China's economy at a glance

by NAB Group Economics

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National Australia Bank

Services underpin China's growth, but forecast is lower, with industry continuing to soften

- China's latest national accounts data showed a slowing trend for China's economy in the September quarter – with gross domestic product rising by 6.9% yoy – falling below the annual growth target for the first time this year. Reaching China's annual growth target appears more challenging following the latest data release. As a result, we are revising our forecasts for China's growth – to 6.9% for 2015 (7.1% previously) and 6.7%for 2016 (6.9% previously).

- Weakness in the industrial sector remains evident – China's industrial production growth slowed to 5.7% yoy (from 6.1% in August), while fixed asset investment slowed to 6.8% yoy (from 9.2% previously) – the lowest rate of growth since December 2002. Slowing investment in the real estate and manufacturing sectors has been the key driver of this trend.

- Services remain the main engine for growth, and real retail sales growth accelerated – at 10.8% yoy (compared with 10.3% previously), around trend levels over the past few years.

- China's trade surplus edged marginally wider in September – with weaker imports (in year-on-year terms) raising concerns around the health of the broader Chinese economy. These concerns are somewhat overblown, given the impact of falling commodity prices on import values.

- China's new credit expanded in September – totalling RMB 1.3 trillion (compared with RMB 1.1 trillion in August) – almost 14.5% higher in year-on-year terms. Recent months have seen an expansion in overall credit, in stark contrast to the declines across the first half of the year.

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Contact

Gerard Burg gerard.burg@nab.com.au

Gross Domestic Product

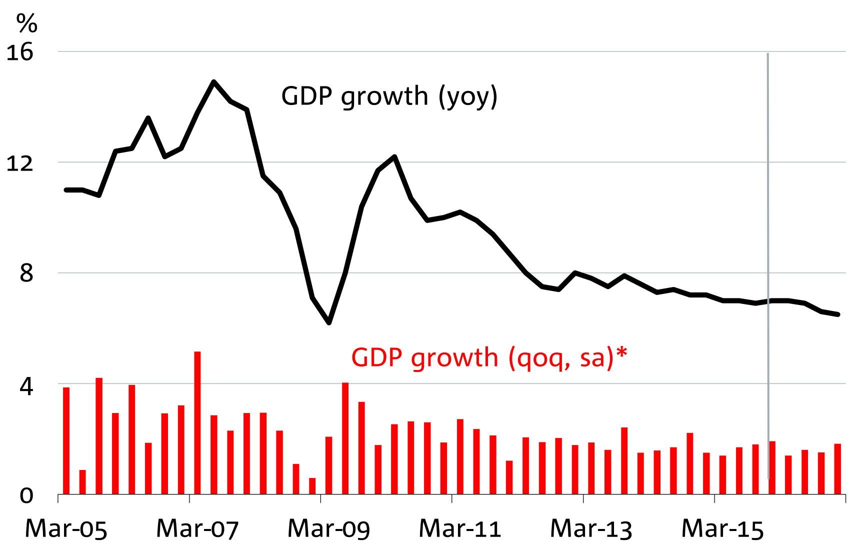
- China's latest national accounts data showed a slowing trend for China's economy in the September quarter – with gross domestic product rising by 6.9% yoy – falling below the annual growth target for the first time this year. That said, this result was stronger than market expectations, at 6.7% in Bloomberg's analyst survey.

- As we have previously noted, there are some inconsistencies in official data – with the NBS's seasonally adjusted quarterly growth data pointing to a weaker rate at 6.6% yoy. This highlights continued concerns that the headline figure may overstate growth – although as we noted this month, China's national accounting methodology is dated and therefore may underestimate the overall size of the economy.

- China's services sector remains the main engine for growth – with output rising by 8.6% yoy in Q3 – largely unchanged from the previous quarter – while real growth in the industrial sector slowing – down to 5.8% yoy (from 5.9% previously). Of particular interest will be the growth in non-financial services – given that finance (likely connected to the equity boom) was a major contributor to growth in the first half of 2015.

