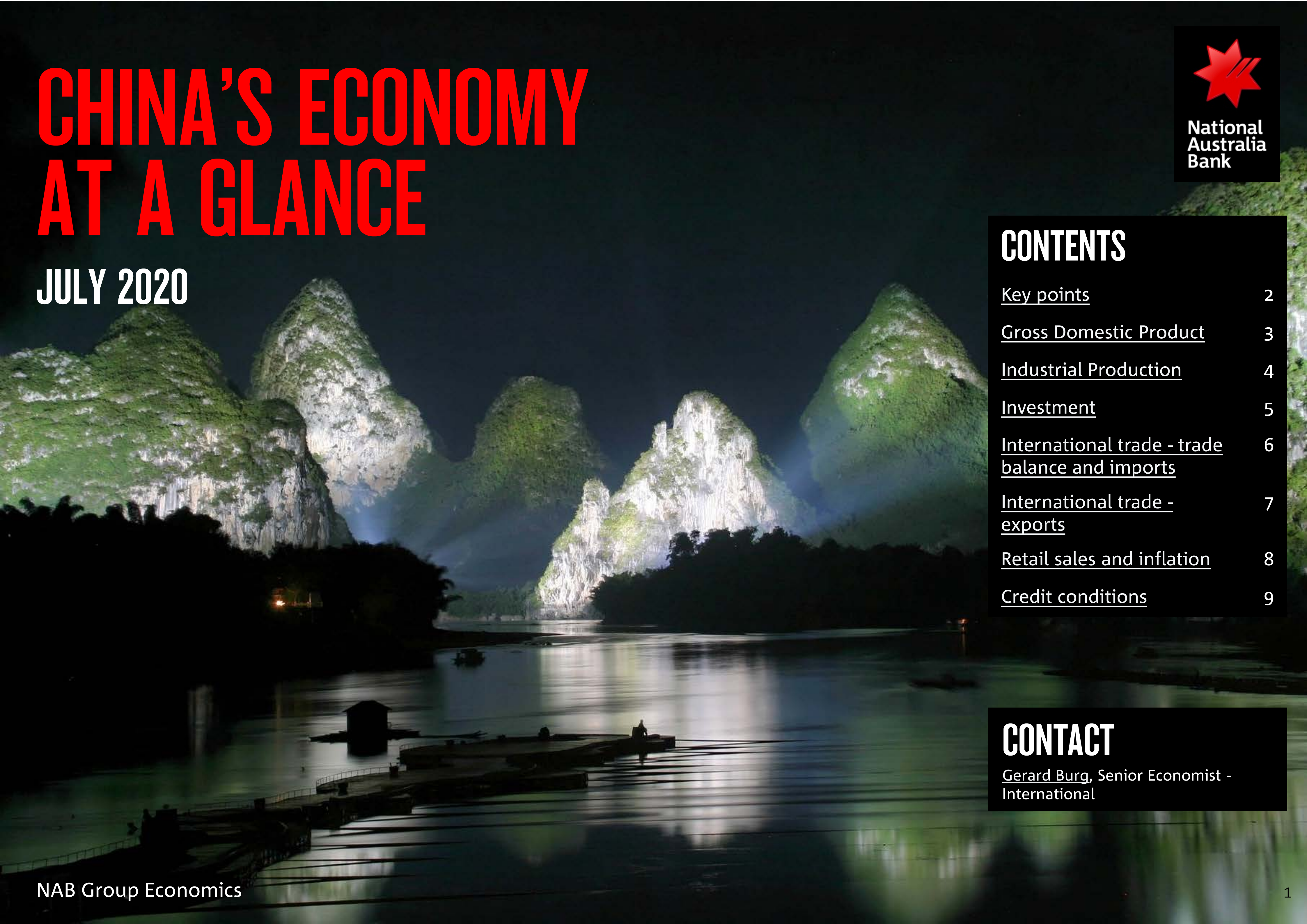

CHINA'S ECONOMY AT A GLANCE

JULY 2020

National Australia Bank

CONTENTS

CONTACT

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KEY POINTS

China’s old economy drives growth to unexpected high in Q2

- China’s latest national accounts data showed the economy expanded by 3.2% yoy in Q2 2020, compared with a 6.8% contraction in Q1. This was well above the mean of consensus forecasts – however the wide range of these forecasts highlighted the considerable uncertainty around China’s economic conditions.

- This recovery was driven by China’s “old economy” – with manufacturing and construction growing more rapidly than services (the key engine of growth over the past decade). Industrial production has continued to recover, while fixed asset investment soared – led by state-owned enterprises. In contrast, consumption trends were relatively weaker, with retail sales falling year-on-year in June (albeit less significantly than in Q1). This raises some concerns around the sustainability of the recovery – particularly given ongoing weakness in export markets.

