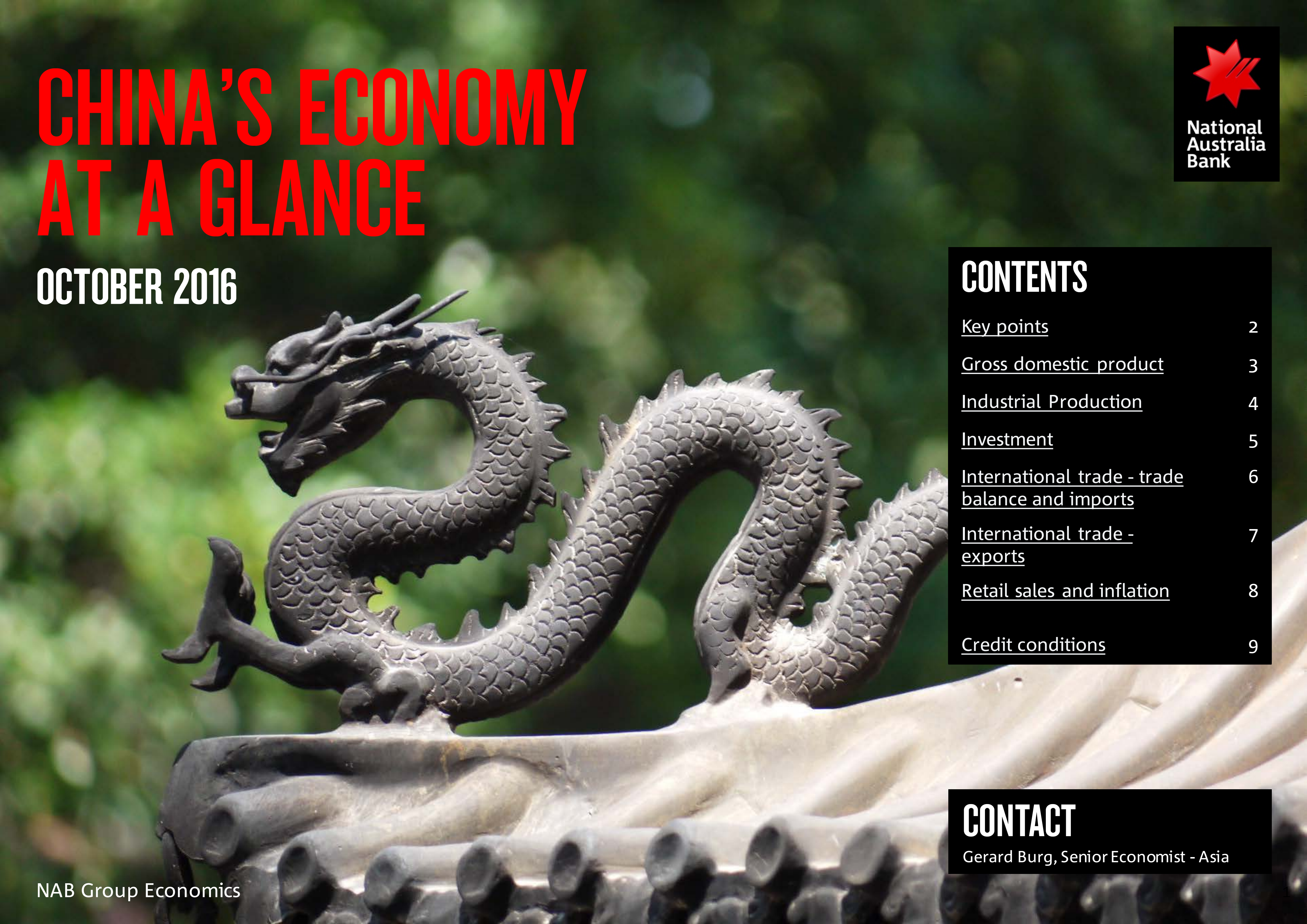
CHINA'S ECONOMY AT A GLANCE

OCTOBER 2016



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KEY POINTS

China's economy continued to track sideways – but weaker real estate could cool conditions in Q4

- China's economy grew by 6.7% yoy in Q3 – the same level recorded in both the March and June quarters. This level was in line with market expectations, and remains within Beijing's target range of 6.5% to 7.0%. Booming property sales helped underpinned this growth, and government efforts to cool property speculation may have a negative impact on Q4 GDP growth. Our forecasts are unchanged, at 6.6% in 2016 and 6.5% in 2017 – with risks weighted to the downside next year.

- House prices continue to grow strongly and sales have remained robust, however weaker real estate investment has impacted construction. New construction starts fell in September – down 3.7% yoy on a three month moving average basis, and this trend may be further exacerbated by tighter regulations around house purchases and mortgage lending.

