CHINA'S ECONOMY AT A GLANCE

JULY 2022

National Australia Bank

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CONTACT

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KEY POINTS

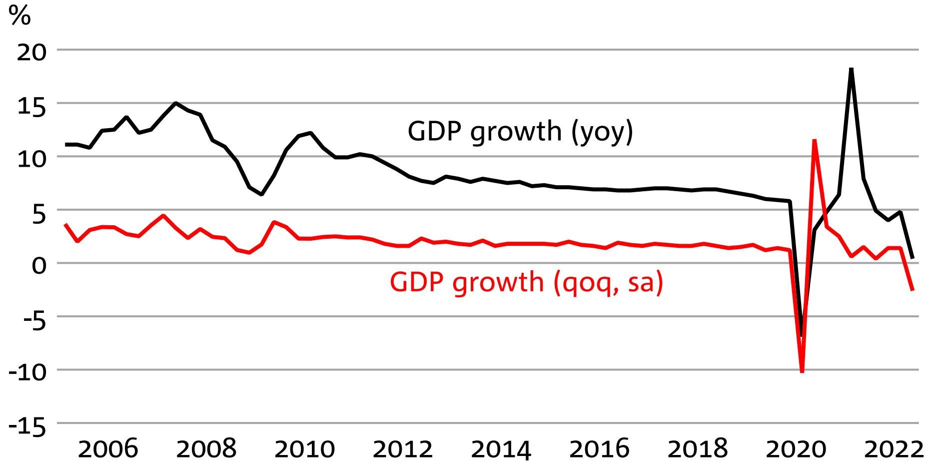
COVID-19 measures hit China's economy harder than expected in Q2, and present downside risk to the outlook

- The impact of COVID-19 restrictions in major population centres such as Shanghai and Beijing were evident in Q2 national accounts data. China's economy grew marginally in year-on-year terms, up by 0.4%, but contracted significantly in quarterly terms – down by 2.6%. This result was considerably weaker than expectations.
- Reflecting the larger than anticipated downturn in Q2, we are once again revising down our growth forecast for 2022. We expect China's economy to grow by 3.5% (4.2% previously), before increasing by 5.9% in 2023 (was 5.6%). This growth will require a significant rebound in activity in the second half – which is likely to be supported by infrastructure developments – meaning that COVID-19 outbreaks remain a downside risk to the outlook. Consumers are likely to remain cautious in the near term, given the lack of fiscal support for households during the pandemic and the risk of further damage to household balance sheets from any further lockdowns.
- The easing of COVID-19 restrictions supported a rebound in industrial activity in June. Industrial production increased by 3.9% yoy (up from 0.7% yoy in May and a 2.9% yoy fall in April). A modest uptick in nominal fixed asset investment growth and easing in producer prices meant that our estimate of real investment growth turned positive, up by 1.0% yoy in June (compared with a 0.4% yoy fall in May).
- China's trade surplus surged in June, increasing to US$97.9 billion – a new record high. This increase reflected a large month-on-month lift in exports (as COVID-19 measures eased in several key locations) and a modest increase in imports.
- Retail price inflation data was not available at the time of writing, however the uptick in CPI (see below) suggests that it would have risen from the 3.3% rate recorded in May. This means that real retail sales would have declined again in June, albeit less than the 9.7% fall in May.
- In the first half of 2022, new credit issuance increased by 17.8% yoy to RMB 21.0 trillion. Bank lending has increased comparatively modestly – up by just 3.5% yoy over this period, while non-bank lending rose by almost 59% yoy during the first half (led by government bond issuance).
- The People's Bank of China is still seeking to provide monetary support, however this is likely to come by boosting credit availability (most likely through further cuts to the Required Reserve Ratio or via relending facilities) rather than lowering rates. The PBoC has maintained its primary policy rate, the one year Loan Prime Rate, unchanged at 3.7% since January 2022. Given the rapid increases in policy rates in advanced economies (with more likely in coming months), a widening monetary policy imbalance risks capital outflows that could destabilise the financial sector, as well as putting downward pressure on the currency. This suggests risk of a policy rate hike would appear larger than any further cuts, despite soft domestic demand conditions.

