# CHINA'S ECONOMY AT A GLANCE

## JULY 2019

National Australia Bank

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## CONTACT


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# KEY POINTS

## Growth slowed in Q2 but policy support should see it stabilise

- China's economy grew by 6.2% yoy in Q2 2019 – in line with our expectations – down from 6.4% yoy in both Q1 2019 and Q4 2018. This rate of growth is softer than the trough recorded during the GFC, meaning that growth in Q2 was the slowest since 1990. Policy makers continue to send mixed messages regarding economic stimulus – however we believe that they are providing sufficient monetary and fiscal support to stabilise short term economic growth around these levels (although trade remains an uncertainty). Our growth forecasts remain unchanged, at 6.25% this year, 6.0% in 2020 and 5.8% in 2021.

- China's industrial production grew surprisingly strongly in June – increasing by 6.3% yoy, compared with just 5.0% in May (which was the weakest increase since the GFC). China's two main manufacturing surveys converged in June – at 49.4 points – as export measures deteriorated.

- China's fixed asset investment grew more strongly in June – with real investment accelerating to 6.3% yoy (from 3.8% previously). Much of the recent pick up in investment in recent months has been driven by State-Owned Enterprises (SOEs) – indicative of government directed measures to stimulate growth.

- China's trade surplus continued to widen in June, reflecting a sizeable month-on-month decline in imports while exports were only marginally lower. The surplus totalled US$51.0 billion, compared with US$41.7 billion in May. Trade with the United States accounts for the majority of China's trade surplus. Two-way trade between the countries has fallen following the implementation of tariffs, but this has not substantially reduced China's trade surplus with the US, which rose to a new record of US$330.8 billion for the twelve months to June.

- Real retail sales growth has continued to recover – increasing by 7.5% yoy (compared with 6.4% in May). Consumer confidence was marginally weaker in May – at 123.4 points (down from 125.3 points in April) – however this remains at levels that are historically high.

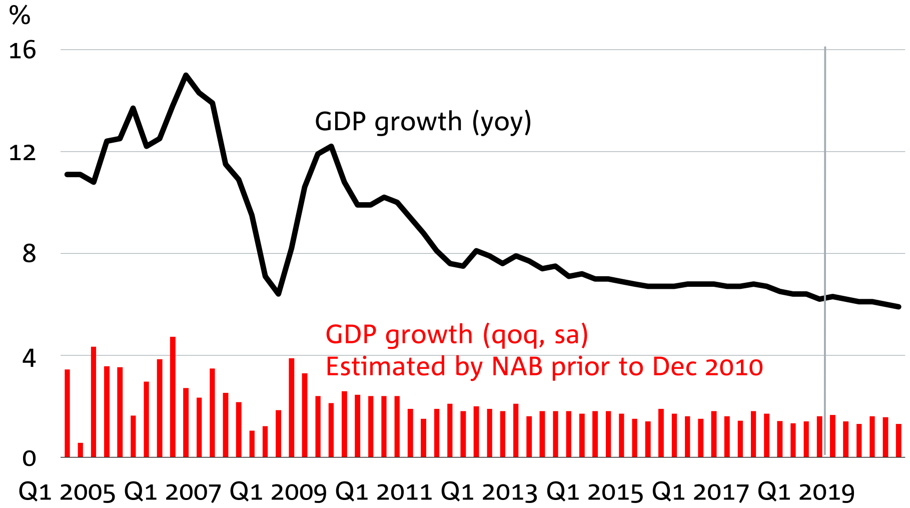
- The provision of monetary support to China's economy has been clearly evident in credit growth in the first half of 2019, and suggests that Chinese authorities have been more concerned this year with short term growth than medium term debt risks. New credit issuance increased by over 31% yoy in this period, to total RMB 13.2 trillion.

- Rumours in July suggest that the PBoC is set to cut the benchmark one-year lending rate. This move (should it happen) would be largely symbolic – the rate hasn't changed since October 2015, and doesn't appear to be particularly relevant since the switch in monetary policy from a quantity to a price based approach (which occurred in November 2015). In contrast, short term interbank lending rates are more important and these rates eased in late-June and early July. The three month Shibor has fallen from around 2.9% in mid-June to around 2.6% at the time of writing.

