CHINA'S ECONOMY AT A GLANCE

OCTOBER 2019

National Australia Bank

CONTENTS

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KEY POINTS

Trade war finally shows its impact on China, as industrial sector drags Q3 growth lower

- China's economy grew by 6.0% yoy in Q3 2019 – the weakest rate of growth since 1990. The slowdown in growth was driven by China's secondary sector – manufacturing and construction – with conditions in the former significantly weaker as a result of the US-China trade war. Given the larger than expected slowdown in growth in Q3, we are revising our near term forecasts lower. Growth for 2019 is forecast at 6.1% (from 6.25% previously), while growth in 2020 is forecast at 5.9% (compared with 6.0% previously).

- China's industrial production growth picked up in September – increasing by 5.8% yoy (compared with a ten year low of 4.4% yoy in August). That said, this rate of growth remains relatively modest by historical standards – highlighting the impact of both slowing domestic demand and the impact of the US-China trade war on the manufacturing sector.

- China's fixed asset investment growth was marginally stronger in September, increasing by 4.8% yoy (compared with 4.3% yoy in August). That said, weakness in the industrial sector has led to falling producer prices – lowering the cost of investment goods. As a result, our estimate of real investment has picked up to 6.4% yoy – a rate that is stronger than those recorded across most of 2017 and 2018, but relatively weak by longer historical standards.

- China's trade surplus was a little wider in September, totalling US$39.7 billion (compared with US$34.8 billion previously). In month-on-month terms, exports rose slightly and imports fell modestly, however both fell noticeably year-on-year, reflecting the deterioration in the global trade environment.

- In mid-October, the US and China agreed to a "phase 1" deal, which suspended the tariff hike scheduled for 15 October, in exchange for additional purchases of US agricultural products and a speeding up of financial market reforms (which would open the Chinese sector to foreign firms). At the time of writing, a comprehensive deal remains a long way away – given the broader structural concerns around intellectual property and industrial support remaining unresolved.

- Producer prices are continuing to fall – suggesting that manufacturers are cutting their factory gate prices to support sales volumes (a view consistent with weak industrial profit trends). Producer prices fell by 1.2% yoy (compared with a 0.8% yoy fall in August), despite a 3.3% yoy increase in global commodity prices (in RMB terms).

- Since late August, the People's Bank of China (PBoC) has adopted the Loan Prime Rate (LPR) as a key monetary policy transmission mechanism. The LPR is based on quotes from major banks, quoted as a premium on the PBoC's Medium Term Lending Facility (MLF) rate. The LPR was set at 4.25% in late August, and was cut to 4.2% in mid-September. Given a general easing in monetary policy conditions globally, there is likely scope for the PBoC to guide the LPR lower in coming months

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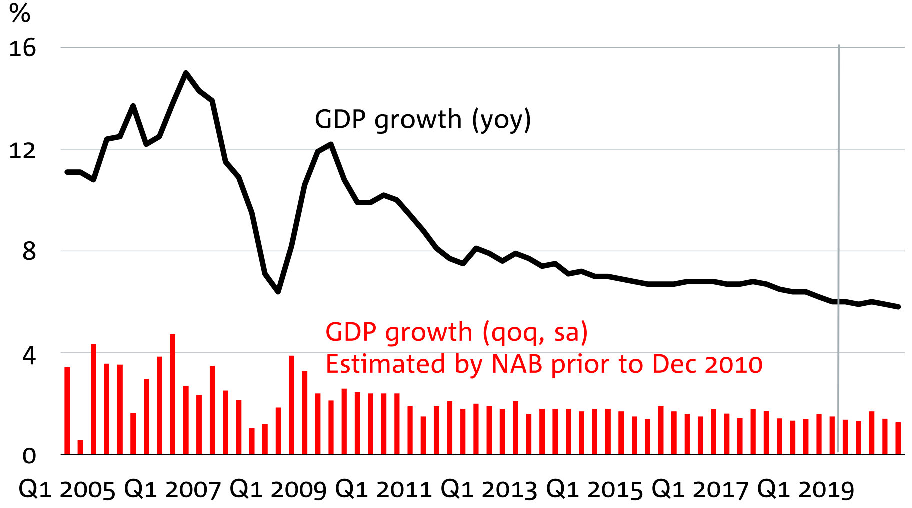
GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH CONTINUES TO SLOW

