NAB Group Economics

China's economy at a glance
July 2024

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Key points

China's growth slowed in Q2, with domestic demand remaining constrained and manufacturers relying on exports

- China's national accounts data showed a slowing trend for growth in Q2, with the headline series expanding by 4.7% yoy (down from 5.3% yoy in Q1). There was a larger slowdown in China's services sector than in its manufacturing & construction industry – with weak domestic demand negatively impacting the former, while the surge in export volumes has helped to underpin the latter. This appears far from sustainable – given growing trade tensions with major export markets and sluggish global growth. We have modestly revised our full year forecasts for China's economy – given that our previous view for 2024 was on the low side. We see growth at 4.7% this year (from 4.5% previously) – below the target of "around 5%". We have revised the forecast for 2025 lower to 4.6% (previously 4.8%).

- China's industrial production growth slowed further in June – increasing by 5.3% yoy, compared with 5.6% yoy in May and 6.7% yoy in April. Strong growth in electronics output was in contrast with weakness in construction-related heavy industry.

- Growth in China's nominal fixed asset investment was marginally stronger in nominal terms in June, but weaker in real terms down to 4.4% yoy (from 4.9% yoy previously). The property sector remains a drag on investment, having contracted year-on-year for 28 months in a row.

- China's trade surplus rose to a record high in June – up to US$99.0 billion – from US$82.6 billion in May. This reflected a month-on-month acceleration in the value of China's exports, while imports weakened.

- Real retail sales growth was 1.8% yoy in June, the weakest result December 2022, which was negatively impacted by the Omicron wave of COVID-19 and the sudden end of zero-COVID policies. This continues to point to the soft domestic demand conditions that have persisted since the pandemic.

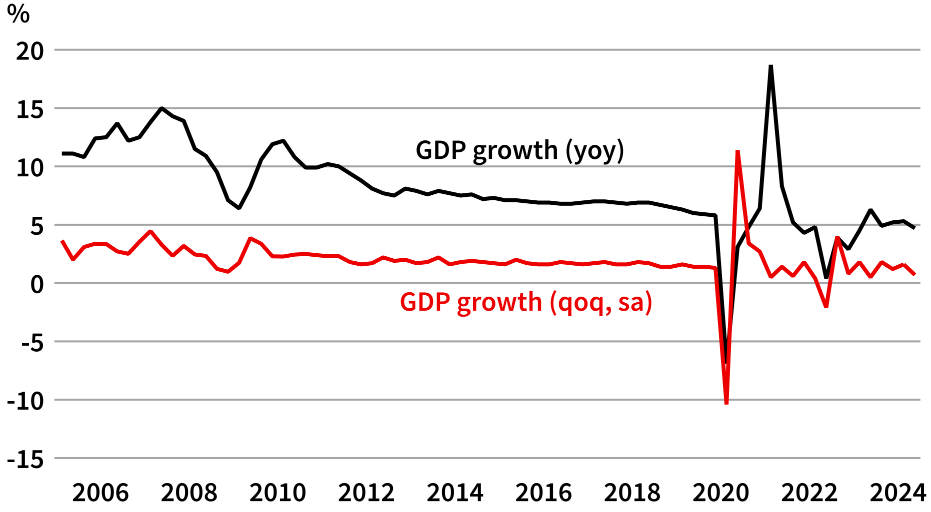
- China's new credit issuance totalled RMB 18.1 trillion in the first half of 2024, representing a year-on-year contraction of 16.0%. Although bank loans continue to account for the largest share of lending, this lending fell relatively more rapidly – down by 20.1% yoy to RMB 12.5 trillion.

- The People's Bank of China (PBoC) is facing an increasingly challenging environment in which to manage monetary policy. Yields on government bonds have fallen rapidly since late November 2023, in stark contrast to trends in advanced economies (where US Treasury yields have trended higher since December) – which could encourage further capital outflows. In early July, the central bank announced that it had secured deals with several institutions to borrow long dated government bonds and sell them into the market to drive down bond prices (and thereby increase yields).

