CHINA'S ECONOMY AT A GLANCE

APRIL 2019

National Australia Bank

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CONTACT

Gerard Burg, Senior Economist - International

NAB Group Economics

KEY POINTS

Credit surge keeps growth stable in Q1, but will the taps stay on?

- Official data showed that China's economy grew by 6.4% yoy in the first quarter of 2019, unchanged from the rate in Q4 2018. This means that growth remains at its equal slowest rate (with the trough of the GFC in Q1 2009) since 1990. Deleveraging had a major impact on growth last year, but the outlook for this program is quite uncertain (given strong growth in new credit in Q1). Our forecasts for China's growth are unchanged – with the structural slowdown of the economy set to continue in coming years. Growth is forecast at 6.25% this year, 6.0% in 2020 before dipping below 6% in 2021.

- China's industrial production grew remarkably strongly in March – increasing by 8.5% yoy, compared with just 5.3% yoy in January and February. This was the largest increase in industrial output since July 2014.

- Compared with the levels across January and February, both exports and imports rose in March. The larger increase in exports leading to a wider trade surplus, totalling US$32.6 billion (up from US$21.9 billion in the first two months). There was a sizeable fall in imports on a year-on-year basis – down 7.6% – with weaker import volumes the main driver. This weakness points to soft domestic demand in recent months, despite the modest turnaround in manufacturing PMIs and producer prices.

- Growth in China's fixed asset investment was more than offset by higher investment goods prices, meaning that our estimate of real investment was a little weaker – at 5.8% yoy in March (down from 6.4% yoy in the first two months). Recent months have seen an acceleration in investment by state-owned enterprises (SOEs).

- Real retail sales dipped slightly in March – to 6.7% yoy (compared with 7.1% yoy across the first two months of the year). China's consumer confidence has remained strong, despite the relative softness in real sales since late 2017, compared with earlier growth rates. In February, consumer confidence reached 126.0 points, an all time high (with the series stretching back to January 1993).

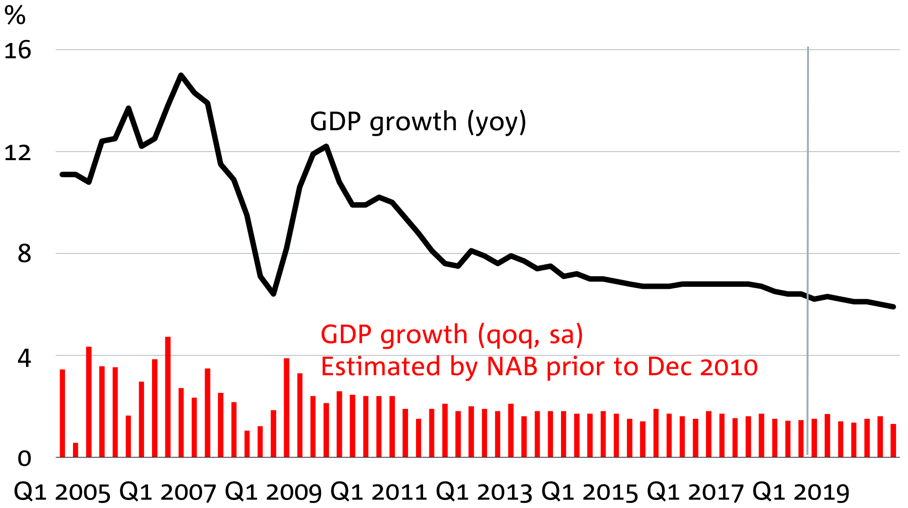
- New credit issuance remained strong in March, with a surge in bank loans accounting for the largest share of the increase. In the first quarter, new credit issuance totalled RMB 8.2 trillion – an increase of 40% yoy. This represents a considerable turn around from the declines in issuance recorded in 2018.

