CHINA'S ECONOMY AT A GLANCE

MAY 2022

National Australia Bank

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KEY POINTS

COVID lockdowns point to weaker growth and greater uncertainty in the near term

- In stark contrast to the more relaxed public health policy of advanced economies, China is persisting with policies frequently described as "zero COVID", which are causing significant economic disruptions following outbreaks. The lower efficacy of domestic vaccines, a weaker healthcare system and a lack of political opposition to these policies means that we expect them to continue for some time (most likely until mRNA vaccination is widespread in China). This means the risk of further Shanghai-style lockdowns remains – implying downside risk to our forecasts and further disruption to already impaired global supply chains. We now expect China's economy to grow by 4.2% in 2022 (from 5.0% previously) and 5.6% in 2023 (from 5.4% previously).

- China's industrial production contracted year-on-year in April – down by 2.9% yoy. PMI surveys highlighted a range of challenges on both the demand side (with new orders weak) and supply side – where production declined, as well as rising input costs and supplier delivery times expanding. Similarly, real fixed asset investment contracted by 3.5% yoy (from a 1.0% yoy increase previously).

- China's trade surplus was marginally stronger in April – edging up to US$51.1 billion (from US$47.4 billion in March). Recent months have seen the trade surplus retreat from the peaks of late 2021, but it remains high by historical standards. Growth in both export and import values slowed considerably in April, which given the large scale increases in trade prices in recent times, implies that trade volumes contracted – in part reflecting the impact of various COVID-19 measures (including the lockdown in Shanghai).

- Retail sales fell sharply in April – reflecting the impact of various COVID-19 lockdowns and measures on consumer demand. Retail price inflation also accelerated in April, meaning that real retail sales fell by 14.0% yoy – compared with a 6.1% yoy decrease previously. This was the largest contraction since the first quarter of 2020.

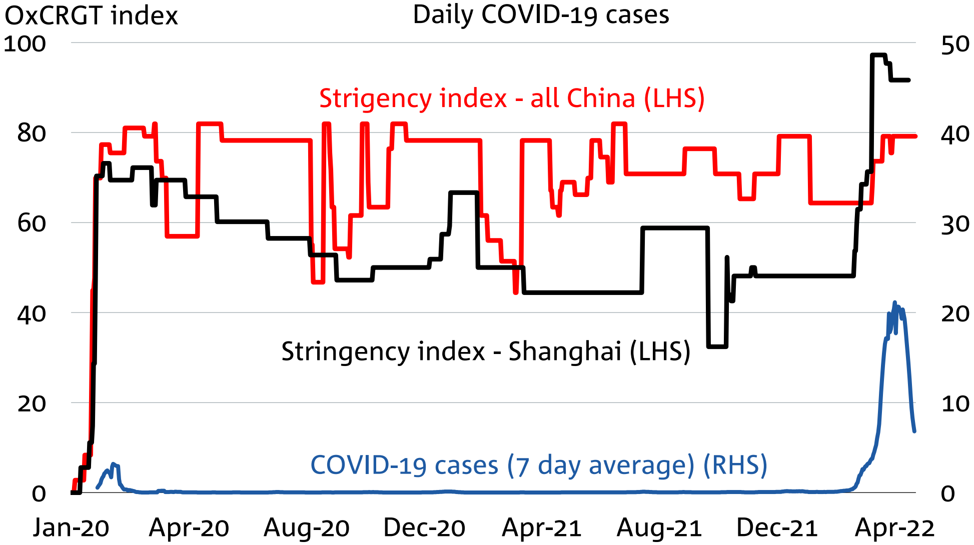
- Over the first four months of the year, total new credit issuance increased by 6.8% yoy to RMB 13.0 trillion. While bank lending accounts for the largest share of this lending, it contracted over this period – down by 5.9% yoy to RMB 8.8 trillion. This decline was driven by the weakness in April, with bank lending rising by 5.2% yoy in Q1 2022. In contrast, government bond issuance rose by 91% yoy over the first four months.

- The People's Bank of China has suggested it intends to step up monetary support, without specifying the tools it is seeking to use, while also noting it aims to keep the exchange rate essentially stable. Since the start of April, the CNY has depreciated by over 5.6% against the US dollar, while the yield on 10 year US Treasuries has exceeded that of China's 10 year government bond since early April. With the Federal Reserve set to lift rates significantly across the remainder of this year (with the risk of further increases in 2023 as well), continued monetary policy imbalance risks capital outflows that could destabilise China's financial sector.