- Given the stronger than expected growth in Q2, we have revised our forecast for 2020 to 1.5% (previously 1.0%), but lowered growth in 2021 to 9.5% (from 9.8% previously).

- China’s trade surplus with the United States has stabilised in recent months, which may add to the tensions between the two countries. There are significant doubts around China’s capacity to fulfil the agricultural purchases from the US required under the Phase One trade deal.

- China’s retail sales recovered further in June, but remained below their year ago level (-1.8% yoy in nominal terms, compared with -2.8% yoy in May). Retail price growth ticked marginally higher in June, meaning that real retail sales fell by 2.9% yoy, a more modest fall than the 3.7% yoy decline in May and double digit rates in Q1.

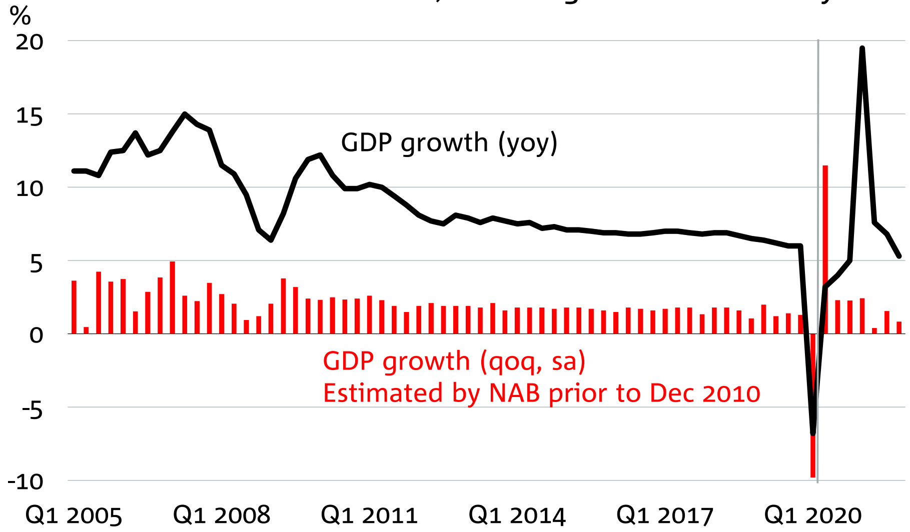
- Credit issuance surged again in June, totalling RMB 3.4 trillion – the fourth straight month that issuance exceeded RMB 3 trillion. When compared with new credit in May, bank lending was stronger, while non-bank lending was relatively stable.

- According to recent statements from the People’s Bank of China, emergency policy measures introduced to counter the COVID-19 downturn are no longer necessary, as the economy returns to a normal state. This may mean greater caution around any further stimulus – particularly given the large scale lending in the first half of the year.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH RECOVERED IN Q2

Quick rebound for Q1 decline, but Q2 growth historically weak

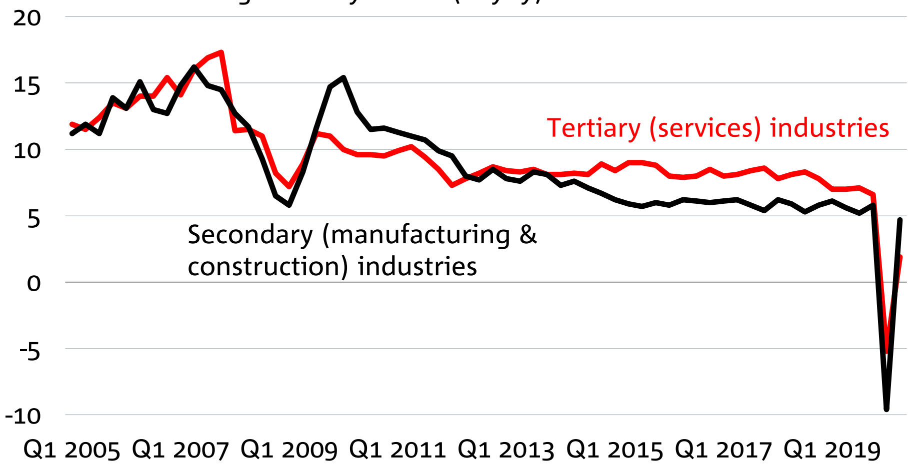


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Old economy – production – drove the rebound

Chinese economic growth by sector (% yoy)



