more give, less take

China's economy at a glance

by NAB Group Economics

13 September 2015

National Australia Bank

Short term disruptions add some uncertainty to extent of China's economic slowdown

- Weak production and import numbers continue to suggest slowing conditions in the industrial sector, however this signal was less clear in August, due to disruptions related to the Tianjin port explosion and industrial shutdowns ahead of the World War 2 anniversary military parade in Beijing. Next month's data should provide a better indicator of underlying conditions.
- China's 2014 GDP was revised lower in September – with growth down to 7.3% (compared with 7.4% previously) – due to weaker growth in services.
- China's industrial production growth remained weak in August – at 6.1% yoy (up marginally from 6.0% last month).
- Growth in fixed asset investment slowed further in August – down to 9.2% yoy (from 10.3% previously) – the lowest rate of growth since December 2012.
- A sharp drop in imports led to another widening in China's trade surplus in August – out to US$60.2 billion (from US$43 billion in July). This level was only marginally below the all time high recorded in February.
- There was a slight increase in headline inflation in August, although the rate remained around the modest trend levels seen over the past eighteen months – with the CPI rising by 2.0% in August (compared with 1.6% in July). Pork prices remain the key influence.
- New credit was stronger in August – almost 13% higher in year-on-year terms. However, it remains around -10% yoy lower over the first eight months of 2015.

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GDP revision lowers 2014 growth rate

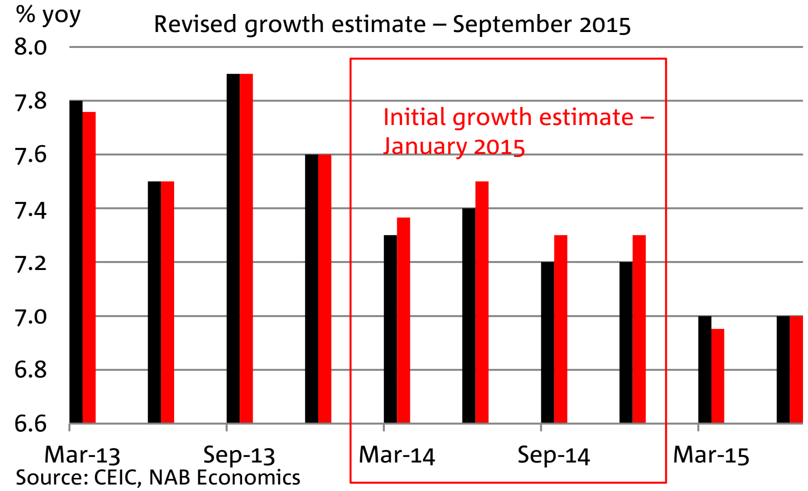
- In early September, the National Bureau of Statistics released revised estimates of China's 2014 gross domestic product, which showed weaker than previously reported growth. China's annual growth for 2014 was cut to 7.3% (in line with NAB's forecast for the year) from the initially reported 7.4%. In addition growth in 2013 was trimmed by 0.05%.

- The key factor behind this downward revision was a lower estimate for China's services sector (which was the main driver of economic growth in the first half of 2015) with agricultural and industrial output revised marginally higher. For the full year, the services sector grew by 7.8%, compared with the 8.1% growth reported in January.

- At this stage there have been no significant alterations to 2015 data, and the National Development and Reform Commission has stated that China will be able to achieve its annual economic growth target of 7%. Lowering the level of GDP for the base year may make this target more easily achieved.

