China trade (Feb)

European crisis bites

Both exports and imports slowed at a faster pace than expected. The 6.9% growth rate of exports during Jan-Feb was half of the rate recorded in Dec and one third of that averaged for 2011. In particular, the ongoing sovereign debt and economic crisis in Europe - China's largest exports destination- is starting to bite. Meanwhile, slowing imports, plus Feb's weaker than expected IP and retail sales growth underscores the continuous slowdown in domestic demand. Today's trade numbers reinforce the need for easing efforts to be stepped up in coming months. We still expect at least another 100bp RRR cuts in 1H 2012.

Facts

At 18.4%, February's exports growth came in lower than our below consensus expectation (Bloomberg: 31%, HSBC 19%). It also spelt an end to the temporary contraction (0.5% y-o-y) of exports growth in January due to the Chinese New Year. However, combining January and February's exports together (to eliminate the distortion of Chinese New Year), exports only expanded by 6.9% y-o-y, less than half the pace of 14.3% y-o-y recorded in 4Q 2011 and one third of that averaged for the whole year 2011 (20.3%). Seasonally adjusted, exports plunged by 27.4% m-o-m following a 3.3% m-o-m contraction in January.

By destination, the exports growth slowdown was broad-based with the biggest drag coming from Europe (China's largest exports desination) and its still unfolding sovereign debt crisis. Exports to the EU contracted by 1.1% y-o-y in Jan-Feb, compared to 6.5% y-o-y in 4Q 2011. Despite a relatively milder slowdown of exports to Japan and the US (14.9% y-o-y and 12% y-o-y in Jan-Feb, respectively, vs. 17.4% y-o-y and 14.3% y-o-y in 4Q), exports to the G3 markets decelerated noticeably to a pace of 6.7% y-o-y in Jan-Feb, from 11.5% y-o-y in 4Q 2011. Meanwhile, exports to non-G3 markets decelerated sharply to 6.9% y-o-y in Jan-Feb, from 16.5% y-o-y in 4Q 2011.

By product, exports of electronic and machinery, which accounted for 59.2% of total exports for the first two months, outperformed the overall exports growth by 8.8% y-o-y growth in Jan-Feb(vs. compared with 11.5% y-o-y in 4Q). In contrast, exports of major labor-intensive products contracted for the Jan-Feb period: textiles exports contracted by 2.6% y-o-y vs. 14.7% y-o-y in 4Q 2011; clothing exports dropped by 2.5% y-o-y vs. 5.6% y-o-y in 4Q 2011; shoe exports contracted by 2.1% y-o-y vs. 10% y-o-y in 4Q 2011.

China's imports picked up to a growth rate of 39.6% y-o-y in February from a 15.3% y-o-y contraction in January, slightly higher than our above consensus expectation (Bloomberg:31.8%, HSBC: 38.5%). In seasonally adjusted terms, import growth rose marginally by 0.3% m-o-m following 2.9% m-o-m contraction in January. That said, imports growth for the Jan-Feb period only expanded by 7.7% y-o-y, sharply slower than the 20.6% y-o-y averaged in 4Q 2011.

By custom regimes, ordinary trade imports rose by 10.3% y-o-y in Jan-Feb (vs. 25.4% y-o-y in 4Q 2011), while processing imports growth decelerated to a growth rate of 2.4% y-o-y in Jan-Feb from 8.6% y-o-y in 4Q.

Imports of most major commodities were mixed in volume terms. Agricultural products and automobile imports were strong. Imports of unwrought copper and unwrought aluminum surged by 49.8% y-o-y and 39.3% y-o-y in Jan-Feb, respectively (vs. 38.7% y-o-y and 5.5% y-o-y in 4Q). Imports of crude oil picked up slightly to 12.7% y-o-y in Jan-Feb compared to 12.5% y-o-

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y in 4Q. Imports of iron ore slowed to 5.7% y-o-y in Jan-Feb, compared to 10.6% y-o-y in 4Q and 10.3% y-o-y in December. Steel products imports dropped by 13% y-o-y in Jan-Feb, compared with a 7.9% y-o-y contraction in 4Q.

