China's economy at a glance

by NAB Group Economics

15 April 2015

National Australia Bank

China's economy records a soft start to the year, but the policy response (if any) is uncertain

- China's economy expanded by 7.0% in Q1 2015, down from 7.3% in Q4 2014. This was the weakest rate of growth since March 2009 – when China was at its lowest point during the GFC.
- Our forecasts are unchanged – with China's economy to grow by 7.1% in 2015 and 6.9% in 2016. Chinese authorities have expended considerable political capital in describing the slowing trend as the 'new normal' and are unlikely to tolerate growth falling below their target for a second straight year.
- China's industrial sector has slowed further, with growth at 5.6% yoy in March (down from 6.8% across January and February). This result was the slowest rate since early 2009 – at the height of the GFC. Similarly, fixed asset investment – driven by manufacturing and real estate – grew by its slowest rate since 2001 (though lower prices for inputs such as steel mean a less significant slowdown in real terms).
- China's trade surplus plunged in March – down to US$3.1 billion (from a record US$60.6 billion in February), as exports (-15%) fell more sharply than imports (-13%) year on year.
- China's policy makers face significant challenges in coming months – which will test the overall commitment to broad-based financial reforms. With Q1 GDP growth at the Government's target for 2015, the PBoC will face pressure for stimulus – potentially via further cuts to interest rates and the Reserve Requirement Ratio (RRR) – but the bank will be concerned about further growth in the already high debt levels.

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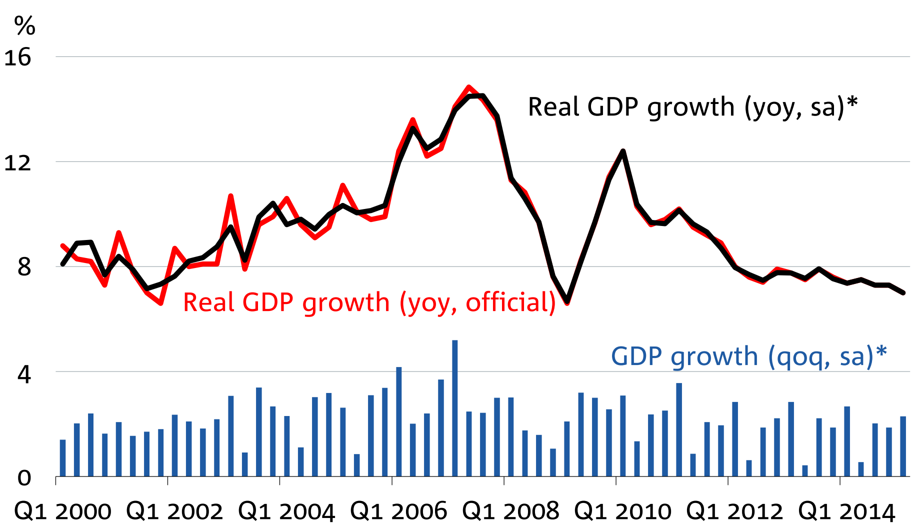
Gross Domestic Product

- China's latest national accounts data showed that the economy expanded by 7.0% in the first quarter of 2015, down from 7.3% in Q4 2014. This was the weakest rate of growth since March 2009 – when China was at its lowest point during the GFC.
- Our forecasts are unchanged – with China's economy to grow by 7.1% in 2015 and 6.9% in 2016. Chinese authorities have expended considerable political capital in describing the slowing trend as the 'new normal' and are unlikely to tolerate growth falling below their target for a second straight year.

