CHINA'S ECONOMY AT A GLANCE

SEPTEMBER 2019

National Australia Bank

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CONTACT

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KEY POINTS

China’s industrial sector struggling ahead of the latest round of trade measures

- The latest indicators of China’s economy suggest continued weakness – particularly in the industrial sector – prior to the latest round of trade measures that commenced on 1 September. For now our forecasts of China’s economic growth are unchanged – at 6.25% this year and 6.0% in 2020 – however there is some downside risk to this outlook.

- Growth in China’s industrial production slowed further in August – down to 4.4% yoy (from 4.8% in July). This was the weakest rate of growth since the trough of the Global Financial Crisis (with 3.8% yoy growth across January and February 2009), and came ahead of the latest round of US tariffs on Chinese exports – meaning that there is limited scope for improvement in the short term.

- Growth in nominal fixed asset investment slowed considerably in August, but so too did producer prices (and by extension, the cost of investment goods), meaning that real investment growth slowed moderately, down to 5.5% yoy (from 5.7% previously). There has been a slowing trend in private sector investment in recent months. In contrast, investment by State-Owned Enterprises (SOEs) increased by 7.1% yoy in August – which may reflect government led efforts to boost growth.

- China’s trade surplus narrowed in August, totalling US$34.8 billion (compared with US$44.6 billion in July), as exports declined month-on-month in contrast with a slight increase in the value of imports. The United States continues to account for the majority of China’s trade surplus, despite the declines in two-way trade between the countries due to the tariffs already implemented.

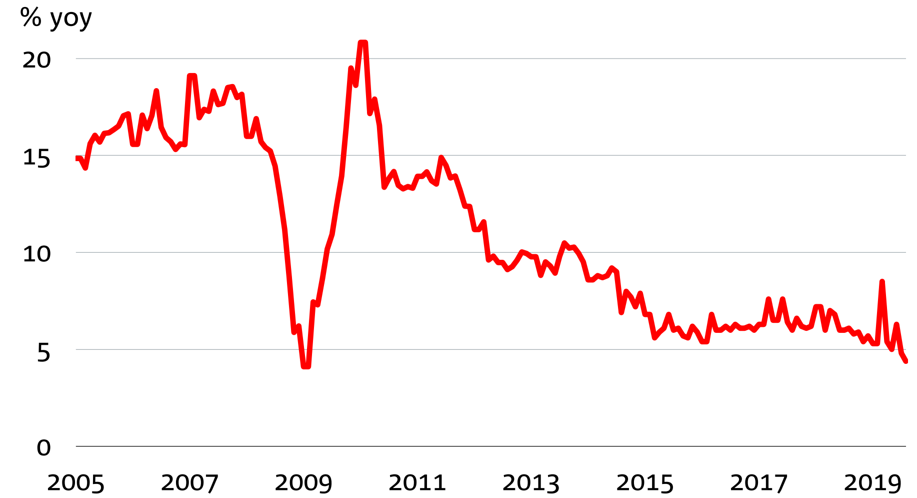
- Real retail sales slowed marginally in August – down to 5.6% yoy (from 5.7% yoy in July) – continuing a clear downward trend since mid-2017. The most recent reading for consumer confidence – recorded in July – was marginally softer at 124.4 points (down from the second highest reading of all time in June of 125.9 points), a level that remains historically high, and at odds with the slowing trend for retail sales growth.

