China's economy at a glance

by NAB Group Economics

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National Australia Bank

The modest recovery in industry unlikely to continue, China is moving away from the 'old economy'

- Indicators of China's industrial sector were somewhat improved in November, with both industrial production and fixed asset investment showing stronger growth following recent lows in September. The pickup in investment came despite a further contraction in real estate investment.
- We don't anticipate a strengthening in industrial growth to continue – it is worth noting that both major industrial surveys remain in negative territory – as China's economy continues to transition to consumption based growth.
- Trends in the retail sector remain strong – with real retail sales growth at 11% yoy in November – signalling the stronger performance of China's services sector. November also saw Singles' Day – the world's largest online shopping day, with total sales over six times that of the US Cyber Monday.
- Trade data continued to highlight the weaker industrial growth trends – with both import and export values declining year-on-year. China's trade surplus was lower in November – due to month-on-month increase in imports – but remained at historically high levels.
- In November, the IMF announced that China's currency will be included in the Special Drawing Rights basket – commencing in October 2016. Its share – at 10.9% – will be larger than both the Japanese Yen and British Pound in the new basket. It remains to be seen what impact this will have on demand for the Yuan and on global capital flows – however this move may provide a signal of international support for the reform agenda proposed by China's leadership.

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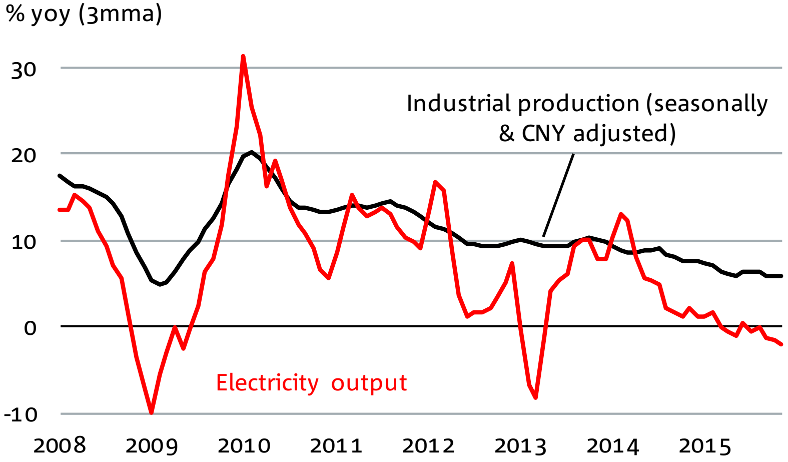
Industrial production

- China's industrial production improved a little in November, with growth at 6.2% yoy (compared with 5.6% in October). While this rate of growth was comparatively low (from a historical perspective), it was the strongest rate since June, and was well above market expectations (at 5.7% yoy in the Bloomberg survey).

- Trends by industry sector remain divergent – with cement manufacturing slumping – down by -6.6% yoy – and crude steel falling by -1.6% yoy. In contrast, motor vehicle output has improved, rising by 16% yoy.

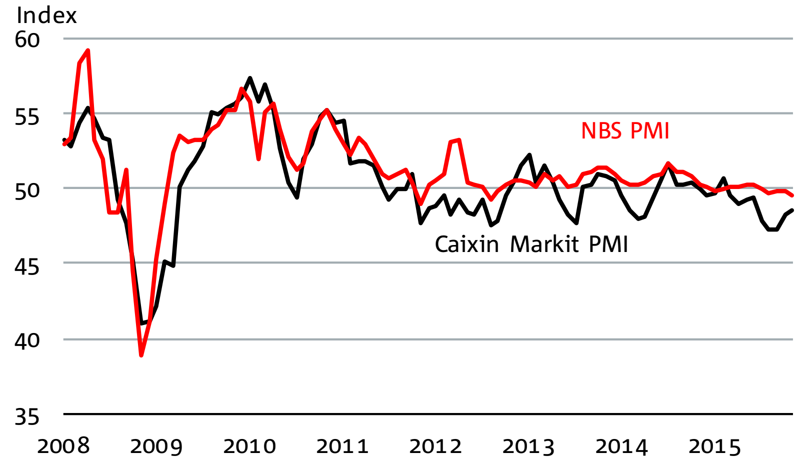
- China's industrial surveys remained in negative territory in November, however trends differed. The official NBS PMI deteriorated slightly – down to 49.6 points (from 49.8 points previously). In contrast, the Caixin Markit PMI improved, edging back up to 48.6 points (from 48.3 points in October) – reducing the gap between the two measures.

