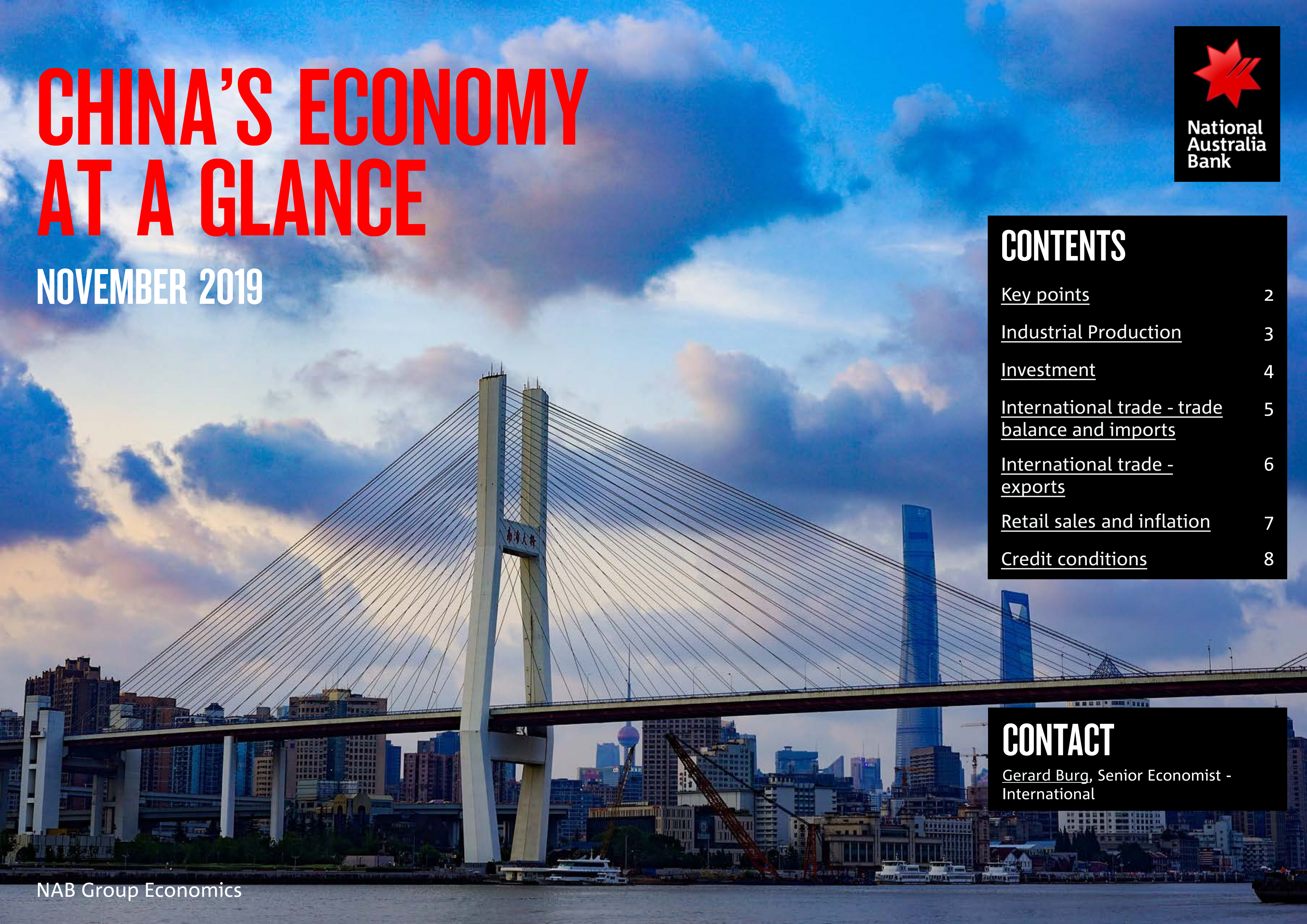

CHINA'S ECONOMY AT A GLANCE

NOVEMBER 2019

National Australia Bank

CONTENTS

CONTACT

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KEY POINTS

October data were weak, but birthday celebrations make them harder to gauge

- Most of China's indicators were relatively weak in year-on-year terms in October. While some part of this weakness reflects the impact of the US-China trade war – which was also evident in September – they may also reflect disruptions caused by the celebrations for the 70th anniversary of the founding of the People's Republic of China at the start of the month. As a result, we argue that the weakness this month should not be over emphasised. Our forecasts for China's economic growth are unchanged – at 6.1% for 2019, 5.9% for 2020 and 5.8% for 2021.

