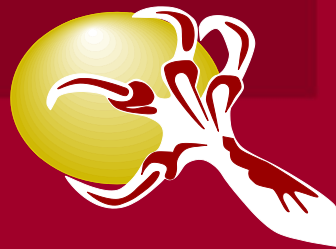


# CHINA: THE CHART PACK

APRIL  
2014

\* INFORMATION  
CURRENT AS OF  
APRIL 22, 2014.

**Westpac**  
Institutional  
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# Phat Dragon

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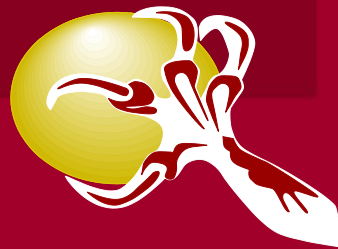
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# China: the key messages

The end-2013 data described an investment cycle that was beginning to decelerate, with the softer elements beginning to out-weigh those that were still in good health. **Clearly 2014 was beginning on a softer footing than the year that just closed, as *Phat Dragon* had long foreshadowed. The Q1 data, when it arrived, confirmed the slowdown in no uncertain terms.** The weakness of nominal activity was particularly striking in the March quarter national accounts, consistent with the deterioration of survey measures of business conditions throughout the quarter.

*Phat Dragon* notes that the poor partial data has been principally due to **weak outcomes in manufacturing** (an overdue crunch for heavy industry) and utilities capex (a surprise, reflecting tighter fiscal policy and weaker SOE activity in 2013H2) in the months of January and February, with the **weakness spilling over into real estate construction** in March. Transport has been surprisingly resilient though, with central and western regions still seeing some action in this space. Also, the value of new projects unexpectedly spiked higher in the new calendar year, implying that **the investment pipeline is being replenished to some degree**, supporting a stabilisation of growth around the middle of the year. The composition of investment will continue to shift, but the growth rate will retain a “17” handle even as the sectoral situation settles down. Note that *Phat Dragon* published a 17.0% forecast for CY2014 fixed investment ahead of the Jan-Feb data outturn, while the NPC’s FAI target is 17.5%.

**An additional factor influencing *Phat Dragon’s* forecasts is the tightening of credit conditions since the June quarter of 2013.** Our research indicates that shifts in credit lead developments in the real economy by 6-9 months, so the interbank turmoil of May and June is weighing on the economy now; the erratic credit supply to firms over the second half of the year will hinder 2014H1, while Q1’s OK bank lending, married to a shadow crunch, is relevant for outcomes from late Q3 forward.

# China: the key messages

**Phat Dragon** brought forward the timing of the enactment of growth stabilisation policies from mid-year to ‘immediate’ not long after the NPC. Policy needs be loosened to a degree because without a replenishment of the investment pipeline, the growth pulse will slow to the point where domestic demand growth will fall below 7% in Q3. Chinese policymakers have little room to move nowadays, with domestic demand growth sub 7% viewed as unpalatable from the point of view of job creation and anything exceeding 8% likely to be inflationary.

**This change of tack by domestic policymakers will combine with an improvement in global economic conditions to lift the economy in late 2014, ensuring that it enters 2015 with some positive momentum.**

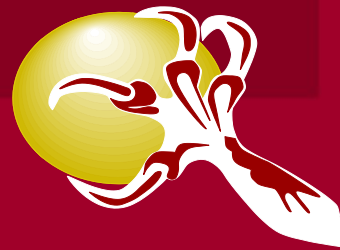
**Phat Dragon** anticipates that the world economy will be significantly firmer in 2015, which will assist China as it attempts to grow in a less credit-intensive fashion.

**While RRR cuts remain possible, Phat Dragon argues that it must be obvious that OMO could not achieve the same ends before the PBoC would choose that avenue for boosting liquidity.** The most likely time for a RRR cut is probably post deposit rate reform, which now has a definite “within two years” timeframe attached to it. (Note that “in the near future” meant 11 months in the case of the wider CNY band, and deposit insurance/guarantee system is likely to be built first).

**Regarding China’s balance sheet challenges, the financial system will remain a source of bearish news flow.** While **Phat Dragon** feels that the ultimate risks relating to Chinese debt are generally exaggerated (it still has a current account surplus after all, and is the world’s second largest international creditor) there seems little doubt in **Phat Dragon’s** mind that **bearish views on the growth-credit nexus will be remunerative in the first half of this year.**

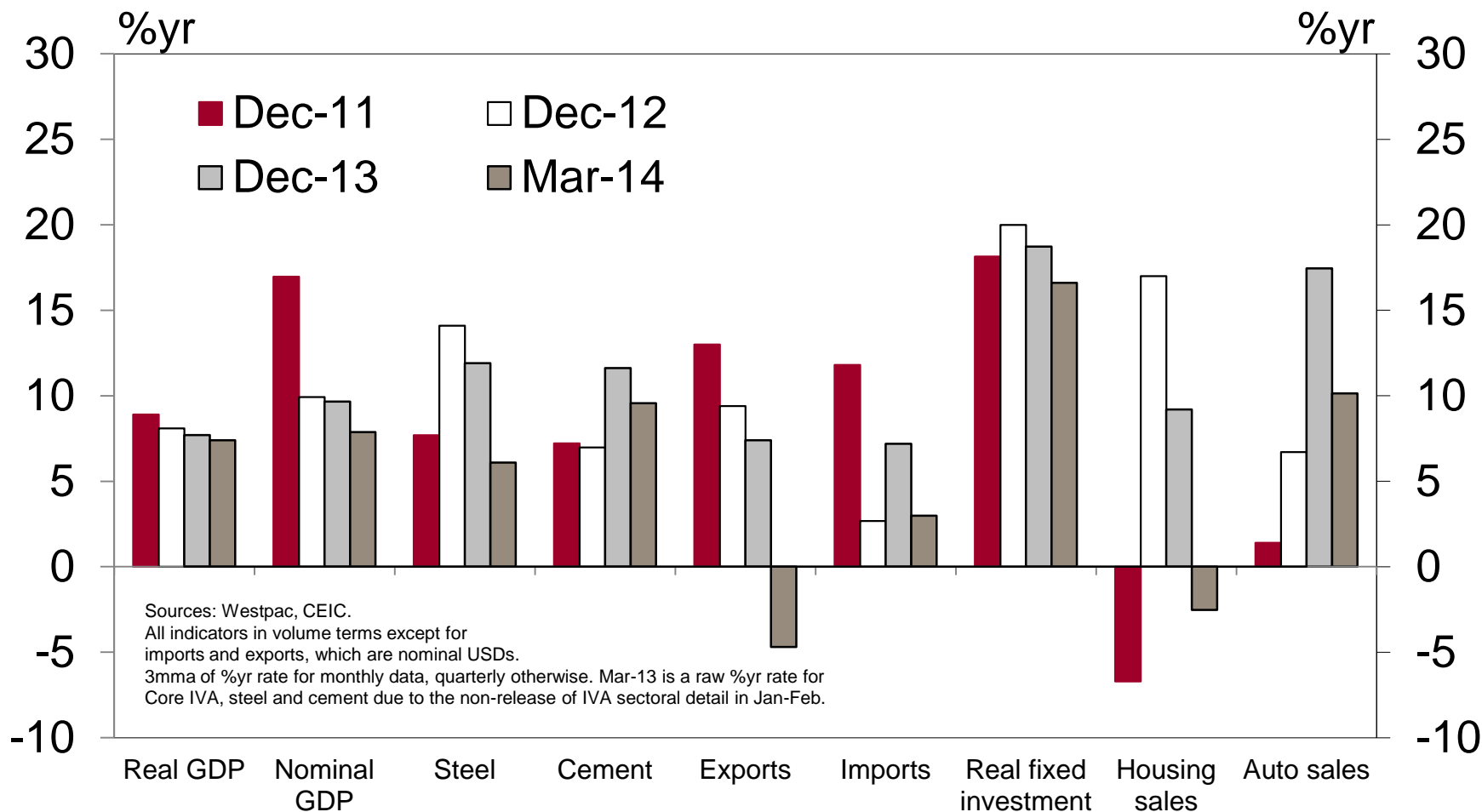
Finally, regarding commodity prices, **Phat Dragon** feels that the threat of a collapse has receded, given seasonality, cost curves and downstream inventory positions.

# AGGREGATE DEMAND

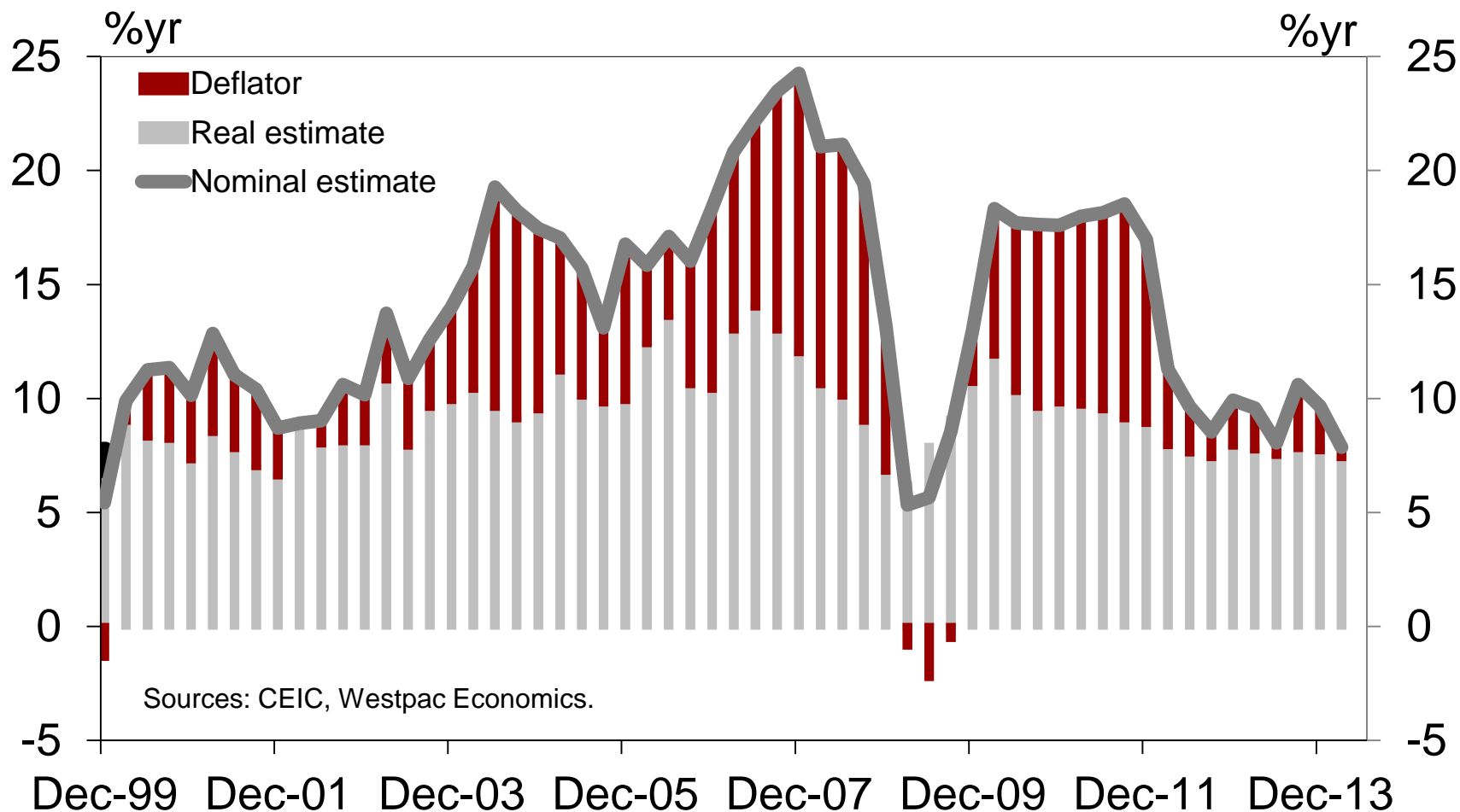


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# Key economic indicators

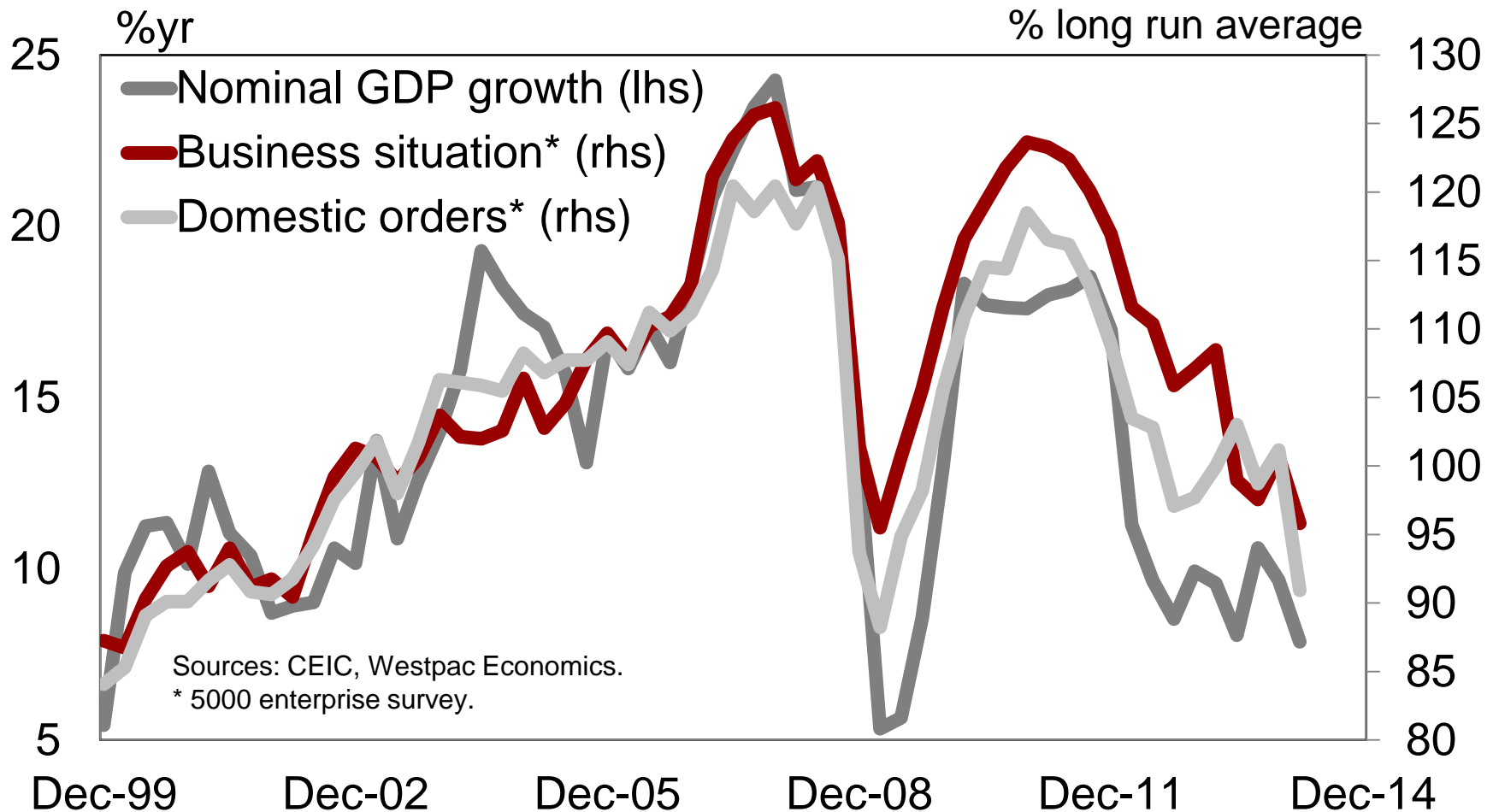


# Chinese GDP: real & nominal estimates

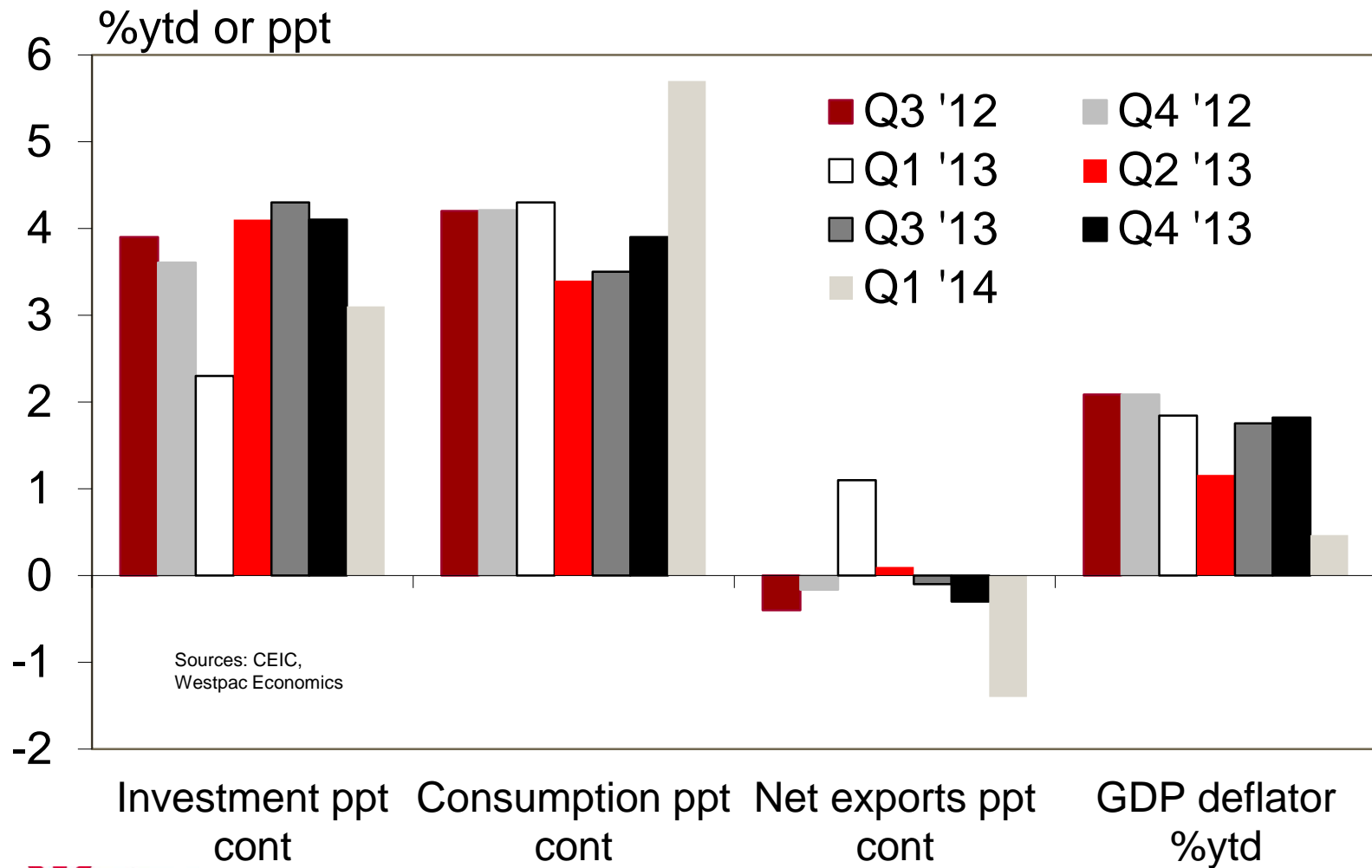




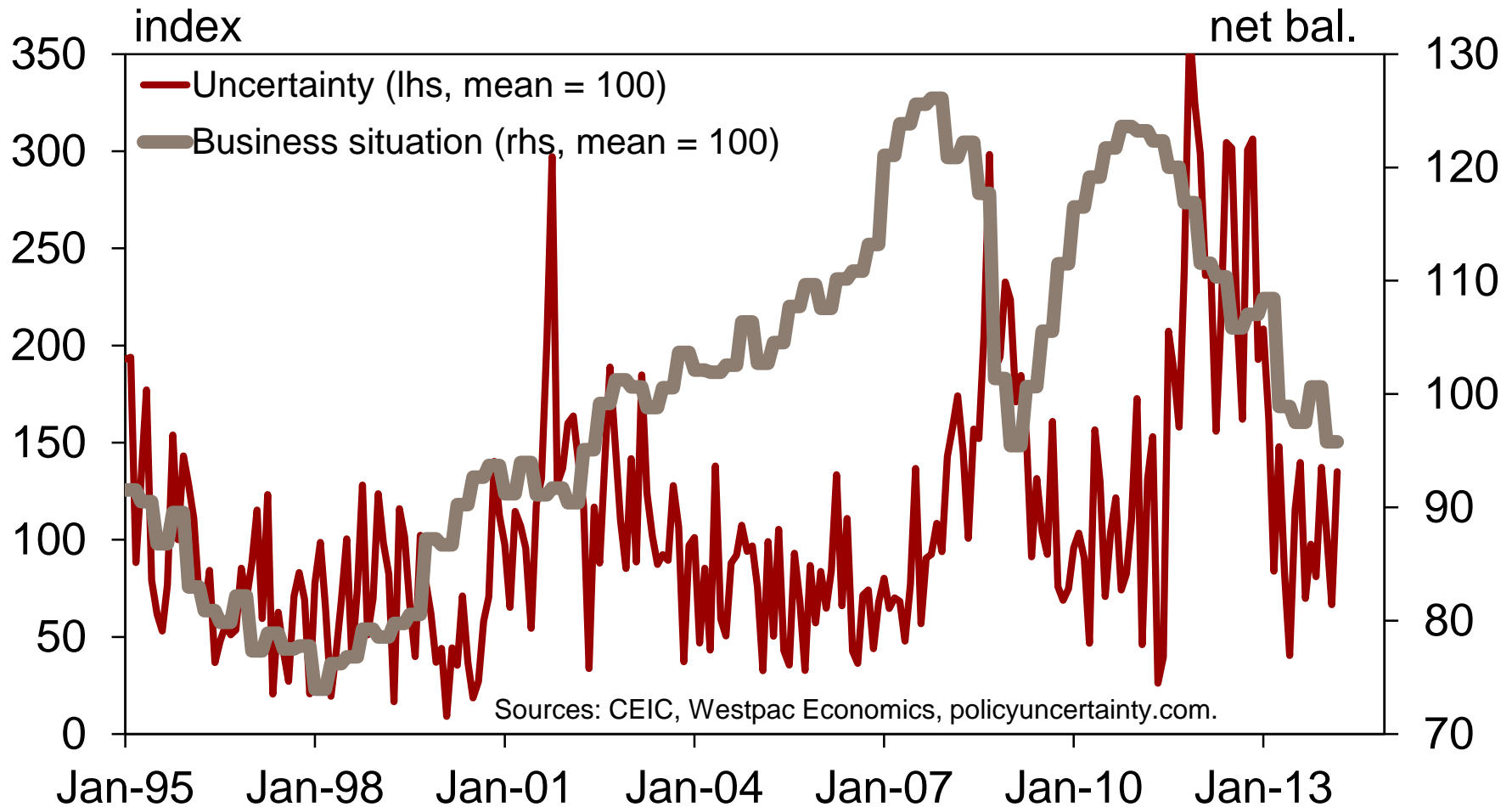
# China: business conditions, orders & GDP



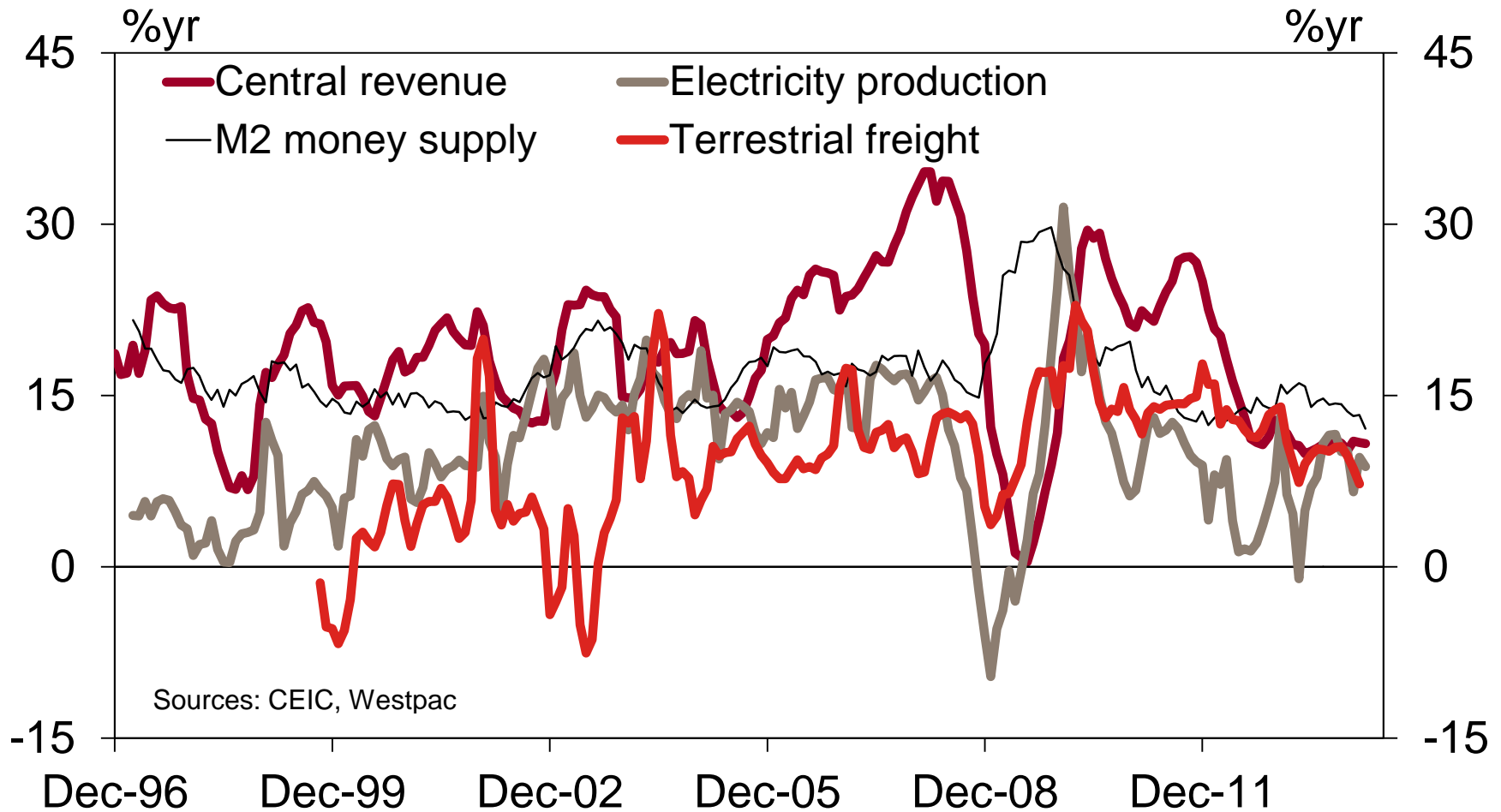
# Various elements of China's national accounts



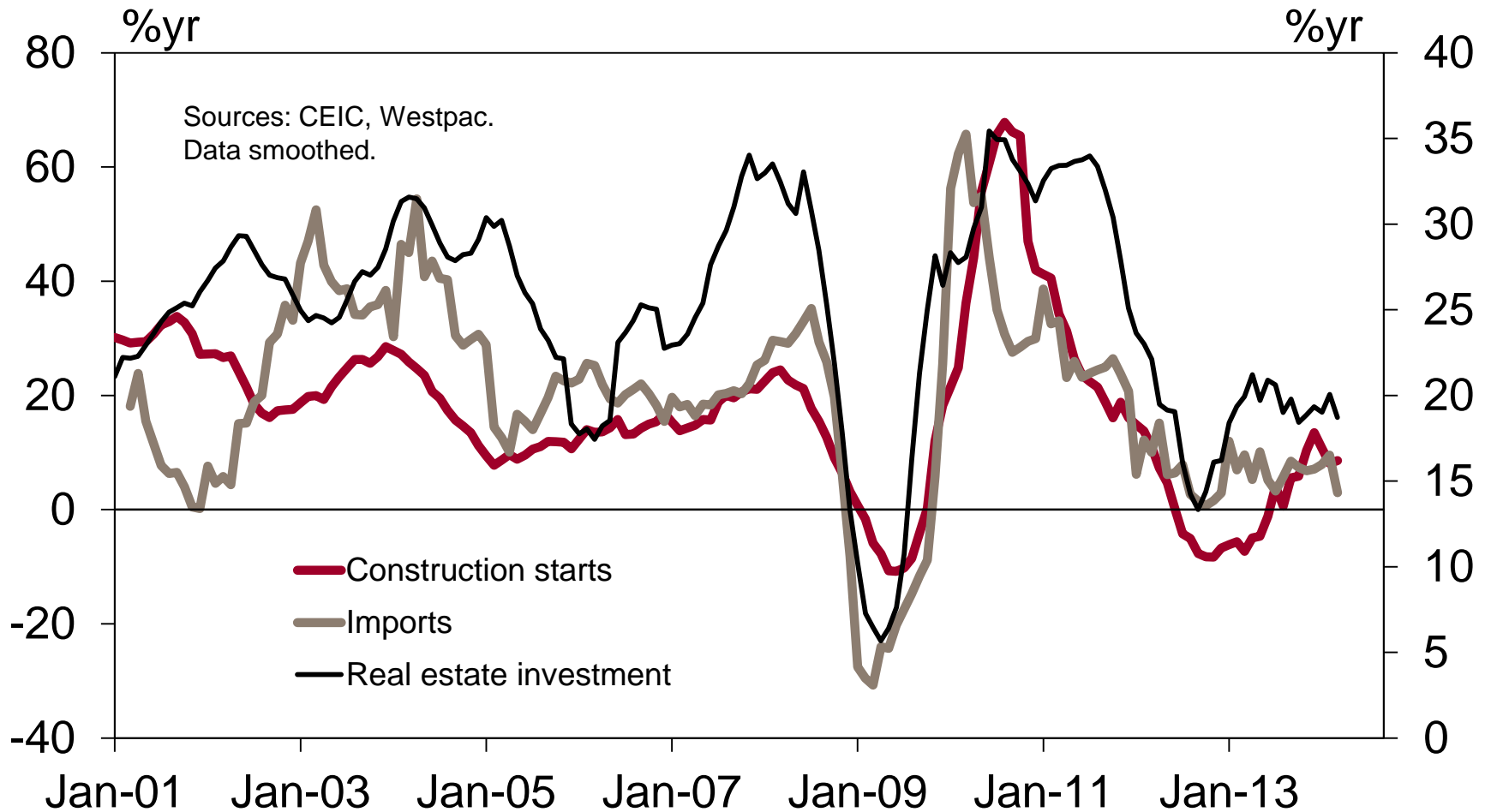
# “Economic uncertainty” & business conditions



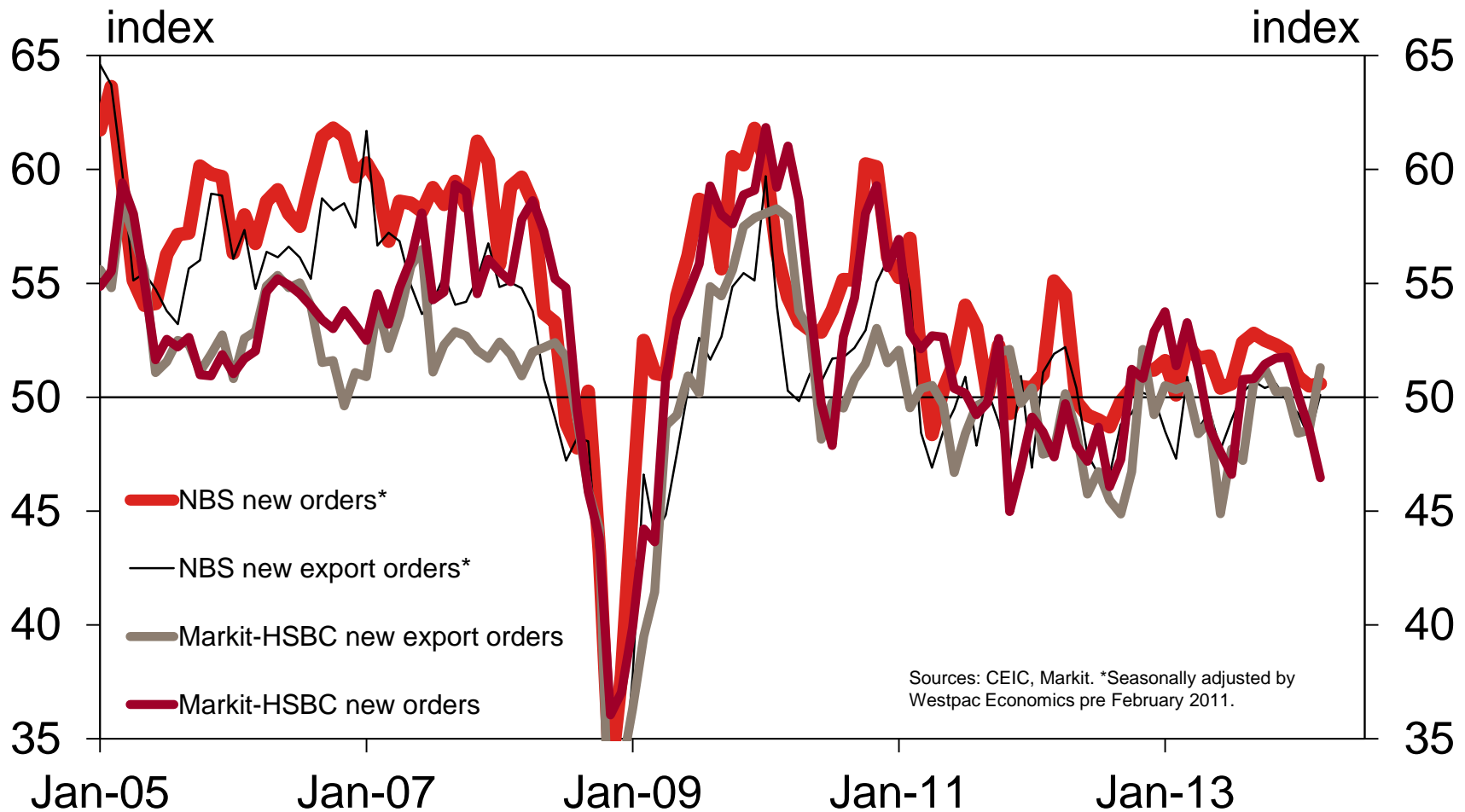
# Aggregate activity proxies



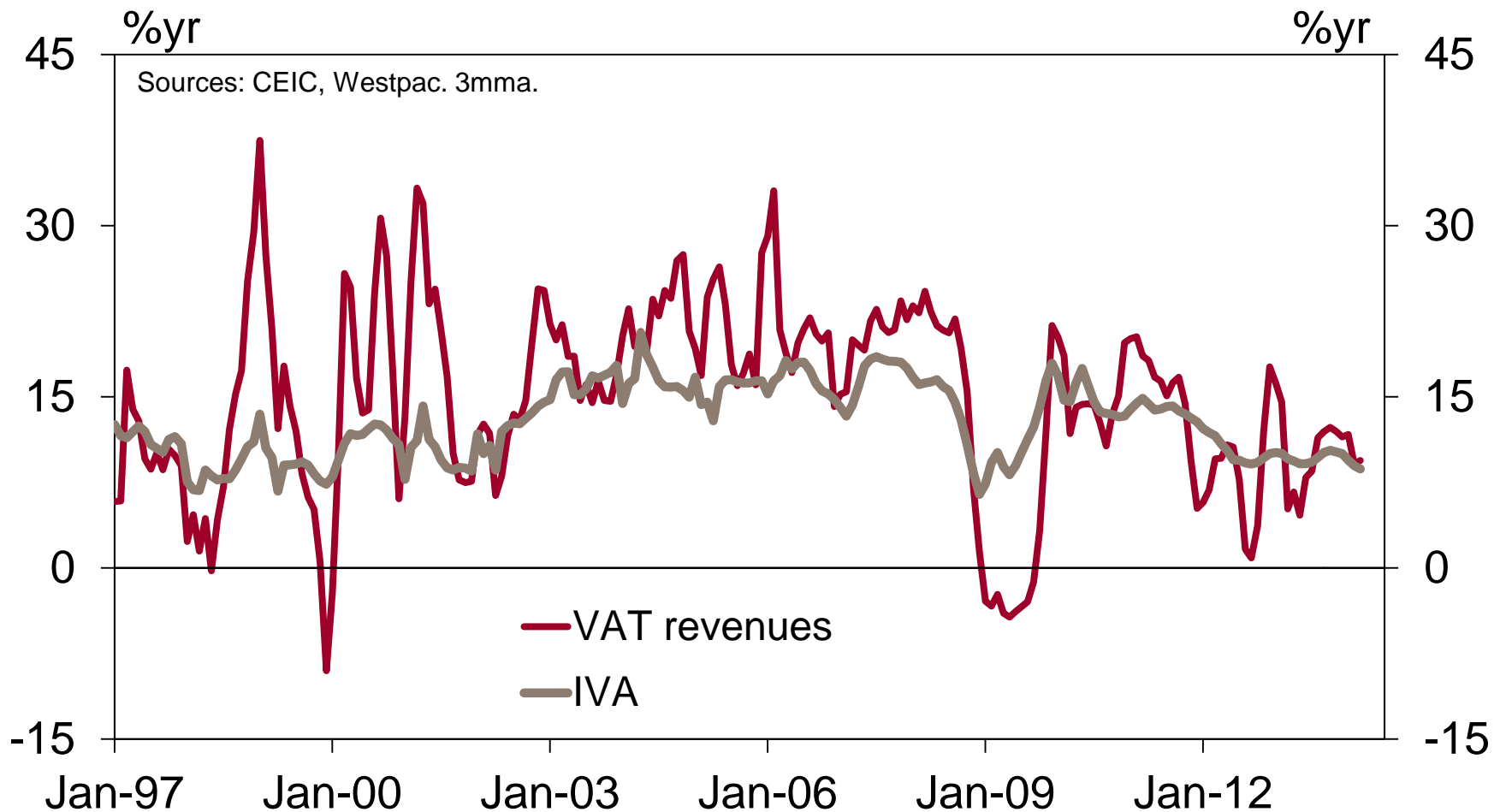
# Aggregate activity proxies



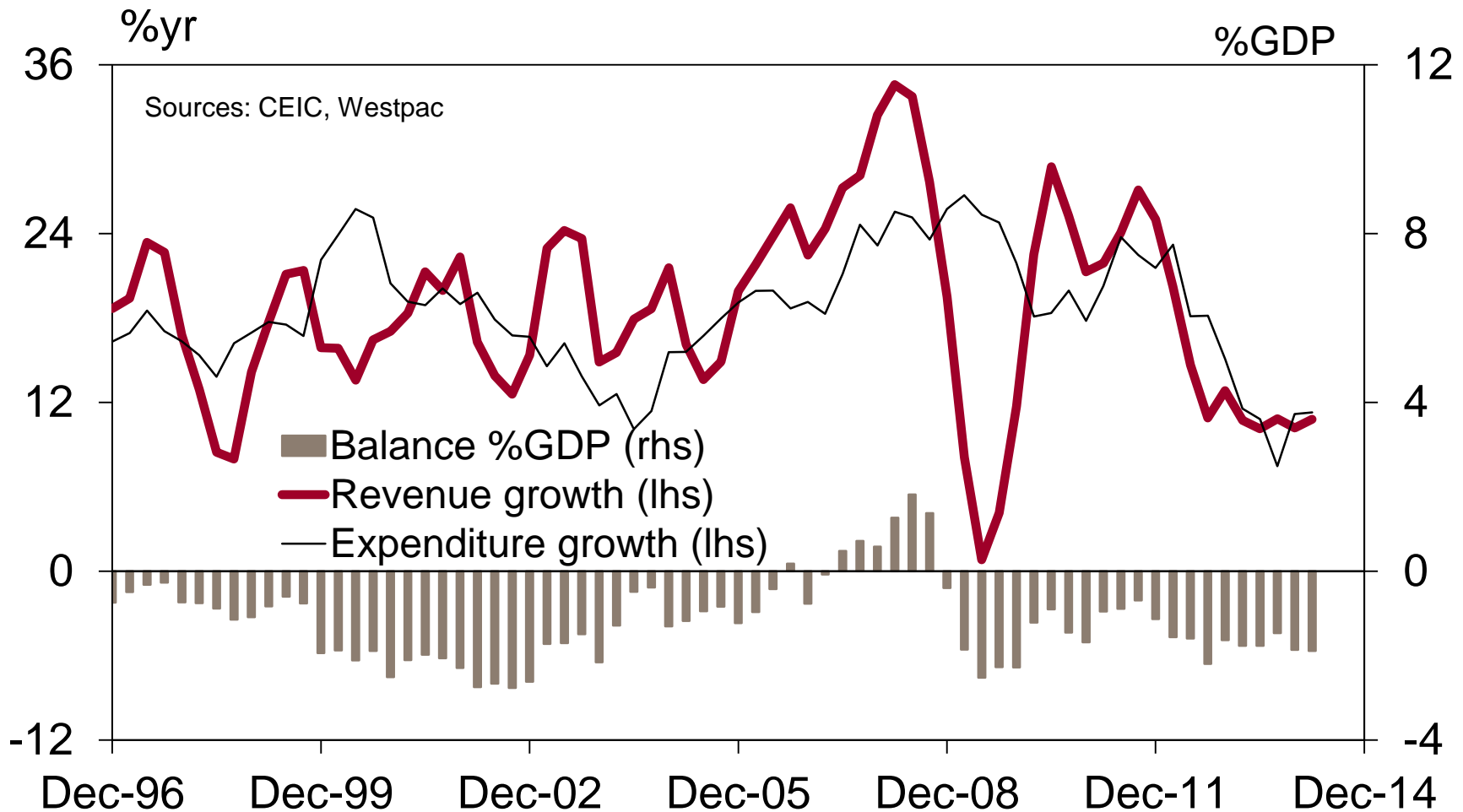
# New orders & export orders: PMI measures



# Central government VAT & IVA

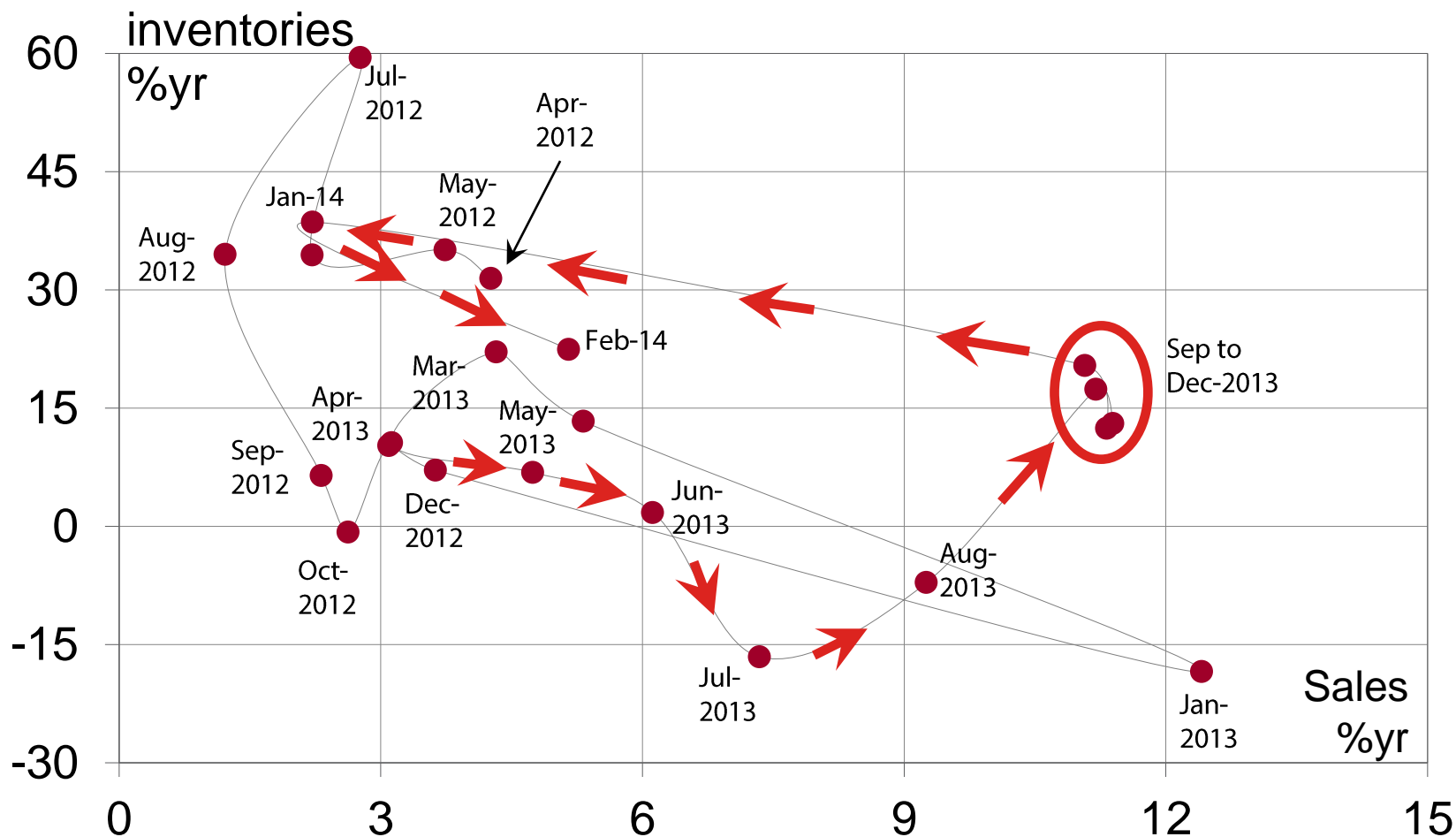


# Central government finances

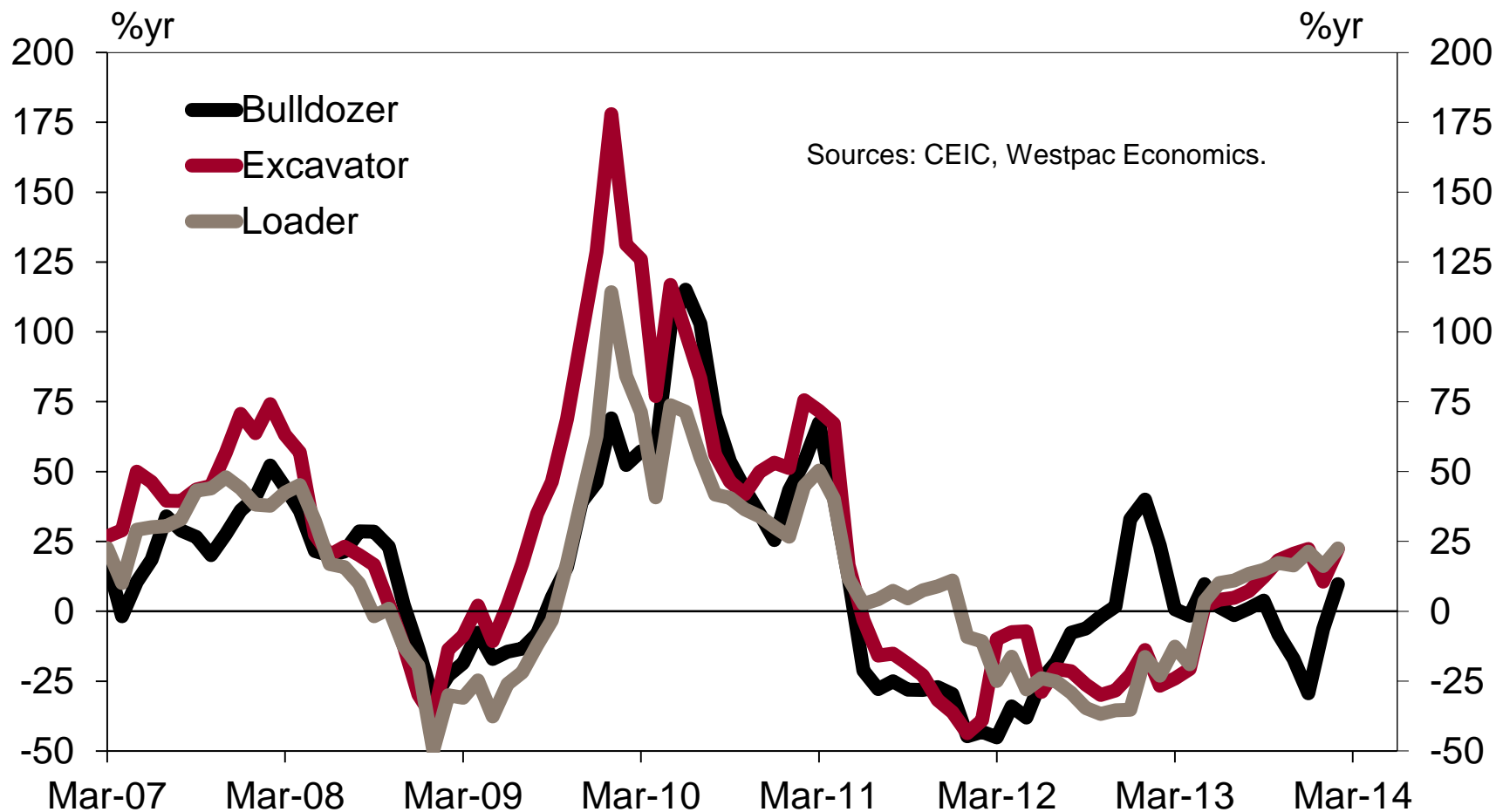




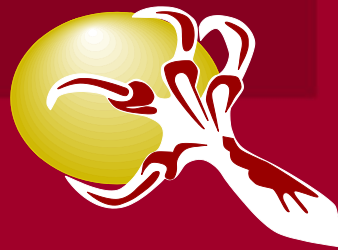
# Steel inventory cycle since April 2012



