NAB Group Economics

China's economy at a glance
August 2023

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Key points

Soft start to Q3 signals a growing chance that China could miss its annual growth target

- Weakness in China's economy that was evident in Q2 has continued into July, with indicators of domestic demand subdued, the real estate sector remaining a headwind and demand for China's goods in export markets continuing to soften. The highly likely modest cut to the PBoC's policy rate later this month (having cut its MTF rate in mid-August) is unlikely to provide much of a boost, given already lacklustre loan demand. While our forecasts for China's growth are unchanged this month – 5.2% for 2023, 4.5% for 2024 and 4.8% for 2025 – risk in the near-term is becoming increasingly weighted to the downside, with a growing chance of China missing its 5% target this year.

- China's industrial production growth slowed marginally in July – increasing by 3.7% yoy (down from 4.4% yoy in June). We are now past the period of significant base effects (related to last year's COVID-19 lockdowns), and growth in output is relatively weak when compared with pre-pandemic trends.

- In real terms, fixed asset investment growth slowed in July to 3.7% yoy (from 6.8% yoy previously). There remains a substantial difference between nominal investment by state-owned enterprises (SOEs) – which rose by 4.9% yoy in July – and private sector firms, where investment contracted by 1.0% yoy. Statements by NBS officials indicate that real estate is the key driver of this divergence.

- China's trade surplus increased month-on-month in July – totalling US$80.6 billion (up from US$70.6 billion in June). This uptick reflected a more rapid decline in imports than exports during the month. Trade volume data is available with a one-month lag, and shows that export volumes fell by 1.7% yoy in June. Tightening monetary policy and a shift in consumption back towards services has impacted demand for China's exports.

- Real retail sales growth slowed in July – increasing by 2.8% yoy (from 3.1% yoy in June) – highlighting the ongoing weakness in domestic demand.

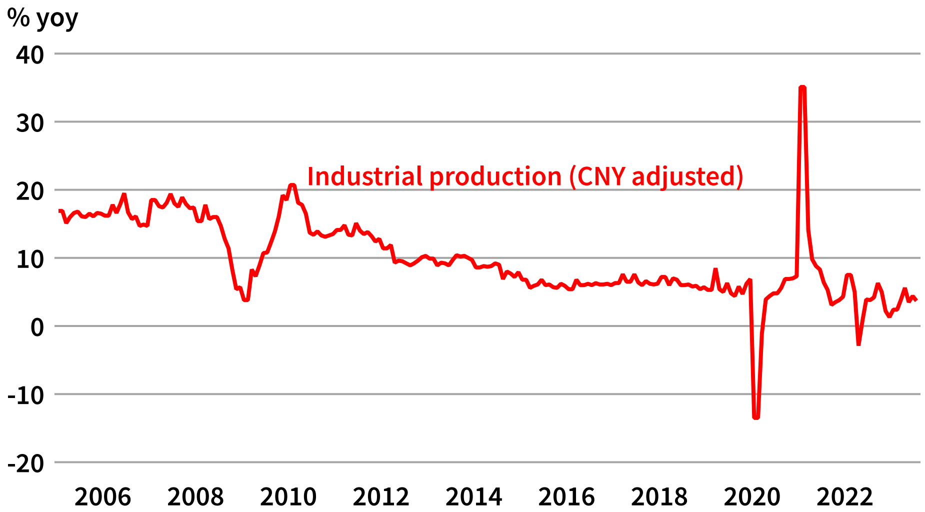
- The People's Bank of China (PBoC) cut the rate on its Medium Term Lending Facility (MTF) by 15 basis points in mid August, to 2.5%. As China's main policy rate – the Loan Prime Rate – is priced off the MTF, we expect the same cut to be implemented on 21 August.

- Despite this likely cut, there remain concerns around loan demand from households and businesses, particularly given that there is no shortage of funds available for lending. The reopening of China's economy, following the abandonment of zero-COVID policies, saw an uptick in the growth of outstanding bank lending, however these measures plateaued across March and April, before subsequently declining.

