China's economy at a glance

by NAB Group Economics

15 May 2015

National Australia Bank

China's share market emerges as a key economic risk in early 2015, as industry remains weak

- More detailed national accounts data showed that the key driver of economic growth in Q1 was the finance sector – which accounted for over a third of the growth in services – which is likely due to the surge in share markets. New investors have been pouring into the market, raising legitimate concerns around the sustainability of these recent trends.
- Our economic forecasts are unchanged (7.1% in 2015, 6.9% in 2016) but we highlight that a major share market correction could pose significant risks for China's growth – particularly the transition towards a consumption based economy.
- China's industrial production remained weak in April – although marginally stronger than March, edging up to 5.9% yoy (from a six year low of 5.6% previously).
- Fixed asset investment continued its slowing trend in April – down to 9.4% yoy (from 13.2% in March) – dragged lower by manufacturing and real estate. This was the slowest rate of growth for investment since December 2001.
- After falling sharply in March, China's trade surplus rebounded in April – rising back to US$34.1 billion (compared with US$3.1 billion in March). This reflected a larger fall in imports (-16% yoy) than exports (-6.4% yoy).
- The People's Bank of China (PBoC) cut interest rates for the third time in six months in May – bringing the one year lending rate to 5.1%. PBoC measures to purchase local government bonds only superficially resembles quantitative easing – which remains unnecessary due to the still high level of the Reserve Requirement Ratio – and is instead seeking to underwrite the debt swap program.

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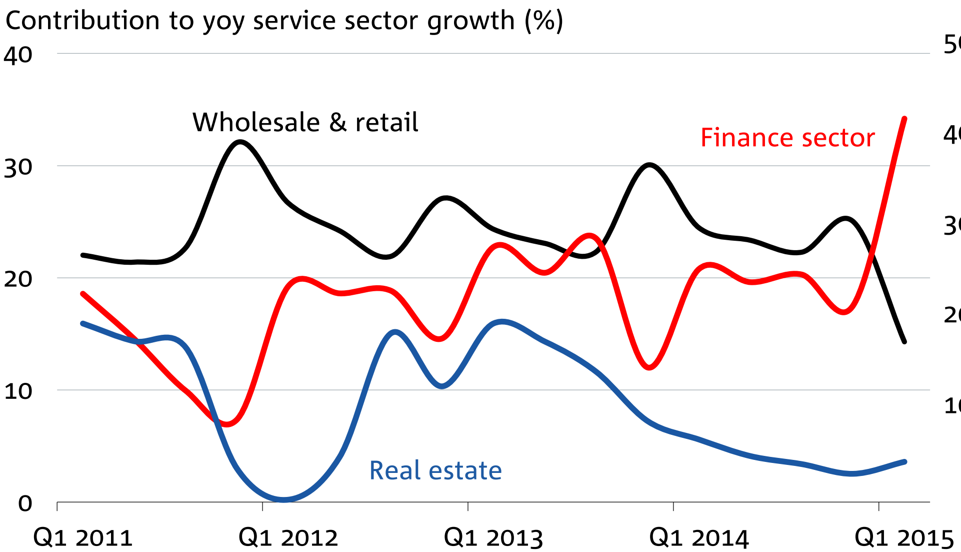
Gross Domestic Product - components

