NAB Group Economics

China's economy at a glance

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Key points

China's recovery lost momentum in Q2 and the outlook for the second half remains cloudy

- China's latest national accounts data showed that its economy grew by 6.3% yoy in Q2, up from a 4.5% yoy increase in Q1, with base effects (related to the COVID-19 lockdowns of Q2 2022) helping to inflate this rate. Overall, this increase was somewhat weaker than market expectations (7.3% yoy in the Reuters poll), and points towards a loss of momentum during the quarter – as seen in the quarter-on-quarter series – as consumers remained relatively subdued. Reflecting the current headwinds, we have lowered our forecast for China's growth in 2023 to 5.2% (from 5.6% previously). Our forecasts for 2024 (4.5%) and 2025 (4.8%) are unchanged.

- Growth in China's industrial production was marginally stronger in June – increasing by 4.4% yoy (up from 3.5% yoy in May). While this rate of increase is comparatively modest, when compared with pre-pandemic trends, the washing out of base effects (that inflated May's growth rate) mean that the pickup this month was more substantial than it first appears.

- Recent softness in nominal investment has been offset by steep declines in producer prices – which flow through to the cost of investment goods. This means that our estimate for real investment accelerated to 7.2% yoy (from 5.3% yoy previously). Investment growth remains concentrated among China's state-owned enterprises (SOEs).

- China's trade surplus was marginally larger in June – totalling US$70.6 billion (from US$65.8 billion in May). This reflected a slight month-on-month uptick in exports combined with a modest downturn in imports – however both measures fell substantially year-on-year.

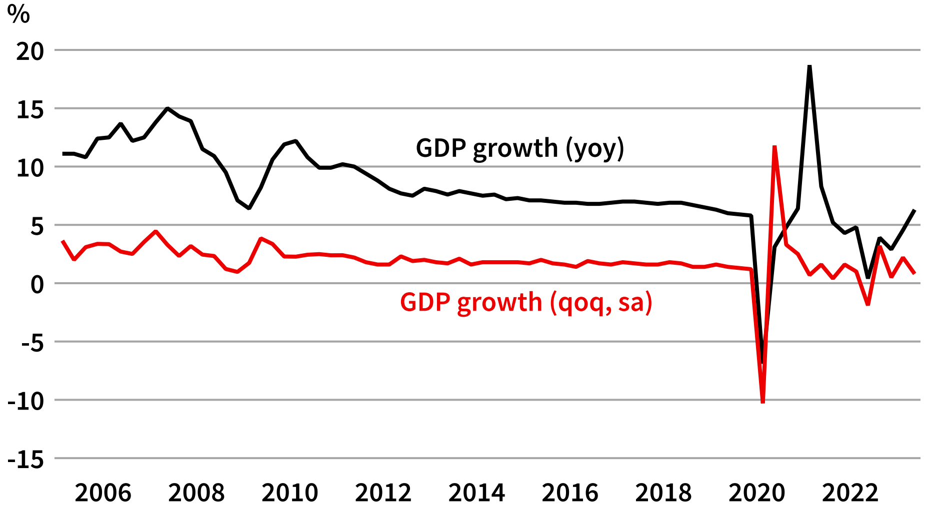
- China's real retail sales growth slowed substantially in June – up by 3.1% yoy (from 12.5% yoy in May) – although it must be stressed that the spike in sales in April and May reflected base effects related of the COVID-19 lockdowns implemented during this period in 2022. When compared with the same period in 2019, real sales were 10.2% yoy higher in June, compared with 8.2% yoy in May and a peak of 12.7% yoy in March, suggesting that consumer demand has remained subdued – consistent with soft trends in inflation.

- The People's Bank of China (PBoC) marginally cut its main policy rate – the Loan Prime Rate – in June, down 10 basis points to 3.55%. This followed on from a cut to the Reserve Requirement Ratio (RRR) in March, that freed up additional funds for banks to lend. While there appears to be no shortage of funds available for lending, the appetite for households and businesses to borrow remains subdued.

