.

The ambiguous role of large-scale corporate pig farming

The efficiency of pig farming has greatly improved, with the rise of large corporate-owned pig farms over the past couple of years. Due to both the anti-pollution campaign and fierce competition, the pig farming industry has experienced a rapid transformation − from backyard pens to automated large-scale hog barns run by large corporations. We have observed a significant decline in the number of small pig farmers (with annual production of 49 or fewer head of hogs) to 40mn units (2016, the latest data point available) from 80mn units in 2007. Meanwhile, the number of large-scale pig farms (with annual production of more than 500 head) doubled to 257k from 125k. The number of the largest farms (with annual production above 50,000 head) expanded more than fivefold to 311 from 50. We believe the rise of big corporate pig farming has improved efficiency significantly, as evidenced by the fact that, despite the straight decline in hog stock from its peak in 2012 (average annual stock at 474mn head in 2009-13 versus 448mn in 2014-18), hog production actually increased over the same period (686mn in 2009-13 versus 714mn in 2014-18; Figure 5).

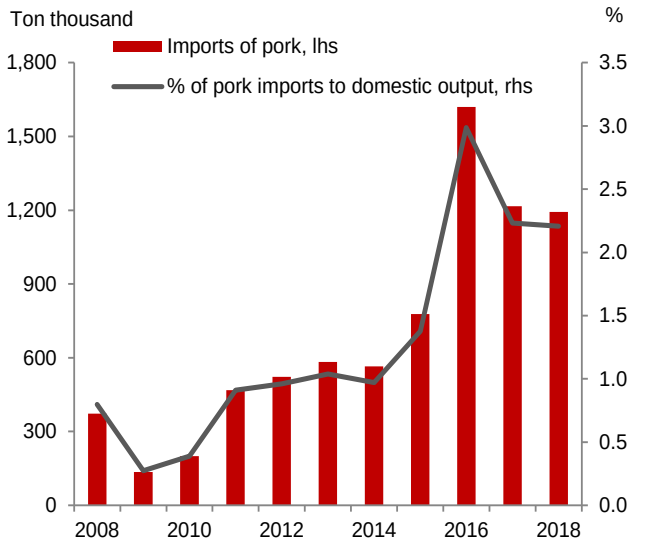
However, although large corporate farms are much better equipped to defend against ASF, the large number of hogs confined in a small area also poses a significant risk, as evidenced by a large corporate farm in China's North-eastern Heilongjiang province in which 73,000 hogs were culled after 4686 were infected by ASF. Therefore, the threat of the ASF could result in a reluctance among large corporate pig farms to rapidly increase hog stocks, despite surging pork prices.

Fig. 5: Production of hogs vs hog stock



Source: CEIC and Nomura Global Economics.

Fig. 6: Pork imports



Source: WIND, CEIC and Nomura Global Economics.

Pork imports are unlikely to fill the gap

We see limited room for ramping up pork imports to compensate for the domestic supply shortage caused by ASF and the downturn of the hog cycle. Pork imports were only a tiny portion of China's total pork consumption. According to China Customs, total imports of pork-related products (including pork and pig offal) were 2.2mn tons in 2018, or only 4% of China's domestic pork production of 54.0mn tons. Considering pork alone, the portion of imports to domestic output is even smaller, with the peak at 3.0% in 2016 when China increased imports significantly, as it was faced with rising pork price inflation and falling hog stocks (Figure 6).

According to the United States Department of Agriculture (USDA), total global pork exports would be around 8.7mn tons in 2019. China is already the largest importer of pork, comprising 22% of global imports in 2018, so we believe there is limited scope for China to greatly increase its imports in 2019. Even if China can double its imports to 4.4mn tons in 2019 (which would equate to ~50% of global pork exports), the increased imports (8% of 2018 China's domestic pork production) could still lag behind the decline in domestic hog production capacity (hog stock contracted by 12.6% y-o-y in January, and further by 16.6% y-o-y in February 2019).

Estimating the impact of the current hog cycle on CPI inflation

The hog cycles, if measured by pork price inflation, have shown a pattern of flattening, with the gap between the peak and trough contracting further in each cycle. In the first cycle, the peak was 80.9% y-o-y and the trough was -32.0%; in the second cycle, the peak and trough were 57.1% y-o-y and -18.7%, respectively; and in the third cycle, they were 33.6% y-o-y and -16.7%. In the previous three hog cycles, the average pork price inflation in their upturns was 40% y-o-y in 2006-08 (lasting for 24 months), 23% in 2010-12 (lasting for 23 months), and 15% in 2015-17 (lasting for 23 months), respectively. One reason behind the flattening of cycles could be the rise of big corporate farming, which is far more efficient and rational in terms of the planning of hog stock. Plus, owing to a declining weighting of pork in the CPI basket to 2.5% since 2015 from above 3% in previous years, the impact of hog cycles on CPI inflation has declined over the past decade.

However, ASF could lengthen the upturn of the current hog cycle, and pork prices could rise to a higher level. Due to the uncertain nature of the ASF outbreak, it is much more challenging to predict the upturn of this hog cycle. By incorporating all available information, including changes in the number of breeding sows, and making what we view as some reasonable assumptions, we expect pork prices to peak at around RMB33/kg in January 2020, which would occur during China's celebration of the LNY holidays. Based on these assumptions, we expect year-on-year CPI inflation to rise from 1.8% in Q1 to 2.7% in Q2, 2.6% in Q3 and 2.8% in Q4, with the annual inflation rate at 2.5% in 2019. Monthly CPI inflation could increase to near the government inflation target of 3.0% at end-2019 and likely peak somewhere near 3.3% y-o-y in January 2020. Based on these estimates, we raise our annual CPI inflation (average of year-on-year monthly CPI inflation) forecast for 2019 to 2.5% from 1.9% (compared with actual inflation of 2.1% in 2018). For 2020, we expect CPI inflation to moderate to 2.3% as pork prices enter a downcycle.

Will the PBoC respond to the rise in CPI inflation?

In the just-concluded National People's Congress conference, the Chinese government once again set a CPI inflation cap at 3.0% (see *China monthly: NPC preview*, 3 March 2019). We assign only a small likelihood to the PBoC reacting to the upcoming rise of CPI inflation by cutting back on its easing agenda.

First, although we believe CPI inflation in certain months may be very close to 3.0% in 2019, the likelihood of annual CPI inflation breaching above 3.0% is quite small for two reasons: (1) PPI inflation already declined to 0.1% y-o-y in January-February, and could decline into negative territory over the next couple months, along with the slowing economy and value-added tax (VAT) cuts. The low and falling PPI inflation could exert downward pressure on non-food CPI inflation; (2) the VAT cuts (3pp for manufactured goods and 1pp for some services) could also directly push down the prices of some consumer goods.

Second, the PBoC has become increasingly experienced in dealing with hog cycles. A sharp rise in pork prices due to the upturn in the hog cycle and the ASF outbreak is unlikely to be sustainable, and should be differentiated from a rise in general price levels from an overheating economy. We expect China's core inflation to remain below 2.0% in 2019.

Forecasts for March and Q1 data

Official PMI: 49.4 (February: 49.2); Caixin PMI: 49.7 (February: 49.9); industrial production: 5.6% y-o-y (Jan-Feb: 5.3%); and real GDP growth: 6.2% y-o-y (Q4: 6.4%)

We expect the official PMI to tick up to 49.4 in March from 49.2 in February. The historical average for 2016-18 points to a seasonal pickup from February to March despite the mixed high-frequency data for the month. Growth of coal consumption by six major power plants and steel production improved, while the operating ratio of blast furnaces moderated further in March. We expect the Caixin PMI to drop modestly to 49.7 in March from 49.9 in February, as small enterprises (the Caixin PMI includes more small enterprises in its sample) faced more challenges from financing to business.

We expect industrial production (IP) growth to rise to 5.6% y-o-y in March from 5.3% in January-February, mainly due to a low base last year, as IP growth fell to 6.0% y-o-y in March from 7.2% in January-February in 2018. The low base last year was partly due to the Lantern Festival (元宵节) which extended into March last year but in February this year, and partly due to the anti-pollution campaign which ended in late March 2018. It's likely, in our view, that IP growth will moderate again in April and May. For Q1, we expect real GDP growth to slow to 6.2% y-o-y from 6.4% in Q4, as the January-February activity data point towards worsening growth momentum.

FAI: 6.5% y-o-y ytd (Jan-Feb: 6.1%)

We expect fixed asset investment (FAI) growth to continue to rise in March, as supported by the pickup in infrastructure investment – its growth slowed significantly from 11.3% y-o-y in Jan-Feb to 6.0% in March last year, while this year it will likely accelerate, in our view, given the intensive approval of infrastructure investment projects and faster issuance of local government special bonds in recent months. That said, the recovery in infrastructure investment growth could be moderate given limited room for local government finance, weighed on by contracting land sales and tax cuts.

Property investment: 11.0% y-o-y ytd (Jan-Feb: 11.6%)

Growth of property investment in January-February rebounded on strong construction-related investment, the growth of that increased to 9.4% y-o-y in January-February from 5.8% in December and 1.2% in Q4 2018. As developers may continue to accelerate building new homes sold through presales over the past couple of years to alleviate new home delivery pressure, we expect overall property investment growth to remain solid in March. Nevertheless, based on high-frequency data covering a sample of 100 cities, growth of land sales in value terms tumbled to -48.7% y-o-y in the first four weeks of March from -21.9% in January-February. As land purchases account for about one-third of overall property investment, we expect headline property investment growth to moderate to 11.0% y-o-y ytd in March from 11.6% in January-February.

Retail sales: 8.2% y-o-y (Jan-Feb: 8.2%).

Although higher CPI inflation and a booming stock market may provide some help, the Lantern Festival may cause some unfavorable base effects for March. Note the Lantern Festival was on 2 March last year, while it was on 19 February this year. Last March's retail sales growth rose 10.1% y-o-y in March 2018 from 9.7% in January-February, also recording the highest print of the year. In addition, despite a smaller contraction in January-February (compared to December), auto sales resumed a large contraction in the first half of March compared to the same period last year, weighing on retail sales. We also note that at least six auto makers cut their retail prices in the last week, as a response to the VAT cut.

Export growth: -1.0% y-o-y in March (February: -20.7%); import growth: -3.0% y-o-y (February: -5.2%); trade surplus: -USD2.1bn (February: USD4.1bn)

According to an interview with the Commissioner-General of China Customs (see link to the news), China's total trades (including exports and imports) rose by 24.7% y-o-y in the first nine days of this March. The y-o-y growth was even higher for exports, up to 39.9%. We believe the reported surge was largely driven by the calendar effects related to the LNY holidays (4-10 February this year; 15-21 February last year). Based on a press conference held by the State Council Information Centre on 14 March, in addition to the seven-day LNY, the calendar effects may also extend to 4-5 days prior to the LNY and 15-20 days following the LNY. As such, we expect export growth to rebound to -1.0% y-o-y in March from -20.7% in February.

On imports, we expect the March y-o-y growth rate to remain weak at -3.0%, but higher than -5.2% in February, mainly supported by less oil price deflation. In particular, daily Brent oil price data suggest a continued recovery, with its y-o-y growth rate up to -0.4% in the first 21 days of March from -2.1% in February. China's resumption of importing agriculture goods from the US may also provide some support to headline import growth. Based on our projections for exports and imports, we expect the trade balance to turn to a deficit of USD2.1bn in March from a surplus of USD4.1bn in February.

PPI inflation: 0.4% y-o-y (February: 0.1%); CPI inflation: 2.2% y-o-y (February: 1.5%).
We expect PPI inflation to rebound in March, due to both sequential price rises as implied by high-frequency data and a low base last year (-0.2% m-o-m in March 2018). Moreover, global oil prices, which are closely correlated with PPI inflation, continued to rise, as suggested by Brent oil price inflation which has narrowed to -0.4% y-o-y in March from -2.1% in February. This also underpins the upward movement of PPI inflation in March.

We expect CPI inflation to rise to 2.2% y-o-y in March from 1.5% in February, mainly driven by a low base for food price inflation last year (-4.2% m-o-m 2018 vs an average of -2.0% over 2013-17). For this March, food prices also fell sequentially, but as implied by the high-frequency data, the decline seemed to be more moderate, with the surges in pork price being one major driver.