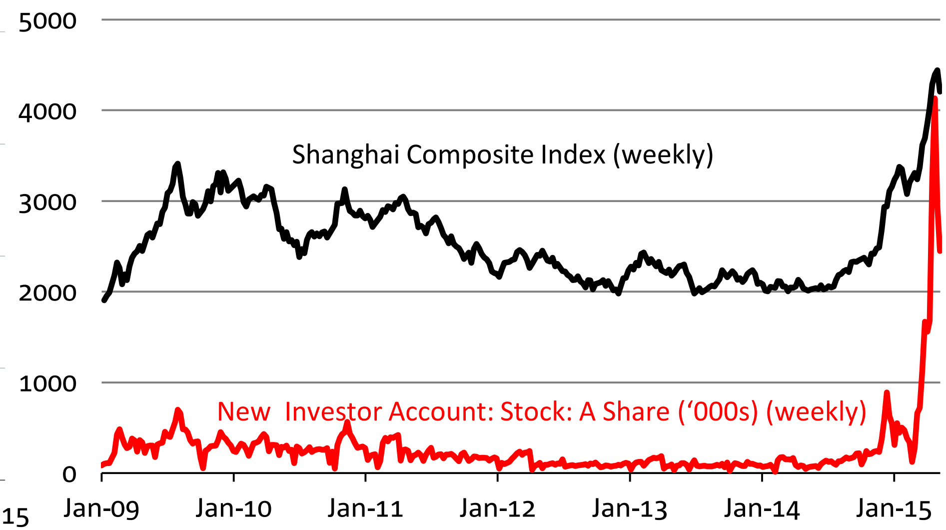
- Last month, we highlighted the shifting pattern of China's growth in the first quarter – with notable weakness in the industrial sector partially offset by growth in services (which accounted for just over half the economy in Q1).
- More detailed accounts (released after our previous report) revealed the key driver of services growth was the finance sector – which contributed 34% of year-on-year growth for services in Q1, compared with just 18% in Q4 2014.
- Given the modest growth in bank loans and the weakness in the shadow banking sector, it is likely that the growth in finance has been driven by brokers – reflecting surging activity in domestic share markets in Q1.
- New investors have been pouring into the market – with over 4 million new trading accounts opened in the third week of April (sixteen times the long term average) – driving the Shanghai composite index to a seven year high (despite slowing economic conditions and weakening corporate profits).
- There are legitimate concerns around the sustainability of these recent trends – particularly given recent attempts to cool margin trading. A recent study by the Southwestern University of Finance and Economics showed that just one-third of new investors in the stock market had graduated from high school.
- Our economic forecasts are unchanged (7.1% in 2015, 6.9% in 2016) but we highlight that a major share market correction could pose significant risks for China's growth – particularly the transition towards a consumption based economy.

Spike in the contribution from the finance sector in Q1 may reflect the broker boom



Sources: CEIC, NAB Economics

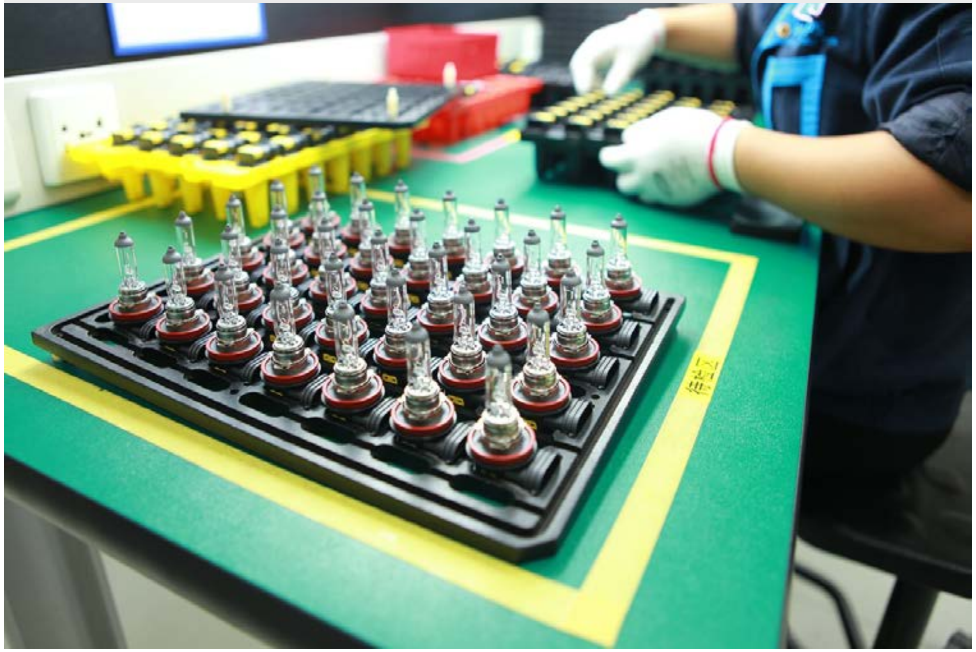
Rapid inflow of new investors in China's share market since the start of 2015 fuelling share market boom



