CHINA'S ECONOMY AT A GLANCE

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KEY POINTS

China's stable growth continued in Q3, but supported by another credit binge

- The 19th National Congress of the Communist Party of China commenced in Beijing this week, a meeting that will shape the country's leadership for the next five years. As many as five of the seven member Politburo Standing Committee are set to retire, and their replacements may signal whether President Xi is likely to serve an additional five year term (beyond the current one ending in 2022) and whether the stalled reform agenda can be brought back on track.

- The latest national accounts data showed that China's economy expanded by 6.8% yoy in the third quarter, compared with 6.9% in Q2. As was the case with Q2, economic growth in Q3 was supported with a large scale increase in credit. Reflecting the strength of economic growth across the first three quarters, we have revised our forecast for 2017 to 6.8% (from 6.7% previously). Our forecasts for 2018 and 2019 are unchanged – at 6.5% and 6.25% respectively.

- China's industrial production grew by 6.6% yoy in September – accelerating from the comparatively weak 6.0% recorded in August. Crude steel production rose in year-on-year terms in September (up by 5.3%) but has declined from recent peaks – down to 71.8 million tonnes (from an all time high of 74.6 million tonnes in August).

- Fixed asset investment grew at a faster rate in September – up by 5.7% yoy (compared with 4.9% in August) – albeit this was still the second lowest rate of growth in 2017. Given the acceleration in producer prices during September, this implies the second straight month of negative real investment – at around -1.4% yoy (compared with -1.6% previously). New construction starts have slowed in recent months – well off the peaks recorded in June. On a three month moving average basis, new residential starts rose by 4.7% yoy in September – the slowest rate of growth this year, and well off the double digit levels of the first half. Similarly, house sales have softened.

- China's trade surplus narrowed further in September – down to US$28.5 billion (compared with US$41.0 billion previously). Compared with the levels from August, there was a sharp increase in imports, while exports were marginally lower. Import volumes of key industrial commodities rose strongly – with iron ore import volumes rising to record levels, a surprise given the planned shutdown of steel capacity in a range of northern cities across November to March.

- Retail sales growth was marginally stronger in September. In line with a slight softening in inflation trends, real retail sales growth was stronger – back up to 9.3% yoy (compared with 8.9% in August). Consumer confidence has continued to improve – albeit only modestly in August – up to 114.7 points (from 114.6 points in July) – the highest level in over two decades.

- China's monetary policy remained relatively stable across Q2 and Q3 – following modest tightening in Q1. Over this period, the 7 day Shibor traded in a range of just 184 basis points – broadly around 2.8%. The Shibor trended closer to 3.0% immediately ahead of the Golden Week holidays (at the start of October) but has subsequently trended lower.

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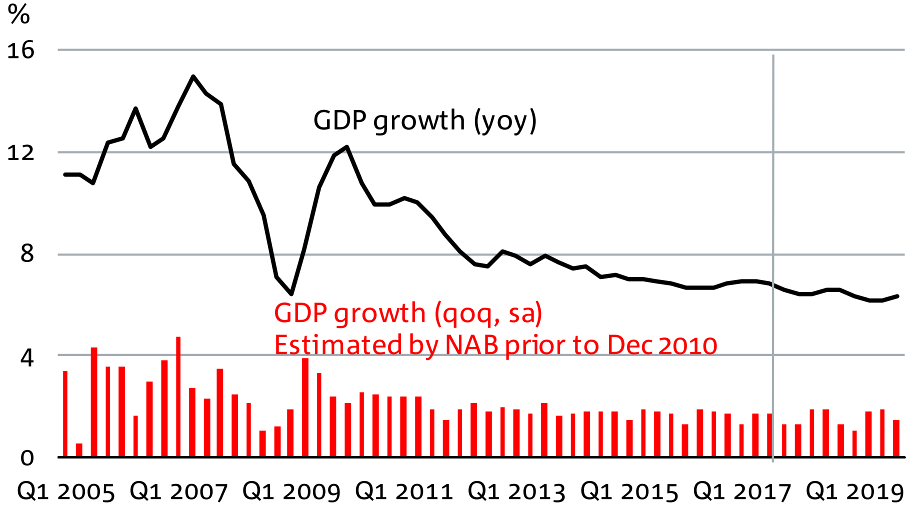
GROSS DOMESTIC PRODUCT

