CHINA'S ECONOMY AT A GLANCE

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National Australia Bank

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KEY POINTS

Indicators point to marginally softer conditions post China's leadership change

- China's new leadership was unveiled following the 19th National Congress in October – which provided President Xi greater influence over policy decisions and increased the likelihood that he will continue to lead the country beyond the end of his second term in 2022. While it is unlikely that the leadership changes will have a measurable impact on China's economy in the short term, greater control may allow for a renewed focus on the stalled reform agenda outlined at 2013's Third Plenum. The need for reform is becoming more urgent, as demographic pressures accelerate (more detail here).

- Growth in industrial production was a little weaker in October – at around 6.2% yoy (compared with 6.6% previously) – essentially back to the trend seen since the start of 2015. Crude steel output rose strongly, but this may reflect production being brought forward ahead of capacity closures between November and March.

- Growth in China's fixed asset investment edged marginally higher in October – rising by 5.8% yoy (compared with 5.7% previously) – although the overall trend has been weaker in recent months. Given the upturn in producer prices in recent months, real investment has been negative recently – down by around 0.9% in October (broadly similar to September). The softer trend for nominal investment has largely come from private sector firms.

- China's trade surplus widened considerably in October, at US$38.2 billion, as imports slowed significantly. Iron ore imports totalled 79.5 million tonnes in October (compared with 102.8 million tonnes previously), the lowest level since February 2016. This likely reflects destocking ahead of the shutdown of steel production capacity between November and March.

- Growth in retail sales was a little softer in October. Given the uptick in inflation during the month, this pushed real retail sales lower – down to around 8.6% yoy (compared with 9.3% previously). Consumer confidence has continued to climb in recent months – up to 118.6 points in September (from 114.7 points previously). This level was the highest recorded since June 1995.

- New credit issuance was somewhat weaker month-on-month in October – in line with typical seasonal trends related to the Golden Week holidays – but remained comparatively strong year-on-year, rising by 17.3%.

- Monetary policy remains fairly stable, with the 7 day Shibor easing from just over 2.9% at the end of Golden Week back to around 2.85% at the time of writing. In the short term, we expect rates to remain around these levels. We believe there is limited downside risk – given the need to address high corporate debt levels and to manage capital flows – with the potential for an upside bias next year – particularly in response to movements from the US Federal Reserve.

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INDUSTRIAL PRODUCTION

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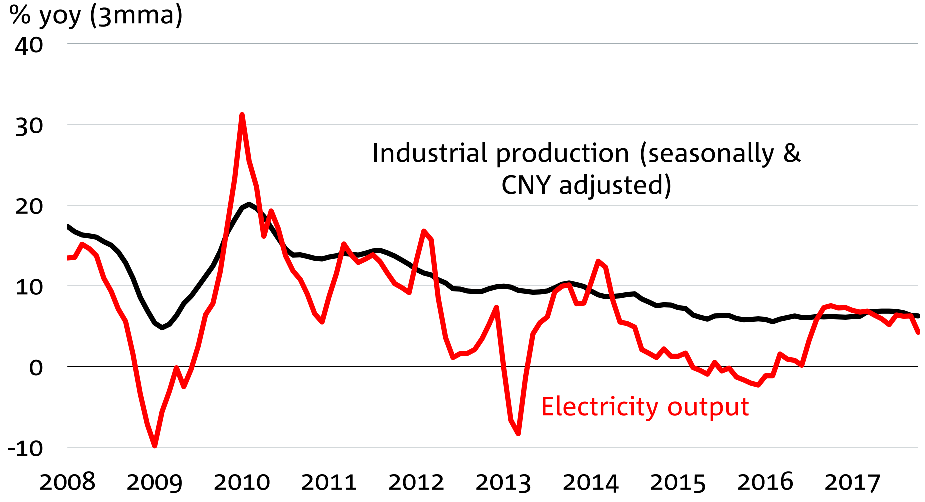
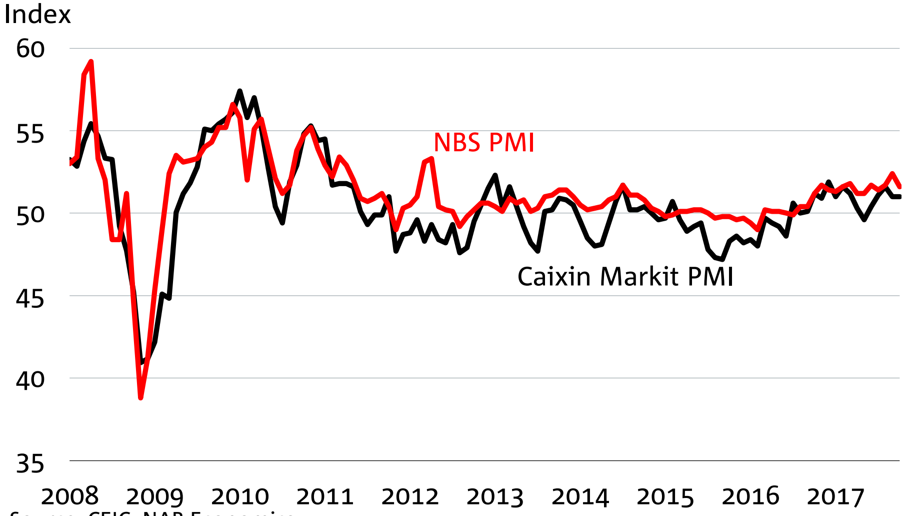
Output growth eased back to trend levels in October