Industrial production

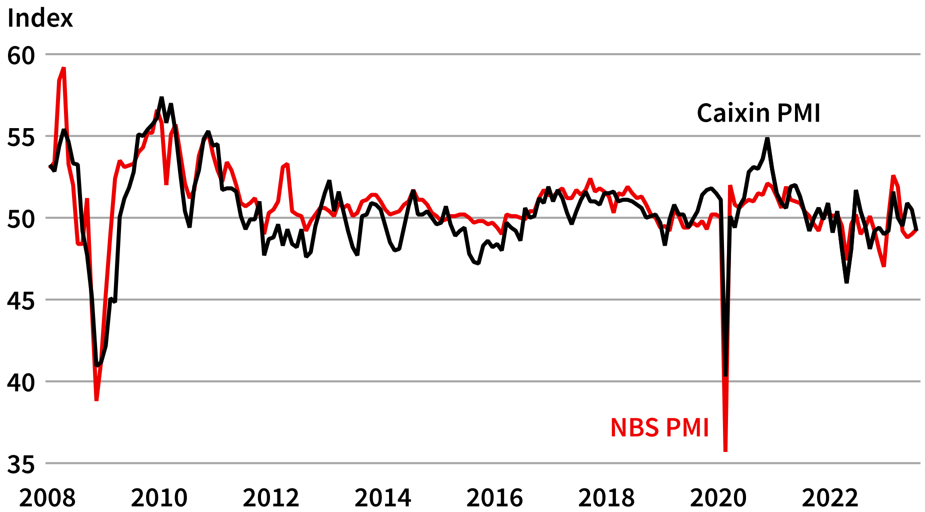
Industrial production growth

Softer output growth in July, well below pre-pandemic trends



Manufacturing PMI surveys

Caixin measure dropped, closing the gap between the two surveys



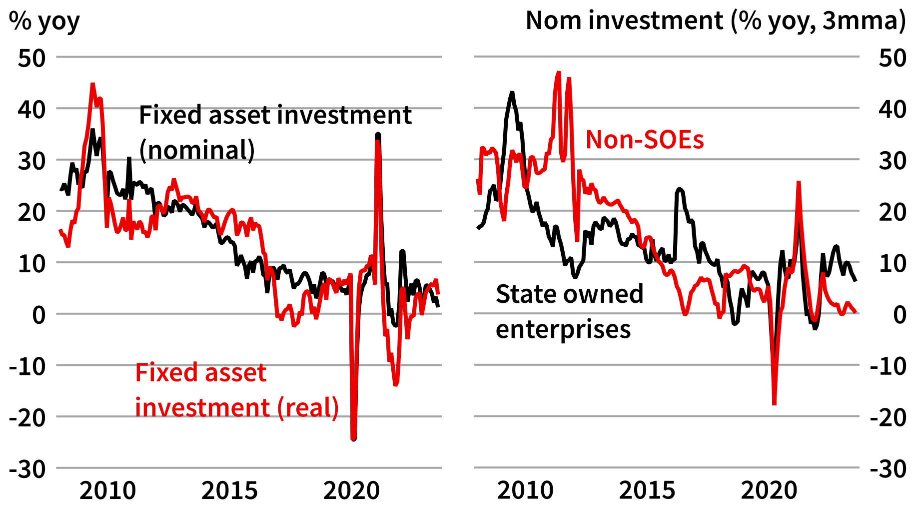
Sources: Macrobond, NAB Economics

- China's industrial production growth slowed marginally in July – increasing by 3.7% yoy (down from 4.4% yoy in June). We are now past the period of significant base effects (related to last year's COVID-19 lockdowns), and growth in output is relatively weak when compared with pre-pandemic trends.
- There was a substantial divergence in growth rates for major industrial sectors in July. Trends were mixed in construction related heavy industry – with cement output falling by 5.7% yoy but crude steel production rose by 11.5% yoy. The latter reflects industry specific base effects – output fell sharply in July 2022 but was little changed month-on-month in July 2023. Motor vehicle output also fell, down by 3.8% yoy, while production of electronics was up by just 0.7% yoy.
- The gap between China's two major manufacturing surveys closed in July. During May and June, the gap opened as respondents to the private Caixin PMI reported slightly positive conditions in the survey, while conditions in the official NBS PMI were in negative territory.
- In July, the Caixin measure turned negative, dropping to 49.2 points (from 50.5 points previously). In contrast, the NBS PMI was slightly less negative – moving up to 49.3 points (from 49.0 points in June).
- The two surveys showed similar trends in a range of key areas – particularly regarding new orders, which were negative in both surveys. New export orders were comparatively weaker – suggesting that firms in the both surveys saw demand conditions more negative abroad than domestically.