- Growth in China's industrial production slowed again in October – increasing by 4.7% yoy (down from 5.8% previously). This was the second weakest rate of growth in ten years (compared with the 4.4% increase in August. There was a growing divergence in the readings from China's two main manufacturing surveys – with the private sector Caixin Markit survey at its strongest level since December 2016.

- Growth in China's fixed asset investment slowed in October – down to 3.7% yoy (from 4.8% previously). Falling prices for investment goods – driven by declining producer prices – provided a partial offset to the slowing investment growth. This meant that in real terms, investment growth was 6.0% yoy in October, down from 6.6% in September. By historical standards, this increase was relatively weak.

- China's trade surplus edged slightly wider for the second straight month in October – to US$42.8 billion (from US$39.2 billion previously). Both exports and imports fell month-on-month, with imports falling more rapidly, albeit this is a typical seasonal pattern – reflecting the Golden Week holidays at the start of the month.

- While there has been progress towards the "Phase One" trade deal between the United States and China, there remains considerable uncertainty. Chinese negotiators are reportedly seeking a roll back of some tariff measures – and it is unclear if the Trump Administration is willing to make such a concession – while a further deterioration in the relationship cannot be ruled out. President Trump has stated "If we don't make a deal, we're going to substantially raise those tariffs."

- Producer price deflation has continued to accelerate – suggesting that one impact of the US-China trade war has been for Chinese manufacturers to cut factory gate prices to support sales volumes. Producer prices fell by 1.6% yoy in October (compared with a 1.2% fall previously).

- The People's Bank of China (PBoC) cut the MLF rate by 5 basis points in early November – to 3.25% - which will likely be reflected in the benchmark Loan Prime Rate when it is announced on 20 November. Compared with policy easing in other countries, this cut was extremely modest, however the PBoC has scope to cut further and faster if required in the future.

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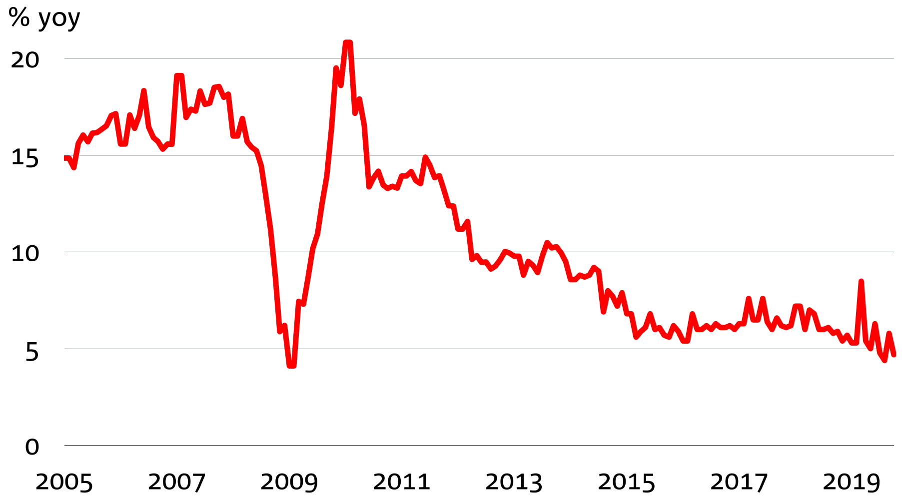
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

