China Economic Briefing

by NAB Group Economics

12 March 2015

National Australia Bank

Lower growth target confirms China's slower economic trajectory

The National People's Congress – the annual meeting of China's parliament – commenced in early March. From an economic perspective, the key announcement was the lowered growth target – to 'about 7%' from 'about 7.5%' in 2014. Last year was the first time since 1989 that China failed to reach its growth target.

Premier Li Keqiang emphasised that the transition towards a service driven economy means that slower economic growth does not translate to weaker employment growth (given the more labour intensive nature of services). Premier Li also signalled further reforms, including the removal of price controls, improving the fiscal relationship between Beijing and local governments and interest rate liberalisation.

Our forecasts remain unchanged – at 7.1% in 2015 and 6.9% in 2016 – with this view consistent with China's new growth target and the willingness of authorities to accept the 'new normal' of lower growth.

Industrial Production and Investment

China's industrial sector eased considerably across the first two months of the year. Growth slowed to 6.8% yoy during the January-February period (compared with market expectations of 7.7%), down from 7.9% in December. This was the slowest rate of growth since February 2009.

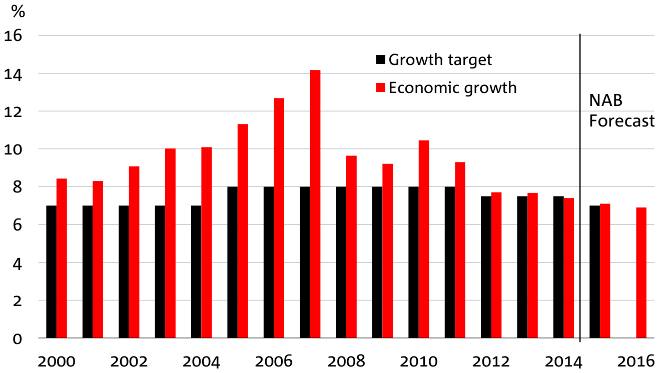
There were anecdotal reports during February that suggested many large industrial firms closed earlier than normal ahead of the Chinese New Year holiday period, which may have impacted this measure.

At the sub-sector level, the overall trend was most evident in the steel sector, with crude steel output falling by -1.5% yoy (compared with 1.5% growth in December 2014), while growth in steel products slowed to 2.1% yoy (from 6.4% previously).

The weak industrial production result was at odds with improving industrial surveys in February. This was particularly the case for the HSBC Markit PMI – which tends to be more representative of SME firms – which rose to 50.7 points (from 49.7 points in January). In contrast, the official NBS PMI was relatively stable – at 49.9 points (from 49.8 points previously).

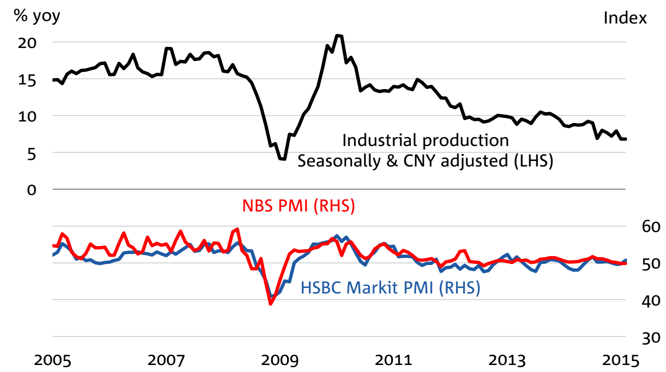
Fixed asset investment was also comparatively weak in early 2015 – growing by 13.9% yoy over January-February (compared with market expectations of 15%), slowing from 14.8% yoy in December 2014.

