NAB Group Economics

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China's economy at a glance

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Key points

China refines, not abandons, zero-COVID and remains without an exit strategy

- In the midst of a third major COVID-19 wave, China's Politburo Standing Committee have announced some easing in public health policy. While financial markets jumped in response, the policy changes appear relatively modest and lockdowns remains a risk. There also remains no clear forward guidance around further policy relaxation – although the PSC statement notes unfavourable climate during the winter and spring – which may indicate mid-2023 may be the earliest window for significant changes. While our economic forecasts are unchanged this month, the current wave adds some downside risk to our 2022 forecast (3.4%) and potentially some upside (via base effects) to 2023 (currently 5.0%).

- China's industrial production growth was slightly slower in October – increasing by 5.0% yoy (compared with 6.3% yoy in September). It is worth noting that growth in both September and October was elevated by base effects – given that the industrial sector was negatively impacted by energy shortages in September 2021 that were not fully resolved in October 2021.

- China's fixed asset investment grew a little slower in October – increasing by 5.0% yoy (down from 6.5% yoy previously). However, recent months have seen a considerable slowdown in producer price growth – which flows through to the cost of investment goods. As a result, we estimate that real investment accelerated in October – up by 4.6% yoy (from 3.8% yoy in September).

- China's trade surplus barely changed in October – edging up to US$85.2 billion (from US$84.7 billion in September). This modest change came despite steep month-on-month falls in both exports and imports. Some of these declines reflect season patterns, with October typically a weaker month than September due to the Golden Week holidays at the start of the month, however imports fell by 0.7% yoy (compared with a 0.3% yoy increase in September).

- Nominal retail sales fell by 0.5% yoy in October (compared with a 2.5% yoy increase in September), the first fall recorded since May (in the midst of the major Omicron COVID-19 wave). This decline may reflect the impact of the latest COVID-19 wave impacting a range of industrial cities. Growth in China's retail prices was a little softer in October, but not enough to offset the fall in nominal sales, meaning that real retail sales fell by 2.7% yoy (from 0.7% yoy in September).

- In the first ten months of 2022, new credit issuance increased by 8.7% yoy to RMB 28.7 trillion. Bank loans increased modestly over this period – up by 1.0% yoy – with a significant slowing in the growth of outstanding loans to households, which has largely been offset by increased lending to businesses. In contrast, non-bank lending increased by 24.8% yoy – with government bonds a key driver.

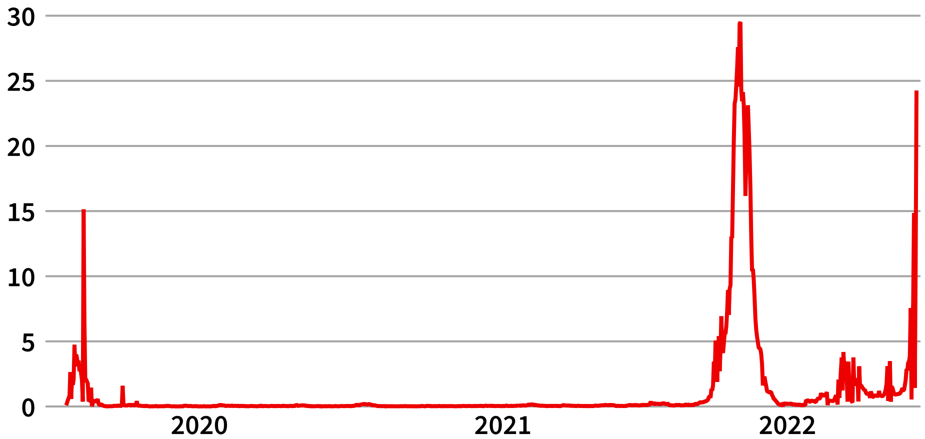
- The People's Bank of China (PBoC) has held the Medium Term Lending Facility (MTF) rate unchanged since July. Statements from the PBoC have suggested that the central bank is seeking to maintain "conventional monetary policy" for as long as possible, while keeping the currency stable. The growing disparity between Chinese policy rates and those abroad has seen the Yuan depreciate considerably since the start of the year, while data from the Institute of International Finance show substantial portfolio (equity and debt) outflows from China since February. The latter presents risks to China's financial stability going forward.

