National Australia Bank

CHINA'S ECONOMY AT A GLANCE

NOVEMBER 2016

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CONTACT

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KEY POINTS

China's economic stability continued into October, however President Trump poses downside risks to the outlook

- The unexpected election of Donald Trump as the next United States President provides greater downside risk to our forecasts – however the uncertainty around policy means that for now they are unchanged (6.5% growth in 2017, 6.25% in 2018). It is too early to know if election rhetoric will translate into policy. The proposal during the campaign to impose a 45% tariff on all Chinese imports to the United States would have a significant impact on China's economy – but would also negatively impact the US.

- China's industrial production growth was unchanged in October – increasing by 6.1% yoy. Construction related industries – steel and cement – recorded stable growth.

- Growth in China's fixed asset investment edged a little higher in October, continuing to recover from very low levels in July. This growth is below the double digit levels of early 2016 and trend declines could resume in coming months. Private sector investment was further improved in October, but remains near historically low levels.

- China's trade surplus widened slightly in October – to US$49.1 billion. In monthly terms, both imports and exports were considerably weaker – however this largely reflected the impact of the Golden Week holidays at the start of the month.

- Retail sales growth was weaker in October, increasing by 10.0% yoy (down from 10.7% in September). Given the strengthening in inflation this month, real retail sales fell from around 9.5% yoy to an estimated 8.9% – the slowest rate of growth since August 2004.

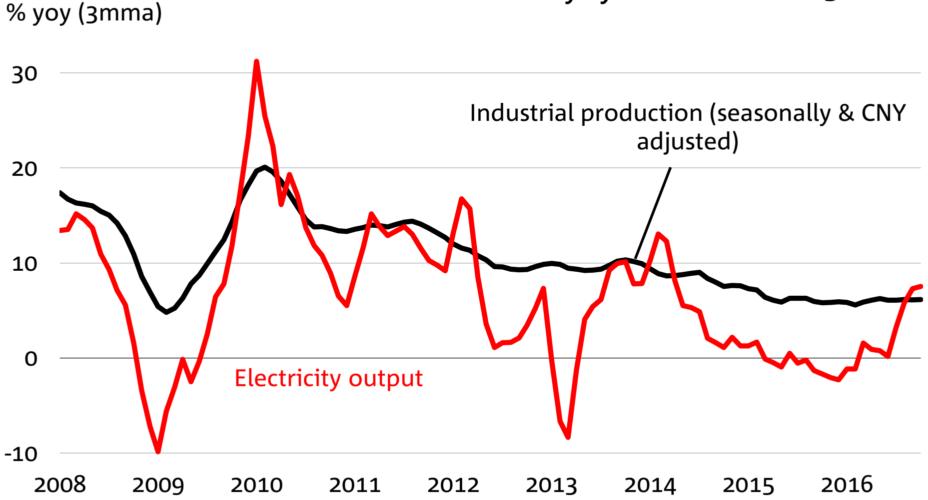
- Headline inflation accelerated in October – with the Consumer Price Index increasing by 2.1% yoy. Producer prices rose comparatively strongly in October – rising by 1.2% yoy – the largest increase since December 2011.

- New credit issuance was relatively modest in October – with aggregate financing totalling RMB 896 billion (down from RMB 1721 billion in September). The monthly decline was largely seasonal, reflecting the impact of the Golden Week holidays at the start of the month.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