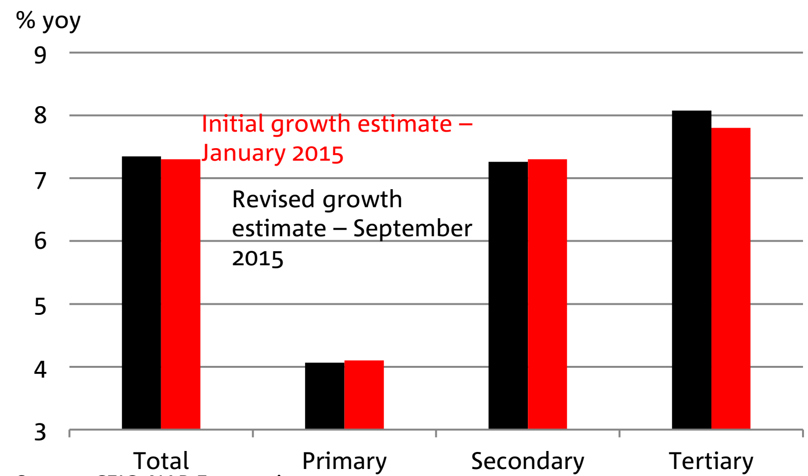
- Our forecasts for economic growth remain unchanged, at 7.1% for 2015 and 6.9% for 2016, however we continue to note that risk is weighted towards the downside. China's Ministry of Finance announced in early September that it will strengthen fiscal policy, boost infrastructure spending and speed up tax reform – which may provide a boost to growth in Q4.

China's economic growth for 2014 was revised lower, with weaker growth across the year



Source: CEIC, NAB Economics

Modest upward revision to agriculture and industry not enough to offset weaker services growth in 2014



Source: CEIC, NAB Economics

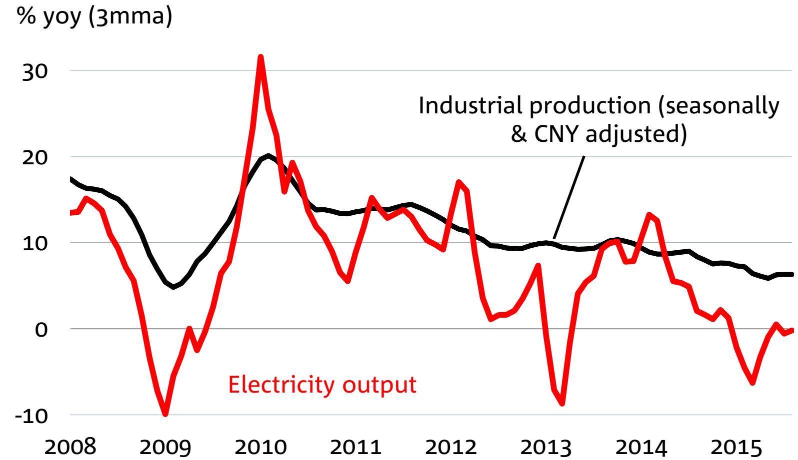
Industrial production

- China's industrial production growth remained weak in August – at 6.1% yoy (up marginally from 6.0% last month) – but in line with expectations. Although industrial production has slowed across 2015, this month's result provides less of a signal, due to disruptions related to the Tianjin port explosion and industrial shutdowns ahead of the World War 2 anniversary military parade in Beijing.

- Heavy industrial production was weaker, with crude steel down by -3.5% yoy and cement output falling by -4.2% yoy. In contrast, electricity production was marginally stronger, up 1% yoy.

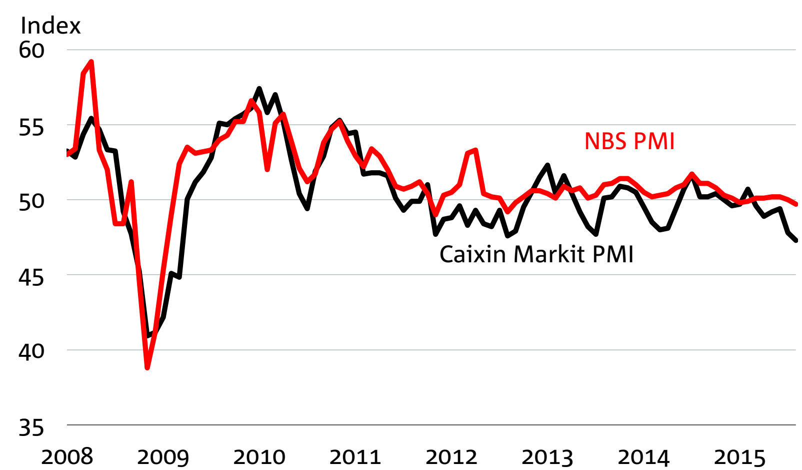
- Both major industrial surveys turned negative in August. The Caixin Markit PMI was down to 47.3 points (from 47.8 points In July) – with the weak flash result of this measure triggering additional turmoil in equity markets. The official NBS PMI eased to 49.7 points (from 50 points previously).

