

| Global Research | 24 April 2017

China SMEI – Softer in April after March mania

- **Headline SMEI eased to 58.0 in April from 60.0 in March; still the second-highest reading since April 2016**
- **All current activity sub-indices subsided, and the outlook turned less positive**
- **Credit conditions turned tougher for SMEs on tighter liquidity; financing costs were stable**
- **Most SMEs expected a stable CNY exchange rate; very few expected lower energy costs in April**

SMEI activity softened after a booming March

The headline reading of our proprietary *Small and Medium Enterprise Confidence Index* (SMEI; Bloomberg: SCCNSMEI <Index>) moderated to 58.0 in April from 60.0 in March. The growth momentum index also retreated to 12.4 from 12.6, reflecting slower growth in SMEs' real activity (Figure 1). This reflects a moderation in both current and prospective SMEI activity after a big jump in March.

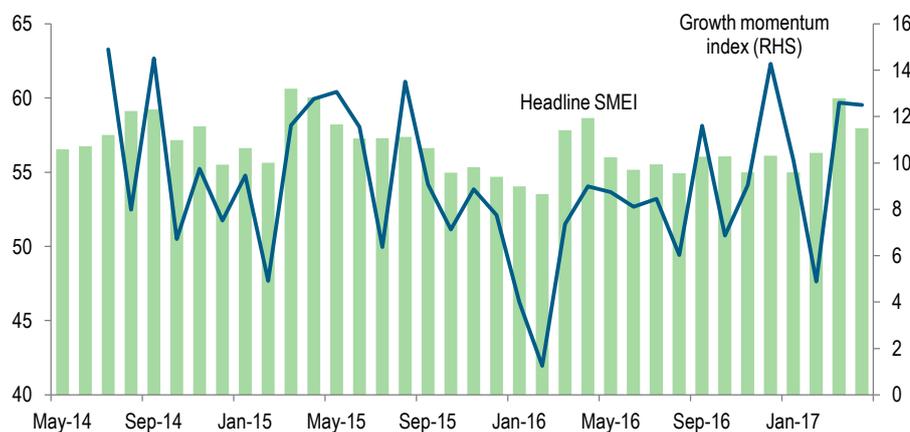
The current performance sub-index fell 1.8ppt to 58.0 in April (Figure 2), with sub-components weakening across the board. Sales and production moderated, affecting profitability, the labour market and capacity usage. By region, SMEs in southern China continued to outperform those in other regions. By industry, the IT and services sectors remained the best performers, while all other sectors moderated.

The downturn in current performance seems to have had a negative impact on business expectations. The current and prospective investment sub-indices both declined, and the expectations sub-indices for sales, production, employment, and capacity usage all softened. Consequently, raw-material inventory growth began to decelerate in April.

SMEs' access to credit turned tougher in April. Tighter monetary policy and stricter financial regulations may continue to make SMEs' access to both bank and non-bank funding difficult. That said, SMEs' funding costs remained stable compared to previous months, according to the survey. About 55% of our surveyed SMEs predicted USD-CNY exchange rate stability, while very few expected lower energy costs in the coming months.

Figure 1: Headline SMEI moderated, with weaker growth momentum

China headline SMEI reading (LHS), growth momentum index (RHS)



Source: Standard Chartered Research

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Both current performance and expectations weakened

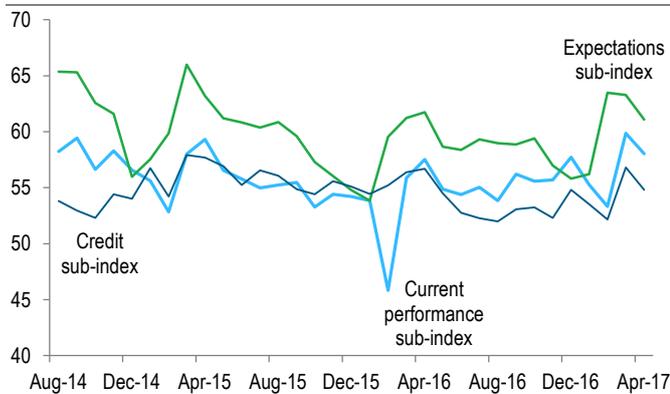
The current performance sub-index retreated to 58.0 in April from 59.8 in March. The expectations sub-index ticked down 0.2ppt to 63.3 but remained at a high level.

