NAB Group Economics

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China's economy at a glance

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Key points

Weakness in domestic demand led to underperformance in May

- Overall, most of the key economic data fell short of market expectations in May – highlighting continued softness in China's economy. In particular, subdued retail sales (when looking though the volatility) and inflation data point to ongoing weakness in domestic demand. While there has been fresh talk of stimulus via easing monetary policy and greater support for real estate, it is not clear that such measures would have a material impact on growth in the near-term. Our economic forecasts are unchanged this month – with China's economy expanding by 5.6% in 2023, 4.5% in 2024 and 4.8% in 2025 – however the current softness highlights some downside risk in the short-term.

- China's industrial production growth was somewhat slower in May – increasing by 3.5% yoy (down from 5.6% yoy in April). It is worth noting that these respective growth rates were impacted by base effects – with a sharp downturn in output in April 2022 (reflecting the lockdown in Shanghai and a range of other cities) followed by a modest upturn in May 2022.

- Slower growth in nominal fixed asset investment was partially offset by further declines in prices, meaning that our estimate of real investment increased by 5.1% yoy in May (down from 5.8% yoy previously). There remains a substantial divide between investment by China's state-owned enterprises (SOEs) (which recorded robust growth) and private sector firms (where growth was negligible).

- China's trade surplus narrowed in May, totalling US$65.8 billion (compared with US$90.2 billion in April). This reflected a month-on-month decline in exports, while imports trended slightly higher. Overall, exports to China's major trading partners fell more rapidly than the total – down by 14.2% yoy – as the share of exports to these countries has continued to decline. In part, this reflects an increase in exports to Russia and other former Soviet Union countries in recent months, along with higher shipments to the Middle East and Africa in recent times.

- China's retail sales growth slowed a little in May but remained strong – with real sales increasing by 12.5% yoy (down from 18.3% yoy in April). That said, these growth rates have been inflated by base effects – reflecting the impact of COVID-19 lockdowns during the same period in 2022. Comparisons to pre-pandemic spending levels show little sign of the long awaited return of the Chinese consumer – consistent with the subdued inflation trends.

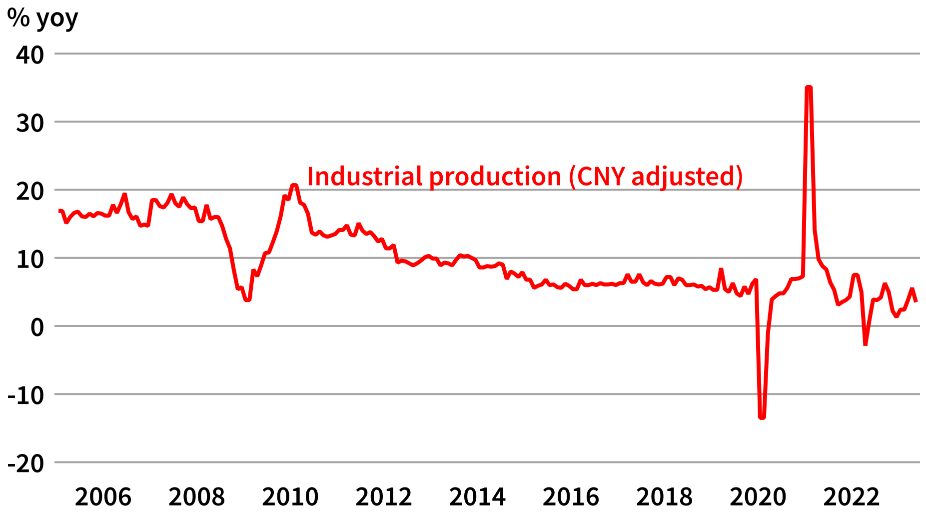
- Chinese authorities are attempting to boost lending via monetary easing. In March, the People's Bank of China (PBoC) cut the Reserve Requirement Ratio (RRR) to free up additional funds for bank lending. This month there were 10 basis point cuts to the 7-day reverse repo rate (used to manage short term liquidity) and the Medium Term Lending Facility (MLF) rate, with similar cuts to the Loan Prime Rate (China's main policy rate) anticipated.

