more give, less take

China Economic Briefing
by NAB Group Economics

13 November 2014

National Australia Bank

China's cooling economic trends could continue into 2015

The cooler economic conditions experienced in the third quarter could continue into Q4 and further into 2015, reflecting the continued reluctance of Chinese policy makers to implement broad based stimulus. Bloomberg reported comments from a PBoC monetary policy advisory committee member who suggested fourth quarter GDP would slow to 7.2% yoy – a view broadly consistent with our forecasts.

President Xi Jinping commented at the APEC CEO Summit earlier this month that 7% growth would continue to rank China as one of the world's fastest growing economies – potentially indicating a lower official growth target in 2015. We forecast economic growth at 7.0% in 2015 and 6.8% in 2016.

Industrial Production and Investment

China's industrial production growth slowed slightly in October – with output growing by 7.7% yoy (down from 8.0% in September), below market expectations. While this growth was stronger than the level recorded in August (6.9% – the slowest growth rate in over five years), it remains relatively weak for the post GFC period.

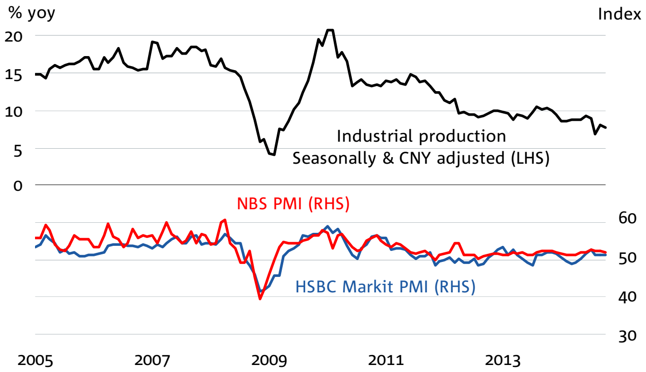
The two main PMI surveys showed minimal change in October. The official PMI eased slightly to 50.8 points (from 51.1 points previously) – with this survey more indicative of conditions for larger State Owned Enterprises. In contrast, the HSBC Markit PMI (which has a greater share of SME firms) was marginally stronger at 50.4 points (from 50.2 points in September).

Production trends were once again mixed at the subsector level. Electricity generation softened in October – growing by 1.9% yoy (compared with 4.1% in September) – while there was an acceleration in motor vehicles, which rose by 6.8% yoy (from 4.5% previously). Construction related sectors such as cement remained weak, falling by -1.1% yoy (from -2.2% last month).

China's fixed asset investment rose slightly in October – up to 14.4% yoy (in seasonally adjusted terms), from 13.8% in September (which was the lowest rate of growth since December 2001). In real terms, the growth has been stronger, rising by 16.8% yoy (from 16.2% previously) – reflecting the falling costs of inputs such as steel.

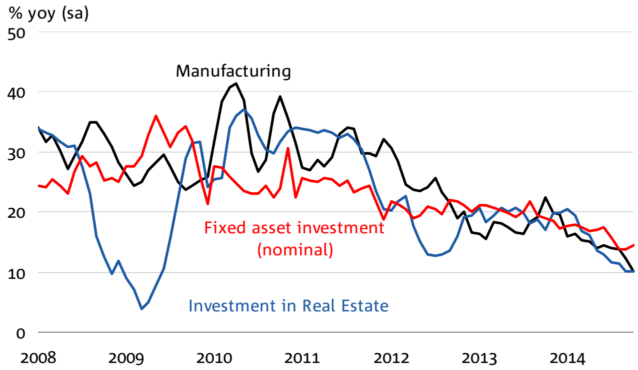
Investment in real estate remains subdued, growing by 10.1% yoy, a level that is unchanged from September and the weakest since the GFC – reflecting conditions in the underlying property sector. Similarly investment in manufacturing slowed to 10.0% yoy – the slowest rate of growth since the series began in 2004.

Industrial production slipped back in October – remaining relatively weak in the post GFC period



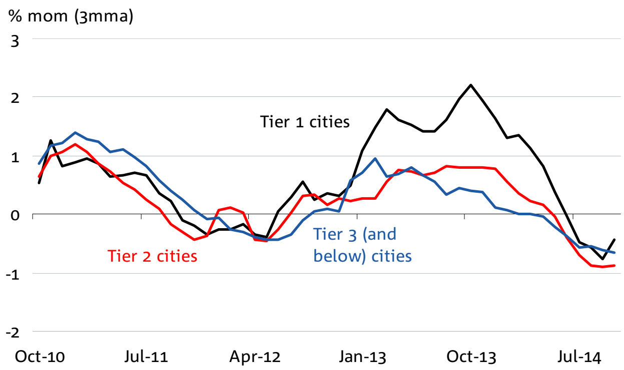
Source: CEIC, NAB Economics

Investment in manufacturing and real estate remains weak – combined these accounted for 59% of fixed asset investment in first nine months



Source: CEIC, NAB Economics

Looser policy in property sector appears to be stabilising the market – slowing falls in prices



Source: China Index Academy, Datastream, NAB Economics

Conditions in housing markets remain weak – existing house prices fell in all 70 cities monitored by the NBS in September, while new house prices fell in 69. That said, China Index Academy data for the top 100 cities shows that the rate of decline has stabilised in tier 2 and 3 cities in October, and decelerated in tier 1 cities.

