CHINA'S ECONOMY AT A GLANCE

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National Australia Bank

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KEY POINTS

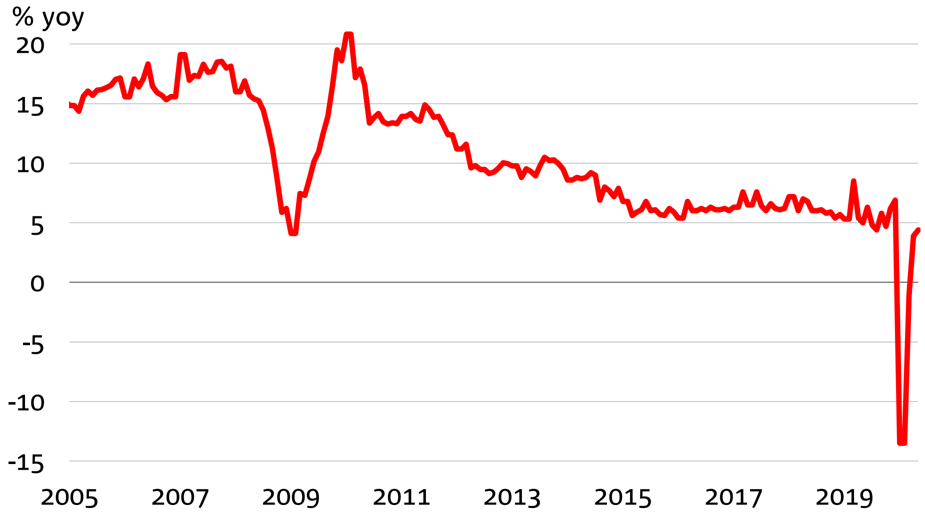
Suppliers are still searching for demand

- China's latest economic data continue to point to a muted recovery from COVID-19 constraints, with stronger performance from the supply side (given growth in industrial production and investment) than the demand side (with retail sales still contracting). Export markets are still constrained, meaning that these relatively weak conditions may continue. Our forecasts are unchanged – with economic growth of 1.0% in 2020 (the weakest growth rate since 1976), before increasing by 9.75% in 2021.
- Growth in China's industrial production picked up in May, rising by 4.4% yoy (compared with 3.9% yoy in April). Although this represents a substantial improvement from the deep declines recorded in February and March, it is worth noting that this increase remains below the trend typical prior to the COVID-19 outbreak.
- Growth in fixed asset investment accelerated in May, increasing by 3.9% yoy (compared with a 0.7% increase in April and steep falls in the first quarter). Producer prices have contracted in recent months, lowering the cost of investment goods, meaning that there has been a far larger increase in real investment – up by around 8.2% yoy (from 4.4% yoy in April).
- China's trade surplus surged in May – totalling US$62.9 billion (compared with US$45.3 billion in April). This was the largest trade surplus on record, reflecting a month-on-month fall in imports that was partly price related, while exports modestly increased from April, with medical supplies contributing to this trend.
- China's retail sales fell again in year-on-year terms in May, albeit more modestly than in the first four months of 2020. In nominal terms, sales declined by 2.8% yoy, compared with -7.5% yoy in April and -15.8% yoy in March. Retail price inflation slowed in May, meaning that real retail sales fell by 3.7% yoy (compared with a 9.0% fall in April).
- There was another surge in credit issuance in May – totalling RMB 3.2 trillion (following on from a RMB 3.1 trillion increase in April). Bank loans only accounted for around half of this increase, with large scale government bond issuance driving non-bank credit.
- Directing credit to small and micro sized businesses remains a priority for Chinese authorities – attempting to counter the long term trends of large banks prioritising lending to large state-owned enterprises. In early June, the People's Bank of China (PBoC) announced that it will introduce a RMB 400 billion quota to purchase 40% of SME loans issued by local banks between March and December.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

