CHINA'S ECONOMY AT A GLANCE

AUGUST 2022

National Australia Bank

CONTACT

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KEY POINTS

Reopening rebound limited by weakness in domestic demand and credit appetite

- There were few positive signs for China's domestic economy in July, with the rebound in June associated with reopening from COVID-19 restrictions quickly fading. Domestic consumption – as indicated by real retail sales – remains subdued (contracting by 0.8% yoy), and the weakness in credit data suggest little appetite to borrow – prompting the modest cut to the Medium Term Lending Facility rate today. While export growth was strong this month – with China's trade surplus rising to a record high – the prospect of weaker demand growth in advanced economies will limit the external sector as a source of growth. Last month, we cut our forecast for China's growth in 2022 to 3.5%, and in this month's Forward View – Global, we cut the forecast for 2023 to 5.4% (from 5.9% previously).

- China's industrial production grew marginally more slowly in July – increasing by 3.8% yoy (from 3.9% yoy in June). When compared with pre-pandemic rates of growth, this remains relatively weak – highlighting modest benefits from the reopening from COVID-19 restrictions in June.

- Growth in China's nominal fixed asset investment slowed in July – up by 3.6% yoy (from 5.8% yoy in June). State-owned enterprises (SOEs) have been the key drivers of investment growth in recent months – nominal SOE investment rose by 11.8% yoy in July, while private sector investment contracted by 0.9% yoy. While producer price growth has eased, real investment remains weak – contracting by 0.7% yoy (from -0.4% yoy in June).

- For the second straight month, China's trade surplus rose in July to a record high. The surplus totalled US$101.3 billion (up from US$97.9 billion in June). In month-on-month terms, exports edged slightly higher, while imports were marginally softer in July.

- New credit issuance slowed substantially in July – following on from the reopening surge seen in June. Total issuance was just RMB 0.8 trillion (compared with RMB 5.2 trillion previously), with modest increases in government bonds and bank lending accounting for the bulk of this increase.

- In recent months, the People's Bank of China has repeatedly indicated that it has sought to provide monetary support to the economy, largely via expanding credit availability. There appears to be limited demand for credit – in part related to the weakness in the property sector and the generally weaker state of the private-sector economy – which likely inspired the 10 basis point cut to the Medium Term Lending Facility (MTF) rate in mid-August.

- With advanced economy central banks rapidly lifting policy rates, there has been limited scope for rate cuts in China, with the widening monetary policy imbalance already risking capital flight. Data from the Institute of International Finance show sizeable portfolio (equity and debt) outflows between May and July 2022 – which could force the PBoC to lift rates or implement other measures (such as capital controls) in coming months in order to prevent destabilisation of the financial sector.

INDUSTRIAL PRODUCTION

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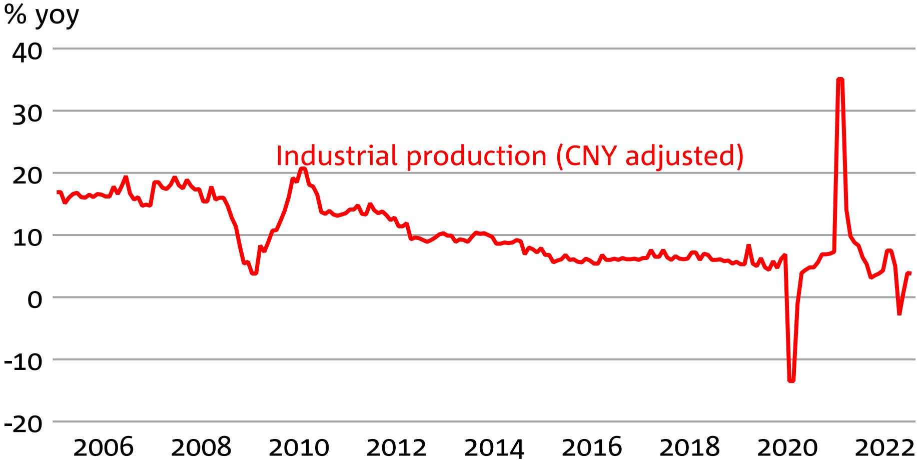
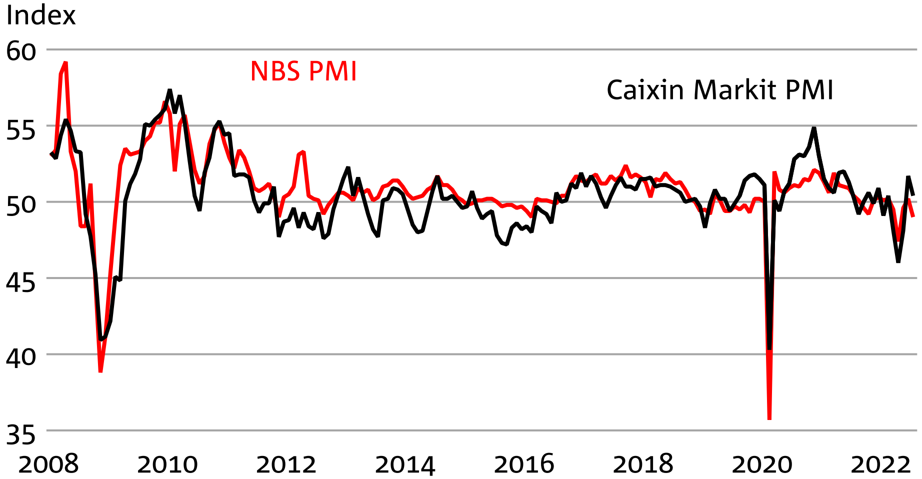
No further bounce in July from removal of COVID-19 constraints