6.0% yoy in Q3 – weakest growth since 1990

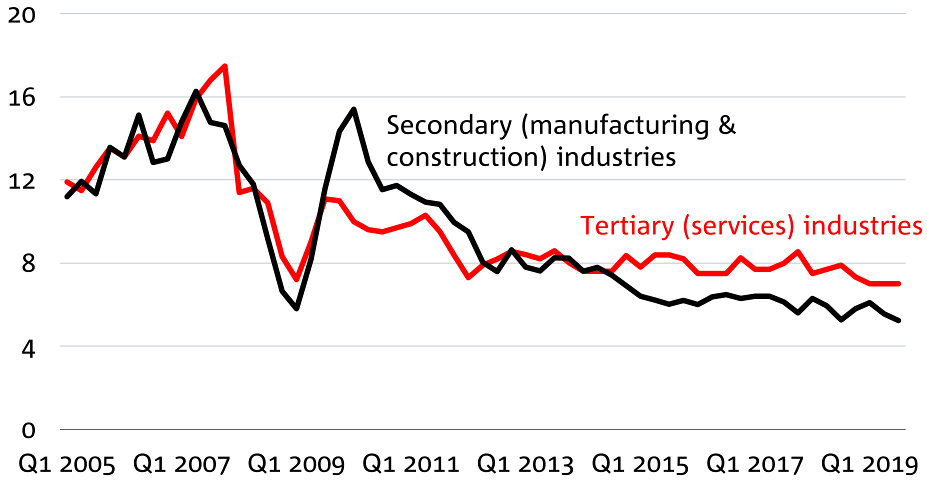


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Tariff-hit industrial sector was the key driver of the slowdown

Chinese economic growth by sector (% yoy)



Source: Refinitiv, NAB Economics

- China's economy grew by 6.0% yoy in the third quarter of 2019 – below our expectations of 6.2% yoy – the weakest rate of growth since 1990. This rate of growth is at the bottom of the Government's annual target of 6%-6.5%.

- The slowdown in growth was driven by China's secondary sector – manufacturing and construction – with conditions in the former significantly weaker as a result of the US-China trade war. This sector grew by 5.2% yoy in Q3 (compared with 5.5% previously).

- In contrast, China's services sector has recorded fairly stable growth – increasing by 7.0% yoy in Q3 – the same rate of growth recorded in the March and June quarters.

- With growth slowing to the bottom of the Government's target, the response from authorities remains a key uncertainty. So far they have resisted the large scale stimulus of earlier episodes (such as those following the global financial crisis and in 2012), conscious of the heavy debt burdens of the corporate sector. That said, there is likely some lower threshold for authorities that could generate a large policy response – particularly if global trading conditions deteriorate further.

- Given the larger than expected slowdown in growth in Q3, we are revising our near term forecasts lower. Growth for 2019 is forecast at 6.1% (from 6.25% previously), while growth in 2020 is forecast at 5.9% (compared with 6.0% previously).

NAB CHINA GDP FORECASTS

%	2019	2020	2021
GDP	6.1	5.9	5.8

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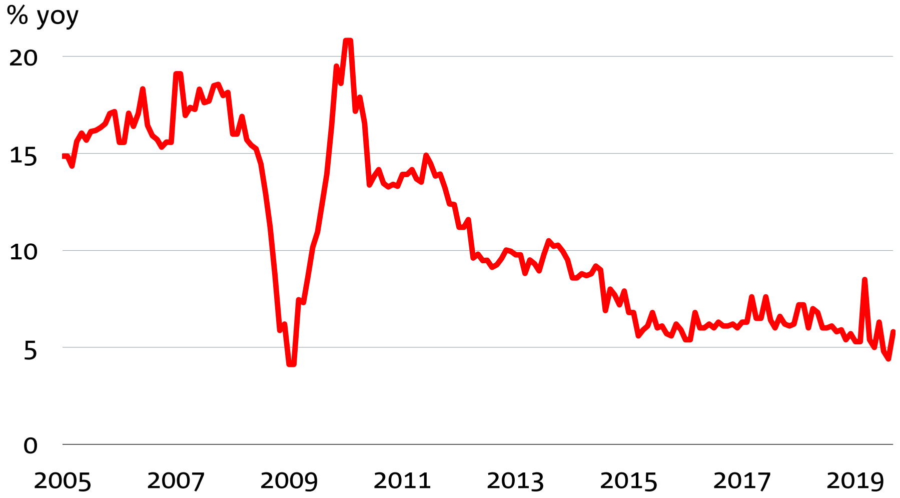
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

