China's economy at a glance

by NAB Group Economics

11 June 2015

National Australia Bank

China's partial economic indicators broadly stable in May, but weak enough for PBoC forecast cuts

- In June, the People's Bank of China (PBoC) cut their economic growth forecast for 2015 from 7.1% to 7.0%. For now, our economic forecasts remain unchanged (7.1% in 2015, 6.9% in 2016) but we note the downside risk presented by any major correction in equities markets.
- China recorded another month of weak industrial production in May – with output rising by 6.1% yoy (from 5.9% in April). This level is only marginally stronger than the six year low of 5.6% recorded in March, but was in line with market expectations.
- Fixed asset investment recorded slightly stronger growth in May, at 10.0% yoy (up from 9.4% in April – which was the slowest rate of growth since December 2001). That said, lower costs for key inputs (including steel) have supported stronger levels of real investment.
- China's trade surplus expanded further in May, rising to US$59.5 billion (from US$34.1 billion in April). This was only marginally below the record level recorded in February 2015 (US$60.6 billion). The increase reflected a more modest decline in exports (-2.5% yoy) than imports (-18%yoy)
- Capital outflows have continued in early 2015 – with the total flow in the March quarter rising to US$159 billion (from US$97 billion in Q4 2014). As we have previously noted, this outflow includes 'hot money', reflecting the unwinding of the carry trade – however some is likely to be officially sanctioned outward foreign investment.

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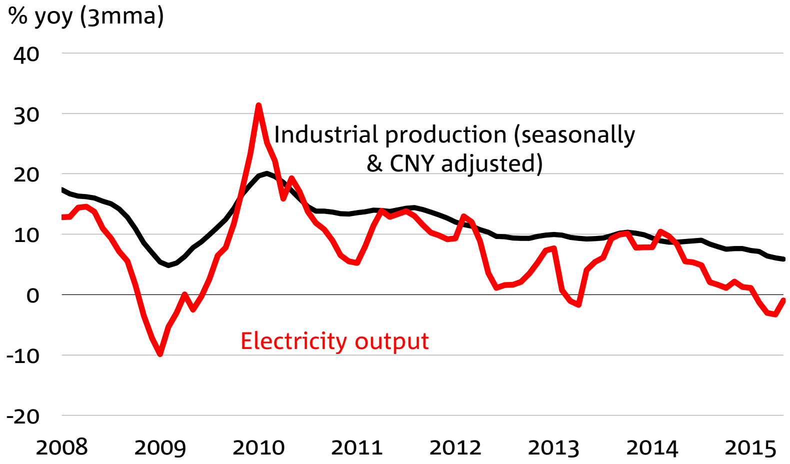
Industrial production

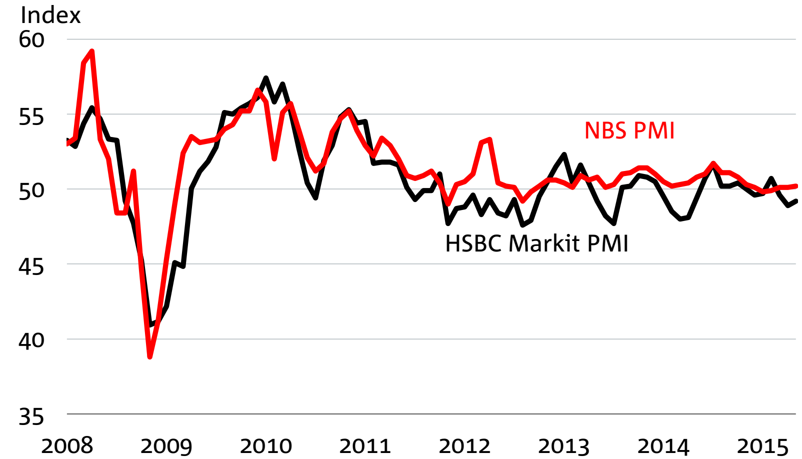
- China recorded another month of weak industrial production in May – with output rising by 6.1% yoy (from 5.9% in April). This level is only marginally stronger than the six year low of 5.6% recorded in March, but was in line with market expectations.
- The continued softness in the industrial sector has been evident in the output of key sub-sectors. Construction related materials, such as cement (-5.4% yoy) and crude steel (-1.7% yoy) have continued to decline, while motor vehicle output also fell (-1.6% yoy).
- China's main industrial surveys showed marginal improvement in May. The official NBS PMI edged up to 50.2 points (from 50.1 points previously) – a largely neutral result. In contrast, the HSBC Markit survey remained negative, at 49.2 points – albeit slightly less negative than April (48.9 points).