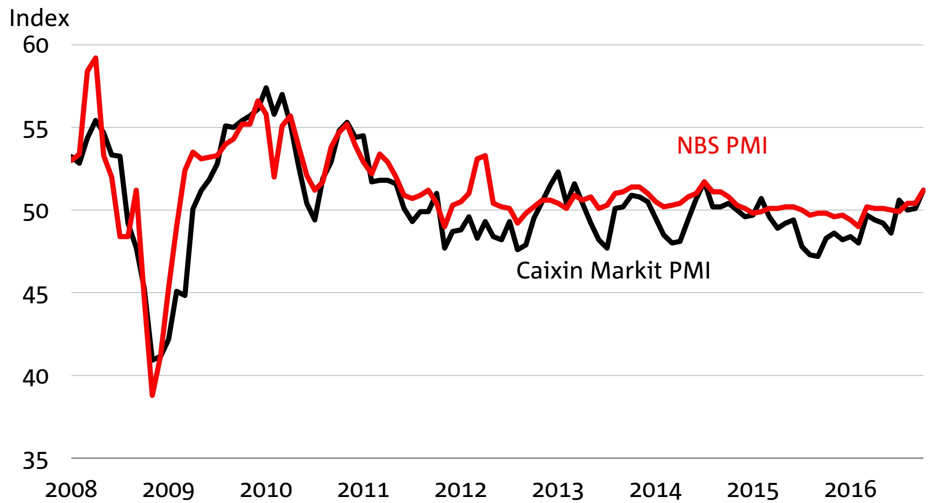
Growth has remained stable near 6% yoy since late 2015



Source: CEIC, NAB Economics

PMI SURVEYS STRONGER IN OCTOBER

Both NBS and Caixin Markit surveys at 51.2 points



Source: CEIC, NAB Economics

- China's industrial production growth was unchanged in October – increasing by 6.1% yoy. This was slightly below market expectations – with respondents to the Bloomberg survey expecting growth of 6.3% yoy.
- Growth in construction related materials remained relatively stable. Crude steel production was up 4.0% yoy (compared with 3.9% yoy in September). Similarly, cement output increased by 3.0% yoy (from 2.9% previously).
- Other major industrial sectors were mixed – with growth in motor vehicle output slowing to 18% yoy (from 32% in September), while electricity output has continued to strengthen – up by 8.0% yoy (from 6.8% in September).
- China's industrial surveys were considerably stronger in October. Both the official NBS PMI and the Caixin Markit PMI were at 51.2 points (up from 50.4 points and 50.1 points respectively in September). For both measures, this was the strongest reading since July 2014.

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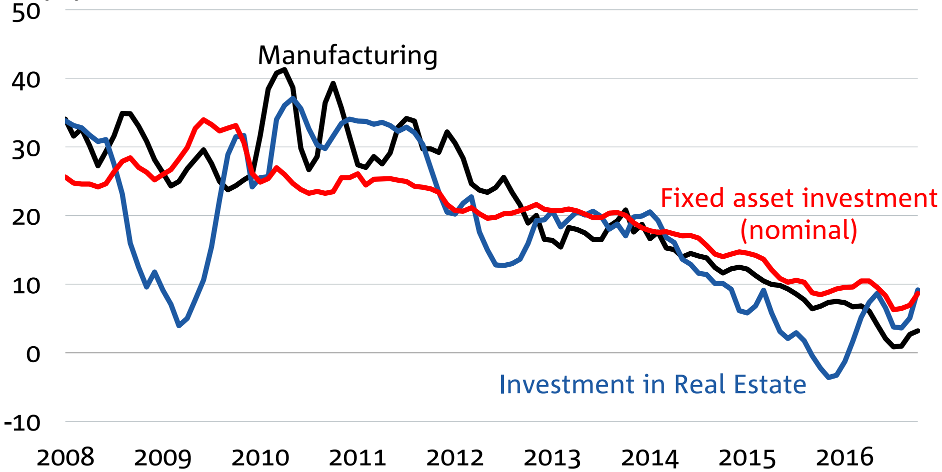
INVESTMENT