- That said, there remains concerns around the strength of credit demand. The modest rebound in lending to households – driven by new mortgage issuance – appears to have run out of momentum, while lending to the business sector appears to have softened in recent months.

Industrial production

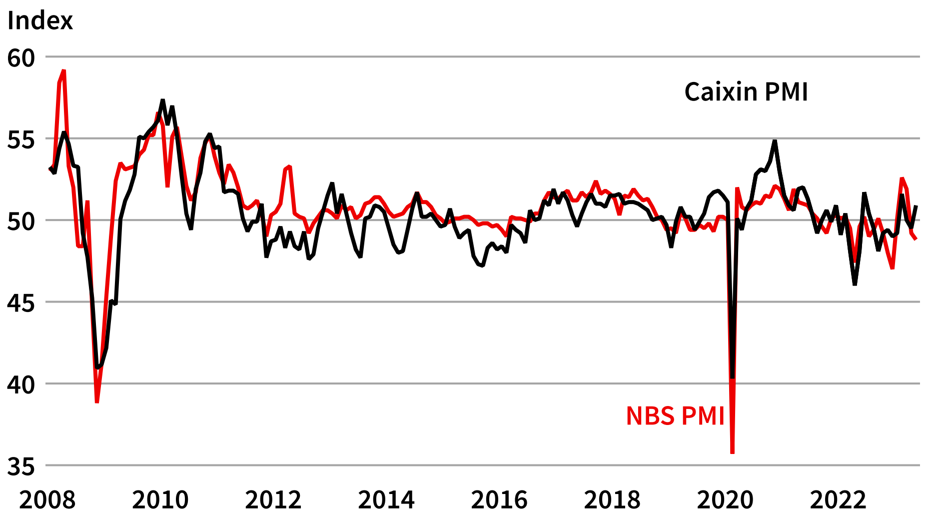
Industrial production

Slower growth in May partly reflects base effects



Manufacturing PMI surveys

Surveys diverge on differing production and orders measures



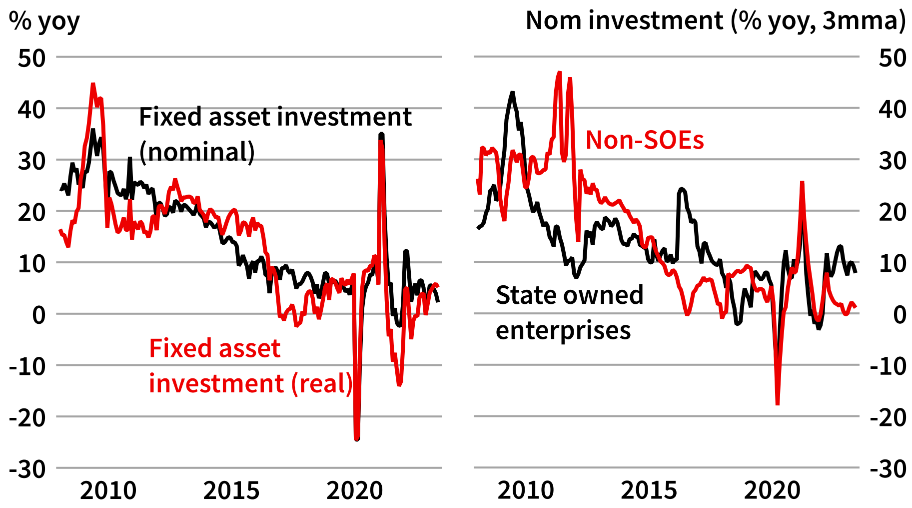
Sources: Macrobond, NAB Economics

- China's industrial production growth was somewhat slower in May – increasing by 3.5% yoy (down from 5.6% yoy in April). It is worth noting that these respective growth rates were impacted by base effects – with a sharp downturn in output in April 2022 (reflecting the lockdown in Shanghai and a range of other cities) followed by a modest upturn in May 2022.
- There were highly divergent trends in production by major industrial sectors. Automobile production (which was heavily impacted by the lockdowns) rose by 17.3% yoy, while electricity production was up 5.6% and electronics output unchanged (with output in this sector less impacted by COVID-19 measures). In contrast, construction-related heavy industries, such as cement and crude steel, fell by 0.4% yoy and 7.3% yoy respectively.
- There was a notable divergence between China's major manufacturing surveys in May. The Caixin PMI rebounded to a positive 50.9 points (compared with a modestly negative 49.5 points in April). In contrast, the official NBS PMI continued to weaken in May – down to 48.8 points (from 49.2 points previously).
- A key contributor to the differing trends were the respective measures of production and new orders. Production was modestly negative in the NBS survey (down from essentially neutral levels in April), while new orders were more steeply negative. In contrast, both of these measures were in positive territory in the Caixin survey in May – in part reflecting the different composition of firms in these surveys (with a greater proportion of private, smaller and new economy firms in the Caixin survey).