Weakness in the industrial sector remains evident – yoy growth barely edging away from the March low



Source: CEIC, NAB Economics

Little positivity in major industrial surveys – NBS conditions neutral; HSBC Markit still slightly negative



Source: CEIC, NAB Economics

Investment

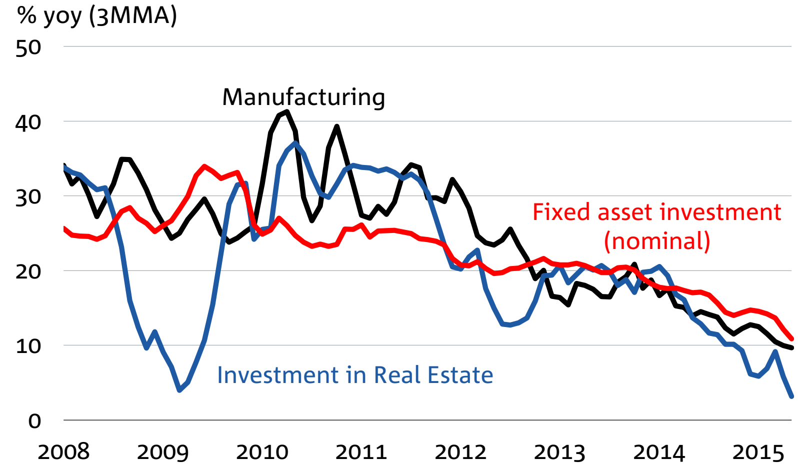
- Fixed asset investment recorded slightly stronger growth in May, at 10.0% yoy (up from 9.4% in April – which was the slowest rate of growth since December 2001). That said, lower costs for key inputs (including steel) have supported stronger levels of real investment.

- Despite this slight increase, investment in both manufacturing and real estate have continued to decline. These sectors accounted for almost 58% of fixed asset investment in 2014. Real estate investment slowed to 3.1% yoy (on a three month moving average), while manufacturing fell to 9.8% yoy.

- Concerns around a major crash in property prices continue to erode. According to China Index Academy data, average property prices rose by 0.1% month-on-month in May (on a three month moving average basis) – the first monthly increase recorded since May 2014. The most significant gains remain in Tier 1 cities (up by 0.6% mom 3mma), while Tier 2 and 3 cities declined by just -0.1% and -0.2% respectively – edging ever closer to neutral levels.

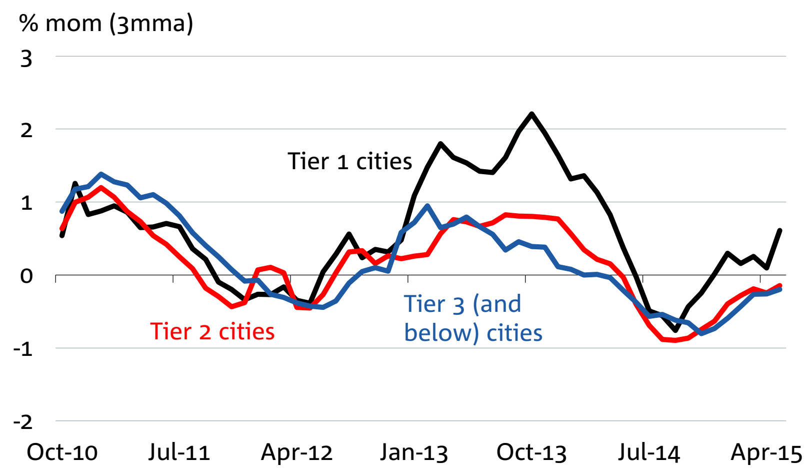
- Although prices for existing real estate appear to be stabilising, this is unlikely to provide support for new construction. Over the first five months of the year, residential construction starts fell by -17.6% yoy – although the rate of decline slowed a little in May. With construction a key source of demand for steel, this points to continued weakness in demand for Australian resources.

