China Flash

March exports fall short of expectations, but the outlook is expected to improve as headwinds fade away.

China's exports unexpectedly fell by -6.6% y/y (BBVA: 3.9%; Consensus: 4.9%) in March, after a -18.1% y/y decline (which is distorted by the seasonal factor of Chinese New Year holidays) in the previous month. Meanwhile, imports unexpectedly declined by -11.3% y/y compared to a 10.4% y/y increase in February, suggesting a sluggish domestic demand. As a consequence, trade balance turned to a slightly surplus of USD 7.7 billion from the deficit of -22.8 USD billion in the previous month. For the first quarter of the year, exports declined by 3.4% y/y in USD terms while imports modestly grew by 1.6% y/y, resulting in a trade surplus of USD16.7 billion.

The disappointing outturns of exports are due to a number of headwinds: first of all, the over-invoicing exports during January-April 2013 tended to drag down exports growth rates of this year; second, the ongoing recovery in major advanced economies hasn't translated into strong external demands yet; and lastly the rapid appreciation of the RMB through January, albeit reversed of late, has weakened the competitiveness of China's exporting goods, especially for labor-intensive products. Looking ahead, we expected exports growth to improve steadily as the demand from advanced economies gradually pick up and the adverse base effect of last year's misreported exports fades away. Exporters can also benefit from the RMB's rapid depreciation of late before the currency resumes its appreciation again in the second half of the year.

- **How did over-invoicing exports affect March outturns?** In general, over-invoicing exports are used to disguise capital inflows which are attracted by higher domestic interest rates and the RMB appreciation. To address the issue, the authorities in May 2013 introduced stricter regulation to clamp down misreported exports. Looking into the breakdown of March exports by geography, exports to Hong Kong, the main destination of over-invoicing exports last year, slumped -43.6% y/y in March after a -24.3% y/y drop in February. In contrast, exports to the rest of the world slightly improved (6.8% y/y in March versus -16.7% y/y in February). It proved that the authorities' regulations have been effective although it also weighed on exports growth rates through the first three months of this year. Looking ahead, the impact of over-invoicing is expected to gradually fade away after April.
- **Weakening growth momentum may prompt the authorities to implement more easing policies.** Growth momentum has been trending down after peaking in Q3 2013, as indicated by recent activities indicators. The weakening can be attributed to the government's efforts to curtail shadow bank lending as well as the newly unveiled measures to tackle the environmental and the over-capacity issues. In view of the weakening momentum, the authorities have already fined-tune their policy stance to sustain growth above their 7% target floor. We expect them to further loosen policies in the coming months, including cuts in reserve required ratio (RRR), more fiscal supports for infrastructure projects and the relaxation of in-place tightening measures on the property market.

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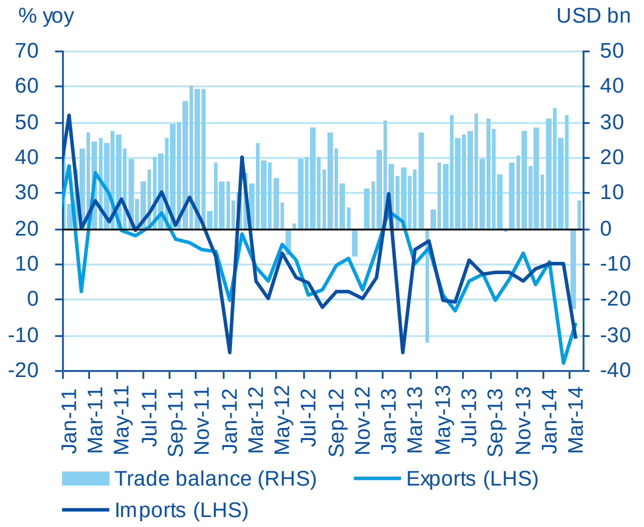
Chart 1

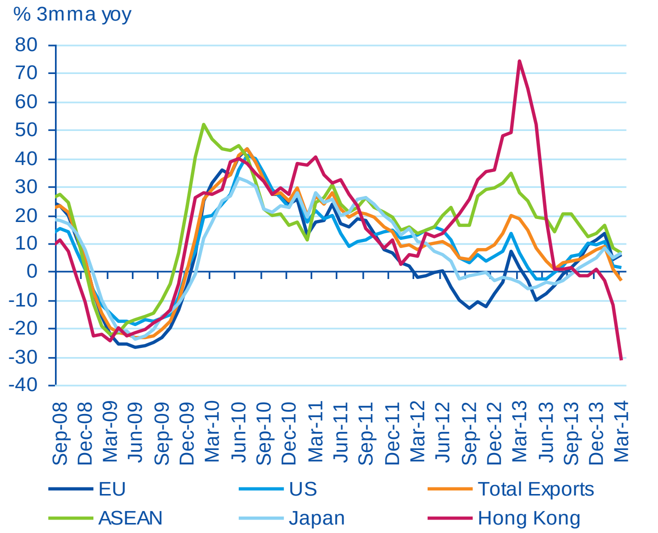
Exports unexpectedly dropped in March…



Source: CEIC and BBVA Research

Chart 2

…led by a big slump in exports to Hong Kong



Source: CEIC and BBVA Research

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