Special update – China modestly eases COVID-19 policies

New COVID-19 cases have risen in recent weeks

Current wave so far China's second largest

Daily confirmed cases of COVID-19 (000s)

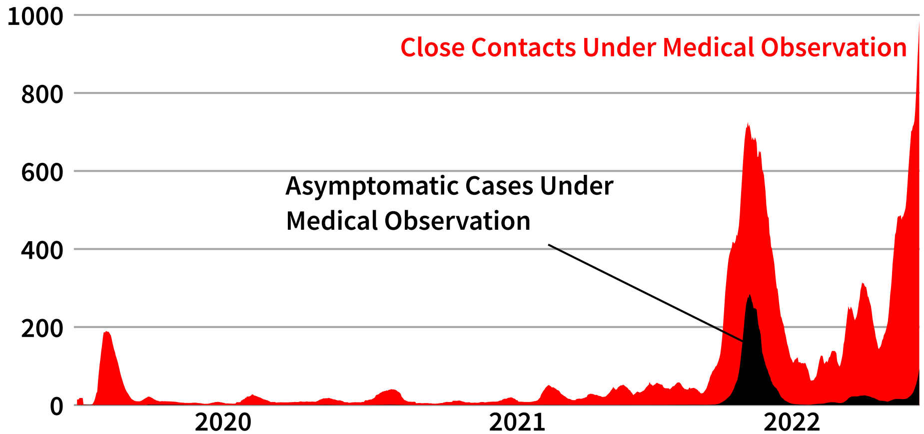


Source: Macrobond, NAB Economics

Residents under quarantine have surged

Vast numbers of close contacts forced into isolation

Chinese residents under quarantine (000s)



Source: Macrobond, NAB Economics

- China is currently experiencing its third major COVID-19 wave – to date it is the second largest following the omicron wave earlier in 2022 that led to the economically damaging lockdown centred on Shanghai. The current outbreak has emerged in major industrial centres such as Guangzhou, Chongqing and Zhengzhou – the latter home to the world's largest iPhone plant – with various restrictions re-imposed (albeit less severe than those imposed on Shanghai).

- This outbreak has seen the number of Chinese residents under quarantine rise to its highest level since the start of the pandemic.

- Rumours circulating on Chinese social media in early November suggested that a committee had been formed to develop plans for a post-COVID-19 reopening – targeting March 2023 – however this was subsequently countered by various officials, most notably China's National Health Commission.

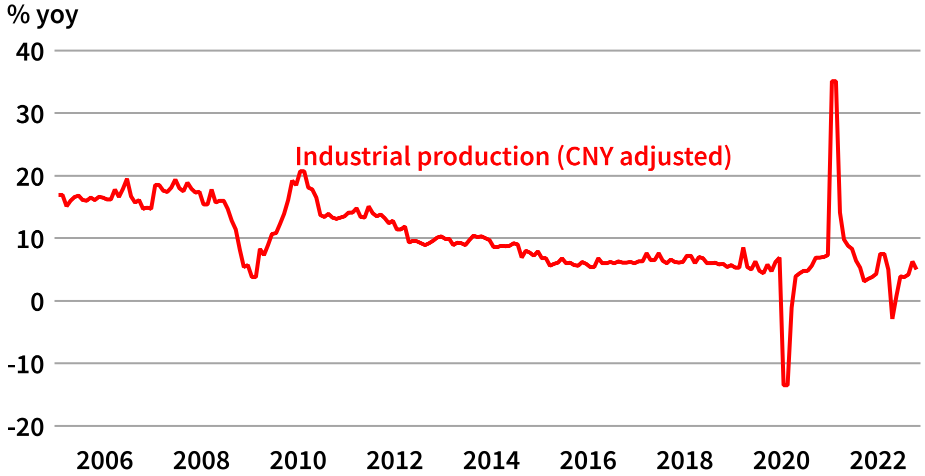
- That said, the Politburo Standing Committee (PSC) meeting on 10 November did introduce some easing of public health measures. Key changes appear to be reducing quarantine periods for primary contacts and foreign visitors to 8 days (from 10), a reduction in contact tracing (particularly related to secondary contacts) and an instruction to local governments to control the pandemic while avoiding economic disruption. A drive to increase vaccination rates among the elderly population was also announced.

