CHINA'S ECONOMY AT A GLANCE

JANUARY 2019

National Australia Bank

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KEY POINTS

China's economy continues to soften, but our outlook is unchanged

- China's economic growth continued to slow in Q4 – down to 6.4% yoy (compared with 6.5% in Q3). This was the equal slowest rate of growth (along with Q1 2009 – the trough of the GFC in China) since 1990. We argue that China's deleveraging program was the key factor in weaker economic conditions in 2018 and that this is likely to continue this year. Our outlook for China remains unchanged – we see growth at 6.25% in 2019 – the mid-point of a rumoured growth target of 6.0%-6.5% – before slowing to 6.0% in 2020. Trade tensions and softening economic conditions in Europe present some downside risk to the forecasts.

- There has been a lot of recent focus on Chinese stimulus in response to slowing economic conditions. While the PBoC has cut the Required Reserve Ratio and governments have brought forward infrastructure projects and introduced tax cuts, the scope of these stimulatory measures are far smaller than earlier episodes (such as 2008 and 2012) and may be intended to manage the slowing economy rather than to maintain growth at high rates. Authorities remain committed to reducing risks in the financial sector and are attempting to balance competing short term (slowing economy) and medium term (debt related) risks.

- Growth in industrial production was marginally stronger in December – at 5.7% yoy (compared with 5.4% in November) – albeit it remained weak by historical standards. China's two major manufacturing surveys turned negative in December, the first time since February 2016 that both surveys recorded a negative result. Both nominal fixed asset investment and investment good prices slowed in December, meaning that real investment remained unchanged at 5.2% yoy – the equal strongest rate of growth since October 2016.

- In month-on-month terms, there was a sharp slowdown in Chinese imports in December, compared with a modest decline in exports. As a result, China's trade surplus expanded significantly, out to US$57.1 billion – the largest value since January 2016. The United States accounts for the largest share of this trade surplus – with no reduction in the measure since the introduction of tariffs by both countries. In December, China's rolling twelve month trade surplus with the United States totalled US$324.4 billion, an all time record.

- Real retail sales accelerated in December – back to 6.7% yoy (from 5.8% previously). That said, this rate of growth remains historically weak – real sales grew by an average of 9.0% in 2017. Despite the comparatively weak trends, consumer confidence has remained strong – with the measure rising to 122.1 points in November – just below early 2018 peaks and well above the levels seen over the previous decade.

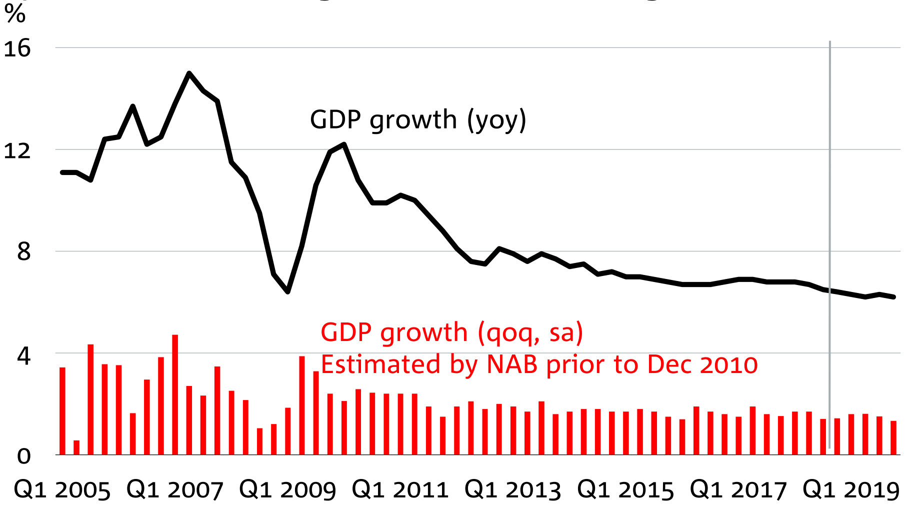
- New credit issuance totalled RMB 19.3 trillion in 2018, a decrease of 14.0%. There remains no evidence of broad based stimulus akin to earlier episodes in response to slowing economic trends – suggesting that addressing high levels of corporate debt remain a priority for authorities. We expect a continuation of this trend in 2019.