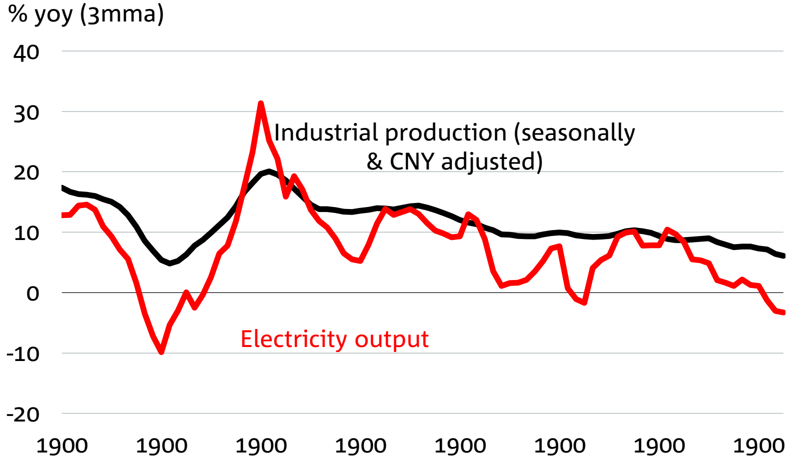
Sources: CEIC, NAB Economics

Industrial production

- China's industrial production remained weak in April – although marginally stronger than March, edging up to 5.9% yoy (from a six year low of 5.6% previously).
- Output contracted in a range of key sectors – including construction related industries such as cement (-7.3% yoy) and crude steel (-0.7% yoy). Production of motor vehicles also fell (-0.3% yoy). In contrast, electricity production edged higher – at 1.0% yoy – though output remains lower on a three month moving basis.
- Results in China's industrial surveys remain weak. The official NBS PMI was unchanged in April, at a neutral 50.1 points. The HSBC Markit PMI – which has a greater focus on SME firms – fell again to 48.9 points in April, from 49.6 points in March.

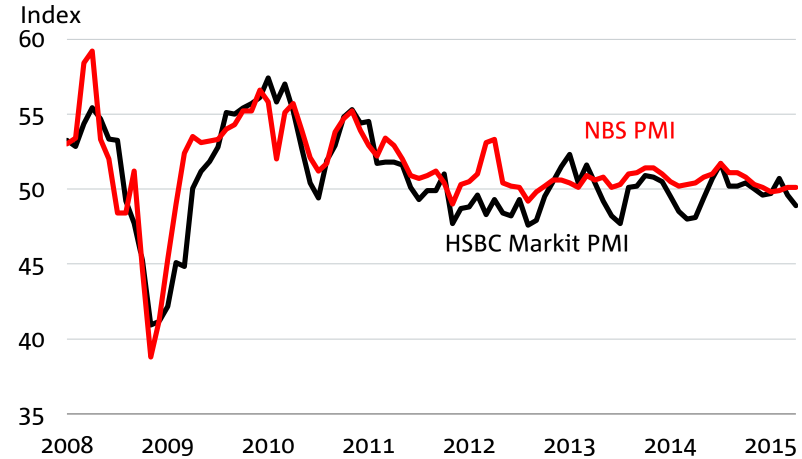


Weakness in the industrial sector remains – April growth edged away from a six year low in March



Source: CEIC, NAB Economics

Major industrial surveys point to neutral conditions (albeit slightly negative for the SME sector)



Source: CEIC, NAB Economics

Investment

- Fixed asset investment continued its slowing trend in April – down to 9.4% yoy (from 13.2% in March). This was the slowest rate of growth for investment since December 2001 (when growth was just 4.9%).