Source: CEIC, NAB Economics

PMI SURVEYS SOFTER IN OCTOBER

Industrial conditions likely to soften in coming months



Source: CEIC, NAB Economics

- Growth in China's industrial production was a little weaker in October – at around 6.2% yoy (compared with 6.6% previously) – essentially back to the trend seen since the start of 2015. This was marginally weaker than market expectations and may reflect government imposed curbs to ensure clear skies during the 19th National Congress mid-month.

- Output trends for key industrial sectors remain divergent. Crude steel output rose month-on-month to 72.4 million tonnes – reflecting strong profitability for producers. However, this may also be the result of production being brought forward, with planned capacity closures across 26 northern Chinese cities between November and March set to commence.

- In contrast, cement production – closely tied to the construction sector – fell by 3.1% yoy, automotive production rose by just 0.6% yoy (compared with 3.1% in September) and electricity output increased by 2.5% (from 5.3% previously).

- The results of China's two major manufacturing surveys differed slightly in October. The official NBA PMI survey pulled back a little – to 51.6 points (from 52.4 points in September – a five year high for this survey). In contrast, the Caixin Markit PMI was stable at 51.0 points.

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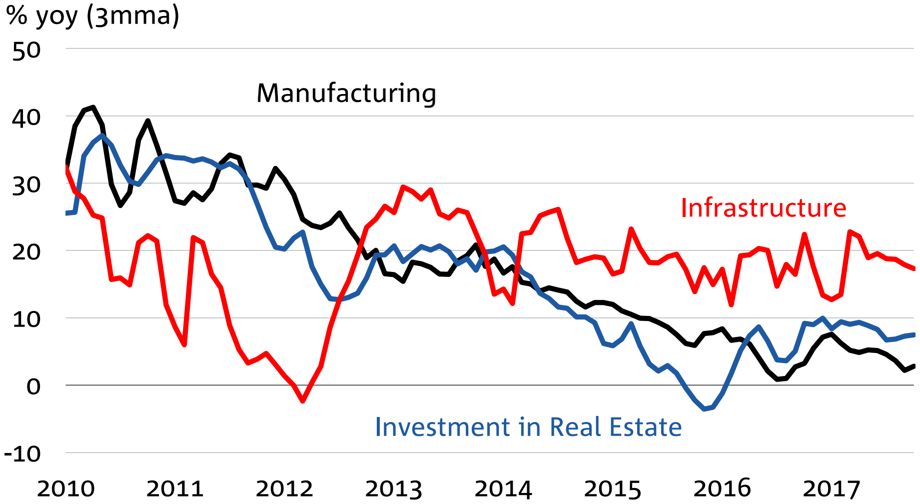
INVESTMENT