- Volatility in the 7 day Shanghai Interbank Offered Rate (Shibor) has increased since the start of the year. In part this may reflect reduced Open Market Operations by the PBoC. Over the same period, there has been a considerable decline in longer term interbank rates – with three month rates down around 51 basis points and one year down by 43 basis points.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH STABLE IN Q1

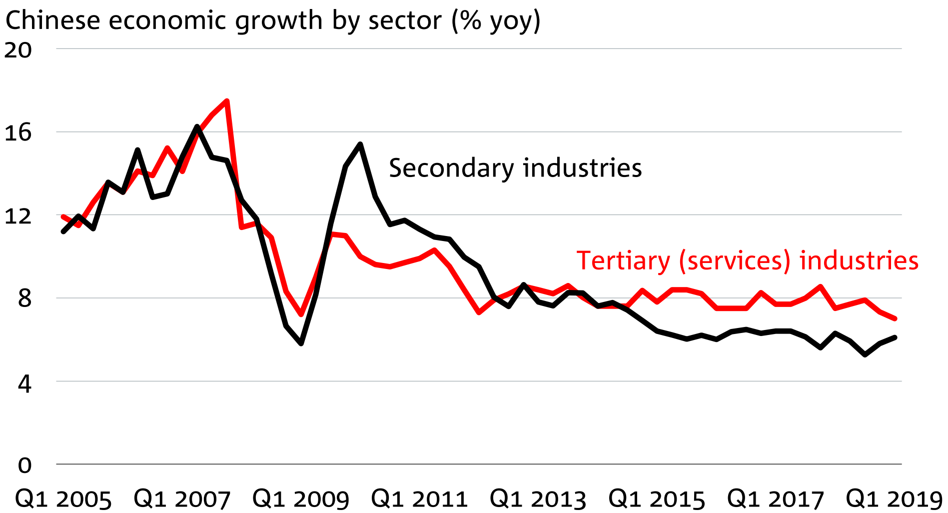
Remains at equal weakest rate of growth since 1990



Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Services still the fastest growing, although softer growth in Q1



Source: Datastream, NAB Economics

- Official data showed that China's economy grew by 6.4% yoy in the first quarter of 2019, unchanged from the rate in Q4 2018 and in line with our expectations. This means that growth remains at its equal slowest rate (with the trough of the GFC in Q1 2009) since 1990 – although official data overlooks a likely slowdown in late 2015/early 2016.

- China's services sector accounts for the largest share of its economy and remains the key engine for its growth. That said, services growth has slowed in recent quarters – down to 7.0% yoy in Q1, from 7.3% yoy in Q4 2018. In contrast, the secondary industries (manufacturing and construction) recorded stronger growth – increasing by 6.1% yoy (from 5.8% yoy previously).

- Deleveraging had a major impact on growth last year, but the outlook for this program is quite uncertain. While statements from the PBoC indicated that it should continue this year, credit issuance grew strongly in the first quarter. Loosening this constraint could support higher than forecast growth in 2019, but also increase debt levels that would increase medium term risks for China's economy.

- Our forecasts for China's growth are unchanged – with the structural slowdown of the economy set to continue in coming years. Growth is forecast at 6.25% this year, 6.0% in 2020 before dipping below 6% in 2021.

NAB CHINA GDP FORECASTS

%	2019	2020	2021
GDP	6.25	6.0	5.8

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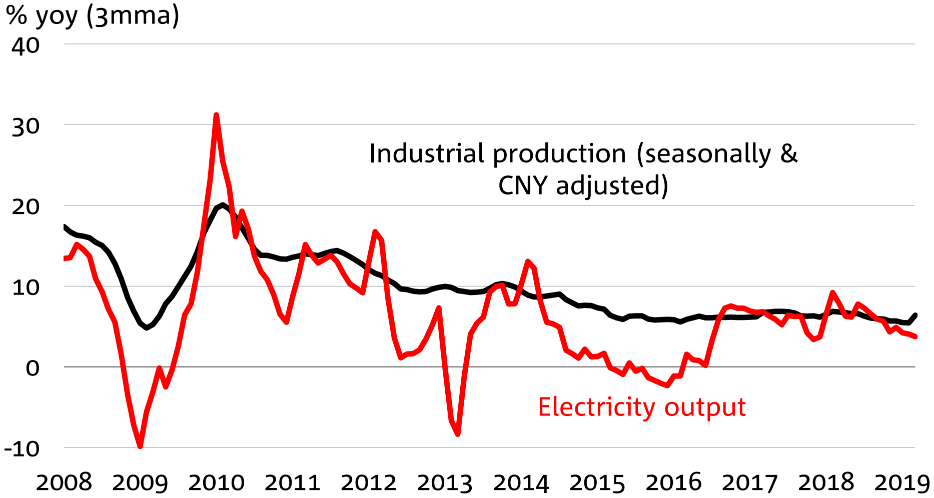
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

