CHINA'S ECONOMY AT A GLANCE

JULY 2017

National Australia Bank

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KEY POINTS

Steady as she goes – economic growth and other key indicators stable in Q2

- In line with the stable trends in China's monthly data, economic growth was unchanged in Q2 at 6.9% yoy. Services remain the key contributor to China's growth (increasing by an unchanged 7.7% yoy in Q2), while the secondary sector expanded by an unchanged 6.4% yoy. The stronger than expected start to the year has resulted in an upward revision to our forecasts – with GDP expected to grow by 6.7% in 2017 (the same rate as in 2016) (previously 6.5%). We continue to anticipate a gradual slowdown in growth in coming years – at 6.5% in 2018 and 6.25% in 2019.

- New credit grew strongly in Q2 – following on from a relatively modest increase in Q1 – expanding by just over 36% yoy. For the first half of the year, new credit totalled RMB 11.2 trillion, an increase of 13.9% yoy. Last week, President Xi instructed China's SOEs (who account for the largest share of Chinese credit) to deleverage – however It is too early to tell if this will have any effect on credit issuance or GDP in the second half.

- China's industrial production accelerated in June – rising by 7.6% yoy (up from 6.5% in May). Steel production surged to a new monthly record in June – with producers benefiting from comparatively cheap inputs (following the correction in metallurgical coal markets) and higher product prices (since mid-April).

- Growth in fixed asset investment was somewhat stronger in June – increasing by 8.6% yoy (compared with 7.9% in May). Investment in the real estate sector has remained strong – despite a range of measures intended to slow activity in the industry. On a trend basis, residential construction starts have eased a little – increasing by 13.1% yoy (3mma), down from 15.1% in May – but it is too early to suggest this will continue, given that monthly construction starts in June were at their strongest level since November 2013.

- China's trade balance continued to widen in June – out to US$42.8 billion (from US$40.5 billion in May). Strong growth in both exports and imports has been driven in part by commodity prices, with the RBA Index of Commodity Prices rising by 23% yoy in June. The current commodity cycle has peaked – the RBA index is down around 16% since January – meaning that the growth in import values is likely to be weaker across the second half of 2017.

- Retail sales growth picked up in June – with real sales rising by 10.0% yoy (from 9.5% in May). Consumer confidence was a touch softer in May, with the index at 112 points (down from 113.4 points in April – the strongest reading in this measure since June 2007).

- There has been minimal change to Chinese monetary policy in recent weeks – with the 7 day Shibor trading in a range of around 16 basis points since the start of June. The rate has dipped back to around 2.8% – around 30 basis points tighter than the start of the year. We continue to expect a modest tightening in monetary policy in the second half of the year – with concerns around the high levels of corporate debt likely to make the PBoC cautious in its approach.

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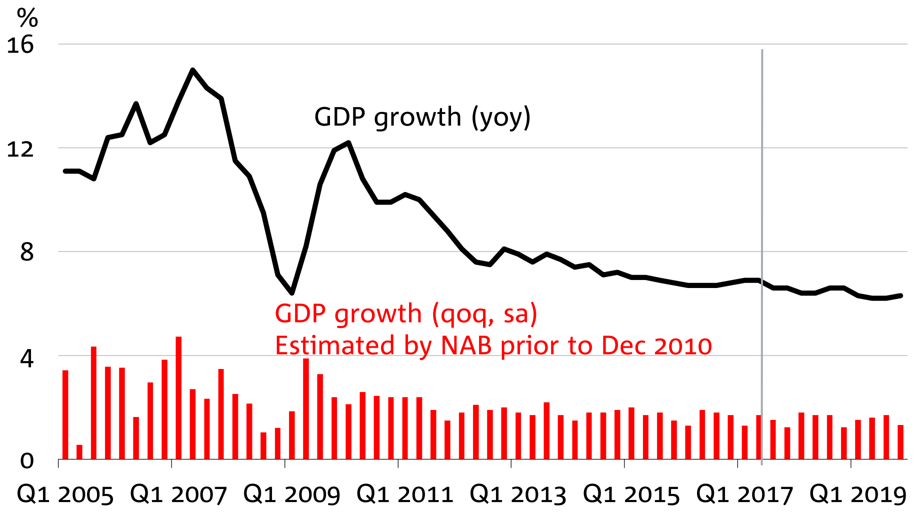
GROSS DOMESTIC PRODUCT