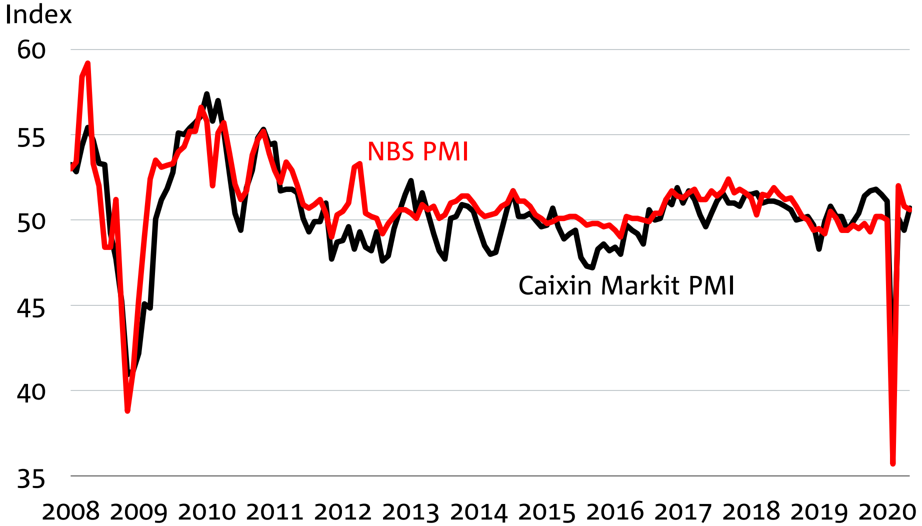
Output growth picked up, but below pre-COVID-19 trends



Source: CEIC, NAB Economics

PMI SURVEYS ONLY SLIGHTLY POSITIVE

Weak domestic and export demand limiting manufacturers



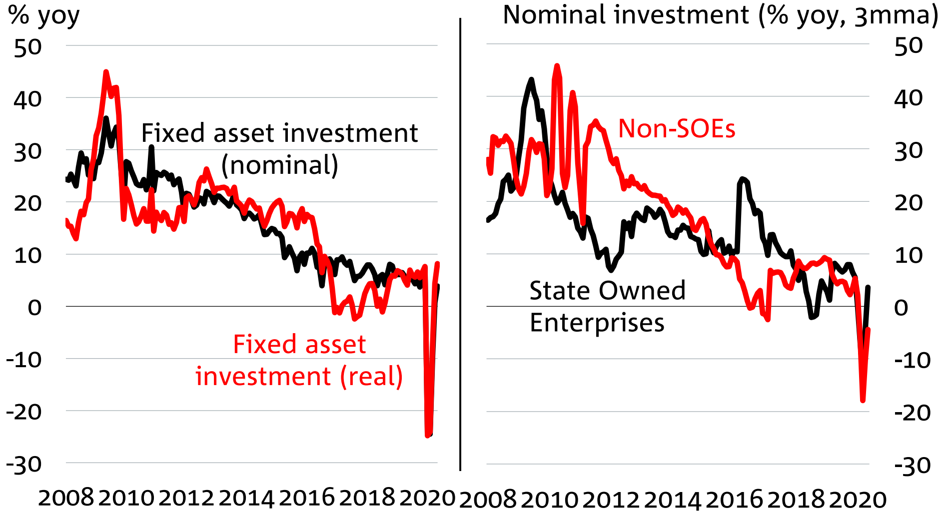
Source: CEIC, NAB Economics

- Growth in China's industrial production picked up in May, rising by 4.4% yoy (compared with 3.9% yoy in April). Although this represents a substantial improvement from the deep declines recorded in February and March, it is worth noting that this increase remains below the trend typical prior to the COVID-19 outbreak.
- Despite the modest increase in aggregate, there were notable accelerations in growth for a range of major industrial sectors – with motor vehicle output increasing by 19% yoy (from 5.1% previously), while cement (up 8.6% yoy), electricity generation (4.3% yoy) and crude steel (4.2% yoy) all recorded stronger growth than in April.
- That said, there remain concerns around the sustainability of this industrial-led recovery – with demand in export markets poor (due to COVID-19 countermeasures still in place) and domestic consumers still remaining somewhat cautious.
- China's two major manufacturing surveys were slightly positive in May. The official NBS PMI survey eased slightly – down to 50.6 points (from 50.8 points in April). In contrast, the Caixin Markit PMI rose to 50.7 points (compared with 49.4 points previously).
- Both surveys continue to highlight the weakness in export markets, with COVID-19 countermeasures and higher (than pre-COVID-19) unemployment rates constraining demand in foreign countries.