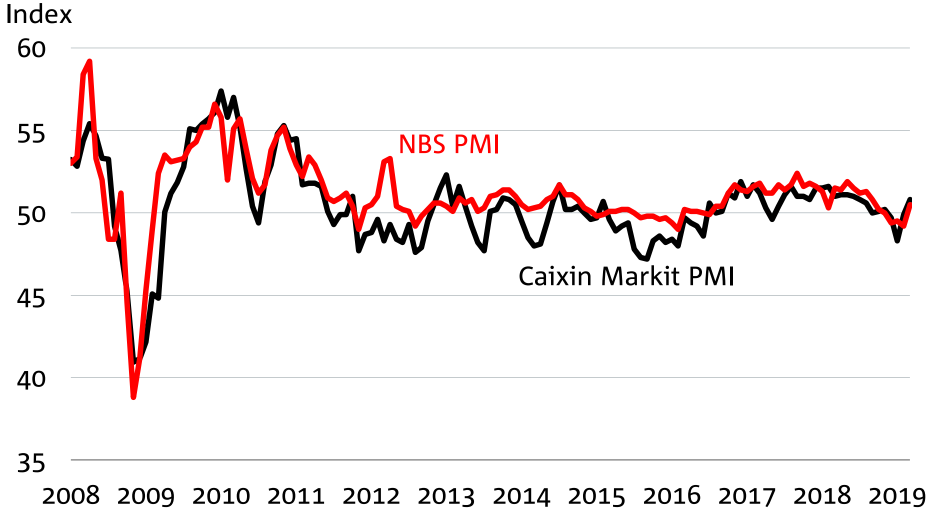
Growth accelerated to multi-year high in March



Source: CEIC, NAB Economics

IMPROVEMENT IN MANUFACTURING SURVEYS

Both PMI readings back into (modestly) positive territory



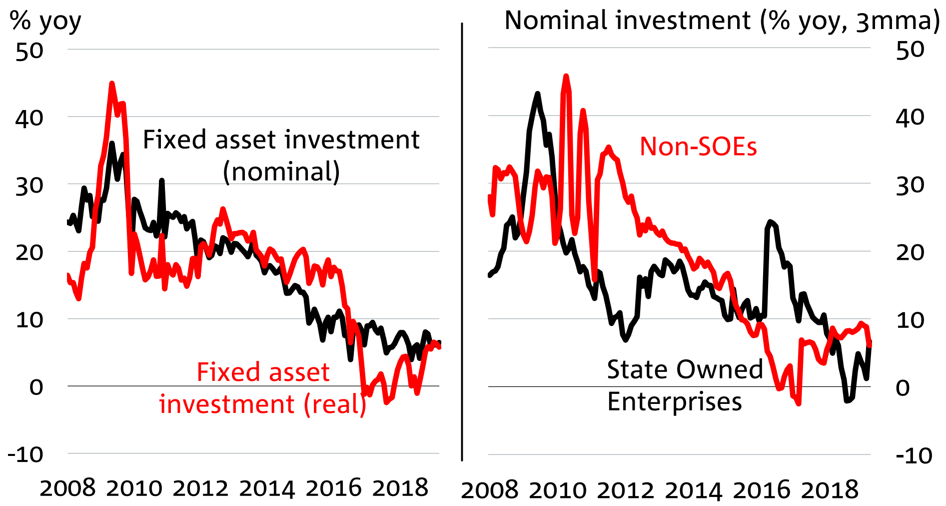
Source: CEIC, NAB Economics

- China's industrial production grew remarkably strongly in March – increasing by 8.5% yoy, compared with just 5.3% yoy in January and February. This was the largest increase in industrial output since July 2014.
- Trends in sub-sectors remain mixed. There was strong growth in construction-related sectors, with cement and crude steel output rising by 22.2% yoy and 10.0% yoy respectively. Similarly, output of consumer electronic products rose by 10.2% yoy.
- In contrast, electricity output rose more moderately – up by 5.4% yoy – while motor vehicle output fell by 2.6% yoy. The auto sector is suffering from lower sales, tied to tighter credit availability.
- There was a notable turnaround in China's two major manufacturing surveys in March – returning to positive territory, following three straight negative months. The official NBS PMI survey was 50.5 points (from 49.2 points previously), while the private sector Caixin Markit PMI moved up to 50.8 points (from 49.9 points).
- Improved domestic trends were the key drivers in both surveys – with new orders measures at their highest in four months and six months in the Caixin Markit and NBS surveys respectively. Export measures were positive in the private survey, but remained negative (albeit less negative than previously) in the official measure.

