# Brief China Economic Update

National Australia Bank

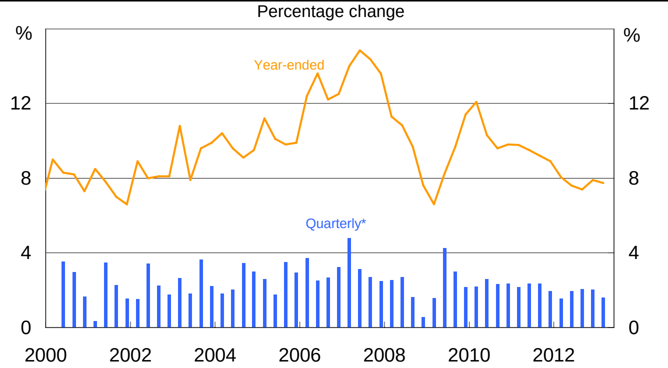
According to Chinese National Accounts released today, the Chinese economy grew 1.6% in the March quarter, which is a 7.7% increase on the same period last year. This result is softer than expected and casts some doubt over expectations for a robust recovery in the Chinese economy in the first half of the year. Official data show that growth over the year was driven by final consumption (contributing 4.3ppts to growth), followed by investment (2.3 ppts). Net exports made its first meaningful contribution in three quarters. Revised q-o-q growth rates suggest the economy's growth momentum weakened noticeably in the start of the year after showing signs of stabilising mid-to-late last year; q-o-q in the December quarter was left unchanged at 2%. This softer than expected outcome for growth sees our average growth forecast for 2013 brought down to slightly below 8%, from 8.2% previously. On a more positive note, inflationary pressures have so far been kept within acceptable levels, meaning that authorities may have more scope to further stimulate the economy in the second half of the year if necessary. We have pushed out our expectations for monetary policy slightly with a hike in interest rates now unlikely to occur until early next year. Note that all figures in this brief may change slightly once all revisions to the data are available.

Evidence of a significant recovery continues to be elusive. Partial indicators have consistently surprised on the downside compared to market expectations, highlighting the slack that remains in private demand despite government efforts to jump start the economy last year. Softness in the partial data suggests to us that risks have become much more heavily skewed to the downside, although solid additions to new credit in the March quarter, along with some healthy forward indicators, still suggest a pick up in economic activity is still on the cards. In addition to that, authorities may be less comfortable with a growth rate that is so close to the official target (7.5%), and may prompt them to ramp up stimulus measures. However, comments accompanying the data release suggest that they are relatively happy with the "stable" outcome for the quarter, as well as the improved balance in growth towards consumption. Moreover, how they manage to balance stimulus with risks from local government debts, inflation pressures and asset bubbles remains to be seen.

Stronger import values growth in March had raised hopes of a return to faster growth in domestic demand – although the softening trend in commodity imports suggested a potential easing of industrial activity. Merchandise imports jumped 47.5% m-o-m in March, although the recovery is exacerbated by seasonal impacts. Data published by the NBS adjusted for seasonality show annualised growth rising to 23.7% over the year from 6.5% in February. By commodity, iron ore, oil, copper and coal volumes were all higher in the month – due to additional trading days – but imports of each fell in the March quarter.

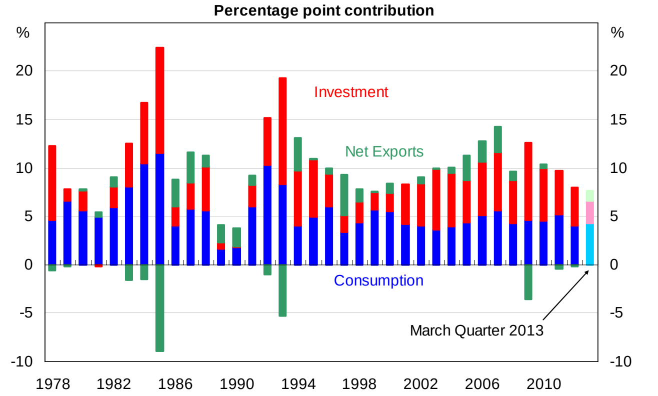
Industrial production eased further in March, dipping below 9% for the first time since last August. This is in contrast to more timely manufacturing PMI's which recorded marginal improvements in the month. The official PMI published by the NBS rose to 50.9 in March (up from 50.1), driven by a pick up in production. New

