China's economy at a glance

by NAB Group Economics

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National Australia Bank

Construction activity has continued to support China's growth in May, but sustainability concerns remain

- China's construction sector continues to drive activity in China's economy – flowing through to heavy industries such as steel and cement. New construction starts rose by 16% yoy over the first five months of the year – with lower growth in May than March and April – however this slower growth was largely due to base effects.
- As we noted last month, we don't believe that the construction rebound is sustainable, with the recovery in house prices largely driven by policy relaxation, loose credit and the poor performance of alternative investment options for individuals – re-inflating the property bubble that had previously deflated to a degree across 2014 and 2015.
- Industrial production growth was unchanged in May at 6.0% yoy – in line with market expectations.
- Fixed asset investment was softer in May, with trends mixed at a sub-sector level – with an acceleration in real estate investment, while investment in manufacturing continued to trend lower.
- China's trade surplus widened in May to US$50.0 billion (from US$45.6 billion previously) due to a month-on-month increase in exports. Price effects continue to influence trade values – with commodity imports increasing strongly in May – particularly construction related iron ore and copper.
- New credit data was unavailable for May at the time of writing.

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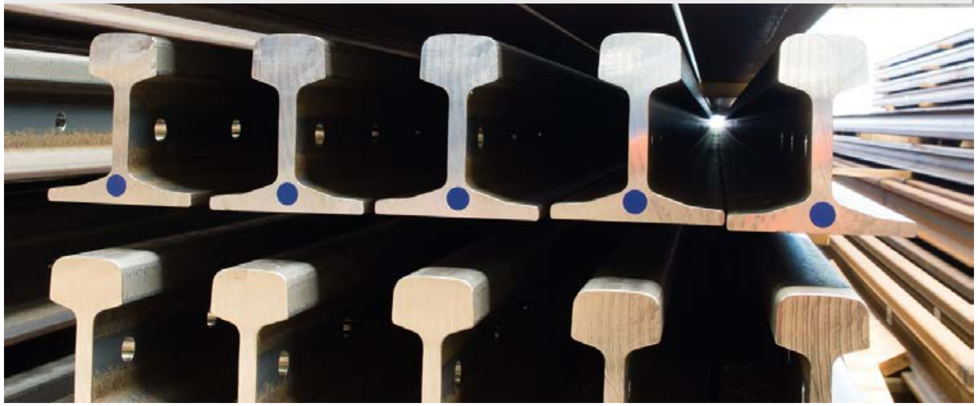
Industrial production

- Growth in China's industrial production was unchanged in May, at 6.0% yoy – the same level recorded in April and in line with market expectations.

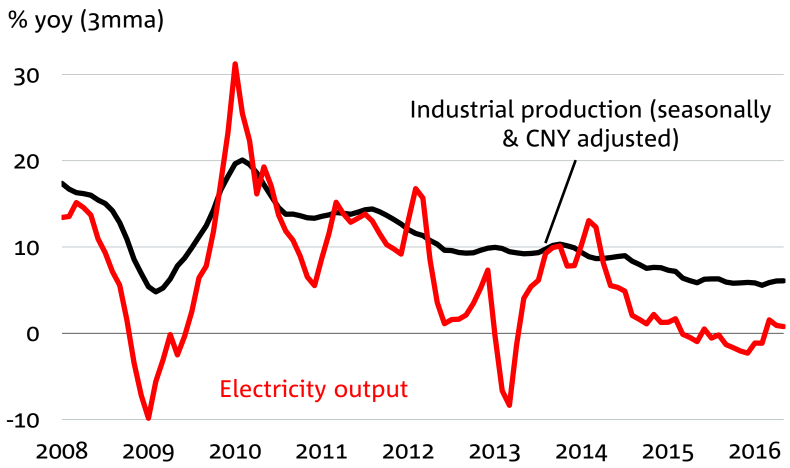
- Key industrial sectors related to construction – such as steel and cement – continued to record solid growth in May, at 1.8% yoy and 2.9% yoy respectively. Growth in motor vehicle output was marginally softer – at 4.1% yoy (from 4.3% previously), while electricity output was unchanged year-on-year.

- China's major industrial surveys were relatively stable in May. The official NBS PMI was unchanged at 50.1 points – recording three months around this level – while the Caixin Markit PMI eased to 49.2 points (from 49.4 points previously).

- We continue to have reservations around the sustainability of the current Chinese construction rebound, and its flow on support for industrial production. While it provides short term support for China's economy, it presents some significant uncertainty as well. Any slowdown in construction would have a major impact on this sector.