Gross domestic product

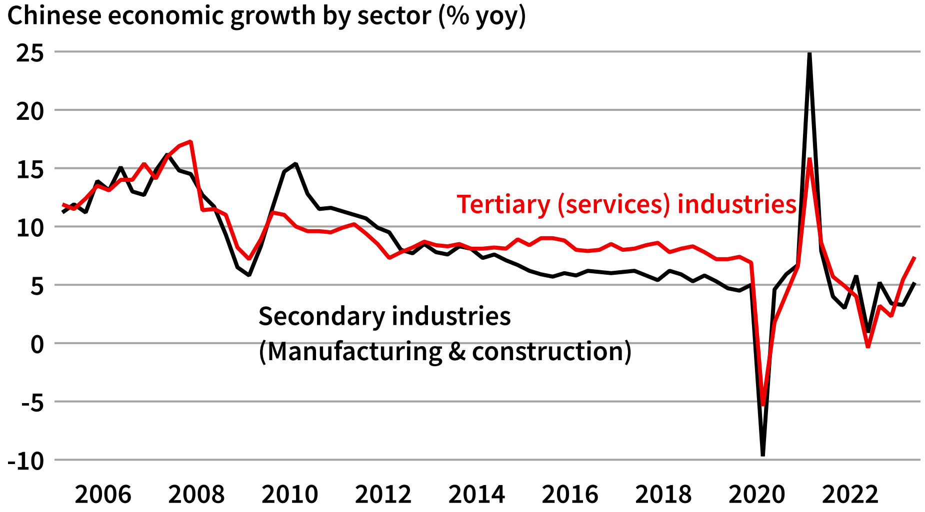
China's economic growth

Quarterly growth points to loss of momentum in Q2



Economic growth by industry

Zero-COVID impacted service sector led the yoy growth in Q2



Sources: Macrobond, NAB Economics

- China's latest national accounts data showed that its economy grew by 6.3% yoy in Q2, up from a 4.5% yoy increase in Q1, with base effects (related to the COVID-19 lockdowns of Q2 2022) helping to inflate this rate. Overall, this increase was somewhat weaker than market expectations (7.3% yoy in the Reuters poll), and points towards a loss of momentum during the quarter – as seen in the quarter-on-quarter series – as consumers remained relatively subdued.
- By broad industry category, the pickup in growth was led by the services sector – up by 7.4% yoy – which was more heavily impacted by last year's lockdown. In contrast, the secondary sector (manufacturing and construction) rose by 5.2% yoy.
- The outlook for the second half of 2023 remains cloudy – reflecting the ongoing weakness in household consumption, the headwinds from the property sector and global trade. Monetary policy stimulus has had little impact so far, with limited appetite for borrowing among businesses and households.
- Reflecting the larger than anticipated slowing, and the potential for momentum to remain soft into the third quarter, we have lowered our forecast for China's growth in 2023 to 5.2% (from 5.6% previously). Our forecasts for 2024 and 2025 are unchanged.