Real estate investment close to turning negative (in yoy terms), while manufacturing investment is also slowing



Source: CEIC, NAB Economics

Monthly residential property prices edged into positive territory in May – led by Tier 1 cities

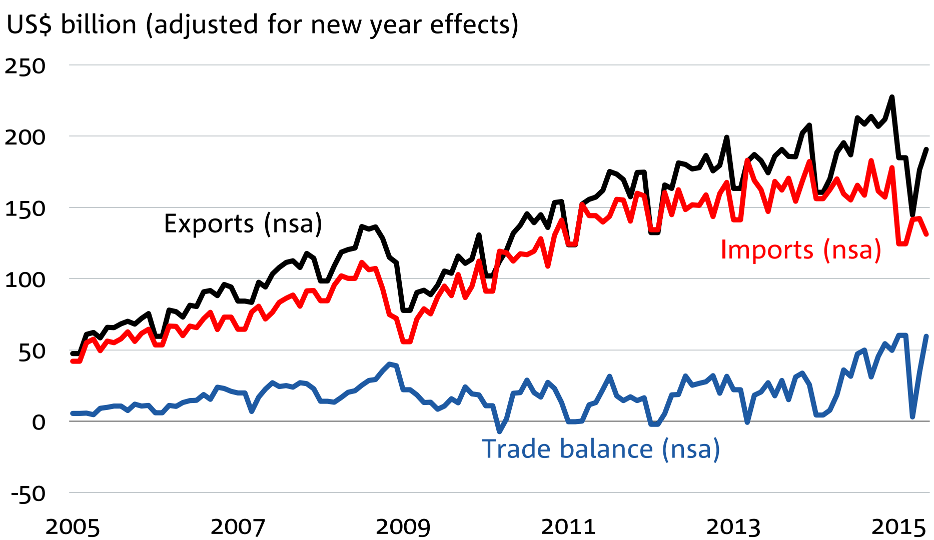


Source: China Index Academy, Datastream, NAB Economics

International trade – trade balance and imports

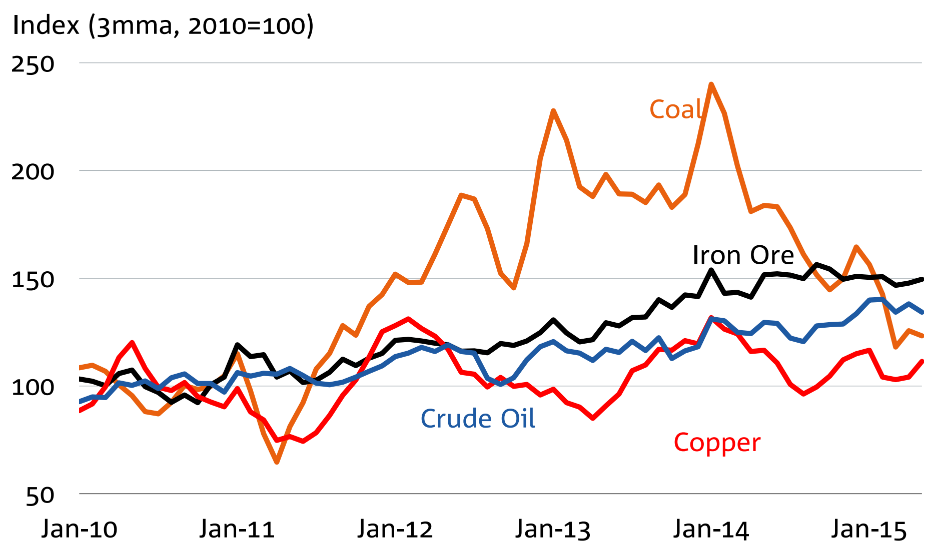
- China's trade surplus expanded further in May, rising to US$59.5 billion (from US$34.1 billion in April). This was only marginally below the record level recorded in February 2015 (US$60.6 billion).
- While exports have recovered from particularly low levels in March, they remain below the levels recorded last year. However the key driver of the wider trade surplus was another pull back in imports.
- China's imports fell to US$131.3 billion in May (compared with US$142.2 billion in April) – down around -18% yoy. As previously noted, falling commodity prices explain some of this decline (the RBA Index of Commodity Prices fell by -27% yoy in May), but volumes are also lower.
- By our estimations, import volumes fell by around -7.6% yoy in the first four months of the year. This has been led by weaker coal volumes (down -38% yoy over the period and another -41% yoy in May) and copper (down -14% yoy in the first four months). In contrast, volumes of crude oil have continued to rise.