- There has been considerable volatility in the 7 day Shanghai Interbank Offered Rate (Shibor) in the past month, spiking ahead of the year end, and plunging in the new year before settling back near the 2.6%-2.65% mark. This has been the trend since the second half of 2018 and we expect that this will remain the target in the short term. Much of the volatility was driven by short term demand for cash – in part related to tax payments – with the PBoC injecting large scale liquidity via open market operations to meet demand.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH EASES FURTHER IN Q4

Equal weakest rate of growth (with GFC trough) since 1990

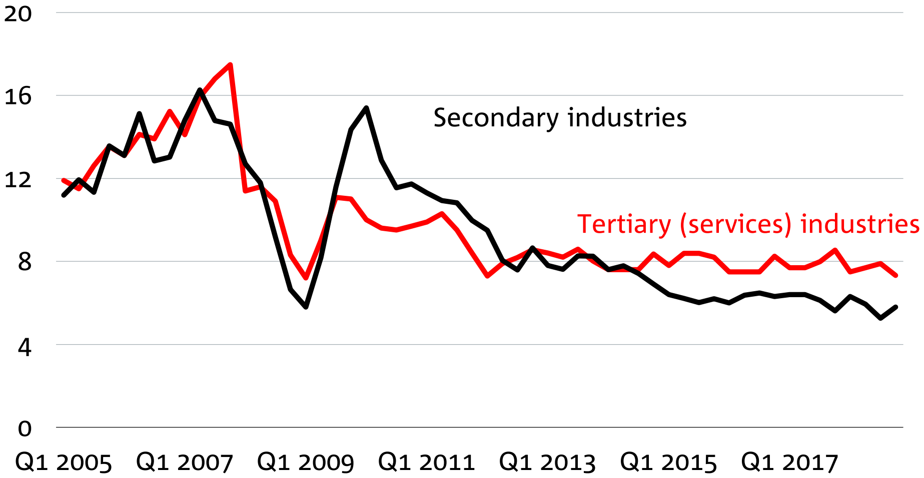


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Services growth softer, the key driver for weaker headline growth

Chinese economic growth by sector (% yoy)



Source: Datastream, NAB Economics

- China's economic growth continued to slow in Q4 – down to 6.4% yoy (compared with 6.5% in Q3). This was the equal slowest rate of growth (along with Q1 2009 – the trough of the GFC in China) since 1990. For the full year, China grew by 6.6% – in line with our forecasts – the slowest since the 3.9% growth recorded in 1990.

- It is worth noting that prior to this data release, China's National Bureau of Statistics revised down growth in 2017 to 6.8% (from 6.9% previously), with weaker growth for each quarter. It is unclear if base effects from this revision boosted Q4 growth rates.

- The key engine for China's growth remains its services sector – which accounts for the largest share of the economy. That said, growth in services slowed in Q4, down to 7.3% yoy (from 7.9% in Q3). In contrast, the secondary industries (manufacturing and construction) recorded slightly stronger growth in Q4 – at 5.8% yoy (from 5.3%) – despite very mixed conditions across this space.

- We argue that China's deleveraging program (and not trade tensions with the United States) was the key factor in weaker economic conditions in 2018. Given that recent statements from the PBoC indicate that deleveraging should continue this year, we see further downside to growth. Our outlook for China remains unchanged – we see growth at 6.25% in 2019 – the mid-point of a rumoured growth target of 6.0%-6.5% – before slowing to 6.0% in 2020. Trade tensions and softening economic conditions in Europe present some downside risk to the forecasts.