Investment

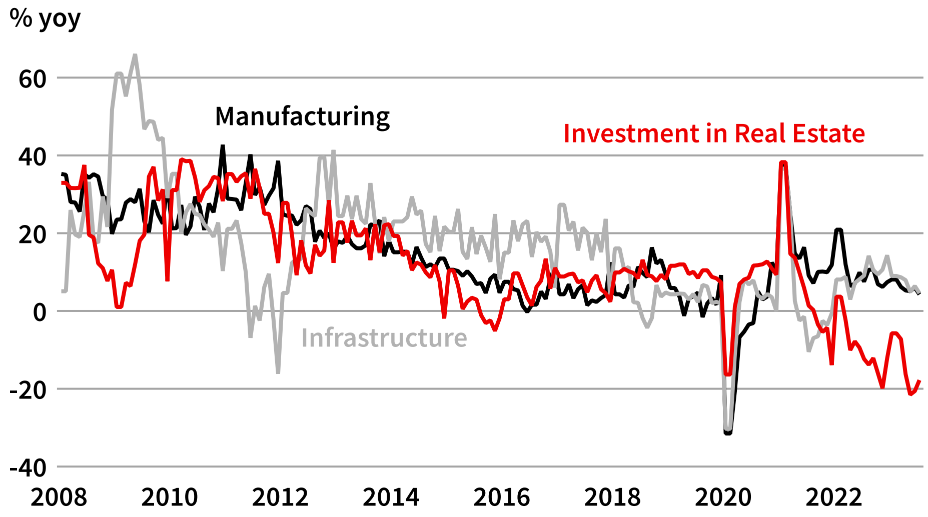
Fixed asset investment growth

Real investment has slowed, private investment remains weak



Fixed asset investment by industry

Real estate remains a major headwind



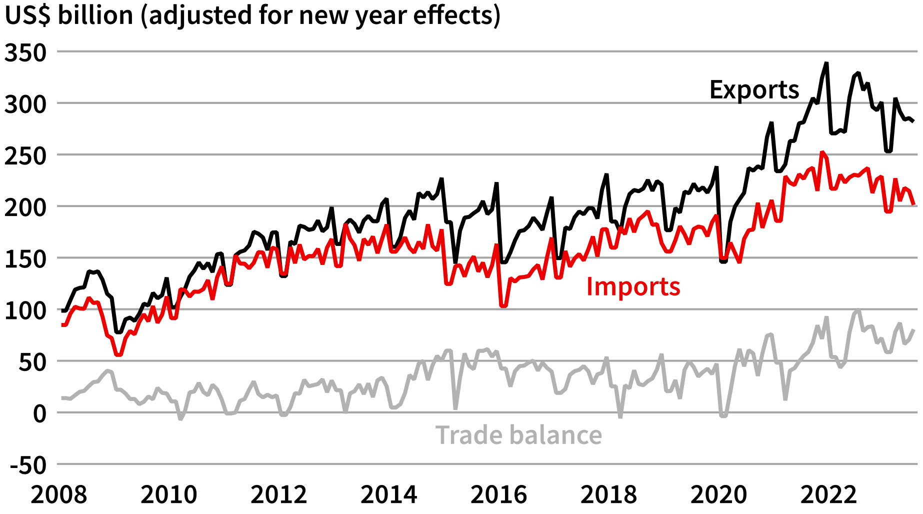
Sources: Macrobond, NAB Economics

- In nominal terms, fixed asset investment growth slowed in July – increasing by 1.2% yoy (from 3.3% yoy in June). To some extent, declining producer prices – which flow through to the cost of investment goods – have helped underpin real investment, albeit our estimate softened this month to 3.7% yoy (from 6.8% yoy previously).
- There remains a substantial difference between nominal investment by state-owned enterprises (SOEs) – which rose by 4.9% yoy in July – and private sector firms, where investment contracted by 1.0% yoy. Statements by NBS officials indicate that real estate is the key driver of this divergence, suggesting that investment by non-real estate private firms exceeded that of non-real estate SOEs in the first half of 2023.
- Real estate investment remains weak – contracting by 17.8% yoy in July. Overall, conditions in the sector remain weak, with Country Garden, the largest private property developer, missing payments on two international bonds this month. New residential construction starts contracted by almost 27% yoy in July.
- In contrast, nominal investment in manufacturing and infrastructure has remained comparatively strong – increasing by 4.3% yoy and 4.6% yoy respectively – albeit these rates of growth have slowed since the start of the year.

