CHINA'S ECONOMY AT A GLANCE

JANUARY 2022

National Australia Bank

CONTENTS

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KEY POINTS

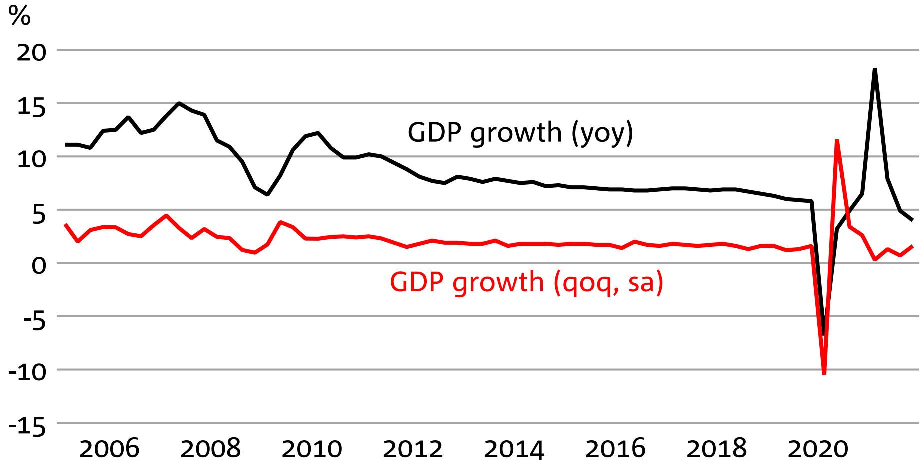
China enters 2022 with relatively weak momentum and considerable uncertainty

- China's economy grew by 8.1% in 2021 – marginally stronger than our forecast of 8.0%. By quarter, year-on-year growth peaked in Q1 at double digit rates (driven by base effects related to the initial COVID-19 outbreak) before trending lower over subsequent quarters.
- The outlook for China's economy has considerable uncertainty – particularly related to the impact of the Omicron variant of COVID-19 and the policy responses (including public health, fiscal and monetary policies) of authorities. We have trimmed our forecast for the full year to 5.8% (previously 6.0%) – with stronger growth expected in the second half of the year. Our forecast for 2023 is unchanged at 5.7%.
- China's industrial output continued to recover in December – increasing by 4.3% yoy (from 3.8% yoy previously). Despite this pickup, growth in industrial production remains historically weak – reflecting a broad range of factors, including the impact of COVID-19 outbreaks, price pressures, shortages of key inputs and apparent weakness in domestic demand.
- Real fixed asset investment continued to contract in December, down by 5.2% yoy, however this was less negative than the 12.0% decline in November. There is a stark contrast between the strength of investment in manufacturing to the declines in real estate.
- China's trade surplus surged to an all time high in December – up to US$94.5 billion (from US$71.7 billion in November). This increase reflected a strong month-on-month increase in exports (which also recorded a record high), while imports eased marginally.
- Real retail sales contracted in December, down by 0.5% yoy (compared with a 0.5% yoy increase in November). This was the first fall since August 2020, and well below pre-COVID-19 trends.
- In mid-December, the People's Bank of China (PBoC) cut its primary policy rate, the Loan Prime Rate (LPR) by 5 basis points to 3.8%, the first rate change since April 2020. This followed the early December cut to the Reserve Requirement Ratio, which expanded banks capacity to lend. In mid-January, the PBoC cut its medium term lending facility (MLF) rate by 10 basis points – which is likely to lead to another LPR cut later this month.
- That said, these modest cuts to interest rates are unlikely to provide a substantial boost to the economy, but send a signal to firms that authorities are seeking to provide support in a slowing environment. We have argued that rate rises in advanced economies in 2022 limit the capacity of the PBoC to substantially cut policy rates – as this may result in capital outflow as well as weaken the currency (which could increase pressure on Chinese firms with US dollar denominated borrowings). As a result, fiscal stimulus may need to provide a greater share of the overall policy support.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH

China's yoy growth has continued to slow across 2021

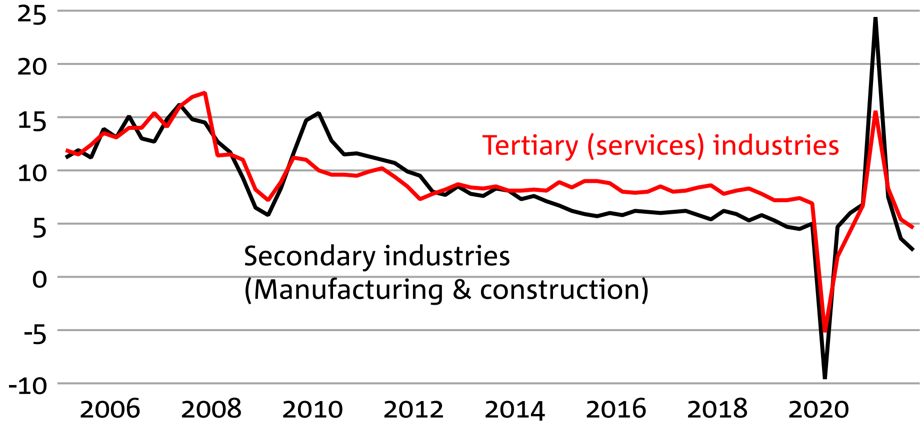


Source: Macrobond, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Industrial sector led the slowdown in yoy growth

Chinese economic growth by sector (% yoy)



Source: Macrobond, NAB Economics

- China's economy grew by 8.1% in 2021 – marginally stronger than our forecast of 8.0%. By quarter, year-on-year growth peaked in Q1 at double digit rates (driven by base effects related to the initial COVID-19 outbreak) before trending lower over subsequent quarters.

- China's economic growth continued to slow in Q4 – with the headline year-on-year figure down to 4.0% (from 4.9% in Q3). A range of factors contributed to this trend – including the weakness in industrial production growth (reflecting the lingering impact of electricity shortages in September through October and declining trends in the construction sector) and retail sales.

- By industry, the declining growth rate was most evident in the secondary sector (manufacturing and construction) – which increased by 2.5% yoy (from 3.6% yoy previously). In contrast, the services sector grew by 4.6% yoy (from 5.4% yoy in Q3).

- The outlook for China's economy has considerable uncertainty – particularly related to the impact of the Omicron variant of COVID-19 and the policy responses (including public health, fiscal and monetary policies) of authorities. Given the weak momentum in key parts of China's economy heading into 2022, we have trimmed our forecast for the full year to 5.8% (previously 6.0%) – with stronger growth expected in the second half of the year. Our forecast for 2023 is unchanged at 5.7%.

NAB CHINA GDP FORECASTS

%	2021	2022	2023
GDP	8.1	5.8	5.7

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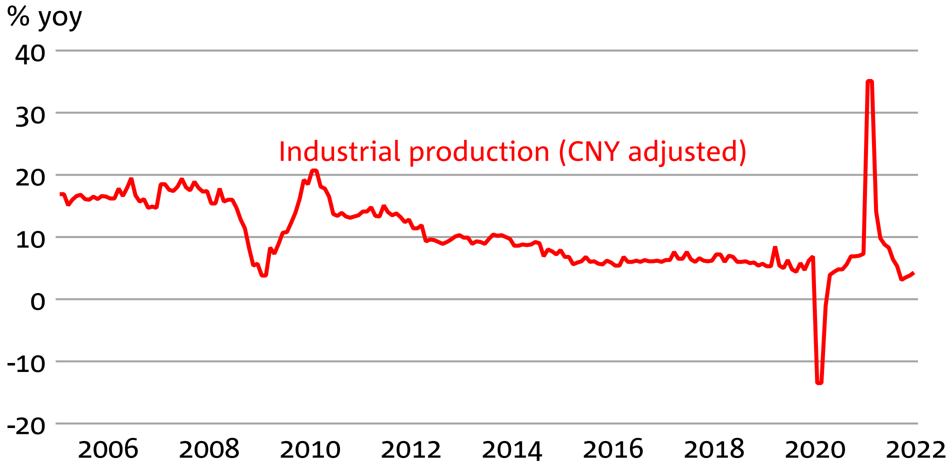
INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

