CHINA'S ECONOMY AT A GLANCE

APRIL 2017

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CONTACT

Gerard Burg, Senior Economist - Asia

KEY POINTS

An improving US-China relationship provides a better environment for China's economy

- Presidents Trump and Xi met in an early April summit, leading to an improvement in the diplomatic relationship between the United States and China (which had been negatively affected by strong rhetoric during the Trump campaign). The summit produced an agreement to initiate 100 days of trade talks – with the US seeking greater access for US beef as well as an opening up of competition within the finance sector. Following the summit, the US Treasury's bi-annual report on foreign exchange policies did not cite China as a currency manipulator (despite Trump's election pledge to do so). Combined, these positive diplomatic trends reduce the likelihood of a trade war between the United States and China – which would have negatively impacted both economies.

- China's economic growth was marginally stronger than expected in Q1 2017 – at 6.9% yoy. While this strong result provides some upside risk to our forecasts, they are unchanged this month (6.5% in 2017). The transition in China's economy continues – with the services sector recording faster than average growth in Q1. In 2015 prices, we estimate that services accounted for around 56% of China's economy in Q1.

- China's industrial production growth accelerated in March, up to 7.6% yoy (from 6.3% over the January-February period). This growth was well above market expectations and was the strongest rate since December 2014.

- China's fixed asset investment recorded stronger nominal growth in March – at around 9.2% yoy (compared with 8.9% over the January-February period). That said, investment goods prices have recorded much stronger inflation in recent months – echoing trends in producer prices and commodity markets – meaning that real investment has trended close to zero growth since December 2016.

- China's trade balance was only marginally wider in March – at US$23.9 billion (up from a smoothed US$20.8 billion across January and February). This surplus is well below the levels recorded across much of the period between 2014 and 2016, but may reflect more accuracy in trade data in early 2017. It is likely that exports to Hong Kong have previously been overstated – due to capital outflows disguised as trade activity – though there was minimal discrepancy in the data for January-February.

- Retail sales accelerated in March, with nominal growth rising to 10.9% yoy (up from 9.6% during the January-February period). Given the softer inflation trends this month, this has pushed real retail sales growth back to 10% yoy – the trend level across 2015 and 2016.

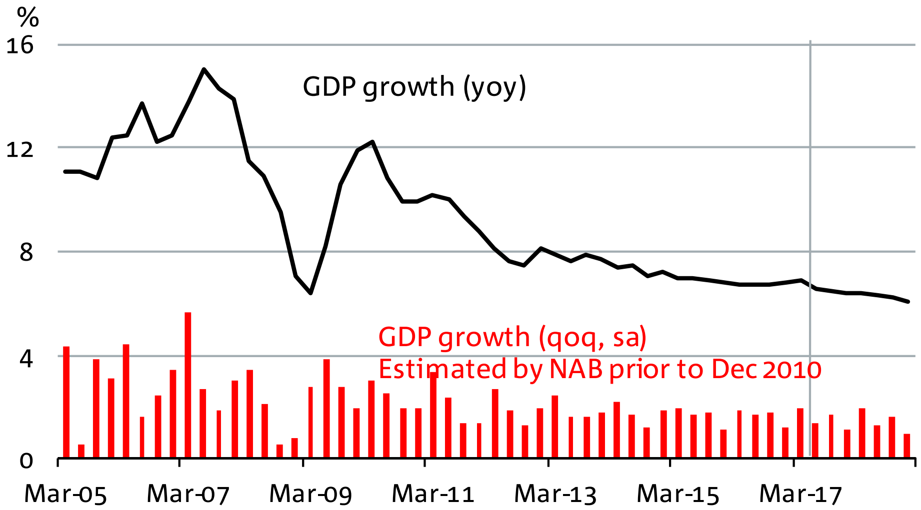
- China's credit growth was relatively modest in Q1 2017, increasing by4.3% yoy, to total RMB 7.0 trillion. This reflected weak credit in March, following on from strong growth in the first two months. Growth in bank loans was comparatively modest, while shadow banking sectors recorded far stronger growth, driven by a rebound in banker's acceptance bills.

- The People's Bank of China has continued to gradually tighten monetary policy – increasing the interest rate on the Standing Lending Facility and the 7 day reverse repo was raised to 2.45% between mid-March and early April. The 7 day Shibor is up around 20 basis points since the start of the year, albeit off its late March peak.

