CHINA'S ECONOMY AT A GLANCE

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CONTACT

Gerard Burg, Senior Economist - International

KEY POINTS

Can China maintain its stable growth profile as trade tensions increase?

- China's economy grew by 6.8% yoy in the first quarter of 2018, unchanged from the rate recorded in Q3 and Q4 2017. Growth in the industrial sector accelerated (despite expectations of weaker conditions) as services growth slowed. The comparatively strong result in Q1 highlights upside risk to our forecast for 2018 (6.5%), however the risk and uncertainty presented by US-China trade tensions (and the potential for a trade war) presents a downside risk as well.

- China recorded a trade deficit in March for the first time in five years (excluding volatile Chinese new year periods). This reflected a considerable slowdown in exports. While trade tensions between China and the United States have risen rapidly over the past month, it is far too early to suggest that this has had an influence. The new orders measure in the NBS PMI survey suggests few short term concerns for exporters – pushing up to 51.3 points (from 49.0 points in February).

- Following on from surprisingly strong growth in industrial output across January and February, China's industrial production grew more modestly in March – increasing by 6.0% yoy. Trends were mixed for construction related sectors, with cement production falling sharply, while steel output rose – close to the record levels of mid-2017.

- Growth in China's fixed asset investment slowed in March – to 7.2% yoy (from 7.9% across January and February). That said, weaker producer price inflation meant that real investment grew at a slightly stronger rate – up to 4.7% yoy (from 4.5% in the first two months). Despite measures to cool the real estate sector – which have seen prices stabilise in the largest tier 1 cities and price growth slow in other locations, we are still waiting to see a clear sign of slowing activity in the sector. Property sales slowed in March, but new construction starts jumped.

- Retail sales data was a little stronger in March, with an upturn in nominal sales and weaker inflation pushing real sales growth up to 8.6% yoy (from 7.9% in the first two months). That said, this increase remains below the rates recorded across most of 2017. Despite the comparative softness in retail sales, Chinese consumer confidence pushed higher in February to 124.0 points – the highest reading since September 1993.

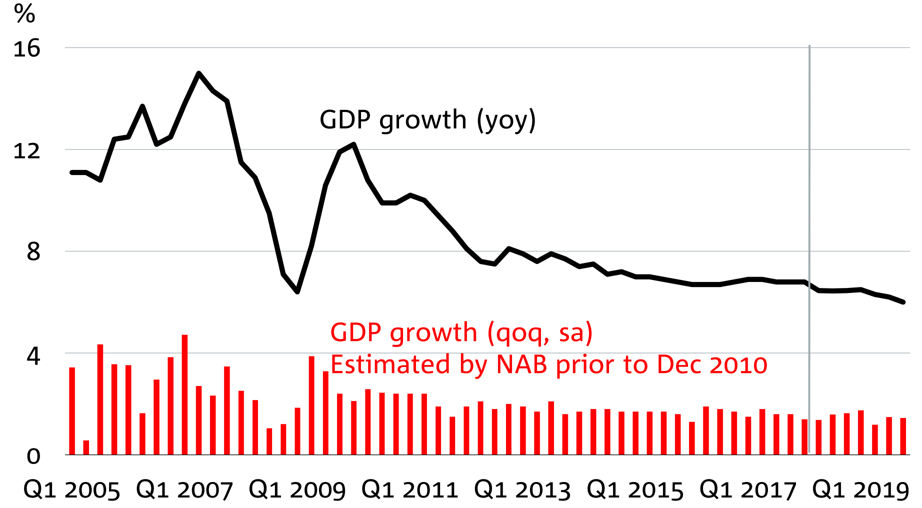
- China's new credit issuance was considerably weaker in the first quarter of 2018, decreasing by 19% yoy. Over this period, bank loans accounted for the majority of credit issuance – with bank lending increasing by 6.9% yoy. Non-bank lending was considerably weaker – reflecting the further tightening of regulation around shadow banking.

- The new governor of the PBoC, Yi Gang, has stated that the bank will continue its prudent monetary policy and is well placed ahead of monetary policy normalisation in other major economies. We maintain an upward bias in terms of Chinese policy rates, however we expect that the PBoC will be cautious around rate increases, given the heavy debt burden of China's corporate sector.