- Importantly these changes are not a broad reopening (in line with trends in other countries) – with the public statement following the PSC meeting emphasising that China would continue "tenaciously pursuing the dynamic zero-COVID policy". Financial markets – most notably in Hong Kong – jumped in response, however this seems at odds with the details – with policy changes relatively modest and lockdowns remaining a risk. There also remains no clear forward guidance around further policy relaxation – although the PSC statement notes unfavourable climate during the winter and spring – which may indicate mid-2023 may be the earliest window for significant changes.

Industrial production

Industrial production

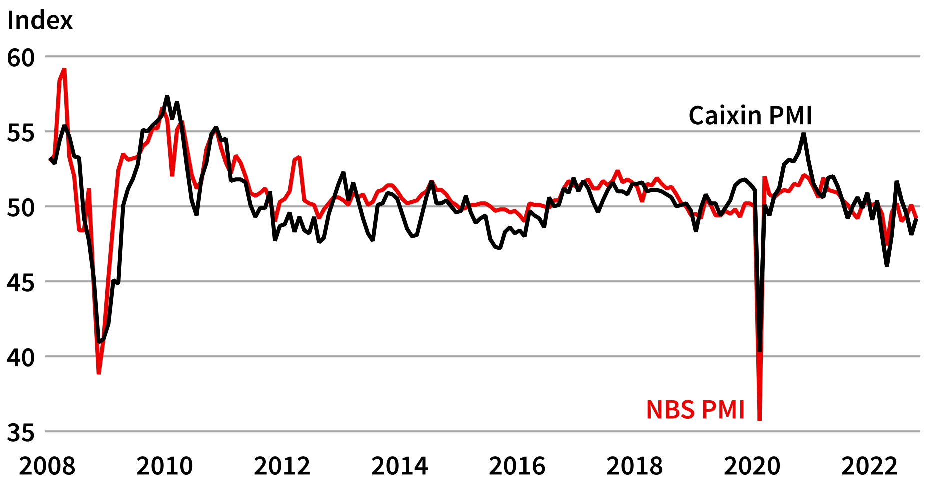
Recent growth a rebound from late 2021 weakness



Source: Macrobond, NAB Economics

Manufacturing surveys in negative territory

Both surveys point to weak demand



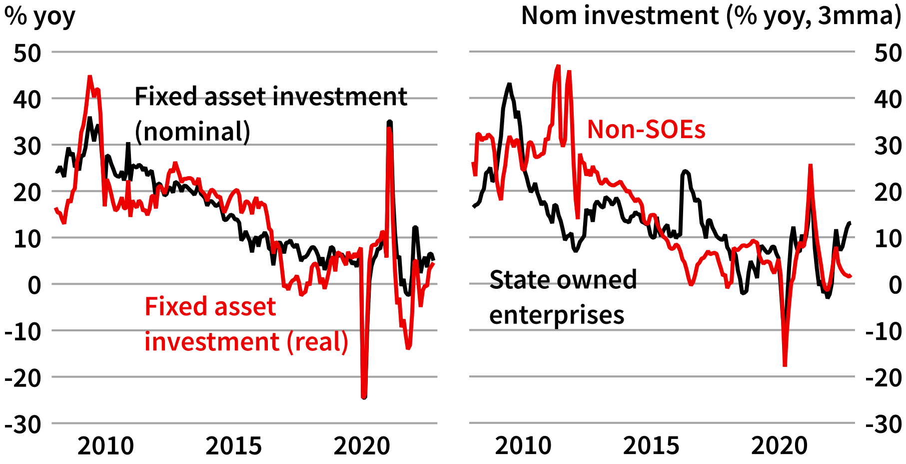
Source: Macrobond, NAB Economics

- China's industrial production growth was slightly slower in October – increasing by 5.0% yoy (compared with 6.3% yoy in September). It is worth noting that growth in both September and October was elevated by base effects – given that the industrial sector was negatively impacted by energy shortages in September 2021 that were not fully resolved in October 2021.
- Growth trends by industry remain highly divergent. There was strong growth in crude steel output – up by 11.0% yoy – albeit this was a sector negatively impacted by the energy shortages in late 2021. Electronics production – which was less impacted – increased by 9.4% yoy and motor vehicle output rose by 8.6% yoy. In contrast, cement manufacturing rose by just 0.4% yoy.
- Both of China's major manufacturing surveys were in negative territory in October. The official NBS PMI dipped lower – to 49.2 points (from an essentially neutral 50.1 points in August). The private sector Caixin PMI was also at 49.2 points (compared with 48.1 points previously).
- The two surveys continue to point to a deterioration in new orders – with export orders particularly weak in the NBS survey (while this measure in the Caixin survey moved closer to neutral levels).