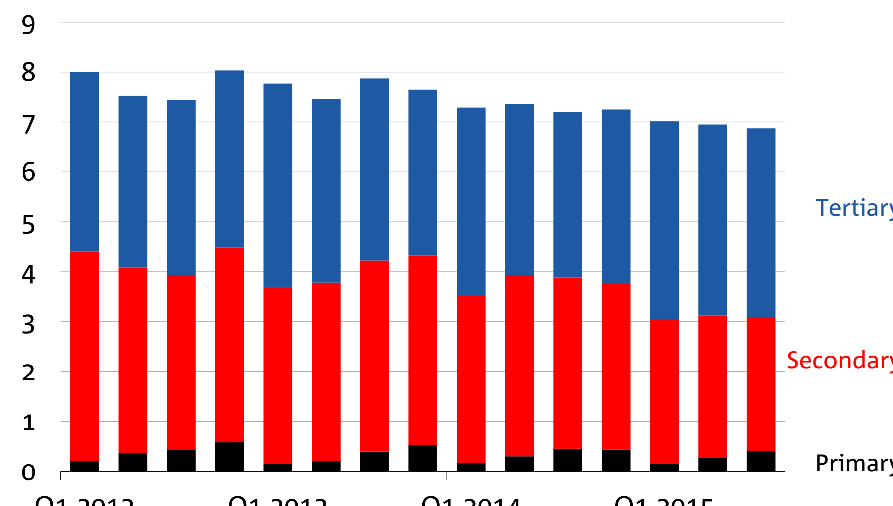
- While lending has expanded and fiscal constraints appear to be easing, reaching China's annual growth target appears more challenging following the latest data release. As a result, we are revising our forecasts for China's growth – to 6.9% for 2015 (7.1% previously) and 6.7% for 2016 (6.9% previously).

Headline real GDP softened in Q3 to 6.9% – however quarterly data indicates a possible weaker trend



Source: CEIC, NAB Economics

Services have been the key contributor to China's growth in recent times – with industry weakening



Source: CEIC, NAB Economics

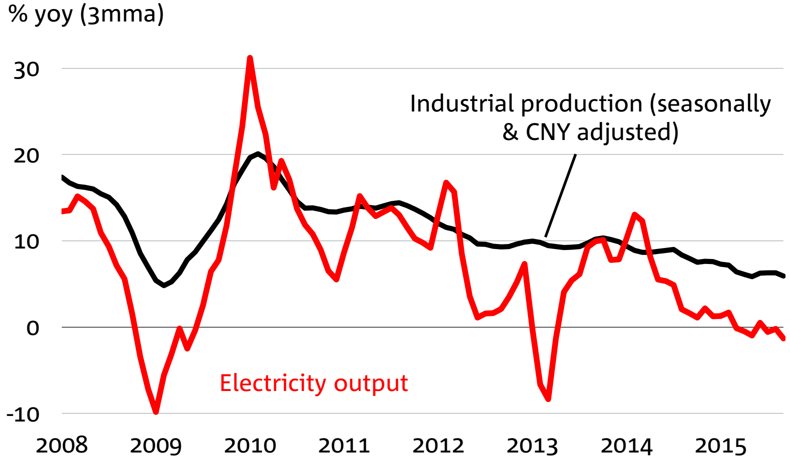
Industrial production

- China's industrial production growth weakened in September – down to 5.7% yoy (from 6.1% in August) and below market expectations (6.0%). While a slowing trend has been evident for some time, it remains unclear how much impact the explosion at the port of Tianjin in August has had on the industrial sector.

- Key heavy industrial sectors saw weaker production in September, with crude steel falling by -3.0% yoy, cement by -2.5% yoy and motor vehicles by -4.7% yoy. Similarly electricity production was down by -3.1% yoy.

