CHINA'S ECONOMY AT A GLANCE

AUGUST 2018

National Australia Bank

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CONTACT

Gerard Burg, Senior Economist - International

KEY POINTS

Will trade tensions tempt China to turn on the taps?

- China's monthly indicators were generally a little softer in July – below market expectations – but not overly negative. Our expectations for weaker economic growth across the second half of the year remains unchanged – with growth to average 6.6% in 2018, before slowing to 6.25% in 2019 and 6.0% in 2020.

- China's deleveraging program continued in July – with new credit issuance contracting. In the first seven months of 2018, new credit issuance decreased by 15% yoy. The squeeze on shadow banking has forced banks to bring off-balance sheet items back to their books as well as direct new funding through traditional channels.

- Monetary policy in China has continued to ease in recent weeks – a loosening of around 35 basis points since June. The big question mark is the direction of policy and lending going forward. Late last week, the China Banking and Insurance Regulatory Commission stated that it would guide financial institutions to expand financing – particularly to small businesses and infrastructure – noting that banks should make full use of current liquidity and current low funding costs. It is unclear at the moment if this would mean a slowing in, or the end of, deleveraging.

- China's trade surplus was marginally narrower in July – at US$28.1 billion (compared with US$41.5 billion in June) – reflecting an upturn in imports, while export values were relatively flat. Imports rose by of 27% yoy (although imports in July 2017 were particularly weak). US tariffs on Chinese imports came into effect in early July, however there was little evidence of an impact in the data (other than a sharp fall in soybean imports). Imports from the US rose by 11% yoy, while exports to the US rose by around the same amount.

- Growth in China's industrial production was unchanged in July – increasing by 6.0% yoy. This rate was below the trend recorded since the start of 2015 (around 6.3%). It is far too early at this stage to see any impact from US tariffs on China's industrial sector.

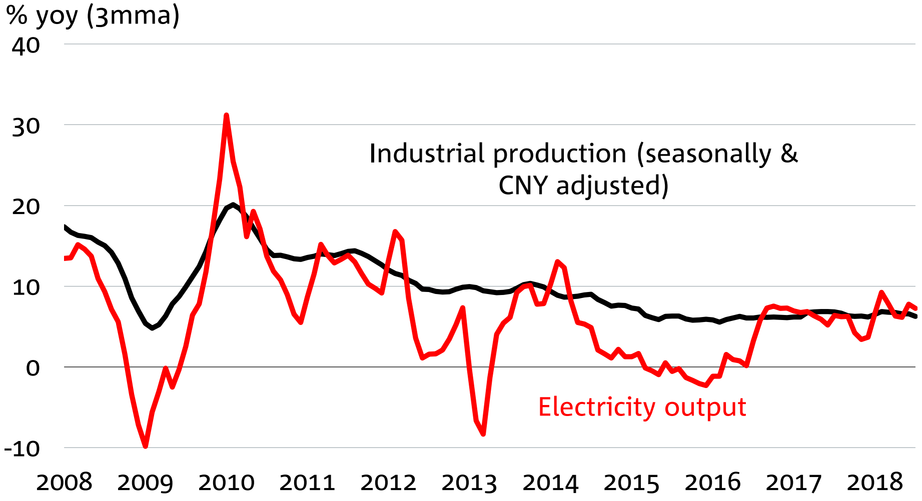
- There was a notable slowing in China's fixed asset investment growth in July. With investment goods prices trending higher, real investment contracted in July – down 0.9% yoy – the first fall since October 2017. Investment by state-owned enterprises (SOEs) has slowed dramatically in recent months, along with a sharp slowdown in infrastructure development – also likely connected to deleveraging.