Investment

Fixed asset investment

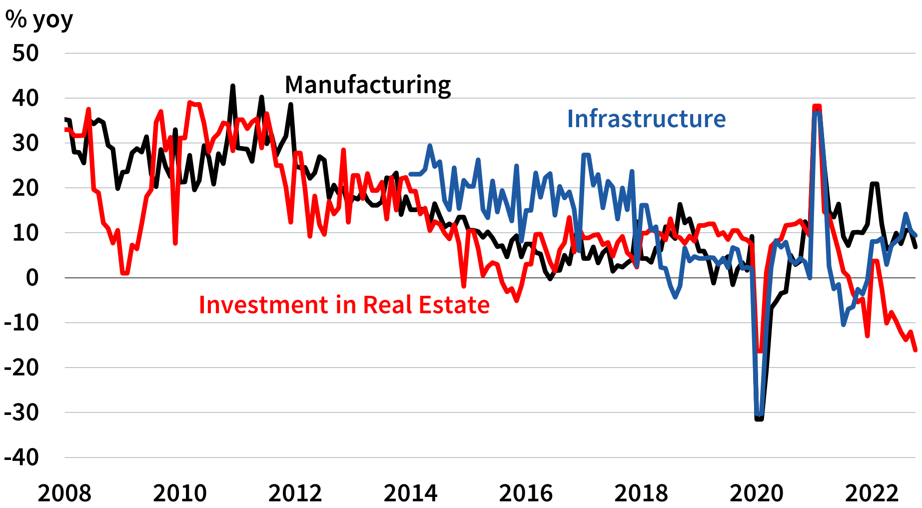
Falling costs support growth in real investment in October



Source: Macrobond, NAB Economics

Fixed asset investment by industry

Real estate investment remains weak on property sector woes



Source: Macrobond, NAB Economics

- China's fixed asset investment grew a little slower in October – increasing by 5.0% yoy (down from 6.5% yoy previously). However, recent months have seen a considerable slowdown in producer price growth – which flows through to the cost of investment goods. As a result, we estimate that real investment accelerated in October – up by 4.6% yoy (from 3.8% yoy in September).

- State-owned enterprises (SOEs) have continued to be the key driver of nominal investment. SOE investment rose by 12.3% yoy in October, in stark contrast to the 0.5% yoy increase from private sector firms. Deteriorating conditions in the property sector may explain some of this weakness.

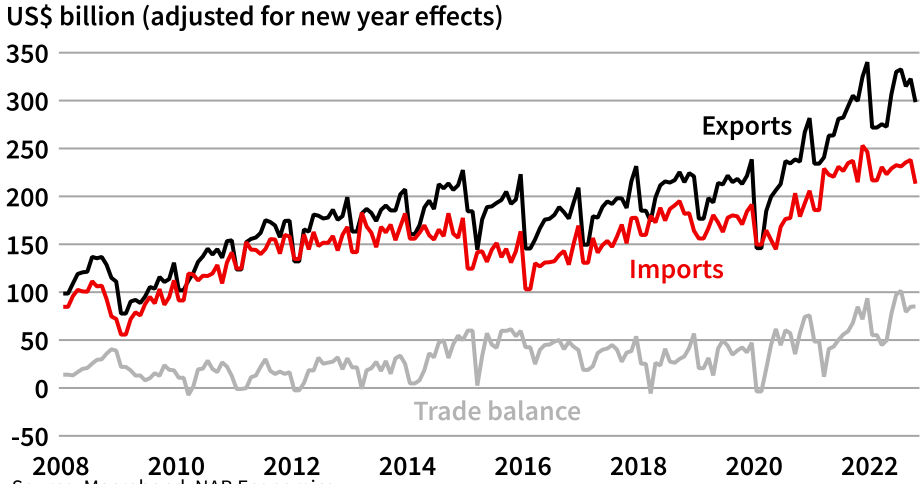
- There remains a wide divergence in investment growth between individual industries. The downturn in China's property sector – following the implementation of the Three Red Lines policy and the collapse of Evergrande – has seen investment in real estate plunge – down by 16.1% yoy in September.