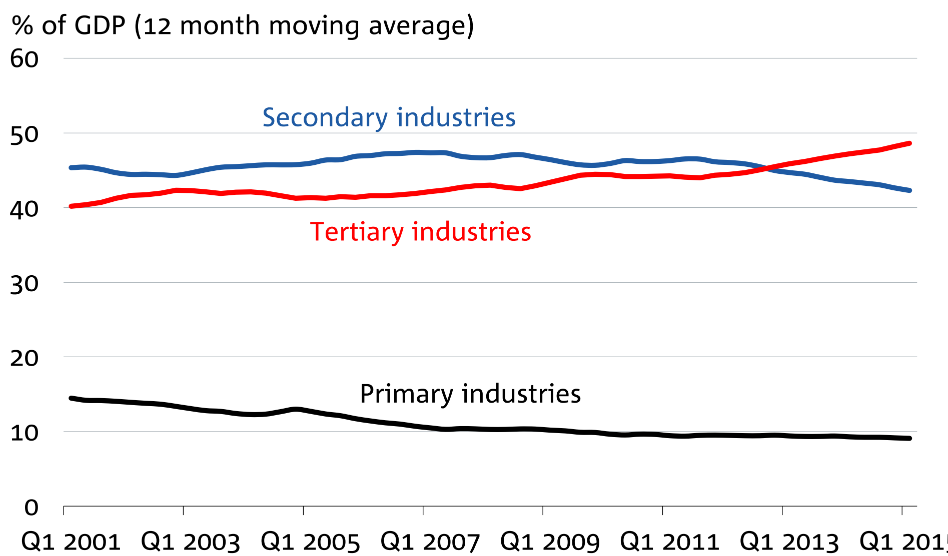
- China's economic growth held up comparatively strongly – given the weakness in the industrial sector (see page 3). In part, this reflects a lower reliance on heavy industry as an engine for growth, as the economy gradually rebalances. China's services sector accounted for just over half of the economy in Q1 (and almost 49% over the twelve months to March).

Real GDP down to 7% in Q1 2015, as the 'new normal' of slower growth continues



* Seasonally adjusted growth series are estimated by NAB.
Source: CEIC, NAB Economics

Growing importance of services highlights the transformation of China

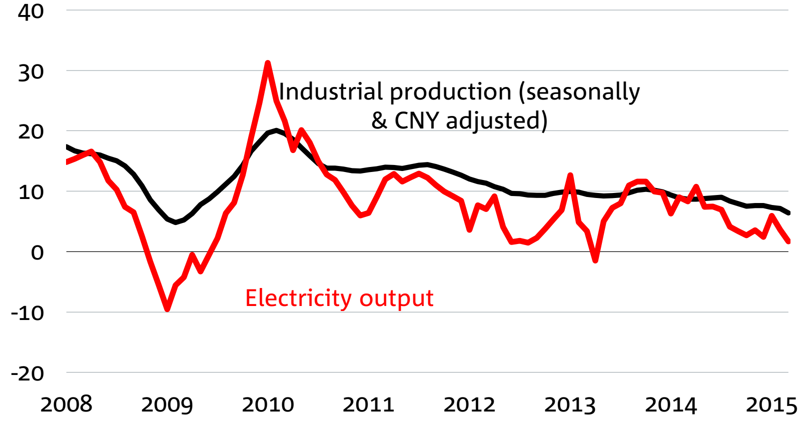


Sources: Datastream, NAB Economics

Industrial production

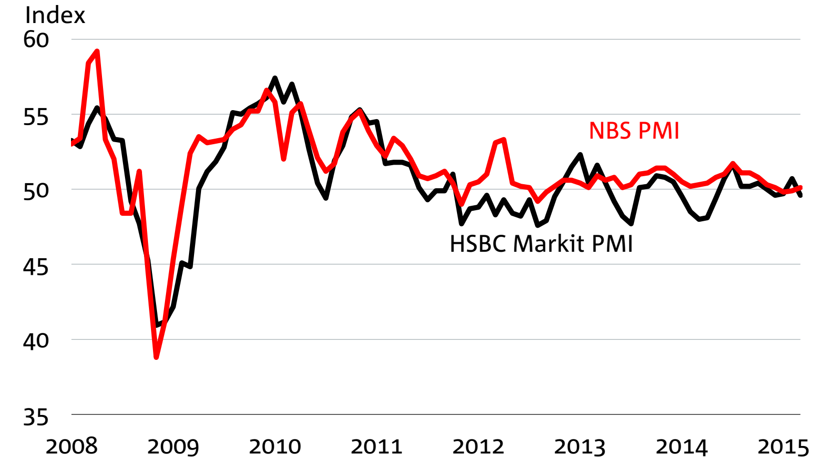
- China's industrial sector has slowed further from its weak start to the year, with growth at 5.6% yoy in March (down from 6.8% across January and February). This result was well below market expectations (of 7% growth) and was the slowest rate since early 2009 – at the height of the GFC.
- At a sub-sector level, weakness was evident in key construction related sectors, with output of cement plunging (-20.5% yoy) and crude steel easing (-1.2% yoy). Electricity production also fell in year-on-year terms, down -3.7% in March.
- The weak industrial production result was not evident in the major industrial surveys released earlier in the month – which recorded levels that were comparatively neutral. The official NBS PMI improved marginally, trending up to 50.1 points (from 49.9 points in February) – with this survey typically more representative of larger state owned enterprises. In contrast, the HSBC Markit PMI – which has a greater share of SME firms – edged down to 49.6 points (from 50.7 points previously).

