CHINA'S ECONOMY AT A GLANCE

SEPTEMBER 2017

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CONTACT

Gerard Burg, Senior Economist - Asia

KEY POINTS

China's old economy surprises on the downside, may point to weaker Q3 growth

- We have previously flagged the potential for slowing economic growth in the second half of 2017 – following the surprisingly strong results in the first half of the year. Two months of weaker fixed asset investment – particularly this month's result – and industrial production (China's old economy) could signal softer GDP growth this quarter. Our economic forecasts remain unchanged – we anticipate growth of 6.7% in 2017 (unchanged from 2016), before easing to 6.5% in 2018 and 6.25% in 2019.

- Fixed asset investment stood out for its weakness this month. Nominal investment rose by 4.9% yoy (compared with 6.8% in July), however the upturn in producer prices suggests that the growth in real investment was negative – at around -2.4% yoy – the largest real decline recorded since late 1995. In nominal terms, manufacturing investment was particularly weak, while real estate investment was relatively stable (albeit at weaker rates than the first half of 2017). Despite some softer trends for housing starts and house prices, it is too early to say there has been a broad slowdown in construction activity – particularly given the strength in Chinese steel production (a key input to the sector).

- Growth in China's industrial production slowed a little further in August – with output up by 6.0% yoy (from 6.4% previously). Crude steel continues to surge – with production rising by 8.7% yoy to 74.6 million tonnes – the third straight month of record output. In contrast, cement – another construction related sector – saw output fall by 3.7% yoy.

- China's trade surplus narrowed in August – down to US$42.0 billion (compared with US$46.7 billion in July) – driven by a sizeable month-on-month increase in imports. Much of the growth in import values has been driven by commodity price trends, with volumes rising more modestly. Export data remains impacted by historical distortions in China-Hong Kong data, which understates current growth.

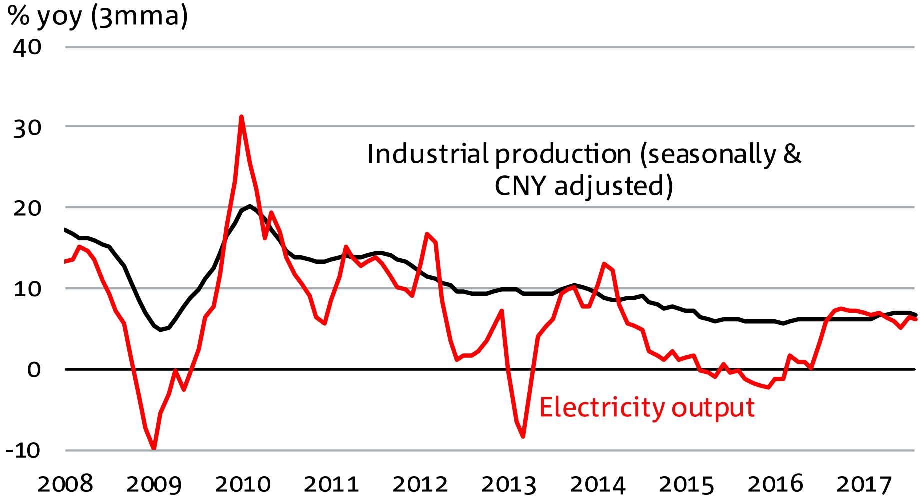
- Nominal retail sales growth was a little softer in August, which combined with a slightly stronger rate of inflation, has pushed down the growth in real retail sales to 8.9% yoy (from 9.6% in July). The slowing trend for real retail sales across the past two months came despite consumer confidence rising further in July – up to 114.6 points – the highest level in over two decades.

- The relative stability in China's monetary policy has continued in recent months, with the 7 day Shibor trading in a narrow range of 12.5 basis points since the start of August. That said, the Shibor has softened in September, down to around 2.8% at the time of writing. The PBoC is pursuing 'prudent and neutral' monetary policy in 2017 – aiming to maintain stable liquidity and 'hold interest rates at an appropriate level'. Managing the sizeable corporate debt burden and the risk of capital flight should US interest rates rise further (as expected) means we maintain an upside bias to rate expectations over the next twelve months.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