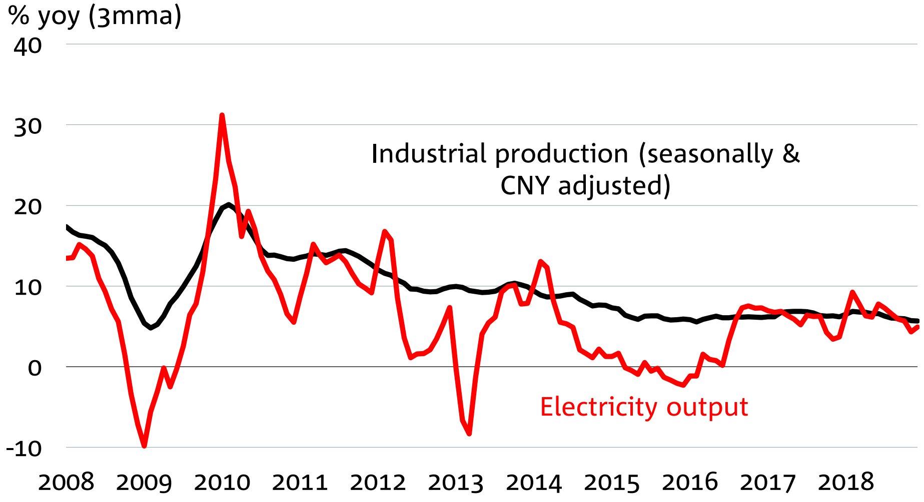
NAB CHINA GDP FORECASTS

%	2018	2019	2020
GDP	6.6	6.25	6.0

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

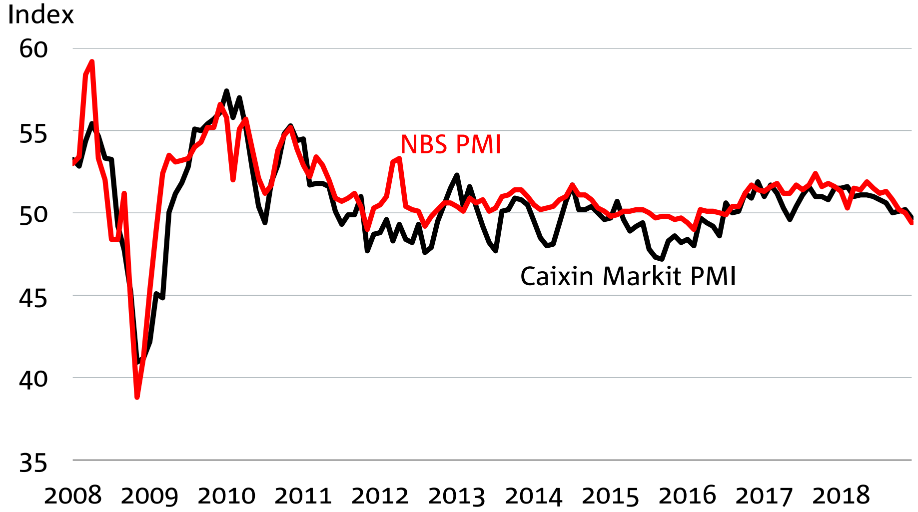
Growth remaining weak, with divergent sub-sector trends



Source: CEIC, NAB Economics

PMI SURVEYS TURN NEGATIVE IN DECEMBER

First time that both have been sub-50 points since February 2016



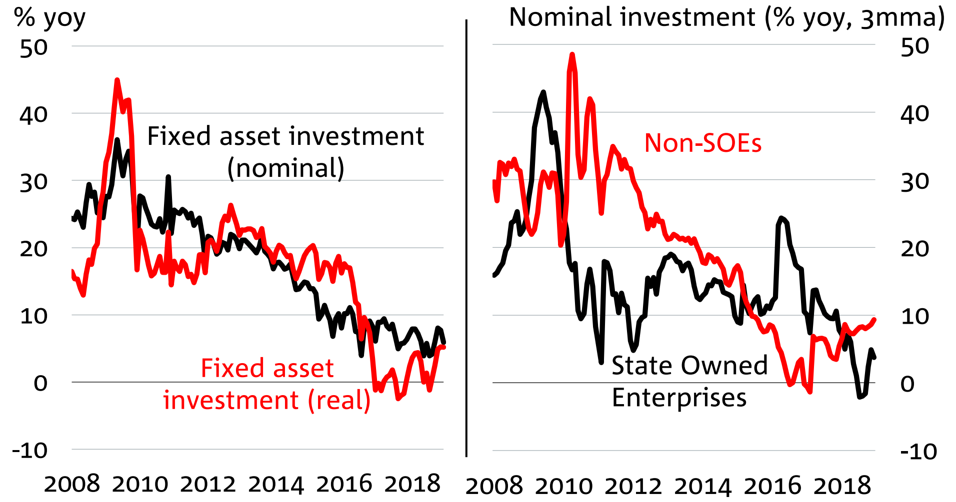
Source: CEIC, NAB Economics

- Growth in industrial production was marginally stronger in December – at 5.7% yoy (compared with 5.4% in November) – albeit it remained weak by historical standards.
- There remain some highly divergent trends by major industrial sectors. Output of consumer electronics has remained strong – increasing by 10.5% yoy – as has steel output, which rose by 8.2% yoy (driven in part by less severe winter capacity closures this year than last).
- In stark contrast, motor vehicle production has continued to fall – down by 14.9% yoy. Sales of new motor vehicles have fallen substantially this year – likely linked to weaker credit issuance – and inventories have risen.
- China's two major manufacturing surveys turned negative in December. The official NBS PMI survey fell to 49.4 points (from 50.0 points previously), while the private sector Caixin Markit PMI declined to 49.7 points (from 50.2 points in November). This was the first time since February 2016 that both surveys recorded a negative result.
- These surveys have highlighted weakness in export markets for some time – new export orders in the official survey has been negative for seven straight months, while the Caixin measure has been below the 50 point market for nine months in a row – with respondents to this survey thought to be more export focussed.

