CHINA'S ECONOMY AT A GLANCE

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National Australia Bank

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KEY POINTS

China's official data may underestimate the strength of growth in 2017

- China's economy grew by 6.9% in 2017 (compared with 6.7% in 2016), the first acceleration in growth since 2010. This was well ahead of the Government's annual growth target of 6.5%. That said, it is possible that the official figure underestimates the strength of growth in 2017 – given that several local governments have confirmed that 2016 economic data was overstated. We will be watching closely this year for any revisions to historical data. Our forecasts for growth are unchanged, at 6.5% in 2018 and 6.25% in 2019.

- Growth in China's industrial production edged higher in December – increasing by 6.2% yoy – with growth remaining around the trend levels exhibited since the start of 2015. Despite this stable growth, output in a number of key industrial sectors was weaker. In particular, steel output was well below the recent peaks in August – suggesting the capacity closures across 26 northern Chinese cities may be having an impact.

- China's fixed asset investment accelerated in December – increasing by 7.2% yoy (compared with 6.3% in November). Producer price inflation has softened, meaning that real investment accelerated more rapidly – up to 2.5% yoy (from 0.8% previously). Real estate investment dipped and house sales remained weak in December, however residential construction starts remained stable. We continue to expect that softer house prices and sales (along with weaker investment) will flow through into weaker construction activity in 2018 – a contributor to slowing economic growth.

- China's trade surplus widened substantially in December, with exports growing strongly month-on-month (to a new record level), while imports remained essentially stable. The surplus totalled US$54.7 billion – the largest level since January 2016. That said, there is considerable uncertainty about the accuracy of the export figure – with a sizeable increase in the reported value of exports to Hong Kong in both November and December (relative to earlier in the year). It appears possible that false invoicing – overstating exports as a means of circumventing capital controls – may be returning (more on this in our December China Economic Update).

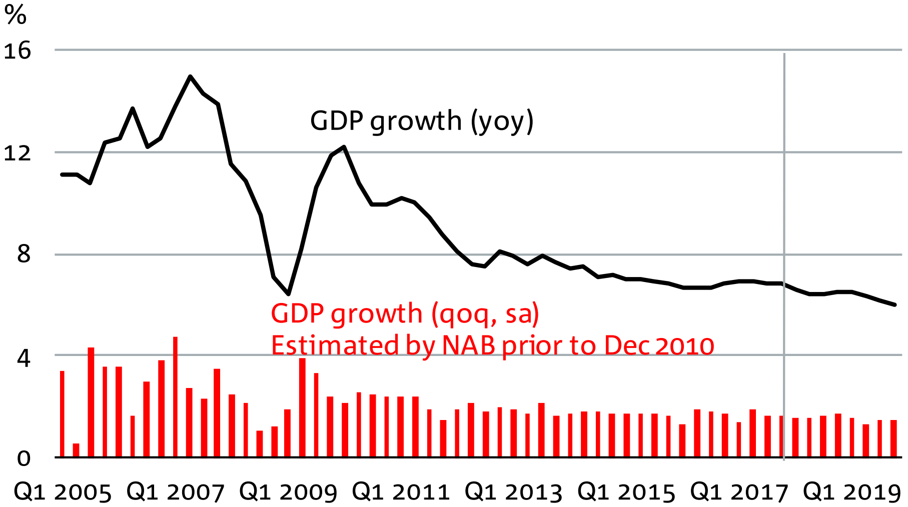
- China's new credit issuance totalled RMB 19.4 billion in 2017, an increase of 9.1%. The bulk of the increase in credit issuance occurred across the second and third quarters – up by 36% yoy and 24% yoy respectively – while it declined in Q4 – falling by 13% yoy. Traditional bank loans accounted for the major of new credit in 2017, at 71% of the total (the largest since 2009), indicating that tighter regulation around shadow banking has impacted the sector.

- The People's Bank of China responded partially to the increase in US interest rates – lifting the rate on the Standing Lending Facility and Reverse Repos by 5 basis points. Despite these increases, the 7 day Shibor remained has remained broadly stable. In early January, the PBoC stated that it will continue its "prudent and neutral" monetary policy and maintain stable liquidity in 2018. This may necessitate gradual increases in rates across the year, should the US Federal Reserve raise rates as expected.