Lower growth target confirmed at the National People's Congress – slower growth the 'new normal'



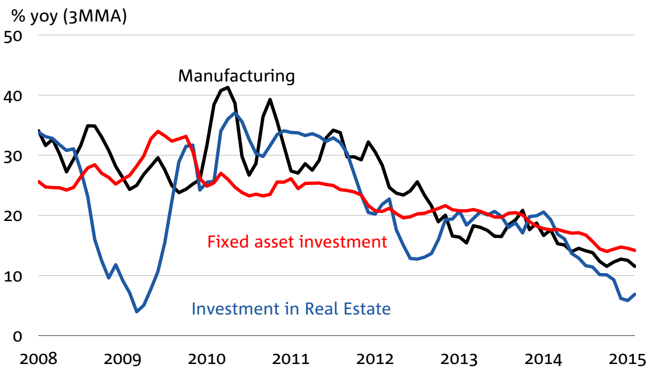
Sources: CEIC, NAB Economics

Industrial production particularly weak at the start of 2015 – despite neutral PMI surveys



Source: CEIC, NAB Economics

Fixed asset investment continuing to trend lower – led by real estate and manufacturing



Source: CEIC, NAB Economics

Slowing nominal investment should be considered in the context of falling prices for key inputs – with accelerating deflation in the corporate goods price index in recent months. As a result, real investment has remained fairly stable at 19.4% yoy in early 2015 (compared with 19.1% in December).

That said, investment in manufacturing and real estate has slowed more rapidly – reflecting in part the tough conditions in these sectors. Investment in real estate edged higher in February – to 6.9% yoy (on a three month moving basis), albeit well below the double digit growth levels recorded across most of 2014.

Price trends in the residential property sector appear to be stabilising. Data from China Index Academy shows house prices in Tier 1 cities rose in monthly terms over the past two months, while declines in other cities have become less pronounced. That said, downside risks persist, and the construction sector is likely to remain weak this year.

International trade

China's trade surplus edged higher from January's record level – up to a new high of US$60.6 billion in February, from US$60.0 billion previously. While February is typically a subdued month for trade, exports were considerably stronger than the weak levels recorded a year ago.

China's exports totalled US$169.2 billion in February – an increase of 48.3% yoy. We prefer to smooth trade data across January and February (due to the different timing of Chinese New Year each year) – which results in a lower (but still strong) growth rate of 15.0% yoy over the first two months (compared with 9.5% yoy in December).

By market, smoothed export growth was strongest for the United States – up by 21% yoy (from 9.9% in December) – and the European Union – up by 13% yoy (from 4.9% previously). In contrast, exports to Asian markets rose by 12% yoy, down from 15% in December.

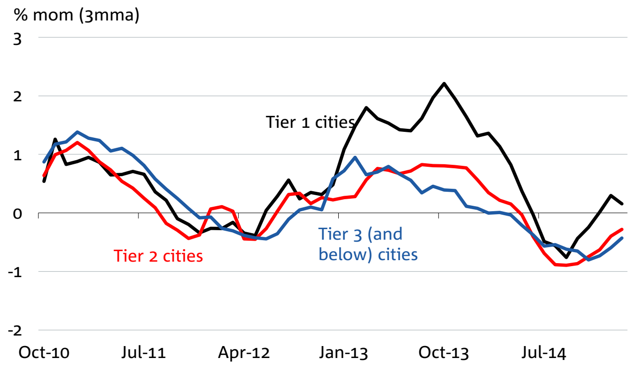
There was a considerable contrast between exports to Hong Kong and other Asian markets. Exports to non-Hong Kong Asia rose by 26% yoy, while exports to Hong Kong fell by -5.6% yoy over January-February.

This has narrowed the discrepancy between China and Hong Kong trade data from around US$18 billion in December 2014 to near zero in January – which may reflect a renewed crackdown on false invoicing used to avoid capital controls.

Imports slowed to US$108.6 billion in February – down around -21% yoy. Smoothed across the first two months of the year, imports were down around -20% yoy, with price effects a major contributor. The RBA Index of Commodity Prices was down -27% yoy in February (in US$ terms).