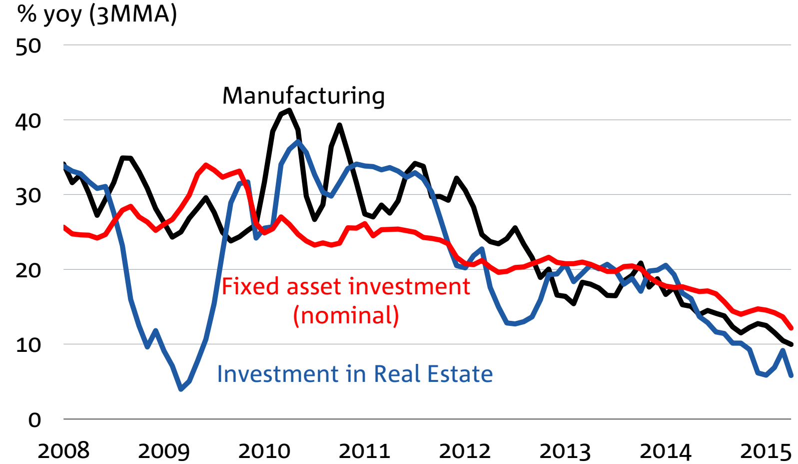
- Investment costs have fallen considerably across the past few years – as prices for key inputs such as steel have fallen. These falling prices have supported the level of real investment – albeit this measure also fell in April – down to an estimated 14.6% yoy (from 18.4% in March).

- Investment in manufacturing and real estate has dominated fixed asset investment in recent years (accounting for 58% of the total in 2014) – but weaker growth in these sectors is contributing to the slowing trend. Investment in real estate slowed to just 5.8% yoy (on a three month moving basis, from 9.1% previously), while manufacturing investment slowed to just 10% yoy.

- Conditions in the real estate sector are likely to remain subdued – however a major crash appears unlikely, with markets generally stabilising. Prices remain well below the peak levels of last year, however China Index Academy data was stable month-on-month in April, with prices in tier 1 cities rising marginally over the same period.

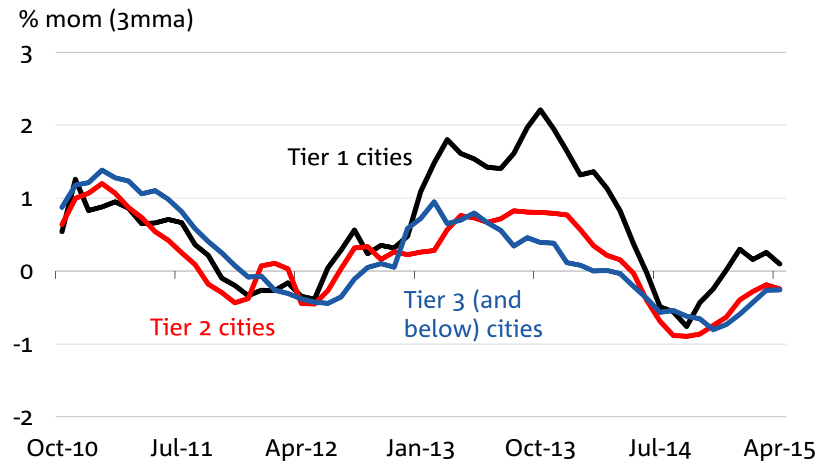
- The weakness in real estate investment is evident in new construction – with residential construction starts falling by -19.5% yoy over the first four months of the year. With property markets unlikely to support a rebound in construction activity, this will continue to impact on demand for Australian resources.

Real estate and manufacturing continues to drag fixed asset investment lower in April



Source: CEIC, NAB Economics

Average property prices unchanged in April (month-on-month) but tier 1 still comparatively stronger than others



