

# China Economic Update



It has been an eventful month with the annual National People's Congress (NPC) getting underway early last week, while a number of policies to curb property prices were also announced in the lead up to the gathering – triggering a sharp correction in equity markets. The NPC is an important assembly of the Chinese leadership where the annual budget and economic targets are announced – the GDP growth target for 2013 was kept at 7.5%. Chinese statistical authorities have also recently released some of the major economic data for February. We had been eagerly anticipating the February data for further confirmation that the turnaround in the economy seen late last year continued into 2013. February data is more informative as it tends to be more complete than January, and allows us to (attempt to) look through seasonal distortions from Lunar New Year (although residual seasonality often remains).

Many of the partial indicators – particularly those relating to private domestic demand – came in below expectations this month. Even after taking January and February together (a simple way of adjusting for some of the LNY impacts) the outcomes still cast some doubt on the expectation for a rapid recovery in the economy during the first half of the year. This softness in the partials suggest that the need for policy tightening may arise later than currently forecast (September quarter), despite an acceleration in CPI for February that was largely seasonal.

Nevertheless, we maintain our expectation for a modest recovery in the economy this year to around 8¼% (above the government's 7.5% target), with the majority of the acceleration to occur in H1. However, with a substantial pick-up in private domestic demand remaining elusive, the balance of risks to the outlook has shifted to the downside.

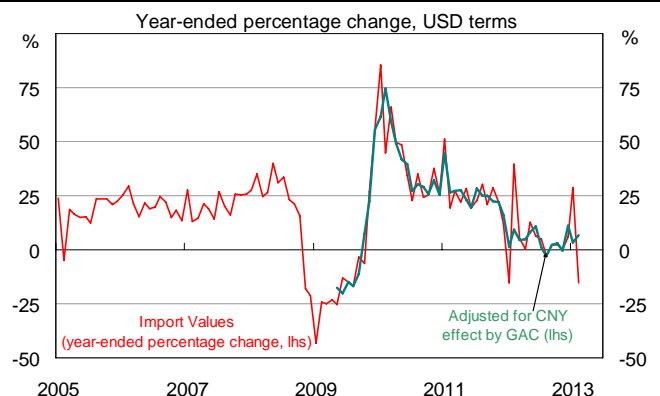
A sharp decline in Chinese imports has raised some alarm bells over the strength of China's domestic demand. Merchandise imports declined 15.2% y-o-y in February, although the slowdown is exacerbated by fewer working days this February compared to last year. However, seasonally adjusted imports data published by the NBS indicate a more positive trend in imports with growth actually accelerating to 6½% over the year from 3.4% in January. By commodity, iron ore, oil and copper were all lower over the year to date – copper recording significant declines (27.8%). Iron ore imports were 1.9% lower following a sharp increase in prices, despite a pick-up in daily steel production in February, while crude oil imports were down 2.4% over the year-to-date.

Industrial production eased in the first two months of the year, broadly in line with a softening of both manufacturing PMI's. The official PMI published by the NBS shows little sign of a significant rebound in manufacturing activity over coming months with new domestic orders remaining neutral, while export orders have deteriorated – in contrast with the solid exports data for February (see below). The PMI is continuing to show some destocking pressures in the manufacturing sector with the finished goods inventory component hitting its lowest level since early 2011. Electricity production – often sighted as a good indicator of the underlying strength of the economy – softened significantly, rising just 3.4% in the year-to-date. In contrast, the auto industry has continued to gain momentum with growth picking up to 12.4% ytd

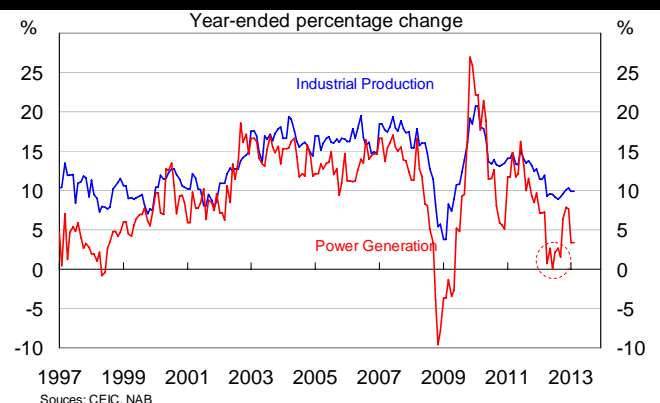
## Markets losing confidence in the recovery (Shanghai Composite)



## Merchandise Imports Growth



## Industrial Production



(from 5.3% y-o-y in January), while average daily steel production was up more than 4½% in February (according to China Iron and Steel Association (CISA)).