INVESTMENT

FIXED ASSET INVESTMENT

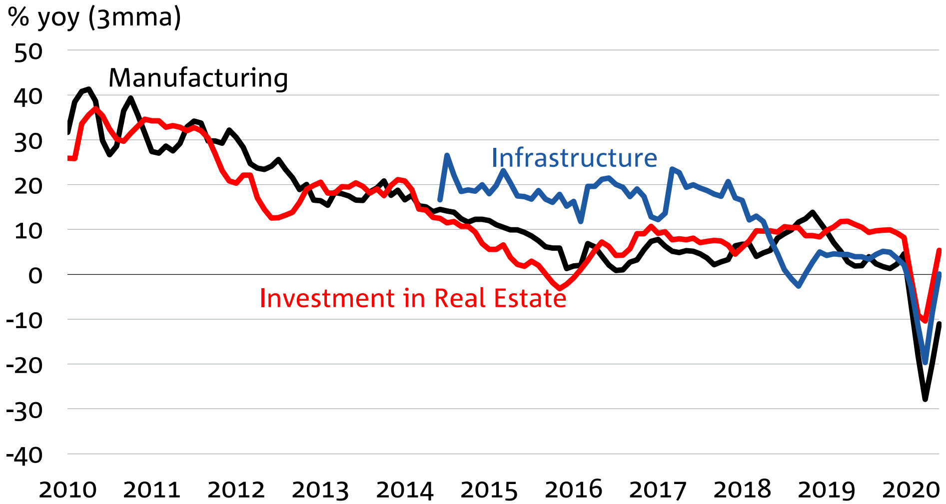
SOEs continue to drive the recovery in investment



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Real estate and infrastructure faster to recover than manufacturing



Source: CEIC, NAB Economics

- Growth in fixed asset investment accelerated in May, increasing by 3.9% yoy (compared with a 0.7% increase in April and steep falls in the first quarter). Producer prices have contracted in recent months, lowering the cost of investment goods, meaning that there has been a far larger increase in real investment – up by around 8.2% yoy (from 4.4% yoy in April).

- The growth in nominal investment was driven by state-owned enterprises (SOEs) – with SOE investment increasing by 11.4% yoy in May, compared with a 0.1% yoy fall in private sector investment.

- There are signs that infrastructure investment is starting to accelerate – in part reflecting the decision of Chinese authorities to bring forward local government bond issuance. Infrastructure investment rose by 8.3% yoy in May.

- On a three month moving average basis, the real estate sector has seen the most rapid recovery in investment – increasing by 5.4% yoy (3mma) in May – followed by infrastructure (recording no growth on the moving average basis, due to steep falls in March). Manufacturing investment is continuing to decline, down by 11.0% yoy (3mma).

- The increase in real estate investment is notable, given that Chinese authorities had initially attempted to limit funds flowing into the sector – such as excluding real estate lending from earlier monetary policy easing.

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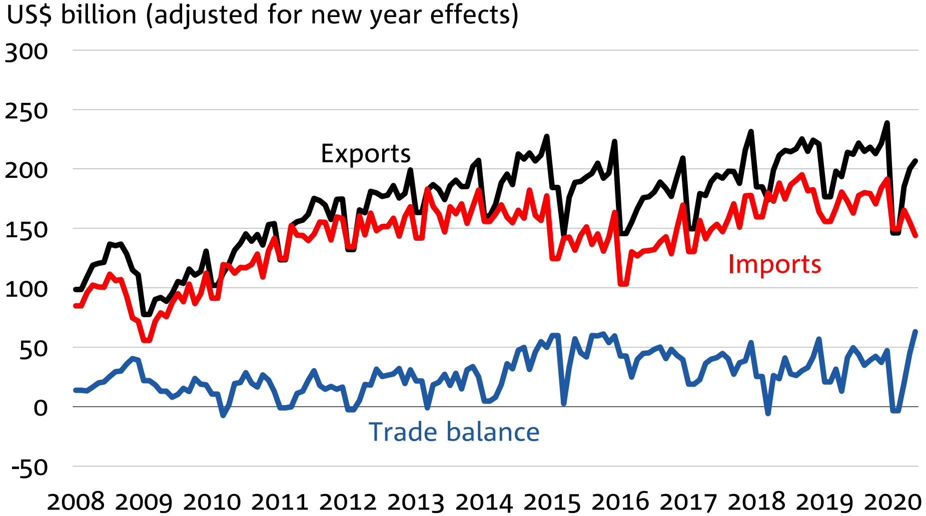
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