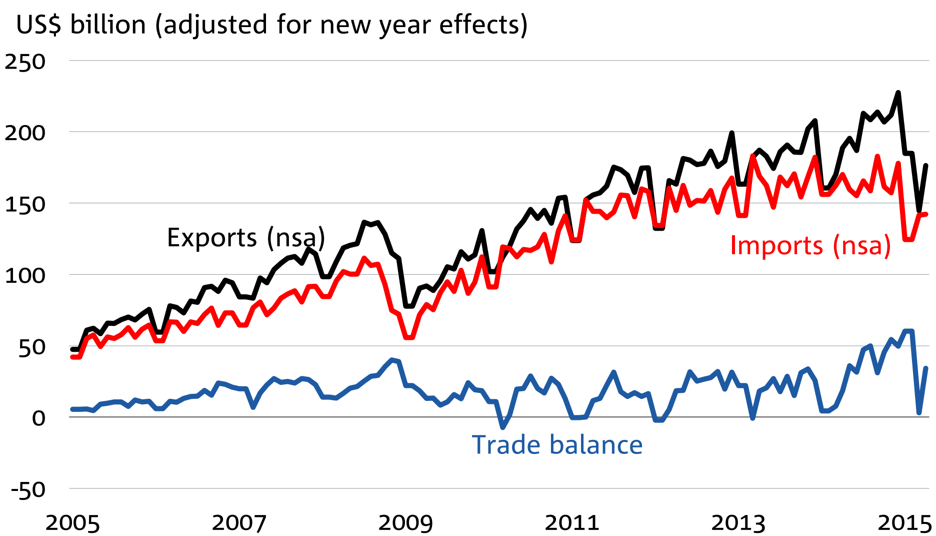
Source: China Index Academy, Datastream, NAB Economics

International trade – trade balance and imports

- After falling sharply in March, China's trade surplus rebounded in April – rising back to US$34.1 billion (compared with US$3.1 billion in March).
- This recovery reflected a strengthening in exports compared with March – albeit still well below the (likely distorted) peaks of late last year – while imports remained largely unchanged.

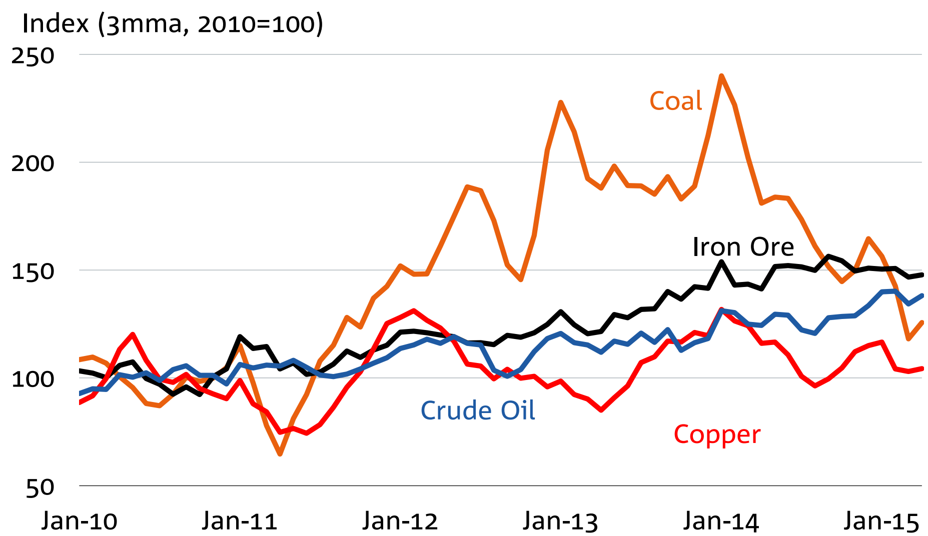
- China's imports edged up in April (when compared to March) – to SU$142.2 billion (from US$141.5 billion previously) – but remained well below the levels recorded a year ago (-16% yoy). Falling prices – particularly for commodities – have contributed to this weakness, with the RBA Index of Commodity Prices falling by 29% yoy in April (in US dollar terms).
- That said, the volume of commodity imports has also weakened – reflecting weaker industrial demand. Coal imports fell by 26% yoy in April, while iron ore (-3.8% yoy) and copper (-4.2% yoy) imports also declined. In contrast, crude oil imports rose by 8.7% yoy.

