

January 20 2016

## China Chartbook December 2015 Data

December Data Was Softer Than the Previous Month.  
Rebalancing Continues.

**December economic data in a nutshell:** December data was a bit softer than the previous month, but Q4 points to a modestly weaker but broadly stable economy. Concerns over hard-landing economic prospects are overdone. Consumption remains strong. Service growth is robust. Heavy industries, like steel and cement, are still falling like a bag of hammers as overcapacity weighs on traditional growth driver sectors. Fiscal expenditures picked up. Credit growth has stabilized at a weak 11-12%. The housing market is improving, and construction is less negative.

**2015 saw substantial rebalancing and an acceleration of the two-speed economy.** Within 2015's 6.9% real GDP growth, there were some significant developments. Underdeveloped services grew at a rapid 8.3% accounting for 50.5% of GDP. Industry and construction slowed to 6.0%, nearly half the pace of just 5 years ago. Consumption was the biggest driver of growth. According to the NBS, private and public consumption contributed nearly two-thirds of economic growth last year, a record number. Retail sales growing at 10.7% in 2015 outpaced production - running around 6.1% - by a wide margin. The long-awaited economic rebalancing is clearly underway.

China will slow this year, and 2016 will be another year of speculation about just how much lower the slowdown can go. I would argue that for those outside of mainland China the real question should be not "how much will GDP growth slow?" but "how far will industry slow?" The divergence between services and industry will deepen next year. Rapid growth in services and consumption are both great for domestic stability and those who sell their wares within China's borders. But, another year of slower factory output means another year of sluggish commodity and machinery demand. A stable China growing at 6.5% next year means a positive contribution to global growth on a mathematical basis, but means more weakness passed along to economies linked to China's once insatiable demand for machinery and commodities.

**A Soft Landing + Economic Rebalancing = Good news for consumption and service sectors, but not very good news for industry and the lion's share of import demand from the rest of the world.**

LaoHu Economics Blog  
[LaoHuEconomics.com](http://LaoHuEconomics.com)

This chart book covers December 2015 economic data. For details on my 2016 outlook and key developments in 2015 see the following blog postings on my website:

<http://laohueconomics.com/new-china-economics-blog/2015/12/21/china-2016-a-brief-overview-of->

<http://laohueconomics.com/new-china-economics-blog/2015/12/17/china-2015-in-review-well-that-was-an-interesting-year>

---

### December 2015 Summary Data

---

	<b>Dec '15</b>	<b>Nov '15</b>
In Production	5.9%	6.2%
Retail Sales	11.1%	11.2%
Real Retail Sales	10.7%	11.0%
Investment	6.8%	10.8%
Exports	-1.4%	-6.8%
Imports	-7.6%	-8.7%
Manu PMI	49.7	49.6
Service PMI	54.4	53.6
Housing Sales	1.4%	7.8%
Completed Housing	-14.4%	-2.0%
Housing Starts	-6.5%	-20.7%
CPI	1.6%	1.5%
Outstanding Loans	14.3%	14.9%
Total Credit YoY	11.6%	11.9%
M2 YoY	13.3%	13.7%

China's share of total global exports is still rising, and the trade surplus continues to hit new record highs. **Those two factors leave little reason for an engineered fx devaluation from Beijing meant to make exports more competitive.** Exports are already competitive, and growth stimulus needs to come from domestic tools. Downward pressure on the yuan is primarily due to significant outflows driven mainly by sentiment.