Surplus surged to a new record in May



Sources: CEIC, NAB Economics

CHINA'S TRADE SURPLUS WITH THE UNITED STATES

Doubts grow that China can meet Phase One deal commitments

Sources: CEIC, NAB Economics

- China's trade surplus surged in May – totalling US$62.9 billion (compared with US$45.3 billion in April). This was the largest trade surplus on record, reflecting a month-on-month fall in imports that was partly price related, while exports modestly increased from April, with medical supplies contributing to this trend.

- The largest share of China's trade surplus is with the United States. Although the surplus has narrowed from its peak prior to the US-China trade war – when it exceeded US$330 billion on a twelve month rolling sum basis – it has stabilised in recent months near US$275 billion, as imports from the US have retreated more rapidly than China's exports to the US. There are growing doubts that China will be able to fulfil the agricultural import provisions of the Phase One trade deal with the US, which could reignite the trade war between the two countries.

- China's imports fell to US$143.9 billion in May (compared with US$154.9 billion previously). In year-on-year terms, imports fell by 16.7%.

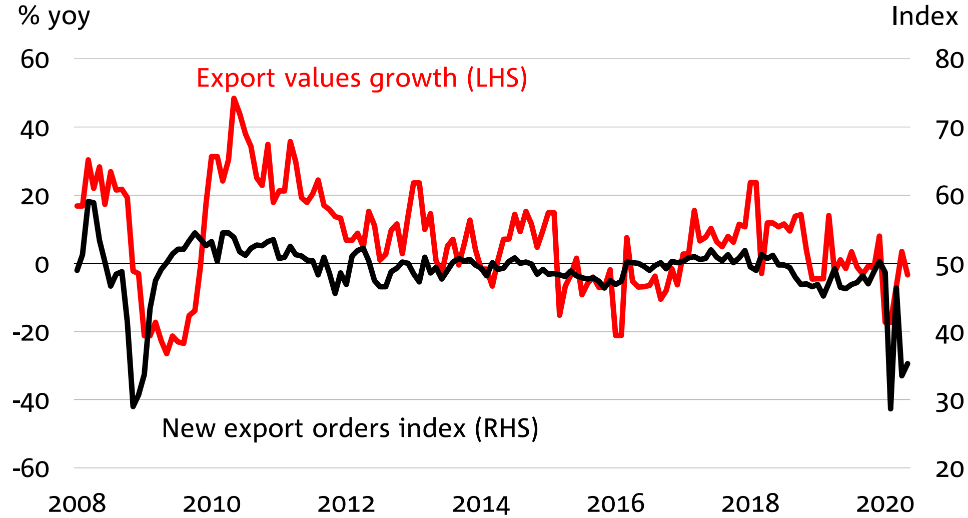
- Our estimate of import volumes – which uses global commodity prices as a proxy for import prices – suggests that China's import volumes fell by 7.3% yoy (on a three month moving average basis) in May, compared with a 3.1% yoy (3mma) fall in average prices.

- That said, there were some large increases in volumes for some key commodities, with crude oil imports rising by 19.3% yoy and unwrought copper imports increasing by 21.1% yoy. There was also a modest increase in iron ore imports – up by 3.9% yoy. In contrast, the volume of coal imports fell by almost 20% yoy.