Source: Refinitiv, NAB Economics

- China's latest national accounts data showed the economy expanded by 3.2% yoy in Q2 2020, compared with a 6.8% contraction in Q1. This was well above the mean of consensus forecasts – however the wide range of these forecasts highlighted the considerable uncertainty around China's economic conditions.
- It is worth noting that this rate of growth is well below the pre-COVID-19 trend, when China's economy was growing by around 6.0% yoy.
- The breakdown of growth by industry shows that China's secondary sector – comprising manufacturing and construction – drove the rebound in growth in Q2, increasing by 4.7% yoy. This sector represents China's old economy – with the sector having steadily lost share to services over the past decade.
- In contrast, the tertiary (or services) sector increased by just 1.9% yoy – in line with relatively weak consumer trends.
- We expect a continued gradual recovery in economic growth in the second half of 2020, however uncertainty remains – given the risks of second wave COVID-19 outbreaks (like the outbreak in Beijing in June) and the potential for ongoing weakness in export markets. Given relatively weak retail sales, it remains to be seen whether this industrial led recovery can be sustained.
- Given the stronger than expected growth in Q2, we have revised our forecast for 2020 to 1.5% (previously 1.0%), but lowered growth in 2021 to 9.5% (from 9.8% previously).

NAB CHINA GDP FORECASTS

%	2019	2020	2021
GDP	6.1	1.5	9.5

National Australia Bank

INDUSTRIAL PRODUCTION

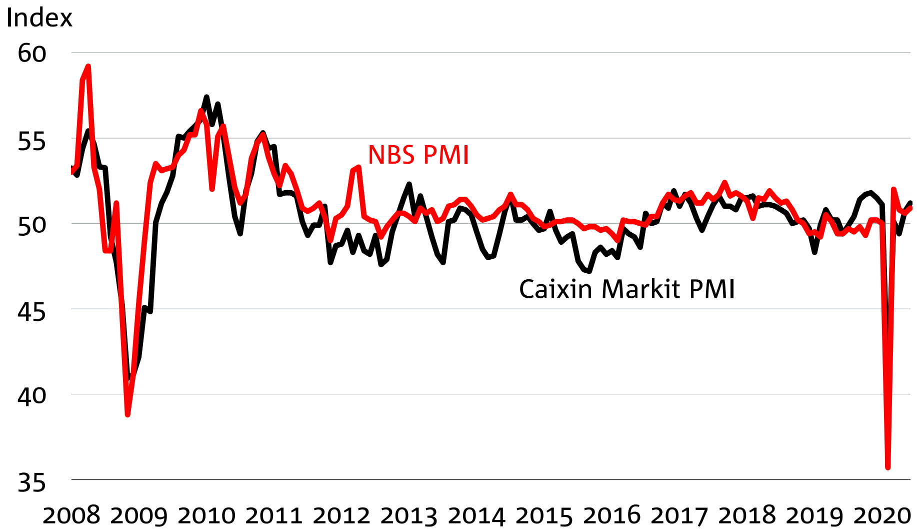
INDUSTRIAL PRODUCTION

China's Q2 recovery has been led by industry

Source: CEIC, NAB Economics

PMI SURVEYS A LITTLE MORE POSITIVE IN JUNE

Domestic demand picking up, but exports remain subdued



Source: CEIC, NAB Economics

- China's industrial production grew a little more strongly in June – increasing by 4.8% yoy (from 4.4% yoy in May). The industrial sector appears to have been the critical driver of China's return to economic growth in Q2 – albeit growth in industrial production remains a little weaker than its pre-COVID-19 trends (with output increasing by 5.7% in 2019).

- There was strong growth in a range of major industrial sectors – particularly motor vehicles, which increased by 20.4% yoy in June. Consumer electronics also expanded rapidly, up by 12.6% yoy. Heavy industrial sectors grew slightly more moderately – with cement increasing by 8.4% yoy and crude steel growing by 4.5% yoy.

- There remain some concerns about the sustainability of a supply-led recovery underway. While consumer demand appears to be trending in the right direction, retail sales continued to contract in Q2, and export demand trends remain negative.