Gross domestic product

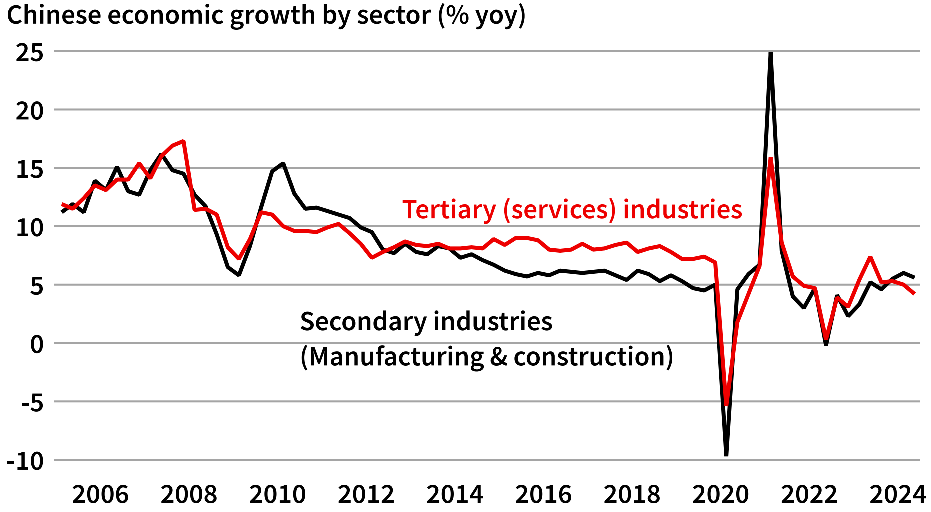
China's economic growth

Growth slowed in Q2 below market expectations



Economic growth by industry

Weak domestic demand sees services sector slowing more rapidly



Sources: Macrobond, NAB Economics

- Official data suggests that China's economy expanded by 4.7% yoy in Q2 (down from a 5.3% yoy increase in Q1). In seasonally adjusted terms, the economy grew by 0.7% qoq, down from a revised down 1.5% increase in Q1. This outcome fell below market expectations – with the Reuters poll at 5.1% yoy and 1.1% qoq – but was somewhat higher than we had expected.
- There was a widening gap between the growth rates of major industrial categories – with a modest easing in the secondary sector growth (comprising manufacturing and construction) – down to 5.6% yoy (from 6.0% yoy in Q1). In contrast, growth in the tertiary (services) sector slowed to 4.2% yoy (from 5.0% yoy previously).
- This pattern is consistent with trends that we have observed in recent months – with weak domestic demand negatively impacting the services sector, while the surge in export volumes has helped to underpin industrial output. This appears far from sustainable – given only soft global growth and growing trade tensions with major export markets.
- We have modestly revised our full year forecasts for China's economy – given that our previous view for 2024 was on the low side. We see growth at 4.7% this year (from 4.5% previously) – below the target of "around 5%". We have revised the forecast for 2025 lower to 4.6% (previously 4.8%).