- Mortgage lending has surged this year, with mortgages accounting for around 36% of total bank lending over the first nine months of the year – far above the longer term trend. The People's Bank of China (PBoC) has instructed banks to rein in mortgage credit and better manage risk – which may impact credit growth in Q4.

- Growth in China's industrial production slowed slightly in September, down to 6.1% yoy (compared with 6.3% in August), but still in line with recent trends.

- A slight month-on-month fall in China's exports and an upturn in imports saw the country's trade surplus narrow somewhat in September – down to US$42.0 billion (from US$52.0 billion previously).

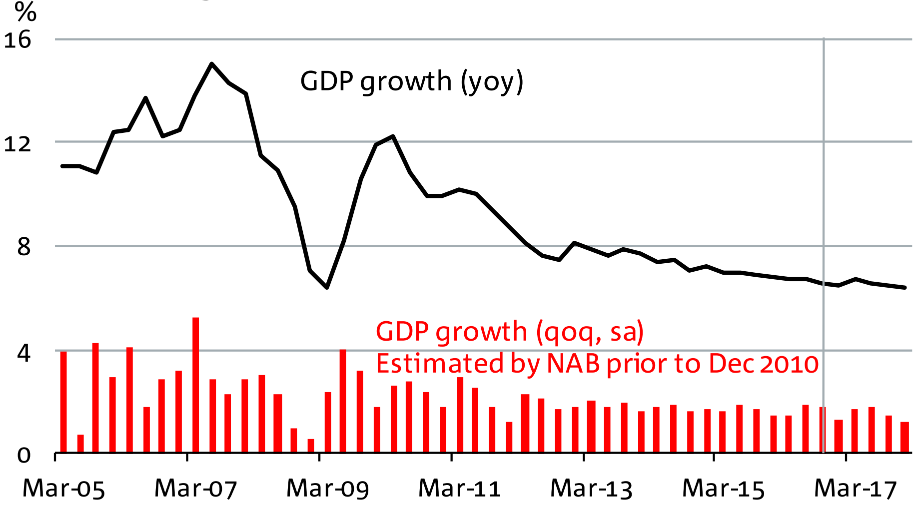
- Retail sales growth edged slightly higher in September, with growth at 10.7% yoy (up from 10.6% in August). Retail price inflation has remained subdued in recent months – meaning our estimate for real retail sales growth has remained above 10%, compared with a softer patch in early 2016.

- Headline inflation picked up in September – with the Consumer Price Index increasing by 1.9% yoy (up from a 15-month low of 1.3% in August). Producer prices rose in September – having recorded fifty-four months of falls – up by 0.1% yoy.

GROSS DOMESTIC PRODUCT

REAL GDP FLAT (AGAIN) AT 6.7% IN Q3

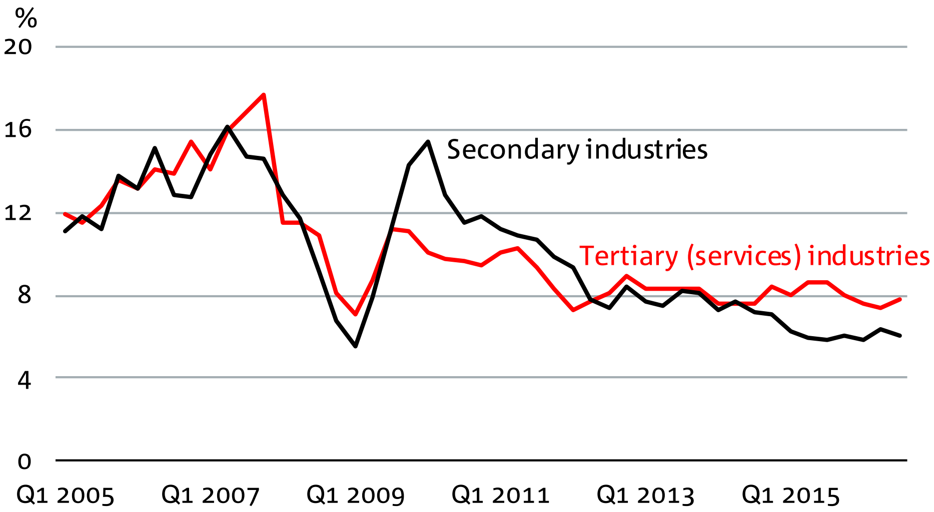
Modest easing trend to continue in 2017



Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Pick up in services – but some may be property related