- Real retail sales growth slowed to 6.7% yoy, the slowest rate of growth since May 2003. Consumer confidence dipped in June – falling to 118.2 points (from 122.9 points in May) – albeit this remains a historically strong result.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

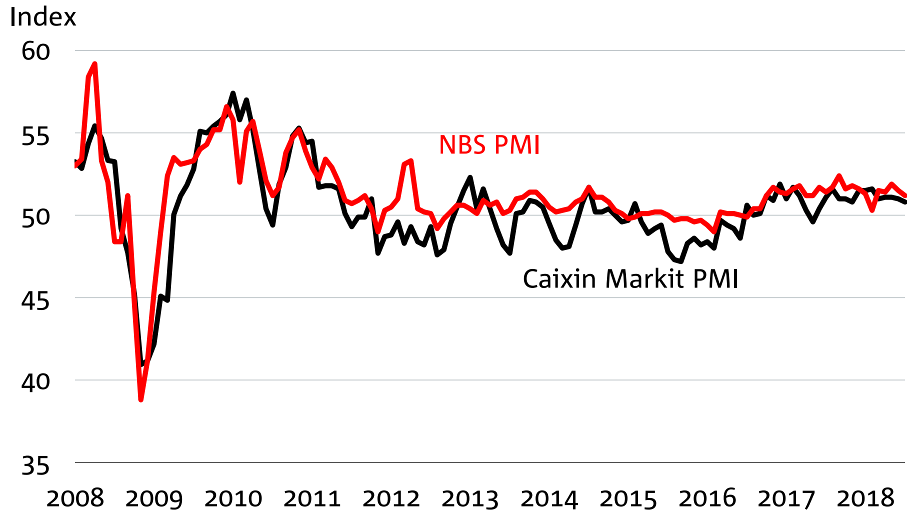
Output growth stable as US tariffs come into effect



Source: CEIC, NAB Economics

PMI SURVEYS SLIGHTLY SOFTER IN JULY

Manufacturing conditions remain in positive territory



Source: CEIC, NAB Economics

- Growth in China's industrial production was unchanged in July – increasing by 6.0% yoy. This rate was below the trend recorded since the start of 2015 (around 6.3%) and generally below market expectations. It is far too early at this stage to see any impact from US tariffs on China's industrial sector.

- Trends in individual industrial sectors remain divergent. Crude steel output rose by 7.2% yoy – to a new monthly record of 81.2 million tonnes – while growth in consumer electronics (including computers, mobile phones and tablets) accelerated to 13.5% yoy (from 10.9% in June). Electricity generation increased by 5.9% yoy (slightly down on growth in June) – supported by strong seasonal demand for air conditioning.

- In contrast, cement production grew modestly – up by 1.6% yoy – while production of motor vehicles fell year-on-year – down 0.5%.

- China's major manufacturing surveys were marginally softer in July, although they remain above the neutral 50 point level. The official NBS PMI survey fell to 51.2 points (from 51.5 points in June) – just below the average across the past two years. The Caixin Markit PMI dipped to 50.8 points (from 51.0 points previously).

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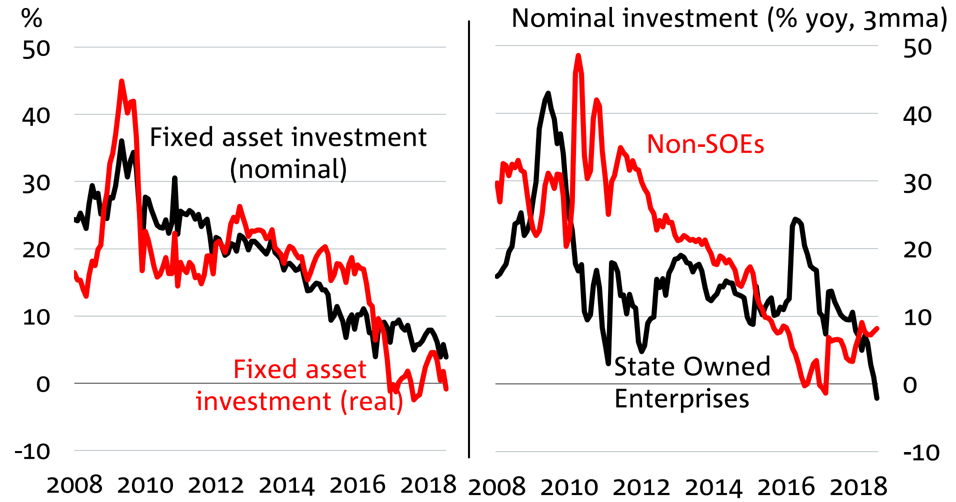
INVESTMENT