REAL GDP EDGES SLIGHTLY DOWN TO 6.8% YOY IN Q3

China's stable growth trend continues

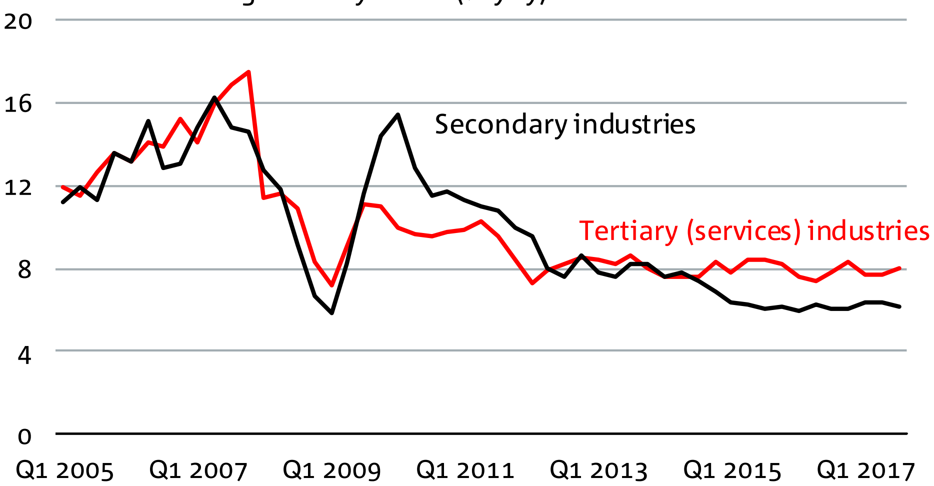


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

The gradual transition towards services continues

Chinese economic growth by sector (% yoy)



Source: Datastream, NAB Economics

- The latest national accounts data showed that China's economy expanded by 6.8% yoy in the third quarter, compared with 6.9% in Q2. This was in line with market expectations in both the Bloomberg and Thomson Reuters surveys.

- As was the case with Q2, economic growth in Q3 was supported with a large scale increase in credit – with credit issuance increasing by 23% yoy, well above nominal economic growth. As a result, China's already high debt to GDP ratio has expanded further – posing some longer term risks to the economy.

- It is worth noting the disconnect between headline annual growth measures and the NBS's seasonally adjusted quarterly growth rates – which imply a slower rate of growth for Q3 at around 6.6%.

- Services remain the key driver of China's economic growth – increasing by 8.0% yoy (compared with 7.7% in Q2). In contrast the contribution from secondary industries declined – growing by 6.1% yoy (from 6.4% previously). This continues to suggest that the gradual transition away from heavy industry towards consumption continues.

- Reflecting the strength of economic growth across the first three quarters, we have revised our forecast for 2017 to 6.8% (from 6.7% previously). Our forecasts for 2018 and 2019 are unchanged – at 6.5% and 6.25% respectively.

NAB GDP FORECASTS

%	2017	2018	2019
GDP	6.8	6.5	6.25

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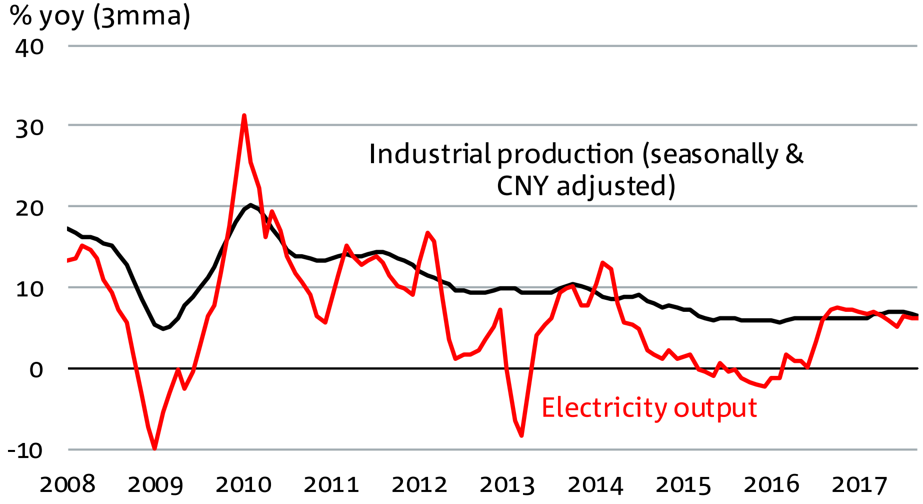
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

