CHINA'S ECONOMY AT A GLANCE

SEPTEMBER 2016

National Australia Bank

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KEY POINTS

No surprises in the latest data, weaker real estate sector leads to a softening in the growth profile

- There were no surprises in the latest Chinese data – with most indicators tracking broadly sideways. As such, there is no change to our expectations for the economy as a whole – with our forecasts for economic growth unchanged at 6.6% in 2016 and 6.5% in 2017 (albeit with risks weighted to the downside for the latter).

- The anticipated slowing trend for China's economy from the second half of 2016 is largely driven by weaker activity in the construction sector. While fixed asset investment was stronger in August – rebounding to 8.1% yoy growth (from a particularly low 3.9% yoy in July) – investment in real estate remained subdued (at 3.6% yoy on a three month moving average basis). This has contributed to the slowdown in residential construction starts – down to 6.7% yoy (3mma) in August, compared with the recent cycle peak of 20% in April.

- Growth in industrial production ticked up in August to 6.3% yoy (from 6.0% in July) – albeit the trend has remained relatively stable across the past six months.

- China's trade surplus was marginally wider in August – at US$52 billion, as both exports and imports rose month-on-month. Import values rose by 1.5% yoy in August – the first increase since October 2014 – in line with commodity price trends.

- There was stronger growth in retail sales in August – with sales volume growth pushing back over 10% yoy. Consumer confidence has improved in recent months, pulling away from a slightly negative reading in May.

- Headline inflation was significantly lower – at 1.3% yoy – on weaker price trends for pork, fresh vegetables and fresh fruit. Producer price trends continue to become less negative (year-on-year) – with prices up around 1.6% since the start of the year.

- The most recent credit data from July shows a slowing trend, in stark contrast to the credit binge in Q1. Our expectations around monetary policy remain unchanged – with no further cuts to the benchmark one year lending rate in 2016. Any policy easing may be driven by cuts to the Required Reserve Ratio – particularly given an apparent increase in capital outflows more recently.

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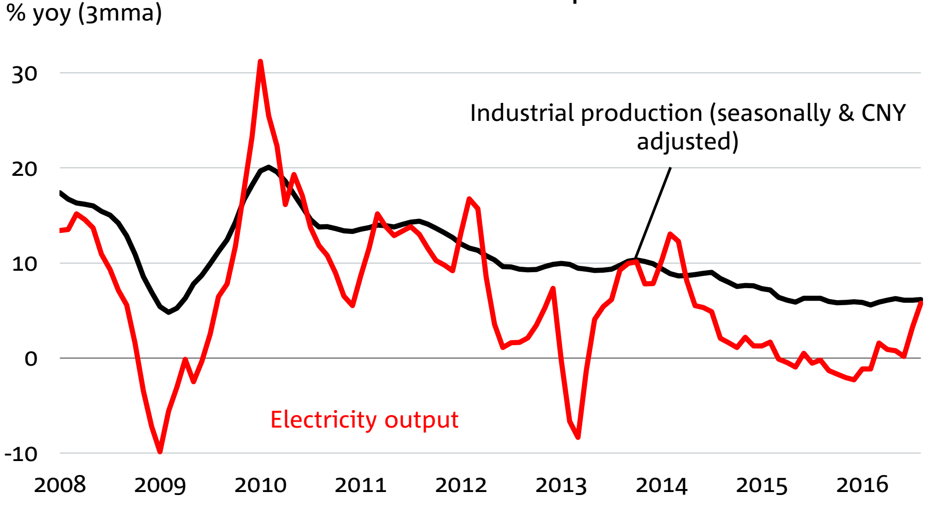
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION GROWTH