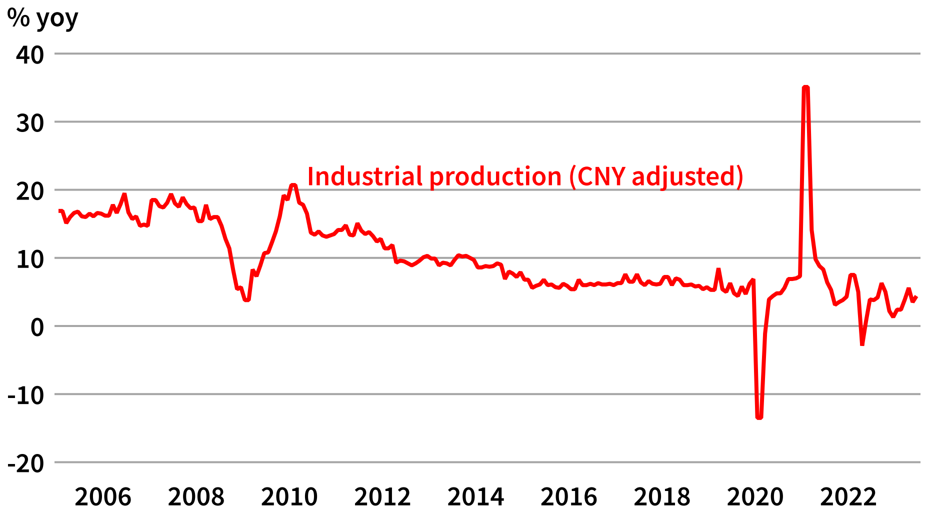
NAB China GDP forecasts

%	2022	2023	2024	2025
GDP	3.0	5.2	4.5	4.8

Industrial production

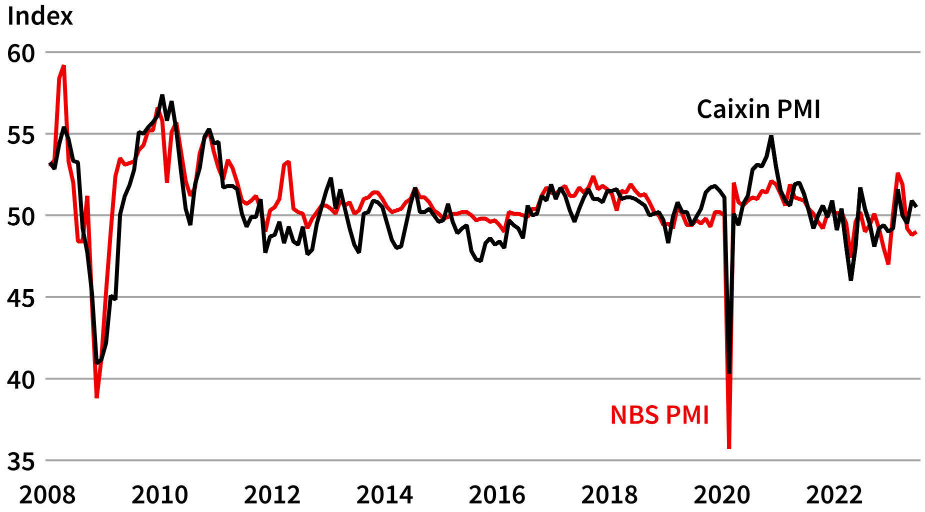
Industrial production growth

Modest pickup from May to June overlooks earlier base effects



Manufacturing PMI surveys

Sizeable gap between major PMI surveys persisted in June



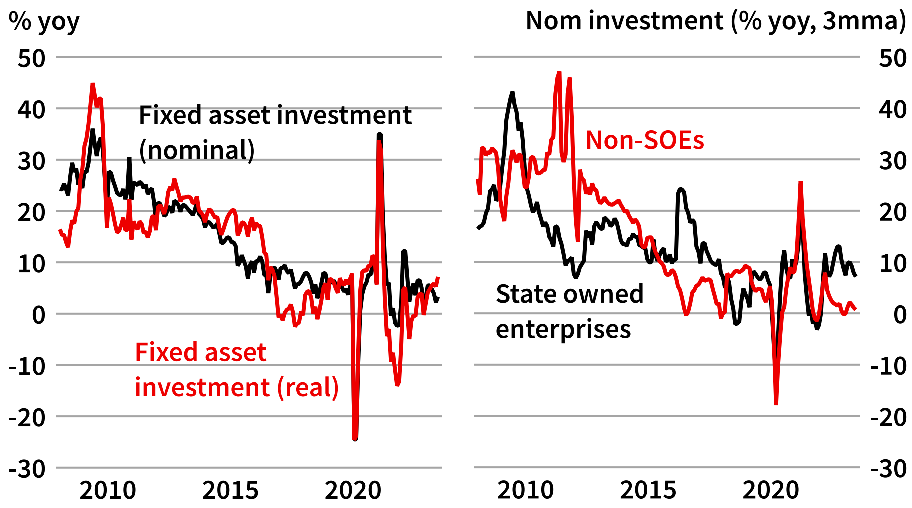
Sources: Macrobond, NAB Economics

- Growth in China's industrial production was marginally stronger in June – increasing by 4.4% yoy (up from 3.5% yoy in May). While this rate of increase is comparatively modest, when compared with pre-pandemic trends, the washing out of base effects (that inflated May's growth rate) mean that the pickup this month was more substantial than it first appears.
- There remain divergent trends in major industrial sectors. Construction related heavy industry – such as crude steel (up 0.4% yoy) and cement (down 0.8% yoy) – remained weak. Automobile production rose by just 0.8% yoy, while electronics (which were not heavily impacted by lockdowns last year) rose by 1.2% yoy. Broader sectors that recorded stronger growth were electrical machinery & equipment, chemicals and non-ferrous metal processing.
- A sizeable gap between China's two major manufacturing surveys opened up in May and remained evident in June. The private sector Caixin PMI eased slightly – down to 50.5 points (from 50.9 points in May). In contrast, the official NBS manufacturing PMI was marginally less negative – at 49.0 points in June (from 48.8 points previously).
- Both surveys recorded marginally positive trends for production, however there remains notable divergence in the measures of demand. New orders remained in positive territory in the Caixin survey, while this measure was still in firmly negative in the official survey. Similarly, respondents to the Caixin survey reported essentially neutral levels for new export orders, while this measure was steeply negative in the NBS survey. In part, the gap between the two surveys may reflect composition differences (with the Caixin survey having a greater proportion of private, smaller and new economy firms).