Weak imports and a rebound in exports drove the trade balance back near record levels in May



Sources: CEIC, NAB Economics

China's falling coal demand having a major impact on import volumes

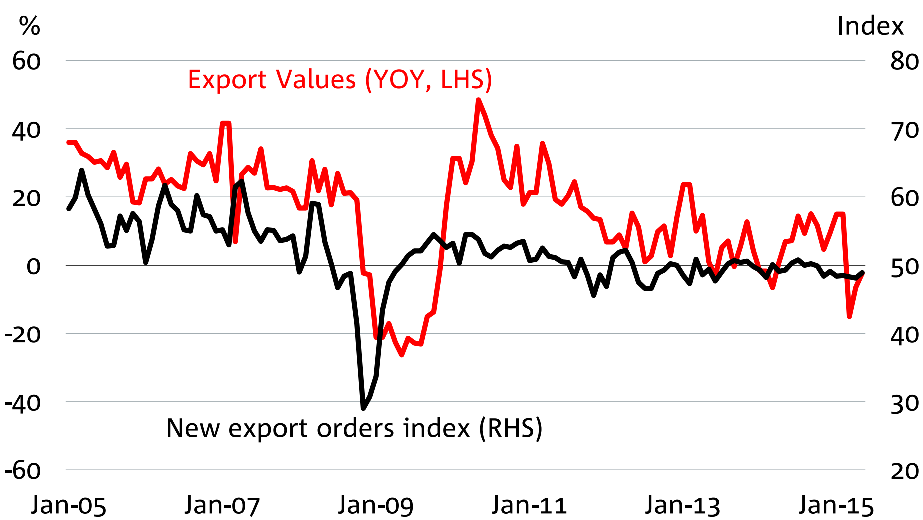


Sources: CEIC, NAB Economics

International trade – exports

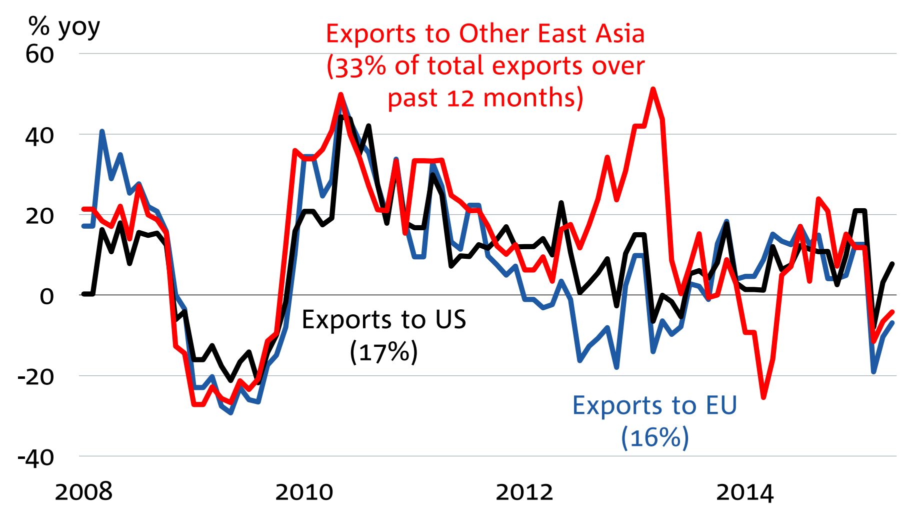
- In month-on-month terms, China's exports rose in May, to US$190.8 billion – although this was around -2.5% lower in yoy terms. The new export orders index in the NBS PMI survey has remained negative since September 2014, edging up to 48.9 points in May (from 48.1 points previously).
- Trends continue to differ significantly by market. Exports to the United States rose by around 7.8% yoy in May (from 3.1% previously). In contrast, exports to East Asia fell by -4.2% yoy and Europe by -6.9% yoy – although these falls were smaller than those recorded in April.
- Trends within Asia continue to differ – with exports to Hong Kong down by -6.9% yoy in May (from -9.0% in April). In contrast, exports to non-Hong Kong Asia fell more modestly – just -1.9% yoy (from -4.7% previously).
- There remains some disparity in reported trade between mainland China and Hong Kong. In April, the gap between customs values was US$4.1 billion – higher than the level recorded in March (US$2.3 billion) but well below the peaks recorded in 2013 and 2014.