Policy makers have reportedly reduced restrictions on purchasing property in some cities, while some banks have lowered deposit requirements for first home buyers and investors. These measures appear to be stabilising markets, although trends in construction have not improved.

International trade

China's trade surplus widened once again in October, as the value of imports pulled back. The surplus stood at US$45.4 billion (compared with US$31.0 billion in September).

In US dollar terms, exports rose by 11.6% yoy in October (down from 15.3% in September). The recent strength in export growth – particularly exports to Hong Kong – appears to indicate the return of false invoicing, distorting the reported values.

Exports to Hong Kong rose by 24% yoy in October (easing back from 34% in September) according to Customs data. However this strong rate of growth is inconsistent with Hong Kong import data – which showed imports increasing by just 5.6% yoy in September. Hong Kong has been the main market used for false invoicing – a method of circumventing China's capital controls.

In contrast, exports to the United States recorded stable growth – at 11% yoy – while exports to the European Union slowed to 4.1% yoy (from 14% previously).

Import trends were soft in October, with growth slowing to 4.7% yoy (from 7.1% in September). The value of imports has been impacted by falling commodity prices, however volumes have also exhibited markedly different conditions. The volumes of crude oil and iron ore (by far the largest commodity imports) increased in October by 18% yoy and 17% yoy respectively – whereas imports of coal fell by -17% yoy and copper -1.6% yoy.

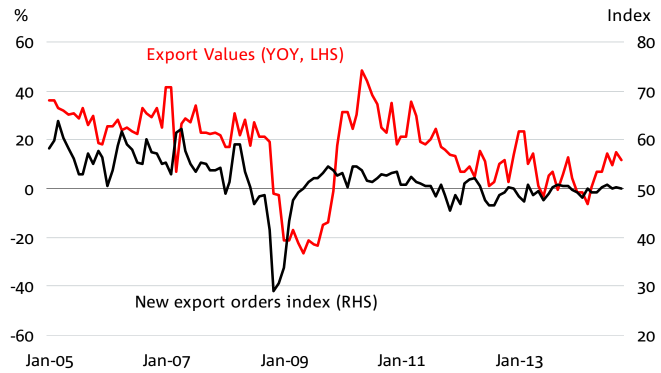
Retail Sales and Inflation

Retail sales eased marginally in October, with nominal growth at 11.5% yoy (down from 11.9% in September) – the weakest rate of growth since February 2006. That said, some of this apparent weakness reflects slowing inflation. In real terms, growth was 10.7% yoy (from 10.8% last month) – slightly below trend levels for the past few years.

There was slower growth in sales of household goods (at 6.5% yoy from 8.5% in September) and motor vehicles (4.5% yoy from 6.7% previously), while food and drink sales picked up from weak levels in September.

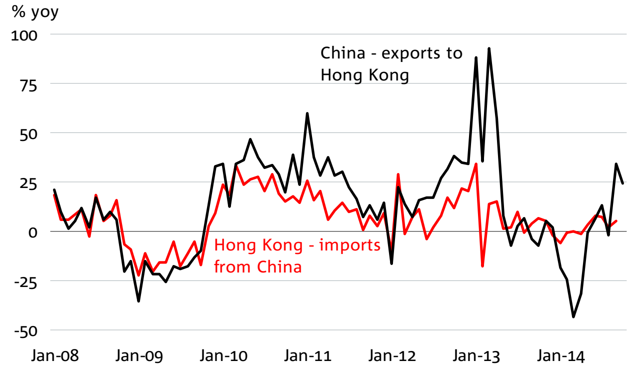
Inflation has remained muted – with consumer prices rising by 1.6% yoy in October (unchanged from last month), the lowest rate since early 2010. This weakness has raised some concerns that deflationary pressures – prevalent in Europe and Japan at present – could appear in China, further constraining growth.