## Real GDP Growth

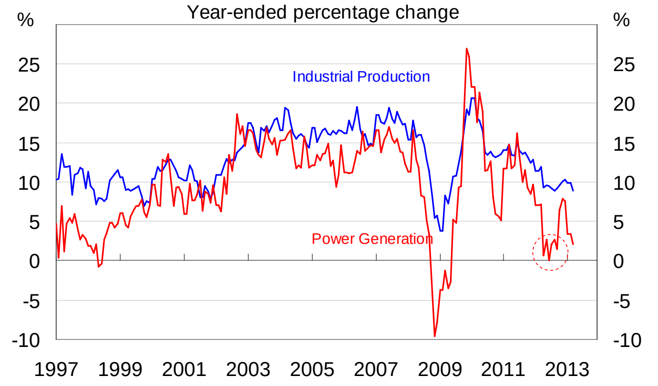



* Data prior to DQ2010 are estimated by NAB.
Source: CEIC Database, NAB

## Contribution to GDP growth




## Industrial Production




Souces: CEIC, NAB

domestic and overseas orders also improved in the month, suggesting a modest pick up in manufacturing activity in coming months. The PMI also pointed to some restocking activity in March with the finished goods inventory component reaching expansionary territory for the first time since last June. Electricity production trends – often cited as a good indicator of the underlying strength of the economy – are looking similar to last April when concerns over a hard landing were more prevalent.

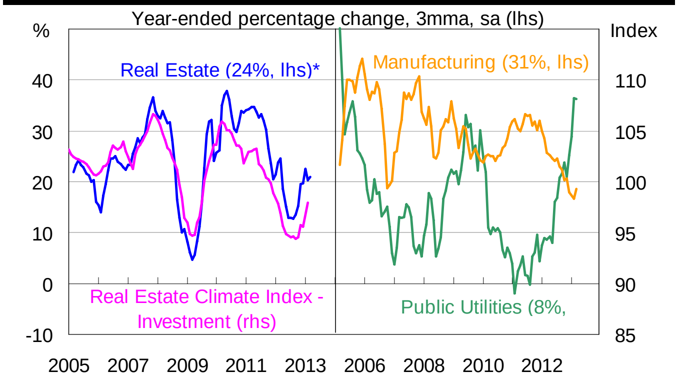
Government investment stimulus appears to be slowing from the pace seen late last year, although growth in central government spending picked up slightly in March. Our estimates of fixed asset investment growth show that momentum has remained relatively steady (increasing 21% y-o-y). By sector, investment in manufacturing has softened significantly since late 2011 as industry comes to grips with overcapacity in some sectors (particularly steel, cement, aluminium, plate glass and coking coal). Growth in real estate investment slowed in March (increasing 17½% y-o-y), but solid growth in the first two months of the year has kept growth above 20% for the quarter as a whole. Investment in real estate may slow further in response to additional uncertainty in the wake of the governments renewed focus on deflating the sector. Some relief will be gained from ongoing investment in affordable housing, helping to keep construction ticking over. Authorities expect to commence 6.3 million affordable housing units, while 4.7 million will be completed in 2013 (down from 7 million starts and 5 million completions planned last year). The announcement of additional controls has had the opposite effect on property sales which have remained strong as buyers attempt to finalise sales before the new controls come into force.

Turning to consumption, nominal retail sales growth picked up slightly in March, but remains relatively subdued at 12.6% over the year. Retail price inflation eased in March, implying a slightly stronger improvement in real retail sales growth (11.7%). While still moderate consumption growth is at odds with current robust levels of consumer confidence, it is more consistent with slower growth in real urban disposable incomes (6.7% y-o-y in the March quarter, down from 9.6% in the December quarter). We were expected to see incomes come under pressure this year following poor outcomes for enterprise profits during 2012. The government's recent clamp down on corruption and public expenses is also continuing to weigh on consumption of luxury goods. By commodity, sales growth for automobiles and petroleum slowed, while sales of furniture, construction materials and communication appliances all picked up.

Exports growth moderated in March to 10% over the year as exports to major markets in the US and Europe slowed. Despite weaker demand from these trading partners, double digit export growth was supported by a sharp pick up in exports to Hong Kong. This result has been viewed with some scepticism as the data appears to be at odds with Hong Kong customs data. It is possible that the pick-up is a reflection of hot money inflows – in the guise of goods trade – looking to capitalise on recent appreciation of the RMB. In what has been seen as support of the hypothesis, spokesman of China's General Administration of Customs (Zheng Yuesheng), said officials were investigating "abnormal trade growth with Hong Kong" and would take regulatory steps if needed. Nevertheless, stronger than expected imports saw the trade balance dip into deficit for the first time since last February (-US$0.9bn). Trade conditions are expected to improve this year in line with a recovery in growth of major developed export markets. Export orders have recently improved, moving back above neutral levels in March.

