Economic Analysis

China | Sluggish exports narrowed trade surplus in February while the run-down of foreign reserves slowed

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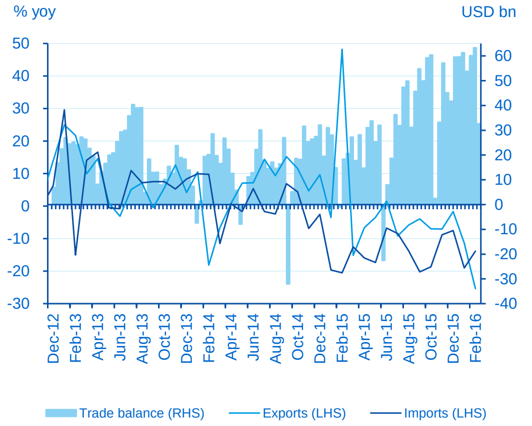
The authorities recently reported trade data and foreign reverses of February, pointing to a mixed picture of the country's external balance. On the positive side, the pace of foreign reserve decline has significantly slowed in February. In particular, a decline of USD 28.6 billion posted in February is way below the January reading of USD 99.4 billion and market expectations (consensus: USD 40.9 billion). We believe that the lower-than-expected outturn was due to more favourable valuation effects (other major currencies slightly appreciated against the USD in February), the seasonality of Chinese New Year holiday as well as investors' stabilized expectations of the RMB value after the central bank's rounds of communications. On the other hand, exports dipped sharply in February, leading to a narrowing trade balance. It suggests that the woes in China's external sector persist amidst escalating uncertainty in global demand.

All in all, it is too early to conclude whether the trend of narrowing trade surplus has become entrenched. The trade surplus could help mitigate the run-down of foreign reserves caused by capital outflows. We maintain that the RMB will continue its gradual depreciation trend through this year to around 6.95 CNY/USD by December.

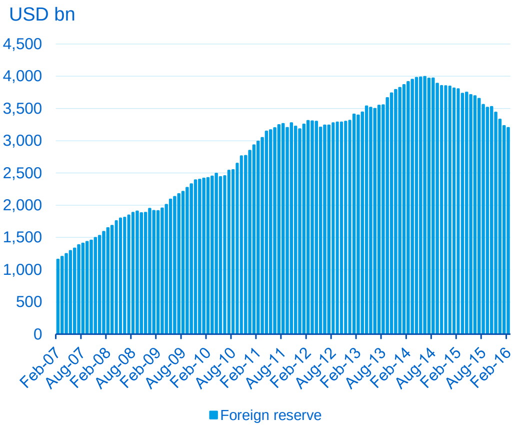
- **Both exports and imports are below the market expectations, narrowing trade balance.** In particular, exports fell by -25.4% y/y in February, significantly below the last month's outcome of -11.2% y/y and the market expectations (consensus: -14.5% y/y). Weaker-than-expected exports can be attributed mainly to weak external demand, stemming from a dampening global financial market uncertainties and its adverse spill-over effect on the real economy. In the meantime, the declining pace of imports continued, coming in at 13.8% y/y from -18.8% y/y in the previous month, which is also below the market consensus -12% y/y. This could suggest that sluggish domestic demand has not shown any signal of recovery during the de-leveraging and de-capacity process. Due to the significant dip of exports, trade surplus narrowed to USD 32.59 billion in February, the lowest in the past 10 months.
- **Foreign reserve decline is smaller than the market expectation.** Foreign reserves declined to USD 3202.3 billion, a moderate decline of USD 28.6 billion from the previous month (consensus: USD 3190 billion). Compared with the January's large decline of USD 99.4 billion, the foreign reserve decline this month actually narrowed. Several reasons could explain: (i) USD Index depreciated by 1.4% in February, amplifying the value of non-USD currencies in the foreign reserve, corresponding to around USD 18 billion of positive valuation effect. (ii) The Chinese New Year holiday lasted 7 days in mainland China, shortening the FX trading days and banks' office hours of FX business, which to a certain extent relieve the capital outflow pressure. (iii) More effective communication between the central bank and the market stabilized the market expectation of RMB, in which the PBoC announced that the RMB fixing price formation mechanism will be based on "the previous day's closing price and a currency basket". Moreover, the recent NPC and CPPC meetings in Beijing also helped to stabilize the market expectations of RMB.

Figure 1
Trade surplus shrunk significantly in February, due to the largely dip of exports



Source: CEIC and BBVA Research

Figure 2
Foreign reserve decline was lower than market expectations, but pressure is still ahead



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