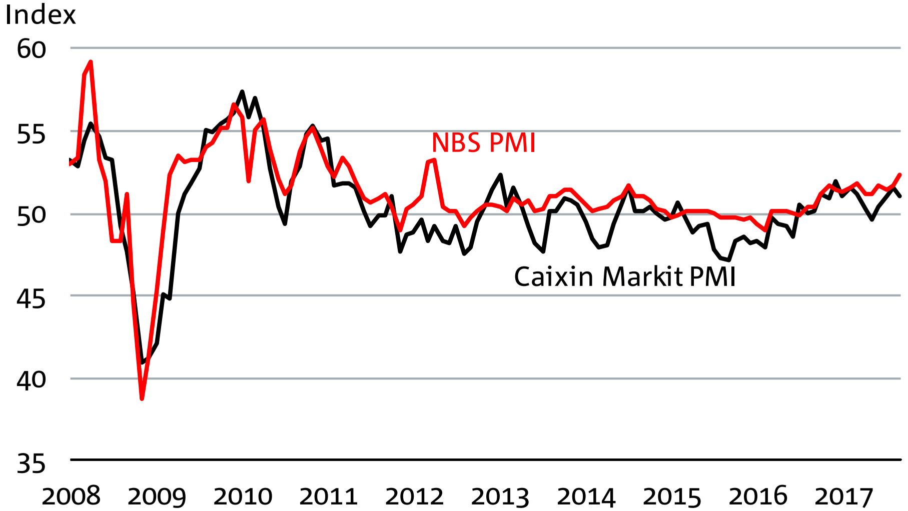
Output accelerated in September – up to 6.6% yoy



Source: CEIC, NAB Economics

PMI SURVEYS DIVERGE IN SEPTEMBER

Official measure rises to five year high



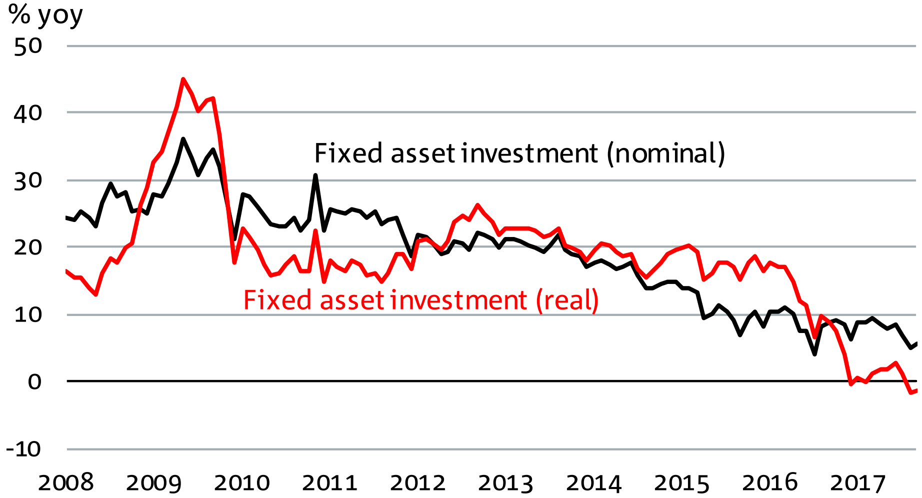
Source: CEIC, NAB Economics

- China's industrial production grew by 6.6% yoy in September – accelerating from the comparatively weak 6.0% recorded in August. This result was marginally ahead of expectations in the Bloomberg poll (6.5%) and well above the Thomson Reuters survey (6.2%).
- Crude steel production rose in year-on-year terms in September (up by 5.3%) but has declined from recent peaks – down to 71.8 million tonnes (from an all time high of 74.6 million tonnes in August). Production of cement – closely tied to the construction sector – fell by 2.0% yoy.
- Motor vehicle production recorded slightly weaker growth (3.1% yoy, compared with 4.7% in August), while electricity output rose by 5.3% yoy (up from 4.8% previously).
- Trends in China's major manufacturing surveys diverged in September. The official NBS PMI pushed higher – to 52.4 points (from 51.7 points previously) – the highest reading for the survey since April 2012. In contrast, the Caixin Markit PMI pulled back, to 51.0 points (from 51.6 points previously). This may reflect the differing composition of these surveys – with the NBS measure typically thought to have a higher share of large SOE firms.