SPECIAL FOCUS: CHINA'S PUBLIC HEALTH POLICY AND ECONOMIC OUTLOOK

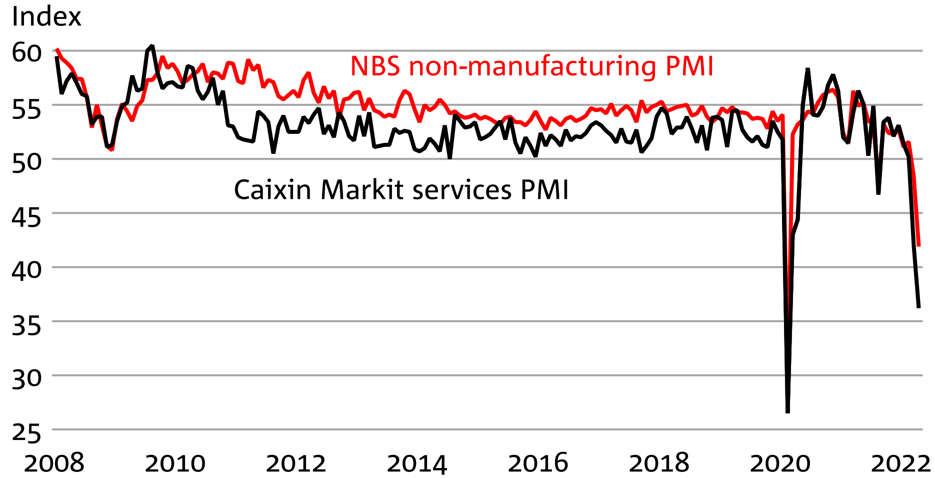
CHINA PERSISTS WITH ZERO-COVID PUBLIC HEALTH POLICY

Shanghai lockdown harsher than initial wave



SERVICES PMIS PLUNGED IN APRIL

Conditions second worst on record (after February 2020)