GROSS DOMESTIC PRODUCT

REAL GDP ACCELERATED TO 6.9% IN Q1 2017

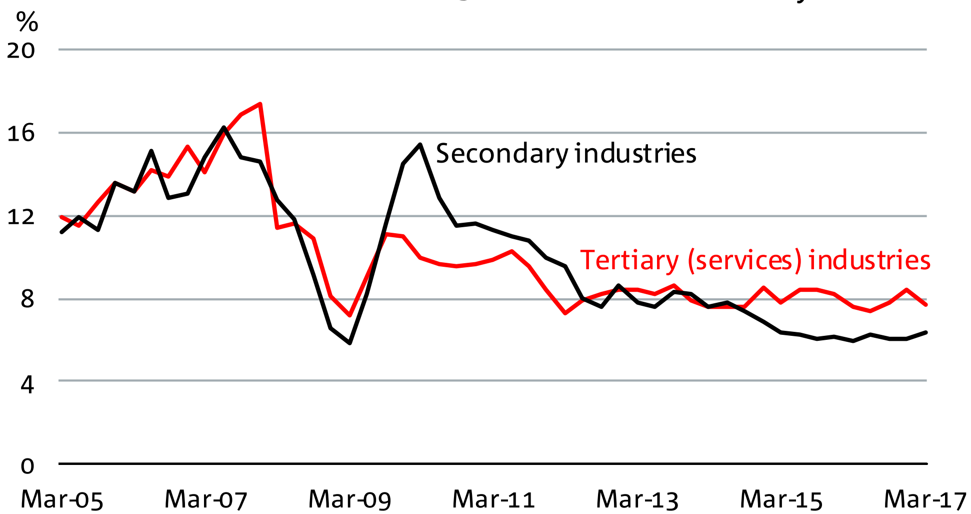
Upside risk to forecast of slowing growth



Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Services accounted for around 56% of China's economy in Q1



Source: Datastream, NAB Economics

- China's latest national accounts data showed a slight acceleration in economic growth, with gross domestic product growing by 6.9% yoy in Q1 (up from 6.8% in Q4 2016). This result was slightly faster than market expectations (at 6.8% in the Thomson Reuters poll).
- The transition in China's economy continues – with the services sector recording faster than average growth at 7.7% yoy in Q1. In 2015 prices, we estimate that services accounted for around 56% of China's economy in Q1. In contrast, secondary industries (manufacturing and construction) – the core of China's old economy – grew by 6.4% yoy, faster than in 2016, but slower than average, meaning the sector continues to lose share.
- The strong start to the year – well above the government's target of 'around 6.5% or higher if possible' – means that there is some upside risk to our forecasts. That said, the construction led boom across the middle of 2016 might result in some cooling in growth in coming quarters, and therefore our forecasts are unchanged, with growth of 6.5% in 2017.

NAB GDP FORECASTS

%	2017	2018	2019
GDP	6.5	6.25	6.0

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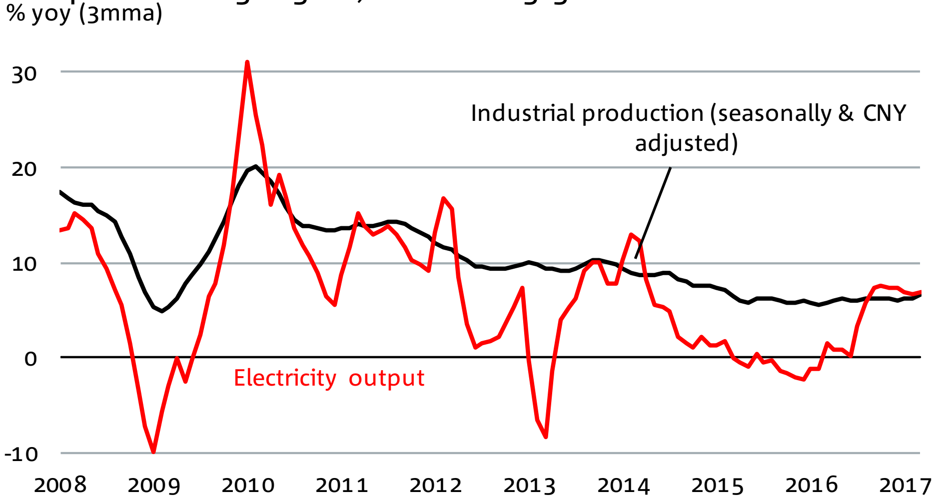
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

