more give, less take

China’s economy at a glance

by NAB Group Economics

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National Australia Bank

Chinese authorities target marginally slower growth, but are content to let debt position deteriorate

- China’s policy makers met at the National People’s Congress in early March, announcing an economic growth target range of 6.5-7%. In addition, they released a target growth rate for total social financing of ‘around 13%’ – which would result in a further deterioration of debt-to-GDP.
- As noted in this month’s China Economic Update, a broader estimate of China’s debt puts this figure at around 308% of GDP – a level comparable to many advanced economies and particularly high for a still developing country. Chinese authorities are now facing a debt dilemma – they can no longer allow debt to grow unchecked, however controlling debt growth would mean accepting a slower rate of economic growth. At least for 2016, they appear content to allow the former to happen.
- Industrial production growth slowed to a seven year low in January-February, while fixed asset investment accelerated slightly, on the back of stronger investment in real estate. New construction starts were stronger over this period, but it is too early to know if this is a trend that can be sustained.
- Retail sales were a little softer – with real retail sales growth likely dipping below 10% yoy, slightly weaker than the levels recorded across most of 2015 but still robust.
- At the end of February, the People’s Bank of China (PBoC) cut the Required Reserve Ratio for the fifth time in a year – down to 17% for large institutions – potentially adding RMB 690 billion in liquidity to financial markets. As we have previously noted, these policy changes are not necessarily stimulatory, as RRR cuts have been necessary to maintain liquidity in the finance sector, given the capital outflow in recent years.

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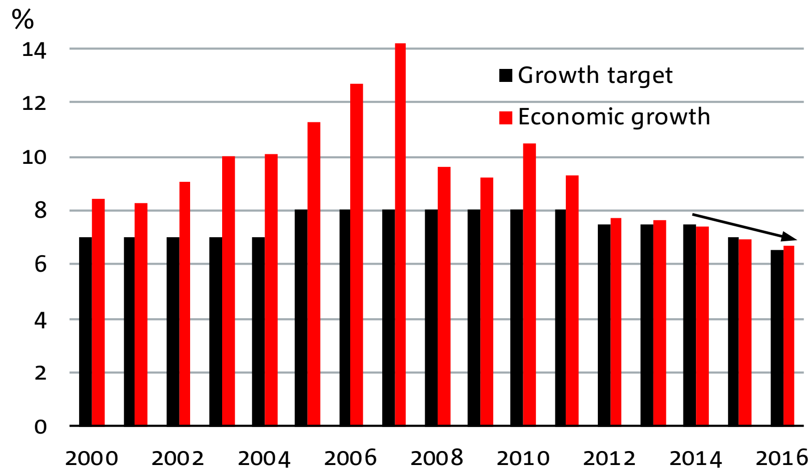
GDP growth target

- China's policy makers met at the National People's Congress in early March, releasing a range of targets for key economic indicators. The most closely watched is the economic growth target, which was slightly reduced for 2016 – to a range of 6.5% to 7.0% – compared with last year's 'around 7.0%'.
- Our forecast for growth is unchanged at 6.7% in 2016 and 6.5% in 2017, although we consider the risks to be weighted to the downside.
- Authorities also set a target for growth in total social financing, at around 13% for 2016 – which would mean a further deterioration in the country's debt-to-GDP ratio.
- As noted in this month's China Economic Update, a broader estimate of China's debt puts this figure at around 308% of GDP – a level comparable to many advanced economies and particularly high for a still developing country.
- Under the newly commenced 13th Five Year Plan, also released at the National People's Congress, China is targeting an average rate of growth of 6.5% in the period to 2020 – which would result in a doubling of GDP over 2010 levels.
- Chinese policy makers are facing a significant dilemma regarding the country's debt. They can no longer afford to allow debt to grow unchecked – as this would increase the likelihood of a major financial crisis and the potential for a hard landing. On the other side, real economic growth is unlikely to be sustainable at the five year target without stronger growth in debt – bringing down the ratio would mean tolerating a considerably lower potential rate for economic growth (something that policy makers are unlikely to tolerate).