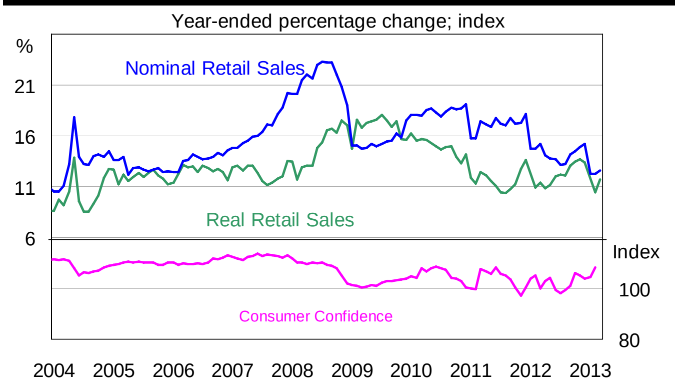
Year-ended CPI growth eased to 2.1% in March (from 3.2% in February), helping to allay concerns that authorities will need to tighten economic policies sooner rather than later. Lower inflation

## Fixed Asset Investment by Sector



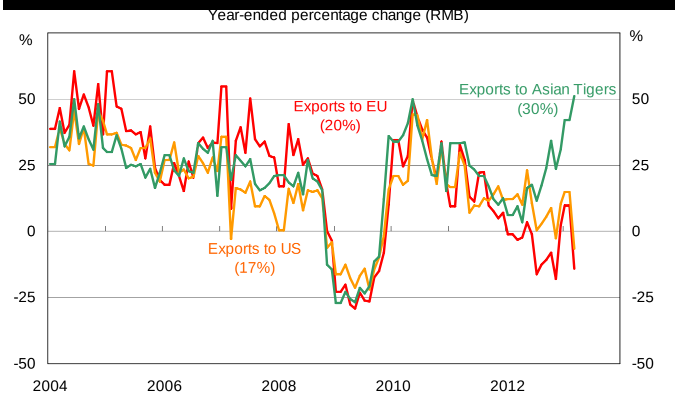

Source: CEIC, NAB
* Number in brackets represents share of total FAI in 2010; Real Estate is using Real Estate Investment data

## Retail Sales



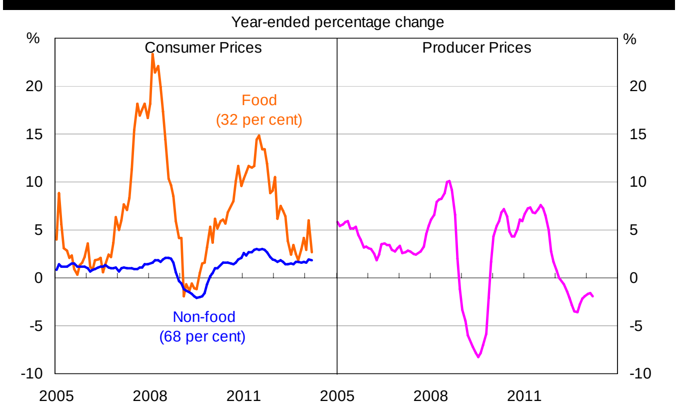

* No observation is shown for January due to the effect of Chinese New Year; Feburary shows the average of January and February compared to December.

## Merchandise exports to major trading partners




Sources: CEIC; NAB

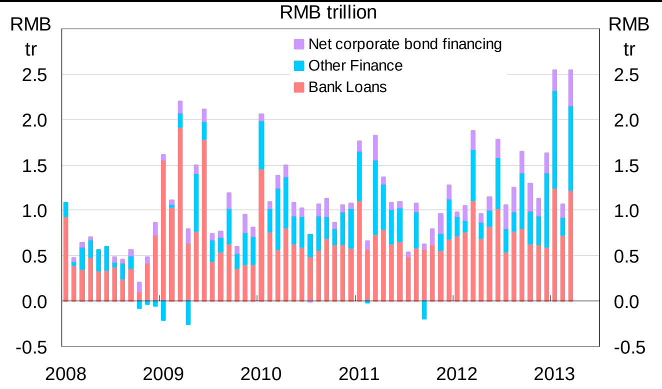
## Inflation



was driven mostly by an easing in food costs – following the traditional spike during Lunar New Year – although non-food inflation also eased slightly. While base effects and an improving global economy (likely to lead to pressure on commodity prices) are expected to boost headline CPI numbers over the rest of the year, upstream prices are still suggesting relatively benign inflation pressures; producer prices fell 1.9% over the year. However, strong credit data may be a forerunner to heightened inflation risk and asset bubbles later in the year. Credit growth has been relatively robust, rising 14.9% over the year to March. There were RMB1.07tn in new bank loans issued in March, up from just RMB619bn in February. However, much of the rise in credit is coming from the non-bank sector where the central bank has less control – macroprudential policies are necessary to restrain expansion of this sector. New non-bank credit increased RMB1.3tn in March compared to RMB330bn in February.

On monetary policy, more abundant liquidity will likely preclude any further cuts to reserve requirements, at least in the near term, as the central bank relies more heavily on short-term policy instruments. Looking through volatility during the holiday period, the PBoC has withdrawn net liquidity from the system in recent months. As inflation gradually lifts towards the new target of 3.5% by the end of the year, the central bank will come under pressure to commence raising interest rates, but we are not forecasting a rate hike (25bp) until the March quarter of 2014.

**New total social financing**




Sources: CEIC; NAB

Statistical releases available here:
[National Bureau of Statistics](#)
A more comprehensive note will be released in the coming week.

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## Important Notices