GROSS DOMESTIC PRODUCT

STABILITY IN REAL GDP CONTINUES

Growth remains at 6.8% yoy (unchanged from Q3 and Q4 2017)

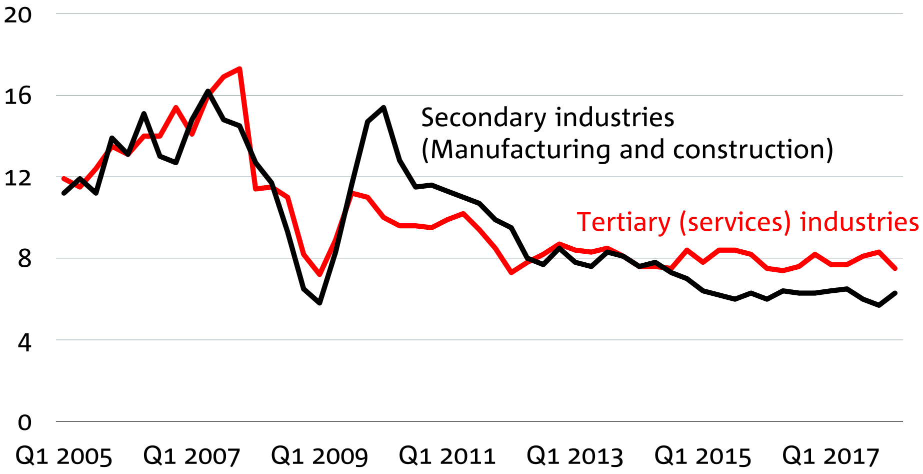


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Industrial upturn as services growth slowed in Q1

Chinese economic growth by sector (% yoy)



Source: CEIC, NAB Economics

- China's economy grew by 6.8% yoy in the first quarter of 2018, unchanged from the rate recorded in Q3 and Q4 2017. This result was broadly in line with market expectations, but could still be viewed as surprisingly strong, given expected weakness in the industrial sector due to anti-pollution measures impacting the steel sector in particular and heavy industry more generally.
- Instead, the industrial sector was stronger in Q1 2018 than in late 2017 – with growth accelerating to 6.3% yoy (compared with 5.7% in Q4 2017). In contrast, growth in the services sector – which remained the key driver of China's economy – was a little more modest, increasing by 7.5% yoy in Q1 (down from 8.3% in the December quarter).
- The comparatively strong result for the first quarter highlights upside risk to our forecasts for 2018 – in line with China's growth target of 6.5%. That said, the risk and uncertainty presented by US-China trade tensions (and the potential for a trade war) presents a downside risk as well, meaning that we are keeping this forecast unchanged.
- We continue to anticipate further easing in China's growth out to 2020, but remain of the view that authorities can manage a soft landing – with growth at 6.0% in 2020.