- The People’s Bank of China (PBoC) reformed policy rate settings in late August– revamping its Loan Prime Rate (LPR) to replace the long running benchmark lending rate. The LPR is based on quotes from ten major banks (soon to be expanded to eighteen), who will now have to provide these quotes as a premium above the PBoC’s Medium Term Lending Facility (MLF) rate – a key source of bank funding and now a key policy rate to monitor. This could provide the PBoC with a more direct way to influence lending rates, with banks required to price their loans off the LPR. The PBoC aims for 30% of new loans to be priced off the LPR by the end of September and 50% by year end.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

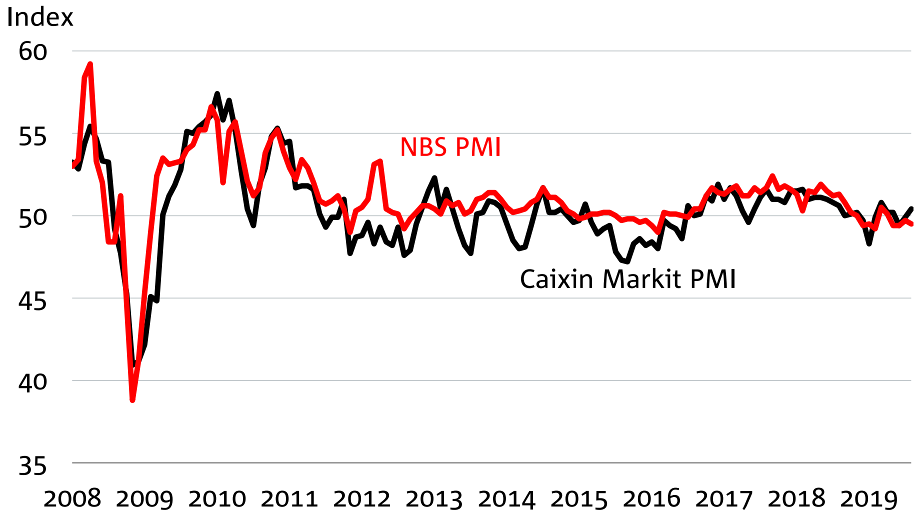
Downward trend in IP growth continued in August