- In contrast, growth in investment in manufacturing and infrastructure have remained comparatively strong – increasing by 6.9% yoy and 9.4% yoy respectively.

International trade – trade balance and imports

China's trade balance

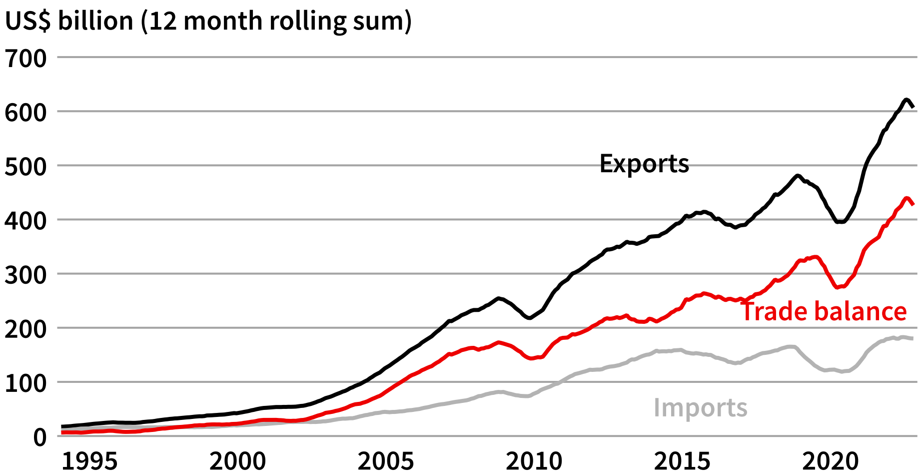
Surplus marginally changed as exports and imports fell



Source: Macrobond, NAB Economics

China's trade surplus with the United States

Rolling surplus has trended lower since July



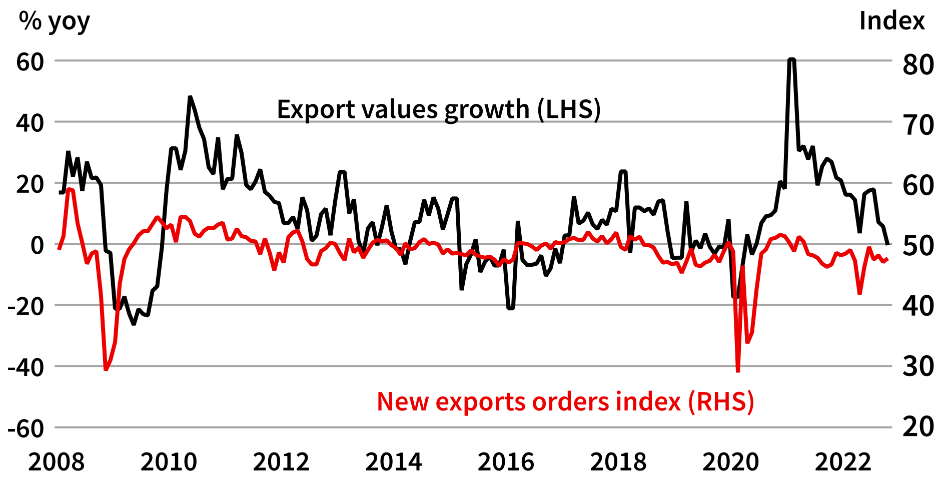
Source: Macrobond, NAB Economics

- China's trade surplus barely changed in October – edging up to US$85.2 billion (from US$84.7 billion in September). This modest change came despite steep month-on-month falls in both exports and imports.
- China's trade balance (on a twelve month rolling basis) with the United States rose significantly from the early stages of the COVID-19 pandemic. This rolling surplus peaked in July 2022 at US$439.7 billion but has since trended lower – to US$426.3 billion in October (as demand in the US has started to soften).
- China's imports totalled US$213.2 billion in October (down from US$238.0 billion previously). Some of this decline reflects season patterns, with October typically a weaker month than September due to the Golden Week holidays at the start of the month, however imports fell by 0.7% yoy (compared with a 0.3% yoy increase in September).
- Growth in import prices has been outpacing volume growth in recent months. Official data show that China's import volumes fell in year-on-year terms between February and September. Using global commodity prices as a proxy for import prices, we estimate that volumes fell by around 4.5% yoy in October.
- Volatility in energy prices has contributed to this divergence between import values and volumes. For example, the value of Chinese fertiliser imports rose by 42% yoy in October, while the volumes fell by 14% yoy (with natural gas a key input to a range of industrial fertilisers). Similarly, crude oil imports rose by almost 44% yoy in value terms, but only 14% yoy in volume.