INVESTMENT

FIXED ASSET INVESTMENT

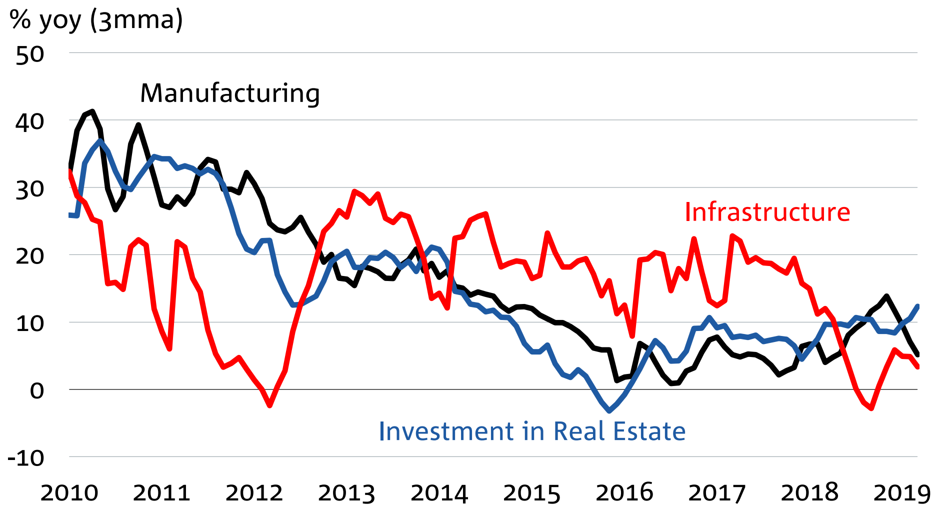
Real investment eases on higher investment goods prices



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Divergent trends, with real estate continuing to grow strongly



Source: CEIC, NAB Economics

- China's fixed asset investment grew by around 6.5% yoy in March, compared with an increase of 6.1% yoy in January and February. This increase was offset by an increase in producer prices – which flow through into the cost of investment goods – meaning that our estimate of real investment was a little weaker – at 5.8% yoy (down from 6.4% yoy in the first two months).

- Recent months have seen an acceleration in investment by state-owned enterprises (SOEs). On a three month moving average basis, nominal SOE investment rose by 6.7% yoy (compared with just 1.2% in February). In contrast, there has been a slowing in private sector investment, down to 6.1% yoy (3mma) (from 8.8% yoy previously).

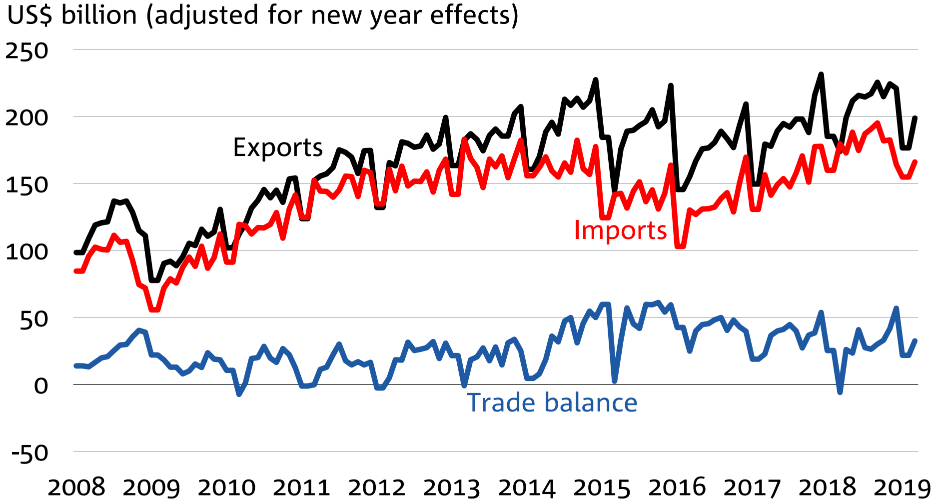
- Investment trends by major industry continue to diverge. Infrastructure and manufacturing have both recorded weaker rates of growth – with infrastructure investment growing by 3.3% yoy (3mma) (down from 4.9% yoy previously). Manufacturing investment increased by 5.1% yoy (3mma), down from 7.0% yoy previously (and double digit growth in the latter part of 2018).