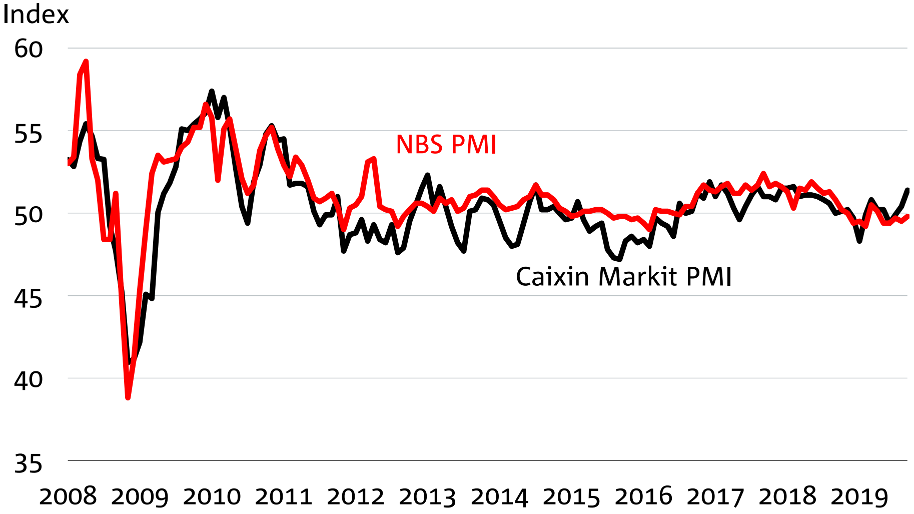
Uptick in output in September, but growth historically modest



Source: CEIC, NAB Economics

LARGE DIVERGENCE BETWEEN CHINA'S PMI SURVEYS

Private sector survey at its strongest level since February 2018



Source: CEIC, NAB Economics

- China's industrial production growth picked up in September – increasing by 5.8% yoy (compared with a ten year low of 4.4% yoy in August). That said, this rate of growth remains relatively modest by historical standards – highlighting the impact of both slowing domestic demand and the impact of the US-China trade war on the manufacturing sector.
- Trends remain highly mixed within individual industrial categories. Output of consumer electronic products rose strongly – up by 11.4% yoy in September – following on from a softer period between July and August. Similarly, electricity generation also accelerated – increasing by 4.7% yoy (compared with just 1.7% yoy previously).
- Construction related heavy industrial sectors grew more modestly – with crude steel output increasing by 2.2% yoy (ahead of capacity closures for the northern winter), while cement production rose by 4.1% yoy (down from 5.1% in August).
- Motor vehicle manufacturing remains weak – with output falling by 6.9% yoy in September. This sector has been hit by weakness in consumer demand, in part related to restrictions on shadow banking lenders that had come to dominate vehicle financing in recent years.
- There remained significant divergence in China's major manufacturing surveys in September. The official NBS PMI survey was less negative – at 49.8 points (from 49.5 points previously) – while the private sector Caixin Markit PMI strengthened to 51.4 points (from 50.4 points in August). This was the strongest reading in the private survey since February 2018.
- The improvement in the Caixin Markit measure was driven by domestic factors, with new export orders remaining negative (as was also the case in the official survey).

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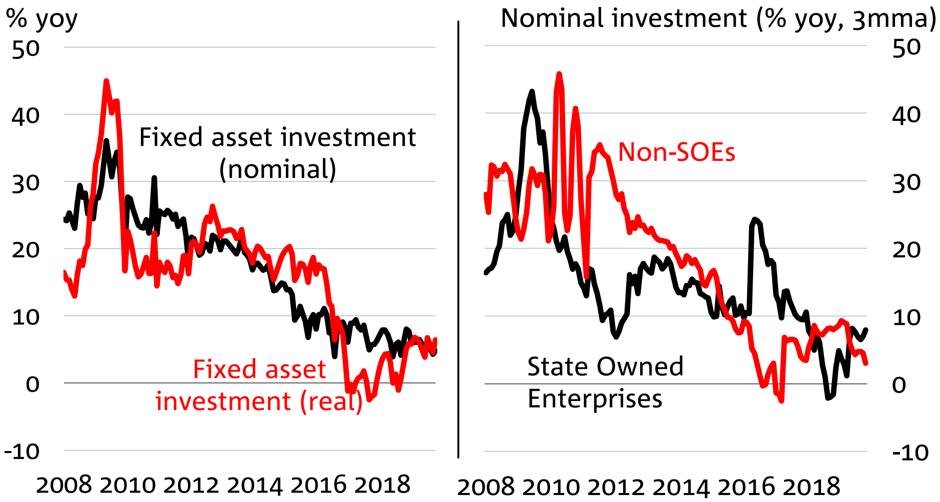
INVESTMENT

