China Economy Update – 29 July 2015

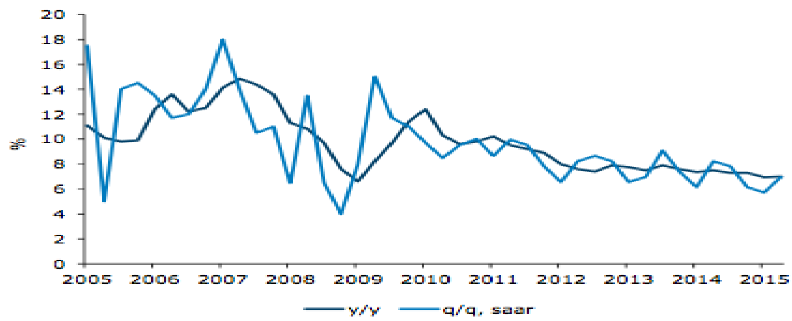
Summary

China's "New Normal" is here to stay; many indices continue to trend downward (the official GDP stat appears to be one of the few which buck the trend). The stock market's wild ride has grabbed headlines –and policymakers' attention this month.

Real Economy

Q2 figures came out: 7.0% (same as Q1) – and bang-on the Government's 7% target. This figure fits awkwardly with other (trending down) indices, leading some analysts to wonder whether growth really was 7%. We've heard that this was in-part achieved by revising down Q2 2014 data – the base-effect pushing up this quarter. Bright spots in the Q2 data were (stock market boom fuelled) financial services and an uptick in property sales. Investment continued to grow less quickly – in particular in areas where there is excess capacity (chart below-right). The PMI data on Friday 24th July added to the pessimism; the lowest reading since March 2014. Chinese government interlocutors have stressed that the 7% goal this year is flexible – it's likely to be under - 6.7% is the market consensus.

FIGURE 1. GDP GROWTH



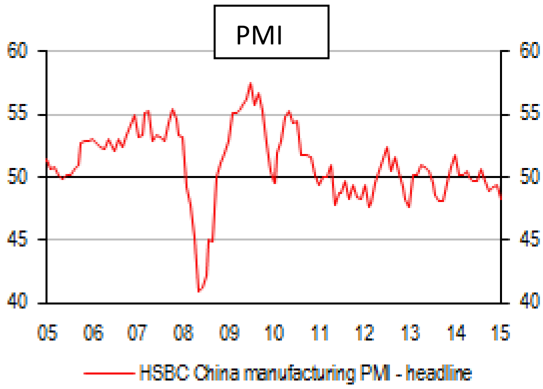


FIGURE 3. FIXED ASSET INVESTMENT, YTD

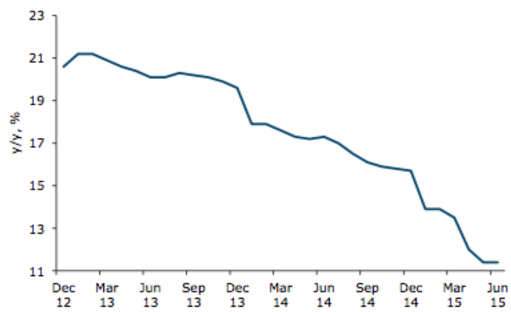
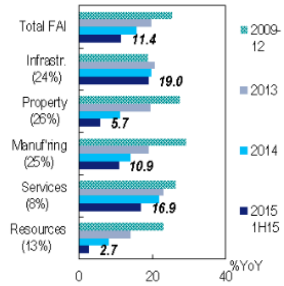


Figure 19. China's FAI growth – challenging for property, manufacturing & resources



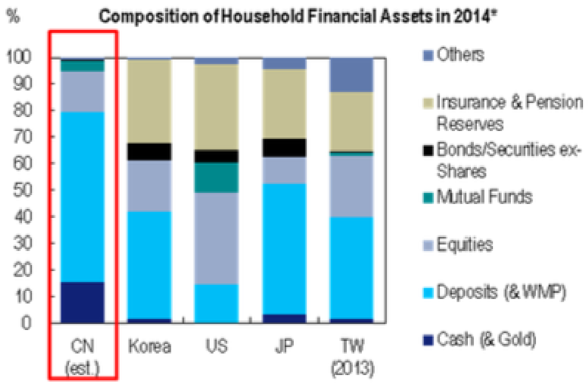
Source: CEIC Citi Research

Stock Market Crash

Undoubtedly the story of July – and quite likely August. We have reported separately in detail on the swings. As massive as the index swings has been the scale of the government response (injecting 5 trillion RMB (£500bn) into the stock market). We believe the drivers to be more political than economic. China's most active investors are retail, not institutional, and many of these were heavily leveraged (unlike the 2007/08 crash) - they will have lost their shirts. We saw a small demonstration outside the Securities Regulator – very rare in China – as well as constant social media criticism.

But a 20% fall in China's stock markets will impact China's economy less than a comparable crash in the UK; between 6-10% of Chinese households own stocks (compared with nearly half of UK), and equity financing only accounts for 3% of aggregate financing. Citi estimate that the stock market boom added an extra 0.6ppts more to GDP growth in 1H15 than in previous years. The gyrations will distract policymakers and give ammunition to those urging a slower pace of reform.

