China Economic Briefing
by NAB Group Economics

23 February 2015

Data points to a soft start in 2015, but wait until post CNY for clear signals

Due to the Chinese New Year holiday period, there are limited partial economic indicators for January each year. The variable timing of the holiday means data for January and February does not necessarily provide a strong guide of underlying conditions. That said, the data available points to a soft start – PMI measures are weak, imports slowed, inflation continues to soften and credit growth contracted.

Global factors could influence the economic outlook for China in 2015 – particularly weaker oil prices. As outlined in our China Economic Update this month, we've modestly revised up our forecast for Chinese growth – to 7.1% in 2015 and 6.9% in 2016 (from 7.0% and 6.8% previously).

While economic modelling indicates that our forecast oil price could provide a stronger boost for China's growth, we expect that Chinese authorities will take advantage of the oil price stimulus to lower public investment and continue the process of cleaning up shadow banking (and with it credit growth more generally).

Industrial Sector

Industrial data was limited for January – the National Bureau of Statistics will release the combined January-February data in mid-March.

The main signals come from the major PMI surveys. The official NBS PMI – which typically features a larger share of large State Owned Enterprises – dipped to 49.8 points in January (from 50.1 points in December). The HSBC Markit PMI (which has a greater representation from Small to Medium sized enterprises) was at 49.7 points (edging up from 49.6 points last month). This was the first time since September 2012 that both surveys recorded sub-50 readings.

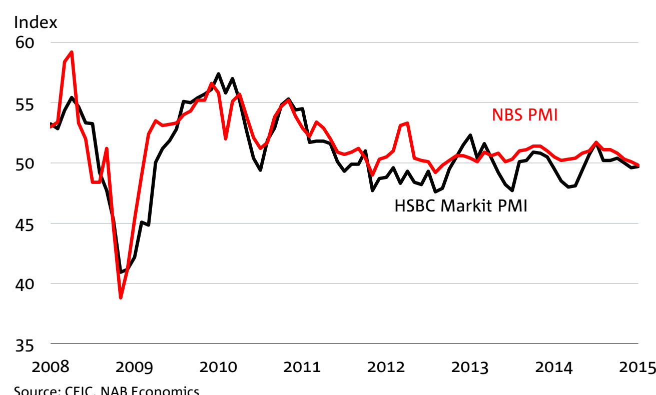
Anecdotal reports suggest many large industrial firms – including those in the steel sector – closed earlier than normal for the Chinese New Year holidays, which may have impacted on these measures.

International trade

China's trade surplus expanded to another new record in January, as the value of imports fell more rapidly than exports. The surplus was US$60.0 billion in January, up from US$49.6 billion in December, and the previous record of US$54.5 billion in November.

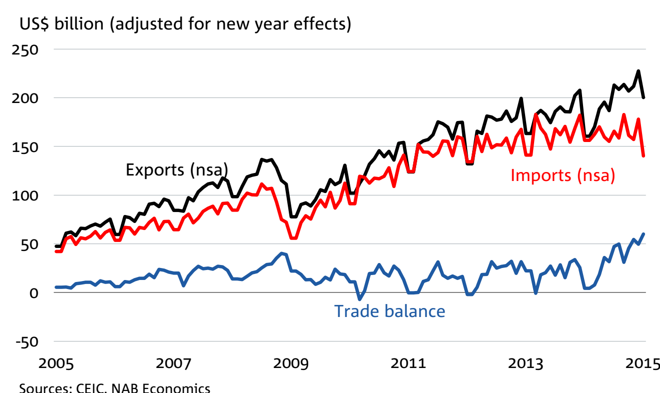
China's exports eased a little in January, down to US$200.3 billion – a decrease of -3.3% yoy. This was compared with relatively strong – though likely distorted by false invoices – growth in the latter part of 2014 (with official growth of 9.7% yoy in December).

Both PMI surveys moved to sub-50 levels in January (first time since September 2012)



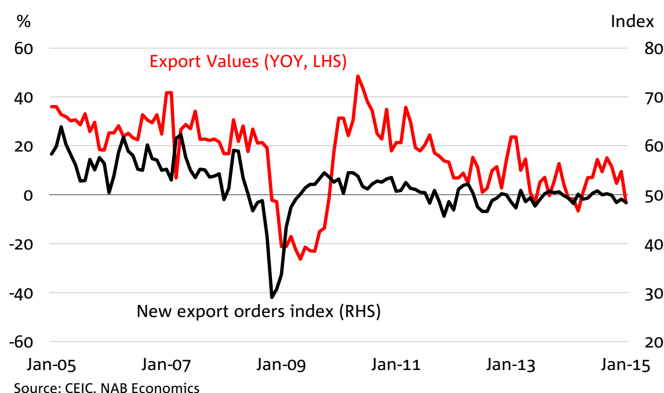
Source: CEIC, NAB Economics

Trade balance hit a new record in January – driven by sharply lower imports



Sources: CEIC, NAB Economics

Growth in exports picked up in December, but was below recent (likely false invoice distorted) highs



Source: CEIC, NAB Economics

Export trends differed significantly between key export markets in January. Exports to the European Union were noticeably weaker – down around -4.6% yoy (compared 4.9% growth in December), while exports to the United States rose by 4.9% yoy (down from 9.9% previously).