- In contrast, investment in real estate has remained strong – increasing by 12.4% yoy (3mma), compared with 10.5% yoy previously. There remain some significant imbalances in the real estate sector, with modest growth in housing sales (up 1.9% yoy) in stark contrast to housing starts (up 19% yoy), which could lead to a rapid slowdown in investment if conditions deteriorate.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS WIDER ON EXPORT PICKUP

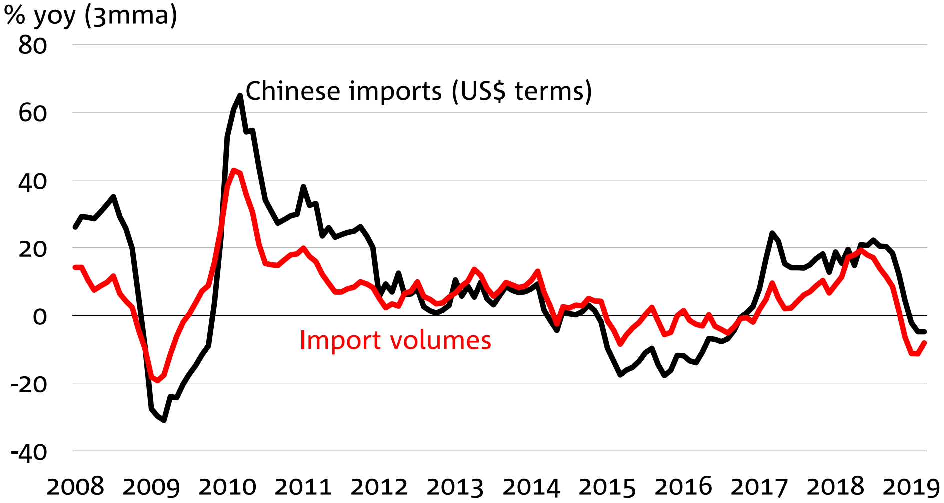
United States accounts for the bulk of surplus



Sources: CEIC, NAB Economics

CHINA'S IMPORT VALUES AND VOLUMES

Weaker imports driven by weaker volumes



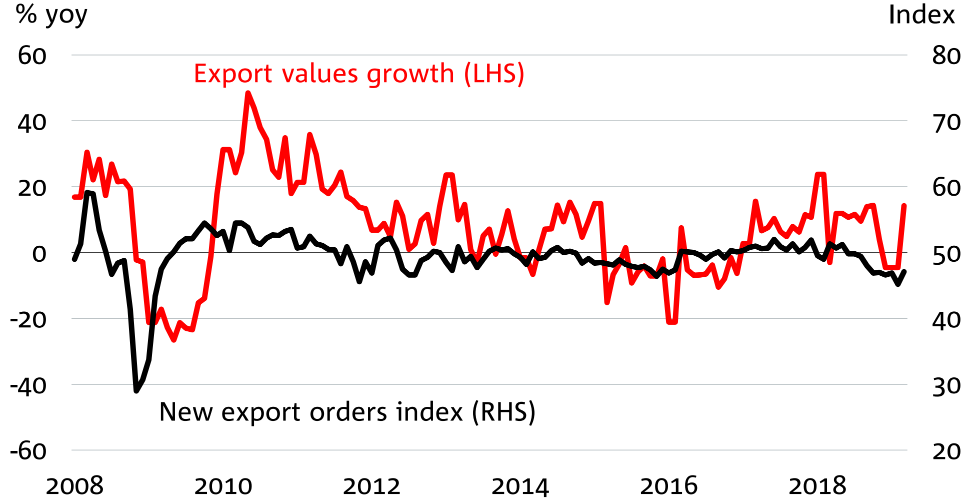
Source: CEIC, NAB Economics

- Compared with the levels across January and February, both exports and imports rose in March. The larger increase in exports leading to a wider trade surplus, totalling US$32.6 billion (up from US$21.9 billion in the first two months).
- The United States continues to account for the bulk of this trade surplus. On a twelve month rolling basis, China's trade surplus with the United States totalled US$328.7 billion, a new all time record. Trade measures introduced by the US to reduce this surplus have not been effective.
- Although China's imports rose compared to the average across the first two months (to US$166.0 billion, from US$154.7 billion), there was a sizeable fall in year-on-year terms – down 7.6%.
- Falling import volumes appear to be the main driver of this decline. There has long been a close relationship between China's import prices and global commodity prices, and the RBA Index of Commodity Prices rose by 6.3% yoy in March – implying that price effects do not explain the fall in import values. Our estimates suggest that China's import volumes fell by 8.1% yoy (on a three month moving average basis), compared with around 11% across January and February.
- This weakness points to soft domestic demand in recent months, despite the modest turnaround in manufacturing PMIs and producer prices.
- There were differing trends for major commodity import volumes. There were steep declines in imports of coal (down 12.1% yoy) and copper (down 10.9% yoy). In contrast, there were modest increases in iron ore and crude oil imports – up 0.7% yoy and 0.4% yoy respectively.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