INVESTMENT

FIXED ASSET INVESTMENT

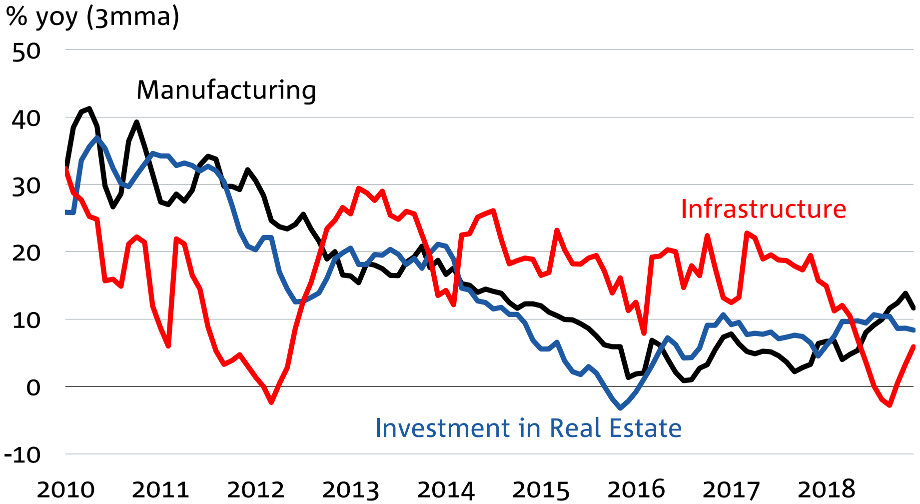
Real investment remains strong; private sector the key driver



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Infrastructure investment continuing to recover



Source: CEIC, NAB Economics

- Growth in China's nominal fixed asset investment slowed once again in December – increasing by just 5.9% yoy (down from 7.7% in November). That said, there was a sharp slowdown in producer prices in December – which flows through into the cost of investment goods – meaning that our estimate of real investment was unchanged at 5.2% yoy – the equal strongest rate of growth since October 2016.

- The private sector continues to drive growth in investment. On a three month moving average basis, nominal private investment rose by 9.3% yoy (compared with 8.6% previously). In contrast, investment by state-owned enterprises (SOEs) increased by 3.7% yoy (3mma), compared with 4.9% previously.

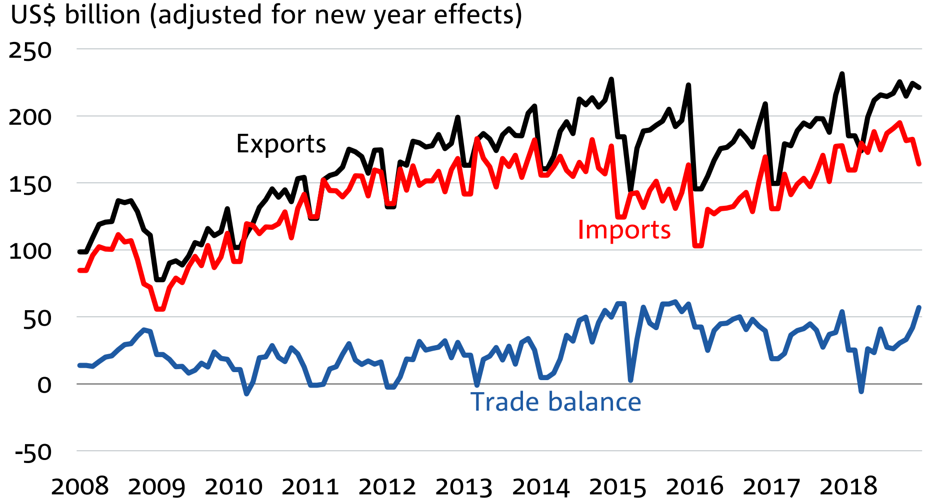
- Investment trends by major industry remain mixed. Infrastructure investment has accelerated in recent months – as local governments have been encouraged to bring forward projects funded by bonds. Infrastructure Investment grew by 5.9% yoy (3mma) in December, up from 3.3% in November. Similarly, growth in manufacturing investment also accelerated across much of the year – albeit it dipped to 11.7% yoy (3mma) in December (from 13.9% previously). It is possible that some of this investment is related to the current anti-pollution drive, which would improve environmental conditions in the country, but not boost future output.