INTERNATIONAL TRADE – EXPORTS

EXPORTS DIPPED IN MAY

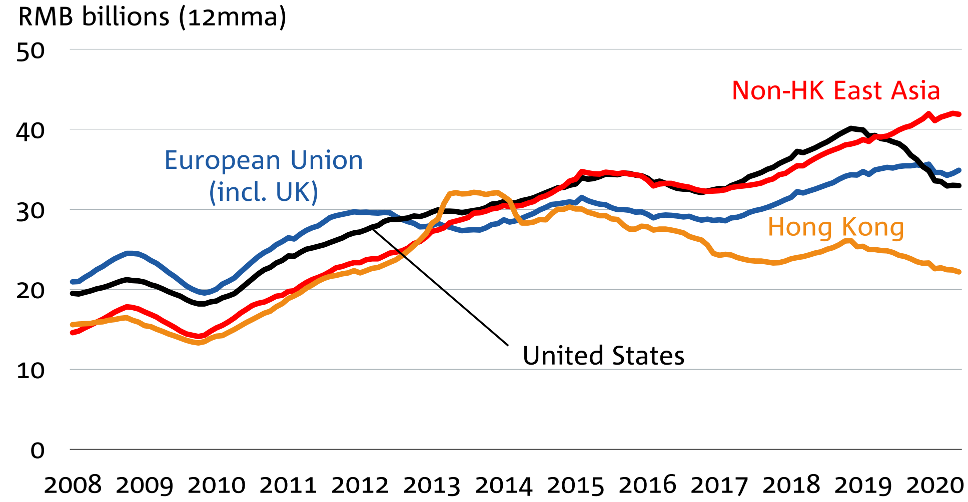
New export orders highlights weakness in global markets



Source: CEIC, NAB Economics

EXPORTS BY MAJOR TRADING PARTNERS

Drop in exports to US is evident



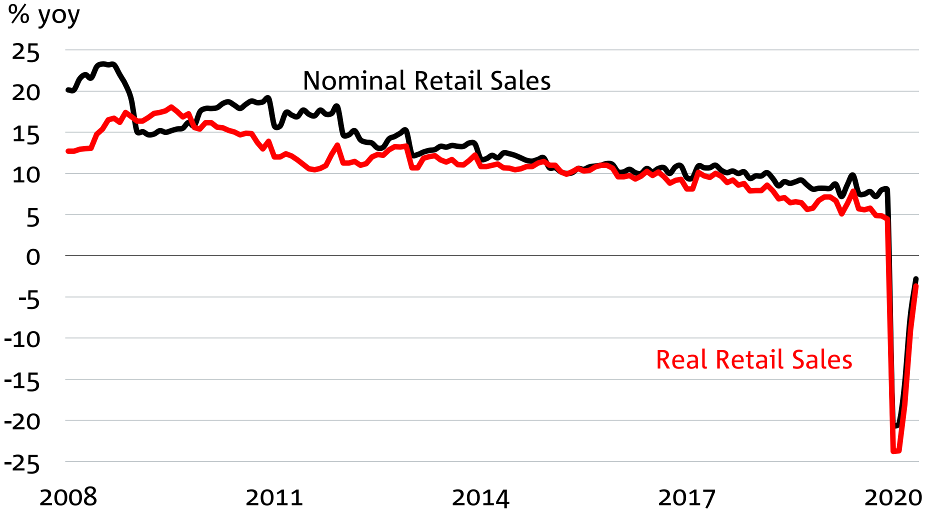
Sources: CEIC, NAB Economics

- China's exports totalled US$206.8 billion in May (up from US$200.2 billion in April). However, this was a fall of 3.3% in year-on-year terms. Prospects for exports remain subdued in the near term – with a range of key trading partners experiencing weaker demand due to COVID-19 countermeasures.
- It is unlikely that there will be a rapid turnaround in export demand in the near term, given higher unemployment rates, damage to household balance sheets and greater consumer caution than pre-COVID-19 levels. The new export orders measure in the NBS manufacturing PMI was at a deeply negative 35.3 points (slightly improved from 33.5 points in April).
- There were some significant differences in exports to major markets in May. Exports to the European Union (including the UK for comparison purposes) surged – increasing by 14.0% yoy. In contrast, exports to the United States fell by 1.2% yoy.
- Exports to East Asian markets also fell significantly – down by 6.5% yoy. However, there was a noticeable difference within this grouping – with exports to Hong Kong falling by 12.1% yoy, while exports to non-Hong Kong East Asia declined by 3.4% yoy. This was lead by falls to the Philippines, Indonesia and Malaysia, while exports to Singapore rose.