# Chinese domestic machinery sales

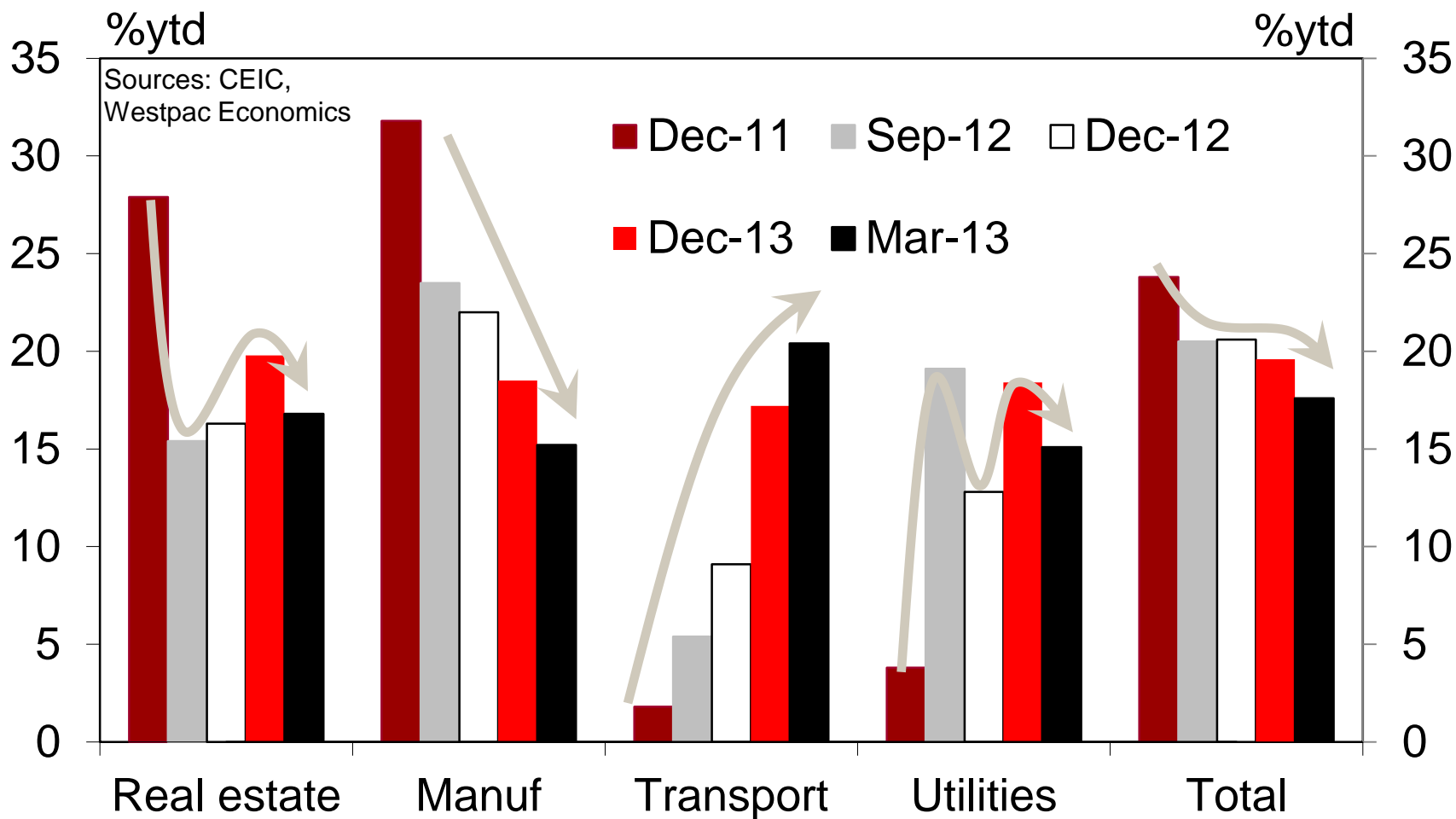


# THE INVESTMENT CYCLE

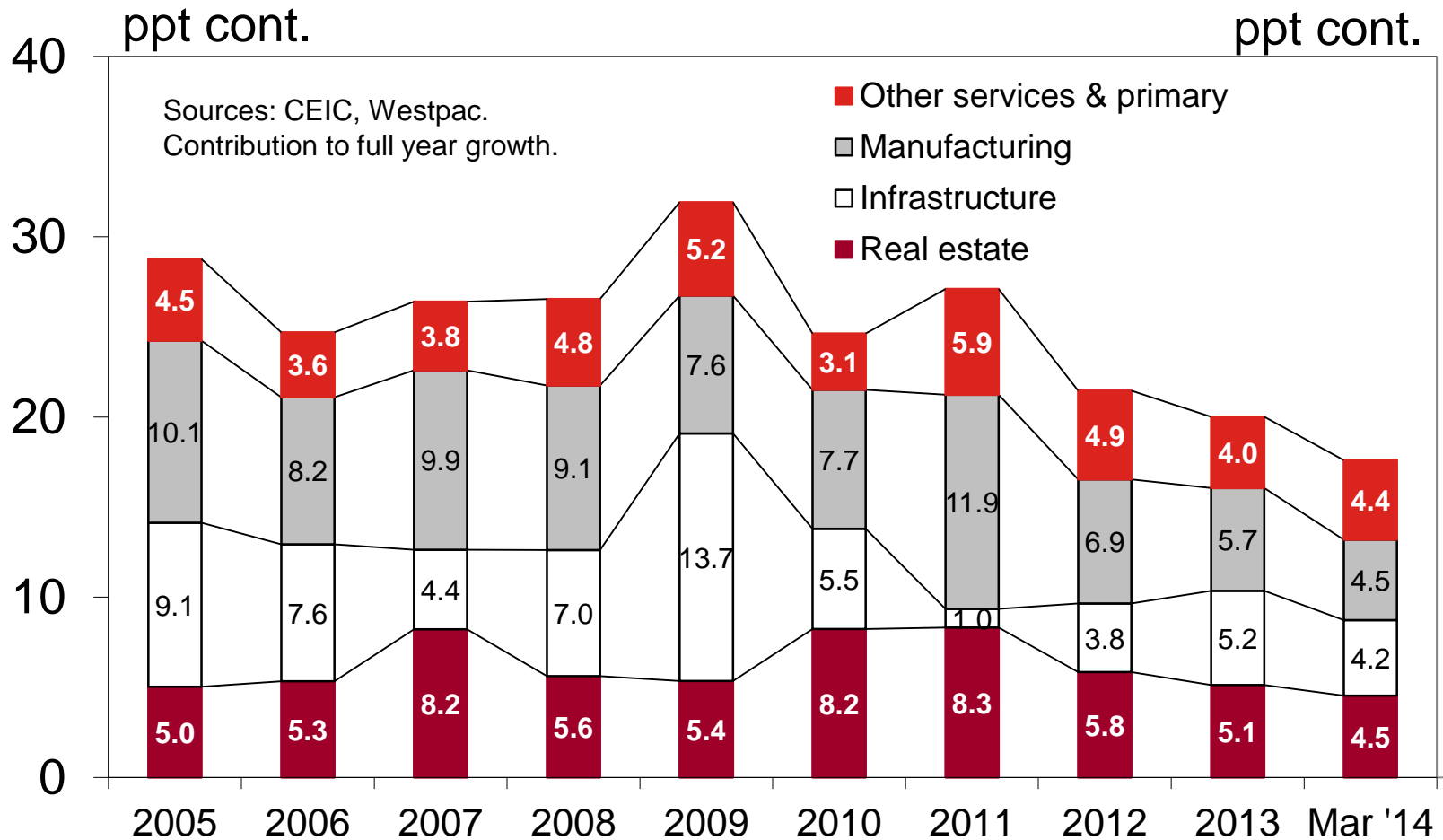


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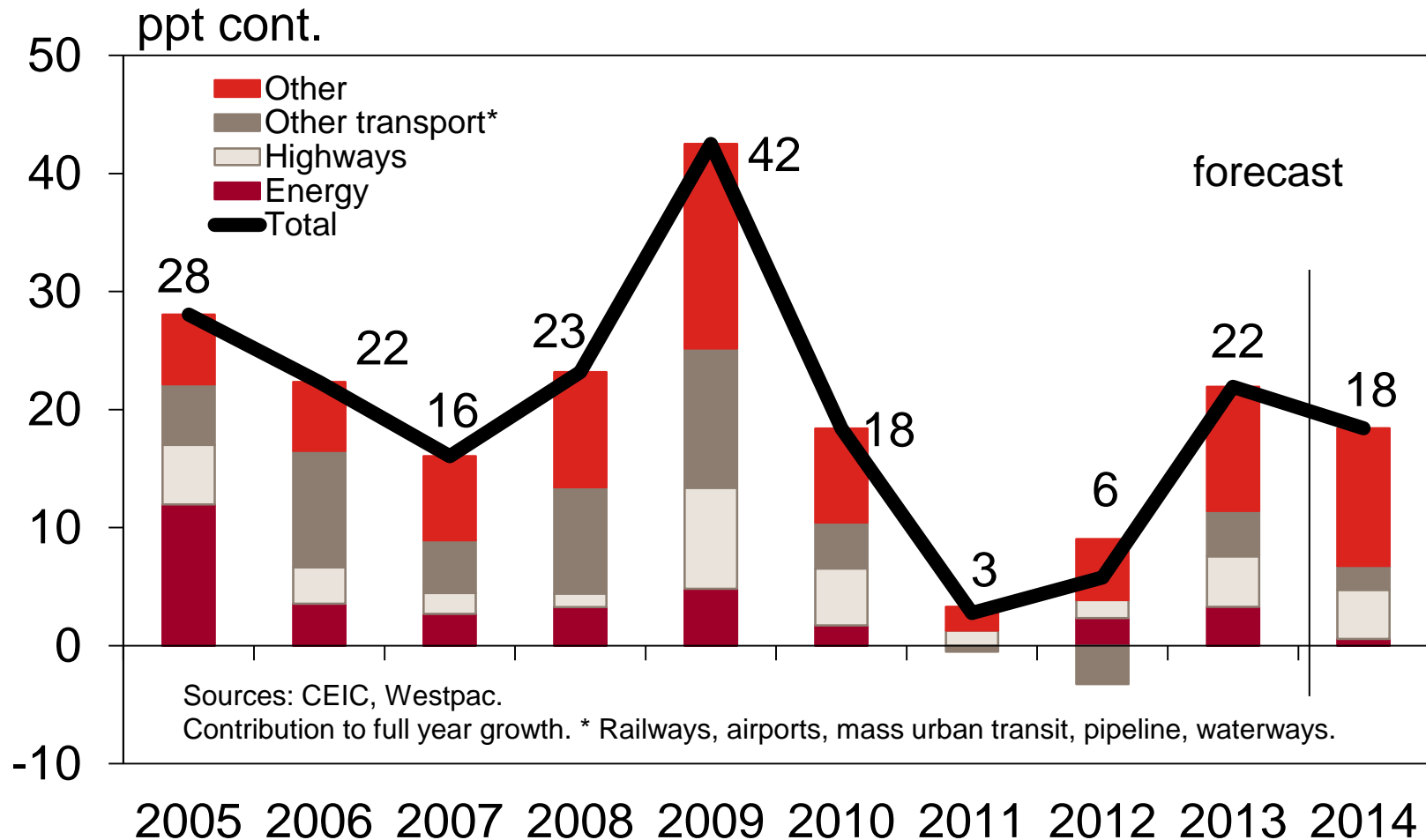
# The development of the investment cycle



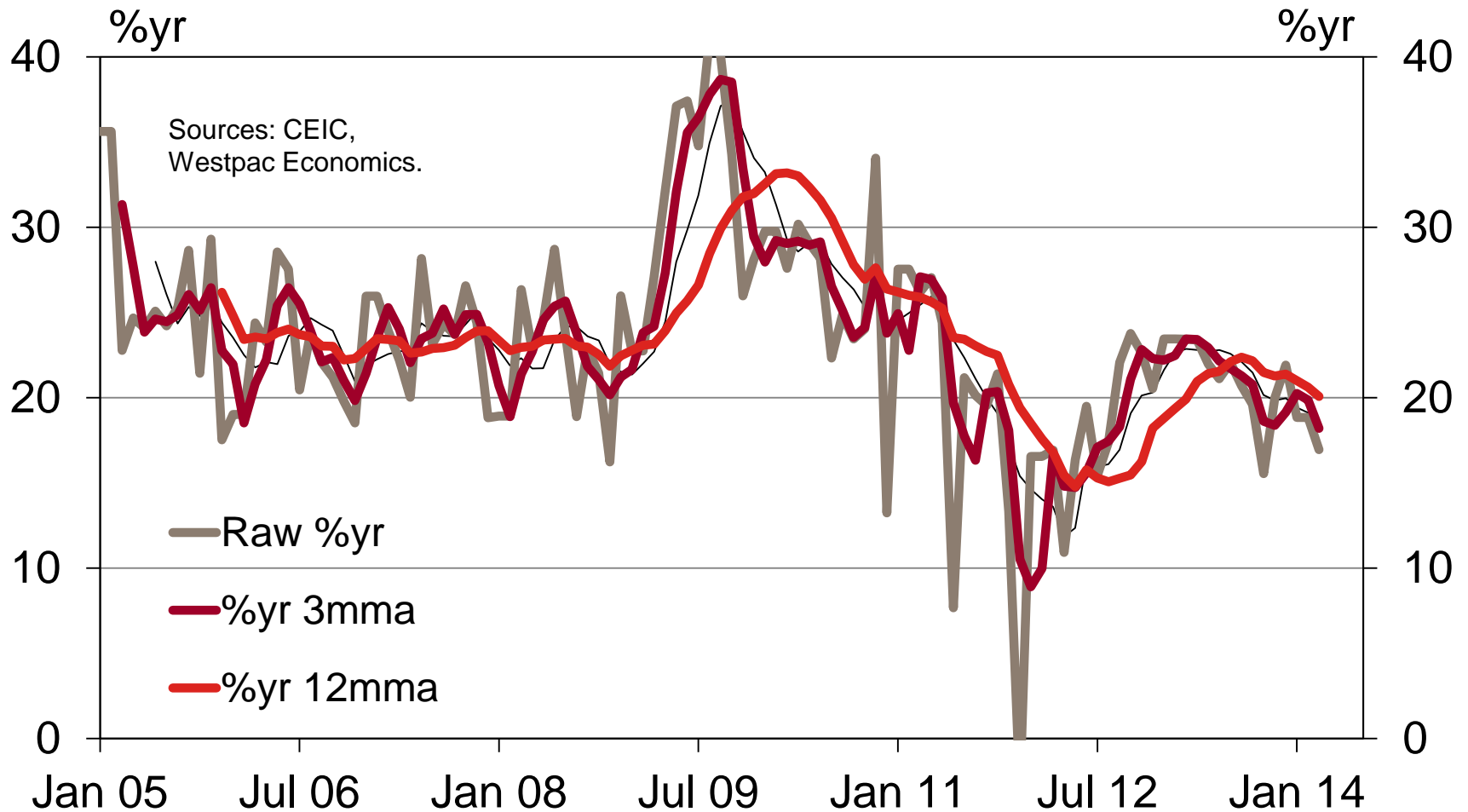
# Contributions to fixed investment growth



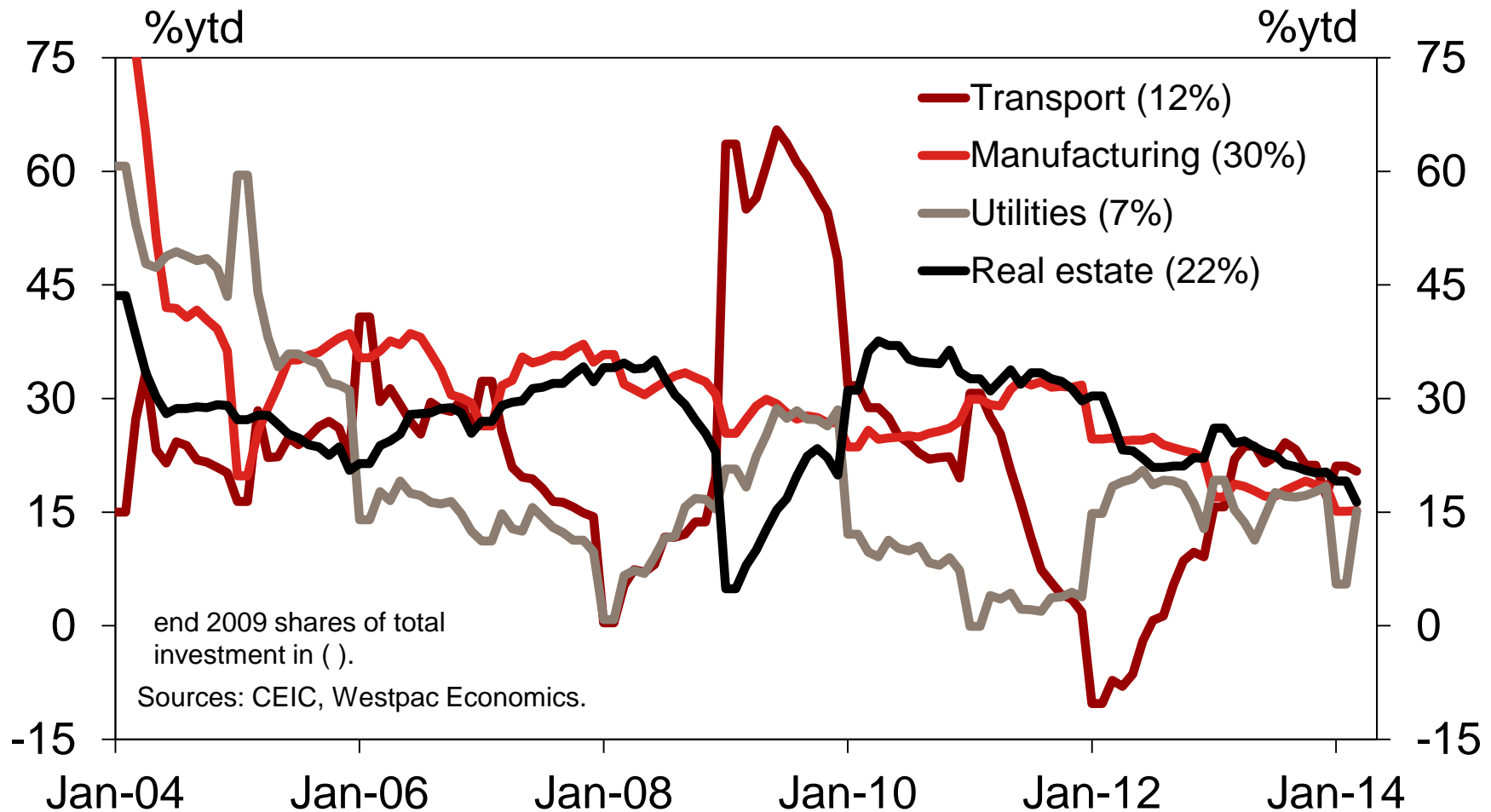
# Chinese infrastructure spending growth



# Chinese construction activity

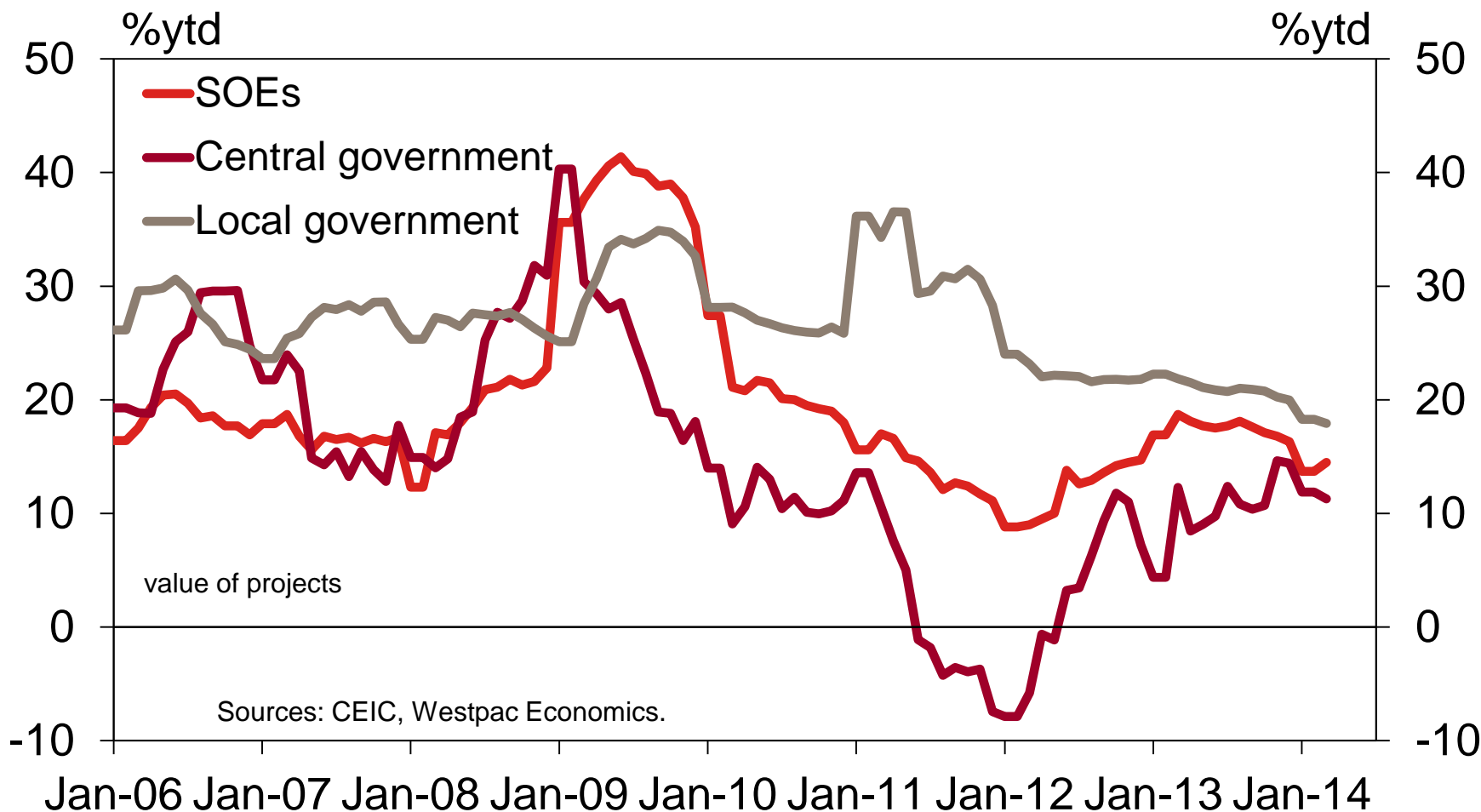


# Chinese investment: converging trajectories

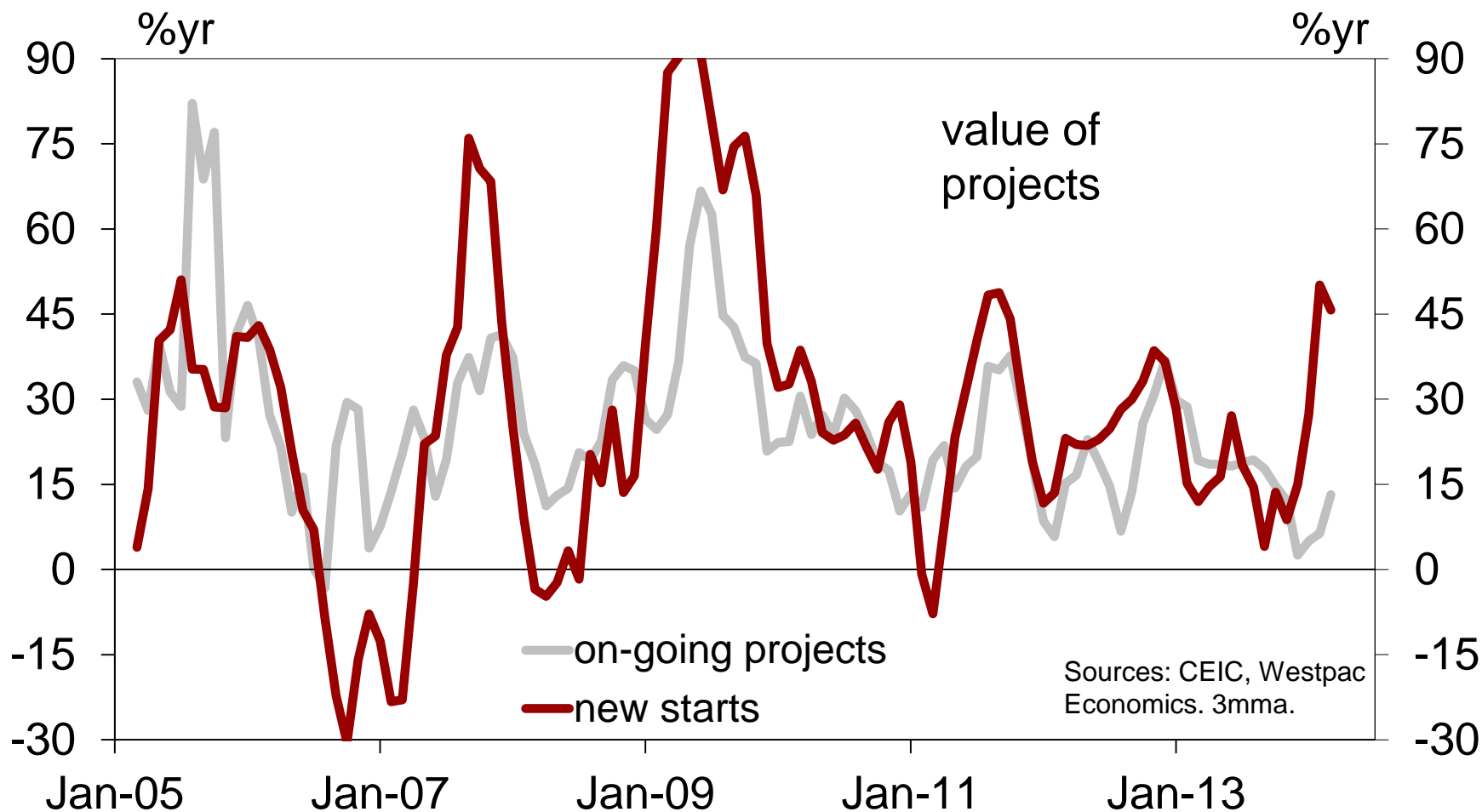




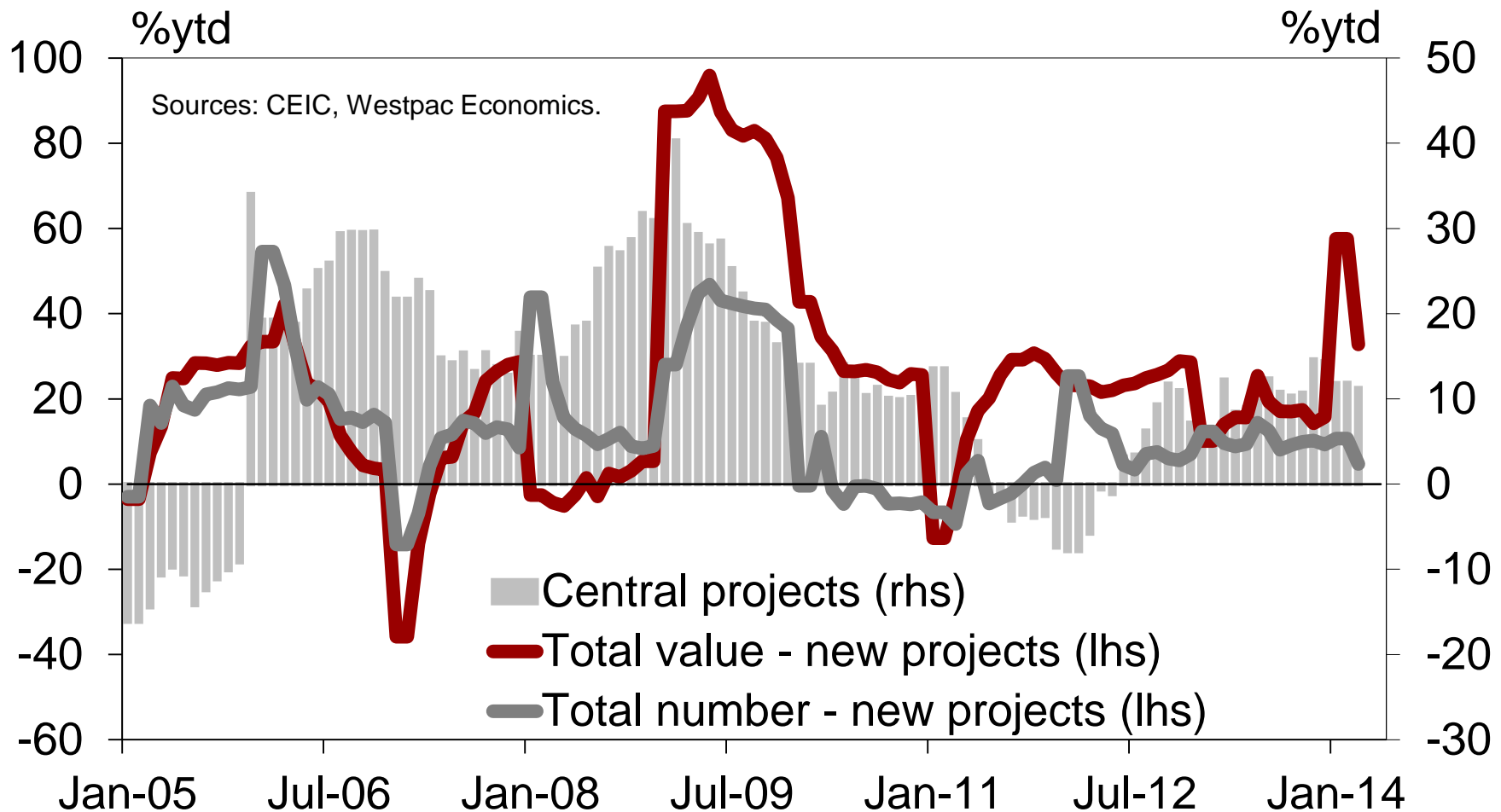
# Investment projects by approver & by SOEs



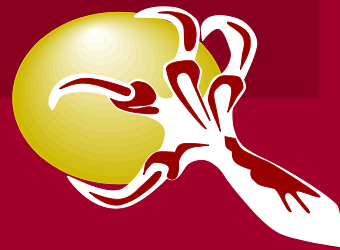
# New and ongoing projects



# The pipeline – new starts, central projects

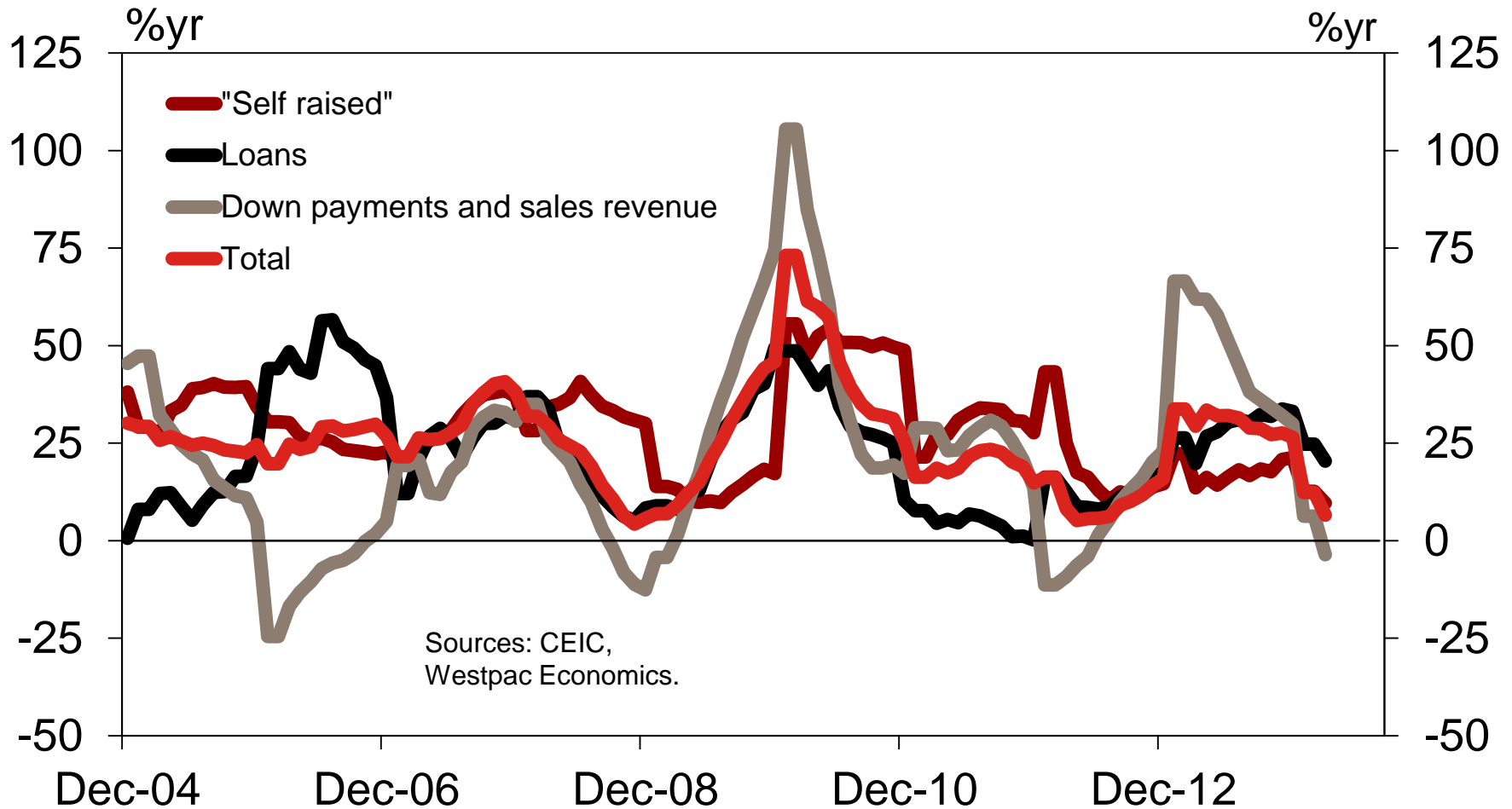


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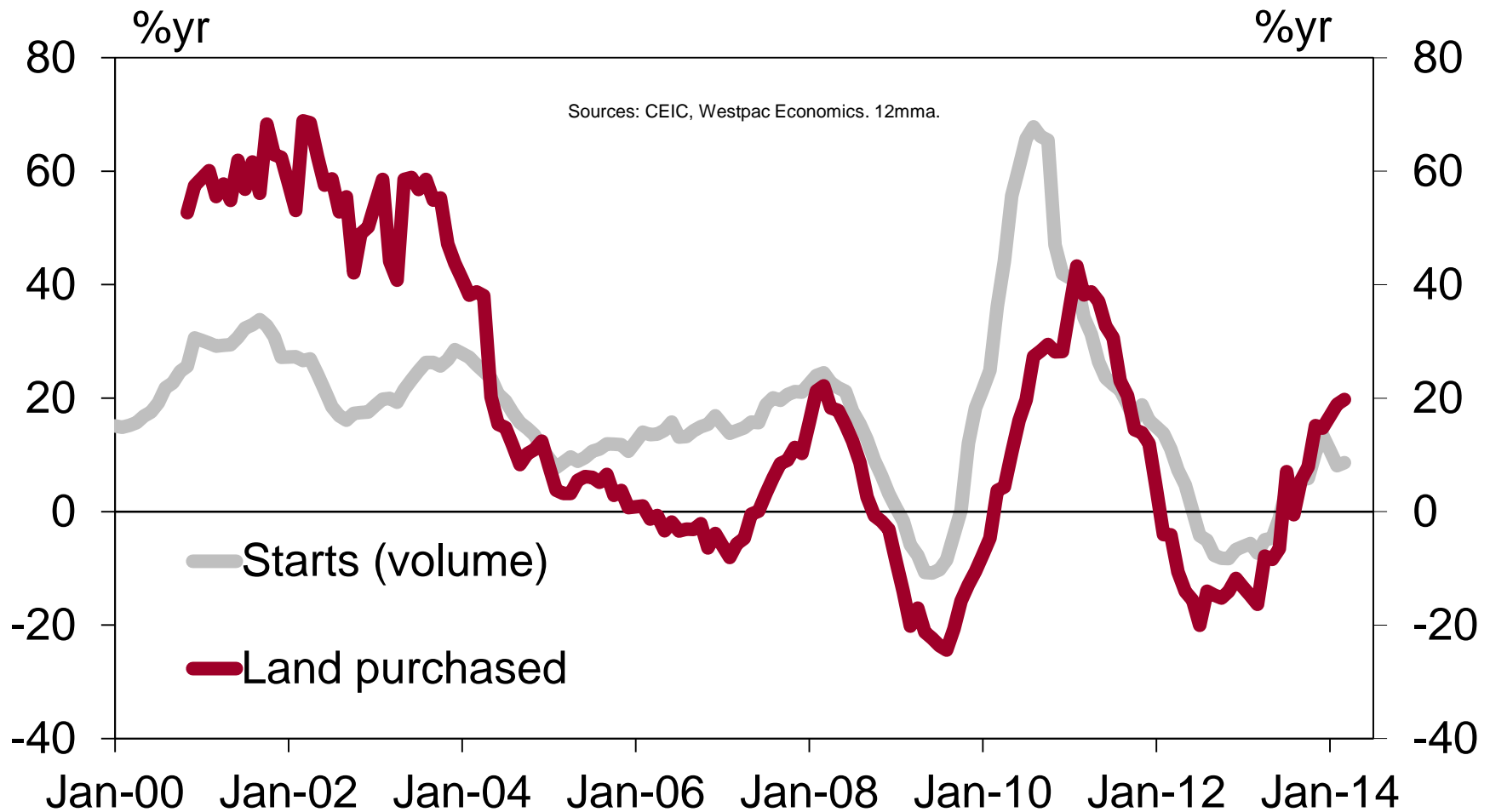


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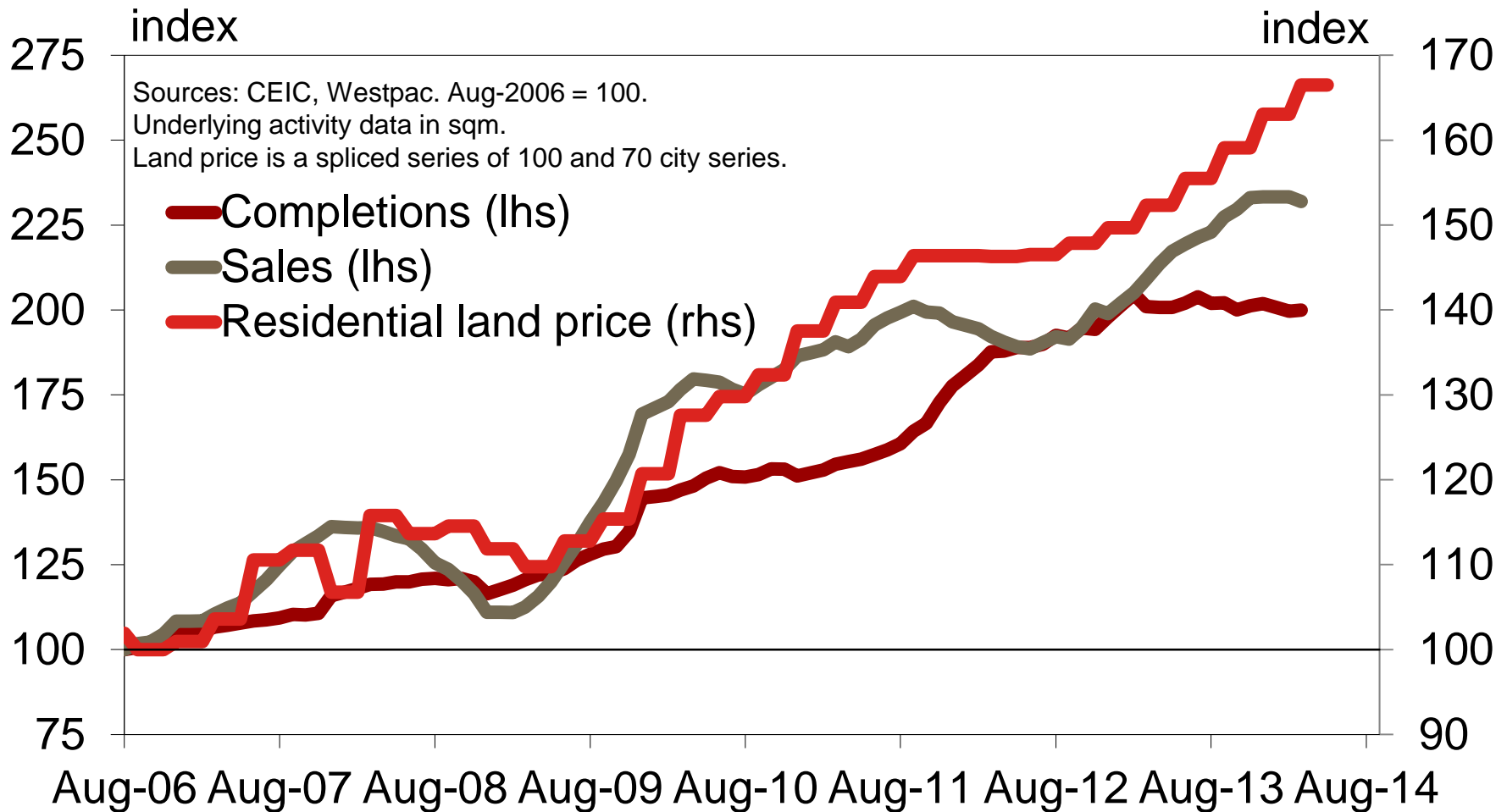
# Property developer finance: growth by type



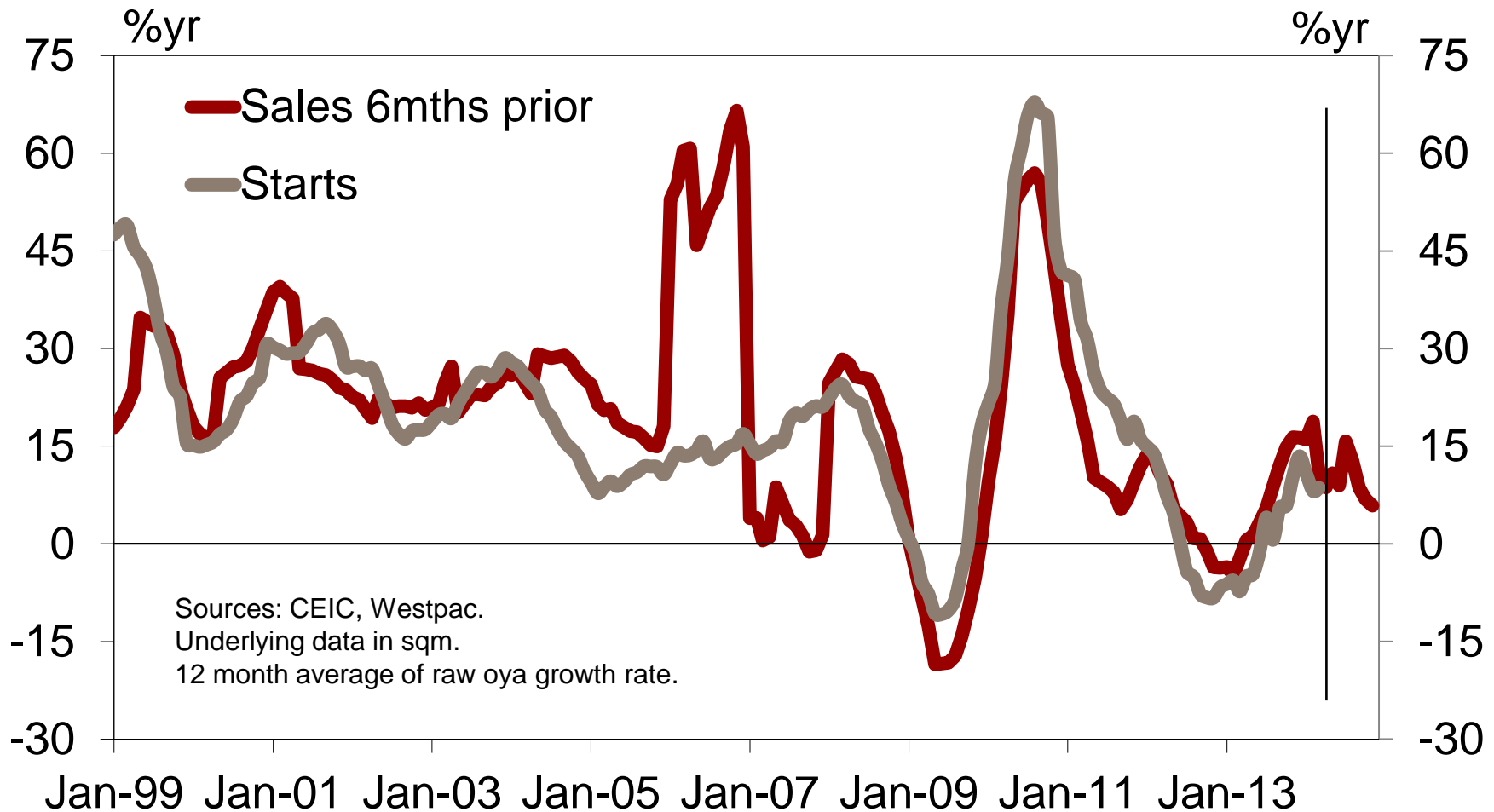
# Land purchased and construction starts