Trade balance widened in April as imports remained unchanged at weak levels



Sources: CEIC, NAB Economics

Crude oil volumes continue to rise, but China's coal demand is falling

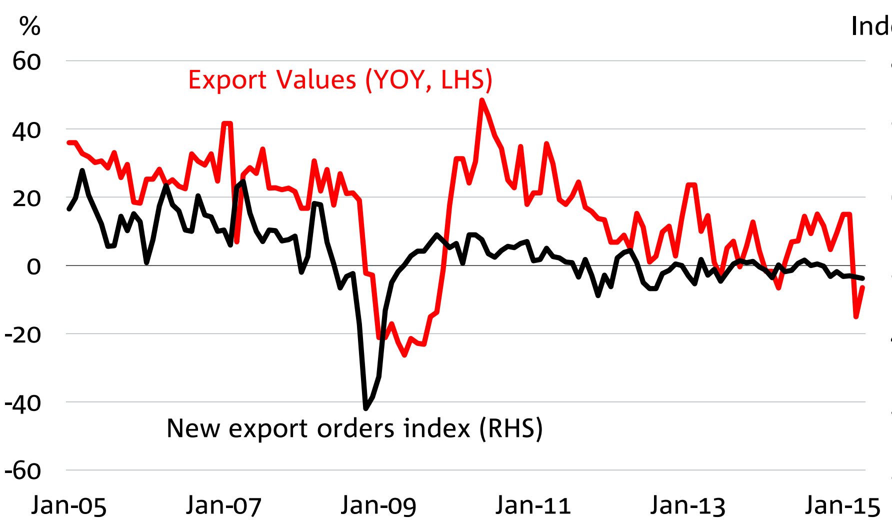


Sources: CEIC, NAB Economics

International trade – exports

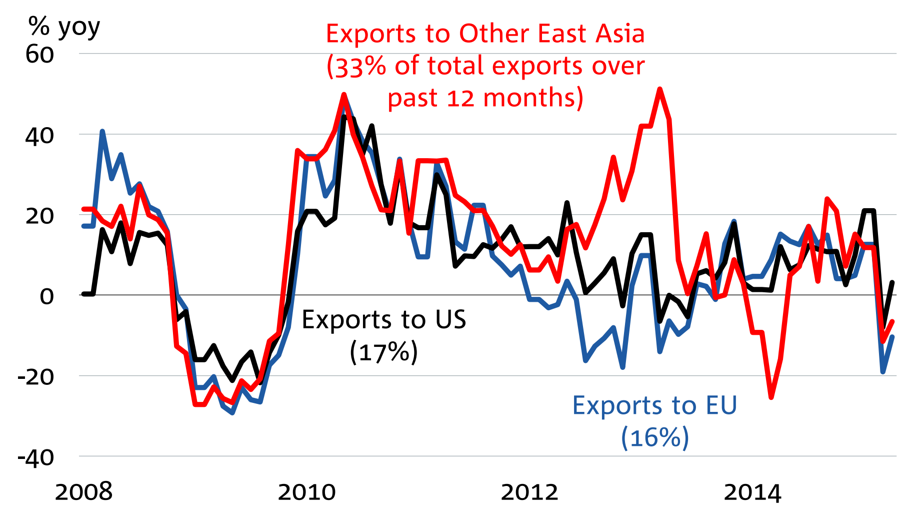
- China's exports totalled US$176.3 billion in April, falling for the second straight month (in year-on-year terms) – at -6.4% yoy. Respondents to the NBS PMI survey have reported negative new export orders since September 2014, with the measure falling to 48.1 points in April (the weakest since this time).
- Export trends differed between markets. Exports to the United States rose modestly, by 3.1% yoy in April (compared with -8.0% in March). In contrast, exports to East Asian markets fell by -6.6% yoy (from -12% previously) while exports to the European Union fell by -10% yoy (from -19% in March).
- Exports to Hong Kong fell again in April, down by -9.0% yoy (compared with -18% In March). In contrast, the decline in non-Hong Kong Asia was more modest, at -4.7% (from -5.6% previously).
- The discrepancy between reported trade between mainland China and Hong Kong has remained comparatively narrow in recent months. In March, the gap between reported custom values was just US$2.3 billion (compared with the 2014 peak level of US$18 billion in December).

Exports fell again in April, though at -6.4% yoy the decline was less severe than March



Source: CEIC, NAB Economics

Exports to the United States rose moderately in April, while falls were recorded in Asia and Europe



Sources: CEIC, NAB Economics

Retail sales and inflation

- Growth in China's retail sales slowed again in April – down to 10.0% yoy (from 10.2% yoy in March). As we have previously noted, the recent downward trend in sales growth has coincided with weak inflation – boosting the value of real sales. Real retail sales grew by 9.9% yoy in April – marginally below trend levels and the weakest growth rate since September 2004.