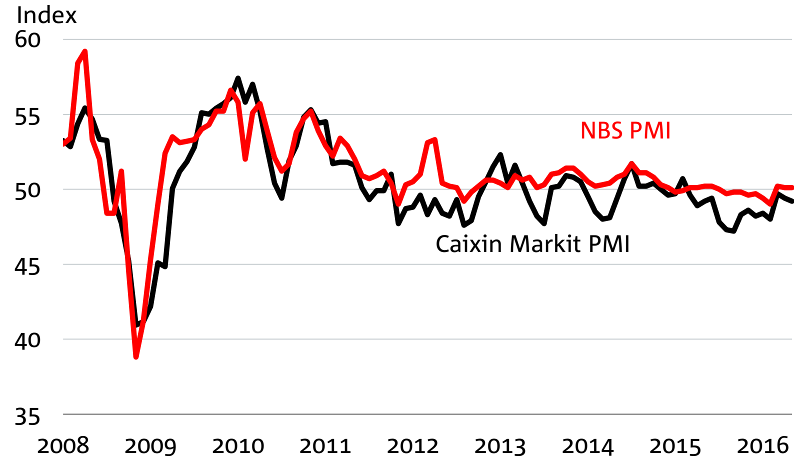


China's construction rebound underpins industrial activity but also presents uncertainty going forward



Source: CEIC, NAB Economics

China's main PMI surveys remained relatively stable, at neutral and marginally negative levels



Source: CEIC, NAB Economics

Investment

- China's fixed asset investment growth slowed in May – down to 7.5% yoy (from 10.1% in April) – well below market expectations. This was the weakest rate of growth since the thirteen year low recorded in September 2015.

- Investment trends were mixed at a sub-sector level. Real estate investment continued to strengthen – to 8.7% yoy (on a three month moving average basis), from 7.3% previously. This reflects the significant rebound in construction activity which has underpinned the industrial recovery in recent months.

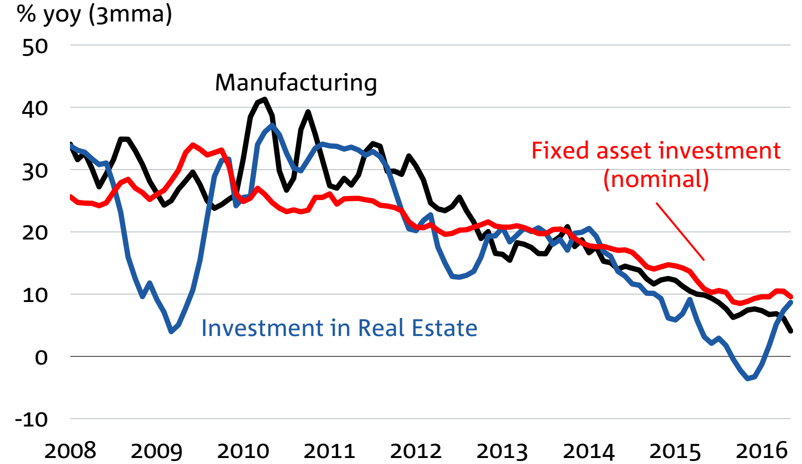
- In contrast, investment in manufacturing slowed further, down to 4.1% yoy (3mma), from 6.1% in April.

- In the first five months of 2016, residential construction starts rose by 16% yoy. The rate of growth slowed a little in May – although this was due to base effects in 2015, with a larger level of starts in May 2015 than April. The stronger construction activity has underpinned demand for key commodities such as steel, cement and copper.

- Property prices have continued to strengthen – rising by 10.3% yoy in May – however this remains largely driven by China's tier 1 cities, where prices rose by 23% yoy, while tier 2 and tier 3 (and below) cities rose by just 4.4% yoy and 4.6% yoy respectively.