Source: Datastream, NAB Economics

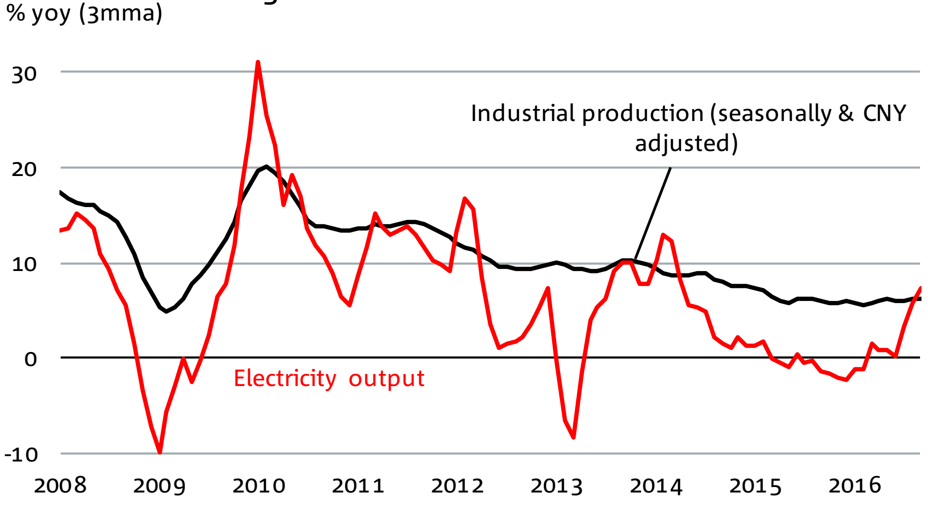
- China's official national accounts data showed no change to the country's economic growth rate in Q3, with the economy growing by 6.7% yoy – the same level recorded in both the March and June quarters. This level was in line with market expectations, and remains within Beijing's target range of 6.5% to 7.0%.
- There were signs that the construction boom of the second quarter is fading – with growth from the secondary sector slowing to 6.1% yoy (from 6.4% in Q2). In contrast, the services sector recorded slightly stronger growth, at 7.8% yoy (from 7.4% previously). That said, booming property sales may have underpinned this growth – we will be looking closely at non-real estate and non-financial services when this data becomes available. Government efforts to cool property speculation may have a negative impact on Q4 GDP growth.
- The latest data provides no reason to alter our forecasts. Given an expected easing in growth in Q4, we expect growth to average 6.6% in 2016, before easing slightly to 6.5% in 2017. As we have previously noted, the risks to this forecast are weighted to the downside next year.

%	2016	2017
GDP	6.6	6.5

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION GROWTH

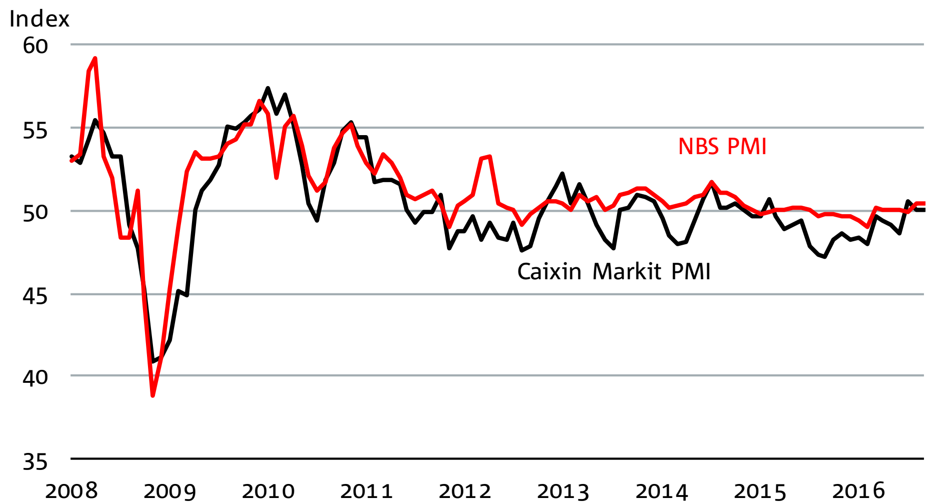
Growth remaining around trend levels



Source: CEIC, NAB Economics

PMI SURVEYS TRACK SIDEWAYS IN SEPTEMBER

NBS at 50.4 points; Caixin Markit at 50.1 points



Source: CEIC, NAB Economics

- Growth in China's industrial production slowed slightly in September, down to 6.1% yoy (compared with 6.3% in August), but still in line with recent trends. Market expectations were stronger – with respondents to the Bloomberg survey expecting growth of 6.4% yoy.

