CHINA'S ECONOMY AT A GLANCE

AUGUST 2019

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KEY POINTS

China's economic indicators a little softer, ahead of further US tariffs

- A broad range of China's economic indicators – including industrial production, fixed asset investment and retail sales – were softer in July, following a surprise pickup in June. A trend across these two months points to a continued gradual slowdown, even before the next phase of US tariffs (and China's retaliatory measures in response). For now, our growth forecasts remain unchanged, at 6.25% yoy in 2019, 6.0% in 2020 and 5.8% in 2021 – on the assumption of a domestic policy response, however the deteriorating US-China trade relationship continues to highlight downside risk.

- Following a surprise upturn in June, China's industrial production growth slowed significantly in July – increasing by 4.8% yoy (compared with 6.3% previously). China's major manufacturing surveys were less negative in July, but both surveys continue to point to negative trends in export orders.

- China's fixed asset investment growth slowed in nominal terms, however this was partially offset but producer price deflation. Our estimate of real investment growth was 5.7% yoy in July (down from 6.3% previously). There has been a noticeably weaker trend for investment by private sector firms in recent months – pulling back from growth of around 9% yoy (on a three month moving average basis) in February to 4.8% yoy (3mma) in July.

- China's trade surplus narrowed slightly in July – totalling US$45.1 billion, compared with US$51.0 billion previously. Both exports and imports grew considerably month-on-month, with the increase in imports more sizeable. The trade relationship with the United States has deteriorated further, with President Trump announcing additional tariffs (initially at 10%) on the final phase of Chinese exports, commencing 1 September (or 15 December depending on the individual product). This would result in almost all of China's exports to the US falling under tariffs.

- Real retail sales grew more modestly in July – at 5.6% yoy, down from a surprisingly strong 7.9% yoy in June. Despite the slowing trend in retail sales since early 2017, consumer confidence measures remain historically high.

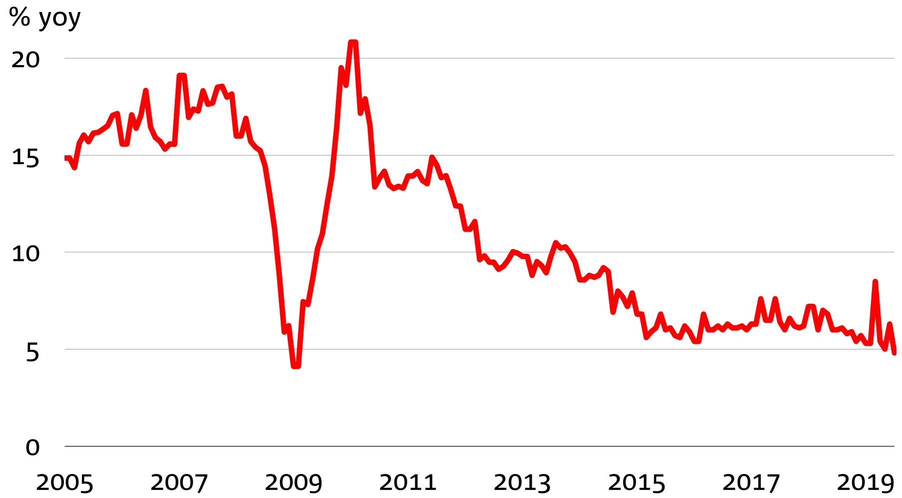
- New credit issuance was considerably weaker in July than the first half of 2019 – falling by almost 18% yoy to RMB 1.0 trillion. There could be some timing issues related to this weakness – growth in the month of June was particularly strong – however some observers have suggested that loan demand has declined.