# GROSS DOMESTIC PRODUCT

## CHINA'S ECONOMIC GROWTH DIPS IN Q2

Slowest rate of growth since 1990

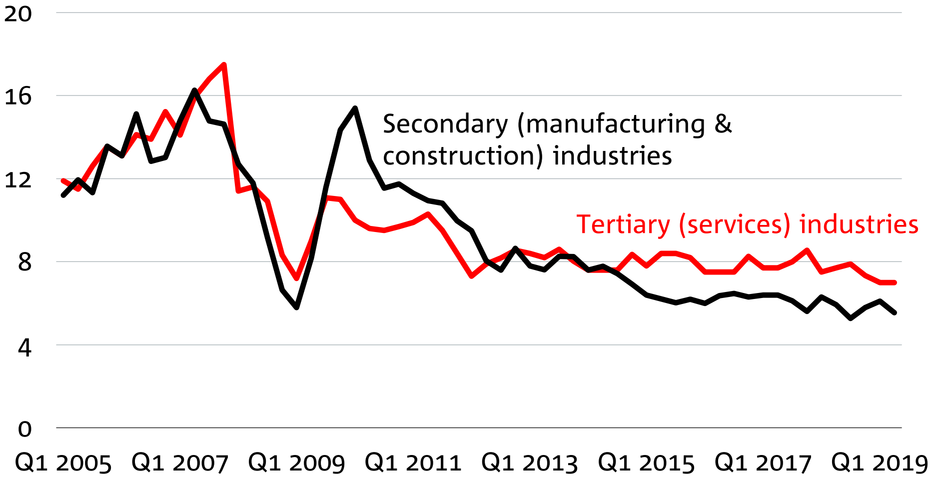



Source: CEIC, NAB Economics

## ECONOMIC GROWTH BY INDUSTRY

Trade-exposed secondary sector slowed in Q2

Chinese economic growth by sector (% yoy)




Source: Datastream, NAB Economics

- China's national accounts data showed that its economy grew by 6.2% yoy in the second quarter of 2019 – in line with our expectations – down from 6.4% yoy in both Q1 2019 and Q4 2018. This rate of growth is softer than the trough recorded during the GFC, meaning that growth in Q2 was the slowest since 1990.
- The slower rate of growth in Q2 was driven by China's secondary industries – manufacturing and construction – in part reflecting the impact of the US-China trade dispute. The secondary sector grew by 5.5% yoy (down from 6.1% previously).
- In contrast, the services sector – which has been the key engine for China's growth over recent years – remained comparatively strong, increasing by 7.0% yoy in Q2 (unchanged from the March quarter).
- Chinese policy makers continue to send mixed messages regarding economic stimulus – however we believe that they are providing sufficient monetary and fiscal support to stabilise short term economic growth around these levels. That said, the trade relationship with the United States continues to provide uncertainty to our outlook.
- With the latest data in line with our expectations, our forecasts for China's growth remain unchanged. Growth is forecast at 6.25% this year, 6.0% in 2020 before dipping below 6.0% in 2021.

## NAB CHINA GDP FORECASTS

| % | 2019 | 2020 | 2021 |
|---|---|---|---|
| GDP | 6.25 | 6.0 | 5.8 |

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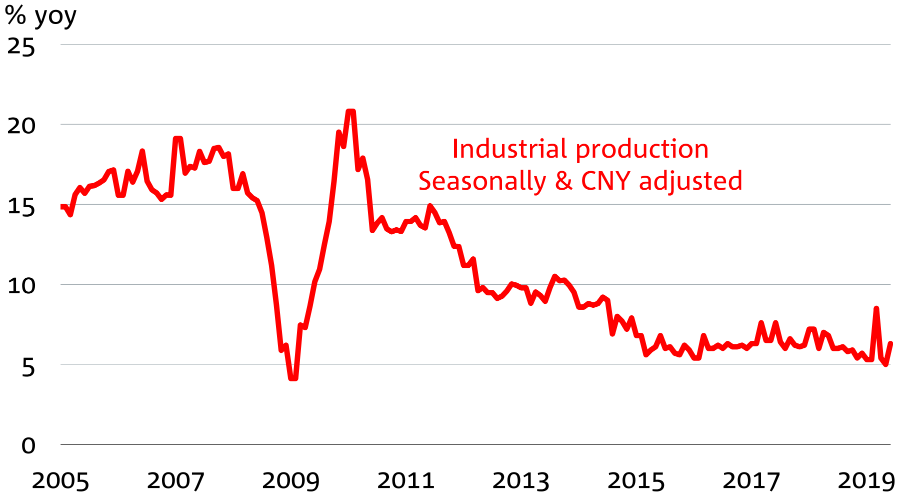
# INDUSTRIAL PRODUCTION