FIXED ASSET INVESTMENT

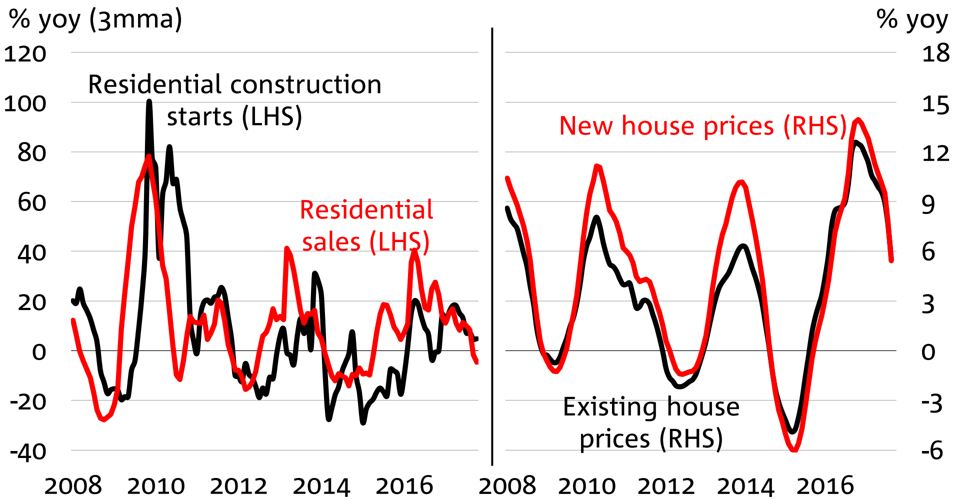
Infrastructure and real estate continue to hold up



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION

Housing sales are now contracting, which should slow construction



Source: CEIC, Datastream, NAB Economics

- Growth in China's fixed asset investment edged marginally higher in October – rising by 5.8% yoy (compared with 5.7% previously) – although the overall trend has been weaker in recent months. Given the upturn in producer prices in recent months, real investment has been negative recently – down by around 0.9% in October (broadly similar to September).

- The softer trend for nominal investment has largely come from private sector firms. Across the last three months, investment by state-owned enterprises (SOEs) has drifted marginally lower – from around 9.8% yoy (on a 3 month moving average basis) to 9.5% yoy. In contrast, private investment has slowed from 5.3% yoy (3mma) to 3.3% yoy over the same period.

- Investment trends by industry remain divergent. Infrastructure investment has remained persistently strong – growing at around 17.3% yoy (3mma) in October. Manufacturing investment has trended lower since the start of the year – albeit it was a little stronger this month at 2.8% yoy (3mma), compared with 2.2% previously. Investment in real estate was a touch stronger – at 7.5% yoy (3mma) – but below the trend from Q4 2016 through Q2 2017.

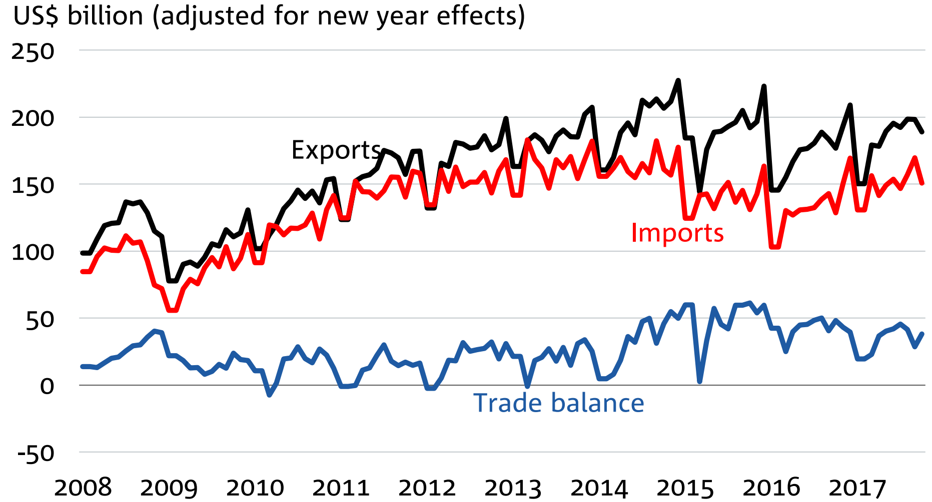
- Measures introduced by Chinese authorities to slow activity appear to be impacting the housing sector. Housing sales are now contracting – falling by 4.6% yoy (3mma) in October, while construction starts have also weakened – increasing by 4.8% yoy (3mma), compared with double digit growth rates across the first half of the year.