GROSS DOMESTIC PRODUCT

CHINA'S ECONOMIC GROWTH

COVID-19 measures constrained activity in Q2

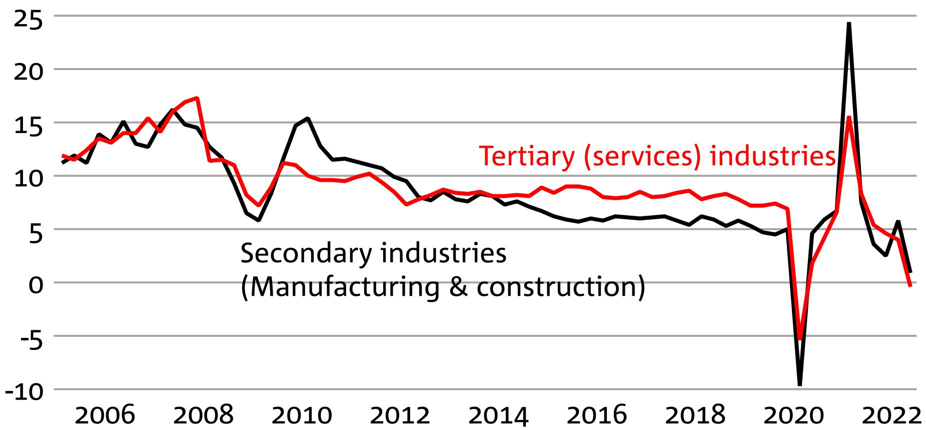


Source: Macrobond, NAB Economics

ECONOMIC GROWTH BY INDUSTRY

Services contracted year-on-year in Q2

Chinese economic growth by sector (% yoy)



Source: Macrobond, NAB Economics

- The impact of COVID-19 restrictions in major population centres such as Shanghai and Beijing were evident in Q2 national accounts data. China's economy grew marginally in year-on-year terms, up by 0.4%, but contracted significantly in quarterly terms – down by 2.6%. This result was considerably weaker than expectations (-1.5% qoq in the Reuters poll).

- The growth breakdown by industry showed a steep downturn across the board – albeit China's services sector contracted in year-on-year terms (down 0.4%), compared with a slight increase in the secondary (manufacturing and construction) sector – up 0.9% yoy.

- Monthly data show the weakest period in the quarter was in April, with the recovery strongest (so far) in June, suggesting that a strong rebound in growth in likely in Q3. That said, Chinese authorities are continuing with their public health measures in response to COVID-19 outbreaks (with a lockdown currently underway in the northwestern city of Xi'an). Fresh outbreaks in Shanghai in recent days have raised concerns that measures could be tightened in the city once again.

- Reflecting the larger than anticipated downturn in Q2, we are once again revising down our growth forecast for 2022. We expect China's economy to grow by 3.5% (4.2% previously), before increasing by 5.9% in 2023 (was 5.6%). This growth will require a significant rebound in activity in the second half – which is likely to be supported by infrastructure developments – meaning that COVID-19 outbreaks remain a downside risk to the outlook. Consumers are likely to remain cautious in the near term, given the lack of fiscal support for households during the pandemic and the risk of further damage to household balance sheets from any further lockdowns.