Exports to Asia were stable in January, however this was due to falling exports to Hong Kong (-11% yoy) being offset by an increase in other Asian markets. We've previously discussed the issues surrounding false invoicing via Hong Kong at some length – as highlighted by the discrepancy in trade data between Hong Kong and China. In December, China Customs data showed US$41.5 billion, compared with just US$23.9 billion reported by Hong Kong Customs. The sharp slowdown in January – to US$23.4 billion – may reflect the impact of a renewed crackdown on the practice.

Imports slowed sharply in January – down -19.9% yoy to US$140.2 billion (compared with a relatively modest -2.3% in December). In part, this reflects the impact of lower commodity prices. In January, the RBA Index of Commodity Prices fell by -26% yoy.

That said, import volumes for major commodities were weak in January – with coal imports dramatically lower (down -53% yoy), along with a sharp fall in copper (-23% yoy). In contrast, declines were smaller for iron ore (down -9.3%) and crude oil (-0.6% yoy).

Given the comparative strength of commodity imports in December (particularly for iron ore and crude oil) and the distortions due to Chinese New Year, we are cautious to draw too many conclusions from the weak results for January.

Inflation

The weak inflation trends evident over the past few months continued in January – with the headline CPI rising by just 0.8% yoy – the weakest rate of growth since November 2009.

Non-food price growth slowed once again – down to just 0.6% yoy (from 0.8% in December). As previously noted, the sharp fall in global oil prices has been a key driver, with the broad transportation & communications category falling by -2.2% yoy in January.

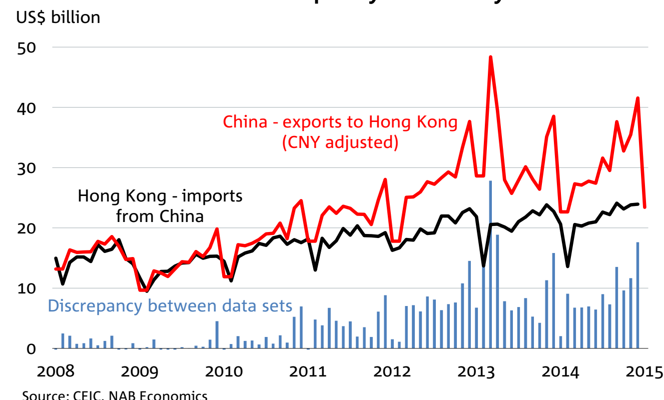
Food prices also decelerated, with growth of 1.1% yoy (down from 2.9% in December). Lower food prices were driven by falling prices for Meat & Poultry (-0.8% yoy) and Fresh Vegetables (-0.6%).

Producer prices fell more sharply in January – with the producer price index falling by -4.3% yoy (compared with -3.3% in December) – the largest decline since October 2009 (while China was recovering from the GFC). Producer prices have fallen for thirty-five consecutive months, although these falls remain closely correlated with commodity price trends. Falling prices remain more evident in heavy industry (down -5.6% yoy in January) than light industry (-0.9% yoy).

Credit conditions

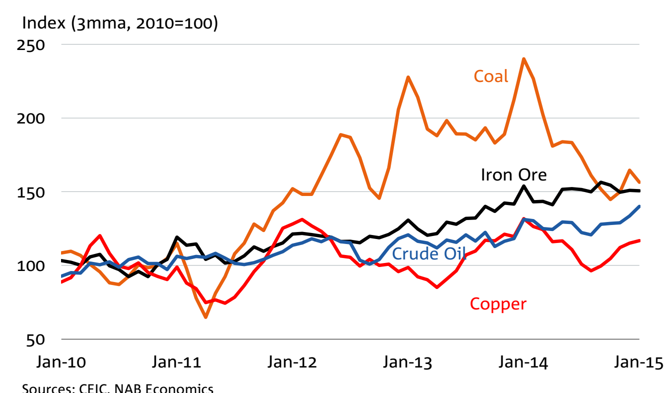
January is a comparatively strong month for credit – as Chinese firms often have to fund payments ahead of the New Year holidays. New credit (total social financing) was

A sharp pullback in reported exports to Hong Kong may indicate lower data discrepancy in January