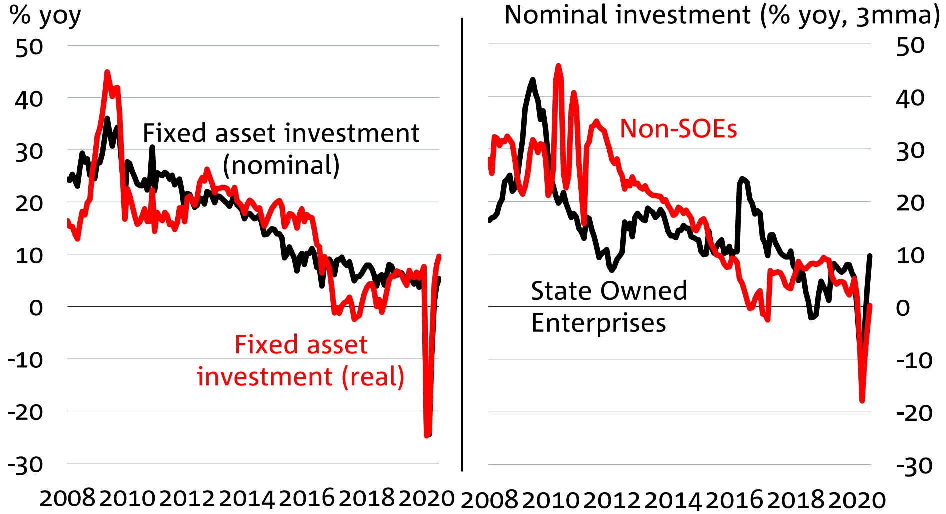
- Both of China's major manufacturing surveys were in positive territory in June. The official NBS PMI – which captures a larger share of big state owned enterprises – edged up to 50.9 points (from 50.6 points in May). The private sector Caixin Markit PMI – which has a greater representation of SME firms – was at 51.2 points (from 50.7 points previously).

- Both surveys point to improving demand from domestic consumers, but that new export orders remain negative.

INVESTMENT

FIXED ASSET INVESTMENT

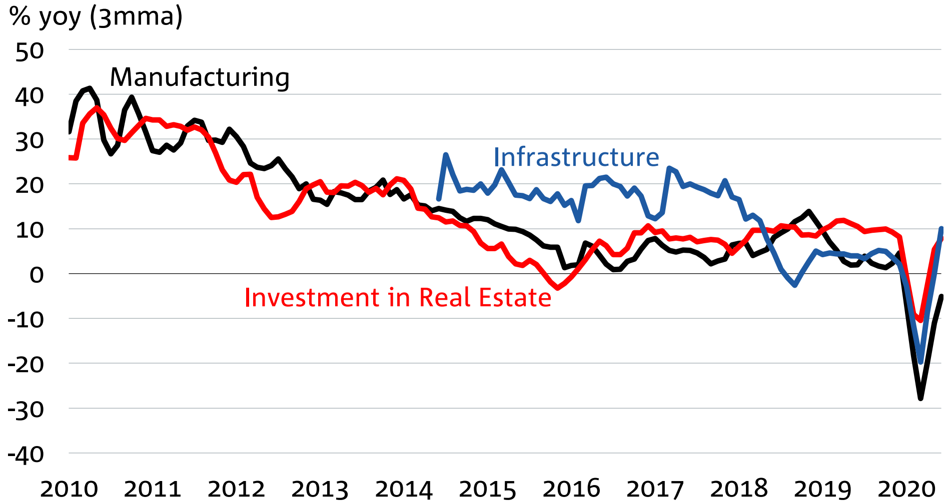
Real investment surged to multi-year highs, led by SOEs



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Infrastructure investment has accelerated rapidly



Source: CEIC, NAB Economics

- Fixed asset investment in China continues to recover, with investment increasing by 5.3% yoy in June (from 3.9% yoy in May). This was in stark contrast to deep falls in investment in Q1. Producer prices have continued to decline in recent months, which flows through into lower costs for investment goods. This means real investment has grown more rapidly – up by an estimated 9.6% yoy in June (from 7.9% yoy in May) – the strongest increase since mid-2016.

- As has been the case in recent months, the growth in nominal investment has been driven by state-owned enterprises (SOEs) – with SOE investment increasing by 9.7% yoy (on a three month moving average basis) compared with an increase of just 0.2% yoy (3mma) for private sector investment.