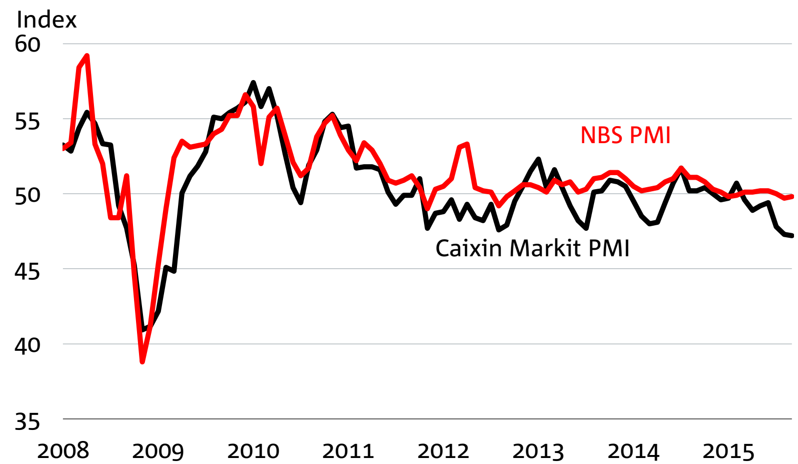
- China's two major industrial surveys remained in negative territory in September, with the gap between them widening marginally. The official NBS PMI edged higher – to a fairly neutral 49.8 points – while the Caixin Markit PMI edged down to 47.2 points – its lowest reading since March 2009.

China's industrial sector softened further in September – the weakest growth since February 2009



Source: CEIC, NAB Economics

The gap between China's two main industrial surveys has widened – with the Caixin Markit survey deteriorating



Source: CEIC, NAB Economics

Investment

- Trends in fixed asset investment continued to soften in September, with growth down to 6.8% yoy (from 9.2% previously) – the lowest rate of growth since December 2002. Slowing investment in the real estate and manufacturing sectors has been the key driver of this trend.

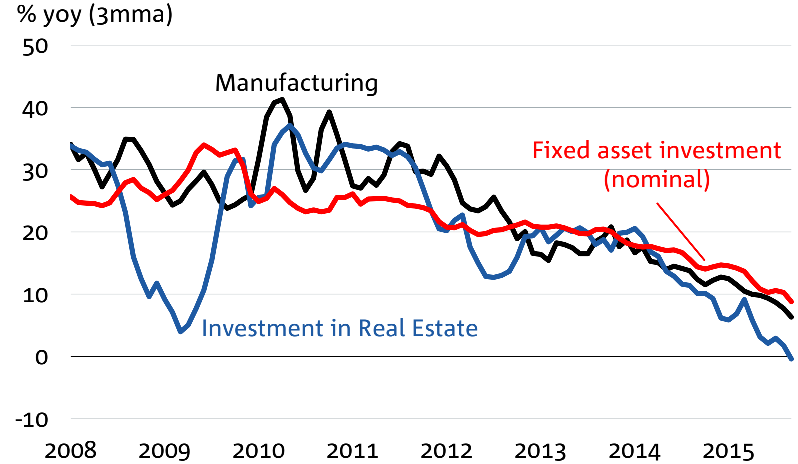
- Investment in real estate is now contracting in year-on-year terms, down by -0.4% yoy (on a three month moving average basis). Manufacturing investment is still growing – but more slowly – at 6.3% yoy (3mma) (from 7.7% previously). Combined, these two sectors accounted for 57% of total fixed asset investment in the first eight months of the year.

- Weakness in residential real estate markets since early 2014 has contributed to the slow down in investment – with soft market conditions discouraging further construction activity. Price trends have improved in recent times – at a national level, China Index Academy data shows house prices rose by 1.4% yoy in September (and 0.6% on a month-on-month basis). That said, the annual increases are driven by tier 1 cities only – prices have stabilised in most smaller cities, but they remain lower in year-on-year terms.

- Slowing real estate investment is evident in construction data – with residential construction starts falling by almost -14% in the first nine months of the year (compared to the same period last year). That said, there was a notable increase in September – with construction starts at the highest level since June 2014 – recording the first year-on-year increase in 2015 (at almost 17% yoy).