INVESTMENT

FIXED ASSET INVESTMENT

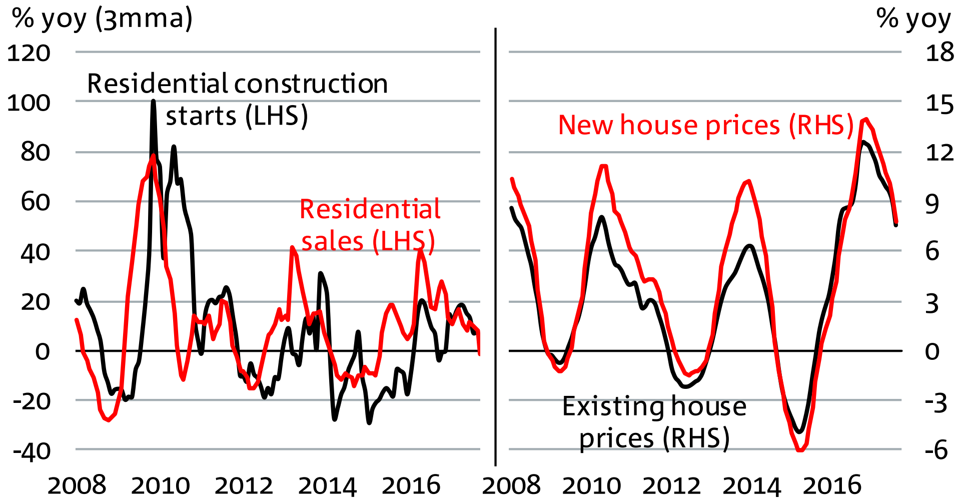
Higher prices pushes real investment growth negative



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION

Housing sales and construction showing signs of slowing



Source: CEIC, Datastream, NAB Economics

- Fixed asset investment grew at a faster rate in September – up by 5.7% yoy (compared with 4.9% in August) – albeit this was still the second lowest rate of growth in 2017. Given the acceleration in producer prices during September, this implies the second straight month of negative real investment – at around -1.4% yoy (compared with -1.6% previously).

- The nominal increase was more evident among China's state-owned enterprises (SOEs) – with investment increasing by 9.8% yoy (compared with 8.3% in August). In contrast, private investment only edged slightly higher – up by 3.3% yoy (from 3.0% previously). That said, on a three month moving average basis, SOE investment grew at its slowest rate since February 2015.

- At an industry level, there continued to be divergent trends in investment. Real estate investment recorded a modest acceleration – up to 7.3% yoy (on a 3 month moving average basis), compared with 6.8% previously. In contrast, manufacturing investment was much weaker – at 2.2% yoy (3mma), from 3.6% in August. When combined, these two sectors accounted for 53% of total fixed asset investment in the first eight months of the year.

- New construction starts have slowed in recent months – well off the peaks recorded in June – however there was a noticeable increase month-on-month in September (possibly in line with the uptick in investment). On a three month moving average basis, new residential starts rose by 4.7% yoy in September – the slowest rate of growth this year, and well off the double digit levels of the first half. Similarly, house sales have softened.

- House price growth has continued to slow – with new properties increasing by just 0.4% mom (3mma) in August, while existing properties rose by 0.3% mom – with prices in China's largest cities contracting. It appears that the tightening in policy is gradually bringing property markets back into order – but it is still too early to tell if this will significantly slow the construction boom – a trend we have been anticipating for some time.

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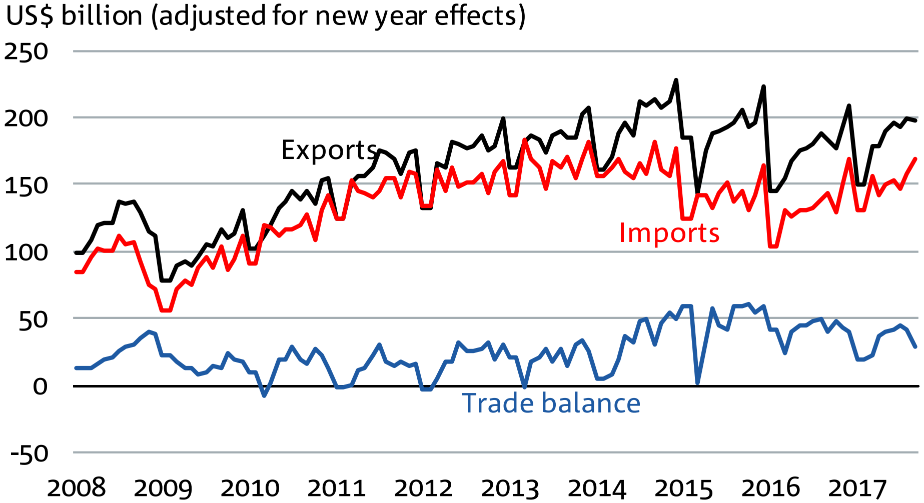
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS MUCH NARROWER IN SEPTEMBER