- In contrast, investment in real estate has eased in recent months – although it has remained relatively high at 8.4% yoy (3mma), compared with double digit levels mid year. This will be a key sector to watch in 2019 given existing imbalances. New residential construction starts have continued to grow strongly, however residential property sales (in square metres) have started to fall in recent months. In such an environment, investment could slow rapidly, unless policy changes boost demand.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS LARGEST SINCE JANUARY 2016

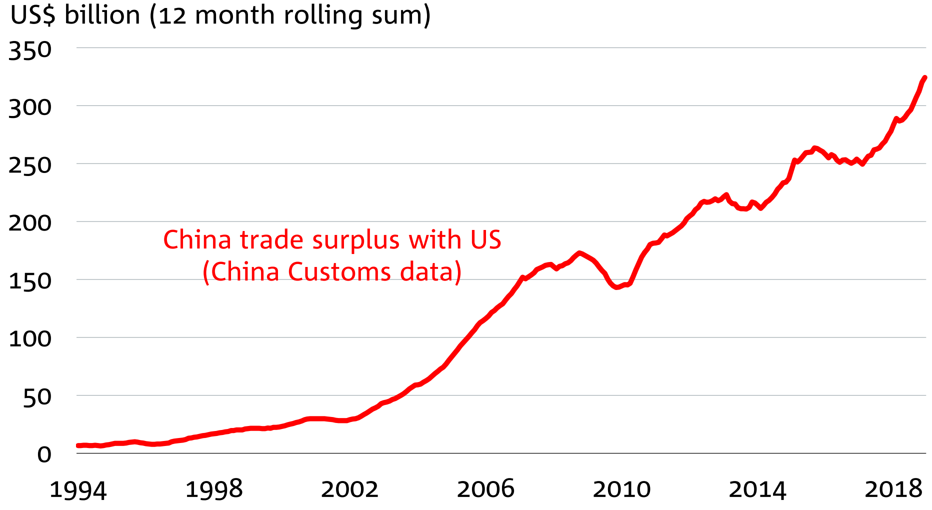
Plunge in imports the driver of the uptick



Sources: CEIC, NAB Economics

CHINA TRADE SURPLUS WITH UNITED STATES

Tariff measures have failed to reduce China's surplus



Sources: CEIC, NAB Economics

- In month-on-month terms, there was a sharp slowdown in Chinese imports in December, compared with a modest decline in exports. As a result, China's trade surplus expanded significantly, out to US$57.1 billion – the largest value since January 2016.

- The United States accounts for the largest share of this trade surplus – with no reduction in the measure since the introduction of tariffs by both countries. In December, China's rolling twelve month trade surplus with the United States totalled US$324.4 billion, an all time record.

- China's imports fell markedly in December, both month-on-month and in year-on-year terms. Imports totalled US$164.2 billion, down from US$182.5 billion in November, a decrease of 7.6% yoy. This was the first year-on-year fall in imports since October 2016.

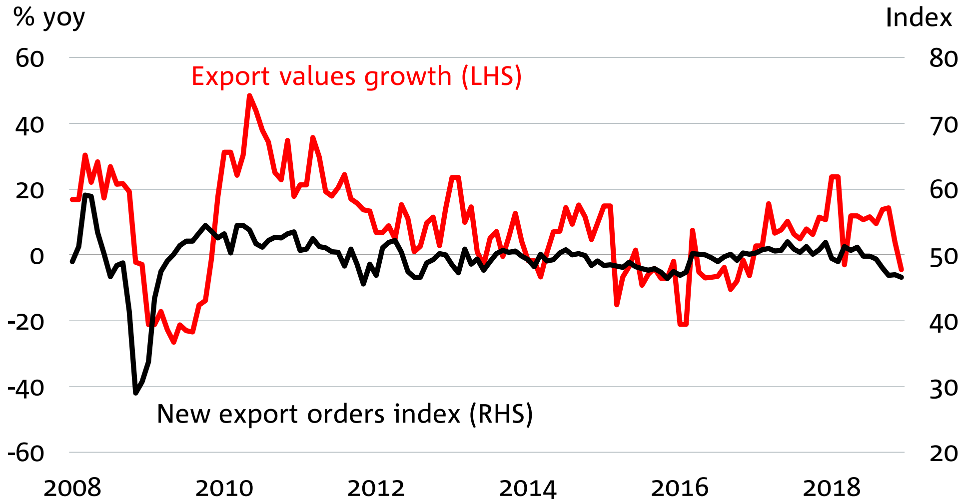
- This decline appeared to be driven by a fall in import volumes. There has traditionally been a close correlation between global commodity prices and Chinese import prices. The RBA Index of Commodity Prices rose by 8.3% yoy in December, implying that the fall in imports was not price related. Our estimate of China's import volumes suggests a decline of almost 10% year-on-year, compared with double digit growth across most of 2018.