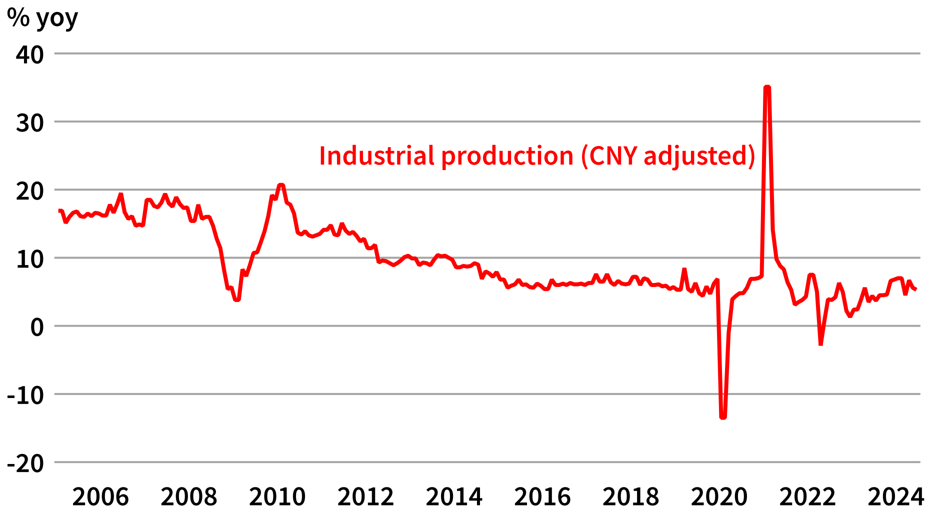
NAB China GDP forecasts

%	2023	2024	2025	2026
GDP	5.2	4.7	4.6	4.4

Industrial production

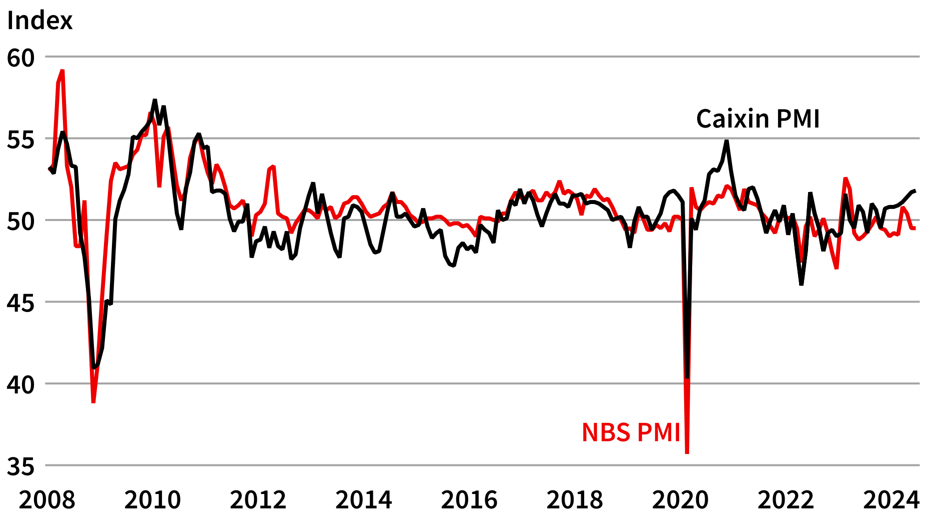
Industrial production growth

Output growth has slowed from April's peak



Manufacturing PMI surveys

Sizeable gap between the two major PMI surveys



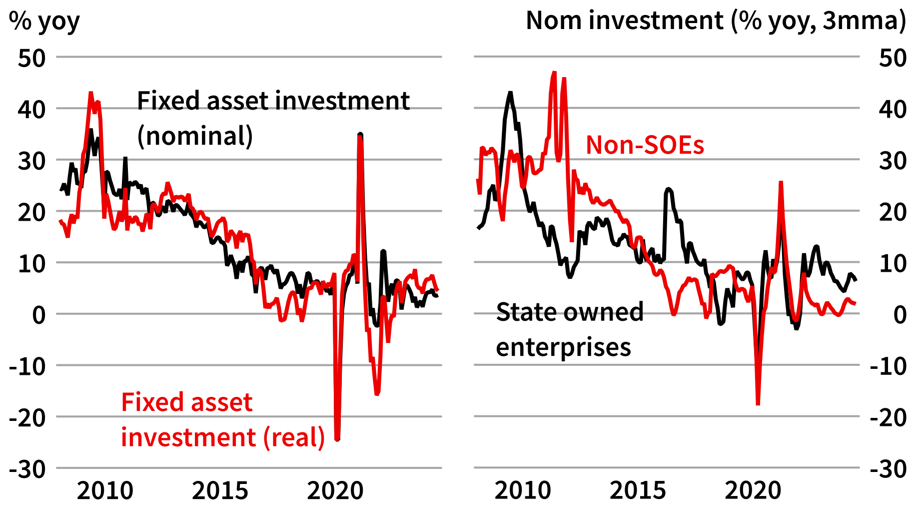
Sources: Macrobond, NAB Economics

- China's industrial production growth slowed further in June – increasing by 5.3% yoy, compared with 5.6% yoy in May and 6.7% yoy in April.
- There remains substantial divergence in trends for individual industries. Production of electronics continues to expand rapidly – up by 11.3% yoy in June – while growth in motor vehicle production has slowed recently, up by 1.8% yoy in June, from double digit growth in April and January-February. Construction related heavy industries remain weak – with crude steel output rising by 0.2% yoy and cement manufacturing down by 10.7% yoy in June.
- Trends in China's major manufacturing surveys remained divergent in June. The Caixin PMI continued to strengthen – moving up to 51.8 points (the strongest reading since May 2021) from 51.7 points in May. In contrast, the official NBS PMI remained in negative territory, albeit unchanged at 49.5 points.
- There remain some substantial differences in the underlying indices within these surveys. The Caixin survey showed production and new orders expanding in June, while production in the NBS survey was less positive and new orders were in negative territory.