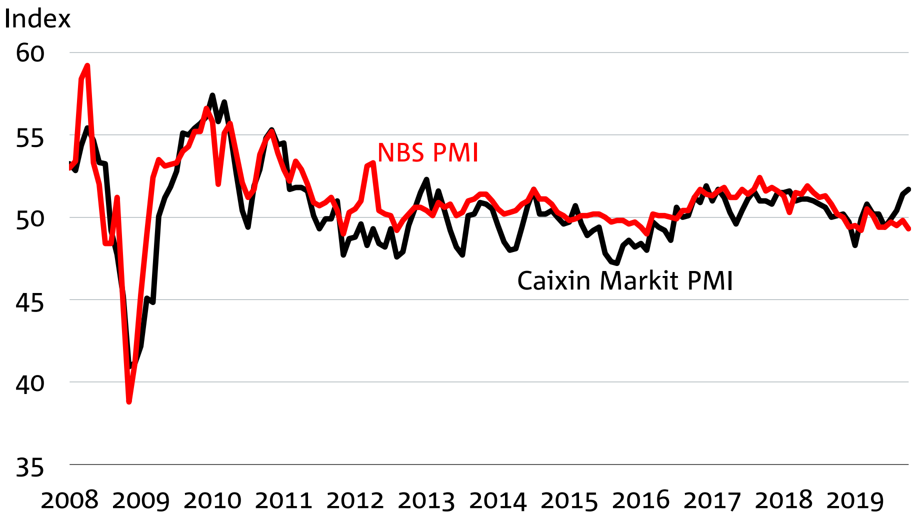
Output growth slowed again in October



Source: CEIC, NAB Economics

CHINA'S MANUFACTURING SURVEYS DIVERGE

Widening gap as Caixin Markit survey highest since December 16



Source: CEIC, NAB Economics

- Growth in China's industrial production slowed again in October – increasing by 4.7% yoy (down from 5.8% previously). This was the second weakest rate of growth in ten years (compared with the 4.4% increase in August).

- Although it is likely that this weakness reflects the impact of the US-China trade war, there may have been some additional impact from the celebrations of the 70th anniversary of the founding of the People's Republic of China.

- Output in a range of sub-sectors contracted in October. Both motor vehicles and cement manufacturing contracted by 2.1% yoy, while crude steel production fell by 0.6% yoy.

- In contrast, there was growth in both electricity output – which rose by 4.0% yoy – and production of consumer electronics – up by 8.2% yoy.

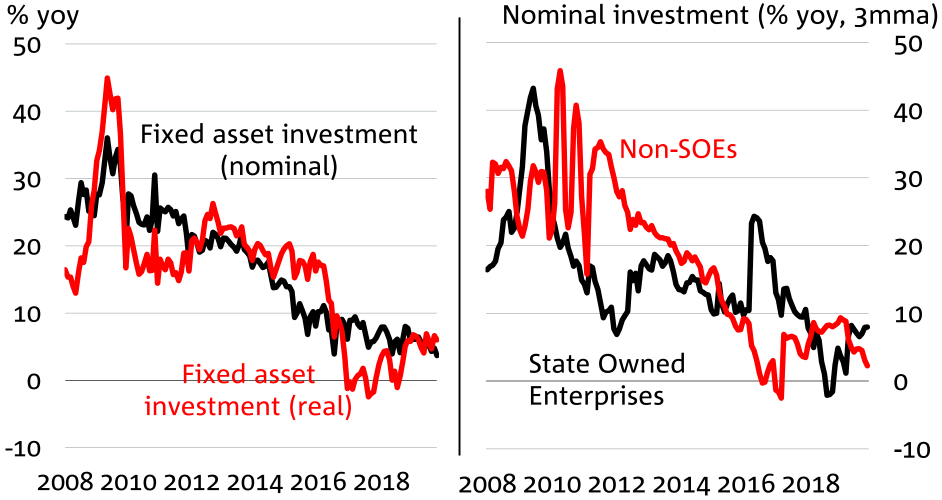
- In recent months there has been a widening gap between China's two major manufacturing surveys. The private sector Caixin Markit PMI has strengthened – up to 51.7 points in October (from 51.4 points previously) – the equal strongest reading since December 2016. In contrast, the official NBS PMI survey was weaker, at 49.3 points (from 49.8 points in September).

- One contributor to the relative strength of the Caixin Markit measure was export orders – which turned positive this month – compared with the long running negativity in the export measure in the NBS survey. Similarly, domestic orders appear stronger in the private sector survey – which may reflect the composition of firms in the respective surveys. It is generally understood that the Caixin Markit survey has a larger proportion of small-to-medium private sector manufacturers.

INVESTMENT

FIXED ASSET INVESTMENT

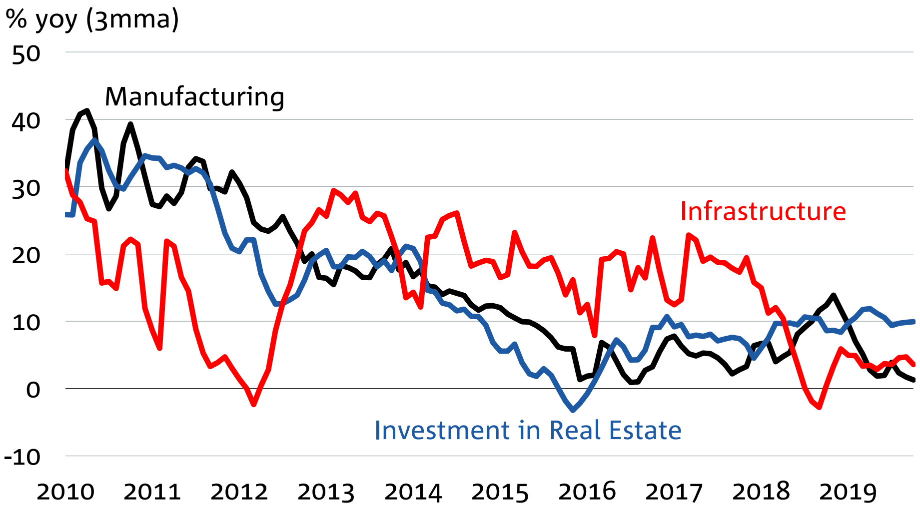
Private sector growth slows; SOE investment growth stable