# Housing sales, completions & land prices

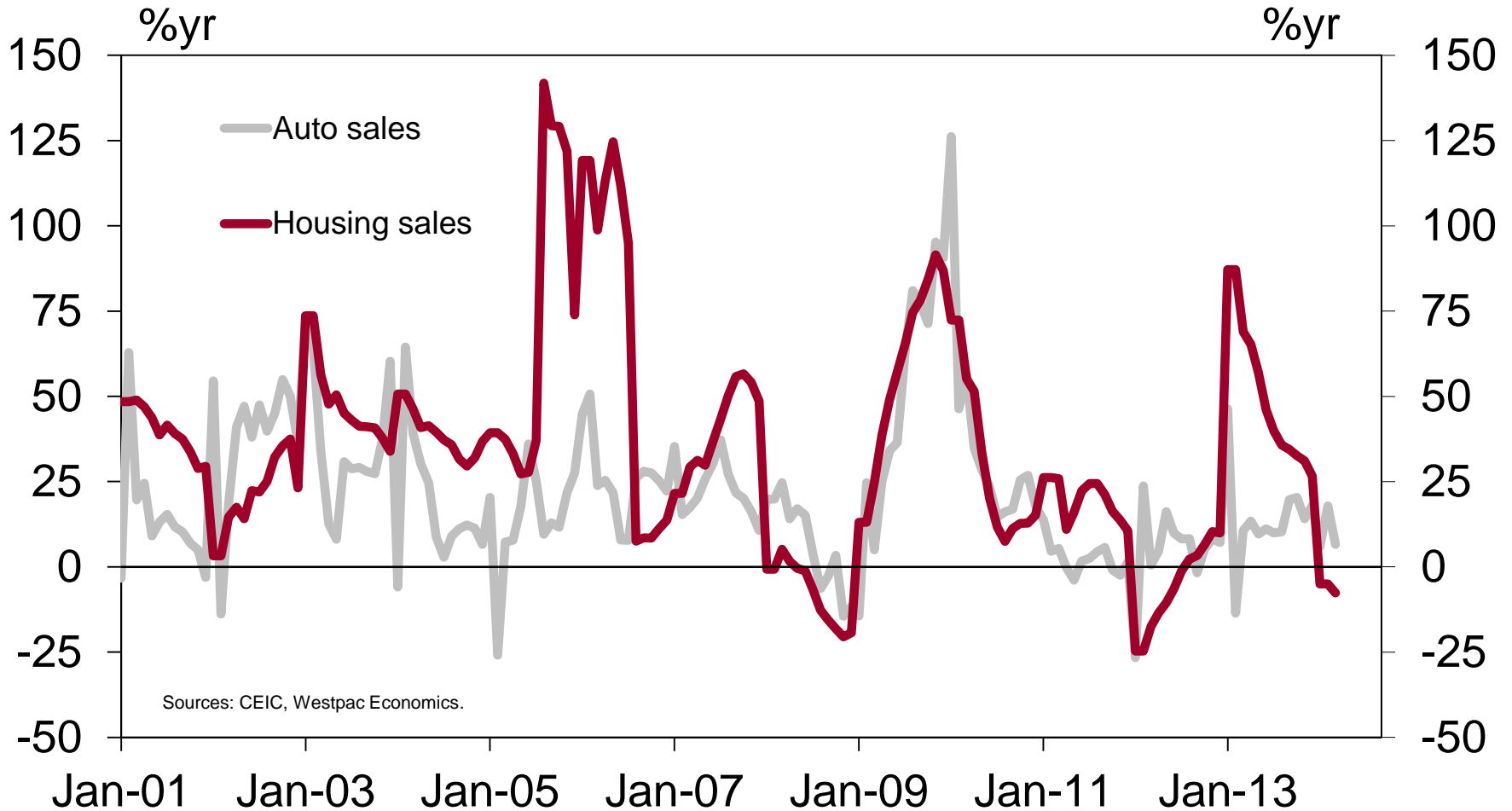


## Sales volumes usually lead starts by 6 months

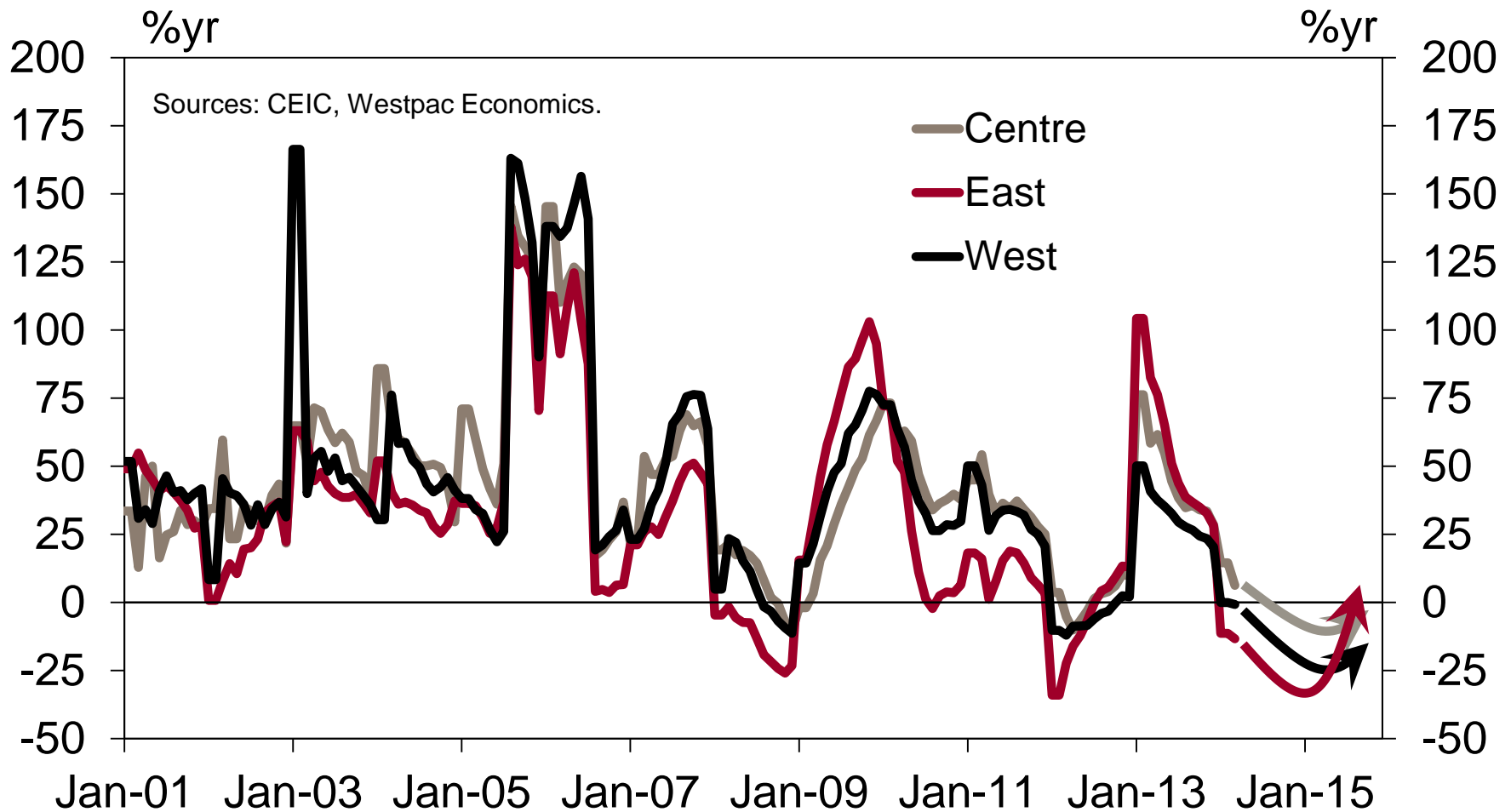




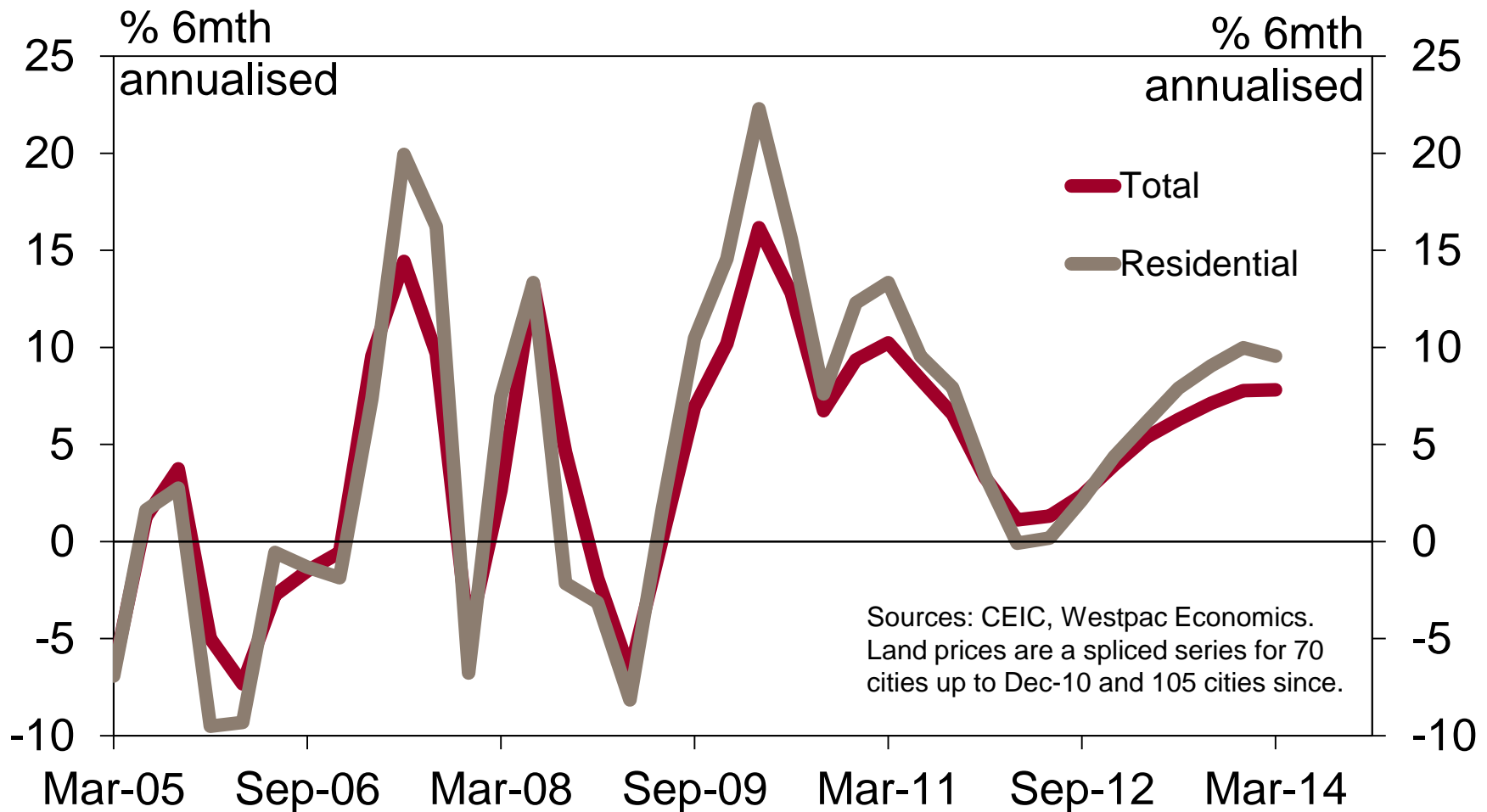
# Housing and auto sales



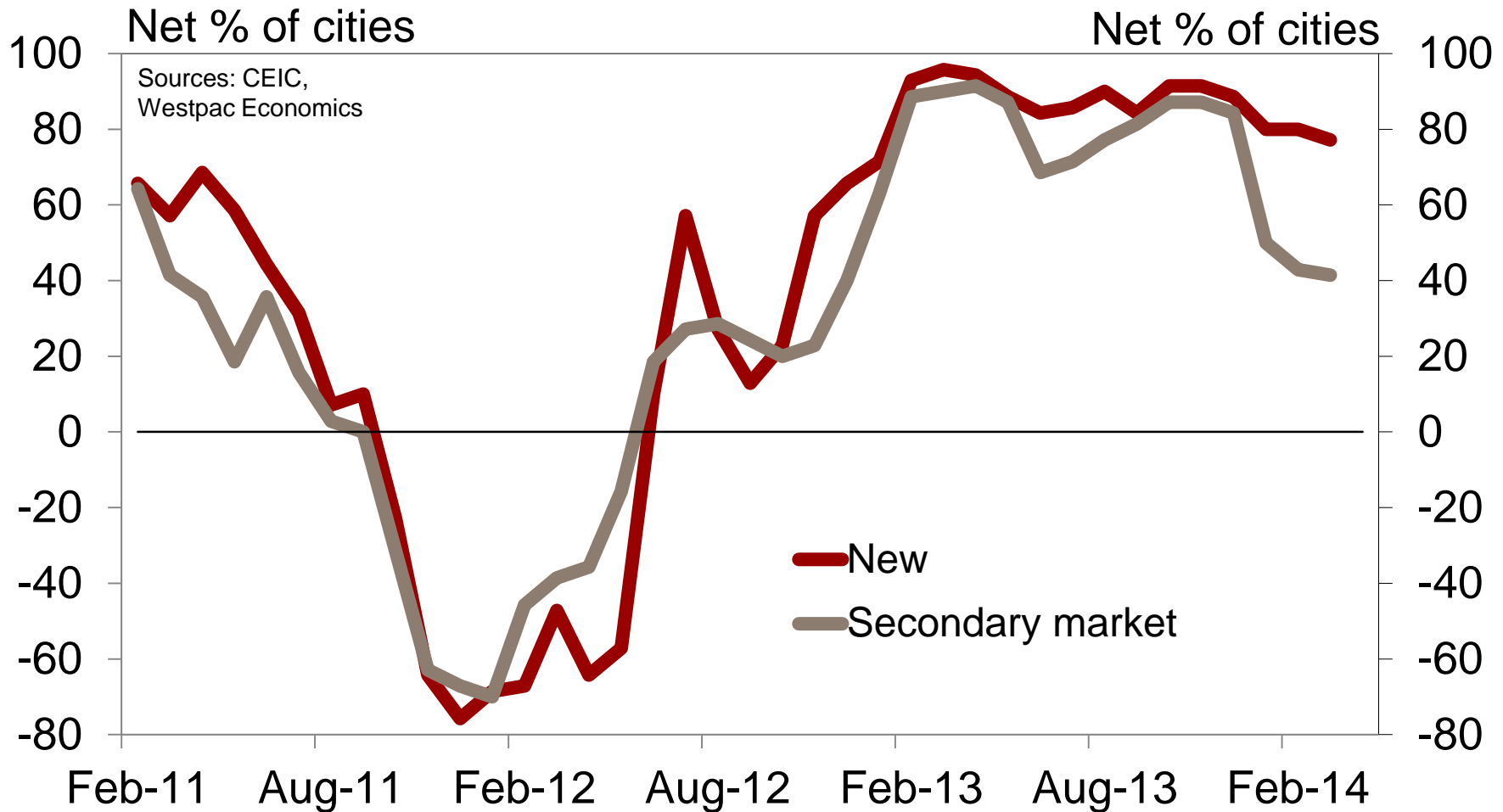
# Chinese housing sales by region



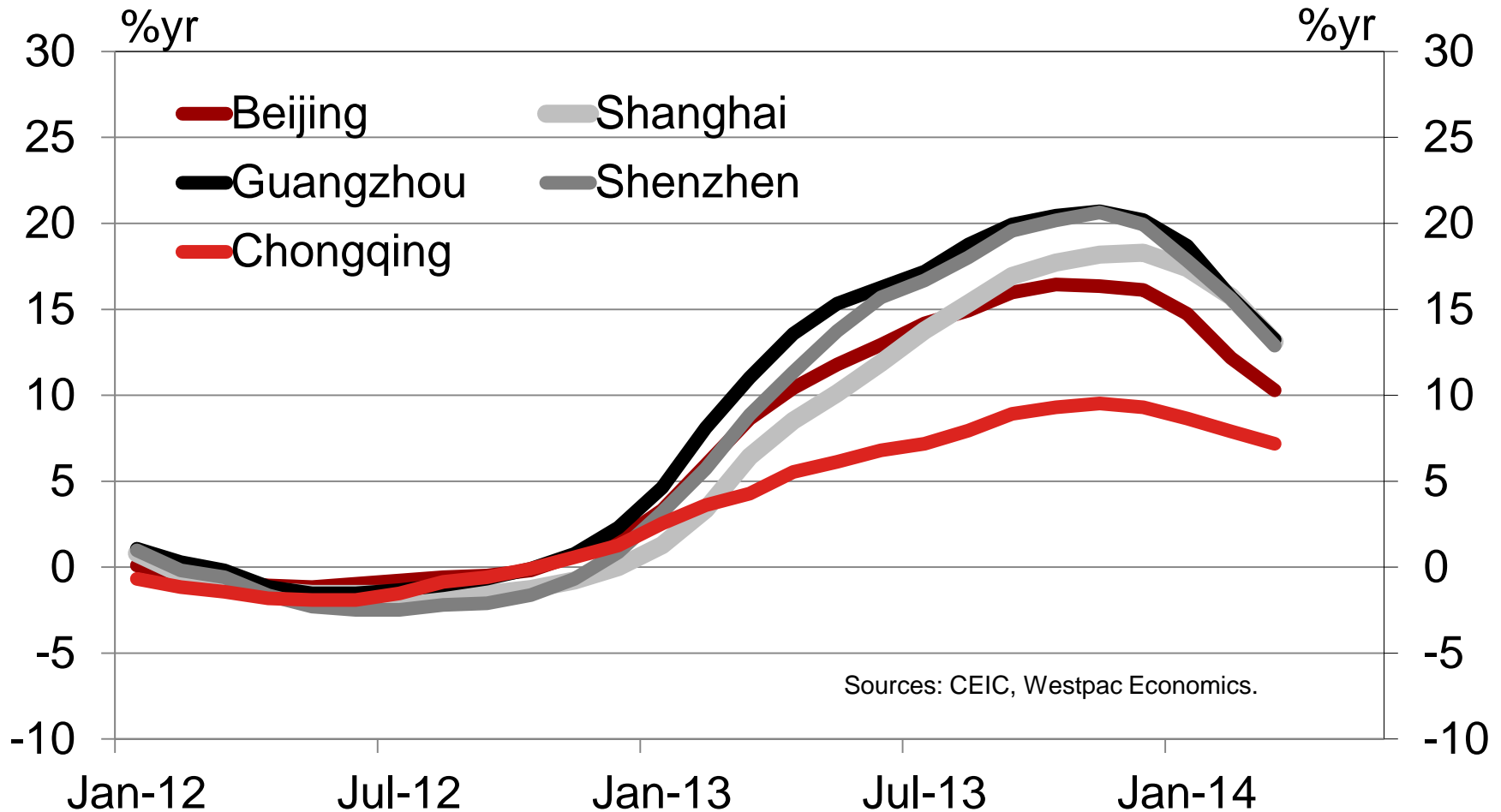
# Chinese land prices: total & residential



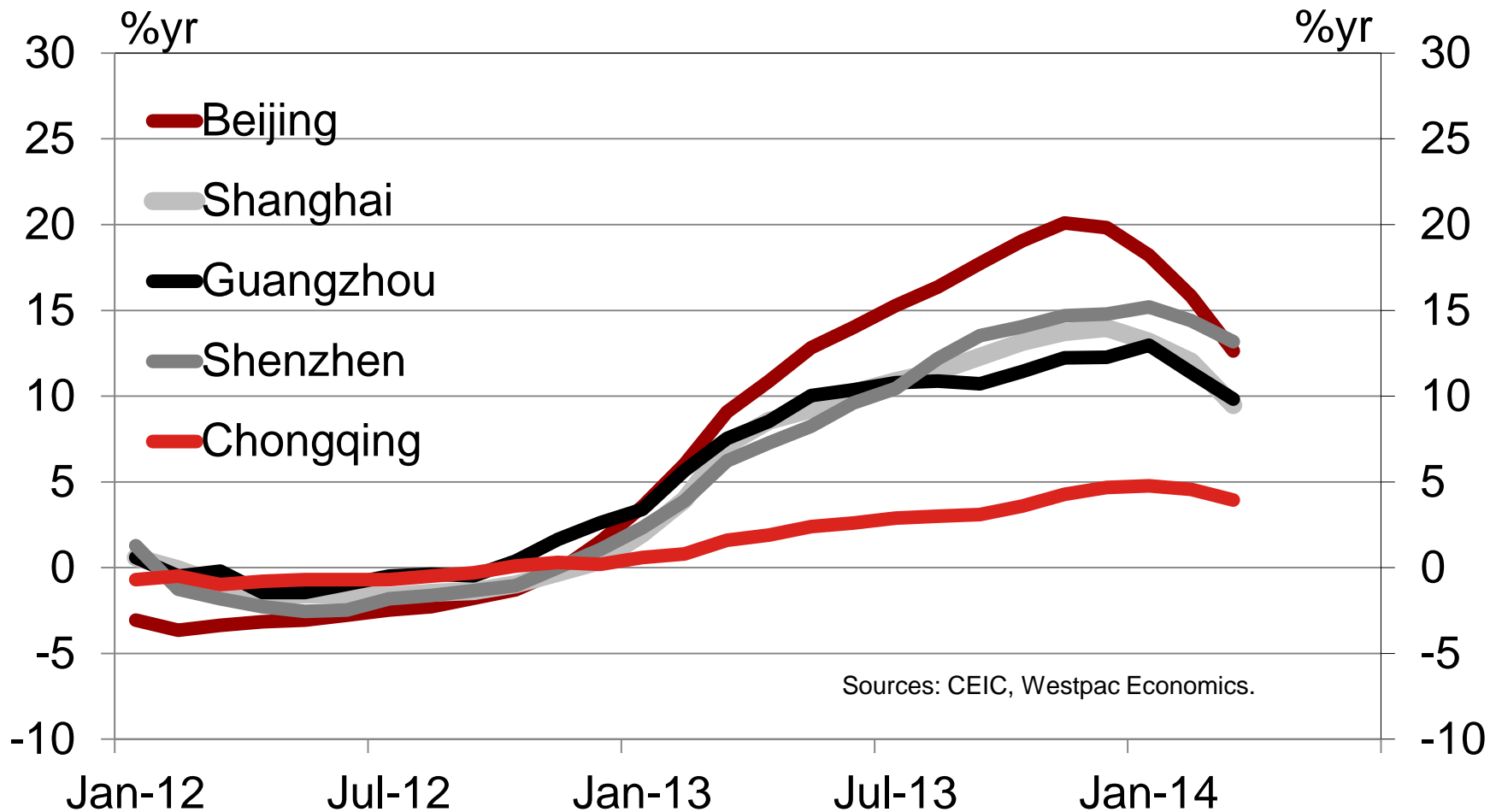
# 70 city house prices: net balance m/m change



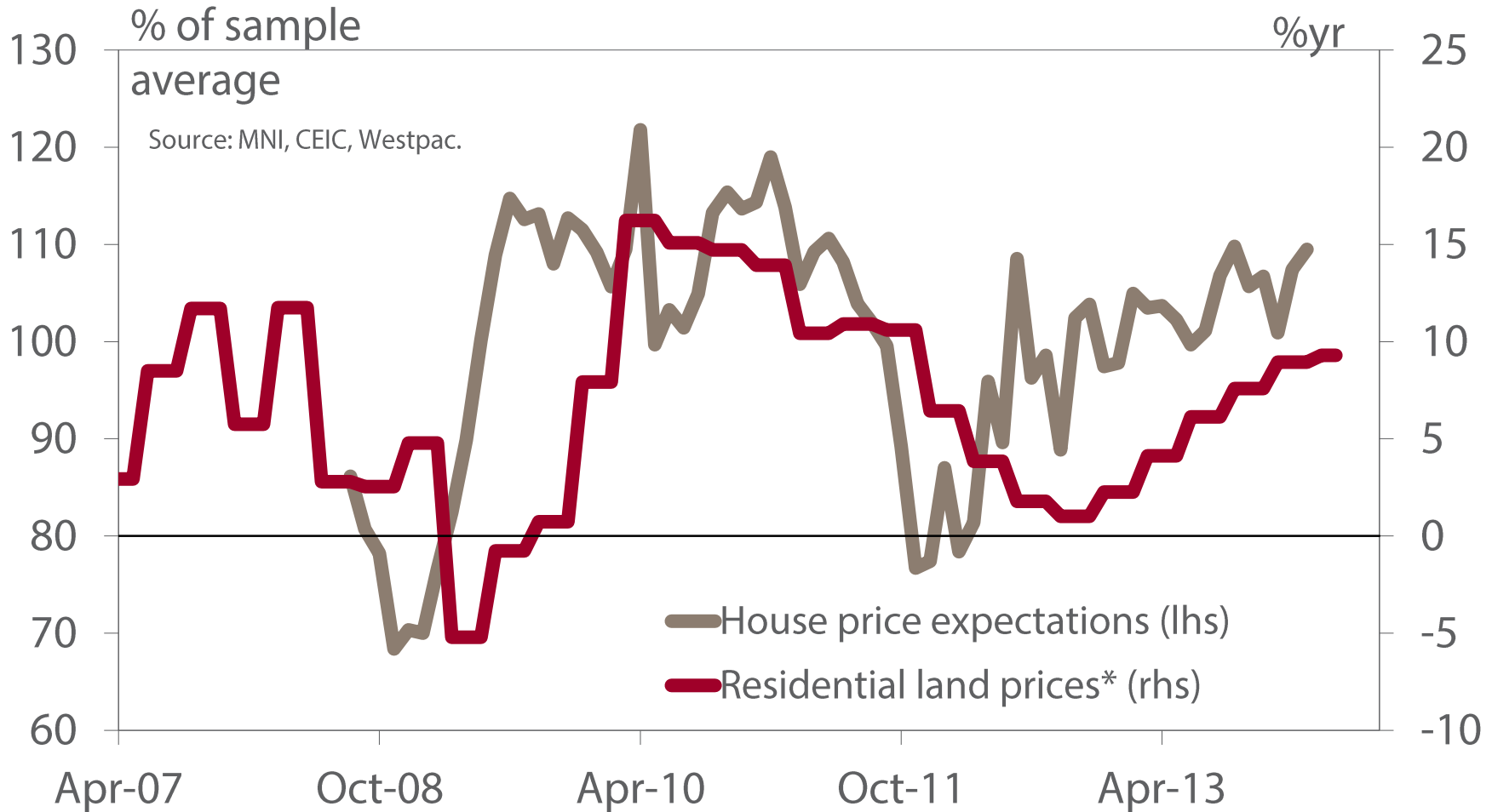
## Major city NEW house prices: growth



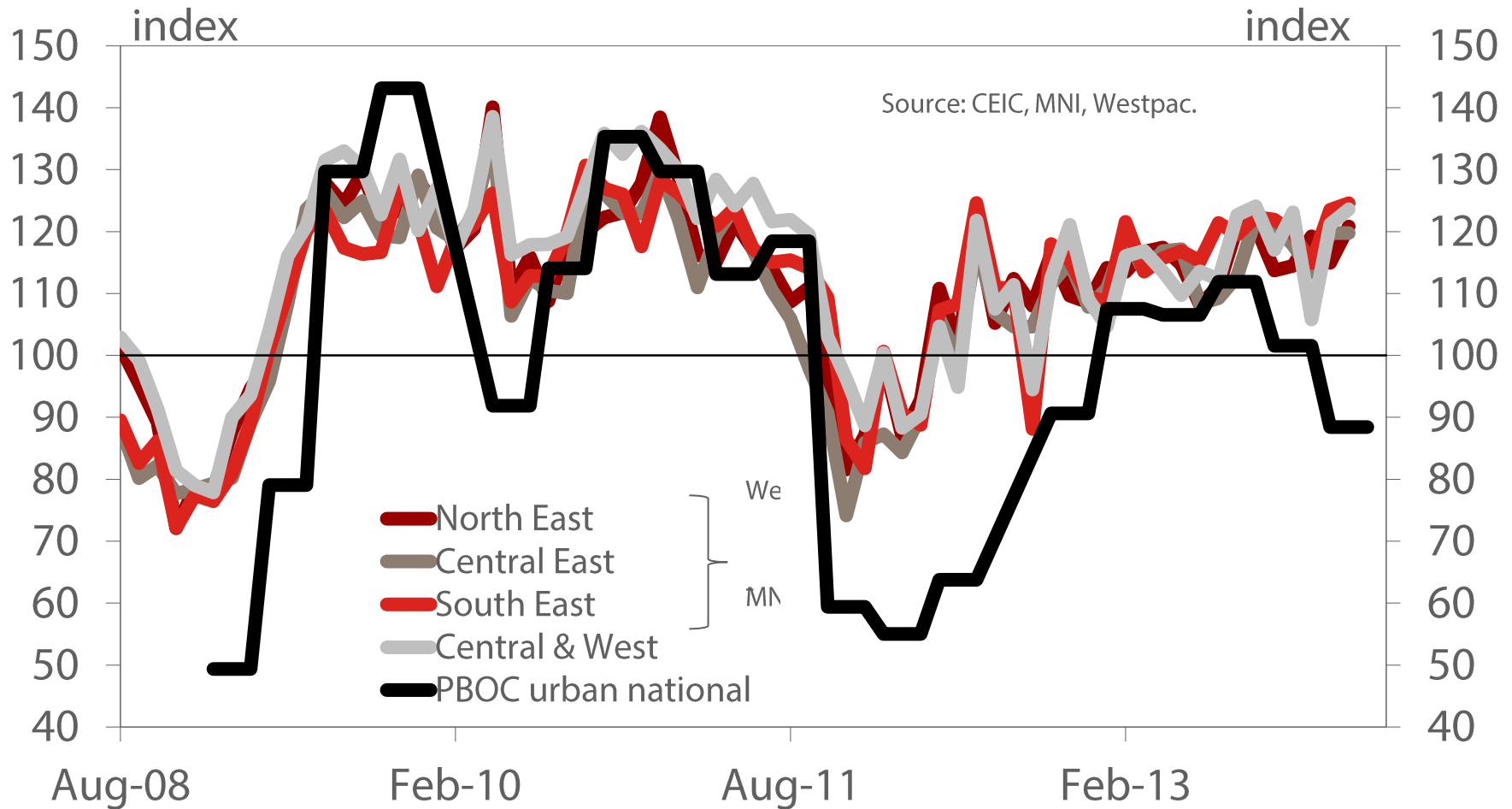
## Major city *secondary* market house prices: growth



## MNI house price expectations & land prices

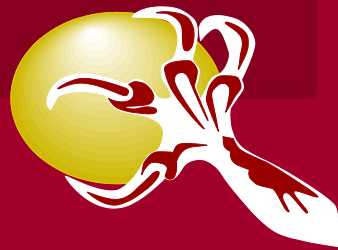


## House price expectations by region



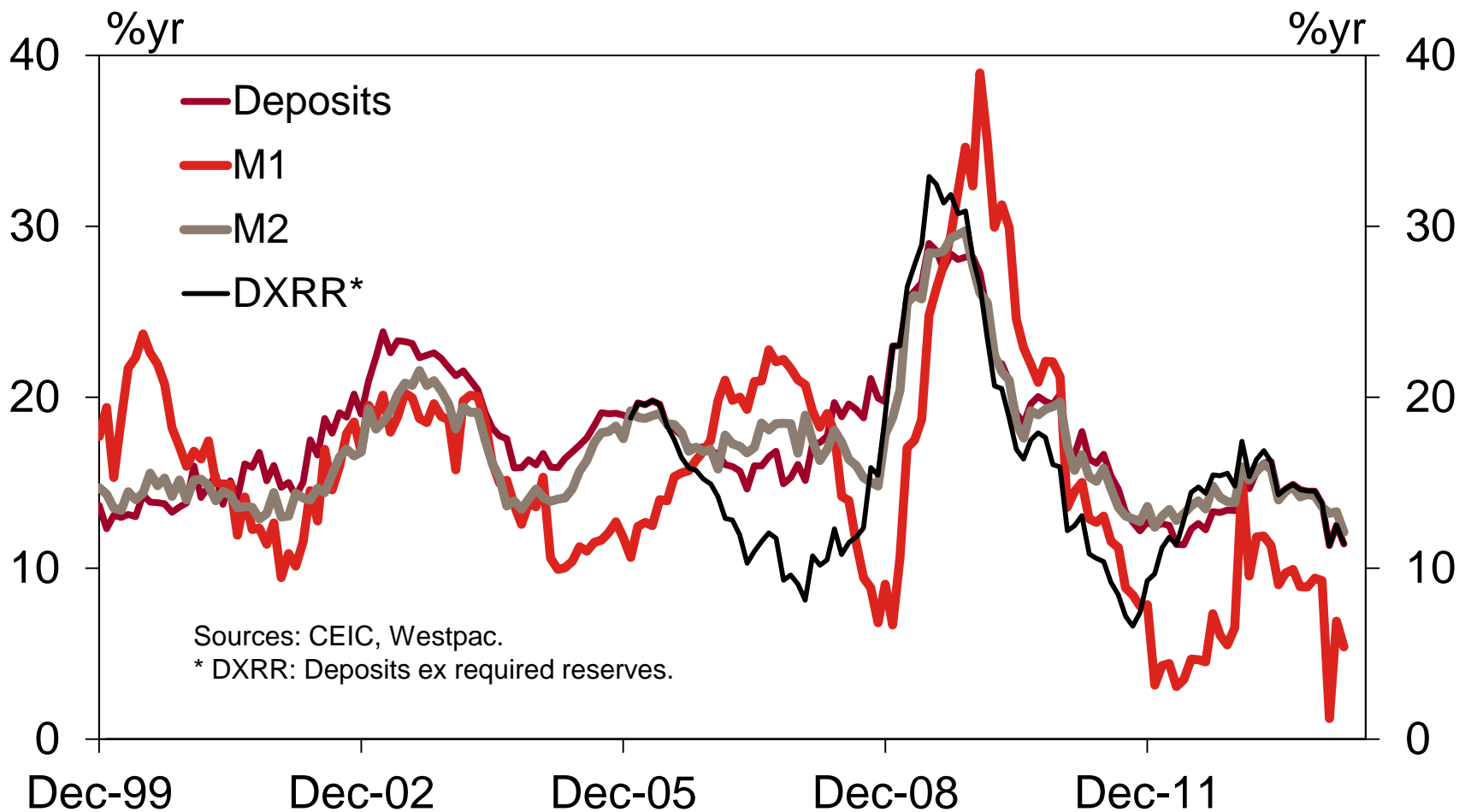


# MONEY & CREDIT

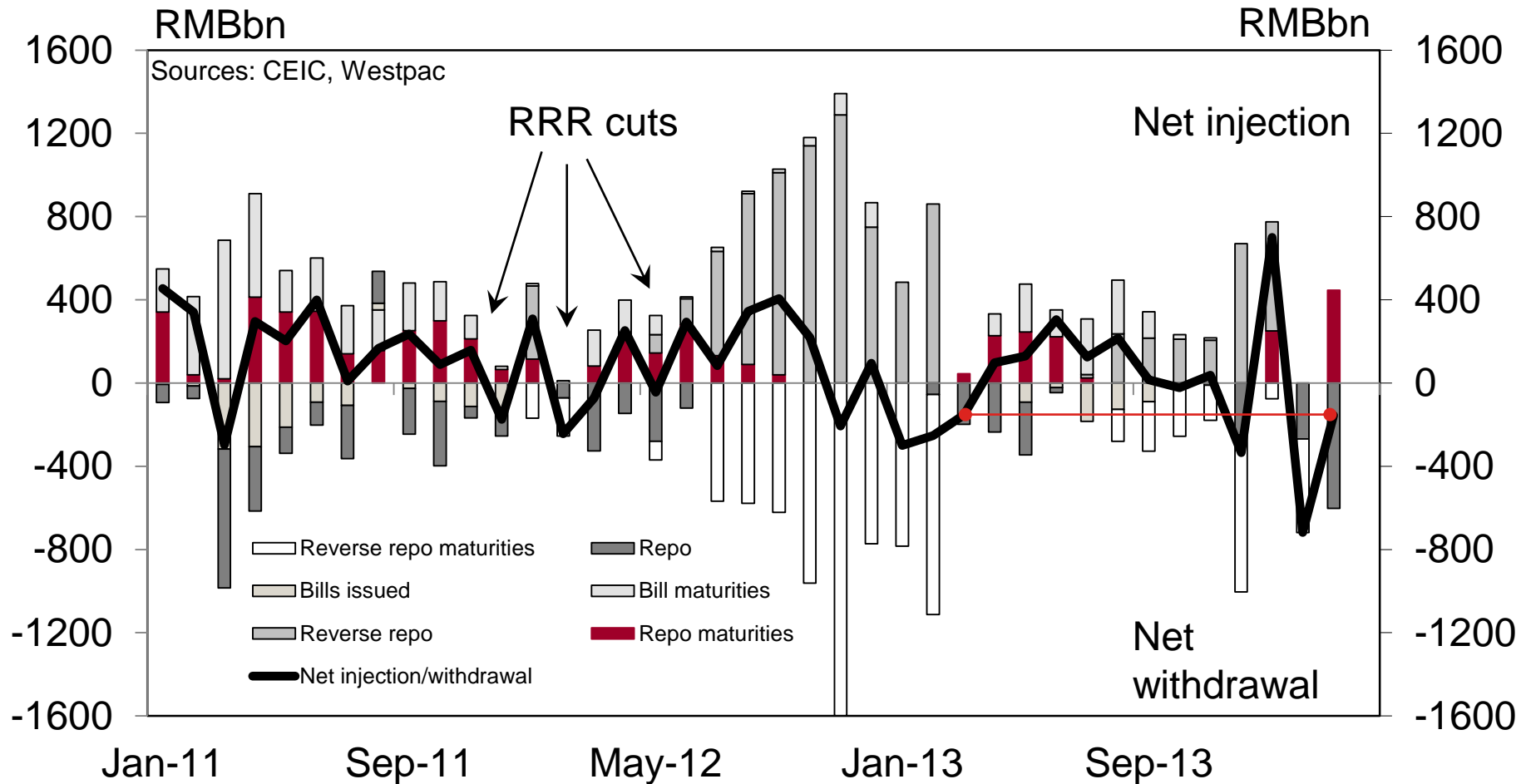


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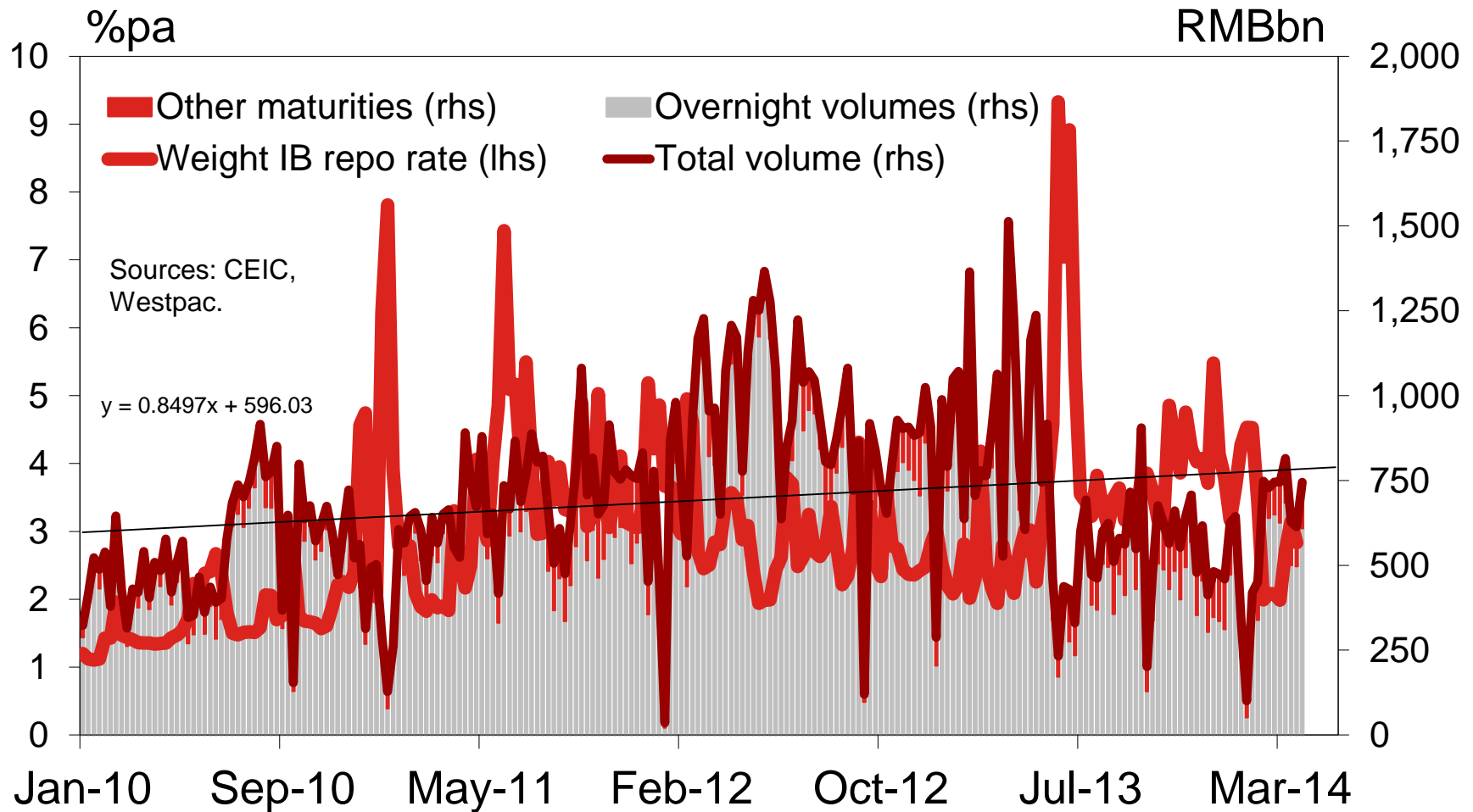
# Growth in the monetary aggregates



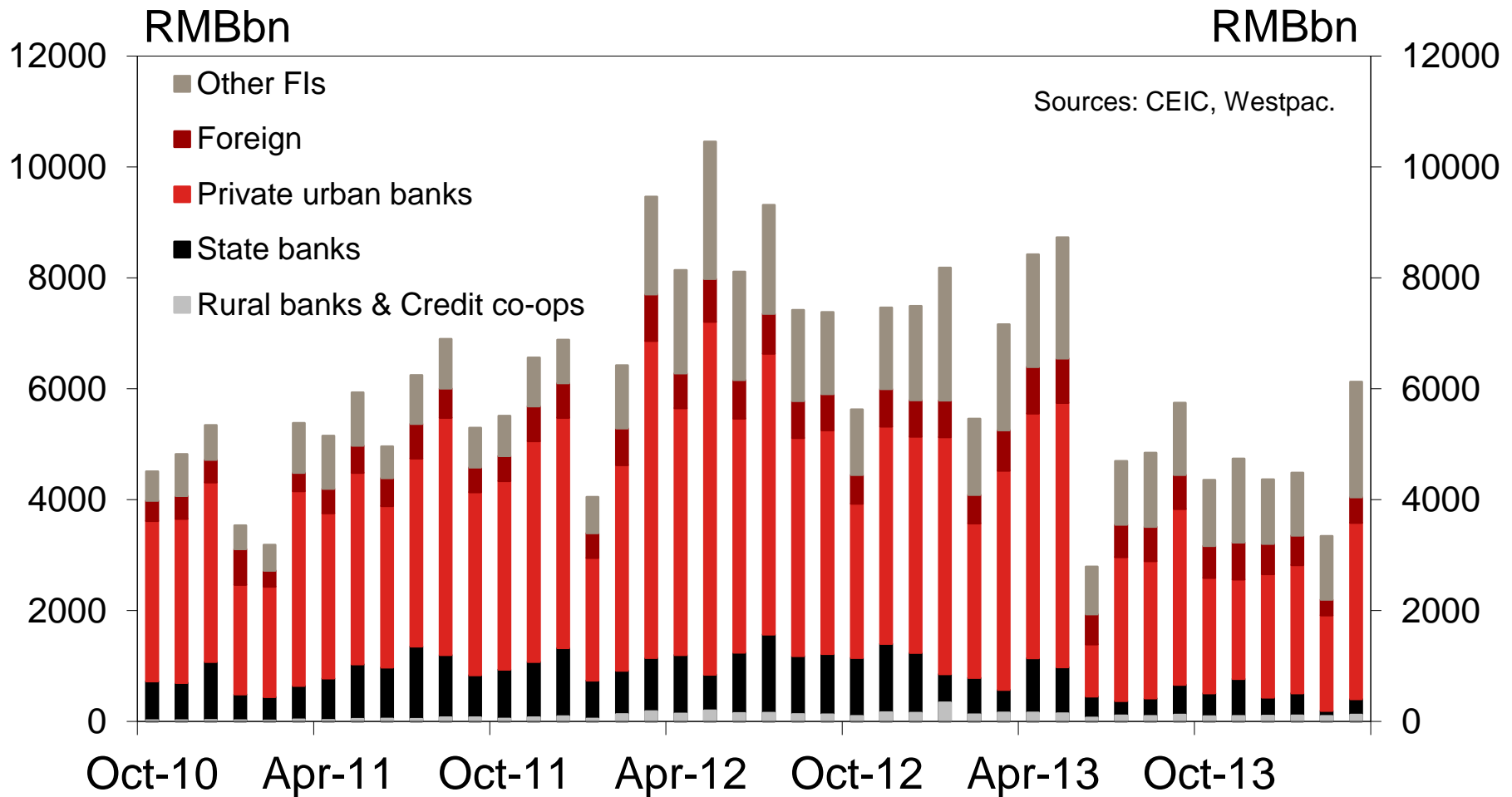
# People's Bank open market operations



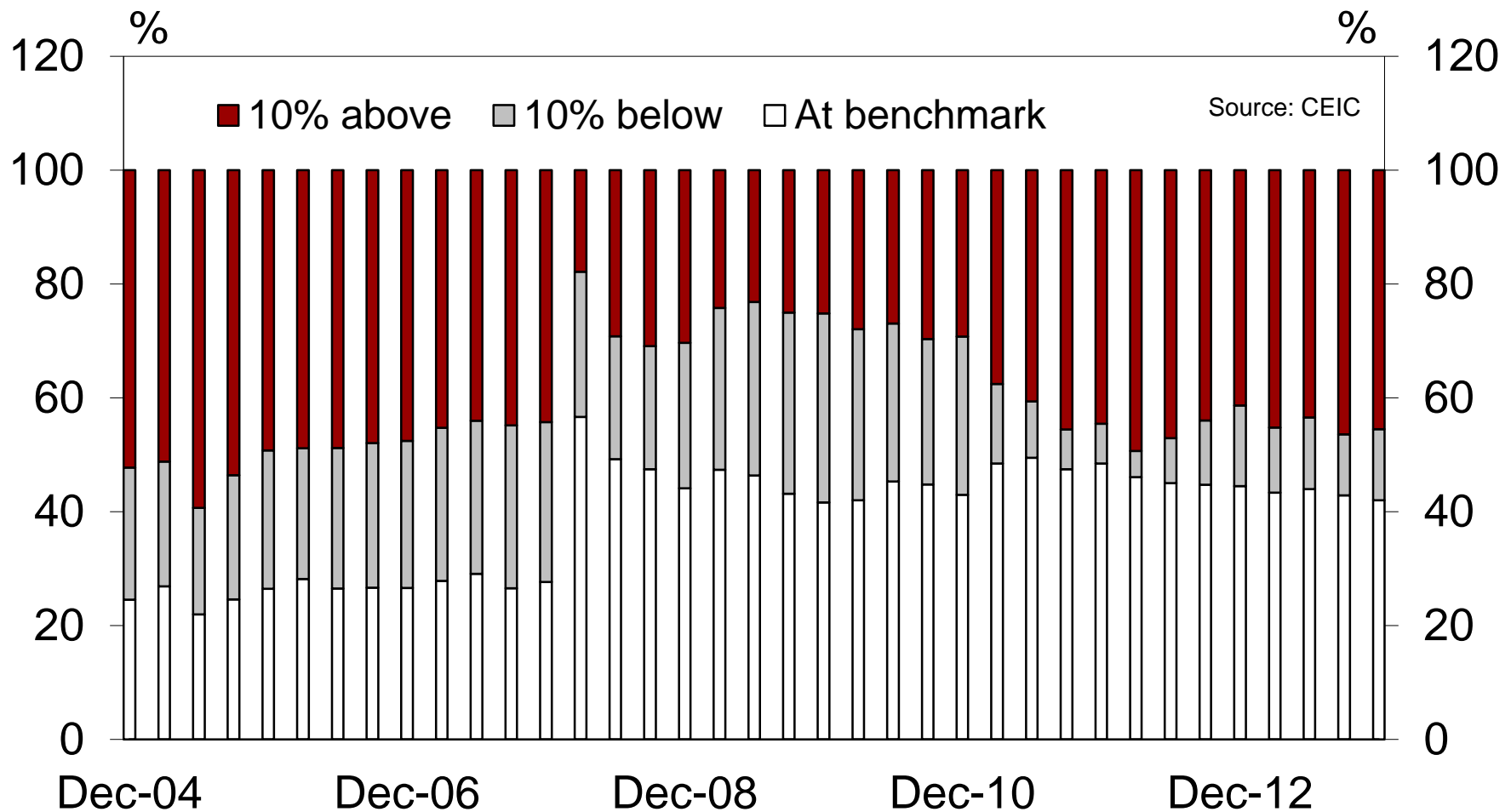
# Interbank loan volume & IB repo rate: weekly



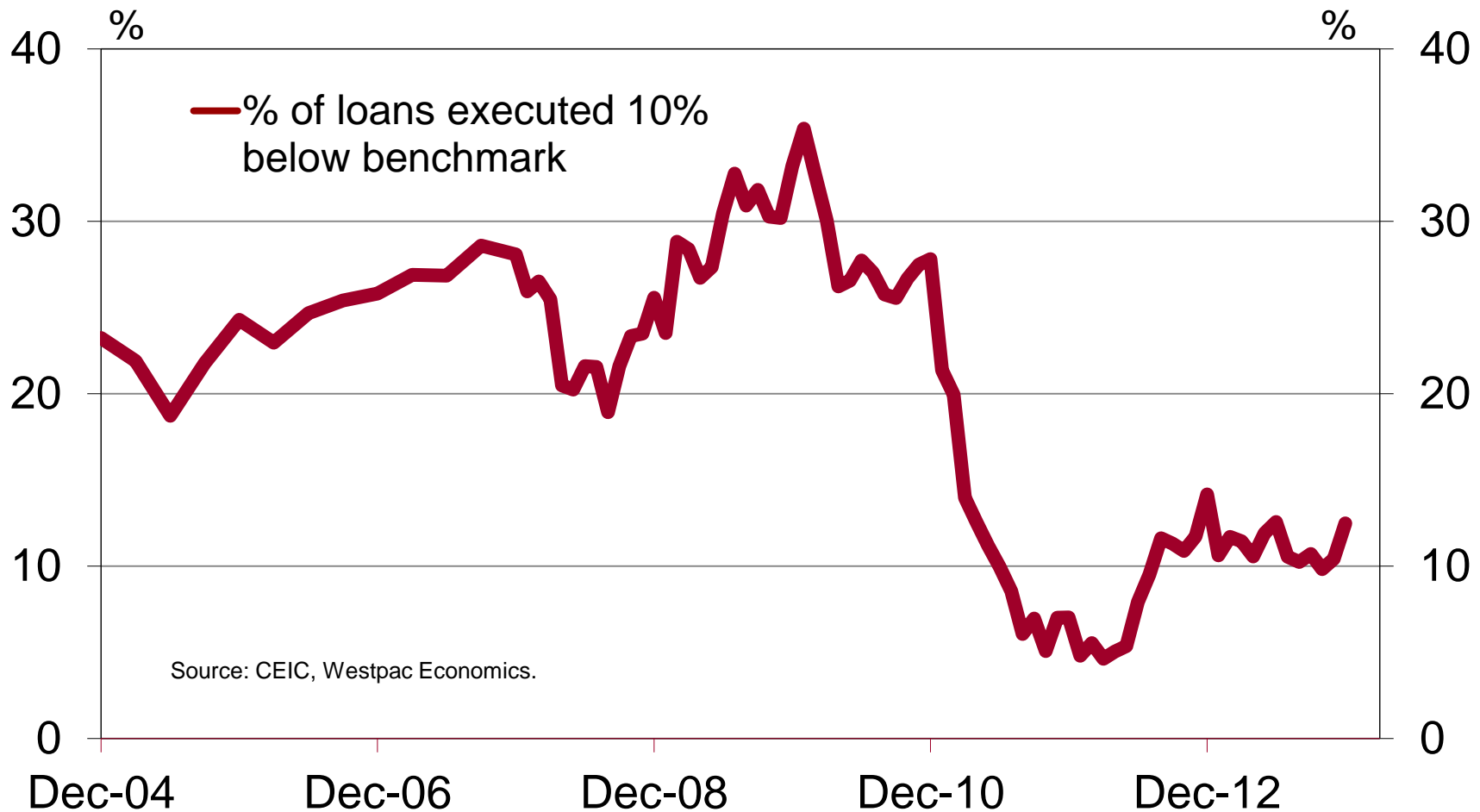
# Interbank loan turnover volume by type of FI