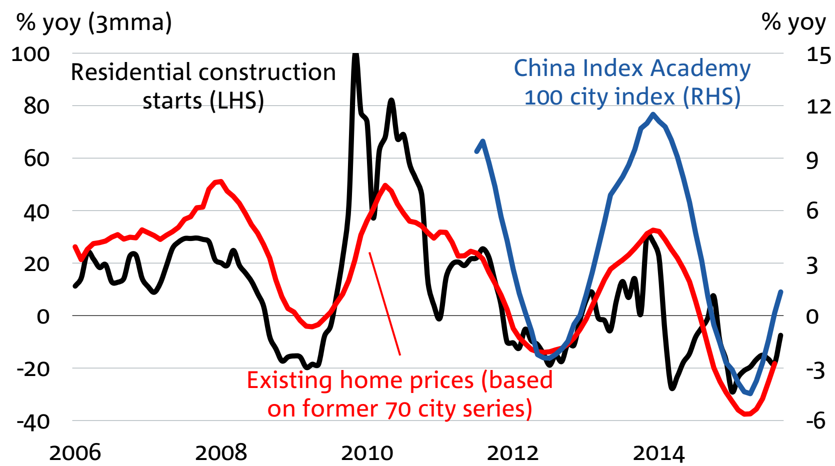
- We will continue to monitor these trends closely to see if a recovery in construction activity can be sustained – a trend that would be unlikely without further strengthening in property markets outside the tier 1 cities.

The weakness in real estate and manufacturing has dragged investment growth into single digit levels



Source: CEIC, NAB Economics

Residential construction activity improved in September – but it is unclear if this can be maintained

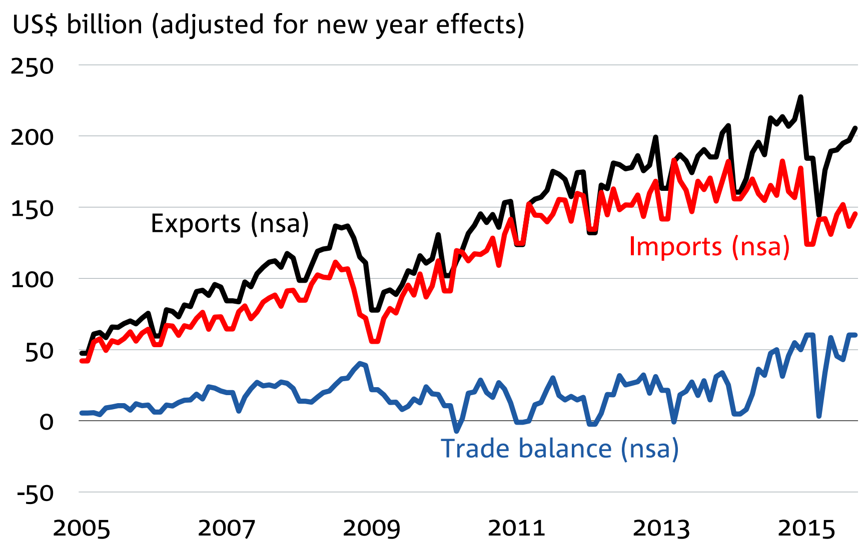


Source: CEIC, Datastream, NAB Economics

International trade – trade balance and imports

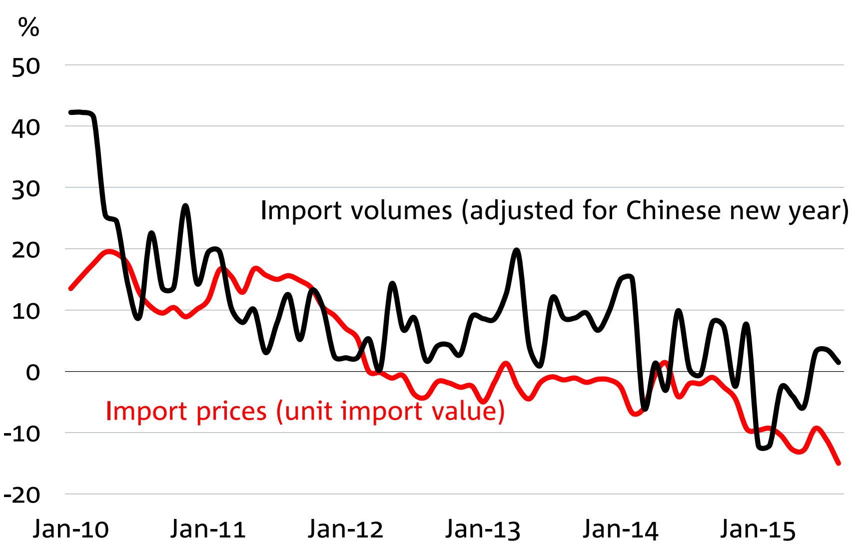
- China's trade surplus was marginally wider in September, with both imports and exports strengthening in month-on-month terms (despite another sharp drop in the year-on-year growth for imports). The surplus was US$60.3 billion (up from US$60.2 billion last month), just below the all time high recorded in February 2015.
- China's imports rose to US$145.2 billion in September (from US$136.6 billion in August) – however this represented a fall of -20.5% in year-on-year terms. The substantial falls in import values have raised concerns around the health of the broader Chinese economy.
- These concerns are somewhat overblown, given the impact of falling commodity prices on import values. Over the first eight months of the year, import values fell by around -14.5% yoy, compared with a decline in volumes of just -3.5% yoy.
- Commodity import volumes have continued to vary – reflecting divergent trends in underlying industrial sectors. Over the first nine months of the year, crude oil imports rose by 8.8% yoy, while iron ore imports were virtually unchanged. In contrast, refined copper fell by -5.3% yoy and coal imports plunged by -29.9% yoy – reflecting weaker conditions in electricity generation and efforts to address pollution.