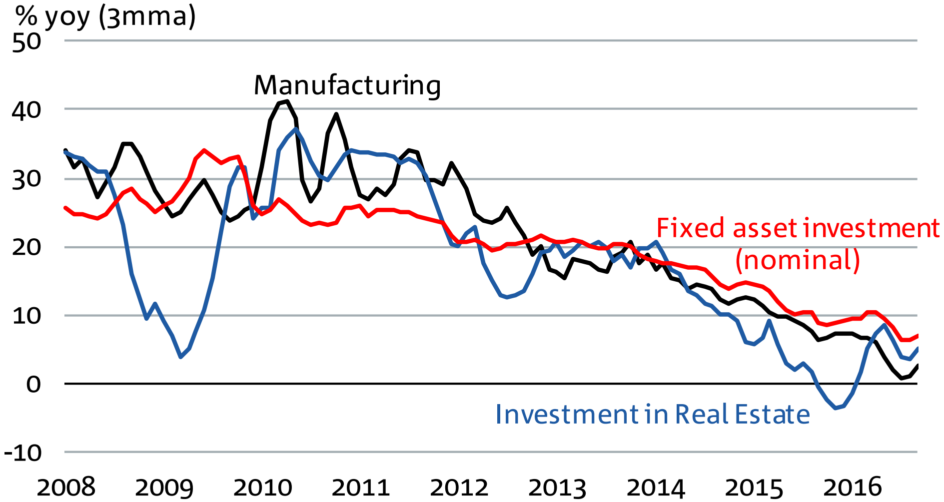
- Production trends in key industrial sectors have remained mixed. There was a slight acceleration in growth for construction related sectors such as steel and cement – up by 3.9% yoy (from 3.0% previously) and 2.9% (from 1.0% in August) respectively. In contrast, electricity output has grown strongly – up by 6.8% yoy (albeit slower growth than the 7.8% recorded in August) and motor vehicle output rose by almost 32% yoy.

- There was no significant change in the readings from China's two main industrial surveys, with both at relatively neutral levels. The official NBS PMI was unchanged at 50.4 points, the second straight month above the 50 point market. The Caixin Markit PMI was marginally stronger, at 50.1 points (from 50.0 points in August).

INVESTMENT

INVESTMENT TRENDS BY INDUSTRY

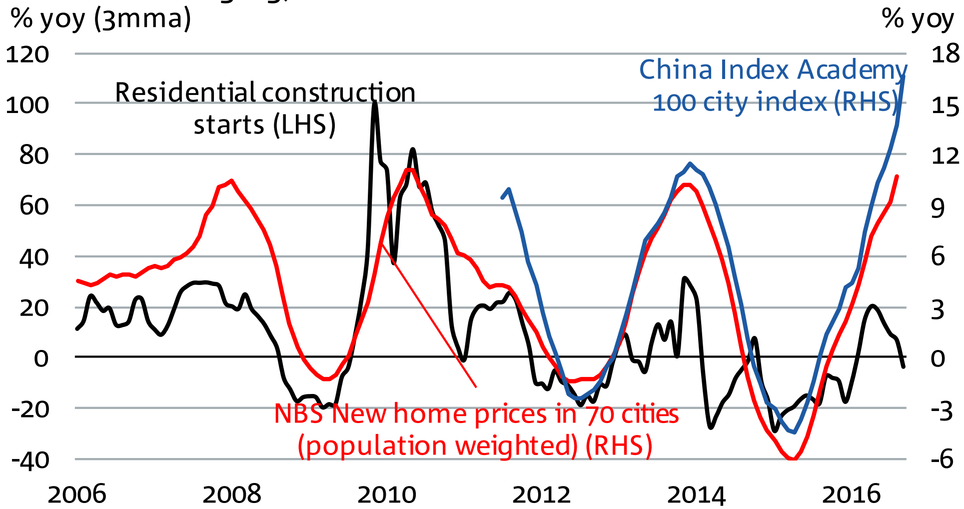
Manufacturing and real estate growth ticks up, but sub-trend



Source: CEIC, NAB Economics

PROPERTY PRICES AND CONSTRUCTION STARTS

Prices still surging, but construction starts are now in decline



Source: CEIC, Datastream, NAB Economics

- China's fixed asset investment continued its modest recovery in September – from particularly weak levels in July. Growth in investment was 8.8% yoy (up from 8.1% in August), however the overall trend remains subdued compared with the double digit growth rates recorded in early 2016.

- Private sector investment tracked slightly higher in September – at around 1.8% yoy on a three month moving average basis – but remains at extremely low levels on a historical basis. In contrast, investment by state-owned enterprises has eased a little, but remains unusually high at almost 18% yoy (3MMA).

- Key sectors such as manufacturing and real estate have recorded a slight improvement in investment growth, but their respective rates remain below the overall trend. On a three month moving average basis, investment in manufacturing grew by 2.7% yoy (up from 1.0% in August). Similarly, investment in real estate rose by 5.1% yoy (up from 3.6% previously). Combined, these two sectors accounted for almost 53% of China's total fixed asset investment in the first eight months of 2016.