Aggregate financing: RMB1,800bn (February: RMB703bn); New RMB loans: RMB1,200bn (February: RMB886bn); M2 growth: 8.2% (February: 8.0%)
The worse-than-expected February slump in new RMB loans and aggregate financing was mainly due to seasonal factors and the LNY distortions. We expect them to rebound in March, as the seasonality will reverse and LNY distortions will largely subside. The strength of new RMB loans may come from stronger mortgage loans (as signalled by some improvement in second-home sales in top-tier cities) and corporate loans (echoing Beijing's call for more financial support for small- and medium-sized enterprises and private enterprises). Among major components of aggregate financing besides the likely rising new RMB loans, net issuance of local government special bonds and corporate bonds may increase from their February levels, as implied by high-frequency data; loan write-offs may jump seasonally (historically tending to surge at the end of quarters); while shadow banking financing is likely to remain sluggish, in our view, due to the ripple effects of previously overdone financing deleveraging. M2 growth may tick up, as we expect a higher level of new loans.

Key events in coming months

End-March:	PBoC Monetary Policy Committee meeting for Q1 2019
28-29 March:	A US delegation led by Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin to visit Beijing for trade talks
Starting from 3 April:	A Chinese delegation led by Vice Premier Liu He to visit Washington for trade talks
April:	2nd Belt and Road Forum for International Cooperation
Mid-May:	The release of the PBoC Monetary Policy Report for Q1 2019
End-June:	PBoC Monetary Policy Committee meeting for Q2 2019
Summer:	Beidaihe meeting
Mid-August:	The release of the PBoC Monetary Policy Report for Q2 2019
End-September:	PBoC Monetary Policy Committee meeting for Q3 2019
5-10 November:	2nd China International Import Expo

Fig. 7: Forecast for March and Q1 economic indicators

Indicators	Unit	March		Jan-Feb	December	2018	Release date
		Nomura	Consensus				
Economic survey							
Official mfg PMI	Index	49.4	49.5	49.4	49.4	50.6	31 Mar
Caixin mfg PMI	Index	49.7	50.0	49.1	49.7	50.7	1 Apr
Activity							
Real GDP growth	% y-o-y	6.2			6.4	6.7	17 Apr
Industrial production (IP)	% y-o-y	5.6		5.3	5.7	6.2	17 Apr
IP for exports	% y-o-y			4.2	4.1	8.5	17 Apr
Fixed asset investment (FAI) ytd	% y-o-y	6.5		6.1	5.9	5.9	17 Apr
FAI	% y-o-y	6.9		6.1	5.9	5.9	17 Apr
Infrastructure investment	% y-o-y			2.5	7.7	1.8	17 Apr
Retail sales	% y-o-y	8.2		8.2	8.2	9.0	17 Apr
Crude steel (volume)	% y-o-y			9.2	8.2	6.6	17 Apr
Steel product (volume)	% y-o-y			10.7	9.1	8.5	17 Apr
Electricity (volume)	% y-o-y			2.9	6.2	6.8	17 Apr
Non-ferrous metal (volume)	% y-o-y			6.2	10.0	6.0	17 Apr
Cement (volume)	% y-o-y			0.5	4.3	3.0	17 Apr
Industrial profit	% y-o-y			-14.0	-1.9	10.3	27 Apr
Inflation							
CPI	% y-o-y	2.2		1.6	1.9	2.1	11 Apr
Food price	% y-o-y			1.3	2.5	1.8	11 Apr
Non-food price	% y-o-y			1.7	1.7	2.2	11 Apr
PPI	% y-o-y	0.4		0.1	0.9	3.5	11 Apr
Trade							
Exports (USD)	% y-o-y	-1.0		-4.6	-4.4	9.9	12 Apr
Imports (USD)	% y-o-y	-3.0		-3.1	-7.6	15.8	12 Apr
Trade balance	USD bn	-2.1		43.7	57.1	351.8	12 Apr
Exports (CNY)	% y-o-y	4.4		0.1	0.2	7.1	12 Apr
Imports (CNY)	% y-o-y	2.5		1.5	-3.1	12.9	12 Apr
Trade balance	CNY bn	-14.2		308.7	395.0	2330.3	12 Apr
Money and credit							
M2	% y-o-y	8.2		8.0	8.1	8.1	10-15 Apr
Aggregate financing	RMB bn	1,800		5,338	1,590	19,258	10-15 Apr
New RMB loan	RMB bn	1,200		4,110	1,080	16,166	10-15 Apr
Corporate bond	RMB bn			580	370	2480	10-15 Apr
Entrusted loan	RMB bn			-121	-224	-1610	10-15 Apr
Trust loan	RMB bn			31	-51	-690	10-15 Apr
Fiscal position							
Fiscal revenue	% y-o-y			7.0	1.9	6.2	mid-Apr
Fiscal expenditure	% y-o-y			14.6	22.7	8.7	mid-Apr
Property market							
Property investment ytd	% y-o-y	11.0		11.6	9.5	9.5	17 Apr
Property investment	% y-o-y	10.4		11.6	8.2	9.5	17 Apr
Property sales (value)	% y-o-y			2.8	12.3	12.2	17 Apr
Floor space sold	% y-o-y			-3.6	0.9	1.3	17 Apr
Floor space started	% y-o-y			6.0	20.5	17.2	17 Apr
Funds for property investment	% y-o-y			-10.6	-4.1	6.4	17 Apr
Land sales (value)	% y-o-y			-13.1	6.7	18.0	17 Apr
Land space sold	% y-o-y			-34.1	13.9	14.2	17 Apr

Note: For the real GDP growth, the forecast is for Q1 2019 and the December value is for Q4 2018. For investment- and property-related indicators, we convert them into year-on-year terms. Source: WIND, CEIC and Nomura Global Economics.

Review of the past month

To eliminate the distortion created from the LNY holidays, which tend to fall on different dates each year, data from January-February were combined to gauge the momentum. We see China's growth slowdown worsened heading into 2019: IP growth fell to 5.3% y-o-y in January-February after a moderate rebound to 5.7% in December; FAI growth rose to 6.1% y-o-y from 5.9% in December 2018, but fell from around 7.3% y-o-y growth in Q4 2018; growth of new home sales in volume terms tumbled to -3.6% y-o-y from 0.9%, despite a pickup in property investment; and retail sales growth remained sluggish at 8.2% y-o-y in January-February, while flat headline growth masked the divergences among product sales. On trade, export growth was unchanged from December 2018 at -4.6% y-o-y in January-February, much weaker that its Q4 level of 3.9%, while import growth picked up a bit to -3.1% y-o-y from -7.6% in December 2018 (Q4 2018: 4.4%). We expect export growth to slow further in coming quarters, due to: 1) the ongoing payback effects from previous front-loading; 2) weakening global demand and deepening tech downcycle; and 3) recent RMB appreciation and uncertainty around China's FX policies amid bumpy US-China trade negotiations.

Headline CPI inflation moderated further to 1.5% y-o-y in February from 1.7% in January, partly owing to a high base last year, while PPI inflation was unchanged at 0.1% y-o-y from January. With January and February combined, aggregate financing and new RMB loans were RMB5,310bn and RMB4,116bn, respectively, this year, significantly above RMB4,269bn and RMB3,739bn over the same period of 2018, and growth of augmented aggregate financing (aggregate financing plus the net increase of government bonds) rose to 10.6% y-o-y in February from 10.2% by end-2018, pointing to an easing bias for monetary policy.

Due to the anti-pollution campaign from November 2017 to March 2018, activity data in January-February this year may have been inflated by a low base. Note there was pent-up demand in April and May 2018, so it is quite likely that activity data in y-o-y terms will be negatively affected in April and May due to the higher base last year. We expect Beijing to ramp up supportive policies in coming months and still believe deregulating the property markets in big cities is the key to unlocking a growth recovery. We expect the PBoC to deliver a 50bp reserve requirement ratio (RRR) cut as early as this April. However, China's onshore stock markets are likely to be a determining factor in whether this prediction materialises, as an outright stock bubble could dissuade the PBoC from cutting.

Forecast revisions:
After the release of January-February data, we are making mark-to-market revisions to our forecasts (Figure 8). We have cut Q1 real GDP growth forecast to 6.2% y-o-y, with annual forecast unchanged at 6.0%. We have raised our CPI inflation forecasts for 2019 and 2020 due to the breakout of ASF and the new hog cycle. We have also revised our forecasts for activity, trade and credit supply for 2019.

Fig. 8: Details of the forecast

%y-o-y growth unless otherwise stated	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	2017	2018	2019	2020
Real GDP	**6.8**	**6.7**	**6.5**	**6.4**	6.2	5.7	6.0	6.2	**6.8**	**6.6**	6.0	6.0
Contributions to GDP (pp):												
Final consumption	**5.3**	**5.3**	**5.0**	**4.6**					**3.9**	**5.0**	4.0	4.1
Gross capital formation	**2.1**	**2.1**	**2.1**	**1.3**					**2.3**	**2.1**	2.1	2.0
Net exports (goods & services)	**-0.6**	**-0.7**	**-0.6**	**0.5**					**0.6**	**-0.6**	-0.1	-0.1
CPI	**2.2**	**1.8**	**2.3**	**2.2**	1.8	2.7	2.6	2.8	**1.6**	**2.1**	2.5	2.3
Core CPI	**2.1**	**1.9**	**1.9**	**1.8**	1.8	2.0	1.9	1.8	**2.2**	**1.9**	1.9	1.9
PPI	**3.7**	**4.1**	**4.1**	**2.3**	0.2	-0.2	-0.7	0.5	**6.3**	**3.5**	-0.1	0.0
Retail sales (nominal)	**9.8**	**9.0**	**9.0**	**8.3**	8.4	8.3	8.5	8.6	**10.2**	**9.0**	8.5	8.5
Fixed-asset investment (nominal, ytd)	**7.5**	**6.0**	**5.4**	**5.9**	6.5	7.3	7.9	7.9	**7.2**	**5.9**	7.9	7.9
Industrial production (real)	**6.8**	**6.6**	**6.0**	**5.7**	5.4	5.3	5.7	5.8	**6.6**	**6.2**	5.6	5.7
Exports (value)	**13.7**	**11.5**	**11.7**	**4.0**	-3.4	-4.0	0.0	5.0	**7.9**	**9.9**	-0.2	3.0
Imports (value)	**19.4**	**20.6**	**20.4**	**4.4**	-3.1	0.5	5.0	8.0	**15.9**	**15.8**	2.7	8.0
Trade surplus (USD bn)	**45.0**	**90.6**	**84.1**	**132.0**	41.8	62.8	55.4	122.5	**419.6**	**351.1**	282.5	181.3
Current account (% of GDP)	**-1.2**	**0.2**	**0.5**	**1.5**	-0.5	-0.1	0.1	0.3	**1.3**	**0.4**	-0.1	-0.2
Fiscal balance (% of GDP)									**-3.7**	**-4.2**	-4.0	-4.0
Outstanding RMB loans	**12.8**	**12.7**	**13.2**	**13.5**	13.5	13.4	13.2	13.5	**12.7**	**13.5**	13.5	13.0
Outstanding aggregate financing (AF)	**11.9**	**11.1**	**10.6**	**9.8**	10.2	10.0	10.2	10.4	**13.4**	**9.8**	10.4	10.2
Outstanding augmented AF	**12.6**	**11.7**	**11.2**	**10.2**	10.6	10.6	10.8	11.0	**14.0**	**10.2**	11.0	10.8
Money supply M2	**8.2**	**8.0**	**8.3**	**8.1**	8.2	8.0	8.0	8.0	**8.1**	**8.1**	8.0	8.0
1-yr benchmark lending rate (% pa)	**4.35**	**4.35**	**4.35**	**4.35**	4.35	4.35	4.35	4.35	**4.35**	**4.35**	4.35	4.35
7-day PBoC's reverse repo rate (% pa)	**2.55**	**2.55**	**2.55**	**2.55**	2.55	2.55	2.55	2.55	**2.50**	**2.55**	2.55	2.55
Reserve requirement ratio (% pa)	**17.0**	**16.0**	**15.5**	**14.5**	13.5	13.0	12.5	12.0	**17.0**	**14.5**	12.0	10.0
Exchange rate (USD/CNY)	**6.28**	**6.62**	**6.87**	**6.88**	6.60	6.90	7.00	7.00	**6.51**	**6.88**	7.00	7.25

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. The USD/CNY forecast is for the spot rate. All forecasts are modal forecasts (i.e., the single most likely outcome). Table reflects data available as of 28 March 2019. Source: CEIC and Nomura Global Economics.