Electricity output has continued to contract, while growth in industrial production marginally improved



Source: CEIC, NAB Economics

Purchasing manager indices remain negative, but the gap is narrowing as the Caixin Markit index trends higher



Source: CEIC, NAB Economics

Investment

- Growth in fixed asset investment continued to improve this month – albeit only marginally – from the extremely weak levels in September. Investment grew by 10.2% yoy in November (up from 9.5% in October), well above market expectations (at around 9.2%). That said, we don't expect a major acceleration in growth over the coming months – with investment continuing to trend lower.

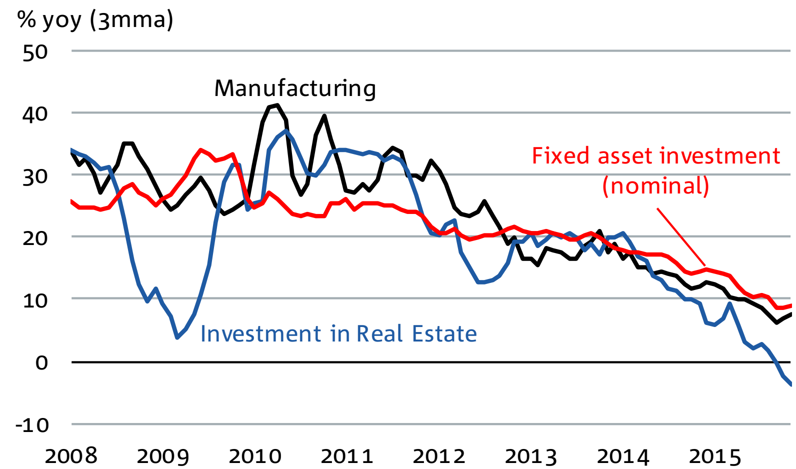
- Growth in manufacturing investment has accelerated slightly in recent months – up to 7.5% yoy (on a three month moving average basis), compared with 6.3% in September. Investment in real estate is contracting – down -3.6% yoy (3mma) in November. Combined, manufacturing and real estate accounted for over 56% of fixed asset investment in the first ten months of the year.

- In contrast, investment in public utilities (21% yoy) and water conservation and environmental management (33% yoy) has continued – with these sectors accounting for around 15% of total investment over the same period.

- Residential property price trends remain unlikely to support a major recovery in property investment – China Index Academy data showed a 2.9% yoy increase in the national average, however the gains have been concentrated in China's tier 1 cities (Beijing, Shanghai, Shenzhen and Guangzhou), where prices rose by 13% yoy in November. In contrast, tier 2 and 3 cities still recorded falling prices (in year-on-year terms) – at -1.0% and -1.6% respectively (although prices are no longer falling month-on-month).

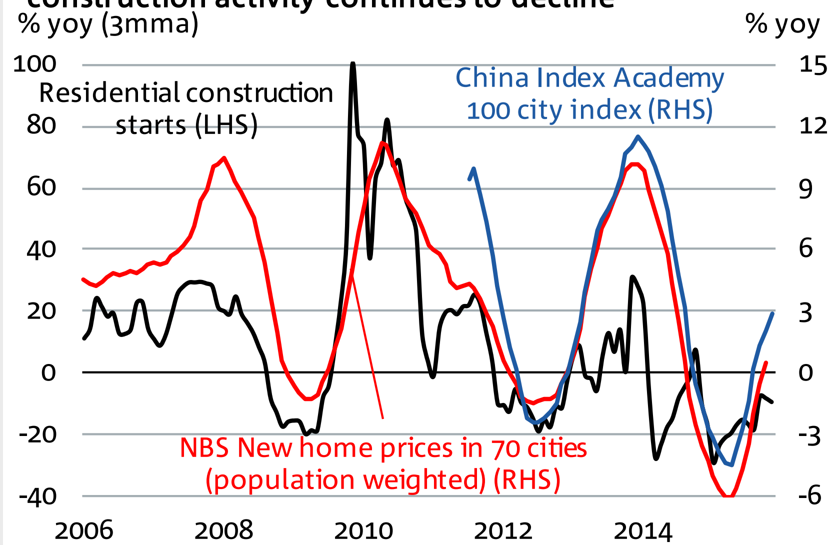
- Despite the improvement in price trends in recent months, residential construction activity remains subdued. New construction starts have contracted in year-on-year terms across 2015 (with the exception of September) – with starts down almost 21% yoy in November.