Investment

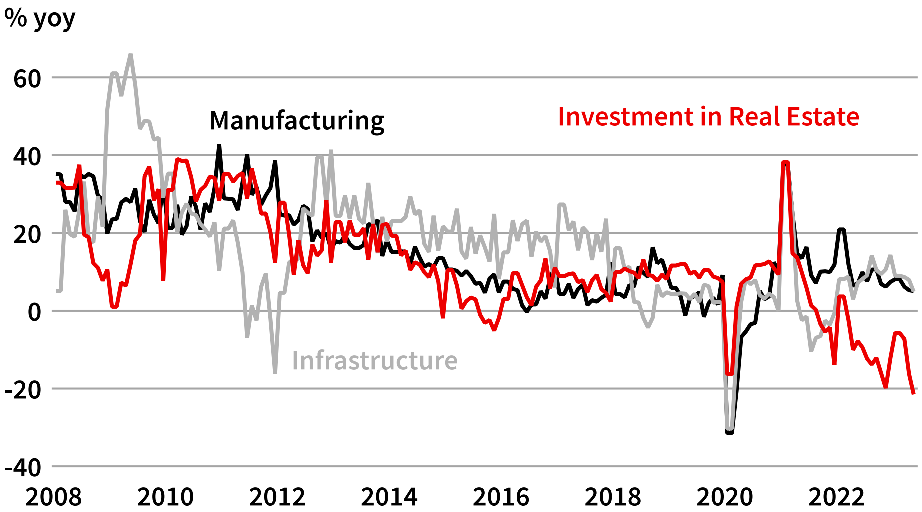
Fixed asset investment growth

Falling prices partially offset weaker nominal growth



Fixed asset investment by industry

Investment in real estate continues to contract



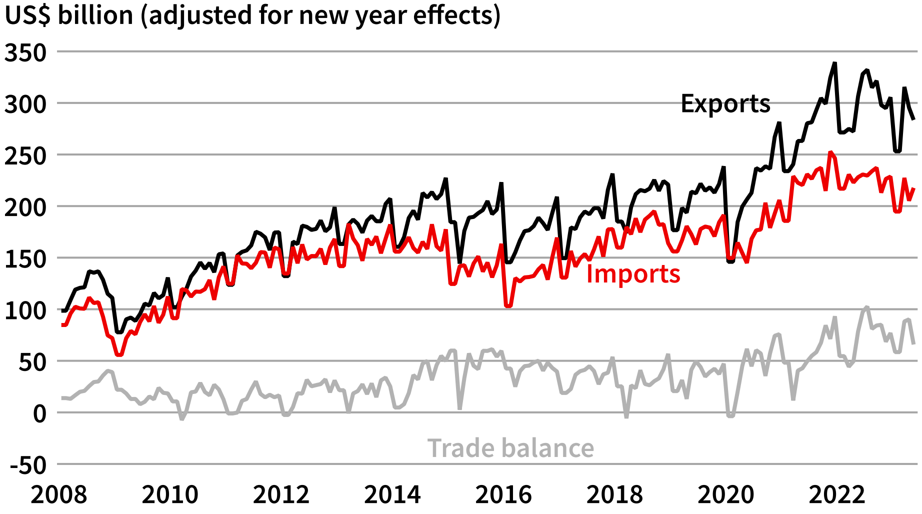
Sources: Macrobond, NAB Economics

- In nominal terms, China's fixed asset investment growth slowed considerably in May – down to 2.2% yoy (from 3.9% yoy in April). However, this was partially offset by further declines in producer prices – which flow through to the cost of investment goods – meaning that our estimate of real investment increased by 5.1% yoy in May (down from 5.8% yoy previously).
- There remains a substantial divide between investment by China's state-owned enterprises (SOEs) and private sector firms. In nominal terms, investment by SOEs rose by 5.6% yoy in May (down from 8.3% yoy previously), while private sector investment edged up by 0.4% yoy (from 1.2% yoy in April).
- There continues to be divergence in investment by major industrial categories. There remains comparatively stronger growth in manufacturing – up 5.1% yoy (from 5.4% yoy in April) – and infrastructure, which increased by 4.9% yoy (from 7.9% yoy previously). The slowing trend in infrastructure growth may reflect the rapid ramp up in infrastructure development in mid-2022 intended to support economic recovery from the COVID-19 lockdowns during this period.
- In contrast, investment in real estate has continued to contract – falling by 21.5% yoy. Although residential property sales appeared close to stabilising in March, they recorded substantial contractions in April and May. Similarly, new residential construction starts remain weak – down by over 31% yoy in May.