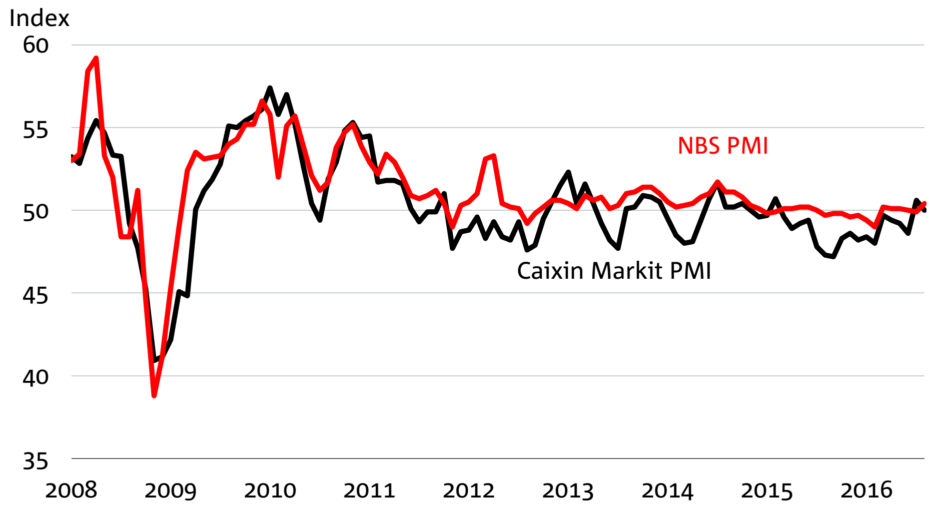
Stable trends in industrial sector over past six months



Source: CEIC, NAB Economics

PMI SURVEYS RELATIVELY NEUTRAL IN AUGUST

Caixin Markit at 50 points; NBS at 50.4 points



Source: CEIC, NAB Economics

- China's industrial sector was a little stronger in August – with growth in industrial production of 6.3% yoy (up from 6.0% in July). This was slightly higher than market expectations (6.2% in the Bloomberg survey), but maintained the broadly stable conditions evident over the past six months.

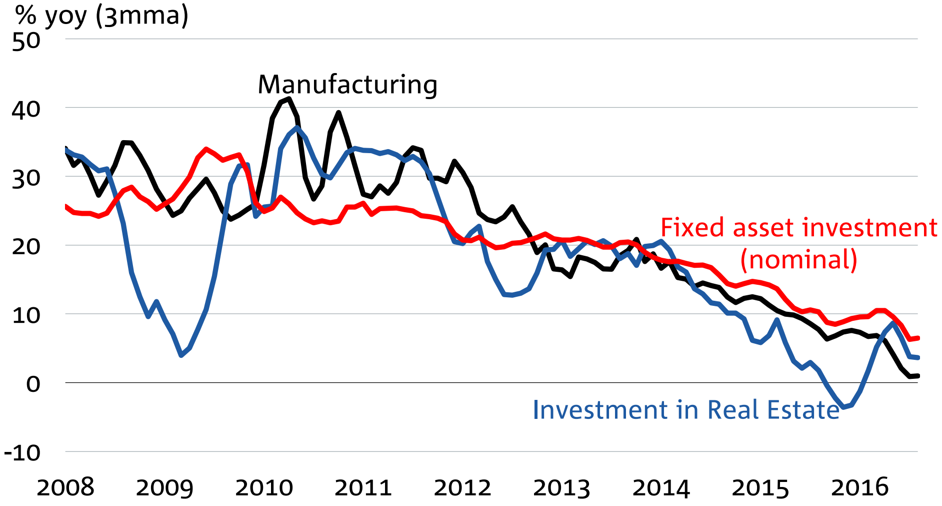
- Trends were mixed at the major product level – with construction related sectors such as steel and cement recording slightly more moderate growth – at 3.0% yoy and 1.0% yoy respectively. In contrast, electricity output rose by 7.8% yoy and motor vehicle output rose by almost 25% yoy.

- There were only modest changes to China's main industrial surveys in August. The official NBS PMI edged back towards positive territory – up to 50.4 points (from 49.9 points in July). In contrast, the Caixin Markit PMI was softer – moving from 50.6 points to a neutral 50.0 points. Despite this decline, this measure remained above the trends recorded in 2015.