China's industrial sector remained weak in August – but impact of disruptions makes the signal unclear



Source: CEIC, NAB Economics

Caixin Markit PMI at its weakest level since March 2009, while NBS survey also turned negative



Source: CEIC, NAB Economics

Investment

- Growth in fixed asset investment slowed further in August – down to 9.2% yoy (from 10.3% previously) – the lowest rate of growth since December 2012. By industry, the growth rate for manufacturing has continued to slow – down to 7.7% yoy in August (from 8.7% previously). Real estate investment data was not available at the time of writing – having recorded 2.9% yoy growth in July.

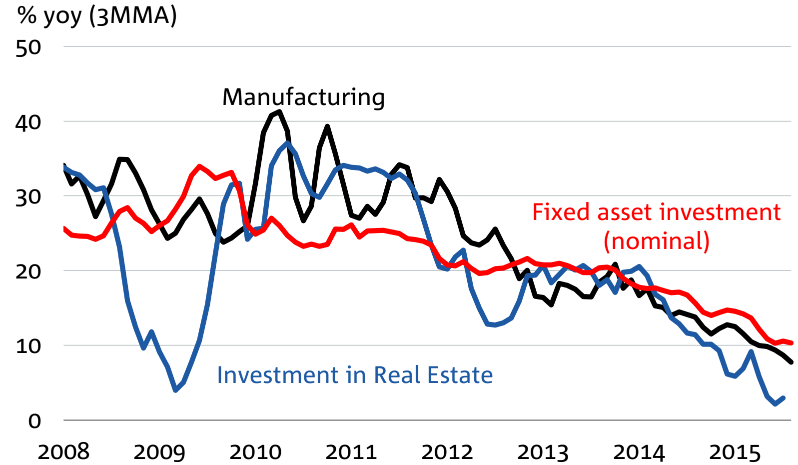
- In the first seven months of 2015, manufacturing and real estate accounted for around 57% of total fixed asset investment.

- Price trends in residential real estate markets continue to improve – at a national level, China Index Academy data showed prices rose by 0.7% month-on-month in August (on a three month moving average basis) and rose in year-on-year terms as well (first time since September 2014).

- That said, this recovery is largely a phenomenon of the tier 1 cities, with price gains far more modest elsewhere. As a result, we continue to expect limited support for new construction activity in the short term.

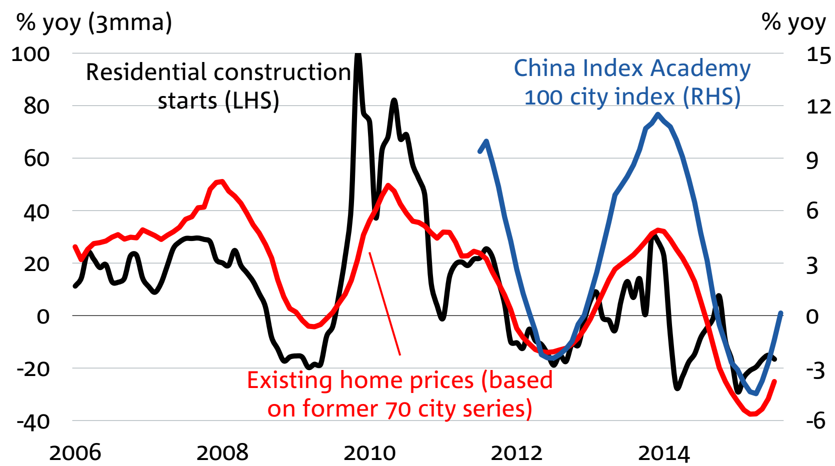
- In the first seven months of 2015, residential construction starts fell by -17.9% yoy, with a flow on effect for China's heavy industry (particularly areas such as steel and cement) which has impacted demand for Australian commodities.