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Real estate investment continues to outpace other industries



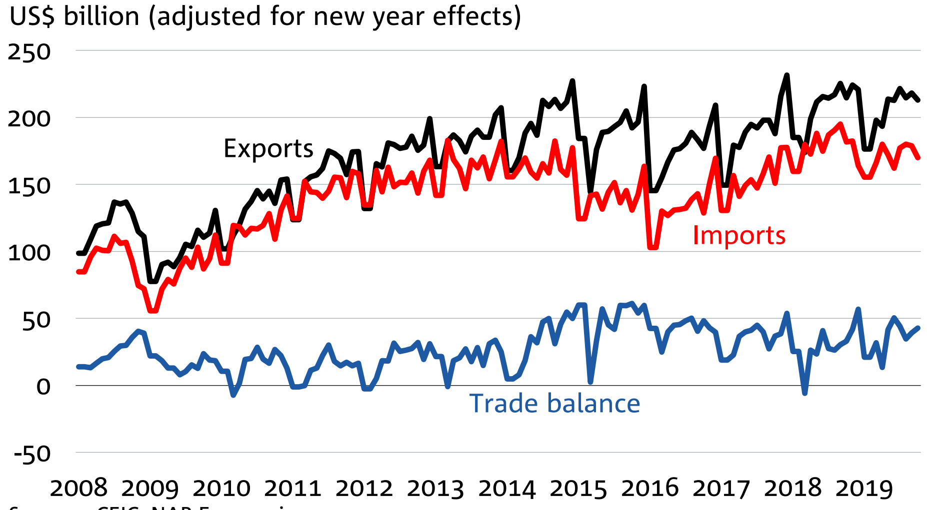
Source: CEIC, NAB Economics

- Growth in China's fixed asset investment slowed in October – down to 3.7% yoy (from 4.8% previously). As with industrial production and trade, it is possible that anniversary celebrations of the People's Republic's founding could have impacted this outcome.
- Falling prices for investment goods – driven by declining producer prices – provided a partial offset to the slowing investment growth. This meant that in real terms, investment growth was 6.0% yoy in October, down from 6.6% in September. By historical standards, this increase was relatively weak.
- The slowdown in nominal investment growth has largely been driven by weakness from private sector firms. On a three month moving average basis, private investment slowed to 2.2% yoy (from 3.0% in September). In contrast, investment by state-owned enterprises (SOEs) grew by 7.9% yoy (3mma) – unchanged from September.
- The trends in investment by industry remain divergent. Investment in real estate continues to increase strongly – by 9.9% yoy (3mma) in October – supporting a strengthening in construction activity. It remains to be seen if this sector can continue to grow strongly in 2020.
- In contrast, investment in manufacturing softened – increasing by 1.3% yoy (3mma) (from 1.7% previously) – as did infrastructure – which grew by 3.6% yoy (3mma), down from 4.7% in September. With the quotas for local government bonds essentially exhausted this year, weakness in infrastructure investment may persist into the new year.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS MARGINALLY WIDER AGAIN IN OCTOBER