Source: CEIC, NAB Economics

PMI SURVEYS DIVERGED IN AUGUST

Private sector survey was surprisingly positive



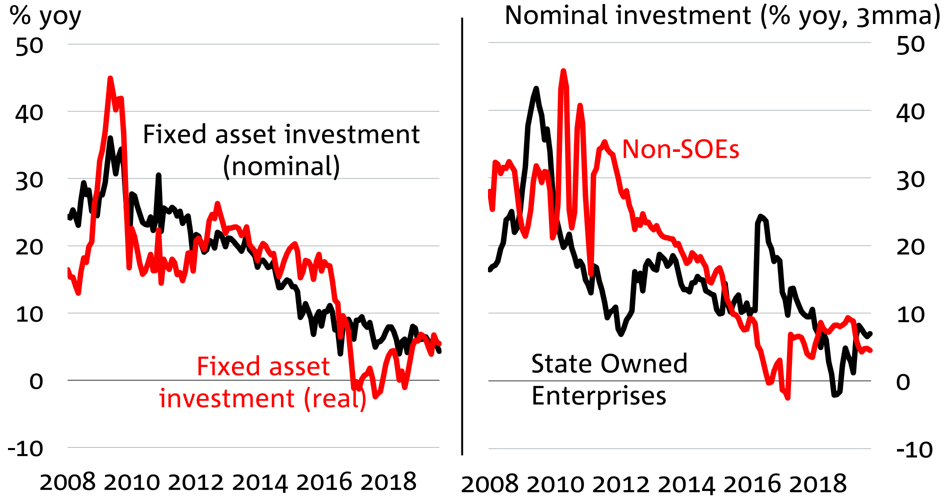
Source: CEIC, NAB Economics

- Growth in China's industrial production slowed further in August – down to 4.4% yoy (from 4.8% in July). This was the weakest rate of growth since the trough of the Global Financial Crisis (with 3.8% yoy growth across January and February 2009), and came ahead of the latest round of US tariffs on Chinese exports – meaning that there is limited scope for improvement in the short term.
- Trends in individual industrial segments remain highly divergent. Output of crude steel rose by 9.3% yoy to over 87 million tonnes, while cement manufacturing rose by 5.1% yoy. Both of these sectors are closely aligned to construction.
- In contrast, motor vehicle manufacturing remains weak – with production falling by 0.6% yoy. This is compared with double digit declines in output between April and July, however it is far too early to suggest that the sector may be turning around.
- Output of consumer electronic products increased by 4.7% yoy in August, however the rate of increase has slowed from double digit rates across the first half of 2019.
- Trends in China's major manufacturing surveys diverged in August. The official NBS PMI was weaker – down to 49.5 points, from 49.7 points in July. In contrast, the private sector Caixin Markit PMI was stronger – turning moderately positive at 50.4 points (compared with an essentially neutral 49.9 points previously) – primarily supported by a pickup in domestic orders. This result was a surprise given the slowing rate of growth in industrial production.
- These readings came ahead of the latest escalation in US tariffs, which commenced on 1 September. A series of further increases scheduled over the next few months will be negative for the manufacturing sector. New export orders in both surveys remained in negative territory in August.

INVESTMENT

FIXED ASSET INVESTMENT

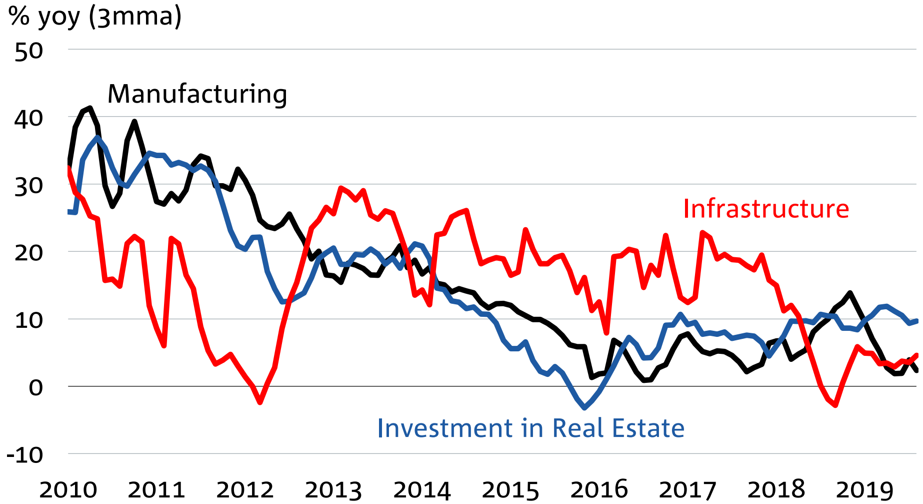
Growth slowing again, with weakness in the private sector



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Real estate investment has continued to hold up