China's growth target has been trimmed in recent years, down to 6.5-7% range in 2016



Sources: CEIC, NAB Economics

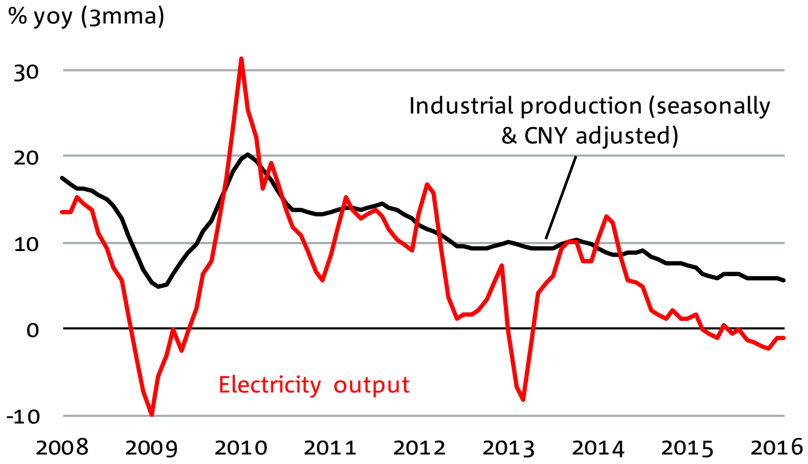
Industrial production

- China's industrial production slowed across January and February – down to 5.4% yoy (compared with 5.9% in December 2014). This rate of growth was below expectations and the slowest rate of growth since the same period in 2009.

- Key heavy industrial sectors remained weak – with crude steel output falling by 5.7% yoy, cement production down 8.2% yoy – reflecting weakness in the construction sector, while the motor vehicle sector recorded growth of 5.3% yoy. Electricity generation was marginally stronger – up 0.3% yoy.

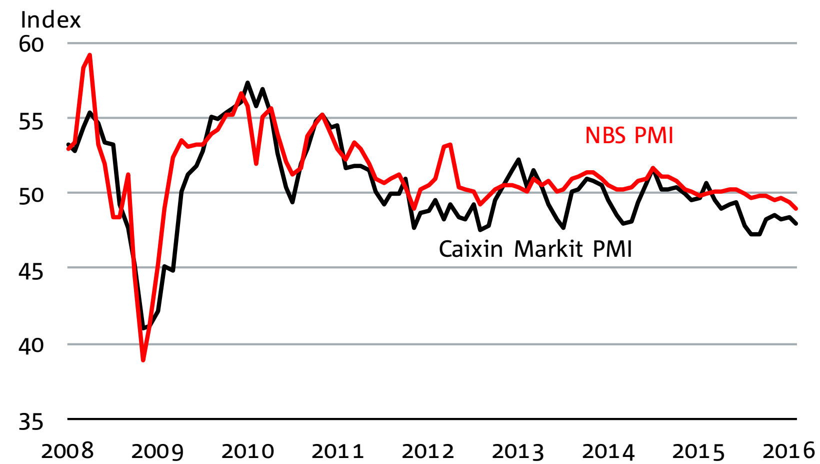
- China's industrial surveys have remained negative in early 2016, with the official NBS survey falling to 49.0 points in February (from 49.4 points previously), the weakest level since January 2009. In contrast, the Caixin Markit PMI also fell, down to 48.0 points (from 48.4 in January), but this measure is less negative than late 2015.

China's industrial production has continued to trend lower, with electricity output largely unchanged



Source: CEIC, NAB Economics

The two major PMI surveys softened in February – with the official survey at its weakest level since early 2009