- Short term interbank rates have exhibited less volatility from mid-July through mid-August – compared with a highly volatile period over the previous six months. The 7 day Shanghai Interbank Offered Rate (Shibor) has trended near 2.6% more recently – close to the trend from mid-2018 to early 2019. The 3 month rate is near its lowest level since mid-2011, albeit there is room for further easing.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

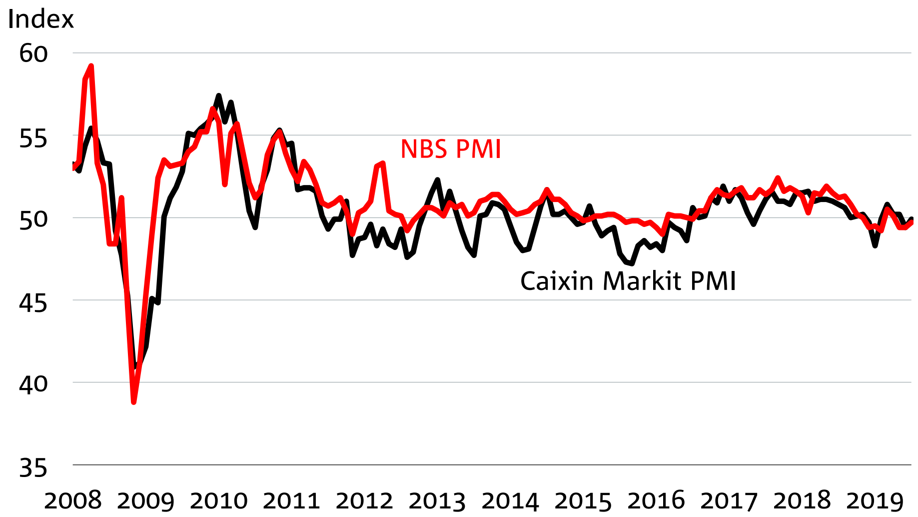
Growth slows to a fresh post-GFC low



Source: CEIC, NAB Economics

PMI SURVEYS MARGINALLY LESS NEGATIVE

Manufacturing conditions approach neutral levels in July



Source: CEIC, NAB Economics

- Following a surprise upturn in June, China's industrial production growth slowed significantly in July – increasing by 4.8% yoy (compared with 6.3% previously). Growth in industrial production has been on a downward trend for some time – not helped by rising tariffs imposed by the United States, a key export market (albeit this result came before the latest escalation, implying further downside risk to growth) – with the outcome in July the weakest since the bottom of the Global Financial Crisis.

- There remains some divergent trends among individual industry sectors. Construction related sectors – such as crude steel and cement – have continued to grow, with output up by 5.0% and 7.5% yoy respectively.

- In contrast, auto manufacturing continues to struggle – reflecting the impact of tighter access to non-bank credit on domestic motor vehicle demand – with output down by 11.5% yoy.

- Production of consumer electronics equipment recorded slowing growth – down to 6.1% yoy (from double digit rates between the start of 2017 through to June 2019). Electricity output rose by just 0.6% yoy (from 2.8% yoy previously).

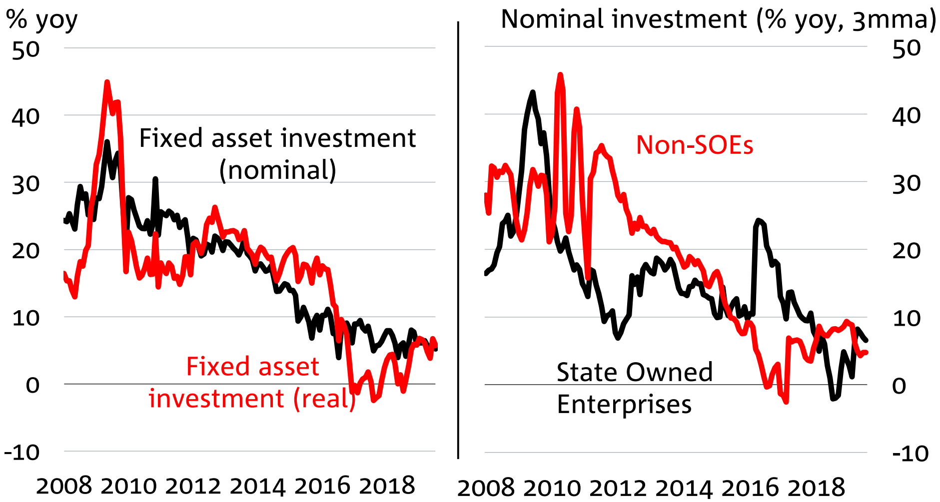
- China's major manufacturing surveys were less negative in July. The official NBS PMI survey moved up to a modestly negative 49.7 points (compared with 49.4 points in June). In contrast, the private sector Caixin Markit PMI survey was essentially neutral at 49.9 points (from 49.4 points previously).