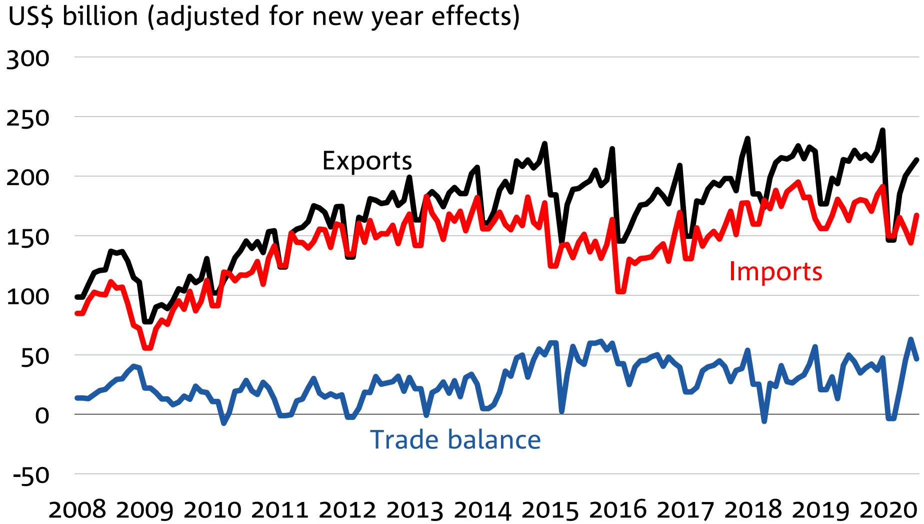
- Trends in investment by industry are showing signs of divergence. Manufacturing investment continues to contract, with nominal investment falling by 5.1% yoy (3mma) in June. In contrast, investment in real estate grew more strongly – up to 7.9% yoy (3mma) compared with 5.4% yoy (3mma) in May.

- However infrastructure investment was the rapid accelerator in June. Chinese authorities brought forward local government bond issuance, which now appears to be flowing through into activity, with investment rising by 10% yoy (3mma) in June, from 0% growth (3mma) previously.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

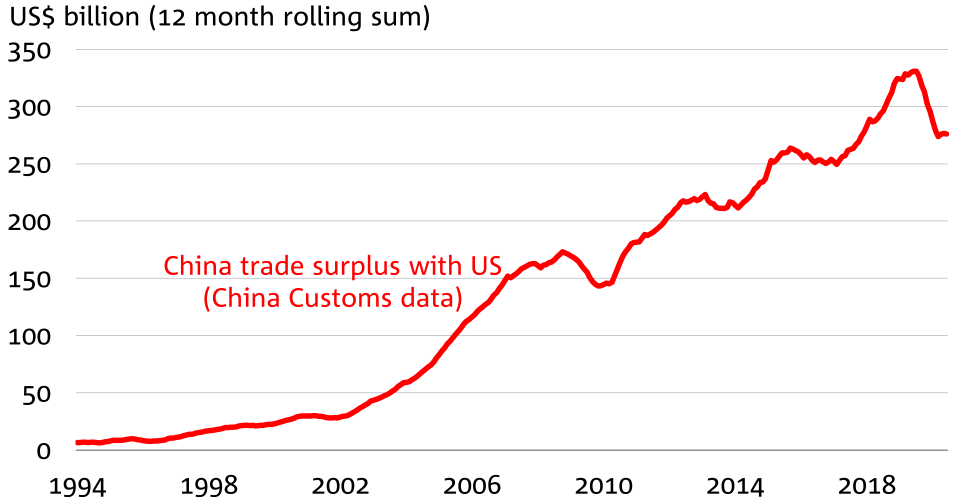
Surplus eased back in June from May's record level



