CHINA'S ECONOMY AT A GLANCE

AUGUST 2017

National Australia Bank

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KEY POINTS

Chinese data generally weaker in July, returning to trend after strong June

- Most of China's monthly indicators were weaker in July – albeit many coming back to trend (particularly industrial production and retail) after strong growth in June. Nothing in this month's release changes our views around the Chinese economy – which is expected to grow by 6.7% in 2017 (the same rate as 2016), before slowing to 6.5% in 2018 and 6.25% in 2019.

- Growth in China's industrial production slowed in July – down from a two and a half year high in June – back to the trend rate for the past three years. Crude steel output surged again in July – up to 74.0 million tonnes, the second straight month of record output.

- China's fixed asset investment grew a little slower in July, with a softer trend in both real estate and manufacturing. New construction starts slowed significantly in July, although it is too early to tell if policies designed to cool conditions in the real estate and construction sector are impacting. We have been expecting construction activity to slow for some time, but we are cautious not to read too much into July's relative weakness – particularly given the strength in China's steel output. That said, should it be sustained, Chinese steel demand and iron ore consumption would be likely to fall in coming months.

- China's trade surplus increased further in July – up to US$46.7 billion (compared with US$42.8 billion previously). Both exports and imports were weaker than the levels recorded in June. Price trends in commodity markets have had a major influence on China's trade values – with the RBA Index of Commodity Prices rising by 17% yoy (down from 22% in June). Commodity prices have generally declined since the start of the year, with the RBA index down around 14% since the cyclical peak in February – meaning that the positive price effects on China's trade values are likely to be far more modest in coming months.

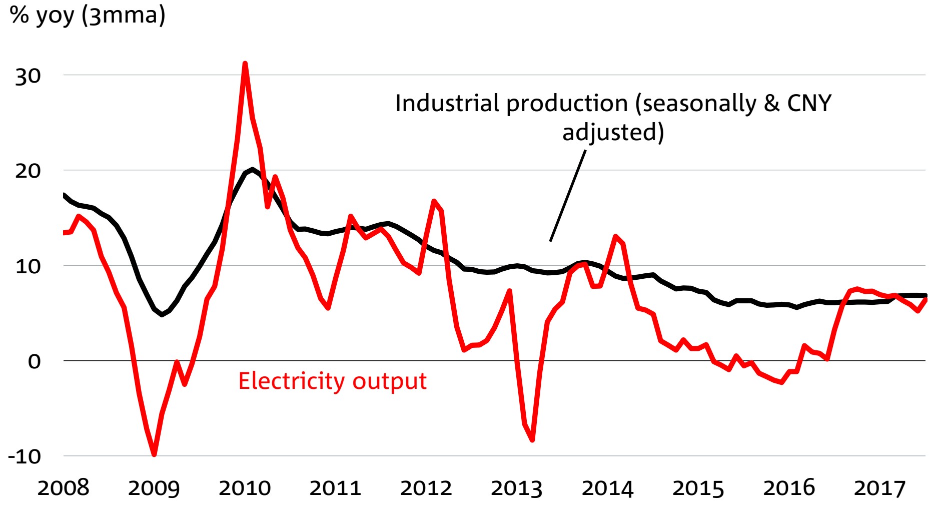
- Retail sales were somewhat weaker in July – with nominal sales growth at 10.4% yoy (compared with 11% previously). Consumer confidence recovered in June, with the index at 113.3 points, just off the near-decade long high recorded in April (113.4 points).