- House price trends have also continued to soften – with new and existing properties rising by just 0.2% mom (3mma) in September. In particular, prices in China's largest tier 1 cities are now contracting month-on-month. Tighter policy measures and falling sales should see construction activity slow further in coming months.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS WIDENED IN OCTOBER

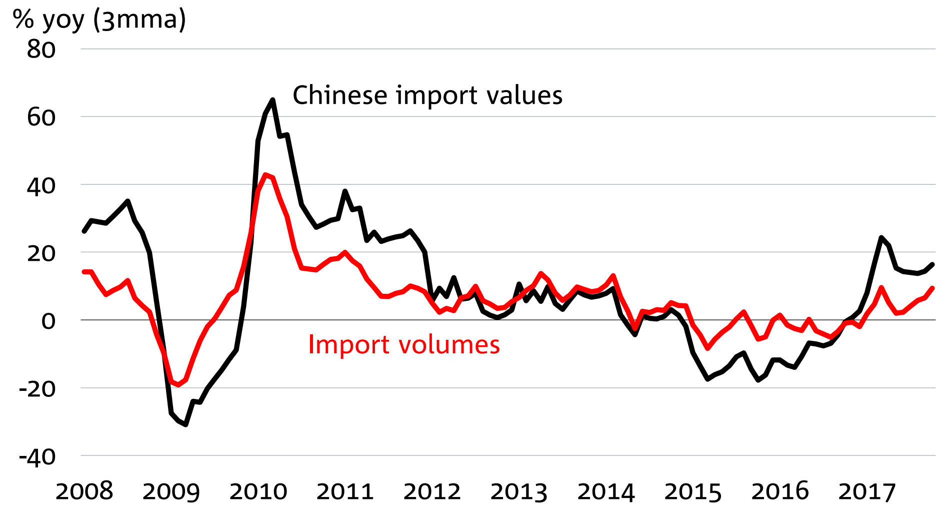
Sharp month-on-month falls in imports



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

Import volumes have risen in recent months, as price effects fade



Source: CEIC, NAB Economics

- China's trade surplus widened considerably in October – following the unusually narrow gap in September – as imports slowed significantly. The surplus stood at US$38.2 billion (compared with US$28.6 billion previously).
- Import values were considerably weaker month-on-month – however this is a typical seasonal pattern, in part related to the Golden Week holidays at the start of the month. Imports totalled US$150.8 billion (compared with US$169.6 billion in September) – however this still represented a sizeable increase year-on-year (17.2%).
- Price effects drove some of the year-on-year increase in import values – although the increases in commodity prices have been smaller in recent months than at the start of the year. The RBA Index of Commodity Prices rose by just 11.3% yoy in October (compared with over 21% in September) – meaning that import volumes have generally risen.
- That said, trends for key commodities were mixed, with a sharp slowdown in import volumes month-on-month following a sharp spike in September. Iron ore imports totalled 79.5 million tonnes in October (compared with 102.8 million tonnes previously), the lowest level since February 2016. This likely reflects destocking ahead of the planned shutdown of steel production capacity across a range of northern cities between November and March.
- Coal imports were also weaker – at 21.2 million tonnes (from 27.1 million tonnes in September) – while crude oil and copper imports were also weaker month-on-month (but rose in year-on-year terms – up by 7.8% and 13.8% respectively).

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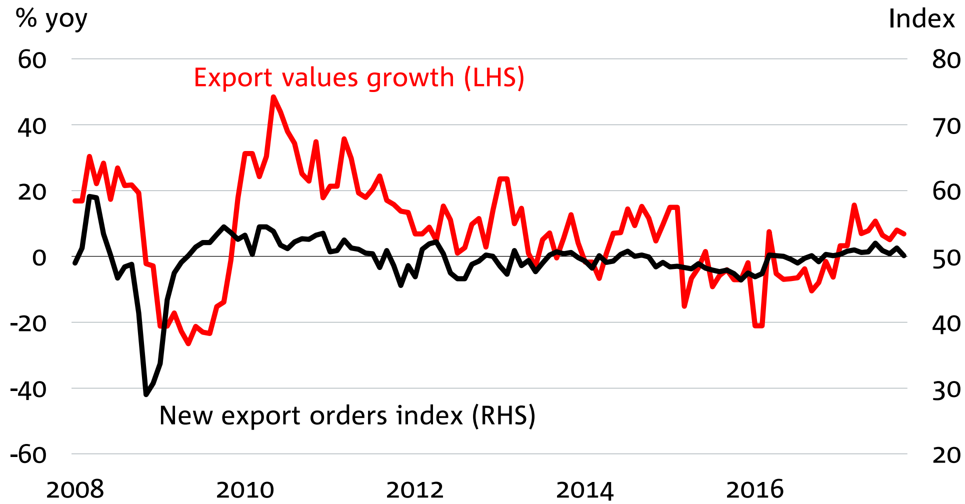
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

