China Economic Briefing

by NAB Group Economics

12 December 2014

National Australia Bank

Industrial trends soft in November, growth in 2015 likely lower

China's Central Economic Work Conference occurred this week, the annual closed door meeting where policy makers set the country's economic agenda. There is a growing expectation that the meeting will lower China's economic growth target for 2015 – down from this year's 'about 7.5%' to 7.0% – however this change may not be officially announced until the National People's Congress meets next March.

Growth of 7.0% in 2015 – which remains our forecast – would be the slowest rate of growth since 1990. China's growth is forecast to ease further to 6.8% in 2016.

Industrial Production and Investment

Growth in industrial production slowed noticeably in November, with output rising by 7.2% yoy (compared with 7.7% in October). The APEC conference – held in Beijing in early November – may have negatively impacted industrial activity, with much of Hebei's steel sector (among other industries) cutting output to reduce pollution during the event.

China's PMI surveys both softened in November. The HSBC Markit PMI eased to 50.0 points (from 50.4 points in October), while the official PMI was 50.3 points (down from 50.8 points previously).

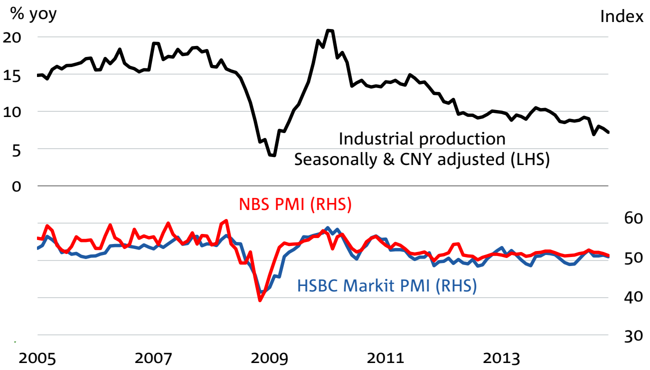
Trends were weaker across a range of industrial sectors. Cement production contracted, down by -4.0% yoy, while steel was slightly weaker, at -0.2% yoy, suffering from both weakness in construction and the Hebei shutdown. Electricity output was also softer, with growth at 0.6% yoy, from 1.9% in October.

For the second straight month, China's fixed asset investment strengthened – rising by 14.9% yoy (compared with 14.4% in October). Falling prices for key inputs – such as steel – has limited recent declines in real investment, with this measure growing by 17.3% yoy in November (up from 16.8% previously).

That said, investment in real estate continued to weaken – with growth slowing to 9.3% yoy (from 10.1% last month) – weaker than at any point since the GFC. Investment in the manufacturing sector was relatively stable, at 10.2% yoy, compared with 10.0% previously.

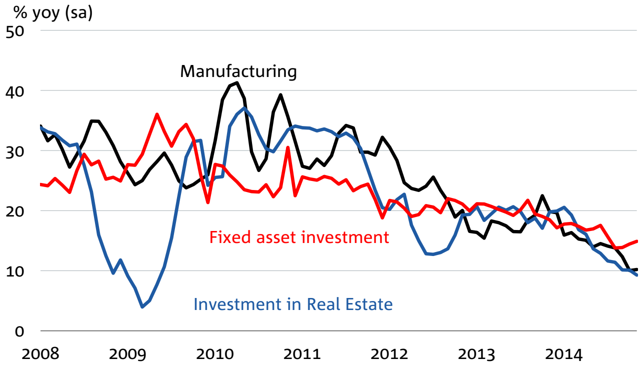
Property markets appear to be stabilising – following a series of policy relaxations. According to China Index Academy data, average prices in Tier 1 cities rose in November – albeit by just 0.3%, following on from six months of declines. Prices in lower tier cities continue to fall, but in the case of tier 2, the rate of decline has slowed.