Investment

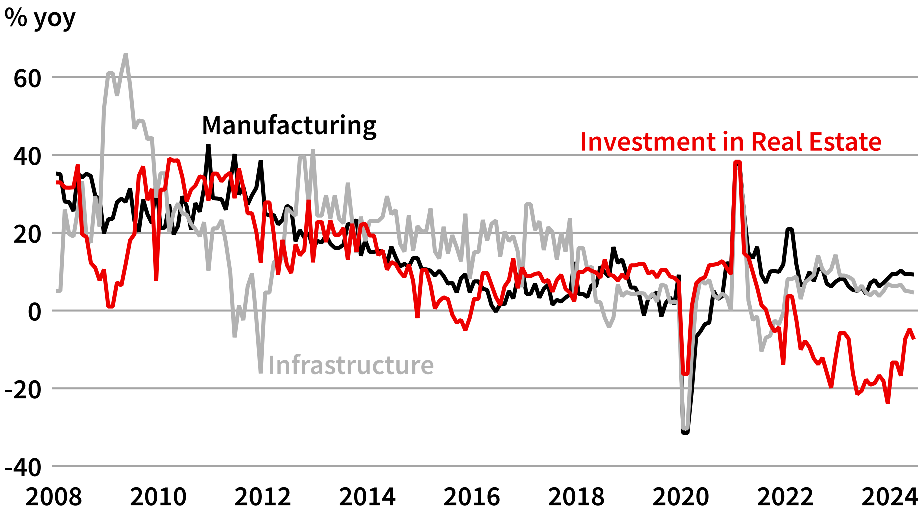
Fixed asset investment growth

Investment growth remains relatively subdued, particularly private



Fixed asset investment by industry

Real estate investment remains a drag on growth



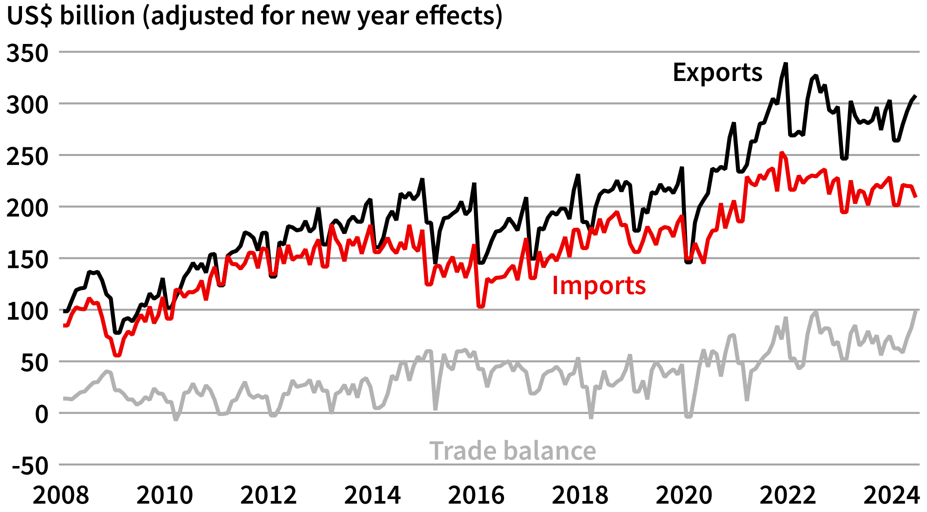
Sources: Macrobond, NAB Economics

- Growth in China's nominal fixed asset investment was marginally stronger in June – increasing by 3.6% yoy (from 3.5% yoy in May). Deflating this measure using the producer price index implies that real investment growth slowed in June – down to 4.4% yoy (from 4.9% yoy previously).
- Growth in investment by China's state-owned enterprise (SOEs) has remained comparatively strong – with nominal investment rising by 6.1% yoy in June. In contrast, investment by private sector firms has been relatively subdued, rising by just 1.9% yoy. Some of this divergence is related to the downturn in China's property sector.
- There remains considerable divergence in investment by broad industrial categories. Manufacturing investment has remained comparatively strong – increasing by 9.3% yoy in June (unchanged from May), while growth in infrastructure investment slowed slightly – rising by 4.6% yoy (down from 4.9% yoy previously).
- Investment in real estate has now contracted year-on-year for 28 months in a row, falling by 7.4% yoy in June (compared with -4.7% yoy in May). Conditions in China's residential property sector remain broadly negative – with sales falling by 14.3% yoy in June, while construction starts fell by 18.3% yoy .