Source: Macrobond, NAB Economics

PMI SURVEYS SHOW LIMITED REOPENING BENEFITS

Official PMI turned negative in July, with Caixin measure neutral



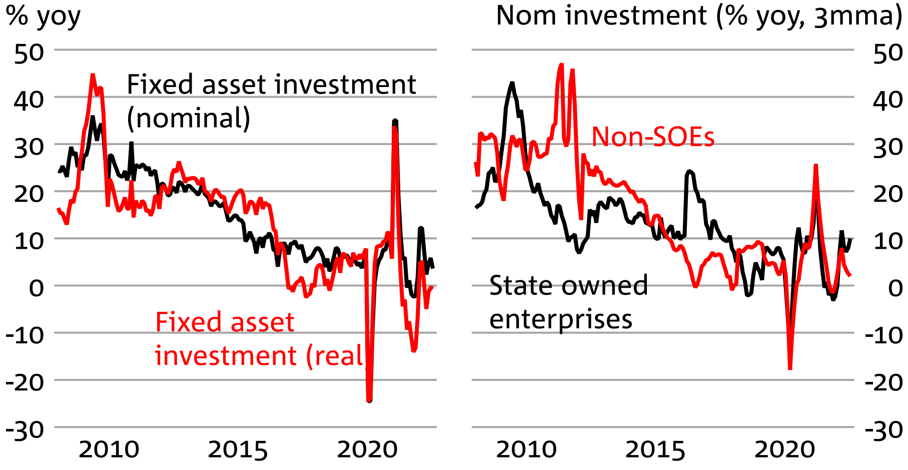
Source: Macrobond, NAB Economics

- China's industrial production grew marginally more slowly in July – increasing by 3.8% yoy (from 3.9% yoy in June). When compared with pre-pandemic rates of growth, this remains relatively weak – highlighting modest benefits from the reopening from COVID-19 restrictions in June.
- Trends within the industrial sector remain highly divergent. Reflecting the weak conditions in the construction sector, related heavy industries continue to contract, with output of cement and crude steel down by 7.0% yoy and 6.4% yoy respectively. In contrast, production of motor vehicles rose strongly – up by 31.5% yoy – and electronics manufacturing rose by 7.3% yoy.
- China's manufacturing PMIs dipped lower in July, following the rebound in June – as parts of the country reopened as COVID-19 restrictions eased. The official NBS PMI dropped back into negative territory – at 49.0 points (from 50.2 points in June). The Caixin Markit PMI fell to 50.4 points in July (from 51.7 points previously).
- Both surveys recorded weaker readings for new orders – highlighting ongoing softness in China's domestic demand – albeit this measure was negative in the NBS survey and marginally positive in the Caixin survey. There was also a similar trend with new export orders.