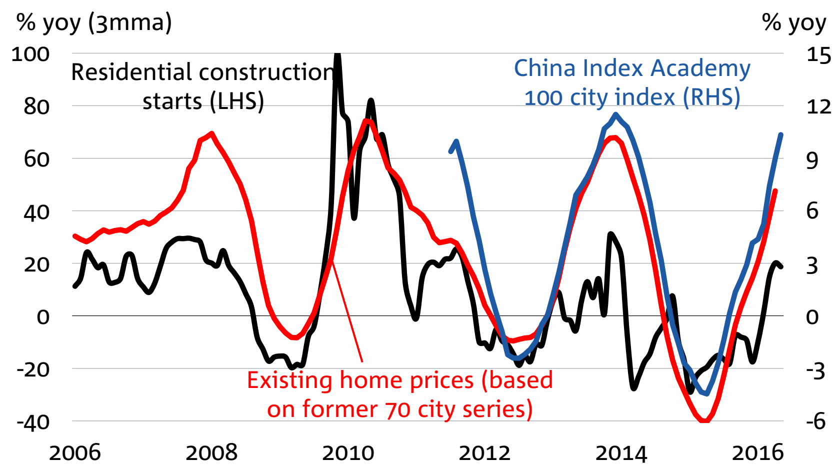
- As we noted last month, we don't believe the recovery in housing markets is supported by fundamentals, but rather is related to policy changes that have relaxed purchase requirements, looser credit and the poor performance of alternative investment options (following the share market correction and crackdowns on shadow banking). At the time of writing, new credit data was unavailable for May.

Investment trends diverge by sector – with manufacturing slowing while real estate strengthened in May



Source: CEIC, NAB Economics

Property prices and construction activity have rebounded on policy changes, rather than stronger fundamentals

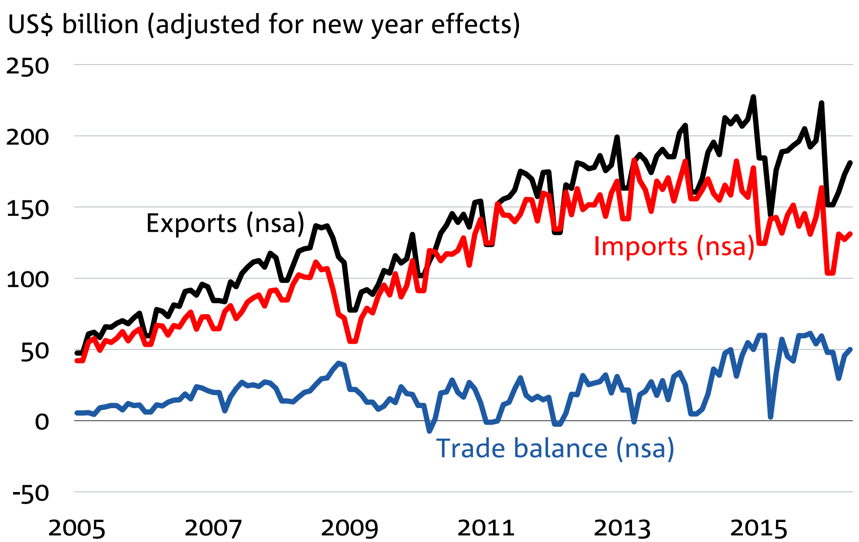


Source: CEIC, Datastream, NAB Economics

International trade – trade balance and imports

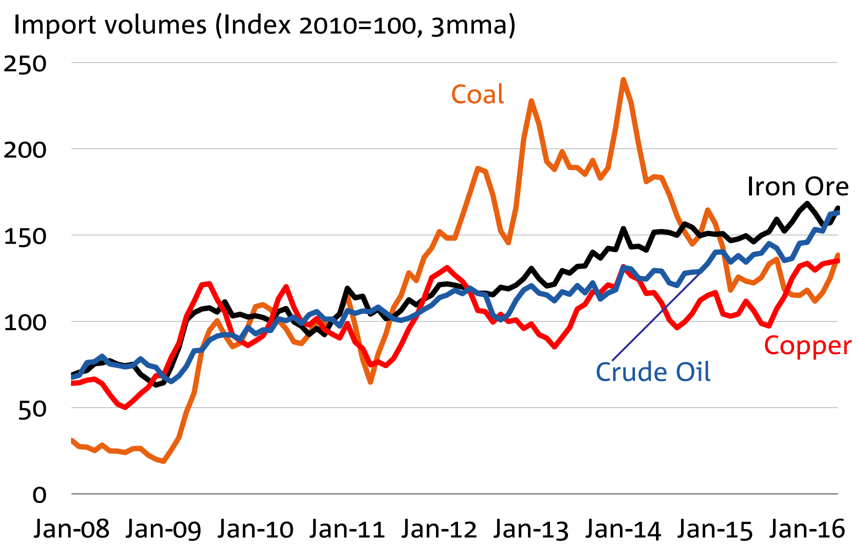
- China's trade surplus widened in May to US$50.0 billion (from US$45.6 billion in April) driven by a sizeable month-on-month increase in exports, while the increase in imports was comparatively modest.
- In year-on-year terms, the value of China's imports was marginally lower – down 0.4% to US$131.1 billion (compared with a fall of 10.9% in April). This level was considerably stronger than market expectations (-6.8% yoy in the Bloomberg survey).
- Price effects have influenced China's weaker import trends since 2014 – with commodity prices trending lower. The RBA Index of Commodity Prices fell by around 9.6% yoy in May, but has trended upwards from a cyclical low in January.
- In contrast, import volumes for commodities have picked up in recent months. Iron ore and copper imports rose by 22% yoy and 19% yoy – underpinned by stronger demand from construction activity – while crude oil and coal imports rose by 39% yoy and 34% yoy respectively (albeit coal volumes are well below peaks in early 2014).