- There was significant divergences in the import volumes of key commodities in December. Imports of crude oil rose by almost 30% yoy to an all time high of 43.7 million tonnes. Imports of iron ore rose more modestly – up by 3.0% yoy. In contrast, there was a dramatic slowdown in coal imports – down 55% yoy, while copper imports fell by 4.7% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

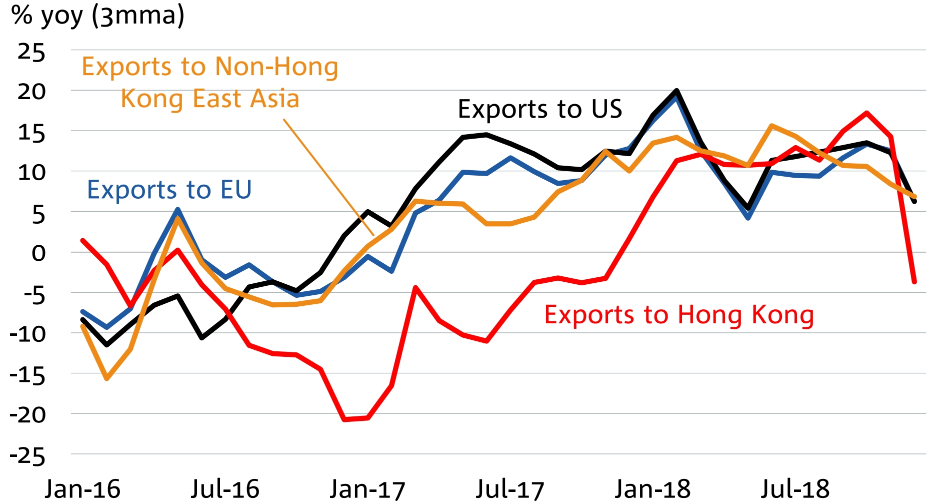
Exports slowed in December, following deteriorating PMIs



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Plunge in exports to HK may reflect distortions in the data



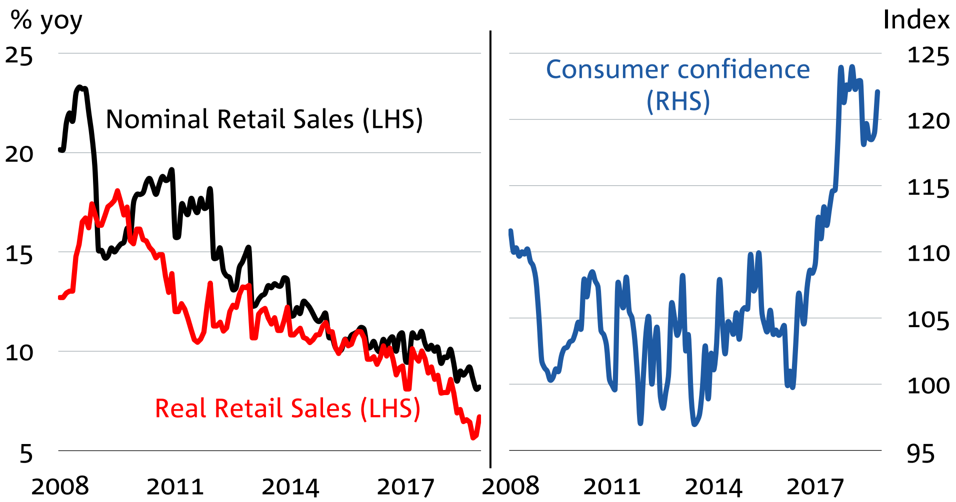
Sources: CEIC, NAB Economics

- China's exports were a little weaker month-on-month in November – at US$221.2 billion (from US$224.3 billion in November) – but considerably weaker year-on-year, down 4.4%. December is typically the peak month for exports. Market conditions for exporters have steadily deteriorated following the announcement and introduction of US tariffs. In December, new export orders in the NBS PMI survey fell to 46.6 points – the weakest reading since November 2015.
- There has been a clear slowdown in growth of exports to the United States in recent months – which likely reflects US importers bringing purchases forward ahead of the introduction of tariffs. Exports to the United States fell by 3.5% yoy in December, compared with double-digit growth between May and October. Bringing forward purchases has likely resulted in artificially weak export volumes in November and December.
- In contrast, exports to the European Union declined at a much more modest rate – down by 0.3% yoy in December.
- There was also a significant slowdown in exports to East Asian trading partners – with a fall of 9.4% yoy. That said, this decline was entirely driven by a fall in exports to Hong Kong, with non-Hong Kong exports increasing by 5.4% yoy. The key driver of this trend was an increase in exports to South Korea and Vietnam.
- In contrast, exports to Hong Kong fell by 26% yoy in December. This outcome reflects a sharp spike in reported Chinese exports in December 2017 that was not evident in Hong Kong Customs data. As we have previously highlighted, discrepancies between these data sources can indicate capital flows being disguised as trade flows, distorting the accuracy of China's trade data. Excluding Hong Kong, China's exports only fell by 0.4% yoy in December.