China's industrial sector continues to slow –down to 5.6% yoy in March (a six year low)



Source: CEIC, NAB Economics

Major industrial surveys point to neutral conditions (albeit slightly negative for the SME sector)



Source: CEIC, NAB Economics

Investment

- Fixed asset investment has continued to trend lower across recent months – down to 13.2% yoy in March (from 13.9% across January and February). This was the slowest rate of growth since December 2001.

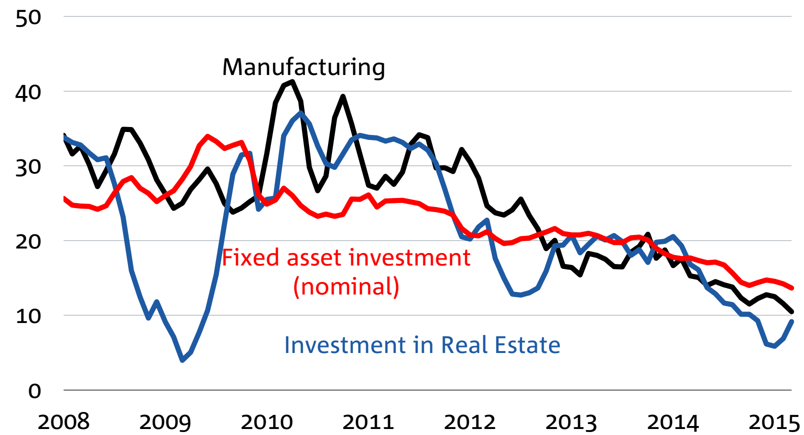
- As we have previously highlighted, investment costs have fallen in recent times – as falling prices for key inputs such as steel have resulted in deflation in the corporate goods price index. As a result, real investment has not fallen as significantly – edging down to 18.8% yoy (from 19.6% in February) – broadly in line with trend levels across 2014.

- Key to the downward trend in nominal fixed asset investment has been the slowdown in manufacturing and real estate investment (which accounted for 58% of the total in 2014). Investment in real estate edged up slightly in March – to a still low 9.1% yoy (on a three month moving basis), while manufacturing trended lower – to 11.5%.

- We expect conditions in the real estate sector to remain subdued this year – with policy relaxation reducing downside risk. Prices for property appear to be stabilising – with China Index Academy data showing growth in Tier 1 cities and near neutral conditions in Tier 2 – reducing the risk of a major property collapse, however construction activity is likely to remain weak.