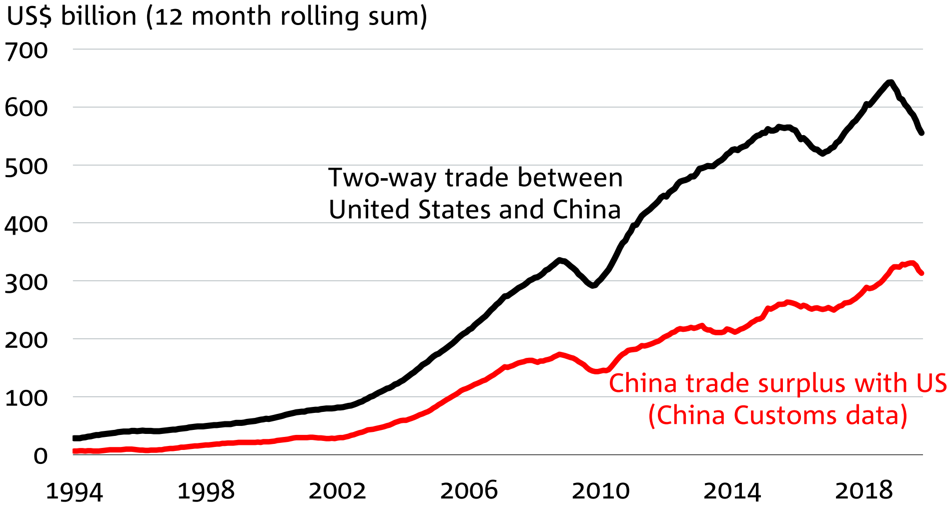
Exports and imports weaker month-on-month in seasonal decline



Sources: CEIC, NAB Economics

TRADE WITH THE UNITED STATES

Two-way trade has pulled back sharply; surplus decline modest



Sources: CEIC, NAB Economics

- China's trade surplus edged slightly wider for the second straight month in October – to US$42.8 billion (from US$39.2 billion previously). Both exports and imports fell month-on-month, with imports falling more rapidly, albeit this is a typical seasonal pattern – reflecting the Golden Week holidays at the start of the month. The celebration of the 70th anniversary of the People's Republic of China's founding at this time may have further impacted industrial activity (including international trade).

- Despite the impact of tariffs imposed by both countries since the start of the US-China trade war, the United States continues to account for the bulk of China's trade surplus – totalling US$26.4 billion for the month. The twelve month rolling trade surplus totalled US$313 billion, down around 5.4% from the peak in June 2019 – well below the 13.5% decline in two-way trade since late 2018.

- China's imports totalled US$170.1 billion in October – down from US$178.9 billion in September – a decline of 6.4% yoy. The US-China trade war has had a impact in China's import demand. Imports from the United States fell by 17.7% yoy (on a three month moving average basis), compared with a 6.0% decline in imports from all other markets.

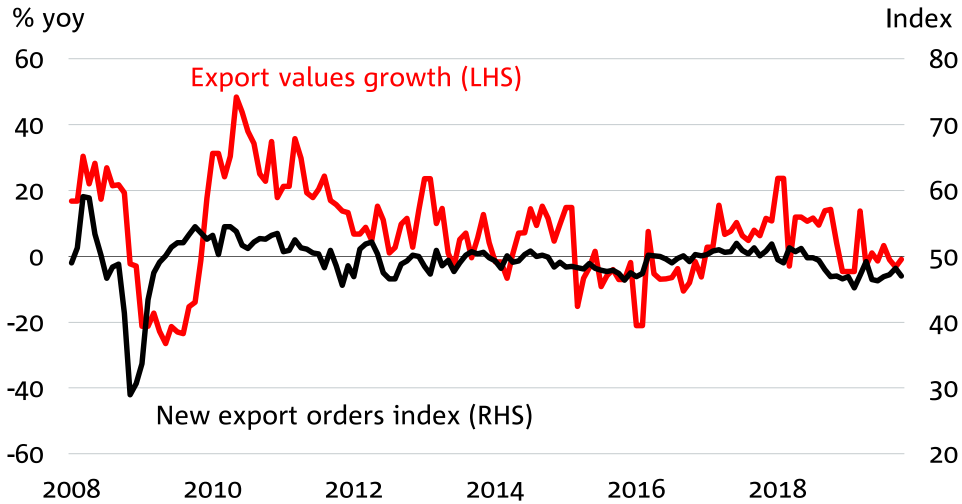
- The value of Chinese imports have declined more rapidly in recent months than global price indices, suggesting that the volume of imports has fallen more strongly. Our estimate of import volumes – which uses global commodity prices as a proxy for the cost of imports – fell by 6.2% yoy (3mma) in October – a little less negative than the 7.3% yoy (3mma) decline in September.