GROSS DOMESTIC PRODUCT

REAL GDP STABLE AT 6.8% IN Q4

Historical revisions could see 2017 growth pushed higher

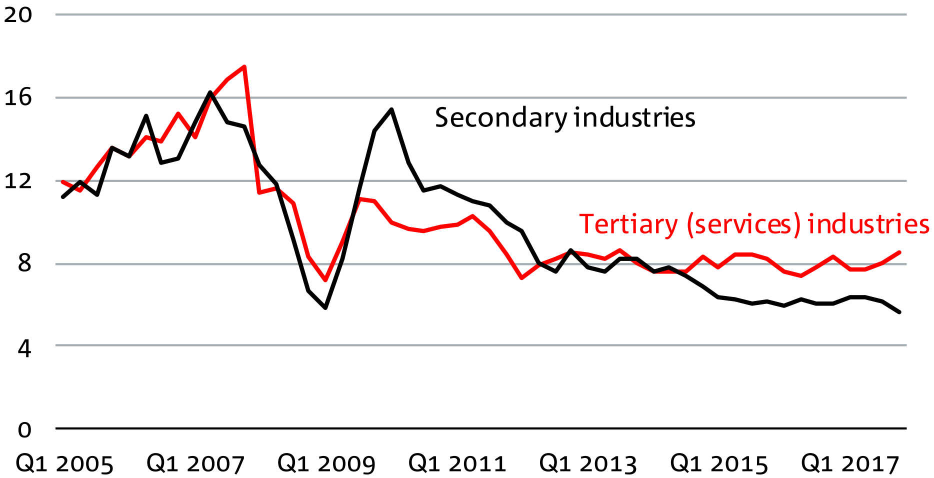


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Service growth accelerated in Q4, as the old economy slowed

Chinese economic growth by sector (% yoy)



Source: Datastream, NAB Economics

- China's economy grew by 6.9% in 2017 (compared with 6.7% in 2016), the first acceleration in growth since 2010. This was well ahead of the Government's annual growth target of 6.5%.
- That said, it is possible that the official figure underestimates the strength of growth in 2017. Three regional governments have confirmed that their economic data was overstated in 2016 – the provinces of Inner Mongolia and Liaoning as well as the municipality of Tianjin. We will be watching closely this year for any revisions to historical data.
- For Q4, the economy grew by 6.8% yoy – with services once again being the key driver. China's services sector grew by 8.5% yoy (up from 8.0% previously), while secondary industries (manufacturing and construction) slowed to 5.6% yoy (from 6.1% in Q3). This suggests that China's gradual transition away from heavy industrial production towards consumption is continuing.
- Our outlook for 2018 remains unchanged – we expect growth to slow, in line with official comments emphasising quality growth over sheer quantity – at 6.5%, before easing further to 6.25% in 2019. Weaker construction activity – as measures to cool China's property sector begin to impact more heavily – is a key driver of this anticipated slowing trend.