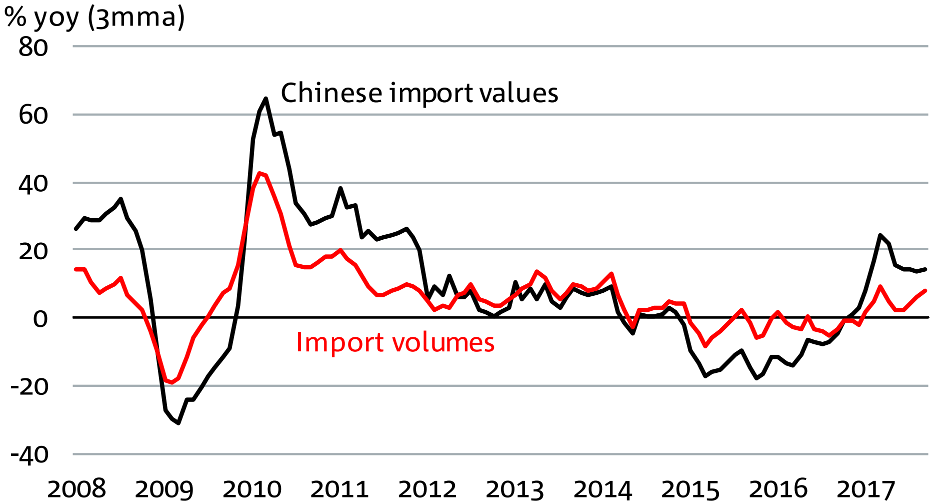
Sharp increase in imports narrows the trade balance



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

Volumes accelerated in September – including iron ore and coal



Source: CEIC, NAB Economics

- China's trade surplus narrowed further in September – down to US$28.5 billion (compared with US$41.0 billion previously). Compared with the levels from August, there was a sharp increase in imports, while exports were marginally lower.
- China's imports totalled US$169.8 billion in September (compared with US$157.5 billion in August) – an increase of 18.7% yoy. This level was the strongest result since December 2014. Some of this increase reflects price effects – with the RBA Index of Commodity Prices rising by 20% yoy – however it appears that volumes rose strongly as well.
- Import volumes appear to have increased strongly in September – with our estimate increasing by 11.7% yoy. On a three month moving average basis, volumes rose by 7.7% yoy in September, compared with 6.0% in August.
- There was a significant ramp up in import volumes of some key commodities – particularly iron ore and coal. Iron ore imports rose by 10.6% yoy to 102.8 million tonnes, an all time record. The strength of this increase was surprising – given the planned shutdown of steel capacity in a range of northern cities across November to March, along with a slowing in steel output.
- Similarly, coal imports rose strongly – up to 27.1 million tonnes – an increase of 10.8% yoy and the highest level since December 2014. Reports in September suggested that authorities were seeking to restrict coal imports to support domestic coal consumption – meaning this may reflect stockpiling ahead of these changes.
- Other major commodity imports also rose strongly – with copper volumes rising by 26% yoy and crude oil by 11.9% yoy.

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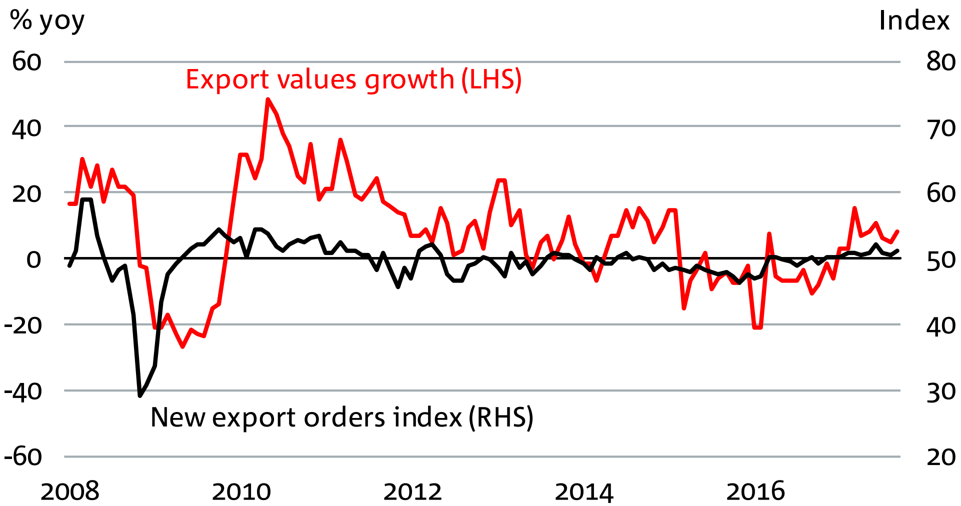
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