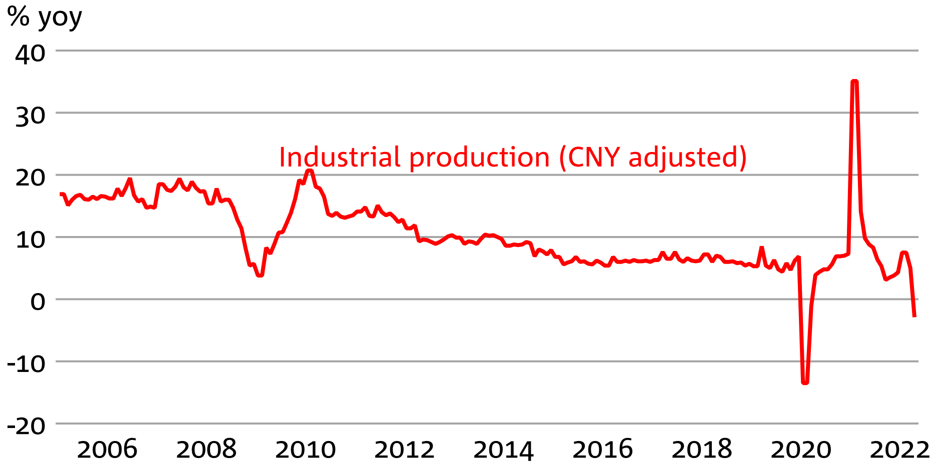
Source: Macrobond, NAB Economics

- Since widespread vaccination has been possible, China's public health response to COVID-19 has differed considerably to advanced economies. Chinese authorities have continued to implement strict lockdowns in response to COVID-19 outbreaks, while most advanced economies have remained open, as large case numbers have not resulted in a corresponding increase in hospitalisations and deaths. China's approach has come at considerable economic cost – particularly as the highly transmissible Omicron variant has proved more difficult to control.
- The recent focus of these measures has been Shanghai – China's largest city and a major driver of its economy. Initially intended to be two five day periods (one period for each half of the city) to allow for mass testing of the population, the lockdown has now extended beyond five weeks, with the Oxford Coronavirus Government Response Tracker suggesting that measures imposed in the city were harsher than the initial COVID-19 wave.
- Other localities have also implemented measures to differing degrees – with rumours at the time of writing that Beijing may impose a lockdown due to rising case numbers. The impact of these measures is evident in services/non-manufacturing PMIs – which plunged to the second lowest readings on record for both surveys (following the initial wave of February 2020). Disruptions to economic activity will spill-over to international markets through already impaired supply chains.
- It appears that China will persist with this public health policy for some time. While China's vaccination rate is reasonably high (by international standards), it is widely believed that domestically produced vaccines provide limited protection against Omicron. In addition, the older aged population is not as highly vaccinated as younger age groups and is highly vulnerable to COVID-19. As study from late 2021 published by the Chinese Centre for Disease Control and Prevention showed that adopting advanced economy policy settings would result in a rapid increase in COVID-19 cases that would quickly overwhelm China's healthcare system. These policies may continue until there is widespread mRNA vaccination in China.
- There also seems to be little political impetus for policy changes. President Xi has publicly associated himself with these policies as recently as early May. Reports suggest there is little to no debate regarding strategy within the Communist Party.
- Reflecting the impact of the recent lockdowns on economic activity, we have cut our forecast for 2022 to 4.2% (previously 5.0%). Given the risk of further outbreaks around the country, downside risk to this outlook remains. That said, recent reports suggest that Chinese authorities remain committed to their 2022 growth target of 5.5%.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

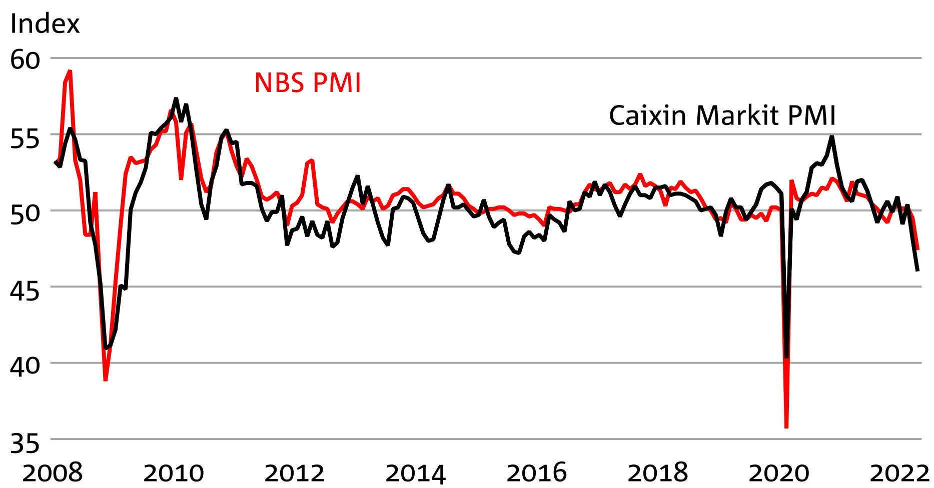
China's COVID-19 response hit industry in April



Source: Macrobond, NAB Economics

MANUFACTURING SURVEYS MORE NEGATIVE IN APRIL

Readings at their lowest since February 2020



Source: Macrobond, NAB Economics

- China's industrial production contracted year-on-year in April – down by 2.9% yoy. Various localities in China have implemented restrictions in response to COVID-19 – with Shanghai the most prominent – severely impacting industrial activity.

- Individual industrial sectors were impacted to differing degrees in April. Output of automobiles plunged – down almost 44% yoy – while there were also sizeable falls for construction-related heavy industry, with cement and crude steel falling by 18.9% yoy and 5.2% yoy respectively. In contrast, output of electronics continued to grow – up by 4.9% - albeit this was well below the double digit grow rates recorded in recent months.

- Both of China's major manufacturing surveys were more negative in April – in part reflecting the impact of a series of lockdowns and other policy responses to various COVID-19 outbreaks – most notably the strict lockdown in Shanghai.

- The private sector Caixin Markit manufacturing PMI fell to 46.0 points (from 48.1 points in February), the weakest reading in this measure since February 2020 (the initial wave of COVID-19). Similarly, the official NBS manufacturing PMI dropped to 47.4 points in April (from 49.5 points previously).

- A range of sub-indices deteriorated in both surveys – highlighting tougher conditions on both the demand side (with new orders weak) and supply side – where production declined, as well as rising input costs and supplier delivery times expanding.

