National Australia Bank

CHINA'S ECONOMY AT A GLANCE

MARCH 2017

CONTENTS

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KEY POINTS

An encouraging start to 2017 – although strength still comes from the old economy, with retail trends disappointing

- China's National People's Congress – the annual meeting of the country's parliament – was held in early March, unveiling the government's targets for the year. The economic growth target was subtly weakened – to 'around 6.5%, or higher if possible'. Given this, our forecast for Chinese economic growth is unchanged, at 6.5% in 2017. We feel that risks are relatively balanced between upside – ongoing fiscal stimulus and real estate investment – and downside – trade uncertainty from the United States.

- China's industrial production recorded stronger growth across January-February, at 6.3% yoy (up from 6.0% in December). Recent trends in PMI surveys suggest robust conditions for manufacturers in the early part of 2017.

- The growth in China's fixed asset investment accelerated a little during January-February – at around 8.9% yoy (compared with 6.3% in December). The balance between state-owned and private investment has gradually begun to narrow – suggesting an improving trend in private sector confidence.

- China's trade balance plunged in February – switching into deficit. Smoothed across the first two months – to remove the effects of Chinese New Year volatility, the trade surplus narrowed to US$21.1 billion (down from US$40.7 billion in December 2016). Commodity prices influenced these trends, driving up import values. While exports were sharply lower, the discrepancy between Hong Kong and Chinese customs data was negligible in January – suggesting that export data could be artificially low in 2017.

- Retail sales growth was comparatively weaker for the first two months of 2017 – at 9.5% yoy (down from 10.9% in December). Given the stronger trend in retail price inflation – at around 1.3% over the period, this has pushed real retail sales growth to around 8.2% yoy at the start of the year, well below 2016 trend levels.

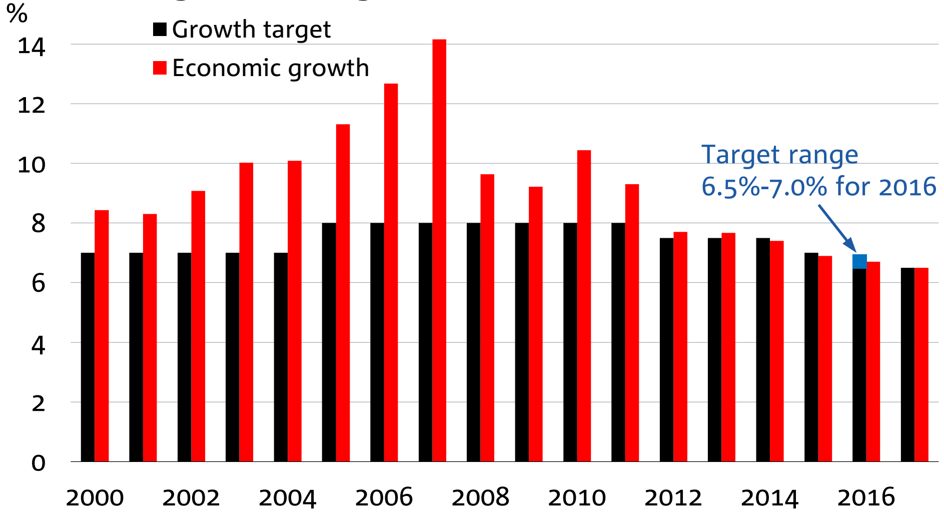
- China's credit growth was quite strong over the first two months of the year – totalling RMB 4.8 trillion, an increase of 13.5% yoy. The total for January was a new monthly record level.

- Monetary policy appears to be tightening – albeit only very slightly. The People's Bank of China (PBoC) increased the interest rate on the Standing Lending Facility (SLF) by 10 basis points, and guiding the 7 day SHIBOR higher.