Sources: CEIC, NAB Economics

CHINA'S TRADE SURPLUS WITH THE UNITED STATES

Surplus has stabilised, which is likely to raise tensions



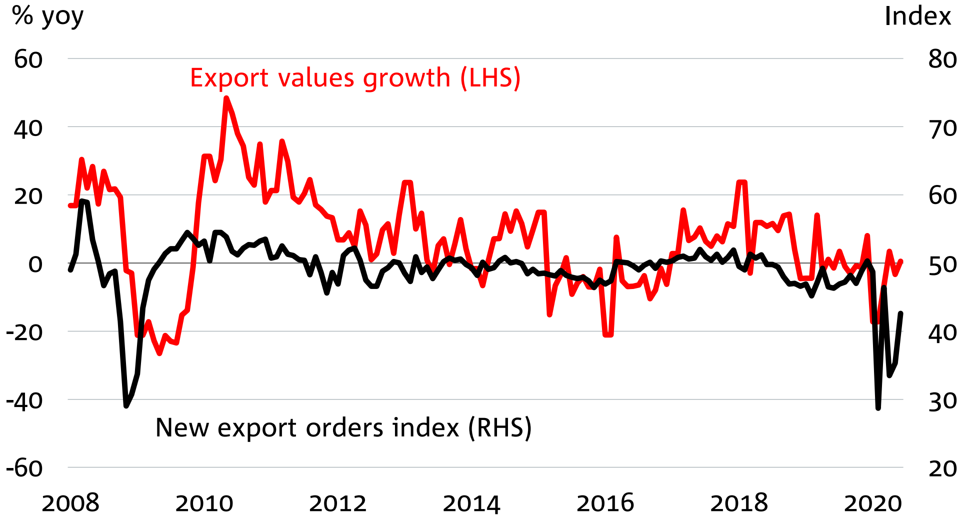
Sources: CEIC, NAB Economics

- China's trade surplus narrowed in June from its record level in May – totalling US$46.4 billion, down from US$62.9 billion – but remains at a level that is historically high. A rebound in imports in June was the key driver of the narrowing in the surplus.
- The bulk of China's trade surplus is with the United States. As a result of the US-China trade war, the surplus narrowed, from a rolling twelve month sum in excess of US$330 billion in mid-2019 to around US$275 billion in early 2020. However it has stabilised at this level in recent months, which may add to the tensions between the two countries. There are significant doubts around China's capacity to fulfil the agricultural purchases from the US required under the Phase One trade deal.
- China's imports rose to US$167.2 billion in June (compared with US$143.9 billion in May) – the largest monthly total in the year to date. Imports increased by 2.4% yoy.
- Our estimate of import volumes, which uses global commodity prices as a proxy for import prices, suggest that China's import volumes fell steeply year-on-year in April and May, followed by a more modest increase in June.
- There was a notable increase in imports for a number of key commodities in June. In particular, copper imports rose sharply – more than double the level in June 2019. Imports of iron ore and crude oil also rose strongly – up by 35% yoy and 34% yoy respectively. In contrast, the volume of coal imports fell by 6.7% yoy (albeit there was a sizeable increase month-on-month).

INTERNATIONAL TRADE – EXPORTS

EXPORTS MARGINALLY INCREASED IN JUNE

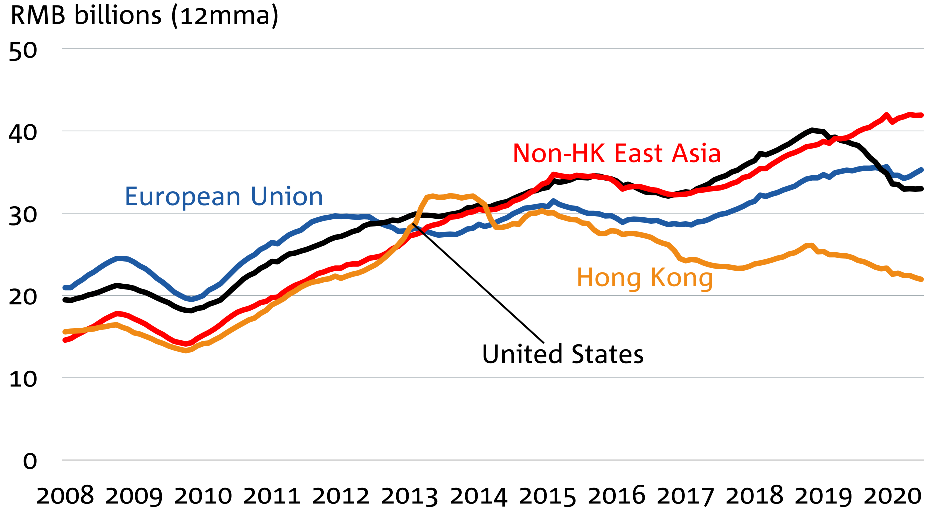
Export orders negative, but heading in the right direction



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Shipments to the US have declined, but accelerated to East Asia



Sources: CEIC, NAB Economics

- China's exports rose month-on-month, totalling US$213.6 billion in June, from US$206.8 billion previously. That said, this represented an increase of just 0.5% yoy. While global economic conditions appeared to improve in June (relative to the previous few months), global trade (and with it demand for China's exports) have remained constrained by various COVID-19 countermeasures and related consumer caution.

- New export orders in the NBS manufacturing PMI remained negative in June – at 42.6 points – however this measure is gradually heading in the right direction (up from 35.3 points in May).

- Trends in exports to key markets remain divergent. Exports to the European Union (which for the purposes of year-on-year comparison includes the UK) increased strongly – up by 13.3% yoy. In contrast, exports to the United States rose by just 1.4% yoy.