- The new export order measures remained negative in both surveys – albeit these measures were less negative than those recorded in June. It is worth noting that both of these surveys were taken ahead of the latest increase in US tariffs, meaning that a deterioration in conditions in coming months is likely – although there may be some pull forward of orders for goods subject to tariffs from 15 December.

INVESTMENT

FIXED ASSET INVESTMENT

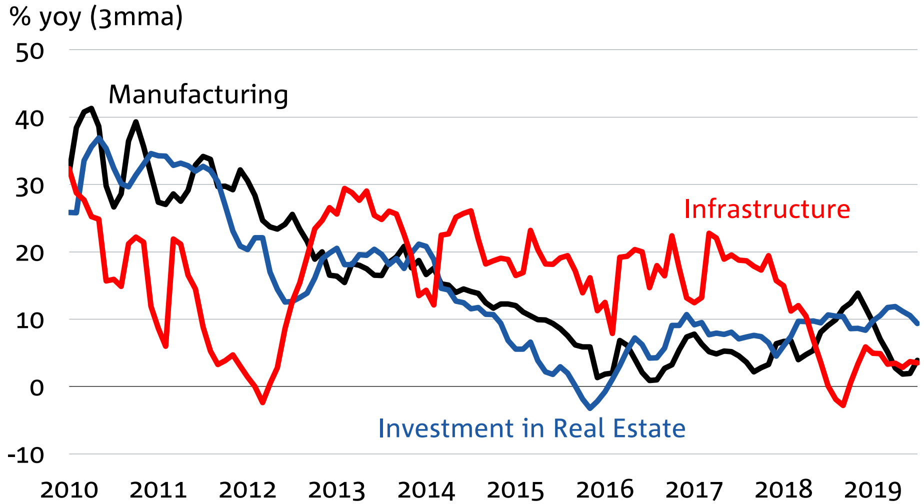
Investment pulled back in July after relative strength in June



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Real estate investment has remained solid



Source: CEIC, NAB Economics

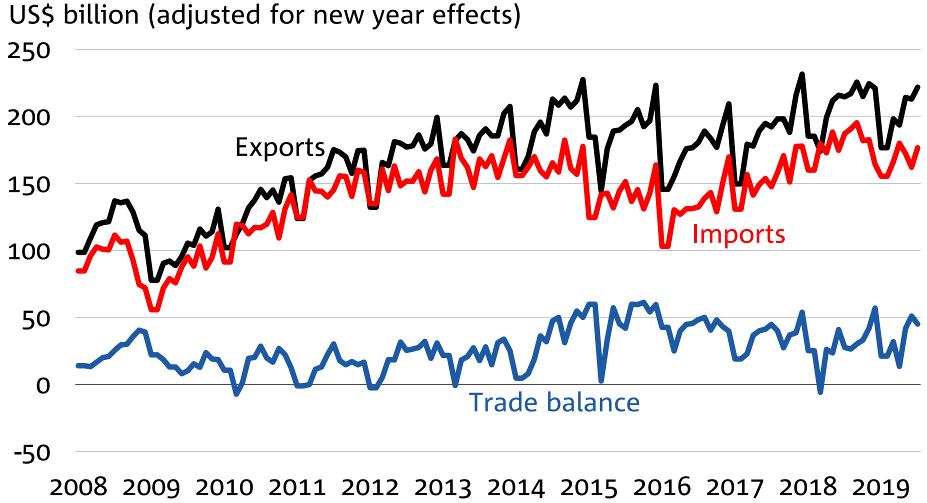
- In nominal terms, China's fixed asset investment growth slowed in July – down to 5.2% yoy (compared with 6.3% yoy in June). Producer prices have turned deflationary – flowing through into falling costs for investment goods – meaning a smaller slowdown in our estimate of real investment growth, at 5.7% yoy (down from 6.3% previously).
- There has been a noticeably weaker trend for investment by private sector firms in recent months – pulling back from growth of around 9% yoy (on a three month moving average basis) in February to 4.8% yoy (3mma) in July. In contrast, there has been a pick up in investment by State-Owned Enterprises (SOEs) since early in the year – albeit growth dipped slightly in July, down to 6.6% yoy (3mma) from 7.0% in june.
- Investment trends continue to diverge across industry segments. Investment in real estate has continue to increase relatively strongly – dipping slightly to 9.4% yoy (3mma) from 10.5% yoy previously. Growth in this sector continues to outpace investment in sectors such as manufacturing (which increased by 3.9% yoy (3mma), up from 1.9% previously) and infrastructure (up by 3.5% yoy).
- Chinese authorities have suggested that they do not intend to use residential construction as a stimulatory target to offset the impact of US tariffs. House sales have slowed in recent months – down by 1.1% yoy (3mma) in July – while housing construction starts grew by 6.2% yoy (3mma), down from double digit rates in the first five months of the year. Land sales are also sharply lower. Combined, these factors suggest that real estate investment could slow in coming months.