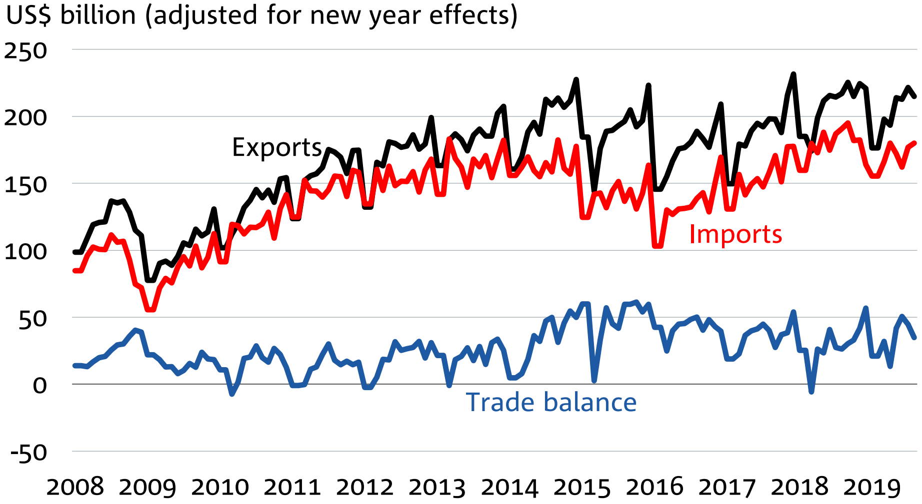
Source: CEIC, NAB Economics

- Growth in China's fixed asset investment slowed again in August, down to 4.3% yoy (compared with 5.2% in July). Producer prices have been falling, which flows through into lower costs for investment goods, meaning that our estimate of real investment is stronger than the nominal rate – increasing by 5.5% yoy (down from 5.7% previously).
- There has been a slowing trend in private sector investment in recent months – with an increase in nominal investment of just 2.8% yoy in August (down from 3.7% yoy in July and 6.5% yoy in June). In contrast, investment by State-Owned Enterprises (SOEs) increased by 7.1% yoy in August – which may reflect government led efforts to boost growth.
- Investment trends remain highly mixed at the industry level. Investment in real estate has continued to grow comparatively strongly – up by 9.7% yoy (on a three month moving average basis). In contrast, investment in manufacturing continues to slow – increasing by just 2.3% yoy (3mma), down from 3.9% previously.
- Infrastructure investment growth has shown little acceleration– up by just 4.4% yoy (3mma) – despite this sector being a target for stimulus. That said, this may reflect a timing issue. According to Bloomberg, there has been a ramp up in infrastructure project approvals by the National Development and Reform Commission – meaning growth could increase later in the year and into 2020.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS NARROWED IN AUGUST

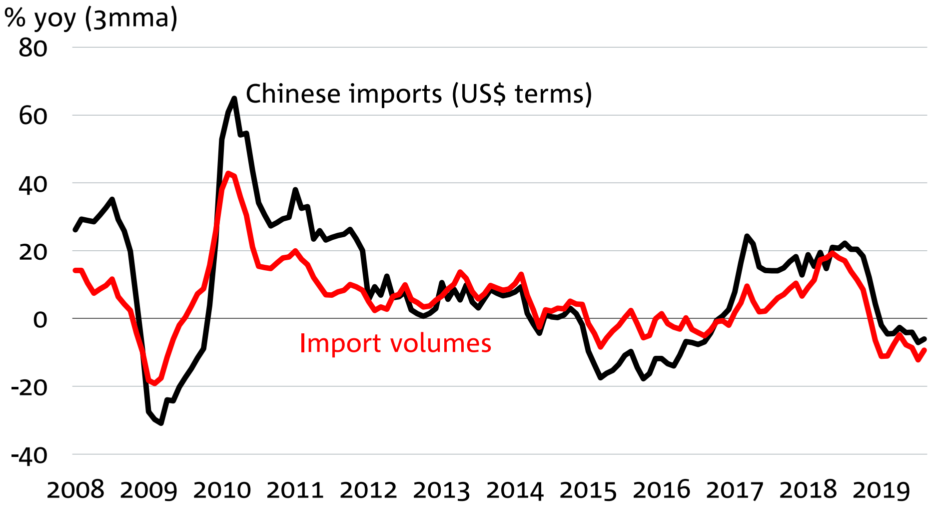
Both exports and imports down year-on-year



Sources: CEIC, NAB Economics

IMPORT VALUES AND VOLUMES

China's import volumes have declined since late 2018



Source: CEIC, NAB Economics

- China's trade surplus narrowed in August, totalling US$34.8 billion (compared with US$44.6 billion in July), as exports declined month-on-month in contrast with a slight increase in the value of imports.

- The United States continues to account for the majority of China's trade surplus, despite the declines in two-way trade between the countries due to the tariffs already implemented. China's twelve month rolling trade surplus with the US narrowed slightly in August – down to US$326.6 billion, compared with a record US$330.8 billion in the twelve months to June 2019.

- The value of China's imports edged up to US$180.0 billion in August (from US$177.0 billion in July) – however this represented a fall of around 5.6% yoy. Increasing trade barriers on US goods have had a clear impact on Chinese demand – imports from the US fell by 27% yoy, compared with a 4.4% yoy decline from all other countries.

