ECONOMICS: ASIAN PERSPECTIVES

AS CHINA STOPS BUYING, WORLD SUFFERS

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China's weak import data reflect slackening domestic demand. But talk of recession is overdone, given that much of the decline in imports is attributable to lower prices. Moreover, it is also a result of Chinese industry's shift toward domestic suppliers, as the nation's manufacturers reduce their reliance on imported material.

The recent sharp decline in Chinese imports is widely blamed for the continued weakness in global oil and commodity markets. Some investors say it proves that China is already in recession, while others argue that the momentum has actually improved recently. We think that, to grasp the big picture, it's important to strip out the effect of a big decline in import prices and assess the trend in volume terms.

In our view, China's import demand is undoubtedly slackening. Its drop has tracked a similar slide in domestic demand. But the weakness is not as severe as the headline numbers in nominal terms suggest. And it is also partly due to a growing trend toward "in-sourcing" among the nation's manufacturers—i.e., their reduced reliance on purchases from overseas suppliers.

As an aside, oil imports have bucked the trend, rising probably owing to purchases for strategic reserves. China appears to be taking advantage of lower oil prices.

The bottom line is that China's imports are not collapsing. They remain sluggish and match the slowdown in industrial output and a sharp inventory correction in many local industries. But, as we have argued before, growth in services should prevent the overall economy from lapsing into recession ("Changing Nature of China as a Global Growth Driver," *Asian Perspectives,* October 16, 2015).

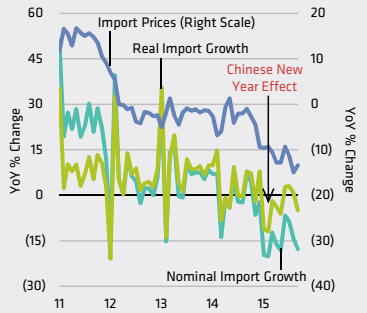
Be that as it may, foreign industries and countries that have relied too much on exports to China in recent years may continue to have a tough time, perhaps for a protracted period, as China's economic rebalancing trudges on.

Not So Frightening, Adjusted for Prices

China's overall import prices have been declining on a year-on-year basis since 2015, falling by around 13%–15% in the past few months. Taking that into account, imports have held up relatively well in volume terms, even though they still contracted by around 5% year on year in September (*Display 1*).

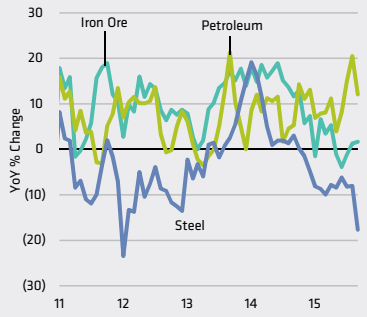
If we take out the distortion caused by the timing of the Lunar New Year holidays in the first quarter, it's fair to say that import volume growth has basically hovered at around 0% throughout this year. We do not see a significant recovery anytime soon, but neither do we see the sort of collapse that many in the market today seem to be expecting.

Display 1
Price Fall Exacebrates Import Drop



As of September 2015
Source: CEIC Data and AB

Display 2
Oil Bucks Trend



As of September 2015
Source: CEIC Data and AB

Strategic Oil Purchases Resume

A product-by-product breakdown of imports in volume terms reveals a trend that is similar to the slowdown in industrial output and a correction in inventory. Essentially, demand in all major heavy industry-related areas has slackened, as has demand in machinery and equipment.

A recent pickup in copper and aluminum imports is hard to explain, but we blame it on the high volatility associated with these items' typically short and sharp domestic inventory cycles.

An outlier is crude oil imports, with volume growth picking up to a double-digit pace over the past quarter (*Display 2, previous page*). This has come hand in hand with the recent relapse in global crude oil prices, which strongly hints that China has resumed purchases to build up its strategic reserves at lower prices. Revived car sales in September and October may also have contributed to oil demand recently.

Less Reliance on Imports

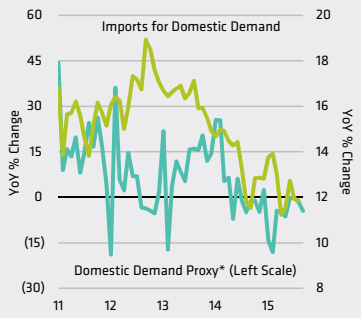
China has also published two very useful series in its import data: imports linked to domestic demand and imports related to further processing and assembling. The former provides a good gauge on final domestic demand, and the latter for export prospects.

In volume terms, imports for domestic demand have dovetailed with our estimated domestic demand proxy. Both indicate a sluggish trend, with growth hovering at around 0% (*Display 3*). Imports by the export sectors have eased off from last year's elevated levels (*Display 4*).

In the background, there is a steady structural change—reduced reliance among Chinese manufacturing exporters on processing imported materials (*Display 5*). The growing in-sourcing (as opposed to outsourcing) of the production supply chain seems to be taking root. This longer-term trend adds to the cyclical pressure on foreign suppliers' sales in China. ■

Display 3
Local Demand Weakens

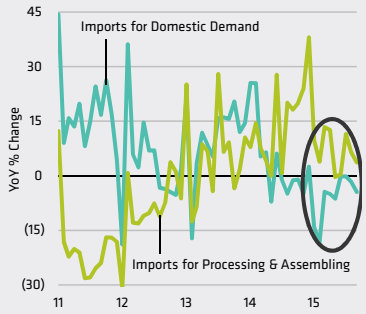
China's Domestic Demand Trends



As of September 2015
*Weighted average of real growth in industrial production, fixed-asset investment and retail sales
Source: CEIC Data and AB

Display 4
Imports by both Domestic and Export Sectors Have Slackened

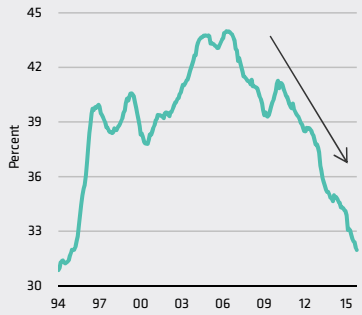
China's Imports by Type (Volume Terms)



As of September 2015
Source: CEIC Data and AB

Display 5
"In-Sourcing" Grows in Manaufac-turng Exports

Exports of Goods Made from Imported Materials
(% of Total Exports)
Imported Materials
(% of Total Exports)



As of October 2015
Source: CEIC Data and AB