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# Mizuho Economic Outlook & Analysis

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September 27, 2019

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## *Slowing exports dampening China's manufacturing investment*

*Impact of US-China trade tensions on  
capital spending by listed firms*

### < Summary >

- ◆ As downward pressure on exports grew due to the global manufacturing slump and re-intensification of US-China trade tensions, growth of investment in China's manufacturing industries slowed down after peaking out in September 2018 and has continued to lack strength since the turn of the year.
- ◆ Looking at investment by listed companies, those with high dependence on exports saw growth of their investment weaken through the first half of 2019, indicating that sluggish exports are putting a damper on manufacturing investment.
- ◆ If the fourth round of US retaliatory tariffs against China is imposed in its entirety as scheduled, downward pressure on manufacturing investment, particularly among export-oriented companies, is highly likely to remain unchecked. Manufacturing investment is expected to keep slowing for the time being and remain subdued in 2020.

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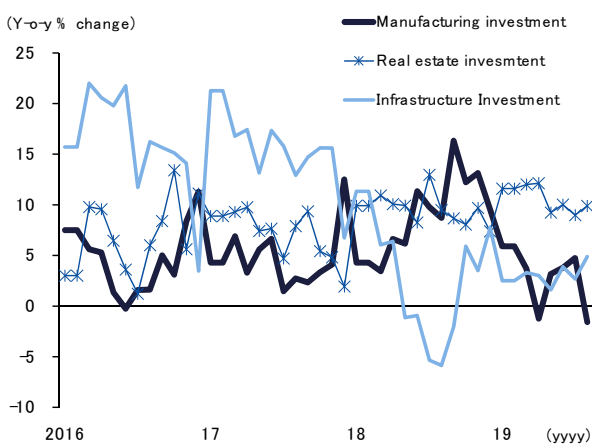
## 1. China's manufacturing investment increasingly decelerating

Growth of investment in fixed assets in August 2019 slowed to +4.2% y-o-y (July: +5.1% y-o-y) for the second consecutive slowdown. While investment in infrastructure and real estate turned upward, albeit only moderately, investment in manufacturing decreased -1.6% y-o-year, pulling down the overall fixed assets investment growth (**Chart 1**). A broad range of manufacturing industries saw y-o-y declines in investment, including mining and processing of non-ferrous metals, manufacture of general purpose machinery, and manufacturer of electrical machinery and apparatus.

It is possible that the global manufacturing slump and re-intensification of US-China trade tensions are putting a damper on China's manufacturing industries. Growth of manufacturing investment slowed after peaking out in September 2018. After falling -1.2% y-o-y in April 2019 for the first y-o-y drop in about three years, manufacturing investment recovered temporarily in May-July but turned down again in August, continuing its lackluster performance. The purchasing managers' index (PMI) for China's manufacturing sector, as announced by the National Bureau of Statistics (NBS), came to 49.5 in August, staying below the expansion-contraction dividing line of 50 for four months on end (**Chart 2**). While the PMI component index for new orders (domestic demand plus exports) remained at around 50, the index for new export orders stood at 47.2, remaining substantially below 50 for the 14th consecutive month.

If the adverse effects of US-China trade tensions spread not only to exports but also investment broadly, it could cause the Chinese economy to slow down further. In the Chinese economy, it is already difficult to expect consumption growth to turn upward amid the slowing growth of income, rising unemployment rate and larger household debt. In addition, the Chinese government's continued efforts to rein in the housing market are making it hard to anticipate a strong recovery of real estate investment. In this paper, we conduct an analysis of differences

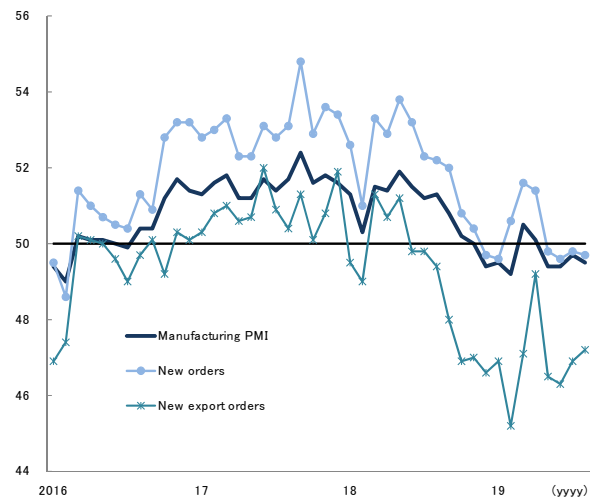
**Chart 1: Manufacturing investment**



Note: The year-to-date cumulative total converted into a single month data. January and February data shows changes of cumulative total of January-February over the same period a year ago.