Sales and production weakened in April after a strong rebound in March, putting downward pressure on the labour market and profitability

- Sales slowed in April, with a cautious outlook for demand.** The current performance reading for new orders edged down to 63.9 in April from 64.3 in March, and the reading for new export orders dropped 2.3ppt to 56.2 (Figure 4). These declines reflected weaker demand both from China and abroad. The outlook reading for new orders also declined to 68.4 in April from 70.1 in March, implying a cautious demand outlook.
- Production fell after a strong rebound.** The current performance reading for production ticked down to 62.9 in April from 63.8 prior (Figure 4), reflecting softer production activity in April after a sharp rebound the previous month. Furthermore, production may have already peaked – the production expectations reading fell 3ppt to 68.7 in April, implying a less optimistic outlook for growth.
- Both prospective and current investment weakened.** The current performance reading for investment fell to 55.9 in April from 57.9 in March (Figure 5). The investment outlook reading also declined by 2.0ppt to 55.9, pointing to weaker investment appetite down the road.

Figure 2: Current performance and expectations sub-indices all weakened

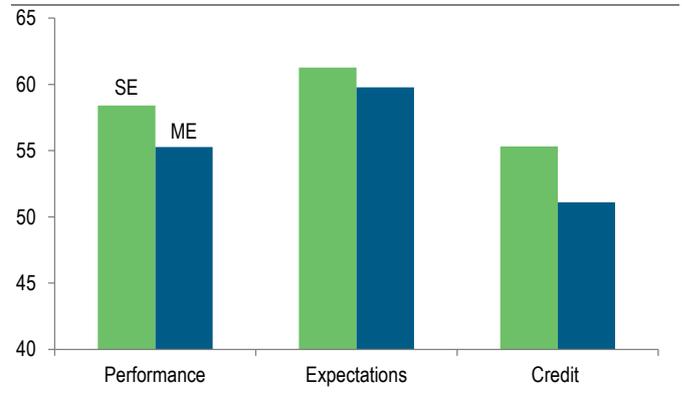
Current performance, expectations and credit sub-indices



Source: Standard Chartered Research

Figure 3: Performance of medium-sized enterprises (MEs) and small enterprises (SEs) both weakened

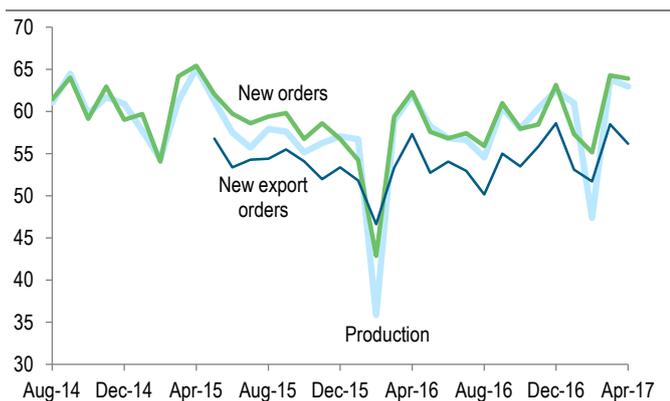
Current performance, expectations and credit sub-indices