Government investment stimulus appears to have been scaled back a little in recent months with central government spending growth clearly slowing. Nevertheless, our estimates of fixed asset investment growth show that investment momentum has remained steady (increasing 21% y-o-y). The NPC confirmed that the government will maintain its proactive fiscal policy stance and the budget deficit for 2013 was recently announced to be RMB1.2 trillion in 2013 (2% of GDP), up from last year's budgeted deficit of RMB800 billion. In a positive sign of commitment by the leadership to rebalancing, the budget has a heavy focus on social spending with RMB1½ to be spent on education, health care, social security and affordable housing (up 13% from last year's budget).

By sector, investment in manufacturing has softened significantly since late 2011, although this may come as good news to authorities following recent warnings from the National Development & Reform Commission (NDRC) that some sectors within China's manufacturing industry face significant overcapacity (particularly steel, cement, aluminium, plate glass and coking coal). Growth in real estate investment has accelerated from the lows of last year (increasing 22.8% y-o-y), spurred on by the anticipation of additional government investment and rising prices. However, the outlook for the sector has turned less favourable with the government announcing a number of additional curbs on the sector in late February (see table below). While these curbs are expected to weigh on building activity, the impact could be gradual, with ongoing investment in affordable housing helping to keep construction ticking over. Authorities expect to commence 6.3 million affordable housing units, while 4.7 million will be completed in 2013 (down from 7 million starts and 5 million completions planned last year). However, we expect to see additional curbs on real estate if the sector continues to pick up during the year.

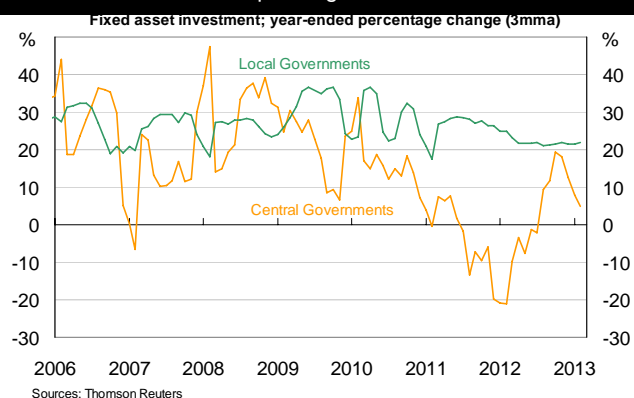
**Recent Curbs on Real Estate**

<b>Price Targets</b>	Local governments to set annual price easing targets
<b>Purchase Restrictions</b>	transaction taxes, increased down payments and interest rates for 2nd homes, restrictions on purchases by non-locals
<b>Land Supply</b>	Increase land supplies and availability of information on land supply
<b>Affordable housing</b>	Accelerate construction on subsidised housing and include migrant workers in the housing program
<b>Market Supervision</b>	Improve availability of market information and persecute the spreading of false information