FIXED ASSET INVESTMENT

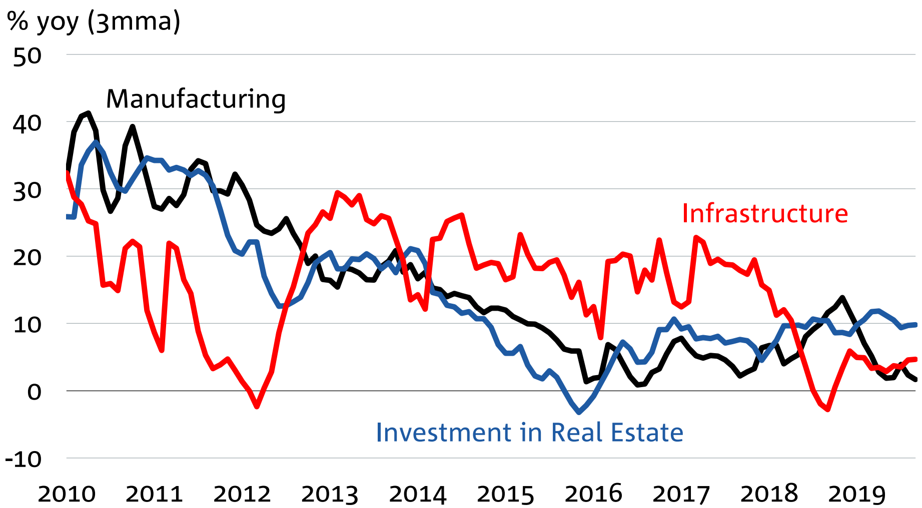
Upward trend in real investment, but growth historically weak



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Real estate investment outperforming other industries



Source: CEIC, NAB Economics

- China's fixed asset investment growth was marginally stronger in September, increasing by 4.8% yoy (compared with 4.3% yoy in August). That said, weakness in the industrial sector has led to falling producer prices – lowering the cost of investment goods. As a result, our estimate of real investment has picked up to 6.4% yoy (from a downwardly revised 4.5% in August) – a rate that is stronger than those recorded across most of 2017 and 2018, but relatively weak by longer historical standards.

- A slowdown in private sector investment has been the key driver of the recent weakness in nominal investment. On a three month moving average basis, private investment slowed to 3.0% yoy in September (compared with 4.5% previously). In contrast, investment by state-owned enterprises (SOEs) accelerated – increasing by 7.9% yoy (3mma), from 7.0% in August.

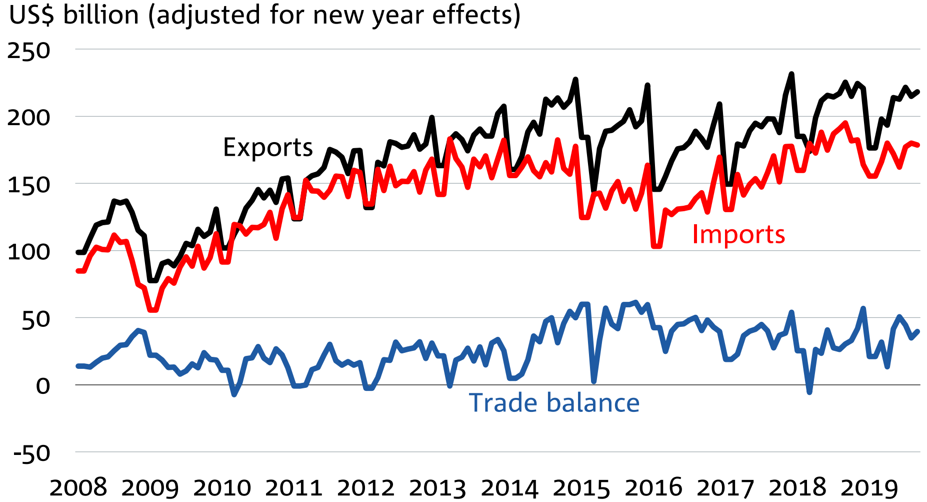
- Trends in investment by industry remain highly mixed. Investment in real estate has remained strong – increasing by 9.8% yoy (3mma) – despite a noticeable slowing trend in residential construction starts (up by 4.4% yoy in September, compared with double digit rates across most of 2018). This suggests some downside risk to real estate investment in coming months.