REAL GDP UNCHANGED AT 6.9% YOY IN Q2

Key indicators were generally stable in the quarter

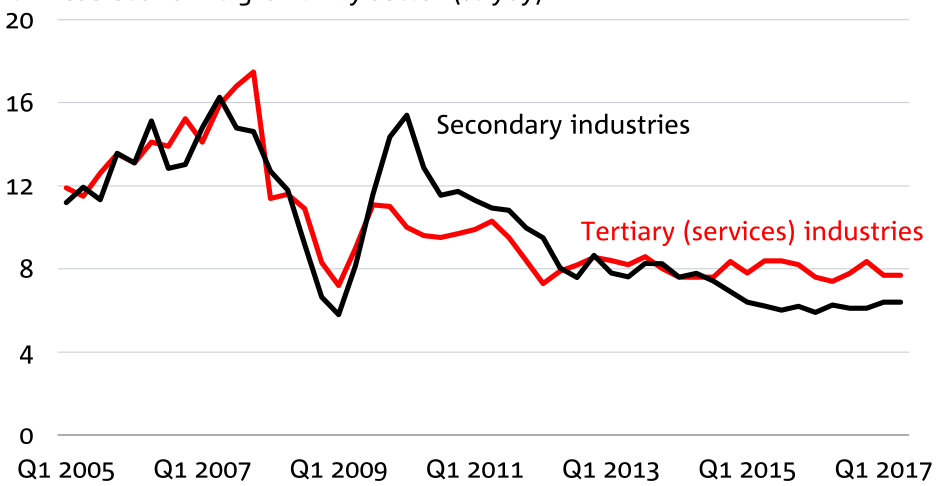


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Services share of China's economy continues to rise

Chinese economic growth by sector (% yoy)



Source: Datastream, NAB Economics

- China's national accounts data showed that the economy expanded by 6.9% yoy in the second quarter, the same rate recorded in Q1. This was ahead of market expectations – at 6.8% in both the Bloomberg and Thomson Reuters polls. This increase was accompanied by a massive increase in credit – up around 36% yoy in the second quarter.

- Last week, President Xi instructed China's SOEs (who account for the largest share of Chinese credit) to deleverage – however It is too early to tell if this will have any effect on credit issuance or GDP in the second half.

- There is a slight disconnect between headline annual growth measures, and the NBS's seasonally adjusted quarterly growth rates – which imply a slightly softer annual growth rate around 6.7%.

- Recent months have seen considerable stability in key economic indicators, and this trend was continued in sectoral GDP data. Services remains the key contributor to growth – at 7.7% yoy in Q2 (unchanged from Q1) – while secondary industries (manufacturing and construction) grew slightly slower than the overall economy, at 6.4% yoy (also unchanged).

- The stronger than expected start to the year has resulted in an upward revision to our forecasts – with GDP expected to grow by 6.7% in 2017 (the same rate as in 2016) (previously 6.5%). We continue to anticipate a gradual slowdown in growth in coming years – at 6.5% in 2018 and 6.25% in 2019.

NAB GDP FORECASTS

%	2017	2018	2019
GDP	6.7	6.5	6.25

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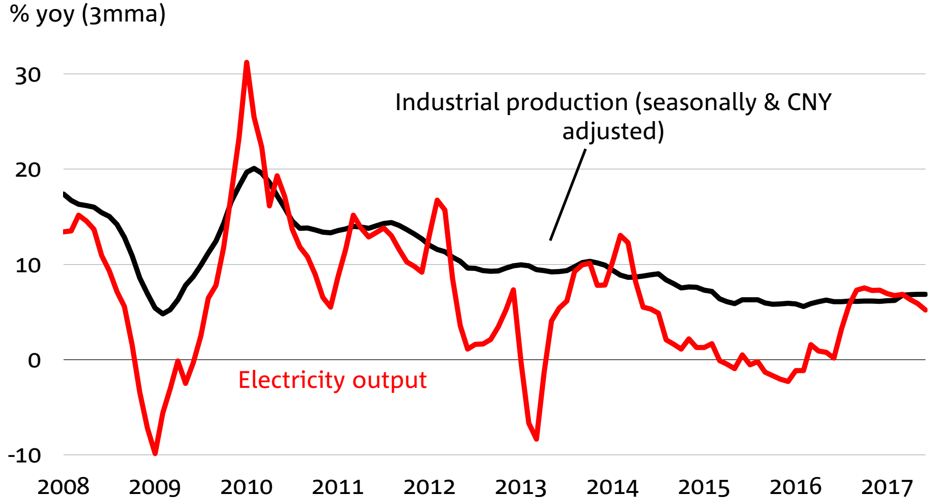
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