- While house prices continue to grow strongly – with the China Index Academy average price up almost 17% yoy in September – and sales have remained robust, the weaker real estate investment has impacted on construction. New construction starts fell in September – down 3.7% yoy on a three month moving average basis.

- This trend may be further exacerbated by tighter regulations around house purchases – with a range of tier two and tier three cities introducing a fresh round of restrictions to cool markets. Similarly, the People's Bank of China has instructed banks to rein in mortgage credit and better manage risk. This may further cool overall investment in coming months, flowing through into weaker industrial and commodity demand.

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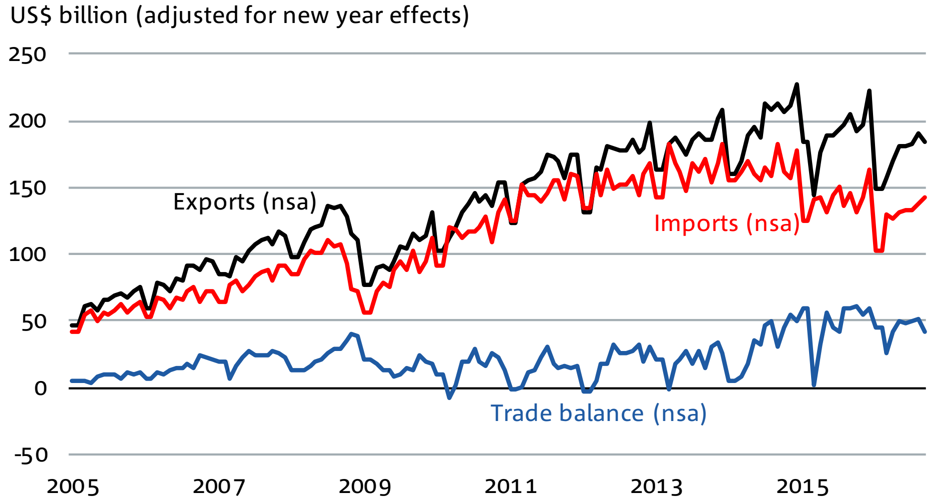
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

NARROWER TRADE SURPLUS IN SEPTEMBER

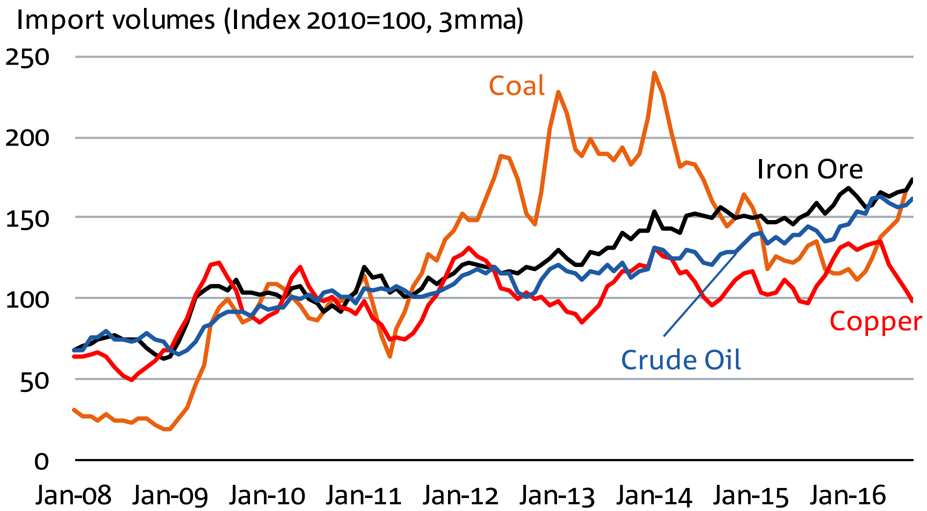
Month-on-month increase in imports, while exports eased