- Chinese monetary policy has remained stable in recent months – with the 7 day Shanghai Interbank Offered Rate (Shibor) trading in a range of almost 11 basis points since the start of July. At the time of writing, the Shibor has edged close to 2.9%, which represents around 40 basis points of tightening since the start of the year, but it is essentially unchanged since late April. We continue to expect some modest tightening in coming months, albeit concerns around the high levels of corporate debt, and the capacity of firms to service said debt, will make the PBoC cautious in its approach.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

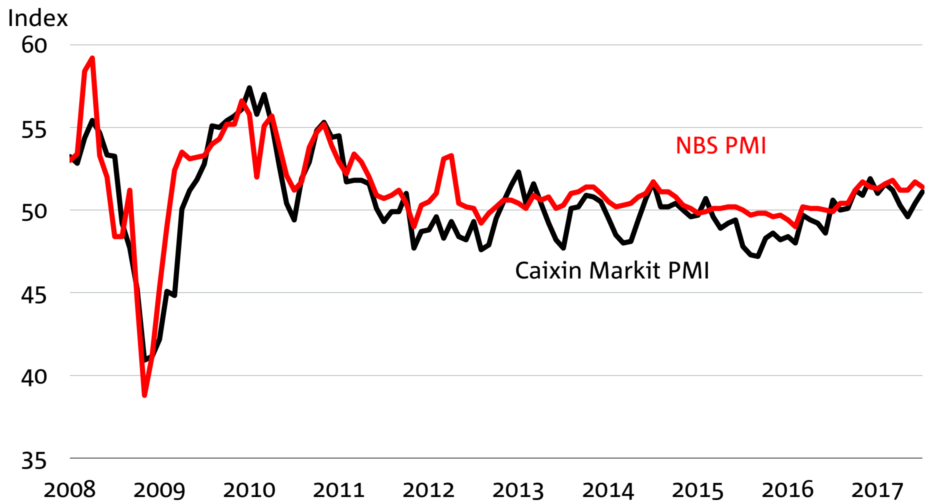
Output growth back to trend levels in July



Source: CEIC, NAB Economics

PMI SURVEYS REMAINING POSITIVE

Industrial surveys point to positive manufacturing conditions



Source: CEIC, NAB Economics

- Growth in China's industrial production slowed in July – increasing by 6.4% yoy (down from a two and a half year high of 7.6% in June) – a rate that is around the trend for the past three years. This result was weaker than market expectations – with polls by both Thomson Reuters and Bloomberg predicting growth at 7.2%.

- Trends in individual industrial sectors continue to diverge. Crude steel output surged again in July – up by 10.3% yoy to 74.0 million tonnes – the second straight month of record output. Similarly, electricity production rose strongly – up by 8.6%, in part reflecting heat wave conditions during the month.

- In contrast, cement output fell by 0.9% yoy, while motor vehicle production rose by 4.3% yoy (down from 6.2% previously).

- China's major industrial surveys continue to point to positive conditions in the manufacturing sector. The official NBS PMI survey pulled back slightly in July – to 51.4 points (from 51.7 points previously) but remained near multi-year highs. The Caixin Markit PMI moved higher – up to 51.1 points (from 50.4 points previously).

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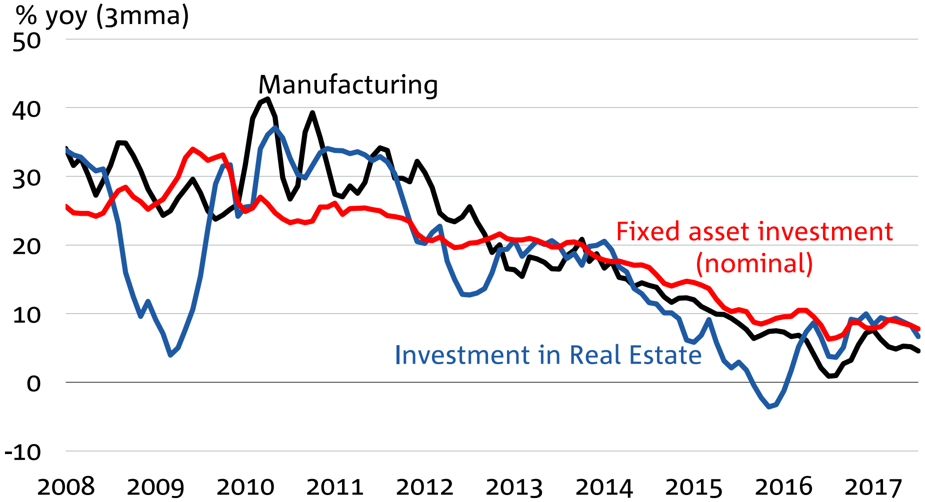
INVESTMENT