Source: Standard Chartered Research

Figure 4: Sales and production moderated

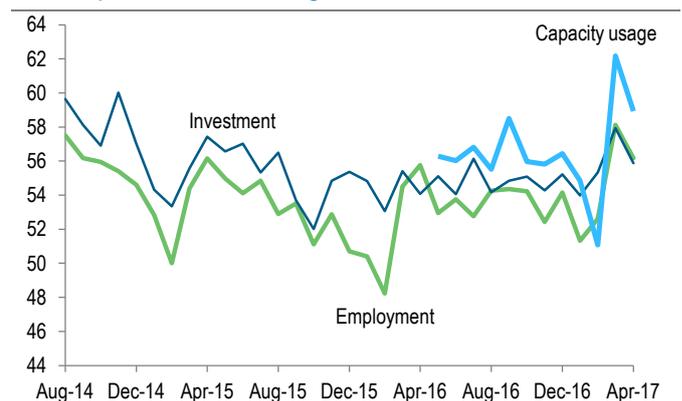
Current performance readings



Source: Standard Chartered Research

Figure 5: Employment, capacity and investment indices declined

Current performance readings



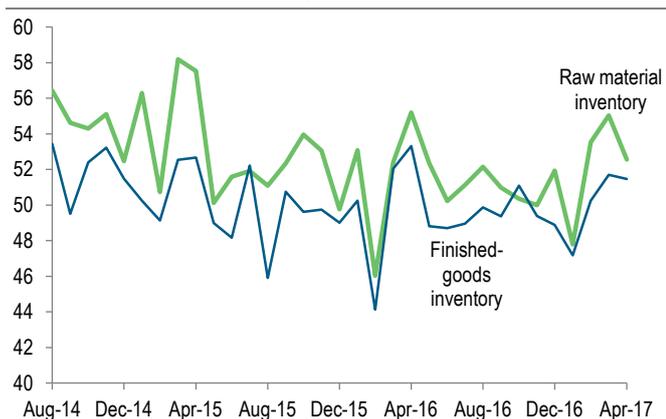
Source: Standard Chartered Research



- **Labour market softened as production lost steam.** The current performance readings for employment and capacity usage retreated 1.9ppt and 3.3ppt, respectively, in April as a result of cooling production during the month (Figure 5). Their forward-looking readings also softened 3.0ppt and 1.8ppt, respectively, from March. The implementation of supply-side reforms and capacity reduction may continue to weigh on the labour market this year.
- **Raw-material inventory growth is slowing.** The current performance reading for raw-material inventory weakened to 52.6 in April from 55.0 in March (Figure 6), indicating slower inventory growth during the month. The outlook reading for raw-material inventory also moderated to 56.9 in April from 59.1 in March, pointing to continued weakness in the coming months due to cooling business sentiment.
- **Finished-goods inventory started to level off.** The current performance reading for finished-goods inventory edged down to 51.5 in April from 51.7 in March, and the outlook reading fell 2.1ppt to 51.5 (Figure 6). Both readings have remained high in recent months, reflecting re-stocking. But with demand softening, this process may have run its course.
- **Rising output prices boosted profitability.** Despite a falling input price index, the current performance index for profitability weakened to 61.9 in April from 62.5 in March as a result of slower sales and falling output prices (Figure 7). This trend is set to continue, as the outlook reading for profitability moderated by 1.5ppt in April, reflecting softer business sentiment.

Figure 6: Raw-material and finished-goods inventories softened; outlook is moderating