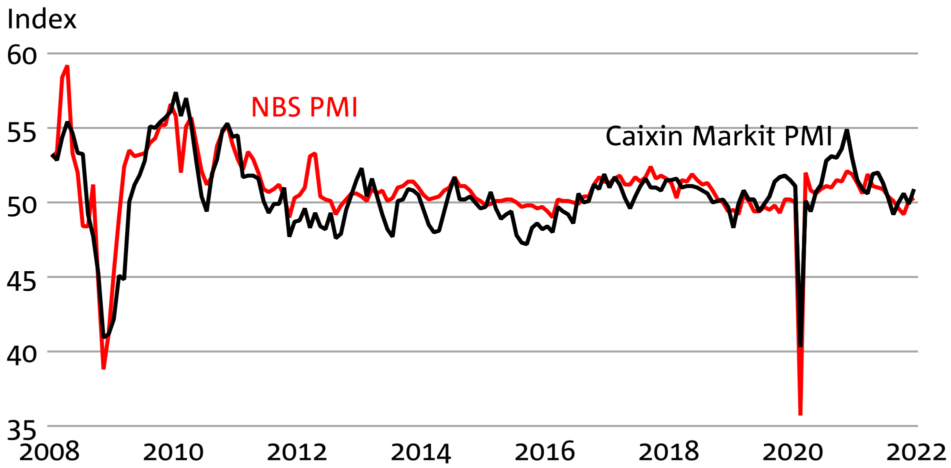
Output continues to gradually recover, but still historically weak



Source: Macrobond, NAB Economics

MANUFACTURING PMIS WERE POSITIVE IN DECEMBER

Caixin survey saw much stronger improvement



Source: Macrobond, NAB Economics

- China's industrial output continued to recover in December – increasing by 4.3% yoy (from 3.8% yoy previously). Despite this pickup, growth in industrial production remains historically weak – reflecting a broad range of factors, including the impact of COVID-19 outbreaks, price pressures, shortages of key inputs and apparent weakness in domestic demand.

- Output trends by industry remained mixed in December. Production of electronics rose by 12.0% yoy, while motor vehicle output increased by 3.4% yoy (the first monthly increase since April 2021).

- In contrast, output of construction related sectors – such as crude steel and cement – fell by 6.8% yoy and 11.1% yoy respectively. Similarly, electricity output fell by 2.1% yoy.

- China's two major manufacturing surveys were in positive territory in December, albeit the gap between the two surveys widened somewhat when compared with November.

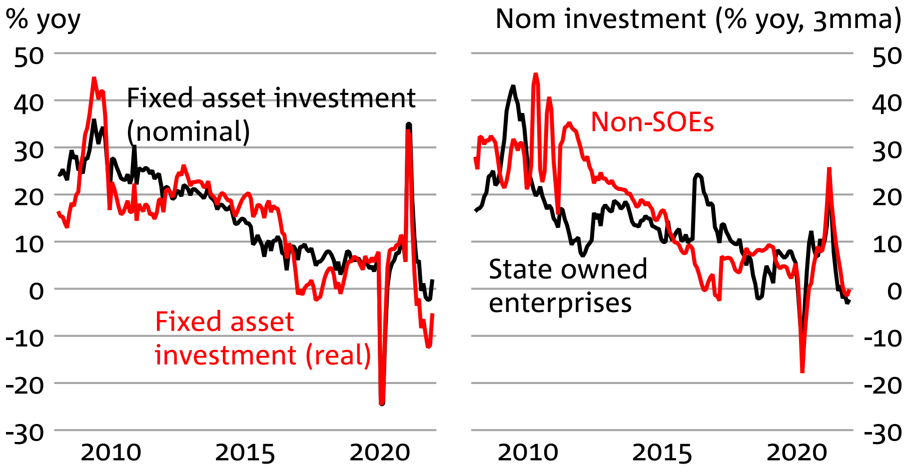
- The official NBS PMI survey was marginally stronger – at 50.3 points (from 50.1 points previously). In contrast, there was a larger improvement in the Caixin Markit PMI – which rose to 50.9 points (from 49.9 points in November). Significant differences between the two surveys may reflect the differing composition of firms in each survey (with the Caixin Markit survey generally thought to have a larger share of SME and private sector respondents).