INVESTMENT BY INDUSTRY

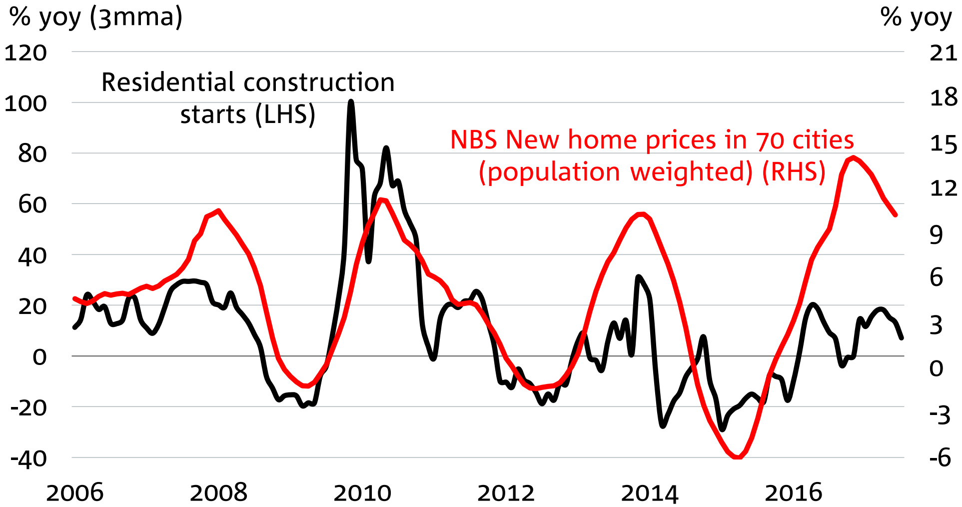
Real estate leads the overall softening in investment



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION TRENDING LOWER

Too early to signal anticipated slowdown in construction



Source: CEIC, Datastream, NAB Economics

- China's fixed asset investment grew a little slower in July – increasing by 6.8% yoy (compared with 8.6% in June). Given that producer prices have been relatively stable in recent months, this suggests that real investment pulled back in July to around 1.0% yoy from around 2.7% yoy previously, the weakest rate of growth since February.

- The recovery in private sector investment appeared to stall in July, with growth at 6.5% yoy (3mma), down from 6.6% in June – albeit raw monthly growth rates show a greater slowdown (to 4.9% yoy). Investment by state-owned firms has continued to slow – down to 10.2% yoy – as the impact of the SOE investment surge in Q2 2016 starts to wash away.

- By industry, there was a slowing trend for both real estate and manufacturing. Investment in real estate grew by 6.7% yoy in July (on a three month moving average basis), compared with 8.3% previously. Manufacturing investment eased to 4.6% yoy (down from 5.2% in June). These two sectors accounted for just over 54% of China's total fixed asset investment in the first half of 2017.

- New construction starts slowed significantly in July, although it is too early to tell if policies designed to cool conditions in the real estate and construction sector are impacting. Three month moving average starts rose by 7.1% yoy (down from 13.1% in June). This was the weakest rate of growth since November 2016.