- While import volumes appear to have declined, there was an increase in imports for a number of major commodities. There were large increases in crude oil and coal import volumes – up by 17.1% yoy and 11.3% yoy respectively – while iron ore increased by 5.1% yoy and copper by 1.9% yoy.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORTS VALUES CONTINUE TO DECLINE

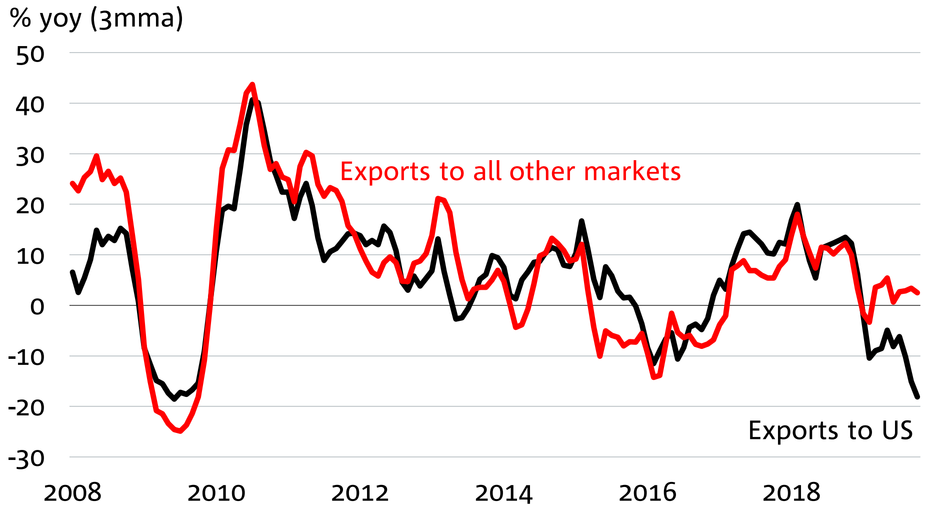
Surveyed new export orders remain negative



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Impact of US tariffs evident in export data



Sources: CEIC, NAB Economics

- China's exports totalled US$212.9 billion in October, down from US$218.1 billion in September – a decline of 0.9% yoy. Exporters in the official NBS PMI survey have reported negative export orders since May 2018 – with the measure at 47.0 points in October (from 48.2 points in September).

- While there has been progress towards the "Phase One" trade deal between the United States and China, there remains considerable uncertainty. Chinese negotiators are reportedly seeking a roll back of some tariff measures – and it is unclear if the Trump Administration is willing to make such as concession – while a further deterioration in the relationship cannot be ruled out. President Trump has stated "If we don't make a deal, we're going to substantially raise those tariffs."

- Trends differ between key export markets. The increasing US tariffs over the past eighteen months have had an impact – with exports falling by 18.1% yoy (on a three month moving average basis) in October, compared with a 2.5% yoy (3mma) increase in exports to all other markets.

- Exports to East Asia rose by just 0.9% yoy (3mma) – however this included a reported 11.9% yoy (3mma) fall in exports to Hong Kong. China's trade data with Hong Kong has been subject to considerable distortions in the past – with capital flows disguised as trade activity. In the first nine months of the year, Chinese customs data reported a decline in exports to Hong Kong of 8.3% yoy. In contrast, Hong Kong customs data reported a more modest fall – of around 4.6% yoy.

- Exports to non-Hong Kong East Asia rose by 10.0% yoy (3mma) – led by increases in exports to Vietnam, Taiwan and the Philippines. Exports to the European Union also rose, albeit relatively modestly, increasing by 2.1% yoy (3mma).

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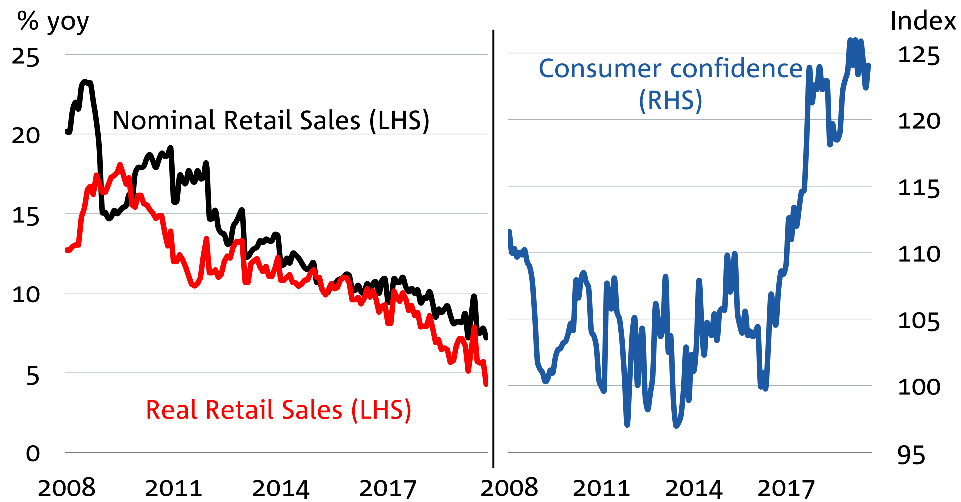
RETAIL SALES AND INFLATION