Source: Made by MHRI based on National Bureau of Statistics of China, CEIC Data

**Chart 2: Manufacturing PMI**



Source: Made by MHRI based on National Bureau of Statistics of China, CEIC Data

in investment trends depending on the differing degrees of export dependence among companies based on data of capital spending of listed companies for which detailed financial information is available, and then offer an outlook for future investment trends.

## 2. Investment by listed manufacturing companies

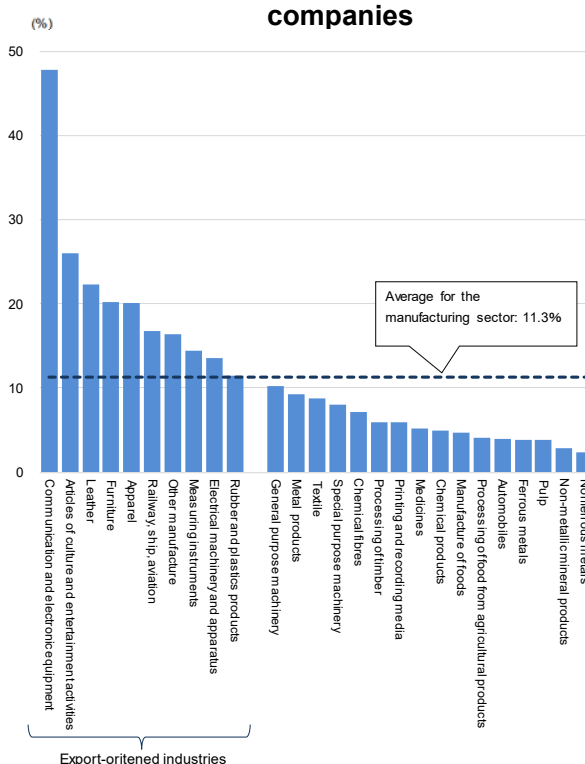
### (1) Classification of companies based on dependence on exports

First, we sort out data on listed companies subject to our analysis. Of companies listed on securities exchanges on mainland China (A and B shares) covered by Wind, a major Chinese financial information services vendor, there are a total of 2,326 manufacturing companies (hereinafter referred to as “listed manufacturers”). As an indicator of investment by listed manufacturers, we use cash flow from investing activities, “cash outlays for purchases/construction of tangible fixed assets, intangible assets and other long-term assets<sup>1</sup>” (hereinafter referred to “investment-related outlays”). In this paper, we make use of data for 1,697 companies, out of listed manufacturers, for which data on investment-related outlays is available from the Jan-Mar quarter of 2015 through the Apr-Jun quarter of 2019.

Next, we classify listed manufacturers into industries highly dependent on exports and other industries. Here, we use China Industrial Enterprises Statistics of the National Bureau of Statistics of China to calculate the export sales ratio (exports sales/industrial sales). Then, against base of the average ratio for the entire manufacturing sector (11.3% in 2016), we classify listed manufacturers into “export-oriented industries” (10 industries<sup>2</sup>) and other industries (Chart 3).

Furthermore, although the number of data is limited, we use data on “export-oriented companies” as defined by Wind with more definite high dependence on exports (of companies listed on securities exchanges in mainland China, companies with the export sales ratio in excess of 60% in 2018)<sup>3</sup>. Of the

**Chart 3: Export sales ratio of export-oriented companies**



Note: 1. Export sales ratio = Export sales/industrial sales (2016).  
 2. Repair services of metal products, machinery and equipment were excluded as there is no listed company to be covered. Manufacturers of liquor, beverages and refined tea, and tobacco, with the export sales ratio of 2% or less, were also omitted.  
 Source: Made by MHRI based on National Bureau of Statistics of China, CEIC Data

<sup>1</sup> See Ministry of Finance, “Accounting Standards for Enterprises No. 31 – Cash Flow Statements,” etc.

<sup>2</sup> The export sales ratio of repair services of metal products, machinery and equipment exceeded the average ratio for the entire manufacturing sector. But they are excluded in this paper as there is no listed company to be covered in this particular industry.

<sup>3</sup> Excluding ST stocks and \*ST stocks, which are equivalent to stocks placed on the supervisory post for possible delisting in Japan.