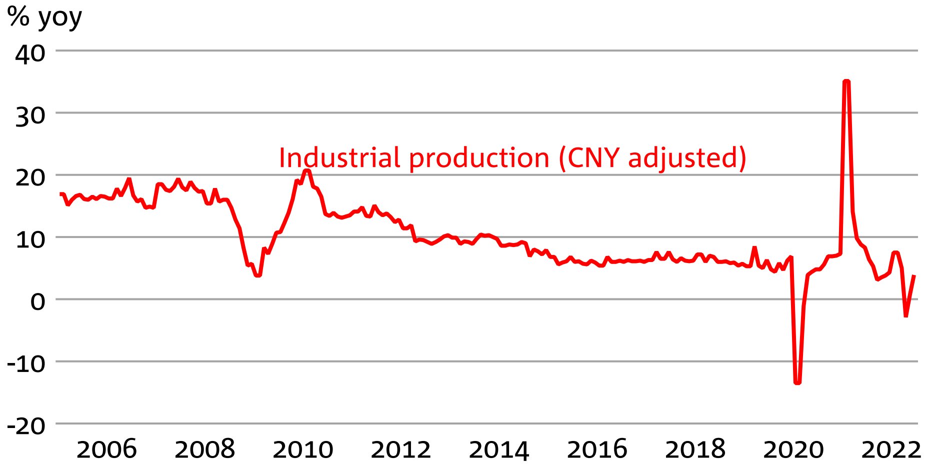
NAB CHINA GDP FORECASTS

%	2021	2022	2023	2024
GDP	8.1	3.5	5.9	4.9

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

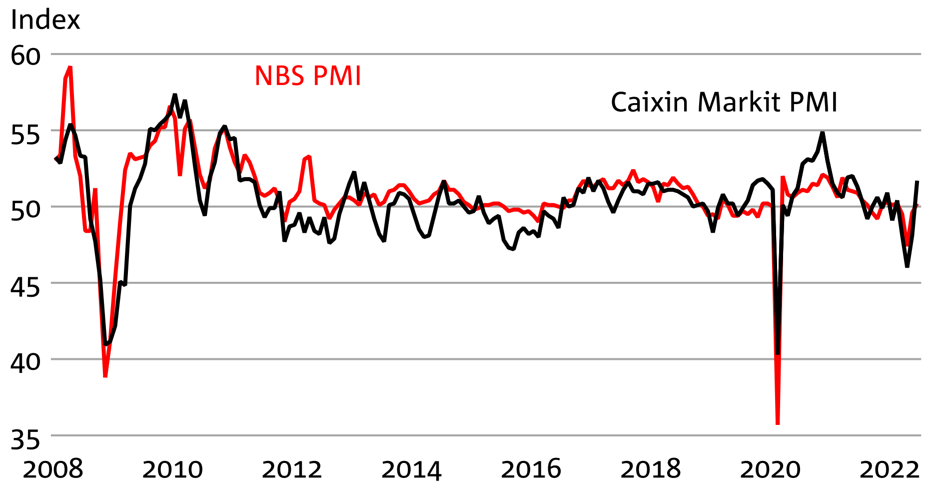
Easing COVID-19 restrictions supported rebound in output



Source: Macrobond, NAB Economics

MANUFACTURING PMIS TURN POSITIVE IN JUNE

Recovery driven by reopening in Shanghai & Beijing



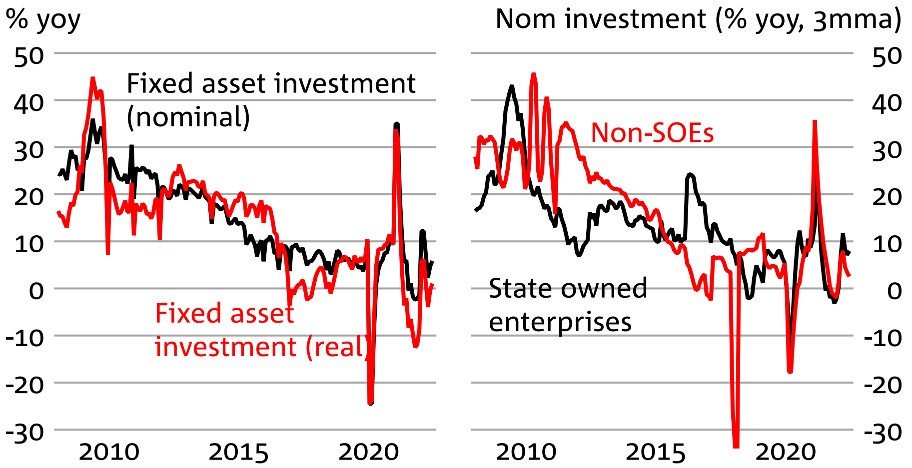
Source: Macrobond, NAB Economics

- The easing of COVID-19 restrictions supported a rebound in industrial activity in June. Industrial production increased by 3.9% yoy (up from 0.7% yoy in May and a 2.9% yoy fall in April).
- That said, this recovery was far from even – with a wide divergence in trends by major industrial sectors. Reflecting the weakness in the construction sector, heavy industry tied to this sector continued to contract, with cement and crude steel output falling by 12.9% yoy and 3.3% yoy respectively. In contrast, motor vehicle production accelerated – up 26.8% yoy – while electronics manufacturing remained robust – increasing by 11.0% yoy.
- Following on from weak readings recorded in April and May, China's major manufacturing surveys returned to positive territory in June, as the easing of COVID-19 measures in Shanghai and Beijing supported a recovery in economic activity.
- The private sector Caixin Markit PMI rebounded strongly in June – moving up to 51.7 points (from 48.1 points in May). In contrast, the pickup in the official NBS PMI was more modest, rising to 50.2 points in June (having been comparatively less negative at 49.6 points previously).
- Both surveys noted positive readings for production and new orders, however there was some slight differences between these surveys regarding new export orders – with this measure turning positive in the Caixin Markit survey, while remaining negative in the NBS survey (albeit recording the least negative outcome since April 2021).