FIXED ASSET INVESTMENT

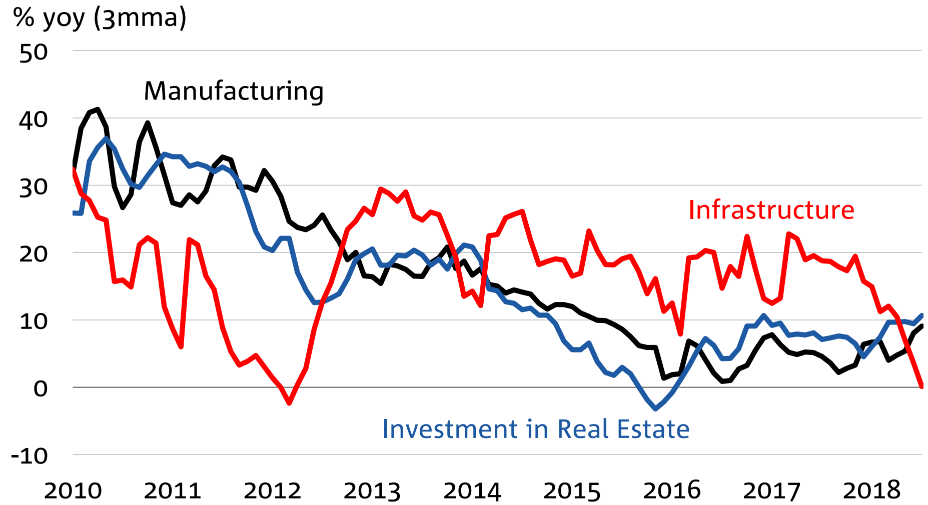
Real investment contracted in July, led by SOEs



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY SECTOR

Infrastructure investment has stalled – likely due to deleveraging



Source: CEIC, NAB Economics

- There was a notable slowing in China's fixed asset investment growth in July – with nominal investment increasing by 3.0% yoy (compared with 5.7% in June). With investment goods prices trending higher – in line with producer prices – we estimate that real investment contracted in July – down 0.9% yoy – the first fall since October 2017.

- Investment by state-owned enterprises (SOEs) has slowed dramatically in recent months – likely as a consequence of financial market deleveraging that has slowed credit growth and prioritised smaller businesses. On a three month moving average basis, nominal SOE investment contracted by 2.1% yoy (compared with a 1.0% increase in June). In contrast, private sector investment has accelerated – to 8.2% yoy (3mma), from 7.7% previously.

- Trends at an industry level remain highly divergent. There has been a sharp slowdown in infrastructure development in recent months – with nominal investment slowing to just 0.1% yoy (3mma) in July. Again, this is likely connected to deleveraging – with high indebted local governments responsible for the bulk of infrastructure funding. It is worth noting that Chinese financial authorities are pushing banks to lend to this sector.

- In contrast, investment in real estate has remained relatively stable in recent months, pushing up above 10% yoy (3mma) in July, while manufacturing investment has accelerated – up to 9.1% yoy (3mma) (from a low of 2.2% in September 2017).

- Our expectations of a slowing in residential property construction activity are yet to eventuate – with floor space sales increasing in July – up 7.9% yoy (3mma), compared with 3.6% in June – and residential building starts rising by 26% yoy (3mma) (from almost 17% previously). House prices have started to trend higher again more recently – with official data suggesting that prices rose 0.5% yoy (3mma) nationally – lead by increases in tier 2 and tier 3 cities.