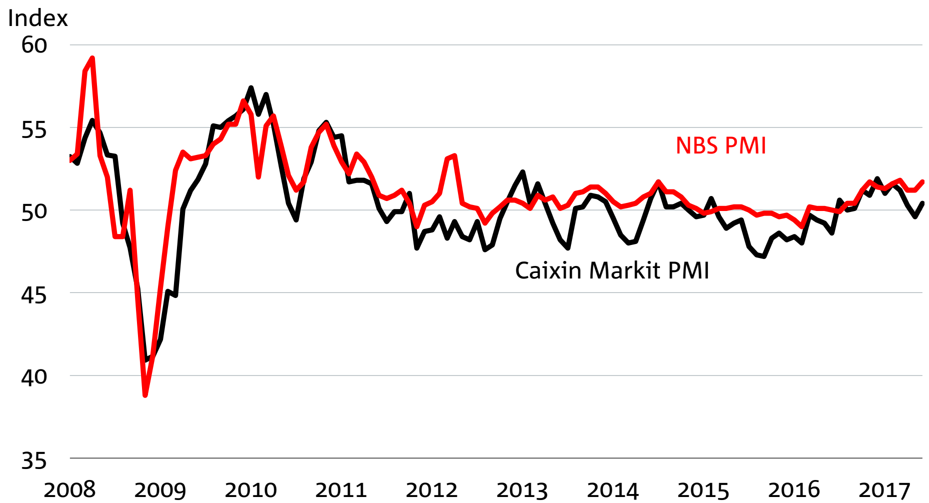
Output growth rose to a two and a half year high in June



Source: CEIC, NAB Economics

PMI SURVEYS STILL DIVERGENT

Caixin Markit measure edges back to positive territory



Source: CEIC, NAB Economics

- China's industrial production accelerated in June – rising by 7.6% yoy (up from 6.5% in May). This result was considerably stronger than market expectations (at 6.5% in both the Bloomberg and Thomson Reuters polls) and, along with March 2017, was the equal strongest rate of growth since December 2014.

- Steel production surged in June – up by 5.7% yoy to 73.2 million tonnes (a new monthly record) – with producers benefiting from comparatively cheap inputs (following the correction in metallurgical coal markets) and higher product prices (since mid-April). In contrast, cement output (another industrial product linked to the construction sector) fell by 0.9% yoy.

- Other key industrial sectors – such as motor vehicles and electricity – saw relatively stable growth, at 6.2% yoy and 5.2% yoy respectively.

- Trends in China's main industrial surveys remained divergent in June. The official NBS PMI survey edged slightly higher – to 54.9 points (from 54.5 points previously) – just below the recent cyclical high recorded in March. In contrast, the Caixin Markit PMI measure moved back into positive territory – to 50.4 points (from 49.6 points previously).

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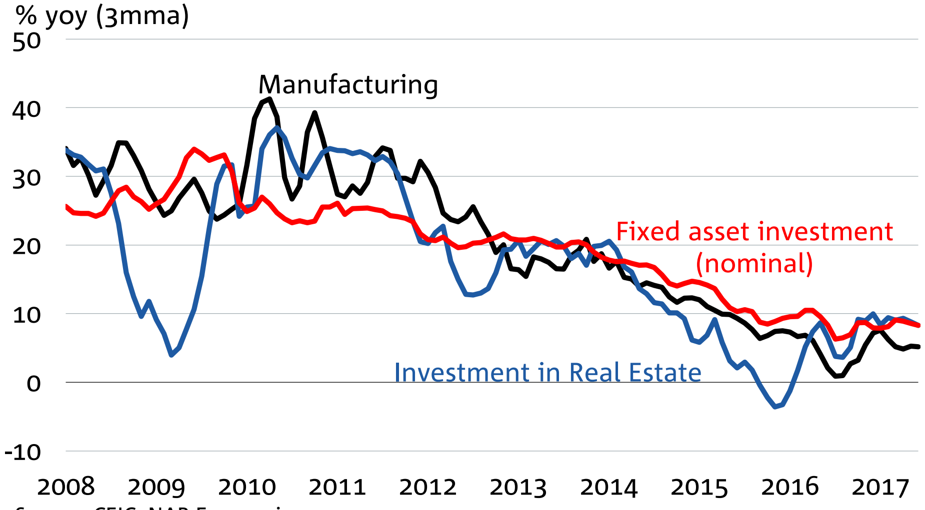
INVESTMENT