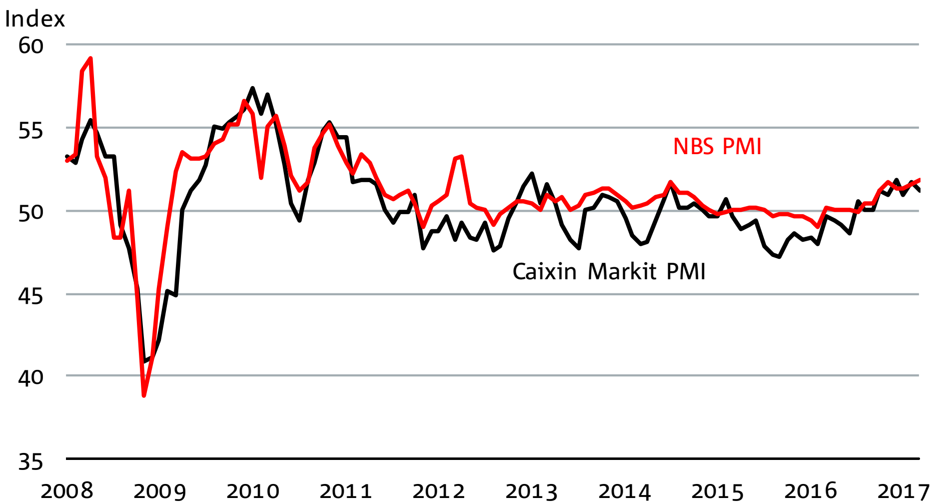
Output trending higher, with strong growth in March



Source: CEIC, NAB Economics

PMI SURVEYS

Robust conditions for manufacturers in Q1 2017



Source: CEIC, NAB Economics

- China's industrial production growth accelerated in March, up to 7.6% yoy (from 6.3% over the January-February period). This growth was well above market expectations (at just 6.3% in the Thomson Reuters poll), and was the strongest rate since December 2014.
- Despite the strong overall growth, growth in some major industrial sectors was comparatively weak. Motor vehicle output recorded slower growth at 4.8% yoy (down from around 11% yoy in January-February), while growth in crude steel was also softer (1.8% yoy, down from 5.3% over the first two months).
- Other sectors saw stronger growth – with electricity output accelerating to 7.2% yoy in March (from 6.3% yoy during January-February), while cement output was up by 0.3% yoy (compared with a contraction of 0.4% previously).
- China's major industrial surveys recorded robust results across the first quarter – particularly in contrast to the conditions across much of 2015 and 2016. The official NBS PMI survey was marginally stronger in March – at 51.8 points (from 51.6 points previously), while the Caixin Markit PMI was down a little – at 51.2 points (from 51.7 points in February).

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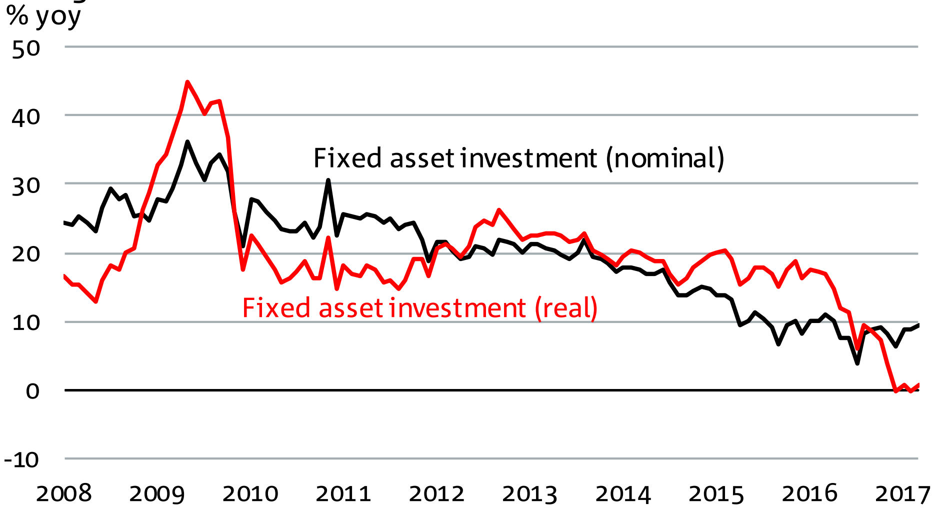
INVESTMENT