Recent articles on policy

Date	Articles
13-March-19	China: RRR cuts are coming, but the timing depends on stock markets
11-March-19	China: PBoC held a press conference on FX, rates, credit and its policy stance
7-March-19	China's property sector: A frigid winter despite green shoots in Tier-1 cities
5-March-19	China: Takeaways from the 2019 Government Work Report

Recent articles on data releases

Date	Articles
27-March-19	China: Industrial profit contracts in January-February
25-March-19	China: PBoC survey suggests stronger corporate loan demand in Q1
19-March-19	China: The rebound of consumption tax revenue growth does not signal a recovery
18-March-19	China: Fiscal revenue remained weak despite rise in some Jan-Feb fiscal data
15-March-19	China: Property price inflation continues to ease in February
14-March-19	China's growth slowdown worsened in the first two months of the year
10-March-19	China: New credit slumped in February mainly due to LNY distortions
9-March-19	China: CPI lower and PPI unchanged in February
8-March-19	China: Exports reverse to a contraction in February

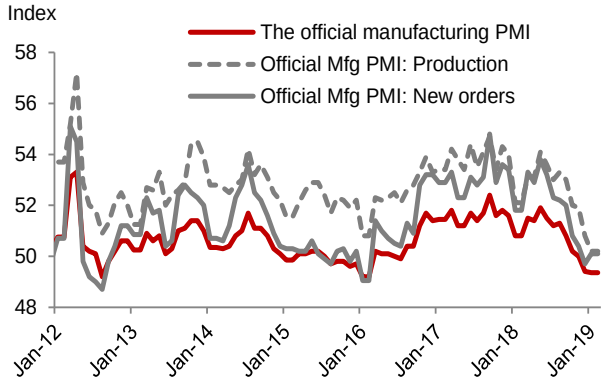
Chart pack

The official and Caixin PMIs

The official manufacturing PMI, which reflects sequential growth momentum, slowed to 49.2 in February from 49.5 in January. The drop was mainly driven by the production and raw materials inventory sub-indices. The new orders sub-index rose to 50.6 in February from 49.6 January, but the new export orders sub-index fell to 45.2 from 46.9, suggesting new domestic orders rose at a faster pace. The *Caixin* manufacturing PMI rose to 49.9 in February from 48.3 in January, with the January-February print at 49.1.

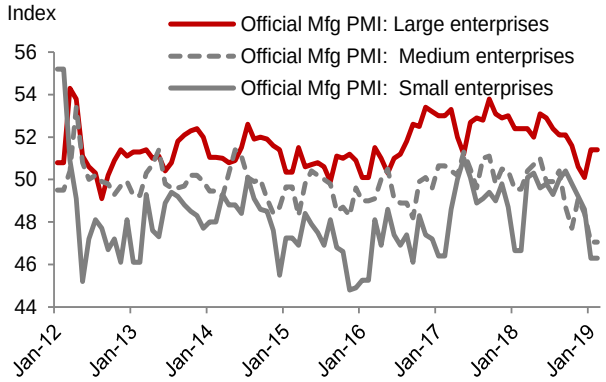
The official non-manufacturing PMI fell to 54.3 in February from 54.7 in January. By industry, the construction sub-index dropped to 59.2 from 60.9 in January, while the services sector sub-index eased slightly to 53.5 from 53.6.

Fig. 9: The official manufacturing PMI and its components



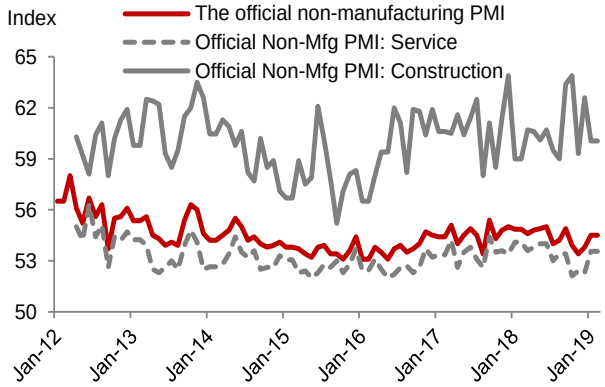
Source: CEIC and Nomura Global Economics.

Fig. 10: The official manufacturing PMIs by enterprise size



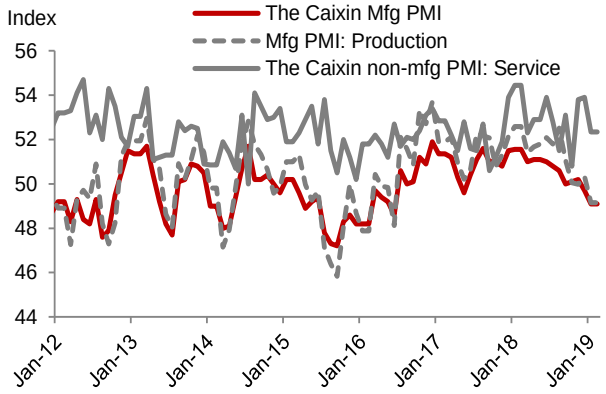
Source: CEIC and Nomura Global Economics.

Fig. 11: The official non-mfg PMI and its components



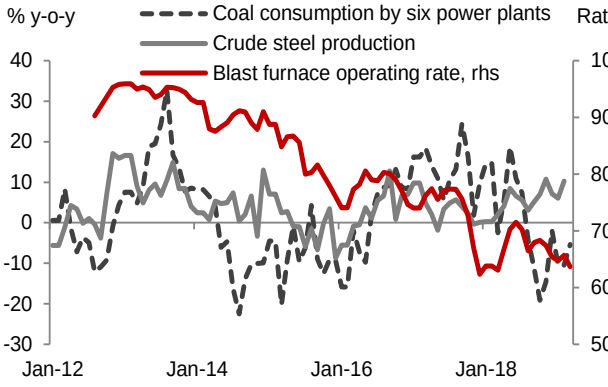
Source: CEIC and Nomura Global Economics.

Fig. 12: The Caixin mfg and non-mfg PMI



Source: CEIC and Nomura Global Economics.

Fig. 13: High-frequency economic activity data



Source: CEIC and Nomura Global Economics.

Fig. 14: Industrial inventory

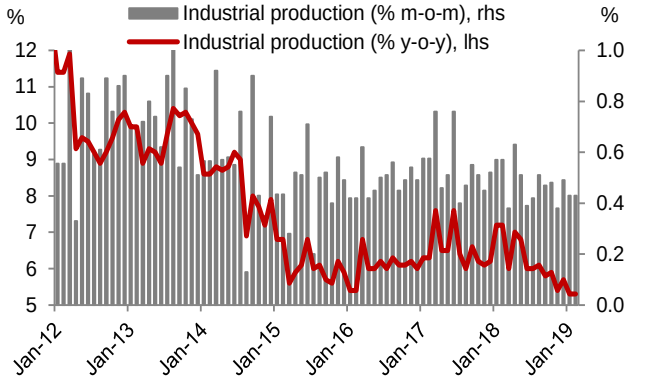
Source: CEIC and Nomura Global Economics.

Industrial production

IP growth declined to a weaker-than-expected 5.3% y-o-y from 5.7% in both December and Q4 (2018 full-year: 6.2%). In m-o-m terms, it slowed to 0.4% in January-February from 0.5% in December. By industry, output growth moderated to 0.3% y-o-y in January-February from 3.6% in December for the mining sector, declined to 6.8% from 9.6% for the utilities sector and ticked up to 5.6% y-o-y from 5.5% for the manufacturing sector

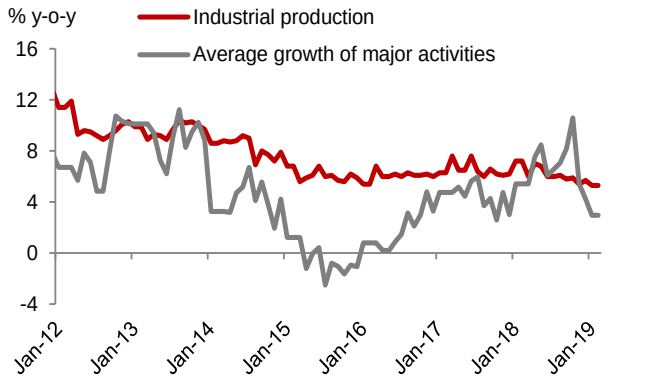
Production growth by product was mixed. Production growth of crude steel rose to 9.2% y-o-y in January-February from 8.2% in December, that for steel products rose to 10.7% from 9.1%, and that for power generation fell to 2.9% y-o-y from 6.2%. In terms of high-tech products, the production growth of industrial robots and new energy cars both improved. Growth of delivered value for exports remained largely stable in January-February compared to that in December, consistent with stable export growth during the period.

Fig. 15: Industrial production growth: y-o-y vs m-o-m



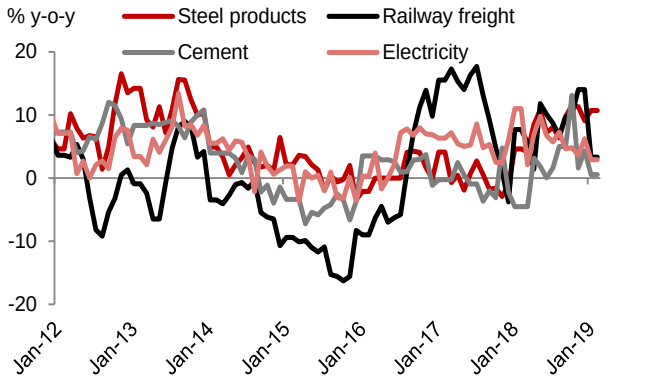
Source: CEIC and Nomura Global Economics.

Fig. 16: Industrial production vs major activity growth



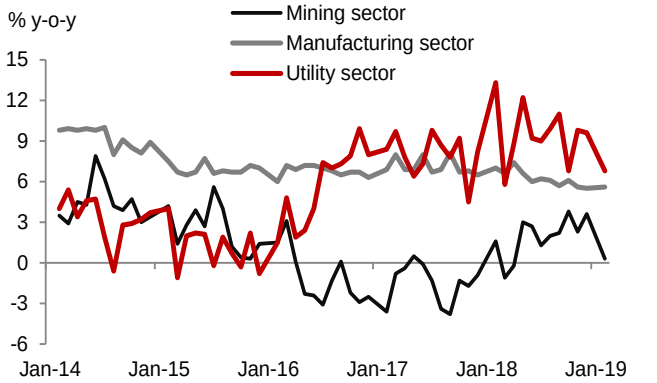
Source: CEIC and Nomura Global Economics.

Fig. 17: Production of major industrial products



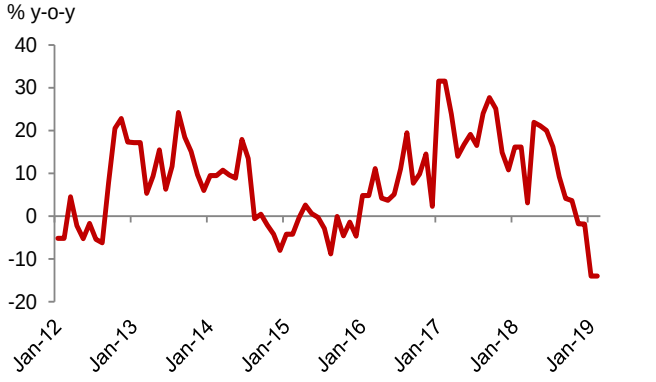
Source: CEIC and Nomura Global Economics.

Fig. 18: Industrial production by sector



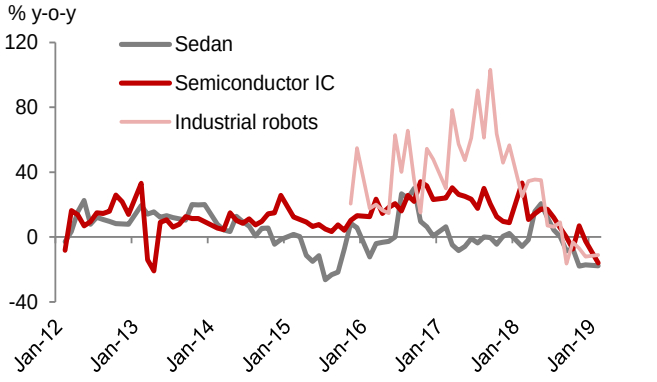
Source: CEIC and Nomura Global Economics.

Fig. 19: Industrial profit



Source: CEIC and Nomura Global Economics.