Investment

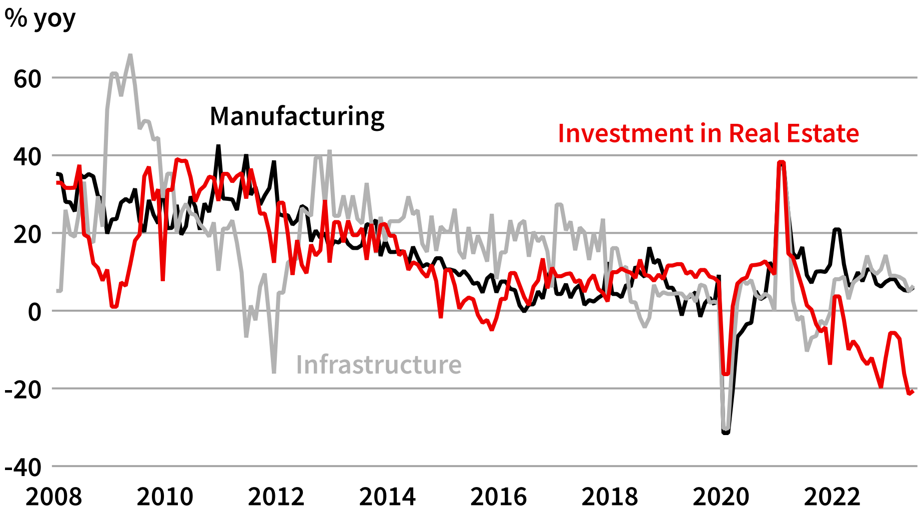
Fixed asset investment growth

Producer price deflation helping to boost real investment



Fixed asset investment by industry

Real estate sector remains contractionary despite policy efforts



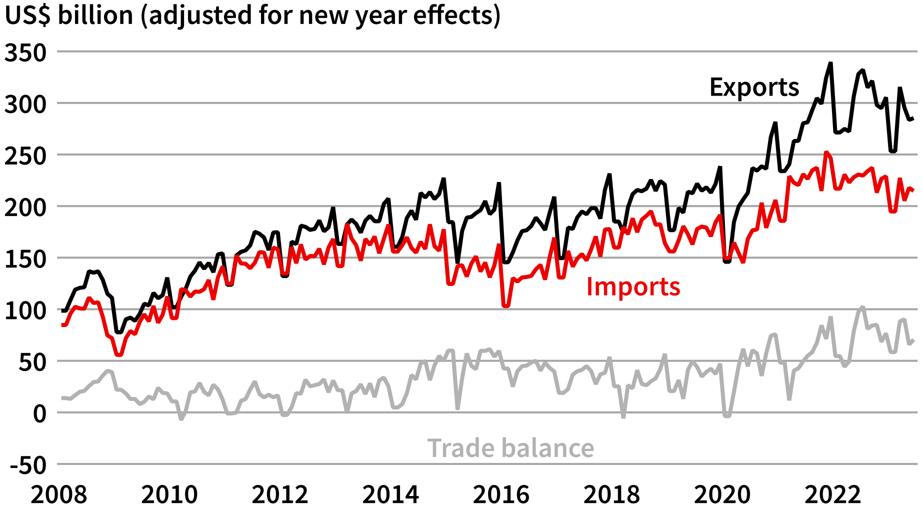
Sources: Macrobond, NAB Economics

- Nominal fixed asset investment grew a little more strongly in June – increasing by 3.3% yoy (up from 2.2% yoy in May). However, recent softness in nominal investment has been offset by steep declines in producer prices – which flow through to the cost of investment goods. This means that our estimate for real investment accelerated to 7.2% yoy (from 5.3% yoy previously).
- Investment growth remains concentrated among China's state-owned enterprises (SOEs). In nominal terms, investment by SOEs rose by 7.4% yoy in June (up from 5.6% yoy previously). In contrast, private sector investment edged up to 0.6% yoy (from 0.4% yoy in May).
- Similarly, there remains considerable divergence in investment by major industrial categories. Both the manufacturing and infrastructure sectors continue to record comparatively strong growth in nominal investment – up by 6.0% yoy and 6.4% yoy respectively in June – albeit infrastructure growth has slowed in recent months, which may reflect the boost in spending during this period in 2022 to support the recovery from the Q2 lockdowns.
- Investment in real estate has continued to contract – despite policy efforts to support the sector in recent months – down by 20.6% yoy in June. Residential property sales fell by almost 28% yoy in June, while new construction starts plunged over 33% yoy. Even the special purpose lending to property developers to complete stalled projects has had limited effect – with Yicai reporting that only 34% of unfinished presold homes identified in September 2022 had been completed as of May.