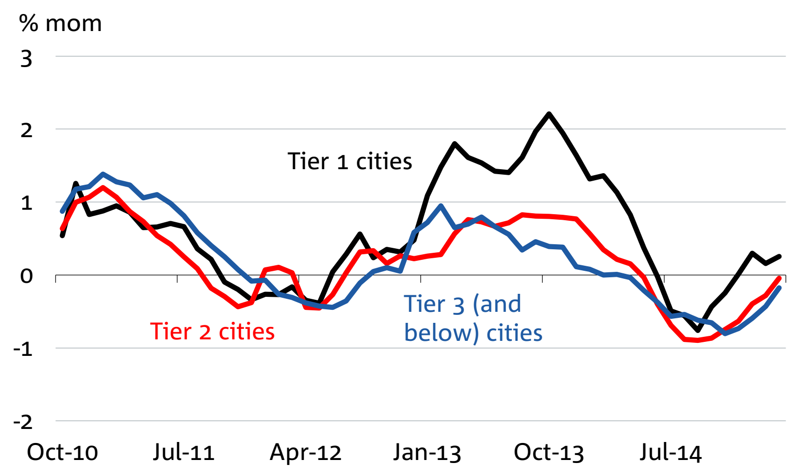
- Residential property starts fell by -21% yoy in March (following on from a -20% fall across January-February), which will continue to impact on local government budgets and demand for Australian resources. The broad construction sector accounts for over half of China's steel demand.

Fixed asset investment continuing to trend down to a 14 year low – led by real estate and manufacturing



Source: CEIC, NAB Economics

Property prices are stabilising, but new construction activity is likely to remain weak



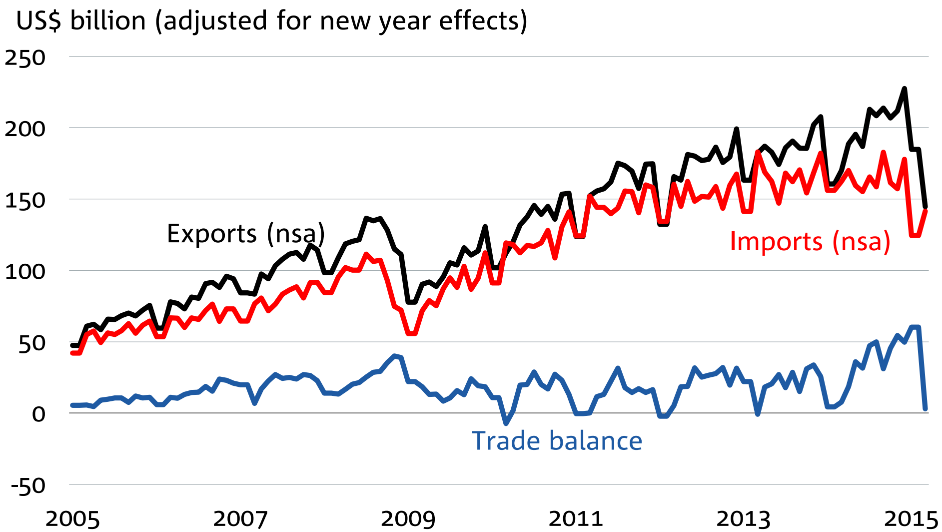
Source: China Index Academy, Datastream, NAB Economics

International trade – trade balance and imports

- China's trade surplus plunged in March – down to US$3.1 billion (from a record US$60.6 billion in February), as exports fell more sharply than imports year on year.
- When adjusted for Chinese New Year effects, the trade balance was at its lowest level since March 2013 – however there remains considerable uncertainty around distortions in the historical series.