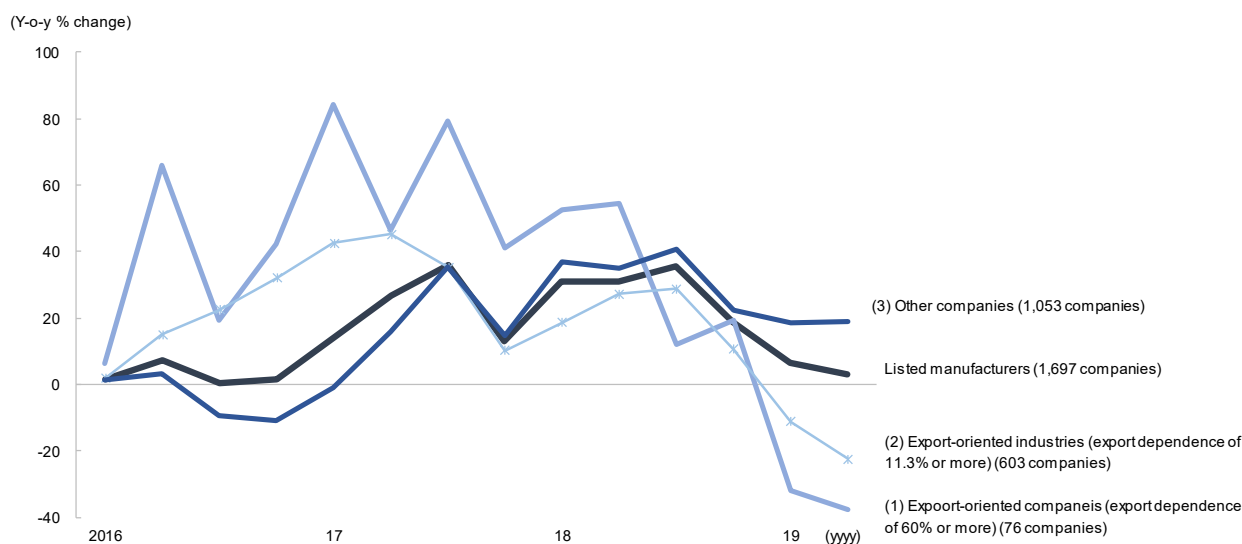
total of 165 companies covered, there are 76 listed manufacturers for which data on investment-related outlays is available. Industries for “export-oriented companies” include those other than the above-mentioned “export-oriented industries”<sup>4</sup>.

Based on the classification standards above, we classify these companies into (1) “export-oriented companies (with the export dependence of 60% or more) (76 companies), (2) “export-oriented industries (with the export dependence of 11.3% or more” (603 companies), and (3) other companies that do not belong either to “export-oriented industries (with the export dependence of 11.3% or more)” or to “export-oriented companies (with the export dependence of 60% or more)” (1,053 companies). Generally speaking, the dependence on exports is higher in the order of (1), (2) and (3).

## (2) Companies with higher export dependence see investment growth decelerate more rapidly

Chart 4 shows y-o-y % changes of investment-related outlays based on the company classification of (1) to (3) above. It indicates that investment-related outlays of companies deemed to have the high dependence on exports started to decline from the latter half of 2018 following the intensification of US-China trade tensions. The margin of decline in investment-related outlays is larger in the order of (1) and (2). In particular, companies in (1) expanded the negative margins significantly, suffering the y-o-y fall of -37.7% during the Apr-Jun quarter of 2019. On the other hand, companies with a lesser degree of dependence on overseas sales classified into (3) maintained the positive growth in

**Chart 4: Investment-related outlays of listed manufacturers**



Note: 1. “Export-oriented industries” refer to industries whose export sales ratio (export sales/industrial sales) in China Industrial Enterprises Statistics is higher than the average ratio for the entire manufacturing sector (11.3% for 2016).  
 2. “Export-oriented companies” refer to companies whose export sales ratio for 2018 exceeds 60% in the statistics of Wind.

Source: Made by MHRI based on Wind

<sup>4</sup> Industries to which 76 “export-oriented companies” belong are as follows: Communication and electronic equipment (17 companies); special purpose machinery (9 companies); electrical machinery and apparatus (9 companies); chemical products (8 companies); general purpose machinery (6 companies); medicines (4 companies); metal products (4 companies); textile (3 companies); furniture (2 companies); foods (2 companies); leather (2 companies); non-metallic mineral products (2 companies); apparel (2 companies); railway, ship, aviation (2 companies); automobiles (one company); liquor and beverages (one company); rubber and plastics products (one company); and nonferrous metals (one company).

investment-related outlays in 2019 after their growth slowed somewhat at the end of 2018. Thus, it is inferred that investment-related outlays are declining more significantly for companies with higher export dependence.