International trade – trade balance and imports

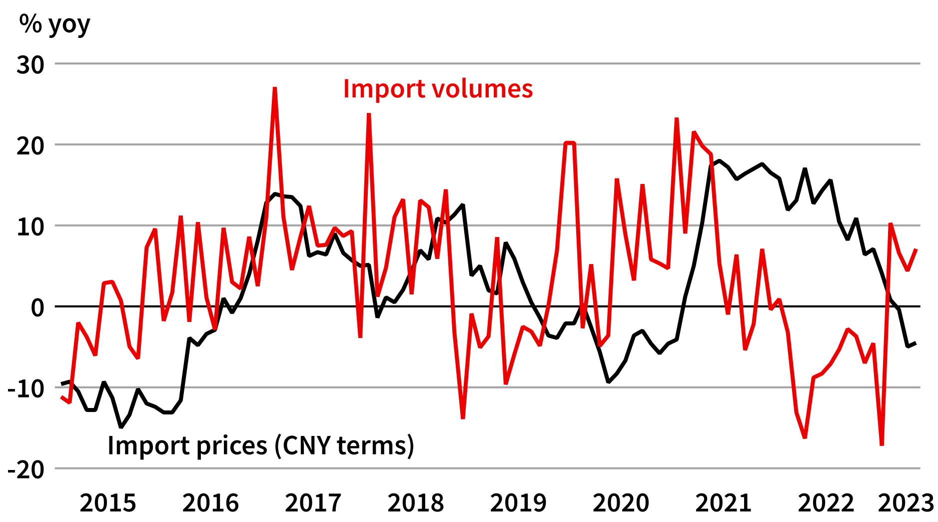
China's trade balance

Trade surplus edges higher but trade activity has fallen yoy



Import volumes and prices

Falling import values driven by prices in recent months



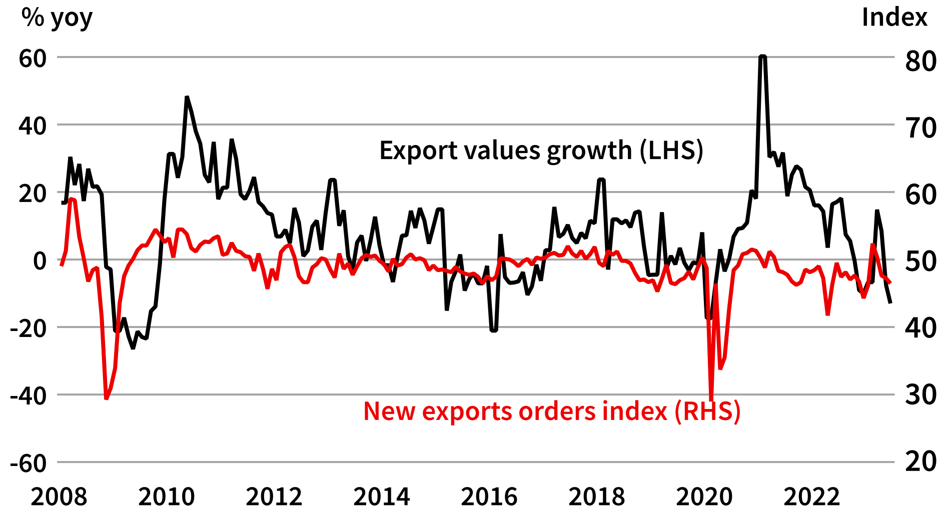
- China's trade surplus was marginally larger in June – totalling US$70.6 billion (from US$65.8 billion in May). This reflected a slight month-on-month uptick in exports combined with a modest downturn in imports – however both measures fell substantially year-on-year.
- China's rolling twelve month trade surplus with the United States has trended lower since its peak in July 2022, when it totalled US$439.7 billion. In June, it fell to US$357.8 billion (from US$370.5 billion May) – reflecting in part the steep declines in exports to the US in recent months – however it remains above the peak levels recorded prior to the US-China trade war.
- China's imports eased to US$214.7 billion in June (down from US$217.7 billion previously). This represented a decline of 6.9% yoy.
- Declines in the value of imports in recent months have largely been price related – with import volumes increasing in year-on-year terms since February. Import volumes rose by over 7% yoy in May, but our estimate for June, which uses global commodity prices as a proxy for import prices, was a little weaker, at around 3%.
- In particular, it has been energy commodity prices that have fallen significantly over the past year, contributing to the divergence between import values and volumes. For example, volumes of refined petroleum rose by 169% yoy in June, compared with a 58% increase in values. Coal imports more than doubled, while the value increased by less than 50%. Similarly, the value of crude oil imports fell by 1.4% yoy, but the volume rose by 45% yoy.