RETAIL SALES AND CONSUMER CONFIDENCE

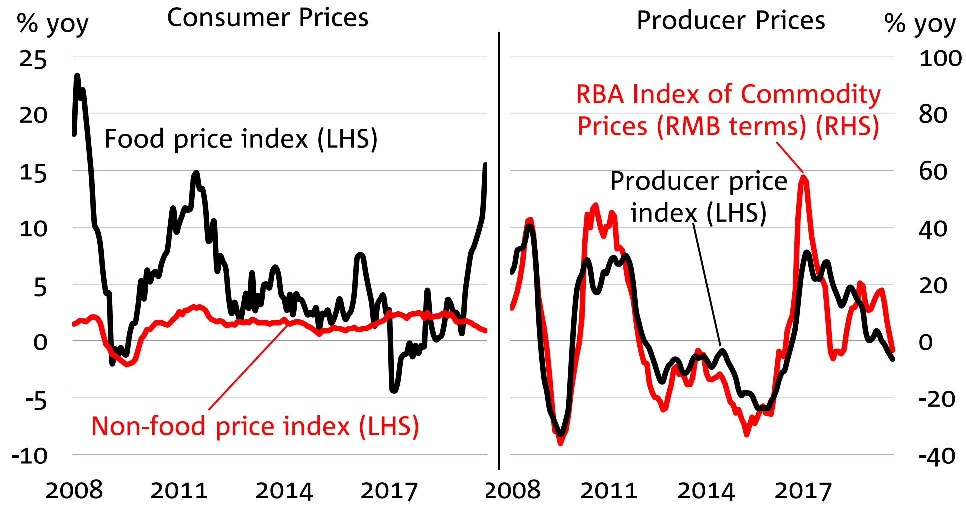
Real sales growth drop below 5% but confidence remains high



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Food prices continue to surge on sky high pork inflation