- Our estimates of China's import volumes – which are based on import values and global commodity prices – suggest declines (on a three month moving average basis) since December 2018. The RBA Index of Commodity Prices rose by 4.6% yoy in August – following on from double digit increases in both June and July. Our estimate suggests that China's import volumes fell by 9.4% yoy (3mma) in August.

- Despite these high level declines, import volumes for a range of major commodities increased in August. There were strong increases in imports of coal – up by 14.9% yoy – and crude oil, which rose by 9.9% yoy. Iron ore imports also rose – up by 6.1% yoy, to 94.8 million tonnes (the fourth largest monthly volume of all time). In contrast, copper imports fell by 3.8% yoy.

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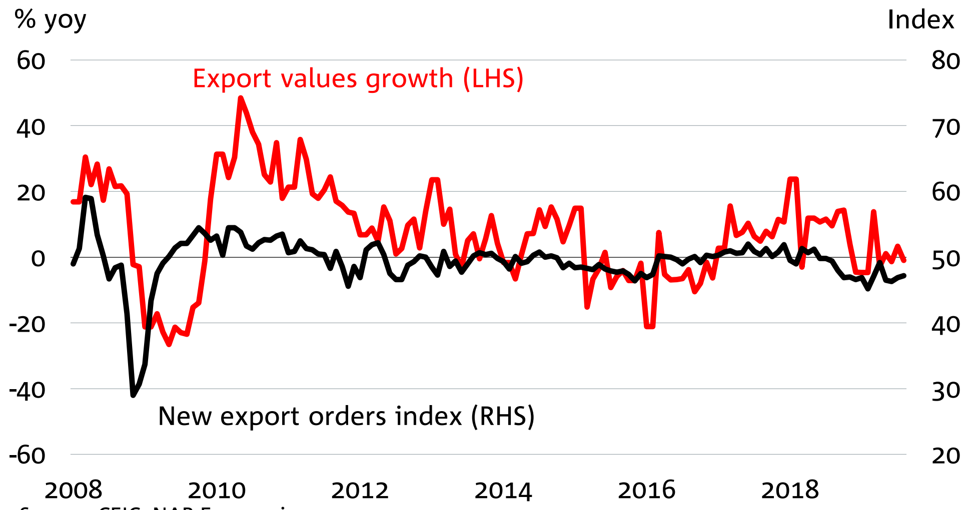
INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS MARGINALLY WEAKER YOY

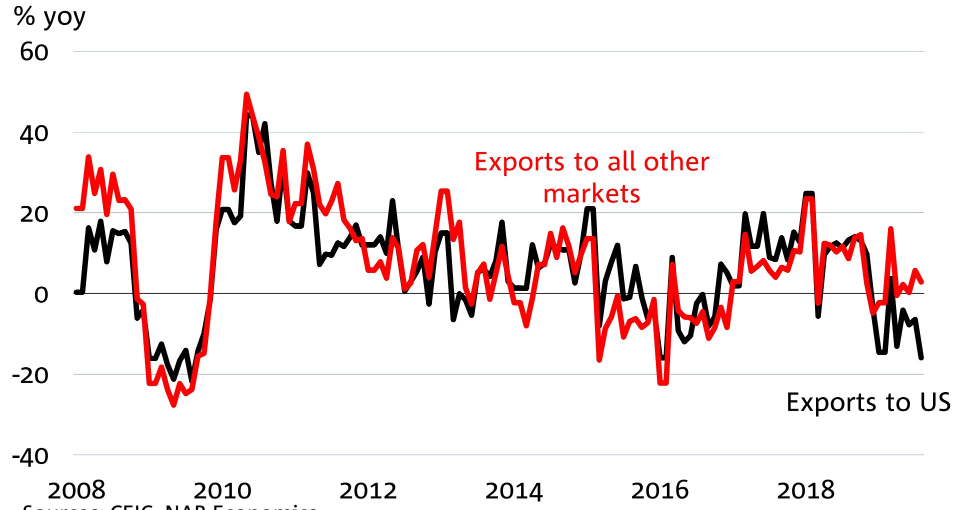
New export orders remain negative



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Falling exports largely driven by US declines