Sources: CEIC, NAB Economics

KEY COMMODITY IMPORT VOLUMES

Domestic supply restrictions drive coal imports higher



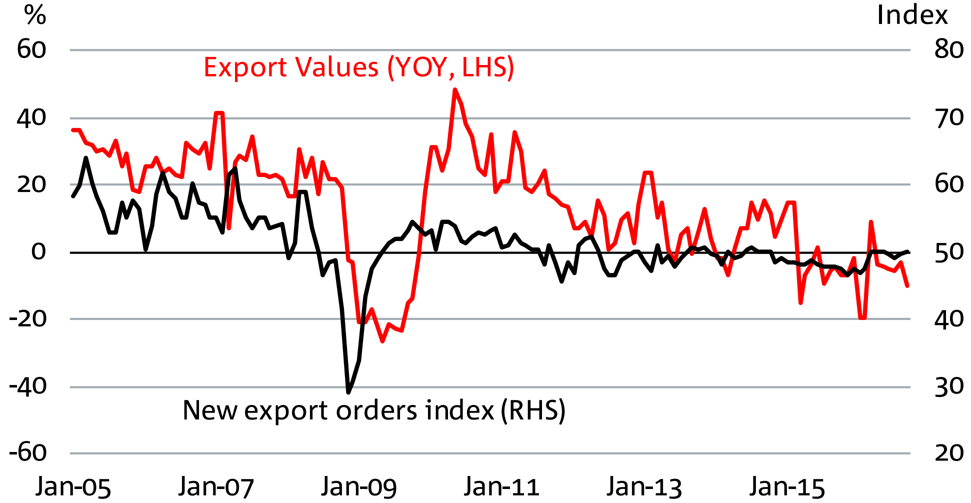
Sources: CEIC, NAB Economics

- A slight month-on-month fall in China's exports and an upturn in imports saw the country's trade surplus narrow somewhat in September – down to US$42.0 billion (from US$52.0 billion previously).
- Despite increasing when compared with levels in August, the value of China's imports fell year-on-year, down 1.9% (following on from a slight increase last month). This outcome was weaker than market expectations – with an increase of 0.6% yoy anticipated in the Bloomberg survey.
- Until recently, falling commodity prices have had a major impact on import values – driving them lower. However, commodity prices rose in September – with the RBA Index of Commodity Prices increasing by 2.3% yoy to its highest level since June 2015.
- Trends in key commodity markets have been mixed. Coal imports have surged since February – as policy changes have restricted domestic output (in an effort to improve profitability for domestic miners), forcing consumers back to global markets – with import volumes increasing by 38% yoy.
- Import volume growth was somewhat more modest for crude oil – up 18% yoy – and iron ore – up 8.0% yoy to 93 million tonnes, the second largest monthly level on record. In contrast, copper imports have fallen sharply, down 25% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS FELL IN SEPTEMBER

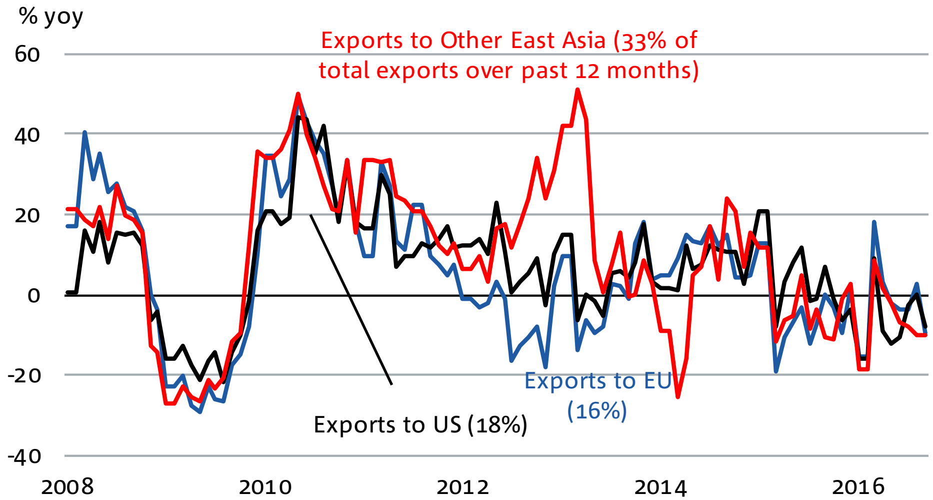
New orders remain essentially unchanged



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADE PARTNERS

Relatively uniform decline across major partners



Sources: CEIC, NAB Economics

- China's exports totalled US$184.5 billion in September (down from US$190.6 billion previously), a year-on-year decline of 10.0%. This was considerably larger than market expectations (at -3.3% yoy in the Bloomberg survey).

- This sharp fall was in stark contrast to the marginal improvement in confidence among Chinese exporters. The new export order measure in the NBS PMI survey rose to 50.1 points in September, up from 49.7 points in August.

- Exports to China's major trading partners fell relatively uniformly in September. Exports to the United States fell by 8.1% yoy, a slightly smaller decline than that recorded to the European Union (-9.8% yoy) and East Asia (-9.9% yoy).

- Unlike previous months, there was little distinction between the growth rate in exports to Hong Kong and other East Asia – with the former falling by 10.3% yoy, and the latter by 9.5% yoy. That said, reported exports to Hong Kong were at their highest level for 2016 – potentially indicating fresh capital outflow related distortions.