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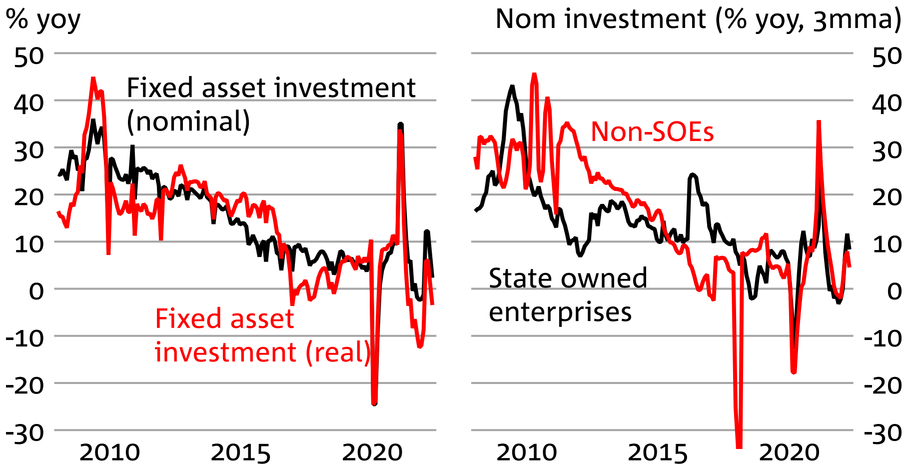
INVESTMENT

FIXED ASSET INVESTMENT

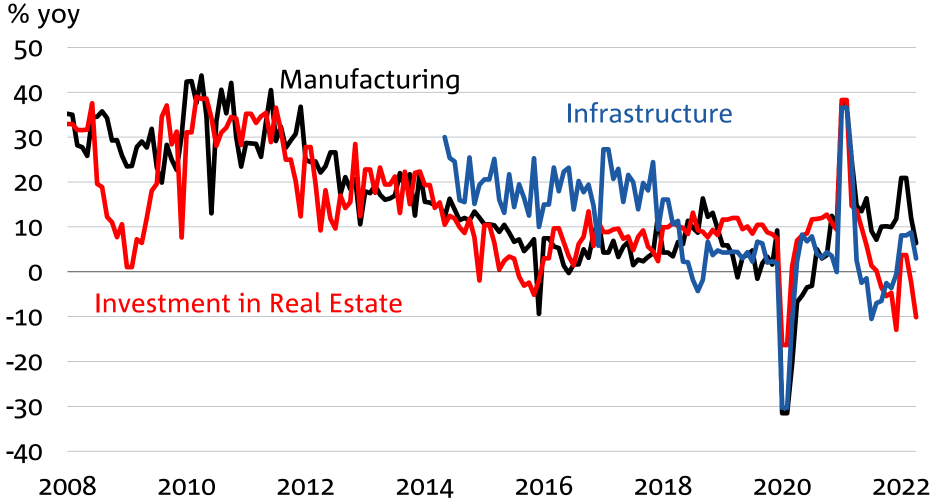
Real investment contracted in April



Source: Macrobond, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Real estate investment declined sharply in April



Source: Macrobond, NAB Economics

- There was a substantial slowing in nominal fixed asset investment in April – down to 2.3% yoy (from 7.1% yoy in March). In contrast, there was only a marginal easing in producer price growth – which flows through to the cost of investment goods – meaning that our estimate of real investment turned negative – contracting by 3.5% yoy (from a 1.0% yoy increase previously).

- Recent months have seen nominal investment by state-owned enterprises (SOEs) grow more rapidly than private sector firms, however both slowed significantly in April. Nominal investment by SOEs rose by 4.6% yoy (down from 10.0% yoy in March), while private sector investment dropped to 1.0% yoy (from 5.4% yoy previously).

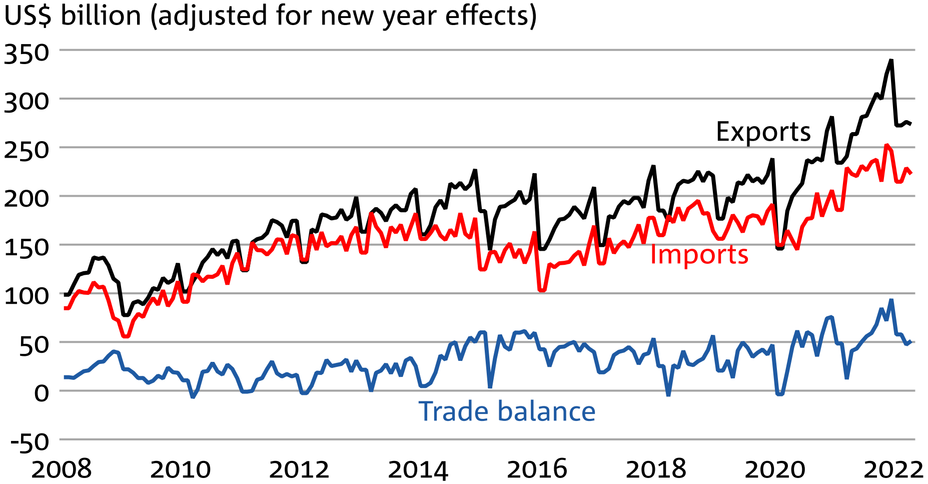
- Investment trends continue to diverge by sector. Manufacturing investment has continued to increase comparatively strongly – up by 6.4% yoy in April (albeit down from double digit growth over the past seven months). Similarly, growth in infrastructure investment was slower in April – increasing by 3.0% yoy, compared with growth of 8.8% yoy in March.