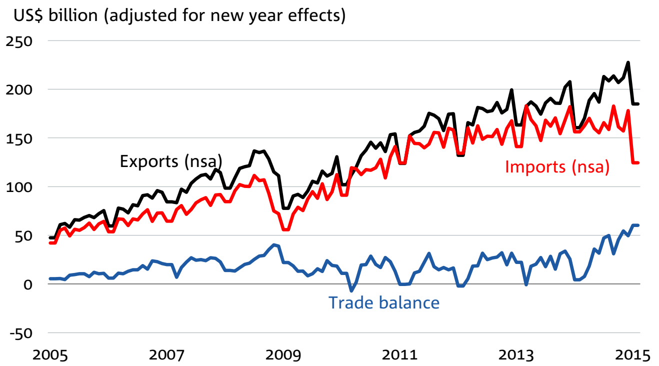
Trends differed across major commodities. Over the two month period, import volumes for coal and copper fell sharply (down -45% yoy and -24% yoy respectively). In contrast, iron ore imports were marginally softer, down -1.0% yoy, and crude oil imports were stronger, up 4.5% yoy.

Property markets appear to be stabilising, with price growth in Tier 1 cities in early 2015



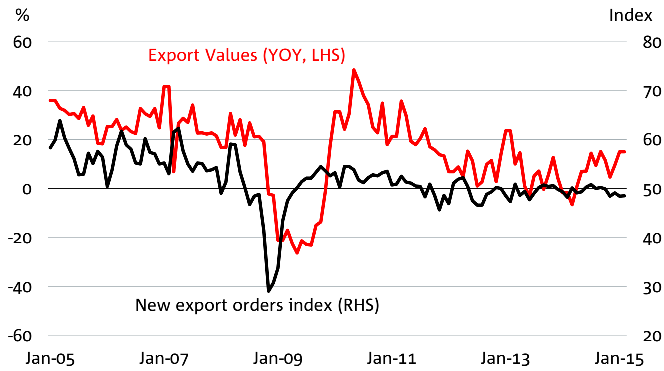
Source: China Index Academy, Datastream, NAB Economics

New record trade balance despite seasonal weakness at the start of the year



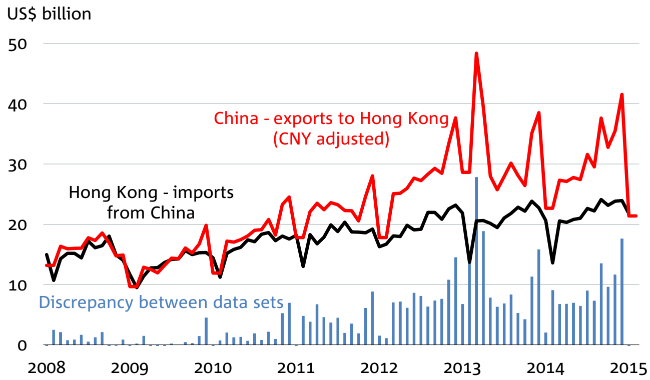
Sources: CEIC, NAB Economics

Export growth remained strong in early 2015



Source: CEIC, NAB Economics

Sharp contraction in the discrepancy between China and HK trade data



Source: CEIC, NAB Economics

Retail Sales and Inflation

Retail sales growth slowed in the first two months of 2015 – increasing by 10.7% yoy in January-February (down from 11.9% in December 2014). Sales have been consistently trending down since early 2012 – however this has also coincided with slowing retail price inflation, which has boosted real sales. Real retail sales grew by 10.8% yoy (compared with a recent high of 11.5% in December) – around trend levels for recent years.

While the headline result appears negative, a substantial fall in the value of fuel purchases contributed to the slower growth in spending. Fuel purchases fell by -6.7% yoy over January-February – in part due to falling global oil prices.

Inflation trends were marginally stronger in February – with headline CPI rising by 1.4% yoy (up from a five year low of 0.8% in January). Some of this pickup may be related to the timing of Chinese New Year and does not necessarily indicate a reverse of the recent disinflationary trend.

Food prices were the main contributor to the uptick in headline inflation, with growth of 2.4% yoy (up from 1.1% in January. There was a noticeable increase in prices of meat & poultry, seafood and fresh vegetables.

Non-food price growth was marginally higher – rising by 0.9% yoy (compared with 0.6% previously). Falling oil prices have driven much of the weakness in non-food prices.