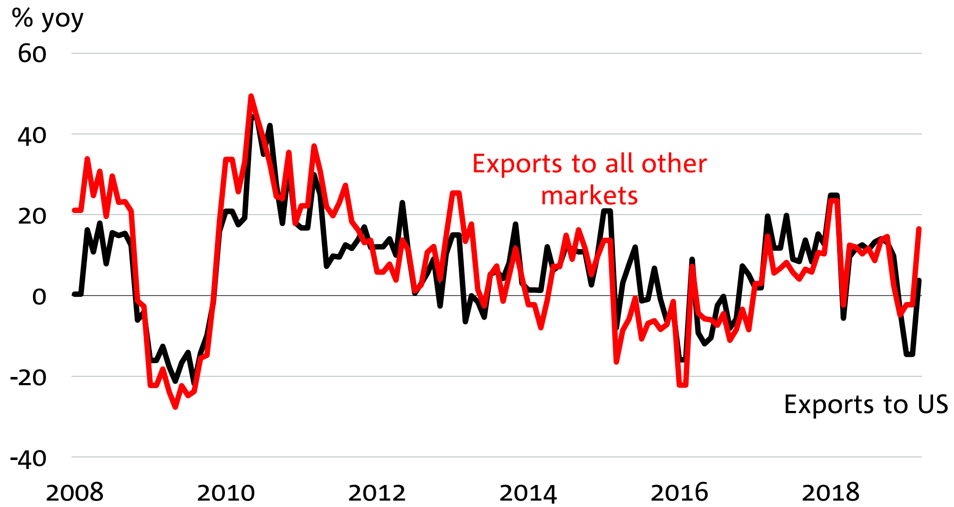
Strong increase due largely to weakness in March 2018



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Exports to the US lagging other trading partners



Sources: CEIC, NAB Economics

- China's exports rose month-on-month – to US$198.7 billion in March, compared with an average of US$176.5 billion across January and February. In year-on-year terms, exports grew strongly – up by 14.2% yoy – however this in part reflects relative weakness in exports in March 2018.
- The new export orders measure in the NBS PMI survey was marginally higher in March – at 47.1 points (compared with 45.2 points previously) – however this reading remains firmly in negative territory.
- As has been the case since December 2018, growth in exports to the United States has lagged other major trading partners, increasing by just 3.7% yoy. This reflects the impact of US tariffs – both in terms of the direct impact on consumer demand as well as the lagged effect of purchases being brought forward to the latter months of 2018.
- In contrast, exports to the European Union surged in March, increasing by 23.7% yoy. That said, compared with the rest of 2018, exports to the EU in March 2018 were particularly weak, overstating the strength of this result.
- Exports to East Asia also grew strongly – up by 11.4% yoy. Compared with other markets, exports to Hong Kong have remained weak – falling by around 0.9% yoy, however we have previously noted that trade data between Hong Kong and China is subject to considerable distortions (with capital flows disguised as trade activity to avoid capital controls).
- Exports to non-Hong Kong East Asia rose by 19.8% yoy, with a strong increase in exports to Vietnam, the Philippines, Taiwan, Malaysia and Indonesia.

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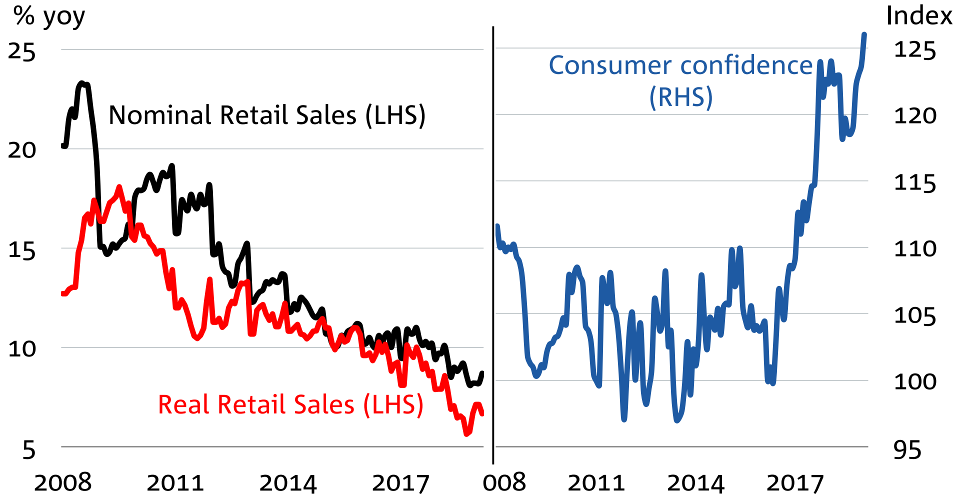
RETAIL SALES AND INFLATION