- Lower fuel prices have influenced retail sales – with fuel purchases down by -7.4% yoy in April (following on from -8.0% in March). This may have contributed to the still high levels of consumer confidence.

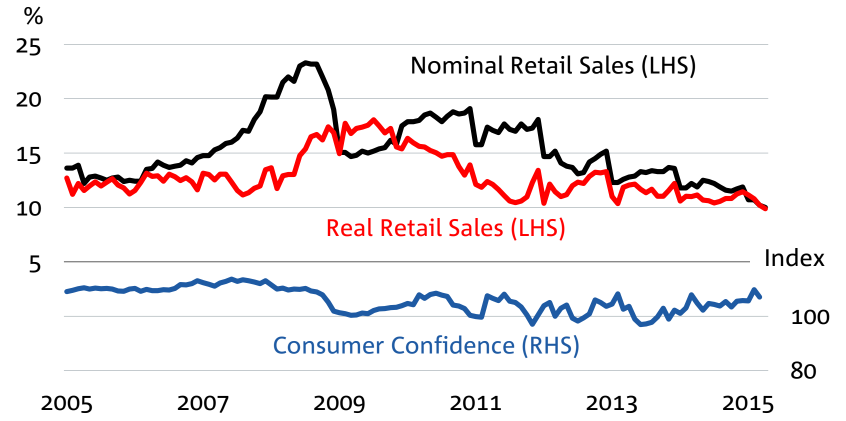
- China's inflation edged marginally higher in April – with the headline CPI rising by 1.5% yoy (compared with 1.4% in March). Despite the slight increase, price growth remains weak when compared with recent years.

- Food prices continue to rise more rapidly than non-food – with growth at 2.7% yoy in April (compared with 2.3% in March). Prices of meat & poultry and fresh vegetables were the main contributor to this increase.

- Non-food price growth has remained weak – at just 0.9% yoy in April (unchanged for the past two months). Lower fuel costs continue to influence this trend, with the Transport & Telecom sub-component remaining negative in year-on-year terms.

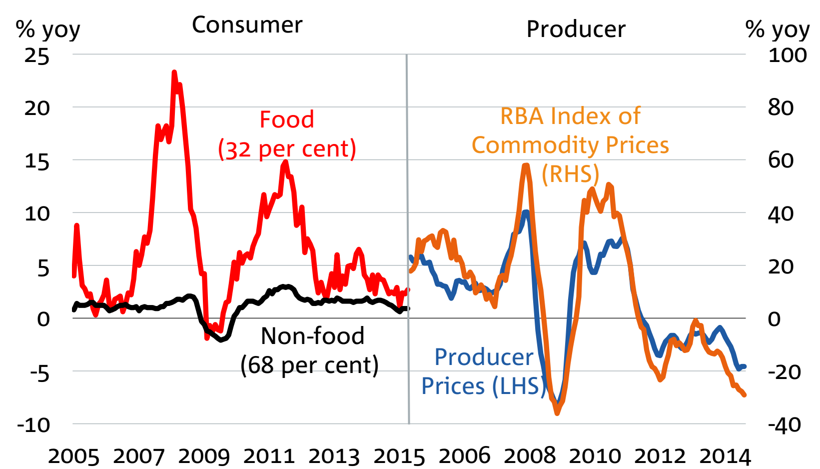
- Producer prices have fallen for thirty-eight months in a row – down by -4.6% yoy in April (unchanged from March). Falling commodity prices continues to be the main influence, with heavy industry prices falling by -5.9% yoy, compared with just -1.0% for light industry.

Nominal retail sales continue to ease – though lower fuel prices may be an influence



* Adjusted for Chinese New Year effects
Source: CEIC, NAB Economics

Food prices drove marginal increase in inflation (which remains weak). Producer prices continue to fall



Sources: CEIC, RBA, NAB Economics

Credit conditions

- In May, the People's Bank of China (PBoC) cut interest rates for the third time in six months. The benchmark one-year lending rate was lowered by 25 basis points to 5.1% (in line with our expectations), while the deposit rate was cut by the same amount to 2.25%. Despite the cuts to lending rates, these are yet to fully flow through to average rates for borrowers – with some loans adjusted annually.