RETAIL SALES AND INFLATION

RETAIL SALES

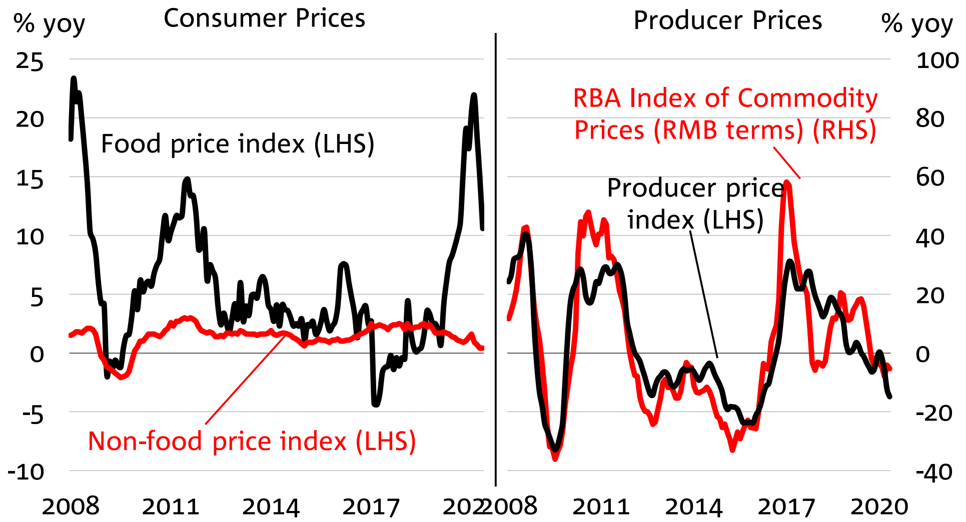
Sales growth still negative, albeit less so, in May



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Weak demand sees consumer prices ease and producer prices fall



Source: CEIC, RBA, NAB Economics

- China's retail sales fell again in year-on-year terms in May, albeit more modestly than in the first four months of 2020. In nominal terms, sales declined by 2.8% yoy, compared with -7.5% yoy in April and -15.8% yoy in March. Retail price inflation slowed in May, meaning that real retail sales fell by 3.7% yoy (compared with a 9.0% fall in April).

- Growth in China's consumer prices has continued to slow – with the headline Consumer Price Index rising by 2.4% yoy in May, compared with 3.3% yoy in April. Food price growth remains the key driver of this trend, however this price pressure has been easing.

- Food prices rose by 10.6% yoy in May, down from 14.8% yoy in April. Pork prices have been elevated since early 2019, reflecting the impact of the African Swine Fever on China's pork supply. In May, pork prices rose by almost 82% yoy (down from 97% yoy in April). In contrast, prices for fresh fruits and fresh vegetables fell by 19.3% and 8.5% yoy respectively.

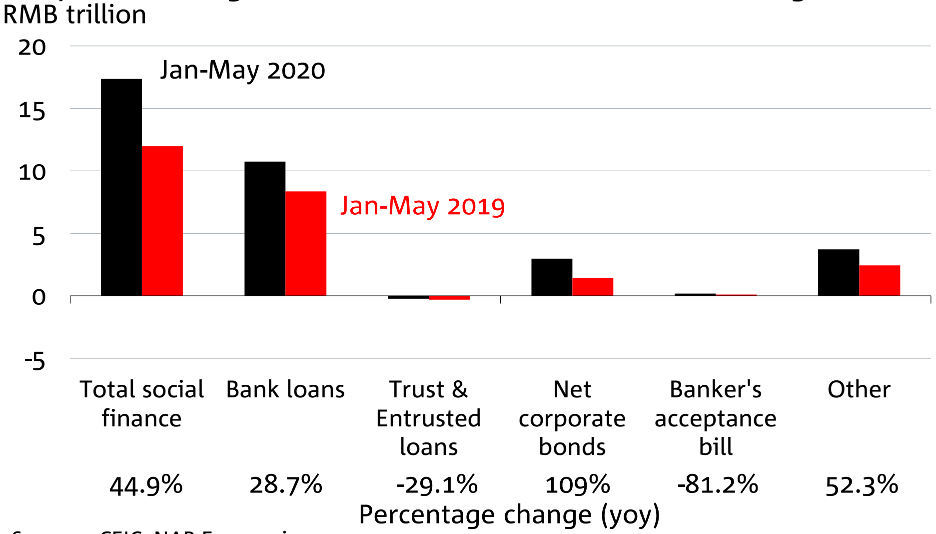
- In contrast, non-food price growth remained unchanged in May, increasing by just 0.4% yoy. This is compared with an average increase of around 1.4% in 2019. One contributor to this trend was falling vehicle fuel prices – which dropped 22% yoy in May – however this also highlights softness in demand.