Key sectors such as manufacturing and real estate continue to drag fixed asset investment lower



Source: CEIC, NAB Economics

Residential construction activity continues to contract in year-on-year terms on limited investment

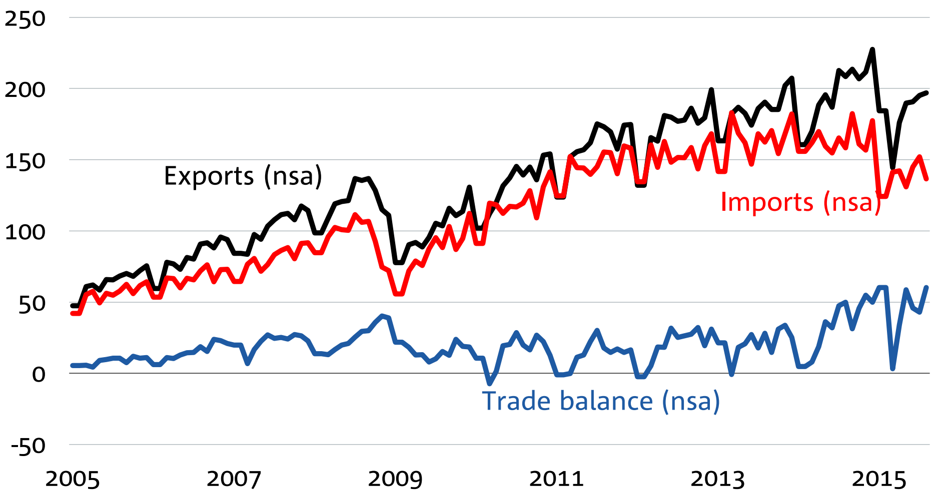


Source: CEIC, Datastream, NAB Economics

International trade – trade balance and imports

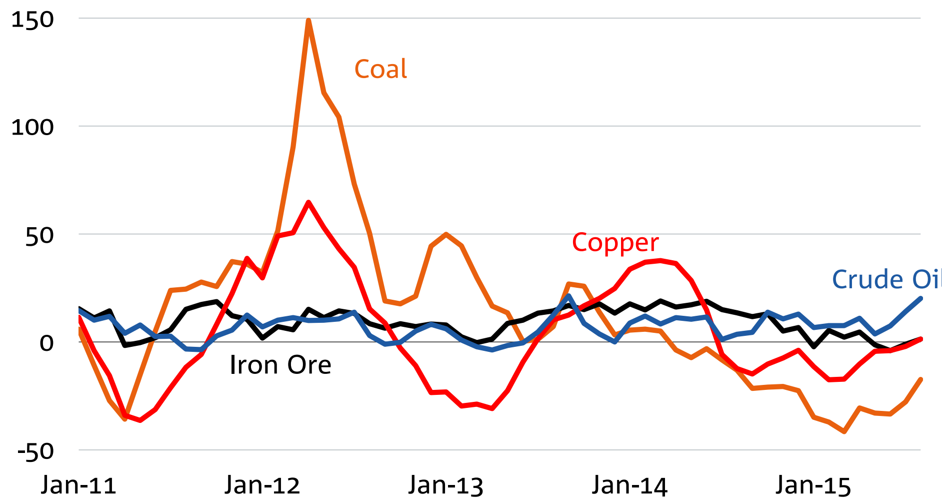
- A sharp drop in imports led to another widening in China's trade surplus in August – out to US$60.2 billion (from US$43 billion in July). This level was only marginally below the all time high recorded in February.
- China's imports fell to US$136.6 billion in August (from US$152.1 billion in July) – down around -13.8% yoy. As was the case with industrial production, the combined effects of the Tianjin port explosion and the Beijing military parade may have adversely impacted import data.
- Significant falls in commodity prices over the past twelve months have impacted US dollar denominated import values. Falls in volumes have been less significant – in the first seven months of the year, import volumes fell by -4.1% yoy (compared with a -14.6% fall in values over the same period).
- Divergent trends in import volumes by commodity highlight differing industry conditions. Over the first eight months of the year, crude oil imports rose by 9.8% yoy, while iron ore imports were marginally lower. In contrast, refined copper and coal imports were sharply lower – at -8.0% yoy and -31% yoy respectively.