RETAIL SALES AND INFLATION

REAL RETAIL SALES STRONGER IN DECEMBER

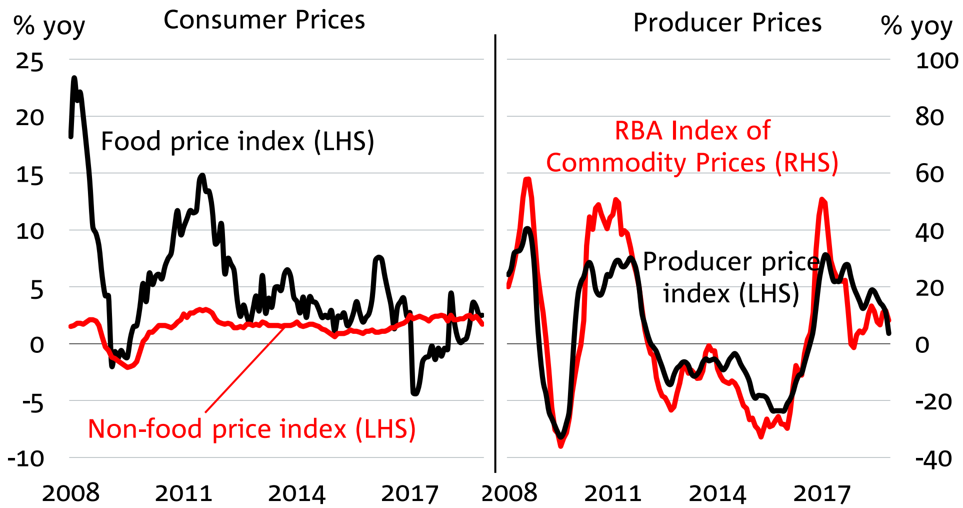
Softer inflation boosted sales, but still historically weak



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Chinese inflation has weakened in recent months



Source: CEIC, RBA, NAB Economics

- There was a marginal upturn in nominal retail sales in December – with growth up to 8.2% yoy (from 8.1% previously). That said, this was accompanied by a sharp slowing in retail price inflation – down to 1.4% yoy from 2.2% in November – much larger than the slowdown in the CPI.

- As a result, real retail sales accelerated in December – back to 6.7% yoy (from 5.8% previously). That said, this rate of growth remains historically weak – real sales grew by an average of 9.0% in 2017. Despite the comparatively weak trends, consumer confidence has remained strong – with the measure rising to 122.1 points in November – just below early 2018 peaks and well above the levels seen over the previous decade.

- China's headline inflation has slowed in recent months – possibly indicative of softer domestic economic conditions along with weaker oil prices. The Consumer Price Index increased by 1.9% yoy in December, compared with 2.2% in November.

- Growth in food prices was unchanged in December – increasing by 2.5% yoy. Price growth has eased from a recent peak of 3.6% yoy in September. A significant decline in fresh vegetable prices has been a key driver of this trend.

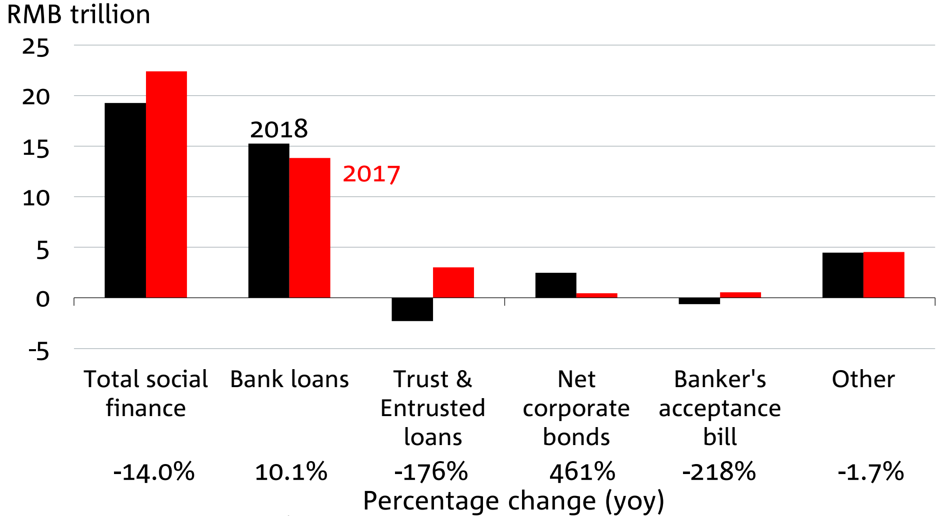
- Non-food price growth has also eased noticeably, down to 1.7% yoy in December, compared with 2.1% in November. A major contributor was the 0.5% fall in vehicle fuel prices, compared with an increase of almost 13% yoy in November.