Sources: CEIC, NAB Economics

- China's exports were weaker month-on-month, totalling US$214.8 billion in August (compared with US$221.6 billion previously) – a decrease of 1.0% yoy. The new export orders measure in the NBS PMI survey remained negative – at 47.2 points (up from 46.9 points in July).
- The impact of US tariffs is evident in China's trade data – exports to the US fell by 10.2% yoy (on a three month moving average basis), compared with an increase of 2.9% yoy (3mma) for all other markets. There remains significant uncertainty around the outlook for the US-China trade relationship – with a number of scheduled tariff increases in coming months, but also further talks planned for early October. As a consequence, the outlook remains unclear.
- Exports to the European Union increased by 2.2% yoy (3mma) in August, while exports to East Asia rose by 2.5% yoy (3mma).
- There remain some significant divergences in Asian data – with exports to Hong Kong falling by 10.5% yoy (3mma). Hong Kong data has been impacted by distortions in the past – including capital flows being disguised as trade activity. According to Hong Kong Customs data, total imports from China fell by 2.6% yoy in the first seven months of 2019, compared with a 7.7% fall in Chinese customs data over the same period.
- Exports to non-Hong Kong East Asia increased strongly – up by 11.4% yoy (3mma) – with sizeable growth in exports to Vietnam, Taiwan, the Philippines and Indonesia.

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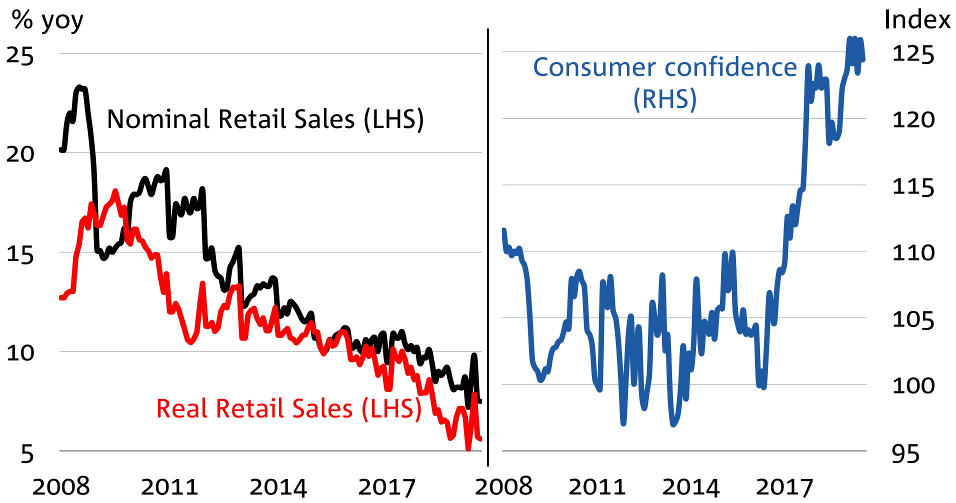
RETAIL SALES AND INFLATION