INVESTMENT

FIXED ASSET INVESTMENT

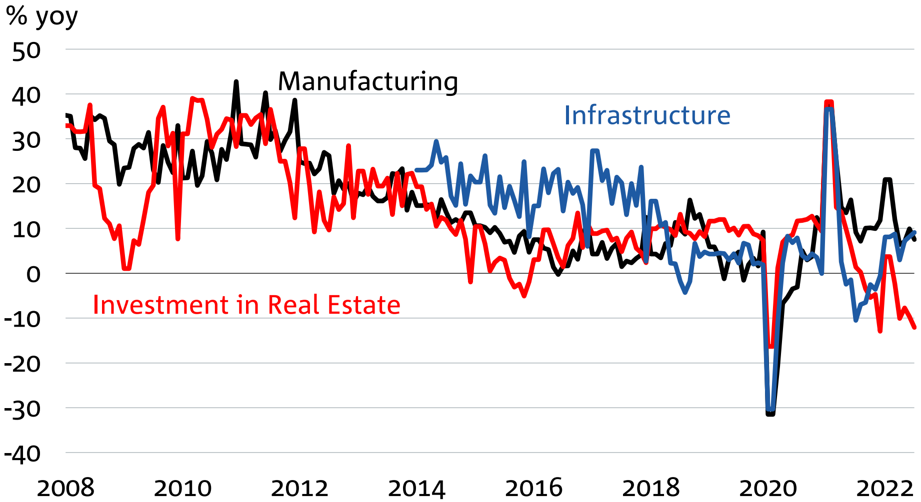
Growing divergence between SOE and private investment



Source: Macrobond, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Real estate investment continues to contract



Source: Macrobond, NAB Economics

- Growth in China's nominal fixed asset investment slowed in July – up by 3.6% yoy (following on from the 5.8% yoy increase in June). Producer price growth has continued to ease – with these softer price trends flowing through to the cost of investment goods (which are estimated from the start of 2022) – meaning that the downward pressure on real investment growth was more modest. We estimate that real investment contracted by 0.7% yoy (compared with a 0.4% yoy fall in June).

- State-owned enterprises (SOEs) have been the key drivers of investment growth in recent months. Nominal SOE investment rose by 11.8% yoy in July (up from 10.9% yoy in June). In contrast, private sector investment contracted – down by 0.9% yoy (from 2.8% yoy previously).

- There remains substantial divergence in investment trends by major industrial sectors. Both manufacturing and infrastructure recorded stronger rates of growth – up 7.5% yoy and 9.1% yoy respectively – while investment in real estate continues to contract – down by 12.1% yoy in July.

- Trends in the property sector remain weak – with steep year-on-year declines recorded in residential building starts and sales (as measured in square metres). The growing trend of mortgage boycotts by purchasers of stalled housing projects will do little to improve confidence of any participants in the sector.

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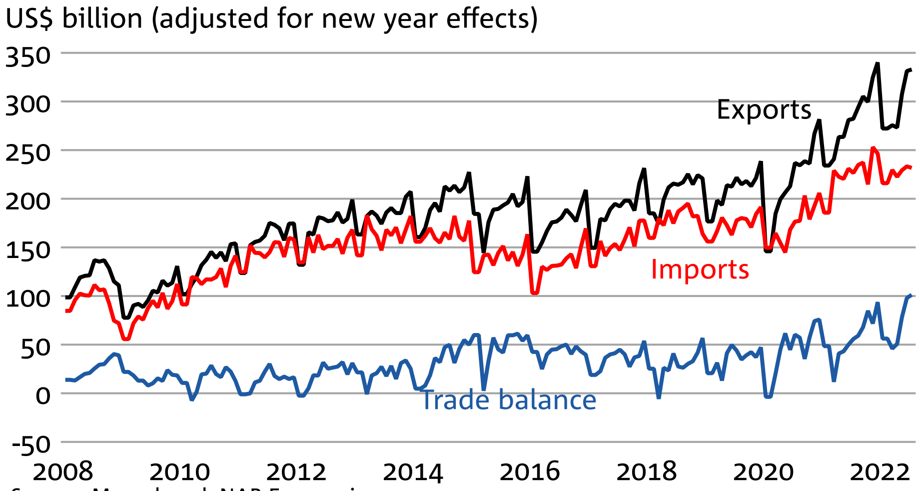
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