For three years, China's producer prices have fallen, with the producer price index down by -4.8% yoy in February (the largest decline since October 2009). Falling commodity prices remain a key factor in these falls, with prices falling more significantly for heavy industry than light(-6.3% yoy vs. -1.0%).

Credit conditions

The People's Bank of China (PBoC) cut interest rates at the start of March (the second cut in three months). The cuts were symmetric (unlike the changes in November), with both the benchmark lending and deposit rates cut by 25 basis points to 5.35% and 2.5% respectively.

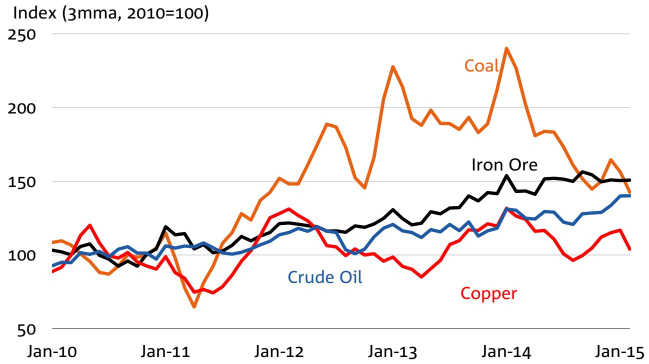
However, as was the case with November's rate change, the maximum ceiling above deposit rates was widened – from 120% to 130% – meaning that the maximum deposit rate fell only modestly – to 3.25% from 3.3%. This is likely to put further pressure on bank profit margins and lead to an improvement asset allocation.

Due to policy constraints such as the Reserve Requirement Ratio, the interest rate cut won't increase liquidity in credit markets, however it will eventually reduce pressure on indebted firms (most loans are repriced on the anniversary of the debt issuance).

Further cuts to the Reserve Requirement Ratio may occur in 2015, but as highlighted in last month's note, this may only occur in order to maintain liquidity in financial markets, given the recent trend of capital outflow.

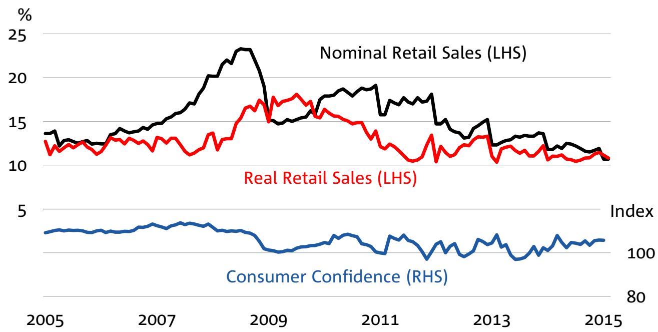
At the time of writing, data for new credit was not available for February, however market expectations point towards weaker levels (compared with early 2014), in line with tighter regulation around shadow banks.

Mixed trends by commodity – with coal and copper imports weaker in early 2015



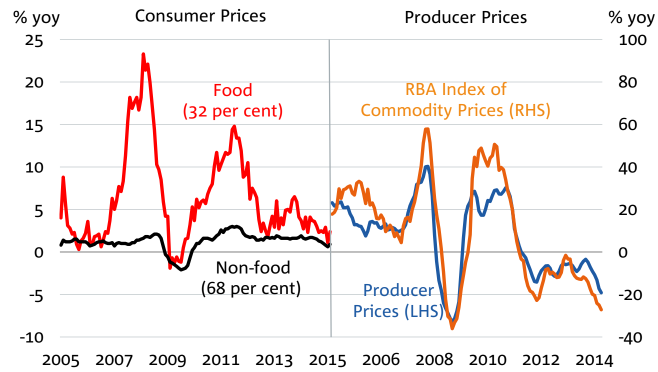
Sources: CEIC, NAB Economics

Retail sales slowed in early 2015 – however falling fuel purchases were a key contributor



* 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

Slight uptick in consumer prices in January, while producer prices have now fallen for three years



Sources: CEIC, RBA, NAB Economics

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