INVESTMENT BY INDUSTRY

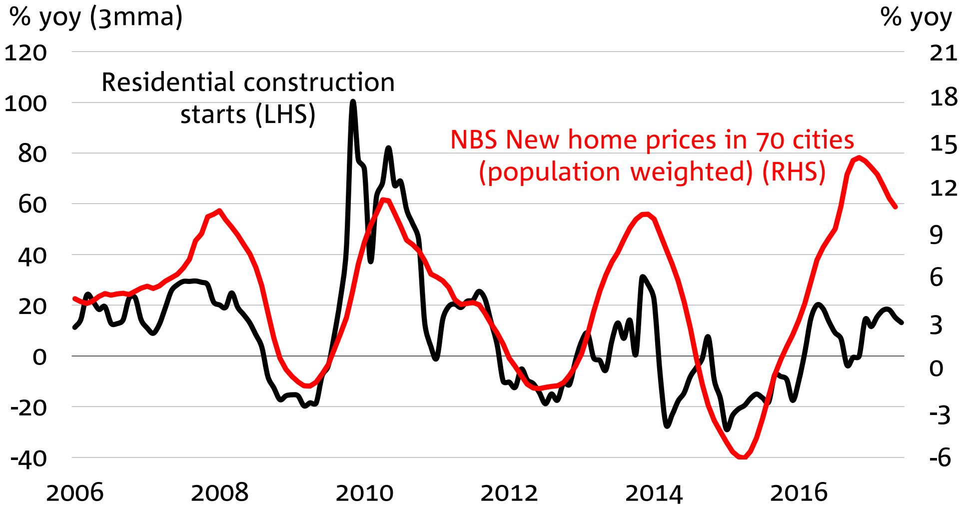
Real estate rolls on, despite efforts to slow the sector



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION

Construction activity trends lower; too soon to indicate slowdown



Source: CEIC, Datastream, NAB Economics

- Growth in fixed asset investment was somewhat stronger in June – increasing by 8.6% yoy (compared with 7.9% in May). The weaker profile for producer prices in recent months suggests that real investment has trended higher – by around 2.2% yoy in June (from 1.5% previously).

- Investment by private sector firms has edged slightly higher in June – rising by 6.6% yoy (on a three month moving average basis). While private sector growth has trended higher recently, it remains below the rates recorded prior to 2016's mid-year plunge. State-owned enterprises recorded slightly weaker growth, at 11.2% yoy (3mma), from 12.2% previously.

- Investment in the real estate sector has remained strong – despite a range of measures intended to slow activity in the industry – rising by 8.3% yoy (3mma), compared with 8.8% previously. Manufacturing investment was relatively stable, up by 5.2% yoy (3mma) (from 5.3% in May). Combined, these sectors accounted for 55% of China's fixed asset investment in the first five months of the year.

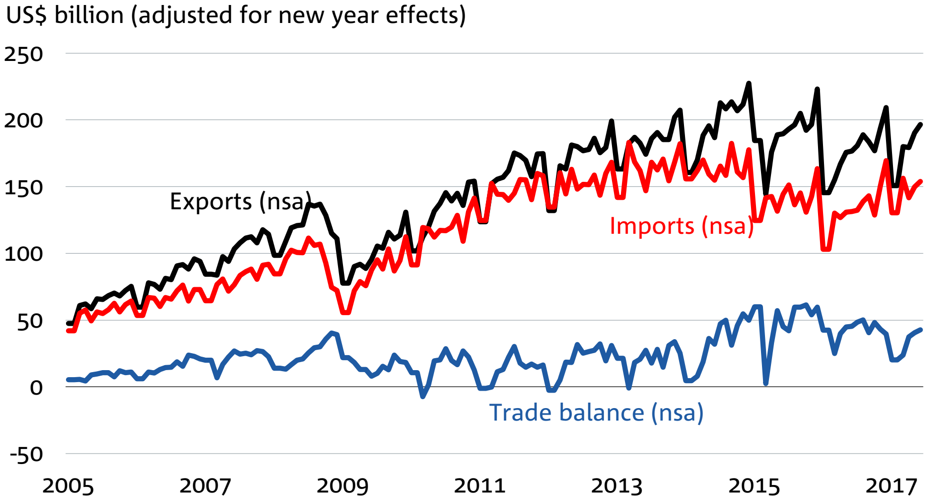
- Policies designed to slow house price growth and construction activity have only had a limited impact to date. Month-on-month housing prices rose by 0.6% (on a 3 month moving average basis) for new builds (up from 0.5% in May) and 0.7% for existing properties (unchanged) in May. The strongest increases have been in tier 3 (and below) cities.