- Both surveys have seen improved trends in manufacturing production in recent months (in part reflecting the easing in electricity shortages) however demand trends have been mixed. New orders in the NBS PMI have remained negative since August, with new export orders particularly negative. In contrast, domestic demand in the Caixin Markit survey rebounded in December.

INVESTMENT

FIXED ASSET INVESTMENT

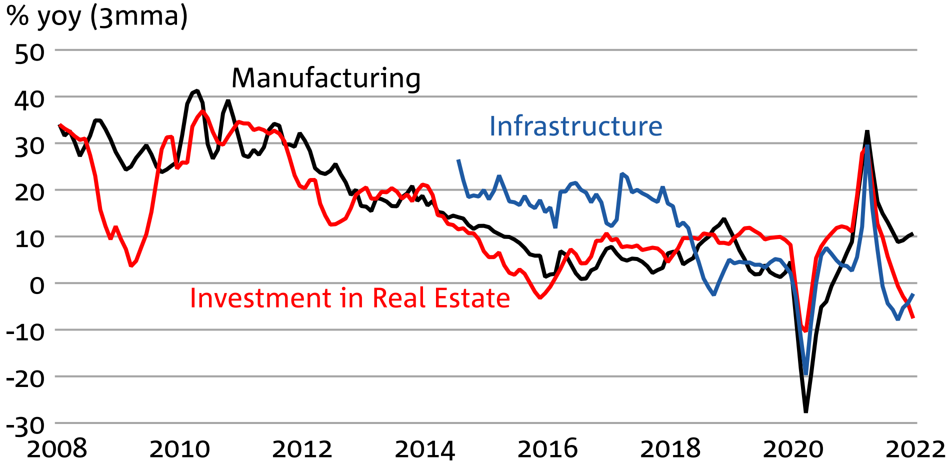
Rising costs continue to see real investment contract in December



Source: Macrobond, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Manufacturing and real estate continue to diverge



Source: Macrobond, NAB Economics

- Nominal fixed asset investment grew modestly in December, following three straight months of decline – increasing by 2.0% yoy (compared with a 2.2% fall in November). Growth in producer prices was a little softer in December, and these prices flow through into the cost of investment goods. As a result, we estimate that real fixed asset investment continued to contract in December, down by 5.2% yoy, however this was less negative than the 12.0% decline in November.

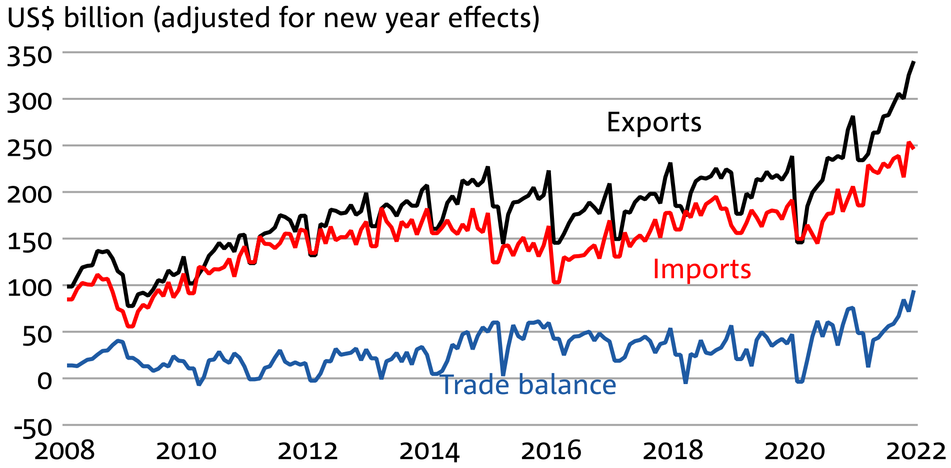
- The nominal increase in fixed asset investment was reflected in growth among both the state-owned enterprises (SOEs) and private sector firms. SOE investment rose by 1.8% yoy (compared with a 6.1% yoy fall in November), while investment by private firms rose by 2.1% (from a 0.1% increase previously).