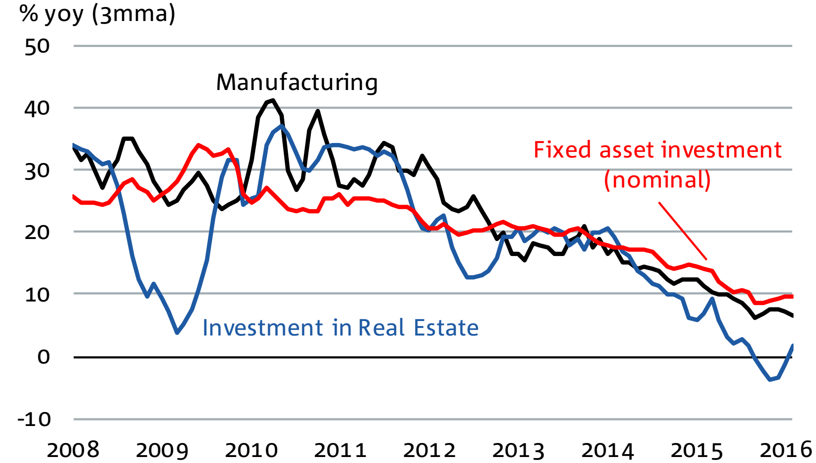


Source: CEIC, NAB Economics

Investment

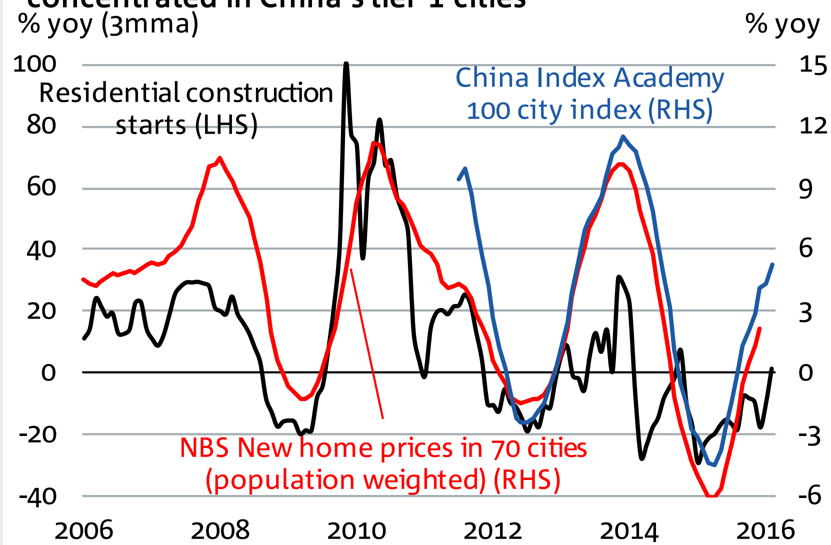
- Fixed asset investment recorded an acceleration in early 2016, with growth at 10.2% yoy across January and February, up from 8.2% yoy in December. It is worth noting that this was around the rate of growth recorded in November 2015, which was well below the trend levels of recent years.
- Investment in the manufacturing sector has continued to slow – reflecting tough industrial conditions and excess production capacity – down to 6.7% yoy (on a three month moving average basis), compared with 7.6% in December. In contrast, there has been a slight improvement in real estate investment, recording growth of 1.7% yoy (3mma) in February, up from -3.3% in December. Combined, these two sectors accounted for almost 56% of total investment in 2015.
- In contrast, strong investment growth has been sustained in water conservation and environmental management (27% yoy across January-February) and public utilities (19% yoy) – with these sectors comprising around 15% of the total in 2015.
- Residential construction activity was stronger in January-February, however it is too soon to know whether this is a trend that can be sustained. New construction starts were up around 9.7% yoy over this period, and up 1.5% yoy on our preferred three month moving average basis (reflecting very weak growth in late 2015).
- House price trends have improved in recent months, however the majority of gains have been in China's tier 1 cities (Beijing, Shanghai, Shenzhen and Guangzhou) – where prices rose by 17% yoy. In contrast, tier 2 cities rose by just 0.3% yoy and tier 3 and below by 1.1% yoy. A more sustained recovery outside tier 1 cities may be required to support sustained stronger construction activity.

Fixed asset investment was marginally stronger in early 2016, with real estate investment turning positive



Source: CEIC, NAB Economics

House price trends have improved, but the growth is concentrated in China's tier 1 cities