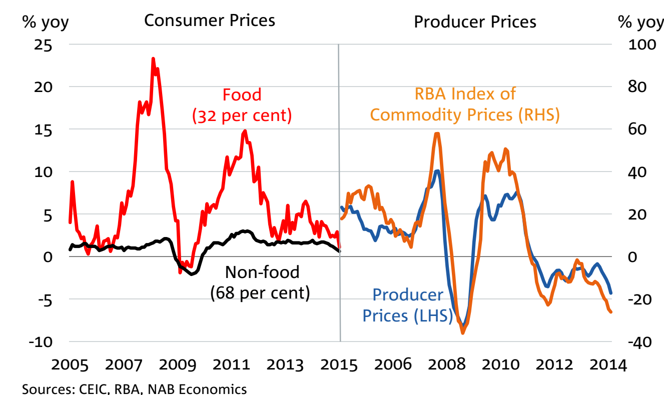
Source: CEIC, NAB Economics

Coal and copper import volumes were significantly lower in January



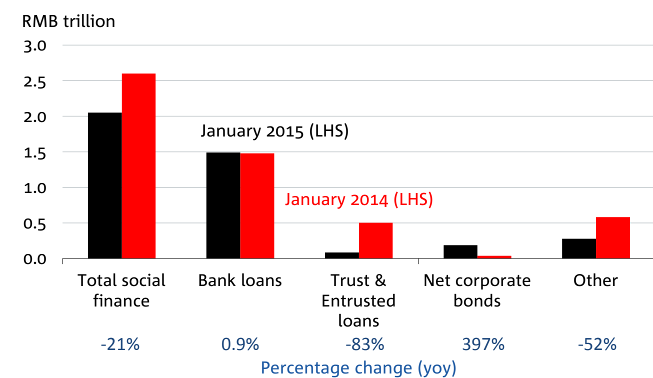
Sources: CEIC, NAB Economics

Inflation has continued to soften – down to five year lows on weaker oil prices



Sources: CEIC, RBA, NAB Economics

Weaker shadow banking drove lower new credit in Jan



Sources: CEIC, NAB Economics

stronger in monthly terms, at RMB 2.1 trillion, but considerably weaker than a year earlier – down -21% yoy.

Tighter regulation around shadow banking continues to impact growth in this sector, while supporting growth in traditional bank loans. New bank loans totalled RMB 1.5 trillion – an increase of 0.9% yoy – while non-bank credit contracted sharply – down -50% yoy (this measure includes some, but not all shadow banking components).

Key shadow banking components declined strongly – entrusted loans by -80% yoy, trust loans by -95% yoy and banker's acceptance bills by -60% yoy.

In early February, the People's Bank of China (PBoC) cut the Reserve Requirement Ratio (RRR) by 50 basis points (to 19.5% for large institutions) – the first change since May 2012. Based on January's deposit levels, this could release around RMB 612 billion in liquidity.

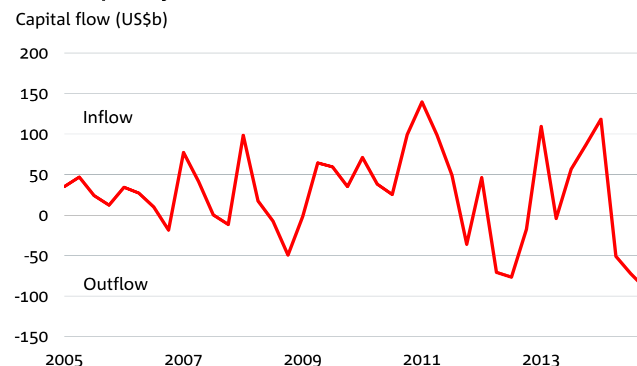
However, comments from the PBoC indicate they do not expect this policy change to be stimulatory, noting a tightening in liquidity conditions in recent time.

For the past three quarters, there has been a significant capital outflow – estimated at around US$214 billion on a net basis. There is speculation that 'hot money' is leaving the country – as the carry trade unwinds. This speculative trade has involved borrowing from overseas markets at relatively low interest rates and investing in higher yielding Chinese assets (particularly in the shadow banking sector), anticipating an appreciating Yuan.

Given the expectations of higher interest rates in the US, the crackdown in shadow banking in China and the recent depreciation of the Yuan (against the US dollar), there is little to suggest a reverse in the recent outflow trend.

The amount of liquidity released by the RRR cut is close to the level of capital outflow in the December quarter – US$91 billion or RMB 569 billion – suggesting that there is some merit to the PBoC's minimal stimulatory argument.

Hot money outflow contributed to RRR cut, in order to meet liquidity needs



Source: CEIC, NAB Economics

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