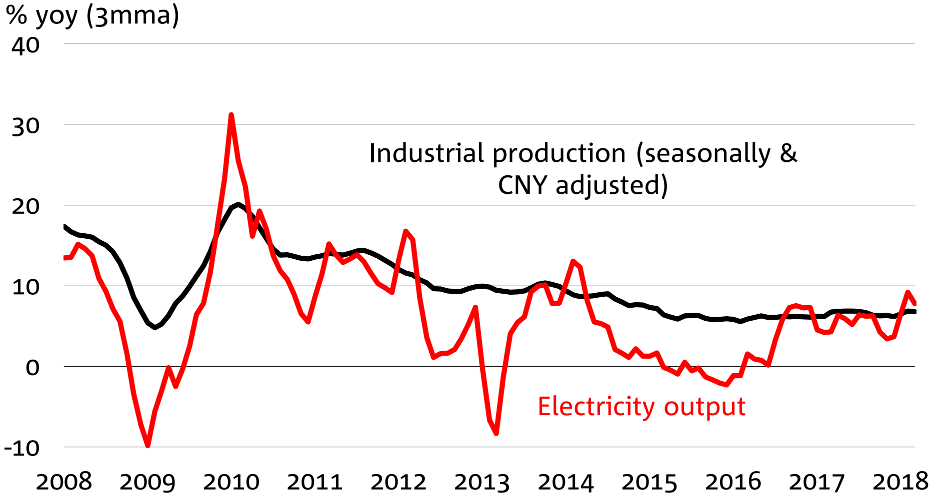
NAB GDP FORECASTS

%	2018	2019	2020
GDP	6.5	6.25	6.0

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

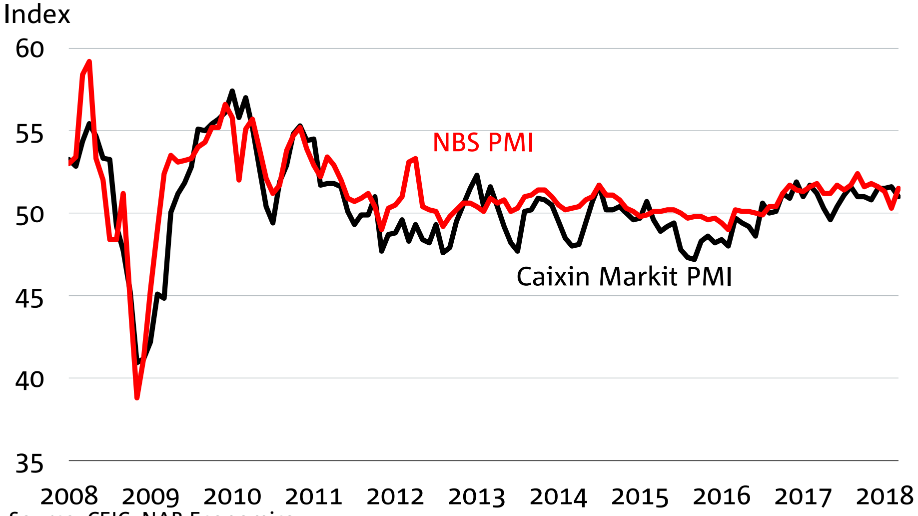
Growth softer in March following strong January-February period



Source: CEIC, NAB Economics

PMI SURVEYS CONVERGE IN MARCH

Mixed trends bring survey readings closer together



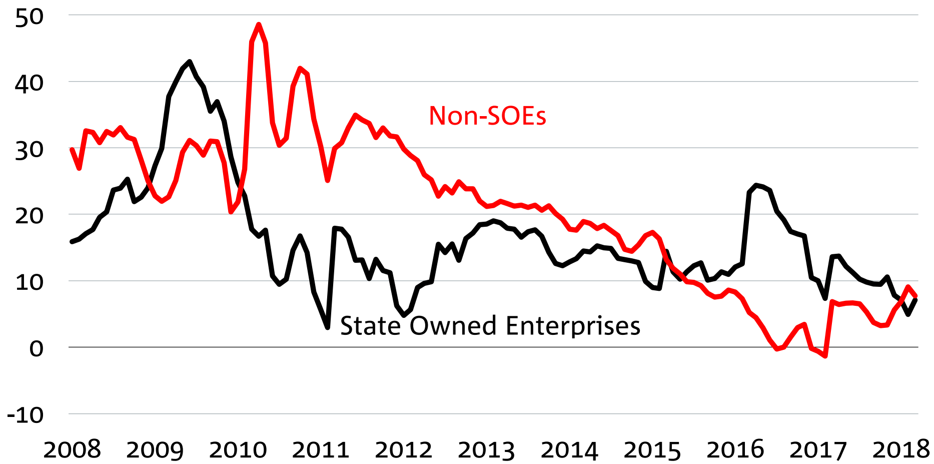
Source: CEIC, NAB Economics

- Following on from surprisingly strong growth in industrial output across January and February, China's industrial production grew more modestly in March – increasing by 6.0% yoy (compared with 7.2% in the first two months).
- Trends in key industrial sectors diverged in March. Cement output – closely tied to the construction sector – was sharply weaker, falling by over 15% yoy. In contrast, steel production (also a key construction input) rose by 4.5% yoy – with output not far below all time highs recorded mid last year.
- In contrast growth in electricity generation and motor vehicles was relatively modest – increasing by 2.1% yoy and 0.9% yoy respectively.
- China's major industrial surveys showed divergent trends again in March, narrowing a relatively wide gap between the measure recorded in February. The NBS PMI survey was stronger – pushing up to 51.5 points (compared with a relatively weak result of 50.3 points in February). In contrast, the Caixin Markit PMI softened – to 51.0 points (from 51.6 points last month).