FIXED ASSET INVESTMENT

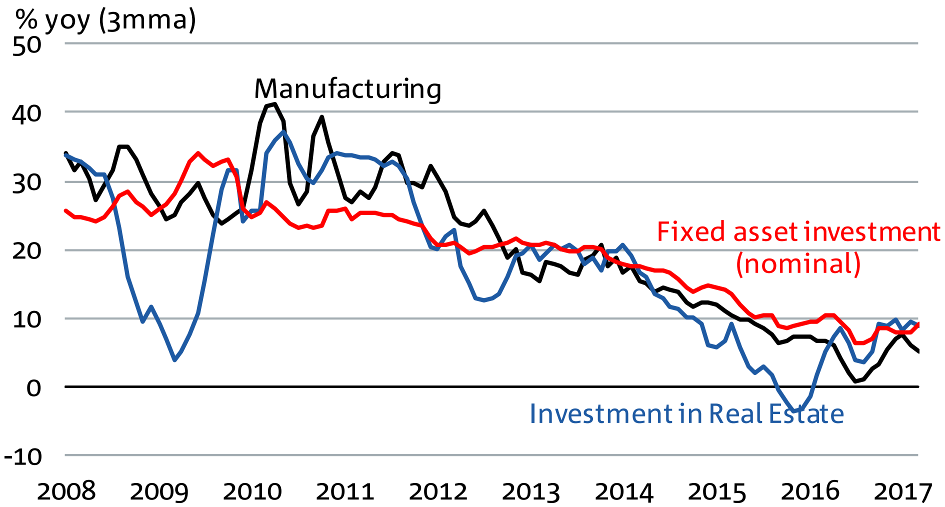
Rising inflation drives real investment towards zero since late '16



Source: CEIC, NAB Economics

INVESTMENT TRENDS BY INDUSTY

Real estate investment continues to defy slowing price growth



Source: CEIC, NAB Economics

- China's fixed asset investment recorded stronger nominal growth in March – at around 9.2% yoy (compared with 8.9% over the January-February period). That said, investment goods prices have recorded much stronger inflation in recent months – echoing trends in producer prices and commodity markets – meaning that real investment has trended close to zero growth since December 2016. Real growth was around 0.6% yoy in March, from 0.2% across January-February.

- Investment trends were mixed in key sectors . Real estate investment has remained robust (in nominal terms) – rising by 9.1% yoy (on a three month moving average basis), while investment in manufacturing slowed to 5.2% yoy (3mma) (from 6.2% last month).

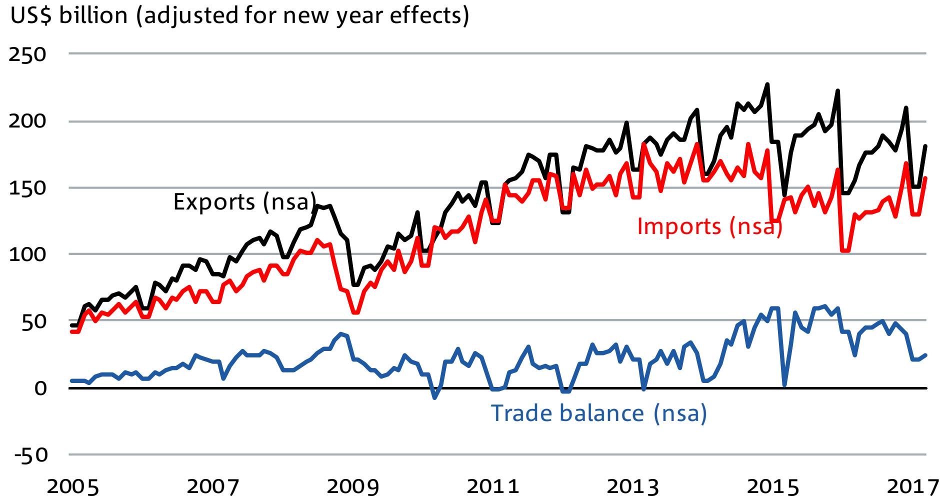
- Efforts to address concerns of property price bubbles have been relatively effective in slowing price growth – population weighted average prices rose by just 0.2% month-on-month in February, with no growth in tier 1 cities – but have failed to slow investment and construction activity. New construction starts rose by 18.1% yoy (3mma) in March, having accelerated from almost 12% yoy in January. We anticipate tightening regulations around the residential property sector will slow construction activity in coming months – with flow on effects to the industrial sector and demand for commodities – but construction has remained strong than expected for a number of months.