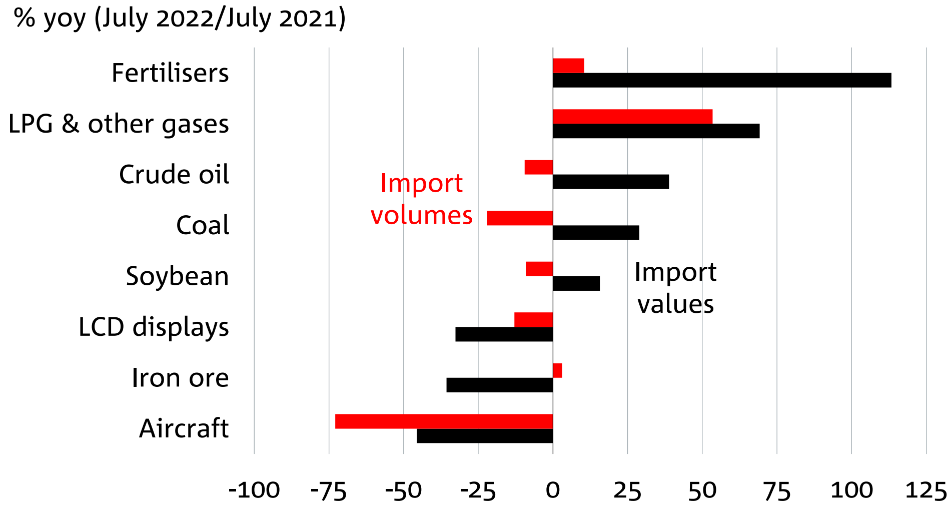
Record high surplus for the second straight month



Source: Macrobond, NAB Economics

IMPORT VALUES AND VOLUMES

Energy imports among the most impacted by price effects



Source: Datastream, NAB Economics

- For the second straight month, China's trade surplus rose in July to a record high. The surplus totalled US$101.3 billion (up from US$97.9 billion in June). In month-on-month terms, exports edged slightly higher, while imports were marginally softer in July.
- China's trade surplus with the United States has continued to climb – rising to US$439.7 billion in the twelve months to July – a new record high. China's failure to meet its commitments under the Phase One trade deal have increased tensions between the two countries (already raised by the earlier trade war), and these tensions have been further exacerbated by US House Speaker Nancy Pelosi's recent visit to Taiwan.
- China's imports totalled US$231.7 billion in July (compared with US$233.3 billion previously). This represented a modest increase in year-on-year terms, up just 2.3% yoy.
- Import prices have increased significantly in 2022 and have been the major driver of the growth in import values. China's trade index showed a modest year-on-year increase in import volumes in January, followed by sizeable declines between February and June. Given that commodity prices fell significantly in July, it appears likely that the decline in volumes in July will be more modest than in June (when they fell by 8.3% yoy).
- The impact of rising energy prices in 2022 is evident in the disparity between the values and volumes of a range of commodities. For example, the value of fertiliser imports rose by 113% yoy in July, while the volumes increased by just 10.4% yoy. Similarly, volumes of crude oil and coal contracted in July, while the value of those imports rose. In contrast, the price of iron ore fell year-on-year – leading to declining values while volumes edged higher.

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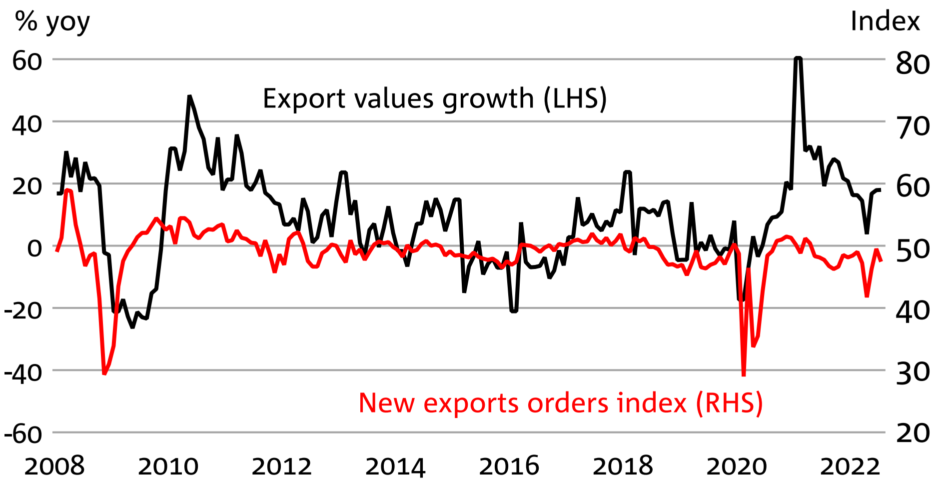
INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