INVESTMENT

FIXED ASSET INVESTMENT BY SECTOR

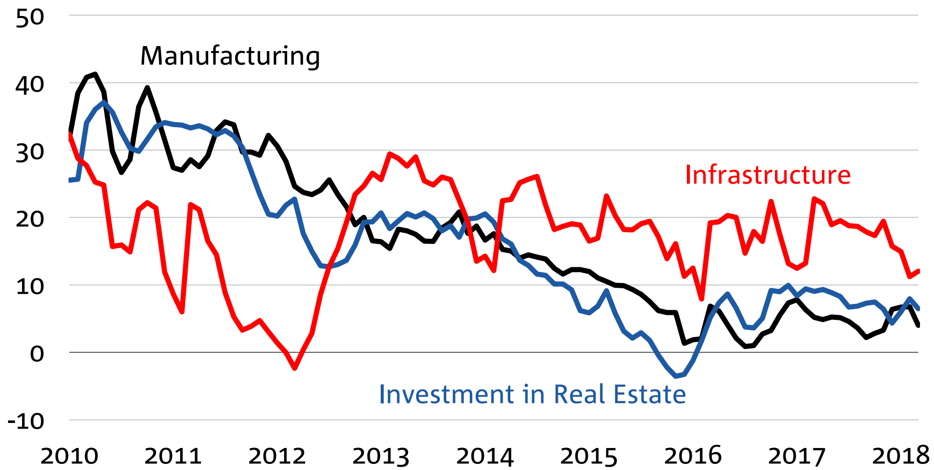
The gradual recovery in private investment has continued



Source: CEIC, Datastream, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Infrastructure investment has slowed considerably in early 2018



Source: CEIC, NAB Economics

- Growth in China's fixed asset investment slowed in March – to 7.2% yoy (from 7.9% across January and February). That said, weaker producer price inflation – flowing through into the cost of investment goods – meant that real investment grew at a slightly stronger rate – up to 4.7% yoy (from 4.5% in the first two months).

- Investment by private sector firms has gradually trended higher – following the slowdown between early 2015 and early 2017. On a three month moving average basis, private sector investment grew by 7.7% yoy in March, compared with an average 5.5% in 2017. In contrast, growth in investment by state-owned enterprises has trended lower – down to 7.1% (3mma) in March (compared with double digit growth across 2016 and most of 2017).

- Trends at an industry level continue to differ significantly. There has been a notable slowdown in infrastructure investment since November 2017 – down from around 19% yoy to 12% yoy (3mma) in March. Similarly, manufacturing investment has also softened – down to 4.0% (3mma) in March (compared with 6.8% in February).

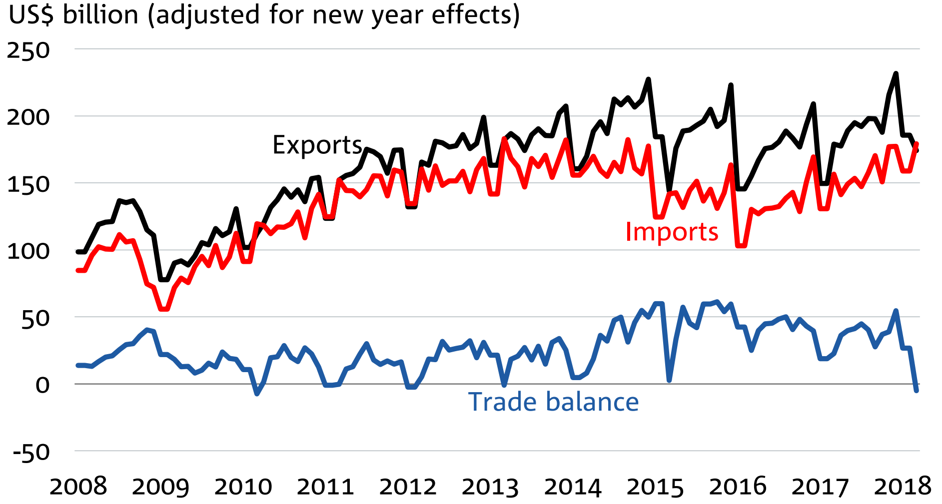
- In contrast, investment in real estate has held up comparatively well – increasing by 6.5% yoy (3mma) in March – from a recent low of 4.3% in December 2017. Despite measures to cool the real estate sector – which have seen prices stabilise in the largest tier 1 cities and price growth slow in other locations, we are still waiting to see a clear sign of slowing activity in the sector.

- Residential property sales have slowed in early 2018 – increasing by 2.5% yoy (3mma) in March (following a surge in sales in late 2017), but construction starts rebounded – increasing by 12.2% yoy (3mma) in March (compared with 6.3% in February).