International trade – trade balance and imports

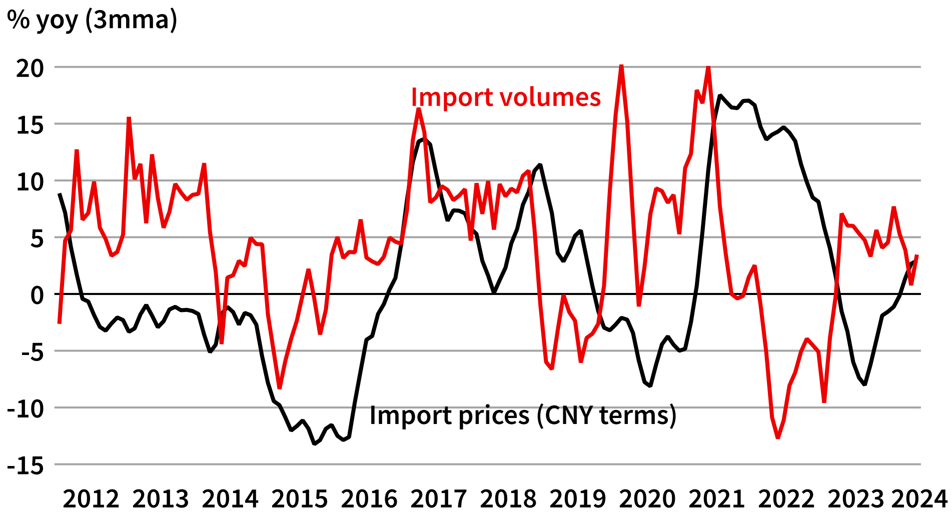
China's trade balance

Trade surplus rose to record high as exports & imports diverged



China's import prices and volumes

Import prices starting to climb, impacting volumes



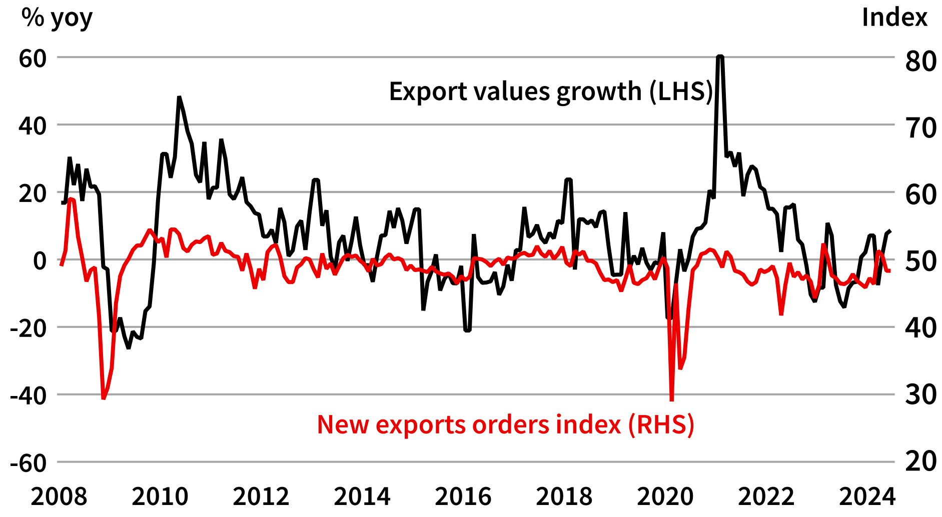
- China's trade surplus rose to a record high in June – up to US$99.0 billion – from US$82.6 billion in May. This reflected a month-on-month acceleration in the value of China's exports, while imports weakened.
- The record surplus in June drove an increase in the rolling twelve-month trade surplus to US$857.6 billion (from US$828.1 billion in the twelve months to May). The scale of this trade imbalance has intensified tensions with various other countries – with Indonesia following the United States and European Union in imposing tariffs on Chinese exports in late June – albeit Indonesia targeted lower value added products, rather than the high tech goods sanctioned by the US and EU.
- The value of China's imports eased further in June, down to US$208.8 billion (from US$219.7 billion previously). In year-on-year terms, this represented a decline of 2.3%.
- For much of 2023, import volumes grew strongly – boosted by falling prices over much of the period (particularly those of energy commodities). However, import prices have climbed in year-on-year terms since March and there has been a notable shift down in import volumes.
- That said, there have been highly divergent trends within individual import categories. Year-on-year price increases have been most evident in sectors such as refined copper products, pharmaceuticals, refined petroleum products, rubber and crude oil. In contrast, prices for soybeans, fertilisers and machine tools fell steeply.