INVESTMENT

FIXED ASSET INVESTMENT

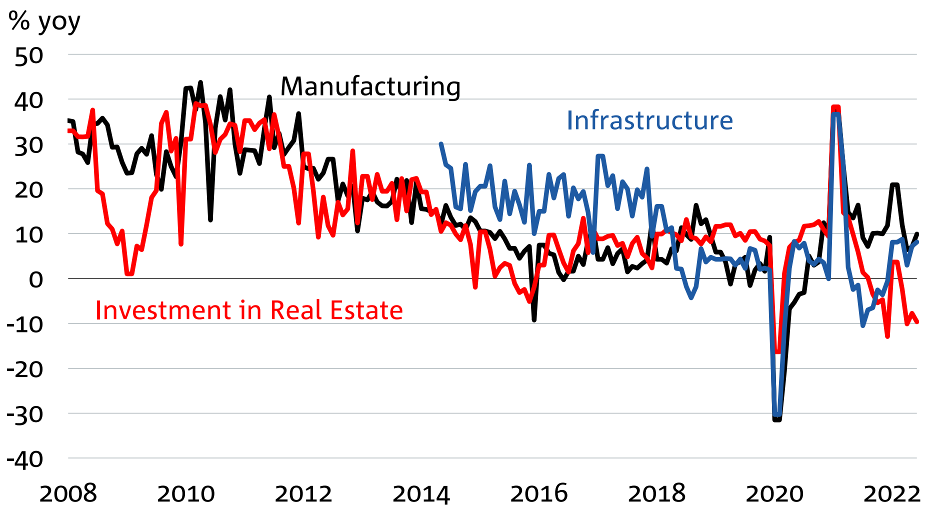
Real investment turned marginally positive in June



Source: Macrobond, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Manufacturing and infrastructure strengthen, RE remains weak



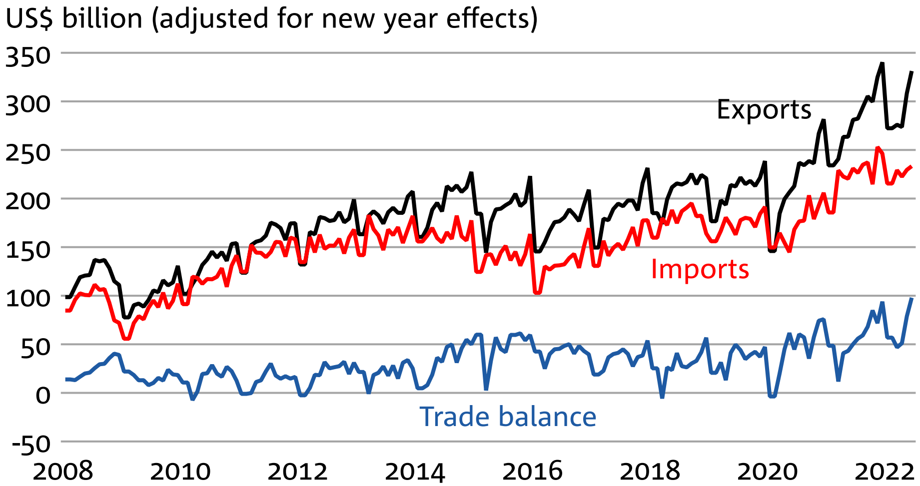
Source: Macrobond, NAB Economics

- China's nominal fixed asset investment recorded another modest uptick in growth in June – increasing by 5.8% yoy (up form 4.7% yoy in May). Growth in producer prices has continued to gradually ease – and this flows through into the cost of investment goods – meaning that our estimate of real investment growth turned positive, up by 1.0% yoy in June (compared with a 0.4% yoy fall in May and a 4.0% yoy contraction in April).
- State-owned enterprises (SOEs) have increased investment more rapidly than private sector firms in 2022. Nominal SOE investment rose by 10.9% yoy in June (up from 6.9% yoy in May), while private sector investment slowed somewhat – increasing by 2.8% yoy in June (down from 3.6% yoy previously).
- Major industrial sectors continue to exhibit diverging trends. Growth in nominal investment in both manufacturing and infrastructure have continued to pick up – increasing by 9.9% yoy and 8.2% yoy respectively. In contrast, investment in real estate continues to contract – reflecting the underlying weakness in the sector – down by 9.7% yoy in June.
- Despite commentary from various Chinese authorities that they intended to stabilise the real estate sector – including cutting longer term interest rates tied closely to mortgage pricing, the volume of residential property sales and new construction starts has continued to contract sharply.