NATIONAL PEOPLE'S CONGRESS

GROWTH TARGET SUBTLY LOWER IN 2017

No clear range to the target, unlike 2016



Sources: CEIC, NAB Economics

THE GREAT HALL OF THE PEOPLE

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- China's National People's Congress – the annual meeting of the country's parliament – was held in early March. The congress provides the main guidance around China's economic policy agenda for the year.
- In terms of economic growth, there was a modest change to the growth target for 2017. Premier Li announced a target of 'around 6.5%, or higher if possible' – compared with last year's range of 6.5% to 7.0%.
- Other targets included the budget deficit at 3% of GDP – in line with last year's target, but narrower than last year's actual outcome of 3.8%. Fiscal stimulus was critical to economic growth in 2016, so a realised decline in the deficit could lead to weaker growth prospects.
- On the financial front, the targets for money supply (M2) and aggregate financing growth were trimmed to 12% (from a 13% target last year) – although M2 only grew by 11.3% for the full year, while aggregate financing grew by over 15%.
- Following the National People's Congress, we see little need to change our forecasts, with economic growth expected to fall to target levels of 6.5% in 2017 and 6.25% in 2018. We feel that risks are relatively balanced between upside – ongoing fiscal stimulus and real estate investment – and downside – trade uncertainty from the United States.

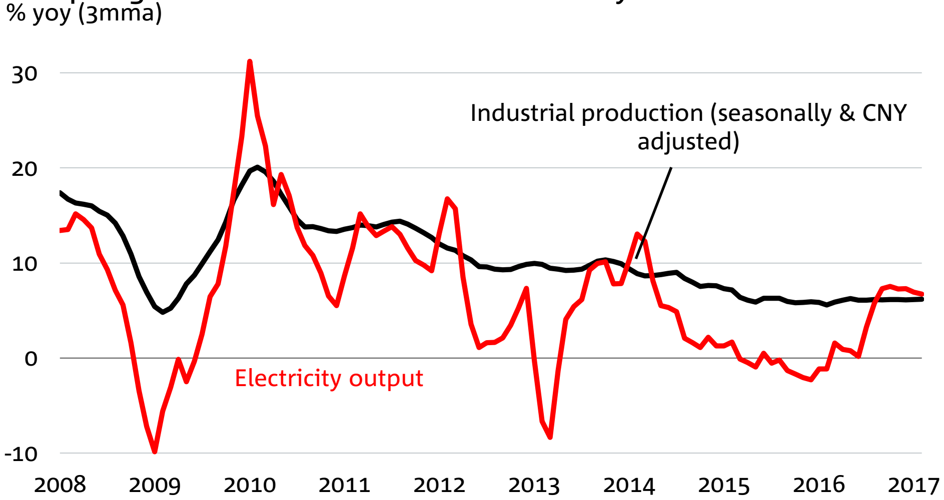
NAB GDP FORECASTS

%	2016 (actual)	2017	2018
GDP	6.7	6.5	6.25

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

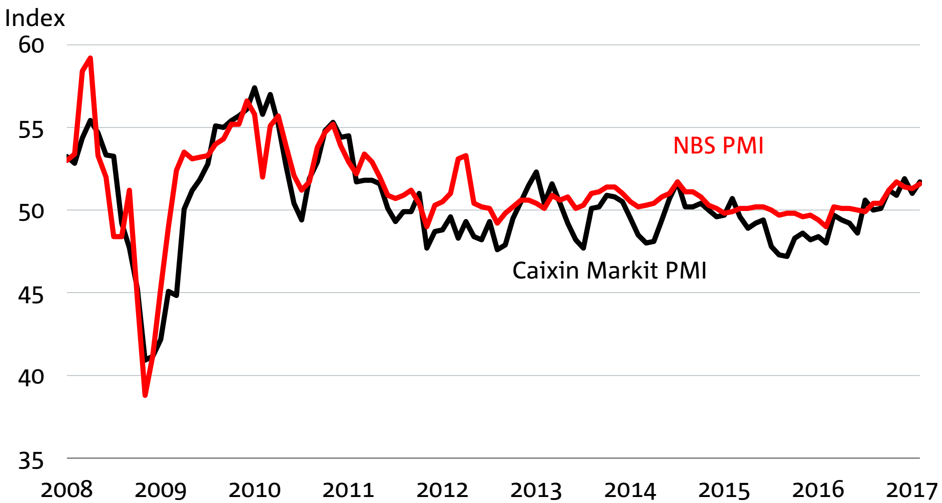
Output growth continues to track sideways near 6%



Source: CEIC, NAB Economics

PMI SURVEYS

Manufacturing conditions appeared robust in early 2017



Source: CEIC, NAB Economics

- China's industrial production recorded stronger growth across January-February, at 6.3% yoy (up from 6.0% in December). This was marginally above the trend level seen across much of 2016, and just above market expectations (at 6.2% in the Bloomberg survey).