- Producer prices rose by just 0.9% yoy in December, compared with 2.7% in November. This was the weakest outcome since September 2016. Recent months have seen the relationship between producer prices and global commodity prices become closer once again. The weakness in producer prices may indicate softness in both global and domestic markets – with reports of exporters cutting prices to support volumes.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

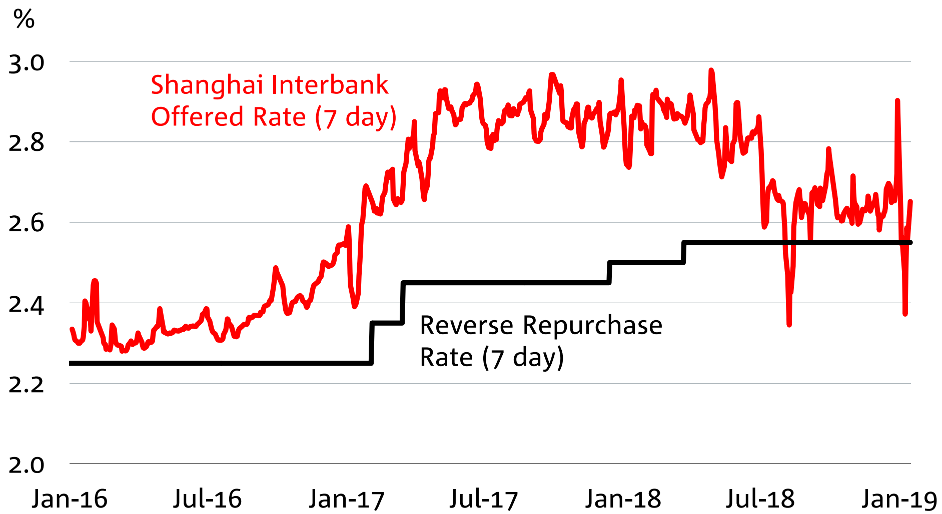
Sharp drop in non-bank lending drove declines in 2018



Sources: CEIC, NAB Economics

VOLATILE SHIBOR IN EARLY JANUARY

No clear sign of monetary easing



Source: CEIC, NAB Economics

- New credit issuance was marginally stronger in year-on-year terms in December, with lending rising by 0.2%. That said, new issuance was not particularly strong by historical standards – with the nominal value below the levels recorded in December 2016 and December 2014.

- For the full year, new credit issuance totalled RMB 19.3 trillion, a decrease of 14.0%. There remains no evidence of broad based stimulus akin to earlier episodes in response to slowing economic trends – suggesting that addressing high levels of corporate debt remain a priority for authorities. We expect a continuation of this trend in 2019 based on PBoC comments.

- Bank lending accounted for the majority of new credit issuance, with bank loans increasing by 10.1% yoy in 2018. Tighter regulation around shadow banking forced banks to direct funding through traditional channels. Bank loans accounted for 79% of total credit issuance in 2018.

- In contrast, non-bank lending fell by around 53% yoy in 2018 to RMB 4.0 trillion. The largest share of non-bank lending was corporate bond issuance – at around RMB 2.5 trillion. In contrast, net lending via shadow banking sectors (including trust and entrusted loans and banker’s acceptance bills) contracted in 2018, reflecting tighter regulation.

- There has been considerable volatility in the 7 day Shanghai Interbank Offered Rate (Shibor) in the past month, spiking ahead of the year end, and plunging in the new year before settling back near the 2.6%-2.65% mark. This has been the trend since the second half of 2018 and we expect that this will remain the target in the short term. Much of the volatility was driven by short term demand for cash – in part related to tax payments – with the PBoC injecting large scale liquidity via open market operations to meet demand.

- In early January the PBoC announced another cut to the Required Reserve Ratio (RRR) for banks. The 1% cut will free up around RMB 800 billion in liquidity (with banks being required to use just under half of the funds to repay maturing medium term lending facility loans).

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