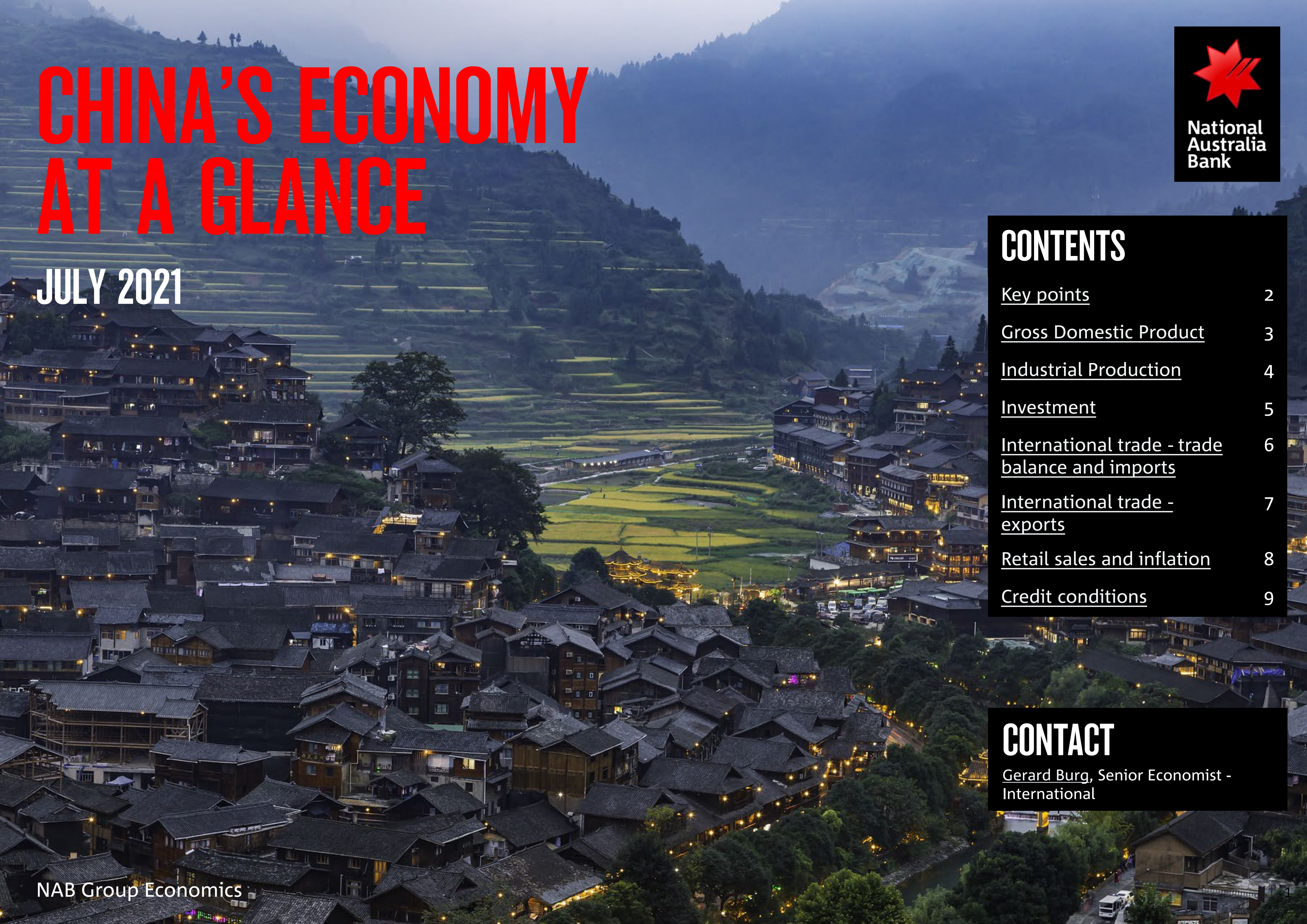

CHINA'S ECONOMY AT A GLANCE

JULY 2021

National Australia Bank

CONTENTS

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KEY POINTS

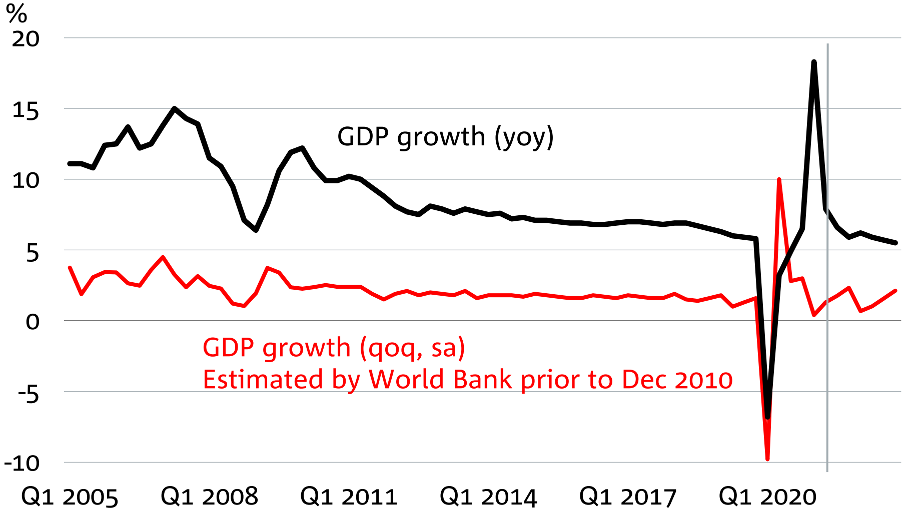
China's economy grew largely as expected in Q2, but imbalance between production and consumption persists

- China's latest national accounts data showed continued strong growth in Q2, with economic activity expanding by 7.9% yoy – broadly in line with market expectations. With economic growth in Q2 broadly in line with our expectations, our forecast for growth in 2021 is unchanged at 9.5%. That said, risks around this forecast are likely weighted to the downside. Similarly, our forecasts for 2022 and 2023 are unchanged – which sub-6%growth as household consumption returns to the forefront of economic activity.
- China's industrial production growth eased a little in June – increasing by 8.3% yoy (compared with 8.8% yoy in May). There has been a downward trend in the year-on-year rate for several months, as base effects gradual erode. On a seasonally adjusted basis, month-on-month growth in industrial production was around 0.56%, broadly around the trend exhibited since November 2020.
- Nominal growth in China's fixed asset investment was marginally higher in June – up by 6.0% yoy. Producer prices have accelerated significantly in recent months – with the increase in factory gate prices rapidly flowing through into the cost of investment goods. We estimate real fixed asset investment fell by 4.0% yoy (compared with a 3.1% yoy fall in May and a 3.9% yoy increase in April).
- China's trade surplus widened further in June – totalling US$51.5 billion (compared with US$45.5 billion in May). Both exports and imports rose month-on-month, with a larger increase in exports driving the increase in the surplus.
- Real retail sales eased a little in June to 9.8% yoy (from 10.1% previously). Retail sales continue to lag other major indicators – suggesting that China's economic growth remains imbalanced (which consumption lagging). When compared with June 2019, real retail sales were around 6.6% higher – well below the double digit growth in industrial production.
- In the first half of 2021, new credit issuance totalled RMB 17.7 trillion, a decrease of 15.1% yoy. Over this time, bank lending increased – up by 3.9% yoy – totalling RMB 13.2 trillion (or 74% of the total). In contrast, non-bank lending fell by over 44% yoy over the first six months, to RMB 4.5 trillion. This largely reflected declines in corporate and government bond issuance – which fell by 56% yoy and 35% yoy respectively over the period.
- The People's Bank of China (PBoC) announced a surprise cut to the Required Reserve Ratio (RRR) on 9 July. This cut will free up around RMB 1 trillion for banks (albeit not all of it will be available to lend), with an unidentified portion of the RMB 1 trillion being used to repay maturing medium term loans. Around RMB 4.15 trillion of MLF loans from the PBoC mature in the second half of 2021. The Loan Prime Rate (the PBoC's main policy rate) has remained at 3.85% since April 2020 and we anticipate it remaining at this rate for some time.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH

YOY growth slowing as base effects erode

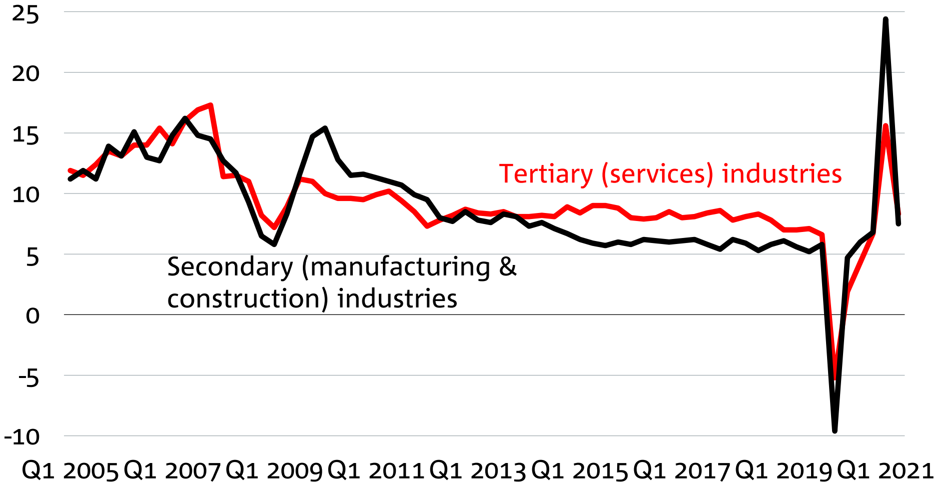


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Manufacturing & construction critical in driving China's recovery

Chinese economic growth by sector (% yoy)



Source: Refinitiv, NAB Economics

- China's latest national accounts data showed continued strong growth in Q2, with economic activity expanding by 7.9% yoy – broadly in line with market expectations (8.0% in the Bloomberg poll, which was also our forecast). The slowdown from the 18.3% yoy increase in Q1 was primarily due to smaller base effects – given that China was hardest hit by COVID-19 in Q1 2020, and was recovering in Q2 2020.

- There was a considerable uptick in the seasonally adjusted quarterly growth series – which increased by 1.3% qoq, however the growth rate for Q1 was revised down (now 0.4% qoq, from 0.6% qoq previously), along with a series of other historical changes. This series implies a slightly lower year-on-year growth rate than the headline series – at 7.7%.

- Year-on-year growth in the secondary industries (including manufacturing and construction) slowed more significantly between Q1 and Q2 2021 (from 24.4% yoy to 7.5% yoy) than for the services sector (from 15.6% yoy to 8.3% yoy). It is worth noting that secondary industries recovered more rapidly from the 2020 downturn than services. When compared with Q2 2019, output from the secondary sector was 12.6% higher in Q2 2021, while services increased by just 10.4% – highlighting the importance of China's "old economy" in driving its recovery.

- With economic growth in Q2 broadly in line with our expectations, our forecast for growth in 2021 is unchanged at 9.5%. That said, risks around this forecast are likely weighted to the downside. Similarly, our forecasts for 2022 and 2023 are unchanged – which sub-6% growth as household consumption returns to the forefront of economic activity.

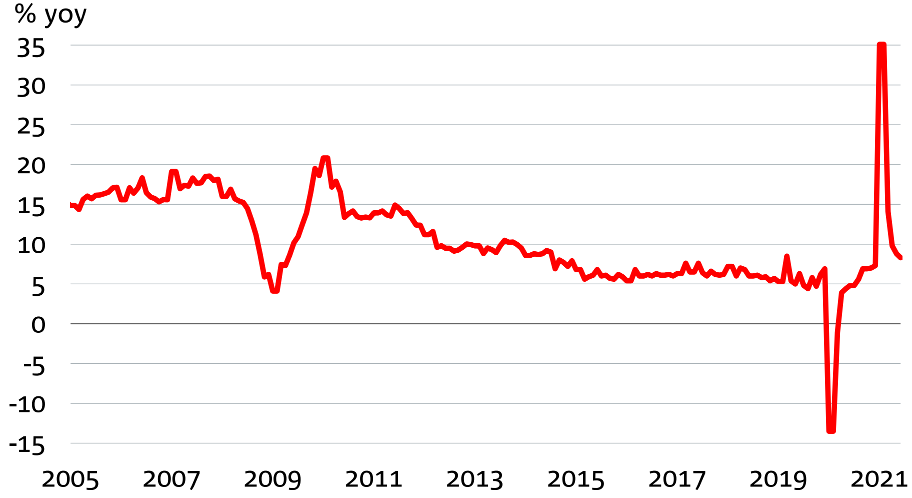
NAB CHINA GDP FORECASTS

%	2021	2022	2023
GDP	9.5	5.8	5.6

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

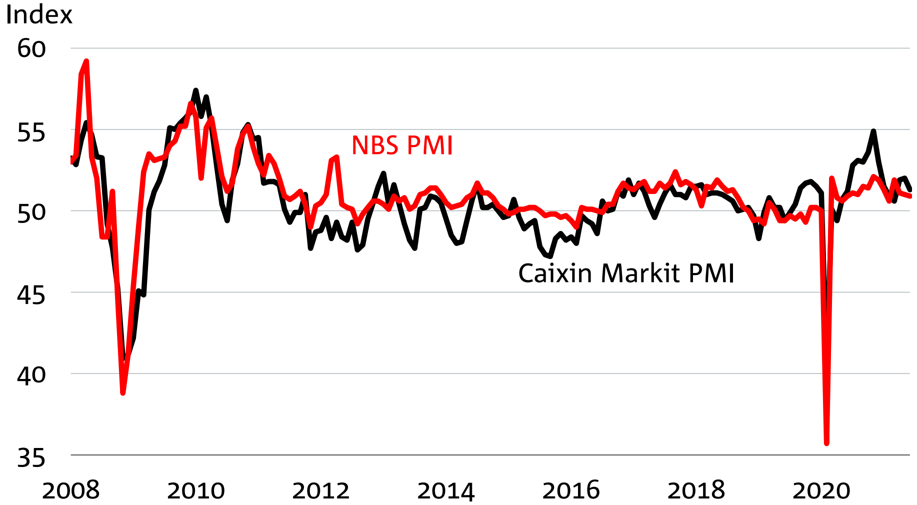
Slowing growth reflects base effects, with mom growth stable



Source: CEIC, NAB Economics

MANUFACTURING SURVEYS CONVERGED IN JUNE

New export orders measures have deteriorated in recent months



Source: CEIC, NAB Economics

- China's industrial production growth eased a little in June – increasing by 8.3% yoy (compared with 8.8% yoy in May). There has been a downward trend in the year-on-year rate for several months, as base effects gradual erode (reflecting the recovery that was underway in China's industrial sector at this time a year ago). When compared with June 2019, industrial output was around 13.5% higher in June 2021.

- On a seasonally adjusted basis, month-on-month growth in industrial production was around 0.56% – slightly stronger than the rate recorded in the previous two months, but broadly around the trend exhibited since November 2020.

- Trends were highly mixed across individual industrial sub-sectors in June. Production of electronics remained strong – increasing by 13.4% yoy, while electricity output rose by 7.4% yoy. Crude steel output rose only modestly – up by 1.5% yoy.

- In contrast, output of motor vehicles fell sharply – down by 13.1% yoy (which may be connected to current shortages of semi-conductors) – while cement output fell by 2.9% yoy.

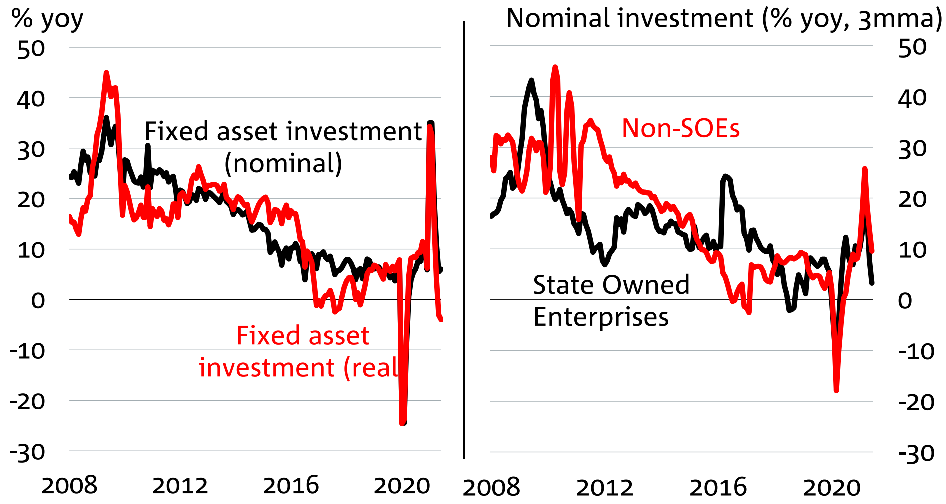
- After two months of diverging trends, China's major manufacturing surveys converged in June. The official NBS PMI had been comparatively weaker between April and May, but only eased marginally in June – to 50.9 points (from 51.0 points in May). In contrast, the private sector Caixin Markit PMI fell to 51.3 points (from 52.0 points previously).

- The new export orders measure shifted from positive to neutral levels in the Caixin Markit survey – with respondents noting the impact of COVID-19 outbreaks limiting demand in key export markets – while it remained negative in the NBS survey. Both of these measures have deteriorated in recent months.

INVESTMENT

FIXED ASSET INVESTMENT

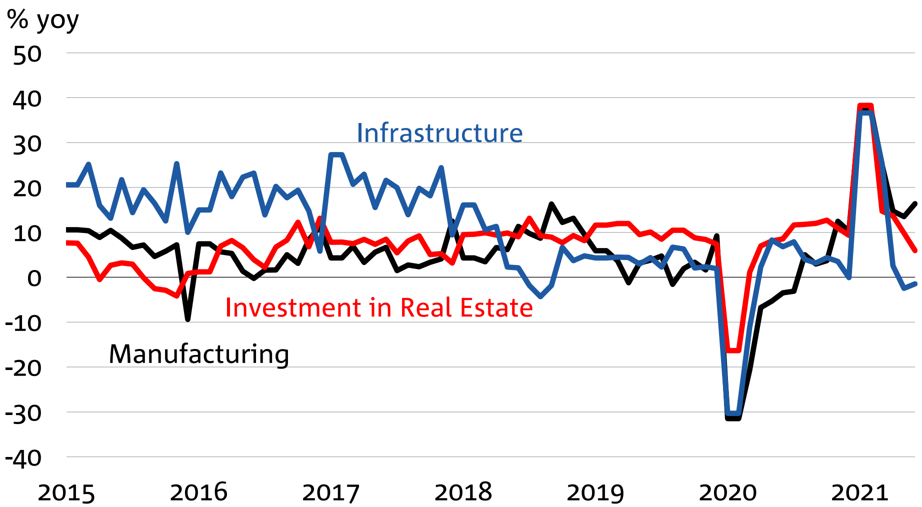
Real investment contracted for the second straight month



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Diverging trends by industry, with infrastructure contracting



Source: CEIC, NAB Economics

- Nominal growth in China's fixed asset investment was marginally higher in June – up by 6.0% yoy (from 5.5% in May). As we noted last month, the slowdown from double digit growth earlier in the year appears larger than would be explained by diminishing base effects alone. In part, it may reflect financial constraints, given the contraction in new credit issuance across the first half of the year – with investment in infrastructure contracting by 1.5% yoy in June.

- Producer prices have accelerated significantly in recent months – with the increase in factory gate prices rapidly flowing through into the cost of investment goods. We estimate real fixed asset investment fell by 4.0% yoy (compared with a 3.1% yoy fall in May and a 3.9% yoy increase in April).

- Nominal investment by state owned enterprises increased by 4.6% yoy in June (compared with a 3.3% contraction recorded in May). In contrast, private sector investment increased by 6.9% yoy, slowing from the 10.7% yoy growth previously.

- In contrast with the decline in investment in infrastructure, there was a strong increase in investment in manufacturing (up 16.4% yoy) and a relatively more modest increase in real estate (up by 5.9% yoy).

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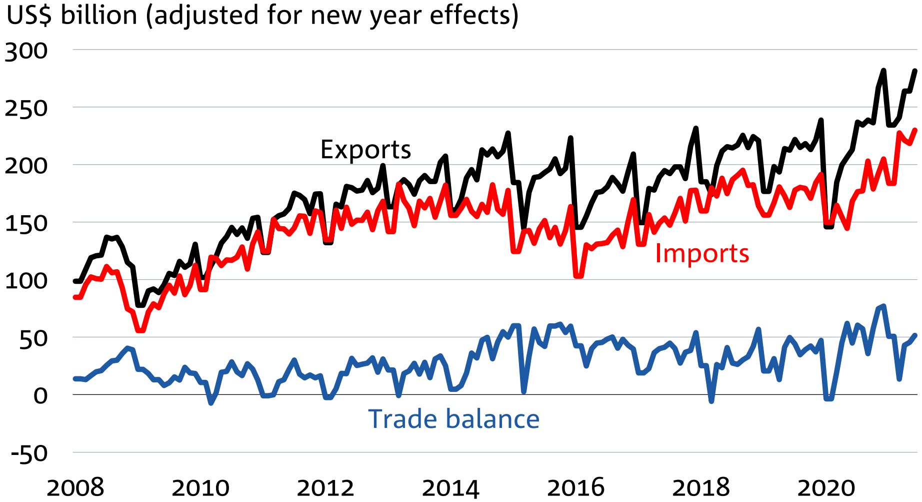
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

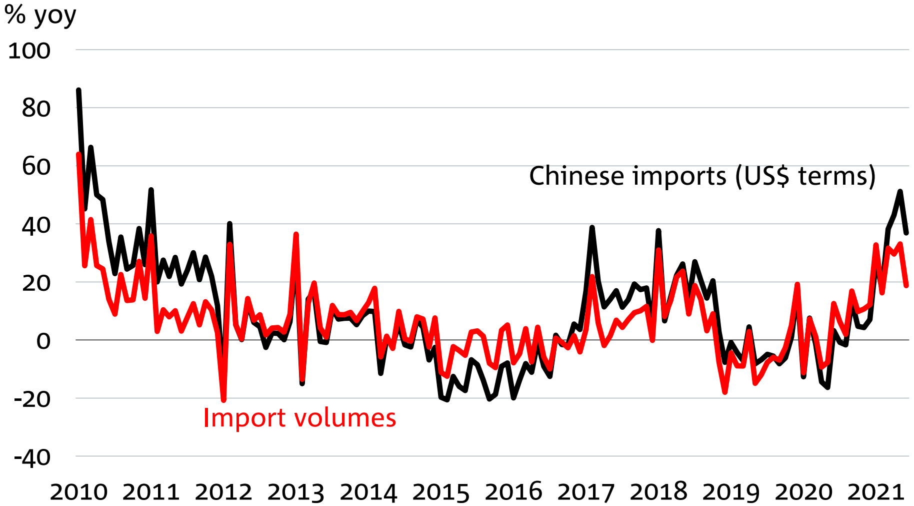
Surplus widens as exports grow more rapidly than imports mom



Sources: CEIC, NAB Economics

CHINA'S IMPORT VALUES AND VOLUMES

Strong increase in imports driven by prices and volumes



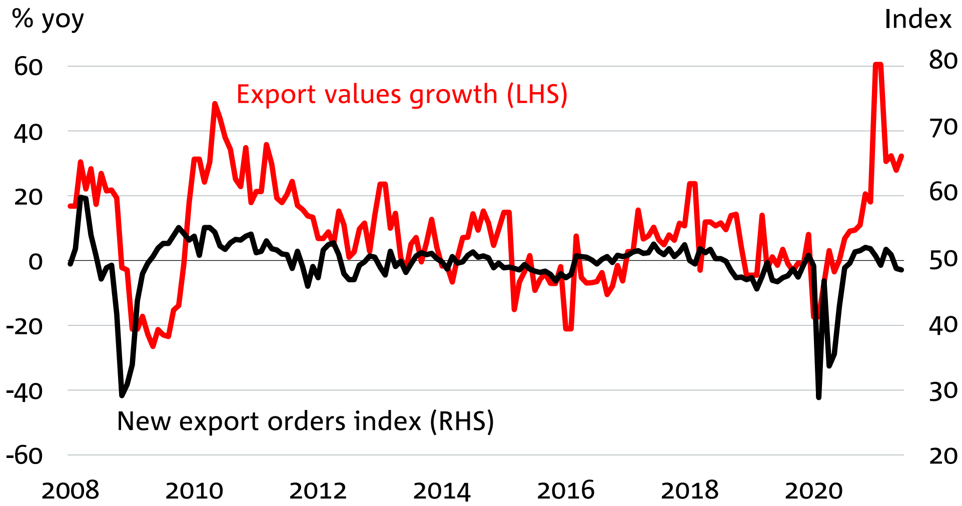
Source: CEIC, NAB Economics

- China's trade surplus widened further in June – totalling US$51.5 billion (compared with US$45.5 billion in May). Both exports and imports rose month-on-month, with a larger increase in exports driving the increase in the surplus.
- China's trade surplus with the United States has continued to widen – increasing month-on-month since March 2021. The rolling twelve month surplus rose to a new record high of US$361.3 billion – the fifth month in a row that a new record has been set. Tariffs from the US-China trade war remain in place in both countries, and at this stage there appears to be little impetus to remove them.
- China's imports totalled US$229.9 billion in June, up from US$218.4 billion in May. This represented an increase of 36.7% in year-on-year terms. Part of this increase reflects base effects, with imports starting to increase in June 2020, following on from the trough in May 2020 (as COVID-19 closures in key trade partners limited supplies), however they were still well below pre-COVID-19 levels.
- Rising commodity prices contributed to the increase in China's import values. The RBA Index of Commodity Prices rose by 55.3% yoy in US dollar terms. Our estimate of import volumes uses commodity prices as a proxy for China's import prices (which haven't been updated since December 2020). This estimate suggests that import volumes rose by 18.8% yoy.
- This increase was not necessarily evident in the imports of some major commodities. Import volumes of iron ore fell by 12.1% yoy, while there were even larger falls for crude oil and copper (down 24.5% yoy and 34.5% yoy respectively).
- In contrast, there were large scale increases in import volumes for Liquefied Natural Gas (up 76% yoy), semi-conductors (up 61.8% yoy) and motor vehicles (up by 33.8% yoy).

INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

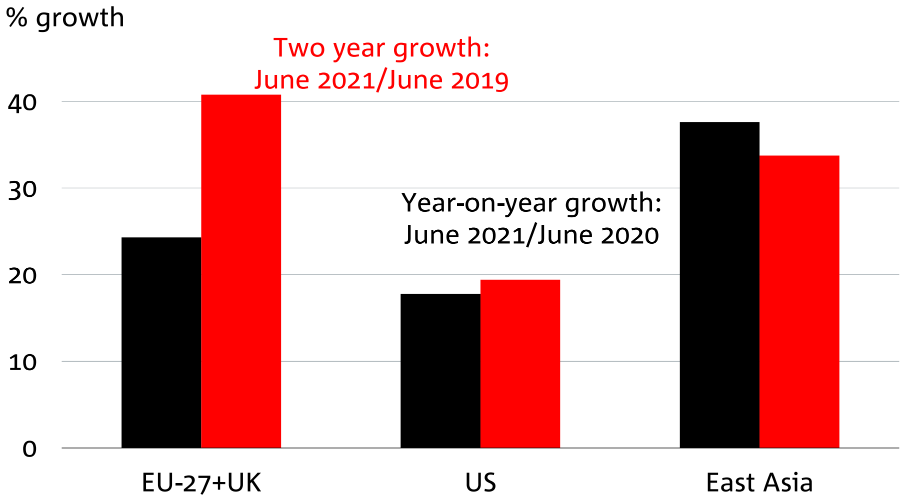
Export growth has held up, but new orders are negative



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Exports to the US have lagged other markets over past two years



Source: CEIC, NAB Economics

- China's exports rose strongly month-on-month, rising to US$281.4 billion in June (from US$263.9 billion previously). This represented an increase of 32.2% in year-on-year terms. This growth rate was surprisingly strong, given that base effects have started to erode. China's exports were already starting to recover in June 2020 – as demand for electronics and medical supplies picked up.

- The new export orders measure in the NBS PMI survey was marginally weaker in June – down to 48.1 points (from 48.3 points previously). Some of the increase in export values would be price related – reflected in the recent surges in producer prices – and this could start to impact demand in major export markets, along with fresh outbreaks of COVID-19 in some regions.

- There remains some notable divergence in export growth to China's major trading partners. In year-on-year terms, there was strong growth in exports to East Asia (up 37.6% yoy) and the European Union-27 + the United Kingdom (up by 24.3% yoy). In contrast, exports to the United States rose by just 17.8% yoy.

- That said, the differing timings of COVID-19 countermeasures in 2020 in different regions results in divergent base effects for these countries. In June 2020, exports rose strongly to Europe, modestly to the United States and fell to East Asia.

- Over the two years to June 2020, exports to the EU-27+UK rose by 40.8%, exports to East Asia rose by 33.8% while exports to the US lagged – up by 19.4%, which may reflect the impact of US tariffs on the demand for China's goods.

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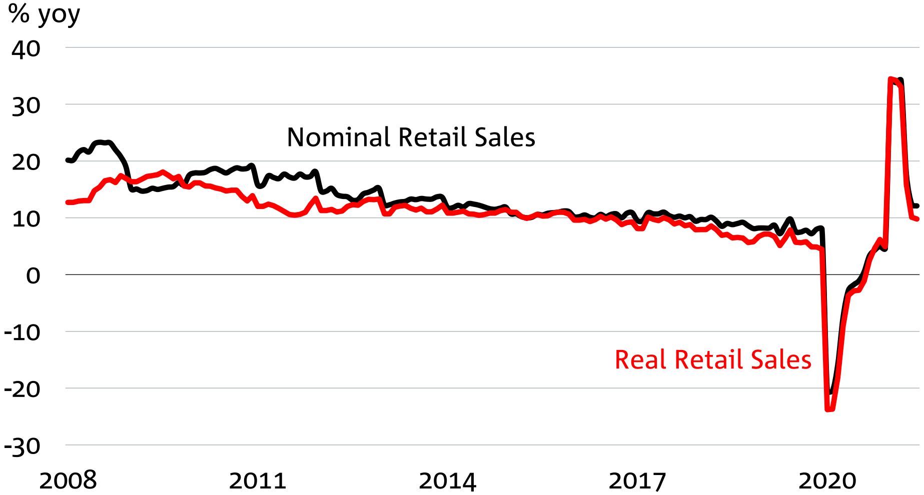
RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

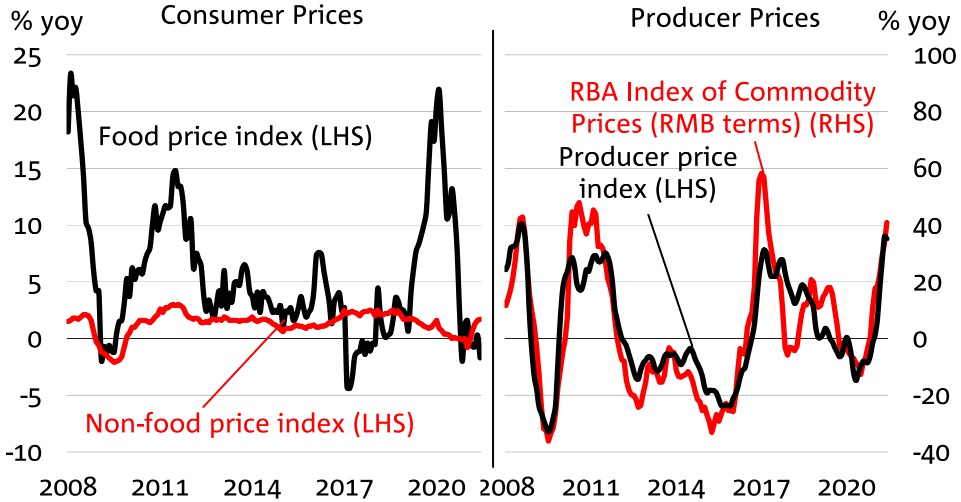
Real sales continue to lag behind industrial output



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Consumer prices muted as producer prices surge



Source: CEIC, RBA, NAB Economics

- Nominal growth in China's retail sales has continued to trend lower, as the base effects that resulted from COVID-19's impact in 2020 gradually wash away. In June, nominal sales increased by 12.1% yoy, compared with 12.4% yoy in May. Retail price inflation was stable in June – meaning that real retail sales eased a little in June to 9.8% yoy (from 10.1% previously).
- Retail sales continue to lag other major indicators – suggesting that China's economic growth remains imbalanced (which consumption lagging). When compared with June 2019, real retail sales were around 6.6% higher – well below the double digit growth in industrial production.
- Growth in China's headline consumer prices moderated in June – with the consumer price index increasing by 1.1% yoy (compared with 1.3% yoy in May). The easing was driven by food prices.
- Food prices fell by 1.7% yoy in June, compared with a 0.3% increase in May. Meat prices remain a major driver – with pork prices falling by 36.5% yoy. According to reports, China's pork supply has largely recovered from the impact of African swine fever, however the spread of a new strain remains a significant risk. In contrast, seafood prices rose by 14.2% yoy and fresh fruit prices increased by 3.1% yoy.
- Non-food prices have continued to increase – up by 1.7% yoy in June (up marginally from the 1.6% yoy increase in May). Vehicle fuel prices are a major contributor to this increase – up by 23.6% yoy in June, reflecting the upward trend in global oil prices.
- Producer price growth remained strong in June, at 8.8% yoy (compared with 9.0% yoy previously). Surging global commodity prices have been a major contributor to the increase – increasing the input costs for manufacturing firms – with the RBA Index of Commodity Prices (converted to RMB terms) increasing by 40.8% yoy (from 34.5% yoy in May). This reflected a large increase in bulk commodities (such as iron ore and coal) as well as energy prices.

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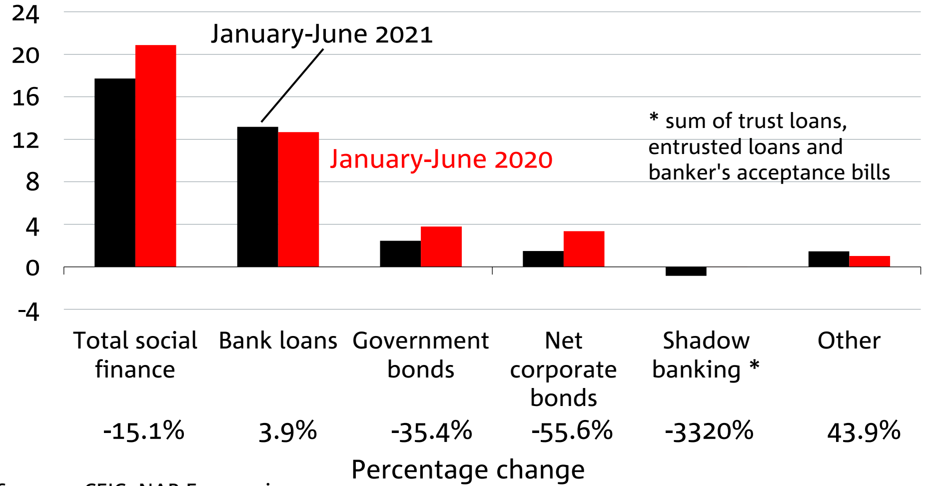
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

Credit issuance fell across H1, despite a yoy increase in June

RMB trillion

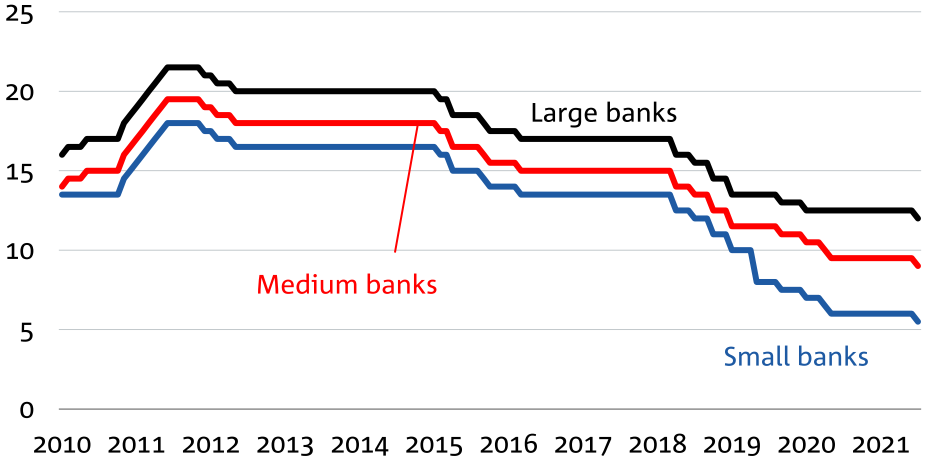


Sources: CEIC, NAB Economics

CHINA'S REQUIRED RESERVE RATIO

Loan repayment requirements may limit stimulatory effect of cut

Required reserve ratio (%)



Sources: CEIC, NAB Economics

- China's new credit issuance rose by 5.8% yoy in June, following on from three months of steep monthly declines, driven by a strong increase in bank lending.
- In the first half of 2021, new credit issuance totalled RMB 17.7 trillion, a decrease of 15.1% yoy. Over this time, bank lending increased – up by 3.9% yoy – totalling RMB 13.2 trillion (or 74% of the total).
- In contrast, non-bank lending fell by over 44% yoy over the first six months, to RMB 4.5 trillion. This largely reflected declines in corporate and government bond issuance – which fell by 56% yoy and 35% yoy respectively over the period.
- The People's Bank of China (PBoC) announced a surprise cut to the Required Reserve Ratio (RRR) on 9 July. This cut will free up around RMB 1 trillion for banks (albeit not all of it will be available to lend), with the PBoC stating that the goal was to support interbank liquidity and capital markets but that their overall monetary policy stance remains unchanged. The Loan Prime Rate (the PBoC's main policy rate) has remained at 3.85% since April 2020 and we anticipate it remaining at this rate for some time.
- The previous RRR cut for small and medium institutions was in mid-May 2020, while the previous cut for large institutions was in early January 2020.
- It is worth noting that this RRR cut is not as stimulatory as it may appear – with an unidentified portion of the RMB 1 trillion being used to repay maturing medium term loans. Around RMB 4.15 trillion of MLF loans from the PBoC mature in the second half of 2021.

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