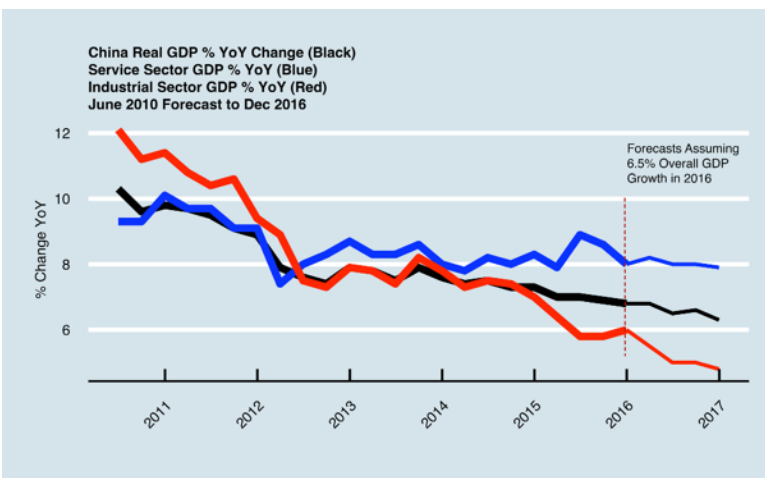
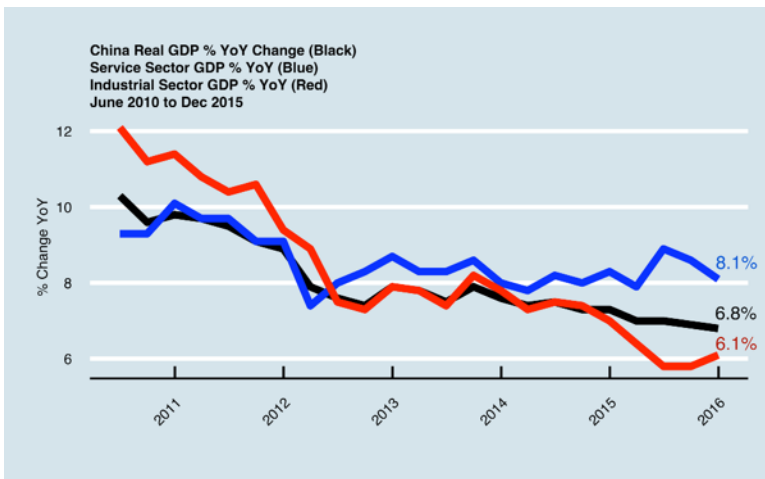
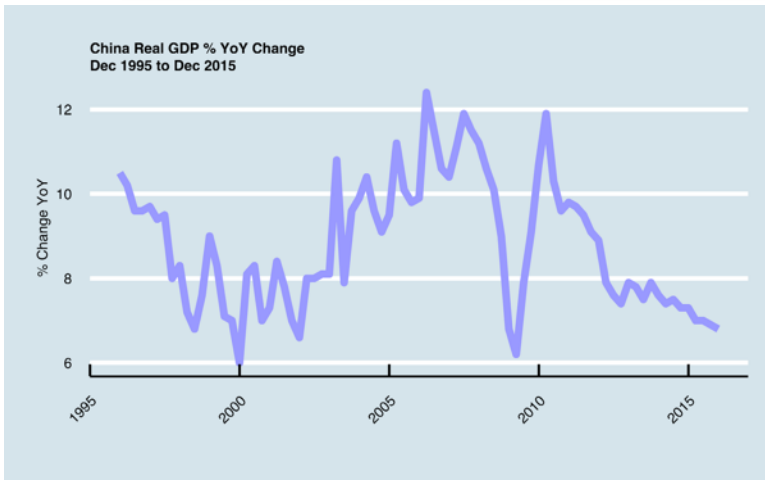
**In March, Beijing will probably announce another lowering of the growth target by 0.50% in 2016.** That will mean less reflation effort by Beijing, and therefore weaker industry next year. Beijing has also hinted that fiscal stimulus will come through tax cuts, not spending, which will mean less stimulus directly flowing to traditional heavy industries.

After seemingly waiting in vain for a meaningful boost from government stimulative measures, we are finally seeing those measures bear fruit. **After over a year of easing, credit growth seems to have stabilized from its long downward march. Fiscal expenditures rose over the last few months of 2015.** As a result, we will see momentum in the real economy for some months to come.

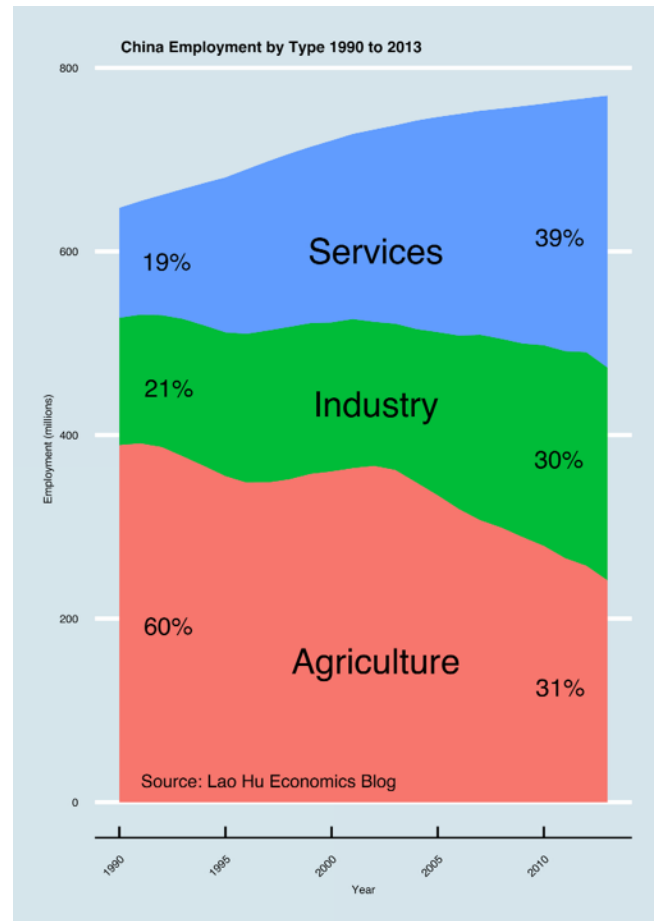
**The links between China's stock market and the real economy are minimal.** 90% of the market participants are retail investors, as opposed to institutional. And a major chunk of investors are new to stock investing, having opened the first accounts last year. Institutional investors put money to work in China's stable bond market - the third largest in the world - leaving equities as a venue for irrational stock gamblers. The local bond market has been both stable and strong during stock turmoil. Only 8% of the adult population owns shares, and liquidity is massive - bank deposits in the country are 200% of GDP. Statistical analysis shows no direct relationship between share prices and economic activity over the last few years. A share sell-off should not be confused with a hard landing in the economy. The Shanghai stock exchange is the world's largest gambling den, and should not be confused with the real economy. **Whatever your China economic growth outlook was on December 31st, the events of early January should not change that outlook.**

