

# China Economic Briefing



Partial economic indicators continue to highlight softening trends in China, evident since the latter part of 2013. These trends remain in line with our expectations, and as such, our forecasts for Chinese economic growth are unchanged at 7.3% in 2014 (before slowing to 7% in 2015).

Recent commentary by both China's President and the Governor of the People's Bank of China appears to indicate an acceptance of slower growth trends – with Governor Zhou Xiaochuan commenting that the Government would 'fine tune' its policy to counter economic cycles but not use any large-scale stimulus to boost the economy (China Daily).

### Industrial Production and Investment

Industrial production was marginally softer in April – increasing by 8.7% yoy (compared with 8.8% in March). Although production levels are slightly above the recent lows of February, output remains comparatively soft, around the weakest levels since China recovered from the GFC.

The various manufacturing PMI surveys highlight mixed conditions in the industrial sector – between large state-owned producers and small-to-medium private firms. The official NBS PMI (covering larger firms) was slightly improved in April at 50.4 points (compared with 50.3 points last month), while the HSBC Markit PMI continued to weaken – down to 48.1 points (from 48.3 points previously).

The trends in major industrial sectors remained mixed. Growth accelerated in rolled steel output (5.4% yoy from 5.0% in March) and motor vehicles (7.9% yoy compared with 7.3% previously). In contrast, growth rates slowed for electricity output – down to 4.4% yoy versus 6.2% in March – and cement, which increased by 3.9% yoy (down from 5.9% last month).

Fixed asset investment continued to slow in April, with the growth rate easing to 16.8% yoy (on a seasonally adjusted basis) – compared with 17.4% in March.

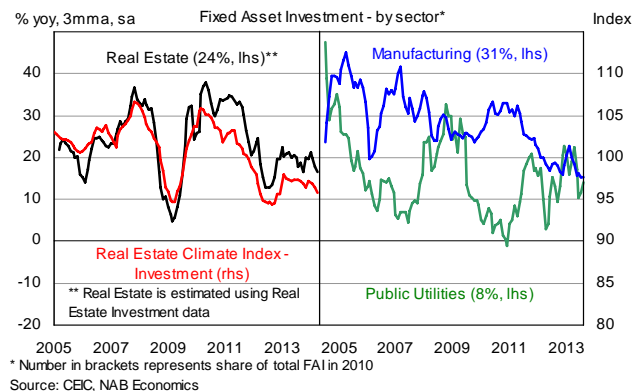
Investment trends have continued to weaken across a range of key segments – with seasonally adjusted investment in real estate slowing to 16% yoy (compared with 18% in March), while manufacturing increased by 15.2% yoy (edging down from 15.3% last month) – the weakest growth rate since disaggregated data was first released in 2004.

As highlighted in our major release last month, growth trends in the residential property sector appear to be slowing (although data is quite inadequate). Weak conditions in the residential property market could have a major impact on construction and demand for land, and therefore impact local government revenues and increase concerns around local government debt (due to the importance of land sales in servicing government debt).

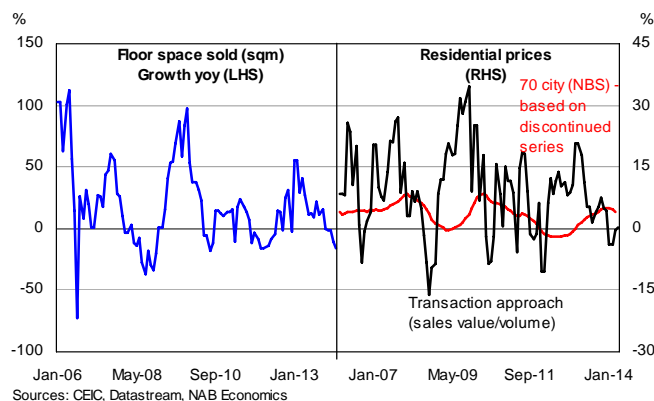
### Industrial production trends remaining soft in April



### Investment easing in real estate and manufacturing



### Residential property sector slowing – concern for local gov'ts



**International trade**

In year-on-year terms, trade data for April was marginally stronger, a surprising result given the distortions in export data recorded in the first half of last year. There were slight increases in both exports and imports, with the trade surplus widening to US\$18.5 billion (compared with US\$7.7 billion in March) – ahead of market expectations.