China's trade surplus widened in May as exports expanded month-on-month



Sources: CEIC, NAB Economics

The rebound in construction has supported stronger iron ore and copper imports

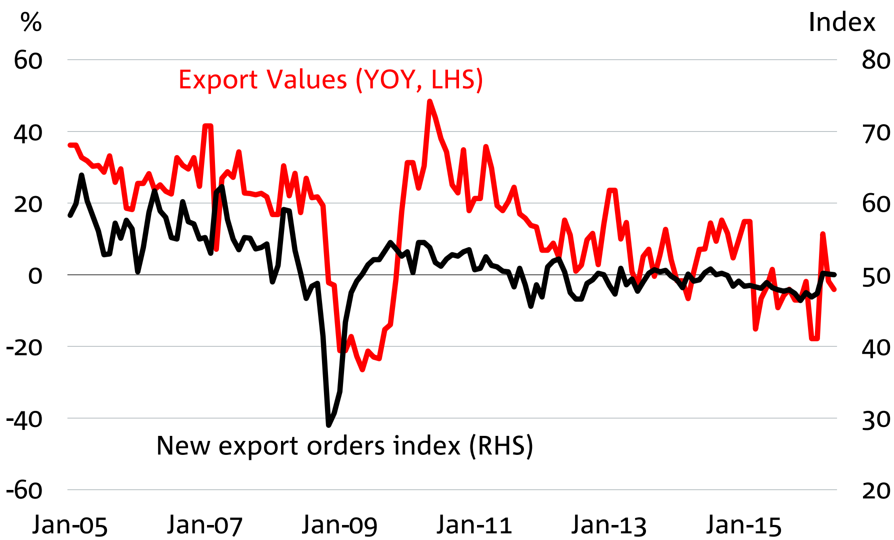


Sources: CEIC, NAB Economics

International trade – exports

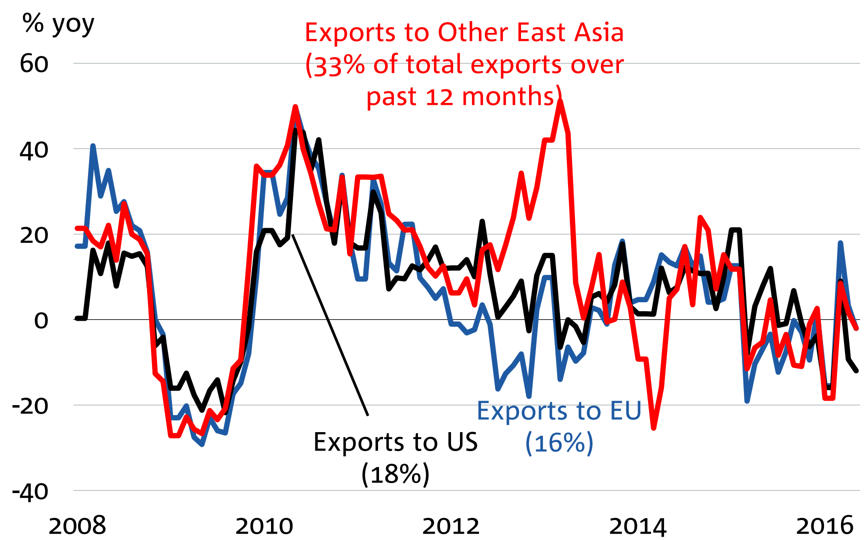
- China's exports totalled US$181.1 billion in May, up from US$172.7 billion in April. While exports rose month-on-month, there was a decline in year-on-year terms of 4.1%.
- New export orders – as reported in the NBS PMI survey – have remained stable at neutral levels – 50.0 points in May (compared with 50.1 points in April and 50.2 points in March). These levels were considerably stronger than those recorded across much of 2015.
- By destination, the main contributor to the decline in exports was the United States – where exports fell by 12% yoy (compared with -9.3% in April).
- In contrast, exports to the European Union and other East Asian markets fell by 2.1% yoy for both markets (having recorded increases in April).
- Declines in Hong Kong drove the weaker trend for Asian exports – falling by 4.4% yoy, compared with a fall of just 0.3% for non-Hong Kong Asia. Trends were mixed, with weaker deliveries to Korea, Malaysia, Taiwan and Singapore, and increases to the Philippines, Vietnam, Thailand and Indonesia.