Fig. 20: Output growth of new economy components



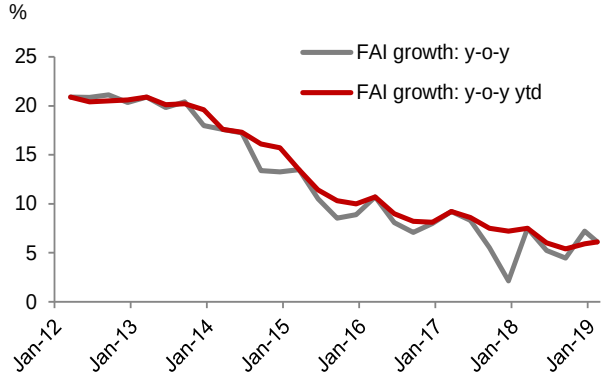
Source: CEIC and Nomura Global Economics.

Investment and the property sector

Headline FAI growth rose to 6.1% y-o-y in January-February from 5.9% in December (2018: 5.9%). By sector, growth of infrastructure investment slowed to 2.5% y-o-y from 7.7% in December (2018: 1.8%), while manufacturing sector investment eased to 5.9% from 9.5% (2018: 9.5%). Private investment growth fell to 7.5% y-o-y in January-February from 8.7% in December (2018: 8.7%), while that by state-owned enterprises rose to 5.5% from -2.0% (2018: 1.9%).

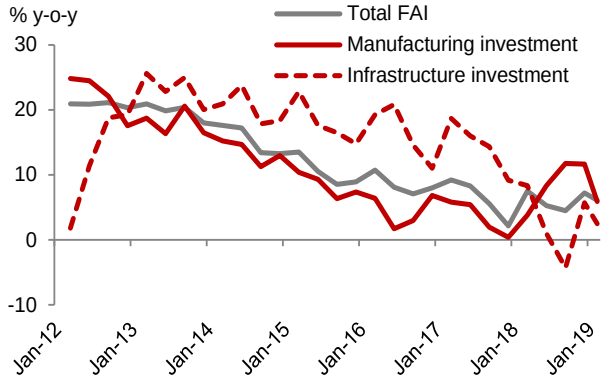
Despite a rebound in property investment growth to 11.6% y-o-y in January-February from 8.2% in December, most property indicators slowed in the first two months of 2019: new home sales resumed its contraction, growth of land sales (by volume) slumped, and growth of new home starts plunged.

Fig. 21: FAI growth: y-o-y vs y-o-y ytd



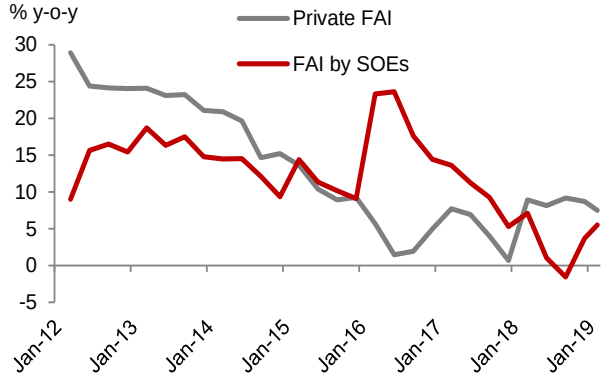
Source: CEIC and Nomura Global Economics.

Fig. 22: FAI growth by sector



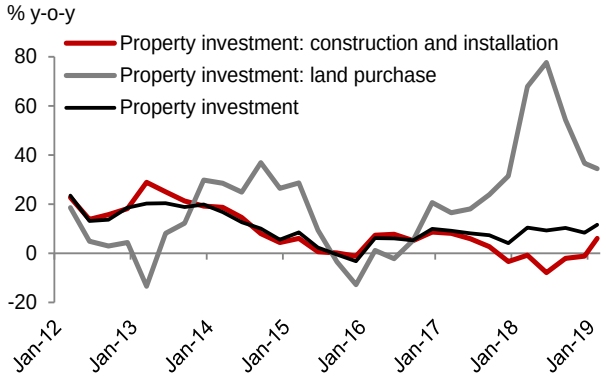
Source: CEIC and Nomura Global Economics.

Fig. 23: FAI growth: State-owned vs private investment



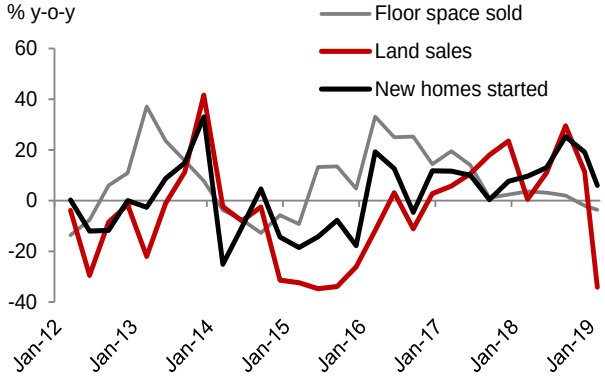
Source: CEIC and Nomura Global Economics.

Fig. 24: Property investment



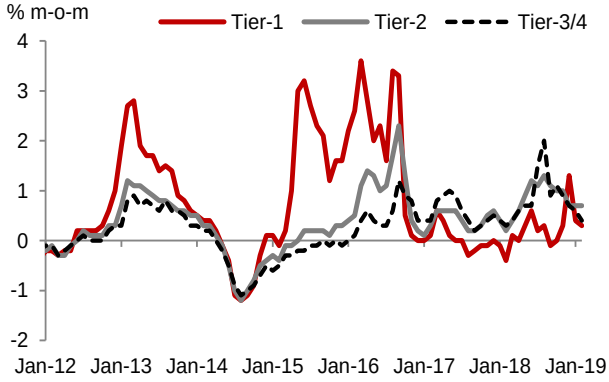
Source: CEIC and Nomura Global Economics.

Fig. 25: Property sales and new starts versus land sales



Source: CEIC and Nomura Global Economics.

Fig. 26: Residential price inflation (by city tier)



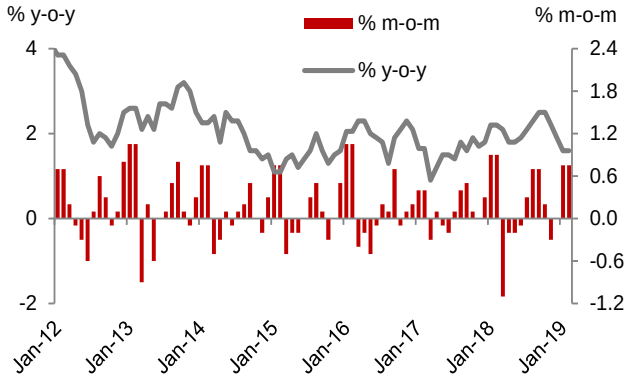
Source: WIND and Nomura Global Economics.

Inflation

Headline CPI inflation moderated further to 1.5% y-o-y in February from 1.7% in January, continuously dragged by food price inflation. Food price inflation fell to 0.7% y-o-y in February from 1.9% in January, while non-food price inflation remained unchanged at 1.7%. Excluding food and energy components, core CPI inflation eased to 1.8% y-o-y from 1.9%. In month-on-month terms, CPI inflation rose further to 1.0% in February from 0.5% in January.

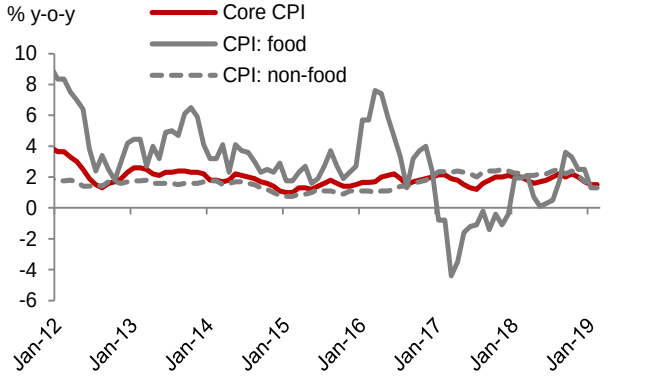
PPI inflation remained subdued at 0.1% y-o-y in February, unchanged from January. In month-on-month terms, PPI inflation rose to -0.1% from -0.6%. PPI inflation in the mining and raw materials sectors rose in February, but in the processing sector, it stabilised.

Fig. 27: CPI inflation



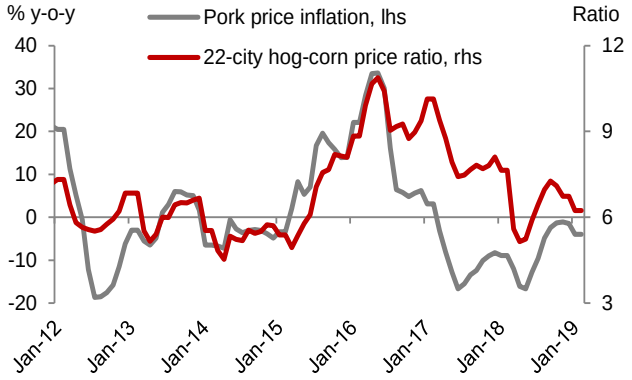
Source: CEIC and Nomura Global Economics.

Fig. 28: CPI inflation: food vs non-food prices



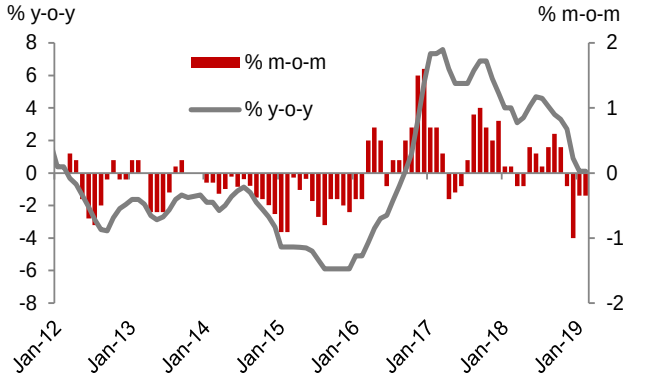
Source: CEIC and Nomura Global Economics.

Fig. 29: Pork price inflation and hog-corn price ratio



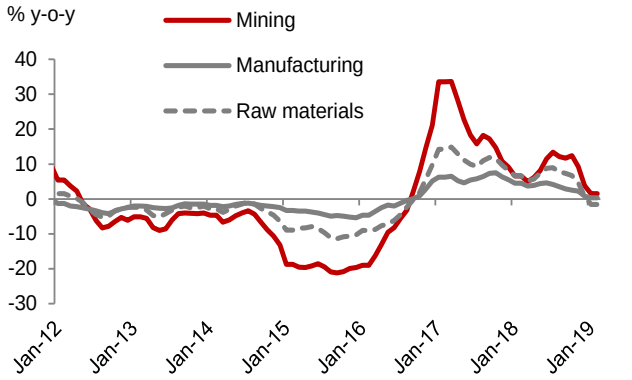
Source: CEIC, WIND and Nomura Global Economics. Note: 6 is the breakeven threshold for hog raisers.

Fig. 30: PPI inflation



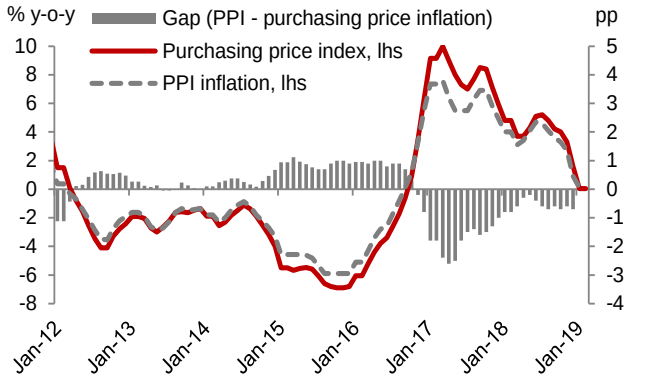
Source: CEIC and Nomura Global Economics.

Fig. 31: PPI inflation by sector



Source: CEIC and Nomura Global Economics.