China's trade surplus remained close to record levels – with imports staying well below year-ago levels



Sources: CEIC, NAB Economics

Weakness in import data is more related to falling prices (particularly for commodities) than volumes



Source: CEIC, NAB Economics

International trade – exports

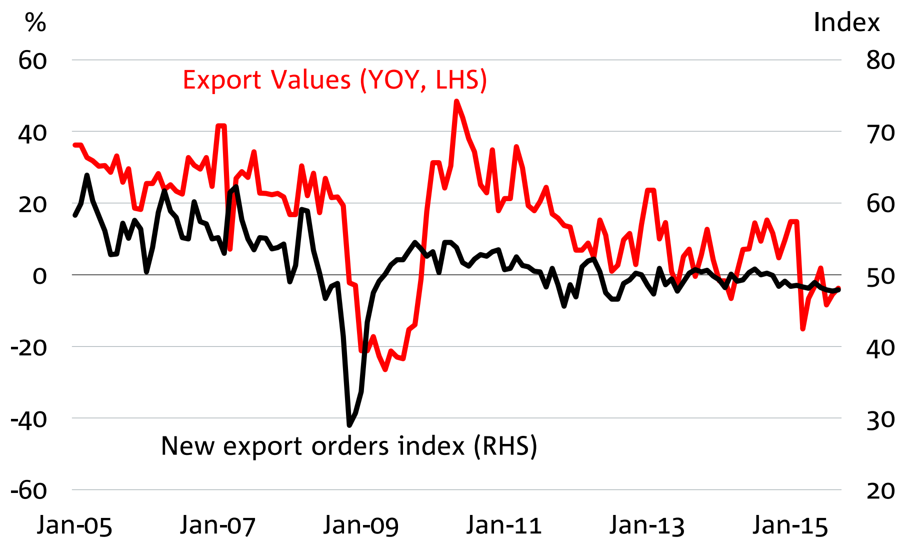
- China's exports totalled US$205.6 billion in September, up from US$196.9 billion previously – but around -3.7% lower in year-on-year terms. Despite the recent devaluation of the Yuan, sentiment among exporters remain negative – with the new export orders index in the NBS PMI survey at 47.9 points in September (up marginally from 47.7 points previously).

- While the overall level of exports was lower year-on-year, there was considerable divergence by major market. Exports to the United States rose – up 6.7% yoy – while exports to the European Union were unchanged year-on-year. In contrast, exports to East Asia were noticeably lower – at -10.7% yoy.

- The key driver of weaker exports to Asia was another deterioration in Hong Kong deliveries. Exports to Hong Kong fell by -23.0% yoy (compared with -3.8% yoy in August), while exports to other Asian destinations rose moderately – up 2.9% yoy (from -3.2% yoy previously).