National Australia Bank

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS DIPPED MARGINALLY IN JULY

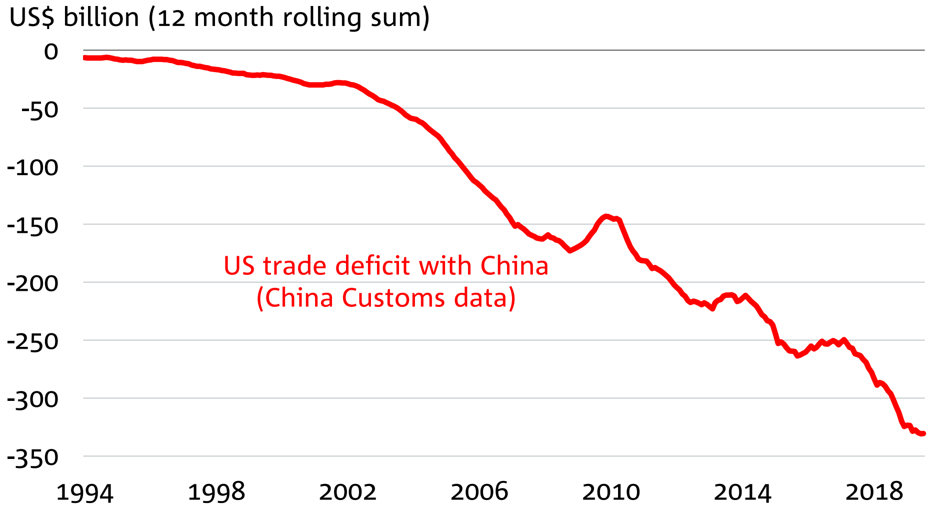
Stronger month-on-month increase in imports