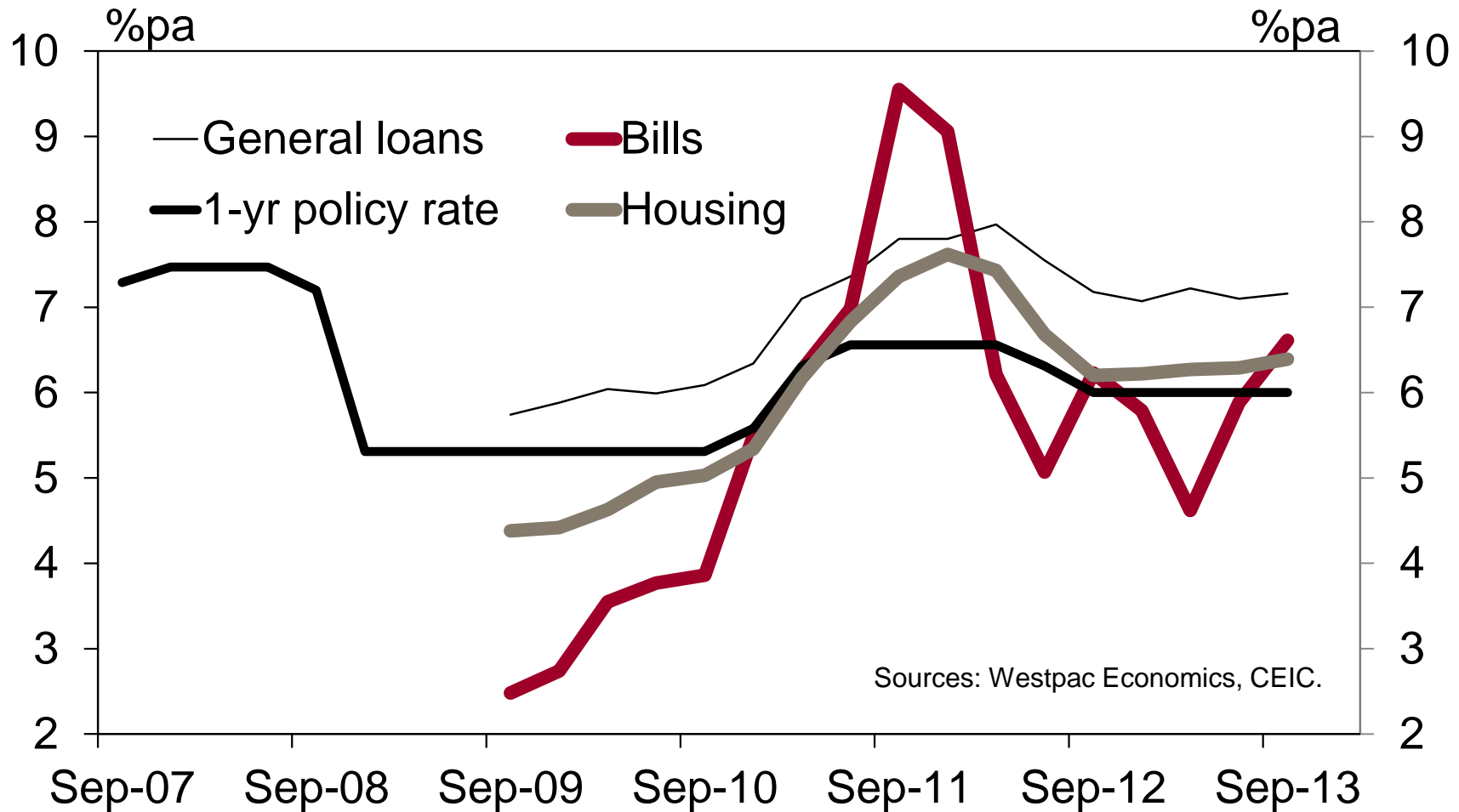
# Loans executed relative to benchmark



# Percent of loans issued at a discount

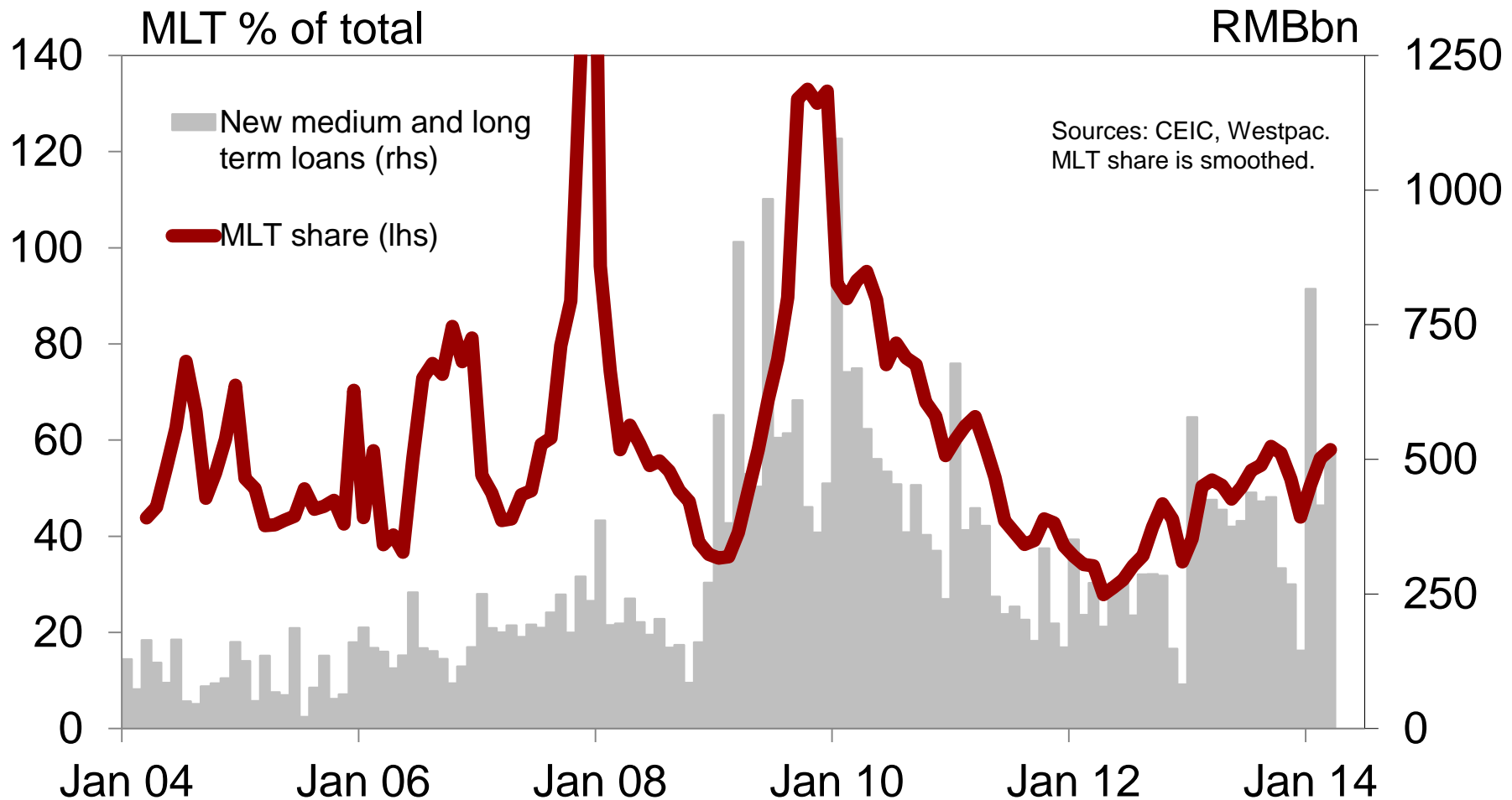


# The policy benchmark & actual loan rates

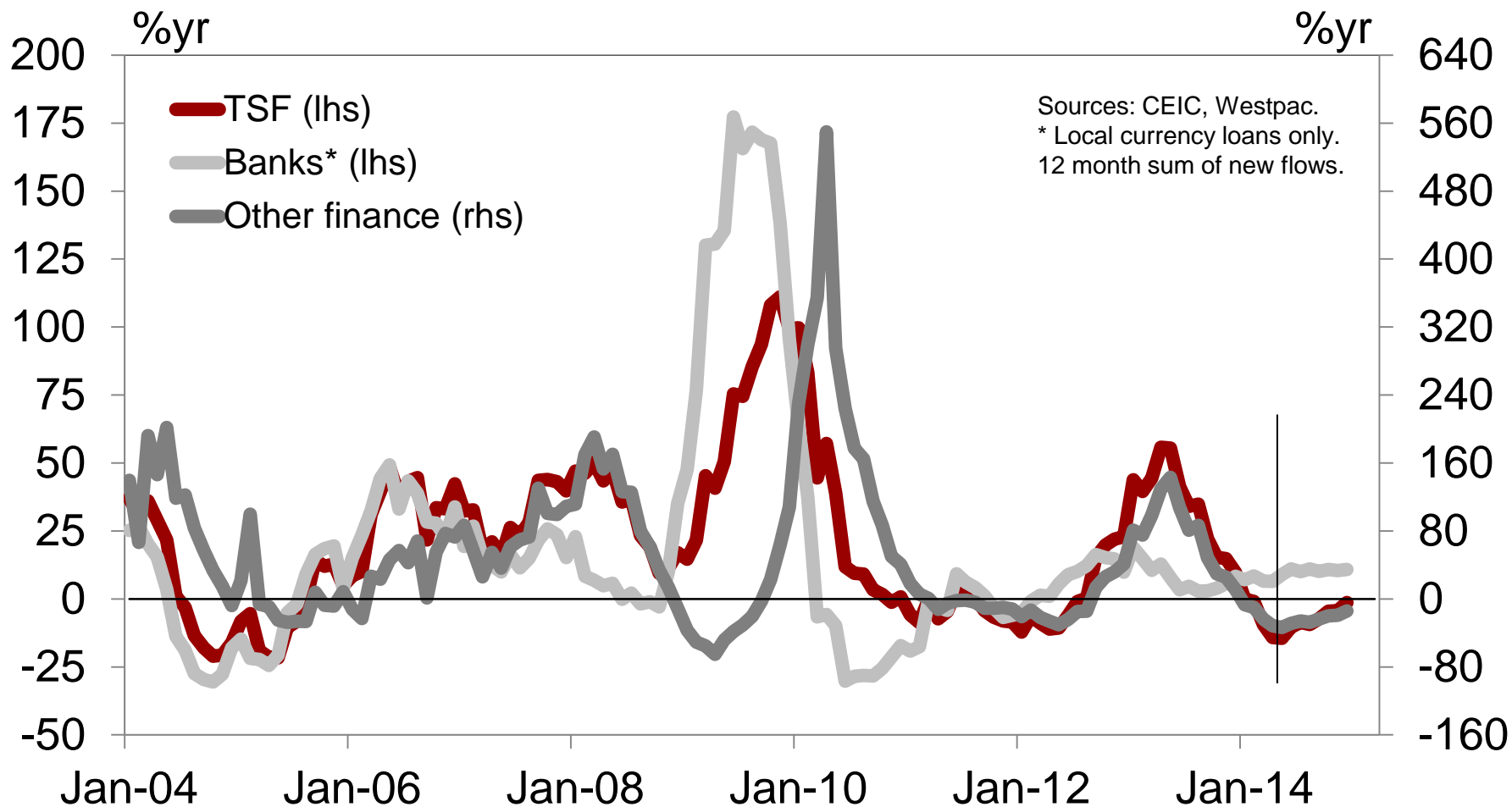




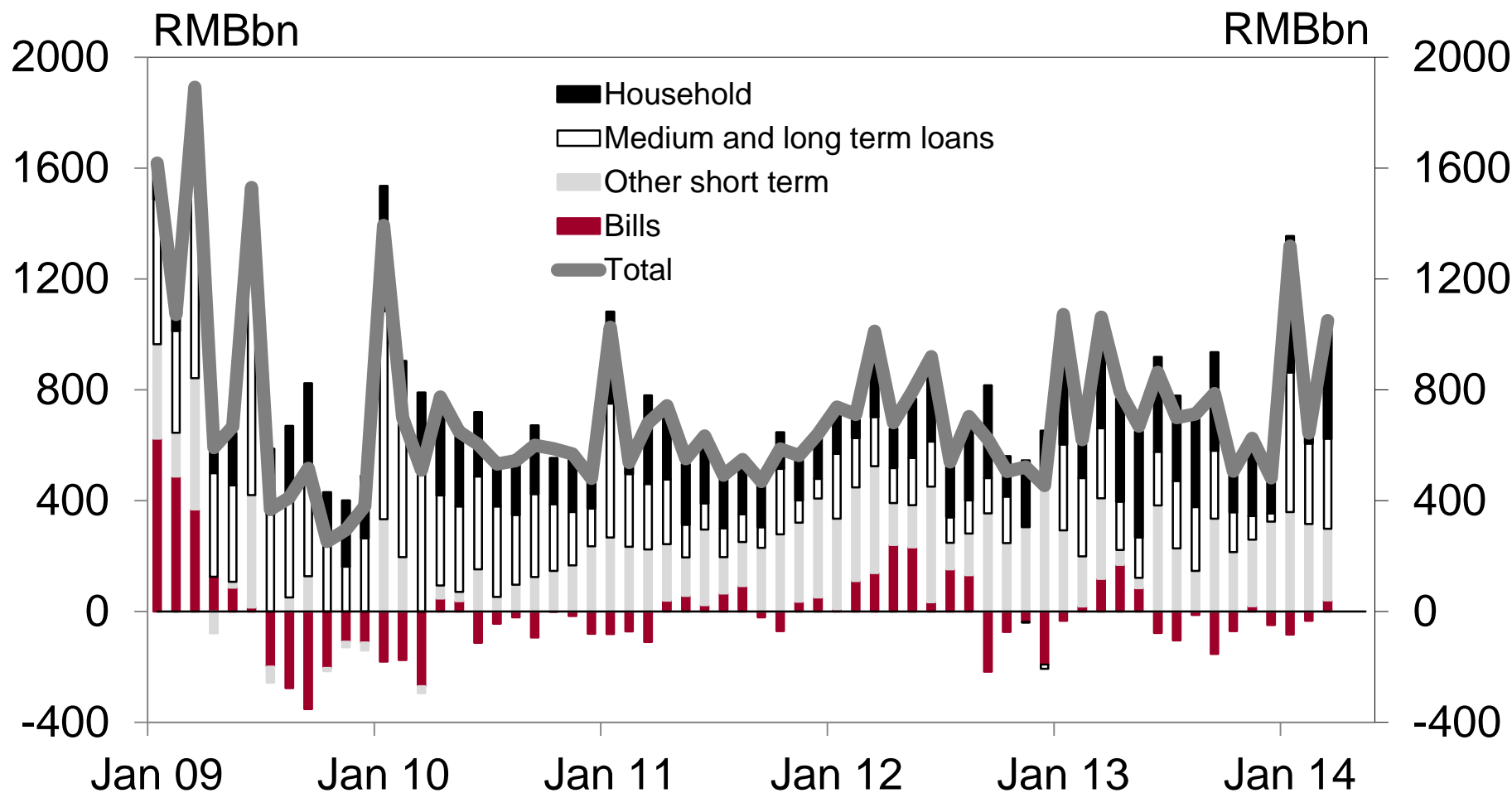
# Medium & long term loans



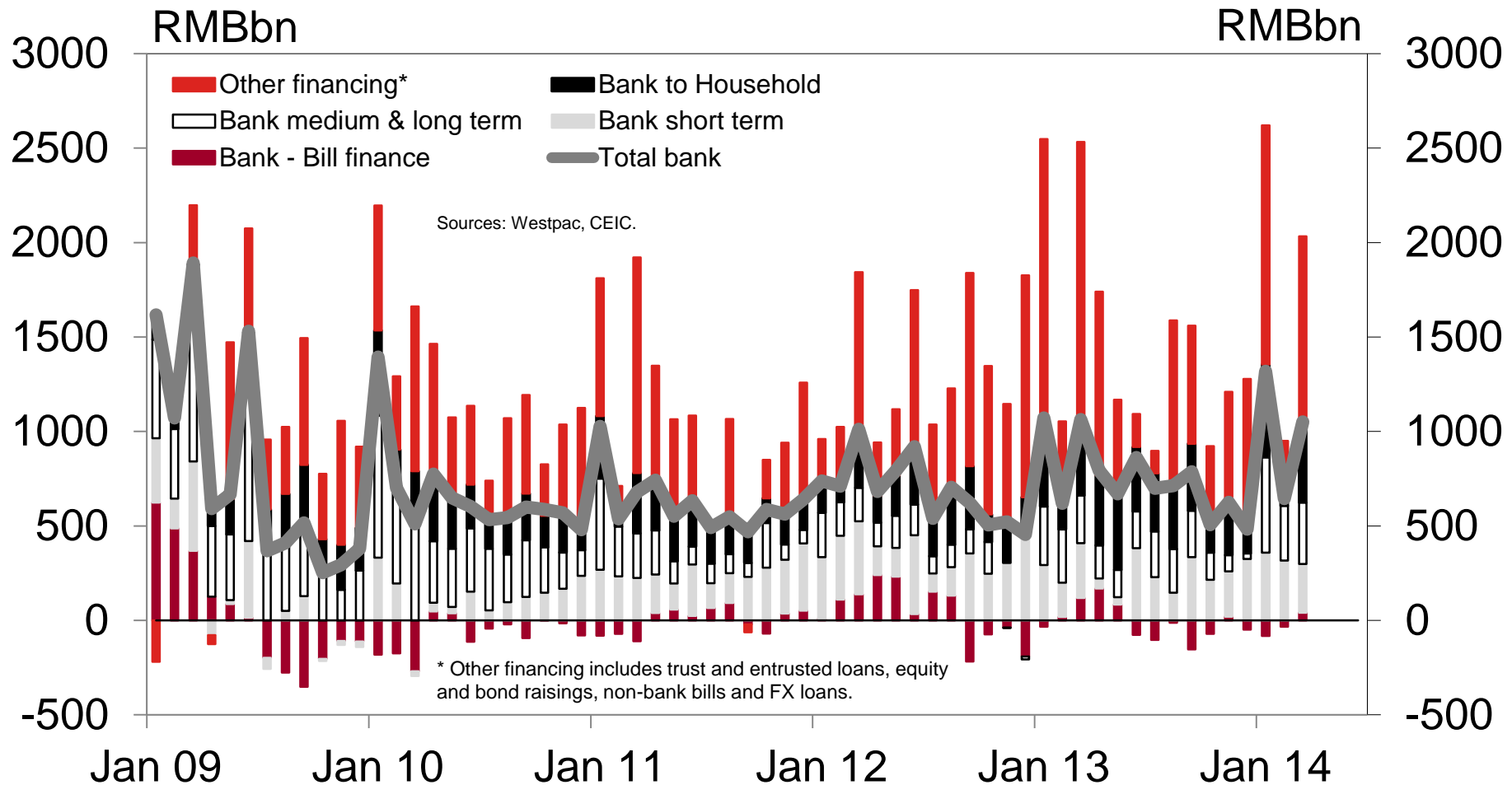
# Total credit supply – new flows



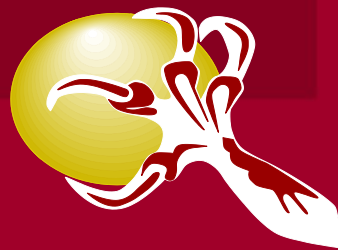
# New bank credit flows



# New lending: not quite déjà vu in Q1



# PUBLIC DEBT

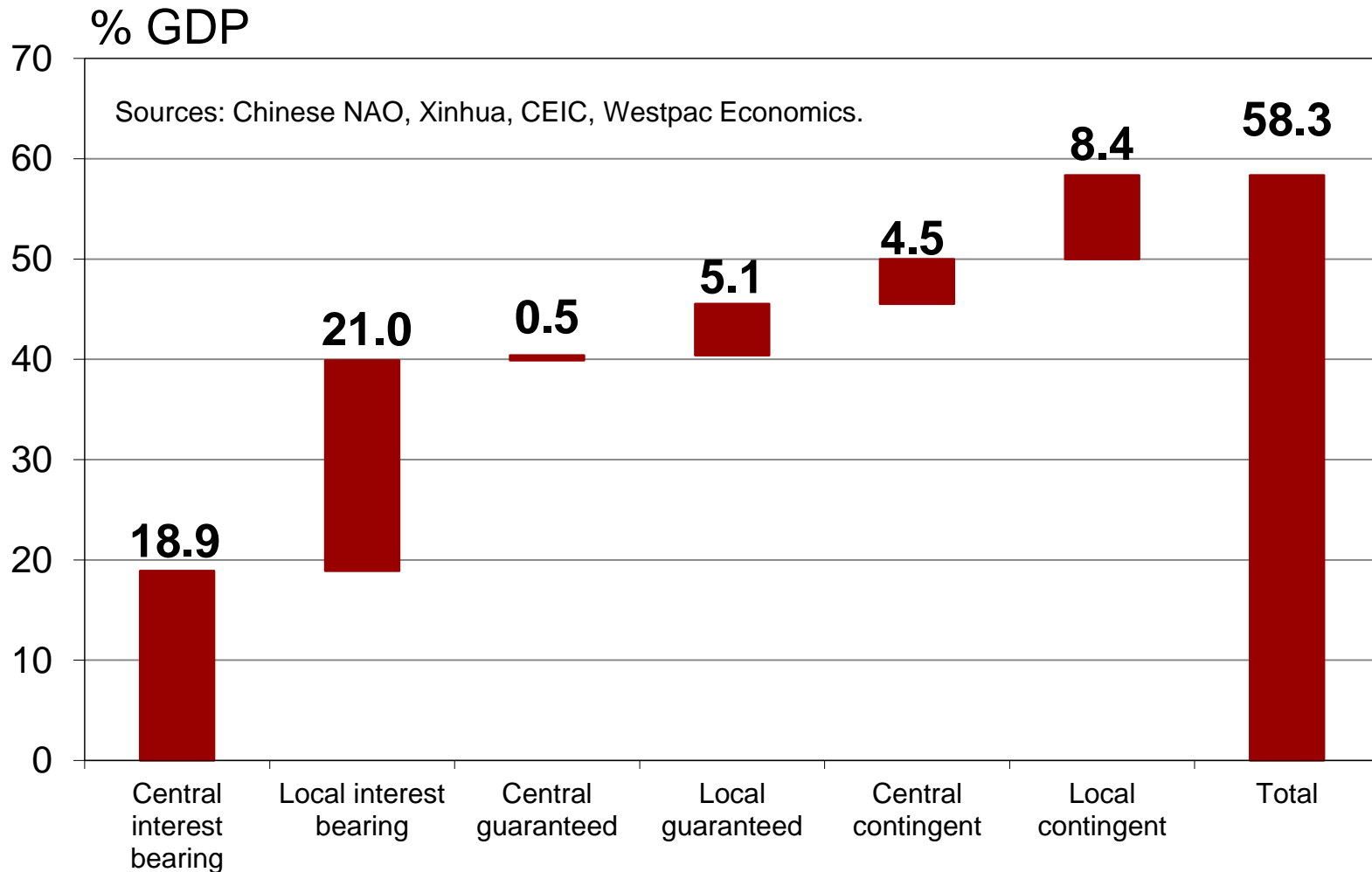


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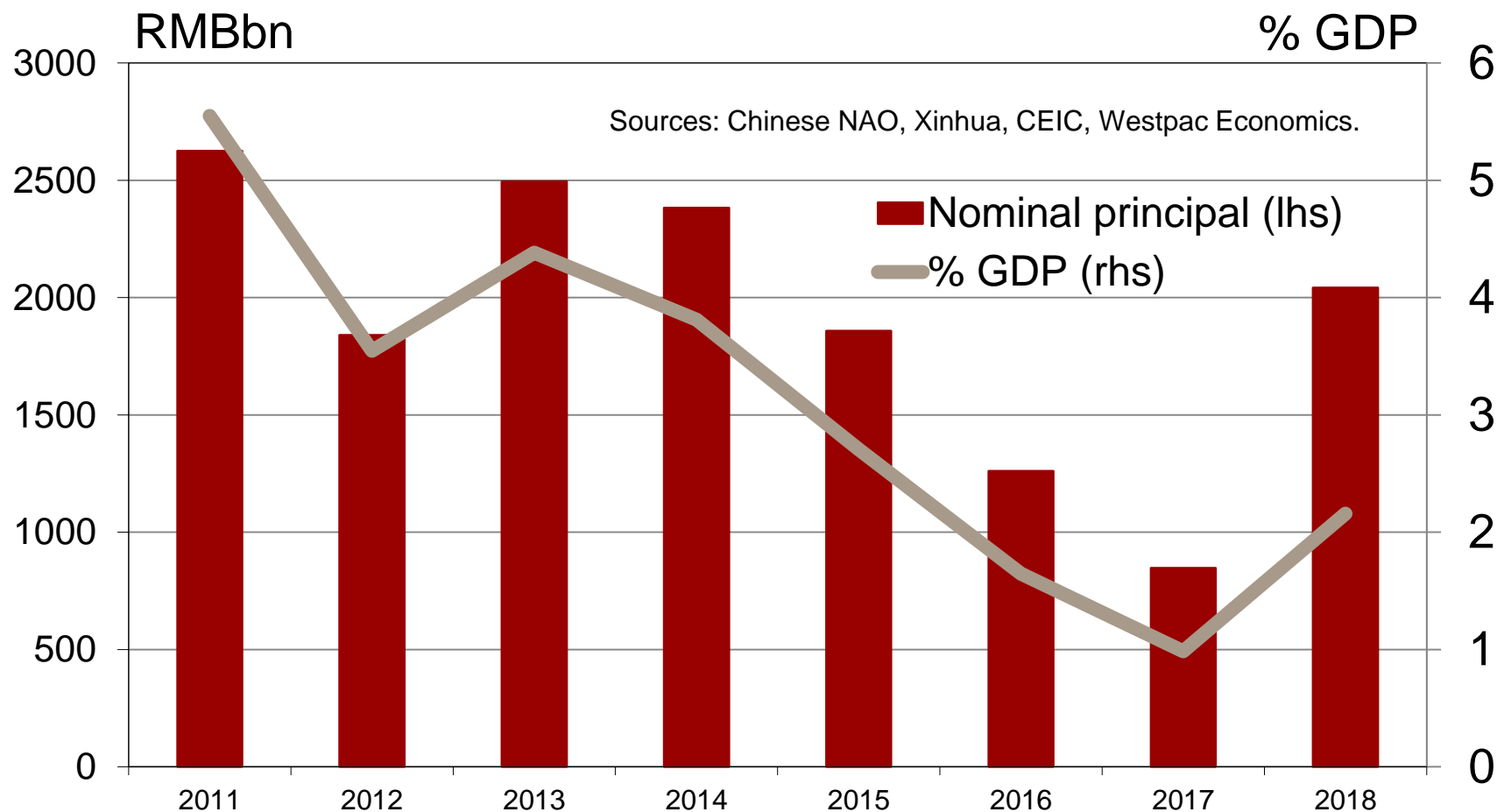
# Debt in the Chinese economy: stylized facts

Sector	Characterisation of its debt load
Urban households	<b>Low – mortgage exposure &lt; 20% of GDP</b>
Rural households	Very low - property rights & collateral issue
<b>State owned firms</b>	<b>Too much – ease of access to banks</b>
Private firms	Low – difficulty of access to banks
Central government	Low – but has huge contingent liabilities
<b>Local government</b>	<b>Too much – vertical fiscal imbalance &amp; stimulus era hangover.</b>
<b>The nation as a whole</b>	<b>Huge international creditor</b>

# China's public debt as of June 2013



# Local government debt maturity profile





# A five year scenario for local government debt

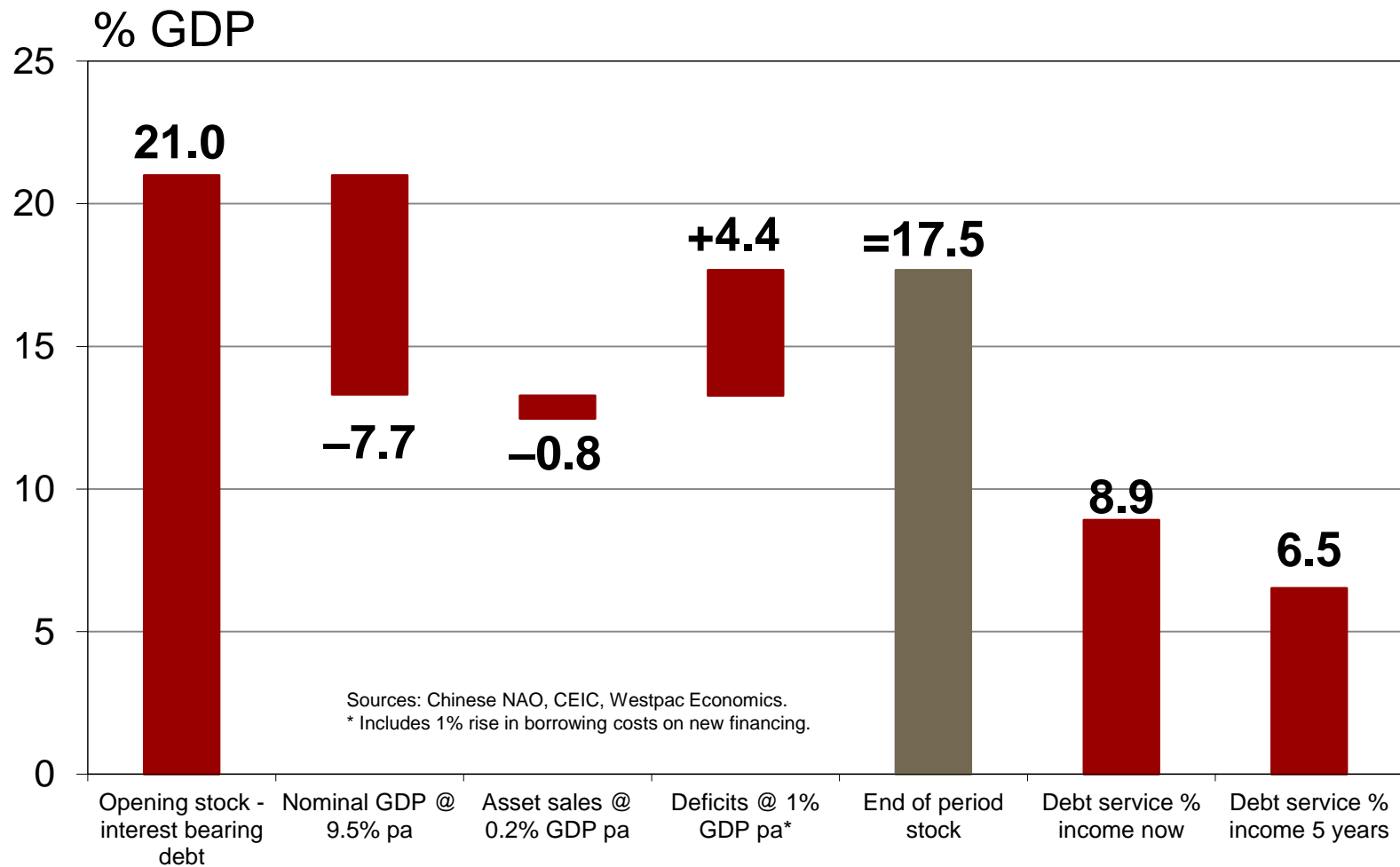
The assumptions:

- All existing interest bearing liabilities (21% of GDP) rolled over.
- Nominal GDP grows at 9.5% per annum (7% real and 2.5% IPD)
- Existing & refinanced borrowings cost 5%, new borrowings cost 6%.
- Local deficits run at 1% of GDP per annum
- Asset sales of 0.2% of GDP per annum
- Directly controlled local revenues increase by 0.5% of GDP annually
- Grants from central government increase by 0.5% of GDP annually (Beijing grasps reality of vertical fiscal imbalance)

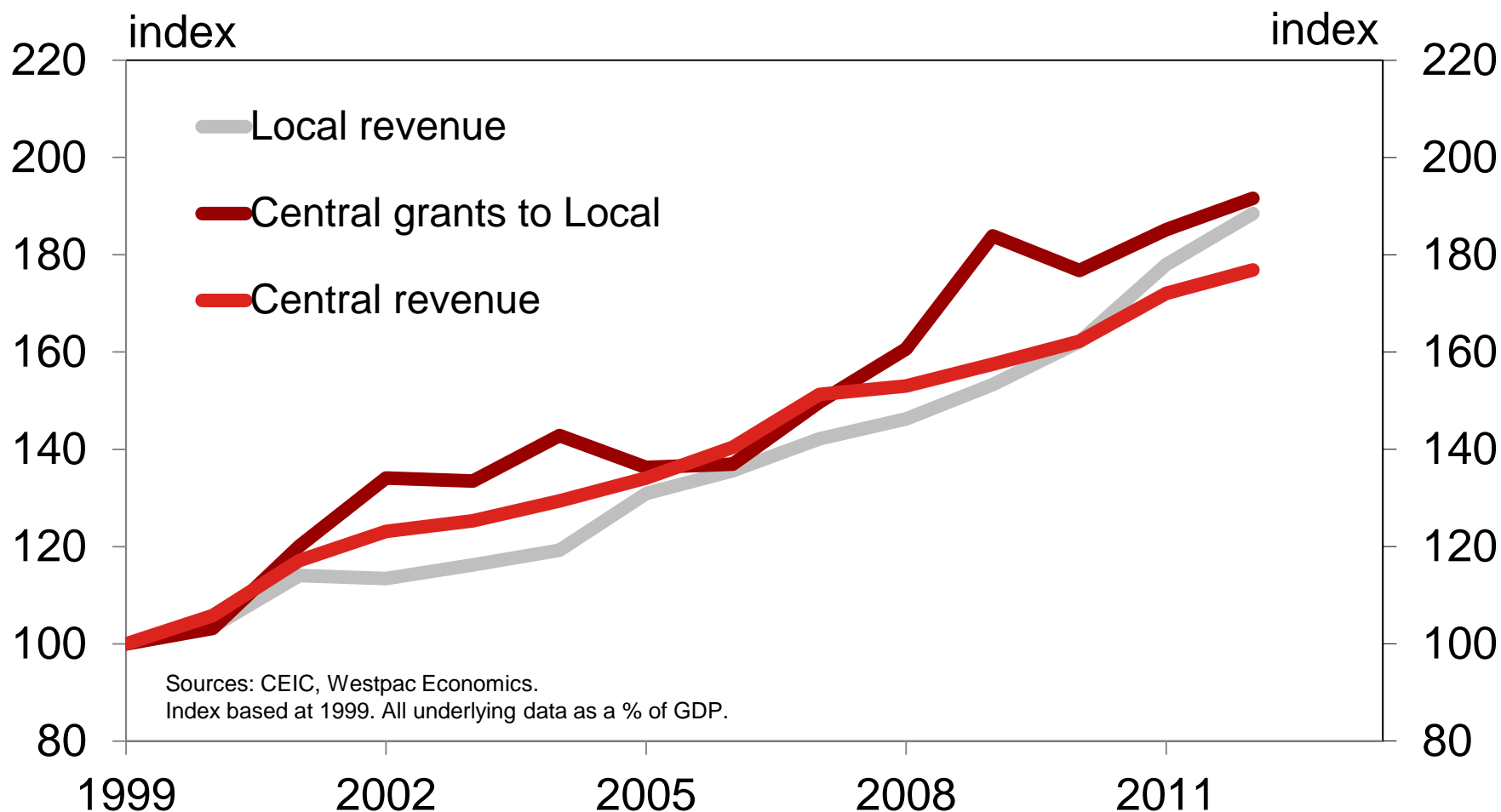
The assumptions:

- Presently, estimated debt servicing is equal to 8.9% of directly controlled revenues and 5.1% of total revenues (including central grants).
- Under the above, estimated debt servicing will fall to 6.5% of directly controlled revenues and 3.6% of total revenues (including central grants).
- The decomposition of these estimates is overleaf.

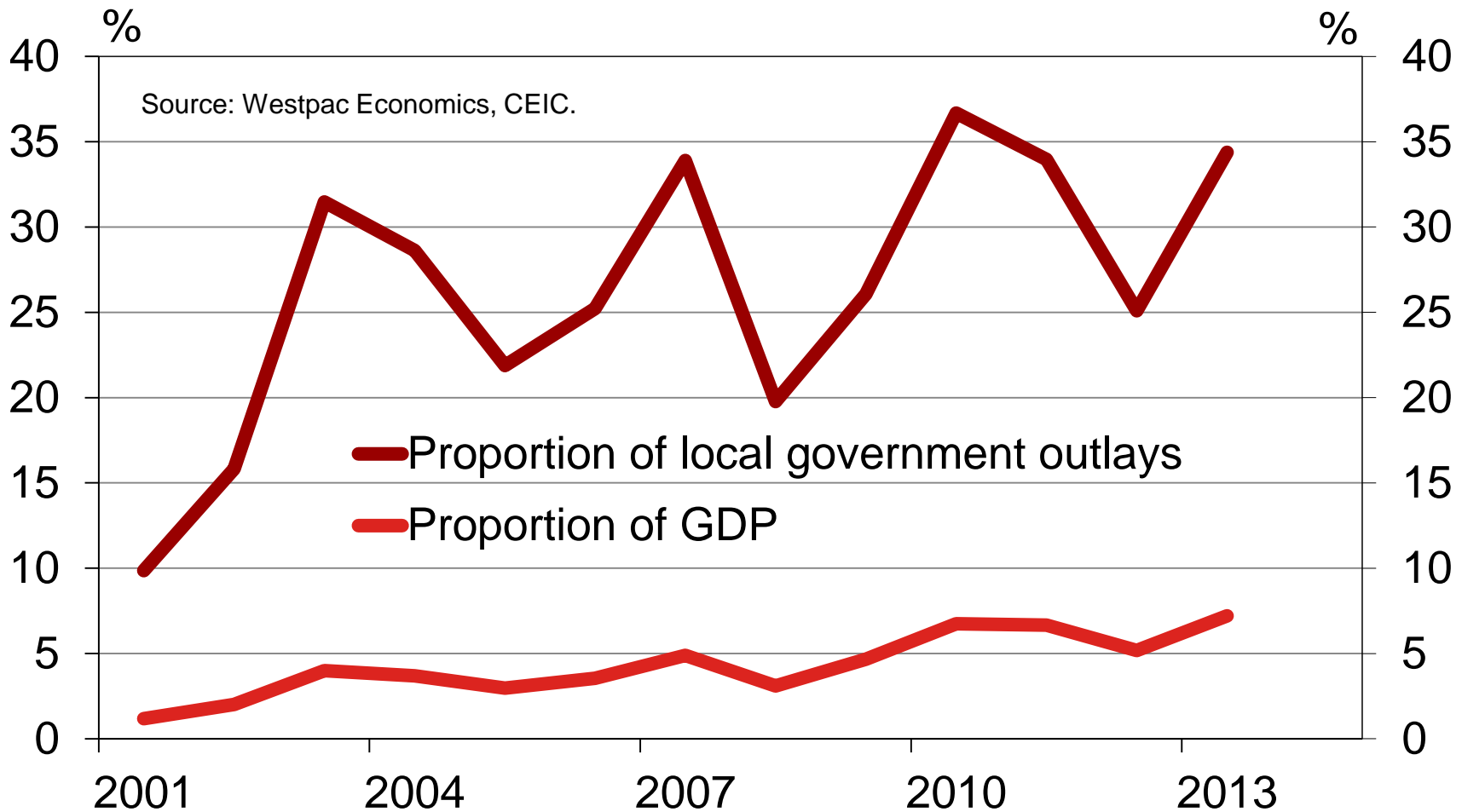
# A five year scenario for local government debt



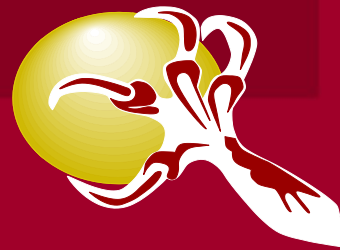
# Rising revenue intensity of GDP in China