## INDUSTRIAL PRODUCTION

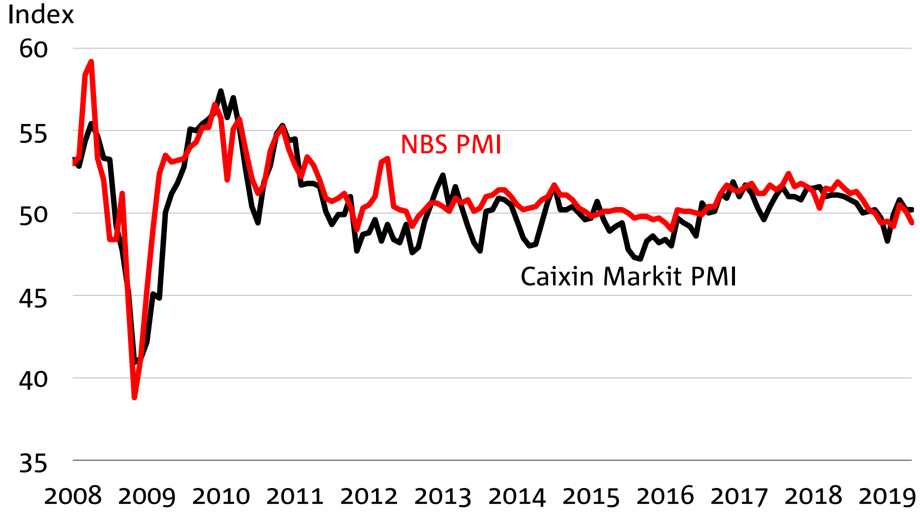
Growth rebounded from its post-GFC low




Source: CEIC, NAB Economics

## PMI SURVEYS CONVERGED IN JUNE

Both surveys report negative export order measures



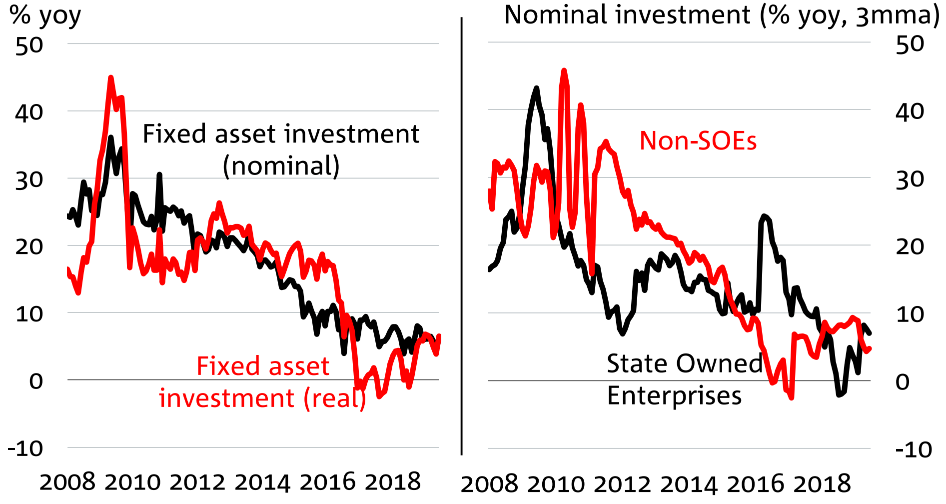

Source: CEIC, NAB Economics

- China's industrial production grew surprisingly strongly in June – increasing by 6.3% yoy, compared with just 5.0% in May (which was the weakest increase since the GFC).
- Trends in individual industries remain highly divergent. Crude steel production has remained strong – increasing by 10% yoy (albeit retreating slightly from last month's record levels), while cement (which like steel is closely tied to construction) increased by 6.0% yoy.
- Consumer electronics production has also grown relatively strongly – with the sector not yet falling under US tariff measures – increasing by 10.4% yoy in June. Electricity output rose more modestly, up by 2.8% yoy.
- Motor vehicle manufacturing continues to suffer – with domestic demand hit by tighter access to credit (particularly through shadow banking channels). Vehicle output fell by 15.2% yoy – with the level in June 2019 around 37% below the peak recorded in November 2017.
- China's two main manufacturing surveys converged in June. The official NBS PMI survey (which has a larger share of large state owned enterprises in its sample) was unchanged at 49.4 points, while the private Caixin Markit PMI dropped to 49.4 points (from 50.2 points previously). The latter survey has a larger share of private SME firms. It is worth noting that both surveys are above (if only slightly) the lows recorded earlier in the year.
- Given the deterioration in the US-China trade relationship, it is unsurprising that new export order measures were negative in both surveys. Export orders in the NBS survey has been negative since June 2018 and deteriorated last month, while the Caixin measure turned negative, from a surprise positive reading in May.