INVESTMENT TRENDS BY INDUSTRY

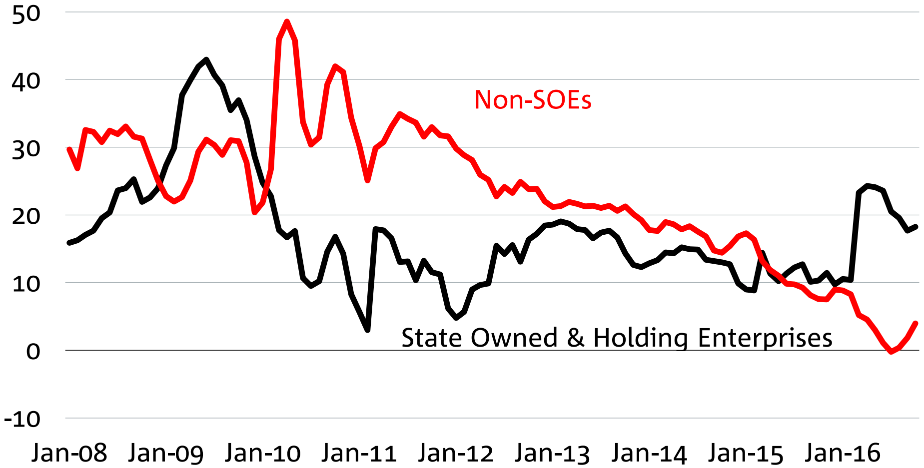
Real estate investment recovers – despite policy changes



Source: CEIC, NAB Economics

INVESTMENT TRENDS BY SECTOR

Private investment trending higher, but still historically weak



Source: CEIC, Datastream, NAB Economics

- Growth in China's fixed asset investment edged a little higher in October – to 9.0% yoy (up from 8.8% in September) – continuing to recover from very low levels in July. This growth is below the double digit levels of early 2016 and trend declines could resume in coming months.
- Private sector investment was further improved in October – with growth at around 4.0% yoy (on a three month moving average basis) – up from 1.8% previously – but remains near historically low levels. Investment by state-owned enterprises remained strong – at just over 18% yoy (3mma) in October – highlighting that short term measures to underpin growth remain in effect.
- Investment in manufacturing was marginally stronger in October – growing by 3.2% yoy (3mma), up from 2.7% in September.
- Investment in real estate has strengthened in recent months – despite the growing international concerns of a property bubble. On a three month moving average basis, real estate investment increased by 9.2% yoy in October (up from 5.1% in August). This was despite tighter regulation on house purchases in a range of tier 2 and 3 cities and instructions from the People's Bank of China to rein in bank mortgage credit.
- House prices continued to grow in October, however the rate of growth stabilised on a monthly basis. The China Index Academy average of 100 cities rose by 2.2% month-on-month in October (unchanged from September), with price growth in tier 1 cities slowing from 2.6% mom to 2.2%. Housing sales remained strong in October, up 28% yoy (3mma), while construction starts declined by 0.6% yoy (3mma) – more modestly than the 3.7% fall in September.
- We continue to expect a cooling in residential construction in coming months, with investment in the industry providing less support for economic growth.

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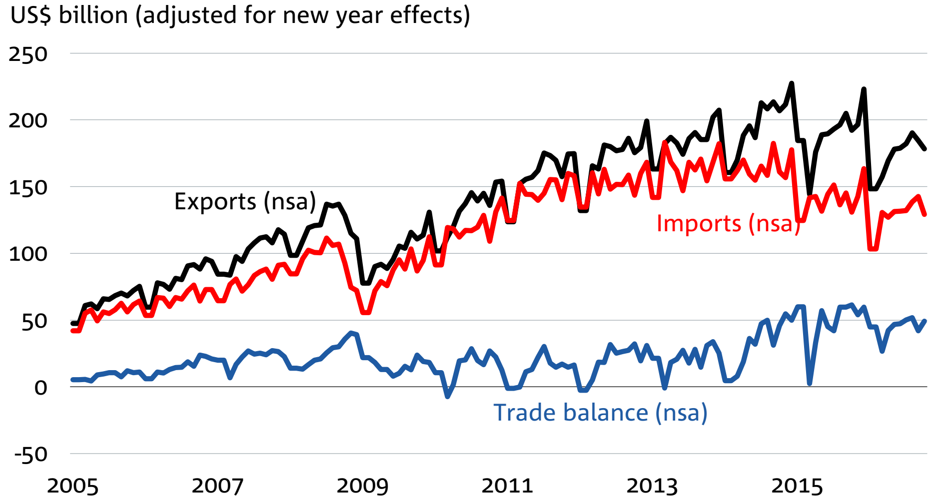
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS MARGINALLY WIDER IN OCTOBER