International trade – trade balance and imports

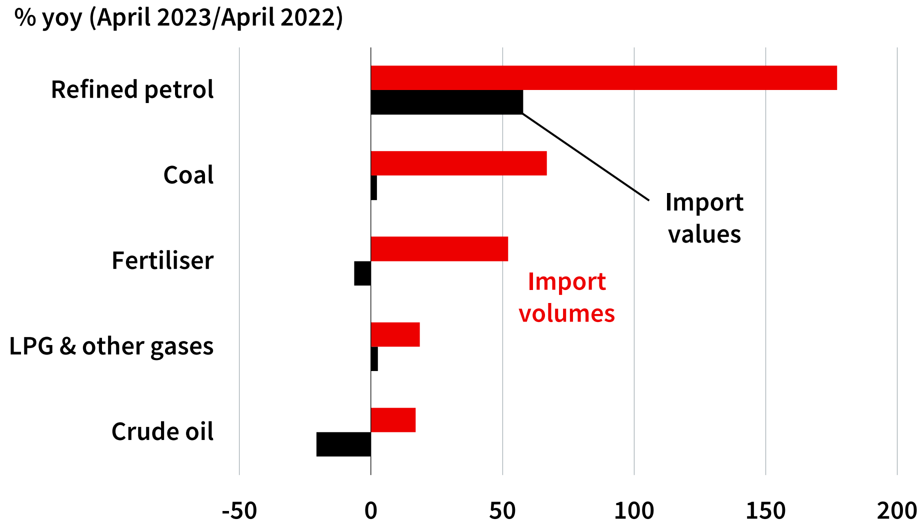
China's trade balance

Trade surplus rose as imports declined more rapidly than exports



Import volumes and values

Energy-related imports display the impact of falling prices



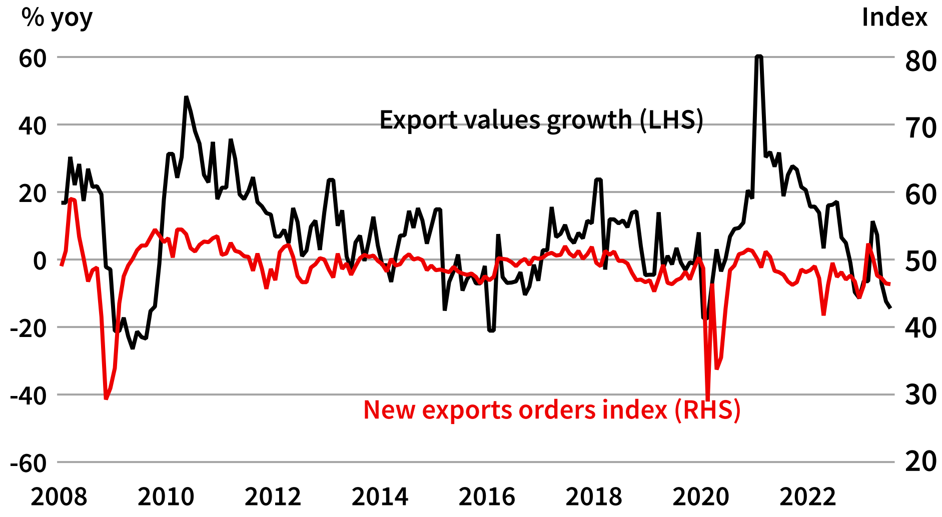
Sources: Macrobond, NAB Economics

- China's trade surplus increased month-on-month in July – totalling US$80.6 billion (up from US$70.6 billion in June). This uptick reflected a more rapid decline in imports than exports during the month.
- Since peaking in July 2022, China's rolling twelve month trade surplus with the United States has continued to trend lower – down to US$346.9 billion in July 2023. This was the first time since March 2021 that the rolling surplus was less than US$350 billion, but is still above the peaks ahead of the US-China trade war.
- The total value of China's imports declined to US$201.2 billion in July (down from US$217.4 billion previously). In year-on-year terms, the value of imports fell by 12.4%.
- The key driver of falling import values in recent months has been a steep declines in prices. Import prices (in RMB terms) fell by 8.5% yoy in June, far outpacing the 2.6% yoy fall in the total value of imports. In contrast to the trends across 2022 – when import volumes contracted in year-on-year terms in most months – volumes grew strongly in the first half of 2023.
- The divergence between import values and volumes in 2023 has been most evident in energy commodities– reflecting the drop in energy prices when compared with the period following Russia's invasion of Ukraine. This divergence is most evident in refined petroleum products – where the volume of imports rose by 177% yoy in July, while the value increased by just 58% yoy. Similarly, coal volumes rose by 67% yoy, while the value was just 2.2% yoy higher.