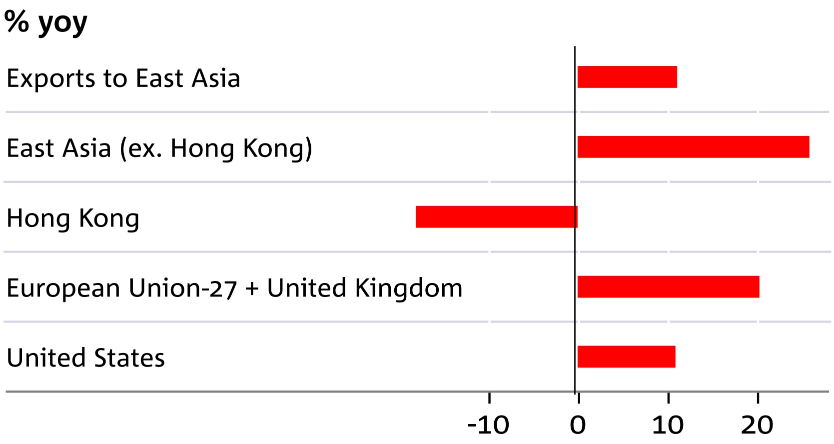
Surge in export values despite still negative export order readings



Source: Macrobond, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Surge in exports to Europe and East Asia (ex. HK)



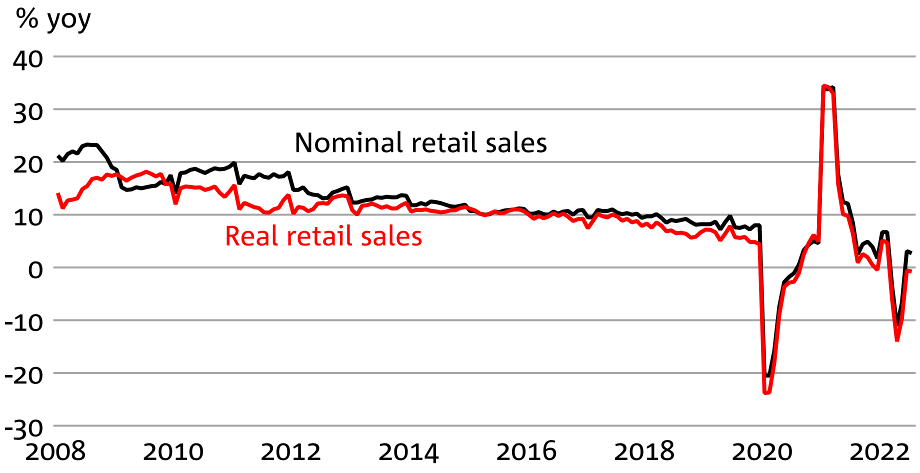
Source: Macrobond, NAB Economics

- China's exports edged higher month-on-month in July – increasing to US$333.0 billion (from US$331.4 billion previously). This is the second largest monthly total on record (exceeded only by the US$340.2 billion total in December 2021). In year-on-year terms, exports rose by 18.0%.
- Much like imports, rising prices have contributed to this increase. In June, export prices rose by over 15% yoy – meaning that prices accounted for the bulk of the 17.9% yoy increase in overall export values for that month.
- The new export orders measure in the NBS manufacturing PMI survey weakened in July – down to 47.4 points (from 49.5 points previously). Prospects for export growth going forward are weaker – with our expectations of a steep slowdown in advanced economy growth set to limit export demand.
- Exports rose strongly for the bulk of China's major trading partners in July. Exports to the European Union-27 + the United Kingdom rose strongly (despite the UK lagging behind, as it has since mid-2021) – up by 20.4% yoy. Exports to East Asia and the United States grew by 11.2% yoy and 11.0% yoy respectively.
- That said, growth in exports to East Asia were constrained by a reported contraction in shipments to Hong Kong. Historically there have been substantial divergences in trade flows reported by China Customs and Hong Kong Customs – at times reflecting capital flows being disguised as trade activity – with China's reported exports over 9% larger than the value reported by Hong Kong. This suggests that the fall in exports may be overstated, albeit it appears likely that they did fall.
- Excluding Hong Kong, exports to East Asia rose by 26.0% yoy, with Singapore, Malaysia and South Korea recording sizeable increases.

RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

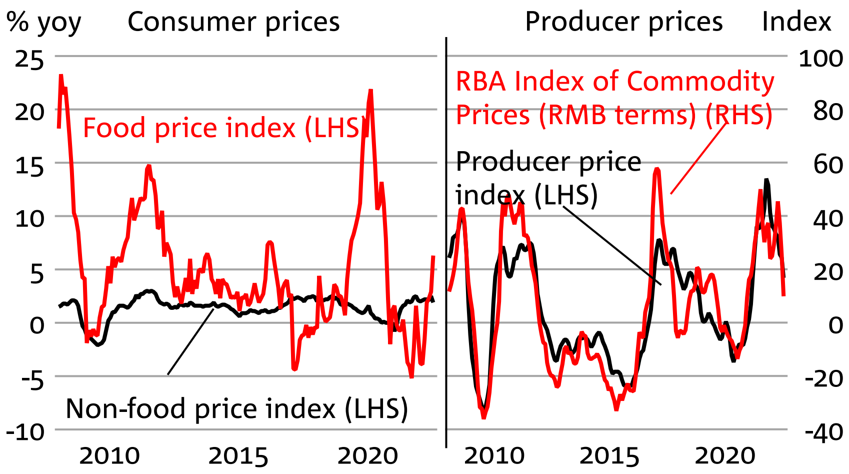
Falling real sales highlights weak household demand



Source: Macrobond, NAB Economics

CONSUMER AND PRODUCER PRICES

Food prices spiked in July as pork prices jumped



Source: Macrobond, NAB Economics

- Growth in China's nominal retail sales eased slightly in July – pointing to limited benefits from the post-COVID-19 reopening – up by 2.7% yoy (from 3.1% yoy in June). These rates of growth remain well below pre-pandemic rates of growth – highlighting the limited fiscal support for households.

- Despite the uptick in the consumer price index (see below), growth in the retail price index was marginally softer in July. This meant that real retail sales contracted by 0.8% yoy in July (compared with a 0.6% decline in June).

- China's consumer prices grew more strongly in July – with the consumer price index rising by 2.7% yoy (up from 2.5% yoy previously). This was the fastest rate of growth since April 2020, but remains modest when compared with the surging rates of price growth globally.

- Food prices were the key driver of the increase in July – up by 6.3% yoy (from 2.9% yoy previously). Until recently, falling pork prices had kept food price inflation well under control – reflecting the recovery of pork supply following the African swine fever outbreak in 2018. However pork prices rose sharply in July – up 20.2% yoy (and almost 26% month-on-month) – with the statistics bureau attributing this increase to production cuts as farmers held back stock from markets. Prices of fresh fruit and fresh vegetables also rose strongly.

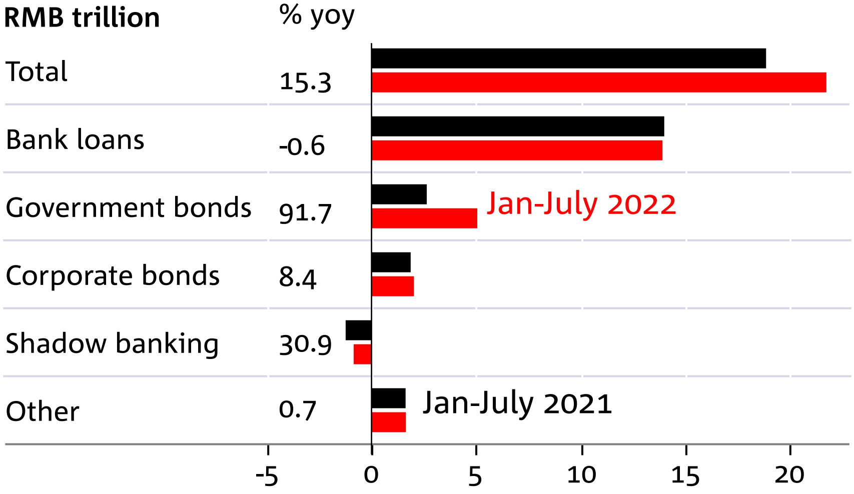
- In contrast, non-food prices grew more modestly – up by 1.9% yoy (from 2.5% yoy in June). In part this may reflect weakness in domestic demand, along with a softening in vehicle fuel price growth – which rose by 24.2% yoy in July (down from 32.8% yoy in June).