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

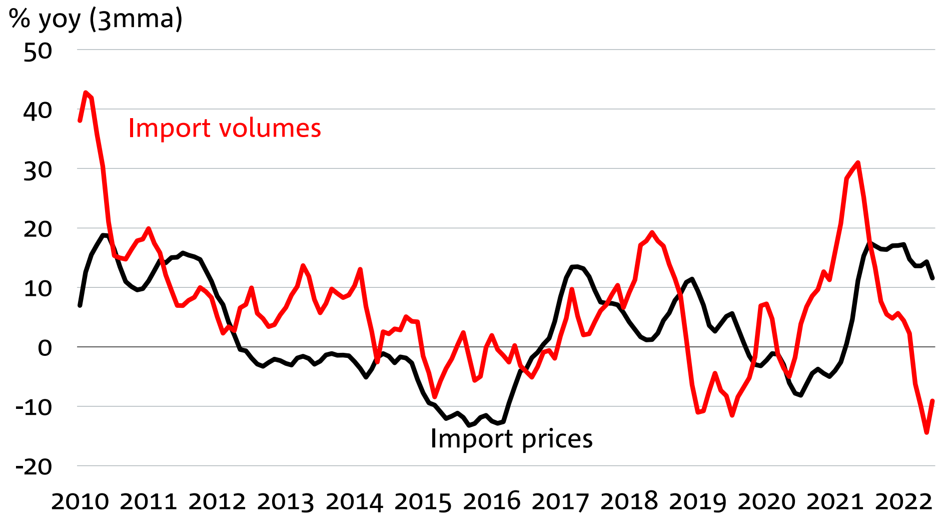
Surplus increases to record high as exports surged in June



Source: Macrobond, NAB Economics

IMPORT VALUES AND VOLUMES

Prices have driven import values higher, with volumes falling



Source: CEIC, Macrobond, NAB Economics

- China's trade surplus surged in June, increasing to US$97.9 billion (from US$78.8 billion in May) – a new record high, exceeding the US$93.9 billion surplus recorded in December 2021. This increase reflected a large month-on-month lift in exports (as COVID-19 measures eased in several key locations) and a modest increase in imports.

- Imports totalled US$233.3 billion in June (up from US$229.5 billion previously). In year-on-year terms, this represented an increase of just 1.0%.

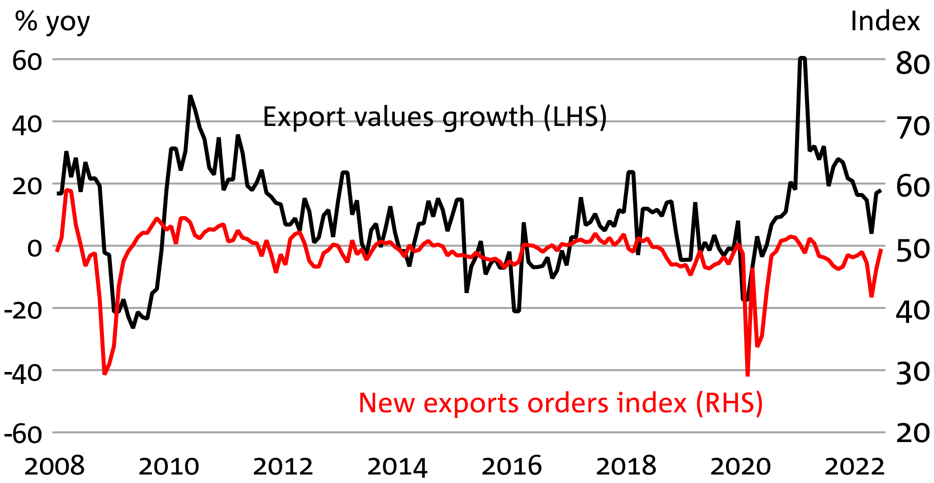
- A key driver of the growth in China's imports in recent times has been rapid increases in prices. Official data suggests that import prices have increased at double digit rates (year-on-year) since April 2021. On the other hand, import volumes have contracted year-on-year since February 2022. There is a one month lag in volume data; our estimate (which uses global commodity prices as a proxy for import prices) suggests volumes fell more modestly in June – down by around 5% yoy, compared with a 8.8% yoy fall in May.