International trade – exports

Export value and new export orders

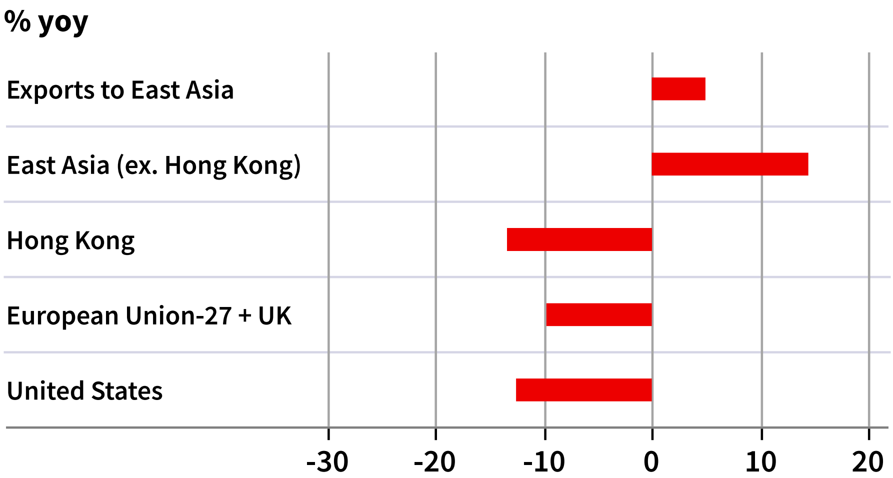
Exports fall for the first time since May 2020