# INVESTMENT

## FIXED ASSET INVESTMENT

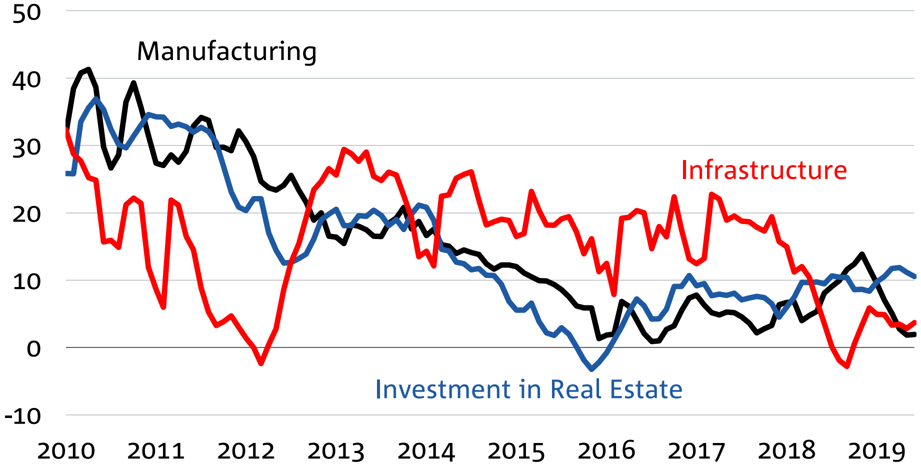
Investment showing signs of recovery, led by SOEs




Source: CEIC, NAB Economics

## FIXED ASSET INVESTMENT BY SECTOR

Manufacturing and infrastructure investment still soft




Source: CEIC, NAB Economics

- China's fixed asset investment grew more strongly in June – increasing by 6.3% yoy (compared with 4.3% in May). Producer price trends have weakened considerably in recent months – with these prices flowing through into the cost of investment goods – meaning that our estimate of real investment also accelerated – to 6.3% yoy (from 3.8% previously).

- Much of the recent pick up in nominal investment onths has been driven by State-Owned Enterprises (SOEs) – indicative of government directed measures to stimulate growth. On a three month moving average basis, investment by SOEs increased by 7.0% yoy. In contrast, private sector investment increased by just 4.7% yoy (3mma).

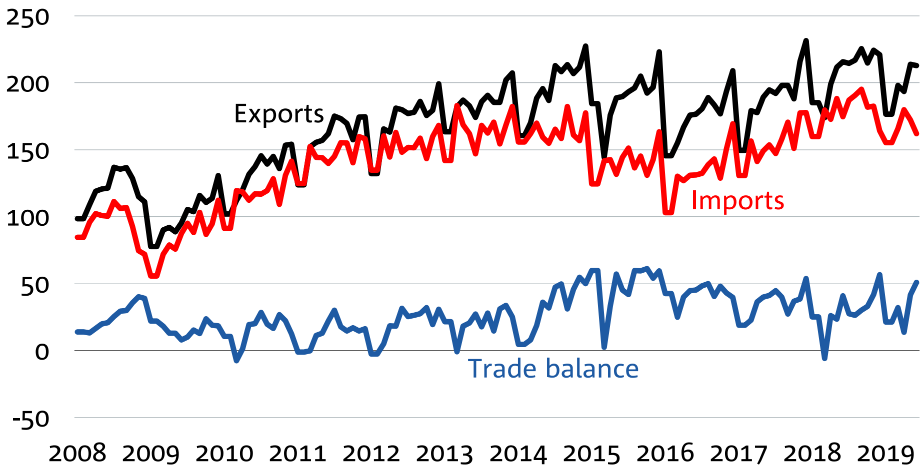
- Investment trends by industry remain highly divergent. Investment in manufacturing has fallen away sharply in recent months – likely a reflection of the weak conditions in the sector (particularly for trade exposed producers). Investment increased by just 1.9% yoy (3mma). Similarly, infrastructure investment has been relatively weak – increasing by 3.7% yoy (3mma).

- In contrast, investment in real estate has continued to increase relatively strongly – up by 10.5% yoy (3mma) in June. It remains to be seen how long real estate investment can remain at these rates. Although residential construction starts have stayed relatively strong – increasing by 9.9% yoy in June, property sales have slowed considerably – down by 1.3% yoy. Further deterioration in property market conditions could result in a rapid slowdown in investment.

# INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

## TRADE SURPLUS CONTINUES TO WIDEN IN JUNE

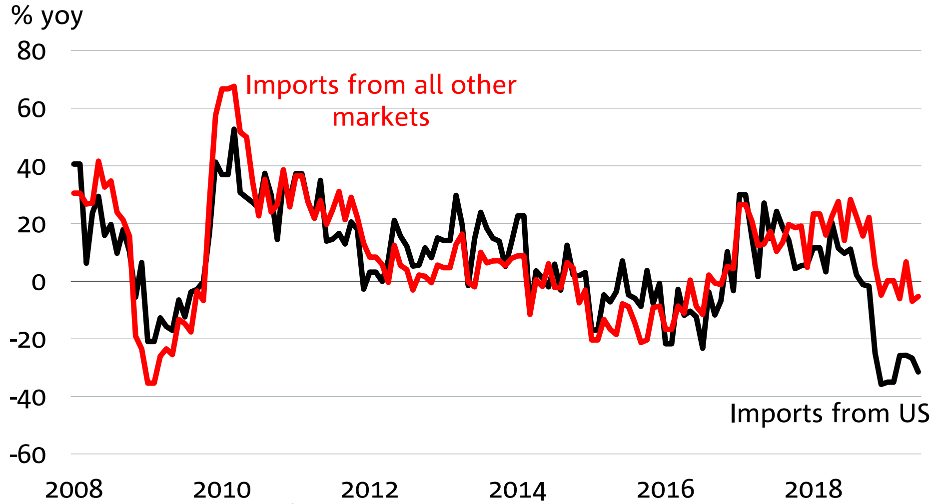
China's imports drop away




Sources: CEIC, NAB Economics

## CHINA'S IMPORTS FROM THE US

Trade measures have heavily impacted US import trends




Sources: CEIC, NAB Economics

- China's trade surplus continued to widen in June, reflecting a sizeable month-on-month decline in imports while exports were only marginally lower. The surplus totalled US$51.0 billion, compared with US$41.7 billion in May.
- Trade with the United States accounts for the majority of China's trade surplus. Two-way trade between the countries has fallen following the implementation of tariffs, but this has not substantially reduced China's trade surplus, which rose to a new record of US$330.8 billion for the twelve months to June.
- The total value of China's imports fell by 7.3% yoy in June – down to US$161.9 billion (compared with US$172.1 billion previously). The impact of China's retaliatory tariffs on US goods is evident in trade data – with imports from the United States falling by over 30% yoy in June – while imports from all other markets fell by around 5.3% yoy.
- For the second straight month, the decline in import values appears to be driven by a sharp fall in import volumes. Our estimate of import prices is based on global commodity price trends – with the RBA Index of Commodity Prices increasing by 10.6% yoy in June. That said, it is worth noting that there has been considerable divergence between individual commodities, and the RBA index is heavily weighted towards iron ore, meaning that the price increase in China may be more muted. On a three month moving average basis, we estimate that China's import volumes fell by 6.4% yoy in June.
- Import volumes for major commodities continue to exhibit divergent trends. Imports of crude oil increased strongly – up by 15.2% yoy – while coal imports also increased – rising by 6.4% yoy. In contrast, there were falls in iron ore imports – down 9.7% yoy (potentially reflecting supply constraints that have sent prices surging) – and copper, which fell by 27% yoy.

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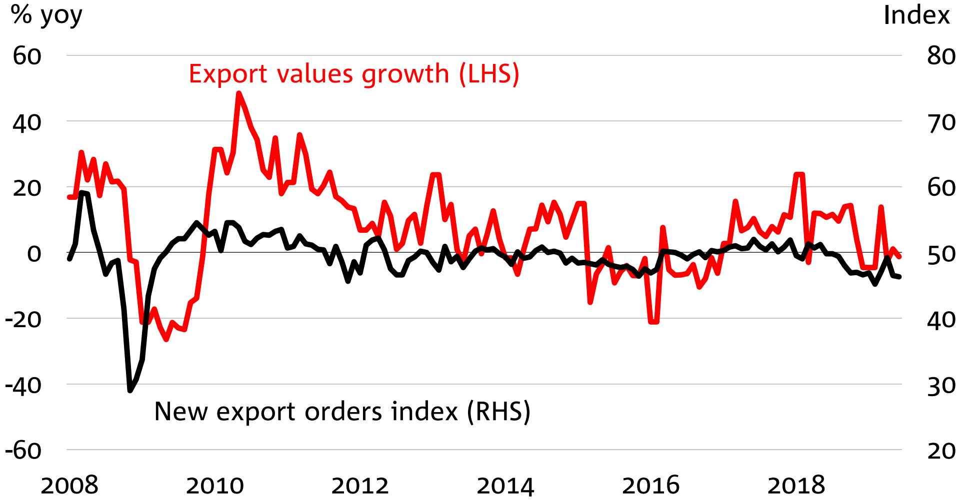
# INTERNATIONAL TRADE – EXPORTS