- In contrast, nominal real estate investment was sharply weaker in April – contracting by 10.1% yoy (following on from a 2.4% yoy fall in March). Following the collapse of Evergrande (China's second largest property developer) authorities have sought to stabilise the real estate sector, however residential sales and new construction starts continue to contract. It is unclear if a 20 basis point cut to the floor for mortgage rates will have any material impact on underlying conditions in the sector.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

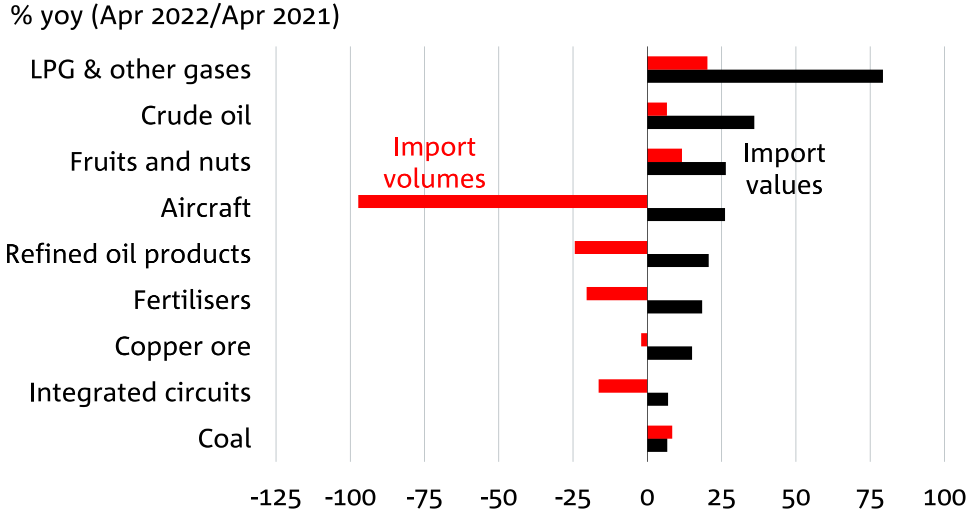
Little change month-on-month for exports and imports