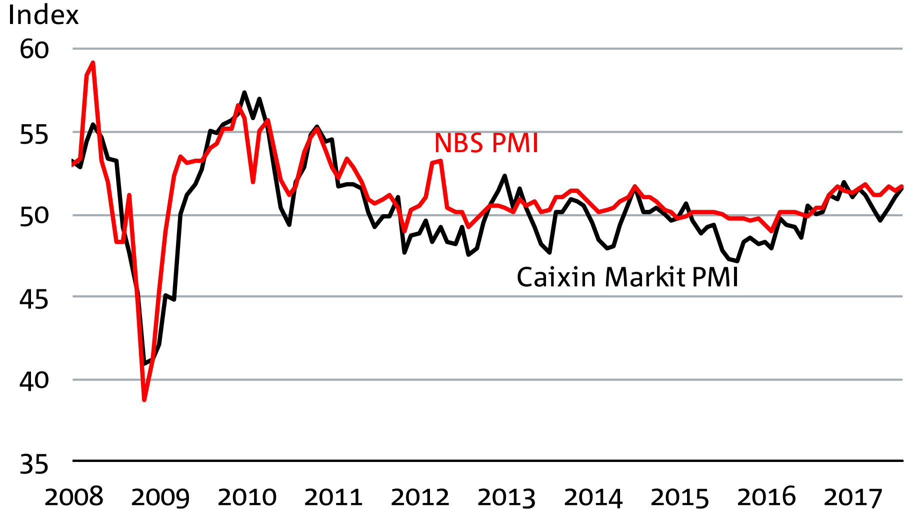
Output growth dipped in August, just below trend levels



Source: CEIC, NAB Economics

PMI SURVEYS STRONGER IN AUGUST

China's manufacturing conditions remain positive



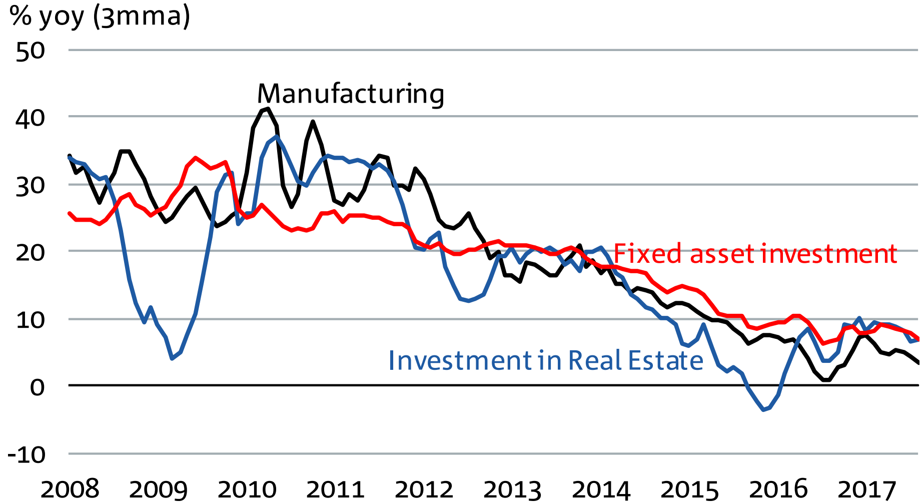
Source: CEIC, NAB Economics

- Growth in China's industrial production slowed a little further in August – with output up by 6.0% yoy (compared with 6.4% in July and a two and a half year high of 7.6% in June). This increase was below market expectations (at 6.6% in the Thomson Reuters poll and 6.7% in the Bloomberg survey).
- Individual industries continued to display mixed trends. Crude steel continues to surge – with production rising by 8.7% yoy to 74.6 million tonnes – the third straight month of record output. In contrast, cement – another construction related sector – saw output fall by 3.7% yoy.
- Both motor vehicle production and electricity output recorded robust output growth – at 4.7% yoy and 4.8% yoy respectively.
- There was a modest improvement in both of China's major manufacturing surveys in August. The official NBS PMI edged up to 51.7 points (from 51.4 points in July) – just below the multi-year high recorded in March. The Caixin Markit PMI rose more strongly – up to 51.6 points (from 51.1 points previously).