Industrial production fell to 7.2% yoy in November, though distorted data due to APEC shutdowns



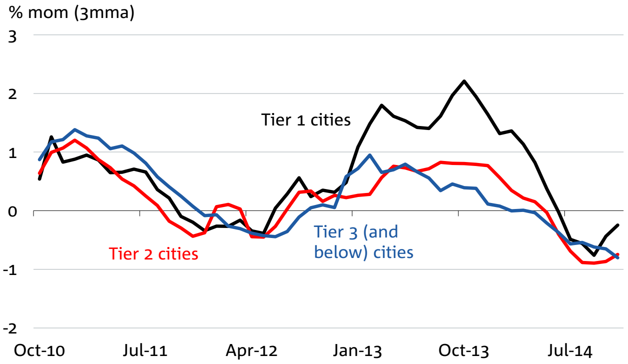
Source: CEIC, NAB Economics

Fixed asset investment slightly stronger in November, but still weak in manufacturing and real estate



Source: CEIC, NAB Economics

Property prices continued to fall across China, but looser policy appears to be stabilising markets



Source: China Index Academy, Datastream, NAB Economics

International trade

China's trade surplus climbed to a new record in November, as the country's imports contracted in year on year terms. The surplus was US$54.5 billion (up from US$45.4 billion in October).

US dollar denominated exports increased by 4.7% yoy in November (below the level of expectations) – down from 11.6% previously. According to China Customs data, exports to Hong Kong slowed in November, rising by just 1.0% yoy (compared with 24% in October).

However, in dollar terms exports to Hong Kong rose month on month to US$35.5 billion (from US$32.7 billion). That said, there is a considerable discrepancy between Chinese and Hong Kong data for this trade flow. According to Hong Kong Customs, imports from China in October totalled US$23.1 billion – a difference of almost US$10 billion.

This discrepancy highlights the issue of false invoicing (used to circumvent China's capital controls) that continues to distort trade data. Hong Kong has been the main export destination for these schemes.

Export trends to other major markets were mixed – with deliveries to the European Union stable at 4.1% yoy and the United States weaker at 7.2% yoy (from 11% previously).

China's import trends were particularly weak in November, falling by -6.7% yoy (compared with growth of 4.7% in October). The value of China's imports has been impacted by falling commodity prices, while volumes have also varied – with coal imports sharply lower in 2014.

In terms of major commodities, coal import volumes were down -26% yoy, copper by -3.6% yoy and iron ore by -13% yoy. Iron ore imports were likely impacted by the APEC related shutdown to Hebei's steel sector – this was the first year on year decline in iron ore imports this year.

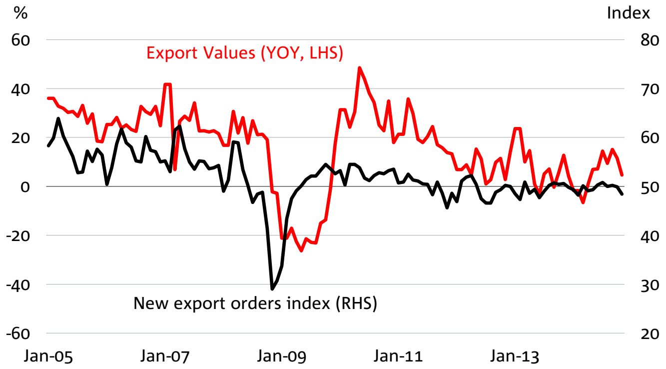
Retail Sales and Inflation

China's retail sales trends have remained relatively subdued, at 11.7% yoy in November (compared with 11.5% previously, which was the weakest rate of growth since February 2006). However, it is worth noting that retail price inflation has continued to weaken – just 0.4% yoy in November, meaning that real retail sales have trended higher in recent months – up by 11.3% yoy, from 10.7% previously.

Sales of food & beverages and clothing & footwear strengthened (rising by 13.0% yoy and 13.4% yoy respectively). In contrast, there was a notable slowdown in automotive sales, with growth of 2.0% yoy, compared with 4.5% in October.