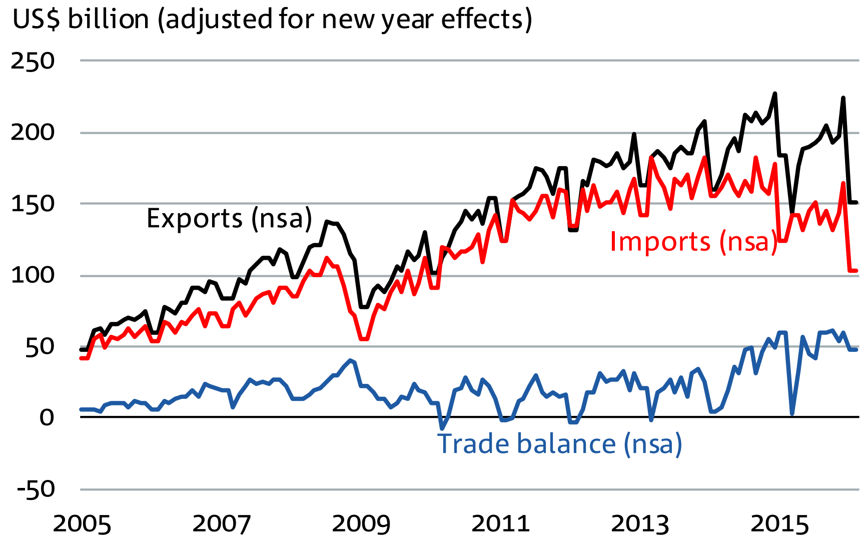


Source: CEIC, Datastream, NAB Economics

International trade – trade balance and imports

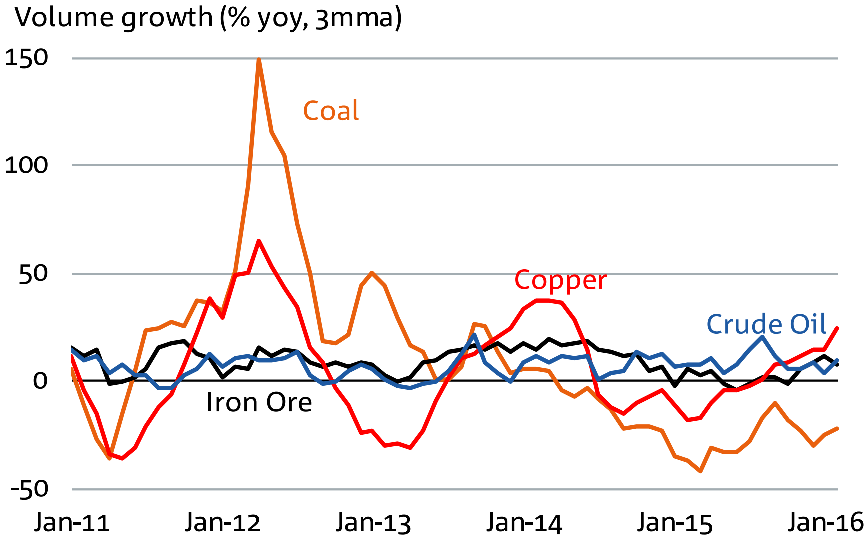
- China's trade activity pulled back sharply over the first two months of the year, with substantial falls in both imports and exports – both from the levels of late 2015 and from levels a year ago. China's trade surplus only narrowed marginally – averaging US$47.9 billion a month across January and February (compared with US$59.4 billion in December 2015).
- Across January and February, China's imports totalled US$207.5 billion, a year on year fall of 17%. In part, this reflects the continued falls in commodity prices, with the RBA Index of Commodity Prices falling by almost 25% yoy in the first two months of the year.
- In contrast, the volume of imports has declined less significantly, down by only around 2.8% in 2015, and around 6.8% in January (although the earlier timing of Chinese new year may have distorted the latter result).
- In terms of major commodities, there were noticeable increases in imports of copper (up 23% yoy in January-February), crude oil (up 9.3% yoy) and iron ore (up 6.3% yoy). In contrast, the declining trend for coal continued, down by 10% yoy over the first two months.