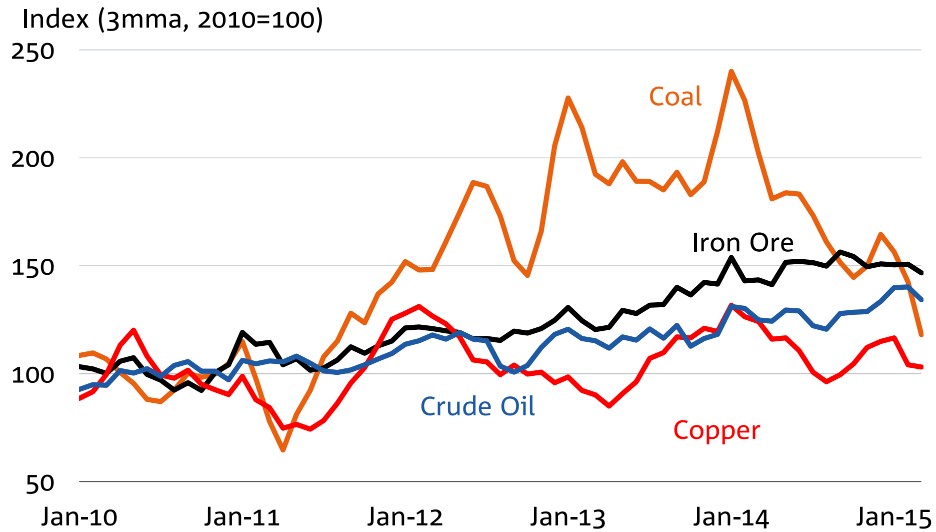
- Imports strengthened marginally in March (from February), edging up to US$142.6 billion – however this was sharply weaker in year-on-year terms, down -13%. Falling commodity prices over this period have contributed to this trend, with the RBA Index of Commodity Prices down around -28% yoy in March (in US$ terms).
- The volume of commodity imports have continued to diverge in March. Imports of coal have continued to fall – down by -33% yoy, while copper was -2% weaker. In contrast, imports of crude oil rose by 14% yoy and iron ore by 9% yoy – with consumers benefiting from much lower prices.