INVESTMENT

INVESTMENT TRENDS BY INDUSTRY

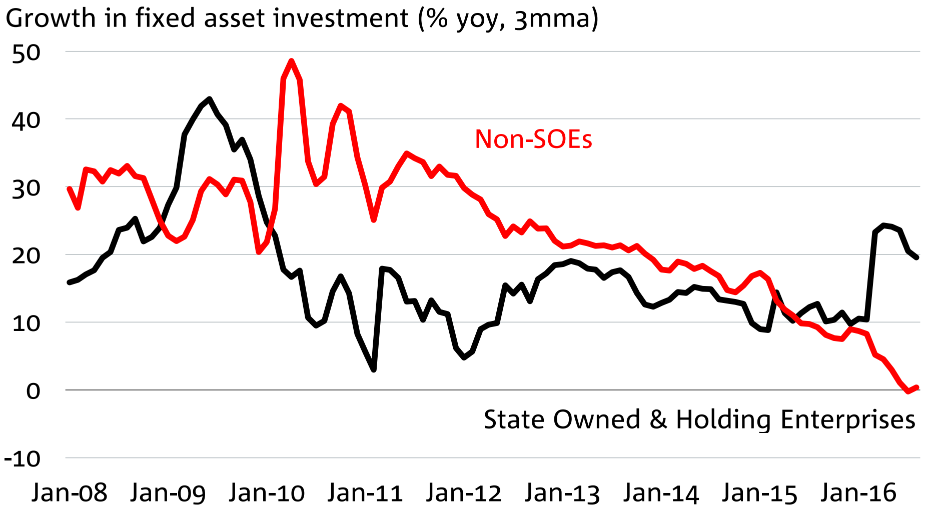
Real estate and manufacturing investment still lagging



Source: CEIC, NAB Economics

INVESTMENT TRENDS BY SECTOR

State-owned enterprises still dominating growth



Source: CEIC, Datastream, NAB Economics

- Following very weak conditions in July, growth in China's fixed asset investment strengthened in August – at 8.1% yoy (up from 3.9% previously) – albeit still below the double digit growth rates recorded across the first four months of the year.
- Key sectors for investment such as manufacturing and real estate have remained comparatively soft. On the three month moving average basis, manufacturing investment grew by 1.0% yoy in August (compared with 0.9% previously), while real estate investment recorded 3.6% yoy growth (down from 3.8%). Combined, these sectors accounted for almost 56% of total investment in the first half of 2016.
- In contrast, stronger growth was recorded in sectors such as Water Conservation (21% yoy 3mma) and Transport (15%) – which accounted for just under 20% of total investment in H1 2016.
- State-owned enterprises (SOEs) have continued to drive investment in recent months – despite efforts to reform the sector. In August, SOE investment rose by 20% yoy (3mma), compared with just 0.4% for non-state firms.
- The weaker level of real estate investment has hit construction activity. New residential construction starts have slowed considerably – down to just 6.7% yoy (3mma) in August (compared with the recent cycle peak of 20% in April). This has flow on effects to the demand for key construction materials such as steel and cement and demand for Australian iron ore.
- While momentum in real estate investment and construction is slowing, housing prices continue to grow. Month-on-month, prices were up 1.7% yoy in August, led by a 2.1% increase in China's largest tier 1 cities.