International trade – exports

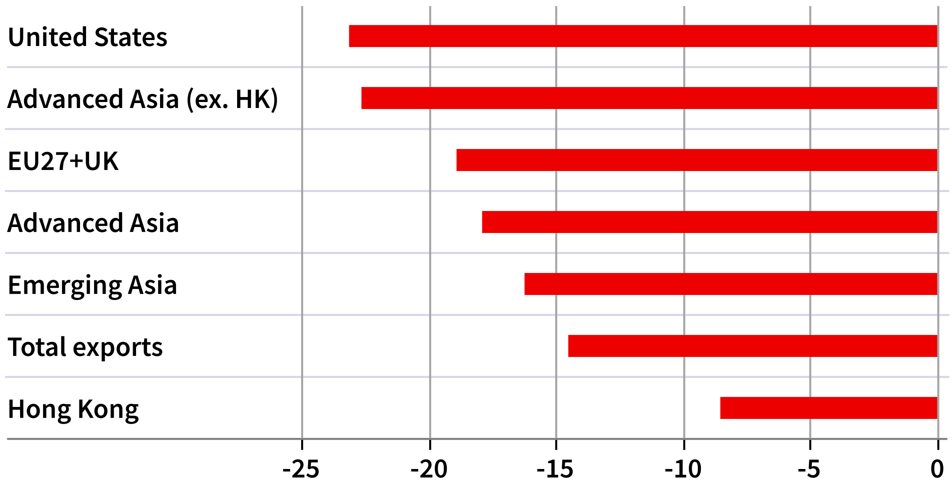
Export value and new export orders

Exports contracted sharply year-on-year



Exports to major trading partners

The United States saw the largest decline in exports



Sources: Macrobond, NAB Economics

- The value of China's exports totalled US$281.8 billion in July (down from US$285.3 billion in June). While this was a relatively modest decline month-on-month, it represented a fall of 14.5% year-on-year. The new export orders measure in the NBS PMI survey remained firmly in negative territory – at 46.3 points (edging down from 46.4 points in June).

- As was the case with imports, falling export prices have had an influence on this trend – export prices fell by 6.7% yoy in June (there is a one month lag on these data) – however export volumes also fell (down by 1.7% yoy in June). Tightening monetary policy and a shift in consumption back towards services has impacted demand for China's exports.

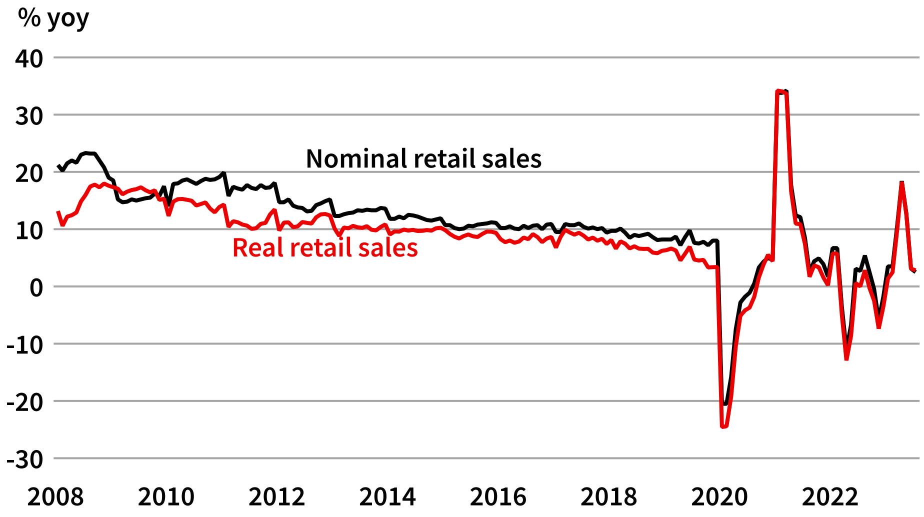
- As has been the case for several months, exports to most of China's major trading partners fell more rapidly than the overall average. In a large part, this reflects the increase in exports to the Russian Federation – up by 51.8% yoy in July) – along with other former Soviet Union member states.