- When comparing import volumes and values by individual products, the impacts of higher energy costs (when compared with June 2021) are highly apparent. For example, the value of fertiliser imports (for which natural gas is a key input) rose by 109%, while volumes increased by just 6.2% – albeit this market has also been impacted by the Russia-Ukraine conflict. Similarly, there were much larger increases in the value of crude oil and coal imports, while the volume of these products fell year-on-year.

INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

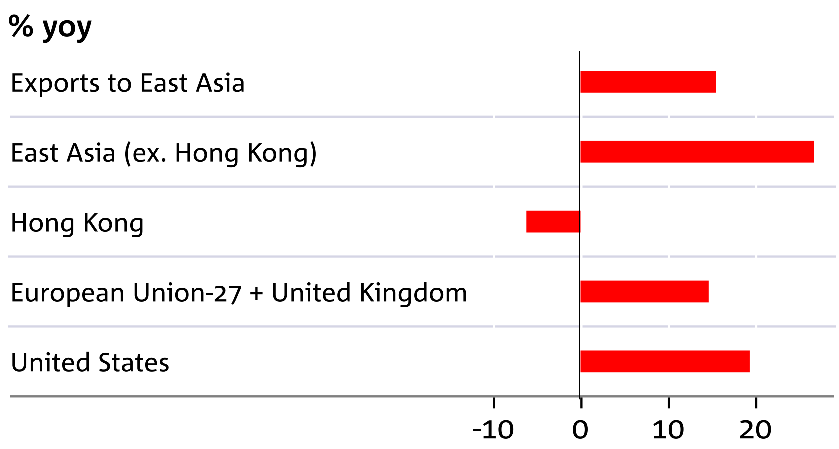
Surge in export values despite still negative export order readings



Source: Macrobond, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Strong growth to major partners, albeit reported decline to HK



Source: Macrobond, NAB Economics

- China's exports jumped in June, rising to US$331.4 billion (from US$308.2 billion previously). This was the second largest monthly total on record – only exceeded by December 2021 – and likely reflects some catch up in deliveries following the impact of COVID-19 measures on exports across April and May. This suggests that this strength is unlikely to be maintained in coming months.

- Despite a pickup in June, the new export orders measure in the NBS PMI survey remained in negative territory – at 49.5 points (from 46.2 points previously) – albeit this was the strongest reading since April 2021.

- There were strong increases to the majority of China's major trading partners. Exports to the United States rose by 19.3% yoy in June, while exports to the European Union-27 + the United Kingdom rose by 14.6% yoy (despite exports to the UK having fallen modestly in June). Exports to East Asia increased 15.5% yoy, despite another fall in exports to Hong Kong.

- Exports to Hong Kong fell by 6.2% yoy in June. We have previously noted the frequent divergences between official Chinese and Hong Kong customs data regarding trade between the two parties – with the gap often due to capital flows being disguised as trade activity. In June 2021, China's reported exports to Hong Kong were almost 10% higher than Hong Kong Customs reported – suggesting the reported fall in exports this month may not be entirely accurate.

- Excluding Hong Kong, exports to East Asia rose by 26.7% yoy – led by increased shipments to South Korea, Malaysia and Singapore among others.

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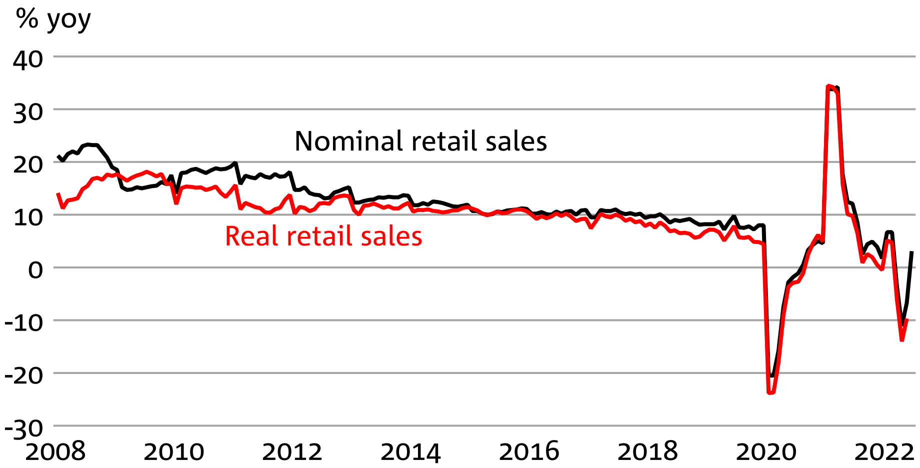
RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