Source: Macrobond, NAB Economics

Exports to major trading partners

Weaker demand appears evident in US and European trends



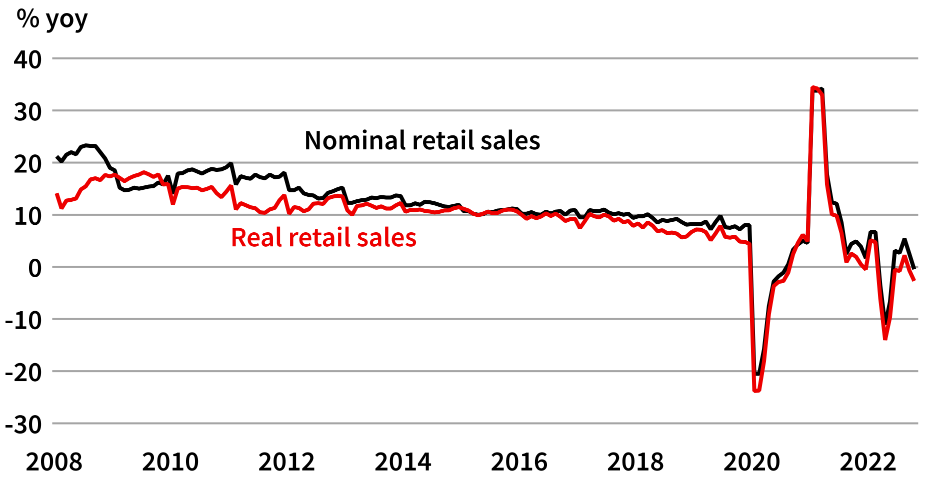
Source: Macrobond, NAB Economics

- The value of China's exports fell in October – down to US$298.4 billion (from US322.8 billion in September). Although this level remained comparatively strong from a historical perspective (being the eleventh highest monthly record on total), it represented a decline in year-on-year terms, down by 0.4%. Weaker consumption trends in advanced economies – reflecting the impact of tightening monetary policy – could see exports fall further in coming months.
- In a similar fashion to imports, rising prices contributed significantly to the growth in export values recorded until September this year. Export prices rose by 13.1% yoy in September (compared with a 5.7% yoy increase in export values).
- The new export orders measure in the NBS manufacturing survey has been in negative territory since May 2021, albeit it was slightly less negative in October – at 47.6 points (compared with 47.0 points in September).
- There was some notable divergence in terms of exports to major trading partners in October. There were steep falls in exports to the United States and European Union-27 + the United Kingdom – down by 12.6% yoy and 9.8% yoy respectively. This appears consistent with weaker demand in these regions following monetary policy tightening since early 2022.
- Exports to Hong Kong were also sharply lower – down 13.4% yoy. Overall exports to East Asia rose by 5.0% yoy, but after excluding Hong Kong, exports to other East Asia rose by 14.5% yoy – with a surge in exports to Singapore driving the increase.

Retail sales and inflation

Retail sales growth

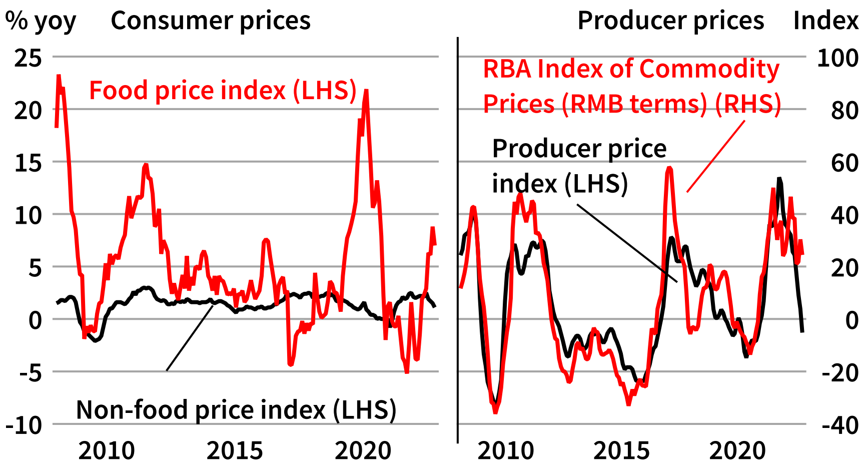
Fresh COVID-19 outbreaks saw real sales fall further in October



Source: Macrobond, NAB Economics

Consumer and producer prices

Producer prices decline despite strong growth in input costs



Source: Macrobond, NAB Economics

- Nominal retail sales fell by 0.5% yoy in October (compared with a 2.5% yoy increase in September), the first fall recorded since May (in the midst of the major Omicron COVID-19 wave). This decline may reflect the impact of the latest COVID-19 wave impacting a range of industrial cities (see page 3).

- Growth in China's retail prices was a little softer in October, but not enough to offset the fall in nominal sales, meaning that real retail sales fell by 2.7% yoy (from 0.7% yoy in September).

- China's consumer prices growth slowed in October – with the headline consumer price increase increasing by 2.1% yoy (down from 2.8% yoy in September). Compared with rapid price growth in other major economies, China's inflation rate remains weak, in a large part reflecting the softness in domestic demand.

- Growth in food prices remains comparatively strong, albeit it slowed considerably in October – down to 7.0% yoy (from 8.8% yoy previously). This slower trend was despite another acceleration in pork prices – which rose by almost 52% yoy. Fresh fruit prices rose by 12.6% yoy, while fresh vegetables fell by 8.1% yoy.

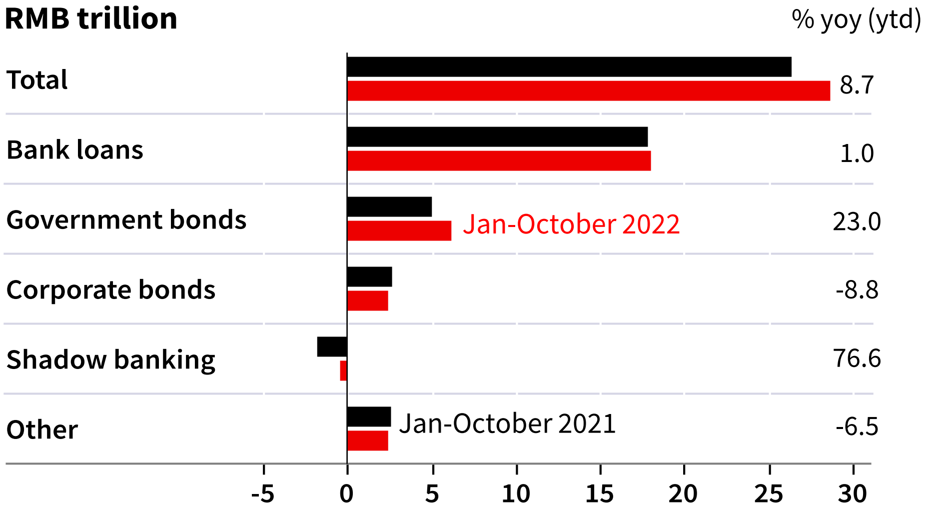
- Non-food prices slowed considerably in October – down to 1.1% yoy (from 1.5% yoy previously). Vehicle fuel prices rose by 12.4% yoy in October (although this was down from 19.0% yoy in September).