Merchandise exports rose by 0.8% yoy (in US dollar terms) in April. In year-to-date terms, exports are down around 2.3% - reflecting the crackdown that commenced in the second half of last year on false invoicing used by some firms to avoid capital controls. We continue to anticipate weak export trends in the first half, given these trends.

There was a marked divergence in export trends by region. Exports to both Europe and the United States increased strongly – up 15% yoy and 12% yoy respectively. In contrast, exports to East Asia remained weak – down by around -16% yoy (albeit compared with -25% yoy in March). Hong Kong was the main destination for the false invoice schemes and exports to the region were down -31% yoy, while East Asia excluding Hong Kong saw exports rise by 3.0%.

By product category, export trends remained negative for both High Tech products and Mechanical & Electrical goods – which may be connected to the invoicing issues – with exports falling by -11% and -3.2% yoy (in seasonally adjusted terms). In contrast, exports of Agricultural products increased by 6.2% yoy (seasonally adjusted).

Imports recovered in April, increasing by 0.7% yoy – after a sharp (and surprising) fall in March of -11%. Growth in imports has been driven more by increasing volume than the price of goods – with commodity prices softening since peaks in late 2011.

By commodity, import volumes remained mixed – with coal imports down by around -5.5% yoy (particularly for metallurgical coal, although this may reflect destocking trends by steel mills), while there were large increases in copper (52% yoy), iron ore (24% yoy) and crude oil (21% yoy).

**Retail Sales and Inflation**

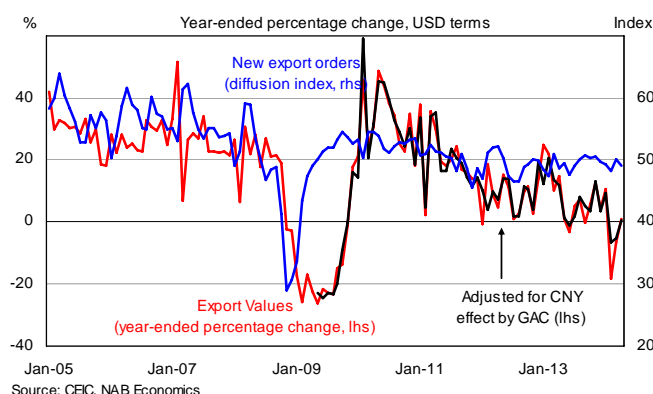
Retail sales growth was largely unchanged in April – with nominal growth of 11.9% yoy (compared with 12.2% in March) – slightly below market expectations.

Similarly, there was little change in real sales growth – with an increase of 11.0% yoy (compared with 10.9% previously). There was a noticeable increase in consumer confidence in March – pushing up to its highest level since February 2013.

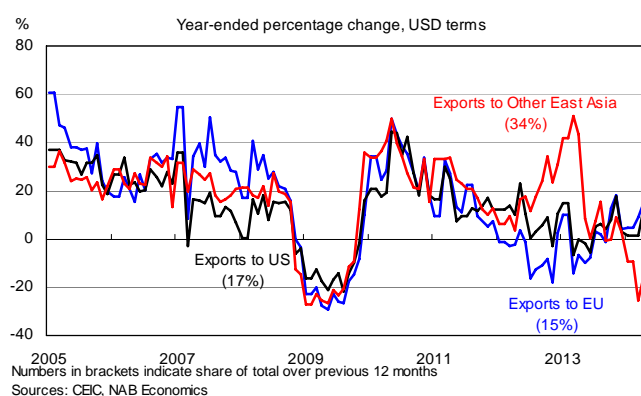
Sales growth for food and drink was in line with total retail sales – increasing by 11.9% yoy (compared with 9.9% in March). In contrast, there were marked slowdowns in both Household goods – with growth at 2.9% yoy (compared with 13% previously) – and Jewellery (which contracted by -30% yoy, from -6.1% last month). Motor vehicle sales remained robust at 12% yoy (from 14% in March).