Source: Macrobond, NAB Economics

IMPORT VOLUMES AND VALUES

China's import values inflated by surging prices



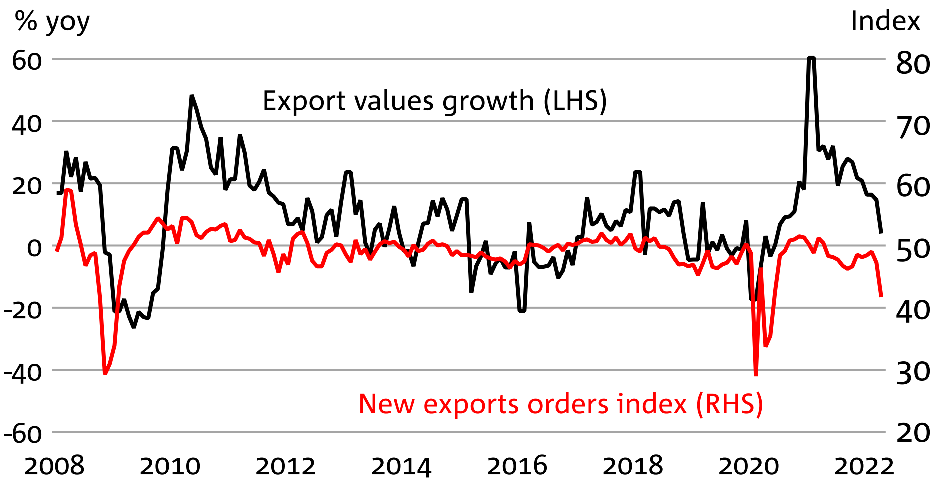
Source: Datastream, NAB Economics

- China's trade surplus was marginally stronger in April – edging up to US$51.1 billion (from US$47.4 billion in March). Recent months have seen the trade surplus retreat from the peaks of late 2021, but it remains high by historical standards.
- China's imports were a little weaker month-on-month – totalling US$222.5 billion (down from US$228.7 billion in March). In year-on-year terms, imports were essentially unchanged. Given that import prices have risen significantly over the past year, this implies that import volumes were considerably lower in April – in part reflecting the impact of lockdowns in various cities (most notably Shanghai).
- From the second half of 2021, import prices have been a larger factor than volumes in explaining the increases in China's import values. Official data showed that volumes fell by around 13.1% yoy in March, following on from a 3.2% decline in February. Our estimate of volumes for April – which uses global commodity prices as a proxy for import prices – suggests another sizeable decline.
- The impact of rising prices is evident when comparing the fastest growing imports (by value) to the volume of these products. Rising energy and fertiliser prices – which have surged following Russia's invasion of Ukraine – are particularly evident, with the value of LPG and other gases rising by 79% yoy in April, compared with an increase of just 20% yoy in volume terms.

INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

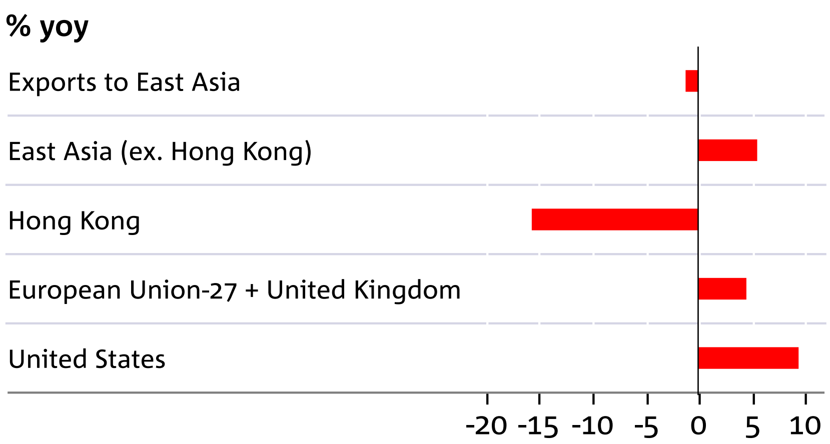
Export growth slowed significantly in April



Source: Macrobond, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Divergent trends in April, driven by steep decline in Hong Kong