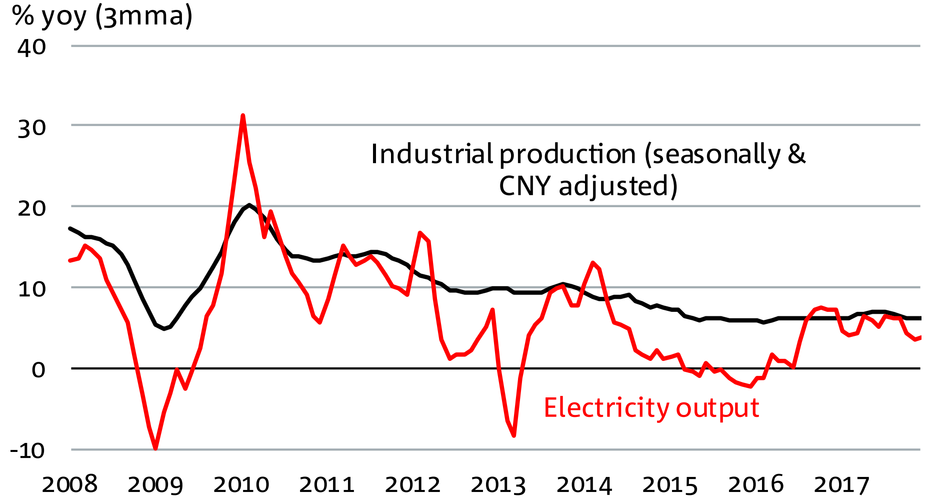
NAB GDP FORECASTS

%	2017	2018	2019
GDP	6.9	6.5	6.25

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

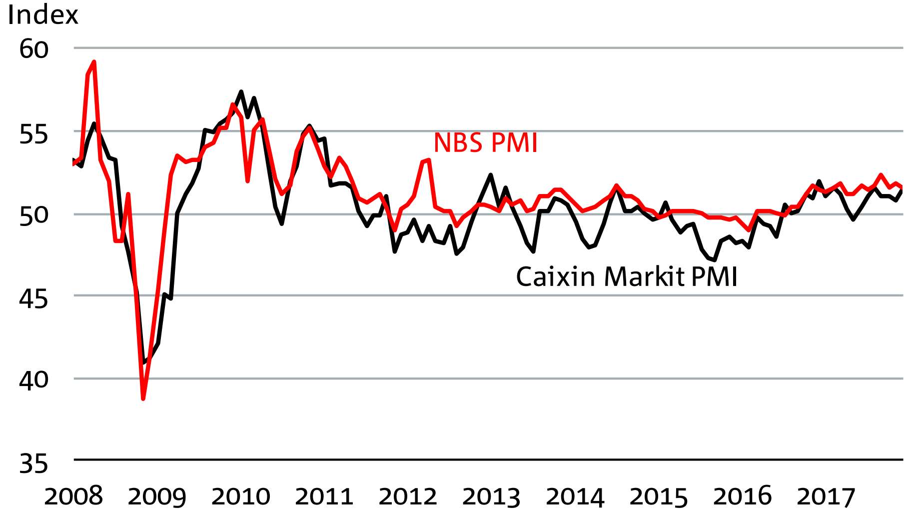
Output growth remaining around trend in December



Source: CEIC, NAB Economics

PMI SURVEYS CONVERGED IN DECEMBER

Industrial conditions have remained positive



Source: CEIC, NAB Economics

- Growth in China's industrial production edged higher in December – increasing by 6.2% yoy (compared with 6.1% previously) – with growth remaining around the trend levels exhibited since the start of 2015.
- Despite this stable growth, output in a number of key industrial sectors was weaker. Cement manufacturing declined by 2.2% yoy, while crude steel output grew by just 1.8% yoy. Steel output totalled 67.1 million tonnes, up marginally from November, but well below the peak in August (74.6 million tonnes) – suggesting the capacity closures across 26 northern Chinese cities may be having an impact.
- Production of motor vehicles increased by just 0.4% yoy in December – with growth softer across Q4, following stronger conditions in the first three quarters. Electricity production was stronger, growing by 6.0% yoy (up from 2.4% previously).
- China's major industrial surveys pointed to positive conditions in the manufacturing sector in December, with a convergence in the two measures. The official NBS PMI survey was marginally softer – at 51.6 points (from 51.8 points in November), the same level recorded in October. In contrast, there was an improvement in the Caixin Markit PMI – moving up to 51.5 points (from 50.8 points in previously).

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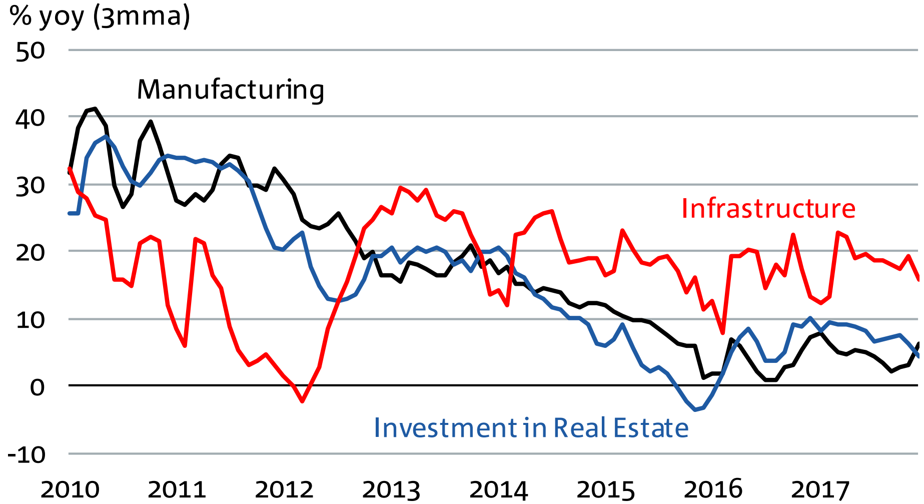
INVESTMENT