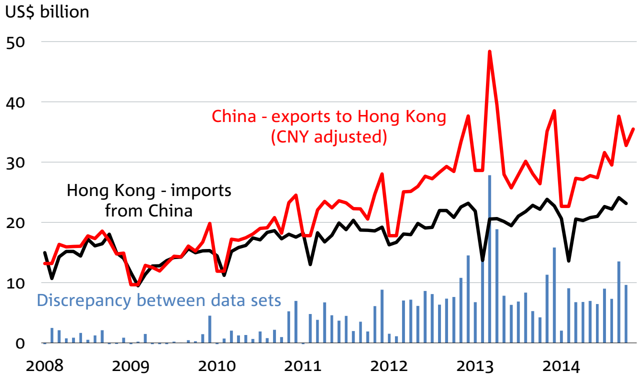
Inflationary pressure has continued to ease, with the headline CPI at 1.4% yoy in November – down from 1.6% previously. This was the lowest rate since November 2009 – as China was coming out of a GFC related deflationary phase.

Export growth weaker this month, distortions persist



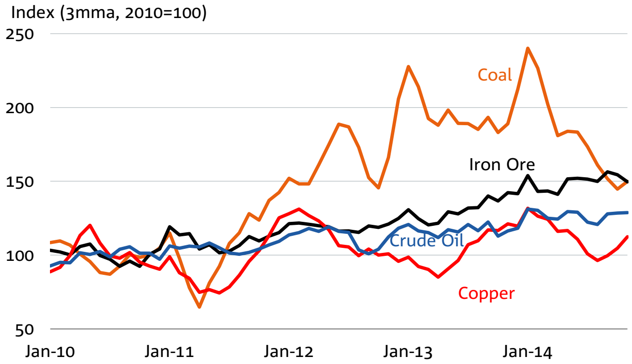
Source: CEIC, NAB Economics

Recent spike in discrepancy between HK and China's trade data highlights false invoice distortion



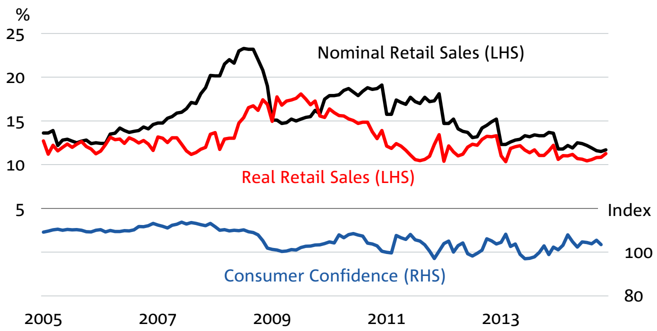
Source: CEIC, NAB Economics

Weak imports of commodities in November may have been related to APEC shutdowns



Sources: CEIC, NAB Economics

Weaker inflation narrows gap between nominal & real 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.
Source: CEIC, NAB Economics

Food prices have continued to soften, with an increase of 2.3% yoy in November (2.5% last month) – well below the levels of early 2014. Prices for meat and poultry rose modestly (0.5% yoy, compared with 1.1% last month), while fresh vegetables fell, down -5.2% yoy – the eighth straight month of declines.

Non-food price trends have continued to soften, with growth down to 1.0% yoy in November, from 1.2% previously.

Producer prices have fallen for thirty-three months in a row, with prices down -2.7% yoy. Producer price deflation remains linked to falling commodity prices – with heavy industry prices down by -3.5% yoy, compared with just -0.6% yoy for light industry.

Credit conditions

The People's Bank of China (PBoC) made surprise cuts to benchmark interest rates in late November – with the lending rate cut by 40 bps to 5.6% and the deposit rate by 25 bps to 2.75%. The asymmetric nature of these changes theoretically places some additional burden on the banking sector, however banks may seek to maintain margins by increasing rates on loans.