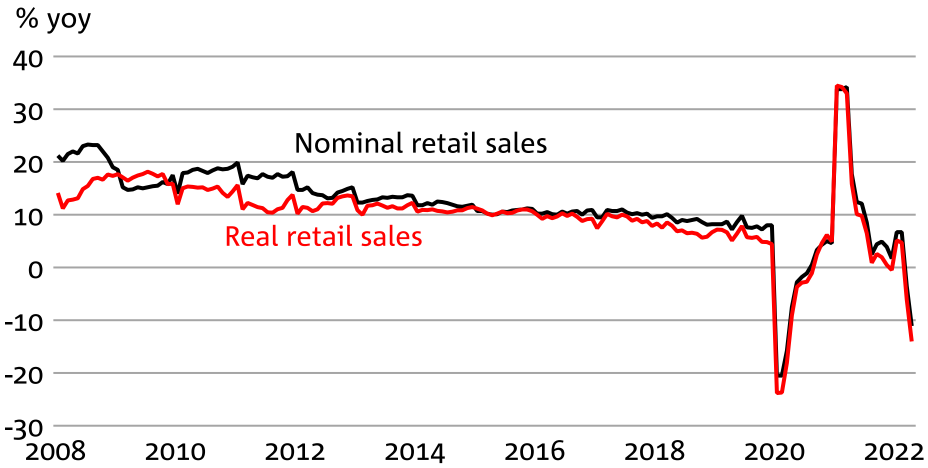
Source: Macrobond, NAB Economics

- China's exports were marginally weaker month-on-month in April – totalling US$273.6 billion (from US$276.1 billion previously). There was a marked slowdown in the year-on-year growth rate in April – down to 3.9% yoy (from 14.7% yoy in March).
- The new export orders measure in the NBS PMI survey was also markedly weaker – down to 41.6 points – the weakest reading since May 2020, when most other economies were still heavily impacted by the initial COVID-19 wave.
- Export prices have trended higher in recent months – up by 11.1% yoy in March – in part reflecting the effects of commodity prices and other supply chain pressures flowing through the manufacturing sector.
- There were stark differences in exports to China's major trading partners in April. Exports to the United States recorded the strongest growth – up by 9.4% yoy – while exports to the European Union-27 + the United Kingdom rose by 4.5% yoy. In contrast, exports to East Asia contracted – down 1.2% yoy.
- Exports to Hong Kong fell by 15.7% yoy. Hong Kong trade data continues to have an outsized impact on East Asia's trade data, and has been frequently distorted in the past by capital flows disguised as trade activity. However, recent months have also seen COVID-19 impacting trade, with Hong Kong suffering a significant outbreak.
- Excluding Hong Kong, exports to East Asia rose by 5.5%, with exports to South Korea, the Philippines and Malaysia increasing most strongly in April.

RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

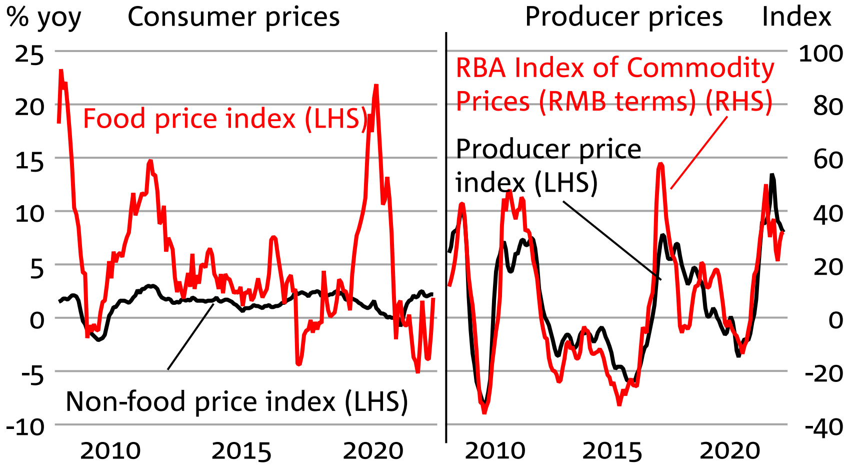
Lockdown drove a plunge in real sales in April



Source: Macrobond, NAB Economics

CONSUMER AND PRODUCER PRICES

Consumer price growth still modest, but has picked up



Source: Macrobond, NAB Economics

- Retail sales fell sharply in April – reflecting the impact of various COVID-19 lockdowns and measures on consumer demand. Nominal retail sales fell by 11.1% yoy (compared with a 3.5% yoy fall in March and a 6.7% yoy increase in January-February).

- Retail price inflation accelerated in April, meaning that there was an even larger fall in real retail sales – down by 14.0% yoy – compared with a 6.1% yoy decrease previously. This was the largest contraction since the first quarter of 2020.

- China's consumer prices rose more rapidly in April – increasing by 2.1% yoy (up from 1.5% yoy in March). That said, this rate of increase is much milder than in most other major economies at present. COVID-19 measures likely had a mixed impact on inflation – with the supply disruptions adding some pressure, while demand has likely been negatively impacted.

- Food prices increased by 1.9% yoy (compared with a 1.5% yoy fall recorded in March). The steep declines in pork prices – reflecting the ongoing recovery from China's African Swine Fever outbreak in 2018 – continues to constrain the food price index, with pork down by 33% yoy in April. In contrast, fresh vegetable prices rose by 24% yoy and fresh fruit increased by 14.1% yoy.