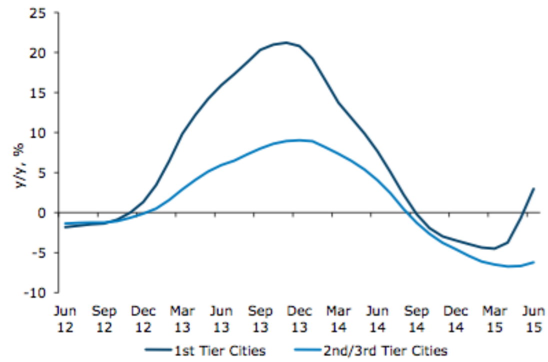
Figure 12. Composition of household financial assets in 2014 – China versus others



Real Estate

Average new home prices rose 0.4% in June over May. The chart shows that in large cities, prices began to rise, while they continued to drop in smaller cities. China's oversupply problem is improving – property sale volumes rose (16% y/y in June versus 15% in May), while new starts fell. The drop in construction will weigh negatively on China's GDP stats, but the fall in inventory is positive for market stability.

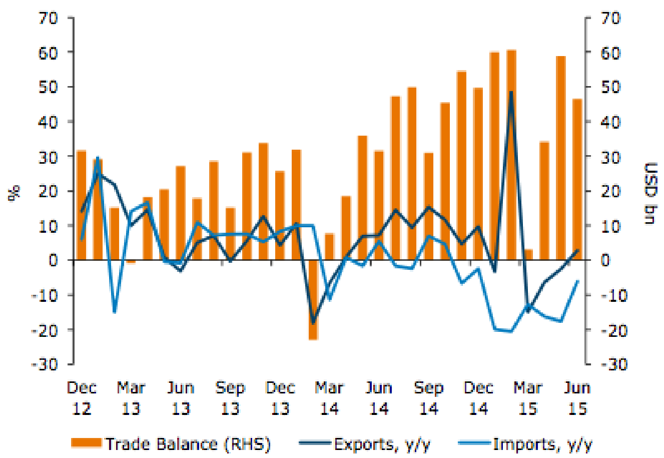
FIGURE 2. PROPERTY PRICES BY SIZE OF CITY



Trade

China continued to run a trade surplus in June – albeit lower than May's. Most notable is that despite a shrinkage in exports to the EU, overall exports grew 2.8% y/y (above market expectations). Imports continued to shrink (-6.3% y/y), but at a slower rate – in part due to lower commodity prices – and in part due to slowing investment growth.

FIGURE 1. TRADE DEVELOPMENTS



These charts below from ANZ illustrate China's trade surpluses with the developed world – and the (commodity-dominated) deficits they have with newly industrialising countries (and Australia and New Zealand). The drop in global commodity prices will continue to benefit China.

FIGURE 5. TRADE BALANCE BY COUNTRY - PART 1 (12M ROLLING SUM)

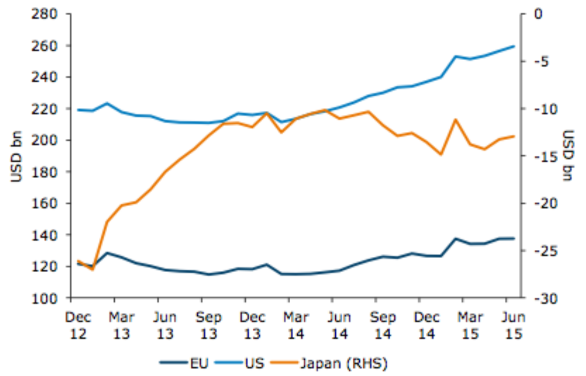
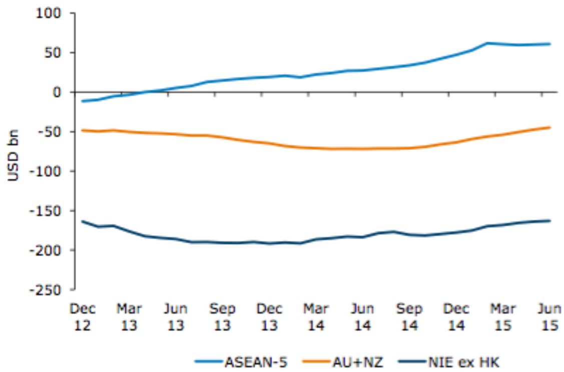


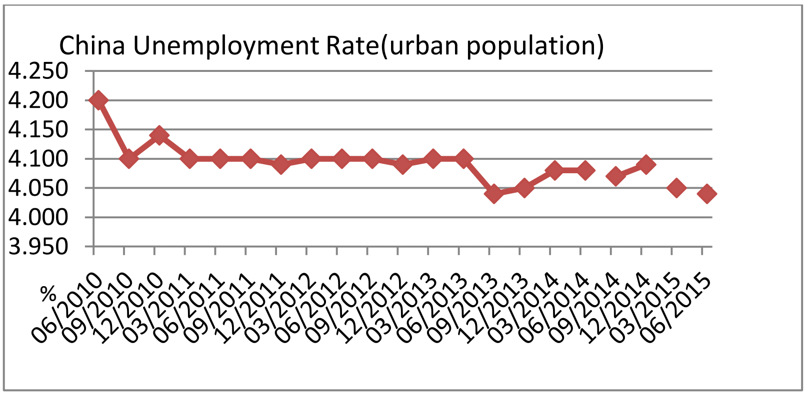
FIGURE 6. TRADE BALANCE BY COUNTRY – PART 2 (12M ROLLING SUM)



Source: CEIC, ANZ Research

Unemployment

We often say that the only number the Communist Party really really care about is unemployment. They only publish the figure for urban areas (i.e. about half of China's population), and given the large number of unregistered urban citizens (some say about 25%), the number is suspect. But for what it's worth: more than 7 million new jobs were created in urban areas in the first half of this year, compared to an official target of 10 million new jobs for the whole year. China's unemployment rate (in 31 major cities) fell in June to the lowest level so far this year: 5.06%. This will give the Party a measure of confidence, despite the flurry of negative data elsewhere in the economy.



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