Trade balance falls sharply from February's record as exports plunged in March



Sources: CEIC, NAB Economics

China's coal imports have continued to fall, along with weak copper volumes

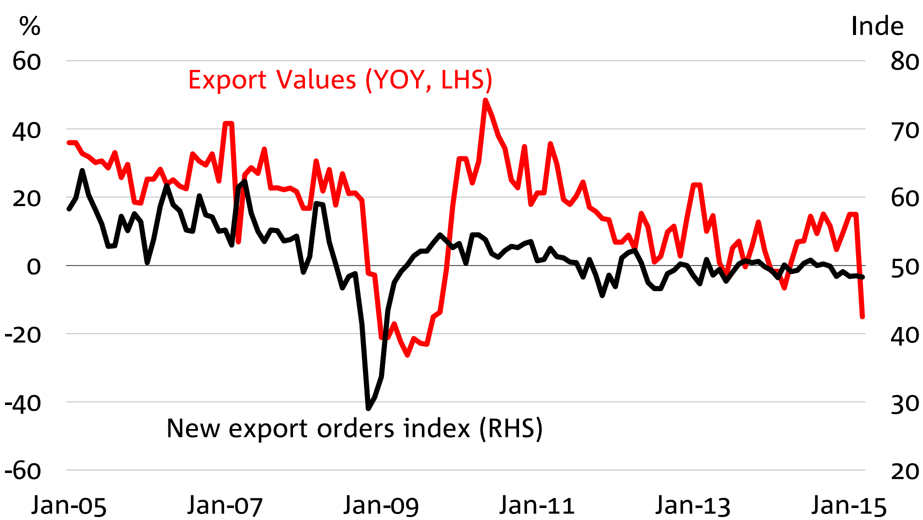


Sources: CEIC, NAB Economics

International trade – exports

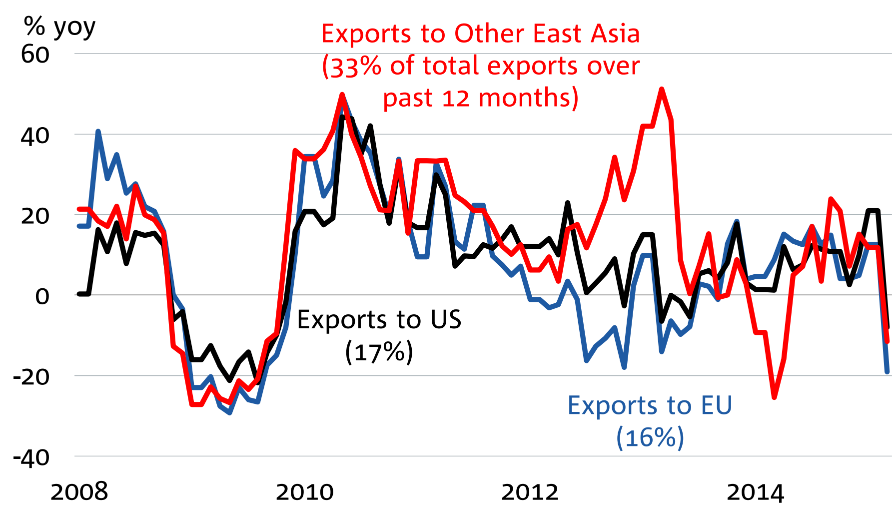
- China's exports totalled US$144.6 billion in March, a fall of -15% yoy (compared with a 15% increase across January-February). This was the sharpest fall since the GFC.
- Exports to all of China's major markets fell, with the European Union recording the largest declines at -19% yoy (compared with an increase of 13% in the first two months), while exports to Asian markets fell by -12% yoy (+12% previously) and the United States by -8% (from +21% previously).
- Across Asia, exports fell in year-on-year terms, however the fall was most noticeable in Hong Kong, where exports fell by -18% yoy. In contrast, the decline in non-Hong Kong Asia was far more modest, at just -5.6% yoy.
- As we have previously highlighted, the discrepancy between mainland China and Hong Kong trade data has narrowed in recent months – from around US$18 billion in December 2014 to around US$4 billion in February – which may reflect efforts to address the false invoicing schemes used to avoid capital controls.

Exports fell sharply in March (compared with reasonable strength across January and February)



Source: CEIC, NAB Economics

Exports to all major markets fell – with the European Union recording the largest decline at -19% yoy



Sources: CEIC, NAB Economics

Retail sales and inflation

- Retail sales growth continued to slow in March – down to 10.2% yoy (from 10.7% in January-February). This level was the lowest since February 2006, however the recent downward trend in sales has coincided with weak inflation (which has boosted the value of real sales). Real sales also grew by 10.2% yoy in March – near the trend level over the past few years.

- Headline retail sales continue to be influenced by the falling value of fuel purchases (due to lower oil prices) – with fuel purchases down -8% yoy in March (from -6.7% in January-February). Car sales also fell noticeably in March, down -1.3% yoy (compared with an increase of 11% yoy previously).

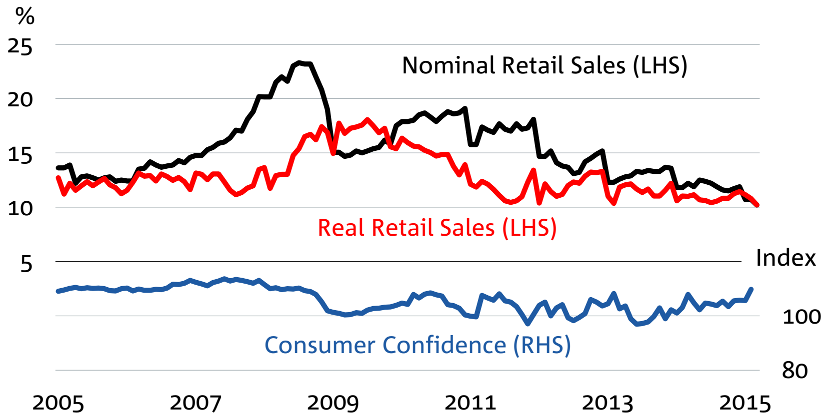
- China's inflation trends have remained subdued in recent months – with the headline CPI rising by 1.4% yoy in March (unchanged from February) – only a little higher than the five year low of 0.8% yoy in January.

- Food prices have been the main contributor to inflation in recent months – with growth of 2.3% yoy in March (compared with 2.4% in February). There was weaker growth in prices for seafood and fresh vegetables, while meat & poultry prices accelerated during the month.

- Non-food prices have remained weak – recording growth of 0.9% yoy in March (unchanged from February). Lower oil prices remain a key contributor, with the Transport & Telecom sub-component negative in year-on-year terms.