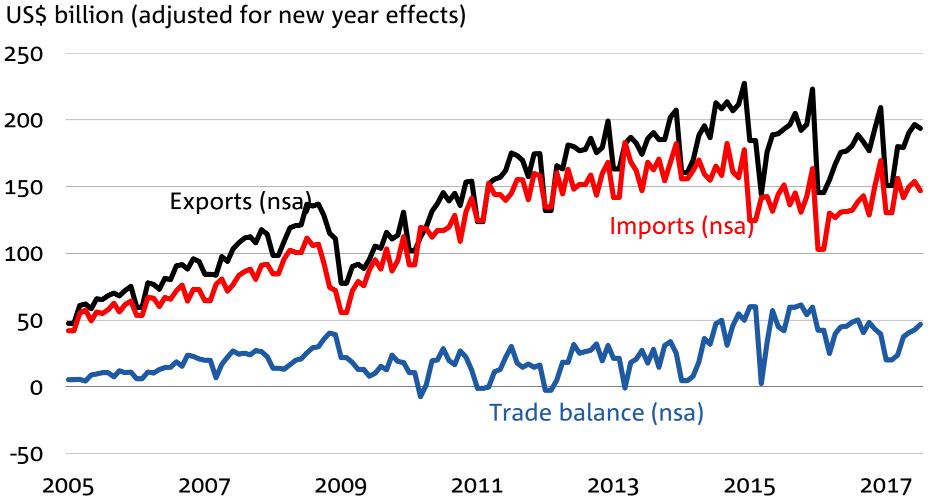
- Similarly, house price growth has appeared to stall in June – with month-on-month (3mma) prices unchanged for new builds at 0.6% and down to 0.6% for existing properties (from 0.7% in May).

- We have been expecting construction activity to slow for some time, but we are cautious not to read too much into July's relative weakness – particularly given the strength in China's steel output. That said, should it be sustained, Chinese steel demand and iron ore consumption would be likely to fall in coming months.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS WIDEST SINCE OCTOBER '16

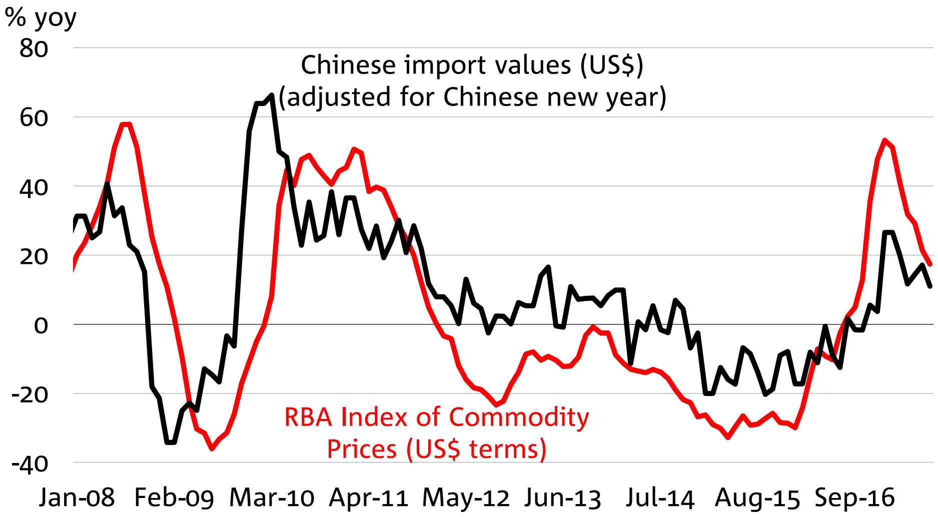
Imports fell faster than exports in July