- Trends by major industrial sector were somewhat divergent. Production of motor vehicles remained very strong – with growth at 11.1% yoy across the two-month period (down from 12.7% in December), while electricity output rose by 6.3% yoy (down from 6.9% in December).

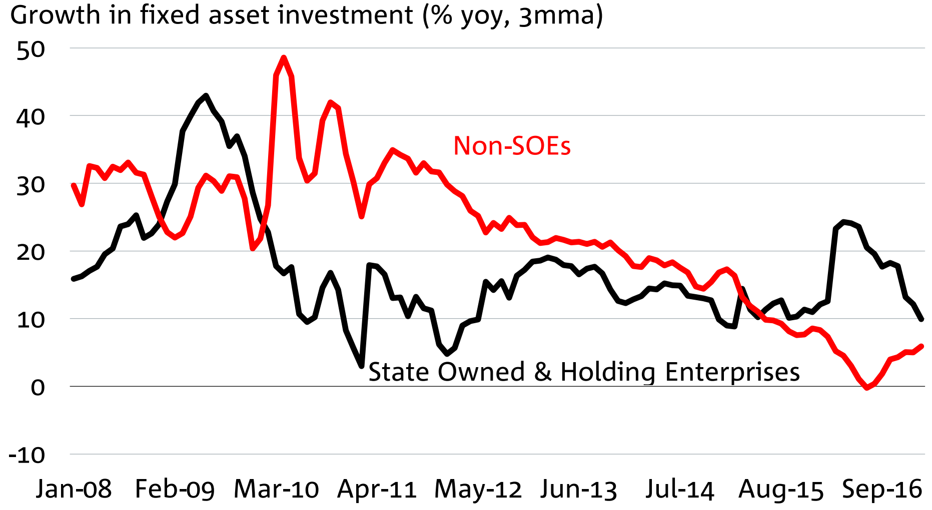
- Construction related heavy industry was quite mixed – with crude steel output fairly robust – with growth of 5.8% yoy (compared with 3.2% in December), while cement production contracted by 0.4% yoy.

- Both of China's major industrial surveys pointed to improved conditions in February – with both remaining firmly in positive territory. The official NBS PMI survey was 51.6 points – just off the multi-year high recorded in November. Similarly, the Caixin Markit PMI was also stronger – at 51.7 points, slightly below the recent peak of December. Both surveys suggest robust conditions for manufacturers in the early part of 2017.

INVESTMENT

INVESTMENT TRENDS BY OWNERSHIP

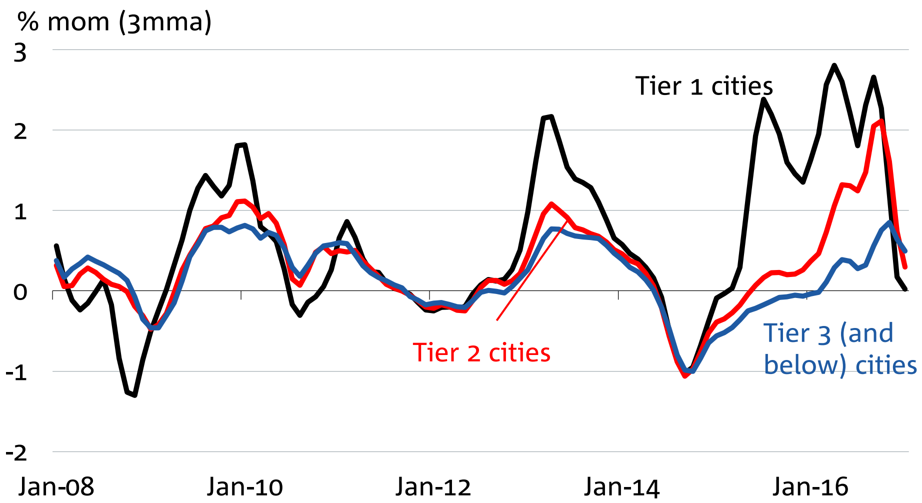
Improving balance in investment, as private sector firms return