Sources: Macrobond, NAB Economics

International trade – exports

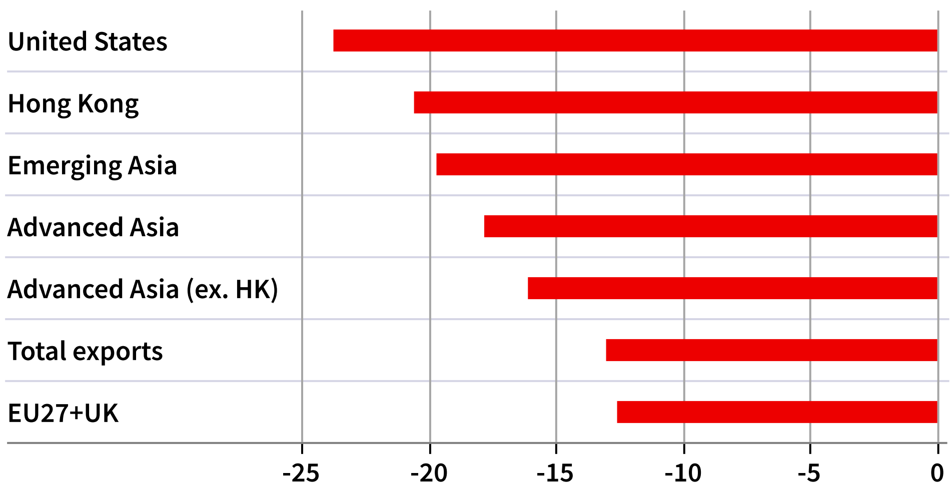
Export value and new export orders

Exports continue to contract; new orders are softer



Exports to major trading partners

Exports falling to all major trading partners



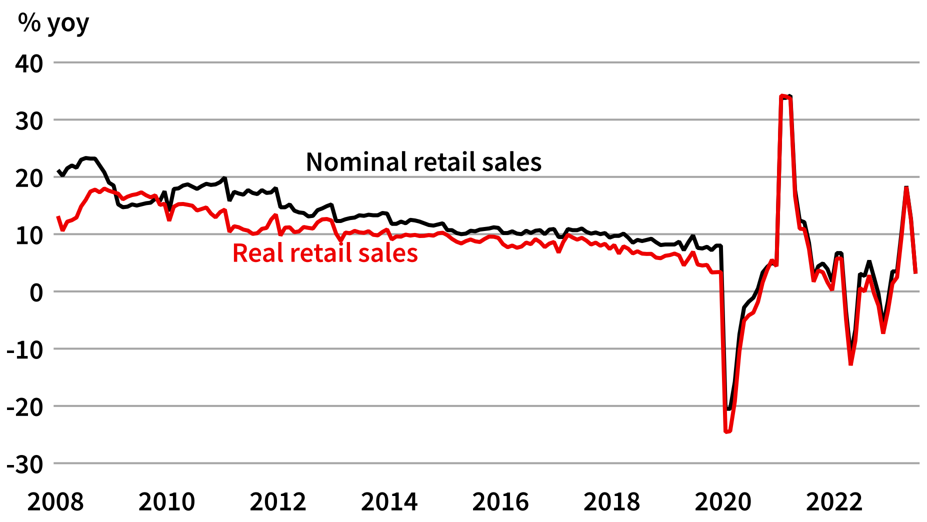
Sources: Macrobond, NAB Economics

- China's exports totalled US$285.3 billion in June (up from US$283.5 billion in May). However, this represented a fall of 13.0% year-on-year. Overall, the softening in exports since the middle of 2022 remains consistent with the weakening trend for global goods demand – with the new export orders measure in the NBS PMI sinking further into negative territory in June (down to 46.4 points, from 47.2 points in May).
- Exports to most of China's major trading partners fell more rapidly than average – reflecting the increase in exports to the Russian Federation (up 91% yoy in June) along with other former Soviet Union members.
- Exports to the United States fell most rapidly – down by almost 24% yoy in June – the eleventh straight month of year-on-year declines – while exports to emerging and advanced Asia fell by 19.7% yoy and 17.8% yoy respectively. In contrast, exports the European Union-27 and the United Kingdom fell by 12.6% yoy.
- Within Asia, exports to Hong Kong fell more rapidly than other markets – down by 20.6% yoy in June, albeit trade data with Hong Kong has frequently been distorted in the past by capital flows being disguised as trade activity. Aside from Hong Kong, there were large declines in exports to South Korea, Taiwan, Japan and the Philippines, while in contrast, exports to Singapore increased by 8.6% yoy.