The PBoC noted rising real interest rates (given the softening inflation trends) and the need to improve the cost and access to finance for SME firms as key drivers for this change. As noted in this month's China Economic Update, SMEs account for a relatively small share of China's corporate bank loans, so there is no certainty that the lower benchmark lending rate will flow through into lower financing costs for these firms.

China's new credit data for November was not released at the time of writing. For the first ten months of the year, the volume of new total social financing declined – down -9.2% yoy to RMB 13.5 trillion.

An increase has only occurred in bank loans (up 2.8% yoy) and corporate bonds (up 23% yoy, but off a smaller base) while components of the shadow banking sector, particularly trust and entrusted loans (down -38% yoy), have contracted. Regulations around shadow banking continue to tighten, with the China Banking Regulatory Commission signalling changes in November – which could include bankers' acceptances and trade finance being included in banks leverage ratios, as well as tighter restrictions on wealth management products, reducing the volume of off balance sheet items.

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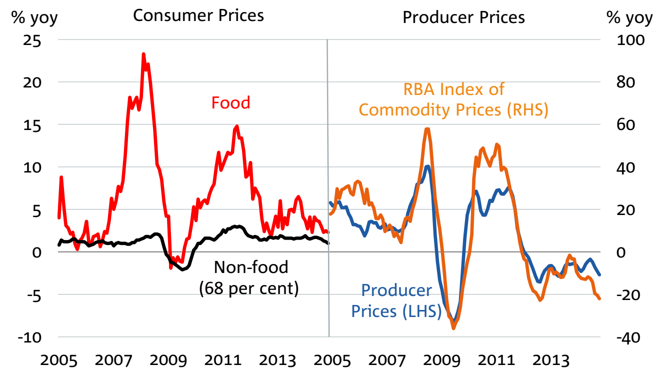
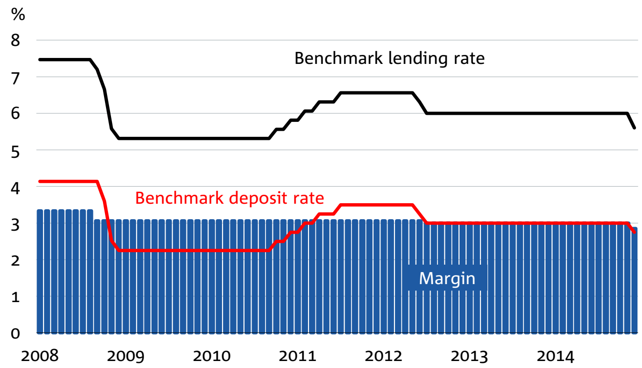
Inflationary trends continue to soften, contributing to recent interest rate cut



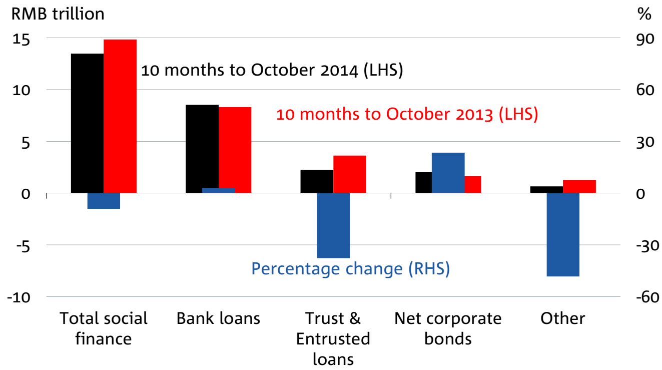
Sources: CEIC, RBA, NAB Economics

The asymmetric cut has narrowed the interest margin for China's banks



Sources: CEIC, NAB Economics

New credit has contracted in 2014, with tighter controls on shadow banking overcoming slightly stronger bank lending



Sources: CEIC, NAB Economics

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