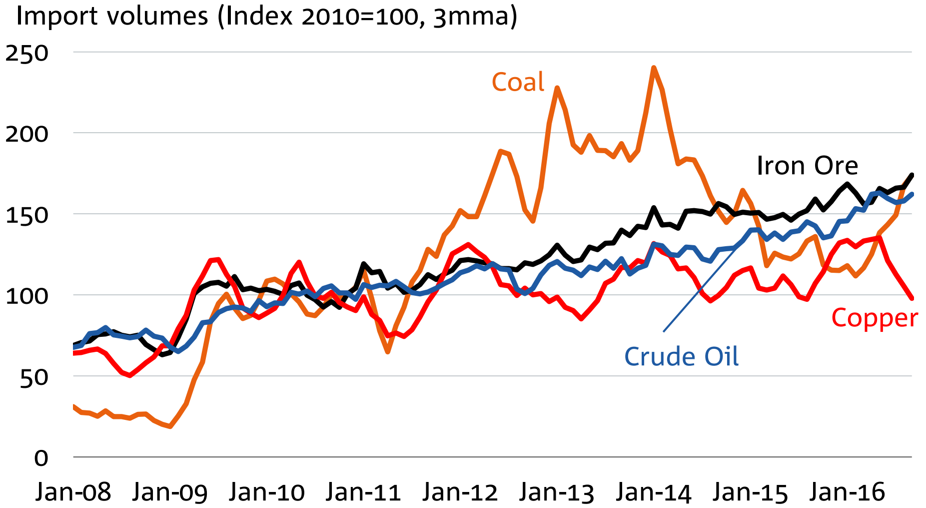
Imports & exports narrow monthly on Golden Week holidays