China's investment growth has edged up slightly in recent months, but continues to fall in real estate



Source: CEIC, NAB Economics

Improving house prices are largely limited to tier 1 cities; construction activity continues to decline

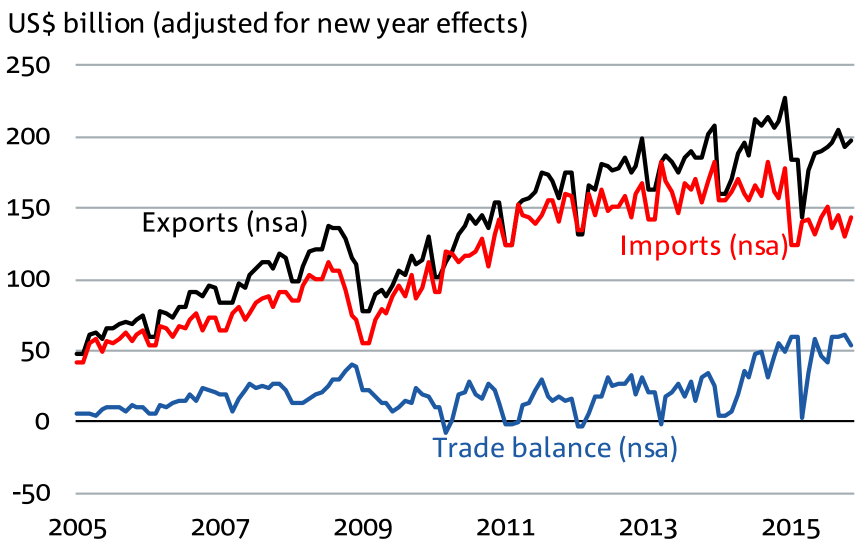


Source: CEIC, Datastream, NAB Economics

International trade – trade balance and imports

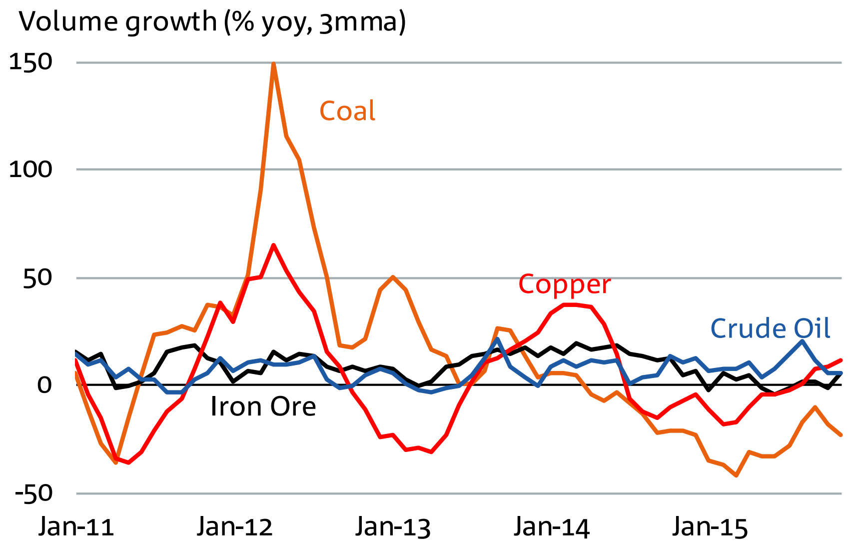
- A month-on-month pick up in imports (which still fell year-on-year) resulted in a narrowing in China's trade surplus in November. The surplus was US$54.1 billion (down from an all time high of US$61.6 billion in October), a level that was still historically high.
- China's imports recovered to US$143.1 billion in November (up from US$130.8 billion in October) – a fall of -8.7% yoy. The weaker level for imports – compared with a year ago – continues to highlight the subdued conditions in China's industrial sector.
- In part this trend reflects falling import prices – the RBA Index of Commodity Prices fell by almost -27% yoy in November – meaning that the value of key imports such as iron ore (-40% yoy in the first eleven months of the year), crude oil (-41%) and coal (-45%) fell sharply, while import volumes (at +1.3%, +8.8% and -22% respectively) were mixed.
- Import data tells us little about the conditions in China's services sector – which has a much lower import reliance than industry – with services providing the key contribution to China's economic growth in 2015.