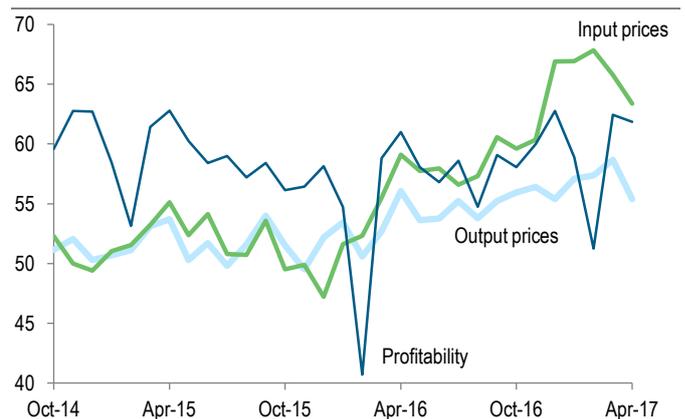
Current performance readings



Source: Standard Chartered Research

Figure 7: Profitability slowed after a strong recovery

Current performance readings



Source: Standard Chartered Research



Credit access turned tighter, but financial costs are stable

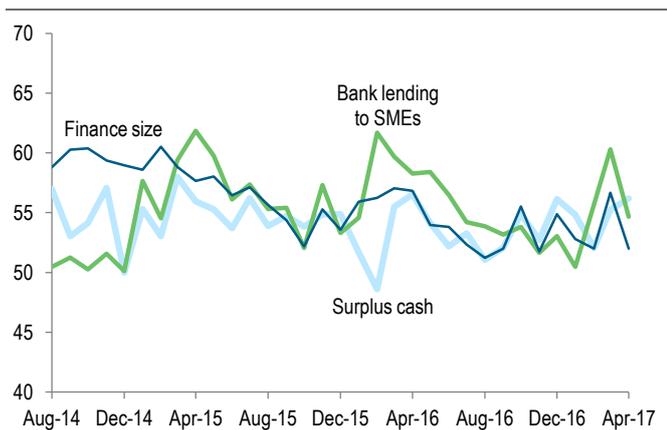
The credit conditions sub-index fell to 54.8 in April from 56.8 in March. This partly reflects the recent tightening of monetary policy and more rigorous financial regulations aimed at encouraging financial deleveraging. Funding costs for SMEs remained stable in April, albeit still high.

Credit access deteriorated, but funding costs remained stable

- Credit access became more difficult for SMEs.** The reading for banks' attitude towards lending to SMEs dropped sharply to 54.7 in April from 60.3 in March, suggesting weak funding support from banks amid tighter liquidity conditions (Figure 8). M2 growth was 10.6% in April, dipping below 11% for the first time since last July and falling significantly below the annual target of 12%. Reflecting slower money and credit growth, the reading for SMEs' total financing size fell significantly to 52.0 in April from 56.7 in March (Figure 8). The sub-index for surplus cash rose 0.9ppt to 56.2, reflecting a comfortable cash position, possibly due to improved profitability. However, the sub-index for receivables turnover fell 1.5ppt to 49.2 in April, indicating headwinds ahead.
- SMEs' funding costs eased mildly but remained high.** The readings for bank and non-bank financing costs remained in contractionary territory, at 46.5 and 47.6, respectively; this indicates still-elevated financing costs (Figure 9; a reading below 50 indicates worsening conditions, i.e., rising costs). The two sub-indices improved slightly from the previous month. The improvement may suggest that recent monetary policy tightening by the People's Bank of China has affected the financial market more than the real economy, and that higher money-market rates have not substantially raised SMEs' borrowing costs. In addition, off-balance-sheet lending activity remains robust, helping to stabilise SMEs' non-bank financing costs.

Figure 8: SMEs' credit demand subsided after a sharp rebound the previous month

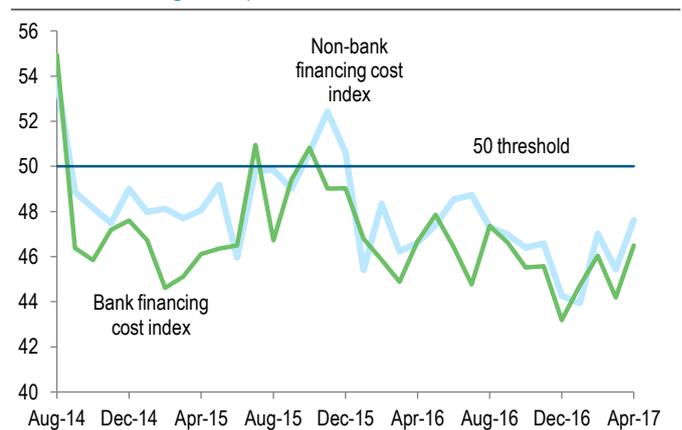
Components measuring credit conditions



Source: Standard Chartered Research

Figure 9: Financing costs for bank loans and non-bank financing stabilised

Bank and non-bank financing cost components (above 50 = improving conditions/falling costs; below 50 = worsening conditions/rising costs)