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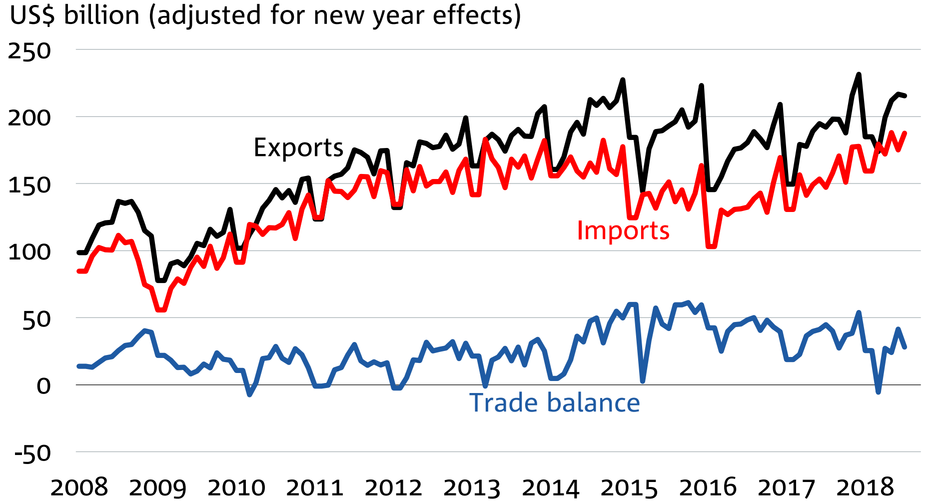
INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

TRADE SURPLUS EDGES DOWN IN JULY

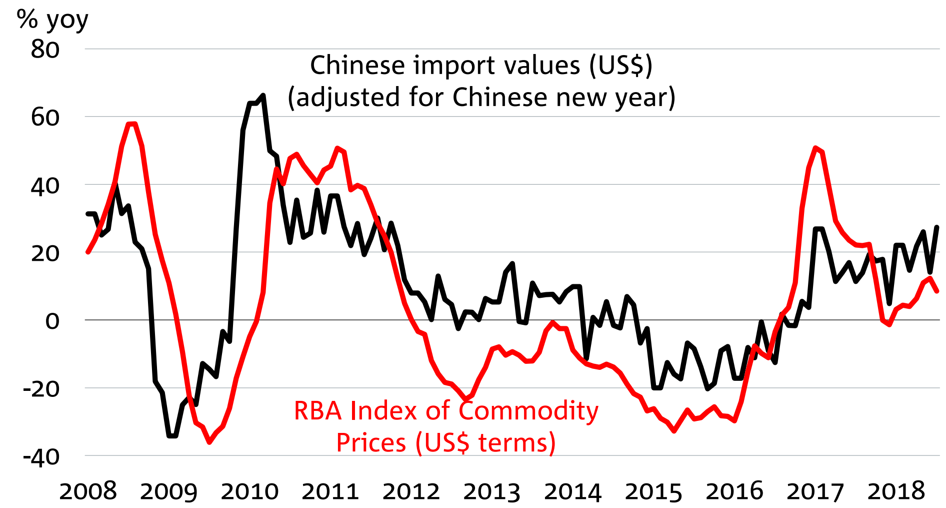
Upturn in imports and flat exports narrowed the gap