Despite an increase from April levels, exports fell yoy in May (the third month in a row)



Source: CEIC, NAB Economics

Exports to Asia and Europe fell again in May, though less significantly than in March



Sources: CEIC, NAB Economics

Retail sales and inflation

- China's retail sales growth was relatively stable in May – edging up to 10.1% yoy (from 10.0% in April). Nominal retail sales growth has trended downwards since late 2010, however recent declines have coincided with a period of low inflation – boosting the value of real sales. In real terms, retail sales grew by 10.2% yoy in May (up from 9.9% in April) – moving back towards trend levels.

- As we have previously noted, lower fuel prices have contributed to slowing retail sales trends – with fuel purchases falling by -5.5% yoy in May – along with weakness in household electrical goods (which could be related to conditions in the real estate sector).

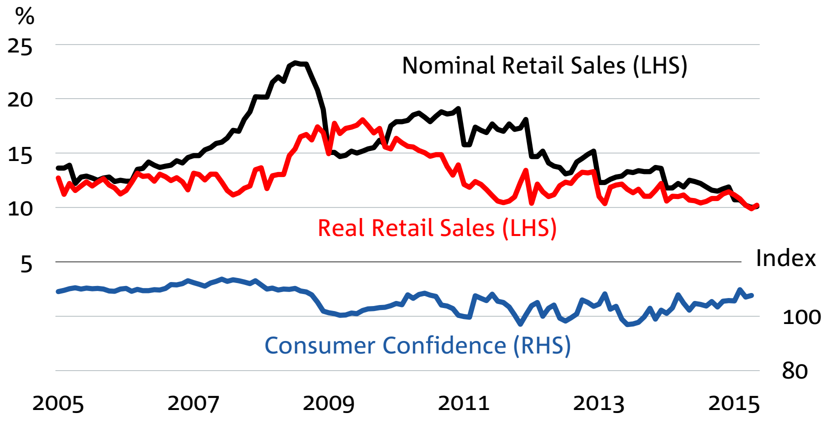
- Inflation trends were slightly softer again in May – with the headline CPI rising by 1.2% yoy (down from 1.5% in May) – continuing the low price growth evident over the past eighteen months.

- The key driver of the softer headline CPI was slower growth in food prices – which rose by 1.6% yoy in May (down from 2.7% in April). The growth rate for meat & poultry slowed, while prices for eggs and fresh fruit fell in year-on-year terms.

- In contrast, non-food price growth has remained stable – edging slightly higher to 1.0% yoy in May (from 0.9% in April). Lower fuel costs continue to limit non-food price growth, with the Transport & Telecom sub-component down around -1.3% yoy in May.