- Private sector investment has continued to trend higher in recent months – up to 7.0% yoy (3mma) in March – compared with the stalled investment growth in mid-2016. Investment by state-owned enterprises was also stronger in March – up by 13.6% yoy (3mma), from 9.9% in February – but well below the surging levels recorded across the middle of last year.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS MARGINALLY WIDER IN MARCH

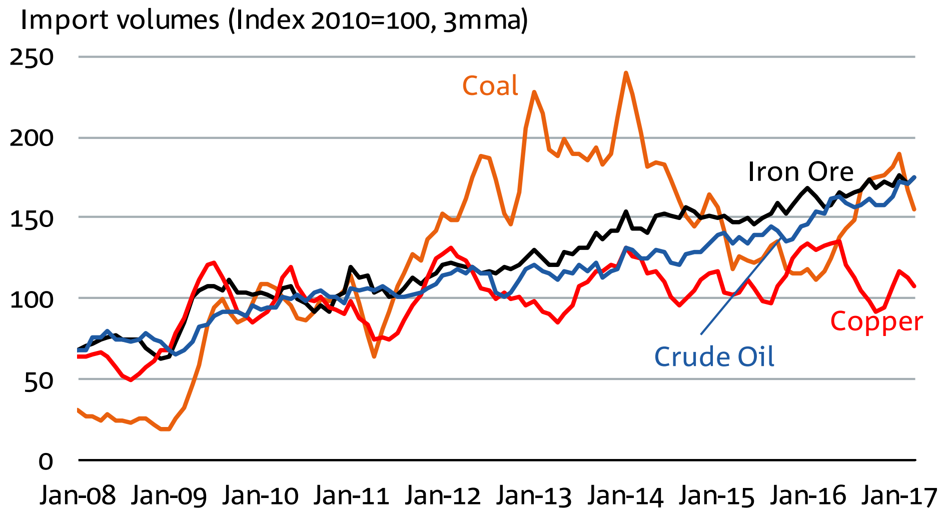
Both exports and imports stronger following Chinese new year



Sources: CEIC, NAB Economics

IMPORT VOLUMES MIXED BY MAJOR COMMODITY

Iron ore & crude oil strong, coal coming off recent peaks



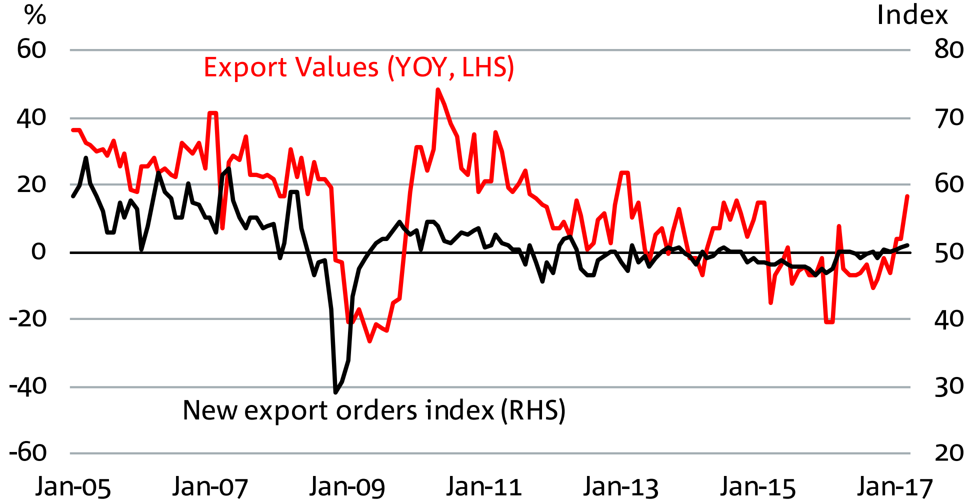
Sources: CEIC, NAB Economics

- China's trade balance was only marginally wider in March – at US$23.9 billion (up from a smoothed US$20.8 billion across January and February). This surplus is well below the levels recorded across much of the period between 2014 and 2016, but may reflect more accuracy in trade data in early 2017.
- China's imports rose strongly in March – up 20.3% yoy to US$156.7 billion, however this growth was lower than the rate across January and February (at 26.3%). Higher commodity prices have contributed to this increase – with the RBA Index of Commodity Prices rising by 46% yoy in March.
- The bulk of the increase in import values appears to be price related. Our estimate of import volumes suggests that they increased by around 6.5% yoy in March, down from over 11% yoy across the first two months of the year.
- Trends for import volumes by key commodity remain mixed. Coal imports rose by 12% yoy, however this rate of growth has slowed substantially over the past few months. Overall volumes were around 18% lower than the peak recorded in November 2016 – with domestic coal supply improving following the relaxation of restrictions on Chinese coal mines.
- Crude oil and iron ore continued to record robust volume growth – up 19% yoy and 11% yoy respectively, while copper imports have continued to fall, down by 25% yoy in March.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS SHARPLY STRONGER IN MARCH