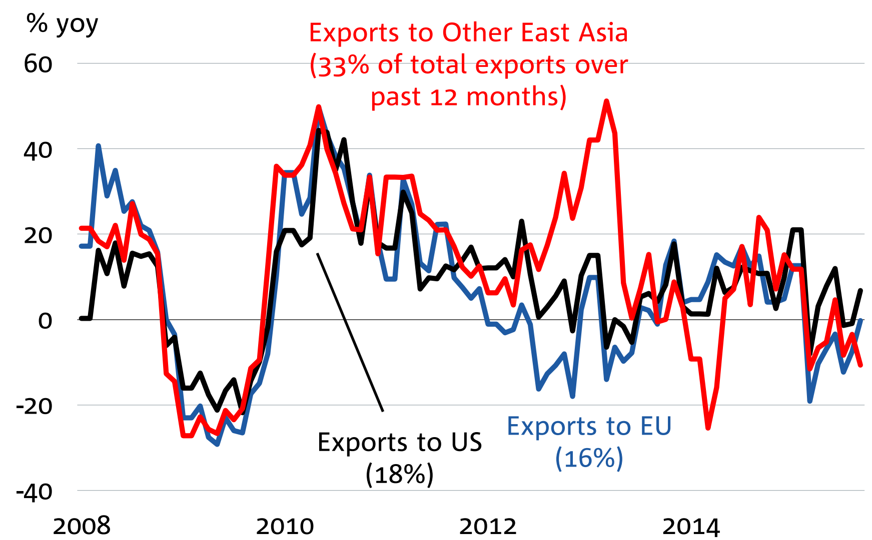
- We have previously noted considerable disparity in the trade data between Hong Kong and mainland China – and the scale of this month's fall may reflect this. In September 2014, China Customs reported exports of US$37.6 billion, compared with Hong Kong Customs reporting imports of just US$24.1 billion – indicating considerable uncertainty around the reported falls in exports.

China's export values fell modestly year-on-year, with exporters remaining negative despite currency trends



Source: CEIC, NAB Economics

Falling exports to Asia drove the declines, but considerable uncertainty with Hong Kong persists