- Exports to the United States fell by 23.1% yoy in July, while exports to the European Union-27 and the United Kingdom dropped by 18.9% yoy. Exports to advanced economies in Asia fell more rapidly than to the emerging markets – down 17.9% yoy and 16.2% yoy respectively – albeit excluding Hong Kong from the advanced economies saw this grouping decline much more rapidly.

Retail sales and inflation

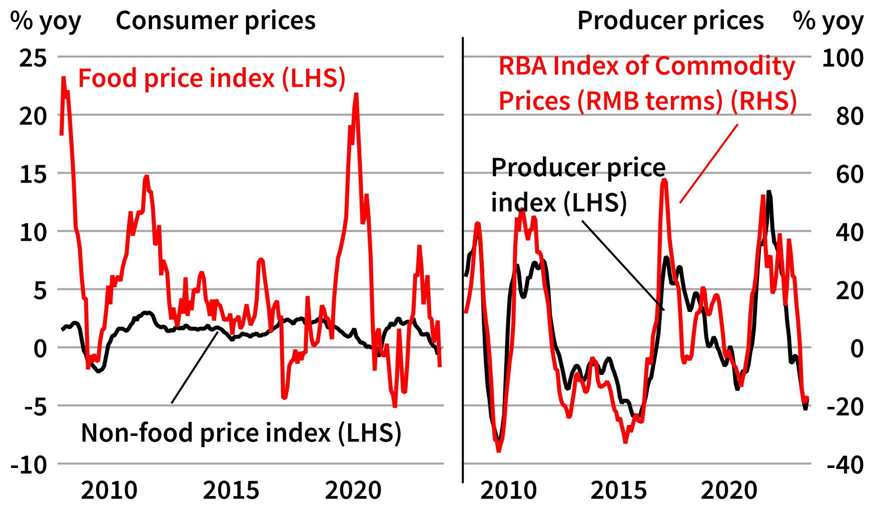
Retail sales growth

Sales growth continued to slow in July



Consumer and producer prices

China's consumer prices slipped into deflation in July



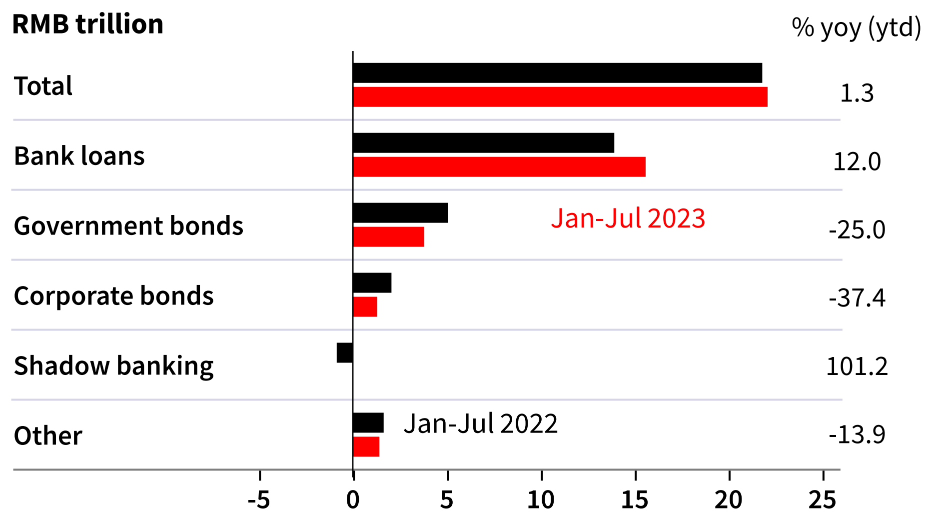
Sources: Macrobond, NAB Economics

- In nominal terms, China's retail sales growth slowed further in July – increasing by 2.5% yoy (from 3.1% yoy in June). As China's retail price index appears to have been discontinued, we now deflate the index by consumer prices. In real terms, sales growth also slowed – increasing by 2.8% yoy (from 3.1% yoy in June) – highlighting the ongoing weakness in domestic demand.
- This softness is also evident in China's inflation data. Headline inflation contracted in July – with consumer prices falling by 0.3% yoy (compared with no change in June). This weakness remains in stark contrast to still rapid price growth across the bulk of major economies globally.
- The contraction in consumer prices was driven by food – which fell by 1.7% yoy (compared with a 2.3% yoy increase in June). Pork was a key driver of this trend – falling by 26.0% yoy in July (compared with a 7.2% yoy fall previously). Fresh vegetables also fell modestly, down 1.5% yoy, but this followed a 10.8% yoy increase in June.
- Non-food prices were unchanged in year-on-year terms in July (from a 0.6% yoy fall in June). Vehicle fuel prices remain a major influence – down by 13.2% yoy in July (compared with a 17.6% fall previously).
- Producer prices have now fallen year-on-year for ten months in a row – down by 4.4% yoy in July (compared with a 5.4% yoy fall in June). Input costs have contributed to this trend, with the RBA Index of Commodity Prices (converted to RMB terms) falling by 16.7% yoy in July. However this trend may also indicate the weakness in both domestic and export markets.