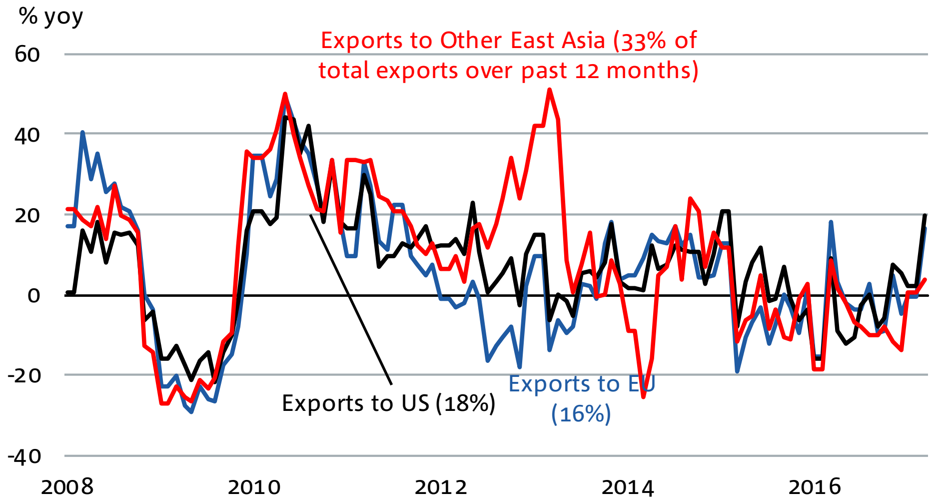
Confidence up to the strongest level since early 2012



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADE PARTNERS

Weak Hong Kong data drags down East Asian growth



Sources: CEIC, NAB Economics

- China's exports rose strongly in March – totalling US$180.6 billion – an increase of 16% yoy (compared with just 3.8% across the first two months of the year).

- Confidence among exporters has moved higher in recent months – with the new export order measure in the NBS PMI survey up to 51 points in March (from 50.8 points in February) – the strongest reading since April 2012.

- Growth trends differed considerably between major trading partners. Exports to the United States recorded the strongest growth in March – at almost 20% yoy – while exports to the European Union also recorded a sharp rise – at almost 17% yoy. In contrast, exports to East Asia rose comparatively modestly, at 3.8% yoy.

- Within the East Asian economies, there was a stark difference between exports to Hong Kong (which fell by 4.8% yoy) and non-Hong Kong East Asia – which recorded growth of 10.2% yoy. The largest increases in this category were recorded in South Korea and Indonesia.

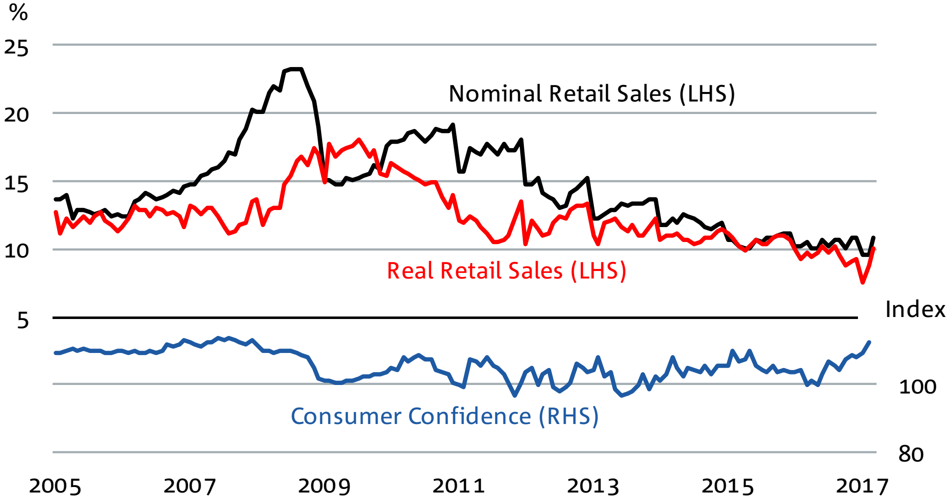
- We have previously noted significant distortions in official trade data between Hong Kong customs and China customs – although the distortion was minimal in the January-February period. It is likely that exports to Hong Kong have previously been overstated – due to capital outflows disguised as trade activity.