Sources: Macrobond, NAB Economics

International trade – exports

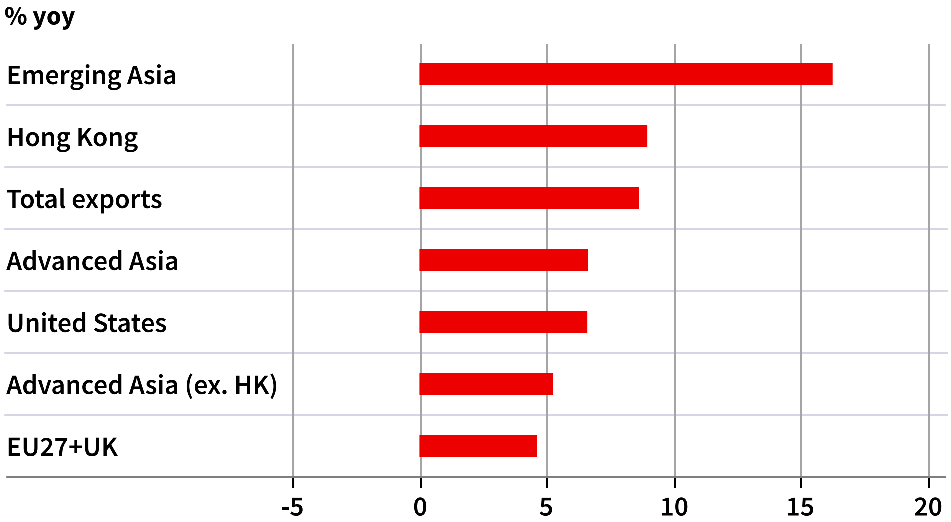
Export value and new export orders

Exports expand despite weak orders in PMI survey



Exports to major trading partners

Emerging Asia recorded the largest increase in Chinese exports



Sources: Macrobond, NAB Economics

- The value of China's exports moved higher in June, rising to US$307.9 billion (from US$302.3 billion previously). In year-on-year terms, exports increased by 8.6%, up from 7.6% yoy in May. While the new export orders measure in the NBS manufacturing PMI remained negative – unchanged at 48.3 points in June – the same measure in the Caixin survey remained positive (albeit it has trended back towards neutral levels in recent months).

- The key driver of the recent increases in export values has been the acceleration in export volumes, as prices for these goods have been falling. Volumes rose by 14.8% yoy in May (compared with 9.8% yoy in April), but export prices fell by 3.2% yoy.

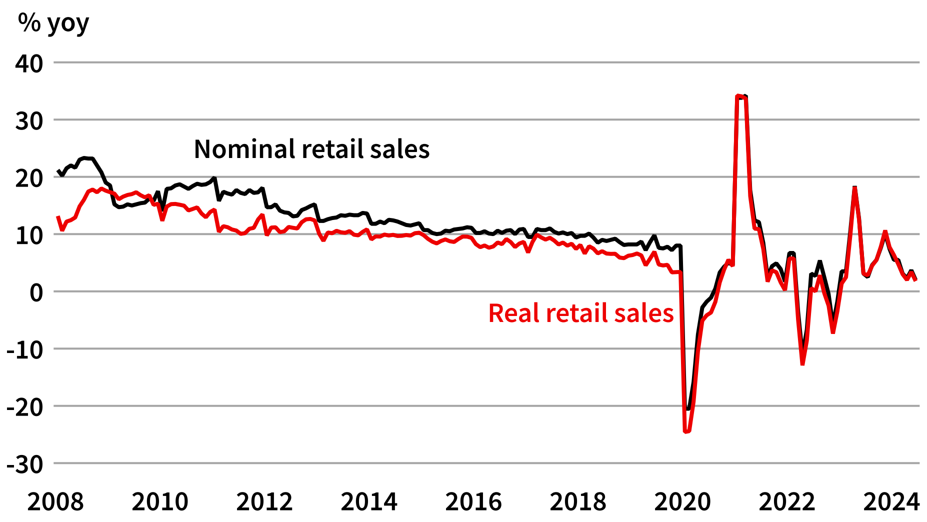
- Emerging Asian economies have recorded the most rapid increase in Chinese exports in recent times, with the value of these deliveries rising by 16.2% yoy in June. In contrast, exports to advanced Asian economies rose by 6.6% yoy, or 5.3% yoy if Hong Kong is excluded. Historically there have been substantial distortions in China's trade data with Hong Kong, in part reflecting capital flows disguised as trade activity.