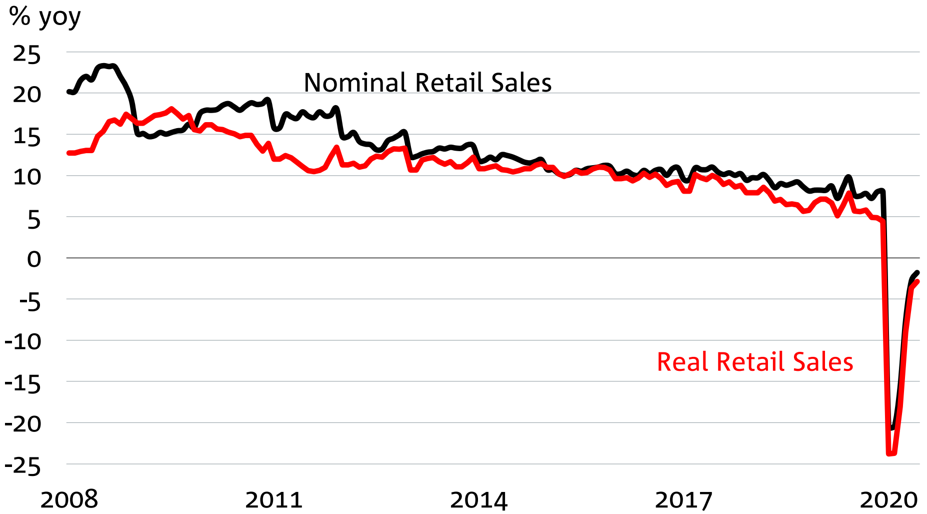
- Exports to East Asian markets fell by 2.8% yoy, however there were significant differences between individual countries. Exports to Hong Kong – where China customs data have historically differed to Hong Kong data, due in part to capital flows being disguised as trade activity – fell by 11.1% yoy.

- In contrast, exports to other East Asian markets rose by 1.8%, with Vietnam and Taiwan recording the largest increases, while exports to Indonesia and South Korea fell.

RETAIL SALES AND INFLATION

RETAIL SALES

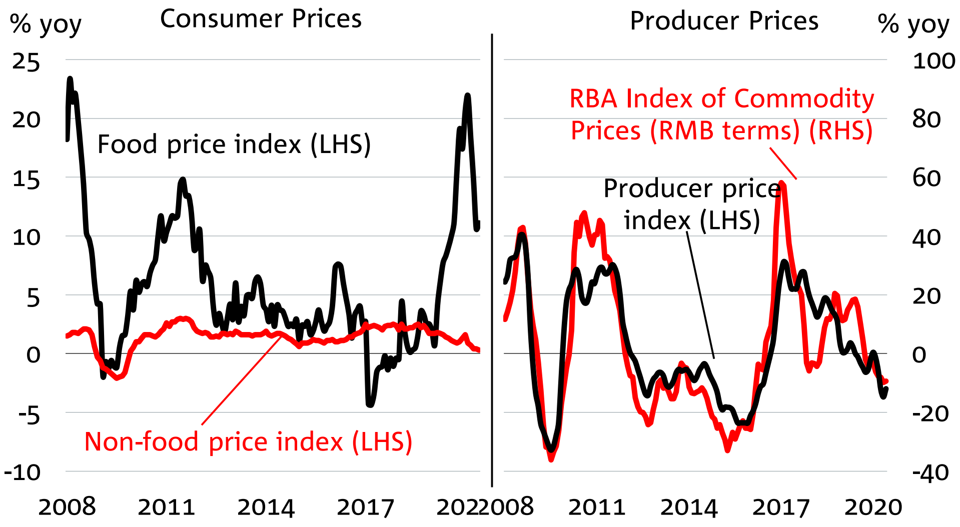
Sales still falling yoy, but less rapidly than before



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Non-food prices remain weak, as producer prices fall yoy



Source: CEIC, RBA, NAB Economics

- China's retail sales recovered further in June, but remained below their year ago level – declining by 1.8% yoy in nominal terms (compared with -2.8% yoy in May). Retail price growth ticked marginally higher in June, meaning that real retail sales fell by 2.9% yoy, a more modest fall than the 3.7% yoy decline in May and double digit rates in Q1.

- Growth in China's consumer prices edged up marginally in June – with the headline Consumer Price Index increasing by 2.5% yoy, from 2.4% yoy in May. The key driver of consumer prices remains food price growth.

- Food prices rose by 11.1% yoy in June, up from 10.6% yoy previously. Pork prices have accelerated since the early months of 2019, due to the impact of African Swine Fever on the country's pork supply – with pork prices increasing by 82% yoy in June, unchanged from May. Fresh vegetable prices also rose – by 4.2% yoy – compared with a fall of 8.5% previously.

- In contrast, growth in non-food prices remains weak – increasing by just 0.3% yoy in June, down from 0.4% yoy previously. This is well below the average increase of 1.4% in 2019. Vehicle fuel prices fell again in June – down by 19.1% yoy – contributing to the weakness in non-food prices.

- Producer prices fell by 3.0% yoy in June, compared with a 3.7% decline in May. In month-on-month terms, prices rose for the first time since November 2019. In part this reflected trends in global commodity markets – with Yuan denominated prices (as measured by the RBA Index of Commodity Prices) falling by 9.4% yoy but increasing by 2.4% month-on-month.