# Land transfer revenues: a financial crutch

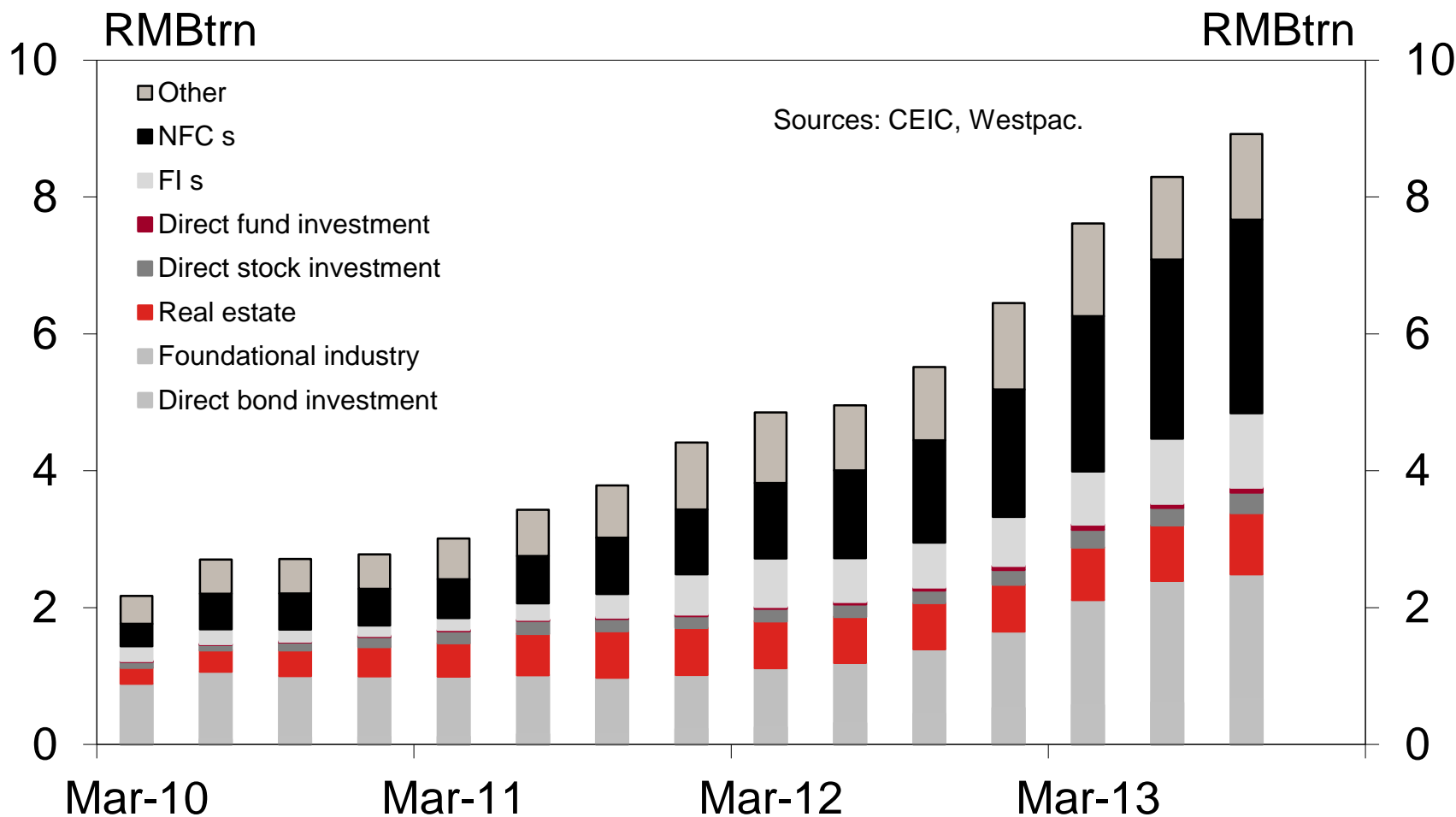


# TRUST COMPANIES

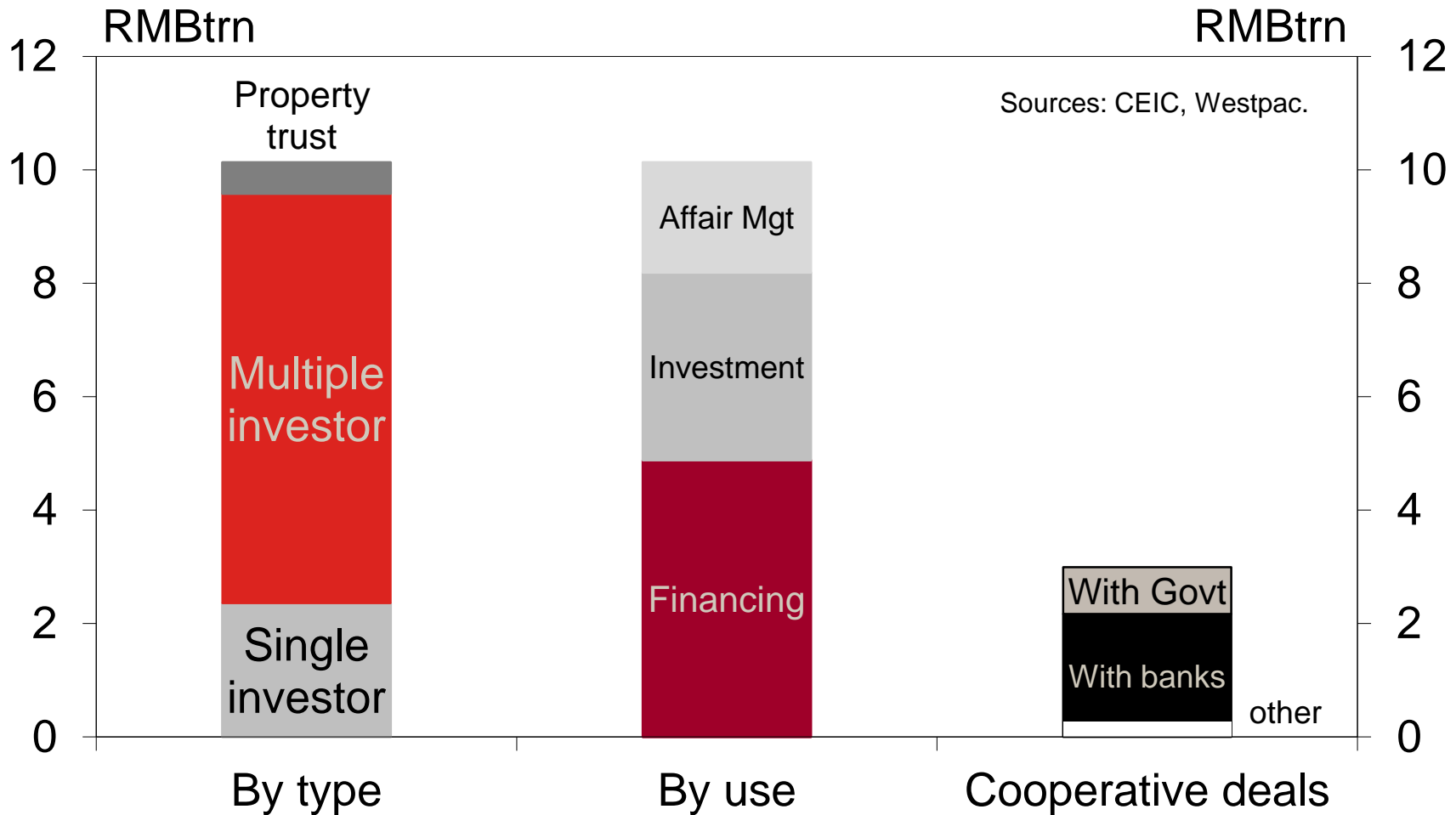


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Dragon**

# Assets of Chinese trust companies

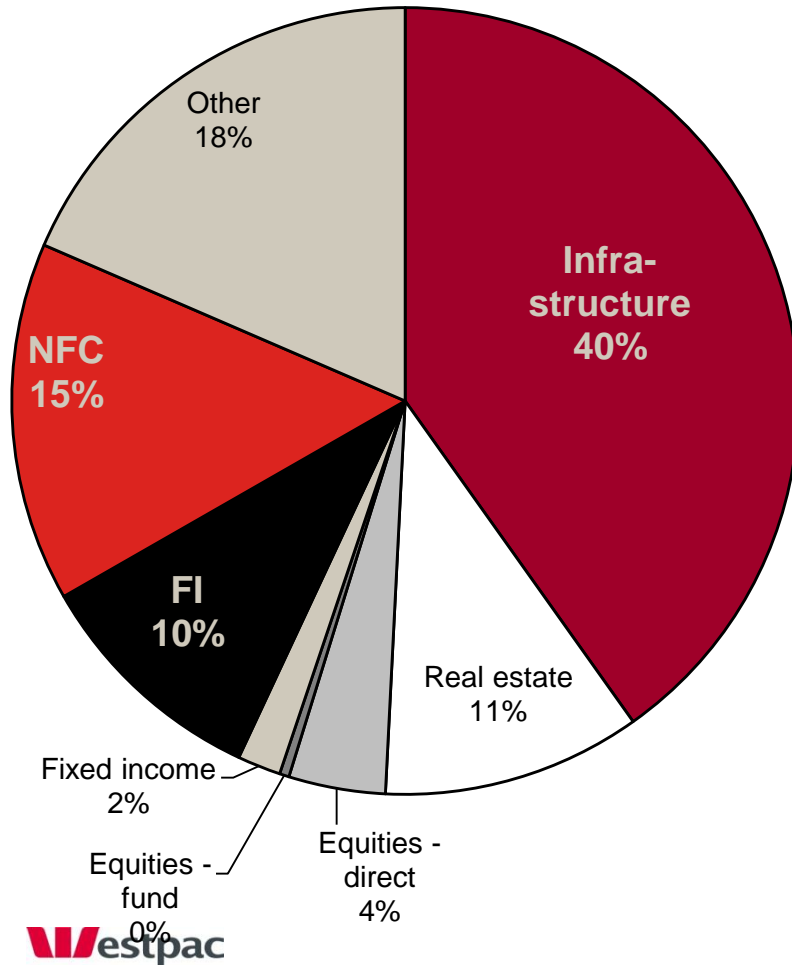


# Chinese trust company activities

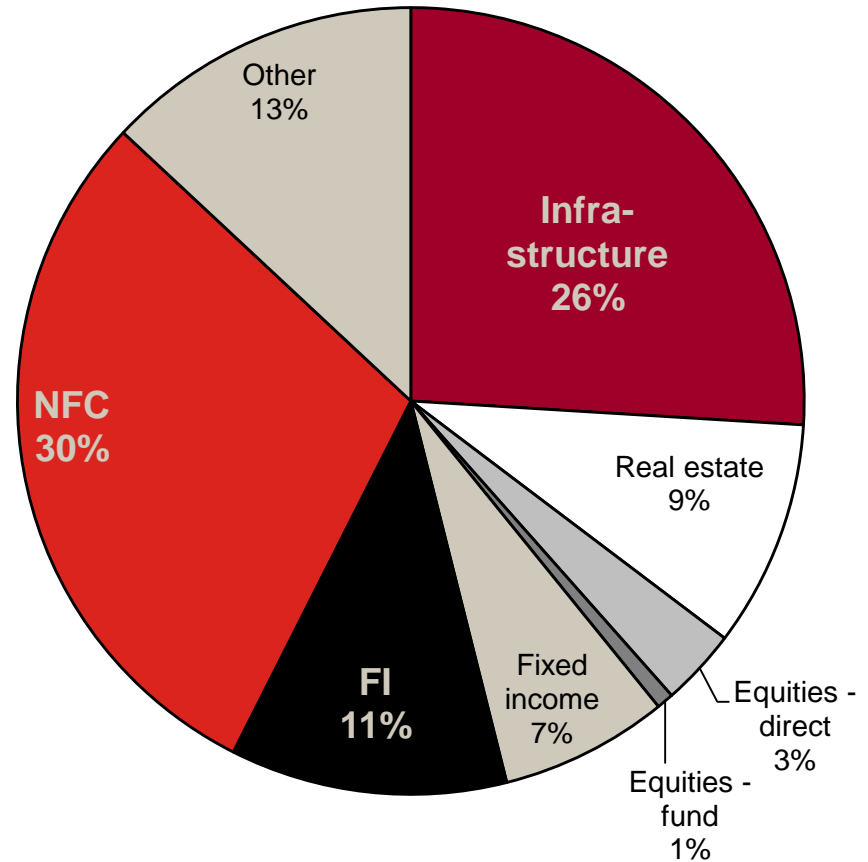


# Chinese trust company assets

**March 2010**

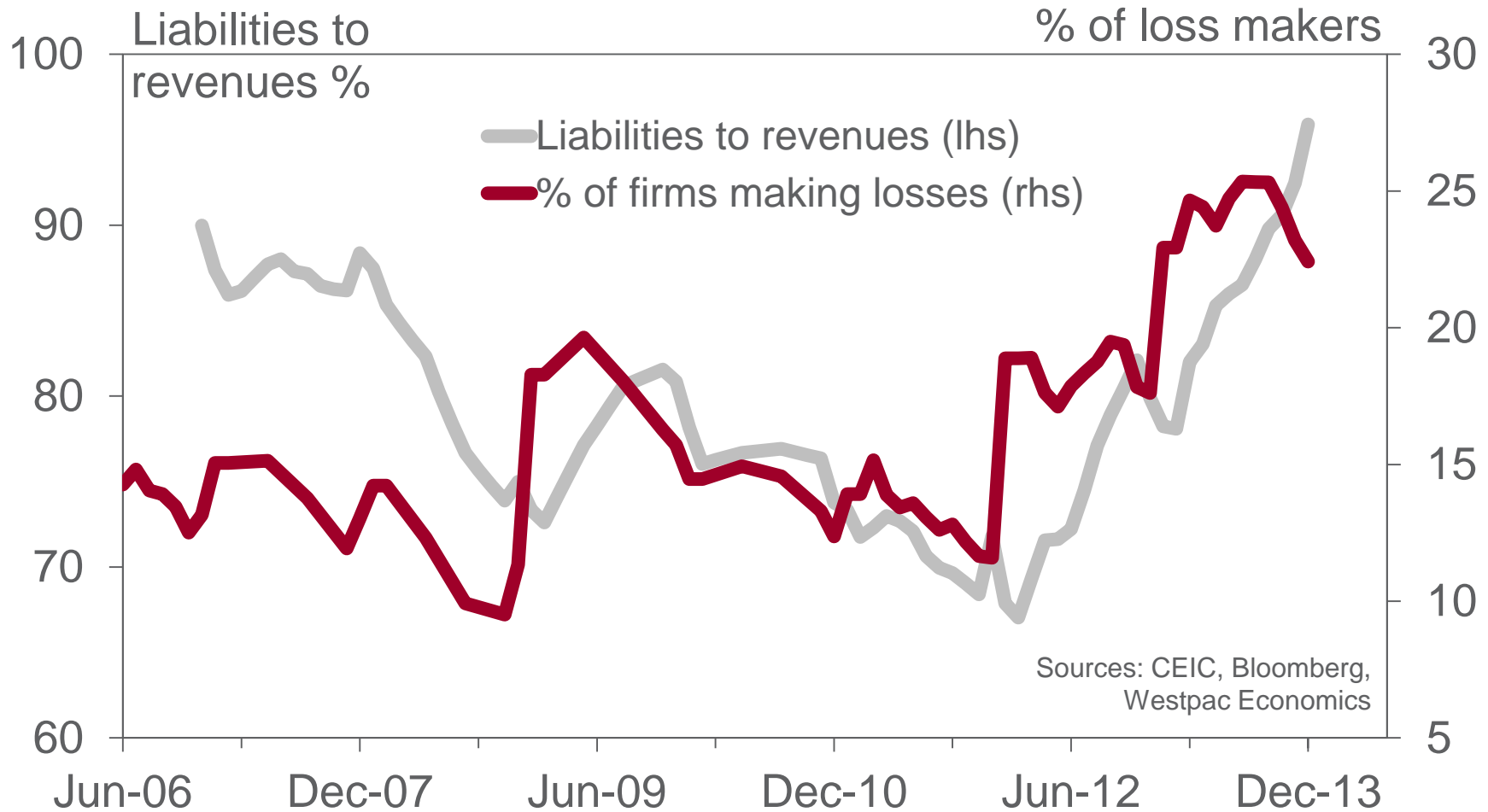


**September 2013**

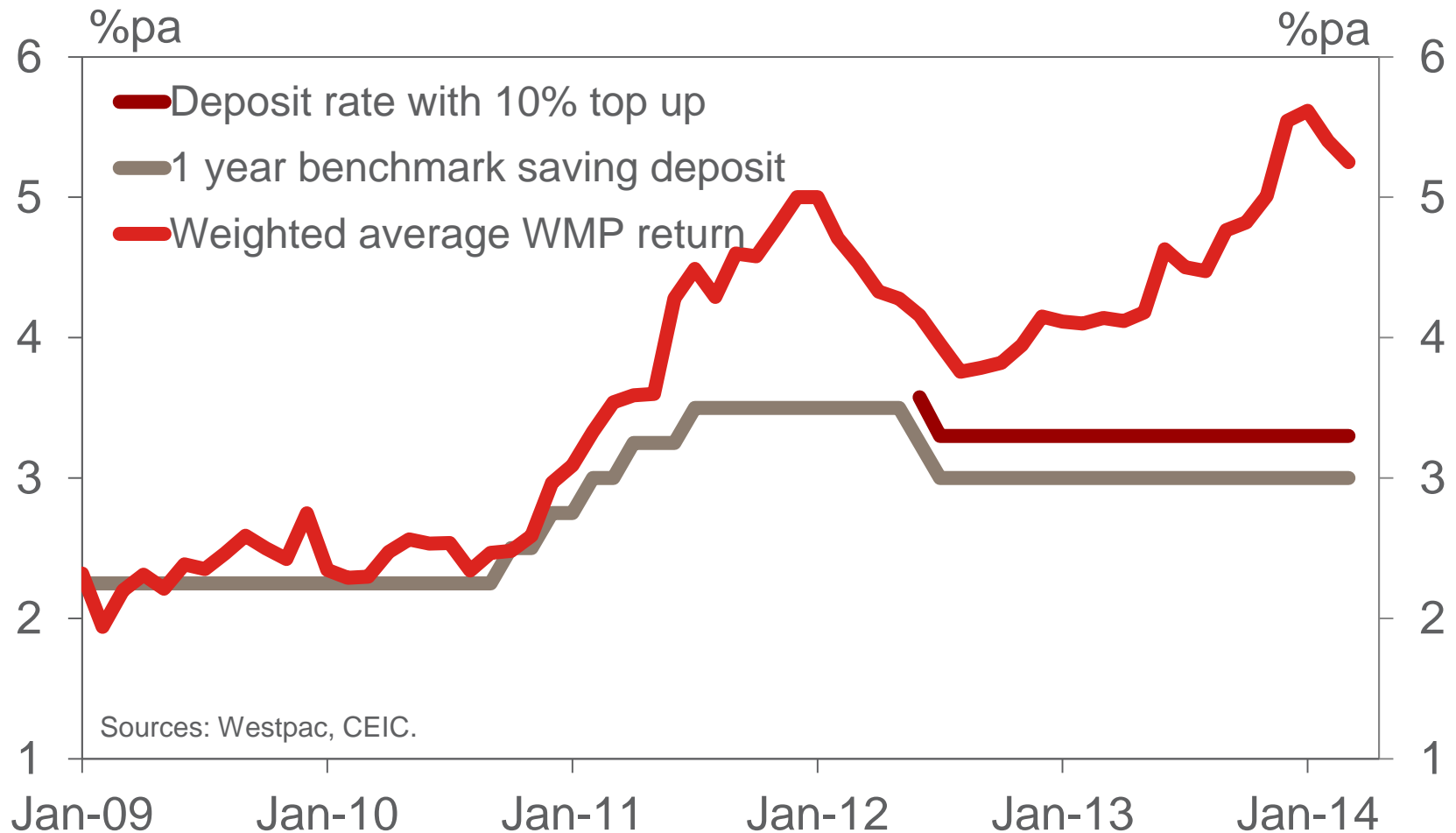




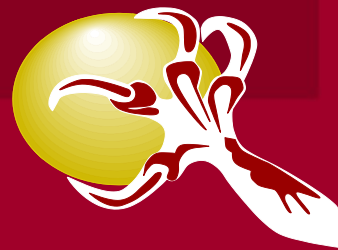
# Coal miners' debt & loss making firms



# The deposit ceiling and WMP returns

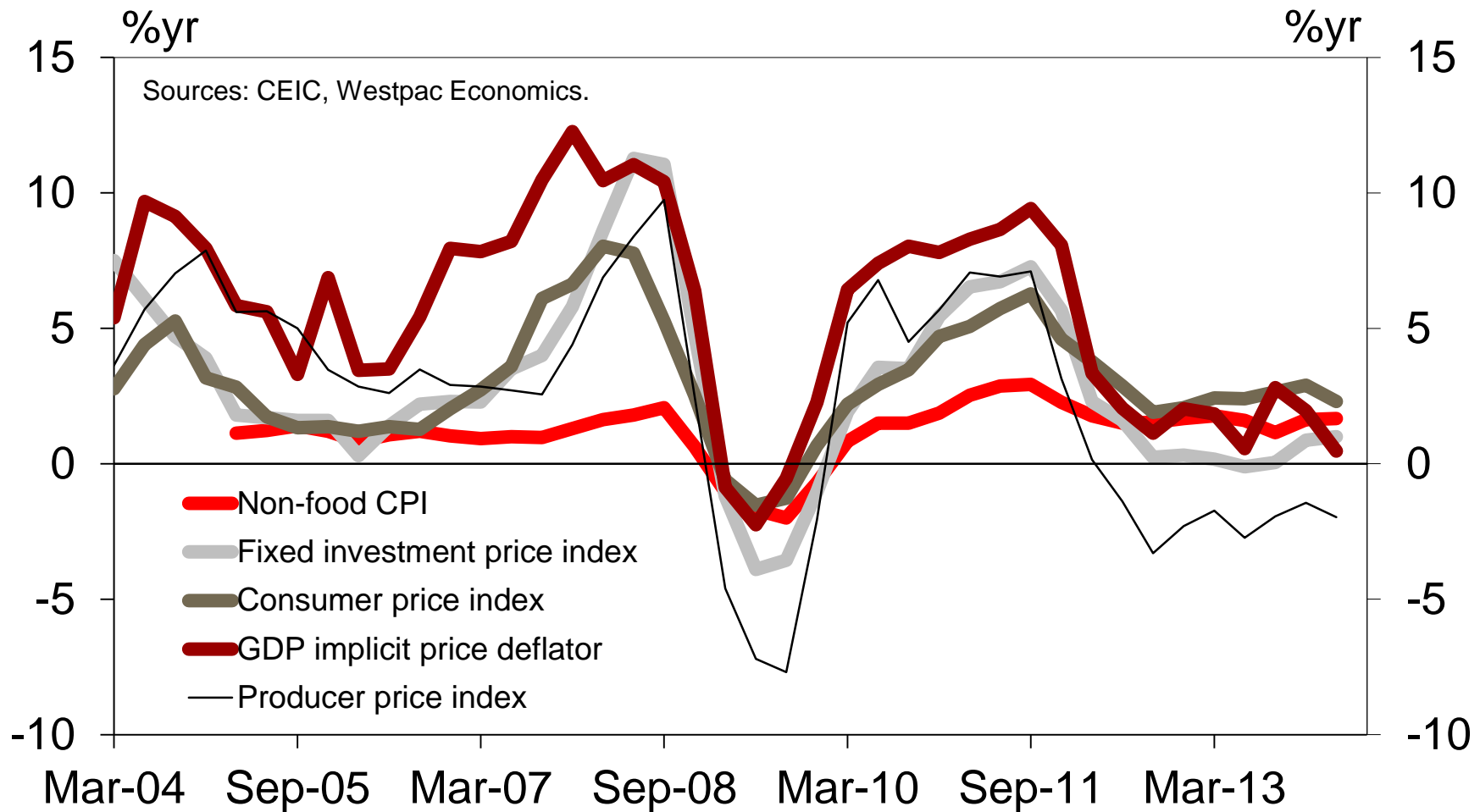


# PRICES

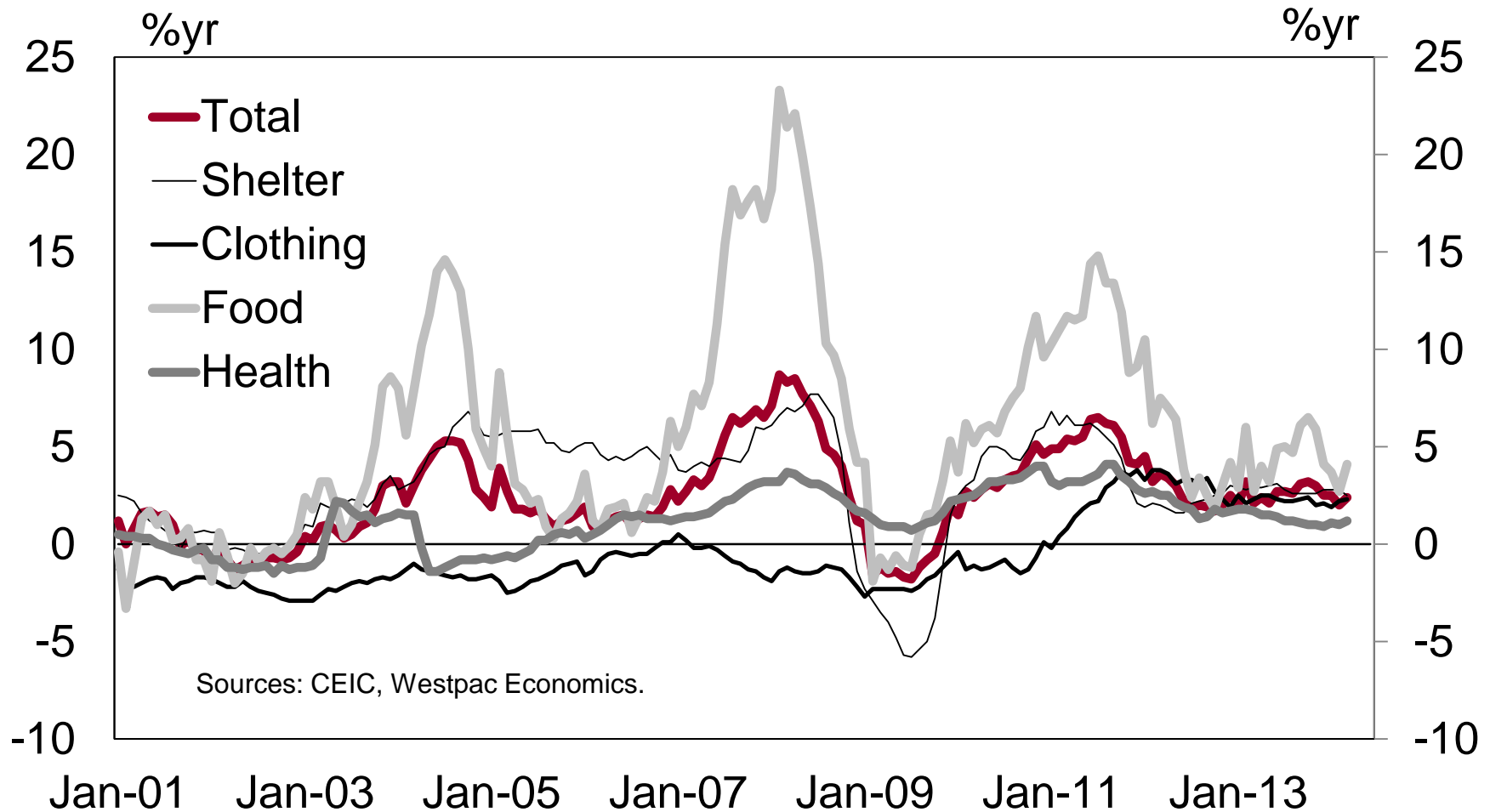


# Phat Dragon

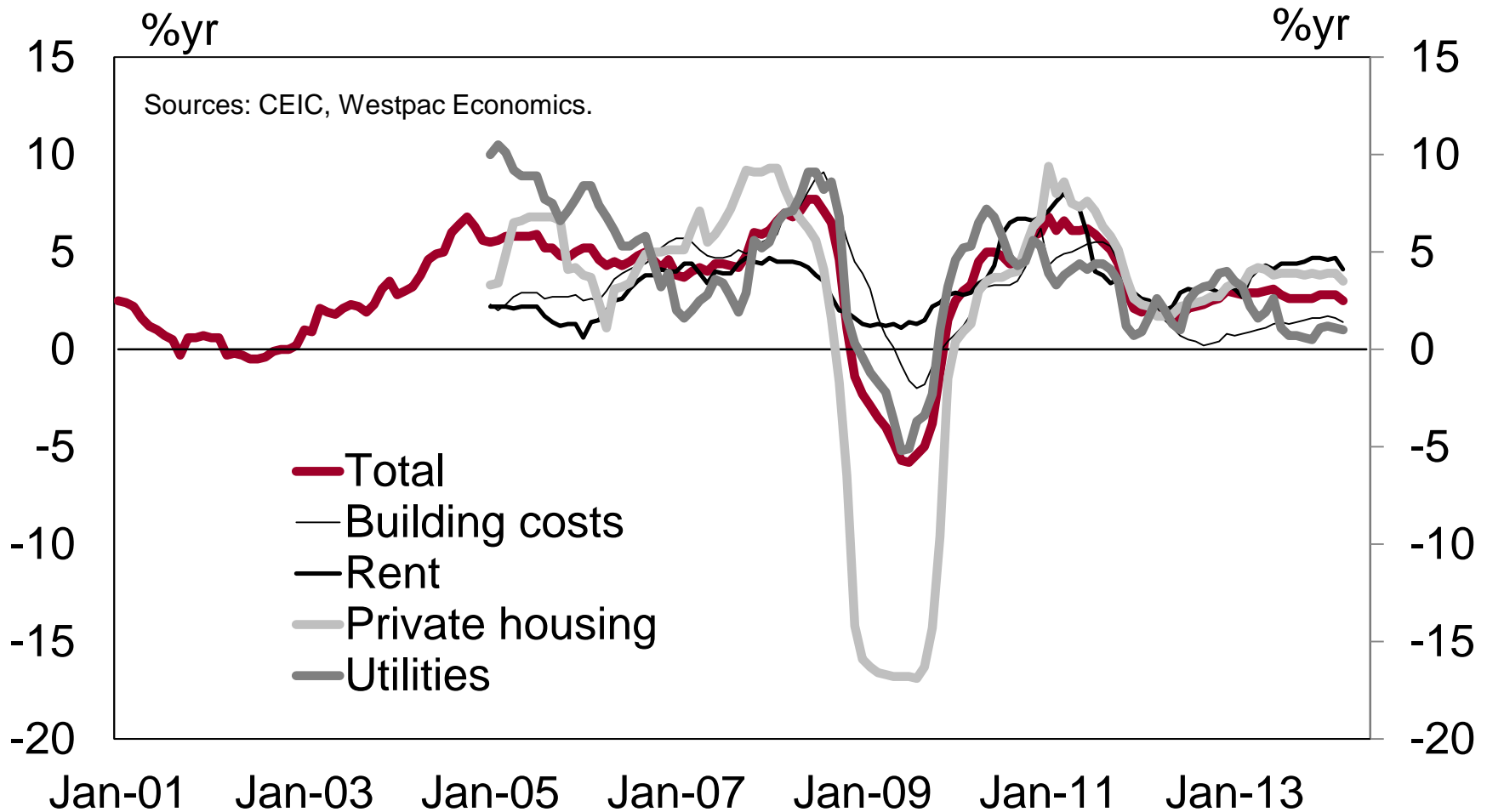
# Various measures of inflation



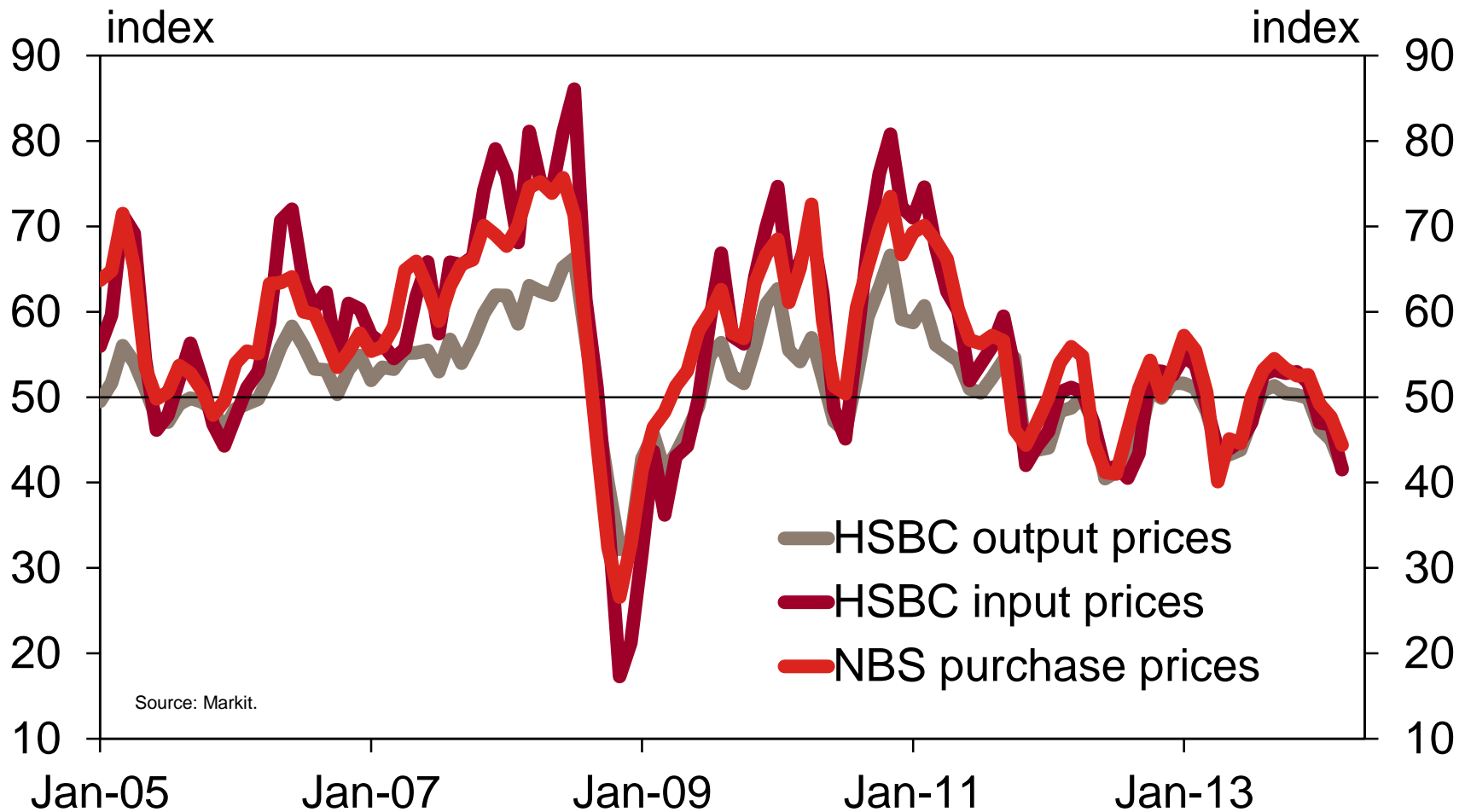
# Chinese consumer prices



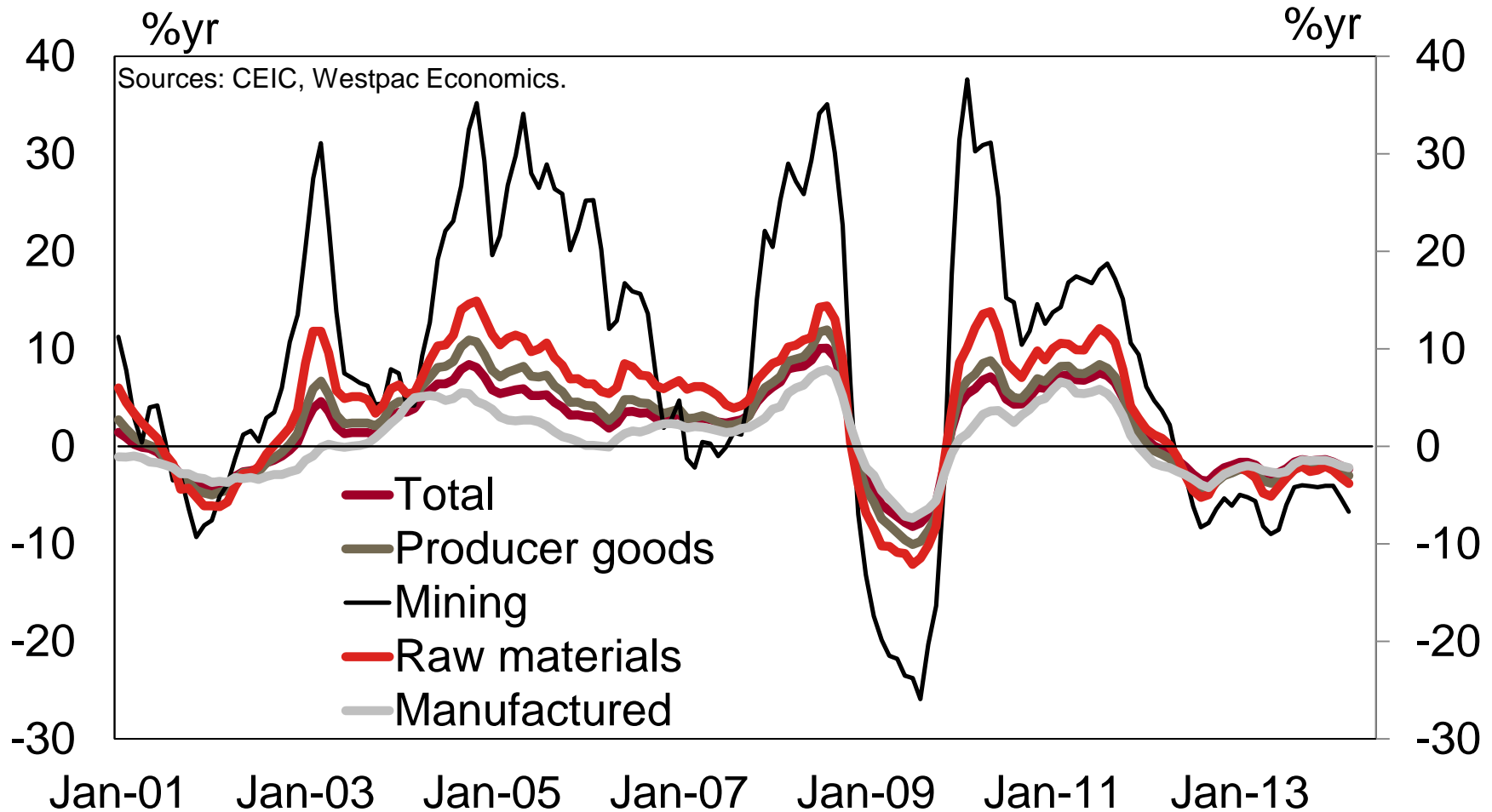
# Chinese CPI: the shelter component



# Input and output prices: PMI basis

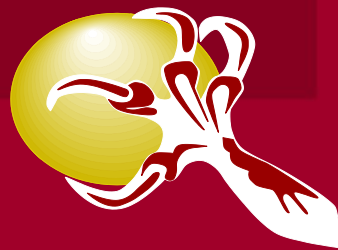


# Chinese producer prices



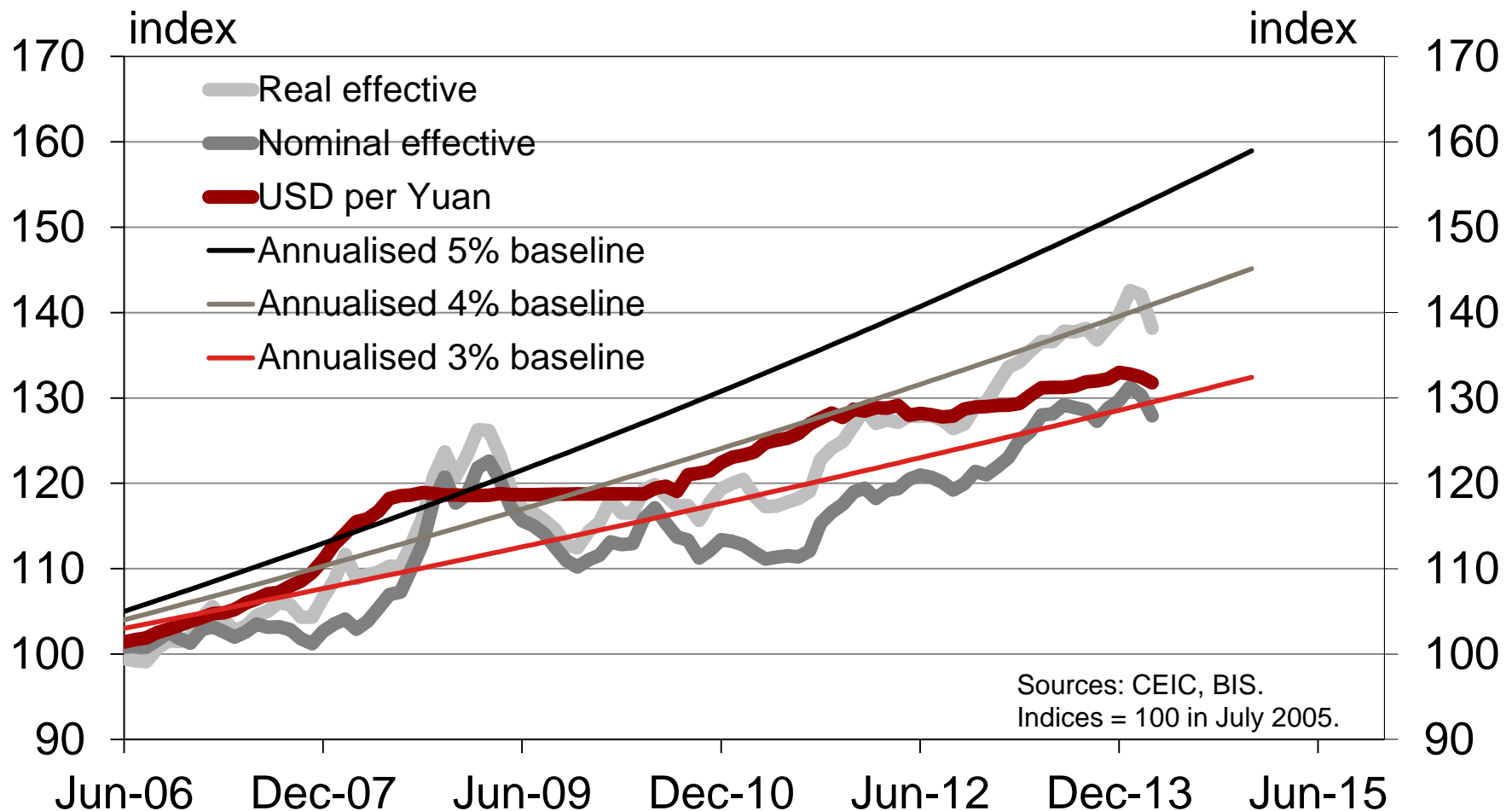


# THE EXCHANGE RATE



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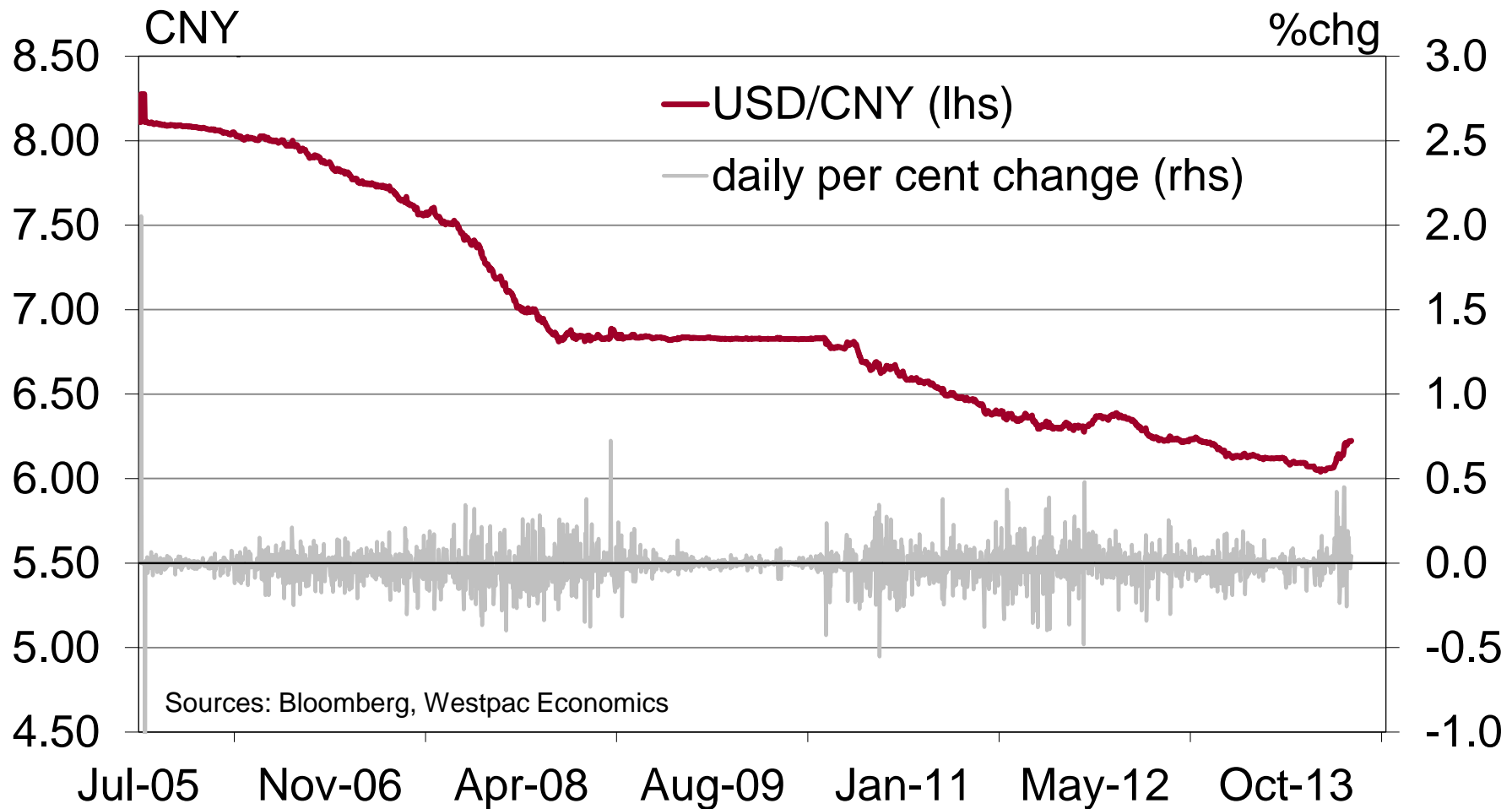
# The path of the Chinese exchange rate