Source: CEIC, Datastream, NAB Economics

HOUSE PRICES

No monthly growth in tier 1 house prices in January



Source: CEIC, Datastream, NAB Economics

- The growth in China's fixed asset investment accelerated a little during January-February – at around 8.9% yoy (compared with 6.3% in December). The balance between state-owned and private investment has gradually begun to narrow – suggesting an improving trend in private sector confidence (echoed in the Caixin PMI survey). On a three month moving average basis, growth in state-owned enterprise investment slowed to 9.9% yoy in February (compared with 13% in December), while private sector investment rose to 5.9% yoy (from 5.0% at the end of 2016).

- Key sectors for fixed asset investment – such as real estate and manufacturing – have recorded stronger trends in recent months, following the cyclical lows of mid-2016. On a three month moving average basis, investment in real estate grew by 9.2% yoy in February (compared with 10.0% in December), while manufacturing grew by 6.2% yoy (down from 7.2% at the end of 2016).

- The ongoing strength in real estate investment has continued to support construction activity. Residential construction starts accelerated once again during January-February – up around 15.5% yoy (three month moving average), compared with a 0.1% yoy fall recorded in November. Residential property sales recorded a similar growth rate over this period.

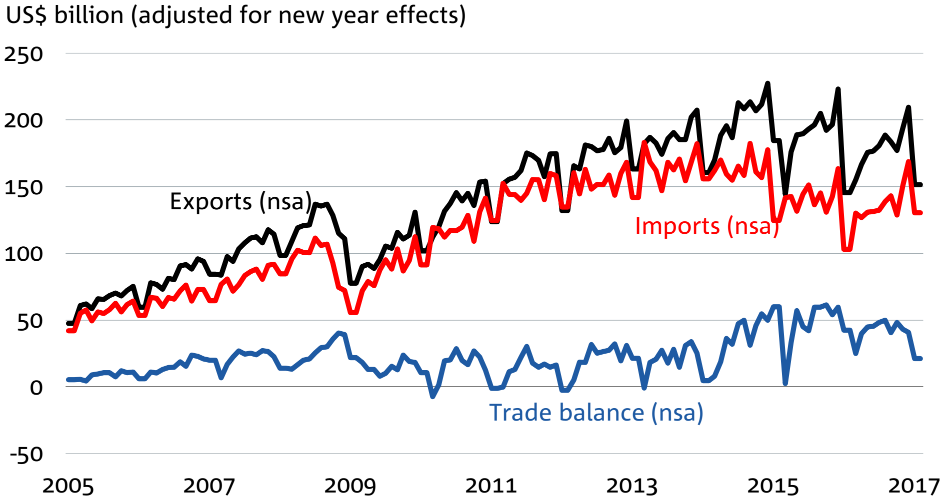
- While policy restrictions introduced by a range of local governments have so far been unable to significantly slow real estate investment and activity, price trends have continued to weaken. Official NBS data showed no growth month-on-month in China's largest tier 1 cities in January, and minimal growth in tiers 2 and 3 (0.3% mom and 0.5% mom respectively).

- While we continue to anticipate a slow down in activity in the real estate sector, the ongoing strength in real estate investment presents some upside risk to our overall economic forecasts for China.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS PLUNGED ON WEAK FEBRUARY DATA