Fig. 32: PPI vs purchasing price index

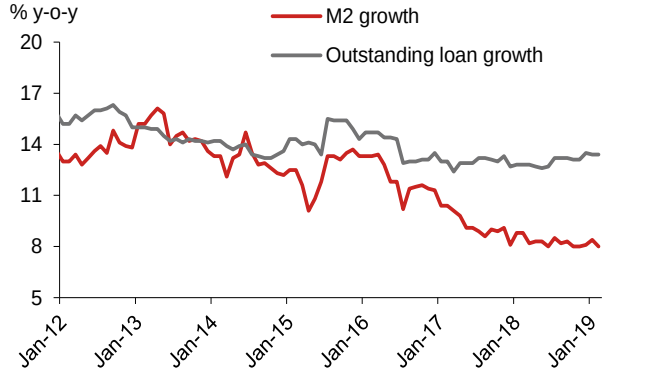


Source: CEIC and Nomura Global Economics.

Money and credit

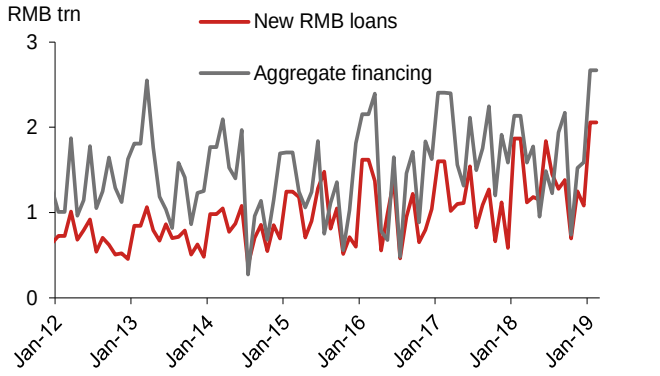
Aggregate financing fell dramatically to RMB703bn in February from its record high of RMB4,635bn in January, taking growth in outstanding aggregate financing down to 10.1% y-o-y from 10.4% in January. The drop in aggregate financing was mainly driven by a decrease in the value of RMB loans, contracting undiscounted banker's bills and falling corporate bond financing. If central and local government bond financing is included, growth of our measure of outstanding augmented aggregate financing declines to 10.6% y-o-y in February from 10.8% in January. New RMB loans fell to RMB886bn in February from RMB3,230bn in January, with growth in outstanding loans unchanged at 13.4% y-o-y from January. New loans to the corporate sector plunged, while those to the household sector turned negative. M2 growth slowed to 8.0% y-o-y in February from 8.4% in January while M1 growth rebounded.

Fig. 33: M2 growth vs outstanding loan growth



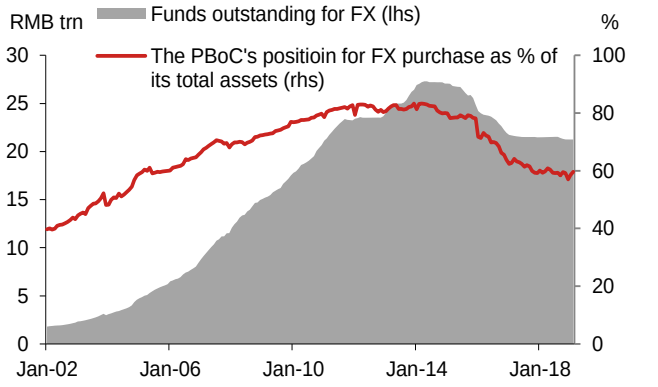
Source: WIND and Nomura Global Economics.

Fig. 34: New RMB loans and aggregate financing



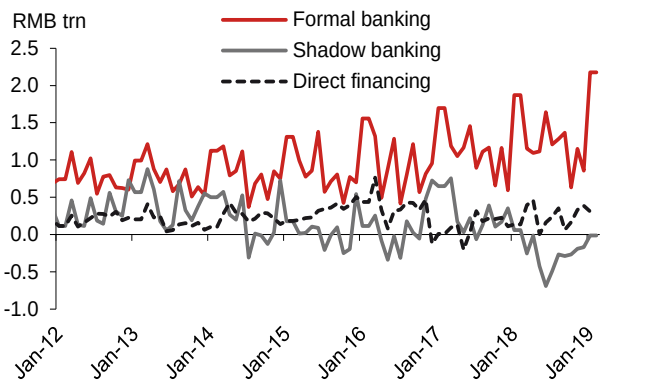
Source: WIND and Nomura Global Economics.

Fig. 35: The PBoC's position for FX purchase and its total assets



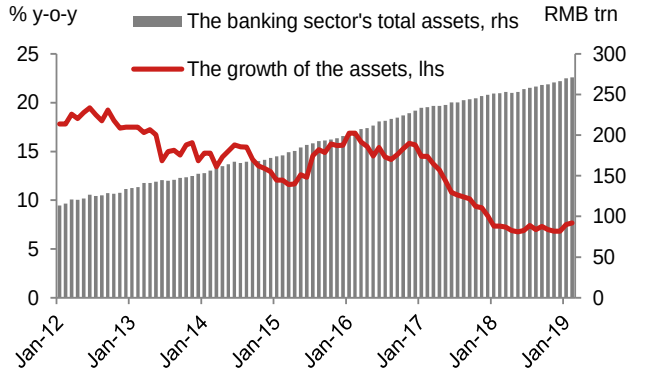
Source: WIND and Nomura Global Economics.

Fig. 36: Formal banking, shadow banking and direct financing in aggregate financing



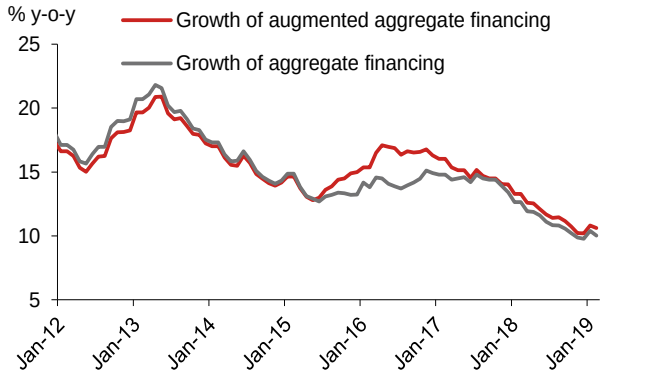
Source: WIND and Nomura Global Economics.

Fig. 37: The banking sector's total assets



Source: CEIC and Nomura Global Economics.

Fig. 38: Growth of outstanding aggregate financing



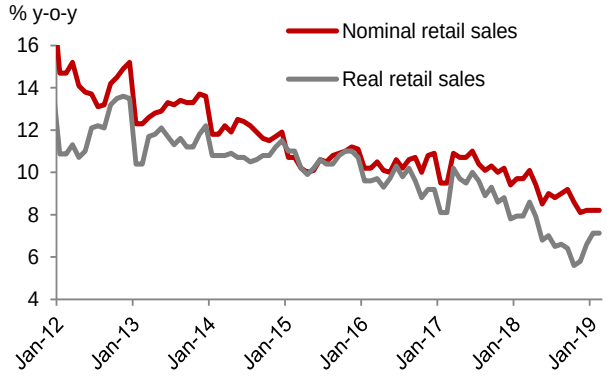
Note: Augmented aggregate financing refers to the sum of outstanding aggregate financing and government bond. Source: WIND and Nomura Global Economics.

Consumption

Retail sales growth remained sluggish at 8.2% y-o-y in January-February, unchanged from December. In real terms, growth rose to 7.1% y-o-y from 6.6%. We remain cautious on the consumption outlook, given the ongoing growth slowdown and already-high household debt burden.

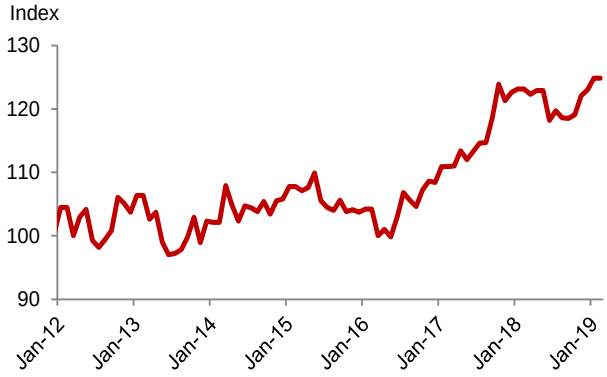
By major product, the decline in auto sales decreased to 2.8% y-o-y in January-February from 8.5% in December; sales growth of oil and oil products moderated to 2.5% y-o-y in January-February from 5.8% in December (2018: 13.3%), despite a recent rise in oil prices; while sales growth of property-related products slowed broadly, mainly dragged by furniture and home-use electronics sales.

Fig. 39: Nominal and real retail sales growth



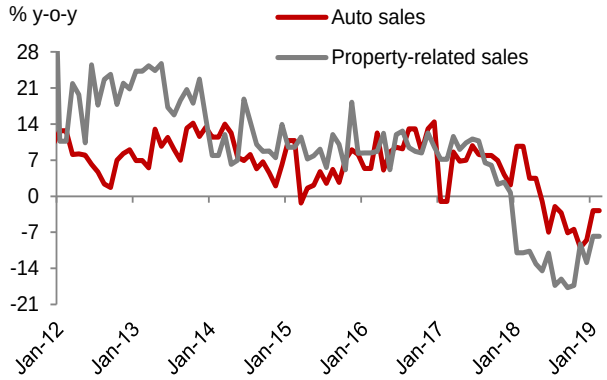
Source: CEIC and Nomura Global Economics.

Fig. 40: Consumer confidence index



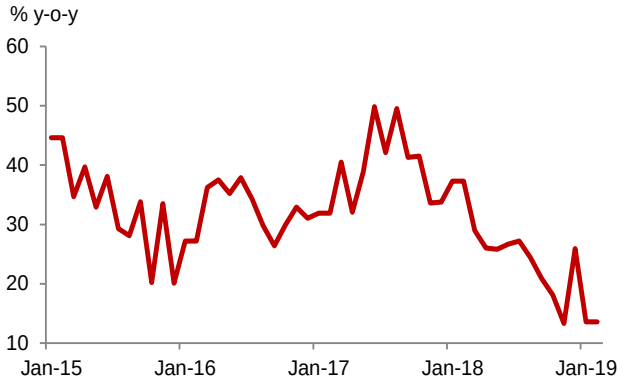
Source: CEIC and Nomura Global Economics.

Fig. 41: Sales growth of auto and property-related goods



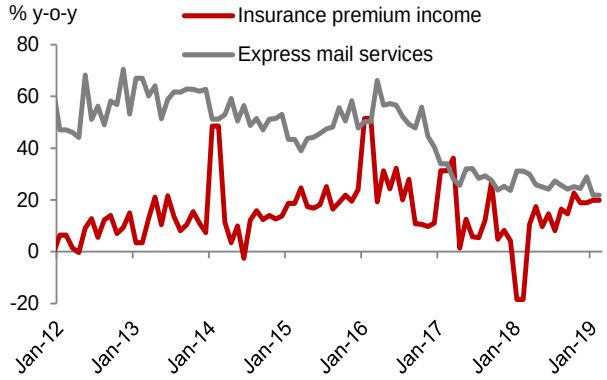
Note: Property-related sales include sales of furniture, construction & decoration materials, and household electric & video appliance. Source: CEIC and Nomura Global Economics.

Fig. 42: Online sales growth



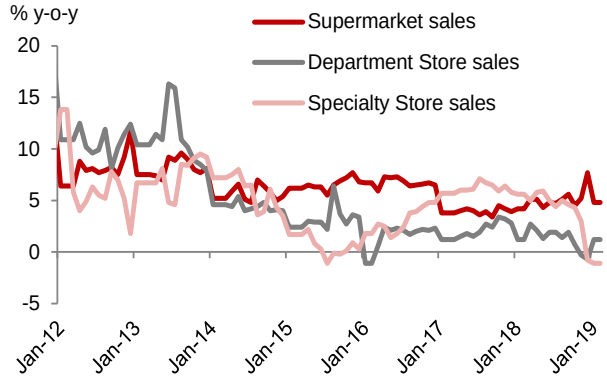
Source: CEIC and Nomura Global Economics.

Fig. 43: Service consumption growth



Source: CEIC and Nomura Global Economics.

Fig. 44: Sales growth by different stores



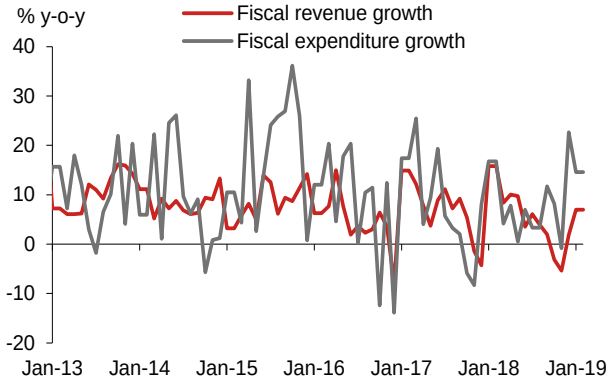
Source: CEIC and Nomura Global Economics.