Retail sales and inflation

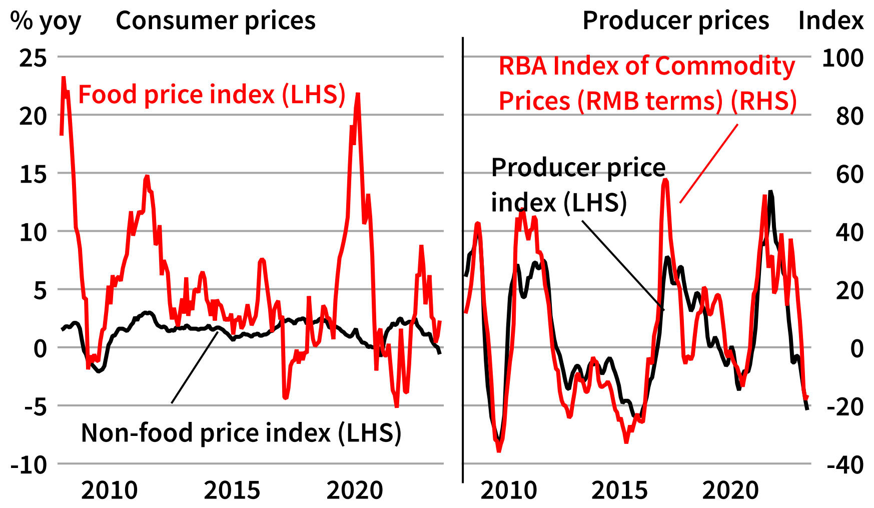
Retail sales growth

Real sales growth slowed in June as base effects washed out



Consumer and producer prices

Non-food prices enter deflation as factory gate prices fall further



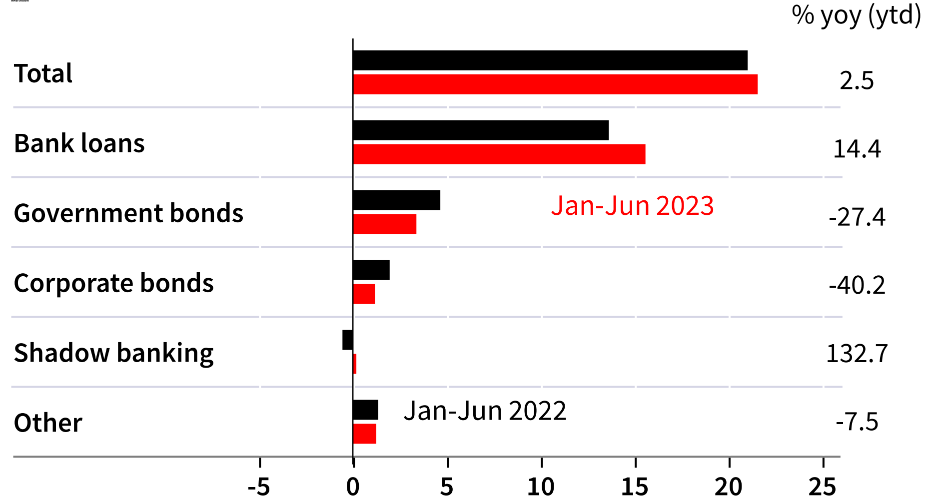
Sources: Macrobond, NAB Economics

- In nominal terms, China's retail sales growth slowed substantially in June – up by 3.1% yoy (from 12.7% yoy in May) – although it must be stressed that the spike in sales in April and May reflected base effects related of the COVID-19 lockdowns implemented during this period in 2022. Adjusted for inflation (using consumer prices), real retail sales also increased by 3.1% yoy, from 12.5% yoy previously.
- The extreme volatility in retail sales growth makes it difficult to identify underlying trends. When compared with the same period in 2019, real sales were 10.2% yoy higher in June, compared with 8.2% yoy in May and a peak of 12.7% yoy in March, suggesting that consumer demand has remained subdued – consistent with soft trends in inflation.
- Headline inflation stalled in June – with consumer prices unchanged year-on-year (compared with a 0.2% yoy increase in May). Overall, the modest increases in China's consumer prices over the past year – in stark contrast with decades high rates in much of the rest of the world – highlight the subdued nature of domestic demand.
- Food price growth accelerated in June – increasing by 2.3% yoy (from 1.0% yoy previously). Prices for both fresh vegetables and fresh fruit were considerably higher in June (up 10.8% yoy and 6.4% yoy respectively), however these increases were partially offset by a 7.2% yoy fall in pork prices. In contrast, non-food prices fell by 0.5% yoy in June (from no change in May). Vehicle fuel prices remain a major influence – down 17.6% yoy in June (compared with an 11.1% yoy fall previously) – broadly in line with global oil price trends. In addition, prices for household goods also fell in June.