Price growth was soft in April, with the headline consumer price index recording an increase of 1.8% yoy (compared with 2.1% in March). Softening in the growth rate for food prices was the main contributor to this trend – with food prices

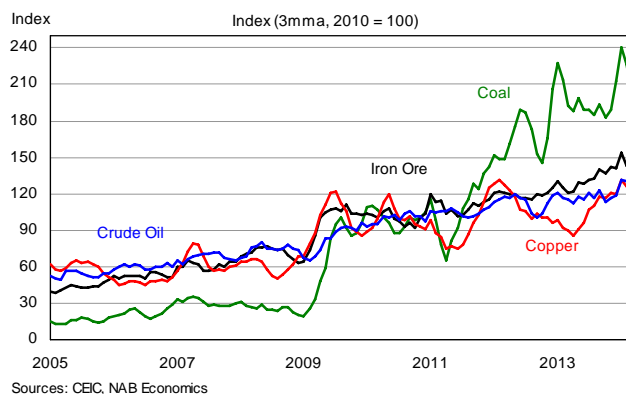
**Export trends to remain weak in the first half of 2014**



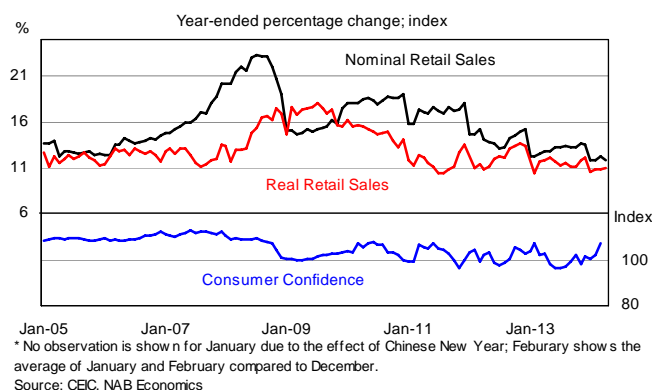
**Exports to United States & Europe pick up in April**



**Commodity import volumes supported by investment**



**Retail sales growth remaining stable, confidence higher**



increasing by 2.3% yoy (compared with 4.1% in March), while non-food prices were relatively stable at 1.6% yoy (from 1.5% previously). The lower growth in food prices was driven by falling prices for fresh vegetables (-7.9% yoy).

Trends for producer prices remained negative – with prices down by -2.0% yoy in April (compared with -2.3% in March). Producer prices have now fallen for twenty-six straight months (the longest decline since late 1999). The falls remain most evident in heavy industry (-2.6% yoy), reflecting the ongoing declines in US dollar denominated commodity prices.

**Policy expectations**

The concerted efforts to slow shadow banking appear to have had an effect, with a substantial pullback in the growth rate for the People’s Bank of China’s (PBoC) Total Social Financing measure since the second half of 2013 – down from 22% yoy in May 2013 to 16.2% yoy in April 2014.

The slowing trend is particularly evident outside the traditional banking sector. Outstanding non-bank lending (which includes some, but not all, components of Shadow Banking) grew by 23% yoy – compared with 41% in May 2013 – with a particularly noticeable slowdown in entrusted and trust loans. In addition, reports have suggested that tighter regulation has forced banks to bring a range of off-balance sheet items (such as Wealth Management Products) back on-book.

That said, credit growth continued to outpace nominal GDP growth in the first quarter – with growth for the twelve months to March 2014 slowing to 9.1% yoy (from 9.5% in the December quarter) – a trend that continues to concern policy makers.

The PBoC was less active in Chinese money markets in April – with the scale of open market operations far below the levels observed in February and March.

That said, the 7-day Shanghai Interbank Offered Rate remained relatively volatile, and remained at comparatively low rates across April. In early May, the SHIBOR was around 3.2%, 100 basis points below the level in early April, and well below the rates during the latter part of 2013.

Longer term rates converged across April – reflecting a marginal increase in 3 year rates and a softening in 5 year, bringing the interest spread back to more typical levels seen across most of 2012 and 2013.