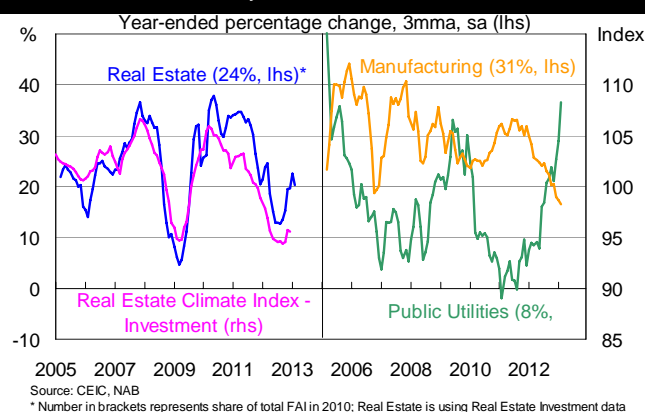
Turning to consumption, nominal retail sales growth was relatively disappointing, decelerating to 12.3% over the year to date on softer than usual activity during LNY. The slowdown in consumption is in stark contrast to the recent improvement seen in consumer confidence – which was surprising in itself given the expectation that weak corporate profits will weigh on income growth. The government's recent clamp down on corruption and public expenses may have also weighed on consumption of luxury goods (spending on catering slowed to 8.4% y-o-y from 15.1% in December). By commodity, the deceleration in sales was relatively broad-based, although office supplies and household electronics were noticeable exceptions.

External demand has been a surprising bright spot in recent months. The trade surplus came in above expectations in the

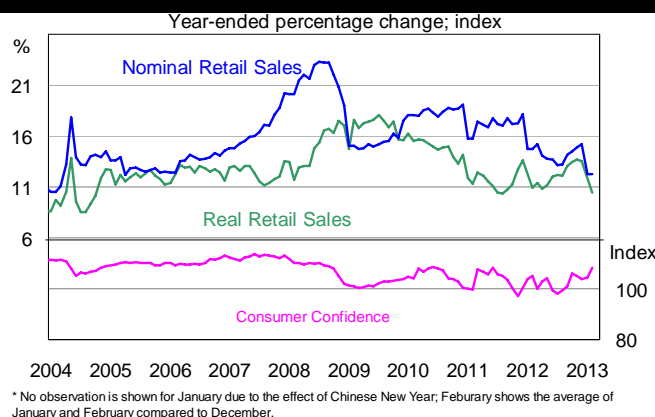
**Government Investment Spending**



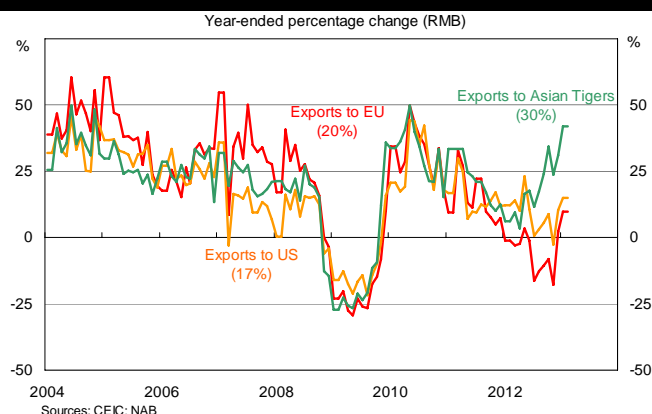
**Fixed Asset Investment by Sector**



**Retail Sales**



**Merchandise exports to major trading partners**



month at US\$15.3bn. Growth in merchandise exports came in at 21.8% over the year, well above market expectations of 8.1%. This outcome reflected a broad based improvement in exports to most major trading partners (including Europe). However, export orders have become more subdued recently and could point to softer export growth in coming months.

Year-ended CPI growth rose to 3.2% in February (from 2% in January), driven by an acceleration in food costs – largely attributable to higher food prices during LNY. While base effects are expected to boost headline CPI numbers over coming months, upstream prices are still suggesting relatively benign inflation pressures; producer prices fell 1.6% over the year.

While we have not ruled out another cut in reserve requirements, the PBoC's recent net liquidity withdrawals and the lower inflation target for 2013 (3.5%, down from 4%), suggests the PBOC see no need to boost liquidity by cutting further. Forex purchasing positions also hit a record high in January, which could be the result of larger capital inflows (as well as a greater willingness to hold RMB) that have increased market liquidity (base money).