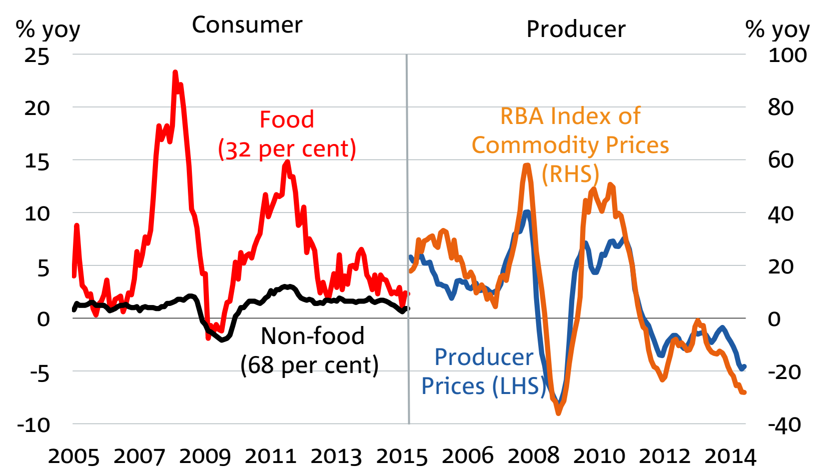
- Producer prices fell again in March – down -4.6% yoy – the thirty-seventh straight month of declines. Weaker commodity prices remains the key driver, with heavy industry prices falling by -5.9% compared with -1.0% for light industry.

Lower global oil prices have impacted nominal retail sales (which were at an eight year low in March)



* Adjusted for Chinese New Year effects
Source: CEIC, NAB Economics

Consumer price inflation remains weak – particularly for non-food – while producer prices fell again



Sources: CEIC, RBA, NAB Economics

Credit conditions

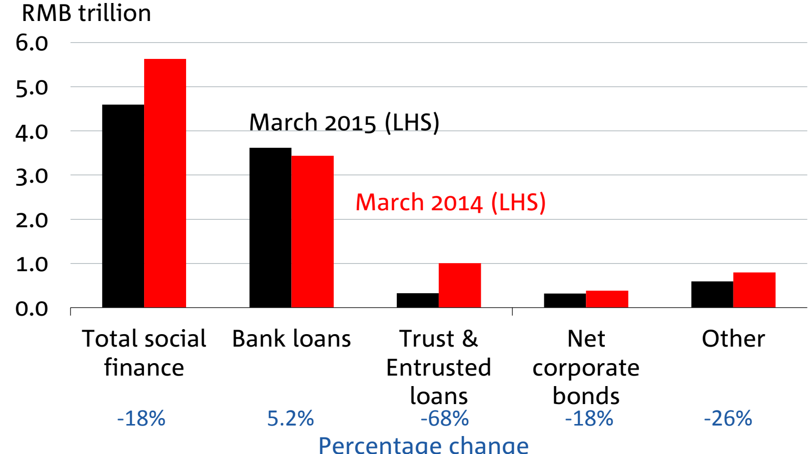
- In late March, the People's Bank of China (PBoC) announced that it would introduce deposit insurance from May 1 – a move seen as critical for the deregulation of deposit rates (which the bank's governor indicated could happen before the end of the year). Increased competition for deposits could drive up lending costs but also improve asset allocation (a critical financial reform for the country).

- New credit was considerably weaker in the first three months of the year (with the month of March particularly soft) – down -18% yoy over the period – reflecting in part the impact of tighter regulation around shadow banking. Traditional bank loans have grown – rising by 5.2% yoy over the period – while non-bank loans fell by -55% yoy, driven by falls in shadow banking components, such as trust loans and entrusted loans.

- China's policy makers face significant challenges in coming months – which will test the overall commitment to broad-based financial reforms. With Q1 GDP growth at the Government's target for 2015, the PBoC will face pressure for stimulus – potentially via further cuts to interest rates and the Reserve Requirement Ratio (RRR) – but the bank will be concerned about further growth in the already high debt levels.

- Further cuts to the RRR may be necessary to simply to maintain liquidity in the financial sector – with capital outflow a significant concern over the last three quarters of 2014 (as conditions in the carry trade turned against investment in China).

Tighter shadow banking regulation has constrained new credit growth (particularly outside the banks)



Sources: CEIC, NAB Economics

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