- Exports to the United States rose by 6.6% yoy while shipments in the European Union-27 + the United Kingdom rose by 4.6% yoy. It is worth noting that the tariffs announced by the US and EU are relatively narrow and are unlikely to substantially impact near term export growth.

Retail sales and inflation

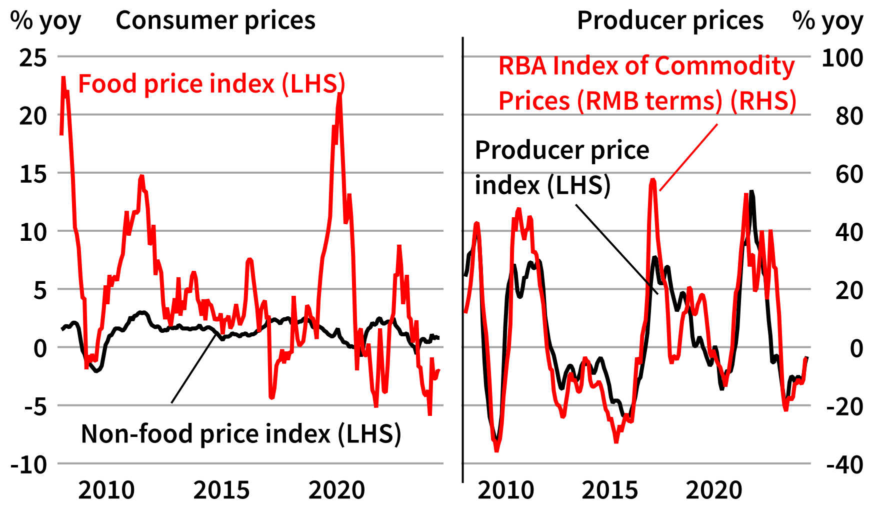
Retail sales growth

Real growth slowed to post-zero-COVID low in June



Consumer and producer prices

Weak inflation trends continue to point to soft domestic demand



Sources: Macrobond, NAB Economics

- In nominal terms, growth in China's retail sales slowed in June, with an increase of 2.0% yoy (compared with 3.7% yoy in May). Adjusted for inflation, real retail sales growth was 1.8% yoy in June, the weakest result December 2022, which was negatively impacted by the Omicron wave of COVID-19 and the sudden end of zero-COVID policies. This continues to point to the soft domestic demand conditions that have persisted since the pandemic.

- Inflation trends in China remain subdued – in stark contrast to persistent above target rates in most advanced economies – in part reflecting the ongoing weakness in domestic demand. The consumer price index rose by 0.2% yoy in June, down from 0.3% yoy previously.

- A key contributor to this weak inflation has been falls in food prices. The food price index fell by 2.1% yoy in June (compared with -2.0% yoy in May). Food prices have fallen since July 2023 and pork prices were a key driver of this trend until April 2024. Subsequently pork prices have accelerated – increasing by 18.1% yoy in June – however food prices have continued to contract, with fresh fruit, fresh vegetables, eggs and dairy products falling.

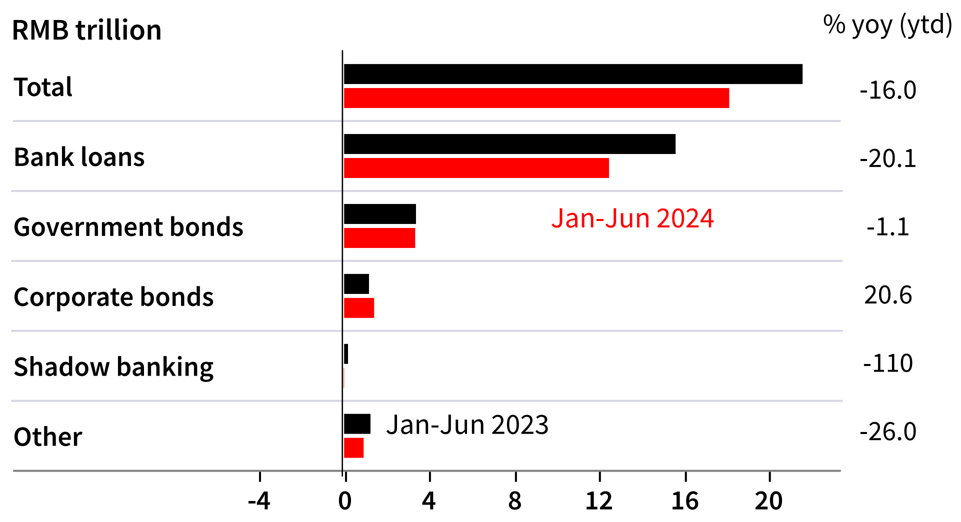
- Growth in non-food prices remained unchanged in June – increasing by 0.8% yoy. Similar to the influence of pork on food prices, vehicle fuel has had a major influence on the modest pickup in non-food prices since the recent lows of July 2023 – increasing by 5.6% yoy in June.