REAL RETAIL SALES DIPPED SLIGHTLY IN MARCH

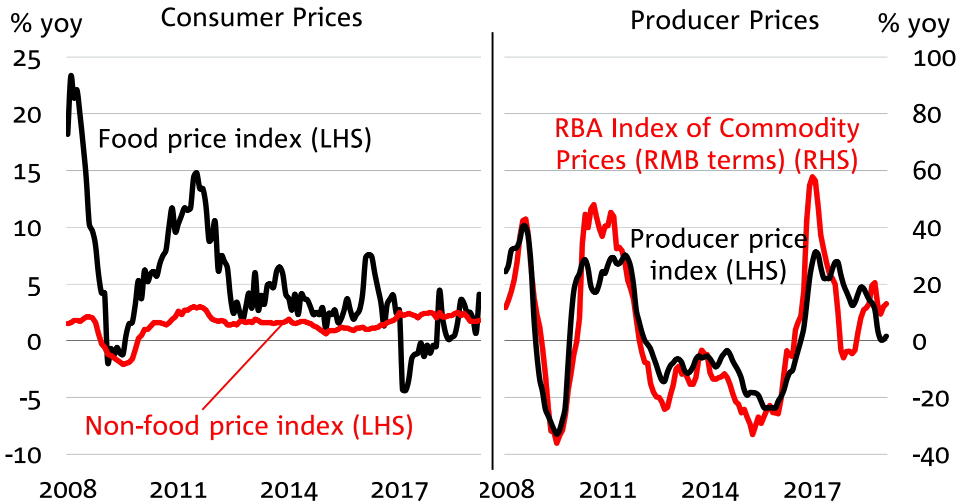
Consumer confidence rose to record levels in February



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Rising pork prices push CPI higher in March



Source: CEIC, RBA, NAB Economics

- Nominal retail sales grew a little more strongly in March – up by 8.7% yoy, compared with 8.2% across January and February. That said, retail price inflation was also stronger – up to 1.9% yoy, from 1.0% previously. As a result, real retail sales dipped slightly – to 6.7% yoy (compared with 7.1% yoy across the first two months of the year).
- China's consumer confidence has remained strong, despite the relative softness in real sales since late 2017, compared with earlier growth rates. In February, consumer confidence reached 126.0 points, an all time high (with the series stretching back to January 1993).
- China's headline inflation picked up in March – with the Consumer Price Index increasing by 2.3% yoy (from 1.5% in February), although it is worth noting that prices declined in month-on-month terms.
- Food price growth was the key driver of the year-on-year increase in consumer prices – increasing by 4.1% yoy. Pork was a major contributor to this trend – with pork prices rising by 5.1% yoy in March, compared with a 4.8% yoy fall in February. African Swine Flu has impacted pork supply in recent months and this issue is unlikely to be resolved quickly. Fresh vegetable prices also rose strongly.
- Non-food price growth was marginally stronger in March – up to 1.8% yoy (from 1.7% previously). Vehicle fuel prices rose by around 3.3% yoy in March (compared with a 2.9% fall in February).
- Producer prices rose by 0.4% yoy in March, compared with the particularly weak 0.1% increases across January and February. With commodity prices increasing by around 13% yoy (in RMB terms), this would typically be associated with larger price increases. It is likely that weakness in both Chinese domestic demand and global markets (despite the growth in exports this month) have limited the capacity of firms passing on higher costs.