Statistical releases available here:

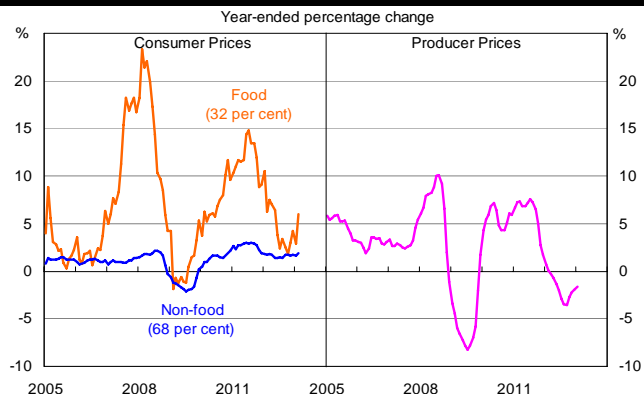
[National Bureau of Statistics](#)

A more comprehensive note will be released in the coming week.

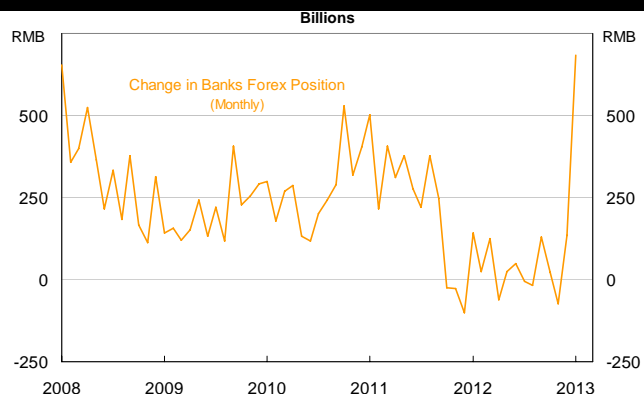
**For more information, please contact**

James Glenn 0392088129

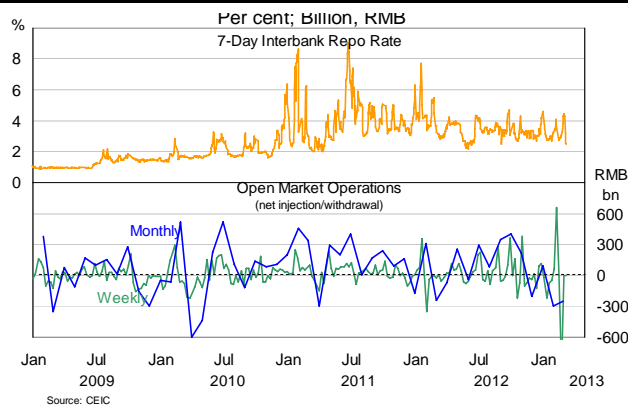
**Inflation**



**Capital inflows picking up pace again**



**Liquidity conditions**



## Global Markets Research

Peter Jolly  
Global Head of Research  
+61 2 9237 1406

### Australia

#### Economics

Rob Henderson  
Chief Economist, Markets  
+61 2 9237 1836

Spiros Papadopoulos  
Senior Economist  
+61 3 8641 0978

David de Garis  
Senior Economist  
+61 3 8641 3045

#### FX Strategy

Ray Attrill  
Global Co-Head of FX Strategy  
+61 2 9237 1848

Emma Lawson  
Senior Currency Strategist  
+61 2 9237 8154

#### Interest Rate Strategy

Skye Masters  
Head of Interest Rate Strategy  
+61 2 9295 1196

Rodrigo Catril  
Interest Rate Strategist  
+61 2 9293 7109

#### Credit Research

Michael Bush  
Head of Credit Research  
+61 3 8641 0575

Ken Hanton  
Senior Credit Analyst  
+61 2 9237 1405

#### Equities

Peter Cashmore  
Senior Real Estate Equity Analyst  
+61 2 9237 8156

Jenny Khamphet  
Senior Real Estate Equity Analyst  
+61 2 9237 9538

## Group Economics

Alan Oster  
Group Chief Economist  
+61 3 8634 2927

### New Zealand

Stephen Toplis  
Head of Research, NZ  
+64 4 474 6905

Craig Ebert  
Senior Economist  
+64 4 474 6799

Doug Steel  
Markets Economist  
+64 4 474 6923

Mike Jones  
Currency Strategist  
+64 4 924 7652

Kymberly Martin  
Strategist  
+64 4 924 7654

### UK/Europe

Nick Parsons  
Head of Research, UK/Europe,  
and Global Co-Head of FX Strategy  
+ 44 207 710 2993