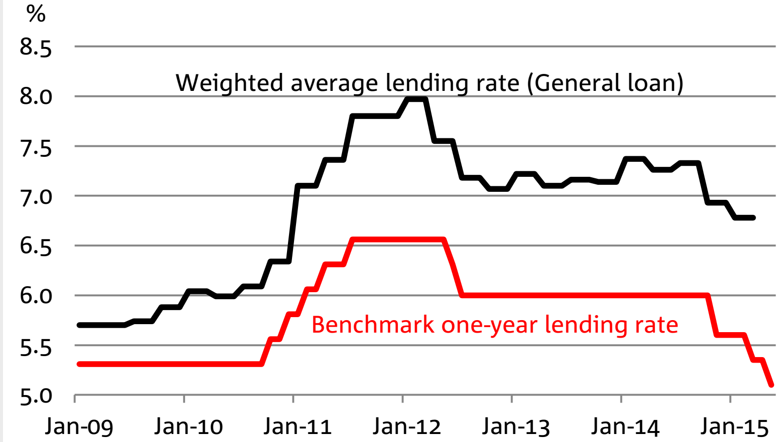
- As with previous cuts to the deposit rate, the margin banks are permitted to offer above the rate was widened – this time to 150%. This allows a marginal increase in the maximum deposit rate (from 3.2% to 3.375%).

- There was considerable speculation in late April that the PBoC was commencing a program of Quantitative Easing (QE) – similar to those implemented in advanced economies in recent years. We argue that PBoC efforts to purchase local government bonds in the secondary market only superficially resemble QE, and instead are effectively underwriting the local government debt swap (given weak demand).

- First, regulatory constraints prevent the bank from directly purchasing these bonds. Secondly, QE is an emergency measure to boost liquidity when conventional monetary policy is no longer effective. The PBoC can continue to cut rates and boost liquidity with further cuts to the Reserve Requirement Ratio (RRR), which remains high. We anticipate further cuts to the RRR across 2015.

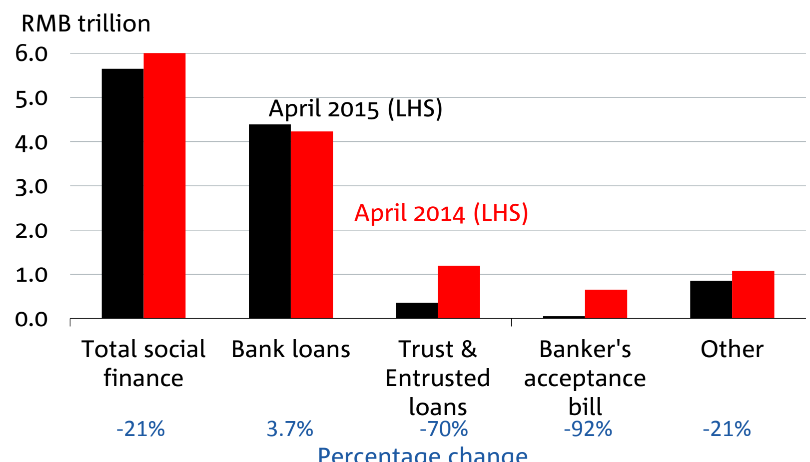
- New credit remains weak, falling by -21% yoy in the first four months. Echoing the trends of 2014, growth was evident in bank loans (which rose by 3.7% yoy over the period, while non-bank credit fell by -57% – led by sharp falls in trust and entrusted loans (down by -70% yoy) and banker's acceptance bills (down -92% yoy). Tighter regulation around shadow banking has constrained the non-bank sector.

Recent interest rate cuts yet to significantly impact rates for most bank customers



Sources: CEIC, NAB Economics

New credit growth has continued to slow – driven by weakness in the shadow banking sector



Sources: CEIC, NAB Economics

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