Sources: CEIC, NAB Economics

IMPORT VALUES AND COMMODITY PRICES

Price effects a major contributor to growth in imports in 2017



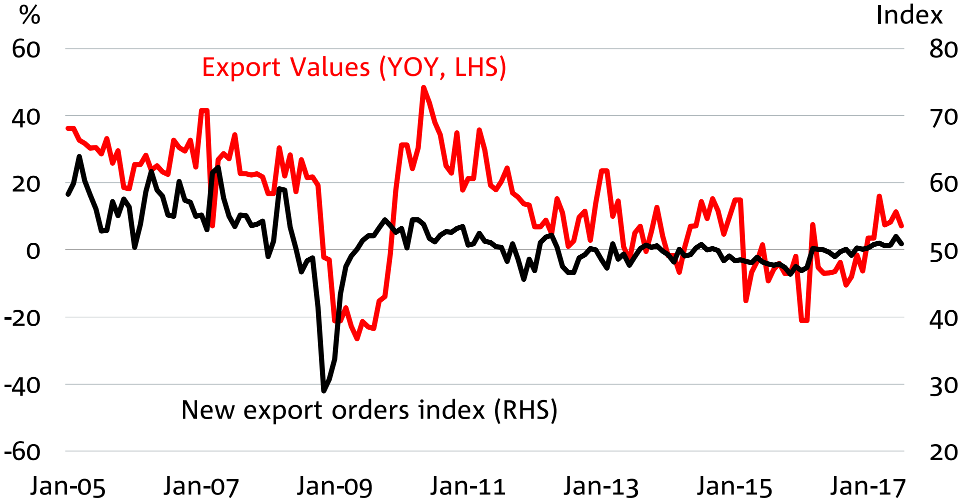
Source: CEIC, NAB Economics

- China's trade surplus increased further in July – up to US$46.7 billion (compared with US$42.8 billion previously). Both exports and imports were weaker than the levels recorded in June.
- China's imports totalled US$146.9 billion in July (down from US$153.8 billion previously) – an increase of 11.0% yoy. Price trends in commodity markets have had a major influence on China's import values – with the RBA Index of Commodity Prices rising by 17% yoy (down from 22% in June). Commodity prices have generally declined since the start of the year, with the RBA index down around 14% since the cyclical peak in February – meaning that the price effects on China's imports are likely to be far more modest in coming months.
- Growth in import volumes has been far more modest, albeit trends have strengthened in recent months. On a three month moving average basis, our estimate of volumes rose by 4.7% yoy in July, up from a recent low of 2.1% in May.
- The import volumes for key commodities were weaker month-on-month in July – with the most noticeable being iron ore – which fell from record levels of 94.7 million tonnes in June to 86.3 million tonnes in July. This level was also 2.4% lower yoy. Similarly, coal import volumes fell by 8.3% yoy.
- In contrast, import volumes of crude oil rose by 11.8% yoy and copper imports rose by 8.3% year.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

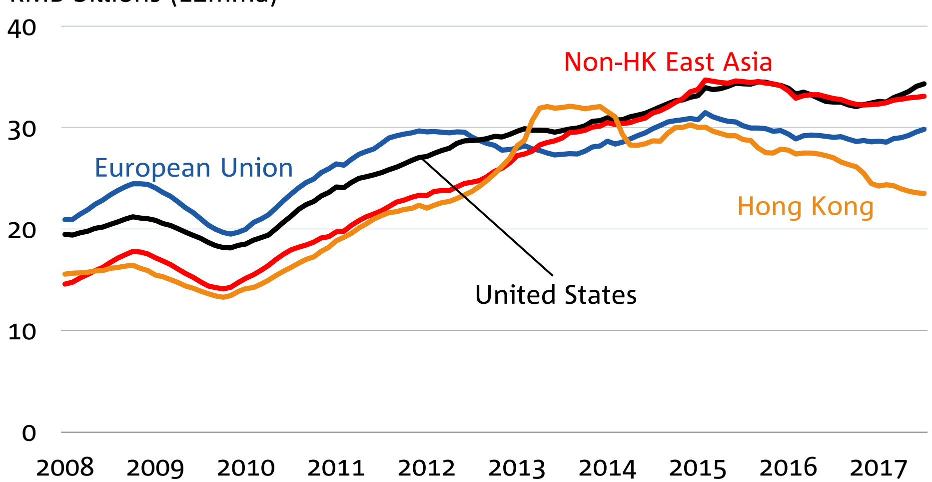
Both export growth and confidence eased in July



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Distorted historical data driving Hong Kong's decline