Source: Standard Chartered Research



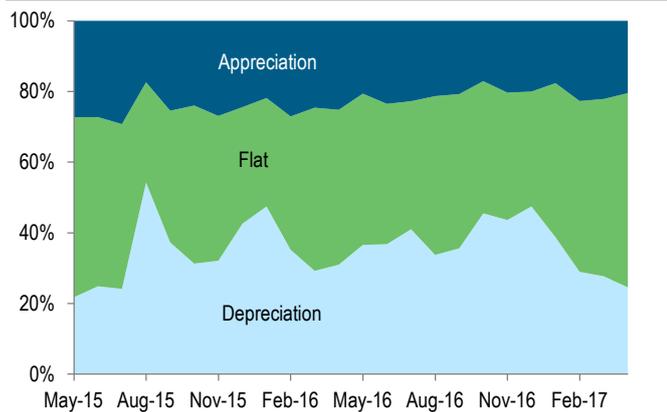
Majority expect CNY stability

More SMEs expect CNY stability, fewer expect lower energy costs

The majority of SMEs in our latest survey said they expected a stable USD-CNY exchange rate and flat or higher energy costs.

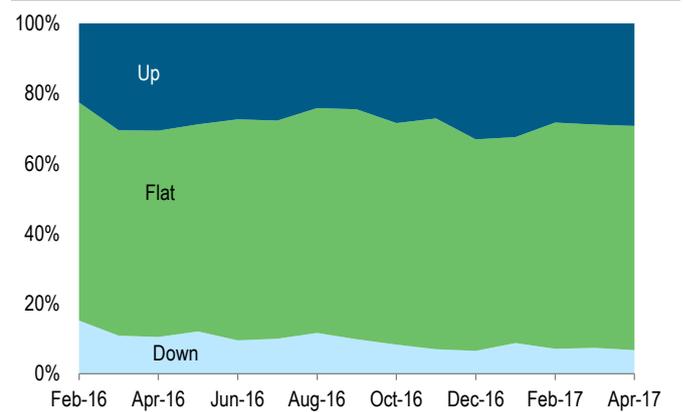
- The proportion of SMEs expecting CNY stability rose to the highest in three years.** 24.5% of respondents predicted further CNY depreciation against the USD – a further drop from 27.7% in March and 28.9% in February. Those expecting CNY depreciation still exceeded those expecting appreciation (20.5%). But 55.0% of the 500+ survey respondents expected a flat CNY exchange rate against the USD in the near term (Figure 10). Our calculations show a small non-FDI capital outflow of USD 14.7bn in March, the second-smallest in 30 months; this suggests a continued improvement in China’s international balance of payments. Recent USD stability reduces the need for CNY intervention, and stricter enforcement of capital controls and tighter monetary policy also helps. In addition, the US Treasury’s decision not to label China a currency manipulator should contribute to a benign backdrop for the CNY in the near term.
- Fewer people expect lower energy costs.** Only 6.1% of respondents – the lowest share in 10 months – said they expect lower energy costs in the near future. 26.7% of respondents predicted higher energy costs, up from 26.0% in March. This left 58.4% of respondents forecasting flat energy costs, 1.0ppt higher than in March.

Figure 10: Expectations of USD-CNY weakness eased
% of responses



Source: Standard Chartered Research

Figure 11: Expectations on energy costs diverged
% of responses



Source: Standard Chartered Research

Figure 12: SMEI headline index and sub-indices

	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17
Headline index	58.7	56.0	55.2	55.5	54.9	56.0	56.1	55.0	56.1	55.0	56.3	60.0	58.0
Performance sub-index	57.5	54.9	54.4	55.0	53.8	56.2	55.6	55.7	57.7	55.3	53.3	59.8	58.0
Expectations sub-index	61.7	58.7	58.4	59.3	59.0	58.9	59.4	57.0	55.8	56.2	63.5	63.3	61.1
Credit sub-index	56.7	54.5	52.8	52.3	52.0	53.1	53.3	52.3	54.8	53.5	52.1	56.8	54.8

Source: Standard Chartered Research



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