A modest recovery in imports narrowed the trade surplus in November, but it remained historically high



Sources: CEIC, NAB Economics

Weaker import values largely a price effect – commodity volumes have not fallen to the same extent

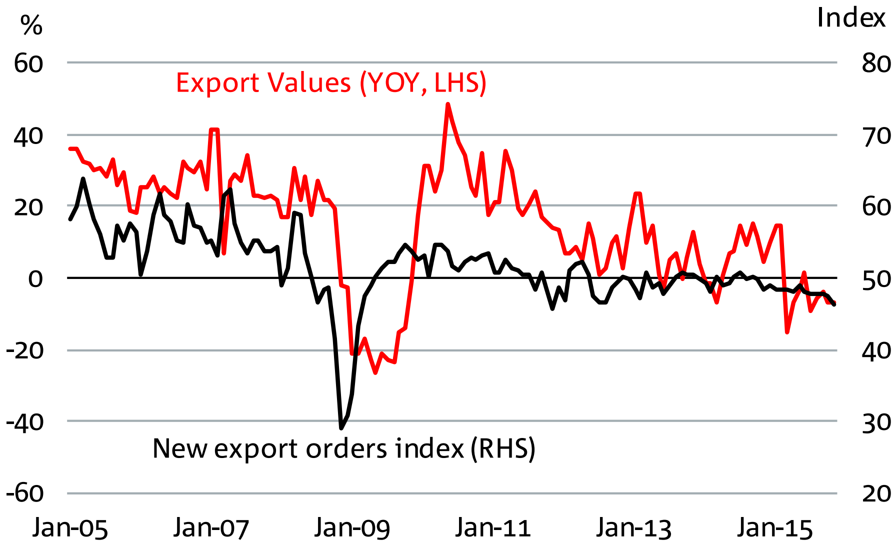


Sources: CEIC, NAB Economics

International trade – exports

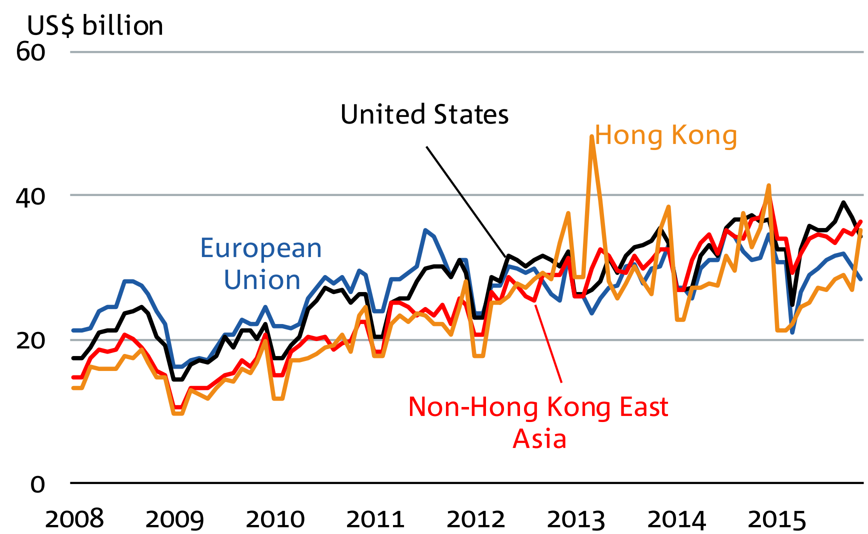
- China's exports were marginally stronger in November – at US$197.2 billion (compared with US$192.4 billion previously) – albeit this still represented a year-on-year fall of -6.8% yoy. There seems to be little prospect of a short term recovery, with the new export orders measure in the NBS PMI survey continuing to slide – to 46.4 points in November (from 47.4 points previously).
- The stronger level of exports (compared with October) was largely due to a sharp rise in the value of exports to Hong Kong – at US$35.3 billion, from US$27.0 billion previously. We have previously highlighted the disparity between Hong Kong and Chinese data – the largest import value Hong Kong Customs have ever reported from China was US$24.1 billion in September 2014.
- This discrepancy suggests there is considerable uncertainty around the actual state of China's exports.
- The year-on-year fall in reported exports was largely driven by the European Union, where exports fell by -9.0% yoy. Exports to the United States also fell notably, down by -5.3% yoy. In contrast, exports to East Asian economies fell by just -1.0% yoy.
- That said, the comparatively modest decline in exports to East Asia was largely driven by the unexpectedly strong result for Hong Kong, which was around -0.5% down on November 2014.