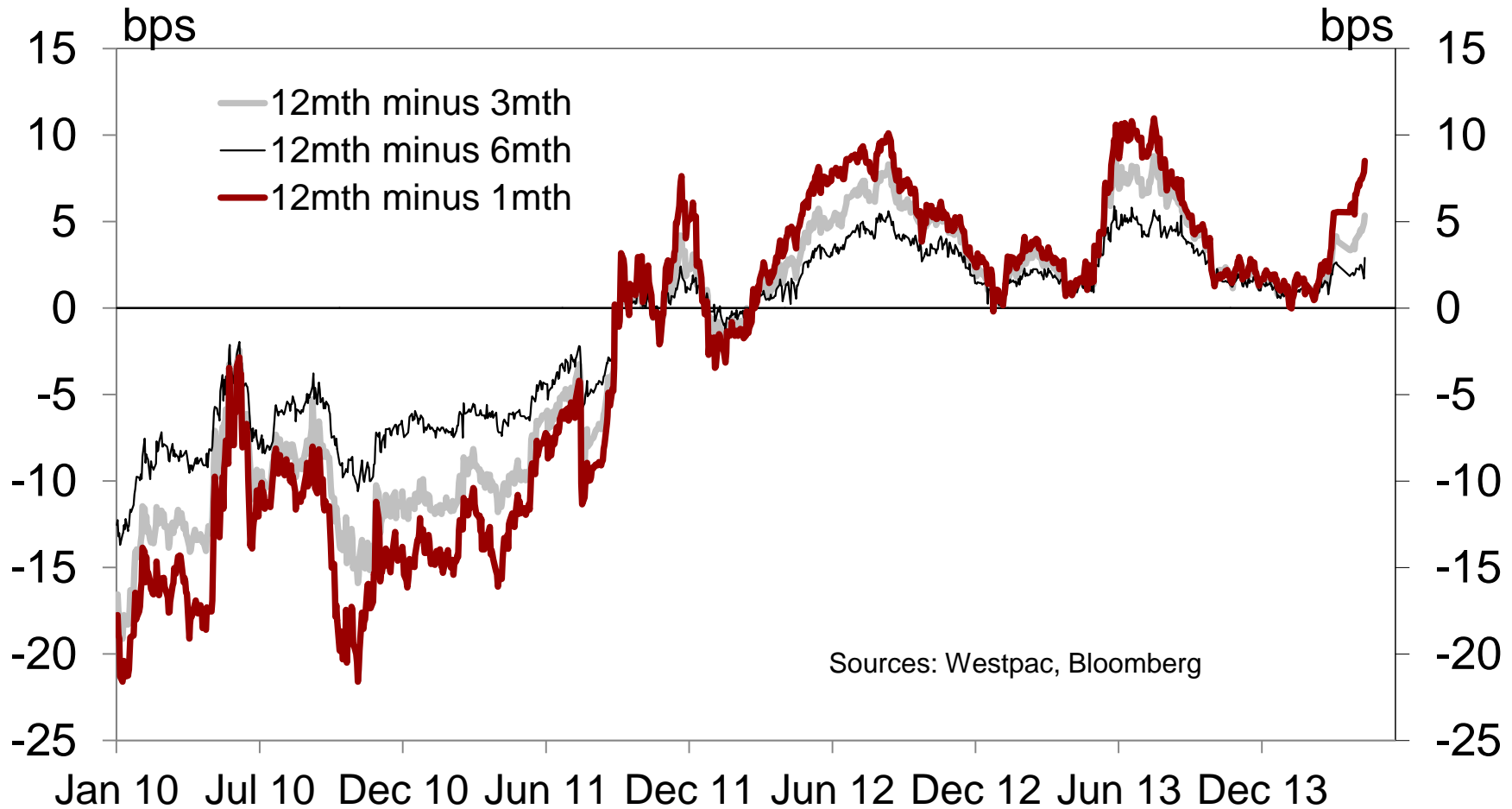
# Onshore CNY and offshore CNH



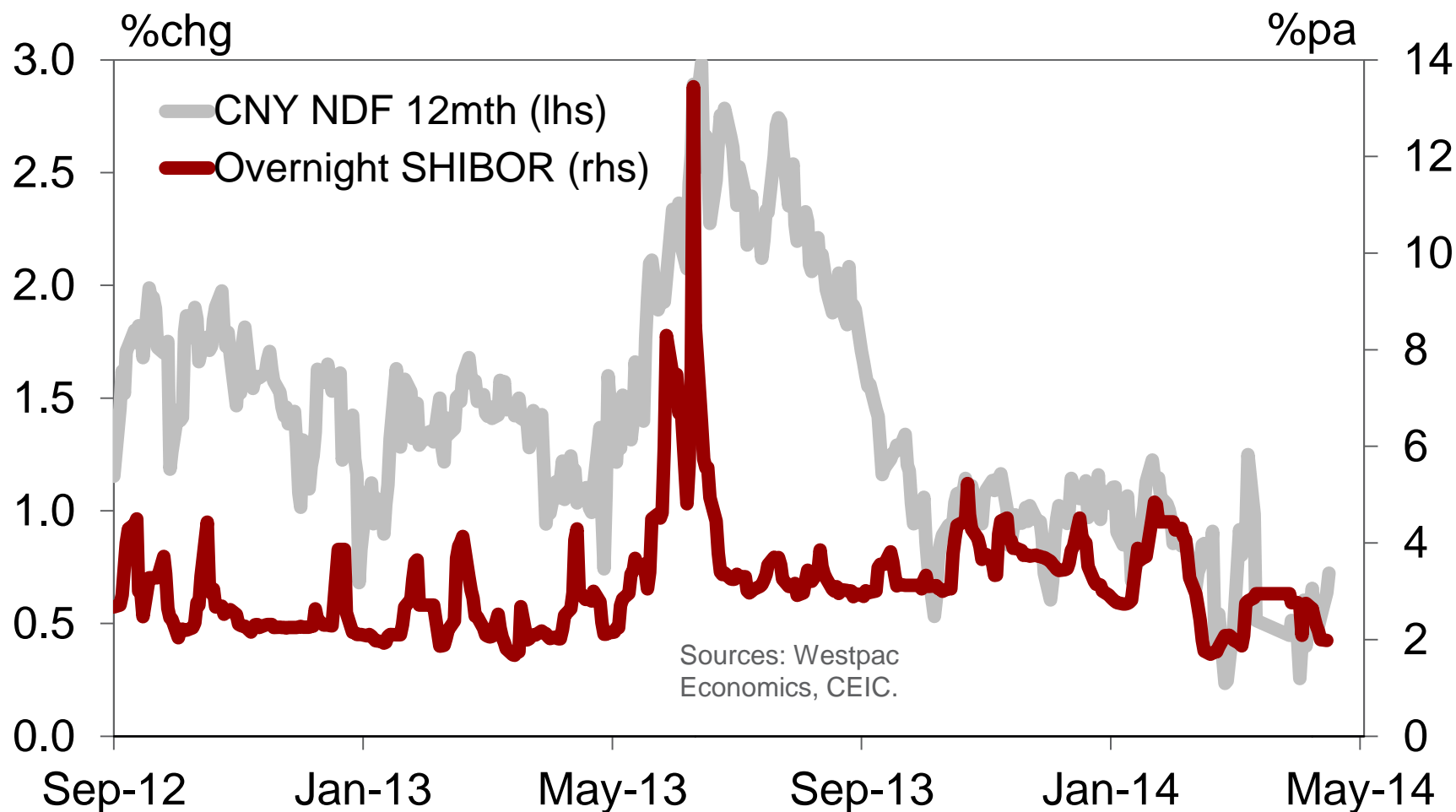
# Chinese exchange rate flexibility



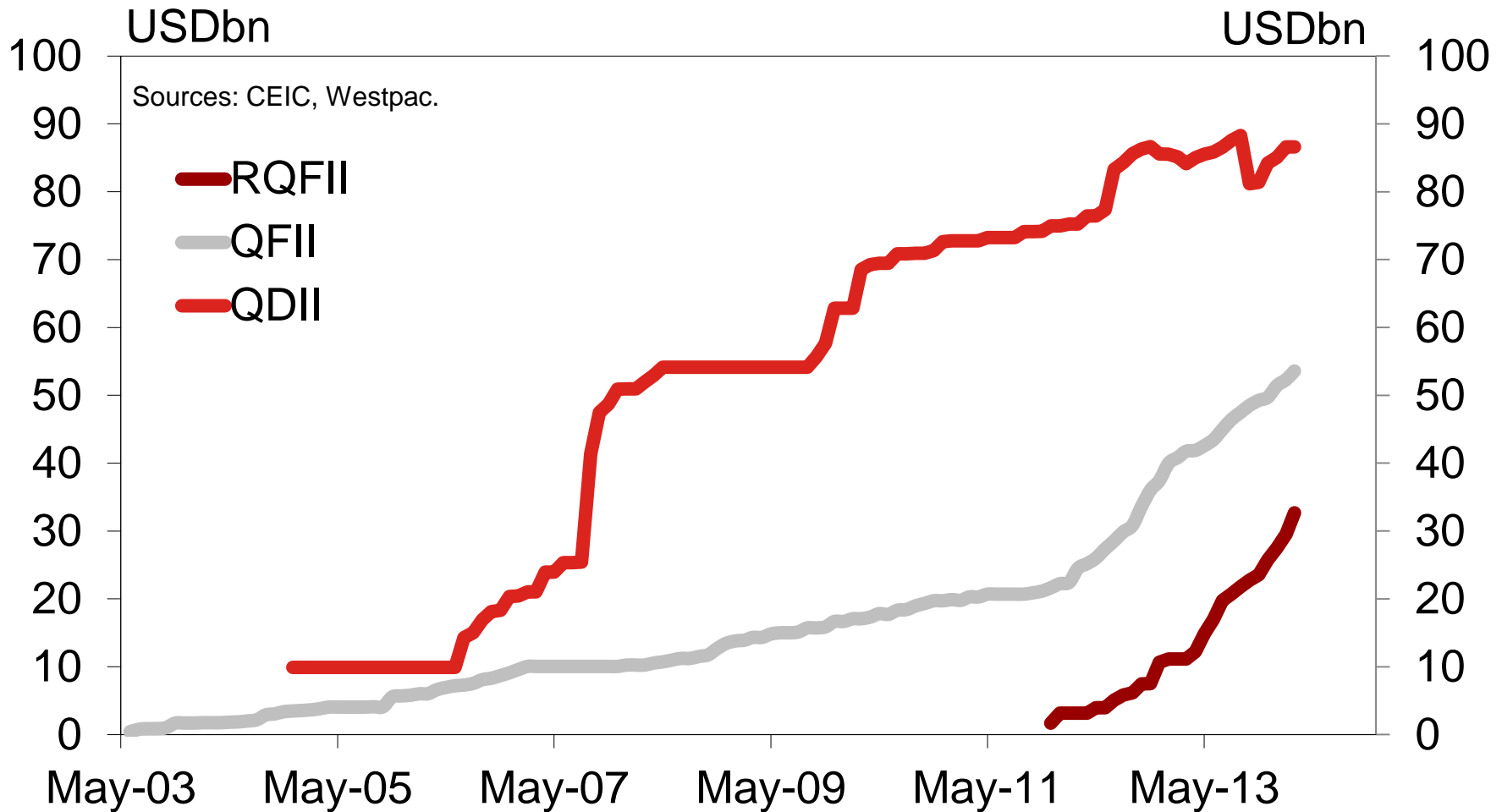
# USD/CNY NDF curves: daily since 2010



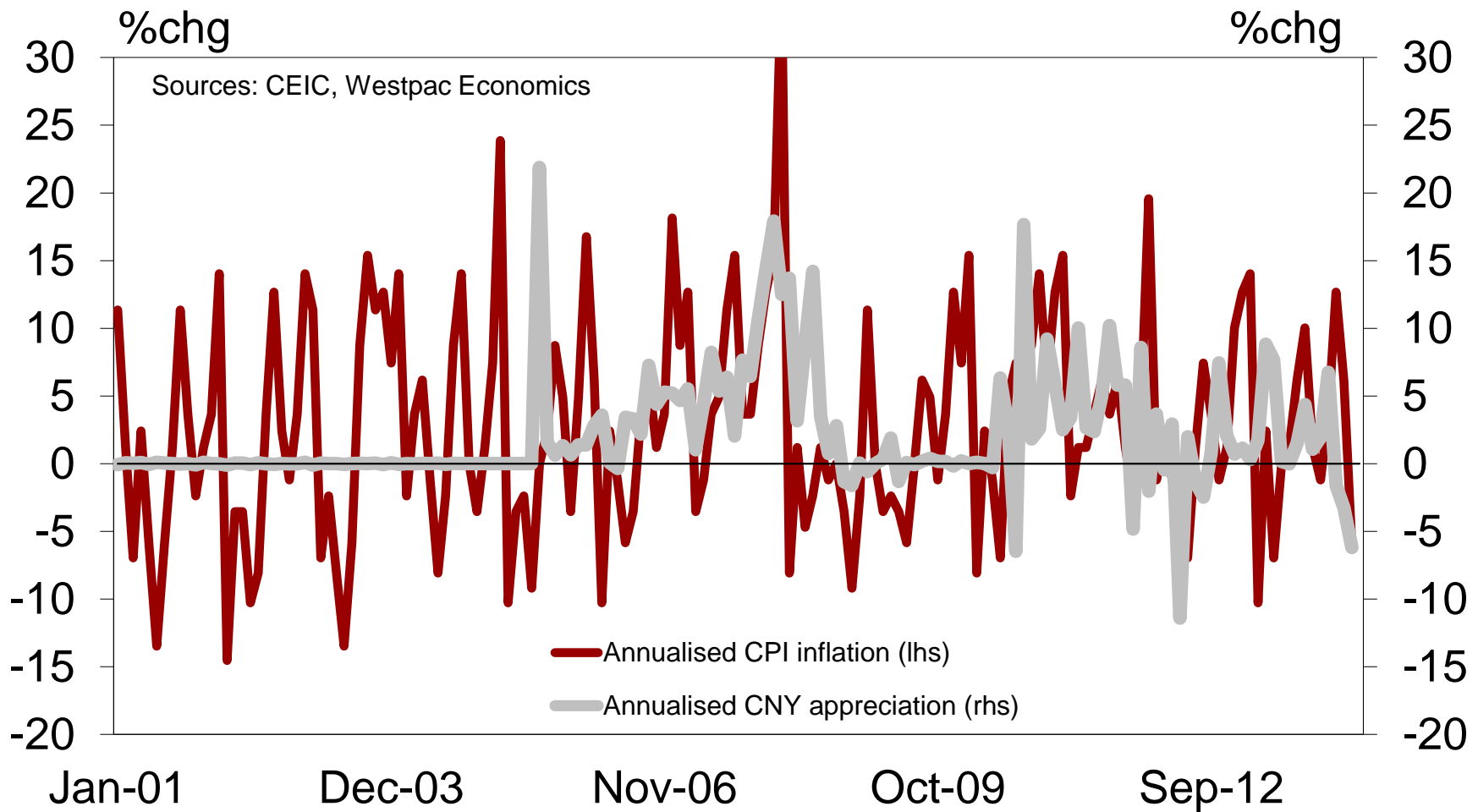
# Overnight SHIBOR & the 12mth CNY NDF



# QFII, RQFII & QDII: accumulated quotas

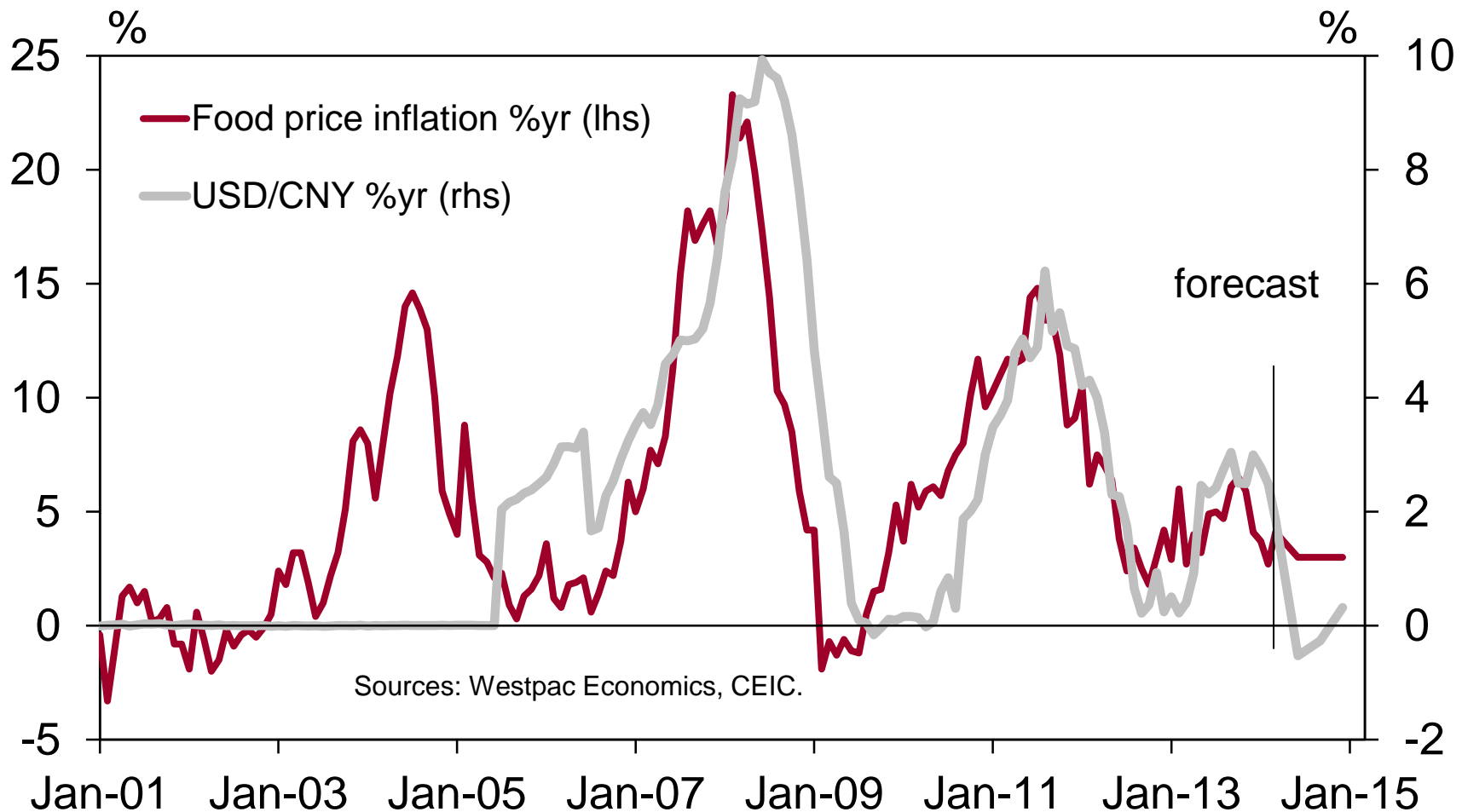


# The exchange rate & inflation

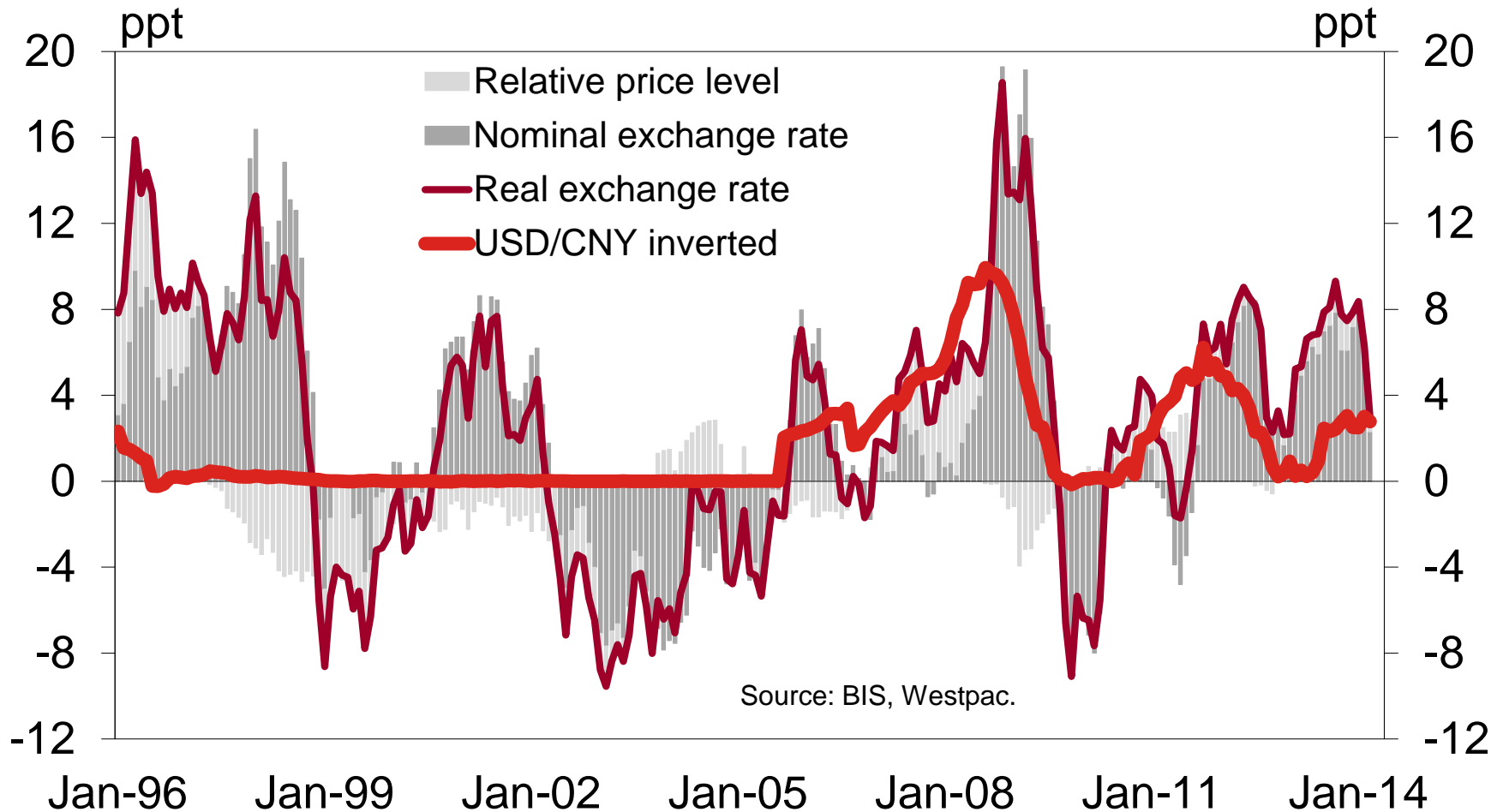




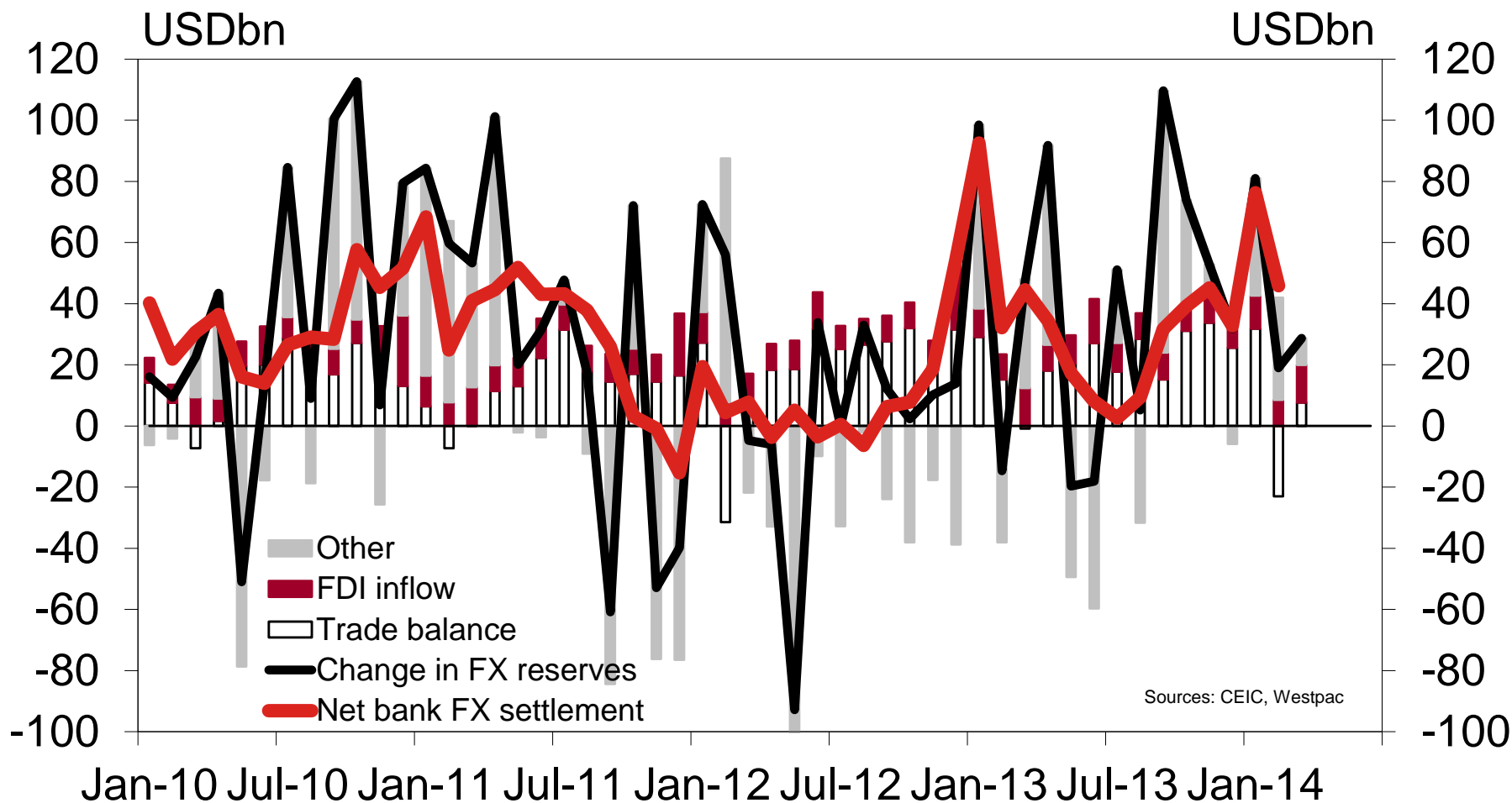
# Food prices & the CNY exchange rate



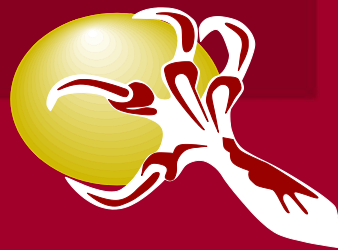
# Decomposing 12 month real CNY appreciation



# FX reserves, capital flows & bank FX positions

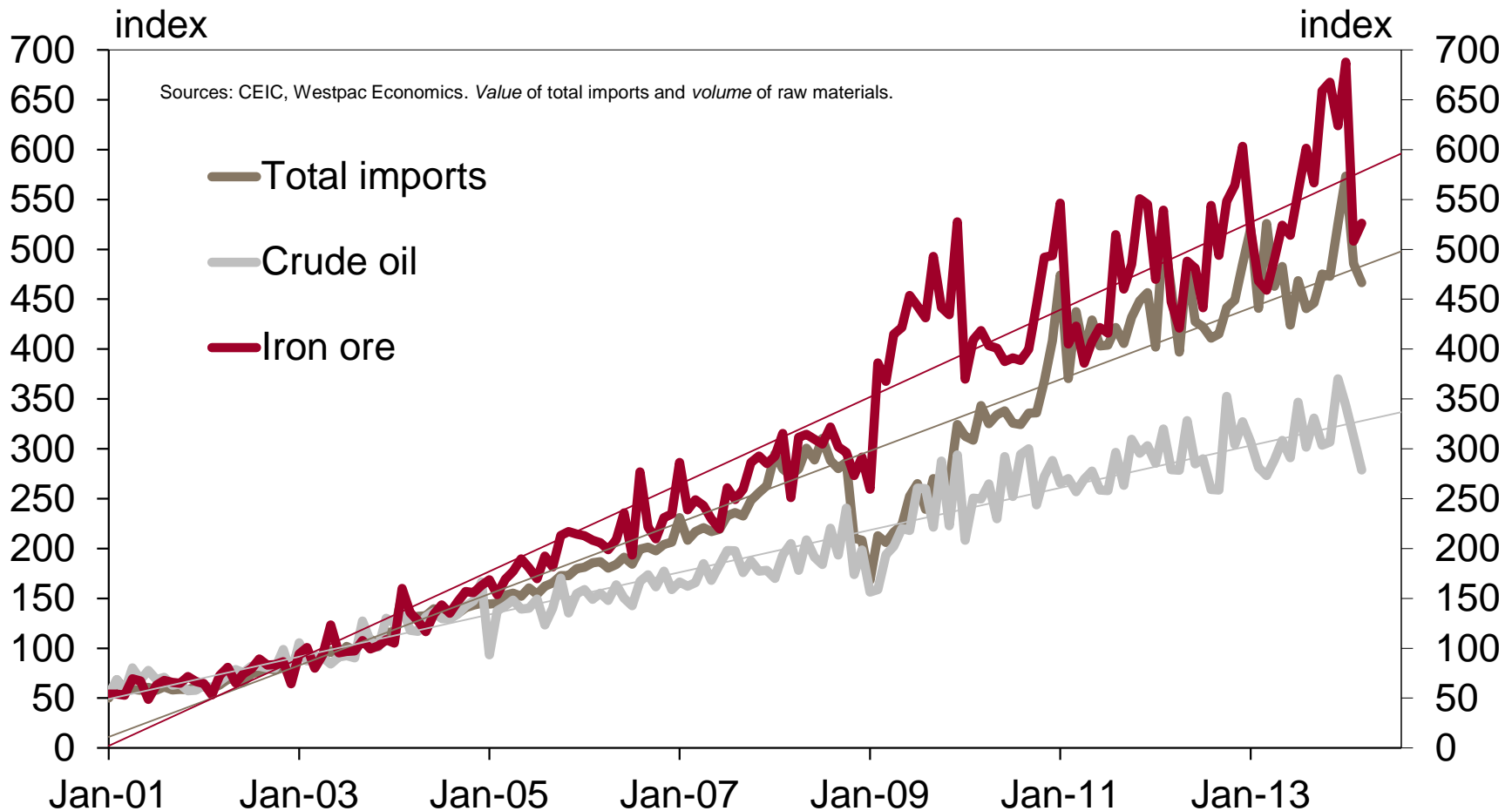


# THE EXTERNAL SECTOR

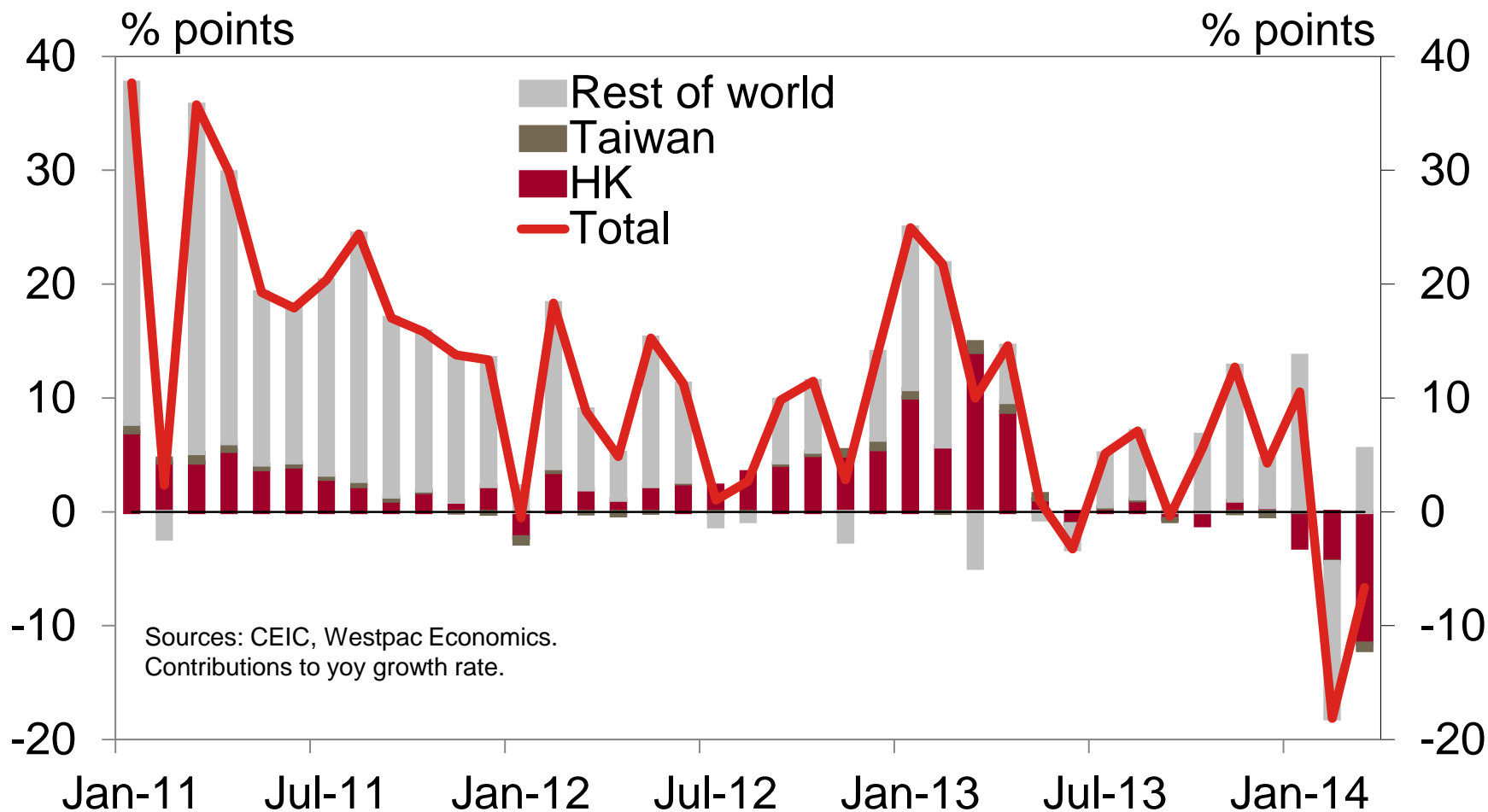


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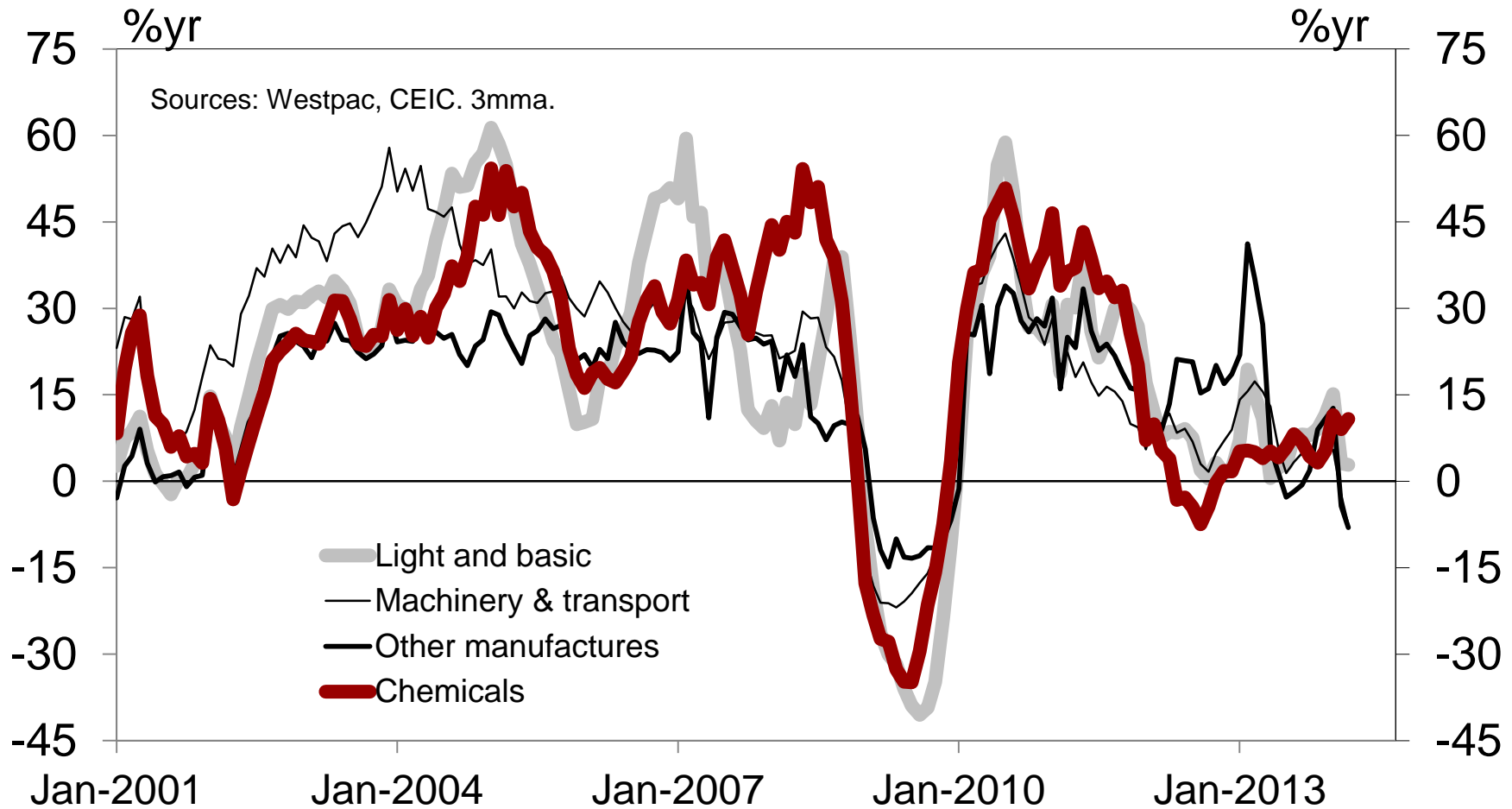
# Chinese imports – total & key raw materials



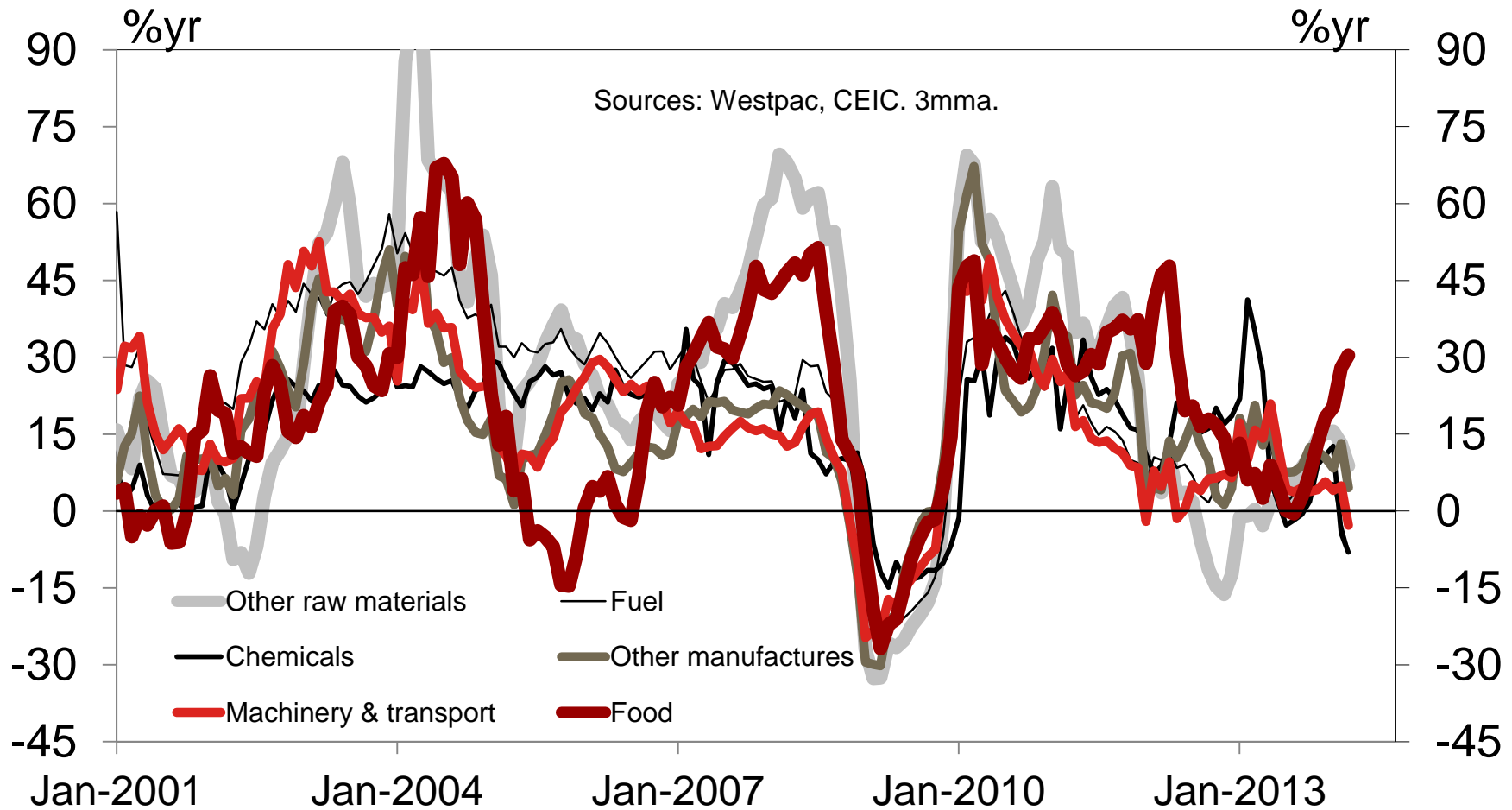
# Contributions to Chinese customs exports



# Exports by broad sector

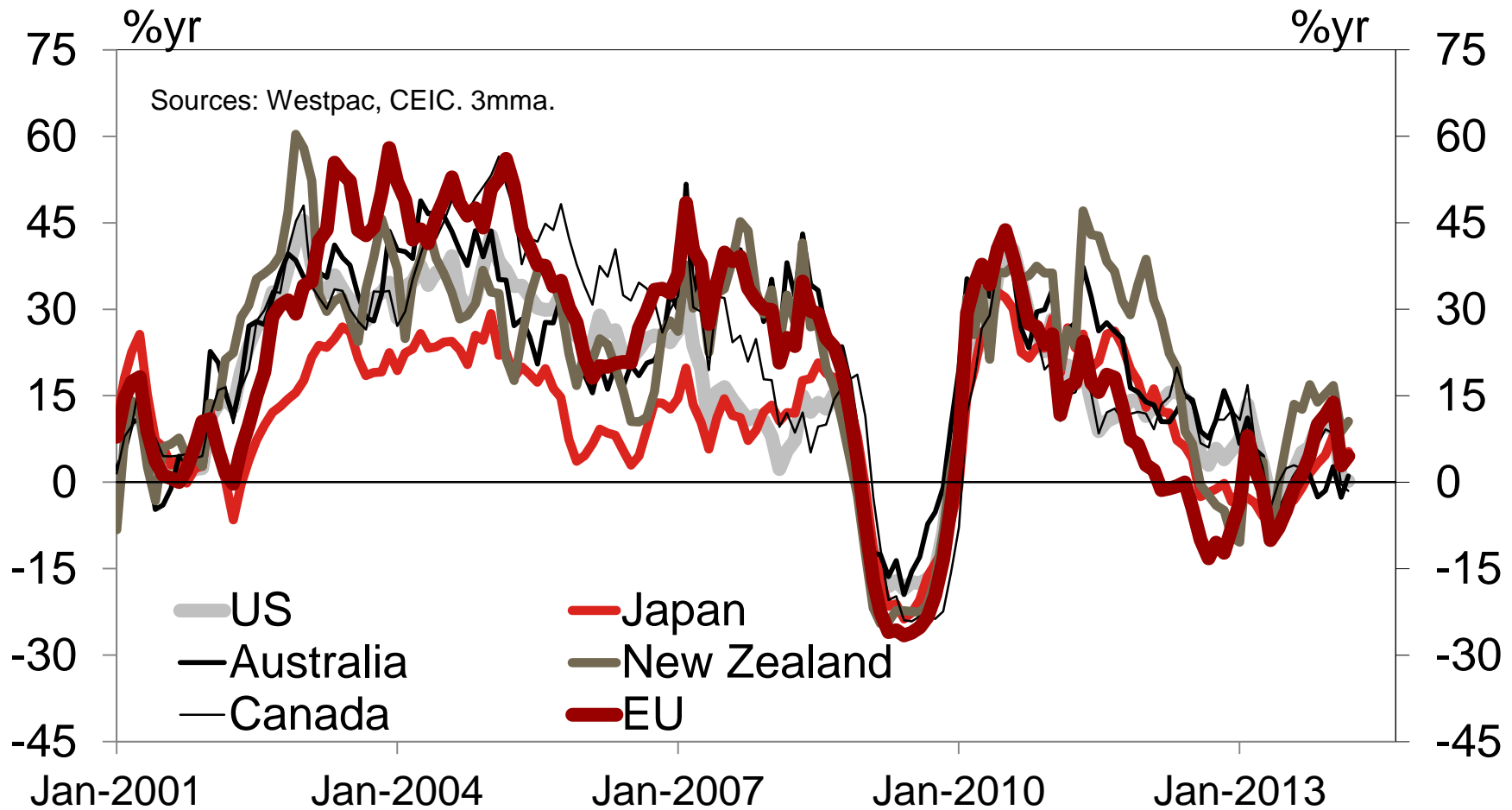


# Imports by broad sector

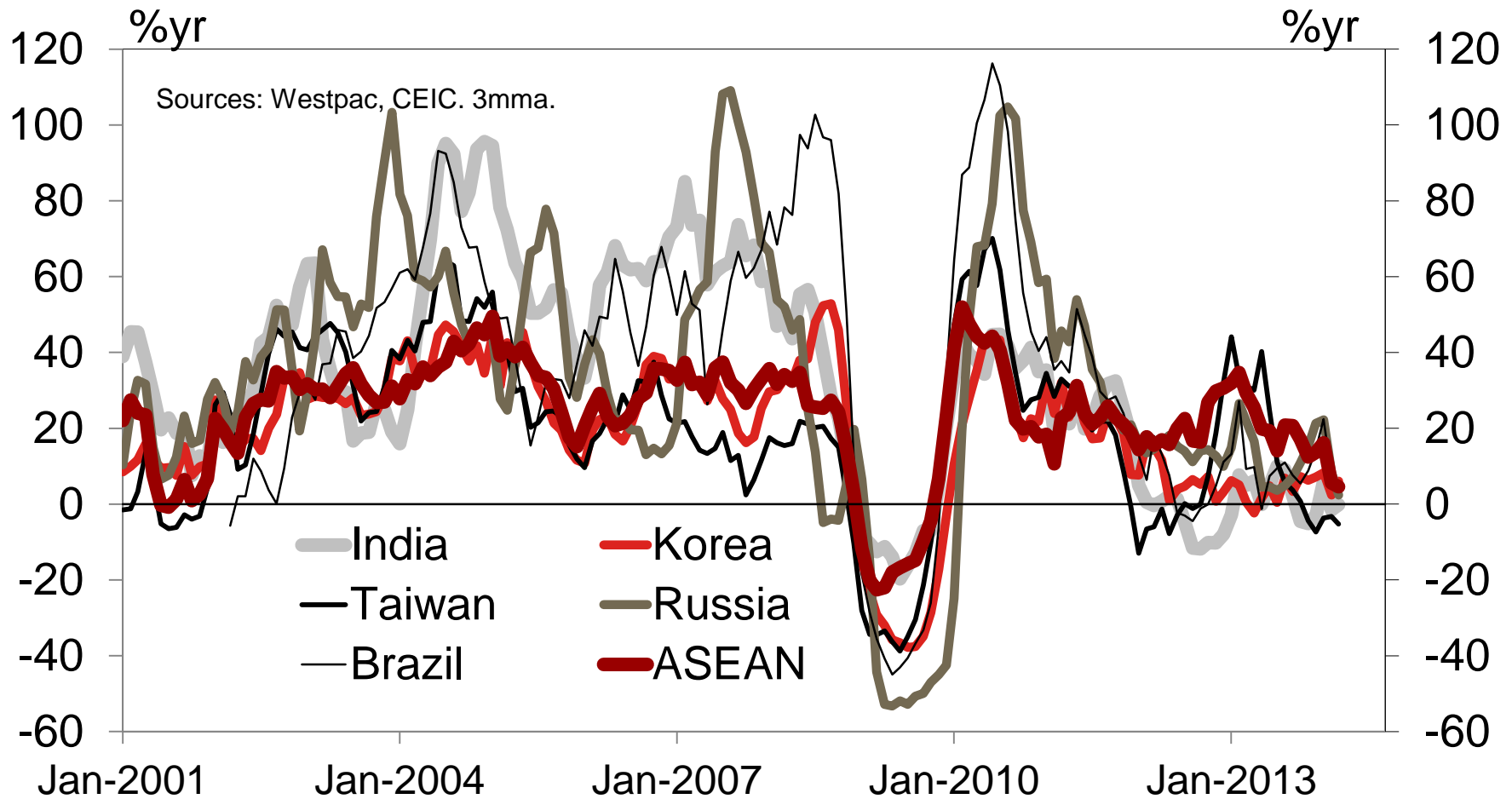




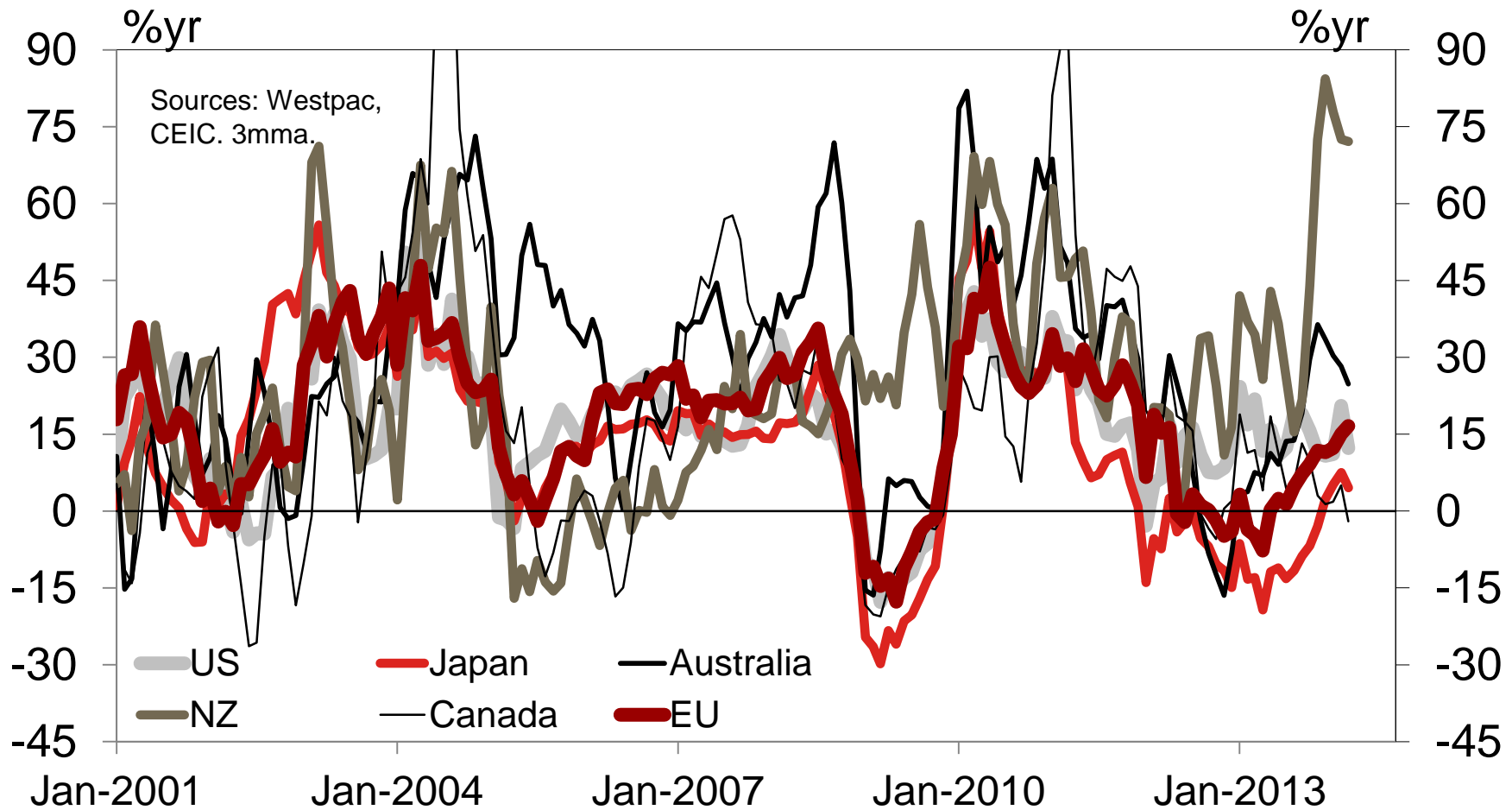
# Chinese exports to developed markets



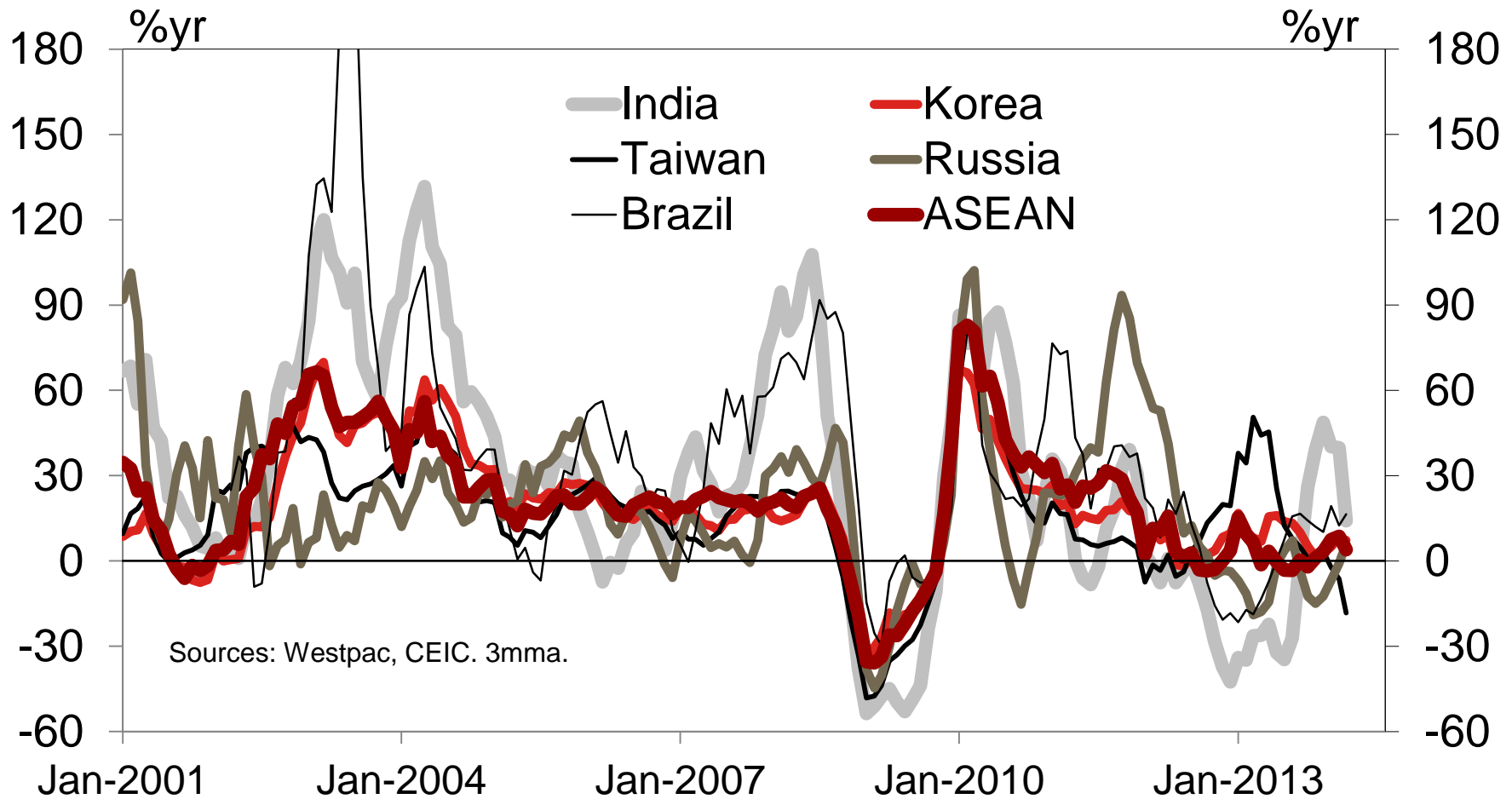
# Exports to emerging markets



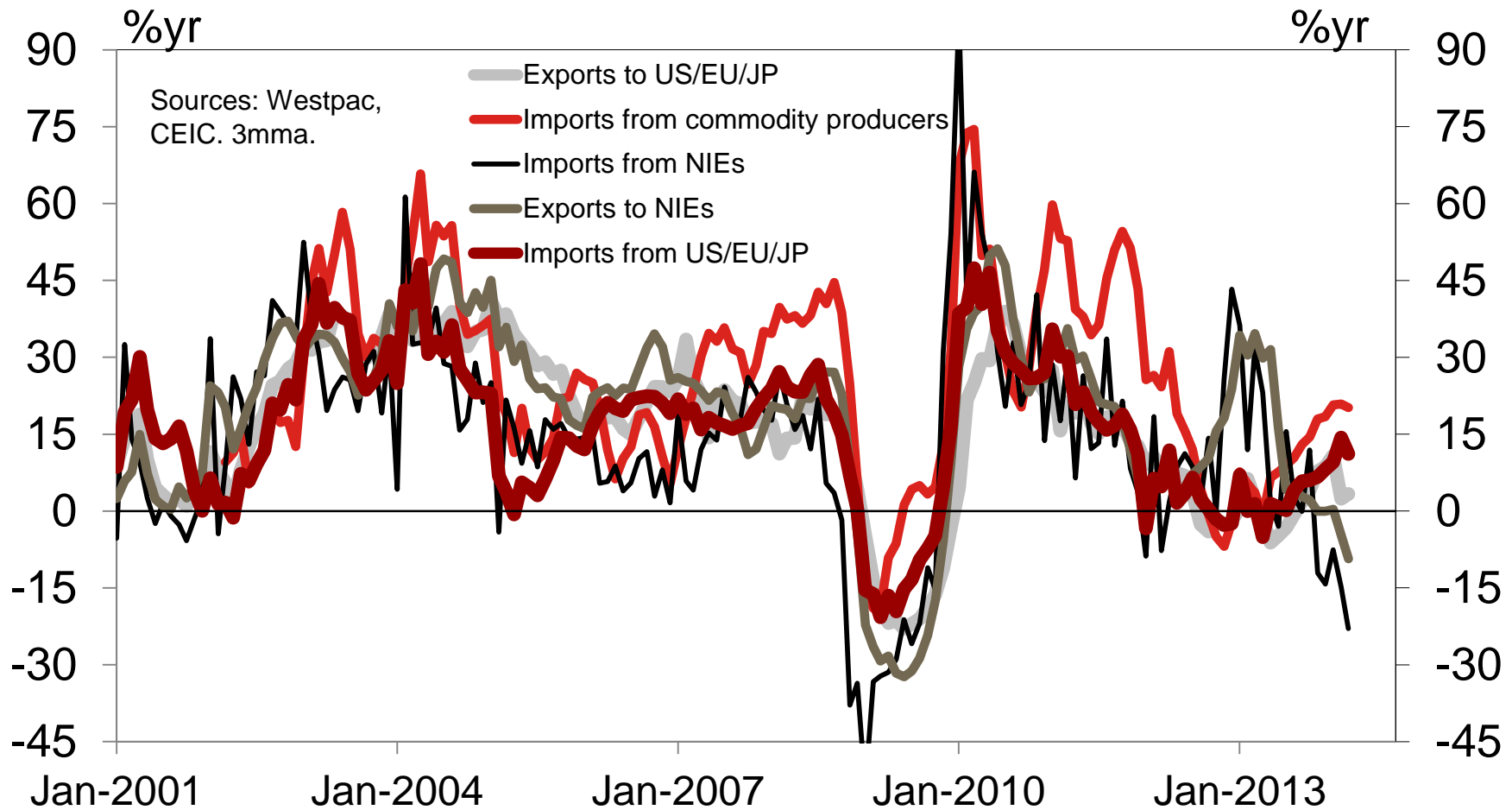
# Chinese imports from developed markets