- On a trend basis, residential construction starts have eased a little – increasing by 13.1% yoy (3mma), down from 15.1% in May – but it is too early to suggest this will continue, given that monthly construction starts in June were at their strongest level since November 2013. We expect construction activity show slow in the second half of 2017 – however activity outpaced our expectations in H1.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS CONTINUED TO WIDEN IN JUNE

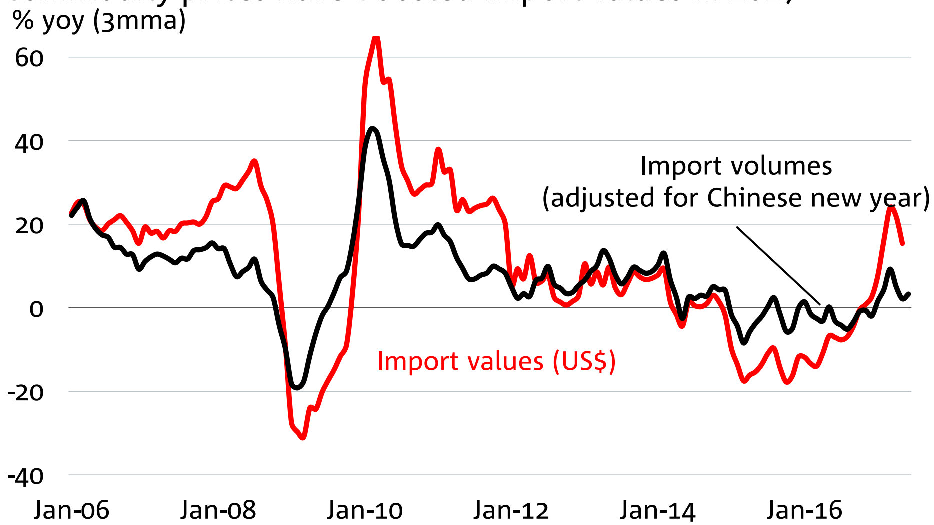
Stronger monthly increase in exports widens the gap



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

Commodity prices have boosted import values in 2017



Source: CEIC, NAB Economics

- China's trade balance continued to widen in June – out to US$42.8 billion (from US$40.5 billion in May). The month-on-month increase in exports outpaced that of imports, leading to the wider gap.
- China's imports were stronger in June – at US$153.8 billion (compared with US$149.8 billion in May), an increase of 17.2% yoy. A major contributor to this trend has been the increase in commodity prices, with the RBA Index of Commodity Prices rising by 22.8% yoy in June. The current commodity cycle has peaked – the RBA index is down around 16% since January – meaning that growth in import values is likely to be weaker across the second half of 2017.
- In contrast to the growth in prices, import volumes have increased at a more modest rate. While import values rose by almost 19% yoy in the first half of 2017, our estimate of volumes increased by just 6.2% yoy.
- Import volumes of key commodities continue to display divergent trends. Iron ore imports rose by 16% yoy in June to 94.7 million tonnes (near the all time high of 96.3 million tonnes in December 2015) in line with strong steel production trends, while crude oil imports rose by 18% yoy.
- In contrast, copper imports fell again – down 7.1% yoy (the tenth straight month of declines) – and coal imports fell by 0.7% yoy. Coal import volumes were almost 20% below their peak in November 2016, as the policy imposed restrictions on domestic coal production have eased.

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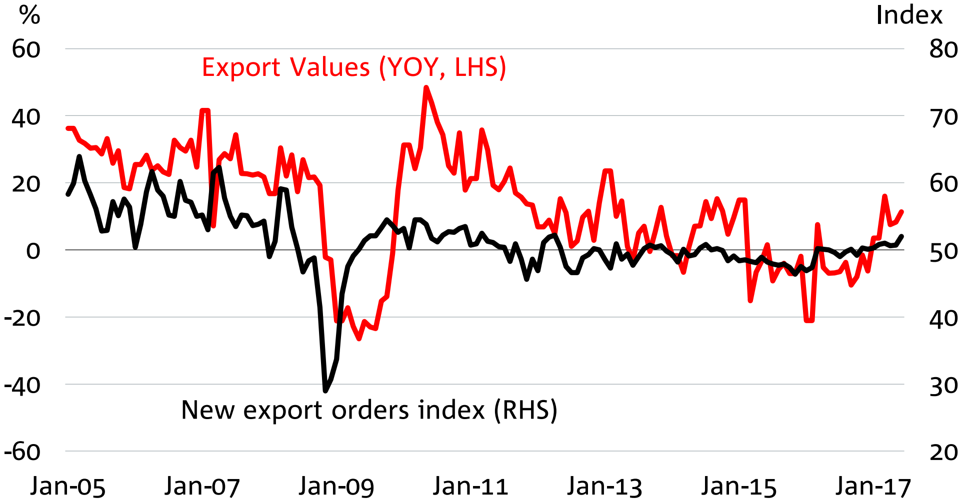
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