As a result, China's trade balance turned to a large deficit of USD31.5bn in February, compared to consensus expectation for a USD5.4bn deficit and January's surplus of USD27.3bn. Taking January and February together, China recorded a trade deficit of USD4.2bn, or nearly five times the trade deficit of USD0.85bn recorded in Jan-Feb last year.

Implications

Despite the rebound after the Chinese New Year, both exports and imports are slowing at a pace faster than expected to a single-digit growth rate in Jan-Feb. Exports were hit hard by the ongoing European debt and economic crisis, despite being counterbalanced by better than expected growth in the US. The weak growth of ordinary trade imports mirrors the further slowdown of ordinary exports.

The exports outlook remains gloomy, considering: a) mild recessions in European economies, b) weak final demand and economic growth in the US economy, c) the slight spillover of the European crisis to economies in the developed and developing world, and d) the looming risk of high oil prices to demand in particular within developed markets.

Strong external headwinds only add more downside risks to growth, whilst domestic demand too continues to slow as indicated by cooling imports growth, and weaker than expected growth in industrial production (IP) and retail sales. Easing import growth for steel and iron ore reflects the continued slowdown in investment. However, a sharp deceleration is unlikely given the revival of restocking of crude oil and metals in response to higher commodity prices.

Net exports will likely become a drag on GDP growth in 1Q, with a weaker than expected exports growth resulting in the largest monthly trade deficit (February) in the past two decades. But for the renminbi, volatility in China's monthly trade balance will unlikely have any meaningful impact in the short term. The renminbi exchange rate will likely continue to appreciate slowly but with increasingly higher volatility.

Bottom line: Today's trade data confirms the weakness in both China's external and domestic fronts. This reinforces the need for further easing measures, especially with inflation falling faster than expected. We expect at least another 100bp worth of RRR cuts in the coming months.

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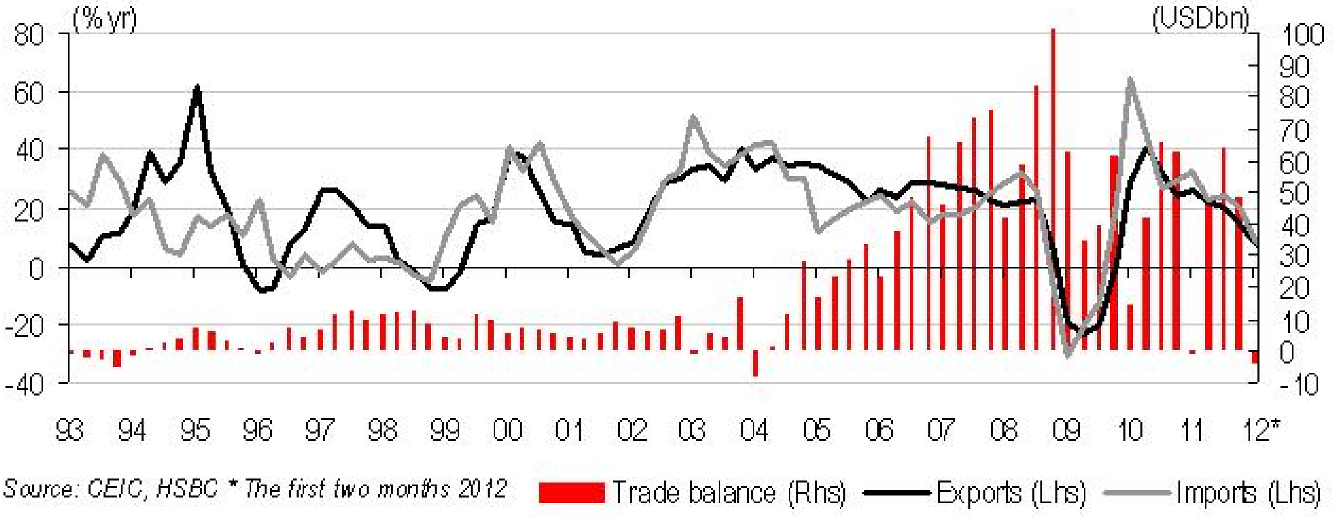
Chart1. Both exports and imports slowed fast to single-digit growth



Source: CEIC, HSBC * The first two months 2012

Disclosure appendix

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