INVESTMENT

INVESTMENT BY INDUSTRY

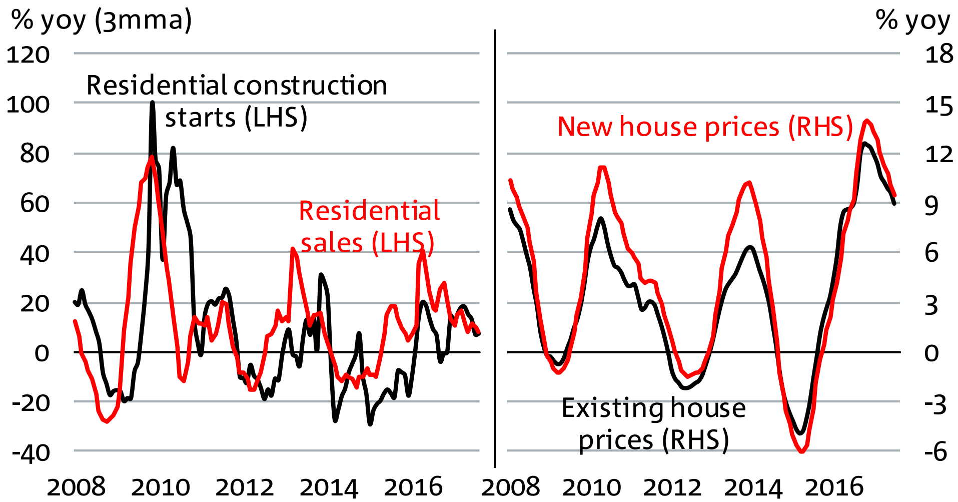
Weaker manufacturing spend pushes investment lower



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION

Softer trends, but too early to confirm a broad slowdown



Source: CEIC, Datastream, NAB Economics

- China's fixed asset investment grew at a much slower rate in August – increasing by 4.9% yoy (compared with 6.8% in July). Reflecting the upturn in producer prices during the month, this suggests that the growth in real investment was negative – at around -2.4% yoy – the largest real decline recorded since late 1995.

- A slowing trend in nominal investment was evident among both private sector firms and state owned enterprises (SOEs) in August. Private sector investment slowed to 3.0% yoy (from 4.9% in July), while SOE investment declined to 8.3% yoy (from 10.3% previously). On a three month moving average basis, the growth in SOE investment was at its slowest pace since February 2015.

- At an industry level, there was a sharp slowdown in manufacturing investment growth – which increased by 3.6% yoy (3mma) in August (down from 4.6% previously). In contrast, investment in real estate was fractionally stronger – at 6.8% yoy (3mma), from 6.7% in July. That said, real estate investment has slowed when compared with the first half of 2017.

- It is still too early to say there has been a broad slowdown in construction activity – a trend we have been anticipating for some time. Three month moving average housing starts rose by 7.4% yoy – up from 7.1% in July, but well below the high double digit growth rates in the first half of the year.

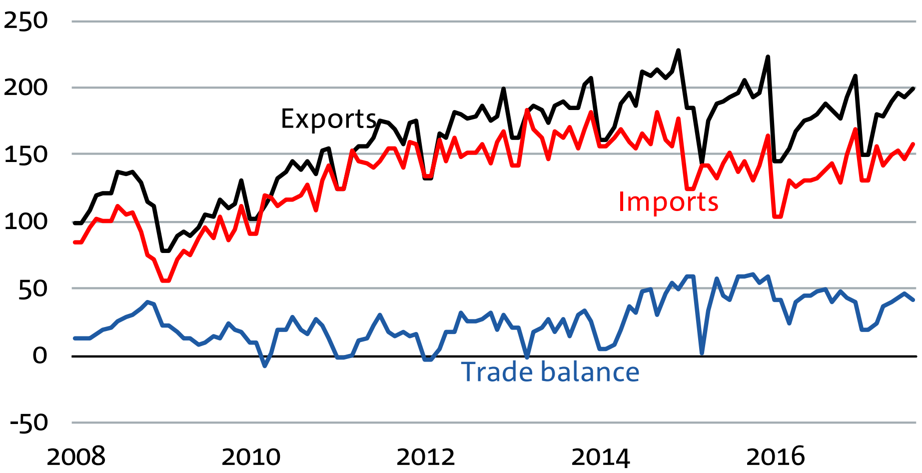
- Similarly, while house price growth was weaker in July – at 0.5% mom (3mma) for new houses and 0.4% mom (3mma) for existing properties (from 0.6% for both measures in June) – it is too early to conclude that policy measures designed to cool the housing market are having an affect.