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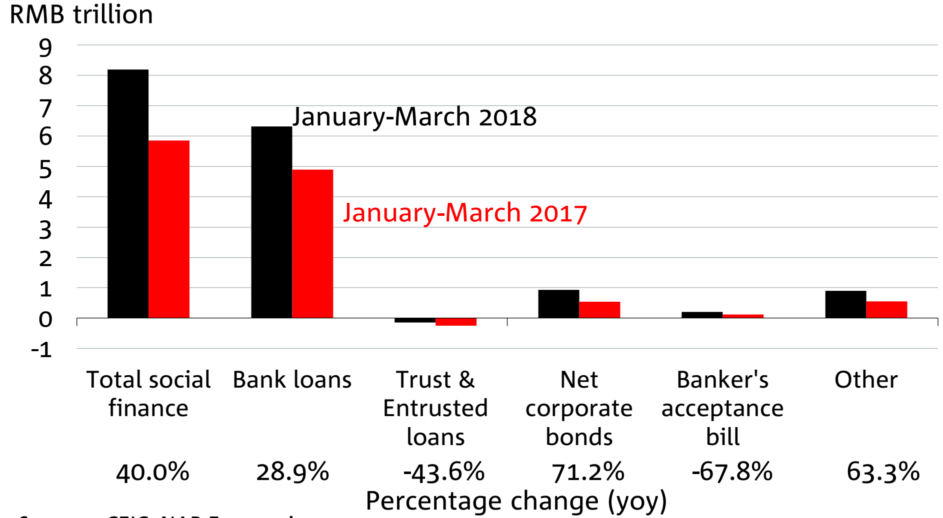
CREDIT CONDITIONS

STRONG GROWTH IN CREDIT ISSUANCE IN Q1

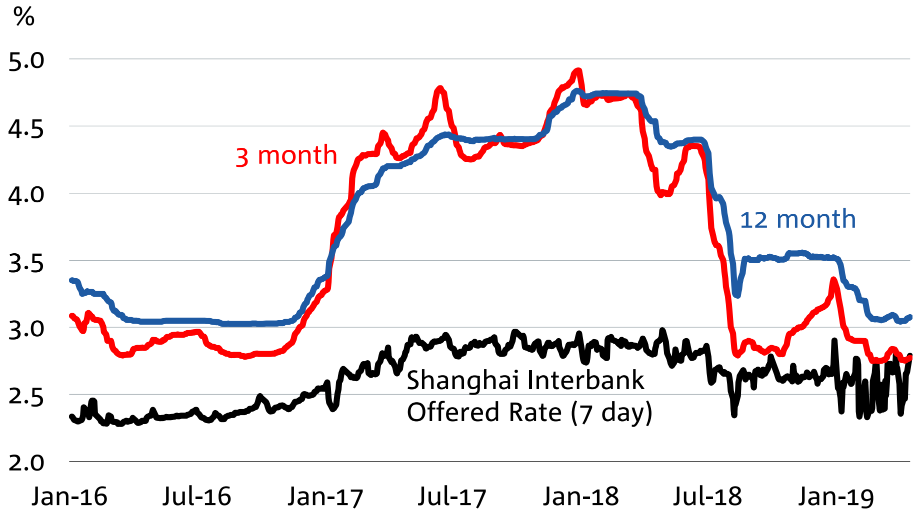
Bank loans account for the largest share of lending



Sources: CEIC, NAB Economics

VOLATILITY IN NEAR TERM SHIBOR HAS CONTINUED

Longer term rates have fallen significantly



Source: CEIC, NAB Economics

- New credit issuance remained strong in March, with a surge in bank loans accounting for the largest share of the increase. In the first quarter, new credit issuance totalled RMB 8.2 trillion – an increase of 40% yoy. This represents a considerable turn around from the declines in issuance recorded in 2018.

- Bank lending has grown rapidly in early 2019 – expanding by almost 29% yoy in the first three months to RMB 6.3 trillion. Chinese authorities have tightened regulation and supervision of the shadow banking sector in recent years, limiting the capacity of banks to lend through off-balance sheet channels.

- Despite this, non-bank lending has increased strongly in the first three months of the year – up around 97% yoy to RMB 1.9 trillion. This increase reflected growth in corporate bond issuance (up 71% yoy) and local government special bond financing (increasing 600% from a very low base in early 2018).

- Volatility in the 7 day Shanghai Interbank Offered Rate (Shibor) has increased since the start of the year. In part this may reflect a pull back in intervention by the People's Bank of China (PBoC), with the scale of Open Market Operations falling considerably in February and March. According to reports, this pull back has continued in April. Since the start of March, the 7 day Shibor has ranged between 2.35% and 2.8%.

- Since the start of the year, there has been a considerable decline in longer term interbank rates – with three month rates down around 51 basis points and one year down by 43 basis points. Rates have fallen even further when compared with mid-2018.

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Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

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

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836