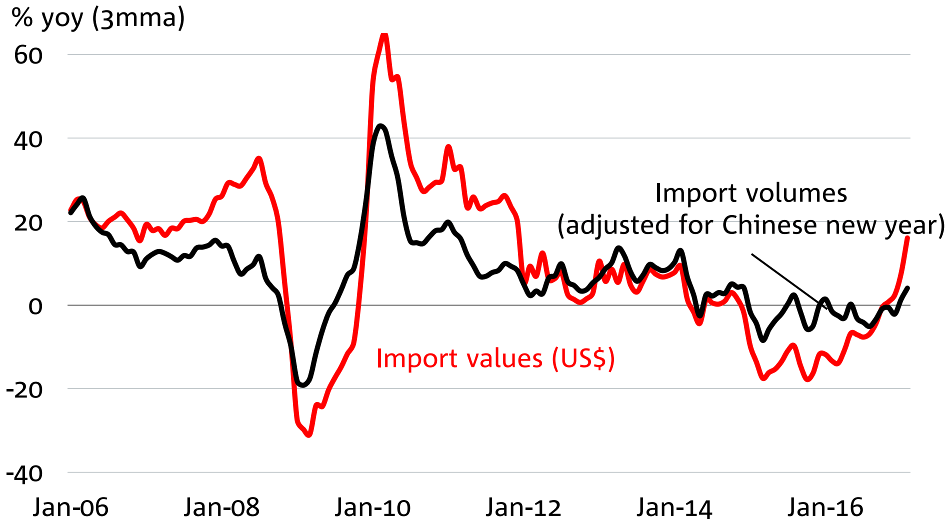
Exports sharply lower during Feb, but potential CNY effects



Sources: CEIC, NAB Economics

IMPORT VOLUMES RISING IN EARLY 2017

But price effects dominating the aggregate import data



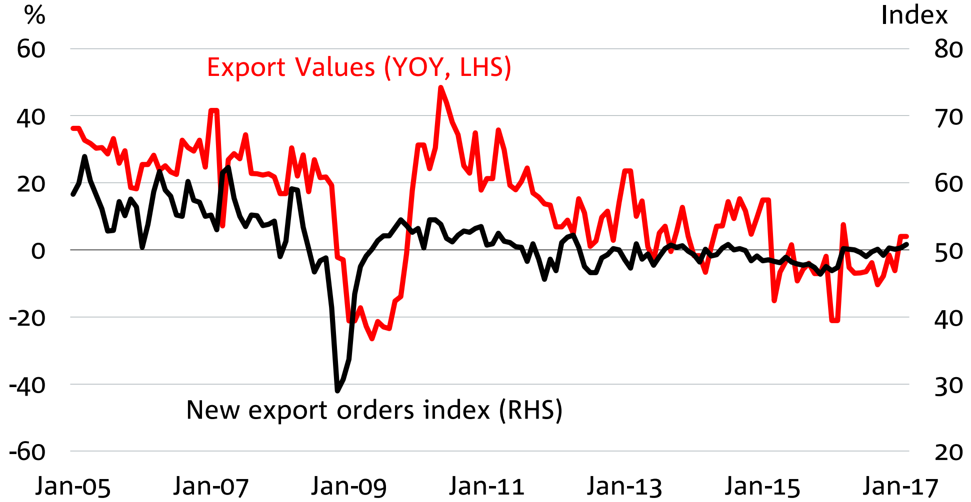
Source: CEIC, NAB Economics

- China's trade balance plunged in February – switching into deficit for the month of US$9.1 billion. Smoothed across the first two months – to remove the effects of Chinese New Year volatility, the trade surplus narrowed to US$21.1 billion (down from US$40.7 billion in December 2016).
- Smoothed over the two-month period, China's imports rose strongly – up 26.4% yoy – to US$260.6 billion. This result was well above market expectations. Higher commodity prices have had a major impact – given that January 2016 was the trough of the current commodity cycle – with the RBA Index of Commodity Prices up around 53% yoy over this period.
- In contrast, our estimate of import volumes – based on price trends – suggests a more modest growth in import volumes, up around 11% yoy over the two month period. That said, import volumes have improved considerably from weak levels in early 2016 – in line with the improvement in manufacturing.
- Import volumes by key commodity remain quite mixed. Coal imports were up around 48% yoy in January-February, reflecting strong increase in import demand across 2016. That said, coal imports have eased back from the peak levels across the second half of 2016 – reflecting the easing in restrictions on domestic mining.
- Imports of both iron ore and crude oil remained strong at the start of 2016 – rising by 12.6% yoy and 12.5% yoy respectively over the two-month period. In contrast, copper imports fell once again – down by 16.3% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS WEAKER THAN EXPECTED