Sources: CEIC, NAB Economics

US-CHINA TRADE DEFICIT

Trade deficit remains near record, despite increasing tariffs



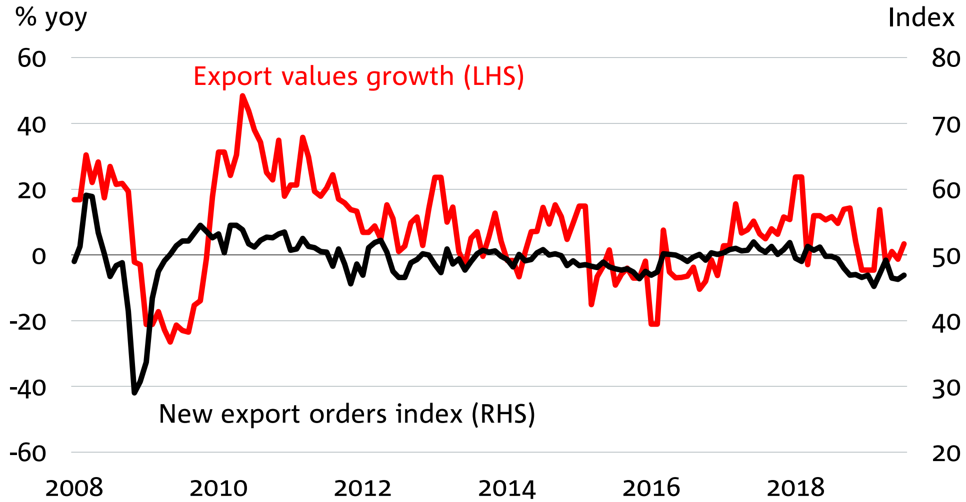
Sources: CEIC, NAB Economics

- China's trade surplus narrowed slightly in July – totalling US$45.1 billion, compared with US$51.0 billion previously. Both exports and imports grew considerably month-on-month, with the increase in imports more sizeable.
- Two-way trade with the United States has slowed considerably this year – as the impact of trade measures introduced by both countries has reduced demand for these goods – with the total falling by 13.7% yoy in the first seven months of the year. However, these measures have not substantially reduced China's trade surplus with the US – which totalled US$330.7 billion in the twelve months to July, marginally below the record level in June.
- While China's imports rose relative to June, they fell in year-on-year terms, down by 5.6% yoy to US$176.5 billion. Imports from the United States fell by 19% yoy (compared with a 4.5% yoy fall for all other markets) – reflecting Chinese policy measures imposed in response to US trade restrictions.
- The decline in total import values in recent months has been driven by falling import volumes, with import prices rising marginally. Our estimate of volumes – based on the relationship between China's import prices and global commodity prices – fell by 11.8% yoy (on a three month moving average basis) in July. Volumes have been declining in year-on-year terms since December 2018.
- That said, there were some strong increases in imports of some key commodities – such as crude oil and coal, up by 13.9% yoy and 13.4% yoy respectively. In contrast, imports of iron ore grew more moderately, increasing by 1.2% yoy, following three months of declines that were likely related to Brazilian export restrictions. Imports of copper fell by 7.1% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS GREW MODESTLY IN JULY