Sources: CEIC, NAB Economics

IMPORT VALUES AND COMMODITY PRICES

Strong growth in values points to increasing volumes



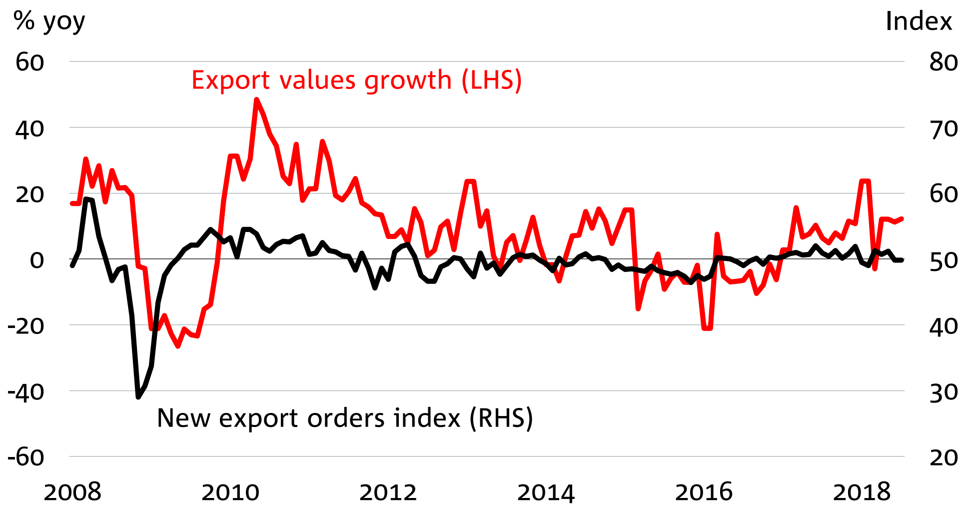
Source: CEIC, NAB Economics

- China's trade surplus was marginally narrower in July – at US$28.1 billion (compared with US$41.5 billion in June) – reflecting an upturn in imports, while export values were relatively flat.
- China's imports rose month-on-month to US$187.5 billion (from US$175.1 billion in June) – an increase of 27% yoy (although it is worth noting that this increase is somewhat inflated as imports in July 2017 were particularly weak).
- US tariffs on Chinese imports came into effect in early July, however there was little evidence of an impact in the data. Imports from the United States rose by 11% yoy – broadly in line with trends over the past twelve months. A further round of tariffs (on US$16 billion of Chinese goods) is set to be introduced 23 August – with the risk of further escalation remaining high.
- There remained divergent trends in imports of major commodities. China's coal imports surged in July – increasing by 49% yoy to 29 million tonnes, the largest volume since January 2014. Heatwave conditions across much of the country underpinned increased demand for coal fired electricity over this period.
- Copper imports also rose strongly – increasing by almost 16% yoy – while imports of iron ore and crude oil rose more modestly – by 4.3% yoy and 3.7% yoy respectively. Imports of soybeans – a key US commodity – were down 20% yoy (but only down around 3.5% yoy on a three month moving average basis) – however volumes in July 2017 were unusually strong, meaning the tariff impact is currently unclear.
- More generally, import volumes have increased strongly since the second half of 2017. Our estimate – based on import values and global commodity prices – rose by almost 19% yoy (on a three month moving average basis) – with monthly volumes for July accelerating following a weak outcome in June.

INTERNATIONAL TRADE – EXPORTS

CHINA'S EXPORT VALUES AND NEW ORDERS

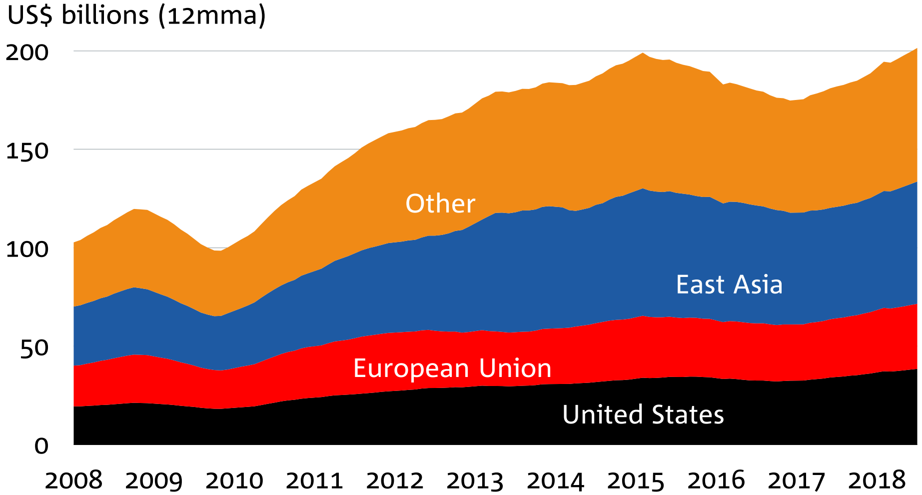
Survey measures yet to show impact of US tariffs



Source: CEIC, NAB Economics

EXPORTS BY MAJOR MARKET

Continued growth to the US in July despite tariff introduction



Sources: CEIC, NAB Economics

- China's export values were essentially flat month-on-month in July – at US$215.6 billion (compared with US$216.6 billion in June) – but rose by 12.2% year-on-year.