- We remain cautious about calling the broad slowdown in construction and housing markets, particularly given the ongoing strength in steel output – with crude steel recording record output for the third straight month. Construction accounts for over half of China's steel demand.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

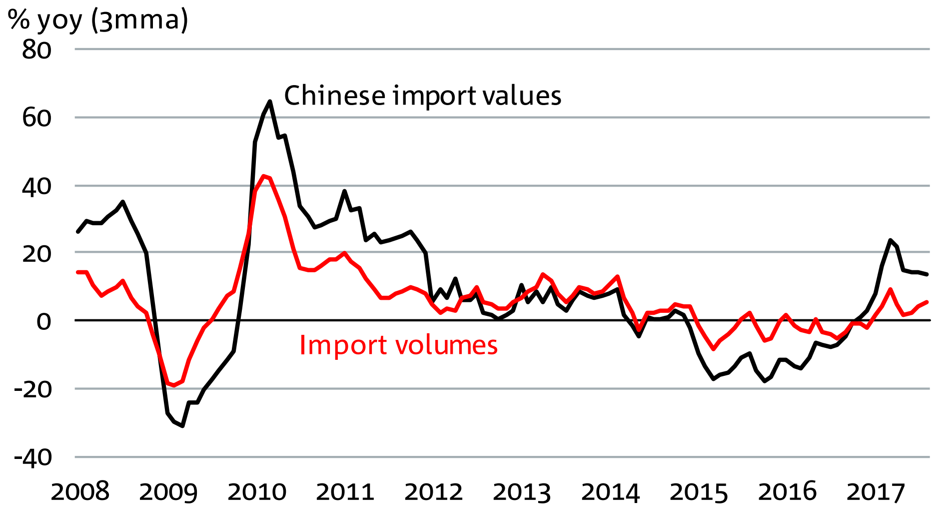
TRADE SURPLUS SLIGHTLY NARROWER IN AUGUST

Strong month-on-month increase in import values



IMPORT VALUES AND VOLUMES

Price effects evident with growth in volumes more modest



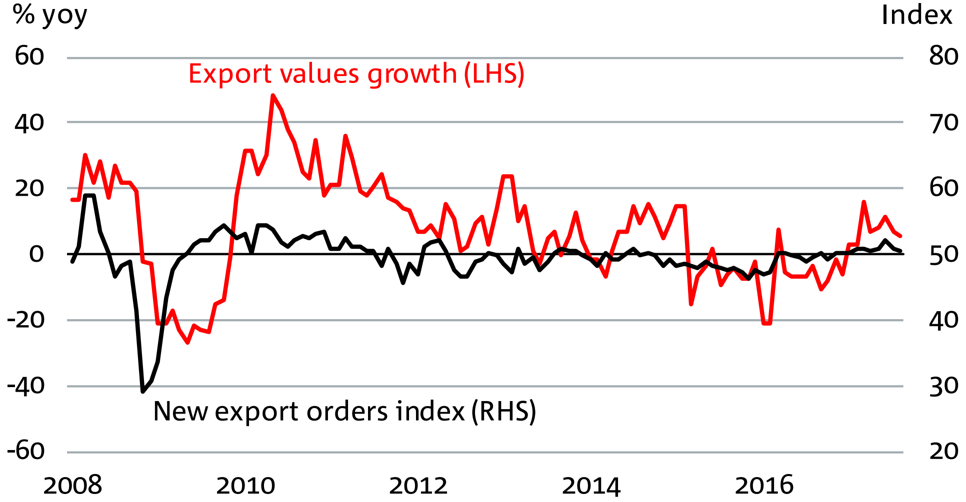
Source: CEIC, NAB Economics

- China's trade surplus narrowed in August – down to US$42.0 billion (compared with US$46.7 billion in July). Both export and import values rose month-on-month, with a sizeable increase in imports narrowing the overall balance.
- China's imports totalled US$157.2 billion in August (up from US$146.8 billion previously), an increase of 13.3% yoy. Trends in commodity prices continue to have a major influence on the growth in import values – with the RBA Index of Commodity Prices rising by 21% yoy and 2.7% month-on-month. Despite the recent uptick in commodity prices, the overall index remains below the recent cyclical peak from February, meaning that the impact of price effects on China's export values should erode in the coming months as price growth stalls.
- In contrast, growth in import volumes has been more modest, but has trended higher in recent months – up by 5.8% yoy (on a three month moving average basis) in August, compared with 4.1% in July and a recent low of 1.9% in May.
- The import trends for key commodities remain quite divergent. Imports of coal rose to 25.3 million tonnes, the highest level this year – albeit volumes were down 5.0% yoy. There is some uncertainty around the outlook for Chinese coal imports – with reports suggesting that authorities are attempting to introduce unofficial import quotas at ports to encourage domestic coal consumption.
- There were modest increases in other major industrial imports, with crude oil volumes rising by 3.4% yoy, while imports of iron ore rose by 1.1% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