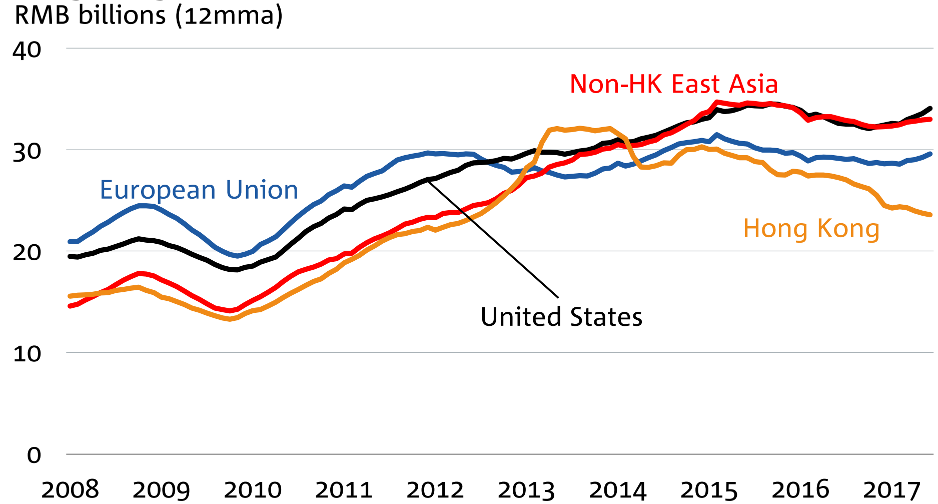
Confidence rises to a five year high



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Hong Kong's artificial decline understates recent export trends