REAL RETAIL SALES HAVE CONTINUED TO SLOW

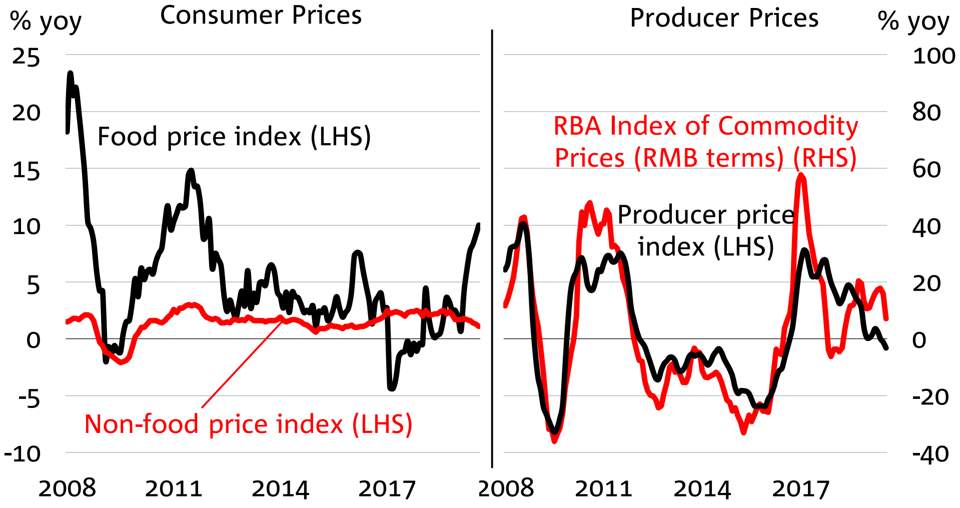
Despite consumer confidence remaining near record highs



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Pork price spike clearly evident; manufacturers cutting prices



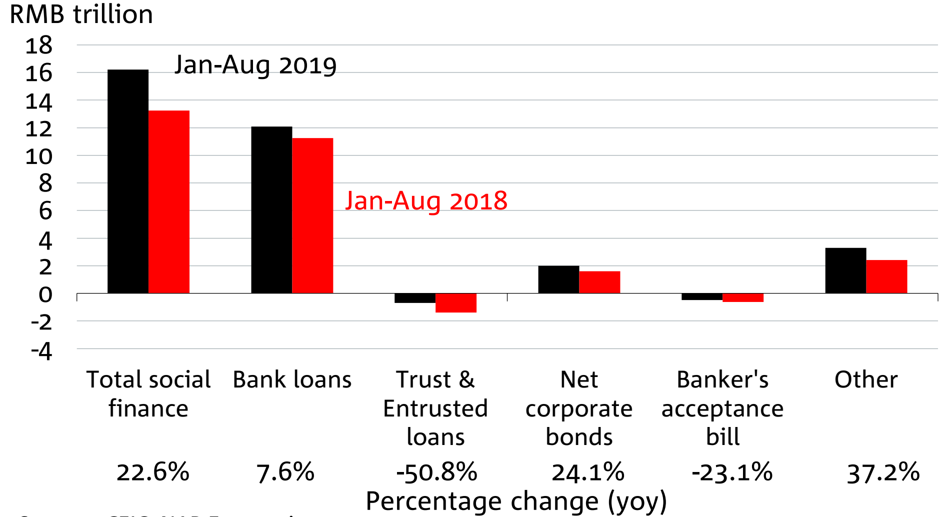
Source: CEIC, RBA, NAB Economics

- In nominal terms, China's retail sales grew by 7.5% yoy in August (down from 7.6% previously). With the growth in consumer prices stable compared with last month, this implies a modest slowing in real retail sales growth – down to 5.6% yoy (from 5.7% yoy in July). There has been a clear downward trend in real sales since mid-2017.
- The most recent reading for consumer confidence – recorded in July – was marginally softer at 124.4 points (down from the second highest reading of all time in June of 125.9 points), a level that remains historically high, and at odds with the slowing trend for retail sales growth.
- Headline inflation was unchanged in August, with the Consumer Price Index increasing by 2.8% yoy (the same increase as July). This stability masks divergent trends in underlying components.
- Food prices have continued to increase strongly – with the food price index increasing by 10.0% yoy in August (up from 9.1% previously), reflecting on-going supply issues. Pork prices have a major impact on food price inflation – and pork increased by almost 46% yoy in August – as the African Swine Flu has cut supply. Prices for fresh fruit rose by 24% yoy – however this increase was down from 39% in July – reflecting the impact of weather related disruptions a few months ago.
- Non-food price growth has continued to slow – increasing by just 1.1% yoy in August (down from 1.3% previously). Vehicle fuel prices fell by 10.2% yoy, contributing to this trend.
- Producer prices fell by 0.8% yoy – the largest decline since June 2016 – another sign of the challenging conditions for China's manufacturers. This was despite a 7.1% yoy increase in commodity prices (in RMB terms) in August, suggesting that manufacturers may be cutting factory gate prices in order to maintain sales volumes.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