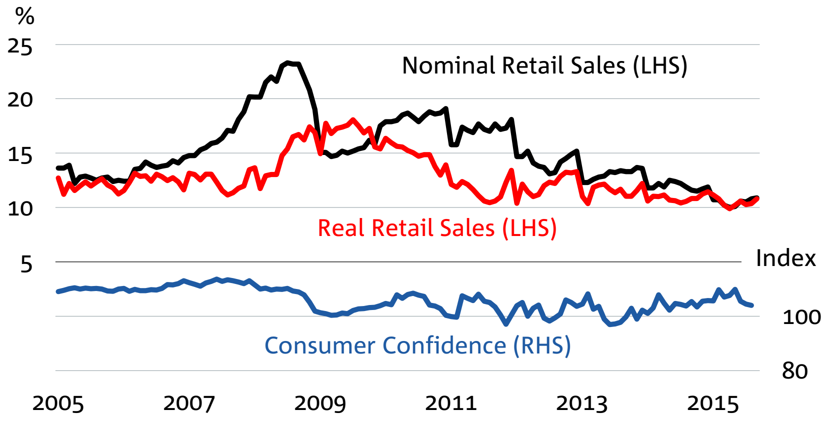


Sources: CEIC, NAB Economics

Retail sales and inflation

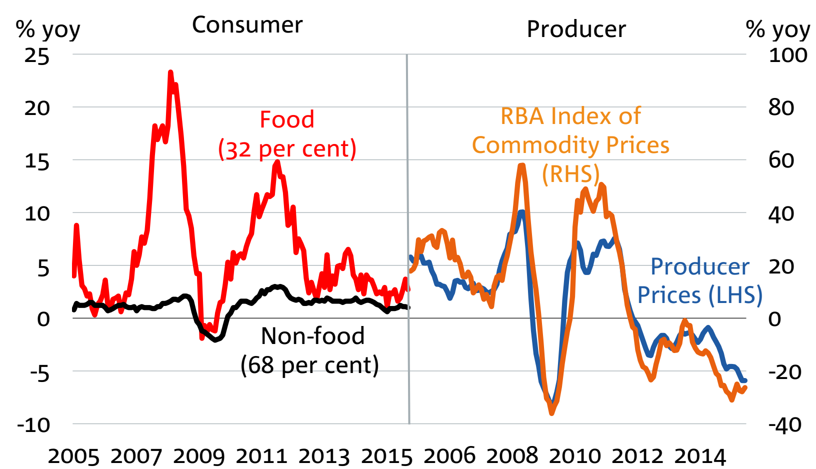
- China's retail sales growth edged higher in September – rising by 10.9% yoy (from 10.8% in August). Retail prices softened once again this month – resulting in a more significant acceleration in real retail sales growth – at 10.8% yoy (compared with 10.3% previously), around trend levels over the past few years.
- Consumer confidence has eased back in recent months – albeit from particularly strong levels in the first half of the year – down to 104.0 points in August (from 104.5 points in July). Importantly, there hasn't been a significant deterioration in consumer confidence, following on from the turmoil in equity markets in recent months.
- Headline inflation softened again in September, with the consumer price index easing back to 1.6% yoy (around the levels of mid-year) from 2.0% in August.
- The slower growth in headline inflation was due to a softening in food price growth – at 2.7% yoy (from 3.7% in August). Pork prices remain a major influence for food price trends, with prices rising by 17.4% yoy (down from 19.6% previously). In contrast, fresh fruit prices fell by -10.7% yoy, while fresh vegetables rose by 10.4% yoy (down from 15.9%).
- Non-food price trends eased marginally, with prices rising by 1.0% yoy (from 1.1% in August). There was little change in fuel price trends this month – down 19.2% yoy (compared with 19.3% previously).
- Producer prices fell for the forty-third month in a row, down by -5.9% yoy (unchanged from the level in August). Falling commodity prices remain a key factor in this trend – the RBA Index of Commodity Prices was -26% yoy lower in September – flowing through into weaker producer prices in heavy industry (-7.8% yoy) than light industry (-1.2% yoy).

Real retail sales have strengthened – moving back to trend growth levels in September



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

Inflation softened again in September, with lower pork price growth easing food price pressure

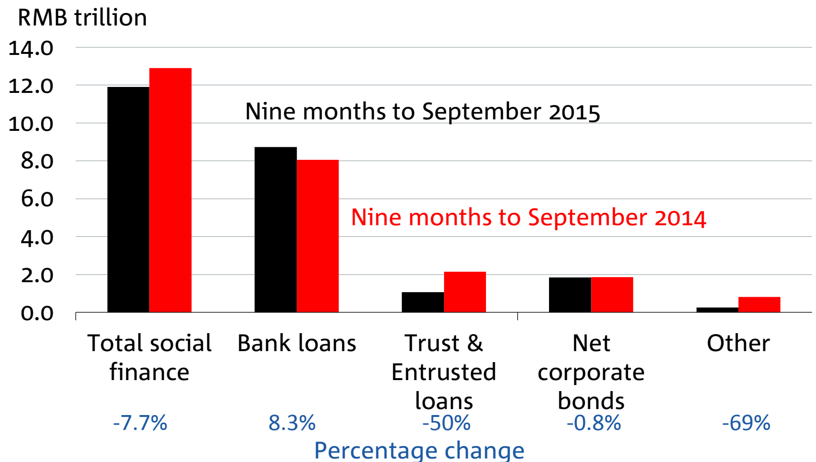


Sources: CEIC, RBA, NAB Economics

Credit conditions

- China's new credit expanded in September – totalling RMB 1.3 trillion (compared with RMB 1.1 trillion in August) – an increase of 14.5% yoy. Recent months have seen an expansion in overall credit, in stark contrast to the declines across the first half of the year.
- Over the first nine months of 2015, total credit was RMB 11.9 trillion, down around -7.7% yoy. Tighter regulation over the shadow banking sector has contributed to this decline, with traditional bank finance rising by 8.3% yoy over this period.
- Key components of the shadow banking sector have contracted this year – with entrusted loans declining by -43% yoy in the first nine months and trust loans by -84% yoy.
- We continue to expect one further cut to interest rates in 2015, to bring the benchmark one year lending rate to 4.35%. Further cuts to the banks Required Reserve Ratio (RRR) are also likely – largely to maintain liquidity in the finance sector in response to capital outflows.

While new credit remains weaker over the course of 2015, credit has accelerated in recent months



Sources: CEIC, NAB Economics

Group Economics
Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Riki Polygenis
Head of Australia Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Amy Li
Economist – Australia
+(61 3) 8634 1563

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Karla Bulauan
Economist – Industry Analysis
+(61 3) 86414028

International Economics
Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia
Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

Distribution
Kevin Tsang
Marketing Manager, Asia
+852 2822 5388

UK/Europe
Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532