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE BALANCE SWITCHES INTO DEFICIT IN MARCH

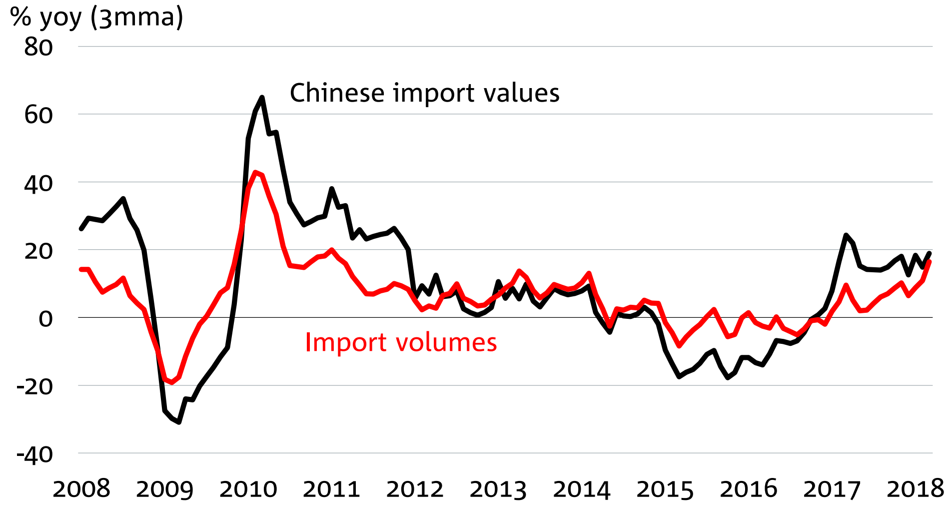
Exports at their weakest since early 2017



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

Growth in imports driven by volumes rather than prices



Source: CEIC, NAB Economics

- China recorded a trade deficit in March for the first time since March 2013 (excluding volatile periods around Chinese new year), as a drop off in exports shifted the trade balance. The deficit totalled US$5.0 billion, compared with an average surplus of US$26.7 billion across January and February.

- China's imports grew strongly in March – up to US$179.1 billion, an increase of over 14% yoy. Although commodity prices have trended up since mid-2017, the year on year increase has been modest, just 1.7% yoy for the RBA Index of Commodity Prices – implying that most of the increase in imports has been driven by volumes.

- Our estimate of volumes suggests that volumes increased by 16.5% yoy (3mma) in March – the strongest increase since early 2011.

- There were considerable differences in the import trends in March for individual commodities. Imports of coal rose strongly – up by almost 21% yoy – in part reflecting the strong demand due to cold weather conditions and shortages in natural gas supplies – while copper and crude oil rose more modestly – increasing by 2.1% yoy and 0.6% yoy respectively. In contrast, volumes of iron ore fell by 10% yoy – despite an increase in steel production in March, near the record levels recorded in mid-2017.

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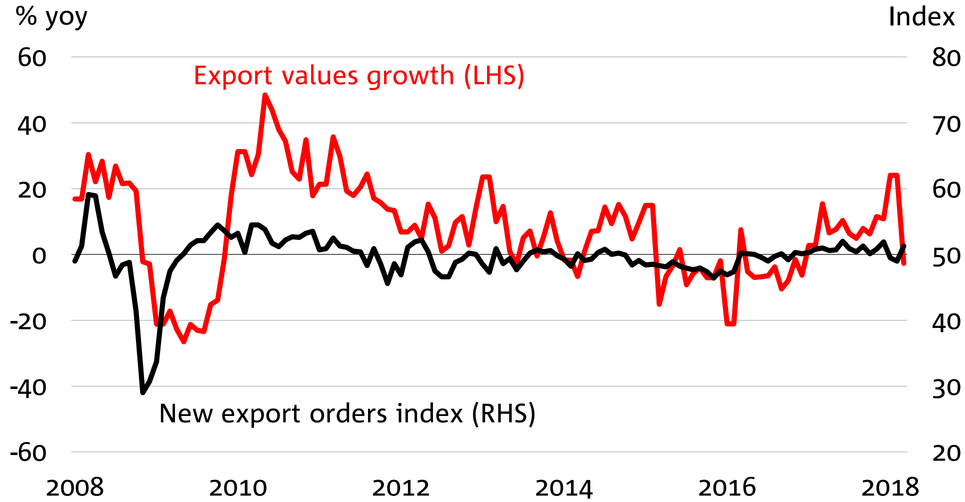
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