Sources: CEIC, NAB Economics

KEY COMMODITY IMPORT VOLUMES

Iron ore & oil climb, coal's rebound continues



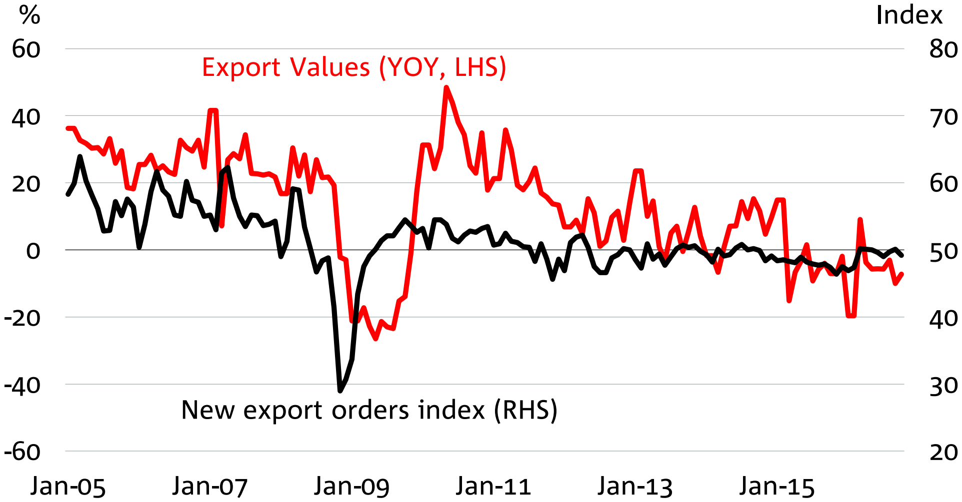
Sources: CEIC, NAB Economics

- China's trade surplus widened slightly in October – to US$49.1 billion (from US$42.0 billion previously). In monthly terms, both imports and exports were considerably weaker – however this largely reflected the impact of the Golden Week holidays at the start of the month.
- The value of China's imports fell slightly in October – down by 1.4% yoy to US$129.1 billion (compared with US$142.5 billion in September). This outcome was broadly in line with market expectations – with a decline of 1.0% yoy in the Bloomberg survey.
- Commodity prices are no longer having a negative impact on import values. In October, the RBA Index of Commodity Prices rose by 14.0% yoy (up from 3.4% previously) – with China's return to seaborne coal markets (following domestic production cuts) having had a major impact.
- Coal import volumes rose by 55% yoy. We expect that the surge in coal prices – particularly metallurgical coal consumed in the steel industry – will encourage Chinese authorities to ease current policy restrictions on coal miners – leading to lower imports in coming months.
- Import volumes for other key commodities were mixed. Crude oil rose by 9.3% yoy and iron ore volumes rose by 7.0% yoy. In contrast, copper imports fell sharply, down by 32% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS HAVE CONTINUED TO WEAKEN

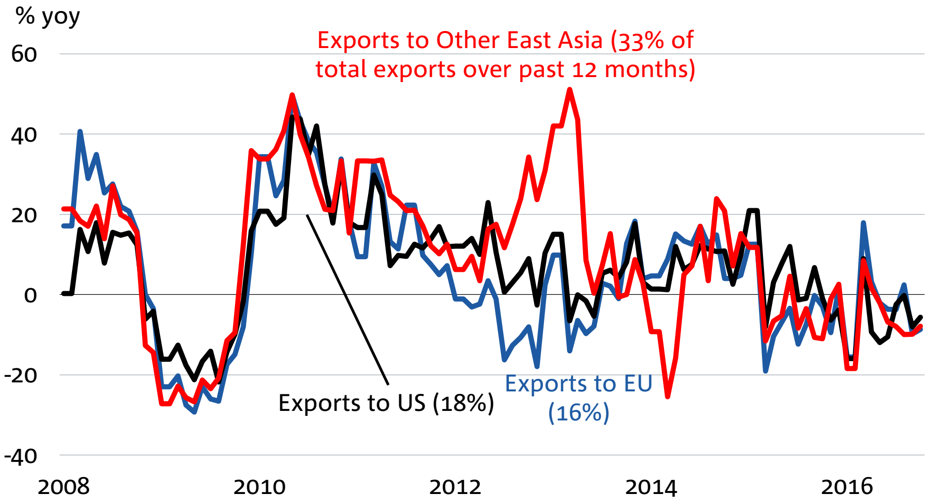
New orders dip back into negative territory



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADE PARTNERS

All major trading partners recorded declines in October



Sources: CEIC, NAB Economics

- The value of China's exports totalled US$178.1 billion in October (down from US$184.5 billion in September) – a year-on-year decline of 7.3% yoy. As with imports, export values were similar to market expectations (at 6.0% yoy in the Bloomberg survey).

- Confidence among exporters was somewhat weaker in October – with the new export order measure of the NBS PMI survey down to 49.2 points (from 50.1 points in September).

- Exports to China's major trading partners fell in October. The smallest decline was in exports to the United States – at 5.6% yoy – while exports to East Asia fell by 7.9%. The largest decline was to the European Union, down by 8.7% yoy.

- Within Asia, exports to Hong Kong fell more rapidly (down 10.0% yoy) than the rest of East Asia (6.3% yoy). That said, the inconsistency between China Customs and Hong Kong Customs data has increased in recent months. Last month, Hong Kong Customs reported a 1.1% yoy increase in exports, compared with a 10.4% decrease in China's official data – reflecting the surge in capital outflows in Q4 2015 that could be distorting the Chinese data.