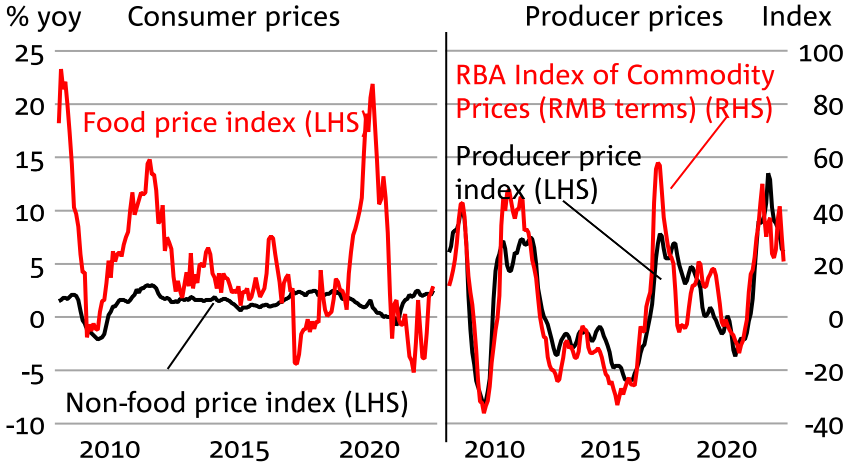
Pickup in nominal sales, but real likely remained negative



Source: Macrobond, NAB Economics

CONSUMER AND PRODUCER PRICES

Consumer prices up as pork price deflation continues to ease



Source: Macrobond, NAB Economics

- China's nominal retail sales recovered in June – again in line with reopening post-COVID-19 measures – increasing by 3.1% yoy (compared with a 6.7% yoy fall in May). That said, this rate of increase was still relatively modest by historical standards (particularly pre-pandemic), highlighting consumer caution and the lack of fiscal support for households (particularly when compared with advanced economies).

- Retail price inflation data was not available at the time of writing, however the uptick in CPI (see below) suggests that it would have risen from the 3.3% rate recorded in May. This means that real retail sales would have declined again in June, albeit less than the 9.7% fall in May.

- Consumer inflationary trends were stronger in June, with the consumer price index increasing by 2.5% yoy (up from 2.1% yoy in both April and May). It is worth noting that growth in China's prices has been comparatively modest in recent months when compared with international trends, albeit this likely reflects the weakness in the domestic economy.

- Food prices rose more strongly in June, up by 2.9% yoy (compared with 2.3% yoy previously). Since late 2020, falling pork prices – as domestic pork supply recovered from the impacts of the earlier African Swine Fever outbreak – have put downward pressure on aggregate food prices, however this effect is now diminishing. Pork prices fell by 6.0% yoy in June, compared with a 21.1% yoy decrease in May (with prices rising month-on-month since April).

- Non-food prices also increased more rapidly – increasing by 2.5% yoy in June (from 2.1% yoy in May). Vehicle fuel prices continue to influence this growth – increasing by 32.8% yoy (compared with 27.1% yoy in May).

- Producer price growth has been slowing in recent months, having peaked in October 2021 at 13.5% yoy. The Producer Price Index rose by 6.1% yoy in June, down from 6.4% yoy in May. Global commodity prices have a major influence on producer prices, with the RBA Index of Commodity Prices (converted into RMB terms) rising by 20.8% yoy in June (down from 30.7% yoy previously).