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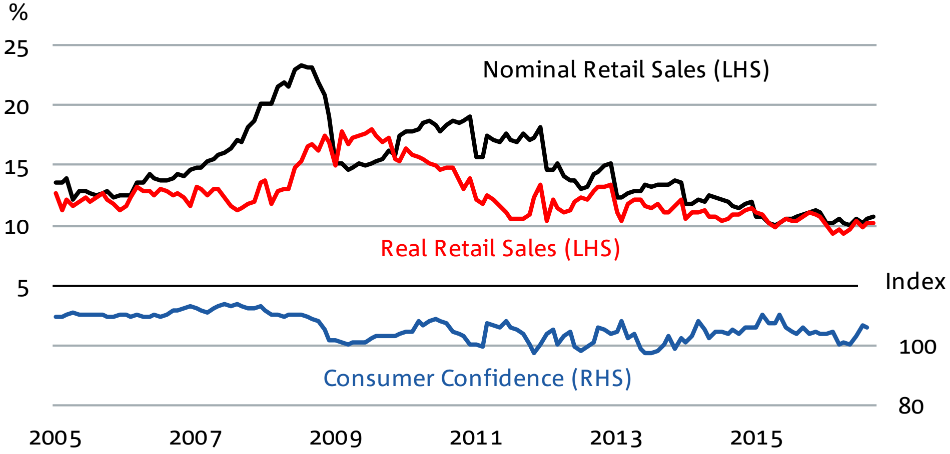
RETAIL SALES AND INFLATION

RETAIL SALES MARGINALLY HIGHER IN SEPTEMBER

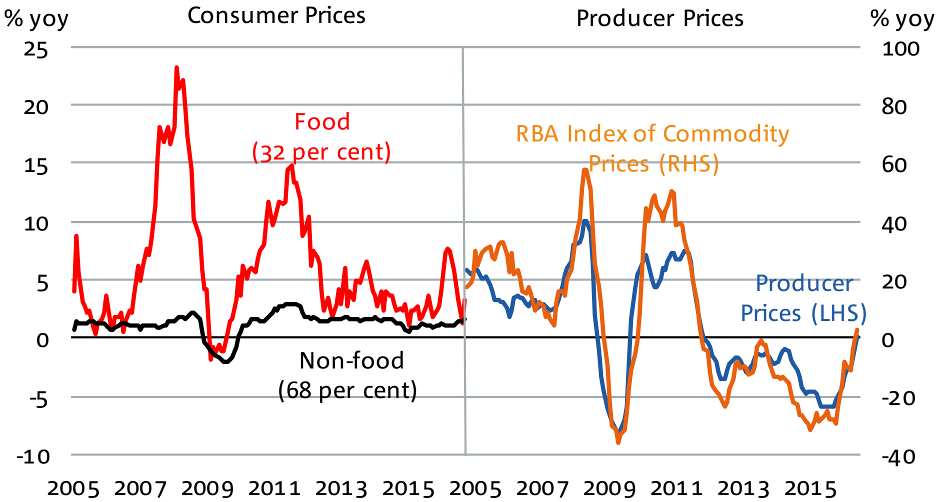
Real sales remained above 10% yoy



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

CONSUMER AND PRODUCER PRICES

Producer prices rise following 54 months of declines



Sources: CEIC, RBA, NAB Economics

- Retail sales growth edged slightly higher in September, with growth at 10.7% yoy (up from 10.6% in August). This result was in line with market expectations. Retail price inflation has remained subdued in recent months – meaning our estimate for real retail sales growth has remained above 10%, compared with a softer patch in early 2016.

- Consumer confidence was marginally lower in August – down to 105.6 points (compared with 106.8 previously) – however it remains firmly in positive territory, have moved up from fairly neutral levels recorded in May.

- Headline inflation picked up in September – with the Consumer Price Index increasing by 1.9% yoy (up from a 15-month low of 1.3% in August).

- The main driver of this acceleration was a pick up in food price inflation – with prices rising by 3.2% yoy (up from just 1.3% in August). Across much of 2016, pork prices have had a major impact on food prices, however pork price growth has eased, down to 5.8% yoy (compared with a peak of almost 34% in May). This month, the key drivers were major rebounds in fresh vegetables (up 7.5% yoy compared with -3.9% in August) and fresh fruit (6.7% yoy from -0.6% previously).

- Non-food price inflation also ticked higher in September – rising by 1.6% yoy (from 1.4% in August). In part this reflects the end of fuel price deflation – fuel prices rose by 2.0% yoy, the first increase since August 2014.

- Producer prices rose in September – having recorded fifty-four months of falls – up by 0.1% yoy. Rising commodity prices – since bottoming out in January – have influenced this trend.