- Investment trends remain mixed across industries. Investment in manufacturing has held up well across 2021 – increasing by 10.6% yoy (on a three month moving average basis) in December. In contrast, investment in infrastructure has continued to contrast, albeit the rate of decline has slowed substantially in recent months. With government bond issuance likely to be brought forward in 2022, this sector could see growth in coming months. Investment in real estate has continued to diminish, down by 7.6% yoy (3mma), as the broader construction sector has slowed

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

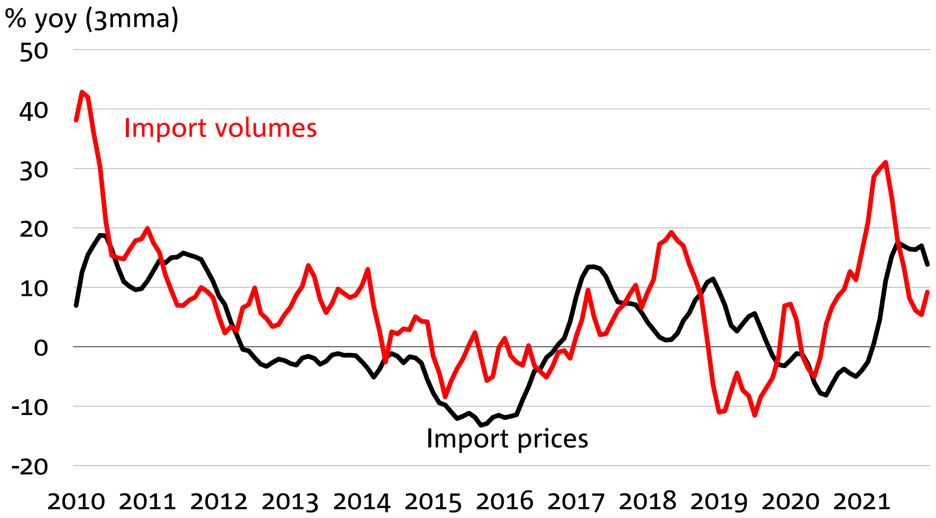
Surplus rises to a fresh record high in December



Source: Macrobond, NAB Economics

IMPORT VOLUMES AND VALUES

Volumes stronger across November and December



Source: CEIC, Macrobond, NAB Economics

- China's trade surplus surged to an all time high in December – up to US$94.5 billion (from US$71.7 billion in November). This increase reflected a strong month-on-month increase in exports (which also recorded a record high), while imports eased marginally.

- China's imports totalled US$246.0 billion in December (down from US$253.8 billion previously). In year-on-year terms, imports rose by 19.5%.

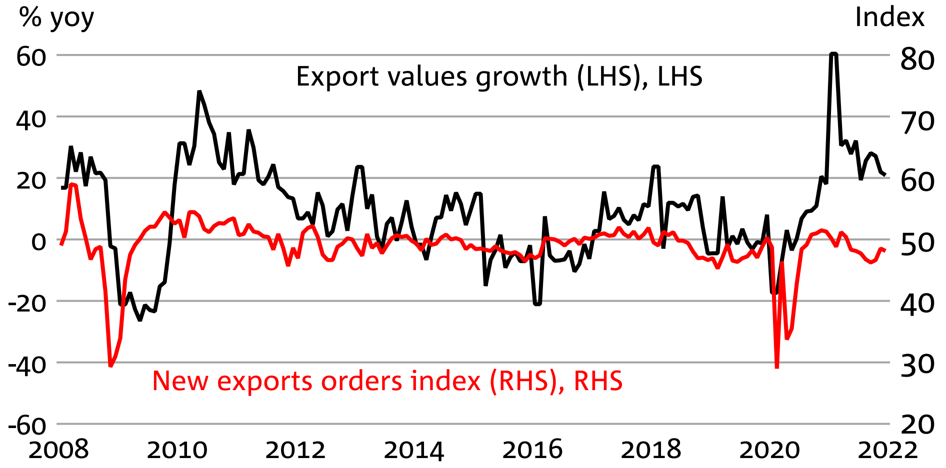
- Import prices have risen strongly across much of 2021 (particularly from April onwards) – contributing to the increase in overall import values across the year – however this price growth likely eased in December. Our estimate of import volumes uses commodity prices as a proxy for China's import prices and suggests that growth in import volumes remained relatively strong in December (up by 11.9% yoy, compared with 12.1% yoy in November) while price growth slowed sharply (from almost 18% yoy in November to around 7% in December). That said, it is worth noting that our proxy has underestimated import prices in recent months (in part as commodity prices do not reflect costs for electronics inputs such as semi-conductors) – meaning that the growth in volumes may be overstated.