Credit conditions

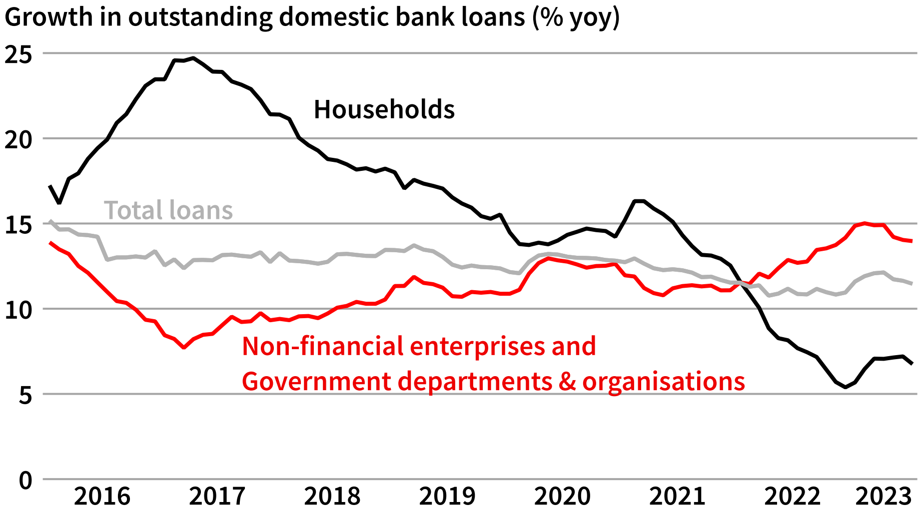
New credit issuance

Credit growth has stalled in recent months



Bank lending

Growth in outstanding loans has slowed on weak demand



Sources: Macrobond, NAB Economics

- New credit issuance was substantially weaker than anticipated in July – totalling just RMB 528 billion (compared with market expectations of around RMB 1.1 trillion). Most of this new credit was driven by government bond issuance – with a modest increase in local currency bank lending largely offset by a decrease in foreign currency loans.
- In the first seven months of 2023, new credit issuance increased by 1.3% yoy to RMB 22.1 trillion. Recent months have seen credit growth contract – between January and April, issuance increased by over 21% yoy, before declining by 28% yoy in between May and July.
- Despite the weakness in July, bank lending has been the key driver over this period – increasing by 12.0% yoy to RMB 15.6 trillion. In contrast, non-bank lending has contracted strongly across the first seven months – down by 17.6% yoy. This reflects sizeable declines in government and corporate bonds over this period.
- The People's Bank of China (PBoC) cut the rate on its Medium Term Lending Facility (MTF) by 15 basis points in mid August, to 2.5%. As China's main policy rate – the Loan Prime Rate – is priced off the MTF, we expect the same cut to be implemented on 21 August.
- Despite this likely cut, there remain concerns around loan demand from households and businesses, particularly given that there is no shortage of funds available for lending. The reopening of China's economy, following the abandonment of zero-COVID policies, saw an uptick in the growth of outstanding bank lending, however these measures plateaued across March and April, before subsequently declining.

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