Export trends continue to deteriorate – with firms reporting worsening new orders



Source: CEIC, NAB Economics

Sharp rise in monthly exports to Hong Kong provides some uncertainty around the strength of exports

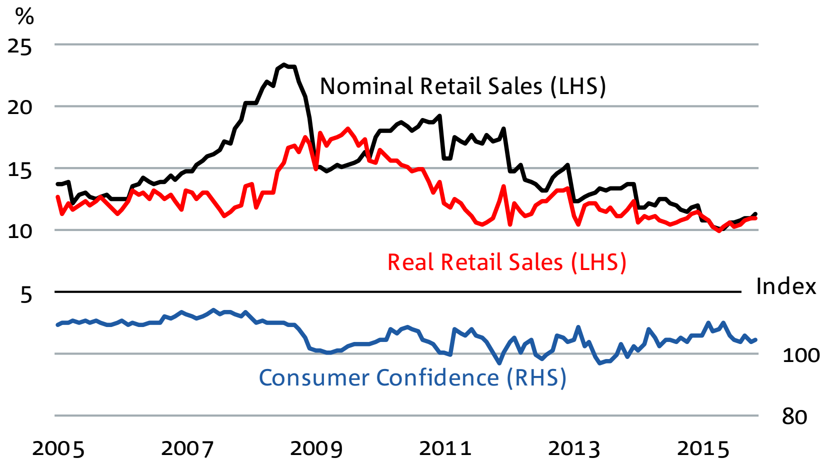


Sources: CEIC, NAB Economics

Retail sales and inflation

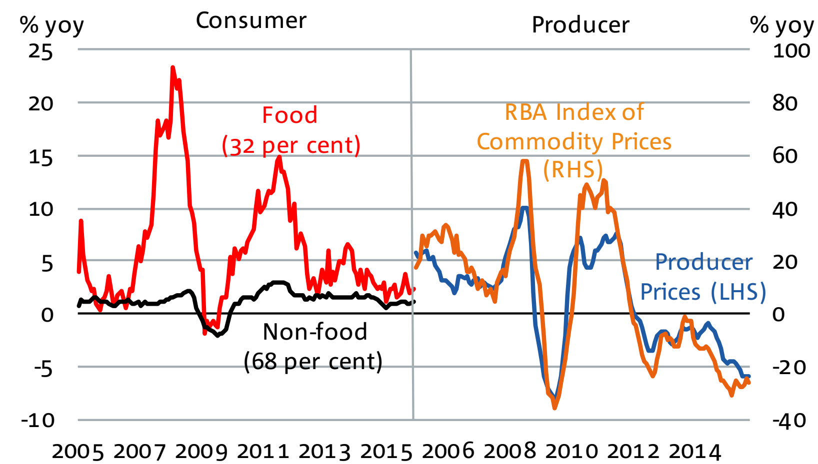
- China's retail sector continues to highlight the stronger performance of the country's services sector (compared with the industrial slowdown). Retail sales growth accelerated slightly in November, up to 11.2% yoy (from 11% in October). Reflecting modest retail price inflation, real retail sales grew by 11.0% – unchanged from October.
- November also saw the biggest online shopping day of the year – Singles' Day on November 11 – with total sales estimated at around US$19 billion. In comparison, Cyber Monday – the major US online retail shopping event – record sales of just US$3 billion this year.
- Inflation trends were marginally stronger in November. The headline CPI edged up to 1.5% yoy (from 1.3% in October), with an increase in food price growth the main contributor. That said, price growth has remained comparatively subdued since the second half of 2014.
- Food price inflation was 2.3% yoy, up from 1.9% previously. Fresh vegetable prices rose more strongly – up by 9.4% yoy (from 4.7% in October), while pork price growth was more modest in November, at 13.9% yoy (down from 15.8% previously).
- Growth in non-food prices was marginally higher – but still within the typical range of the past year – at 1.1% yoy (up from 0.9% in October). Fuel prices continue to influence non-food price trends – but the impact is becoming more modest, with prices for fuel and spares down by -12.4% in November (from -15.5% previously).
- Producer prices fell again – now for the forty-fifth straight month – with prices down by -5.9% yoy (an unchanged rate for the past four months). As we have noted, this trend is more evident in heavy industry (-7.7% yoy) than light industry (-1.3% yoy) – with lower commodity prices influencing this trend. The RBA Index of Commodity Prices fell by almost -27% yoy in November.