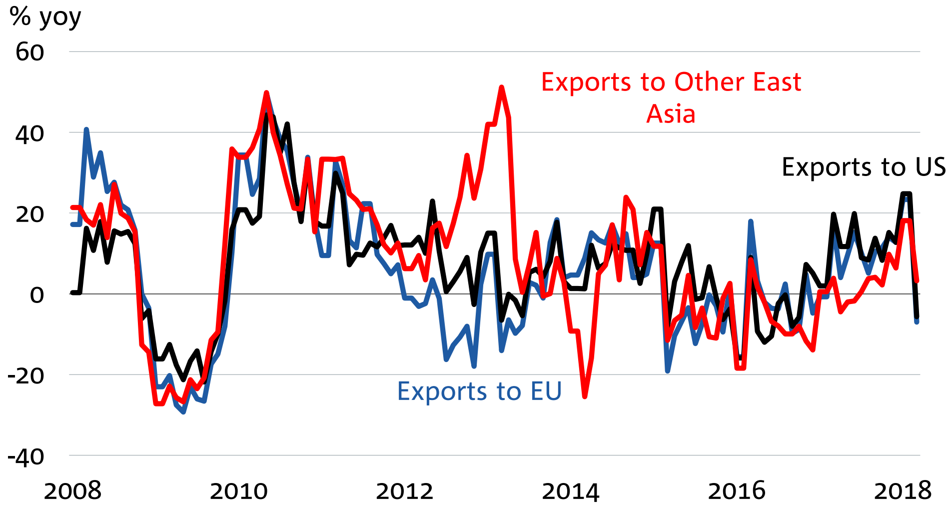
Export growth plunges from extremely strong rates in Jan-Feb



Source: CEIC, NAB Economics

EXPORTS TO MAJOR MARKETS

Sharp slowdown in exports across markets – particularly US & EU



Sources: CEIC, NAB Economics

- China's exports have slowed significantly in March – to US$174.1 billion (compared with an average of US$185.6 billion across January and February). This represented a decrease of 2.7% yoy, however growth over the first two months was particularly strong (averaging 24% yoy).

- While trade tensions between China and the United States have risen rapidly over the past month, it is far too early to suggest that this has had an influence. The new orders measure in the NBS PMI survey suggests few short term concerns for exporters – pushing up to 51.3 points (from 49.0 points in February).

- Export trends differed across China's major trading partners – with values shipped to the European Union and the United States falling by 7.0% yoy and 5.6% yoy respectively. In contrast, exports to East Asian markets rose by 3.3% yoy – albeit this was largely driven by exports to Hong Kong. Non-Hong Kong exports rose by just 0.6% yoy – with Vietnam accounting for the bulk of the increase, while exports to the Philippines and South Korea fell.

- According to China Customs, exports to Hong Kong rose by 7.5% yoy to US$24.2 billion. We have regularly highlighted the discrepancy between China and Hong Kong customs data – although this discrepancy was comparatively small across much of 2017. Overstated exports can reflect efforts by firms to circumvent China's capital controls.

- The potential for a trade war between the United States and China has risen in recent weeks – with China responding in kind to sizeable US tariffs on 1300 Chinese export products. Following a relatively conciliatory speech from President Xi at the Boao Forum in April, it remains to be seen whether both governments fully implement their proposed tariffs, and if further measures will be considered. However a trade war would be a negative for both economies.

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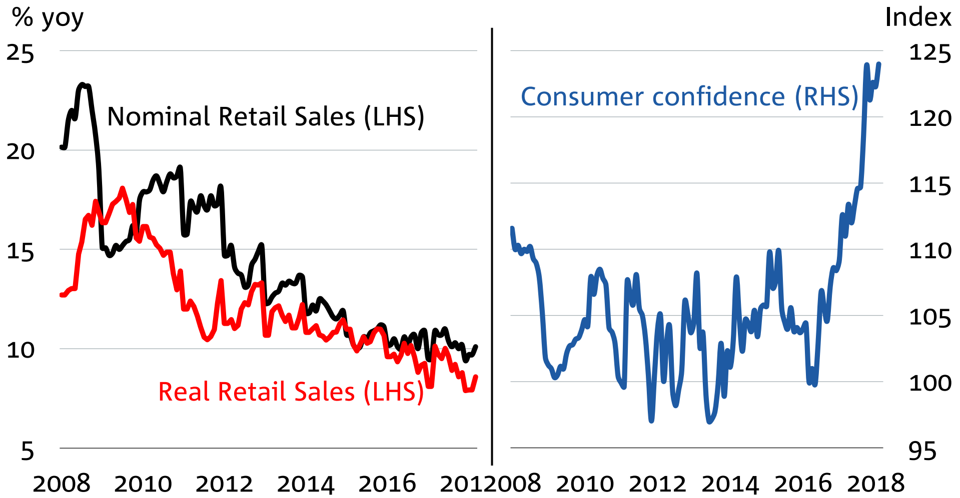
RETAIL SALES AND INFLATION