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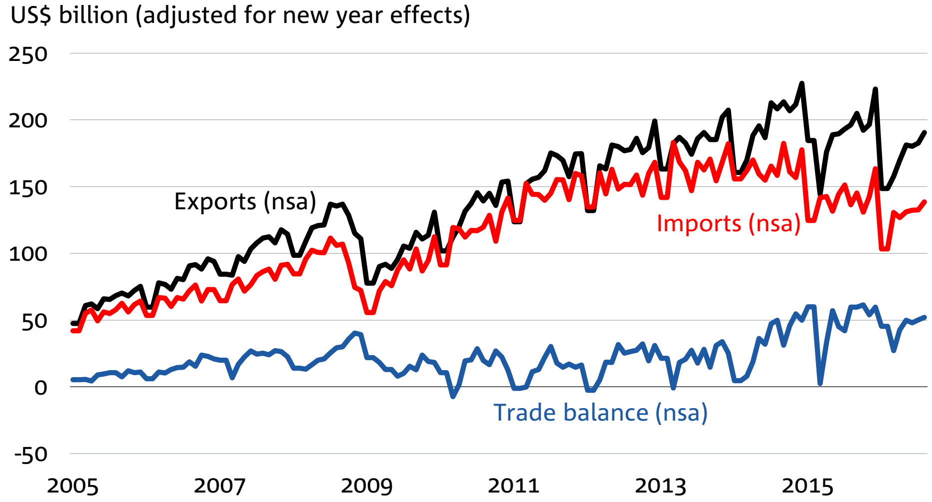
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE SURPLUS EDGES HIGHER IN AUGUST

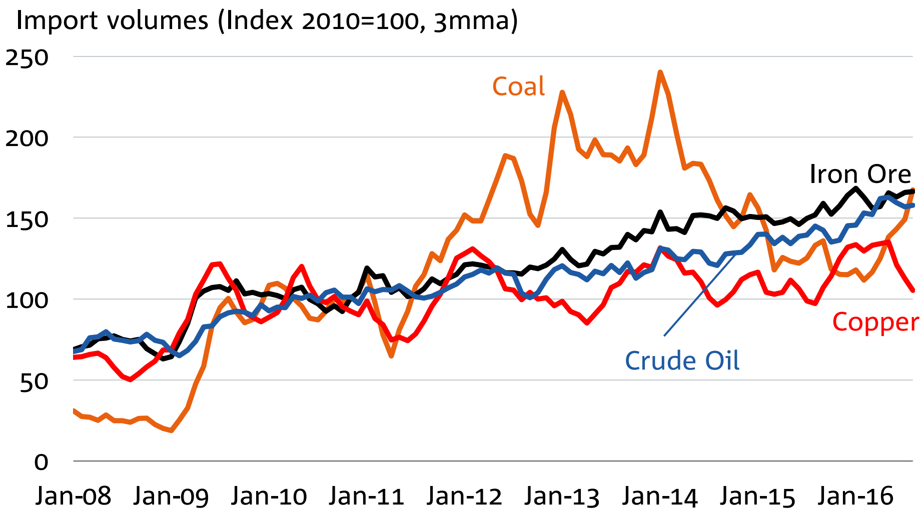
Exports and imports both higher month-on-month