Fiscal revenue, expenditure and balance

China's fiscal revenue growth rose to 7.0% y-o-y in January-February from 1.9% in December. By components, non-tax revenue growth fell dramatically to 10.8% y-o-y from 43.0%, while that of tax revenue improved to 6.6% y-o-y from -10.7%. The sharp rise was mainly driven by bigger-than-usual deferred tax payments from Q4 2018 to Q1 2019. Fiscal expenditure growth slowed to 14.6% y-o-y in January-February from 22.7% in December, but the 14.6% growth was still quite elevated, suggesting the government has been implementing its proactive fiscal policies.

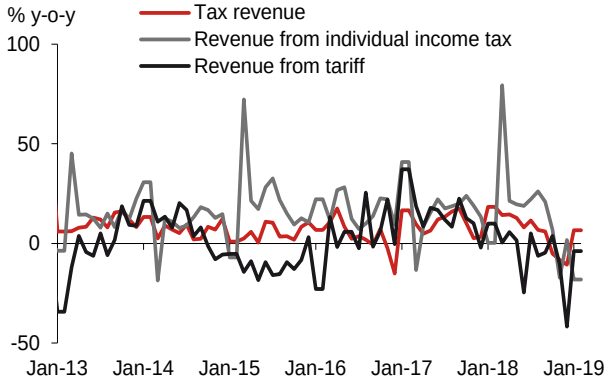
Revenue from government-managed funds fell 2.3% y-o-y in January-February from 9.1% y-o-y growth in December, depressed by falling revenue growth from land sales, which tumbled to -5.3% y-o-y from 10.0%. The issuance of central government bonds (CGBs) slowed in January and February, while LGB issuance surged from RMB64bn in December to RMB418bn in January, and remained elevated at RMB364bn in February.

Fig. 45: Fiscal revenue and expenditure



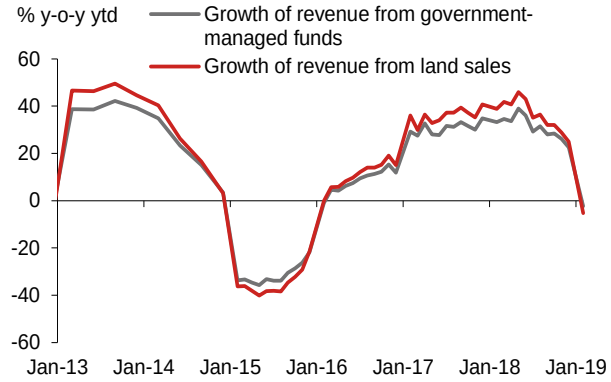
Source: WIND and Nomura Global Economics.

Fig. 46: Breakdown of tax revenue by category



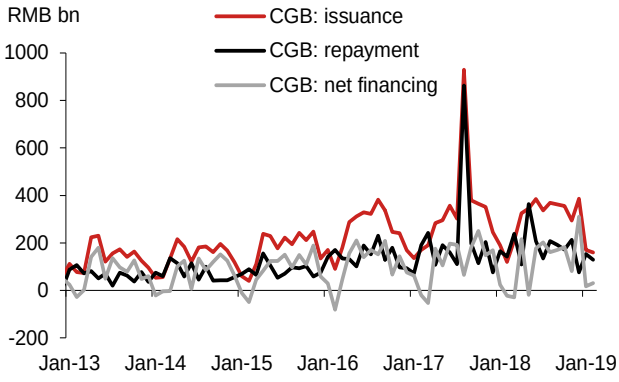
Source: WIND and Nomura Global Economics.

Fig. 47: Revenue from govt-managed funds and land sales



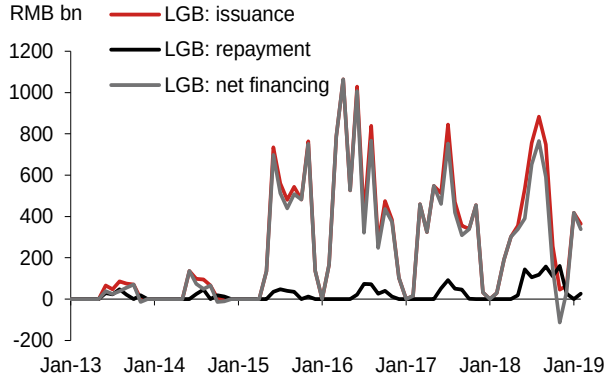
Source: WIND and Nomura Global Economics.

Fig. 48: Issuance, repayment and net financing via CGB



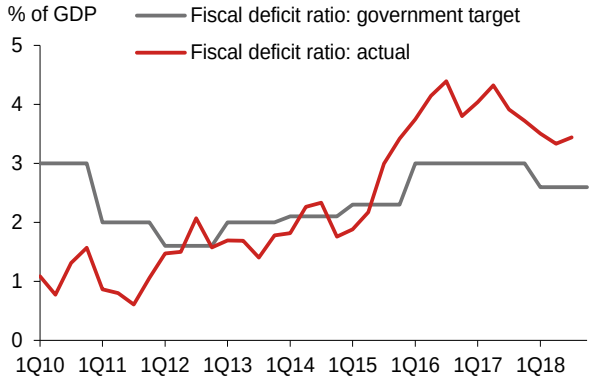
Source: WIND and Nomura Global Economics.

Fig. 49: Issuance, repayment and net financing via LGB



Note: LGB refers to local government bond. Source: WIND and Nomura Global Economics.

Fig. 50: Fiscal deficit ratio: govt target vs actual



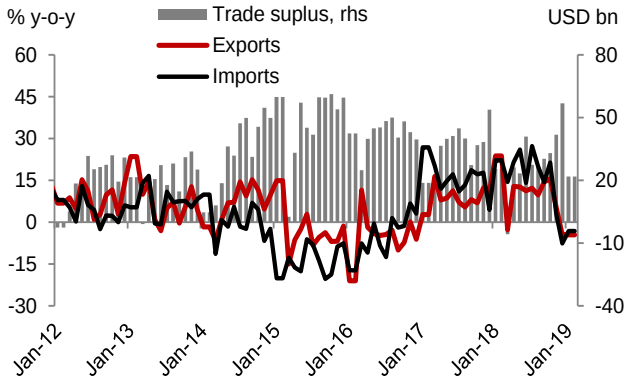
Note: The actual ratio is estimated using the levels of fiscal deficit and nominal GDP, both on a 4Q rolling sum basis. Source: WIND and Nomura Global Economics.

International trade

Export growth in USD terms tumbled to -20.7% y-o-y in February after a rebound of 9.1% in January. With data from January and February combined, export growth was unchanged from December 2018 at -4.6% y-o-y. The contraction of February exports was broad-based across destinations. Growth of exports to the US slumped to -28.6% y-o-y in February from -2.8% in January, caused by the significant payback effects from the previous tariff-led front-loading of US-bound exports and the direct effects from the ongoing 10-25% additional tariffs.

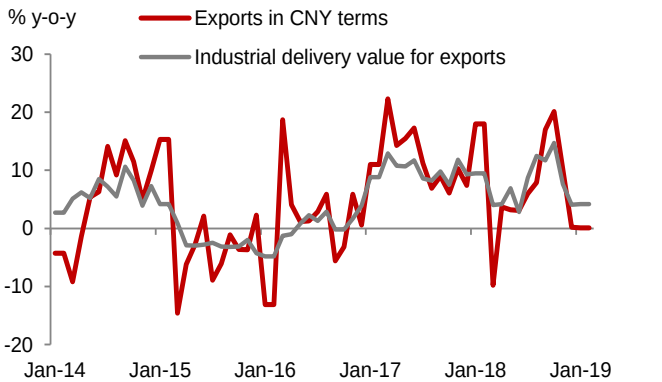
Import growth slowed to -5.2% from -1.5%, and the trade surplus narrowed to USD4.1bn from USD39.2bn, with ordinary and processing imports, not raw materials, driving the import slowdown. With January and February combined, the growth picked up to -3.1% y-o-y.

Fig. 51: Export growth, import growth and trade balance



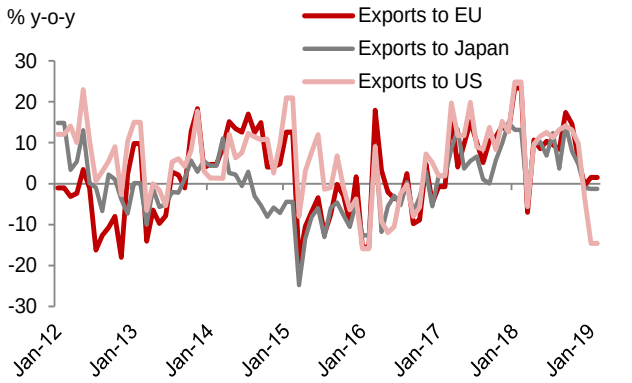
Source: CEIC, WIND and Nomura Global Economics.

Fig. 52: Export growth vs delivered value for exports



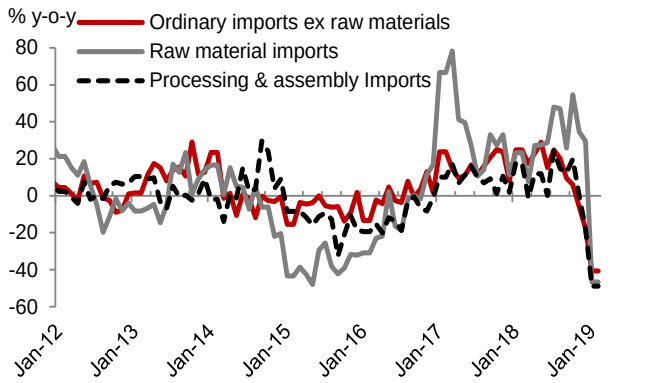
Source: CEIC, WIND and Nomura Global Economics.

Fig. 53: Growth of exports to G3 economies



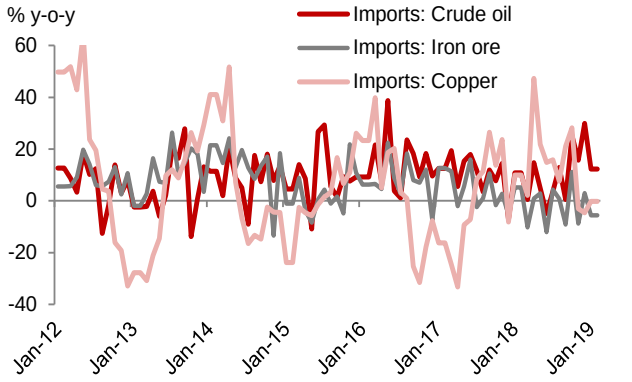
Source: CEIC, WIND and Nomura Global Economics.

Fig. 54: Growth of imports by sector



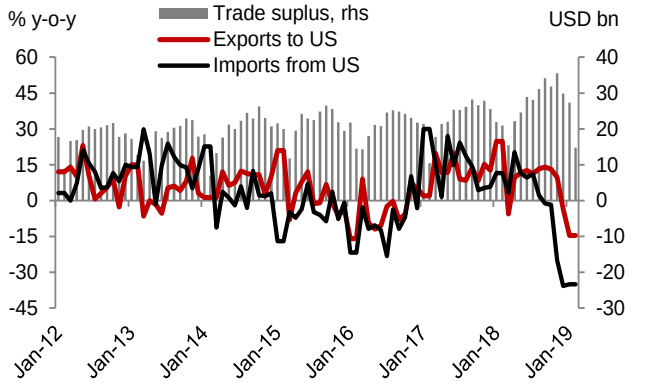
Source: CEIC, WIND and Nomura Global Economics.

Fig. 55: Commodity imports by product in volume terms



Source: CEIC, WIND and Nomura Global Economics.

Fig. 56: Bilateral trade with the US



Source: CEIC, WIND and Nomura Global Economics.