International trade – trade balance and imports

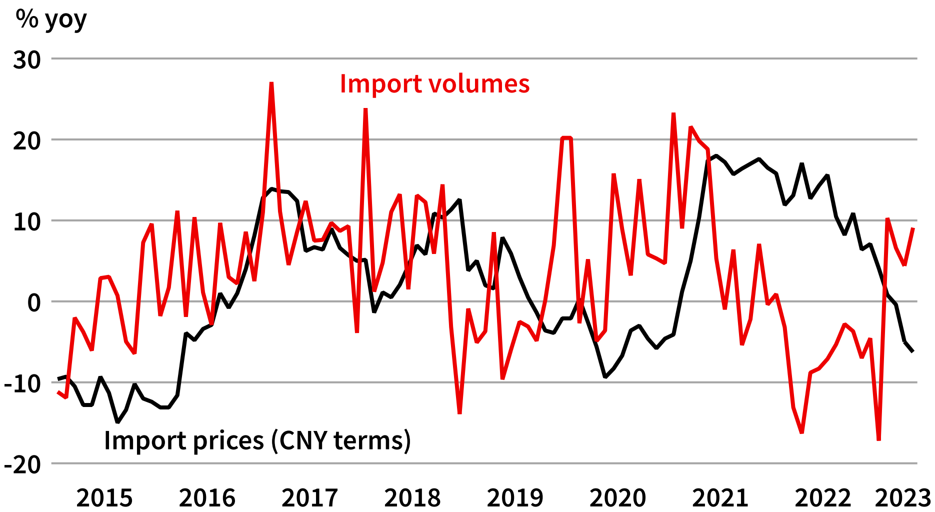
China's trade balance

Trade surplus weaker as exports slowed in May



Import volumes and prices

Falling prices contribute to softer import values



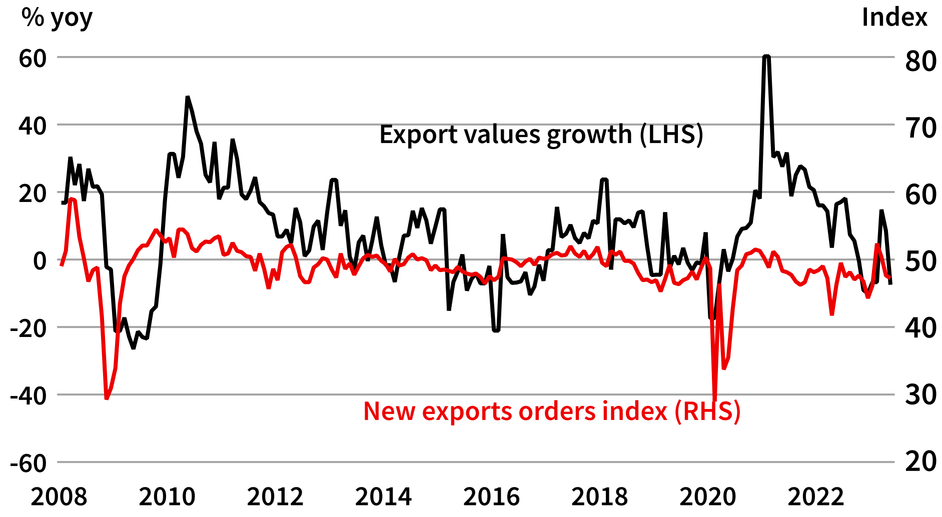
- China's trade surplus narrowed in May, totalling US$65.8 billion (compared with US$90.2 billion in April). This reflected a month-on-month decline in exports, while imports trended slightly higher.
- China's rolling twelve month trade surplus with the United States has continued to trend lower – in part reflecting the slowing trend in goods demand in US. The rolling surplus fell to US$370.5 billion – well below the US$439.7 billion peak of July 2022, but also above the pre-trade war levels (around US$330 billion).
- China's imports rose to US$217.7 billion in May (up from US$205.2 billion previously). In year-on-year terms, imports fell by 4.5%.
- It is worth noting that falling prices have been a key contributor to the easing in import values in recent months. In year-on-year terms, commodity prices (as represented by the RBA Index of Commodity Prices, converted to CNY terms) fell by 18.8%. We estimate that import volumes rose by around 9% yoy in May (compared with a 4.4% yoy increase in April).
- The impact of falling commodity prices remains highly evident among energy commodities, with energy prices having soared following Russia's invasion of Ukraine in February 2022. China's imports of refined petroleum rose by 126% yoy in volume terms, while the value rose by just 48% yoy. Similarly, coal import volumes were almost 93% yoy higher in May, while the value was 36% higher and crude oil import volumes rose 12.3% yoy, while the value fell by 14% yoy.