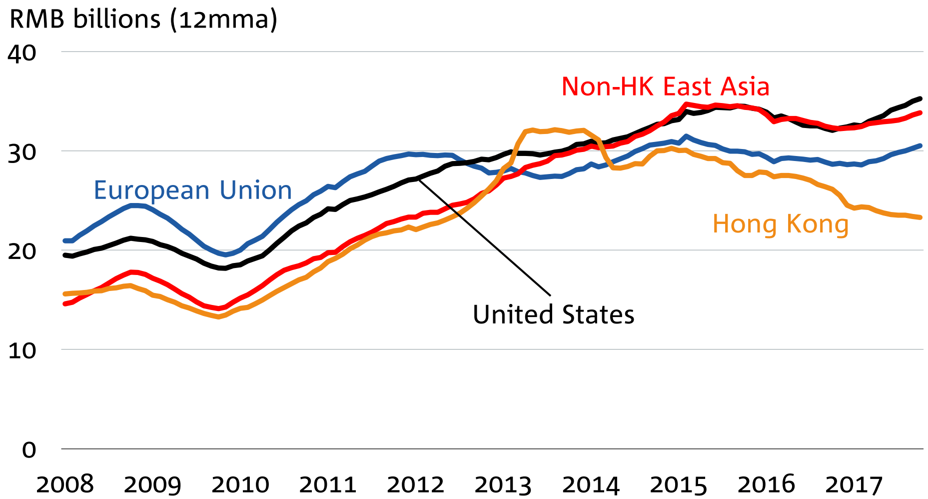
New orders dipped to a twelve month low



Source: CEIC, NAB Economics

EXPORTS BY MAJOR PARTNER

Historical distortions impact China-HK trade data



Sources: CEIC, NAB Economics

- Export values were also weaker in October – although the decline was more modest than for imports – down to US$189.0 billion (from US$198.2 billion previously). Surveys suggest weaker trends among China's exporters in October – with the new orders measure of the NBS PMI survey dropping to 50.1 points (from 51.3 points previously) – the weakest reading in twelve months. It is worth noting that this reading was still stronger than the levels recorded across much of 2014 and 2015.

- China's export data remains impacted by historical distortions that paint an inaccurate picture of current trends. Exports to the European Union rose by 11.4% yoy in October while exports to the United States rose by 8.3% yoy. In contrast, exports to East Asian markets increased by just 2.2%.

- As we have previously highlighted, this weak rate of growth reflects historically overstated exports to Hong Kong. Exports to non-Hong Kong East Asia rose by 7.9% yoy – with Vietnam, South Korea and the Philippines accounting for the largest share of the increase. China's official data suggests that exports to Hong Kong fell by 5.4% yoy in October.

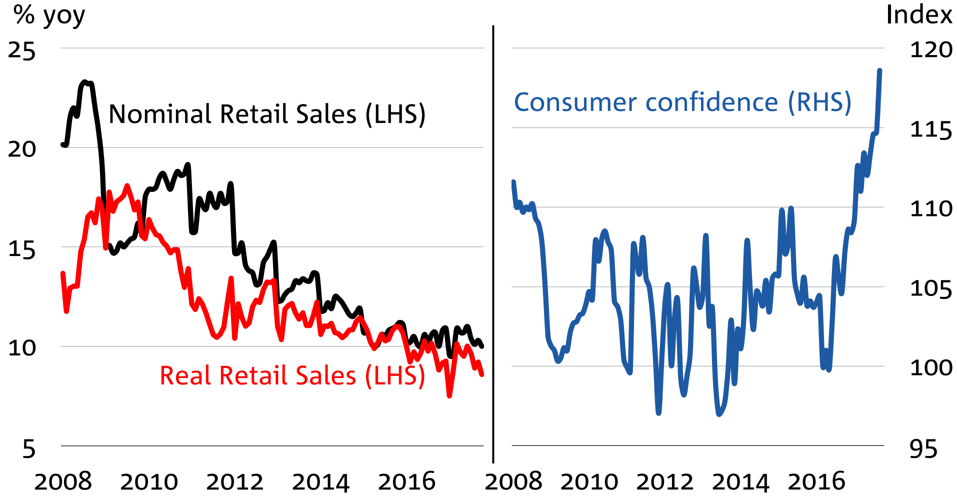
- In the first nine months of 2017, Hong Kong Customs data showed an increase in imports from China of 5.6% yoy, whereas Chinese data showed a fall in exports to Hong Kong of 6.4%. In part this reflects capital flows disguised as trade activity to avoid China's capital controls.