## CHINA'S EXPORTS DIP IN JUNE

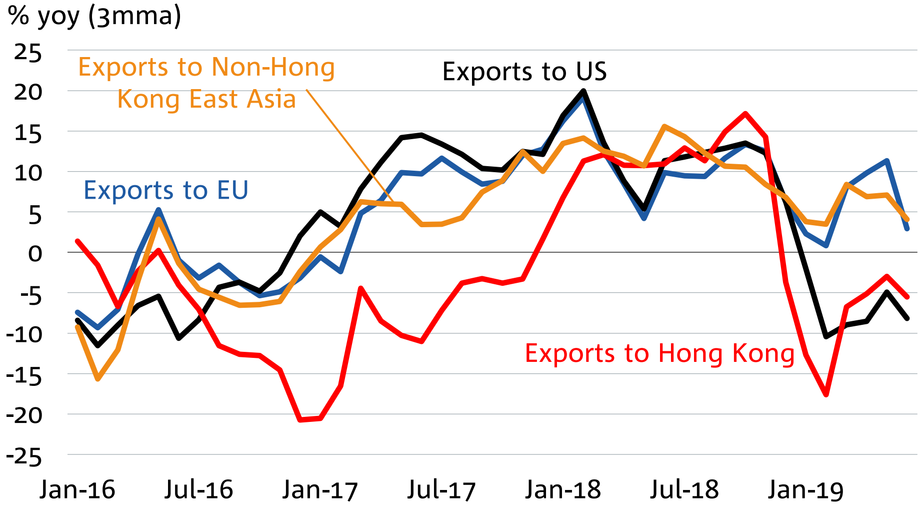
New export orders remain in negative territory




Source: CEIC, NAB Economics

## EXPORTS TO MAJOR TRADING PARTNERS

Weaker trade trends not solely driven by US-China relationship




Sources: CEIC, NAB Economics

- There was a marginal decline in exports in June – with the total value falling by 1.3% yoy to US$212.8 billion (compared with US$213.8 billion in May). According to the NBS PMI survey, new export orders remain firmly negative, with this measure at 46.3 points in June (compared with 46.5 points previously).

- Export trends to key global markets remain highly divergent. China's exports to the United States have continued to fall, down by 8.2% yoy (on a three month moving average basis) – as US trade measures impact demand for Chinese goods. June was the first month following the tariff rate increase (from 10% to 25% on around US$200 billion worth of Chinese goods), and despite the resumption of trade talks, there remains considerable uncertainty around the relationship between the two countries.

- Exports to the European Union increased by 2.9% yoy (3mma) in June – although exports fell year-on-year in the month of June. This highlights the broader (beyond just US-China) weakness in global markets. Exports to Asia rose by just 0.4% yoy (3mma) in June.

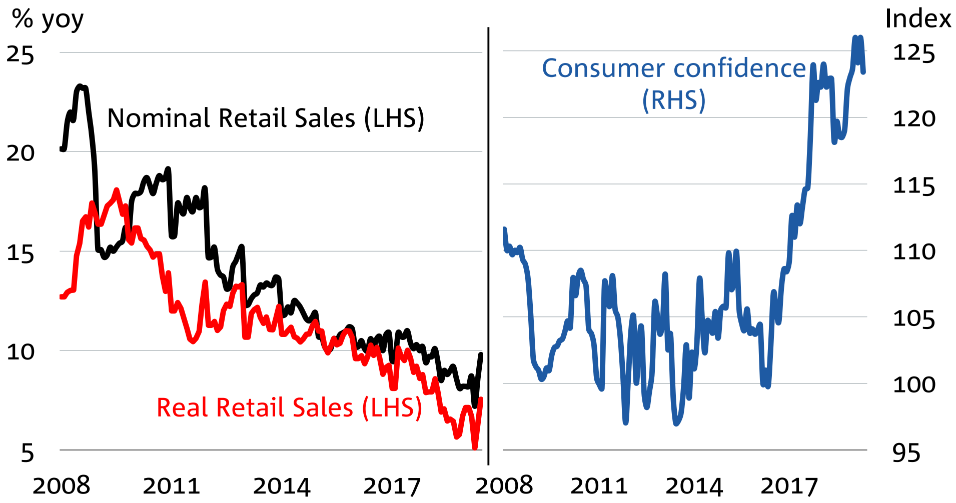
- Trade trends within Asia continue to be influenced by historical distortions in Hong Kong data. Exports to Hong Kong fell by 5.5% yoy (3mma) in June – which may reflect earlier capital flows being disguised as trade activity. In the first five months of 2019, Hong Kong Customs data suggests that imports from China fell by 1.6% yoy, whereas China Customs data reports a fall of 5.6% yoy over the same period.