FIXED ASSET INVESTMENT BY INDUSTRY

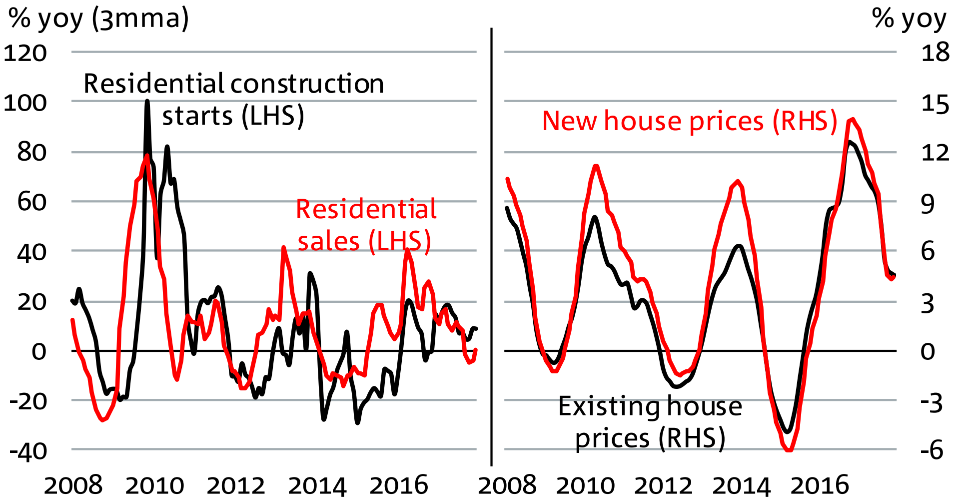
Infrastructure holds firm, real estate softer in December



Source: CEIC, NAB Economics

HOUSE PRICES AND CONSTRUCTION

Housing sales remain weak, but construction activity persists



Source: CEIC, Datastream, NAB Economics

- Growth in China's fixed asset investment accelerated in December – increasing by 7.2% yoy (compared with 6.3% in November). Producer price inflation has softened, meaning that real investment accelerated more rapidly – up to 2.5% yoy (from 0.8% previously).

- Growth in investment by state-owned enterprises (SOEs) continues to outpace private sector firms, however the gap has narrowed in recent months. SOE investment rose by 7.8% yoy (on a three month moving average basis), down from 10.6% yoy in November. In contrast, private firm investment rose by 5.6% yoy (3mma), up from 3.3% previously.

- At an industry level, investment trends remain highly divergent. Investment in infrastructure has continued to grow strongly – increasing by 15.8% yoy (on a three month moving average basis), albeit down from 19.4% previously. Real estate investment dipped – down to 4.3% yoy (3mma) (from 6.4% in November), while manufacturing investment strengthened – up to 6.4% yoy (3mma) (from 3.3% previously).

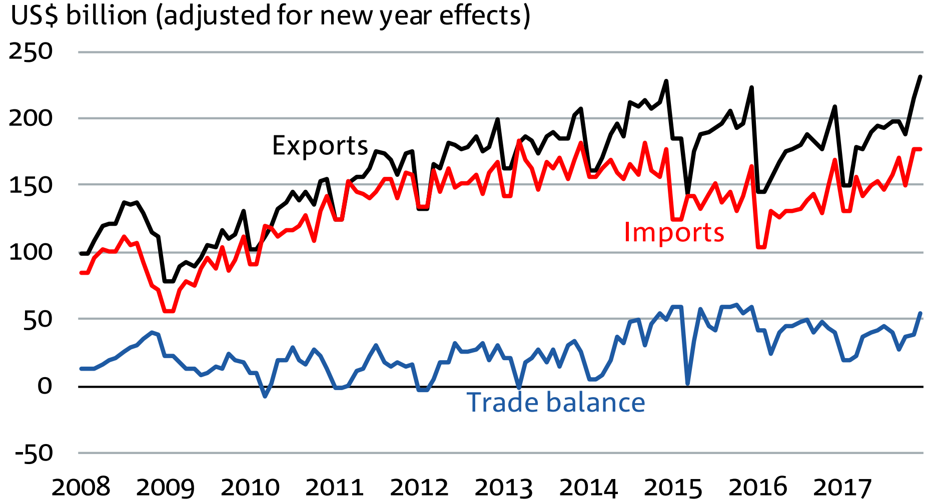
- Measures introduced by Chinese authorities to cool the property sector have not been fully effective to date. Residential construction starts remained stable in December – increasing by 8.8% yoy (3mma), almost twice the rate across September and October, but well below double digit levels in the first half of the year. Housing sales were up by 0.4% yoy (3mma), having declined across the previous three months.