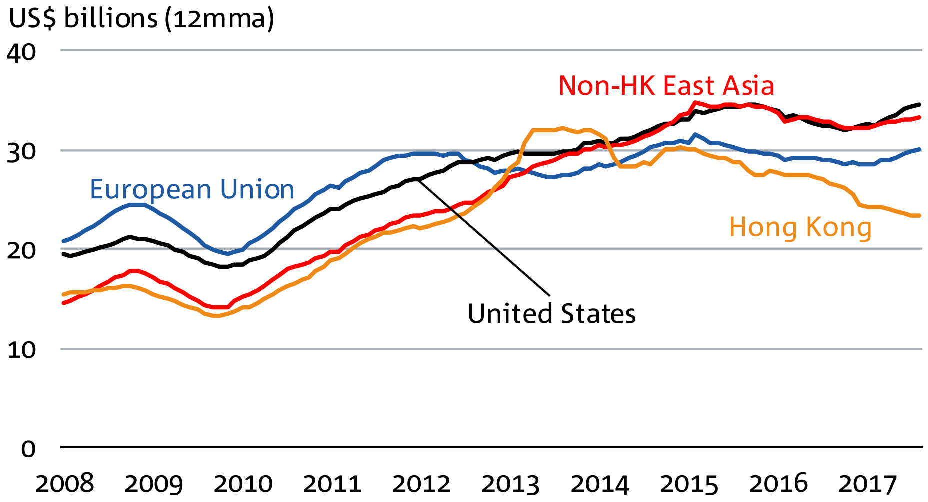
Softer export growth and confidence in August



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Declining trade with Hong Kong not evident in HK data



Sources: CEIC, NAB Economics

- China's exports rose marginally month-on-month, totalling US$199.2 billion (up from US$193.0 billion in July). The confidence of Chinese exporters was a little weaker in August, with the new export orders measure of the NBS PMI survey edging down to 50.4 points (from 50.9 points in July).
- There remains some key differences in the reported exports to major markets. Exports to the United States rose by 8.4% yoy, while exports to the European Union increased by 5.2% yoy. In contrast, exports to other East Asian markets rose by just 3.8% yoy – albeit faster than the 0.5% increase recorded in July.
- For the latter category, exports to non-Hong Kong East Asia rose by 6.6% yoy, while deliveries to Hong Kong fell by 0.1% yoy. Vietnam and Korea accounted for the bulk of the increase.
- As we have previously noted, distortions in reported trade data between China and Hong Kong – in part related to false invoicing schemes that masked capital outflow as trade activity – inflated historical trade data, resulting in weak growth rates that don't accurately reflect current trade flows.
- This is most evident in comparisons between Chinese and Hong Kong customs data. According to Chinese data, exports to Hong Kong fell by 7.4% yoy over the first seven months of the year. Hong Kong customs indicates that imports from China rose by 5.9% yoy over the same period.

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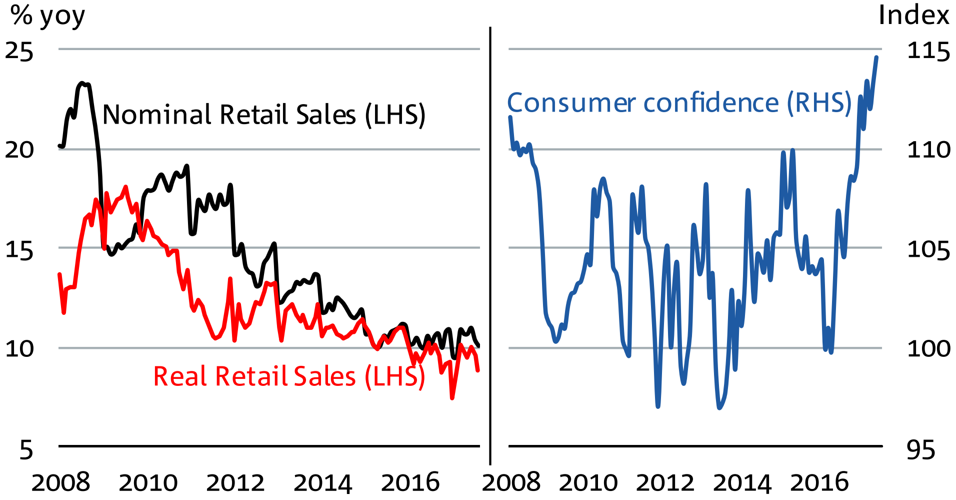
RETAIL SALES AND INFLATION