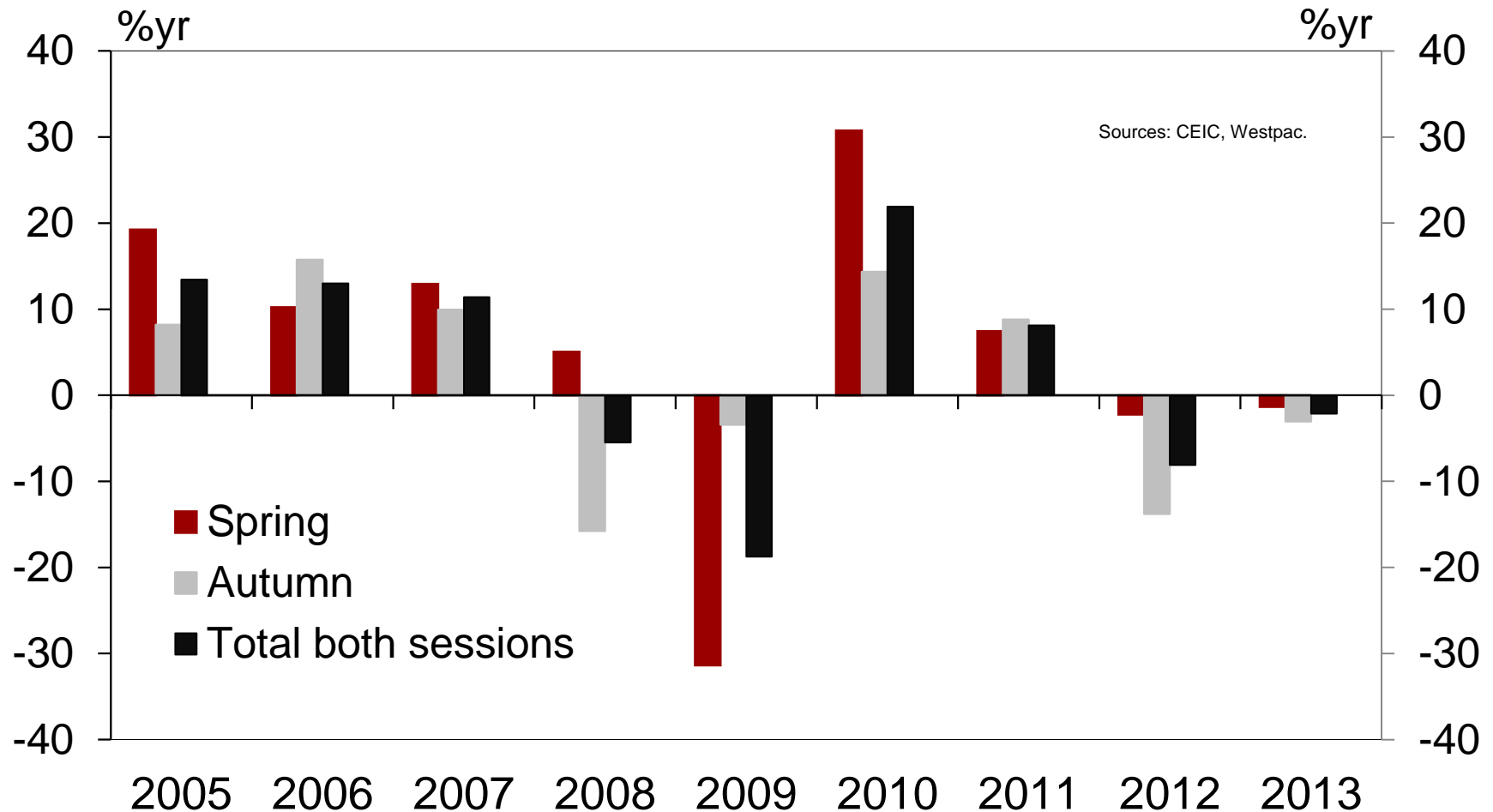
# Imports from emerging markets



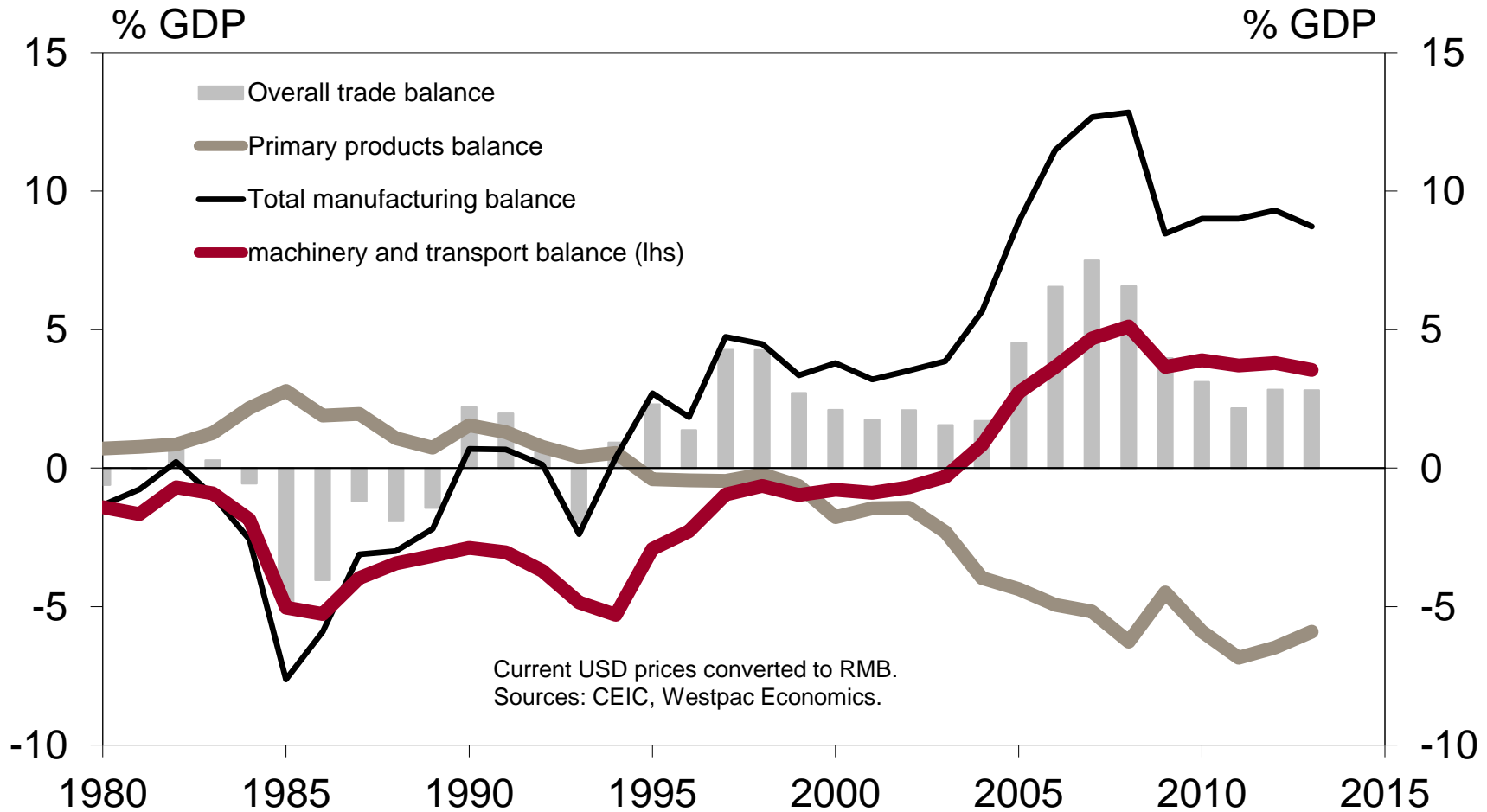
# Chinese trade: uneven outcomes



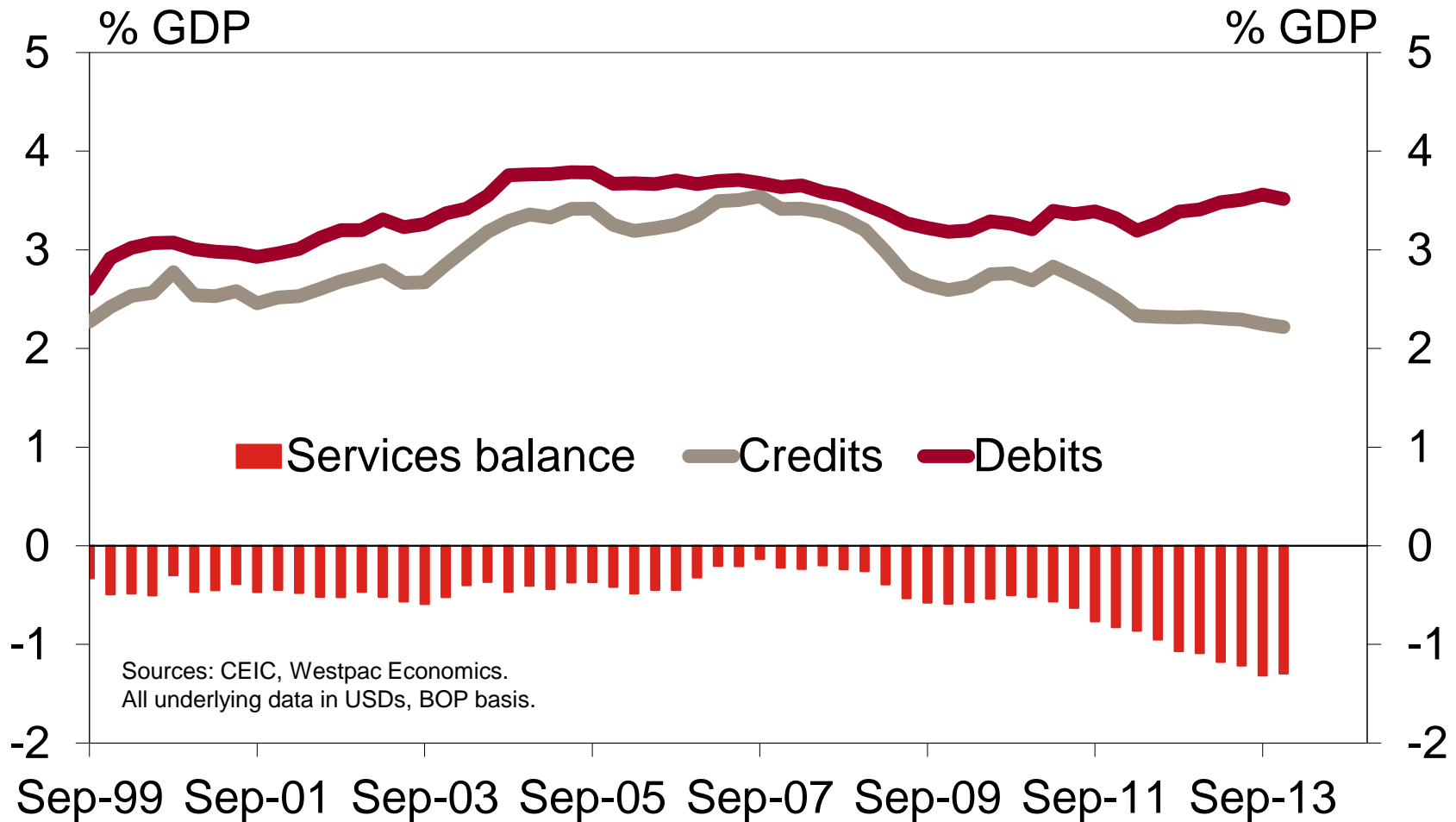
# The Canton Trade Fair: sourcing bellwether



# China's goods trade balance decomposed

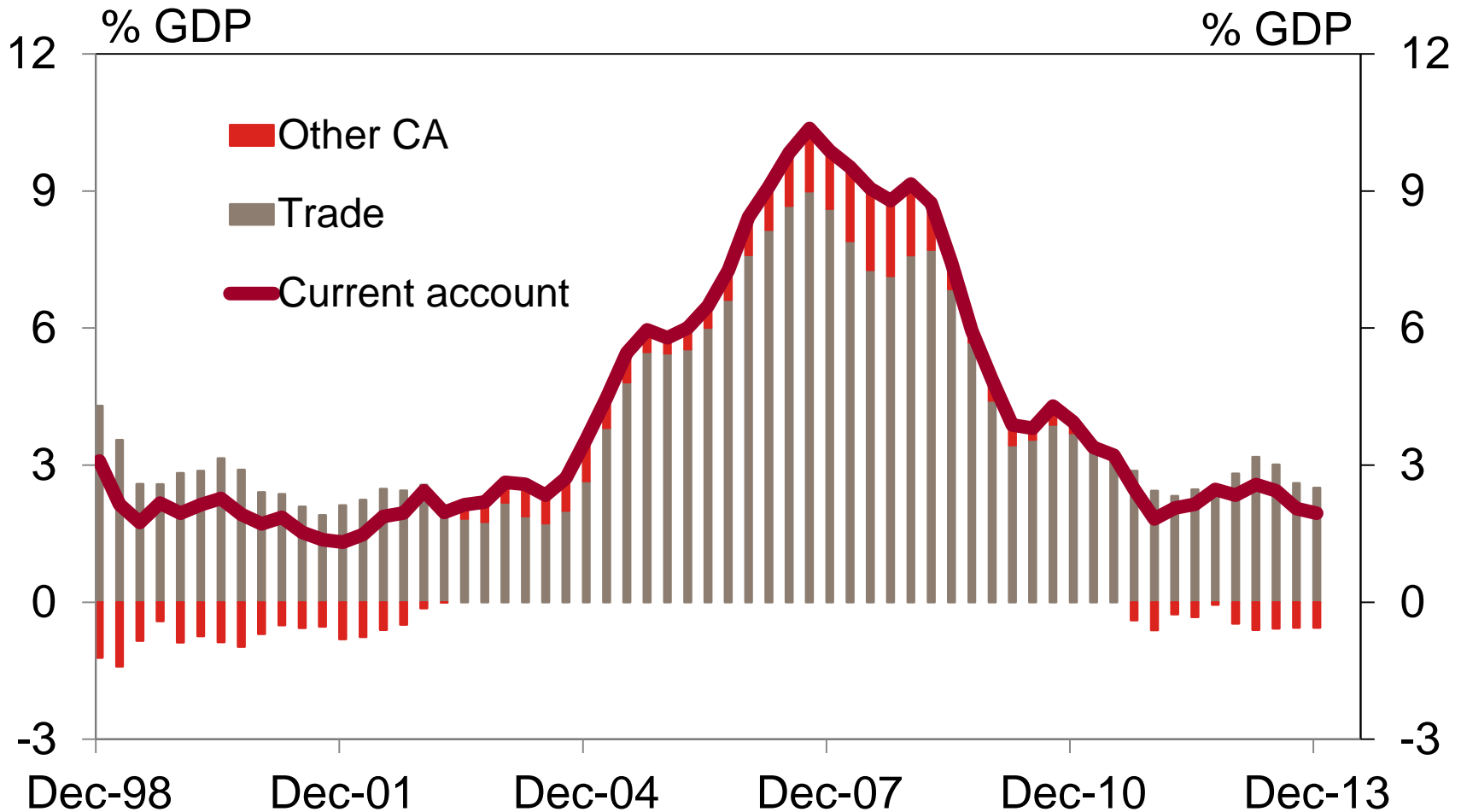


# China's trade balance in services

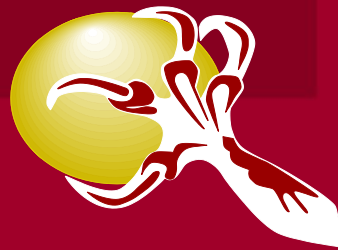




# China's current account balance

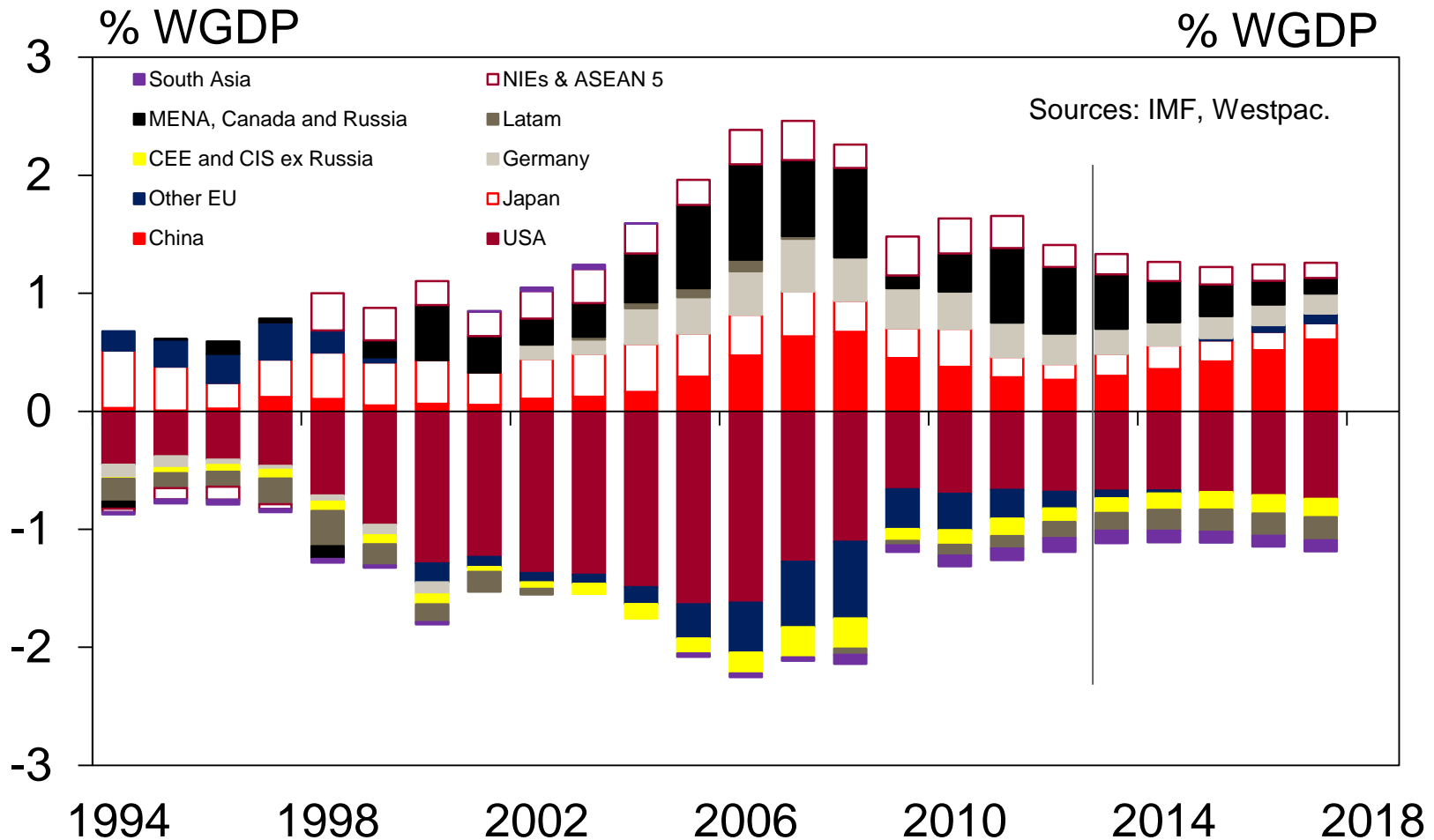


# SELECTED BIG PICTURE ISSUES

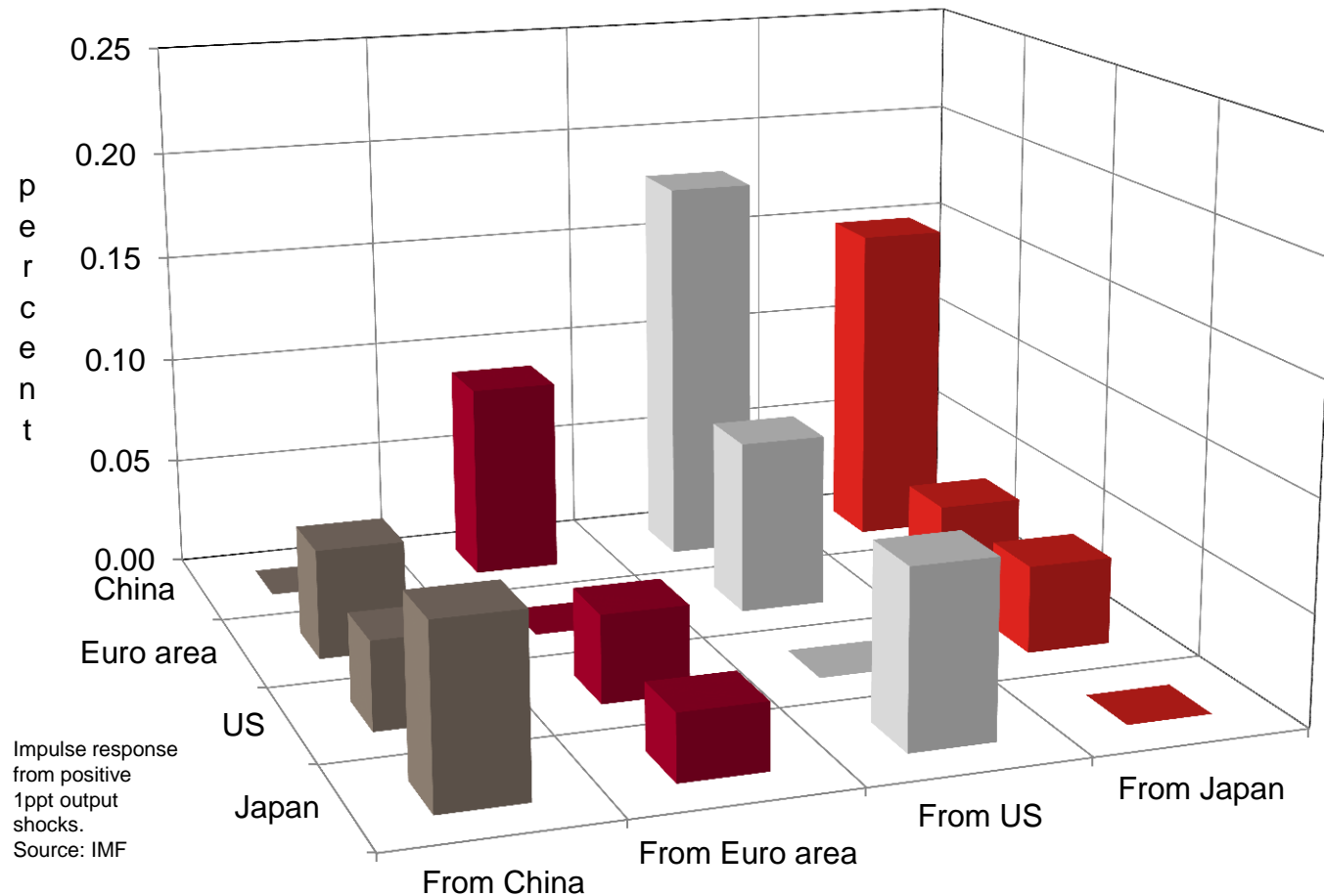


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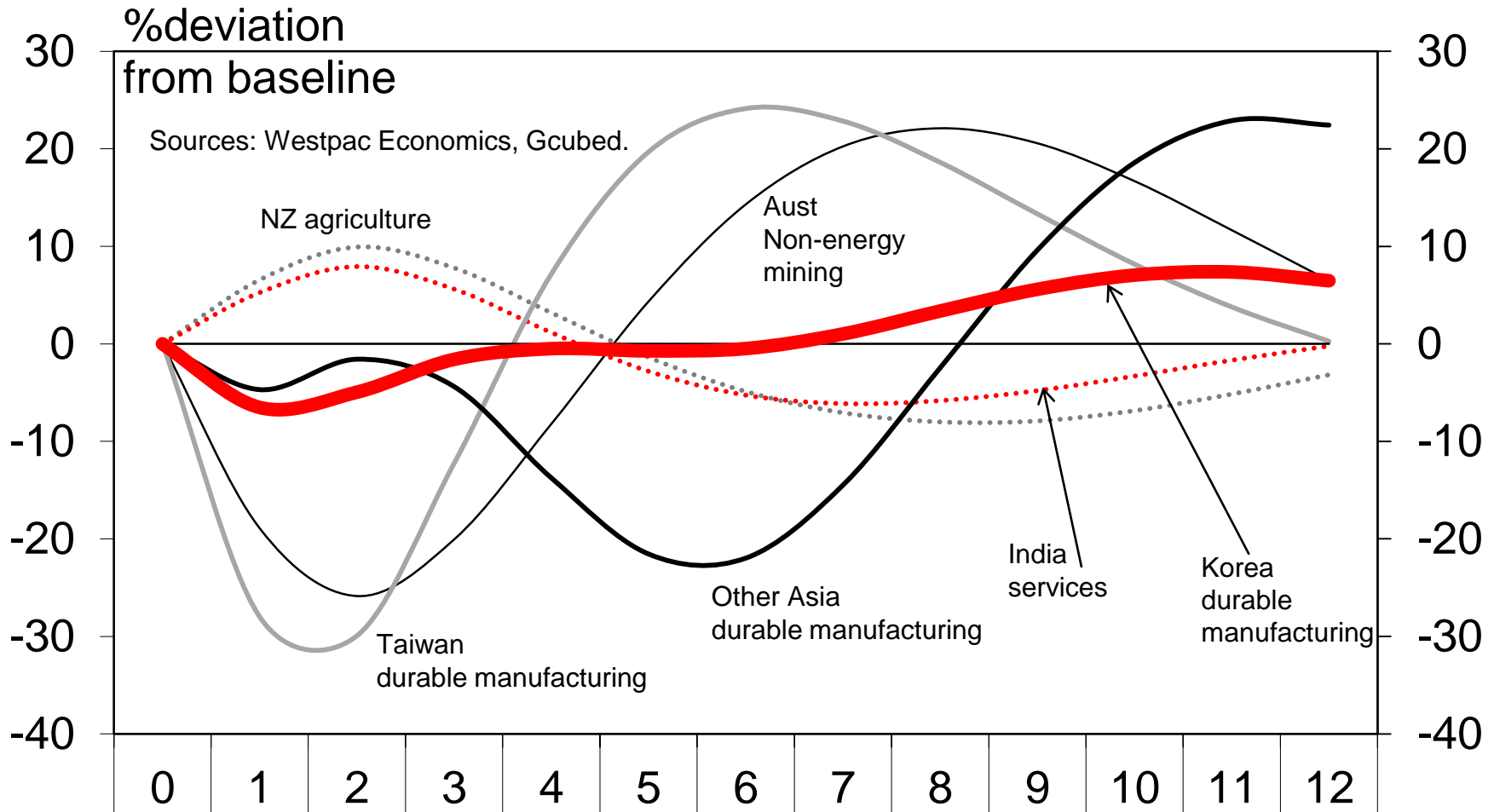
# The state of global imbalances



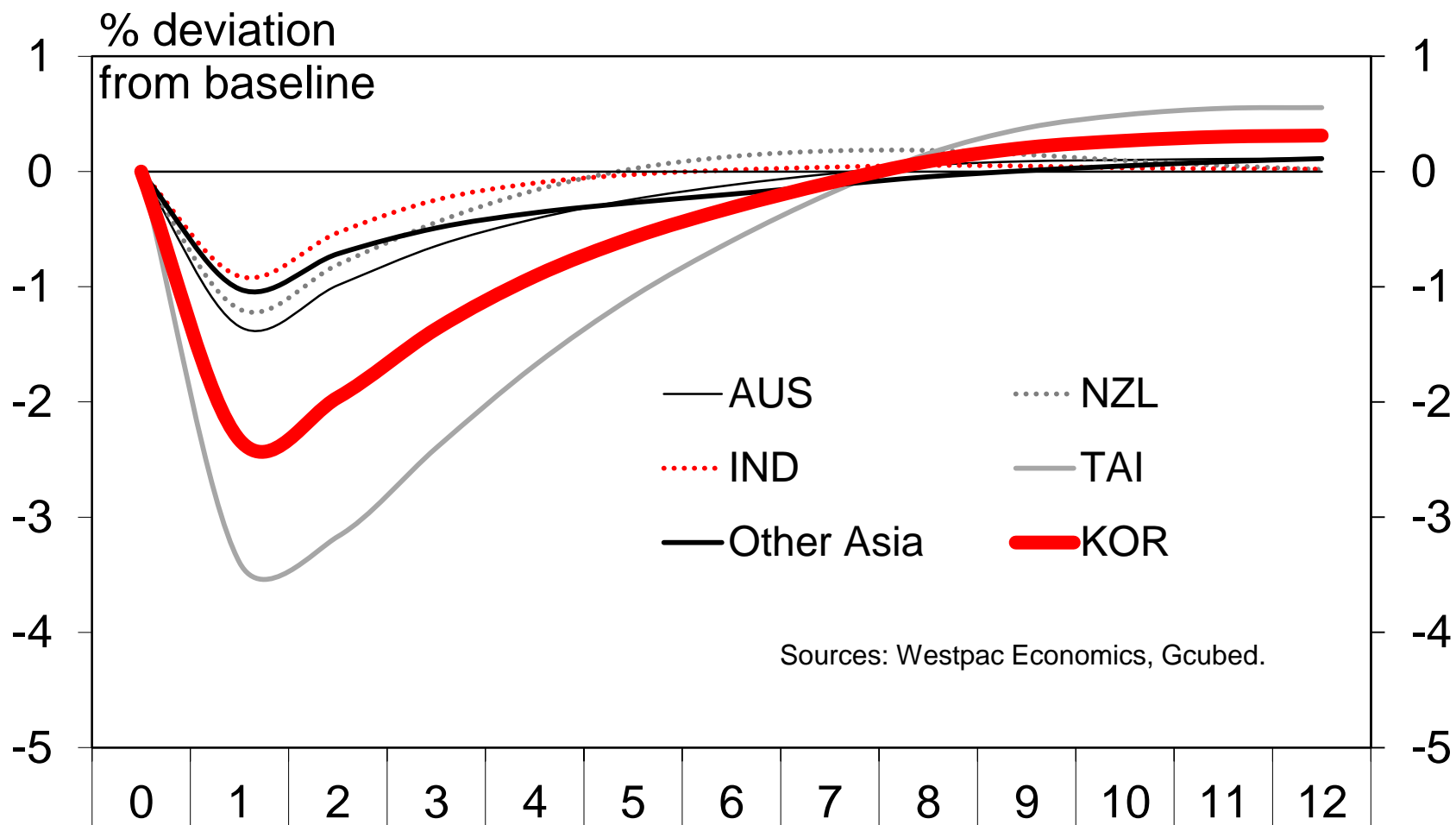
# Growth spillovers between systemic economies



# Investment in a China crunch scenario

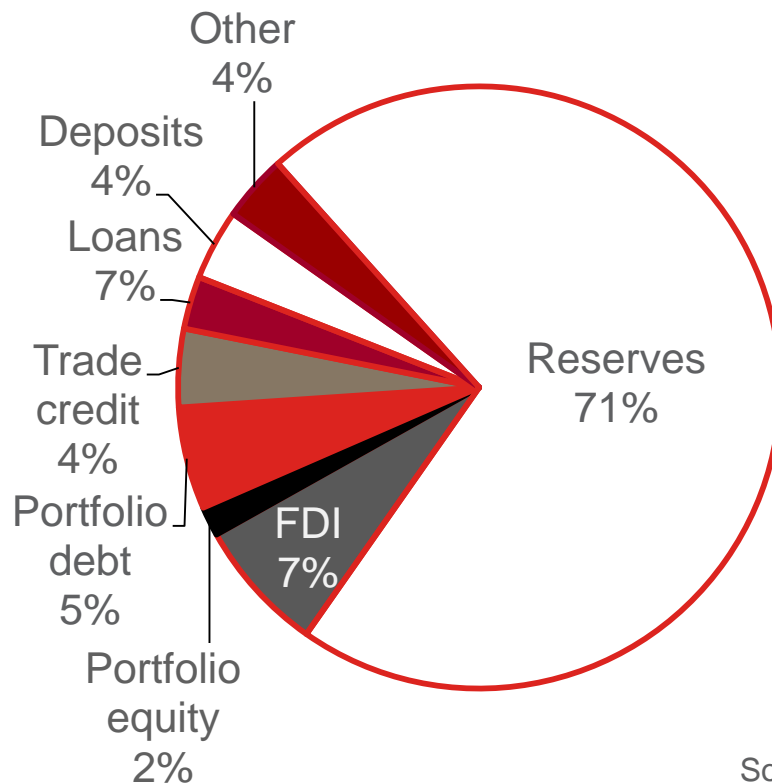


## 2 year interest rates on China crunch scenario

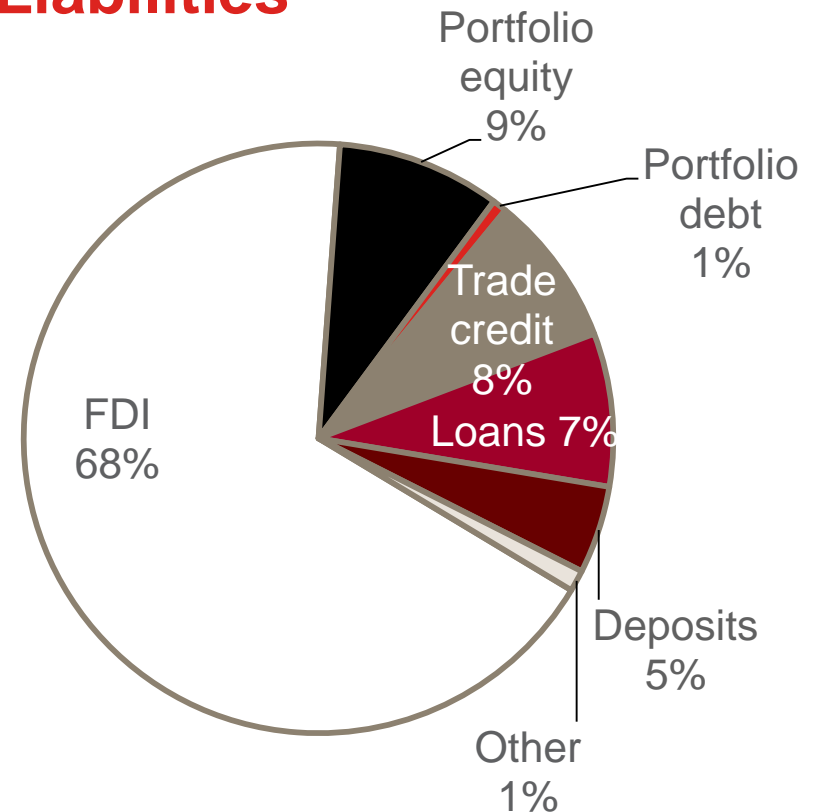


# China's IIP assets & liabilities: 2009

## Assets

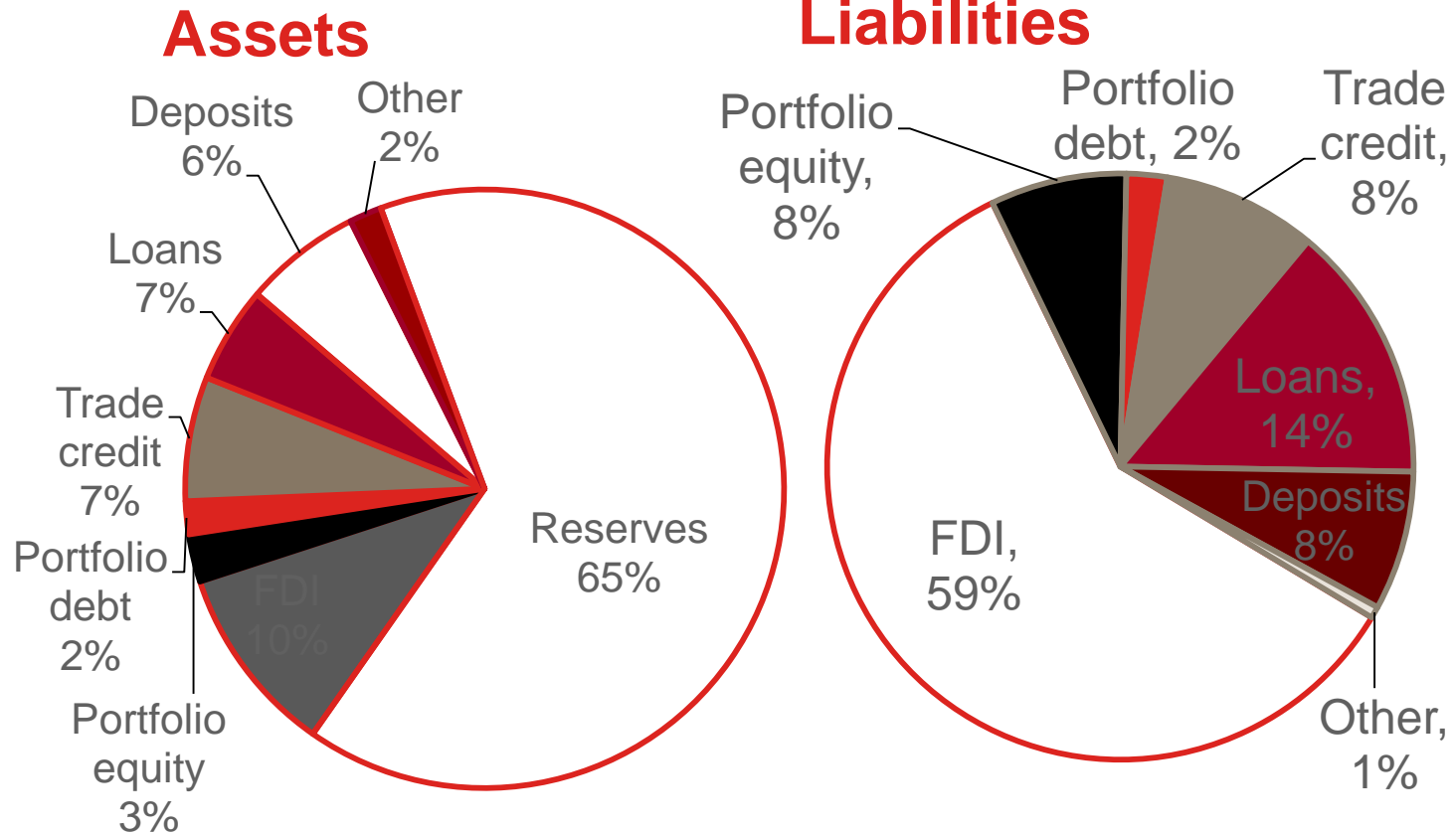


## Liabilities



Sources: CEIC, Westpac Economics

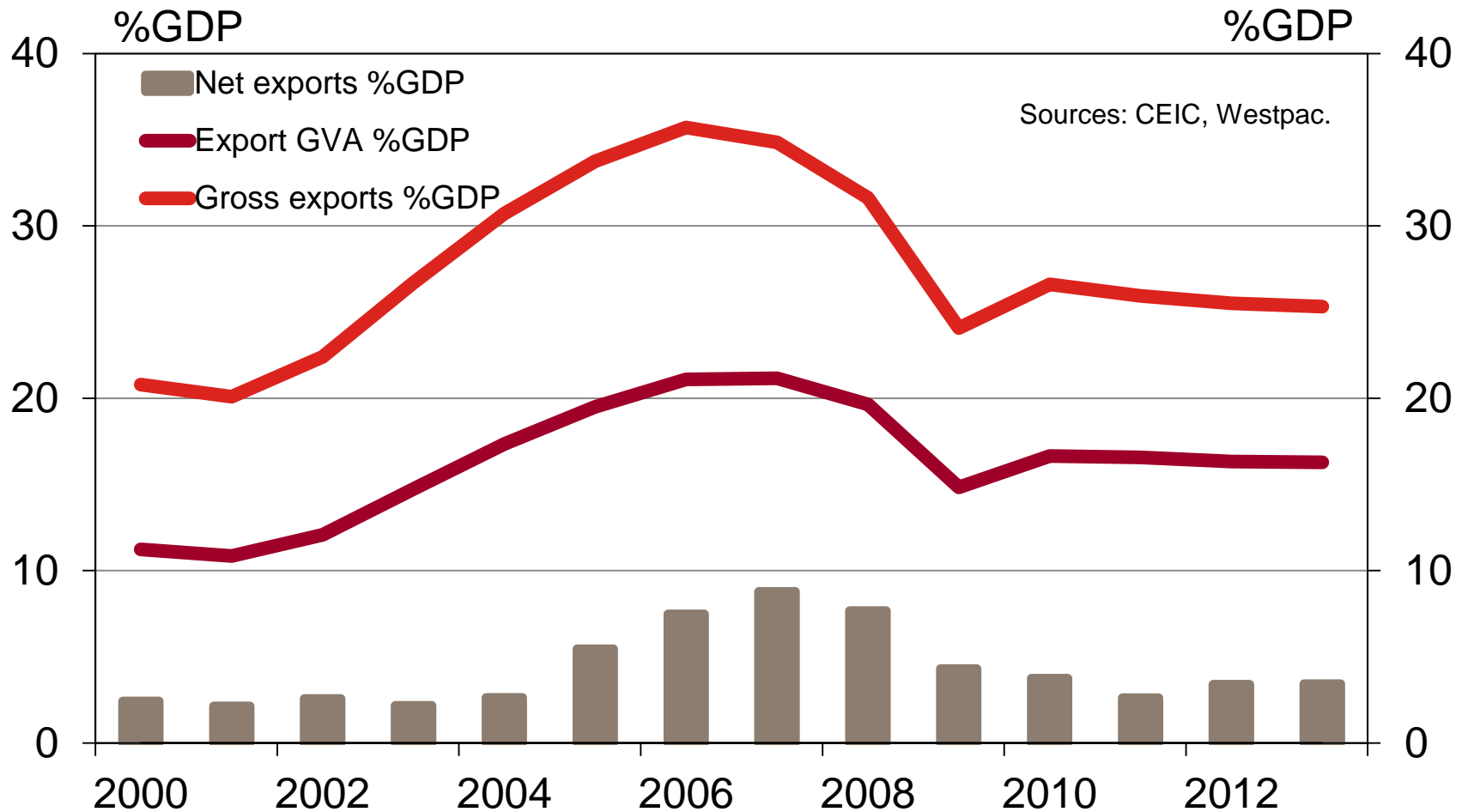
# China's IIP assets & liabilities: 2013



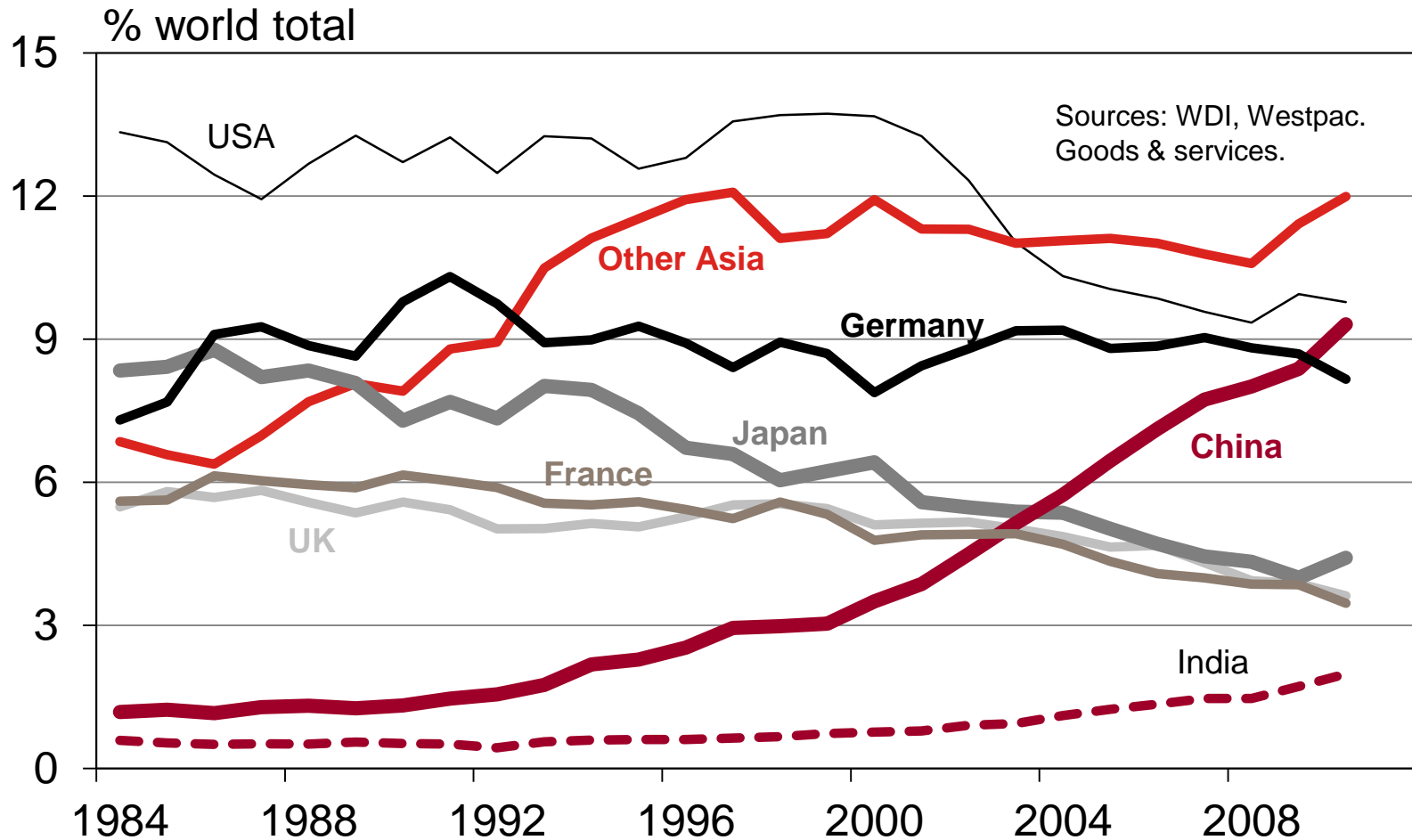
Sources: CEIC, Westpac Economics



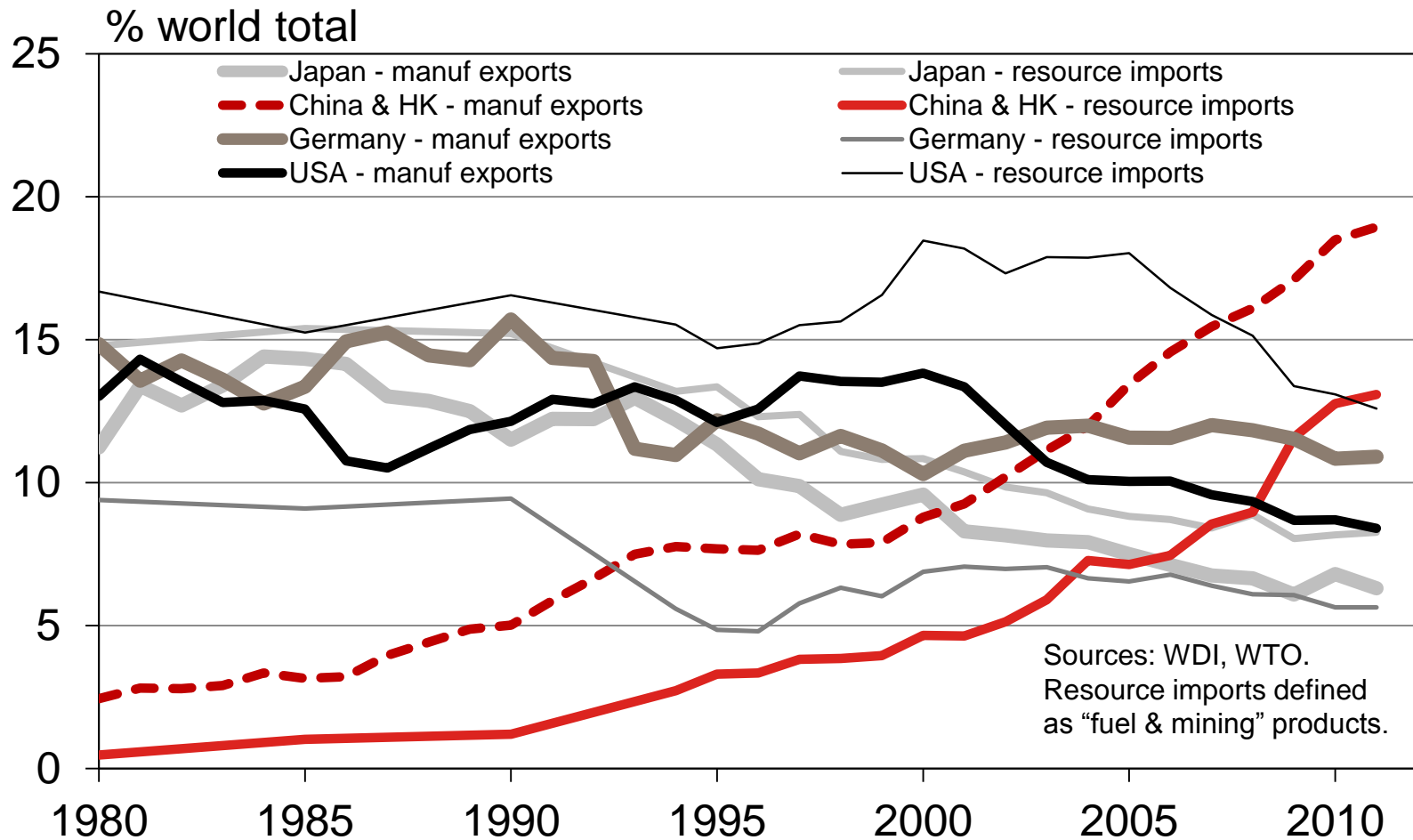
# Various measures of Chinese export 'leverage'



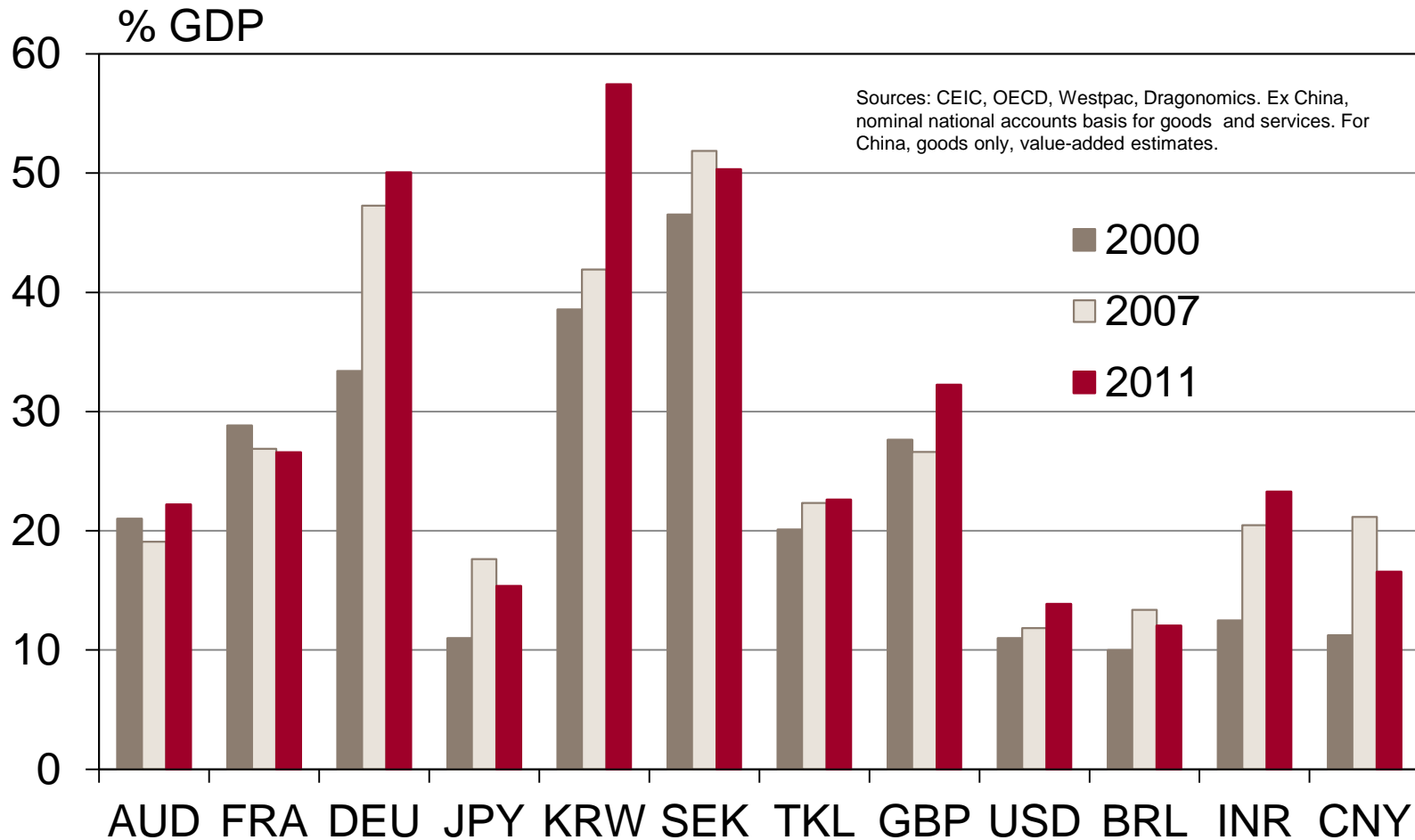
# World export shares by country & region