- Producer price declines accelerated in June – the ninth month in a row that prices have fallen – down by 5.4% yoy (from 4.6% yoy previously). Input costs have contributed to this trend – with the RBA Index of Commodity Prices (converted to RMB terms) down by 16.4% yoy in June.

Credit conditions

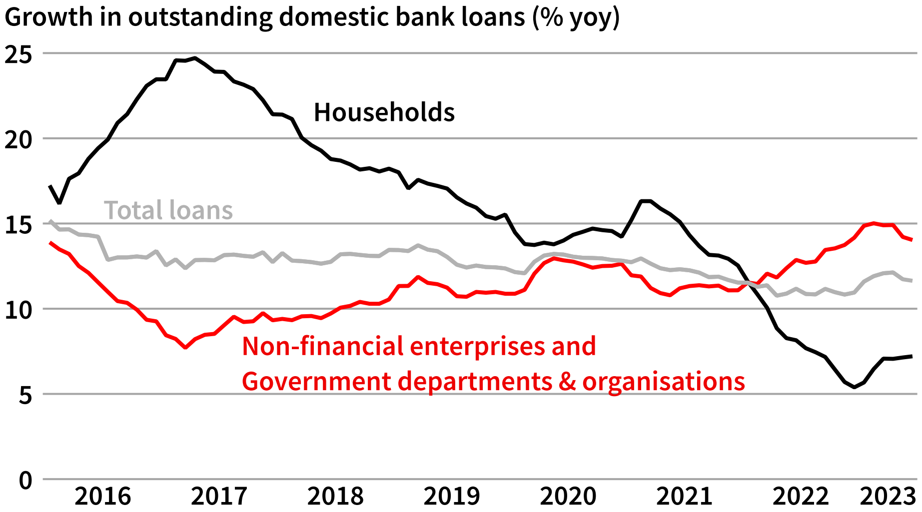
New credit issuance

Surge in bank lending largely offset by non-bank downturn



Bank lending

Growth in outstanding loans point to limited demand



Sources: Macrobond, NAB Economics

- New credit issuance contracted year-on-year in June – albeit this in part reflected the impact of base effects, with June 2022 particularly strong, as Chinese authorities attempted to support a recovery from its Q2 COVID-19 lockdowns in Shanghai and elsewhere with large scale bond issuance.
- Overall, new credit issuance rose by 2.5% yoy in the first half of 2023 to total RMB 21.6 trillion. Bank lending remained the key driver of this increase – up by 14.4% yoy to RMB 15.6 trillion.
- In contrast, non-bank lending plunged in the first half, down by 19.2% yoy. This reflects steep falls in both government and corporate bond issuance, marginally offset by a modest pickup in shadow banking.
- The People's Bank of China (PBoC) marginally cut its main policy rate – the Loan Prime Rate – in June, down 10 basis points to 3.55%. This followed on from a cut to the Reserve Requirement Ratio (RRR) in March, that freed up additional funds for banks to lend.
- While there appears to be no shortage of funds available for lending, the appetite for households and businesses to borrow remains subdued. The PBoC's quarterly banking survey showed a sharp rebound in loan demand in Q1 2023 (following on from incredibly weak conditions across the final 3 quarters of 2022) – as activity recovered following the abandonment of zero-COVID polices – before loan demand fell rapidly back down in Q2 2023. Growth in the outstanding loans to the business sector has slowed recently, while the pickup in household lending appears to have stalled.

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