- Despite the imposition of US tariffs, the new export orders measure in the NBS PMI survey remained stable in July – at a marginally negative 49.8 points. It is worth noting that this result – while weaker then the trend since the start of 2016 – is still stronger than the average between mid-2011 and late 2015.

- Similarly, export data to the United States showed no tariff impact in July – with exports increasing by 11.2% yoy (broadly in line with total export growth). China's trade deficit with the United States rose to a new annualised record to US$296 billion in July. We will be watching this closely in the next few months – as trade may slow if US consumers brought purchases forward to avoid the tariffs.

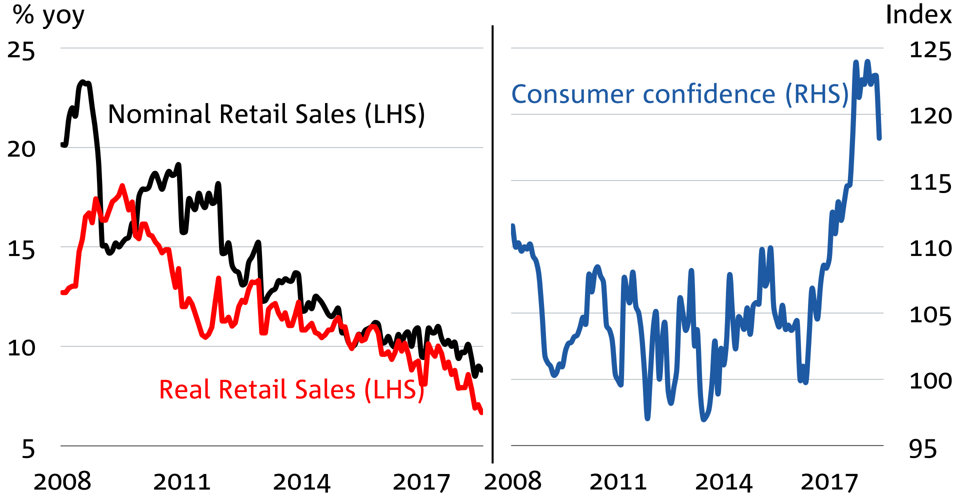
- Exports to other major markets also grew strongly in July. Exports to the European Union rose by 9.5% yoy while shipments to East Asian markets rose by 14.5% yoy. Within the Asian region, exports to Hong Kong rose by almost 17% yoy to US$27.3 billion, while other East Asian markets rose by 13% - led by Indonesia, Vietnam and South Korea.

- The strength of export growth to Hong Kong is a little surprising – with the dollar value of this trade well above levels historically reported by Hong Kong Customs. We have previously noted discrepancies between Hong Kong and Chinese data – with Hong Kong being the main market for false invoicing measures that mask capital flows as trade activity. While the discrepancy was narrow in 2017 (compared with the peaks between 2013 and 2015), it has started to widen once again in 2018.