China's trade surplus eased back slightly in early 2016, as both export and import values plunged



Sources: CEIC, NAB Economics

Stronger import volumes for copper, crude oil and iron ore in early 2016, while coal volumes continue to fall

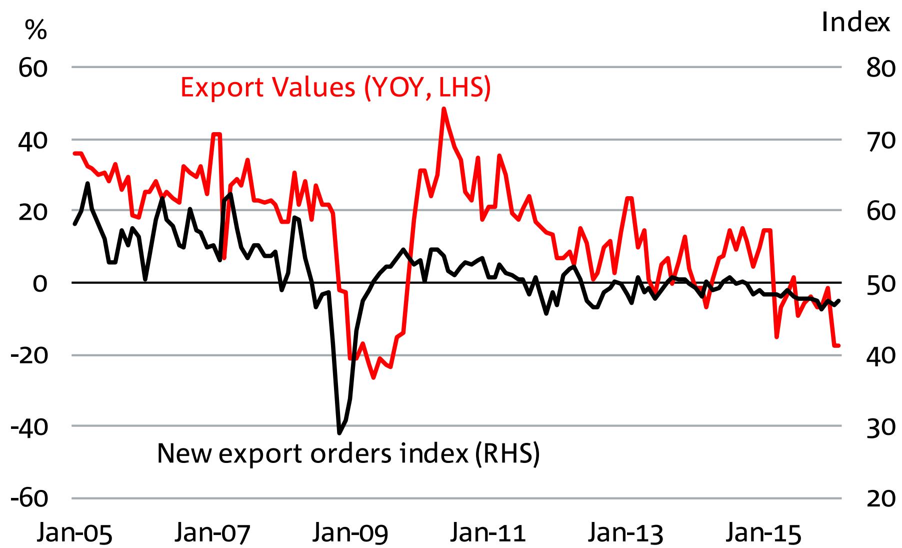


Sources: CEIC, NAB Economics

International trade – exports

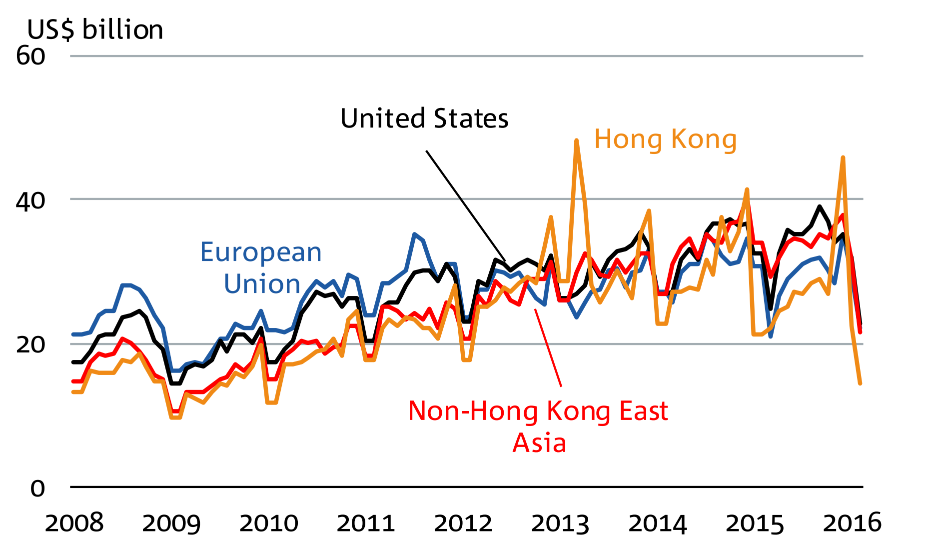
- China's exports totalled US$303.3 billion across January and February, a fall of 18% yoy. China's exporters remain relatively negative, with the new export orders measure in the NBS PMI survey at 47.4 points in February (albeit improved from 46.9 points in January).
- The key driver of the fall in export values over the first two months was a decline in exports to Asia – which fell by over 18% yoy, to US$90 billion. Exports to Europe and the United States fell less significantly – with both down by around 16% yoy.
- Exports to Hong Kong declined less sharply than other markets – down by around 13% yoy across January and February. In contrast, non-Hong Kong Asia saw declines of almost 22% yoy – led by falling export values to Malaysia, South Korea and Vietnam.
- Trade data between China and Hong Kong continues to have considerable distortions, in part due to false invoicing used to hide unapproved capital flows – providing considerable uncertainty around the true level of trade.