REAL RETAIL SALES GROWTH SLIPES

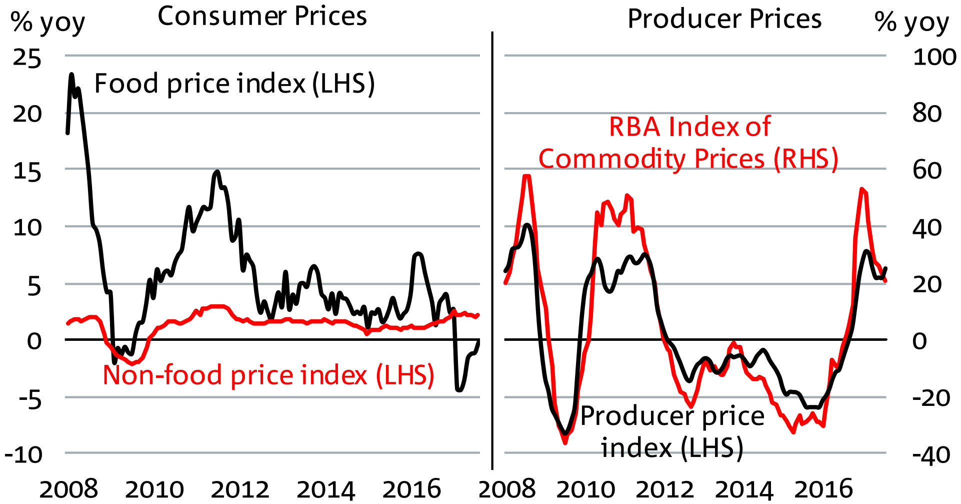
Consumer confidence hit two decade high in July



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Both consumer and producer prices higher in August