- Exports to non-Hong Kong East Asia rose by 4.1% yoy. This increase was driven by sizeable increases in exports to Vietnam, Indonesia and Malaysia.

# RETAIL SALES AND INFLATION

## REAL RETAIL SALES PUSH HIGHER

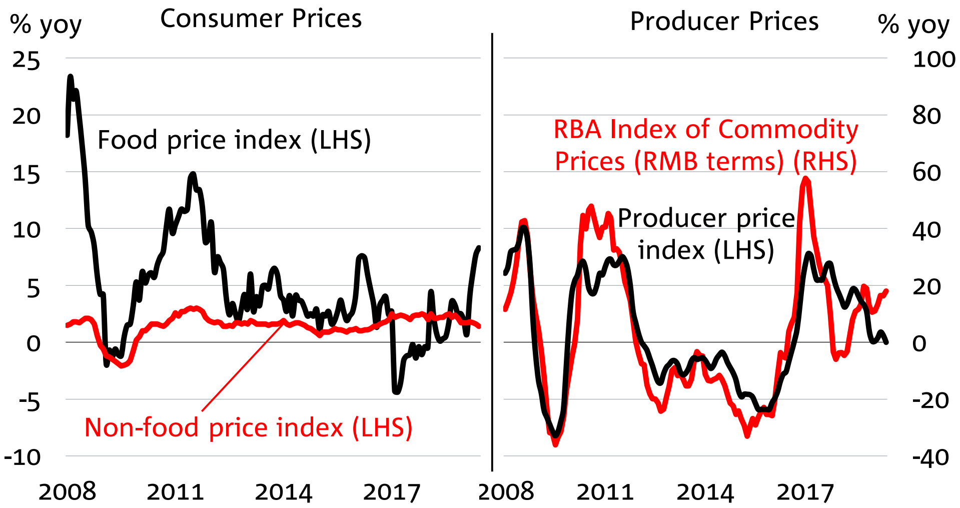
Consumer confidence modestly lower, still near record highs




Source: CEIC, NAB Economics

## CONSUMER AND PRODUCER PRICES

Producer price growth grinds to a halt




Source: CEIC, RBA, NAB Economics

- Nominal retail sales growth has continued to recover – increasing by 9.8% yoy in June (the strongest increase since March 2018). Given the stability in consumer price growth during the month, our estimate of real retail sales was also stronger – increasing by 7.5% yoy (compared with 6.4% in May).
- Consumer confidence was marginally weaker in May – at 123.4 points (down from 125.3 points in April) – however this remains at levels that are historically high.
- The Consumer Price Index rose by 2.7% yoy in June – the same rate of increase as May. Food prices accelerated in June, however this was offset by an easing in non-food price growth.
- Food prices rose by 8.3% yoy in June (compared with 7.7% previously). The key drivers of this increase were pork – which increased by 21.1% yoy – and fresh fruit – which rose by 42.7% yoy. The former has been impacted by African Swine Flu, while the latter has been hit by heavy rains in the south of the country, which disrupted harvesting and transport.
- Non-food price growth continued to ease – increasing by 1.4% yoy (down from 1.6% previously). Vehicle fuel prices were a contributor to this trend, with prices falling by 6.5% yoy in June.
- Producer prices in June were unchanged year-on-year, compared with growth of 0.6% in May. There is a disconnect to commodity price trends – however these trends are not broad based; iron ore has increased strongly, while base metals have fallen. The weakness in producer prices is consistent with the soft trends in China's industrial sector, with firms unable to pass higher costs through to end consumers (reflecting weakness in domestic and global demand).