- Trends in the import volumes of key commodities remain highly mixed. There was a sizeable increase in import volumes for semi-conductors (up by 22.1% yoy) and a range of energy commodities (excluding coal) – with crude oil up by 19.9% yoy, LPG and other gases increasing by 3.8% and refined petroleum products up by 1.4%. While coal volumes fell by over 20% yoy in December, this likely reflected the impact of restocking in November (when volumes tripled in year-on-year terms). Iron ore imports fell by 11.0% yoy, in part reflecting the weaker conditions in China's construction sector.

INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

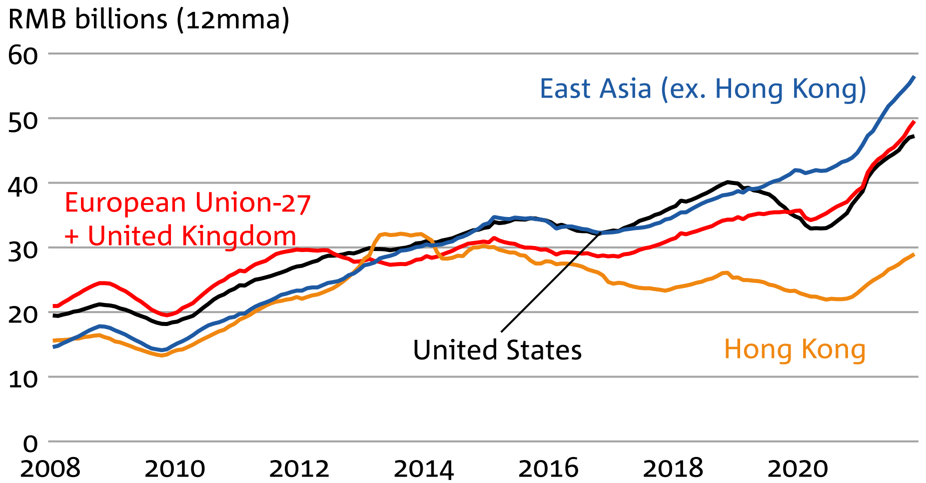
Strong growth has continued, as export values rise to record high



Source: Macrobond, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Strong growth across major trading partners in December



Source: Macrobond, NAB Economics

- The value of China's exports soared month-on-month in December – rising to US$340.5 billion (from US$325.5 billion in November). In year-on-year terms, this was an increase of 20.9%.

- Export prices have risen significantly in recent months (up by 7.5% yoy in November) – contributing to the scale of increase in export values. The past six months have seen the six largest monthly totals in history. However, this has been at odds with weakness in the new export orders measure in the NBS manufacturing PMI survey – which has remained in negative territory over this period.

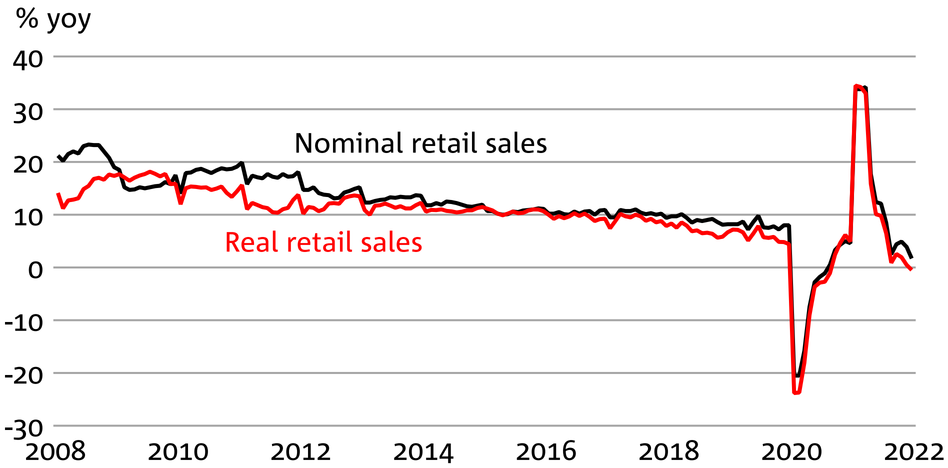
- Exports to China's major trading partners increased strongly in December. Exports to the European Union-27 + the United Kingdom rose by 22.1% yoy, while exports to the United States increased by 21.2% yoy. The increase in imports to East Asia was somewhat more modest at 14.9% yoy.