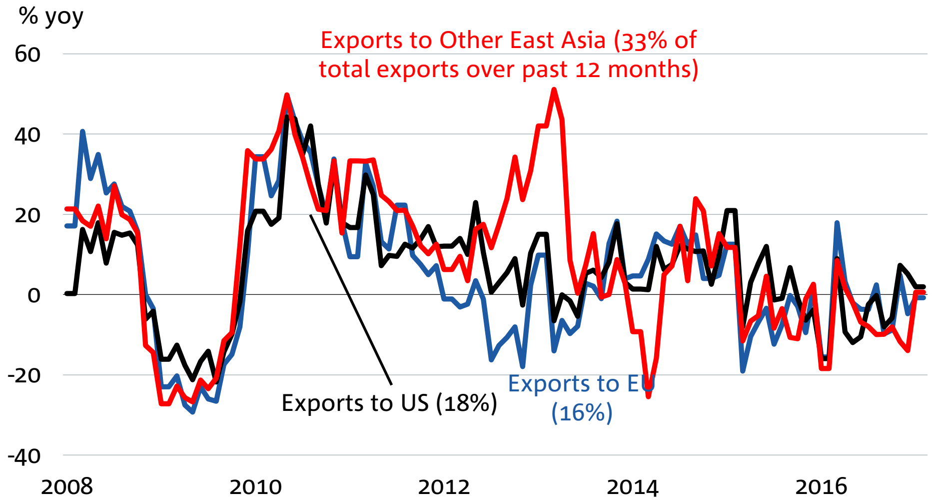
Values sharply weaker in February, but confidence was unshaken



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADE PARTNERS

Convergence in growth rates between partners



Sources: CEIC, NAB Economics

- China's exports fell sharply month-on-month in February – down to US$120.1 billion (from US$182.8 billion in January). That said, smoothed across the two-month period, exports rose by 4.0% yoy. This was well below the double digit growth expected in the Bloomberg survey.
- Despite the weakness in February's data, the confidence of exporters has remained relatively stable – with the new export order measure in the NBS PMI survey trending higher over the period – up from 50.1 points in December 2016 to 50.3 points in January and 50.8 points in February.
- The growth in exports to major trading partners was relatively uniform – when compared with the large divergences of late 2016. Exports to the United States grew by 1.9% yoy over the two-month period, while exports to other East Asian economies rose by 0.6% yoy. In contrast, exports to the European Union contracted modestly, down by 0.8% yoy.
- In terms of East Asia, the value of exports to Hong Kong fell by 4.2% yoy, compared with a 3.9% increase in the value to non-Hong Kong East Asia. South Korea and Vietnam accounted for the bulk of this increase, while exports to Singapore and Thailand slowed.
- The discrepancy between Hong Kong Customs and China Customs data for January was negligible in January – with the former reporting values of around US$19.3 billion to the latter's US$19.2 billion. We will be closely monitoring this trend, given that wide discrepancies recorded in 2015 had a major impact on the accuracy of overall trade data last year.
- Uncertainty around US trade policy persists – with the strongly negative (from a Chinese perspective) rhetoric not yet translating into policy for the Trump Administration.

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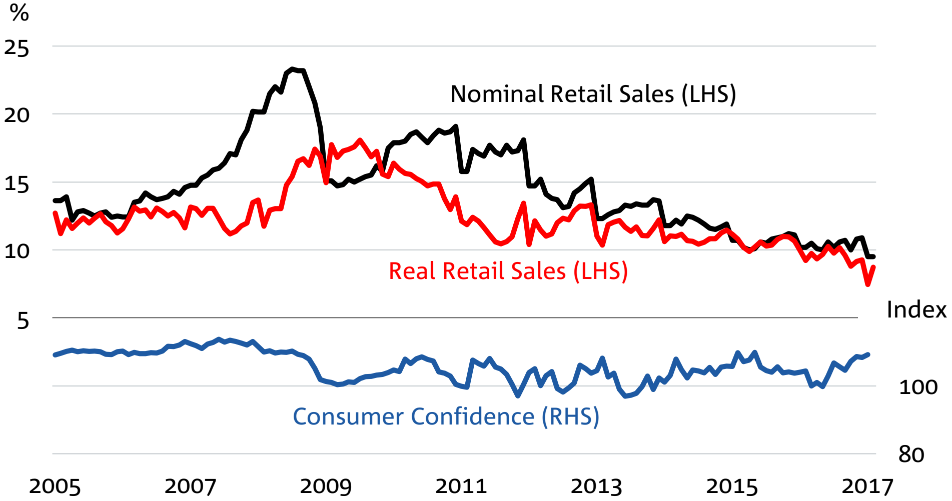
RETAIL SALES AND INFLATION