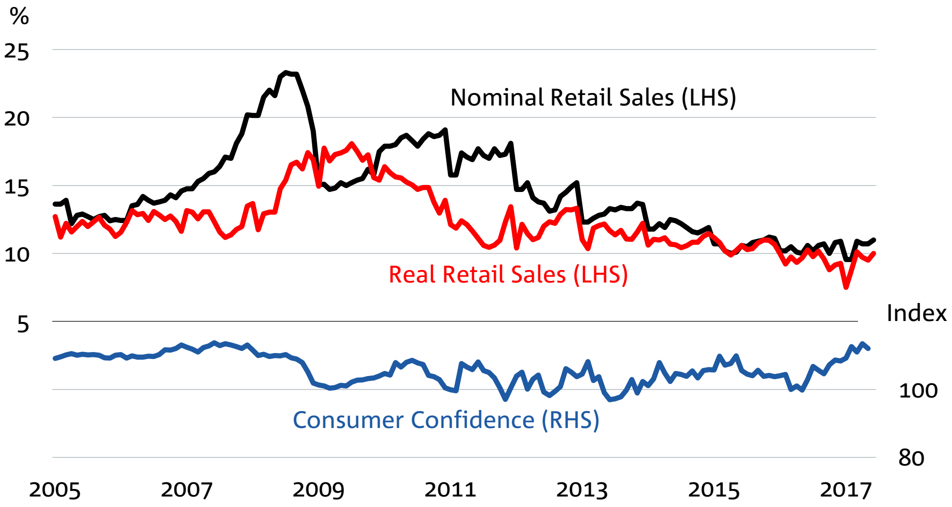
Sources: CEIC, NAB Economics

- China's exports rose by 11.3% yoy in June, to total US$196.6 billion (up from US$190.3 billion in May).
- The confidence of exporters improved considerably this month – with the new export orders measure in the NBS PMI survey rising to 52.0 points (from 50.7 points in May) – the highest reading since April 2012.
- There remains considerable divergence between exports to China's major trading partners. Exports to the United States rose by 19.8% yoy, while exports to the European Union increased by 15.2% yoy. In contrast, exports to other East Asian markets fell by 1.8% yoy.
- Historic distortions in Hong Kong-China trade data continue to impact on East Asian trade. Exports to non-Hong Kong markets rose by 2.6% yoy – led by increased trade with South Korea, Vietnam and Taiwan – while exports to Hong Kong fell by 7.3% yoy.
- The sharp downward trend in exports to Hong Kong is not evident in Hong Kong customs data – highlighting the impact of false invoicing which disguised capital outflows as trade activity – a trend evident between 2012 and 2016. There has been minimal discrepancy between Hong Kong and Chinese trade data in 2017.
- The overstated level of historical exports creates a more negative picture of Chinese trade than is actually the case. In the first five months of the year, Chinese data suggests that exports to Hong Kong fell by 8.2%. In contrast, Hong Kong data recorded an increase of 6.4%.

RETAIL SALES AND INFLATION

REAL RETAIL SALES GROWTH BACK ABOVE 10%

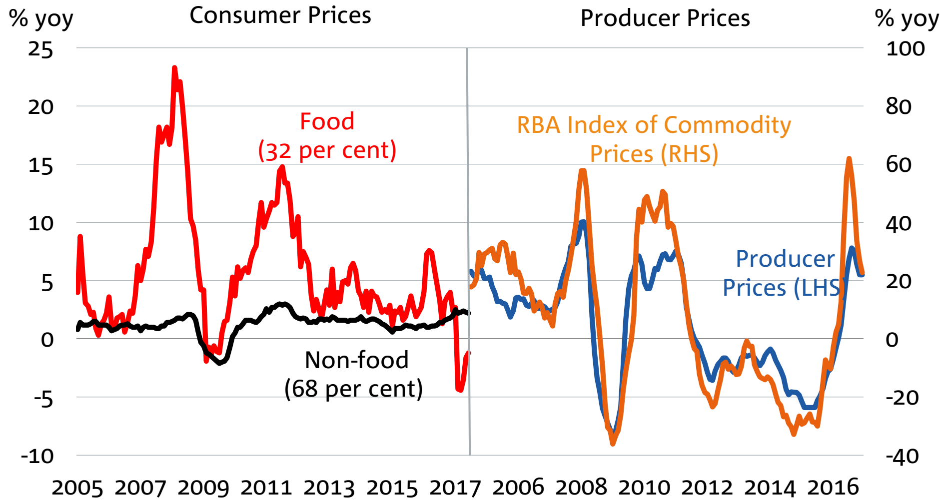
Consumer confidence just off a post-GFC high



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Non-food prices have moved higher; producer momentum slows



Sources: CEIC, RBA, NAB Economics

- Retail sales growth picked up in June – with nominal sales rising by 11.0% yoy (compared with 10.7% in May). Retail price growth was slightly weaker during the month, meaning the real retail sales were much stronger than previously – rising back to 10.0% yoy (from 9.5% in May).

- Consumer confidence was a touch softer in May, with the index at 112 points (down from 113.4 points in April – the strongest reading in this measure since June 2007).

- China's headline inflation was unchanged in June – with the Consumer Price Index remaining at 1.5% yoy.

- Food prices continued to decline in year-on-year terms – with aggregate prices falling by 1.2% yoy (compared with -1.6% in May). Pork prices fell by 16.7% yoy, while eggs were down 9%. In contrast, fresh vegetable prices rose, after four months of sharp declines.

- Non-food price trends have been considerably stronger in the past few months, albeit price growth was marginally softer, at 2.2% yoy in June (down from 2.3% in May). Fuel prices have been a major contributor in recent months, although they only rose by 3.8% yoy in June (compared with 10.2% in May. Healthcare costs have also trended high – up by 5.7% yoy in June.

- Growth in producer prices was unchanged in June – with the producer price index increasing by 5.5% yoy. The upward pressure from commodity prices is starting to wane – the RBA Index of Commodity Prices was up by around 23% yoy in June (from 27% in May). With aggregate commodity prices declining month-on-month recently, producer price growth is likely to soften further in coming months.