- Producer prices have fallen in year-on-year terms since October 2022, albeit the 0.8% yoy fall recorded in June was the smallest decline since December 2022. There remains a close relationship between global commodity prices – as these feed into input costs for manufacturers – and producer prices, with the RBA Index of Commodity Prices falling by 3.8% yoy in June, compared with double digit declines as recently as April 2024.

Credit conditions

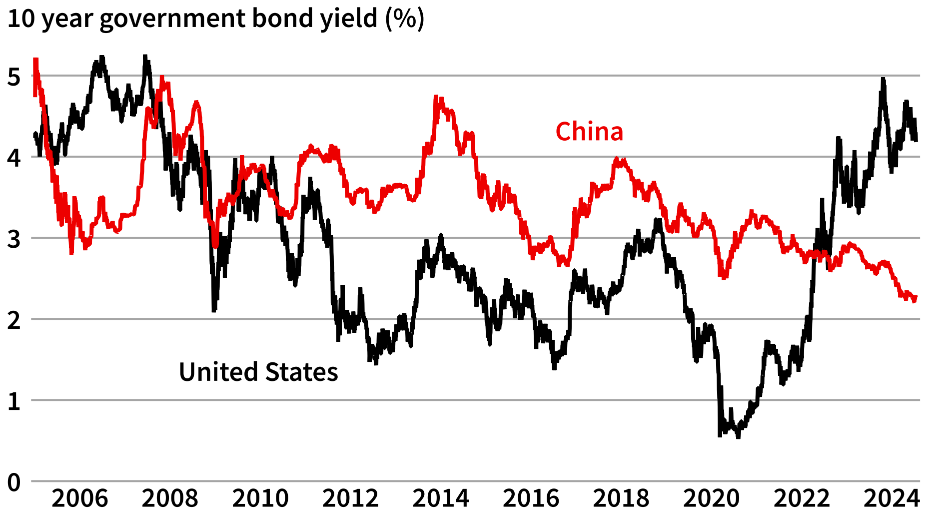
New credit issuance

Bank lending leads new credit issuance declines



Bond yields

Decline in China's yields in contrast to advanced economy trends



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- China's new credit issuance totalled RMB 18.1 trillion in the first half of 2024, representing a year-on-year contraction of 16.0%. Although bank loans continue to account for the largest share of lending, this lending fell relatively more rapidly– down by 20.1% yoy to RMB 12.5 trillion.

- Non-bank lending declined more modestly – down by 5.4% yoy to RMB 5.6 trillion. Both government and corporate bond issuance has ramped up in recent months. Government bond issuance fell by 26% yoy in the first quarter, before increasing by almost 28% yoy in Q2. Corporate bond issuance rose by 15% yoy in Q1 before climbing by 36% yoy in Q2.

- The People's Bank of China (PBoC) is facing an increasingly challenging environment in which to manage monetary policy. Yields on government bonds have fallen rapidly since late November 2023, in stark contrast to trends in advanced economies (where US Treasury yields have trended higher since December) – which could encourage further capital outflows. In early July, the central bank announced that it had secured deals with several institutions to borrow long dated government bonds and sell them into the market to drive down bond prices (and thereby increase yields).

- The PBoC also announced the introduction of new open market operation tools in July in the form of overnight temporary bond repurchase (repo) agreements and reverse repos. The interest rates on these agreements will be 20 basis points below (repo) and 50 basis points above (reverse repo) the seven day reverse repo rate (currently 1.8%) – creating a narrower 70 basis points corridor for short term rates in China (compared with the current 245 bps corridor between the 7-day Standing Facility Rate and the PBoC's excess reserves rate). It appears that the PBoC will transition towards the seven day reverse repo rate being its main policy rate, with the belief that this would allow smoother and more rapid monetary policy transmission.

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