- That said, these policies have been effective in cooling house prices. Prices for new and existing properties rose by 0.3% month-on-month (3mma) and 0.1% mom (3mma) respectively, with growth driven by China's tier 3 (and below) cities. We continue to expect that softer house prices and sales (along with weaker investment) will flow through into weaker construction activity in 2018.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS AT ITS WIDEST LEVEL SINCE EARLY 2016

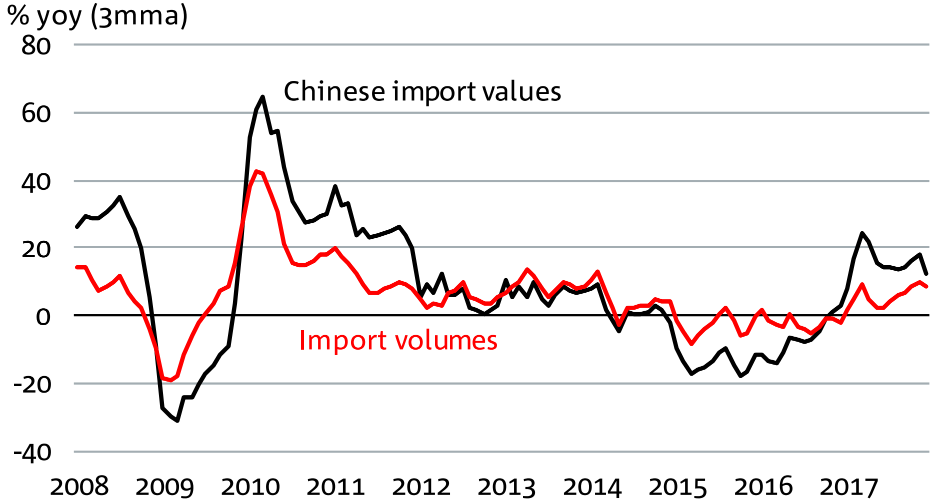
Exports surged month-on-month as imports were steady



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

Rising volumes have been driven stronger import values recently



Source: CEIC, NAB Economics

- China's trade surplus widened substantially in December, with exports growing strongly month-on-month (to a new record level), while imports remained essentially stable. The surplus totalled US$54.7 billion (compared with US$39.0 billion previously) – the largest level since January 2016.

- China's imports totalled US$177.1 billion in December (compared with US$176.9 billion in November) – an increase of 4.5% yoy. Import values have remained comparatively strong, despite the potential for weaker domestic demand, related to the proposed capacity closures in China's steel sector along with anti-pollution inspections across the industrial sector.

- As we have noted in recent months, price effects have been having much less of an impact on import values when compared with earlier in the year. The RBA Index of Commodity Prices fell by 1.2% yoy in December – compared with double digit increases across the first ten months of the year. As a result, we argue that the increase in import values across November and December has largely been driven by volumes. That said, volume growth slowed in December – down to 4.8% yoy from 11.3% yoy in November.

- Import volumes for a number of China's key commodities declined year on year in December – with iron ore falling by 5.4% yoy, copper by 8.2% yoy and crude oil by 7.4% yoy. Coal imports also fell – down by 15% yoy – albeit they rose when compared with the levels in November.

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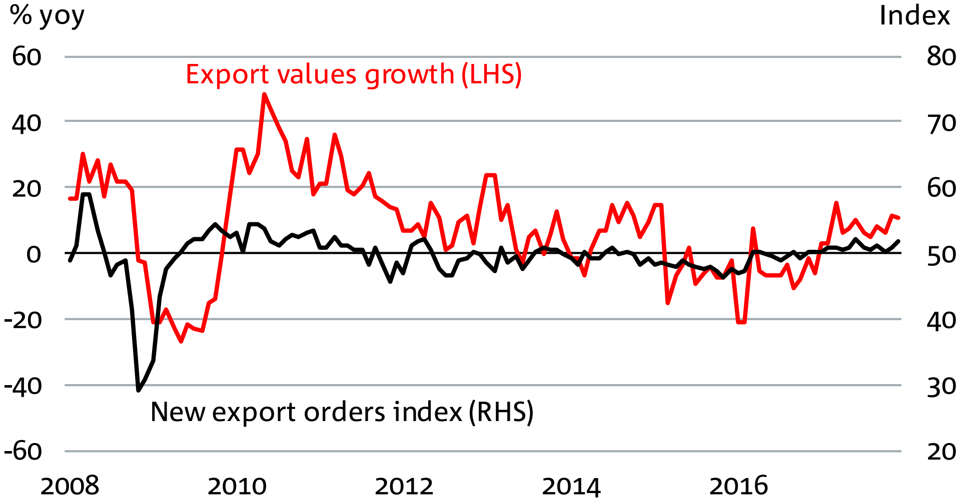
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