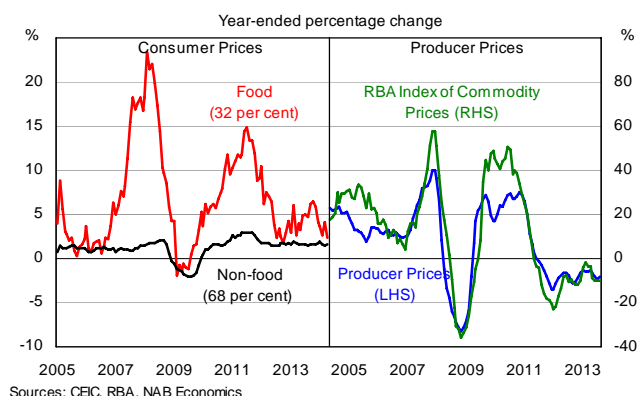
We continue to expect tightening in the SHIBOR across 2014, with the current comparatively low rates at odds with the PBoC’s broader goals of cooling credit growth.

The pace of reform around interest rates remains slow. While there is a broad goal for liberalisation of deposit rates in ‘one to two years’ (as announced by the Governor of the PBoC in March), various Chinese academics believe that the process will be slower – reflecting both the caution of Chinese authorities and the complex range of reforms – including deposit insurance and a workable bankruptcy legal framework – that must be implemented first.

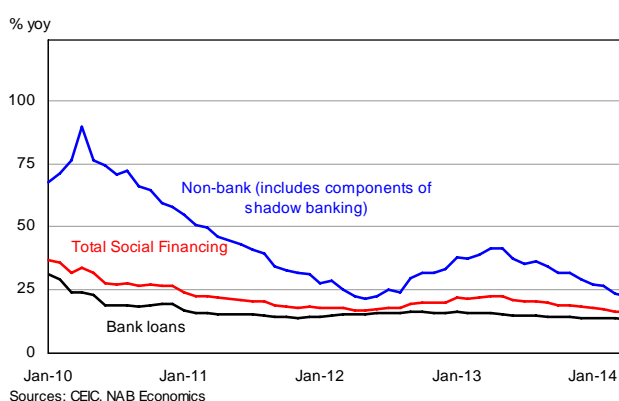
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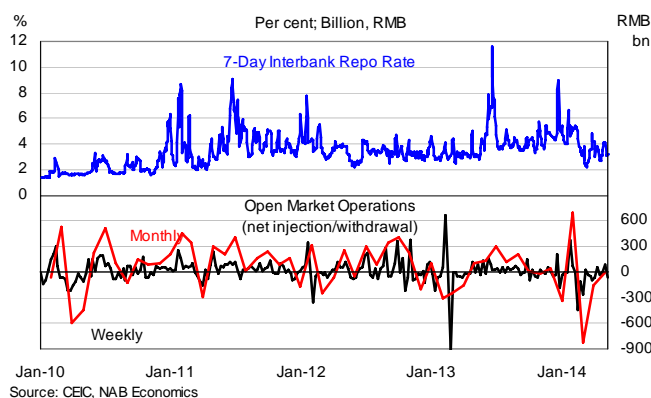
**Consumer and Producer Prices**



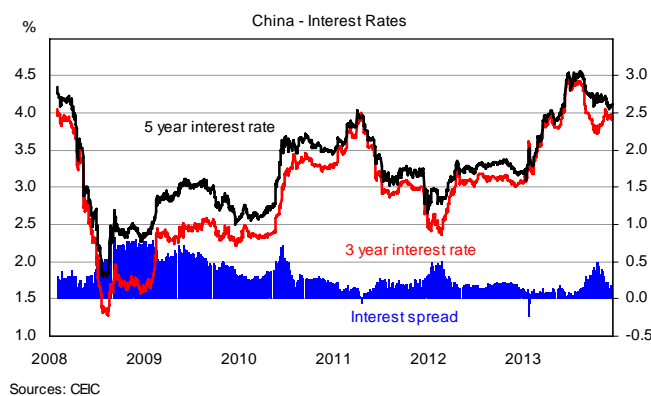
**Credit growth outside the banking sector has slowed**



**Liquidity conditions more volatile in recent months**



**Interest spread narrows as longer term rates converge**



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