- In contrast, investment in manufacturing and infrastructure have remained relatively subdued. Manufacturing investment increased by 1.7% yoy (3mma) in September (down from 2.3% previously), while infrastructure investment rose by 4.7% yoy (3mma). It remains to be seen if local government bond quotas for 2020 will be brought forward to support near term infrastructure investment.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS SLIGHTLY WIDER IN SEPTEMBER

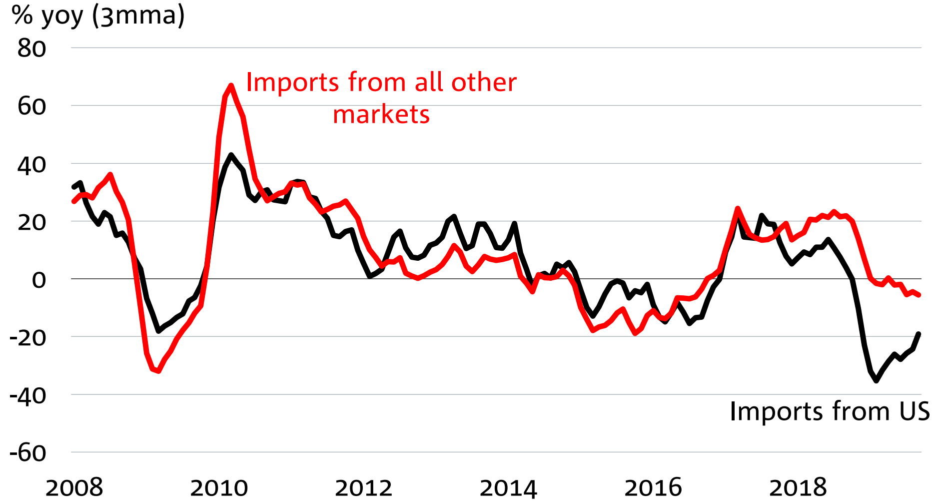
Exports and imports below year-ago levels on trade deterioration



Sources: CEIC, NAB Economics

IMPORTS BY COUNTRY

Trade weakness extends beyond the US-China dispute



Sources: CEIC, NAB Economics

- China's trade surplus was a little wider in September, totalling US$39.7 billion (compared with US$34.8 billion previously). In month-on-month terms, exports rose slightly and imports fell modestly, however both fell noticeably year-on-year, reflecting the deterioration in the global trade environment.

- The United States accounts for the majority of China's trade surplus, albeit this surplus has started to narrow. Two-way trade has plunged due to the tariffs imposed by both countries, down by 15% yoy in the first nine months of the year. The twelve month rolling trade surplus with the US narrowed to US$318.4 billion in September, from a peak of US$330.8 billion in June 2019.

- China's imports dipped in September – down to US$178.5 billion (from US$180.0 billion in August) – but fell significantly in year-on-year terms, down 8.5%. This was fifth month in a row that import values fell year-on-year. Although the US-China trade war has had a clear impact – with imports from the US falling by 15.7% yoy (on a three month moving average basis), negative trends extend further than just the US – with imports from other markets falling by 5.6% yoy (3mma) in September.

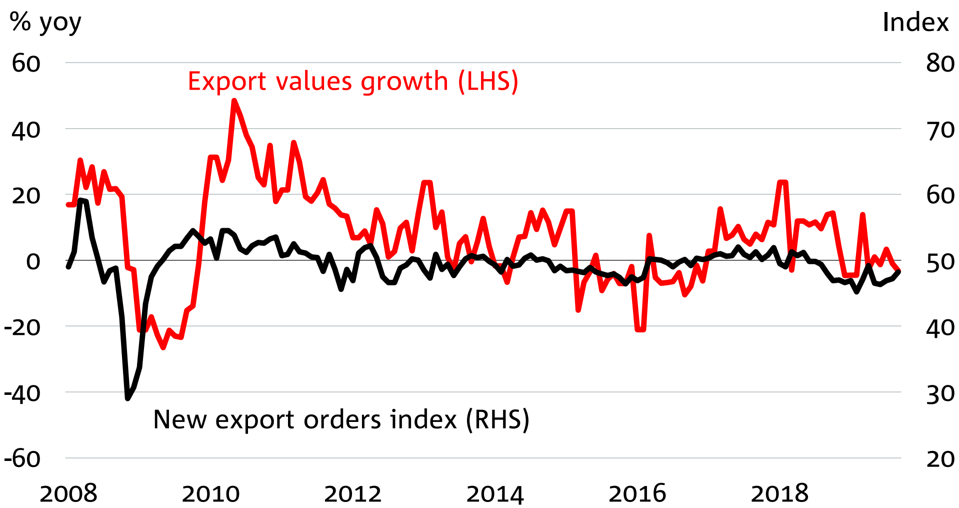
- Our estimate of China's import volumes is based on the total value of imports and global commodity prices. It suggests that volumes have fallen (on a three month moving average basis) since December 2018, with a decline of 7.5% yoy (3mma) in September.