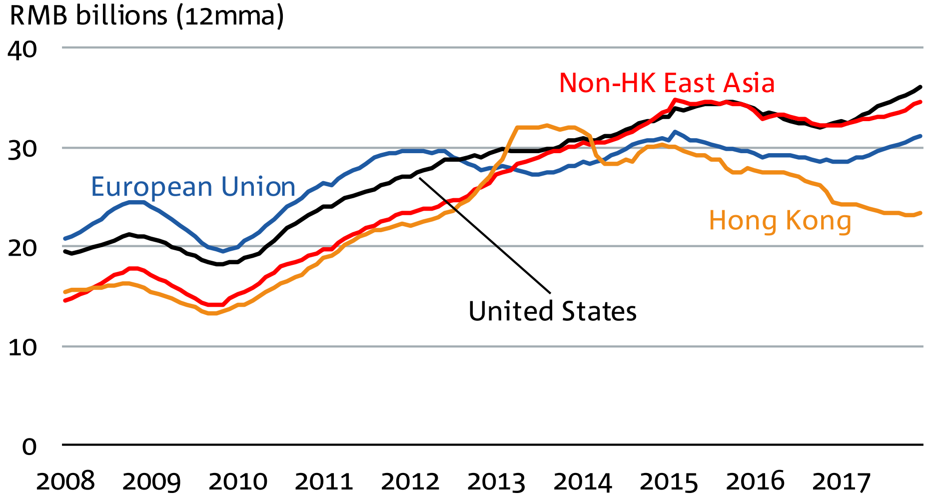
Strong growth sees exports rise to record levels in December



Source: CEIC, NAB Economics

EXPORTS TO MAJOR MARKETS

China's data shows falling exports to Hong Kong in 2017



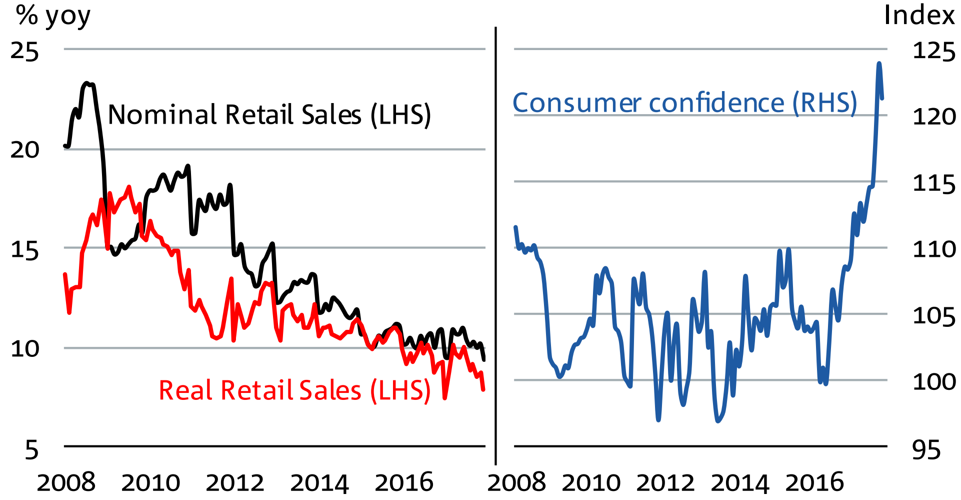
Sources: CEIC, NAB Economics

- China's exports rose to a record level in December – up to US$231.8 billion (compared with US$215.9 billion in November) – an increase of 10.9% yoy. This level surpassed the previous peak recorded in December 2014.
- There was also a noticeable uptick in new export orders in the NBS PMI survey – with this measure up to 51.9 points (from 50.8 points previously) – just below the recent peak of 52.0 points in June 2017.
- That said, there is considerable uncertainty about the accuracy of this export figure – with a sizeable increase in the reported value of exports to Hong Kong in both November and December (relative to earlier in the year). In December, exports to Hong Kong rose by 7.4% yoy to US$36.3 billion (from US$28.0 billion in November). In contrast, Hong Kong Customs data showed imports from China totalling US$25.1 billion in November – an all time high. It appears possible that false invoicing – overstating exports as a means of circumventing capital controls – may be returning (more on this in our December China Economic Update).
- For most of 2017, there was a modest discrepancy between Hong Kong and China Customs data (unlike the previous three years) – meaning that Chinese data has understated growth in exports this year. For the first eleven months of the year, China's reported exports to Hong Kong fell by 5.5% yoy, while Hong Kong's reported imports from China rose by 5.7% yoy.
- Exports to the United States and European Union also rose strongly – with both increasing by 12.7% yoy. Exports to non-Hong Kong East Asia rose more moderately – up by 5.5% yoy. Vietnam and Taiwan accounted for the largest share of this increase.

