Economic Analysis

China's "recessionary trade surplus" continues in May

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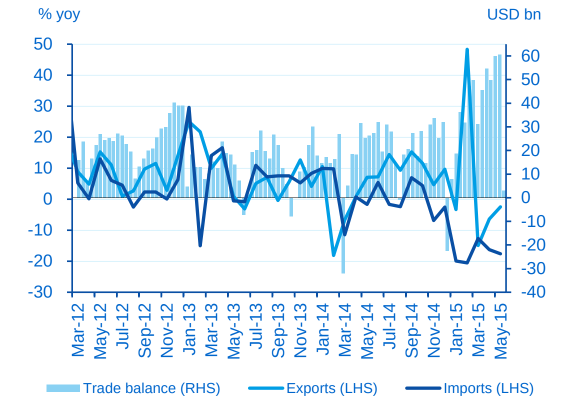
China's trade data announced today indicate that the recessionary trade surplus, a widening trade surplus resulting from a mix of weak exports and even weaker imports, continue through May. In particular, exports registered a year-on-year decline of -2.5% y/y, narrowed from the April outturn of -6.4% y/y and stronger than market consensus of -4.4% y/y. In the meantime, imports slide further by -17.6% y/y from -16.2% y/y in April (consensus: -10% y/y). As a result, trade surplus widened to RMB 366.8 bn (USD 59.49 bn) in May compared to RMB 245.15 bn (USD 44.8 bn) in the previous month (Figure 1). The recessionary trade surplus is due in large part to the weak domestic demand, which has not shown any significant improvement despite the authorities' stepped-up easing efforts. We therefore project that more easing measures are to be implemented in the coming months to spur growth.

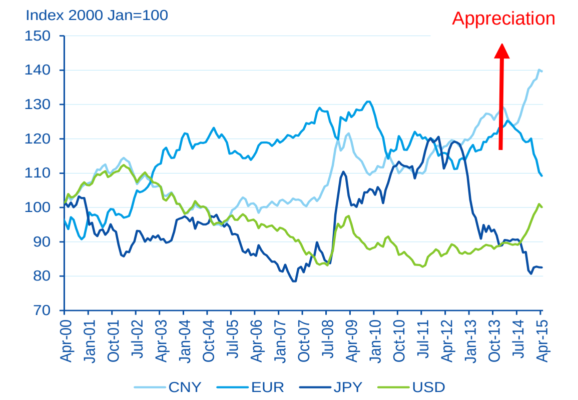
- **Exports were dragged by the processing trade and the currency factor**. Several sub-terms of processing trade exports decreased significantly to -8.7% y/y in May. As the shrinking population of migrant workers has continuously been pushing up labor costs, China's processing trade, which still accounts for around one-third of the total trade, has lost its competitiveness and market share to other emerging countries. The Chinese RMB's strength against other major currencies (except for the USD) also contributed to the decline in shipments. For example, the RMB has appreciated against the Euro and JPY by 7.3% and 3.9% respectively since the beginning of 2015. Consequently, China's exports to Europe and Japan have been weak through the past months.
- **The anemic imports were caused by both falling commodity prices and weak domestic demand.** Almost all commodity imports registered significant declines in value although in terms of volume, crude oil, liquefied petroleum gas and copper ore have registered year-on-year growth in May. Imports of consumer goods (excluding automobile) still held up, consistent with stable domestic consumption. However, imports of capital goods, such as LCD panels and machine tools, significantly dropped in terms of both value and volume, as domestically investment demand remained subdued.
- **Weak domestic demand calls for more easing measures in the coming months.** In the face of continuously sluggish domestic demand, the authorities are well equipped with a wide range of instruments at disposal to spur growth. We envisage that the PBoC will implement additional interest rate cuts of a total 50 bps in the third quarter, which are likely to be accompanied by two RRR cuts of cumulative 100-bps. The PBoC has already employed certain QE-like measures to inject liquidity into the banking system and facilitate the debt-restructuring of local governments. They are anticipated to continue similar operation and even increase the scale of the program. On the fiscal front, the authorities could apply regulatory forbearance to local government financing vehicles (LGFVs), which were prohibited from borrowing via capital market, so as to avoid too sharp fiscal tightening at the local government level. As we reiterated in our relevant notes, the existing fiscal deficit budget (2.3% of GDP) doesn't suffice to offset the impacts of local governments' fiscal consolidation. Apparently, applying regulatory forbearance to local governments could carry risks. It could delay the process of debt restructuring at local governments and dampen the authorities' efforts to impose fiscal discipline on them.

Figure 1
Exports picked up modestly while imports are below market expectation in May



Source: CEIC and BBVA Research

Figure 2
May exports were dragged down by currency effects



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