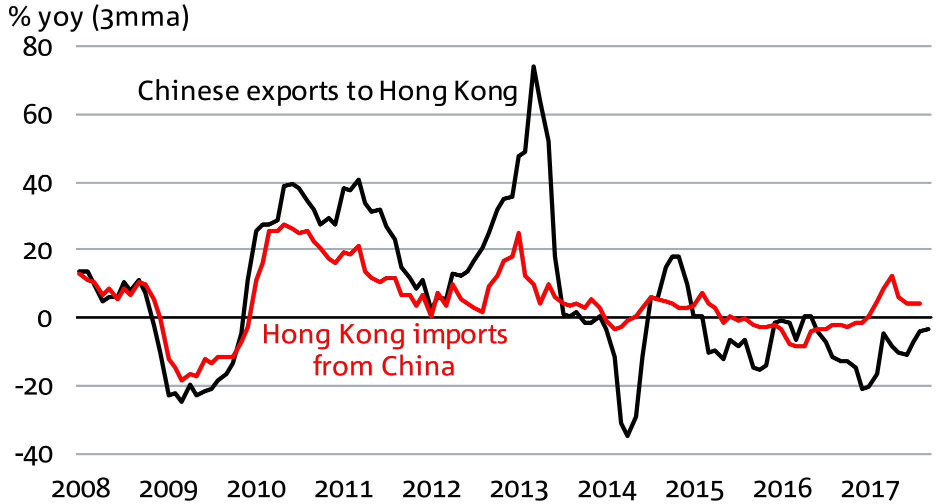
Both export growth and confidence moved higher in September



Source: CEIC, NAB Economics

EXPORTS TO HONG KONG

China's reported declines not evident in Hong Kong data



Source: CEIC, NAB Economics

- Export values dipped marginally month-on-month in September, down to US$198.3 billion (from US$198.6 billion in August) – although this still represented an increase of 8.1% yoy. The confidence of Chinese exporters was stronger in September – with the new export orders measure of the NBS PMI survey back up to 51.3 points (having dipped down to 50.4 points previously).
- China's data continues to show considerable differences in terms of exports by major market. Exports to the United States rose by 13.8% yoy, while exports to the European Union increased by 10.4% yoy. In contrast, exports to East Asian markets rose by just 4.1% yoy.
- Within the East Asian category, exports to Hong Kong fell by 5.7% yoy in September, while exports to non-Hong Kong markets rose by 12.2% yoy, with Vietnam, South Korea, Taiwan and Malaysia accounting for the majority of this increase.
- We have regularly noted the sizeable disparity between Chinese and Hong Kong Customs trade data prior to 2017 – particularly between 2012 and 2016 – and this continues to result in growth rates that distort the actual trade picture. In part this may reflect historical capital flows disguised as trade activity to avoid capital controls.
- For example, over the first eight months of 2017, Hong Kong Customs data shows that imports from China rose by 5.5% yoy. In contrast, Chinese data suggests that exports to Hong Kong fell by 6.5% over the same period.

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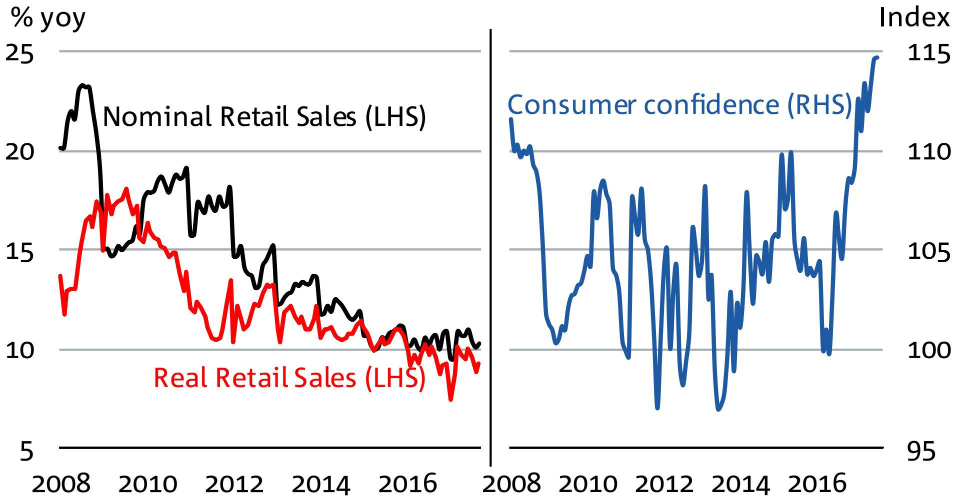
RETAIL SALES AND INFLATION