- It is worth noting that East Asian exports were somewhat constrained by a comparatively weak result for Hong Kong (which rose by 11.5% yoy), which remains prone to considerable distortions due to capital flows being disguised as trade activity. Excluding Hong Kong, exports to East Asia rose by 16.9% yoy – led by increased shipments to South Korea, Malaysia, Thailand and Indonesia.

RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

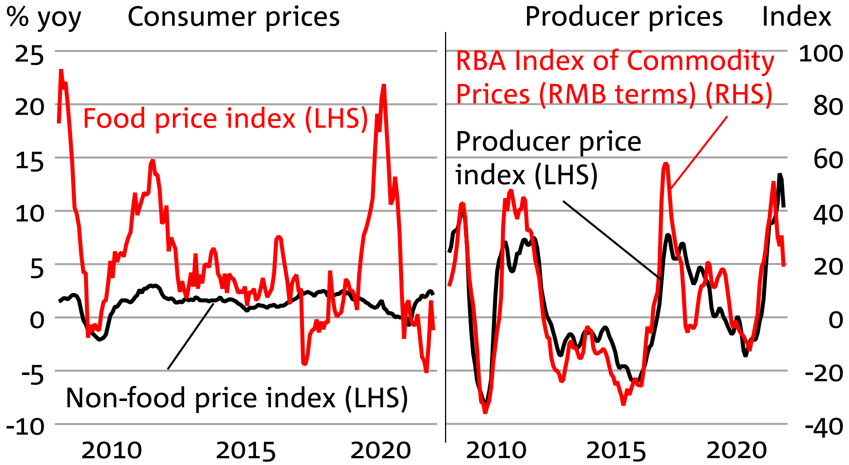
Sales contracted in December for the first time since Aug-20



Source: Macrobond, NAB Economics

CONSUMER AND PRODUCER PRICES

Price pressures weaker, albeit producer growth remains high



Source: Macrobond, NAB Economics

- In nominal terms, growth in China's retail sales continued to slow in December – increasing by just 1.7% yoy (from 3.9% yoy previously). Although retail price inflation was also weaker in December, the decline was less significant than the slowdown in nominal retail sales – meaning that real retail sales contracted in December, down by 0.5% yoy (compared with a 0.5% yoy increase in November). This was the first fall since August 2020, and well below pre-COVID-19 trends.
- Overall, China's consumer price growth slowed in December, with the Consumer Price Index increasing by 1.5% yoy (down from the 2.3% increase in November). Food prices have been the key driver of consumer price trends in recent months – causing both the spike in November and the retreat in December.
- The food price index contracted by 1.2% yoy in December, compared with the 1.6% yoy increase in November. Pork remains a major influence on food prices – with pork prices falling by almost 37% yoy in December (compared with a 33% yoy decline in November). In contrast, fresh vegetables increased by 10.6% yoy, compared with the increase of almost 31% yoy in November related to extreme weather supply disruptions.
- Growth in non-food prices slowed in December – increasing by 2.1% yoy (from 2.5% yoy previously). Increasing vehicle fuel prices have added inflationary pressure since March 2021 – increasing by 22.5% yoy in December, down from almost 36% yoy in November.
- Growth in producer prices has gradually started to slow from its multi-decade high in October. The Producer Price Index rose by 10.3% yoy in December, compared with 12.9% yoy in November and 13.5% yoy in October. A broad range of factors explain the surge in producer prices in recent months – including the impact of electricity shortages, various COVID-19 outbreaks and supply side pressures (including rising commodity prices). When converted into RMB terms, the RBA Index of Commodity Prices rose by 19.0% (down from 30.7% yoy in November), which may suggest that some of the supply side pressures are easing.