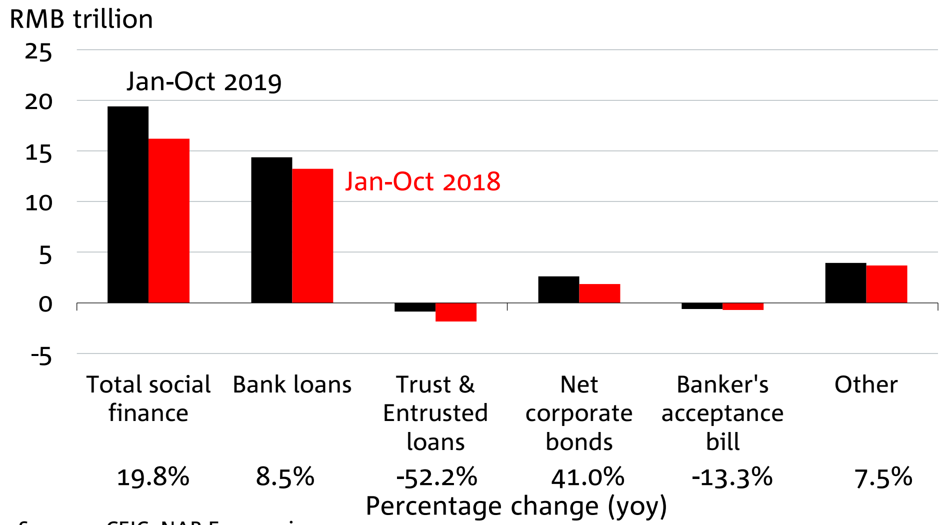
Source: CEIC, RBA, NAB Economics

- China's retail sales increased by 7.2% yoy in nominal terms – a slowdown from the 7.8% yoy increase recorded in September. There has been a rapid acceleration in retail prices in recent months – driven by rising pork prices – meaning that real retails sales grew by 4.3% yoy. This was the lowest rate of growth since April 1994.
- Despite the weakness in real sales growth, the most recent consumer confidence readings (from September) strengthened – up to 124.1 points (from 122.4 points in August). Consumer confidence has remained near its all time highs.
- China's headline inflation rose once again in October, with the Consumer Price Index pushing up to 3.8% yoy (from 3.0% in September).
- Food prices have been the key driver of the increase in the CPI – with the food price index increasing by 15.5% yoy in October (compared with 11.2% previously). African Swine Fever has had a devastating effect on China's pork industry, with pork prices rising by 101% yoy in October. Due to the large scale loss of breeding stock, there is little prospect of a rapid recovery in pork supply – meaning that food price inflation will remain elevated for some time.
- In stark contrast, the non-food price index has seen slowing growth in recent months – down to 0.9% yoy in October (compared with growth in excess of 2% across most of 2017 and 2018). Vehicle fuel prices fell by 15.1% yoy in October, providing some downward pressure to the index.
- Producer price deflation has continued to accelerate – suggesting that one impact of the US-China trade war has been for Chinese manufacturers to cut factory gate prices to support sales volumes. Producer prices fell by 1.6% yoy in October (compared with a 1.2% fall previously). This month saw global commodity prices fall in RMB terms, suggesting reduced profit pressures on manufacturers, when compared with the large increases in input prices in recent months.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

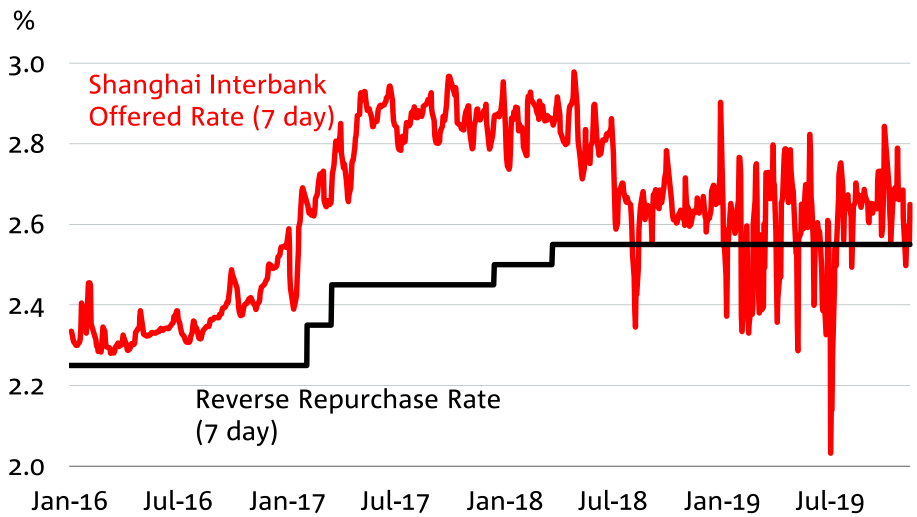
New credit increased strongly in YTD '19, but slowed in October



Sources: CEIC, NAB Economics

SHORT TERM INTEREST RATES

Shibor showing lower volatility than Jan-Aug 2019



Source: CEIC, NAB Economics

- New credit issuance contracted in October – down 16.1% yoy – in part due to a slowdown in local government special bond issuance, as local governments approached their full year quota. Despite earlier expectations that local governments would be permitted to bring 2020 quotas forward to increase spending, this appears not to have occurred.

- Despite the weakness in October, credit has expanded strongly this year. In the first ten months of 2019, new credit issuance totalled RMB 19.4 trillion, an increase of 19.8% yoy. Bank lending accounted for the bulk of this increase – around RMB 14.4 trillion over this period – almost three-quarters of the total.

- There has been a much larger increase in non-bank lending, up by 70.8% yoy in the first ten months. The main contributors to this increase was corporate bond issuance – up by 41% yoy – and local government special bonds – up by 20.4% yoy, while there was a slowing in the decline of a range of shadow banking products (such as trust and entrusted loans and banker's acceptance bills).

- China's new monetary policy rate benchmark – the Loan Prime Rate (LPR) – is based on quotes from major banks as a premium above the PBoC's Medium Term Lending Facility (MLF) rate. This gives the PBoC the ability to guide rates by adjusting the MLF rate. The PBoC cut the MLF rate by 5 basis points in early November – to 3.25% - which will likely be reflected in the LPR when it is announced on 20 November. Compared with policy easing in other countries, this cut was extremely modest, however the PBoC has scope to cut further and faster if required in the future.

- Volatility in short term money markets has eased – when compared with the extremes between January and August this year. The 7 day Shanghai Interbank Offered Rate (Shibor) traded between 2.5% and 2.8% across October and early November. That said, volatility was a little higher than the period from mid-2017 through mid-2018.

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