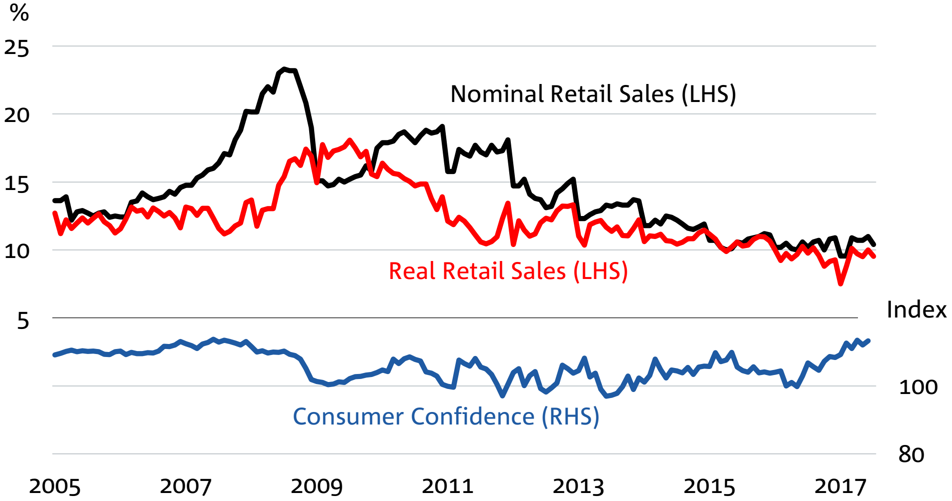
Sources: CEIC, NAB Economics

- China's exports were slightly weaker month-on-month, totalling US$193.6 billion (compared with US$196.6 billion in June). Confidence among Chinese exporters was slightly weaker – with the new export orders measure in the NBS PMI survey pulling back to 50.4 points (from a five year high of 52.0 points in June).
- Previous distortions in China's trade data (which overstated historical export values) continue to impact reported growth rates. This is most evident in diverging export trends between Hong Kong – the main market for the false invoicing schemes that masked capital flows as trade activity between 2012 and 2016 – and other major export markets.
- Exports to the European Union and the United States grew strongly in July – up by 10.1% yoy and 8.9% yoy respectively. In contrast, exports to other East Asian economies rose by just 0.5% yoy.
- Within the latter category, exports to Hong Kong fell by 3.6% yoy (compared with a 7.3% decline recorded in July), while non-Hong Kong Asia rose by 3.7% yoy. Vietnam, South Korea and the Philippines accounted for the majority of the increase.
- The artificially high level for historical exports results in a weaker picture of Chinese trade than is actually the case. In the first half of 2016, Chinese trade data shows that exports to Hong Kong fell by 8.1% yoy, whereas Hong Kong data shows an increase of 6.4% yoy.

RETAIL SALES AND INFLATION

REAL RETAIL SALES DIP BACK UNDER 10%

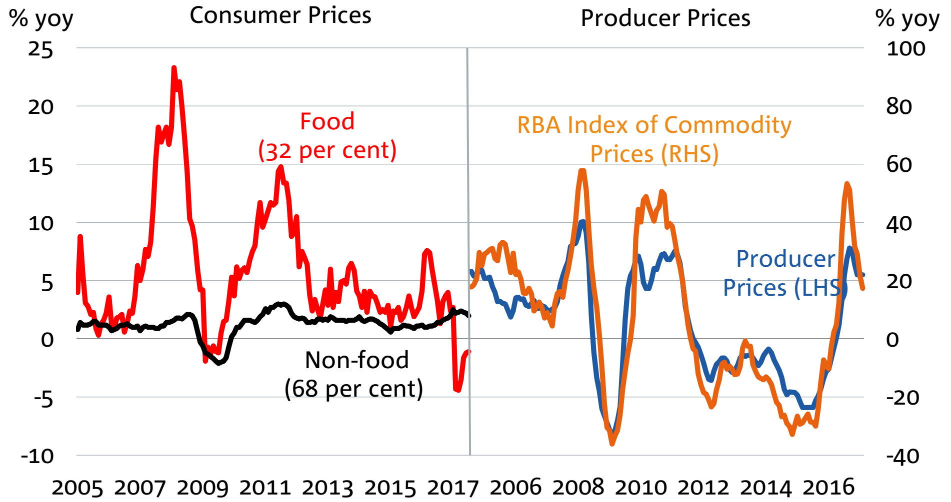
Consumer confidence returns near decade long highs



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Non-food CPI and PPI both trending lower in recent months