Drop off in imports drives trade balance back near record levels in August – but could be short term



Sources: CEIC, NAB Economics

Coal imports continue to fall, while crude oil volumes have risen in 2015



Sources: CEIC, NAB Economics

International trade – exports

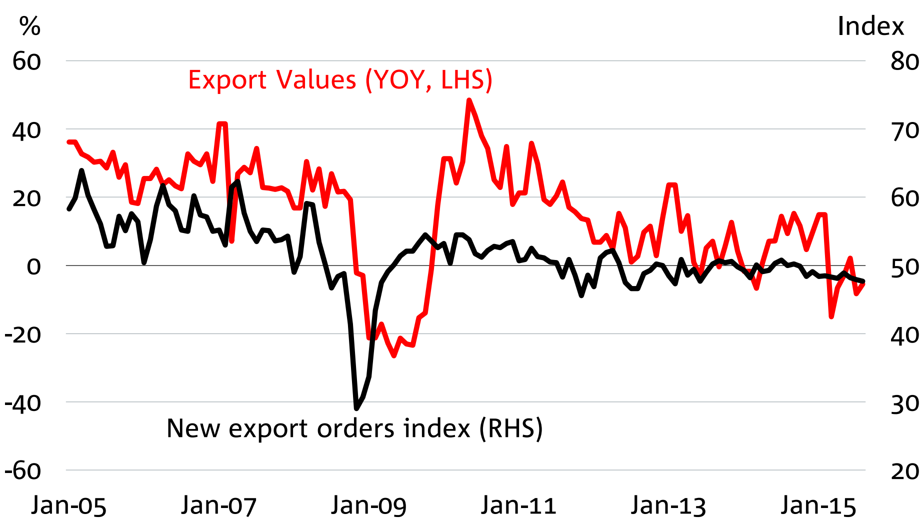
- In August, China's exports totalled US$196.9 billion, marginally higher than the level recorded in July, but around -5.5% lower in year-on-year terms. Survey measures remained weak – the new export orders index in the NBS PMI survey eased to 47.7 points (from 47.9 points) – the lowest level since February 2013.

- The level of exports for each of China's major markets were relatively stable when compared with the levels in July, however they were down in year-on-year terms. The largest fall was in Europe – with exports down -7.5% yoy – followed by East Asia, at -3.5% yoy. In contrast, exports to the United States fell by just -1.0% yoy.

- There was less divergence this month in growth trends between individual markets in Asia. Exports to Hong Kong fell – but less significantly than in July – by -3.8% (compared with -15% previously), while exports to non-Hong Kong Asia fell by -3.2% (from -2.5% last month).

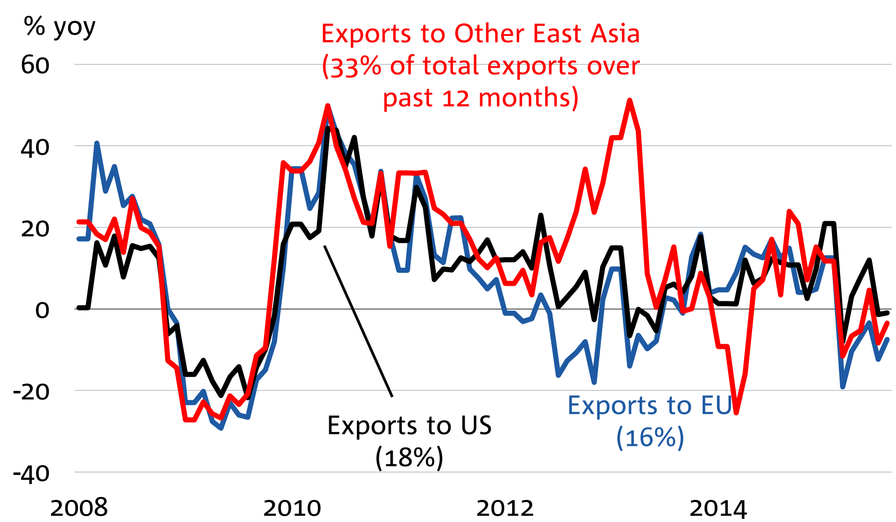
- There remains a sizeable disparity in the reported trade between Hong Kong and mainland China. In July, China customs reported exports to Hong Kong totalling US$26.9 billion, while Hong Kong customs reported imports of US$22.3 billion. That said, the disparity has narrowed relative to the levels of 2013 and 2014, when false invoicing to Hong Kong was used to bypass China's capital controls.