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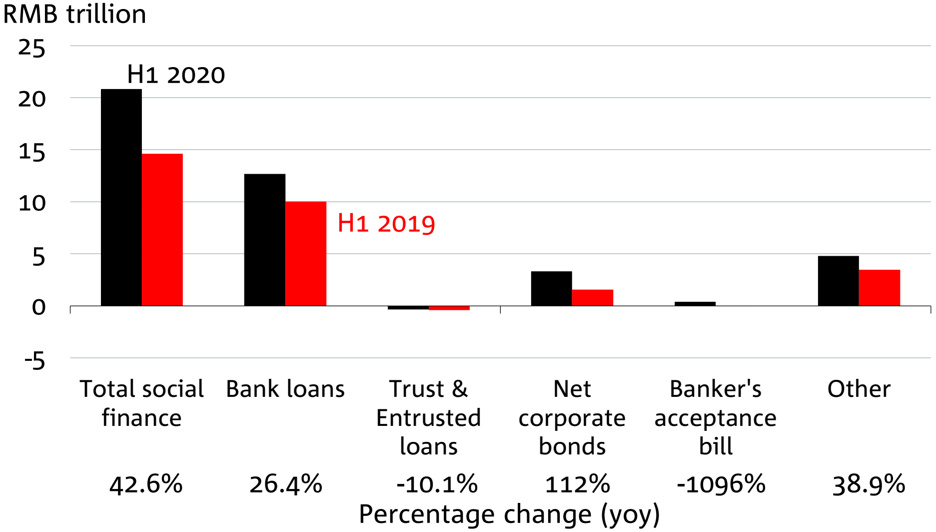
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

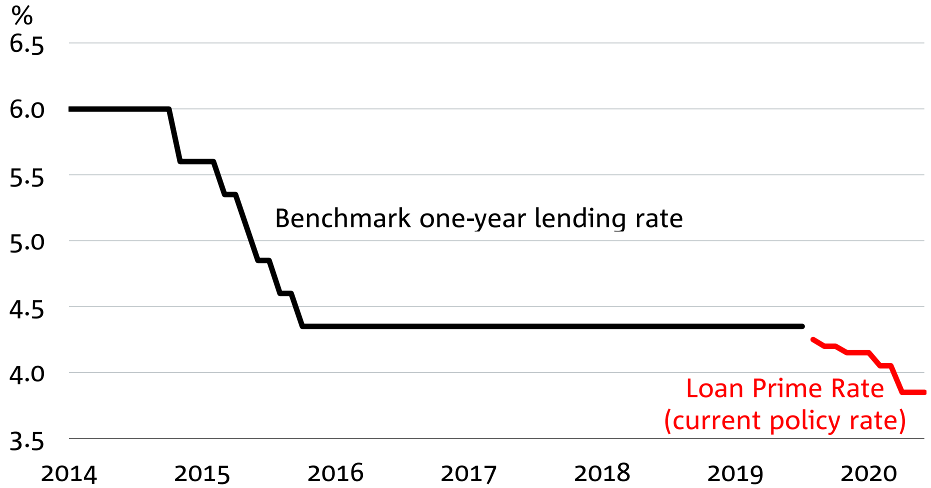
Corporate and government bonds a key driver of growth



Sources: CEIC, NAB Economics

MONETARY POLICY

Modest cuts gives the PBoC considerable policy room



Source: CEIC, NAB Economics

- Credit issuance surged again in June, totalling RMB 3.4 trillion – the fourth straight month that issuance exceeded RMB 3 trillion. When compared with new credit in May, bank lending was stronger, while non-bank lending was relatively stable.
- In the first half of 2020, new credit issuance increased by 42.6% yoy, to total RMB 20.8 trillion. Bank loans continue to account for the largest share of the total – around 61% – however the increase was comparatively modest, up by 26.4% to RMB 12.7 trillion.
- Non-bank lending increased more rapidly across the first half of 2020 – up by 78.0% yoy to RMB 8.2 trillion. Bond issuance by Chinese corporates and governments account for the bulk of this new credit – increasing by 112% yoy and 54% yoy respectively. Unlike earlier periods of stimulus during the past two decades, there has not been a surge in shadow bank lending.
- According to recent statements from the People's Bank of China, emergency policy measures introduced to counter the COVID-19 downturn are no longer necessary, as the economy returns to a normal state. This may mean greater caution around any further stimulus – particularly given the large scale lending in the first half of the year.
- When compared with other major central banks, the PBoC has eased monetary policy modestly, with two cuts to the Loan Prime Rate in 2020. This gives Chinese authorities considerable room to cut rates should the economic recovery disappoint.

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