REAL RETAIL SALES EDGES BACK ABOVE 9%

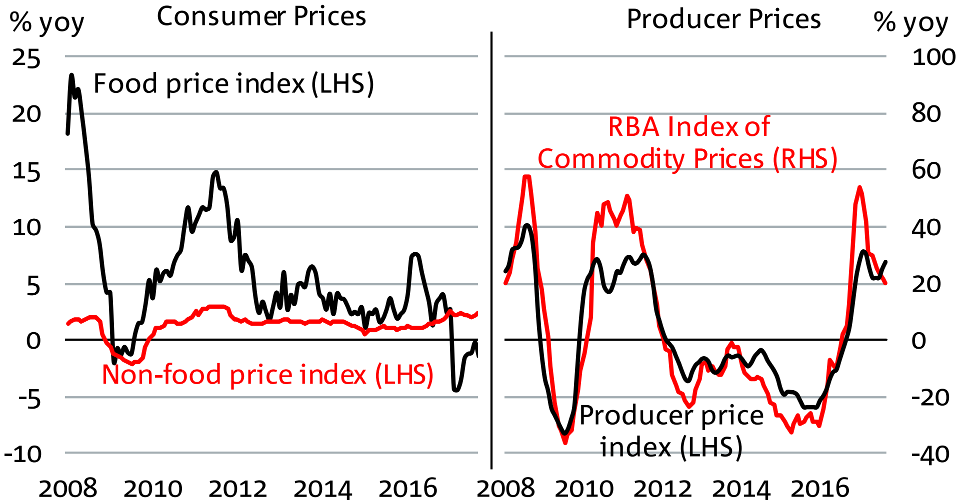
Consumer confidence at a new two decade high in August



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Food prices softer, producer prices ticked higher in September