Exports were weaker in year-on-year terms, with surveyed new orders falling again in August



Source: CEIC, NAB Economics

Exports fell to all major markets in August, with only modest declines in values to the United States



Sources: CEIC, NAB Economics

Retail sales and inflation

- China's retail sales growth edged slightly higher in August – up to 10.8% yoy (from 10.5% in July). Retail price inflation remains modest, but it has edged upwards in recent months, meaning that real retail sales growth was virtually unchanged at 10.4% yoy – marginally below the trend levels exhibited in recent years.

- Consumer confidence has eased in recent months – down from a peak of 109.9 points in May to 104.5 points in July. That said, this measure has not turned negative (as was feared in response to the recent turmoil in equity markets).

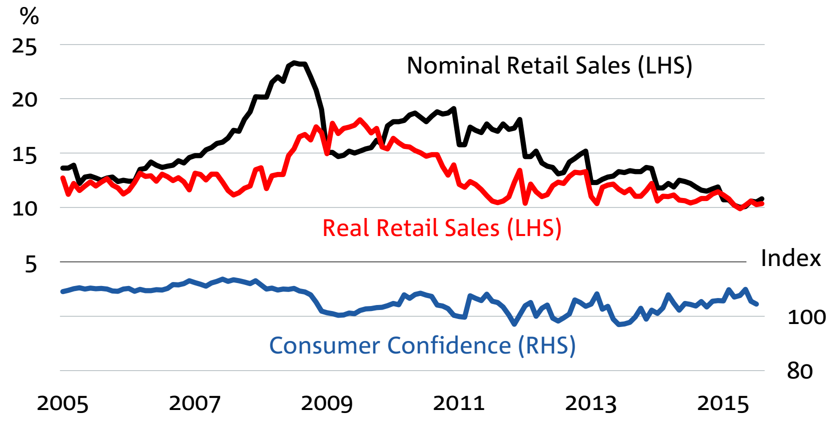
- There was a slight increase in headline inflation in August, although the rate remained around the modest trend levels seen over the past eighteen months – with the CPI rising by 2.0% in August (compared with 1.6% in July).

- The uptick in headline CPI was due to rising food prices – which increased by 3.7% yoy (the highest rate in over 12 months). As was the case last month, pork prices were the key influence – up by around 20% yoy, along with fresh vegetables (which rose by almost 16%).

- Non-food price trends were stable – with prices rising by 1.1% in August (unchanged from July). Sub-components of this index were also relatively stable – with fuel prices continuing to dampen price growth.