Sources: Macrobond, NAB Economics

International trade – exports

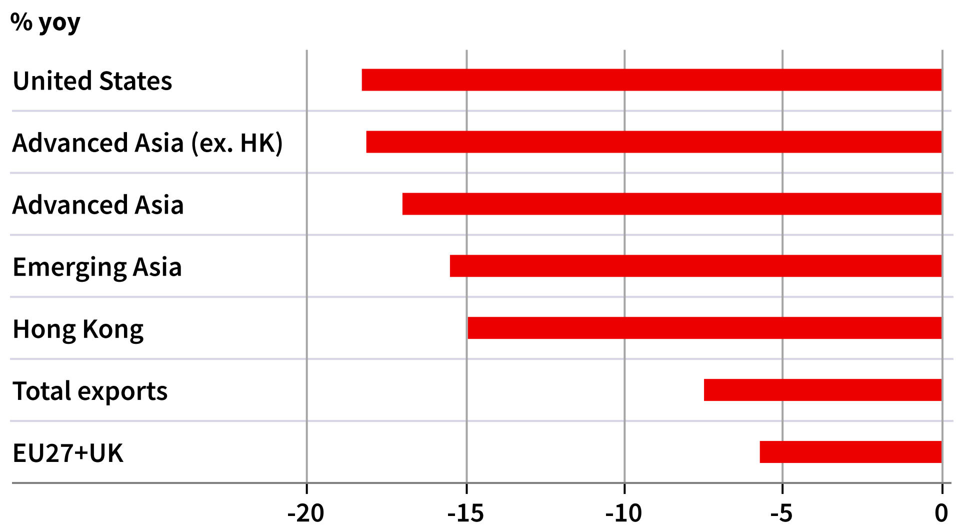
Export value and new export orders

Exports fell year-on-year; demand prospects continuing to ease



Exports to major trading partners

US & advanced Asia led the declines, as overall share fell again



Sources: Macrobond, NAB Economics

- The value of China's exports fell in both month-on-month and year-on-year terms in May. Exports totalled US$283.5 billion (down form US$294.8 billion in April) and this represented a 7.5% yoy decline. The surprise increase in export volumes in March is increasingly appearing anomalous, with demand prospects continuing to weaken.

- New export orders in the NBS PMI survey continued to weaken – down to 47.2 points (from 47.6 points previously) – consistent with the softening in advanced economy goods demand from tighter financial conditions and a rebalancing towards services consumption.

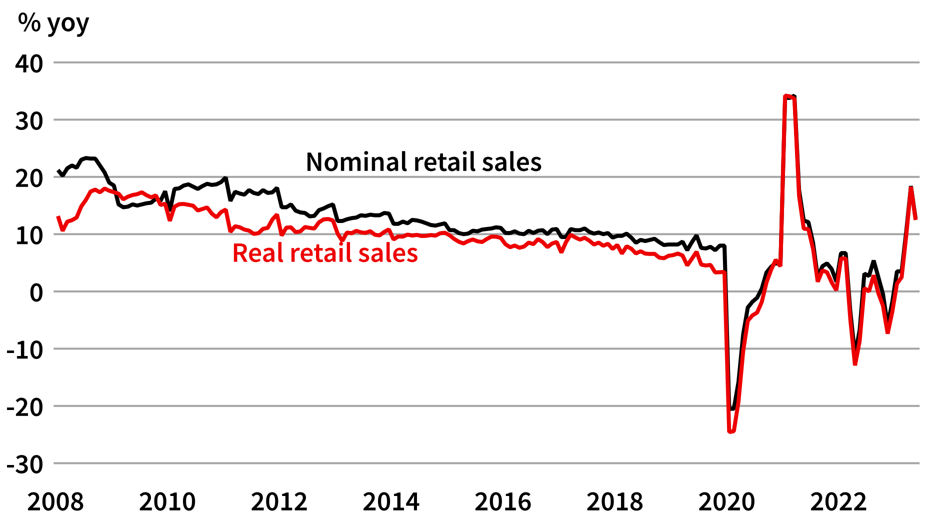
- Overall, exports to China's major trading partners fell more rapidly than the total – down by 14.2% yoy – as the share of exports to these countries has continued to decline. In part, this reflects an increase in exports to Russia and other former Soviet Union countries in recent months, with exports to the Russian Federation increasing by 114.3% yoy in May. In addition, exports to the Middle East and Africa have also increased in recent times.

- Exports to the United States fell sharply in May – down by 18.2% yoy – while exports to advanced Asian economies decreased by 17.0% yoy and emerging Asian economies by 15.5% yoy. In contrast, the declines in exports to the European Union-27 + the United Kingdom were more modest – down by 5.7% yoy.