- An improved relationship between the US and China – following the Trump-Xi summit – and the US Treasury's failure to label China a currency manipulator reduces the likelihood of a trade war between the two countries in the short term – a major positive for China's economy.

RETAIL SALES AND INFLATION

REAL RETAIL SALES BACK TO 10% GROWTH

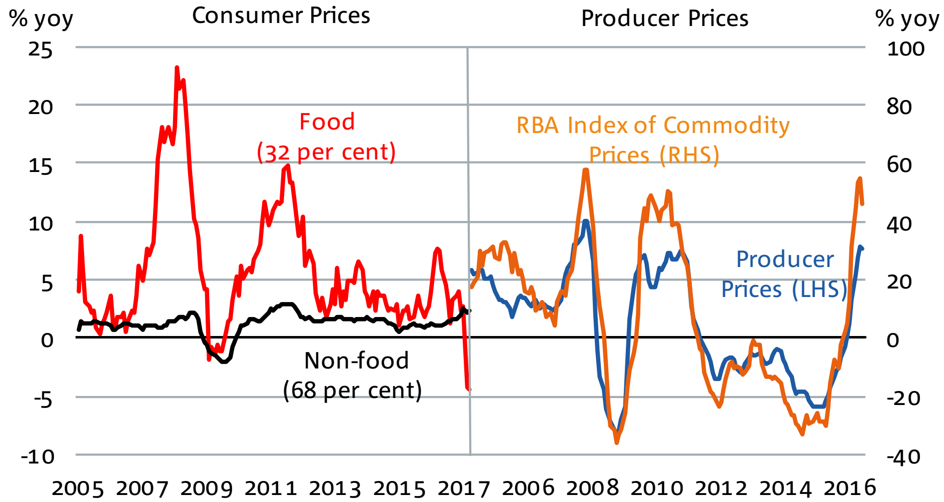
Confidence at highest levels in almost a decade



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Food constraining CPI inflation; commodities driving PPI



Sources: CEIC, RBA, NAB Economics

- Retail sales accelerated in March, with nominal growth rising to 10.9% yoy (up from 9.6% during the January-February period). Given the softer inflation trends this month, this has pushed real retail sales growth back to 10% yoy (from around 8.1% in the first two months of the year) – the trend level across 2015 and 2016.

- Consumer confidence continued to trend higher since the early months of 2016 – up to 112.6 points in February (from 109.2 points in January), the highest level since December 2007.

- China's headline inflation remained comparatively weak in March, with the Consumer Price Index rising by just 0.9% yoy (up from 0.8% in February).

- As was the case in February, food prices recorded deflation – with aggregate food prices falling by 4.4% yoy (compared with -4.3% last month). The largest falls in prices were for fresh vegetables and eggs – down 28% yoy and 12% yoy respectively – while pork prices fell by 3.2% yoy.

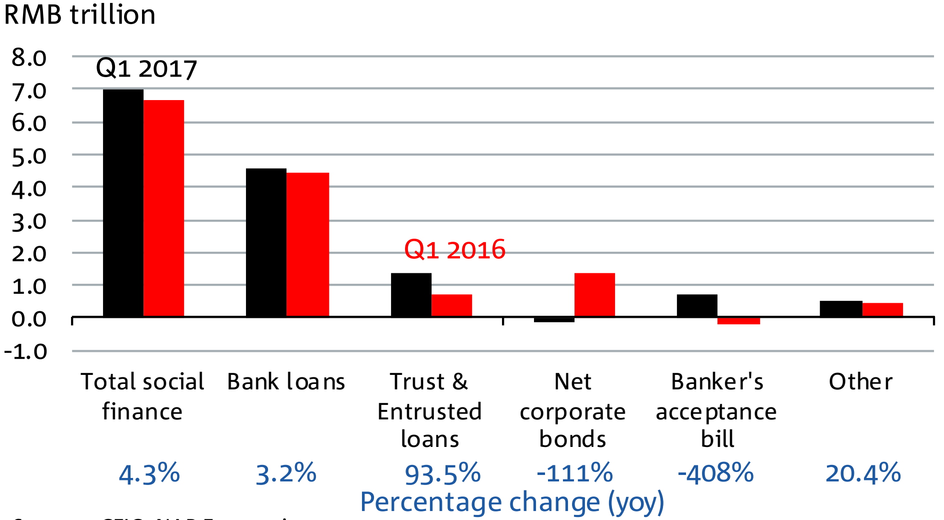
- In contrast, non-food prices have continued on a gradual upward trend (from weak levels across much of 2016) – with the index rising by 2.3% yoy in March (from 2.2% in February). Fuel prices have increased strongly over the past few months – having declined through much of 2016.