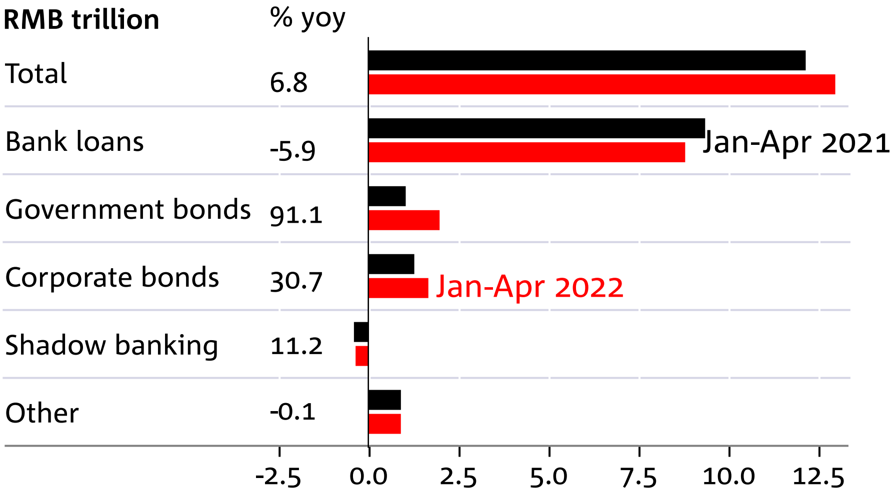
- Non-food price growth was stable in April, at 2.2% yoy. Vehicle fuel prices continue to influence non-food price growth – increasing by 28.4% yoy in April.

- Growth in producer prices has continued to slow – up by 8.0% yoy in April (from 8.3% yoy in March). Growth has declined from double digit levels in late 2021, largely in line with easing in year-on-year commodity price growth between July 2021 and January 2022, however commodity prices have subsequently accelerated (in RMB terms) – a trend that could continue if the currency weakens further.

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

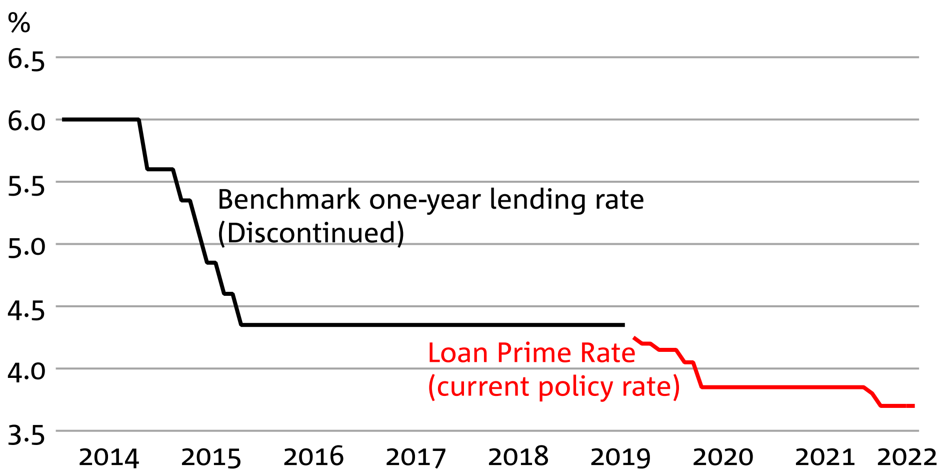
Weakness in April results in bank lending contracting YTD



Source: Macrobond, NAB Economics

MONETARY POLICY

Exchange rate stability goal limits PBoC policy room



Source: Macrobond, NAB Economics

- China's new credit issuance was considerably weaker in April (when compared with the earlier months of 2022) – with lockdowns and other COVID-19 restrictions likely impacting activity. In particular, bank lending slowed sharply.

- Over the first four months of the year, total new credit issuance increased by 6.8% yoy to RMB 13.0 trillion. While bank lending accounts for the largest share of this lending, it contracted over this period – down by 5.9% yoy to RMB 8.8 trillion. This decline was driven by the weakness in April, with bank lending rising by 5.2% yoy in Q1 2022.

- Non-bank lending was also a little softer in April, however it increased strongly over the first four months – up by 49% yoy. Government bond issuance was the key driver – increasing by 91% yoy – while corporate bond issuance also rose significantly (up almost 31% yoy).

- In its Q1 monetary policy implementation report, the People's Bank of China (PBoC) stated that it would step up monetary support for the slowing economy, without specifying the tools it is seeking to use. In mid-April, the PBoC cut the Reserve Requirement Ratio for banks, increasing the funds available for lending to customers, having last cut its main policy rate – the Loan Prime Rate – in January.

- The PBoC also noted that it is seeking to keep the exchange rate essentially stable, which suggests little scope to ease its policy rates. Since the start of April, the CNY has depreciated by over 5.6% against the US dollar, while the yield on 10 year US Treasuries has exceeded that of China's 10 year government bond since early April. With the Federal Reserve set to lift rates significantly across the remainder of this year (with the risk of further increases in 2023 as well), continued monetary policy imbalance risks capital outflows that could destabilise China's financial sector.

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