China's exports fell sharply across the first two months, with exporter sentiment remaining negative



Source: CEIC, NAB Economics

Exports to all major trading partners pulled back in early 2016 – led by other Asian trading partners



Sources: CEIC, NAB Economics

Retail sales and inflation

- China's retail sales growth was somewhat weaker in January and February – at around 10.2% yoy (down from 11.1% yoy in December 2015). The Retail Price Index was not available at the time of writing, however real retail sales likely dropped below 10% – slightly weaker than the levels of 2015, but still robust. Consumer confidence has remained comparatively strong – at 104.0 points in January, up from 103.7 points in December 2015.

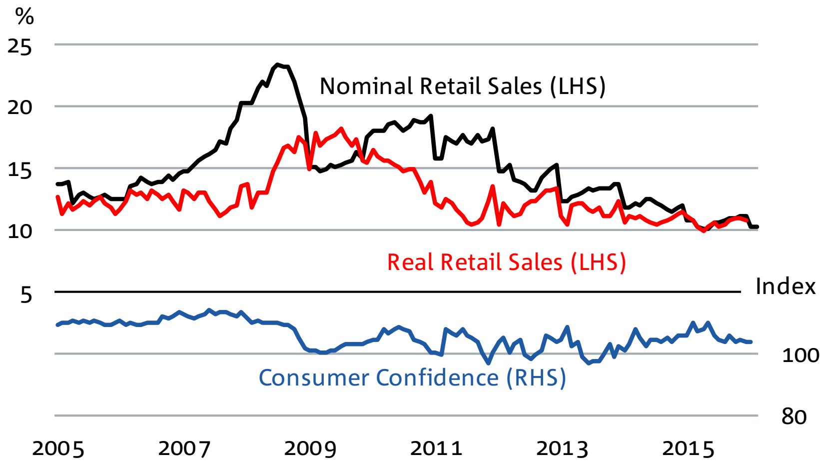
- In February, China recorded the strongest rates of inflation since July 2014 – with the headline CPI rising by 2.3% yoy (up from 1.8% in January). Despite this acceleration, this rate remains subdued when compared with trends prior to 2015.

- Food prices were the driver of the acceleration, with the food index rising by 7.3% yoy – although the earlier timing of Chinese new year potentially distorted this outcome. Pork was a major contributor, with prices up over 25% yoy, along with fresh vegetables (up almost 31% yoy).

- In contrast, non-food price growth remained subdued, at just 1.0% yoy (from 1.2% in January). Fuel prices are continuing to fall, but less significantly in year-on-year terms than previously, down 11.7% yoy in February (from 12.4% in January).

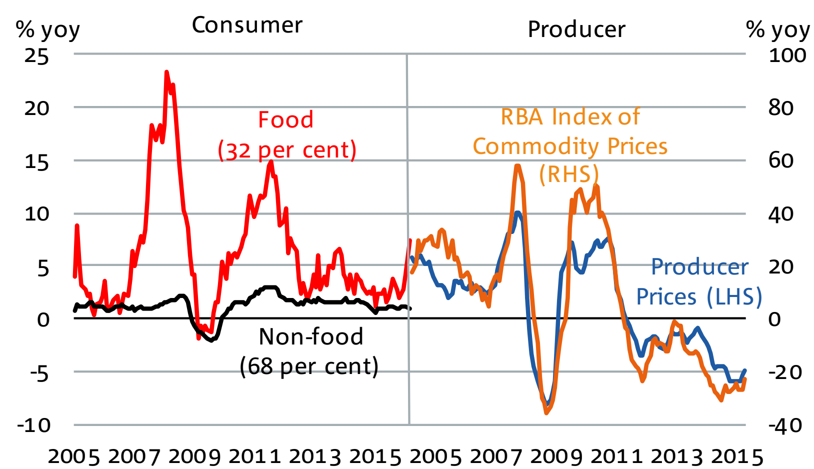
- Producer prices have fallen every month for the past four years – forty-eight months in total – and were down 4.9% yoy in February (compared with 5.3% in January). Prices have consistently fallen faster in heavy industry than light (albeit the National Bureau of Statistics haven't provided this split since November 2015) – with falling commodity prices a major driver – the RBA Index of Commodity Prices fell by 22% yoy in February.