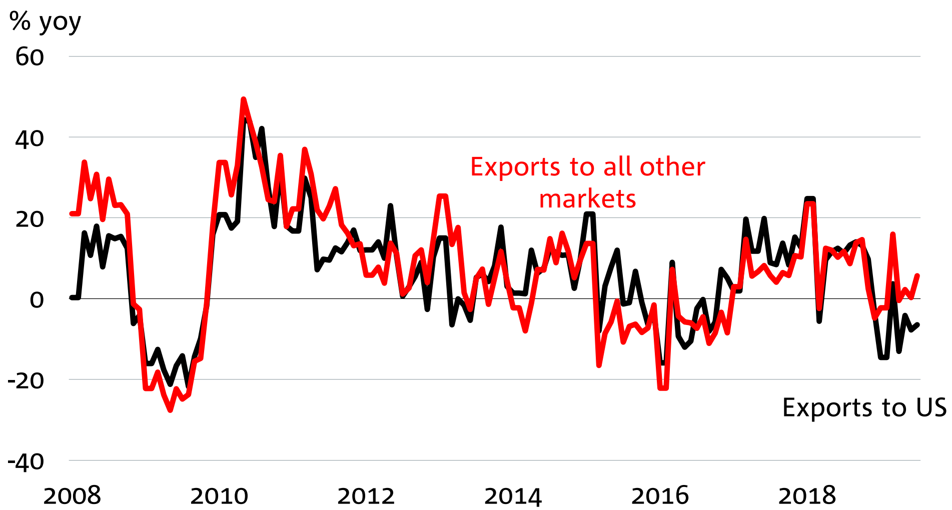
New export orders still remain negative



Source: CEIC, NAB Economics

EXPORTS BY TRADING PARTNER

Impact of US tariffs evident in recent divergence



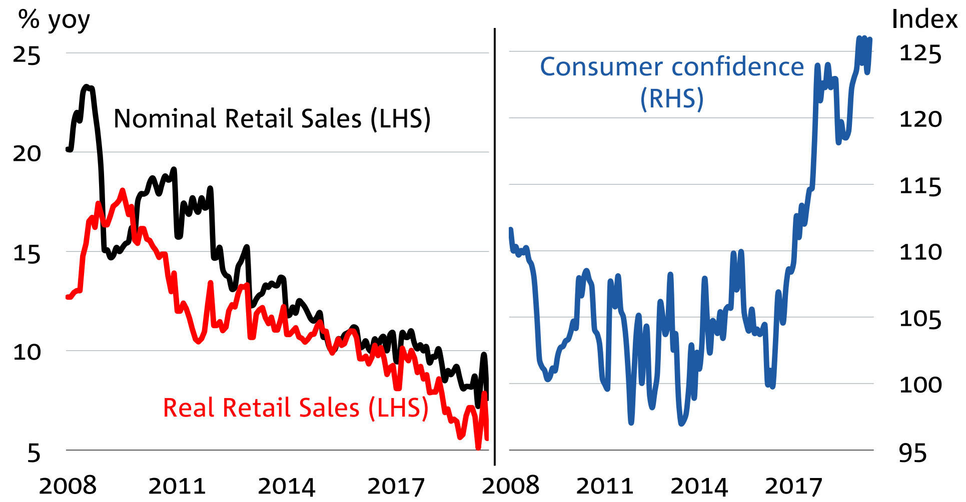
Sources: CEIC, NAB Economics

- China's exports totalled US$221.5 billion in July, an increase of 3.3% yoy (compared with US$212.8 billion in june). Despite this increase, the new export order measure in the NBS PMI survey has remained negative – edging slightly higher to 46.9 points (compared with 46.3 points previously).
- The trade relationship with the United States has deteriorated further, with President Trump announcing additional tariffs (initially at 10%) on the final phase of Chinese exports, commencing 1 September (or 15 December depending on the individual product). This would result in almost all of China's exports to the US falling under tariffs (although it appears that rare earth ores – commonly consumed in high tech applications – will be exempt from tariffs).
- Exports to the United States have continued to fall, down by 6.2% yoy (on a three month moving average basis) – as US tariffs imposed to date have reduced demand for Chinese goods. Uncertainty persists around the future of the trade relationship between the two countries.
- Exports to the European Union rose by 3.1% yoy (3mma) in July – a relatively modest increase compared with the strength across most of 2017 and 2018. Exports to East Asia rose by just 1.8% yoy (3mma).
- There remains a significant difference in terms of export trends within East Asia – in part reflecting historical distortions in trade data with Hong Kong. According to China Customs, exports to Hong Kong fell by 9.2% yoy (3mma) in July, while exports to other East Asia rose by 9.1% yoy (3mma) – led by strong increases in Vietnam, Taiwan and South Korea.
- Hong Kong trade data suggests that imports from China fell by 2.4% yoy in the first half of 2019, compared with a reported 6.1% yoy fall in China's exports to Hong Kong. Some of this disparity may reflect capital flows disguised as trade activity.