RETAIL SALES AND INFLATION

REAL RETAIL SALES SOFTER IN DECEMBER

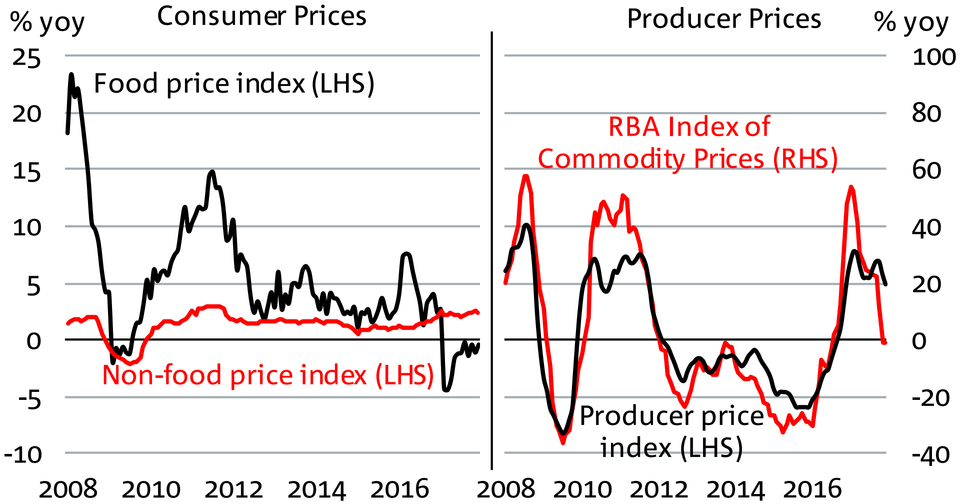
Consumer confidence remains high



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Disconnect between commodity and producer prices remains