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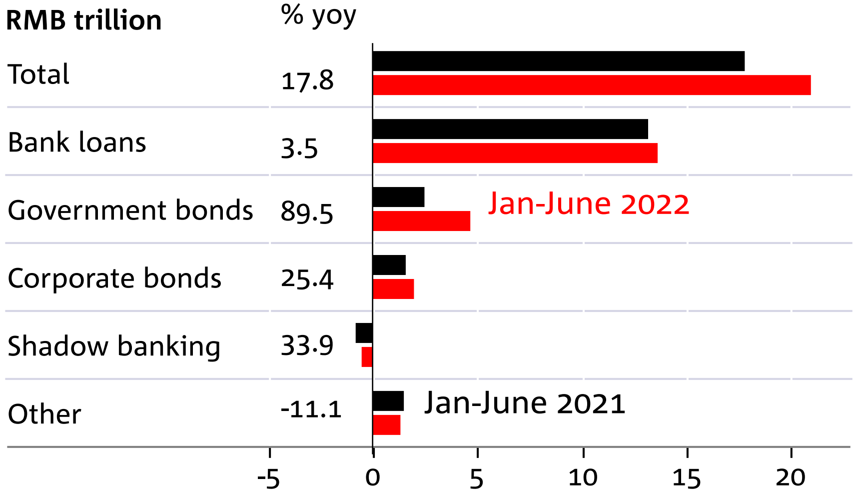
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

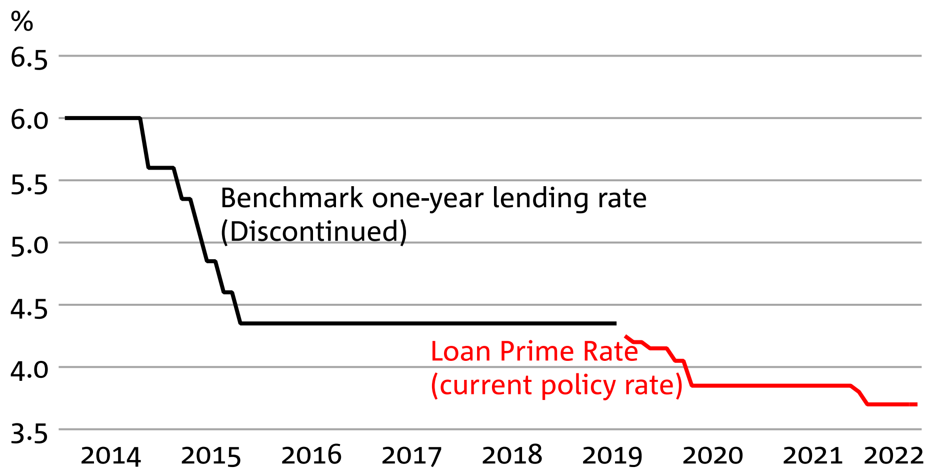
Strong growth in first half thanks to June month credit surge



Source: Macrobond, NAB Economics

POLICY RATE

Rising rates abroad give little room for cuts, and may force hikes



Source: Macrobond, NAB Economics

- New credit issuance surged in June, as the reopening of key regions of the country (following COVID-19 measures across April and May) supported a strong rebound in lending activity. Total issuance was RMB 5.2 trillion (up from RMB 2.8 trillion in May and RMB 0.9 trillion in April), with bank lending accounting for the majority of the increase.

- In the first half of 2022, new credit issuance increased by 17.8% yoy to RMB 21.0 trillion. Despite accounting for the largest share of total issuance, bank lending has increased comparatively modestly – up by just 3.5% yoy over this period to RMB 13.6 trillion.

- In contrast, non-bank lending rose by almost 59% yoy during the first half. Government bond issuance was the key driver – increasing by almost 90% yoy to RMB 4.7 trillion. Corporate bond issuance grew rapidly at the start of the year, but has slowed more recently – up by 25% yoy in the first half. Shadow banking components have continued to contract.

- Recent commentary by the Yi Gang, Governor of the People's Bank of China (PBoC) suggests that the organisation is still seeking to provide monetary support, however this would likely come by boosting credit availability (most likely through further cuts to the Required Reserve Ratio or via relending facilities) rather than lowering rates.

- The PBoC has maintained its primary policy rate, the one year Loan Prime Rate, unchanged at 3.7% since January 2022. Given the rapid increases in policy rates in advanced economies (with more likely in coming months), a widening monetary policy imbalance risks capital outflows that could destabilise the financial sector, as well as putting downward pressure on the currency. This suggests risk of a policy rate hike would appear larger than any further cuts, despite soft domestic demand conditions.

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