- Producer price growth was slightly weaker than February's peak – albeit still strong – with the index rising by 7.6% yoy (down from 7.8% last month). Global commodity price trends continue to influence producer prices – with the RBA Index of Commodity Prices increasing by 46% yoy in March (down from 55% in February). Commodity price increases are likely to become smaller in coming months due to higher base levels (given that January 2016 was the trough of the most recent cycle).

CREDIT CONDITIONS

NEW CREDIT GROWTH

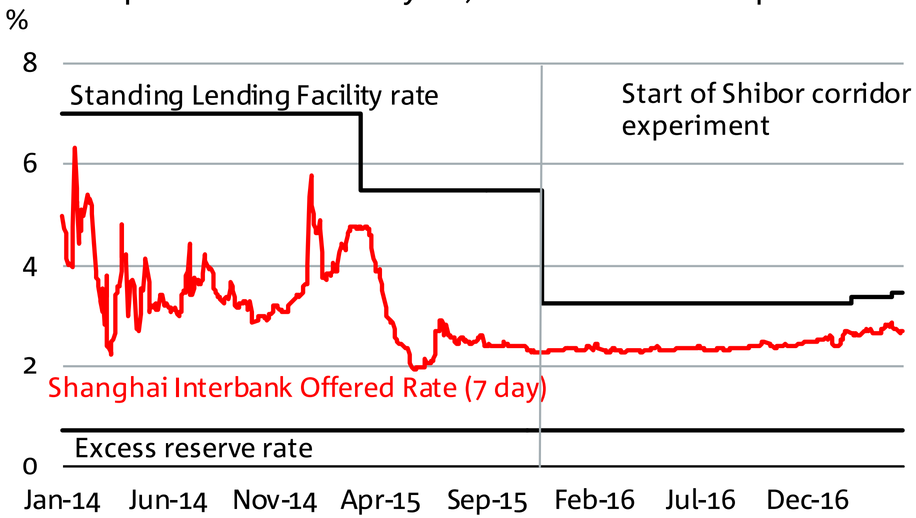
Weak credit growth in March dragged the Q1 rate down to 4.3%



Sources: CEIC, NAB Economics

MONETARY POLICY

Shibor up from start of the year, but off end-March peaks



Source: CEIC, NAB Economics

- China's credit growth was relatively modest in Q1 2017, increasing by4.3% yoy, to total RMB 7.0 trillion. This reflected weak credit in March, following on from strong growth in the first two months.
- While bank loans continue to account for the majority of new credit, growth was slower than total credit in Q1 – increasing by 3.2% yoy to RMB 4.6 trillion. Loans in Renminbi contracted slightly in Q1, however this offset by an increase in foreign currency loans.
- Shadow banking sectors recorded stronger growth – up by 321% yoy – driven largely by a rebound in banker's acceptance bills (which contracted in early 2016), along with increases in trust and entrusted loans.
- In contrast, corporate bond issuance was weak in Q1, with the total debt contracting by RMB 147 billion on a net basis, compared with strong increases in early 2016.
- The People's Bank of China has continued to gradually tighten monetary policy – increasing the interest rate on the Standing Lending Facility (the upper bound of the Shibor corridor adopted since November 2015) by 10 basis points in early April to 3.45%, while the 7 day reverse repo was raised to 2.45% in mid-March.
- The 7 day Shibor has trended higher since the start of the year – at almost 2.7% at the time of writing, up from around 2.5% at the start of January. That said, despite the recent moves from the PBoC, the Shibor has pulled back from recent peaks – at 2.85% at the end of March.
- While the PBoC appears to have a tightening bias, given the rising US fed funds rate and the attempts to control capital outflows, the risks associated with high debts in the corporate sector mean that the PBoC is likely to be cautious with its rate increases.

National Australia Bank

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 Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 4)55 052 519

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

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

Behavioural & Industry Economics

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

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

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy

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

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Andrew Jones
Credit Analyst
+61 3 8641 0978

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

Jason Wong
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

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

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

National Australia Bank