- This distortion should soon have less of an impact on growth rates. The differences between Hong Kong and Chinese trade data has been minimal in 2017, meaning that growth rates in 2018 should present a more accurate picture of trade flows.

RETAIL SALES AND INFLATION

REAL RETAIL SALES DIPS BACK BELOW 9%

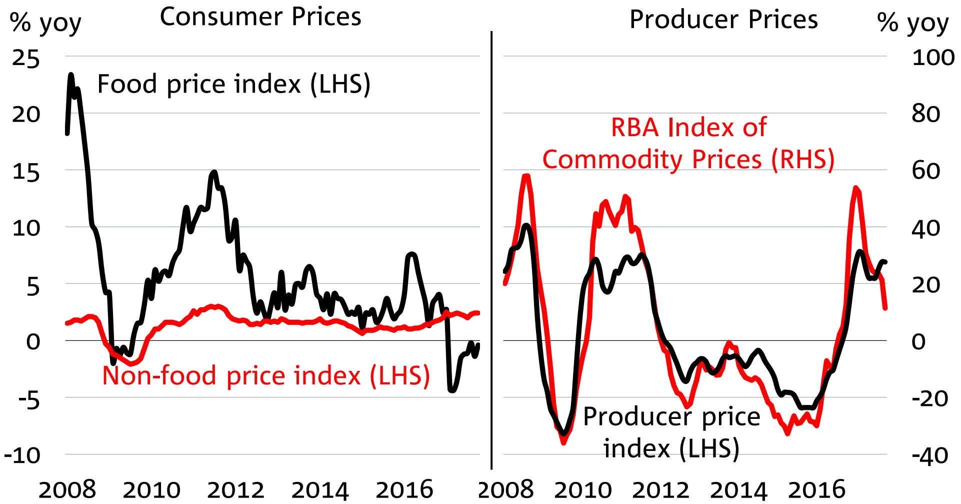
Consumer confidence accelerates to 22 year high



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Food prices less negative; producer prices stable



Source: CEIC, RBA, NAB Economics

- Growth in retail sales was a little softer in October, with nominal sales increasing by 10.0% yoy (compared with 10.3% in September). Given the uptick in inflation during the month, this pushed real retail sales lower – down to around 8.6% yoy (compared with 9.3% previously).
- Consumer confidence has continued to climb in recent months – up to 118.6 points in September (from 114.7 points previously). This level was the highest recorded since June 1995.
- China's headline inflation was somewhat stronger in October, reflecting weaker declines in food prices during the month. The Consumer Price Index rose by 1.9% yoy (compared with 1.6% previously).
- Food prices have fallen over the past nine months, however the decline was modest in October – falling by 0.4% yoy (compared with a 1.4% decline in September). The decrease in pork prices was a little smaller – at 10.1% yoy in October (from -12.4% previously), while prices were more stable for fresh fruit and vegetables.
- Growth in non-food prices was unchanged in October – rising by 2.4% yoy. Vehicle fuel and healthcare costs have continued to rise strongly – up by 7.5% yoy and 7.2% yoy respectively – while property related expenses remained stable at 2.8% yoy.
- The Producer Price Index rose by 6.9% yoy in October – unchanged from the rate recorded in September. The recent uptick in producer prices has been somewhat unexpected – as it has broken a generally close relationship with commodity prices. The RBA Index of Commodity Prices rose by 11.3% yoy in October – the weakest increase since September 2016. This may reflect greater efforts to address pollution impacting the industrial sector.