Retail sales slightly softer in early 2016, with real sales likely dropping below 10% yoy



Source: CEIC, NAB Economics

Surging pork and vegetable prices drove higher consumer prices higher, while producer prices fell again



Sources: CEIC, RBA, NAB Economics

Credit conditions

- At the end of February, the People's Bank of China (PBoC) cut the Required Reserve Ratio for the fifth time in a year – down to 17% for large institutions – potentially adding RMB 690 billion in liquidity to financial markets. As we have previously noted, these policy changes are not necessarily stimulatory, as RRR cuts have been necessary to maintain liquidity in the finance sector, given the capital outflow in recent years.

- We continue to expect two cuts to interest rates in early 2016 – bringing the benchmark one year lending rate to 3.85% by mid-year. Similarly further cuts to the Required Reserve Ratio are likely to maintain liquidity in the finance sector, with capital outflows likely to continue in the short term.

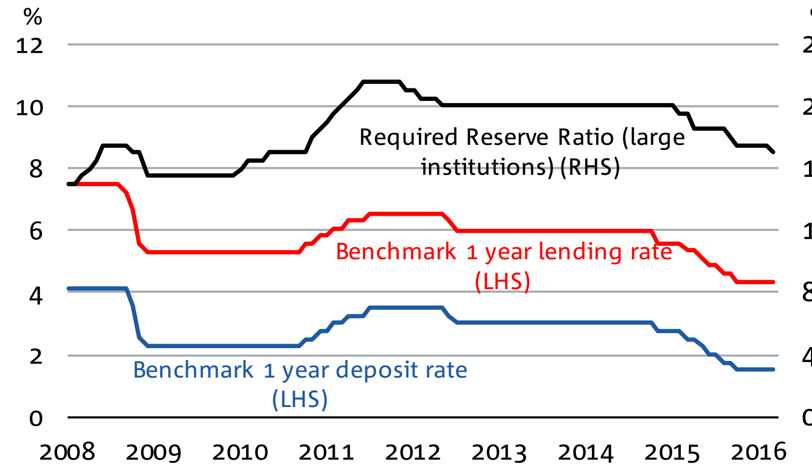
- After a sharp increase in January (ahead of Chinese new year), new credit slowed significantly in February. Over the two month period, aggregate financing totalled RMB 4.2 trillion, an increase of 23% yoy.

- Bank loans recorded slightly slower growth, 19% yoy, to total RMB 3.1 trillion. Efforts to tightened regulation around the shadow banking sector has seen a strong increase in bank loans across the past two years.

- The key driver of other credit was corporate bonds, with net issuance totalling RMB 541 billion in January and February, an increase of 110%.

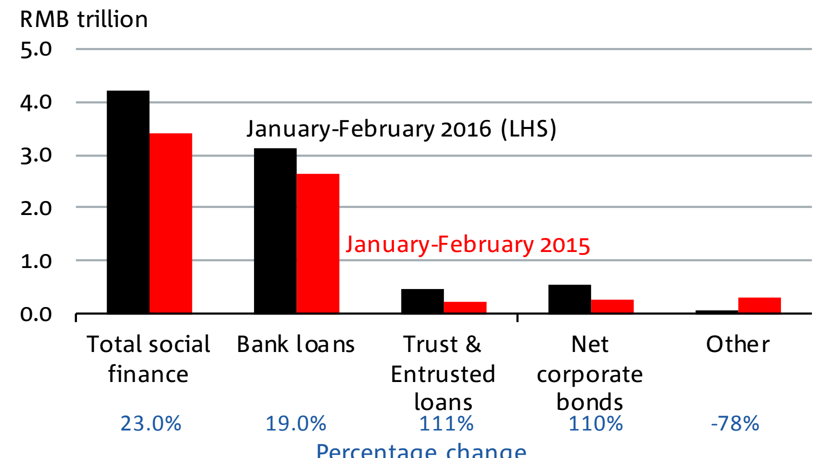
- Key components of the shadow banking sector largely cancelled each other out – with growth in trust and entrusted loans (at 111% yoy) offset by a sharp fall in banker acceptances (-275% yoy).

China's monetary policy has loosened over the past 12 months, with cuts to interest rates and the RRR



Source: CEIC, NAB Economics

Strong increase in new credit in early 2016, driven by bank loans and corporate bonds



Sources: CEIC, NAB Economics

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