REAL RETAIL SALES TICK HIGHER IN MARCH

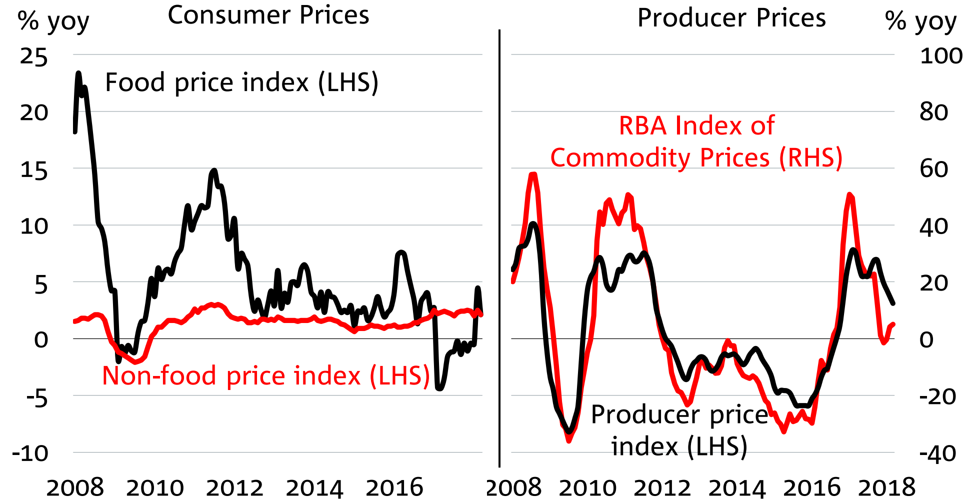
Soft real sales growth contrasts with booming confidence



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Inflation softer following Chinese new year distortions