- Despite the overall decline in import volumes, a number of major commodities recorded strong increases in volumes in September. Coal and crude oil imports grew strongly – up by 20.3% yoy and 10.8% yoy respectively, while iron ore imports also rose – up by 6.3% yoy to 99.4 million tonnes (the largest monthly total since January 2018). In contrast, copper imports fell by almost 15% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS DOWN IN YOY TERMS

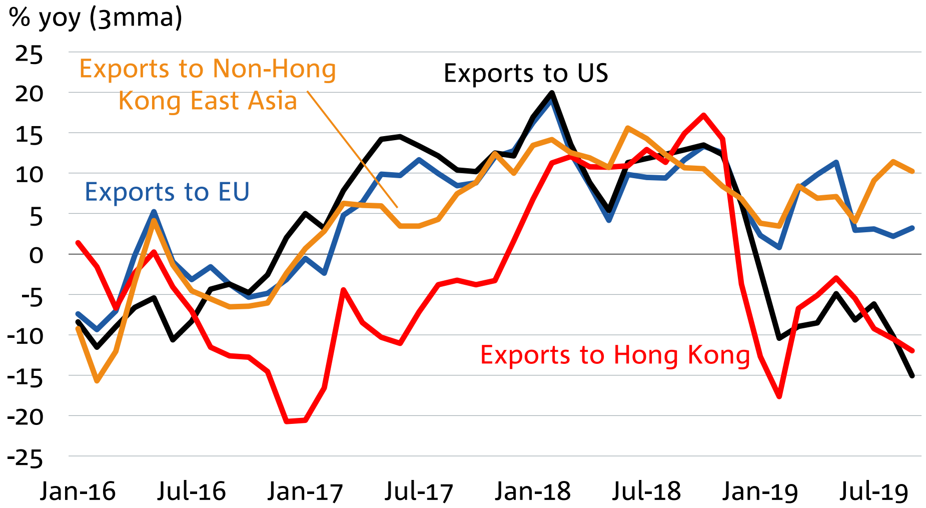
New export orders remain in negative territory



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

The fall in total exports largely driven by the US



Sources: CEIC, NAB Economics

- The value of China's exports rose slightly month-on-month, up to US$218.1 billion in September (compared with US$214.8 billion previously). However this represented a decline of 3.2% yoy. China's exporters continue to report negative conditions in the NBS PMI survey – with new export orders at 48.2 points in September (compared with 47.2 points in August).

- In mid-October, the US and China agreed to a "phase 1" deal, which suspended the tariff hike scheduled for 15 October, in exchange for additional purchases of US agricultural products and a speeding up of financial market reforms (which would open the Chinese sector to foreign firms). At the time of writing, a comprehensive deal remains a long way away – given the broader structural concerns around intellectual property and industrial support remaining unresolved.

- US tariffs have had a major impact on the weaker export trends. Exports to the US fell by 15.1% yoy (on a three month moving average basis), compared with a 3.4% yoy (3mma) increase in exports to all other markets.

- In contrast, exports to the European Union rose by 3.2% yoy (3mma), while exports to East Asia rose by 1.0% yoy (3mma).

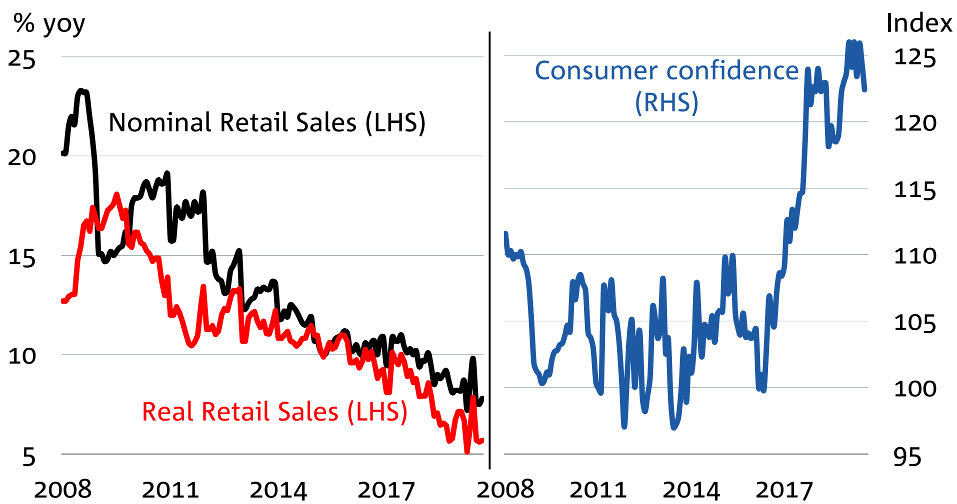
- We have regularly highlighted the distortions in China's trade data with Hong Kong – with false invoicing exports to Hong Kong a way to disguise unauthorised capital flows as trade activity. Exports to Hong Kong reportedly fell by 11.9% yoy (3mma) in September. In the first eight months of 2019, Chinese Customs data suggested that exports to Hong Kong fell by 7.6% yoy, compared with a 4.0% fall as reported by Hong Kong Customs.