Retail sales and inflation

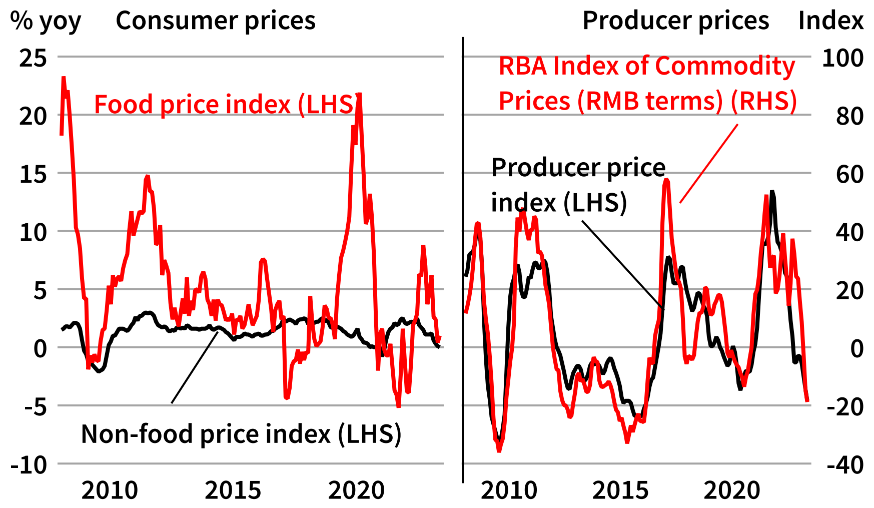
Retail sales growth

Base effects from 2022 lockdowns inflate retail growth



Consumer and producer prices

Inflation continues to point to demand side softness



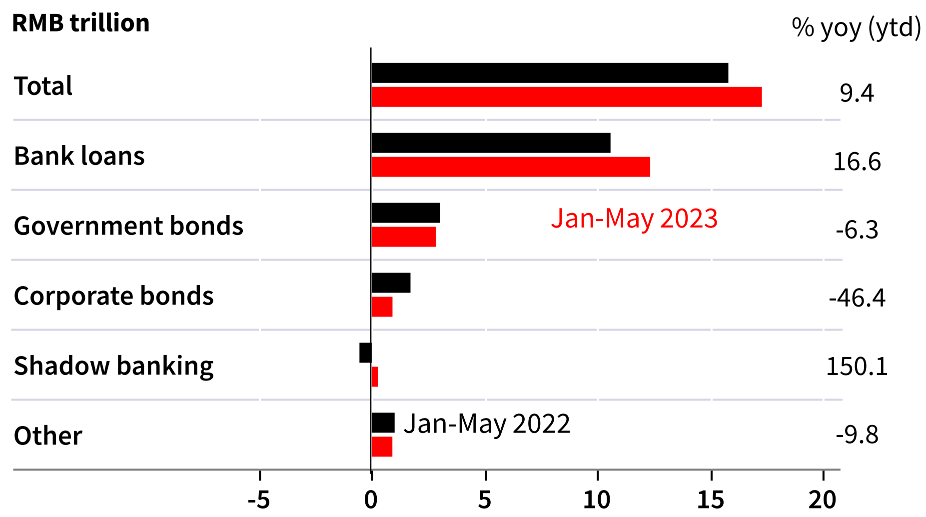
Sources: Macrobond, NAB Economics

- In nominal terms, China's retail sales growth slowed a little in May but remained strong – increasing by 12.7% yoy (down from 18.4% yoy in April). That said, these growth rates have been inflated by base effects – reflecting the impact of COVID-19 lockdowns during the same period in 2022. In real terms, retail sales slowed to 12.5% yoy (from 18.3% yoy previously).
- Given the volatility in retail sales data during the COVID-19 pandemic, it is useful to compare trends to pre-pandemic levels. Real retail sales in May were around 8.2% yoy above the same month in 2019. This compares with a 7.6% increase in April and a 12.7% increase in March. This suggests that the long awaited return of the Chinese consumer is yet to eventuate – consistent with the subdued inflation trends.
- Growth in consumer prices remained extremely weak in May – increasing by just 0.2% yoy (compared with 0.1% yoy in April). The modest increases in China's inflation remains in stark contrast to the rapid increases across much of the rest of the world – pointing to ongoing demand side softness in China.
- Food prices saw a slight acceleration in May – increasing by 1.0% yoy (from 0.4% yoy previously). The key driver of this shift appeared to be fresh vegetables – which fell by 13.5% yoy in April and but declined by just 1.7% yoy in May. Pork prices were weaker, down by 3.2% yoy.
- Non-food prices were unchanged year-on-year (compared with a modest 0.1% yoy increase in April). Vehicle fuel prices continue to fall – reflecting global trends in oil prices – down by 11.1% yoy in May.
- Producer prices fell again in May – the eighth straight month of declines – down by 4.6% yoy (the largest decline in producer prices since February 2016). This remains consistent with weaker trends in global commodity markets – with the RBA Index of Commodity Prices (converted to RMB terms) falling by 18.8% yoy in May.