Sources: CEIC, NAB Economics

KEY COMMODITY IMPORT VOLUMES

Iron ore remains near records; coal rebounds on restrictions



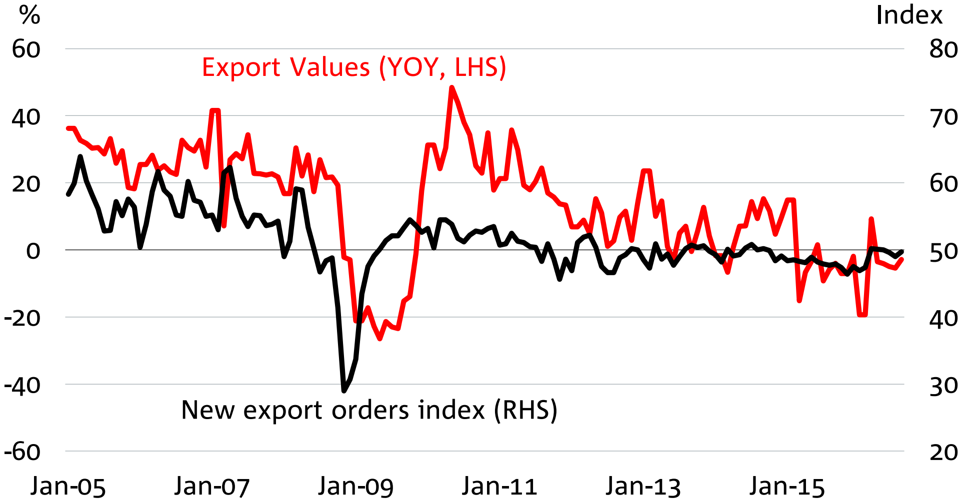
Sources: CEIC, NAB Economics

- China's trade surplus widened slightly again in August, to US$52.0 billion (from a revised US$50.2 billion in July). In month-on-month terms, both exports and imports rose in US dollar terms.
- Import values rose by 1.5% yoy in August – the first increase since October 2014 – to total US$138.5 billion. This result was considerably stronger than market expectations – at -5.4% yoy in the Bloomberg survey.
- Declining import prices have been a major factor in the weaker profile for China's import values since 2014 (prior to August's uptick). The RBA Index of Commodity Prices rose by 0.6% yoy in August – the first increase in this measure since January 2012 – likely contributing to the relatively strong import result.
- Import volumes for key commodities have generally remained strong – with iron ore (up 18% yoy) holding near record levels (despite our expectations for weaker steel demand as construction slows), crude oil increasing by 24% yoy and coal volumes surging – up 52% yoy as consumers seek imported material to replace domestic coal impacted by supply restrictions.
- In an effort to improve profitability of domestic coal miners, Chinese authorities have restricted the number of working days at domestic coal mines to 276 days a year, from a previous limit of 330 days.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS SLIGHTLY SOFTER

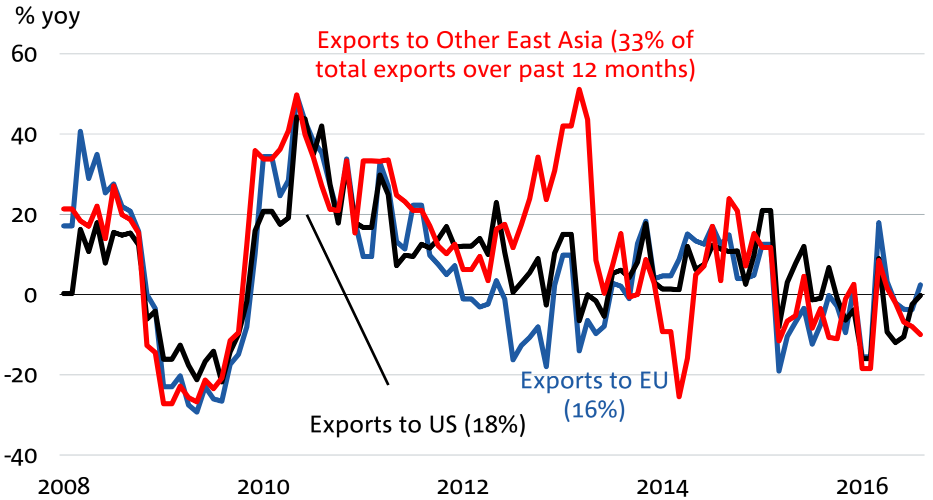
Surveyed new orders remain above 2015 trends



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADE PARTNERS

East Asia diverges from other major markets



Sources: CEIC, NAB Economics

- China's export values rose month-on-month in August, to US$190.6 billion (from US$182.6 billion previously). That said, this represented a decline year-on-year of 2.8% (a little better than market expectations of -4.0% in the Bloomberg survey).

- Compared to relatively weak levels across much of 2015, confidence among China's exporters has improved in recent times. The new export orders measure in the NBS PMI survey has remained close to 50 – at 49.7 points in August (up from 49.0 points in July).

- Export trends were mixed for China's major trading partners. Export values to both the United States and European Union were comparatively strong – recording a 2.4% yoy increase and 0.2% yoy decline respectively – against a sharp decline in exports to East Asia – at -9.9% yoy.