Exports were marginally weaker in year-on-year terms, but exporters report stable orders



Source: CEIC, NAB Economics

Weaker exports to the United States drove the overall decline in exports

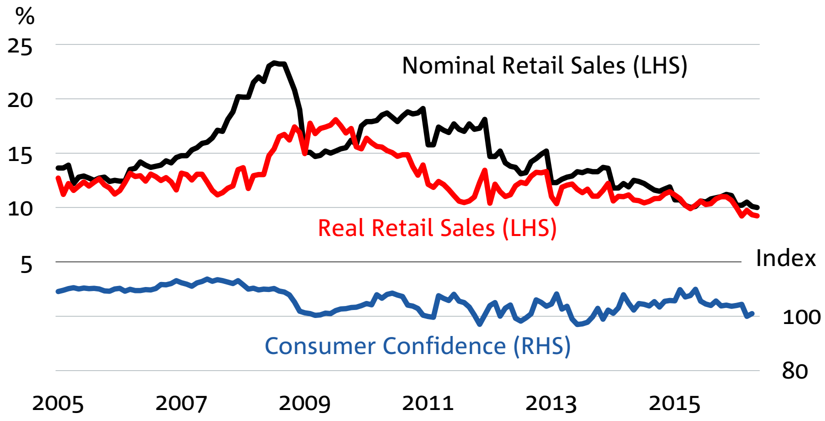


Sources: CEIC, NAB Economics

Retail sales and inflation

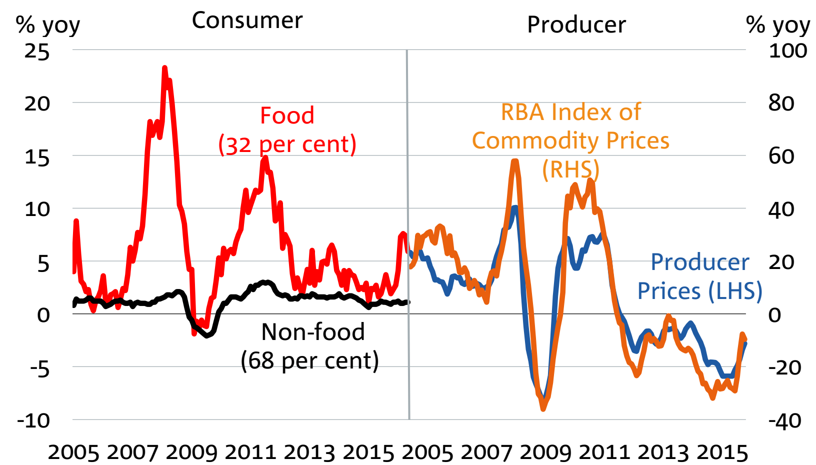
- Retail sales growth was largely unchanged in May – at 10.0% yoy (down from 10.1% in April) – largely in line with market expectations.
- Retail price inflation has picked up in recent months (compared with very weak trends across much of 2015), which has pushed real retail sales below 10% for the past four months (estimated at 9.2% yoy in May).
- Headline inflation was marginally weaker in May – with the Consumer Price Index rising by 2.0% yoy (compared with 2.3% in April). Non-food items remained stable – with prices increasing by 1.1% yoy, an unchanged rate when compared with April.
- Weaker food price inflation was the driver of this slower growth trend, with prices rising by 5.9% yoy in May (down from 7.4% previously). Pork prices continued to increase strongly – up almost 34% yoy –largely unchanged from April – while fresh vegetables increased more modestly, up by 6.4% yoy (compared with 23% last month).
- Producer prices fell for the fifty-first month in a row, however the rate of decline has continued to slow, down by 2.8% yoy (compared with -3.4% in April). In month on month terms, producer prices rose for the third month in succession, up by 0.5%.

Real retail sales have softened a little, but remained above 9% in recent months



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

Consumer price inflation marginally softer in May, as producer prices trend up month-on-month



Sources: CEIC, RBA, NAB Economics

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