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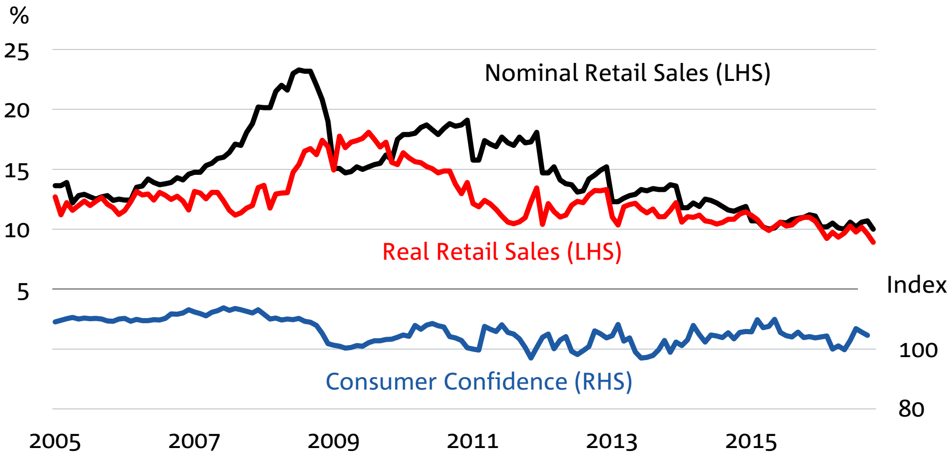
RETAIL SALES AND INFLATION