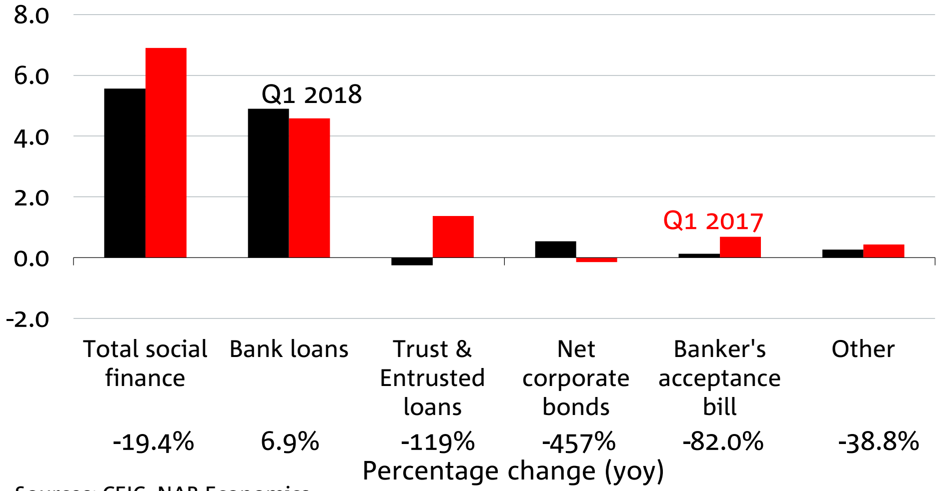
Source: CEIC, RBA, NAB Economics

- Retail sales data was a little stronger in March – increasing by 10.1% yoy in March in nominal terms, compared with an average of 9.7% across January and February. Weaker inflation trends in March boosted real sales further – up to 8.6% yoy (compared with 7.9% in the first two months). That said, this increase remains below the rates recorded across most of 2017.
- Despite the comparative softness in retail sales, Chinese consumer confidence has remained strong – pushing back up in February to 124.0 points – the highest reading since September 1993.
- China's headline inflation was a little softer in March, albeit remaining above the trend exhibited since the latter part of 2014. The Consumer Price Index rose by 2.1% yoy (down from 2.9% in February).
- A retreat in food prices – which rose strongly over the Chinese new year period – was a major contributor to the slowdown in inflation. Food prices rose by 2.1% yoy (compared with 4.4% in February). There was a notable decline in pork prices – down by 12% yoy – while fresh vegetable prices rose by 8.8% yoy (compared with 18% last month).
- Non-food prices were also a little weaker – increasing by 2.1% yoy (from 2.5% in February) – below the typical levels recorded last year. There was softer growth for healthcare costs and vehicle fuel prices (rising by 5.7% yoy and 4.3% yoy respectively).
- Producer price inflation was also softer in March – increasing by 3.1% yoy (compared with 3.7% in February). Since late 2017 there has been a disconnect in the typically close relationship between producer prices and global commodity prices – but we expect the gap to narrow in coming months.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

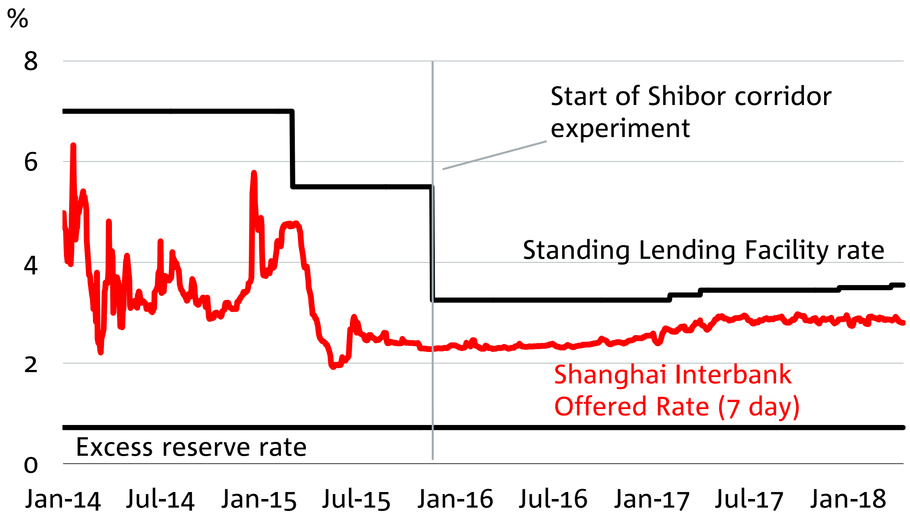
Weaker total issuance as regulators restrict shadow banking



Sources: CEIC, NAB Economics

MONETARY POLICY STABILITY HAS CONTINUED

Upper bound of corridor edging higher



Source: CEIC, NAB Economics

- China's new credit issuance was considerably weaker in the first quarter of 2018. New credit totalled RMB 5.6 trillion, a decrease of 19% yoy. Over this period, bank loans accounted for the majority of credit issuance – with bank lending increasing by 6.9% yoy to RMB 4.9 trillion.

- In contrast, non-bank credit contracted by 71% in the first quarter of 2018, to total RMB 664 billion. The bulk of this total came from corporate bond issuance – which was RMB 537 billion in the March quarter, while components of the shadow banking sector were substantially weaker. Issuance of banker's acceptance bills decreased by 82% yoy, while trust and entrusted loans contracted on a net basis.

- The weaker conditions for shadow banking products highlights further tightening in regulation around the sector – including the recent merger of the China Banking Regulatory Commission and the China Insurance Regulatory Commission, along with an announcement in April that regulators will restrict the brokerages from issuing short term financing notes.

- In late March, the People's Bank of China (PBoC) modestly raised the interest rate for the Standing Lending Facility (the upper band of its policy corridor) by 5 basis points to 3.55%. Despite this increase, the 7 day Shanghai Interbank Offered Rate (Shibor) has continued to track broadly sideways. Since the start of the year, the Shibor has traded in a narrow band – just under 20 basis points – with the rate near 2.8% at the time of writing.

- The new governor of the PBoC, Yi Gang, has stated that the bank will continue its prudent monetary policy and is well placed ahead of monetary policy normalisation in other major economies. We maintain an upward bias in terms of Chinese policy rates, however we expect that the PBoC will be cautious around rate increases, given the heavy debt burden of China's corporate sector.

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

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

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

Gerard Burg
Senior Economist – International
+(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