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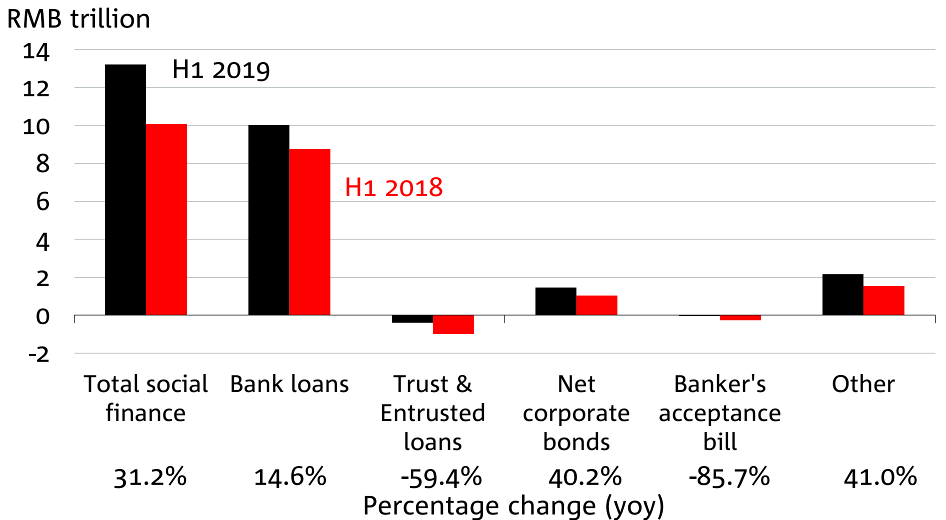
# CREDIT CONDITIONS

## NEW CREDIT ISSUANCE

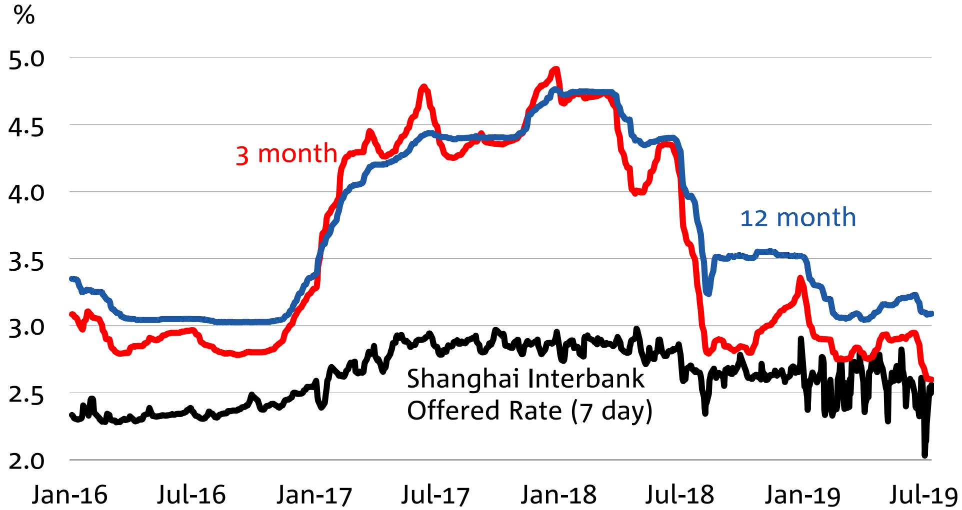
Strong growth as authorities provide monetary support




Sources: CEIC, NAB Economics

## SHORT TERM INTERBANK RATES

Monetary policy appears to have eased




Source: CEIC, NAB Economics

- The provision of monetary support to China's economy has been clearly evident in credit growth in the first half of 2019, and suggests that Chinese authorities have been more concerned this year with short term growth than medium term debt risks. New credit issuance increased by over 31% yoy in this period, to total RMB 13.2 trillion. The increase in bank lending has been more modest – rising by almost 15% yoy in the first half to RMB 10.0 trillion.

- The growth in non-bank lending has been driven by local government special bonds (up around 230% yoy in H1) and net corporate bond issuance (up by 40% yoy). There has also been a slowing decline in segments of shadow banking (such as trust and entrusted loans and banker's acceptance bills), where tighter supervision and regulation has forced banks to lend through traditional channels rather than these products.

- Comments from the PBoC Governor in early June suggested that the bank was looking to ease monetary policy, with rumours in July that the benchmark one-year lending rate may be cut. This move (should it happen) would be largely symbolic – the rate hasn't changed since October 2015, and doesn't appear to be particularly relevant since the switch in monetary policy from a quantity to a price based approach (which occurred in November 2015).

- In contrast, short term interbank lending rates are more important. While volatility in the 7 day Shanghai Interbank Offered Rate (Shibor) has persisted in recent months, the trend rate appears to be heading lower. This is also evident in the three month rate – which has fallen from around 2.9% in mid-June to around 2.6% at the time of writing.

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