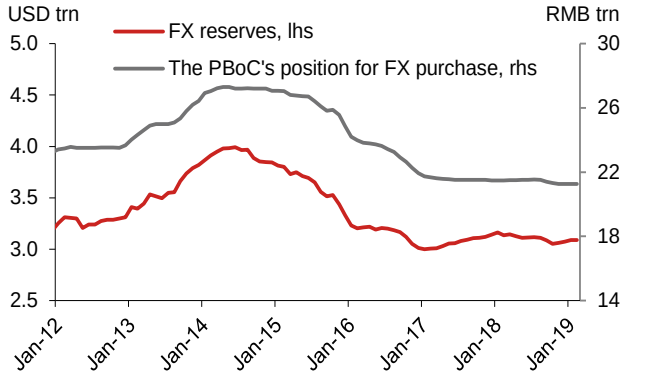
FX reserves and trading

FX reserves rose modestly to USD3.09trn in February. FX settlements and sales by banks both moderated in February, resulting in more FX sales than settlement during the month. The spread between the 10yr China yield and the US Treasury yield widened slightly in March compared with February levels.

The current account balance was in a small surplus of 0.4% of GDP for the whole year of 2018 (2017: 1.3% surplus). This was mainly due to a big surplus in Q4 2018, which reversed the deficit of 1.2% in Q1. The monthly current account surplus moderated to USD23.3bn in January from USD33.1bn in December.

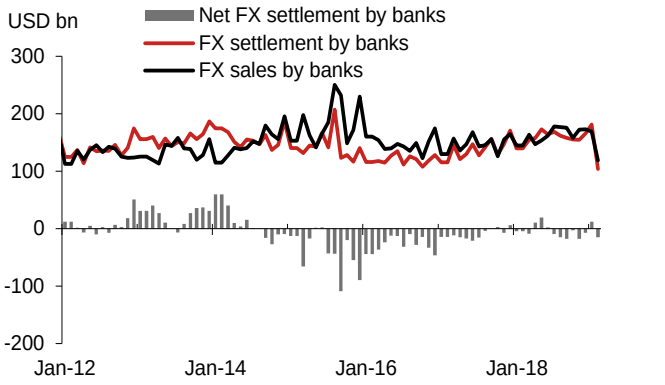
Net foreign investor inflows into China's equity market remained robust in February, and foreign investor inflows into China's local bond market also remained stable, attracted by good market performance.

Fig. 57: FX reserves and the PBoC's position for FX purchase



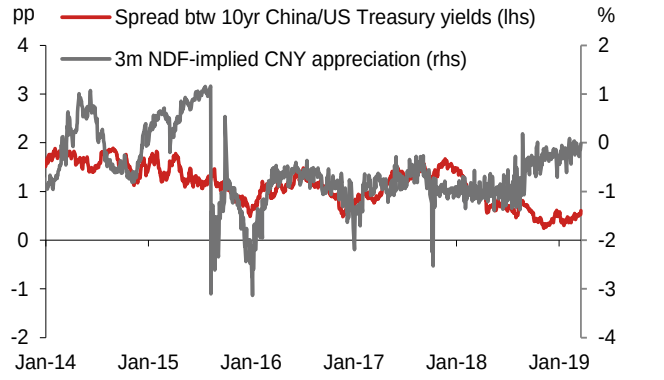
Source: WIND and Nomura Global Economics.

Fig. 58: FX settlement and sales by banks



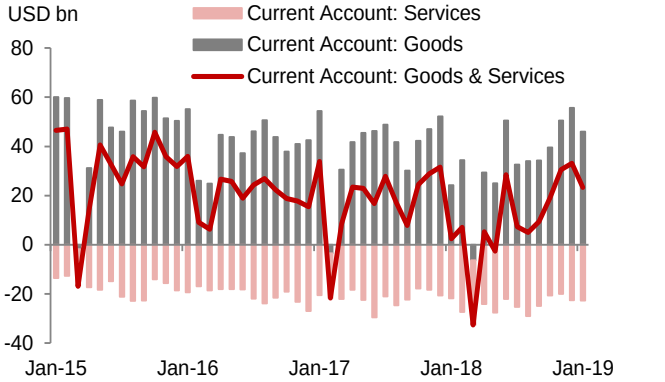
Source: WIND and Nomura Global Economics.

Fig. 59: Indicators for capital outflow pressures



Source: WIND and Nomura Global Economics.

Fig. 60: Monthly current account breakdown

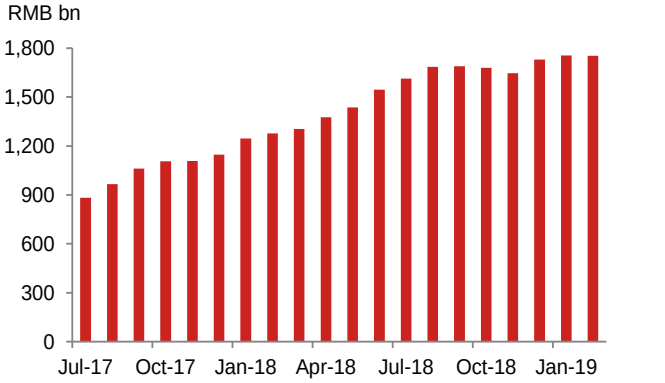


Source: WIND and Nomura Global Economics.

Fig. 61: Stock Connect programme

Source: CEIC and Nomura Global Economics.

Fig. 62: Foreign bond holdings via Bond Connect programme

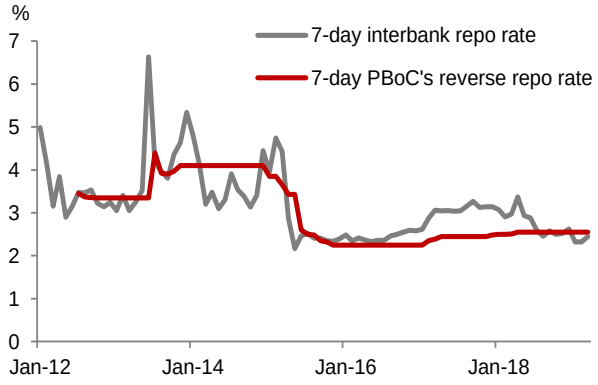


Source: CEIC and Nomura Global Economics.

Financial markets

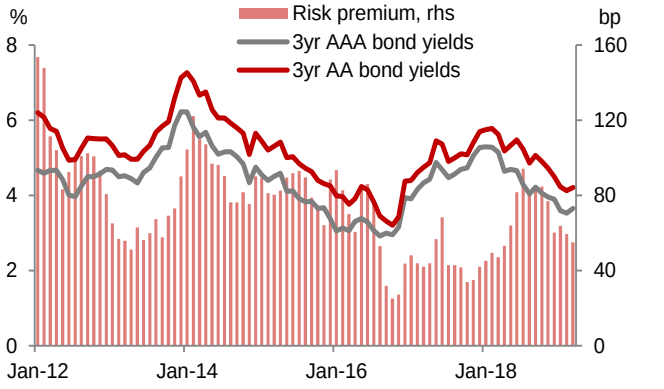
The 7-day PBoC's repo rate remained stable, while the 7-day interbank repo rate rose modestly in March. Corporate bond yields all picked up in March, and the risk premium between AAA-rated and AA-rated bonds narrowed further. The stock market rallied after the LNY holidays, reflected by the higher SHCOMP index and the outstanding value of margin transactions. RMB has continued to appreciate against USD in recent weeks (which is also the case in nominal effective exchange rate terms). Indirect financing (bank loans) remains the main channel for corporate funding, and the share of corporate financing to GDP remained stable in February.

Fig. 63: 7-day repo rate vs OMO rate



Source: Bloomberg, CEIC and Nomura Global Economics.

Fig. 64: 3yr bond yields: AAA vs AA

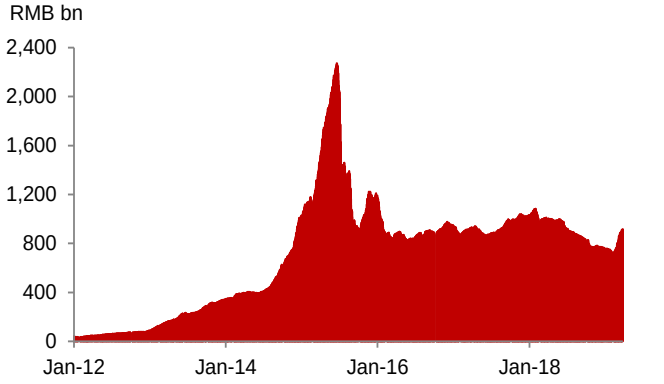


Source: CEIC and Nomura Global Economics.

Fig. 65: SHCOMP index vs stock market turnover

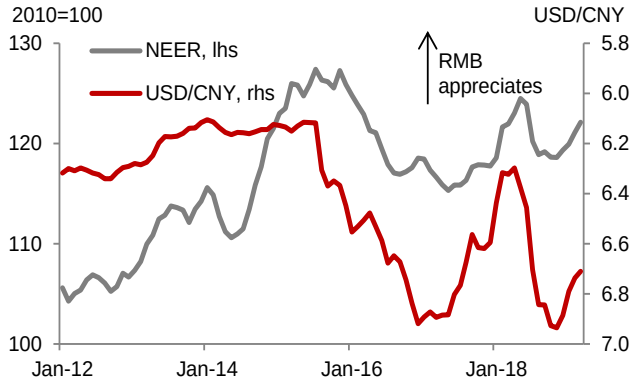
Source: CEIC and Nomura Global Economics.

Fig. 66: Margin transaction (outstanding value)



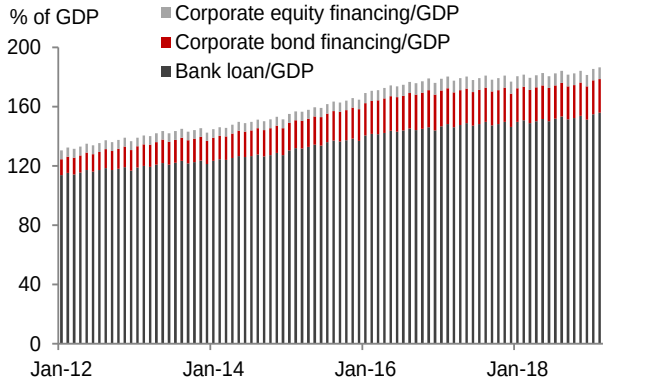
Source: CEIC and Nomura Global Economics.

Fig. 67: USD/CNY vs NEER



Source: CEIC and Nomura Global Economics.

Fig. 68: Direct and indirect financing



Source: CEIC and Nomura Global Economics.

Appendix A-1

Analyst Certification

We, Ting Lu, Jia Yao Wendy Chen, Lisheng Wang and Jing Wang, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

Nomura Group research is available on www.nomuranow.com/research, Bloomberg, Capital IQ, Factset, Reuters and ThomsonOne. Important disclosures may be read at http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx or requested from Nomura Securities International, Inc., or Instinet, LLC on 1-877-865-5752. If you have any difficulties with the website, please email grpsupport@nomura.com for help.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by Investment Banking activities. Unless otherwise noted, the non-US analysts listed at the front of this report are not registered/qualified as research analysts under FINRA rules, may not be associated persons of NSI or ILLC, and may not be subject to FINRA Rule 2241 restrictions on communications with covered companies, public appearances, and trading securities held by a research analyst account.

Nomura Global Financial Products Inc. (“NGFP”) Nomura Derivative Products Inc. (“NDPI”) and Nomura International plc. (“NIplc”) are registered with the Commodities Futures Trading Commission and the National Futures Association (NFA) as swap dealers. NGFP, NDPI, and NIplc are generally engaged in the trading of swaps and other derivative products, any of which may be the subject of this report.