- Producer prices fell by 3.7% yoy in May, compared with 3.1% yoy in April. That said, the month-on-month decline was only modest, falling by 0.4% (the smallest fall since January). Input costs have fallen – with Yuan denominated commodity prices down by 5.3% yoy – but producers also face weakness in both domestic and export markets, limiting pricing power.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

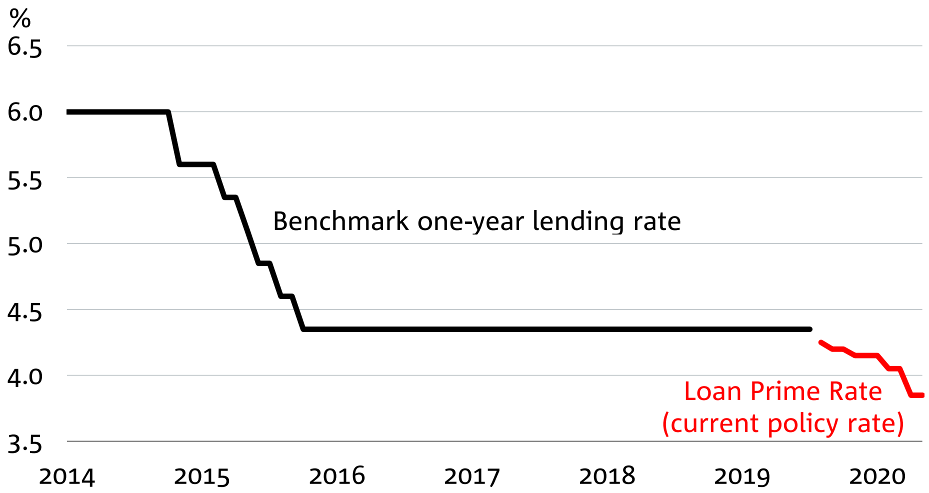
Corporate and government bonds drive non-bank surge



Sources: CEIC, NAB Economics

MONETARY POLICY

Modest rates cuts gives PBoC room to move



Source: CEIC, NAB Economics

- There was another surge in credit issuance in May – totalling RMB 3.2 trillion (following on from a RMB 3.1 trillion increase in April). Bank loans only accounted for around half of this increase, with large scale government bond issuance driving non-bank credit.
- In the first five months of 2020, new credit issuance rose by 44.9% yoy to RMB 17.4 trillion. Bank loans account for the largest share of this new lending, however they have increased at a more modest rate – around 29% yoy to RMB 10.8 trillion.
- In contrast, non-bank lending has increased far more rapidly – up by 82.4% yoy in the first five months to RMB 6.6 trillion. In stark contrast to earlier periods of stimulus (such as following the Global Financial Crisis and the 2012 mini-stimulus) there has not been a surge in shadow bank lending. Instead, net corporate bond issuance more than doubled over this period, while government bond issuance rose by 72.1% yoy.
- Directing credit to small and micro sized businesses remains a priority for Chinese authorities – attempting to counter the long term trends of large banks prioritising lending to large state-owned enterprises. In early June, the People's Bank of China (PBoC) announced that it will introduce a RMB 400 billion quota to purchase 40% of SME loans issued by local banks between March and December.
- Although the PBoC has eased monetary policy twice in 2020 – by guiding the Loan Prime Rate lower through cuts to its Medium Term Lending Facticity rate – it has been far more cautious than advanced economy central banks. That said, this gives the PBoC considerable room to move if the recovery in China's economic activity continues to disappoint.

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