RETAIL SALES WEAKER IN OCTOBER

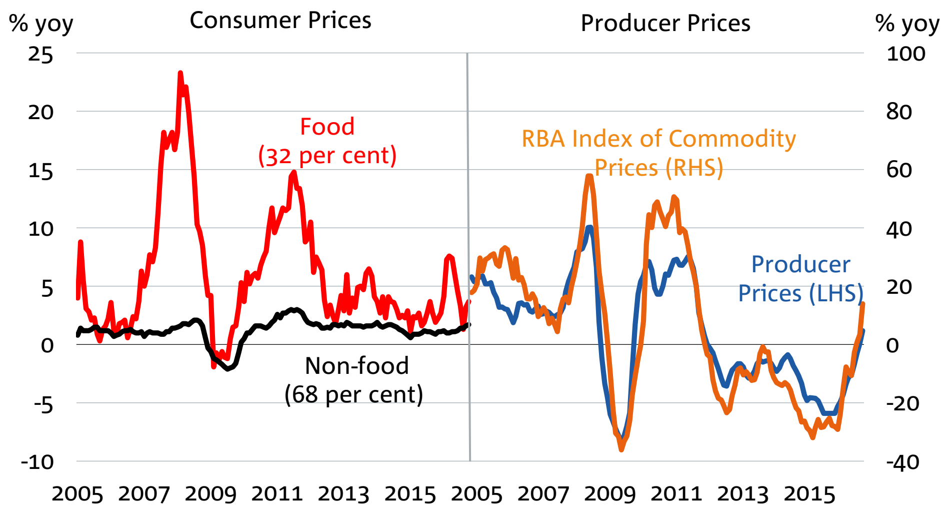
Real sales drop to 12 year low of 9%



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

CONSUMER AND PRODUCER PRICES

Stronger inflation on food and commodity prices



Sources: CEIC, RBA, NAB Economics

- Retail sales growth was weaker in October, increasing by 10.0% yoy (down from 10.7% in September). This undershot market expectations, which were expecting a stable rate of growth at 10.7% yoy (in the Bloomberg survey). Given the strengthening in inflation this month (see below), real retail sales fell from around 9.5% yoy to an estimated 8.9% – the slowest rate of growth since August 2004.
- That said, consumer confidence remained comparatively strong in September – at 104.6 points (down from 105.6 points in August) – firmly in positive territory, compared with neutral levels in early 2016.
- Headline inflation accelerated in October – with the Consumer Price Index increasing by 2.1% yoy (compared with 1.9% in September) – the strongest increase since April 2016.
- Food price inflation was stronger in October – with aggregate prices increasing by 3.7% yoy (up from 3.2% previously). The main contributor to the increase in food prices wasfresh vegetables – which rose by 13% yoy (compared with 7.5% in September). In contrast, pork price growth was softer – at 4.8% yoy (down from 5.8% in September and double digit growth across the first seven months of the year).
- Non-food price inflation edged higher in October – with prices rising by 1.7% yoy (from 1.6% previously) – the strongest rate of growth since June 2014. Fuel prices have risen for the past two months – following on from declines starting in September 2014.
- Producer prices rose comparatively strongly in October – rising by 1.2% yoy (from 0.1% in September). This was the largest increase in producer prices since December 2011. Commodity prices rose sharply in October – up 14% on surging coal prices – contributing to this trend.

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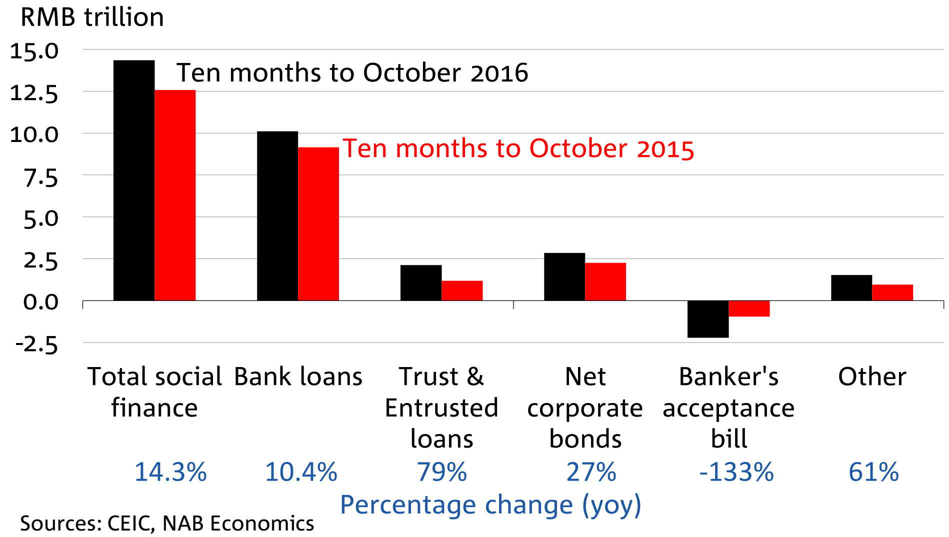
CREDIT CONDITIONS

NEW CREDIT GROWTH

Banks account for the bulk of new lending in 2016



Sources: CEIC, NAB Economics

- New credit issuance was relatively modest in October – with aggregate financing totalling RMB 896 billion (down from RMB 1721 billion in September). The monthly decline was largely seasonal, reflecting the impact of the Golden Week holidays at the start of the month.
- Over the first ten months of 2016, China's aggregate financing expanded by 14.3% yoy to RMB 14.4 trillion. Bank loans continue to account for the majority of this total – almost 74% – having increased by 10.4% yoy over the period. Yuan denominated loans have grown more strongly – up 11.0% yoy to RMB 10.6 trillion, while firms have continued to pay down foreign currency debt.
- The second largest contributor to new credit in 2016 has been corporate bonds – which totalled RMB 2.8 trillion over the first ten months. New bond issuance surged across the first half of the year (up 82% yoy), however growth has steadily slowed – up by 27% yoy over the ten month period.
- Trust and entrusted loans – major components of the shadow banking sector – have grown strongly, up 79% yoy in the first ten months of 2016 to RMB 2.1 trillion. That said, this was off a relatively low base, given the tighter regulation that constrained the sector in 2015. In contrast, banker's acceptance bills have plunged – withdrawing around RMB2.2 trillion from the system.
- 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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