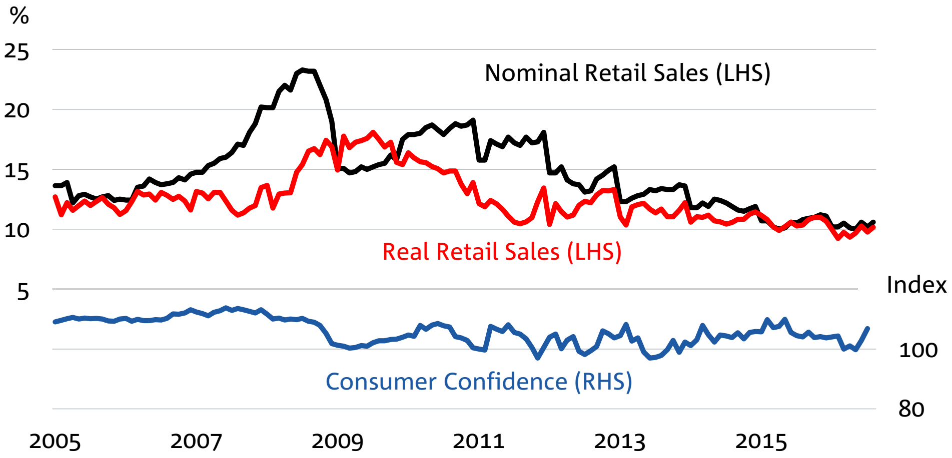
- This trend was driven by a significant fall in exports to Hong Kong – which fell by 17.7% yoy. That said, the reported strength of China's exports to Hong Kong in August 2015 was not evident in Hong Kong customs data – indicating the potential distortions related to capital outflows that impact trade data.

- Exports to non-Hong Kong East Asia fell by a more modest 3.3% yoy – driven by sizeable falls recorded in exports to Taiwan (-16% yoy), Malaysia (-8.1%) and Singapore (-7.3%).