RETAIL SALES AND INFLATION

REAL RETAIL SALES DROPPED IN JULY

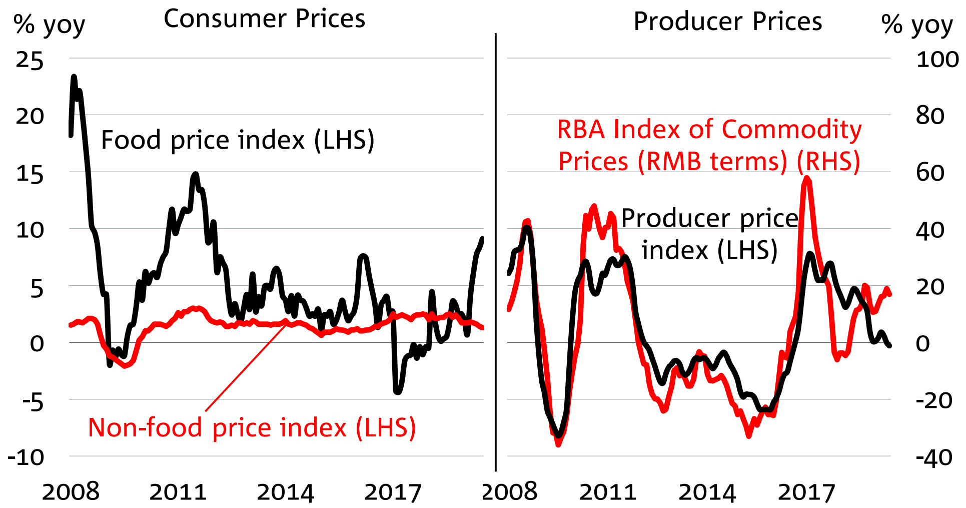
Consumer confidence close to all time highs



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Producer prices turn negative, despite rising input costs



Source: CEIC, RBA, NAB Economics

- Nominal retail sales grew more modestly in July, increasing by 7.6% yoy (down from a relatively strong 9.8% increase in June). A slight increase in consumer price inflation resulted in a larger slowing in real retail sales growth – down to 5.6% yoy (from 7.9% previously).

- Despite the slowing trend in retail sales since early 2017, consumer confidence measures remain historically high. In June, consumer confidence was at 125.9 points (up from 123.4 points previously), just below the all time high of 126 points recorded in February.

- Headline inflation was marginally stronger in July – with the Consumer Price Index increasing by 2.8% yoy in July (compared with 2.7% previously).

- Food prices were the main contributor to the increase – with prices increasing by 9.1% yoy (compared with 8.3% previously) due to supply side pressures. Pork prices continue to have a major influence on food price inflation – increasing by 27% yoy – with supplies constrained by the African Swine Flu outbreak. Fresh fruit prices rose by 39% yoy on weather related disruptions to harvest and transport.

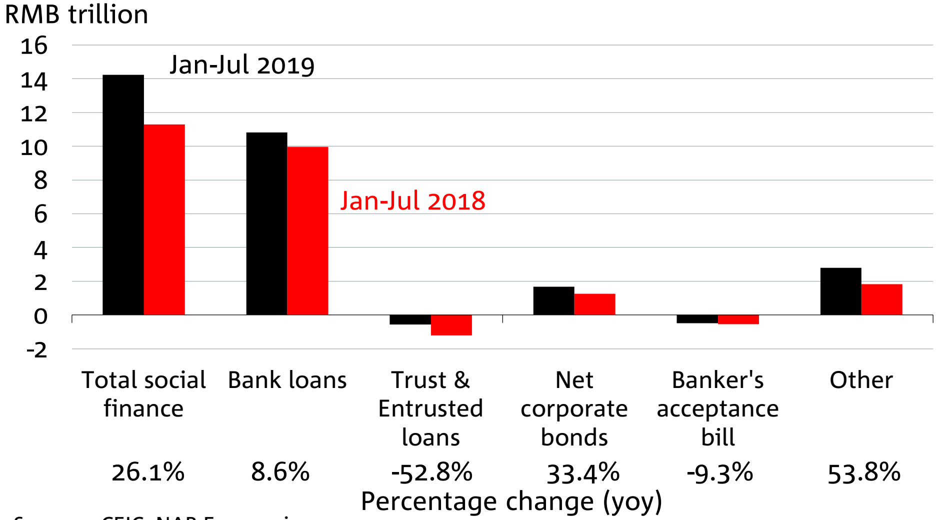
- In contrast, growth in non-food prices has continued to slow – increasing by 1.3% yoy (down from 1.4% previously). Vehicle fuel prices fell by 9.0% yoy in July, while residence expenses rose by just 1.5% yoy (compared with over 2% yoy in the first four months of the year).