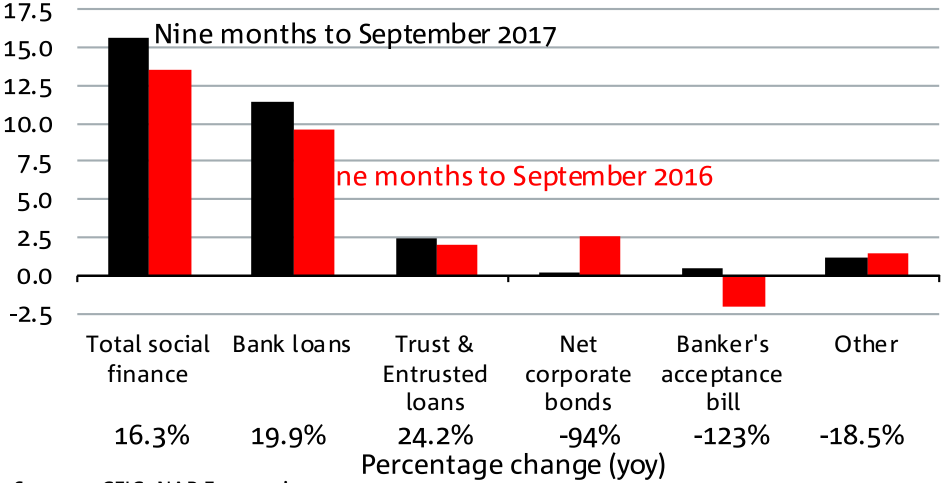
Source: CEIC, RBA, NAB Economics

- Retail sales growth was marginally stronger in September – with nominal sales increasing by 10.3% yoy (compared with 10.1% previously). In line with a slight softening in inflation trends, the improvement in real retail sales was stronger – back up to 9.3% yoy (compared with 8.9% in August).
- Consumer confidence has continued to improve – albeit only modestly in August – up to 114.7 points (from 114.6 points in July) – the highest level in over two decades.
- China's headline inflation was weaker in September, with food price deflation returning (after the moderation of August). The Consumer Price Index rose by 1.6% yoy (down from 1.8% previously).
- Food prices in China have fallen for eight months in a row, with the index dropping by 1.4% yoy (compared with the 0.2% decline in August). This decrease was driven by falling prices for pork (down 12.4%), fresh fruit (down 3.0%) and fresh vegetables (down 1.0%).
- In contrast, non-food prices have continued to grow comparatively strongly – with prices rising by 2.4% yoy (up from 2.3% in August and 2.0% in July). Costs for healthcare and medical services rose by 7.6% yoy, vehicle fuel by 5.1% yoy and property related expenses by 2.8% yoy.
- Producer prices accelerated a little in September – rising by 6.9% yoy (from 6.3% in August) – even as trends in commodity markets (a key driver of producer price trends) softened. The RBA Index of Commodity Prices rose by 20% yoy (compared with 22% in August). Strong demand for heavy industrial products – possibly demand brought forward due to the upcoming industrial shutdown over the November to March period – could explain some of this uptick.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

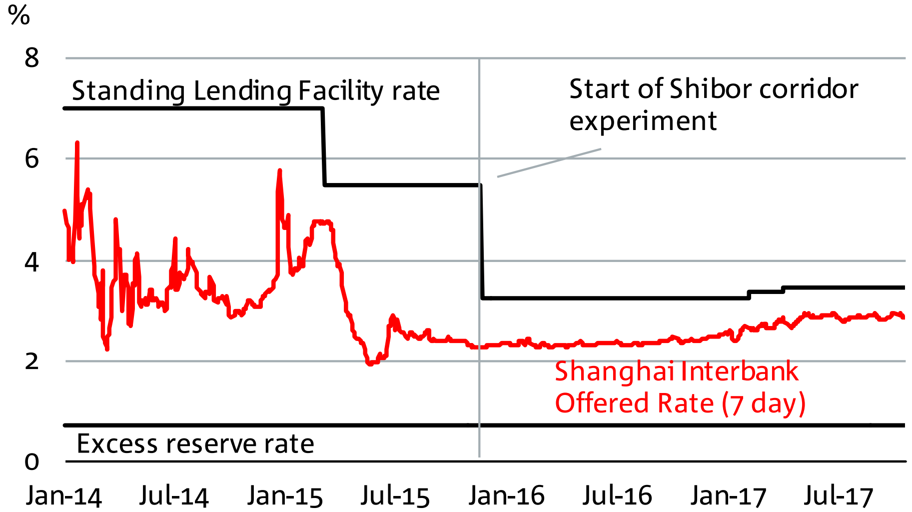
Bank lending driving the growth in Chinese credit



Sources: CEIC, NAB Economics

PBOC MAINTAINING STABLE MONETARY POLICY

Shibor continuing to trend around 2.8%



Source: CEIC, NAB Economics

- China's credit issuance has continued to grow strongly – with new credit rising by 23% yoy in Q3, compared with 36% in Q2. For the first three quarters of 2017, credit issuance totalled RMB 15.7 trillion (an increase of 16.3% yoy).
- Bank loans have grown strongly – accounting for almost three-quarters of new credit – with tighter regulation of the shadow banking sector forcing some lending back through traditional channels. Bank loans totalled RMB 11.5 trillion in the first three quarters, an increase of 20% yoy.
- Non-bank lending increased by around 7.7% yoy over the same period, however trends differed considerably. Key parts of the shadow banking sector – trust and entrusted loans – rose by 24% yoy. Banker's acceptance bills have increased modestly this year – with new issuance totalling RMB 466 billion – but this was much stronger than the sharp contraction over the same period last year.
- In contrast, corporate bond issuance has been markedly weaker this year – totalling just RMB 150 billion in the first nine months – compared with around RMB 2.6 trillion for the same period in 2016.
- China's monetary policy remained relatively stable across Q2 and Q3 – following modest tightening in Q1. Over this period, the 7 day Shibor traded in a range of just 18.4 basis points – just above 2.8%. The Shibor trended closer to 3.0% immediately ahead of the Golden Week holidays (at the start of October) but has subsequently trended lower.
- The PBoC has stated that it is pursuing 'prudent and neutral' monetary policy. Given efforts to address the sizeable corporate debt burden and the risk of capital flight, we argue that there is minimal downside risk to rates, and there may be an upside bias over the next year.
- At the end of September 2017, the PBoC unexpectedly announced a cut to the Required Reserve Ratio – the first since February 2016. Rather than a loosening in monetary policy, this measure was designed to encourage lending to smaller firms (more details here).

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