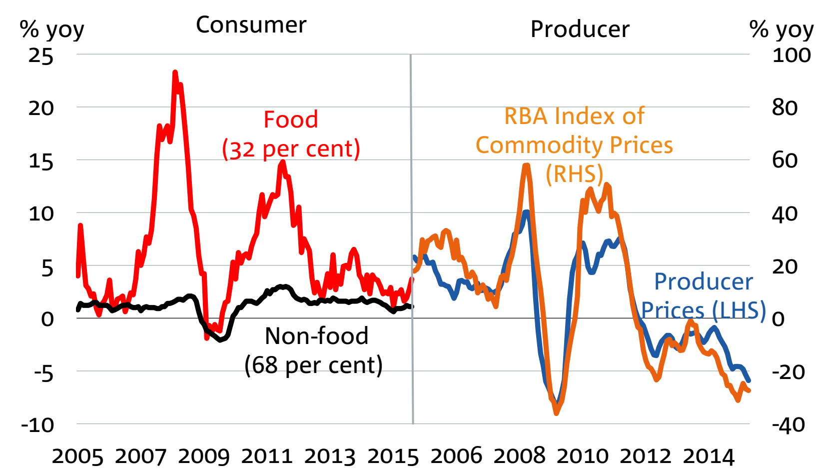
- The decline in producer prices accelerated in August – with prices down by -5.9% yoy (from -5.4% previously) – the forty-second monthly decline in a row). Falling commodity prices continue to drive this trend – with the RBA Index of Commodity Prices falling by over - 27% in August.

Real retail sales continue to track sideways, with growth only marginally sub-trend



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

Pork prices continue to drive modest upturn in consumer inflation, while producer prices have fallen further

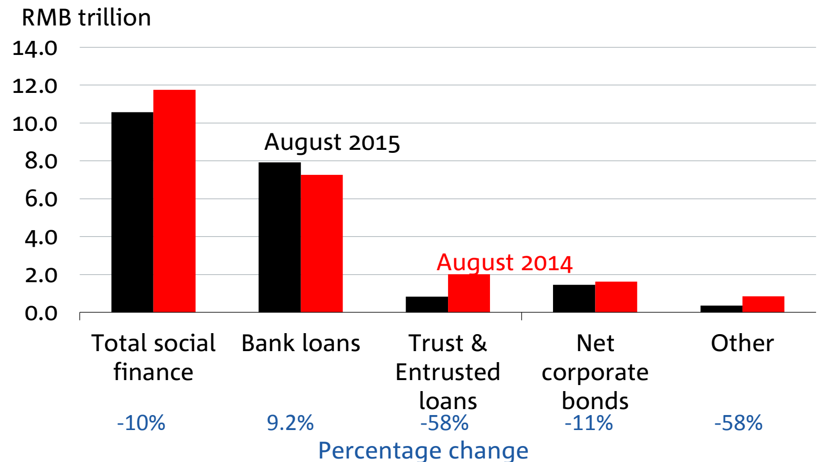


Sources: CEIC, RBA, NAB Economics

Credit conditions

- In late August, the People's Bank of China (PBoC) cut interest rates, at least partially in response to further falls on China's equity markets (that were triggered by weak PMI readings). Both the benchmark one year lending and deposit rates were cut by 25 basis points to 4.6% and 1.75% respectively. This was the fifth cut since November 2014, and was also accompanied by a 50 basis point cut to the Reserve Requirement Ratio (RRR).
- The cut to the deposit rate was accompanied by further policy liberalisation – with the ceiling above the benchmark rate removed for deposits of over a year. Previously banks were permitted to offer deposit rates up to 150% of the benchmark (which is still applicable for short term deposits).
- New credit was stronger in August – at RMB 1.1 trillion (from RMB 718 billion in July) – almost 13% higher in year-on-year terms.
- Over the first eight months of 2015, total social financing was RMB 10.6 trillion, down around -10% yoy. While overall credit has been weaker in 2015, bank loans have increased by 9.2% yoy to RMB 8.0 trillion.
- In contrast, other lending (including that of the shadow banking sector) has contracted considerably in 2015. Non-bank loans fell by -41% yoy in the first eight months of the year, with trust and entrusted loans (two key components of shadow banking) falling by a combined -58% yoy over this period.
- We anticipate at least one further cut to interest rates in 2015, to bring the one year lending rate to 4.35% in Q4. In addition, we expect a further cut to the RRR this year, largely to maintain liquidity in the finance sector lost through capital outflows.

Continued growth in bank credit has been offset by weaker trust and entrusted loans



Sources: CEIC, NAB Economics

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