- Growth in producer prices continued to slow in July, with the producer price index increasing by 4.2% yoy (from 6.1% yoy previously). Global commodity prices are a key driver of producer prices – with the RBA Index of Commodity Prices (when converted into RMB terms) increasing by 9.9% yoy (down from 25.6% yoy in June).

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

Credit growth weaker in July following the June surge

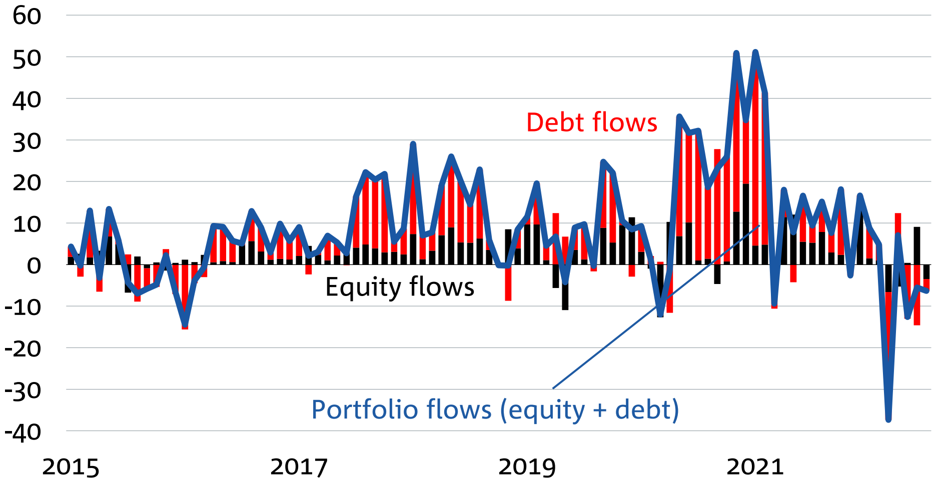


Source: Macrobond, NAB Economics

CAPITAL FLOWS

Monetary policy imbalance has encouraged capital flight

China portfolio capital flows (US% billion)



Source: IIF, NAB Economics

- New credit issuance slowed substantially in July – following on from the reopening surge seen in June. Total issuance was just RMB 0.8 trillion (compared with RMB 5.2 trillion previously), with modest increases in government bonds and bank lending accounting for the bulk of this increase.
- In the first seven months of 2022, new credit issuance increased by 15.3% yoy to RMB 21.8 trillion. Although bank lending accounts for the largest share of total issuance – around 64% – it contracted marginally over this period, down 0.6% yoy.
- In contrast, non-bank lending rose by 61.0% yoy in the first seven months. Government bond issuance accounted for the bulk of this increase – up by almost 92% yoy. Corporate bond issuance had increased rapidly earlier in the year but has slowed significantly more recently – up by 8.4% yoy.
- In recent months, the People's Bank of China has repeatedly indicated that it has sought to provide monetary support to the economy, largely via expanding credit availability. There appears to be limited demand for credit – in part related to the weakness in the property sector and the generally weaker state of the private-sector economy – which likely inspired today's 10 basis point cut to the Medium Term Lending Facility (MTF) rate.
- With advanced economy central banks rapidly lifting policy rates, there has been limited scope for rate cuts in China, with the widening monetary policy imbalance already risking capital flight. Data from the Institute of International Finance show sizeable portfolio (equity and debt) outflows between May and July 2022 – which could force the PBoC to lift rates or implement other measures (such as capital controls) in coming months in order to prevent destabilisation of the financial sector.

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