Credit conditions

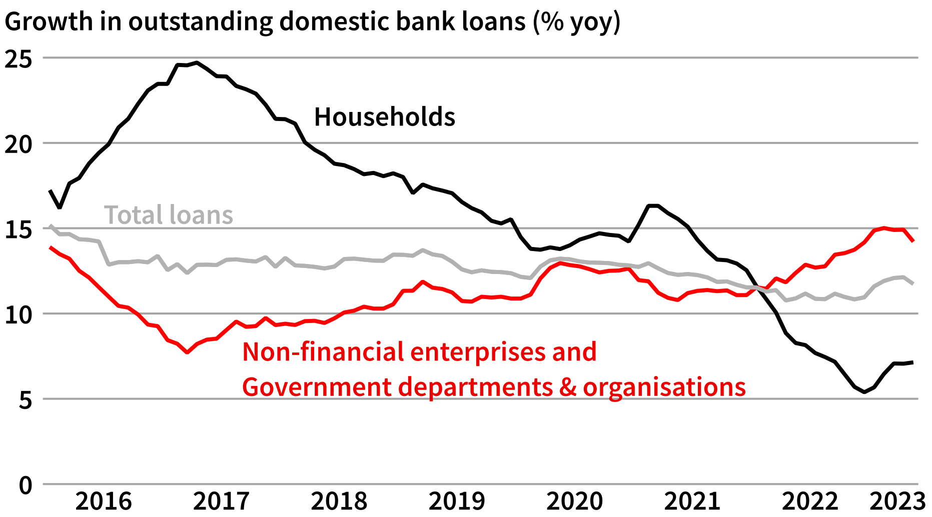
New credit issuance

Bank loans drive lending growth; non-bank contracting



Bank lending

Rebound in lending to households may have run out of momentum



Sources: Macrobond, NAB Economics

- New credit issuance was weaker year-on-year in May, in part reflecting the surge in lending in May 2022 as authorities attempted to support a recovery from the Omicron lockdown in Shanghai. That said, the scale of the increase in May 2023 fell short of market expectations.
- For the first five months of 2023, new credit issuance rose by 9.4% yoy to RMB 17.3 trillion. Bank lending was the driver of this increase – rising by 16.6% yoy to RMB 12.4 trillion.
- In contrast, non-bank lending contracted by 5.2% yoy. This decline reflected steep falls in corporate bond issuance and more modest decreases in government bond issuance partially offset by a slight pickup in shadow bank lending.
- Chinese authorities are attempting to boost lending via monetary easing. In March, the People's Bank of China (PBoC) cut the Reserve Requirement Ratio (RRR) to free up additional funds for bank lending. This month there were 10 basis point cuts to the 7-day reverse repo rate (used to manage short term liquidity) and the Medium Term Lending Facility (MLF) rate, with similar cuts to the Loan Prime Rate (China's main policy rate) anticipated.
- That said, there remains concerns around the strength of credit demand. The modest rebound in lending to households – driven by new mortgage issuance – appears to have run out of momentum, while lending to the business sector appears to have softened in recent months.

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