- Exports to non-Hong Kong East Asia have continued to increase strongly – rising by 10.2% yoy (3mma) in September. The growth in exports has been driven by Vietnam, Taiwan, the Philippines and Malaysia.

RETAIL SALES AND INFLATION

REAL RETAIL SALES GROWTH REMAINS RELATIVELY WEAK

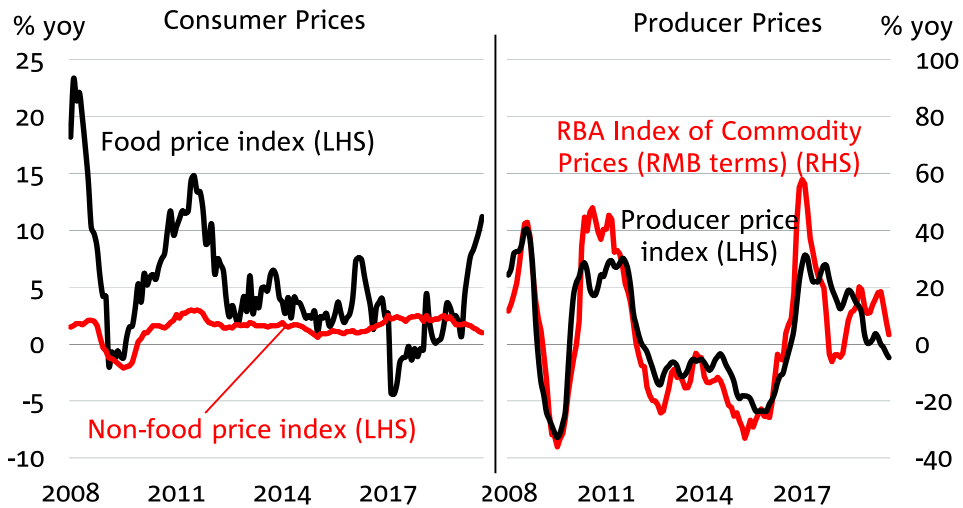
Softness in sales contrasts with strength in confidence



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Pork sends CPI higher; profits squeezed from producer price cuts



Source: CEIC, RBA, NAB Economics

- In nominal terms, China's retail sales growth strengthened a little in September – increasing by 7.8% yoy (compared with 7.5% previously). Retail prices have accelerated – largely driven by rising food costs – meaning that the pick up in real retail sales was more modest – at 5.7% yoy (compared with 5.6% in August).
- The latest consumer confidence readings (from August) were a touch softer – at 122.4 points (compared with 124.4 points in July and the second highest all time reading of 125.9 points in June), however this is a level that remains historically high – despite the weak real sales trend.
- China's headline inflation continued to accelerate in September, with the Consumer Price Index increasing by 3.0% yoy (up from 2.8% yoy in August).
- Food prices were the key driver of this increase – with the food price index up by 11.2% yoy (from 10.0% yoy previously). African Swine Fever has devastated the domestic pork industry, driving pork prices up by 69% yoy in September – with little prospect for a quick recovery, given the loss of breeding stock. This suggests comparatively high food price increases will persist in coming months.
- In contrast, non-food price growth has slowed considerably since mid-2018 – increasing by just 1.0% yoy in September (from 1.1% previously). Vehicle fuel prices continue to fall – down by 12.1% yoy in September (from 10.2% previously).
- Producer prices are continuing to fall – suggesting that manufacturers are cutting their factory gate prices to support sales volumes (a view consistent with weak industrial profit trends). Producer prices fell by 1.2% yoy (compared with a 0.8% yoy fall in August), despite a 3.3% yoy increase in global commodity prices (in RMB terms).