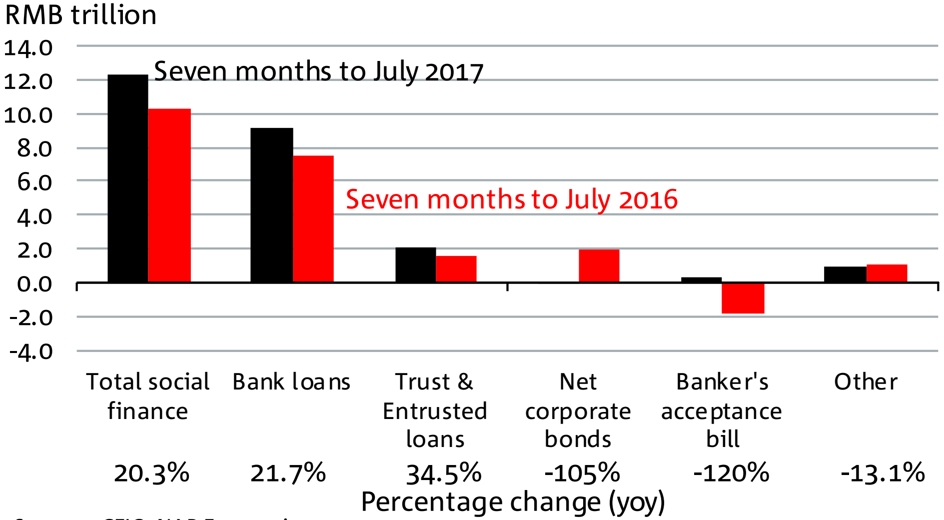
Source: CEIC, RBA, NAB Economics

- Retail sales growth was a little softer in August – with nominal sales increasing by 10.1% yoy (down from 10.4% previously). Combined with a slightly stronger rate of inflation, this has pushed down the growth in real retail sales – to 8.9% yoy (from 9.6% in July).
- The slowing trend for real retail sales across the past two months came despite consumer confidence rising further in July – up to 114.6 points – the highest level in over two decades.
- China's headline inflation was stronger in August, as food price deflation largely disappeared and non-food prices accelerated. The Consumer Price Index rose by 1.8% yoy (compared with 1.4% in July) – the strongest increase since January.
- Food prices have fallen for seven straight months – however the decline was just 0.2% yoy in August (compared with -1.1% in July). The key contributors to this trend were weaker declines in pork prices (which fell by 13% yoy, compared with 16% in July) and eggs (which rose by 4.3% yoy, compared with falls of 4.9% previously).
- There was stronger growth in non-food prices in August – increasing by 2.3% yoy (compared with 2.0% previously). Fuel prices rose by 7.0% yoy (compared with just 1.2% in July), while healthcare costs rose by 5.9% yoy.
- Producer prices grew a little stronger in August – with prices rising by 6.3% yoy (up from the 5.5% growth rate recorded each month between May and July). This increase came despite a modest slowdown in commodity price growth – with the RBA Index of Commodity Prices rising by 21% yoy in August, compared with 22% in July. Weaker growth in commodity prices in coming months could see producer prices soften in coming months – given the close observed relationship between these measures.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

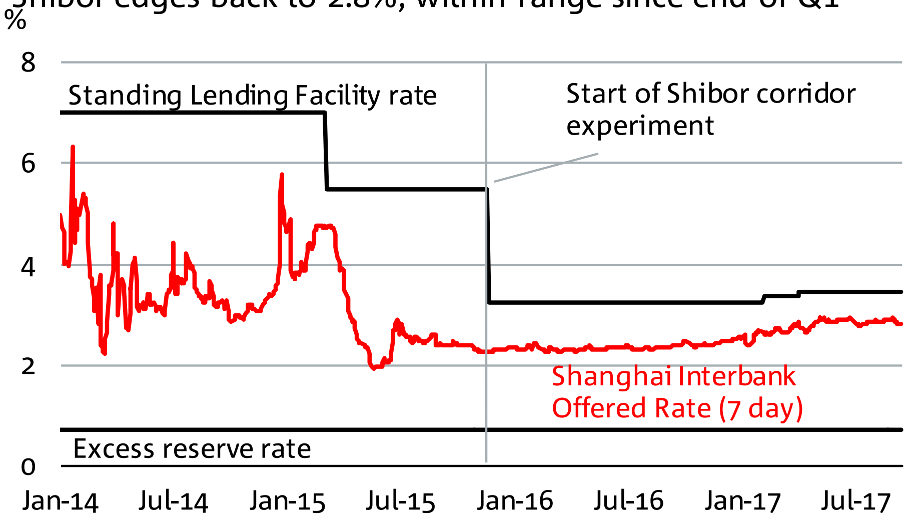
Growth has accelerated as bank loans expand rapidly



Sources: CEIC, NAB Economics

LITTLE MOVEMENT IN MONETARY POLICY

Shibor edges back to 2.8%, within range since end of Q1



Source: CEIC, NAB Economics

- Credit data for August was not available at the time of writing. However, China's new credit issuance rose by 20 % yoy in the first seven months of 2017, to total RMB 12.4 trillion.
- Bank loans accounted for the majority of new credit – in part reflecting tighter regulation of the shadow banking sector. Bank loans totalled RMB 9.2 trillion over the period (almost three-quarters of the total credit issuance) – an increase of 22% yoy.
- That said, parts of the shadow banking sector have continued to record growth. Trust and entrusted loans rose by around 34% yoy in the first seven months of the year, to total RMB 2.0 trillion. Banker's acceptance bills have increased modestly – to RMB 363 billion – having contracted sharply over the same period last year.
- Corporate bond issuance appears to have recommenced in July – with total outstanding debt contracting by RMB 95 billion in the first seven months, compared with RMB 379 billion in the first half.
- The relative stability in China's monetary policy has continued in recent months, with the 7 day Shibor trading in a narrow range of 12.5 basis points since the start of August. That said, the Shibor has softened in September, down to around 2.8% at the time of writing.
- The PBoC is pursuing 'prudent and neutral' monetary policy in 2017 – aiming to maintain stable liquidity and 'hold interest rates at an appropriate level'. Managing the sizeable corporate debt burden and the risk of capital flight should US interest rates rise further (as expected) means we maintain an upside bias to rate expectations over the next twelve months.

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
Director, Economics
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
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

Jason Wong
Currency Strategist
+64 4 924 7652

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

UK/Europe
Gavin Friend
Senior Markets Strategist
+44 207 710 2155

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