### **(3) By industry, communication and electronic equipment, and electrical machinery and apparatus tend to have lower appetite for investment**

When we look at the contribution by industry to investment-related outlays by export-oriented industries (the export dependence of 11.3% or more), it becomes clear that the two industries of communication and electronic equipment (237 companies) and electrical machinery and apparatus (184 companies) pull down such outlays significantly (see **Chart 5** on the following page). Furthermore, it is suggested that it has become increasingly difficult for the increased earnings of these two industries to lead to higher investment. When we looked at the relationship between investment-related outlays in the five six-month periods from Jan-Jun 2017 to Jan-Jun 2019 and corporate earnings<sup>5</sup> in the respective year-before six-month periods, we found that despite the growth of corporate earnings was positive, the number of companies, whose growth of investment-related outlays was negative y-o-y, increased to exceed 30% of the total number of companies in the respective two industries in Jan-Jun 2019, an indication that listed manufacturers are becoming more cautious about capital spending<sup>6</sup> (see **Chart 6** on the following page).

As seen above, growth of asset purchases of listed manufacturers fell sharply for companies that have the higher dependence on external demand, and export-oriented industries tend to show less appetite for investment. These developments tell us that downward pressure on exports associated with US-China trade tensions is putting a damper on investment by manufacturing industries.

### **3. Future outlook – Manufacturing investment likely to remain subdued in 2020**

Looking forward, manufacturing investment is likely to continue slowing for the time being and remain subdued into 2020. If the fourth round of US retaliatory tariffs against China is imposed in its entirety as planned, the tariffs are expected to push down China's exports to the US in 2020 as well, with downward pressure on manufacturing investment likely to continue. The US and China held deputy-level trade talks on September 19, laying the groundwork for cabinet-level negotiations set for the second week of October. While some moves are emerging toward improving the situation, they have yet to dispel the lingering uncertainties about the future.

The Chinese government has adopted a package of measures, including the mitigation of tax burdens, fee reductions and encouragement of bank lending to small businesses. With a deep sense of uncertainties about future still lingering, however, Chinese companies are finding it difficult to embark on aggressive investment, perhaps making the potential effects of the government measures limited.

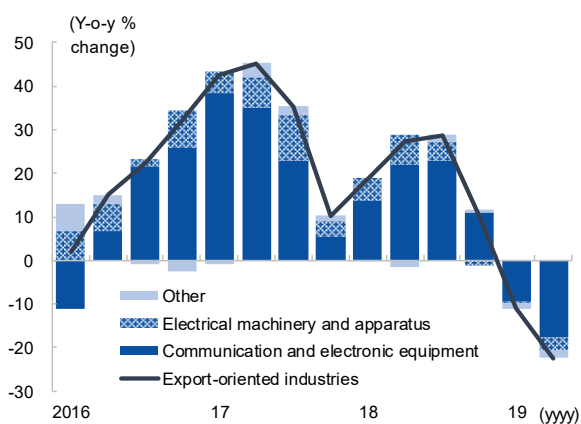
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<sup>5</sup> For corporate earnings, we used total profit. (利润总额)

<sup>6</sup> Corporate earnings are said to precede manufacturing investment by about one year. See Lianxun Securities (联讯证券「制造业投资高速增长还能延续吗？」) (January 27, 2019), Sinolink Securities (国金证券「2019年制造业投资何去何从？」) (May 11, 2019), etc.

An expansion of infrastructure investment is slow at best as well, making it hard to expect a significant recovery of manufacturing investment that relies on infrastructure investment. Amid the continuing impact of US-China trade tensions, it will likely take some time before the Chinese economy recoups its self-sustaining resilience.

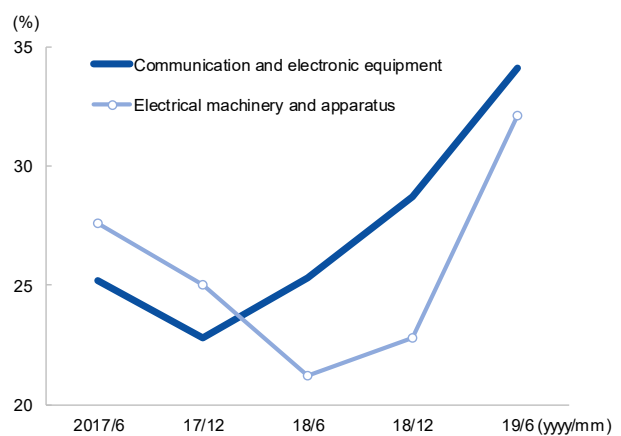
**Chart 5: Investment-related outlays of export-oriented industries (by industry)**



Note: "Other" includes articles of culture and entertainment activities, leather/fur/feather, apparel, furniture, measuring instruments, railway/ship/aviation, rubber and plastics products, and other manufacturing industries.

Source: Made by MHRI based on Wind

**Chart 6: Ratio of companies whose investment-related outlays fell relative to earnings**



Note: For communication and electronic equipment (237 companies) and electrical machinery and apparatus (184 companies), of companies whose y-o-y growth of investment-related outlays was negative in each quarter, the ratio of companies whose growth of earnings over the same period a year ago was positive

Source: Made by MHRI based on Wind