- Producer prices fell year-on-year in October – down by 1.3% yoy (compared with a 0.9% yoy increase in September). This fall came despite a sizeable increase in commodity prices (a key input cost for manufacturers) – with the RBA Index of Commodity Prices (when converted into RMB terms) rising by 24.4% yoy in October. Given weak demand in domestic and foreign markets, Chinese manufacturers may be cutting prices to support production volumes.

Credit conditions

New credit issuance

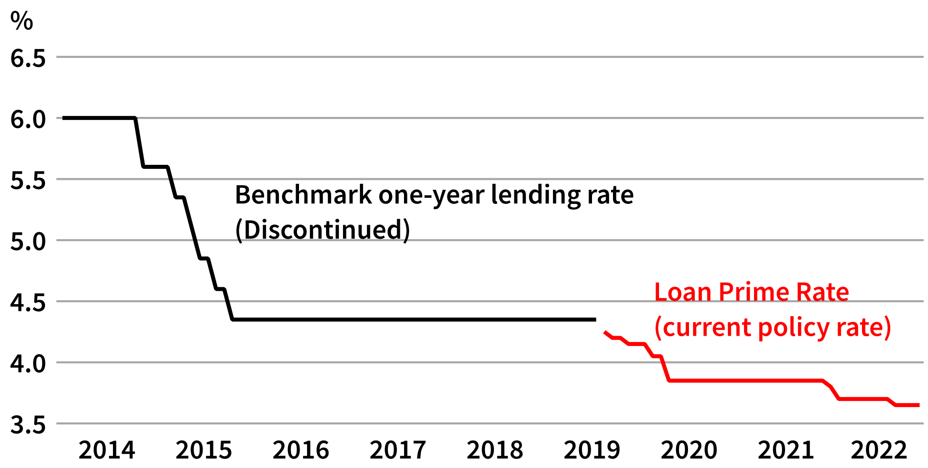
Government bonds remain a key driver of growth



Source: Macrobond, NAB Economics

Monetary policy

China has maintained low rates, counter to global hiking trend



Source: Macrobond, NAB Economics

- Following a strong monthly increase in issuance in September, new credit issuance in October was comparatively weak – falling by around 43% yoy – as both government bond issuance and new bank loans slowed significantly.
- In the first ten months of 2022, new credit issuance increased by 8.7% yoy to RMB 28.7 trillion. Although bank loans account for the largest share of the total, loans have increased only modestly over this period – up by 1.0% yoy. There has been a significant slowing in the growth of outstanding loans to households, which has largely been offset by increased lending to businesses.
- In contrast, non-bank lending increased by 24.8% yoy – with government bonds a key driver – up by 23.0% yoy to RMB 6.2 trillion. Another contributor was a smaller decrease in shadow banking products over the first ten months.
- The People's Bank of China (PBoC) has held the Medium Term Lending Facility (MTF) rate unchanged since July. The MTF directly influences China's primary policy rate – the Loan Prime Rate – which was modestly cut in August and subsequently remained stable (in stark contrast with the steep hikes implemented by major central banks globally).
- Statements from the PBoC have suggested that the central bank is seeking to maintain "conventional monetary policy" for as long as possible, while keeping the currency stable. The growing disparity between Chinese policy rates and those abroad has seen the Yuan depreciate considerably since the start of the year, while data from the Institute of International Finance show substantial portfolio (equity and debt) outflows from China since February. The latter presents risks to China's financial stability going forward.

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