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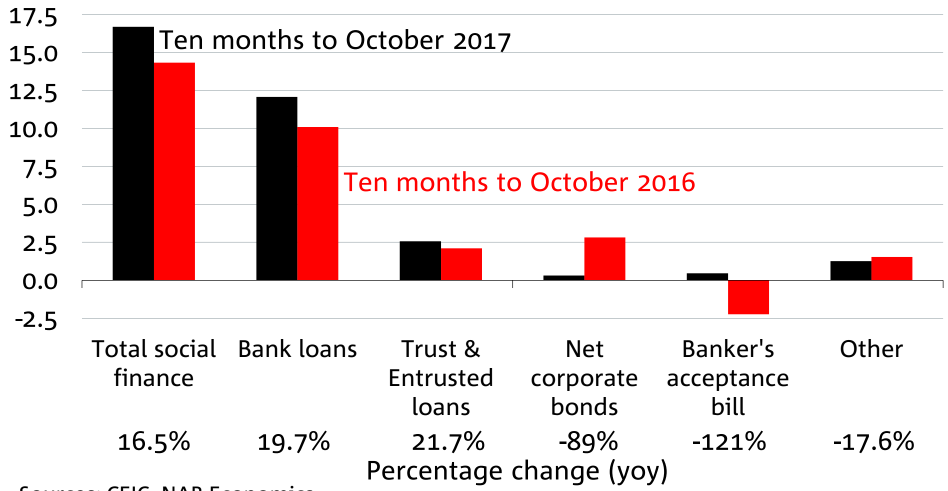
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

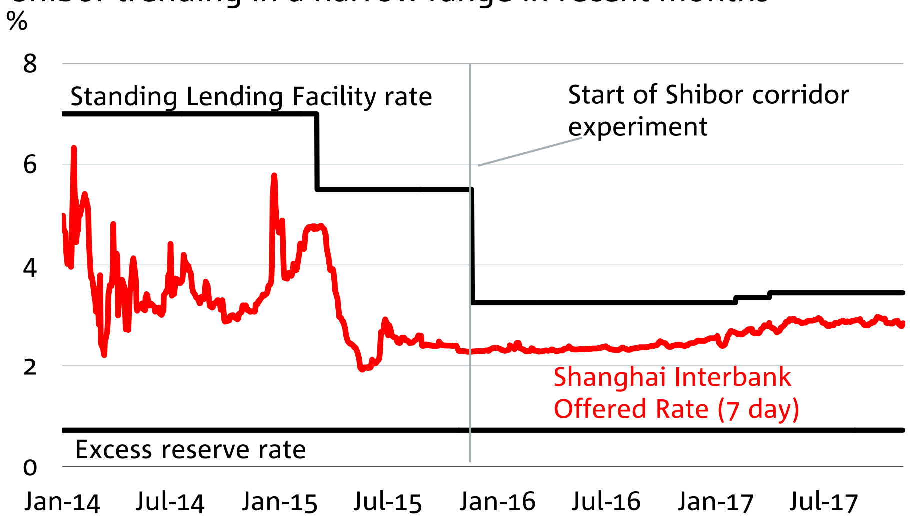
Bank lending driving growth, with mixed trends for non-bank



Sources: CEIC, NAB Economics

MONETARY POLICY REMAINS STABLE

Shibor trending in a narrow range in recent months



Source: CEIC, NAB Economics

- New credit issuance was somewhat weaker month-on-month in October – in line with typical seasonal trends related to the Golden Week holidays – but remained comparatively strong year-on-year, rising by 17.3%. For the first ten months of 2017, credit issuance totalled RMB 16.7 trillion, an increase of 16.5% yoy.
- Bank loans have continued to increase strongly, reflecting closer regulatory scrutiny on off-balance sheet activities that has forced some lending to return to traditional channels. Bank loans rose by almost 20% yoy over the first ten months to RMB 12.1 trillion.
- Over the same period, non-bank lending rose by 8.9% yoy – with markedly different trends in individual sectors. Trust and entrusted loans – two key components of the shadow banking sector – rose by almost 22% yoy. Banker's acceptance bills (which are also included in shadow banking estimates) have seen modest new issuance this year (RMB 467 million), compared with steep declines in the same period last year.
- In stark contrast, corporate bond issuance has been negligible this year – totalling just RMB 309 million in the first ten months – compared with RMB 2.8 trillion over the same period last year.
- The People's Bank of China (PBoC) injected significant liquidity into financial markets in October – around RMB 830 billion – the largest inflows since January 2016. These injections were able to maintain China's stable monetary policy over the period – with the 7 day Shibor easing from just over 2.9% at the end of Golden Week back to around 2.85% at the time of writing.
- In the short term, we expect rates to remain around these levels. We believe there is limited downside risk – given the need to address high corporate debt levels and to manage capital flows – with the potential for an upside bias next year – particularly in response to movements from the US Federal Reserve.

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