RETAIL SALES AND INFLATION

REAL SALES SLOWS TO 15 YEAR LOW

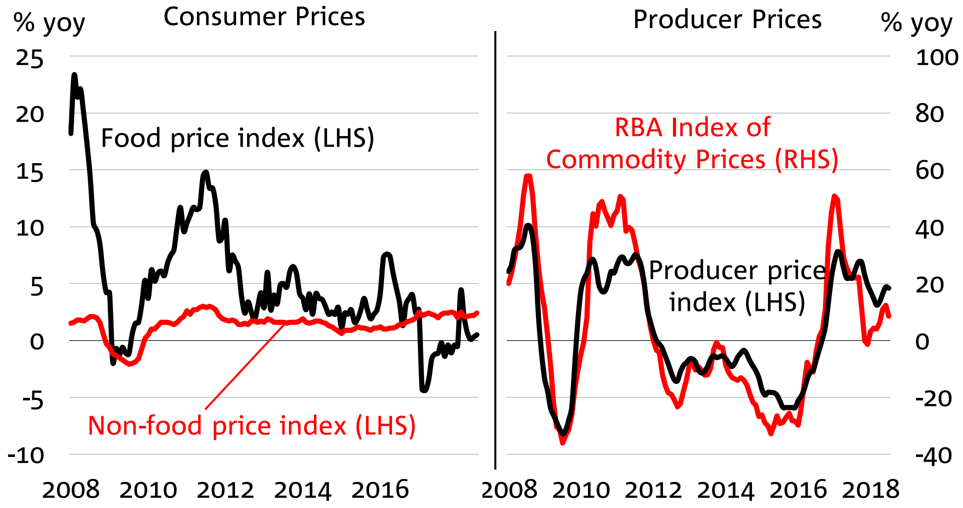
Confidence dips but remains historically high



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Consumer prices stronger as non-food accelerates



Source: CEIC, RBA, NAB Economics

- Growth in retail sales slowed marginally in July – with nominal sales increasing by 8.8% yoy (compared with 9.0% previously). This easing coincided with a slight pickup in inflation – meaning that real retail sales growth slowed to 6.7% yoy, the slowest rate of growth since May 2003.
- Consumer confidence dipped in June – falling to 118.2 points (from 122.9 points in May) – albeit this remains a historically strong result.
- Headline inflation in China was a little stronger in July – with the Consumer Price Index increasing by 2.1% yoy (compared with 1.9% in June).
- There was a modest upturn in food price inflation in July, with prices increasing by 0.5% yoy (from 0.3% in June). In part this increase was driven by a smaller fall in pork prices – down by 9.6% yoy, compared with 12.8% previously – while fresh fruit prices rose by 0.4% yoy (having fallen by 5.3% in June).
- Non-food prices trended higher in July – increasing by 2.4% yoy (from 2.2% previously). Vehicle fuel prices have accelerated sharply – up 22% yoy – while healthcare costs rose 4.6% yoy and residence expenses increased by 2.4% yoy.
- Producer price growth was modestly softer – at 4.6% yoy (from 4.7% previously). As we have previously noted, the previously close relationship between producer prices and commodity prices has broken down since late last year. There have been previous examples of such divergences, however it is unclear if there has been a structural break, due to industry restructuring and anti-pollution measures, or whether these measures will converge once again.

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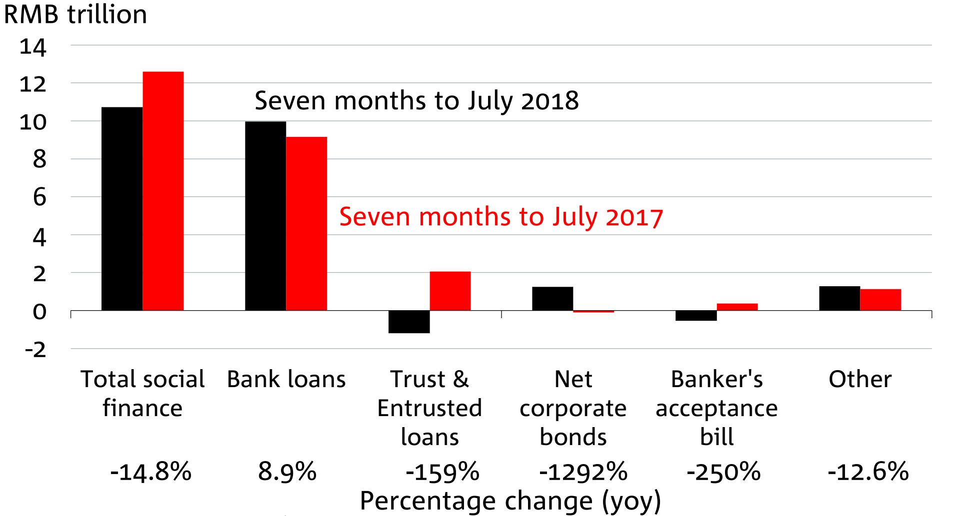
CREDIT CONDITIONS