- Producer prices contracted by 0.3% yoy in July – compared with no change recorded in June. Historically there has been a close relationship between commodity prices (analogous to input costs) and producer prices (on the output side), however this has broken down more recently. This likely reflects the challenging conditions in China's manufacturing sector, with producers unable to pass through cost increases due to the weakness in both domestic and global demand.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

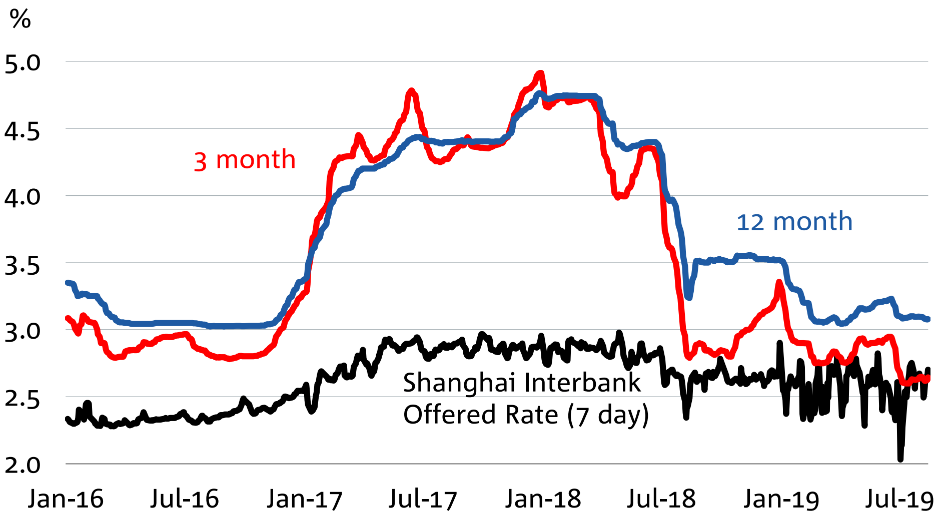
Solid growth in lending in YTD 2019, despite slowing in July



Sources: CEIC, NAB Economics

SHORT TERM INTERBANK RATES

Lower volatility in 7 day Shibor since mid-July



Source: CEIC, NAB Economics

- New credit issuance was considerably weaker in July than the first half of 2019 – falling by almost 18% yoy to RMB 1.0 trillion. There could be some timing issues related to this weakness – growth in the month of June was particularly strong – however some observers have suggested that loan demand has declined.

- In the first seven months of 2019, new credit issuance increased by 26% yoy to RMB 14.2 trillion – suggesting that authorities have sought to provide some additional support for the economy to offset the negative impact of trade tensions with the United States.

- Non-bank lending has increased strongly over this period – led by local government special bonds (which rose by 198% yoy in the first seven months of 2019), while the rate of decline in segments of shadow banking (such as trust and entrusted loans) has slowed. In addition, there has been a sizeable increase in corporate bond issuance (up 33% yoy).

- According to the People's Bank of China, the bank is seeking to maintain prudent monetary policy in the second half of 2019, suggesting that it continues to hold back from large scale monetary stimulus. Despite recent rumours of a cut to the benchmark one-year lending rate (a move that would be largely symbolic), this rate has remained unchanged. It is likely that the PBoC intends to keep some capacity in reserve to respond to any further negative pressure on the economy.

- While the currency has depreciated to marginally over RMB 7 to the US dollar, China's State Administration of Foreign Exchange has stated it doesn't intend to engage in competitive devaluation to offset trade pressures.

- Short term interbank rates have exhibited less volatility from mid-July through mid-August – compared with a highly volatile period over the previous six months. The 7 day Shanghai Interbank Offered Rate (Shibor) has trended near 2.6% more recently – close to the trend from mid-2018 t early 2019. The 3 month rate is near its lowest level since mid-2011, albei there is room for further easing.

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