REAL RETAIL SALES TREND LOWER IN EARLY 2017

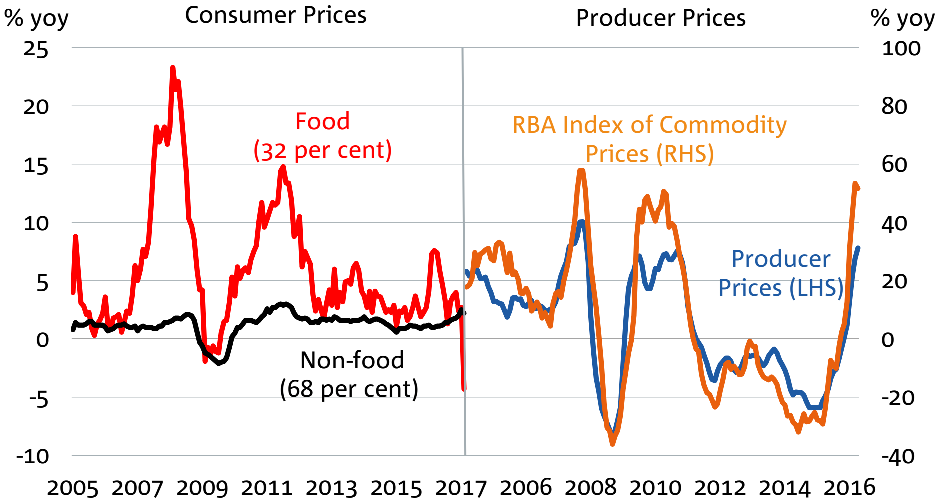
Stronger inflation drives real sales closer to 8%



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Lower CPI on food price falls, but new year effects likely