Disclaimers

This publication contains material that has been prepared by the Nomura Group entity identified on page 1 and, if applicable, with the contributions of one or more Nomura Group entities whose employees and their respective affiliations are specified on page 1 or identified elsewhere in the publication. The term "Nomura Group" used herein refers to Nomura Holdings, Inc. and its affiliates and subsidiaries including: Nomura Securities Co., Ltd. ('NSC') Tokyo, Japan; Nomura International plc ('NIplc'), UK; Nomura Securities International, Inc. ('NSI'), New York, US; Instinet, LLC ('ILLC'); Nomura International (Hong Kong) Ltd. (‘NIHK’), Hong Kong; Nomura Financial Investment (Korea) Co., Ltd. (‘NFIK’), Korea (Information on Nomura analysts registered with the Korea Financial Investment Association ('KOFIA') can be found on the KOFIA Intranet at http://dis.kofia.or.kr); Nomura Singapore Ltd. (‘NSL’), Singapore (Registration number 197201440E, regulated by the Monetary Authority of Singapore); Nomura Australia Ltd. (‘NAL’), Australia (ABN 48 003 032 513), regulated by the Australian Securities and Investment Commission ('ASIC') and holder of an Australian financial services licence number 246412; PT Nomura Sekuritas Indonesia (‘PTNSI’); Nomura Securities Malaysia Sdn. Bhd. (‘NSM’), Malaysia; NIHK, Taipei Branch (‘NITB’), Taiwan; Nomura Financial Advisory and Securities (India) Private Limited (‘NFASL’), Mumbai, India (Registered Address: Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai- 400 018, India; Tel: +91 22 4037 4037, Fax: +91 22 4037 4111; CIN No: U74140MH2007PTC169116, SEBI Registration No. for Stock Broking activities : BSE INB011299030, NSE INB231299034, INF231299034, INE 231299034, MCX: INE261299034; SEBI Registration No. for Merchant Banking : INM000011419; SEBI Registration No. for Research: INH000001014 and NIplc, Madrid Branch (‘NIplc, Madrid’). ‘CNS Thailand’ next to an analyst’s name on the front page of a research report indicates that the analyst is employed by Capital Nomura Securities Public Company Limited (‘CNS’) to provide research assistance services to NSL under an agreement between CNS and NSL. ‘NSFSPL’ next to an employee’s name on the front page of a research report indicates that the individual is employed by Nomura Structured Finance Services Private Limited to provide assistance to certain Nomura entities under inter-company agreements. The "BDO-NS" (which stands for "BDO Nomura Securities, Inc.") placed next to an analyst’s name on the front page of a research report indicates that the analyst is employed by BDO Unibank Inc. ("BDO Unibank") who has been seconded to BDO-NS, to provide research assistance services to NSL under an agreement between BDO Unibank, NSL and BDO-NS. BDO-NS is a Philippines securities dealer, which is a joint venture between BDO Unibank and the Nomura Group.

THIS MATERIAL IS: (I) FOR YOUR PRIVATE INFORMATION, AND WE ARE NOT SOLICITING ANY ACTION BASED UPON IT; (II) NOT TO BE CONSTRUED AS AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY ANY SECURITY IN ANY JURISDICTION WHERE SUCH OFFER OR SOLICITATION WOULD BE ILLEGAL; AND (III) OTHER THAN DISCLOSURES RELATING TO THE NOMURA GROUP, BASED UPON INFORMATION FROM SOURCES THAT WE CONSIDER RELIABLE, BUT HAS NOT BEEN INDEPENDENTLY VERIFIED BY NOMURA GROUP.

Other than disclosures relating to the Nomura Group, the Nomura Group does not warrant or represent that the document is accurate, complete, reliable, fit for any particular purpose or merchantable and does not accept liability for any act (or decision not to act) resulting from use of this document and related data. To the maximum extent permissible all warranties and other assurances by the Nomura Group are hereby excluded and the Nomura Group shall have no liability for the use, misuse, or distribution of this information.

Opinions or estimates expressed are current opinions as of the original publication date appearing on this material and the information, including the opinions and estimates contained herein, are subject to change without notice. The Nomura Group is under no duty to update this document. Any comments or statements made herein are those of the author(s) and may differ from views held by other parties within Nomura Group. Clients should consider whether any advice or recommendation in this report is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The Nomura Group does not provide tax advice.

The Nomura Group, and/or its officers, directors and employees, may, to the extent permitted by applicable law and/or regulation, deal as principal, agent, or otherwise, or have long or short positions in, or buy or sell, the securities, commodities or instruments, or options or other derivative instruments based thereon, of issuers or securities mentioned herein. The Nomura Group companies may also act as market maker or liquidity provider (within the meaning of applicable regulations in the UK) in the financial instruments of the issuer. Where the activity of

market maker is carried out in accordance with the definition given to it by specific laws and regulations of the US or other jurisdictions, this will be separately disclosed within the specific issuer disclosures.

This document may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor's. Reproduction and distribution of third-party content in any form is prohibited except with the prior written permission of the related third-party. Third-party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. Third-party content providers give no express or implied warranties, including, but not limited to, any warranties of merchantability or fitness for a particular purpose or use. Third-party content providers shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or profits and opportunity costs) in connection with any use of their content, including ratings. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

Any MSCI sourced information in this document is the exclusive property of MSCI Inc. ('MSCI'). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, re-disseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI and the MSCI indexes are services marks of MSCI and its affiliates.

The intellectual property rights and any other rights, in Russell/Nomura Japan Equity Index belong to Nomura Securities Co., Ltd. ("Nomura") and Frank Russell Company ("Russell"). Nomura and Russell do not guarantee accuracy, completeness, reliability, usefulness, marketability, merchantability or fitness of the Index, and do not account for business activities or services that any index user and/or its affiliates undertakes with the use of the Index.

Investors should consider this document as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision. Nomura Group produces a number of different types of research product including, among others, fundamental analysis and quantitative analysis; recommendations contained in one type of research product may differ from recommendations contained in other types of research product, whether as a result of differing time horizons, methodologies or otherwise. The Nomura Group publishes research product in a number of different ways including the posting of product on the Nomura Group portals and/or distribution directly to clients. Different groups of clients may receive different products and services from the research department depending on their individual requirements.

Figures presented herein may refer to past performance or simulations based on past performance which are not reliable indicators of future performance. Where the information contains an indication of future performance, such forecasts may not be a reliable indicator of future performance. Moreover, simulations are based on models and simplifying assumptions which may oversimplify and not reflect the future distribution of returns. Any figure, strategy or index created and published for illustrative purposes within this document is not intended for "use" as a "benchmark" as defined by the European Benchmark Regulation.

Certain securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment.

With respect to Fixed Income Research: Recommendations fall into two categories: tactical, which typically last up to three months; or strategic, which typically last from 6-12 months. However, trade recommendations may be reviewed at any time as circumstances change. 'Stop loss' levels for trades are also provided; which, if hit, closes the trade recommendation automatically. Prices and yields shown in recommendations are taken at the time of submission for publication and are based on either indicative Bloomberg, Reuters or Nomura prices and yields at that time. The prices and yields shown are not necessarily those at which the trade recommendation can be implemented.

The securities described herein may not have been registered under the US Securities Act of 1933 (the '1933 Act'), and, in such case, may not be offered or sold in the US or to US persons unless they have been registered under the 1933 Act, or except in compliance with an exemption from the registration requirements of the 1933 Act. Unless governing law permits otherwise, any transaction should be executed via a Nomura entity in your home jurisdiction.

This document has been approved for distribution in the UK and European Economic Area as investment research by NIplc. NIplc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. NIplc is a member of the London Stock Exchange. This document does not constitute a personal recommendation within the meaning of applicable regulations in the UK, or take into account the particular investment objectives, financial situations, or needs of individual investors. This document is intended only for investors who are 'eligible counterparties' or 'professional clients' for the purposes of applicable regulations in the UK, and may not, therefore, be redistributed to persons who are 'retail clients' for such purposes. This document has been approved by NIHK, which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. This document has been approved for distribution in Australia by NAL, which is authorized and regulated in Australia by the ASIC. This document has also been approved for distribution in Malaysia by NSM. In Singapore, this document has been distributed by NSL. NSL accepts legal responsibility for the content of this document, where it concerns securities, futures and foreign exchange, issued by their foreign affiliates in respect of recipients who are not accredited, expert or institutional investors as defined by the Securities and Futures Act (Chapter 289). Recipients of this document in Singapore should contact NSL in respect of matters arising from, or in connection with, this document. Unless prohibited by the provisions of Regulation S of the 1933 Act, this material is distributed in the US, by NSI, a US-registered broker-dealer, which accepts responsibility for its contents in accordance with the provisions of Rule 15a-6, under the US Securities Exchange Act of 1934. The entity that prepared this document permits its separately operated affiliates within the Nomura Group to make copies of such documents available to their clients.

This document has not been approved for distribution to persons other than 'Authorised Persons', 'Exempt Persons' or 'Institutions' (as defined by the Capital Markets Authority) in the Kingdom of Saudi Arabia ('Saudi Arabia') or 'professional clients' (as defined by the Dubai Financial Services Authority) in the United Arab Emirates ('UAE') or a 'Market Counterparty' or 'Business Customers' (as defined by the Qatar Financial Centre Regulatory Authority) in the State of Qatar ('Qatar') by Nomura Saudi Arabia, NIplc or any other member of the Nomura Group, as the case may be. Neither this document nor any copy thereof may be taken or transmitted or distributed, directly or indirectly, by any person other than those authorised to do so into Saudi Arabia or in the UAE or in Qatar or to any person other than 'Authorised Persons', 'Exempt Persons' or 'Institutions' located in Saudi Arabia or 'professional clients' in the UAE or a 'Market Counterparty' or 'Business Customers' in Qatar . By accepting to receive this document, you represent that you are not located in Saudi Arabia or that you are an 'Authorised Person', an 'Exempt Person' or an 'Institution' in Saudi Arabia or that you are a 'professional client' in the UAE or a 'Market Counterparty' or 'Business Customers' in Qatar and agree to comply with these restrictions. Any failure to comply with these restrictions may constitute a violation of the laws of the UAE or Saudi Arabia or Qatar.

For Canadian Investors: This research report was approved for distribution to Canadian investors by Instinet Canada Limited ("ICL"), member of the Investment Industry Regulatory Organization of Canada ("IIROC") and member of the Canadian Investor Protection Fund. An affiliate of ICL prepared the research report (an "Affiliate Research Report") in accordance with the regulatory requirements applicable to research in the affiliate's local jurisdiction, which include conflict of interest disclosure. ICL reviewed this Affiliate Research Report for the purpose of ensuring Canadian disclosures required by IIROC are included. ICL does not receive compensation in respect of the distribution of Affiliate Research

Reports. Pursuant to ICL's policies and procedures regarding the dissemination of research, ICL makes available Affiliate Research Reports to ICL clients and prospective clients only, in electronic and/or in printed form. ICL endeavours to make available and/or distribute Affiliate Research Reports to all intended recipients at the same time. This Affiliate Research Report is not a recommendation and does not take into account the investment objectives, financial situation or particular needs of any particular account.
For report with reference of TAIWAN public companies or authored by Taiwan based research analyst:
THIS DOCUMENT IS SOLELY FOR REFERENCE ONLY. You should independently evaluate the investment risks and are solely responsible for your investment decisions. NO PORTION OF THE REPORT MAY BE REPRODUCED OR QUOTED BY THE PRESS OR ANY OTHER PERSON WITHOUT WRITTEN AUTHORIZATION FROM NOMURA GROUP. Pursuant to Operational Regulations Governing Securities Firms Recommending Trades in Securities to Customers and/or other applicable laws or regulations in Taiwan, you are prohibited to provide the reports to others (including but not limited to related parties, affiliated companies and any other third parties) or engage in any activities in connection with the reports which may involve conflicts of interests. INFORMATION ON SECURITIES / INSTRUMENTS NOT EXECUTABLE BY NOMURA INTERNATIONAL (HONG KONG) LTD., TAIPEI BRANCH IS FOR INFORMATIONAL PURPOSES ONLY AND IS NOT BE CONSTRUED AS A RECOMMENDATION OR A SOLICITATION TO TRADE IN SUCH SECURITIES / INSTRUMENTS.
NO PART OF THIS MATERIAL MAY BE (I) COPIED, PHOTOCOPIED, OR DUPLICATED IN ANY FORM, BY ANY MEANS; OR (II) REDISTRIBUTED WITHOUT THE PRIOR WRITTEN CONSENT OF A MEMBER OF THE NOMURA GROUP. If this document has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this document, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Nomura Securities Co., Ltd.

Financial instruments firm registered with the Kanto Local Finance Bureau (registration No. 142)
Member associations: Japan Securities Dealers Association; Japan Investment Advisers Association; The Financial Futures Association of Japan; and Type II Financial Instruments Firms Association.

The Nomura Group manages conflicts with respect to the production of research through its compliance policies and procedures (including, but not limited to, Conflicts of Interest, Chinese Wall and Confidentiality policies) as well as through the maintenance of Chinese Walls and employee training.
Additional information regarding the methodologies or models used in the production of any investment recommendations contained within this document is available upon request by contacting the Research Analysts listed on the front page. Disclosures information is available upon request and disclosure information is available at the Nomura Disclosure web page:
http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx