CHINA'S ECONOMY AT A GLANCE

OCTOBER 2021

CONTENTS

CONTACT

Gerard Burg, Senior Economist - International

KEY POINTS

A series of crises stalled Q3 growth and present downside risk to the outlook

- China's economy faced a series of crises in Q3 2021. Restrictions were imposed across a range of regions early in the quarter to counter a major COVID-19 outbreak, which impacted economic activity. Later in the period, fuel shortages and energy policy targets led to electricity shortages in a range of provinces. Finally, the likely default (and eventual collapse) of property developer Evergrande fuelled fears of financial contagion. There is uncertainty around how long the impacts of these issues persist – with the potential to negatively impact growth in Q4 as well.

- Overall, headline GDP increased by 4.9% yoy in Q3 – down from 7.9% yoy in Q2. Given the weakness in Q3, we have lowered our full year forecast for 2021 to 8.3% (from 8.7% previously), while raising our forecast for 2022 to 6.0% (from 5.9% previously).

- Growth in China's industrial production slowed further in September – down to 3.1% yoy (from 5.3% yoy previously). Although growth has slowed across much of 2021, as base effects related to the industrial closures of early 2020 have eroded, this slowdown also reflected the impact of electricity shortages during the month, along with supply chain disruptions and slowing demand from the construction sector.

- China's real fixed asset investment contracted in September – falling by 10.1% yoy (from a 6.8% yoy decrease previously). There has been a notable slowing in real estate investment (with nominal investment contracting in September).

- Another surge in exports saw China's trade surplus widen once again in September – totalling US$66.8 billion (from US$58.3 billion previously). This was the third largest monthly surplus on record (behind the levels recorded in December and November 2020). The strong growth in exports to the United States (combined with relatively modest increases in imports) has the potential to reignite trade tensions between the two countries. China's rolling 12 month trade surplus with the United States was US$379 billion in September – setting a new record high for the eighth month in a row.

- Growth in China's retail sales accelerated in September, as easing restrictions (related to the early Q3 COVID-19 outbreak) provided support. We estimate that real retail sales rose by 2.9% yoy in September (up from 0.9% yoy in August). While the direction of retail sales is encouraging, growth remains very weak when compared with pre-COVID-19 levels, and presents a drag to economic growth.

- New credit issuance totalled RMB 24.8 trillion in the first nine months of 2021, a decrease of 16.4% yoy. Over this period, there has been a modest increase in total bank lending – up by 0.5% yoy to RMB 17.1 trillion – while non-bank lending has plunged, driven by steep declines in government and corporate bond issuance.

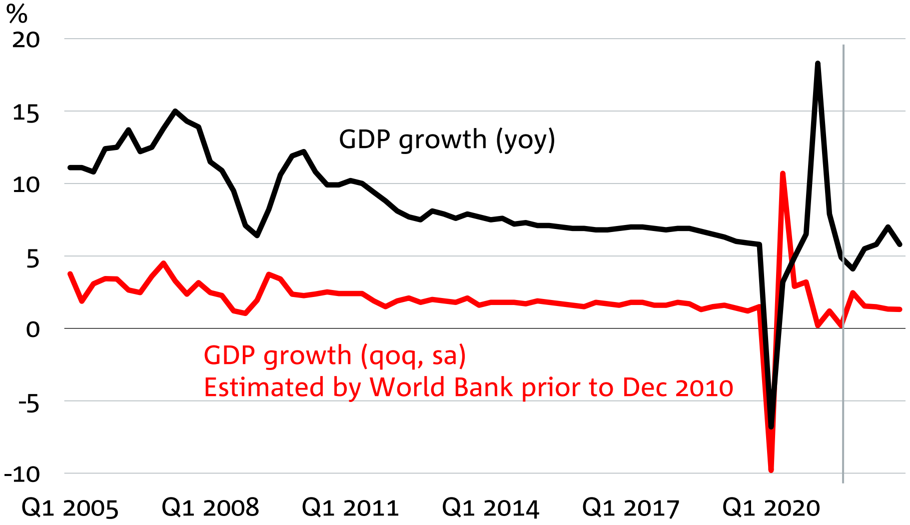
- The PBoC has held the Loan Prime Rate (its main policy rate) stable at 3.85% since April 2020. Recent commentary from Governor Yi Gang indicates that the bank intends to maintain its "normal" policy settings for as long as possible, suggesting a further rate cut is unlikely except in an emergency.

National Australia Bank

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH

A range of crises hit economic activity in Q3

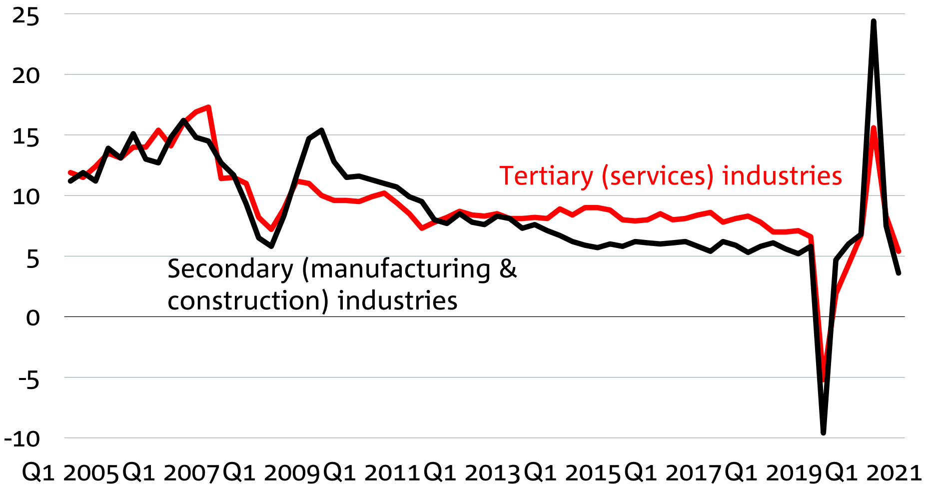


Source: CEIC, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Larger slowdown in industrial sector in Q3

Chinese economic growth by sector (% yoy)



Source: Refinitiv, NAB Economics

- Growth in China's economy slowed considerably in Q3, as a range of crises (including measures to control a major COVID-19 outbreak, electricity shortages and fears around financial contagion) stalled economic activity. Headline GDP increased by 4.9% yoy – down from 7.9% yoy in Q2.

- The slowing trend was particularly evident in the seasonally adjusted quarterly growth series – where growth fell to 0.2% qoq – the same rate of growth as Q1 (following historical revisions) and the equal second weakest on record (after the steep fall in Q1 2020 following the initial COVID-19 outbreak).

- Much of the downturn was driven by the secondary sector (manufacturing and construction) – which had provided much of the impetus of China's recovery from COVID-19. The secondary sector grew by just 3.6% yoy in Q3 (compared with 7.5% yoy in Q2). Slowing in services growth was more modest – despite the more direct impact of COVID-19 countermeasures in Q3 – growing by 5.4% yoy (down from 8.3% yoy previously).

- There is considerable uncertainty around the near term outlook – with a lack of clarity as to how long the crises that impacted China's economy in Q3 will persist. We are assuming no further significant COVID-19 outbreaks (and restrictions) and no major financial disruptions. In addition, we expect that electricity shortages will be quickly resolved (consistent with the large increase in coal imports in September) – however these highlight downside risks to our forecasts.

- Given the weakness in Q3, we have lowered our full year forecast for 2021 to 8.3% (from 8.7% previously), while raising our forecast for 2022 to 6.0% (from 5.9% previously).

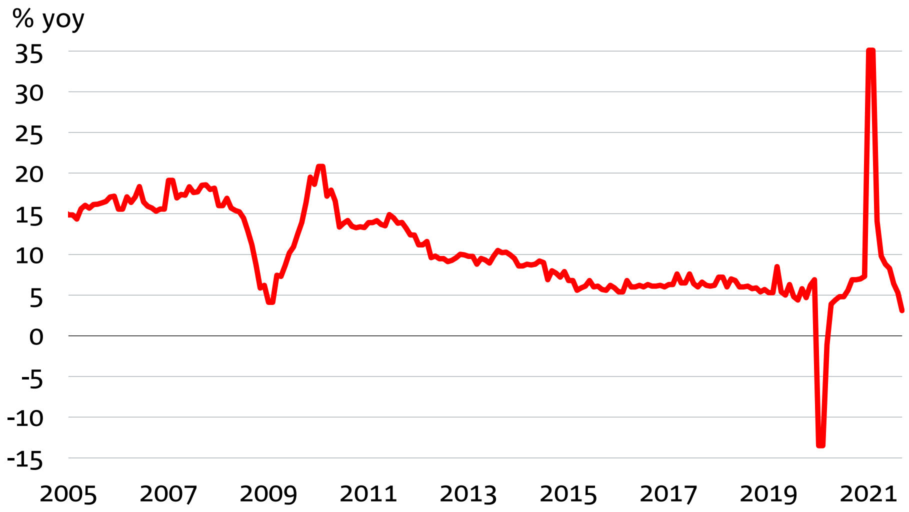
NAB CHINA GDP FORECASTS

%	2021	2022	2023
GDP	8.3	6.0	5.7

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

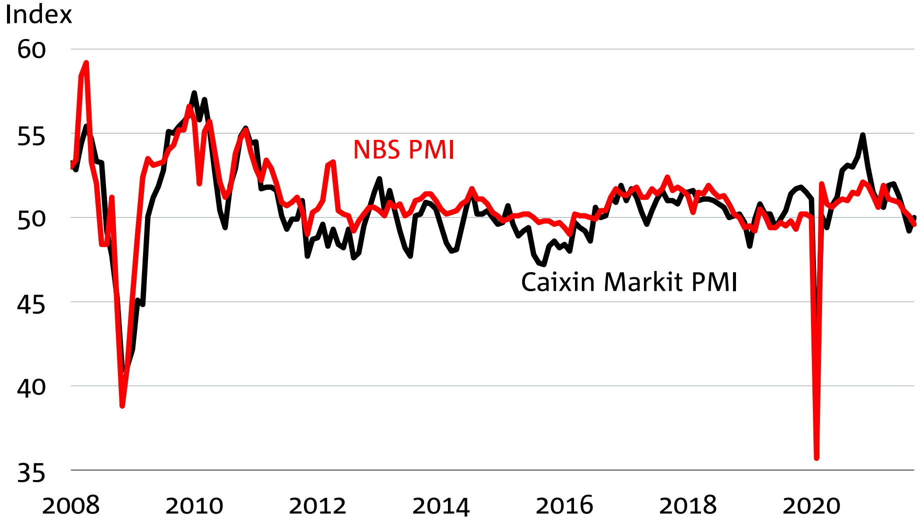
Growth slowed in September on a range of headwinds



Source: CEIC, NAB Economics

MANUFACTURING PMIS REVERSE IN SEPTEMBER

Differing composition of these surveys may explain the trend



Source: CEIC, NAB Economics

- Growth in China's industrial production slowed further in September – down to 3.1% yoy (from 5.3% yoy previously). Although growth has slowed across much of 2021, as base effects related to the industrial closures of early 2020 have eroded, this slowdown also reflected the impact of electricity shortages during the month, along with supply chain disruptions and slowing demand from the construction sector.

- Month-on-month growth in production slowed considerably in September – up by less than 0.1%, compared with around 0.3% in August.

- Production of construction related industries – such as cement and crude steel – plunged in September, down by 13% yoy and 21.2% yoy respectively. There was also a sizeable fall in motor vehicle output, which fell by 13.7% yoy – albeit this could be related to the global shortages of semi-conductors. In contrast, output of electronics rose by 9.5% yoy.

- China's two major manufacturing surveys moved in opposite directions in September. The official NBS PMI survey turned negative – down to 49.6 points (from 50.1 points in August). In contrast, the private sector Caixin Markit PMI recovered – back up to a neutral 50.0 points from 49.2 points previously.

- The differing composition of firms in these surveys may explain some of this divergence. The NBS survey has a larger share of state-owned enterprises, including heavy industrial firms that struggled due to power shortages and slowing construction activity. In contrast, the Caixin Markit survey has more private sector firms, including high tech manufacturers less impacted by these recent trends.

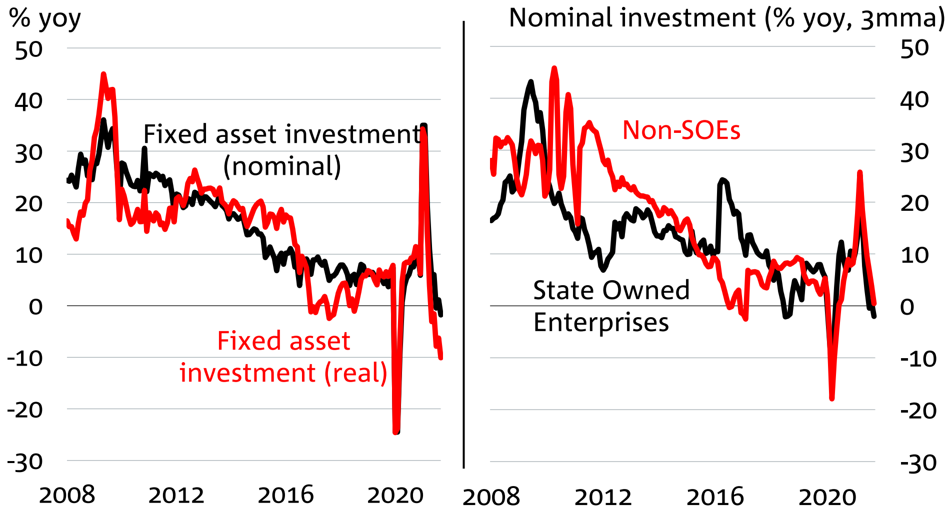
- Contributing to the weakening trend in manufacturing PMIs since the second quarter of 2021 has been the deterioration export orders – with these readings declining further in both surveys in September.

National Australia Bank

INVESTMENT

FIXED ASSET INVESTMENT

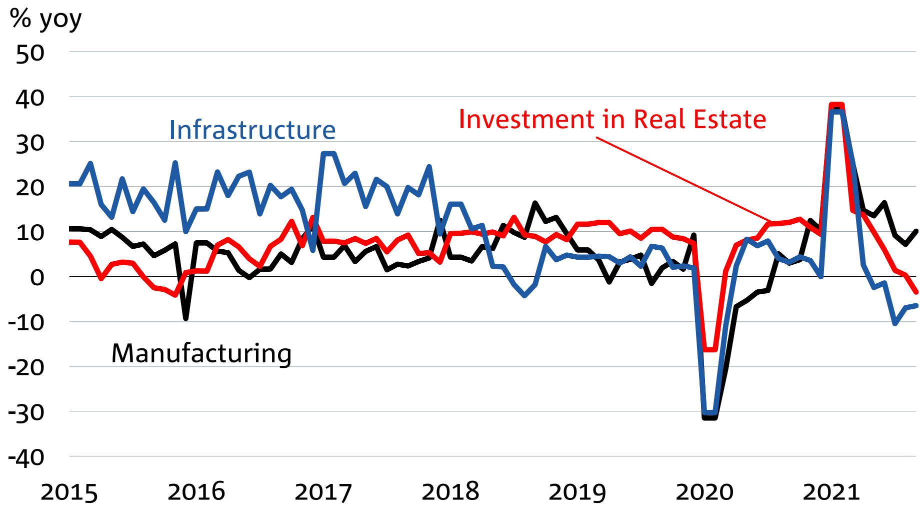
Sharp fall in real investment in September



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Notable downturn in real estate investment



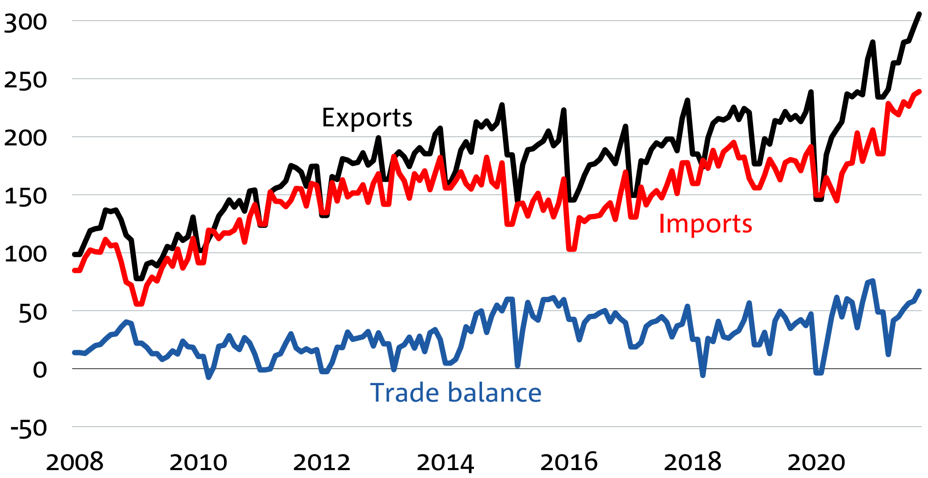
Source: CEIC, NAB Economics

- China's nominal fixed asset investment contracted in September – falling by 1.8% yoy (compared with a 1.1% yoy increase in August). Surging producer prices – which flow through into the cost of investment goods – increases the scale of this decline, meaning that real investment fell by 10.1% yoy (from a 6.8% yoy decrease previously).
- Investment by both State-owned enterprises (SOEs) and private sector firms slowed in nominal terms in September – down by 1.6% yoy and 1.9% yoy respectively. That said, growth trends have been generally weaker for SOEs in recent months.
- By sector, investment in manufacturing has held up comparatively strongly – with nominal investment increasing by 10.0% yoy. In contrast, investment in infrastructure has been weak for much of 2021, contracting by 6.5% yoy in September. Infrastructure investment is largely funded by local governments, and government bond issuance has contracted sharply this year (albeit there has been a pickup in the past two months).
- The noticeable downturn has come from the real estate sector – where investment contracted by 3.5% yoy in September. The likely collapse of Evergrande – the country's second largest property developer – could bring greater regulatory scrutiny to the overall sector (which may result in relatively weaker investment trends going forward).

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

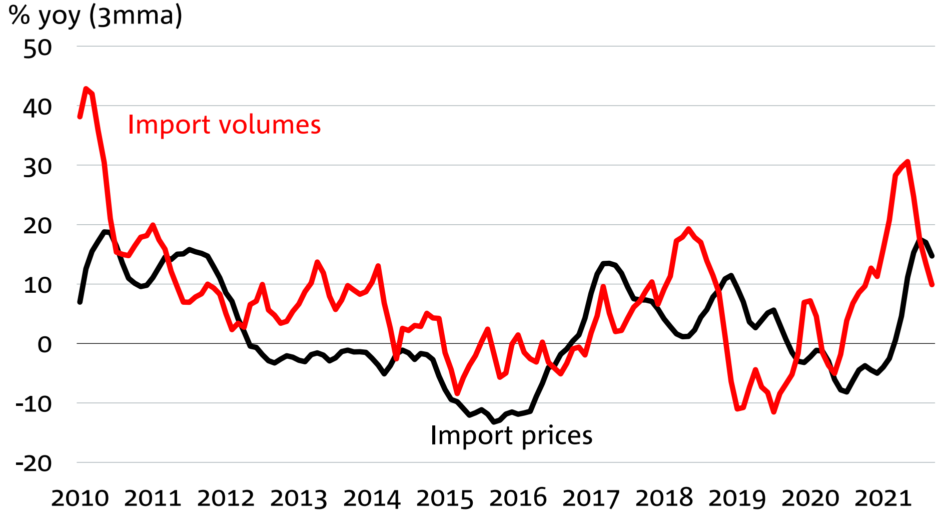
Surplus widened in September on export surge



Sources: CEIC, NAB Economics

IMPORT VOLUMES AND PRICES

Declining base effects and rising prices slowing volume growth



Source: CEIC, NAB Economics

- Another surge in exports (from already high levels in August) saw China's trade surplus widen once again in September – totalling US$66.8 billion (from US$58.3 billion previously). This was the third largest monthly surplus on record (behind the levels recorded in December and November 2020).

- The value of China's imports rose slightly month-on-month, totalling US$239.0 billion (compared with US$236.0 billion in August). In year-on-year terms, the value of imports rose by 17.6%, down from the 33.1% yoy increase recorded in August – albeit trade data have been highly distorted by the differing timings of COVID-19 outbreaks globally.

- A range of factors are influencing the increase in import values, including rising commodity prices and the impacts of supply chain disruptions, in addition to increased volumes of some goods. The RBA Index of Commodity Prices rose by over 38% yoy in September, although this increase was more modest those that recorded in July and August.

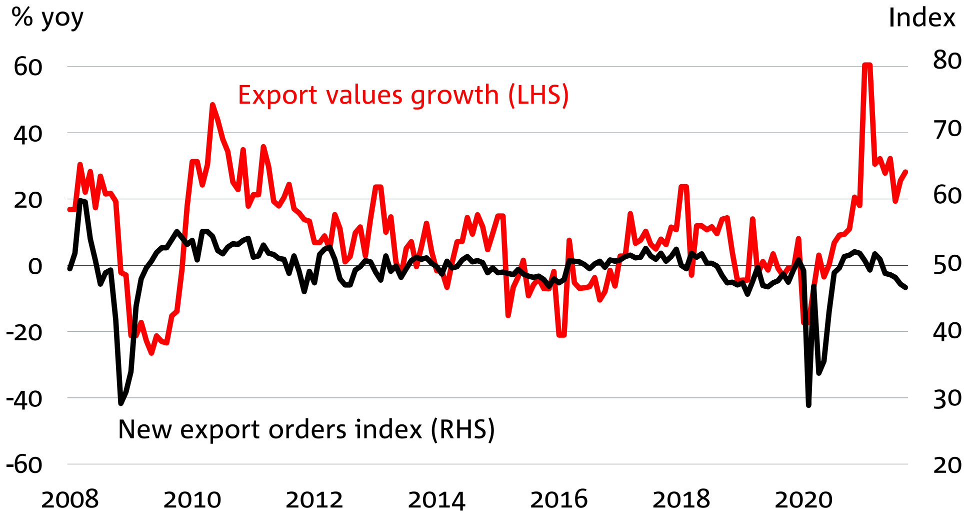
- Our estimate of China's import volumes uses these commodity prices as a proxy for import prices. This suggests that the growth in import volumes has continued to slow – in part as base effects related to the COVID-19 shutdowns of early 2020 wash out. However, this may also reflect the impact of supply disruptions as well as the impact of rising prices on import demand. On a three month moving average basis, import volumes rose by 9.9% yoy in September (compared with 13.5% yoy in August).

- Recent import data suggest that the key drivers of imports are higher value refined products and advanced technologies. Imports of traditional key commodities have contracted in recent times, with imports of refined copper falling by almost 44% yoy in September, while crude oil and iron ore fell by 15% yoy and 12% yoy respectively. In contrast, coal imports rose by 76% yoy – likely reflecting efforts to address shortages of the fuel that have contributed to the country's electricity issues.

INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

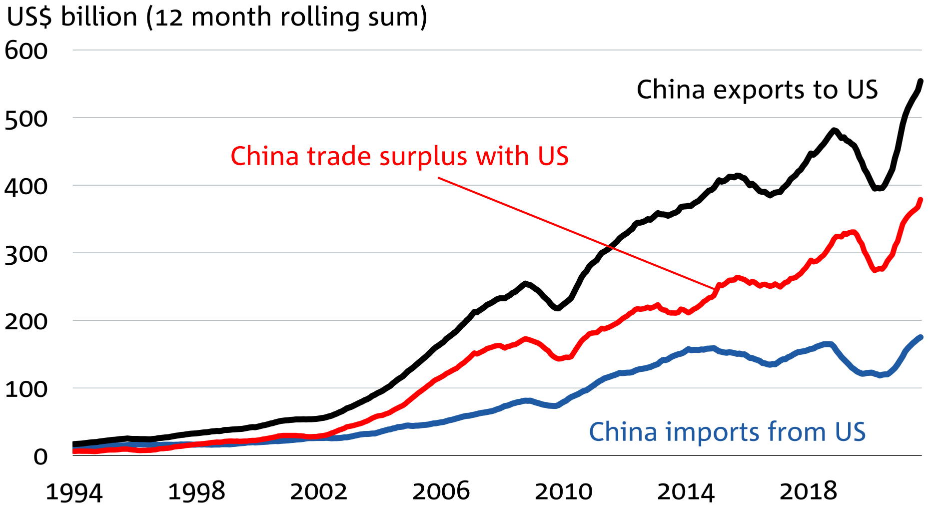
Exports rise to record highs, but new orders weakened further



Source: CEIC, NAB Economics

CHINA-US TRADE RELATIONSHIP

Trade surplus rises to record high; could reignite trade tensions



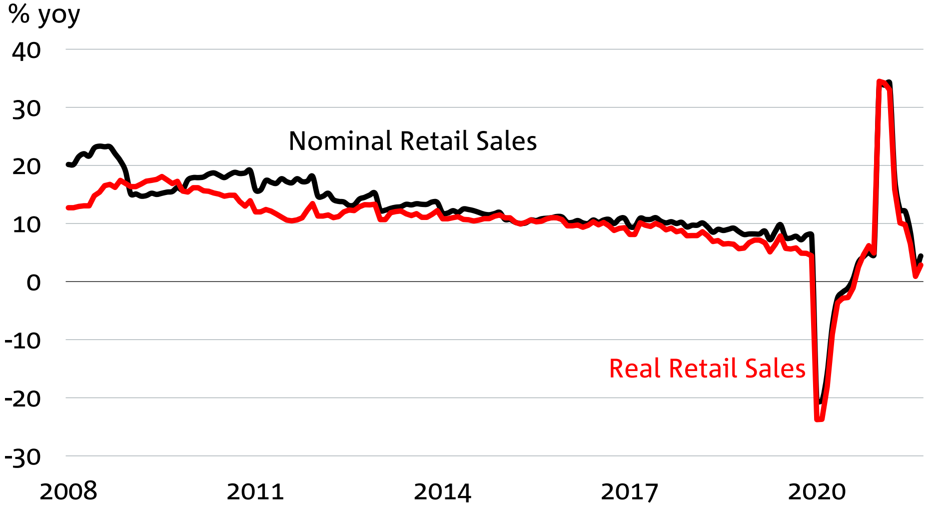
Sources: CEIC, NAB Economics

- China's exports rose strongly month-on-month in September to US$305.7 billion (compared with US$294.3 billion in August). This was the third month in a row that exports were at a record high level. In year-on-year terms, exports rose by 28.1%.
- As is the case with imports, rising prices over recent months explain some of this increase – up by around 6.5% yoy in August, compared with an increase of 8.7% yoy in volumes for the same month.
- The recent strength in exports is not expected to last. The new export orders measure in the NBS manufacturing survey turned negative in May and has continued to deteriorate – down to 46.2 points in September (from 46.7 points in August).
- There was strong growth to China's major trading partners in September. The largest increase in exports was to the United States – which rose by 30.6% yoy. Exports to the European Union-27 + the United Kingdom rose by 25.1% yoy, while exports to Asia increased by 24.2% yoy.
- The strong growth in exports to the United States (combined with relatively modest increases in imports) has the potential to reignite trade tensions between the two countries. China's trade surplus with the United States was at an all time high in September (at US$42 billion) and the rolling 12 month surplus rose to US$379 billion – setting a new record high for the eighth month in a row.
- US Trade Representative Katherine Tai met with Vice Premier Liu He in early October to discuss China's failure to meet its commitments under the "Phase 1" trade deal. At this stage it is unclear as to how the Biden Administration will respond to this situation.

RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

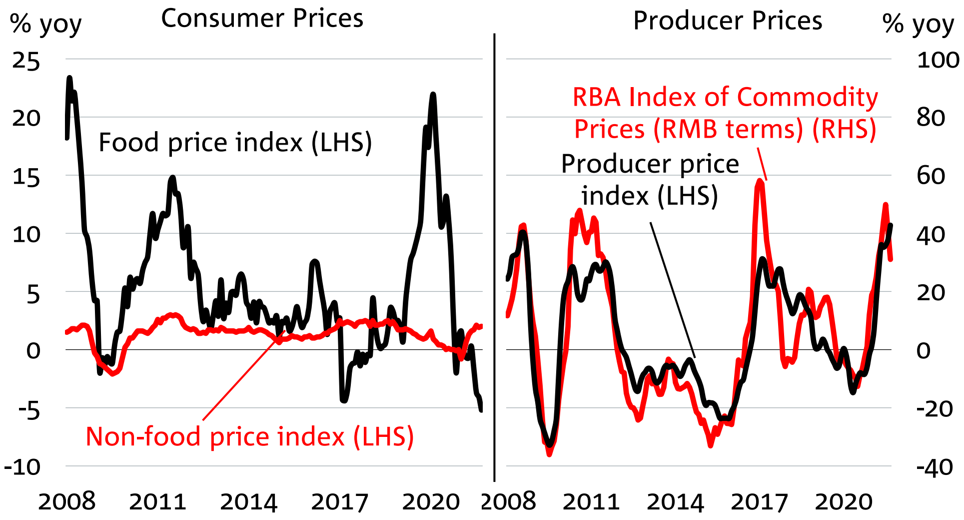
Stronger growth in September, but still historically weak



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Pork keeping CPI under control; other prices still rising



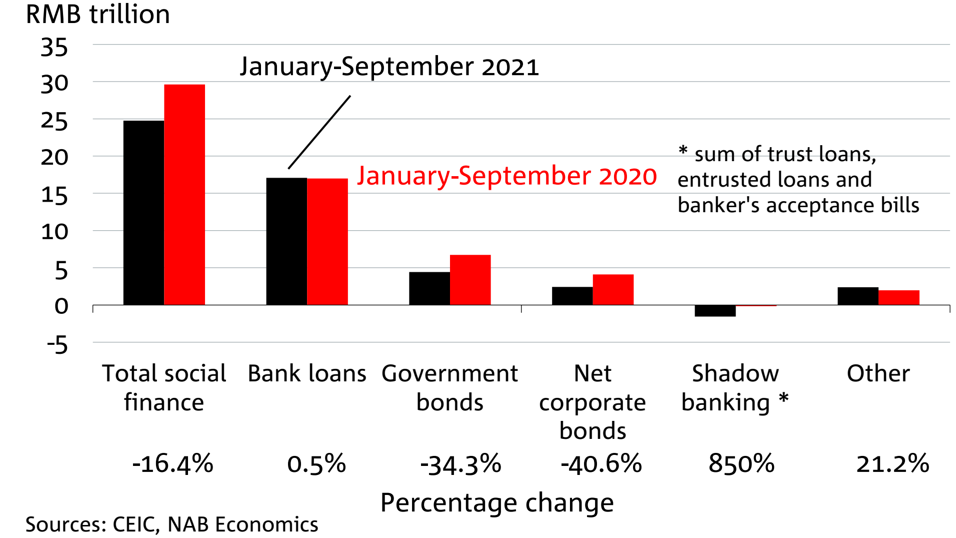
Source: CEIC, RBA, NAB Economics

- Growth in China's retail sales accelerated in September, as easing restrictions (related to the early Q3 COVID-19 outbreak) provided support. Nominal retail sales increased by 4.4% yoy in September (up from 2.5% yoy in August) – still well below the pre-COVID-19 trend.
- The retail price index was unavailable for September at the time of writing, however using the CPI as a proxy, we estimate that real retail sales rose by 2.9% yoy in September (up from 0.9% yoy in August). While the direction of retail sales is encouraging, growth remains very weak when compared with pre-COVID-19 levels, and presents a drag to economic growth.
- China's consumer prices grew a little more slowly in September, with the headline consumer price index rising by 0.7% yoy (down from 0.8% yoy previously). Food price deflation has been driving consumer prices lower since its recent cycle peak in May.
- The food price index decreased by 5.2% yoy in September (compared with a 4.1% yoy fall in August). The main contributor to this trend has been the price of pork – which surged across much of 2019 and 2020, due to the impact of African swine fever on pork supply, and has subsequently fallen as supplies have improved. Pork prices fell by 46.9% yoy in September. In contrast, prices for seafood and eggs rose comparatively strongly.
- Non-food prices rose by 2.0% yoy (up from 1.9% yoy in August). Vehicle fuel prices have risen strongly since March this year – up by 22.8% yoy – in line with increasing global oil prices.
- Producer prices have continued to increase strongly – up by 10.7% yoy in September (from 9.5% yoy in August). Rising commodity prices have flowed through supply chains for manufacturers in recent months – albeit it is worth noting that other supply chain issues could also be influencing this trend. The RBA Index of Commodity Prices (when converted into RMB terms) rose by 31.0% yoy in September (compared with 40.6% yoy in August).

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

Declines in bond issuance driving weaker credit issuance

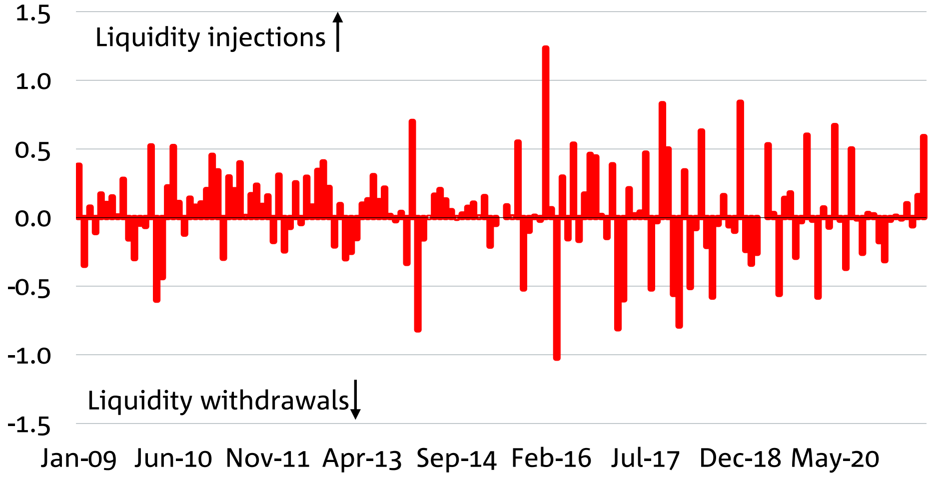


Sources: CEIC, NAB Economics

OPEN MARKET OPERATIONS

PBoC added liquidity in September but face difficult balancing act

Net open market operations (RMB trillions)



Source: CEIC, NAB Economics

- There was little change in China's new credit issuance in September – totalling RMB 2.9 trillion (compared with almost RMB 3.0 trillion in August). It is worth noting that there was a noticeable month-on-month increase in bank loans, while non-bank lending eased.
- New credit issuance totalled RMB 24.8 trillion in the first nine months of 2021, a decrease of 16.4% yoy. Over this period, there has been a modest increase in total bank lending – up by 0.5% yoy to RMB 17.1 trillion.
- In contrast, non-bank lending has fallen significantly over this period – down by 39.3% yoy to RMB 7.7 trillion. Corporate and government bond issuance fell steeply – down by almost 41% yoy and 34% yoy respectively. That said, government bond issuance has increased in both August and September – which may flow through to infrastructure development.
- Concerns around China's financial stability have increased over the past month, given the likelihood of a default by Evergrande, the country's second largest property developer. The People's Bank of China (PBoC) identified the company as one the few that pose systematic risk for the financial sector.
- The PBoC have pumped liquidity into financial markets – with the net inflows in September at their highest level since May 2020 (when the central bank was supporting China's initial COVID-19 recovery). That said, authorities face a difficult balancing act – providing sufficient support to minimise contagion risks around Evergrande's likely collapse, while ensuring there is not excess liquidity, which could encourage already indebted firms to increase leverage and build on existing vulnerabilities.
- The PBoC has held the Loan Prime Rate (its main policy rate) stable at 3.85% since April 2020. Recent commentary from Governor Yi Gang indicates that the bank intends to maintain its "normal" policy settings for as long as possible, suggesting a further rate cut is unlikely except in an emergency.

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 4) 77 746 237

Gerard Burg
Senior Economist – International
+(61 4) 77 723 768

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836