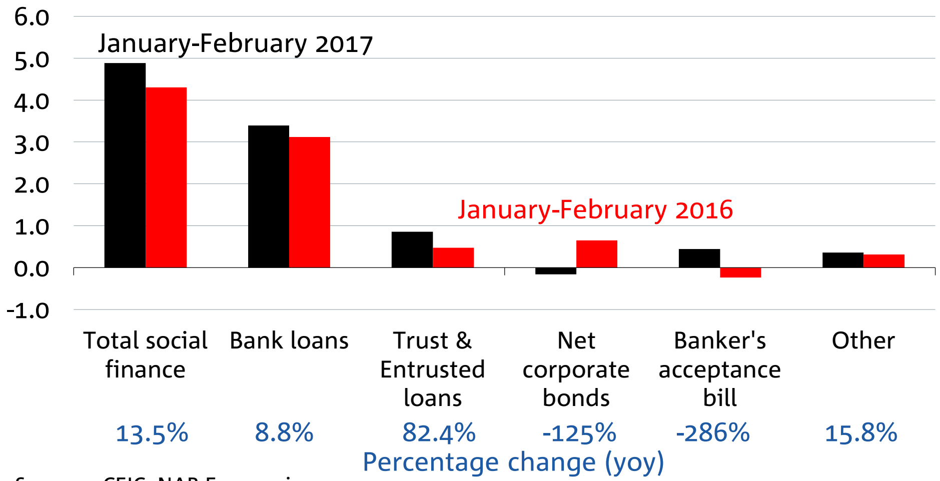
Sources: CEIC, RBA, NAB Economics

- Retail sales growth was weaker for the first two months of 2017 – at 9.5% yoy (down from 10.9% in December). Given the stronger trend in retail price inflation – at around 1.3% over the period, this has pushed real retail sales growth to around 8.2% yoy at the start of the year, from around 9.3% in December.
- Despite the slightly weaker sales growth, consumer confidence has continued to trend higher – up to 109.2 points in January (from 108.4 points in December) – the strongest level since May 2015.
- China's headline inflation was considerably weaker in February, following a strong January – with the Consumer Price Index increasing by just 0.8% yoy (down from 2.5% yoy in January and 2.1% yoy in December 2016). It is possible that the earlier timing of Chinese New Year influenced this result – with food prices typically spiking ahead of the holiday (which was earlier this year).
- Food price inflation was noticeably weaker in February – with aggregate prices falling by 4.3% yoy (compared with a 2.7% increase in January). Prices for fresh vegetables and eggs fell sharply – down 26% yoy and 15% yoy respectively – while pork prices were 0.9% lower.
- Non-food prices have remained relatively more stable, with prices rising by 2.5% yoy in January and 2.2% yoy in February. Fuel prices and residence costs have continued to trend higher.
- Producer prices have continued to trend higher – in line with commodity price trends. The Producer Price Index rose by 6.9% yoy in January and 7.8% yoy in February – the largest price increase since September 2008. The RBA Index of Commodity Prices rose by 51.7% yoy – reflecting the strong increases across 2016, following the trough of the cycle in January.

CREDIT CONDITIONS

NEW CREDIT GROWTH

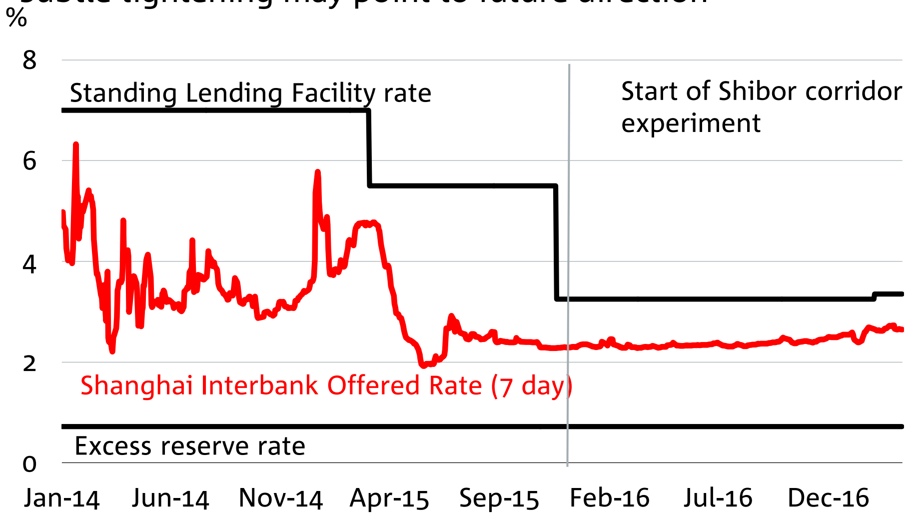
New record in January, but bank loans marginally weaker yoy



Sources: CEIC, NAB Economics

MONETARY POLICY

Subtle tightening may point to future direction



Source: CEIC, NAB Economics

- China's credit growth was quite strong over the first two months of the year – totalling RMB 4.8 trillion, an increase of 13.5% yoy. The total for January was a new monthly record level.
- New bank credit accounts for the bulk of new credit – 69% – but increased more modestly at 8.8% yoy. That said, bank loans increased strongly in February, having contracted in year-on-year terms in January.
- In contrast, the components of the shadow banking sector included in aggregate financing grew strongly – up around 460% yoy – driven by a rebound in Banker's acceptance bills – which were contracting in early 2016 – and trust and entrusted loans.
- Corporate bond issuance was negligible in early 2016, with the total debt outstanding contracting on a net basis, in contrast to a strong increase in early 2016.
- Monetary policy appears to be tightening – albeit only very slightly. The People's Bank of China (PBoC) increased the interest rate on the Standing Lending Facility (SLF) and the 7 day reverse repo at the start of February by 10 basis points to 3.35% and 2.35% respectively The SLF is the upper bound of the Shibor corridor adopted in November 2015. The 7 day Shibor has also trended around 10 basis points since mid-January.
- While the size of the monetary tightening is modest – at just 10 basis points – the significance lies in the direction of the move, pointing to the potential for further tightening as Chinese authorities attempt to manage high debts in the corporate sector.

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