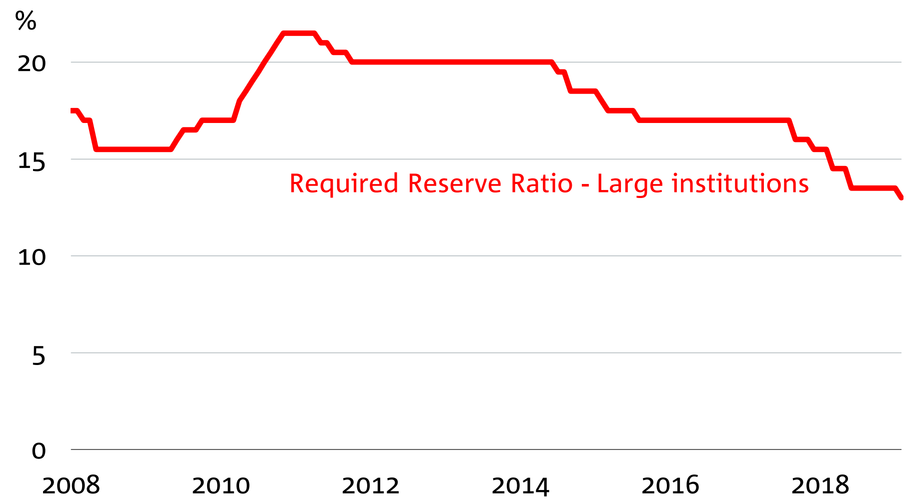
Strong growth in bonds; clamps remain on shadow banking



Sources: CEIC, NAB Economics

REQUIRED RESERVE RATIO

Third cut this year to boost liquidity in lending markets



Source: CEIC, NAB Economics

- New credit issuance has accelerated in 2019, following on from the deleveraging-led declines across the past two years. Aggregate financing rose by 22.6% yoy to RMB 16.2 trillion in the first eight months of the year. Bank lending accounted for the largest share of new credit issuance over this period – totalling RMB 12.1 trillion, an increase of 7.6% yoy.

- Non-bank lending more than doubled in year-on-year terms, with a large scale increase in local government special bonds (up over 100% yoy in the first eight months) – accounting for around 94% of the full year quota for these bonds (with reports suggesting that authorities are bringing forward the 2020 quota to underpin growth). There was also a 24% yoy increase in net corporate bond issuance. In contrast, key components of the shadow banking sector (such as trust loans, entrusted loans and banker's acceptance bills) all declined.

- The People's Bank of China (PBoC) reformed policy rate settings in late August– revamping its Loan Prime Rate (LPR) to replace the long running benchmark lending rate. The LPR is based on quotes from ten major banks (soon to be expanded to eighteen), who will now have to provide these quotes as a premium above the PBoC's Medium Term Lending Facility (MLF) rate – a key source of bank funding and now a key policy rate to monitor. This could provide the PBoC with a more direct way to influence lending rates, with banks required to price their loans off the LPR. The PBoC aims for 30% of new loans to be priced off the LPR by the end of September and 50% by year end.

- The LPR was set at 4.25% – 10 basis points lower than the one year benchmark rate. Some observers expected a larger cut, to provide monetary stimulus, but there is potential for a cut to the MLF on 17 September.

- The PBoC also cut the Required Reserve Ratio for banks by an additional 50 basis points, bringing the rate for large banks down to 13%. Combined with additional reserve cuts for qualified city commercial banks, this is expected to boost liquidity by around RMB 900 billion. This was the third cut of 2019.

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