Gavin Friend  
Markets Strategist  
+44 207 710 2155

Tom Vosa  
Head of Market Economics  
+44 207 710 1573

Simon Ballard  
Senior Credit Strategist  
+44 207 710 2917

Derek Allassani  
Research Production Manager  
+44 207 710 1532

Tom Taylor  
Head of Economics, International  
+61 3 8634 1883

Rob Brooker  
Head of Australian Economics  
+61 3 8634 1663

Alexandra Knight  
Economist – Australia  
+(61 3) 9208 8035

Vyanne Lai  
Economist – Agribusiness  
+(61 3) 8634 3470

Dean Pearson  
Head of Industry Analysis  
+(61 3) 8634 2331

Robert De lure  
Senior Economist – Property  
+(61 3) 8634 4611

Brien McDonald  
Economist – Industry Analysis  
+(61 3) 8634 3837

Gerard Burg  
Economist – Industry Analysis  
+(61 3) 8634 2778

John Sharma  
Economist – Sovereign Risk  
+(61 3) 8634 4514

James Glenn  
Economist – Asia  
+(61 3) 9208 8129

Tony Kelly  
Economist – International  
+(61 3) 9208 5049

## Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

## Important Notices

**Disclaimer:** This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Products are issued by NAB unless otherwise specified.

So far as laws and regulatory requirements permit, NAB, its related companies, associated entities and any officer, employee, agent, adviser or contractor thereof (the "**NAB Group**") does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("**Information**") is accurate, reliable, complete or current. The Information is indicative and prepared for information purposes only and does not purport to contain all matters relevant to any particular investment or financial instrument. The Information is not intended to be relied upon and in all cases anyone proposing to use the Information should independently verify and check its accuracy, completeness, reliability and suitability obtain appropriate professional advice. The Information is not intended to create any legal or fiduciary relationship and nothing contained in this document will be considered an invitation to engage in business, a recommendation, guidance, invitation, inducement, proposal, advice or solicitation to provide investment, financial or banking services or an invitation to engage in business or invest, buy, sell or deal in any securities or other financial instruments.

The Information is subject to change without notice, but the NAB Group shall not be under any duty to update or correct it. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

The NAB Group takes various positions and/or roles in relation to financial products and services, and (subject to NAB policies) may hold a position or act as a price-maker in the financial instruments of any company or issuer discussed within this document, or act and receive fees as an underwriter, placement agent, adviser, broker or lender to such company or issuer. The NAB Group may transact, for its own account or for the account of any client(s), the securities of or other financial instruments relating to any company or issuer described in the Information, including in a manner that is inconsistent with or contrary to the Information.

Subject to any terms implied by law and which cannot be excluded, the NAB Group shall not be liable for any errors, omissions, defects or misrepresentations in the Information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the NAB Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

This document is intended for clients of the NAB Group only and may not be reproduced or distributed without the consent of NAB. The Information is governed by, and is to be construed in accordance with, the laws in force in the State of Victoria, Australia.

**Analyst Disclaimer:** The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

**United Kingdom:** If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated in the UK by the Financial Services Authority. This document is intended for Investment Professionals (as such term is defined in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005), such persons having professional experience in matters relating to investments, and should not be passed to, or relied upon by, any other person who does not have professional experience in matters relating to investments, including but not limited to persons defined as retail clients by the rules of the United Kingdom's Financial Services Authority.

**USA:** If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

**Hong Kong:** In Hong Kong this document is for distribution only to "professional investors" within the meaning of Schedule 1 to the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) ("SFO") and any rules made thereunder and may not be redistributed in whole or in part in Hong Kong to any person. Issued by National Australia Bank Limited, a licensed bank under the Banking Ordinance (Cap. 155, Laws of Hong Kong) and a registered institution under the SFO (central entity number: AAO169).

**New Zealand:** This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. **National Australia Bank Limited is not a registered bank in New Zealand.**

**Japan:** National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.