Sources: CEIC, RBA, NAB Economics

- Retail sales growth was somewhat weaker in July – with nominal sales increasing by 10.4% yoy (compared with 11.0% previously). Reflecting the softening in inflation trends, the decline in real retail sales growth was slightly more modest – with growth of 9.5% yoy (compared with 10.0% in June), the same rate of growth as in May.
- Consumer confidence recovered in June, with the index at 113.3 points, just off the near-decade long high recorded in April (113.4 points).
- Headline inflation dipped slightly in July, with the Consumer Price Index increasing by 1.4% yoy (down from 1.5% in June).
- Food prices have continued to fall in year-on-year terms – aggregate food prices fell by 1.1% yoy (compared with -1.2% in June) – the sixth straight month of declines. The price falls were led by pork (down 16% yoy) and eggs (down 4.9% yoy), while fresh fruit prices rose by just 1.7% yoy (compared with an increase of 9.9% last month).
- Non-food price growth was slightly more modest in July – increasing by 2.0% yoy (down from 2.2% previously). Fuel prices contributed strongly to the run up in non-food prices over the past twelve months, but this trend has weakened – with fuel up by 1.2% yoy in July (compared with 3.8% in June).
- The Producer Price Index was unchanged for the third straight month – with prices rising by 5.5% yoy in July. There has been a notable correlation between producer prices and global commodity prices – with the RBA Index of Commodity Prices rising by 17% yoy in July (down from 22% previously). Despite some volatility, commodity prices have generally been trending lower in recent months, meaning that we anticipate a continuation of the softening in producer prices in coming months.

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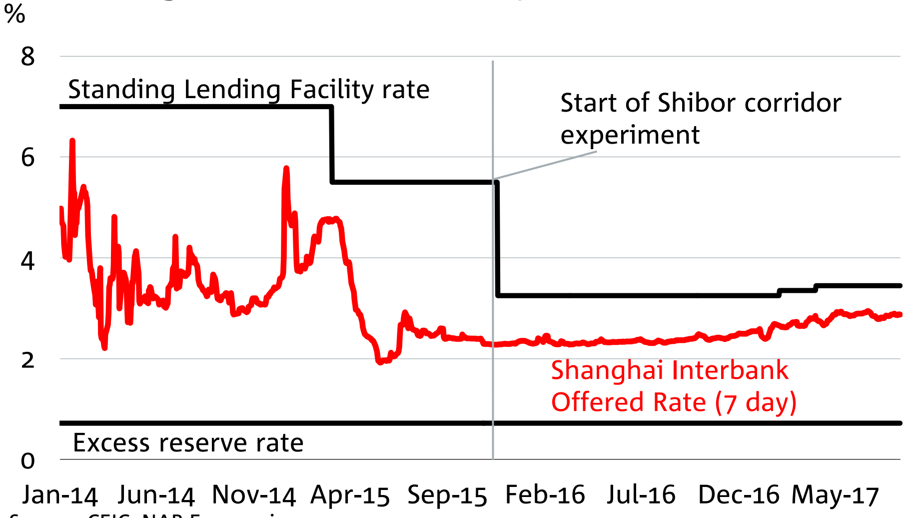
CREDIT CONDITIONS

MONETARY POLICY STABILITY CONTINUES

Little change to Shibor since late April



Source: CEIC, NAB Economics

- China's new credit data for July was not available at the time of writing.
- Chinese monetary policy has remained stable in recent months – with the 7 day Shibor trading in a range of almost 11 basis points since the start of July. At the time of writing, the Shibor has edged close to 2.9%, which represents around 40 basis points of tightening since the start of the year, but it is essentially unchanged since late April.
- The People's Bank of China (PBoC) provided a significant boost to liquidity in July – injecting RMB 470 billion on a net basis (compared with just RMB 40 billion in June). This was the largest injection since June 2016, however it was noted that these funds were intended to meet short term demand – arising from tax and government bond payments due at the time.
- The PBoC has stated that it intends to maintain a neutral monetary policy – however we argue that this still provides some room for modest tightening in coming months – with the Shibor heading closer to 3%. That said, concerns around the high levels of corporate debt, and the capacity of firms to service said debt, will make the PBoC cautious in its approach.

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