China's exports have risen sharply – likely indicating a return of false invoice distortions



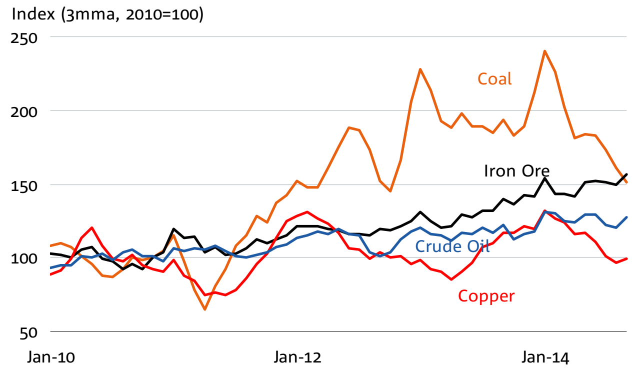
Source: CEIC, NAB Economics

Hong Kong data shows less volatility in China-HK trade



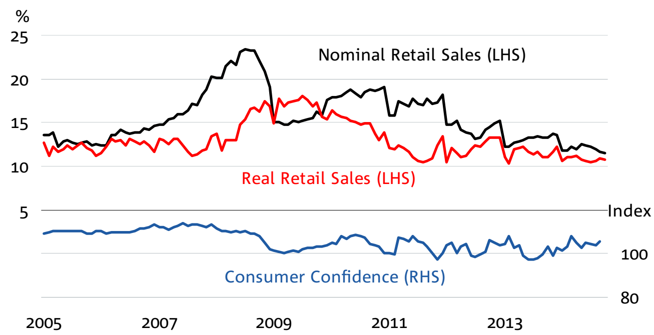
Sources: CEIC, NAB Economics

Volumes for iron ore and crude oil have continued to rise, but coal and copper are weaker



Sources: CEIC, NAB Economics

Slowing nominal sales may reflect weaker inflation



* 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.
Source: CEIC, NAB Economics

At present these deflation concerns for China appear unfounded – the key driver of recent disinflation has been in food prices which rose by 2.5% yoy in October, up from 2.3% in September – well below the levels recorded at the start of the year.

Non-food price growth has eased a little in recent months – down to 1.2% yoy in October, but this measure has been relatively stable across most of the year.

Producer prices fell once again – the thirty-second month in a row, exceeding the previous record from June 1997 to December 1999. Prices fell by -2.2% yoy in October (compared with -1.8% in September). Falling commodity prices continue to be the main influence for producer price deflation, with falls more evident in the heavy industrial sector, where profits have remained in positive territory.

Credit conditions

Data for China's credit conditions was unavailable at the time of writing, however the market expects weaker levels for both bank loans and total social financing than recorded in September (although the record of these expectations has not been particularly good).

Despite calls to cut interest rates, both in response to soft inflation data and weakening economic conditions, China's benchmark lending rate has remained unchanged. The proportion of loans above the benchmark rate has continued to trend higher across recent months – indicating that recent downward trends in three and five year interest rates are yet to translate into easier lending conditions.

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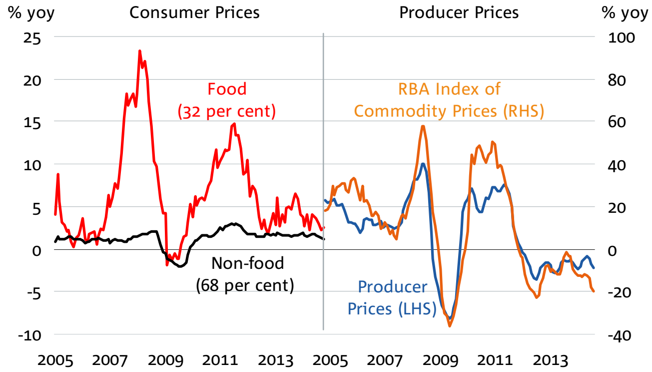
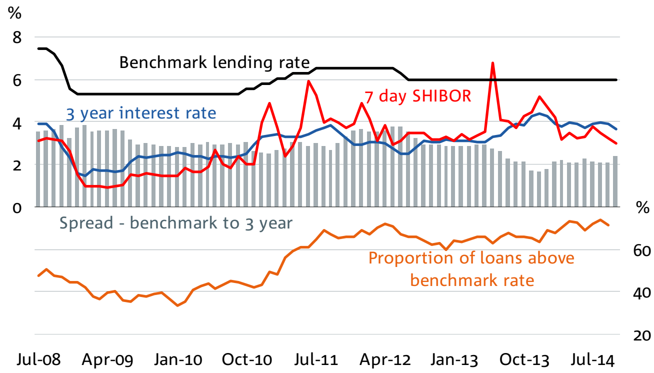
Food prices the main driver of disinflation



Sources: CEIC, RBA, NAB Economics

Benchmark lending rate unmoved, despite slowing conditions



Sources: CEIC, NAB Economics

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