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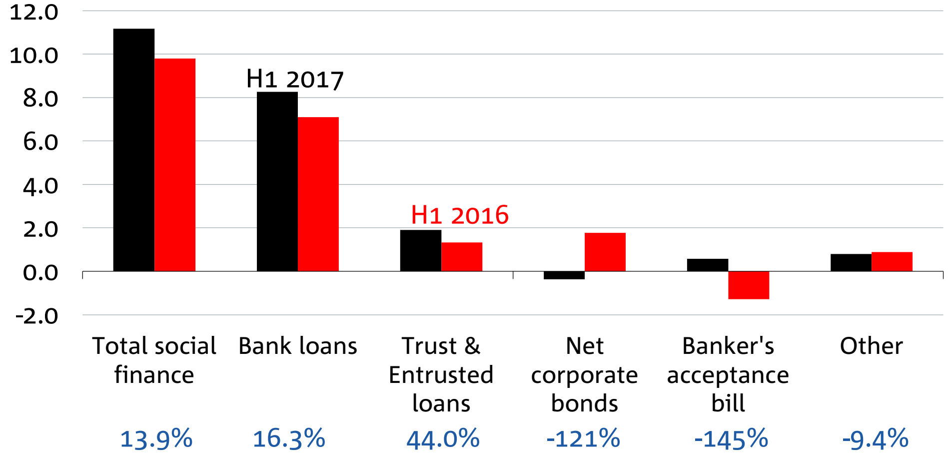
CREDIT CONDITIONS

NEW CREDIT GROWTH

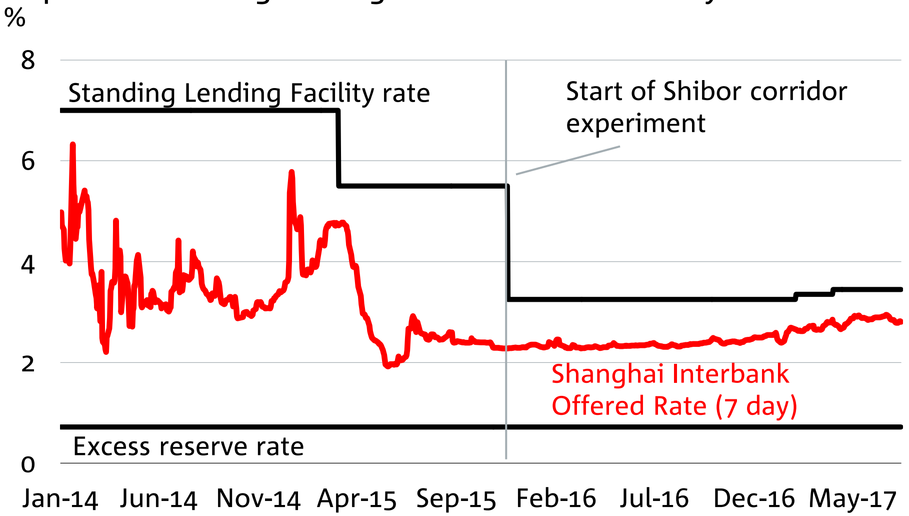
Strong growth (up 36% yoy) in Q2 2017



Sources: CEIC, NAB Economics

PBOC MAINTAINING STABLE MONETARY POLICY

Expect modest tightening in second half of the year



Source: CEIC, NAB Economics

- New credit grew strongly in Q2 – expanding by just over 36% yoy – following on from a relatively modest increase in Q1. For the first half of the year, new credit totalled RMB 11.2 trillion, an increase of 13.9% yoy.
- Bank loans have accelerated in recent months – in part reflecting tightening regulation and oversight of the shadow banking sector boosting demand for traditional bank services. Bank loans totalled RMB 8.3 trillion – almost three-quarters of total new credit – an increase of 16.3% yoy.
- Parts of the shadow banking sector have grown strongly in the first half of the year – albeit coming from a very low base. Trust and entrusted loans rose by around 44% yoy over this period – with entrusted loans slowing markedly in the second quarter – while banker's acceptance bills have increased modestly (compared with a contraction in the first half of 2016).
- Corporate bond issuance remained weak in the first half of the year – with the total outstanding debt contracting by around RMB 370 billion (compared with almost RMB 1.8 trillion in net issuance in H1 2016).
- There has been minimal change to Chinese monetary policy in recent weeks – with the 7 day Shibor trading in a range of around 16 basis points since the start of June. The rate has dipped back to around 2.8% – around 30 basis points tighter than the start of the year.
- The People's Bank of China (PBoC) has maintained a neutral role in recent months – keeping key rates (such as the Standing Lending Facility, Medium Term Lending Facility and 7 day reverse repos) on hold, while only increasing liquidity (via open market operations) modestly – by RMB 40 billion in June.
- We continue to expect a modest tightening in monetary policy in the second half of the year – with concerns around the high levels of corporate debt likely to make the PBoC cautious in its approach.

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