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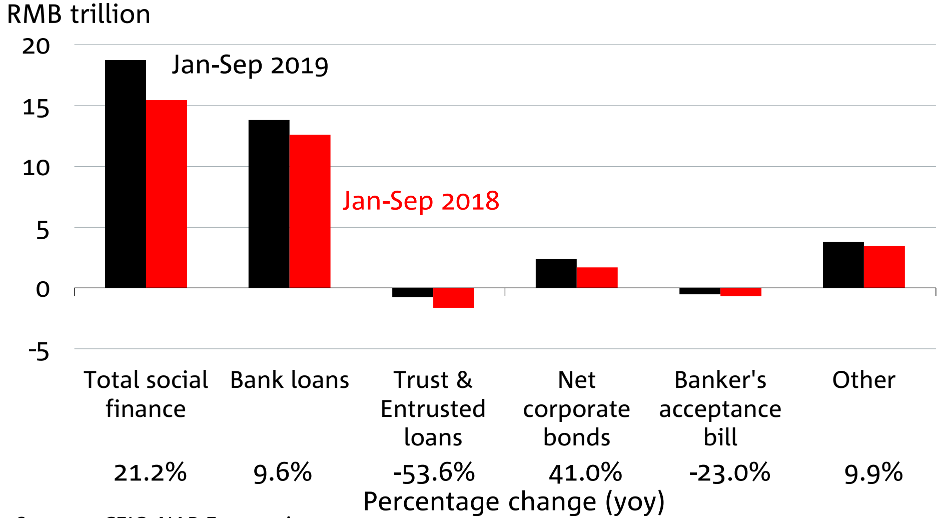
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

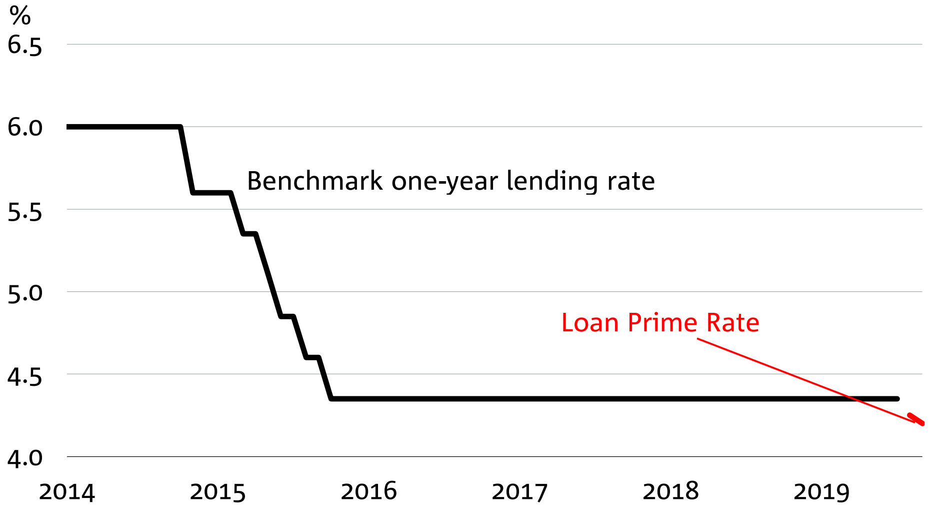
Strong increase in lending in first three quarters of 2019



Sources: CEIC, NAB Economics

CHINA MONETARY POLICY

New Loan Prime Rate has eased monetary policy



Source: CEIC, NAB Economics

- New credit issuance grew strongly across the first nine months of 2019 – increasing by 21.2% yoy to RMB 18.7 trillion – following on from the deleveraging-led declines in 2017 and 2018. Over this period, bank lending increased by 9.6% yoy to RMB 13.8 trillion.

- In contrast, non-banking lending increased by over 72% yoy in the first nine months of the year. The main contributors to this increase were a large scale increase in corporate bond issuance, a slower decline in trust and entrusted loans and a sizeable increase in local government special bonds. China's Finance Ministry has brought forward (by three months) its annual assessment of local government debt needs, however it remains to be seen whether Beijing will bring forward the 2020 quota to underpin near term growth. The full year quota for bond issuance was almost exhausted in September.

- Volatility in short term money markets has eased since late August, following on from a period of unusually high volatility that commenced at the start of 2019. In mid October, the 7 day Shanghai Interbank Offered Rate (Shibor) settled around 2.6% - in line with the average since the start of the year.

- Since late August, the People's Bank of China (PBoC) has adopted the Loan Prime Rate (LPR) as a key monetary policy transmission mechanism. The LPR is based on quotes from major banks, quoted as a premium on the PBoC's Medium Term Lending Facility (MLF) rate.

- The LPR was set at 4.25% in late August, and was cut to 4.2% in mid-September. Given a general easing in monetary policy conditions globally, there is likely scope for the PBoC to guide the LPR lower in coming months.

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