NEW CREDIT ISSUANCE

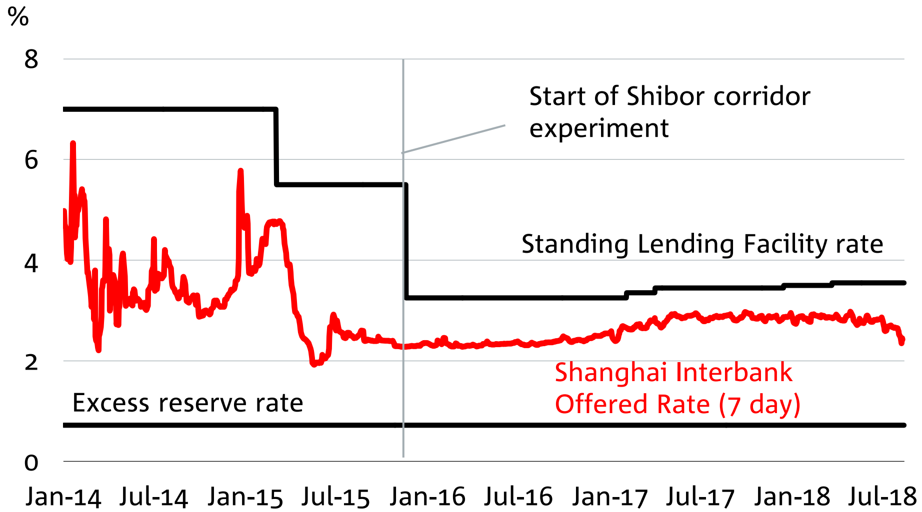
Steep declines in shadow banking has constrained credit issuance



Sources: CEIC, NAB Economics

MONETARY POLICY CONTINUES TO EASE

Shibor drops below 2.5% in August – lowest since mid 2016



Source: CEIC, NAB Economics

- China's deleveraging program continued in July – with new credit issuance remaining weak. In the first seven months of 2018, new credit totalled RMB 10.7 trillion, a decrease of almost 15% yoy. For the month of July alone, new credit issuance declined by 10.7% yoy.

- The squeeze on shadow banking has forced banks to bring off-balance sheet items back to their books as well as direct new funding through traditional channels. This has seen new bank lending increasing by 8.9% yoy in the first seven months, to total RMB 10 trillion.

- In contrast, growth in non-bank lending continues to contract – down by 78% yoy in the first seven months of the year. Corporate bond issuance has been the standout within this category – totalling RMB 1.2 trillion (compared with an net contraction over the same period in 2017). In contrast, issuance of trust and entrusted loans and banker's acceptance bills has plunged – down 159% yoy and 250% yoy respectively – as tighter regulation of these shadow banking sectors has curtailed activity.

- Monetary policy in China has continued to ease in recent weeks – with the 7 day Shanghai Interbank Offered Rate (Shibor) dropping below 2.5% in early August. These are the lowest rates since mid-2016, and represents a loosening of around 35 basis points since June.

- The big question mark is the direction of policy and lending going forward. Late last week, the China Banking and Insurance Regulatory Commission stated that it would guide financial institutions to expand financing – particularly to small businesses and infrastructure – noting that banks should make full use of current liquidity and current low funding costs. It is unclear at the moment if this would mean a slowing in, or the end of, deleveraging (at present we expect the former).

- An end to deleveraging would provide a short term boost to China's economy, but would be a medium term negative, given its high debt levels (our estimate is around 325% of GDP).

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Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

John Sharma
Economist – International
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836