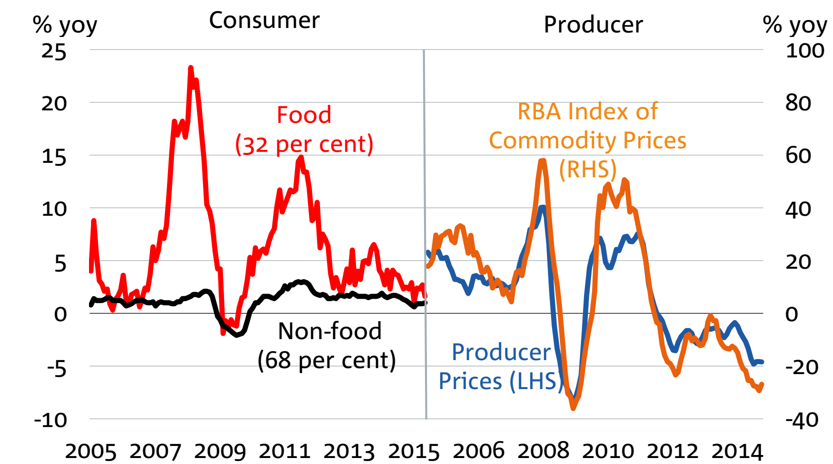
- Producer prices fell for the thirty-ninth straight month in May – down by -4.6% yoy (unchanged from April). The declines continue to point to falling input costs – with commodity prices the main influence. This was evident in the split between heavy industry prices (-6.0% yoy) and light industry (-0.9% yoy).

Retail sales were stable in May, with growth constrained by fuel and household goods purchases



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

Inflation softer in May on weaker food prices. Lower commodity prices keeping producer prices negative



Sources: CEIC, RBA, NAB Economics

Credit conditions

- Capital outflows have continued in early 2015 – with the total flow in the March quarter rising to US$159 billion (from US$97 billion in Q4 2014). As we have previously noted, this outflow includes 'hot money', reflecting the unwinding of the carry trade – however some is likely to be officially sanctioned outward foreign investment.

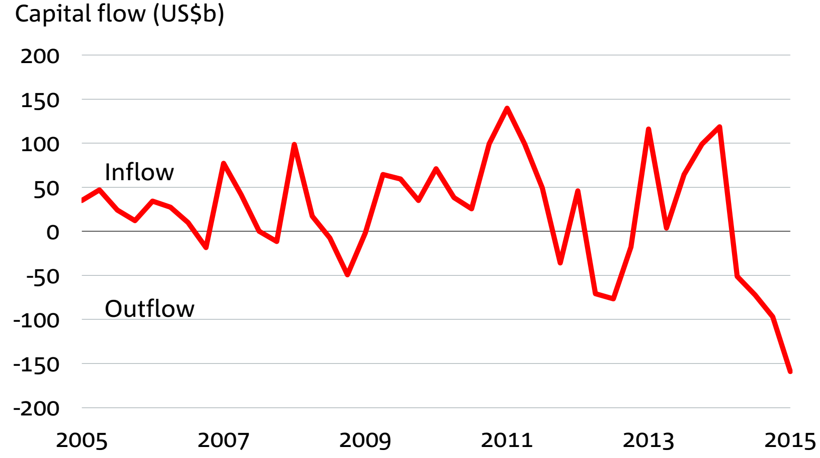
- Since Q2 2014, the carry trade (speculative borrowing abroad at relatively low interest rates and investing in higher yielding Chinese assets) has become less appealing – as interest rate differentials, a crackdown on shadow banking and Yuan movements have all been unfavourable.

- The capital outflow has reduced liquidity in financial markets – a major concern for highly indebted firms – prompting the People's Bank of China (PBoC) to cut the Reserve Requirement Ratio (RRR) again in April, this time by 1% (to 18.5% for large institutions).

- The cut to the RRR added around RMB 1.26 trillion in liquidity (based on the size of deposits in April 2015) – equivalent to around US$200 billion. Much like the previous cut, this liquidity injection was broadly equivalent to the capital outflow in the March quarter.

- Data for new credit was not available at the time of writing. Market expectations have a modest increase in total new credit (compared with the RMB 1.05 trillion in April), but still well levels recorded last year. This means that new credit is still likely to be around -20% yoy lower over the first five months of the year – reflecting the tighter regulation around shadow banking continuing to constrain the non-bank sector.

China's capital outflow expanded in early 2015 – driving RRR cuts to bolster financial market liquidity



Source: CEIC, NAB Economics

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