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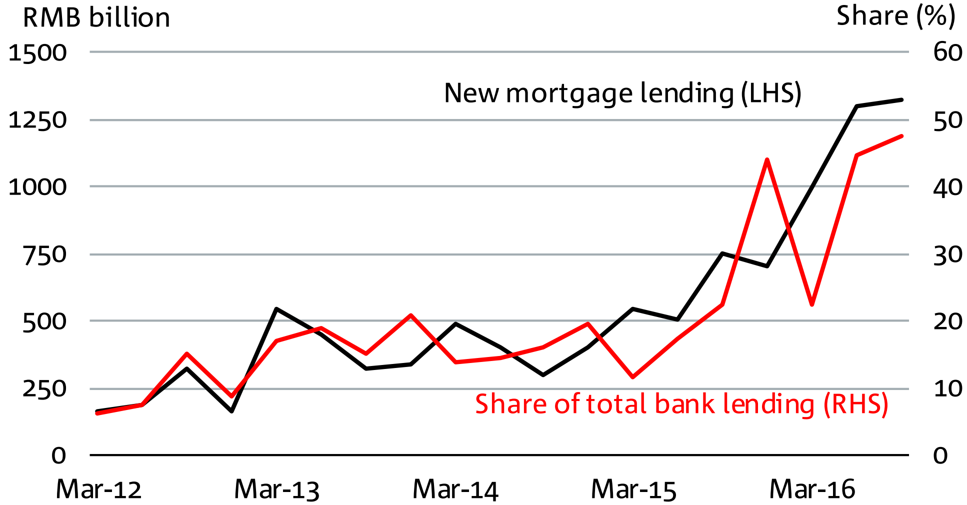
CREDIT CONDITIONS

MORTGAGE LENDING SURGING

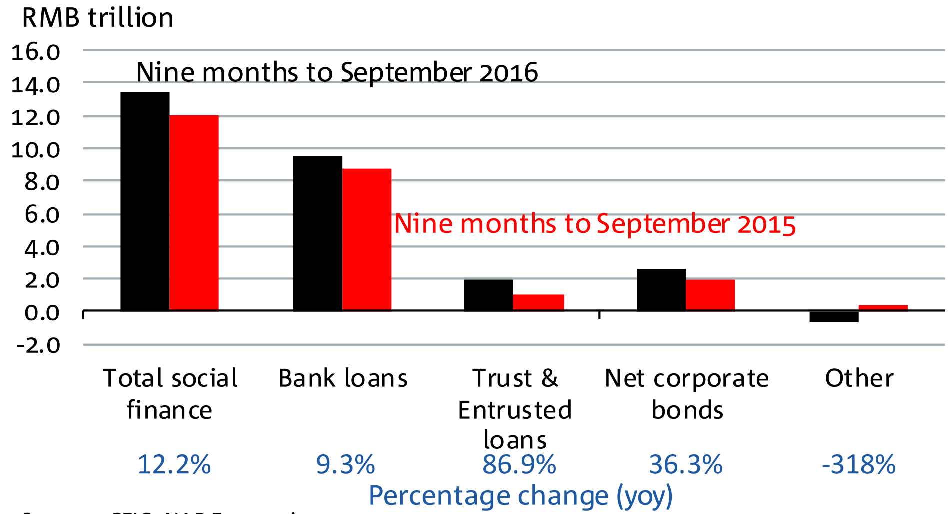
Mortgages around 36% of all lending in YTD 2016



Source: CEIC, NAB Economics

NEW CREDIT GROWTH

Slight pickup in Q3, but below Q1 binge levels



Sources: CEIC, NAB Economics

- The construction and property boom that has underpinned economic growth across the middle of 2016 has largely been fuelled by credit. Mortgage lending has surged this year, with mortgages accounting for around 36% of total bank lending over the first nine months of the year – far above the longer term trend. The People's Bank of China (PBoC) has instructed banks to rein in mortgage credit and better manage risk – which may impact credit growth in Q4.

- New credit growth was somewhat stronger in Q3 – totalling RMB 3.7 trillion (compared with RMB 3.1 trillion in Q2) – but well below the enormous credit binge seen in Q1 (RMB 6.7 trillion).

- For the first nine months of 2016, China's new aggregate financing expanded by 12.2% yoy to RMB 13.5 trillion. Bank loans continue to comprise the majority of this total – around 71% – but this share has eased, with loans increasing by 9.3% yoy. Yuan-denominated loans have grown more strongly (around 11% yoy over this period), with Chinese firms continuing to pay down foreign currency debt.

- Corporate bonds have been the second largest contributor to new credit this year – totalling RMB 2.6 trillion in the first nine months. However, new bond issuance has slowed in recent months, with growth at 36% yoy over this period, having surged in the first half (82%).

- Key shadow banking components – such as trust and entrusted loans – have grown comparatively strongly across the first nine months, at 87% yoy, however this rate of growth has also slowed in recent months. The strong growth rate has also come off a relatively low base, given tightening regulation which constrained the sector in 2015.

- Our monetary policy expectations remain unchanged – with no further cuts to the benchmark one year lending rate in 2016, and one cut in Q1 2017.

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