RETAIL SALES AND INFLATION

RETAIL SALES STRENGTHENED IN AUGUST

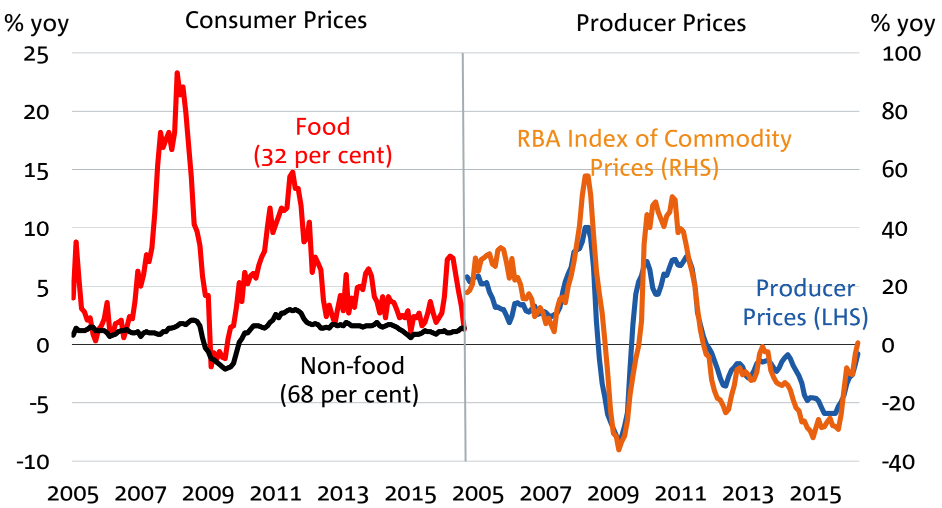
Real sales pushed back above 10% yoy



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

CONSUMER AND PRODUCER PRICES

Food prices much lower in August; producer prices trending up



Sources: CEIC, RBA, NAB Economics

- Retail sales growth was stronger in August, with growth at 10.6% yoy (up from 10.2% in July). This result beat market expectations – at 10.2% in the Bloomberg survey. Retail price inflation has remained controlled – at just 0.4% yoy in July – pushing our estimate of real retail sales growth back above 10% in August – stronger than recent lows near 9% in February and April.
- Consumer confidence has improved in recent months – up 106.8 points in July (from 102.9 points in June) – pulling away from a slightly negative reading in May.
- Headline inflation was considerably softer in August, with the Consumer Price Index increasing by 1.3% yoy (down from 1.8% in July) – the lowest increase since May 2015.
- Weaker growth in food prices was the key driver of this trend – rising by just 1.3% yoy (down from 3.3% in July). Prices for fresh vegetables and fresh fruit fell year-on-year – down 3.9% and 0.6% respectively – while pork prices rose by just 6.4% yoy (from 16% previously) – the smallest increase since May 2015.
- Non-food price inflation was unchanged in August, at 1.4% yoy. Downward pressure from lower automotive fuel prices continues to diminish – down 3.7% yoy (from 6.3% in July).
- Producer prices recorded the fifty-fourth straight month of declines in August, however the rate of decline has continued to slow. The Producer Price Index fell by just 0.8% yoy in August (compared with 1.7% in July). In month-on-month terms, producer prices have started to track higher – since the start of the year, they have risen by around 1.6%.

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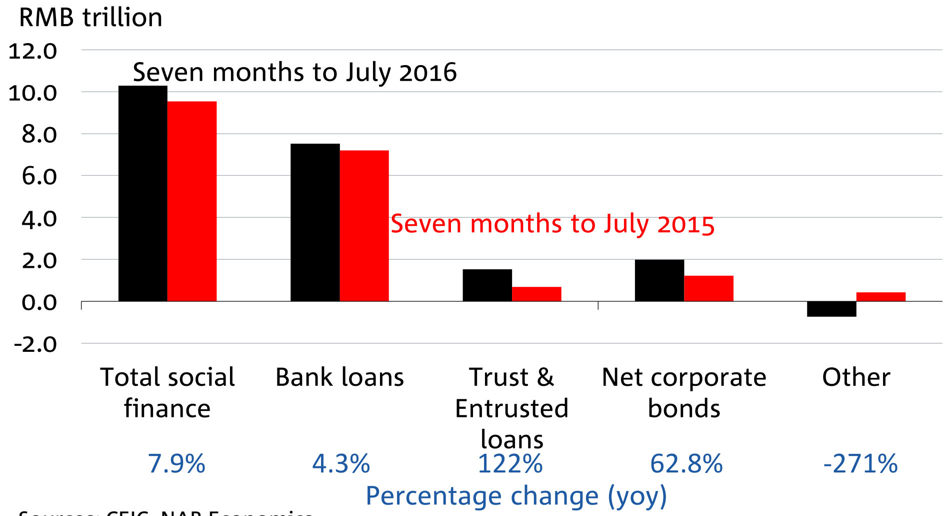
CREDIT CONDITIONS

NEW CREDIT GROWTH SLOWING IN RECENT MONTHS

Growth moderating from Q1 binge levels



Sources: CEIC, NAB Economics

- New credit data for August was unavailable at the time of writing. The most recently available data shows a slowing trend, with a 35% yoy decline recorded in July, in stark contrast to the credit binge in Q1.

- For the first seven months of 2016, aggregate financing expanded by 7.9% yoy to RMB 10.3 trillion. The dominant share of this lending comprises bank loans – at around 73% of the total – although the year-on-year growth in bank loans lags the aggregate – at just 4.3% yoy over the period. This relative weakness reflects efforts by Chinese firms to pay down foreign currency debt – with RMB denominated bank loans growing by over 10% yoy.

- The second largest contributor to aggregate financing has been corporate bond financing – totalling RMB 2.0 trillion in the first seven months – an increase of 63% yoy.

- Key components of the shadow banking sector have recorded strong growth, with trust and entrusted loans growing by a combined 122% yoy in the first seven months – albeit off a small base following policy changes that restricted the sector in 2015.

- Our expectations around monetary policy remain unchanged – with no further cuts to the benchmark one year lending rate in 2016. Any necessary policy easing may be driven by cuts to the Required Reserve Ratio – particularly given an apparent increase in capital outflows more recently.

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