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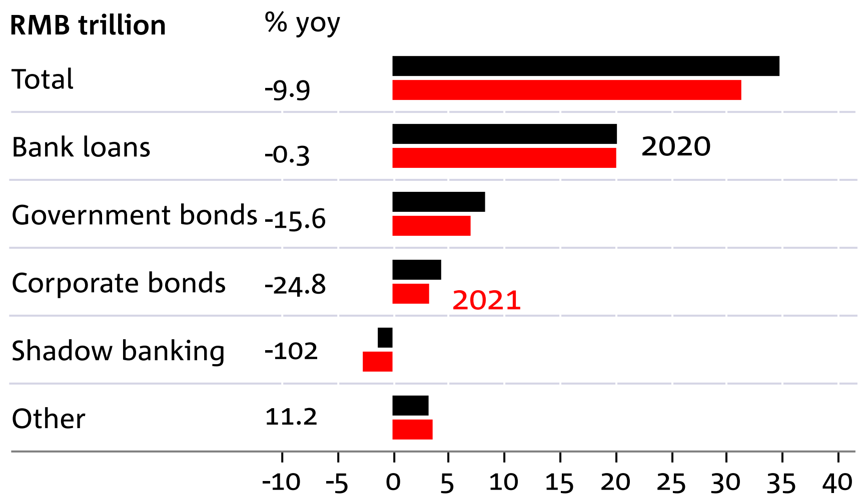
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

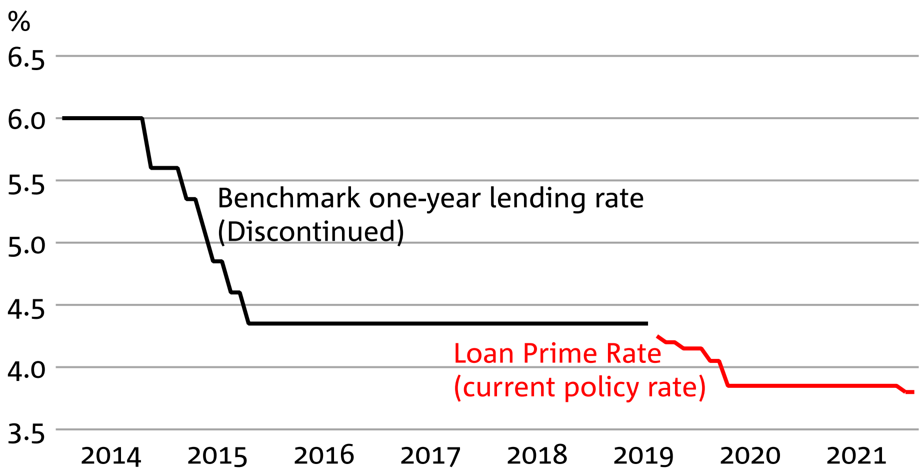
Weaker lending from bonds and shadow banking



Source: Macrobond, NAB Economics

MONETARY POLICY

PBoC trimmed in December; limited capacity for further cuts



Source: Macrobond, NAB Economics

- China's new credit issuance was a little softer month-on-month in December – totalling RMB 2.4 trillion (compared with RMB 2.6 trillion previously). However, this represented a large increase in year-on-year terms – up by almost 44%. A sizeable pickup in government bond issuance contributed to this trend.

- For the full year, China's new credit issuance totalled RMB 31.4 trillion – a decrease of 9.9%. Bank lending was marginally lower in 2021 – totalling RMB 20.1 trillion, a decrease of 0.3%.

- Non-bank lending drove the decline in overall credit issuance – falling by 23.1% to total RMB 11.2 trillion. This decrease has been broad based – with the stock of shadow banking assets (comprising trust and entrusted loans and banker's acceptance bills) continuing to contract, while issuance of government and corporate bonds contracted by 15.6% and 24.8% respectively.

- In mid-December, the People's Bank of China (PBoC) cut its primary policy rate, the Loan Prime Rate (LPR) by 5 basis points to 3.8%, the first rate change since April 2020. This followed the early December cut to the Reserve Requirement Ratio, which expanded banks capacity to lend. In mid-January, the PBoC cut its medium term lending facility (MLF) rate by 10 basis points – which is likely to lead to another LPR cut later this month.

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