Retail sales continue to grow at double-digit levels, as China's economy transitions towards consumption



Source: CEIC, NAB Economics

Price trends remain subdued – with only modest growth in consumer prices, and further falls in producer prices



Sources: CEIC, RBA, NAB Economics

Credit conditions

- In November, the IMF announced that China's currency will be included in the Special Drawing Rights basket – commencing in October 2016. Its share – at 10.9% – will be larger than both the Japanese Yen and British Pound in the new basket. It remains to be seen what impact this will have on demand for the Yuan and on global capital flows – the currency's inclusion in the SDR basket does not mean global FX reserve managers will increase their holdings (for more on this topic, see China's SDR Inclusion: What does it mean for G10 currencies?) – however it may provide a signal of international support for the reform agenda proposed by China's leadership.

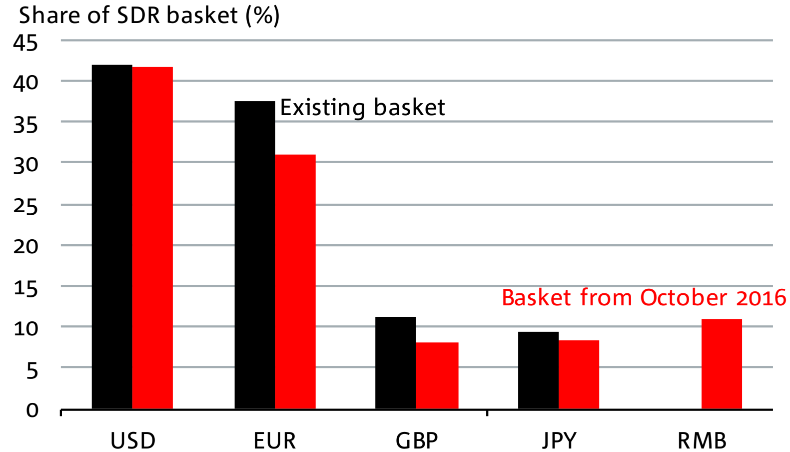
- New credit was stronger in November, after a particularly weak expansion in October, totalling RMB 1.0 trillion (compared with just RMB 477 billion previously) – well above market expectations. That said, new credit remained weaker than the levels from a year ago – extending the declines seen across the year – with the total across the first eleven months of the year at RMB 13.4 trillion – down -8.8% yoy.

- Over this period, bank lending has increased, rising by 5.7% yoy to RMB 9.9 trillion. Tightening regulation around shadow banking forced a range of off balance sheet lending back to traditional bank loans.

- Key components of the shadow banking sector have contracted this year – with entrusted loans down by -40% yoy over the first eleven months of the year, and trust loans falling by -98% yoy over this period.

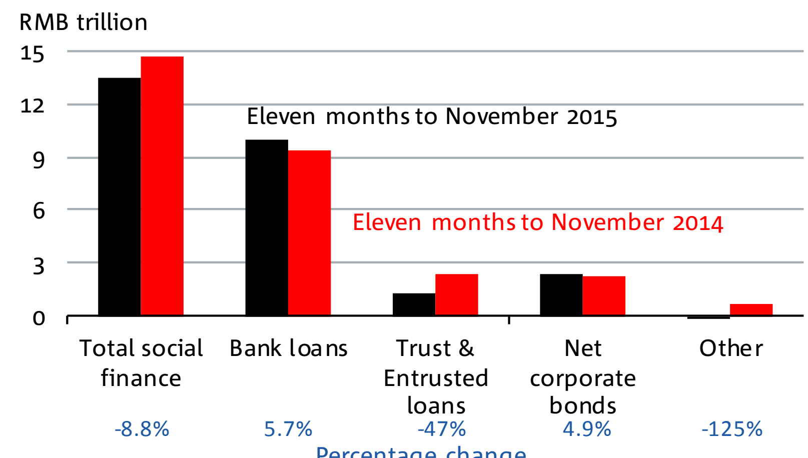
- We expect two cuts to interest rates in 2016 – bringing the benchmark one year lending rate to 3.85% by mid-year. Similarly further cuts to the Required Reserve Ratio are likely to maintain liquidity in the finance sector, with capital outflows likely to continue in the short term.

The inclusion of the Yuan into the IMF's SDR basket provides of vote of confidence to China's reforms



Sources: IMF, NAB Economics

New credit has contracted in 2015, as tighter regulation around shadow banking has impacted lending



Sources: CEIC, NAB Economics

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