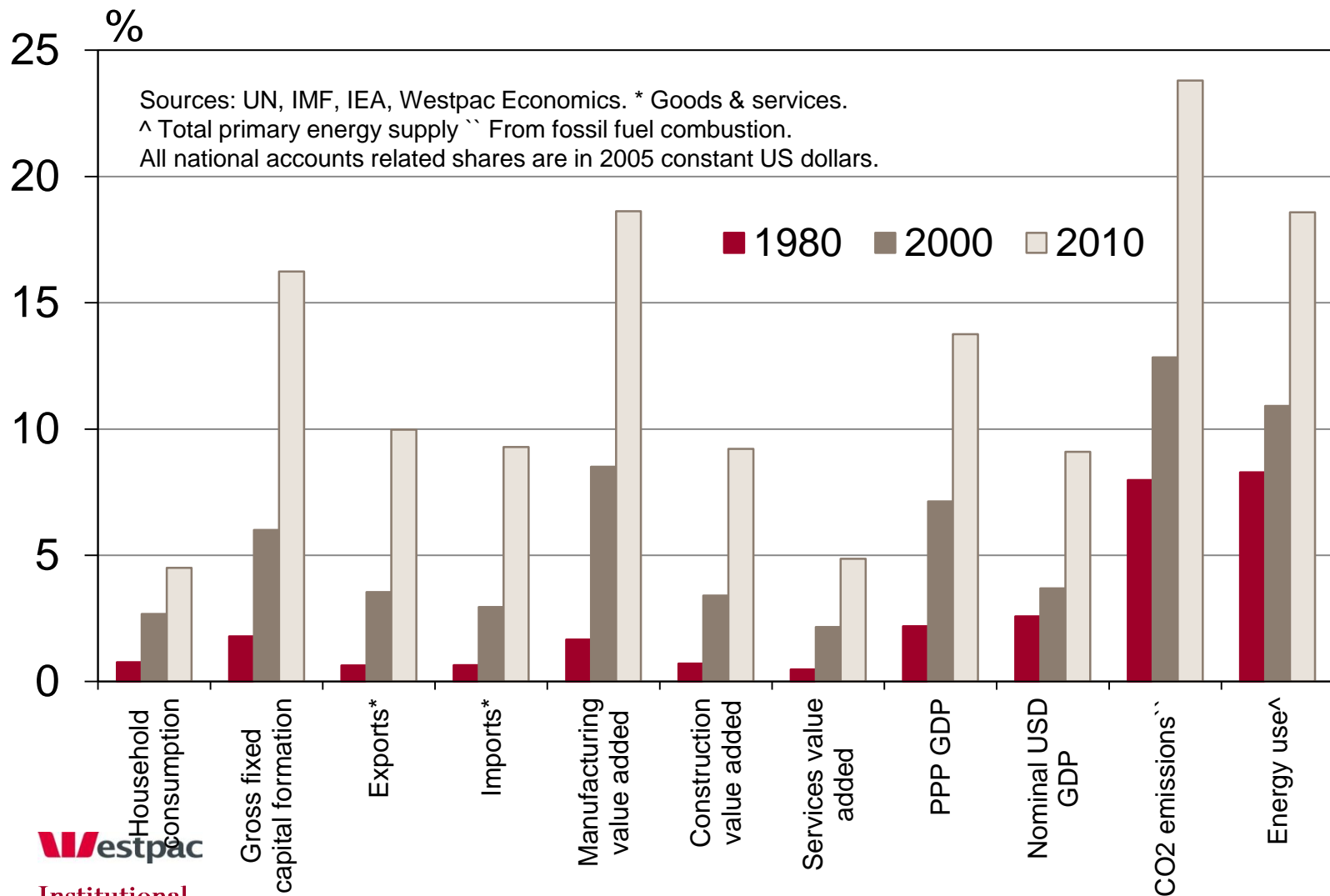
# Manufacturing exports and resource imports



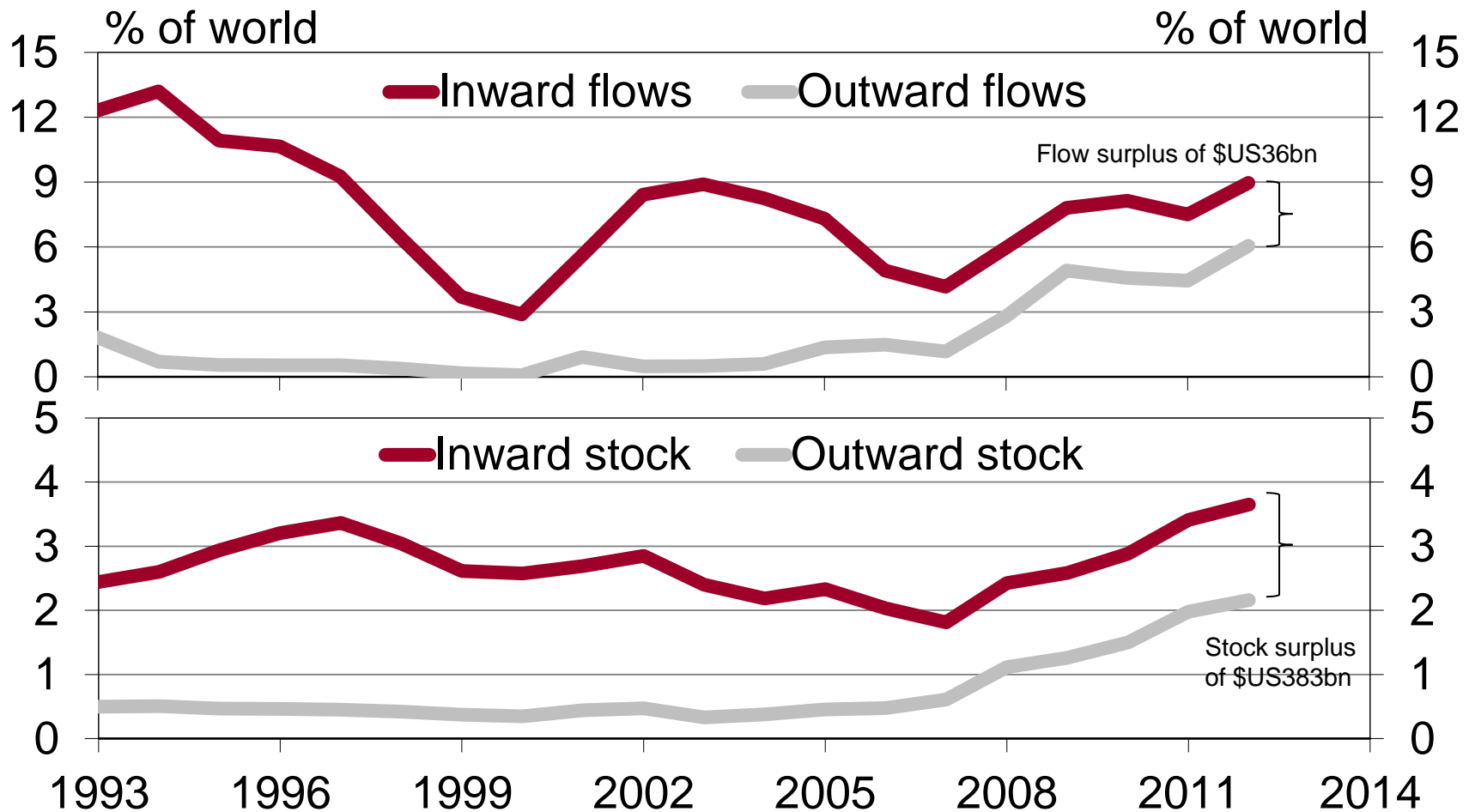
# Nominal export shares: major countries



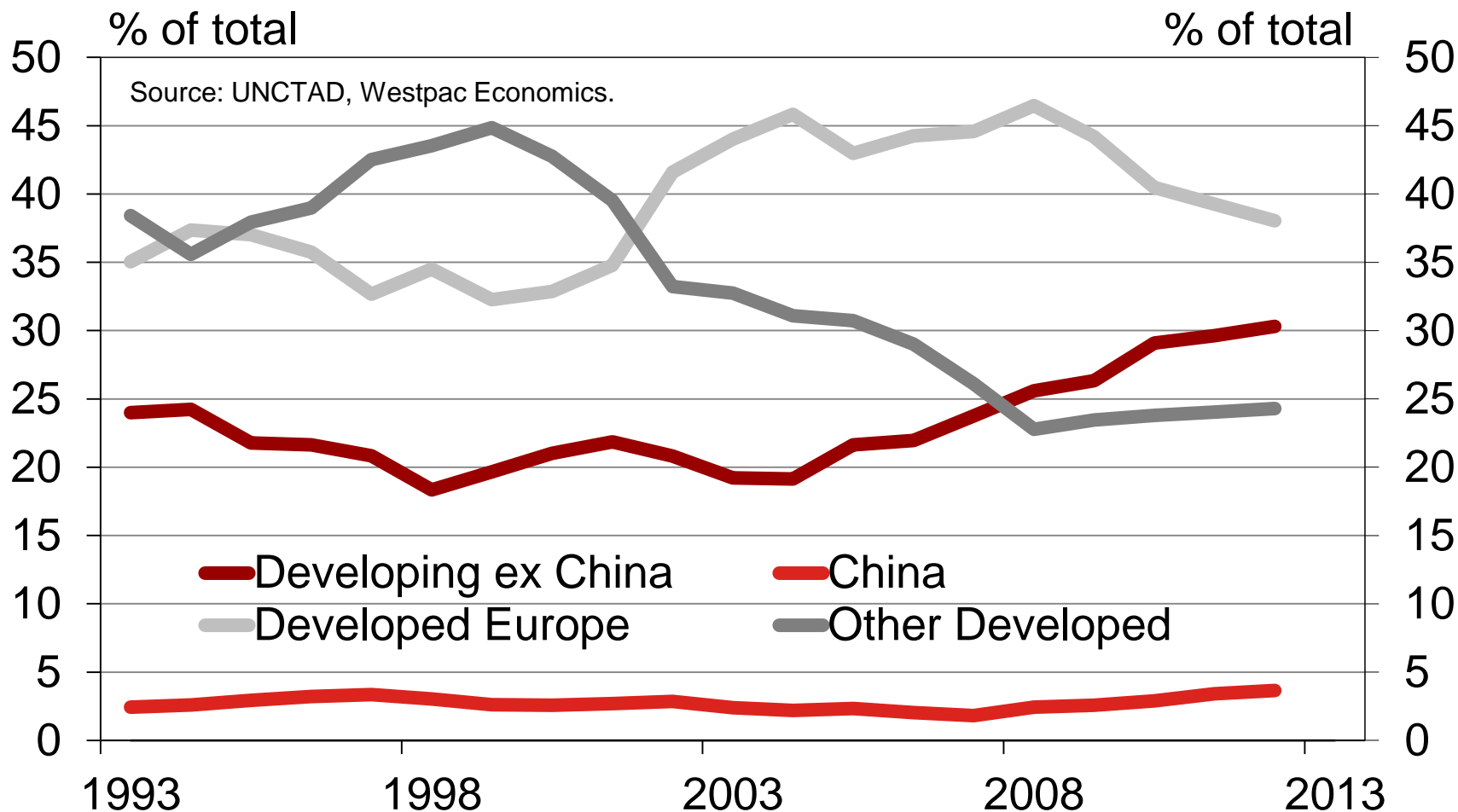
# China's share: selected elements of world activity



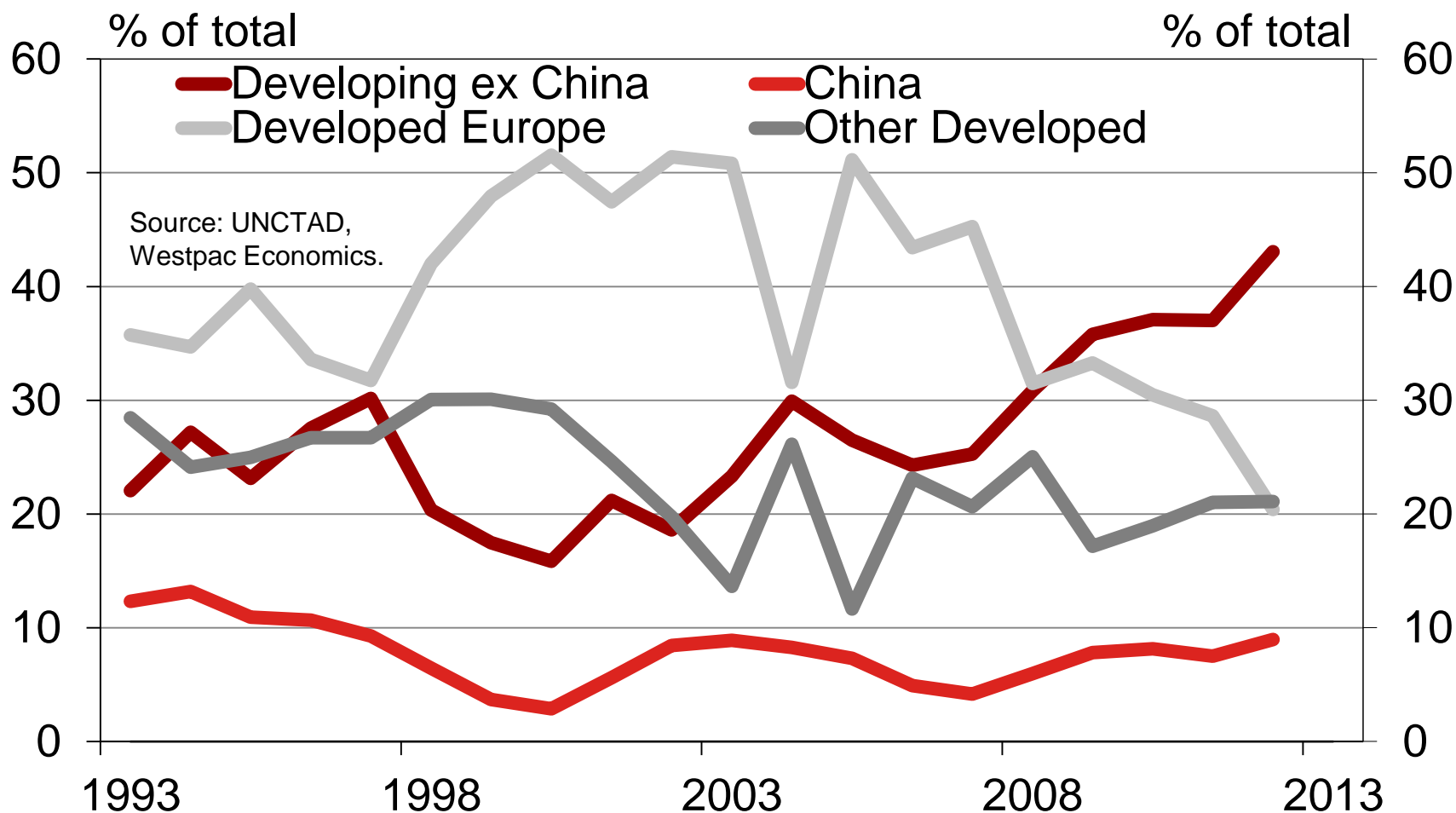
# China's share of global FDI flows & stocks



# Shares of the global inward FDI stock

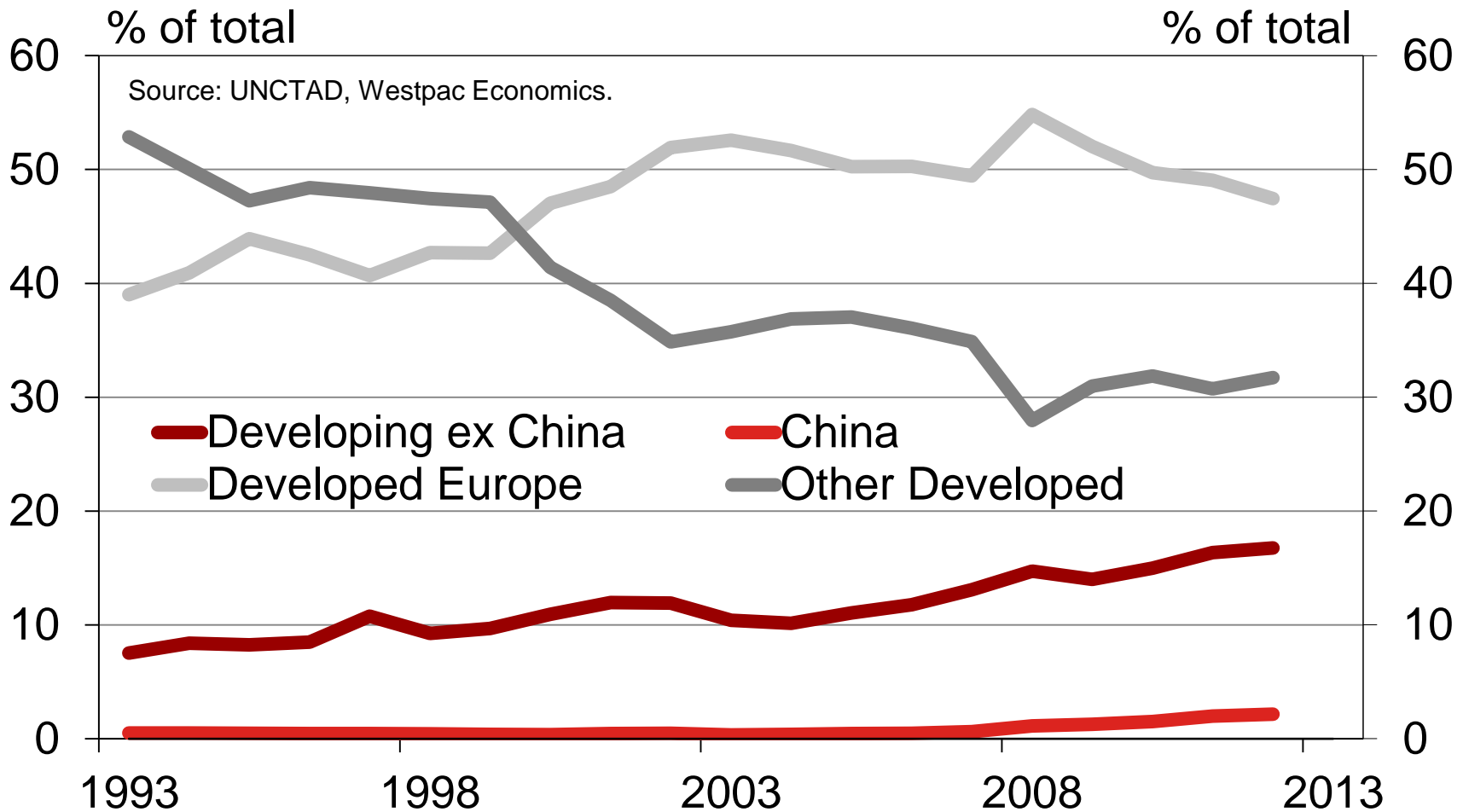


# Shares of global FDI inflows

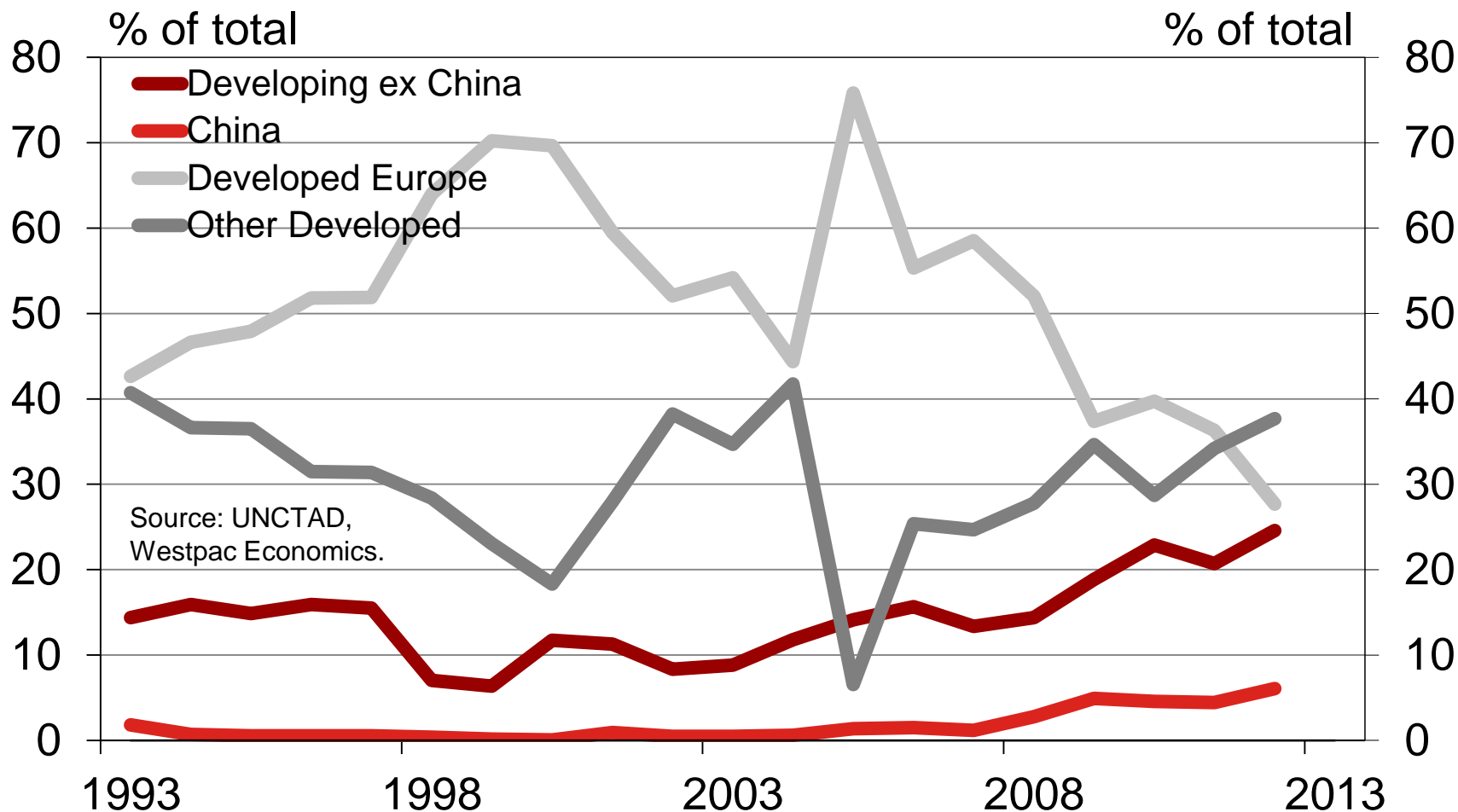




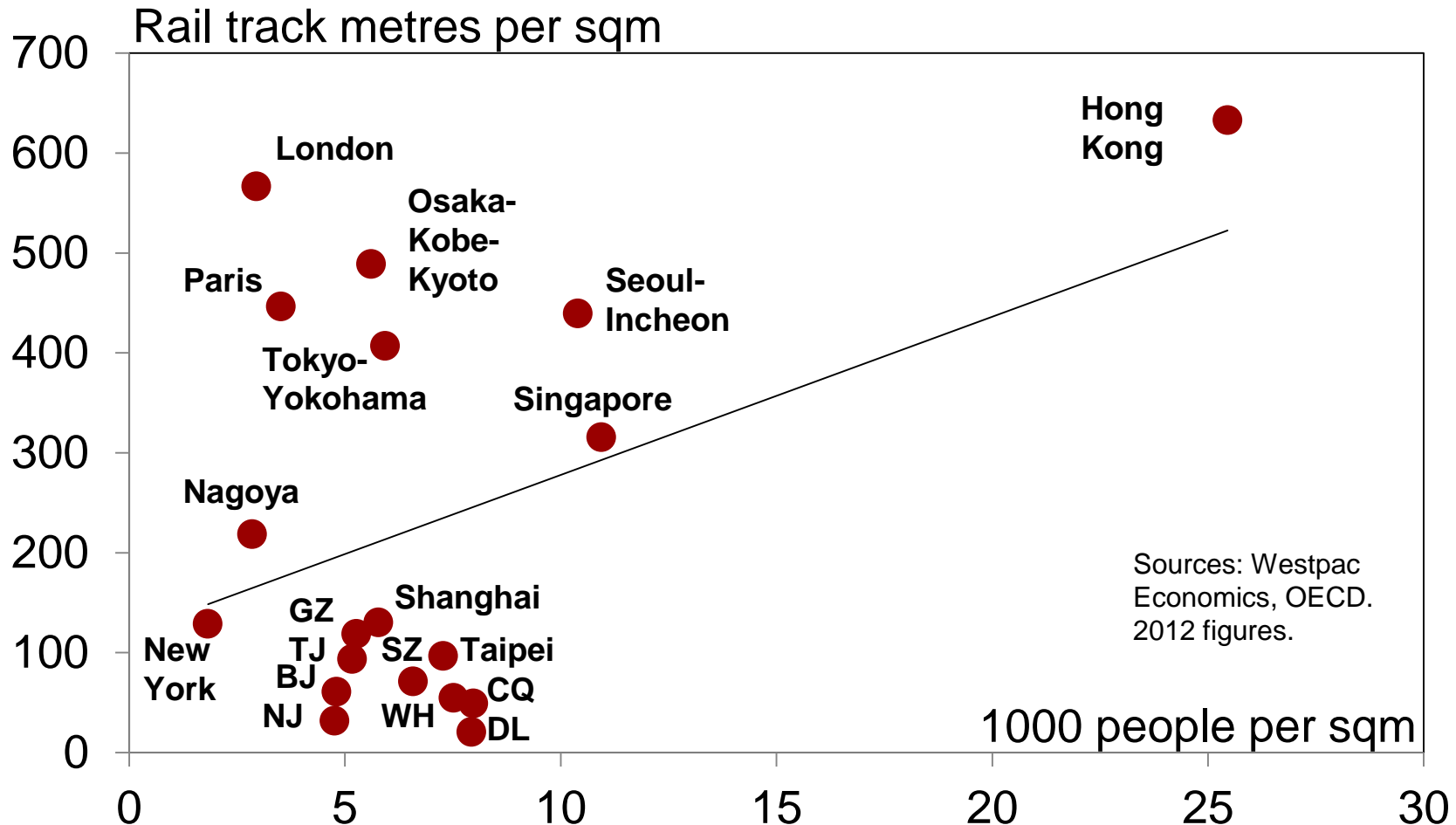
# Shares of the global outward FDI stock



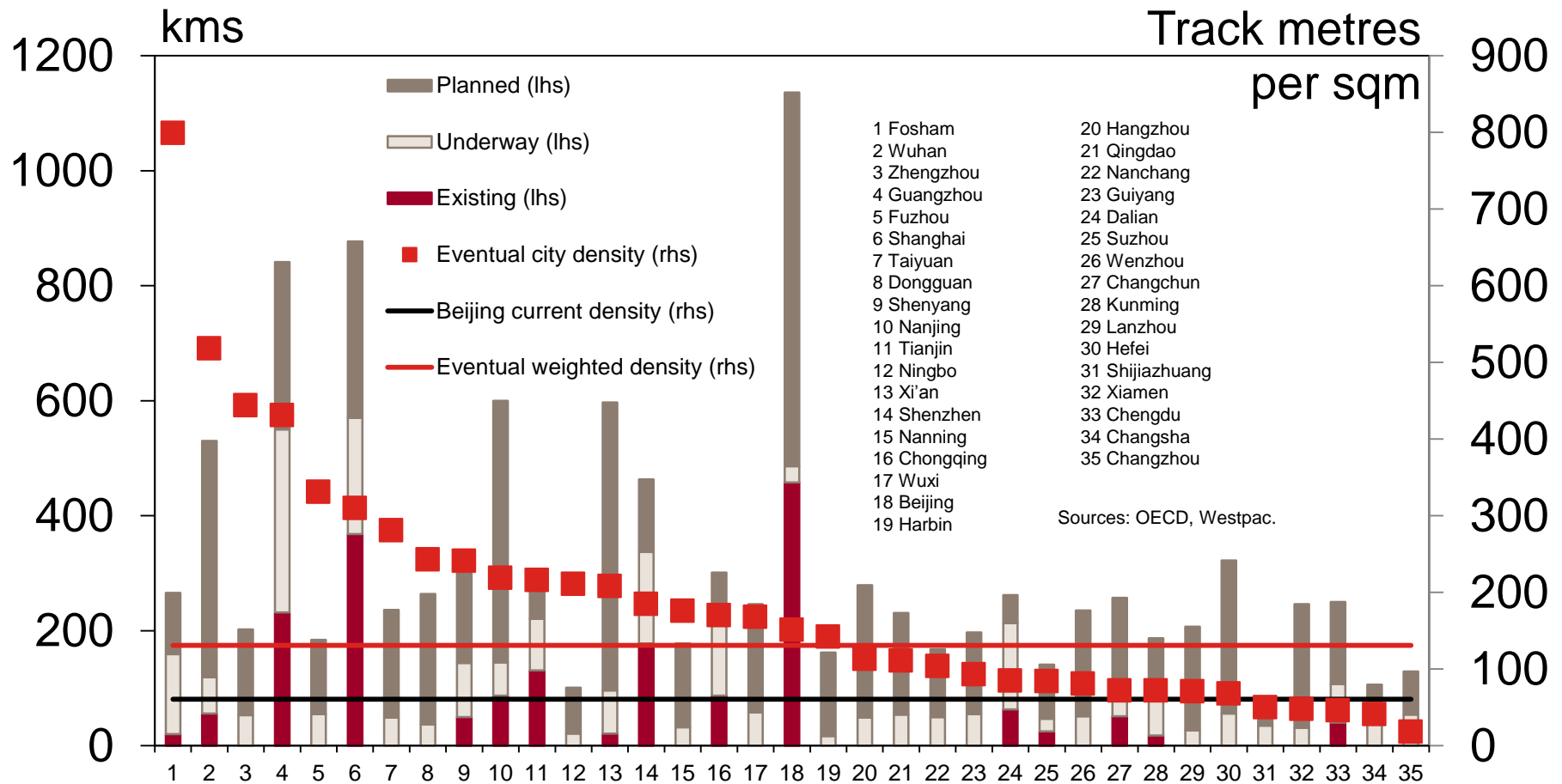
# Shares of global FDI outflows



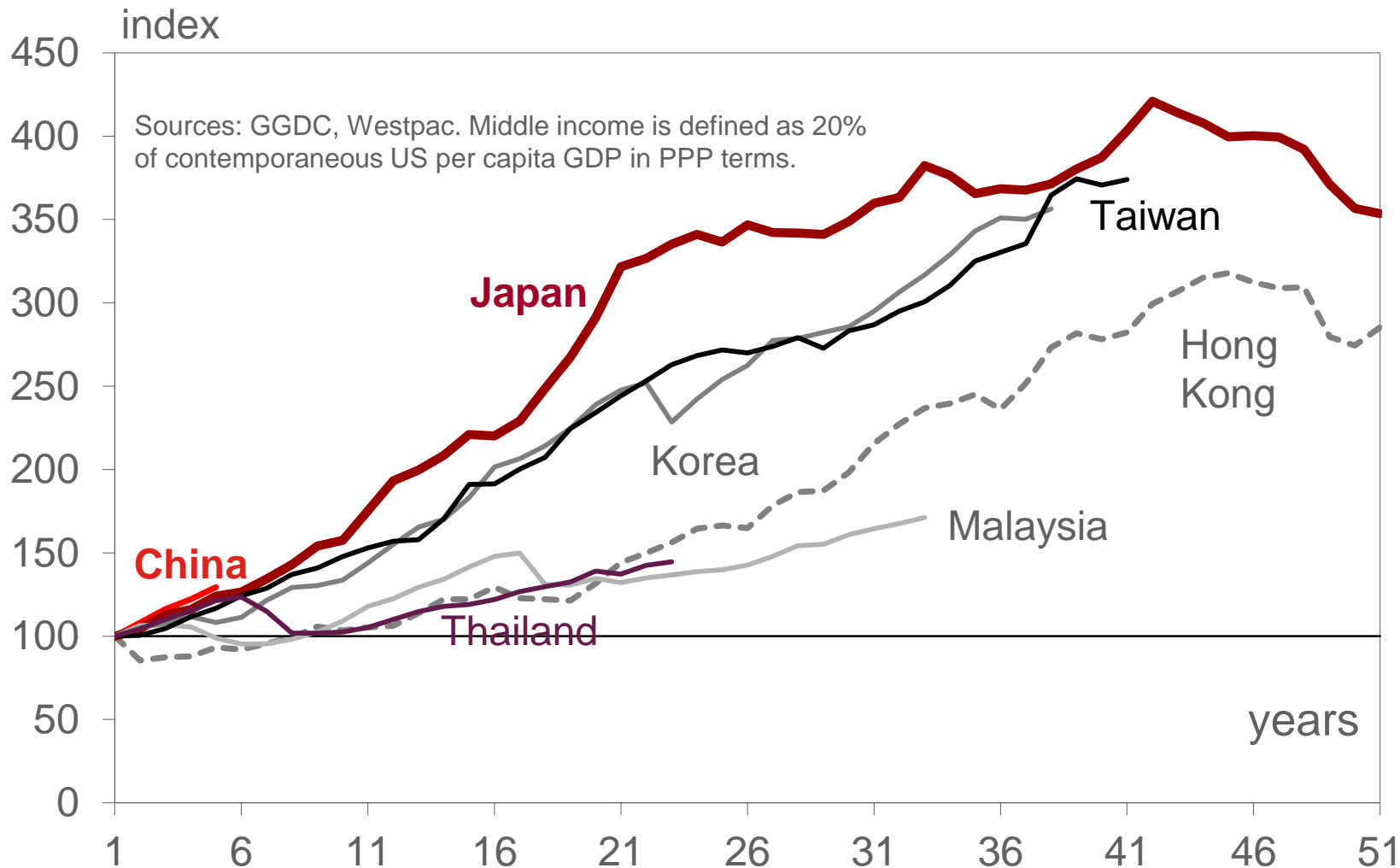
# Major cities: rail network & population density



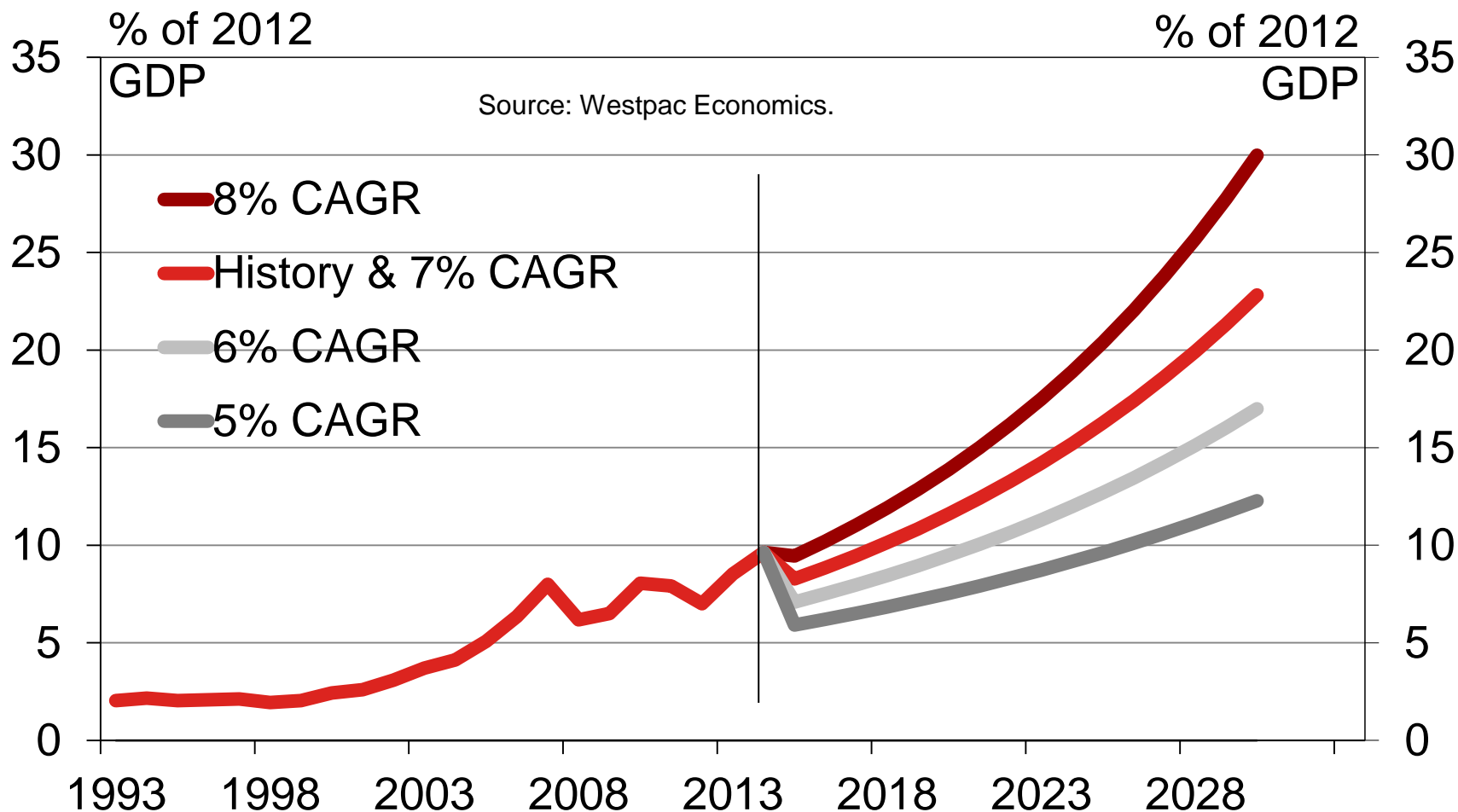
# China: existing and planned subways



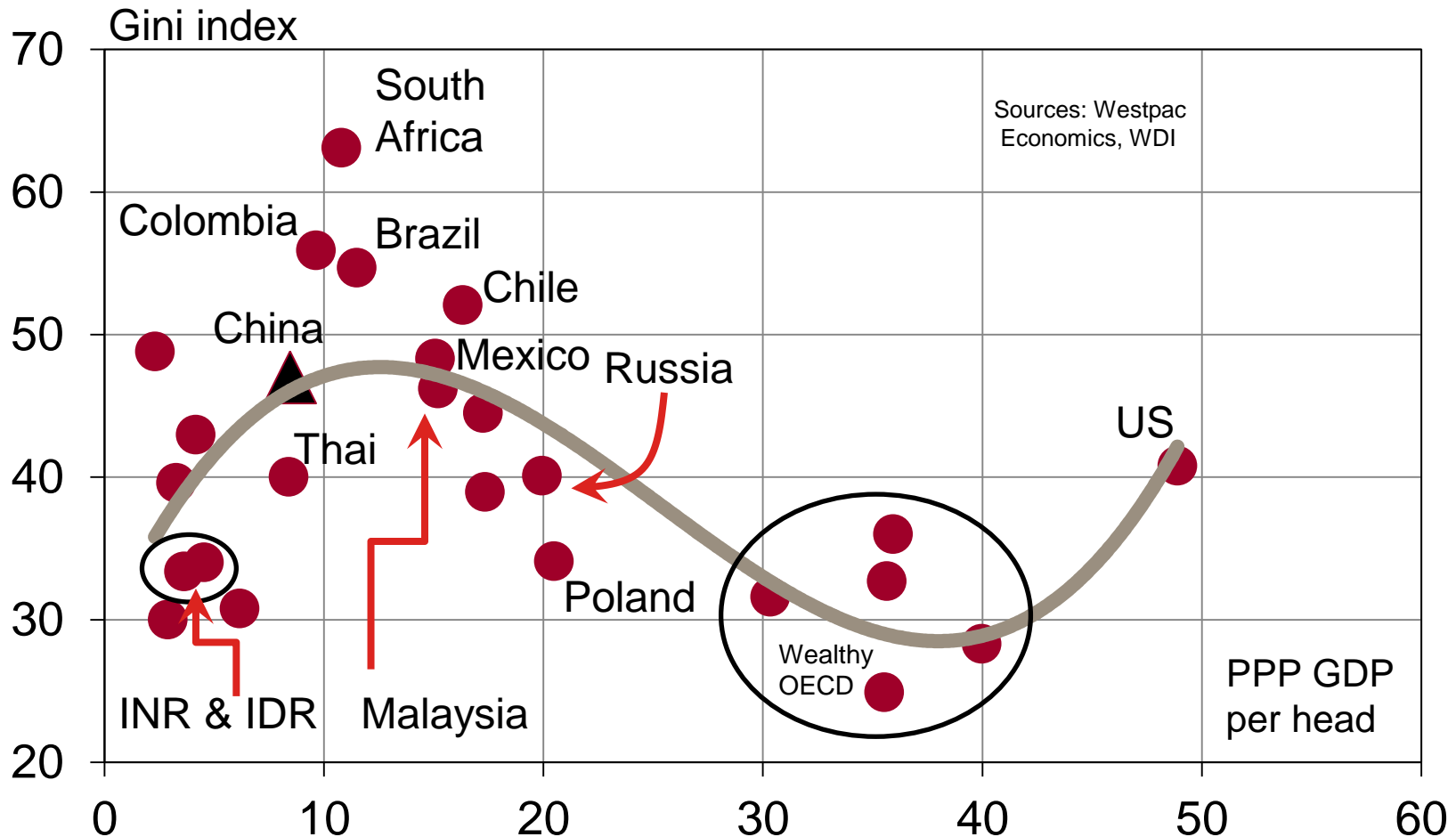
# Per capita growth from middle income stage



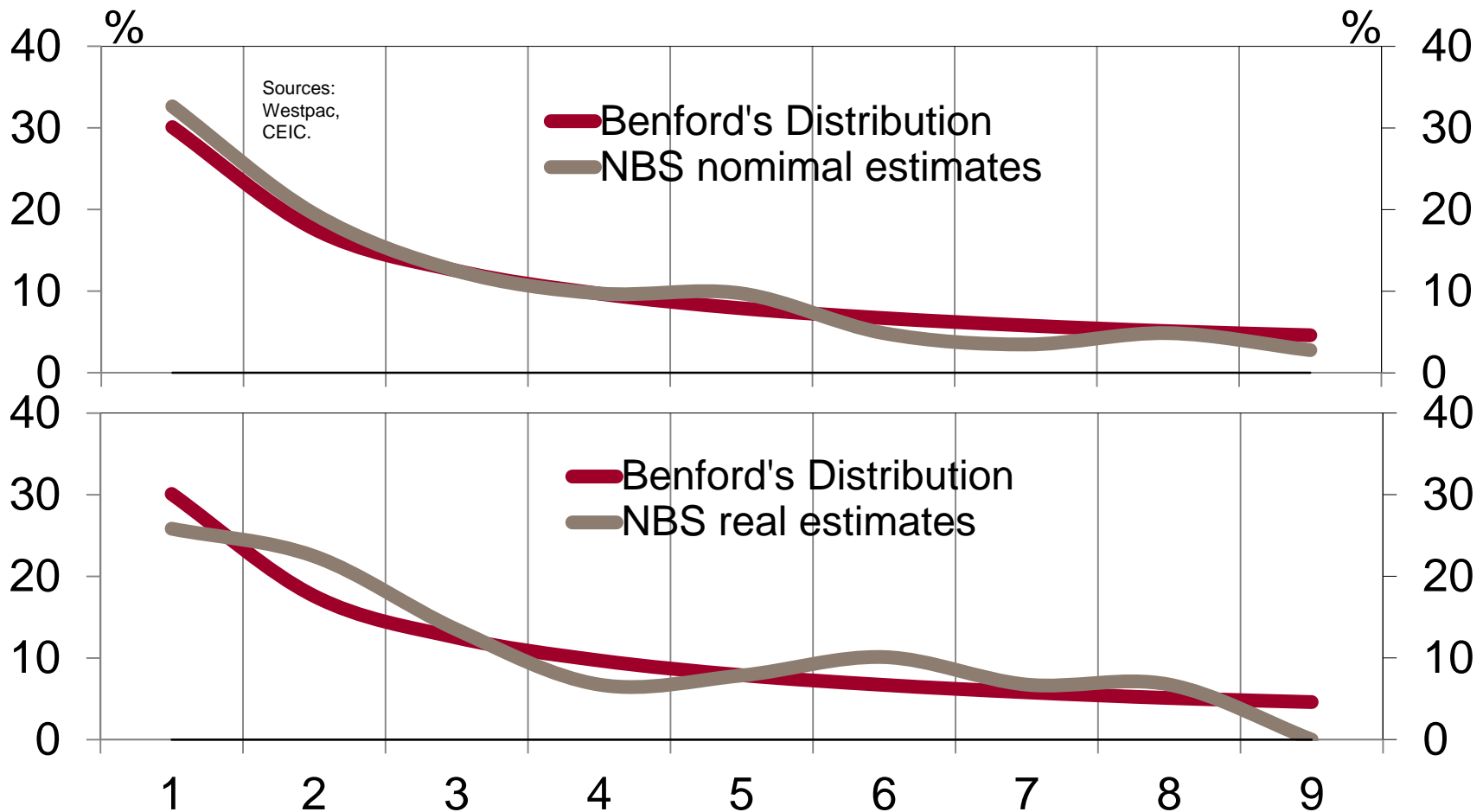
# Chinese real GDP increments: 4 scenarios



# Income level per capita & its distribution



# Benford's law & China's GDP figures





# China: the key messages reiterated

The end-2013 data described an investment cycle that was beginning to decelerate, with the softer elements beginning to out-weigh those that were still in good health. Clearly 2014 was beginning on a softer footing than the year that just closed, as **Phat Dragon** had long foreshadowed. The Q1 data, when it arrived, confirmed the slowdown in no uncertain terms. The weakness of nominal activity was particularly striking in the March quarter national accounts, consistent with the deterioration of survey measures of business conditions throughout the quarter.

**Phat Dragon** notes that the poor partial data has been principally due to **weak outcomes in manufacturing** (an overdue crunch for heavy industry) and utilities capex (a surprise, reflecting tighter fiscal policy and weaker SOE activity in 2013H2) in the months of January and February, with the **weakness spilling over into real estate construction** in March. Transport has been surprisingly resilient though, with central and western regions still seeing some action in this space. Also, the value of new projects unexpectedly spiked higher in the new calendar year, implying that **the investment pipeline is being replenished to some degree**, supporting a stabilisation of growth around the middle of the year. The composition of investment will continue to shift, but the growth rate will retain a “17” handle even as the sectoral situation settles down. Note that **Phat Dragon** published a 17.0% forecast for CY2014 fixed investment ahead of the Jan-Feb data outturn, while the NPC’s FAI target is 17.5%.

An additional factor influencing **Phat Dragon’s** forecasts is the **tightening of credit conditions since the June quarter of 2013**. Our research indicates that shifts in credit lead developments in the real economy by 6-9 months, so the interbank turmoil of May and June is weighing on the economy now; the erratic credit supply to firms over the second half of the year will hinder 2014H1, while Q1’s OK bank lending, married to a shadow crunch, is relevant for outcomes from late Q3 forward.

# China: the key messages reiterated

**Phat Dragon** brought forward the timing of the enactment of growth stabilisation policies from mid-year to ‘immediate’ not long after the NPC. Policy needs be loosened to a degree because without a replenishment of the investment pipeline, the growth pulse will slow to the point where domestic demand growth will fall below 7% in Q3. Chinese policymakers have little room to move nowadays, with domestic demand growth sub 7% viewed as unpalatable from the point of view of job creation and anything exceeding 8% likely to be inflationary.

**This change of tack by domestic policymakers will combine with an improvement in global economic conditions to lift the economy in late 2014, ensuring that it enters 2015 with some positive momentum.** **Phat Dragon** anticipates that the world economy will be significantly firmer in 2015, which will assist China as it attempts to grow in a less credit-intensive fashion.

**While RRR cuts remain possible, Phat Dragon argues that it must be obvious that OMO could not achieve the same ends before the PBoC would choose that avenue for boosting liquidity.** The most likely time for a RRR cut is probably post deposit rate reform, which now has a definite “within two years” timeframe attached to it. (Note that “in the near future” meant 11 months in the case of the wider CNY band, and deposit insurance/guarantee system is likely to be built first).

**Regarding China’s balance sheet challenges, the financial system will remain a source of bearish news flow.** While **Phat Dragon** feels that the ultimate risks relating to Chinese debt are generally exaggerated (it still has a current account surplus after all, and is the world’s second largest international creditor) there seems little doubt in **Phat Dragon’s** mind that **bearish views on the growth-credit nexus will be remunerative in the first half of this year.**

Finally, regarding commodity prices, **Phat Dragon** feels that the threat of a collapse has receded, given seasonality, cost curves and downstream inventory positions.

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