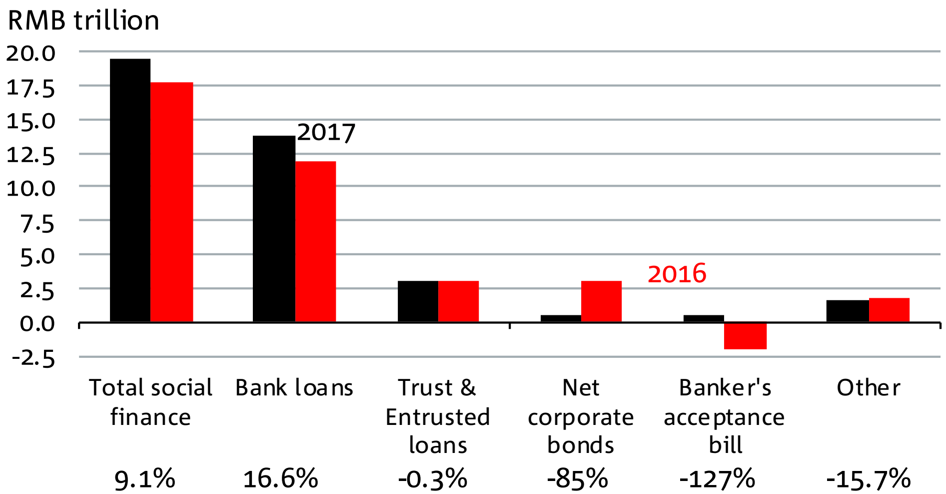
Source: CEIC, RBA, NAB Economics

- Retail sales growth softened in December, dipping to 9.4% yoy (from 10.2% previously). Retail price inflation was marginally stronger, pushing real retail sales growth down to 7.9% yoy (from 8.8% in November) – the weakest increase since January.
- Consumer confidence has remained strong – with the index at 121.3 points in November, just below a twenty four year high of 123.9 points recorded in October.
- China's headline inflation was marginally stronger in December, with the Consumer Price Index rising by 1.8% yoy (compared with 1.7% previously). This slightly higher rate reflected a more modest decrease in food prices during the month.
- Food prices have fallen since February 2017, although the decline was just 0.4% yoy in December (compared with 1.1% in November). Falling prices for pork (down 8.3% yoy) and fresh vegetables (down 8.6% yoy) were the main contributors.
- Non-food prices grew at a slightly slower rate in December – rising by 2.4% yoy (compared with 2.5% previously). Healthcare and Medical Services prices rose by 6.6% yoy, while vehicle fuel costs rose by 9.0% yoy.
- Producer prices rose by 4.9% yoy in December, the weakest increase since November 2016. That said, there remains a significant disconnect between commodity and producer prices – a breakdown of a previously close relationship. The RBA Index of Commodity Prices fell by 1.2% yoy in December. If this disconnect persists, it may reflect improving conditions in export markets, along with efforts to address industrial overcapacity, providing producers with greater pricing power.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

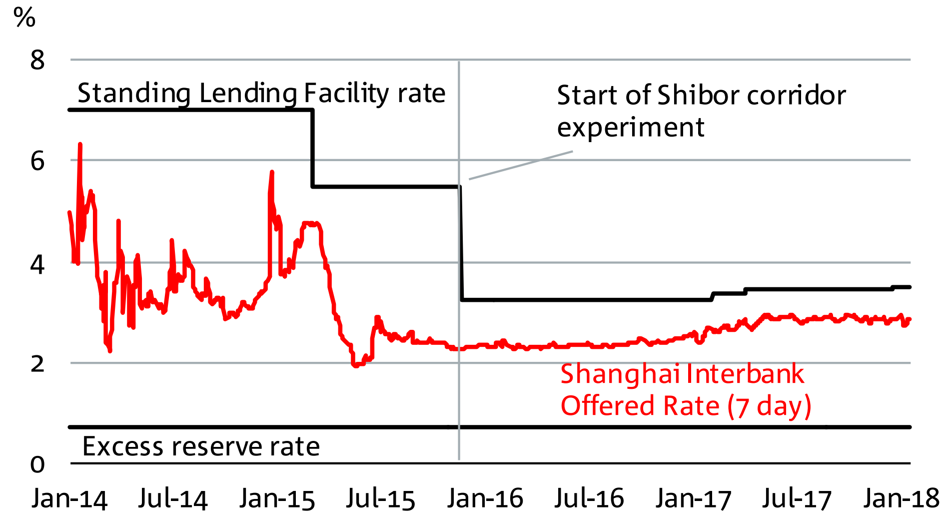
Bank lending drove growth; non-bank credit declined in 2017



Sources: CEIC, NAB Economics

MONETARY POLICY REMAINS STABLE

Shibor yet to rise in response to US Fed Funds Rate increase



Source: CEIC, NAB Economics

- China's new credit issuance totalled RMB 19.4 billion in 2017, an increase of 9.1%. The bulk of the increase in credit issuance occurred across the second and third quarters – up by 36% yoy and 24% yoy respectively – while it declined in Q4 – falling by 13% yoy.
- Traditional bank loans accounted for the major of new credit in 2017, totalling RMB 13.8 billion, an increase of almost 17% yoy. The overall share of bank loans to new credit was 71% – the largest since 2009 – indicating tighter regulation around shadow banking has impacted the sector.
- In contrast, non-bank lending fell by 6.0% yoy to RMB 5.6 billion – with declines in the December quarter particularly notable (down 32% yoy). Trends in individual sectors were markedly different. Entrusted loans fell sharply over the year (down 64%) while trust loans surged from a low base (up 163%) – essentially cancelling each other out. Corporate bond issuance has been extremely weak – down 85% in 2017 – while there was modest issuances of banker's acceptance bills (compared with sharp declines in 2016).
- The People's Bank of China responded partially to the increase in US interest rates – lifting the rate on the Standing Lending Facility and Reverse Repos by 5 basis points (compared with the 25 point hike to US Fed Funds Rate).
- Despite the modest lift in these rates, the 7 day Shanghai Interbank Offered Rate (Shibor) has continued to track broadly sideways. Following the PBoC's rate response, the Shibor moved higher (from around 2.85% in mid December to 2.95% at the end of the year), before retreating again in early January.
- In early January, the PBoC stated that it will continue its "prudent and neutral" monetary policy and maintain stable liquidity in 2018. This may necessitate gradual increases in rates across the year, should the US Federal Reserve raise rates as expected.

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