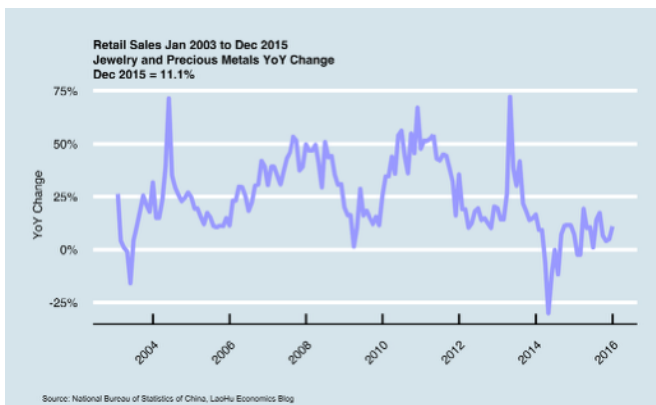
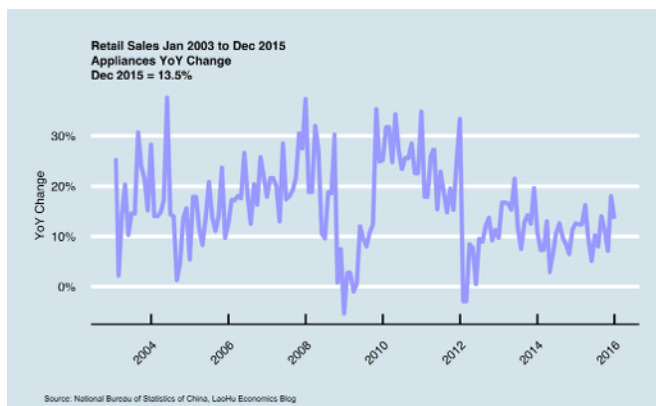
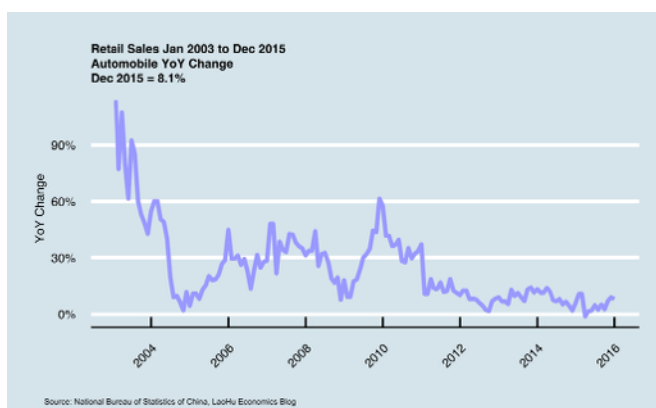
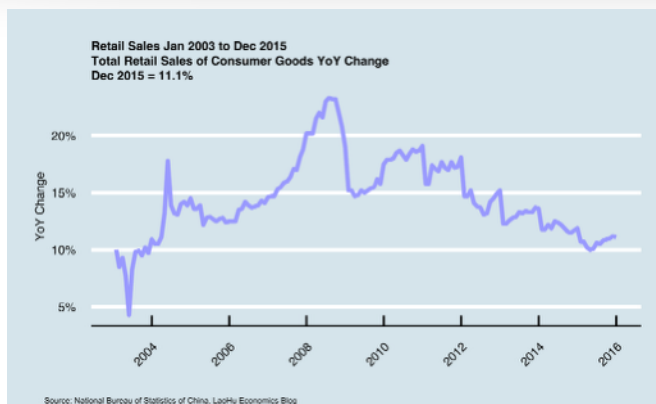
**House prices continue to rise, primarily in the top-tier cities.** Declines in new housing starts have eased, but construction activity still remains a drag on overall growth.

**PBOC easing has not boosted overall credit growth.** Attempts to reflate growth via monetary easing have been negated by reining in shadow banking and cleaning up local government debt.

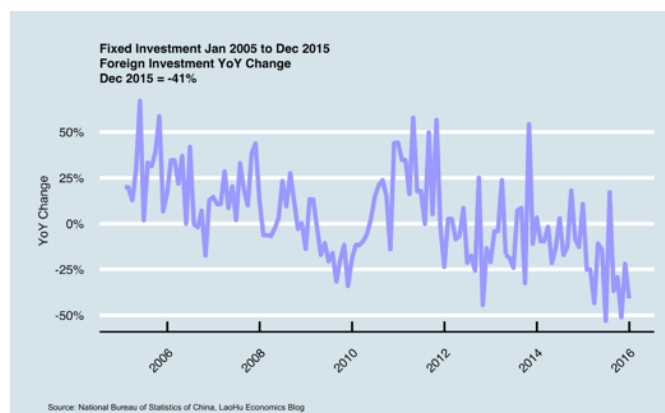
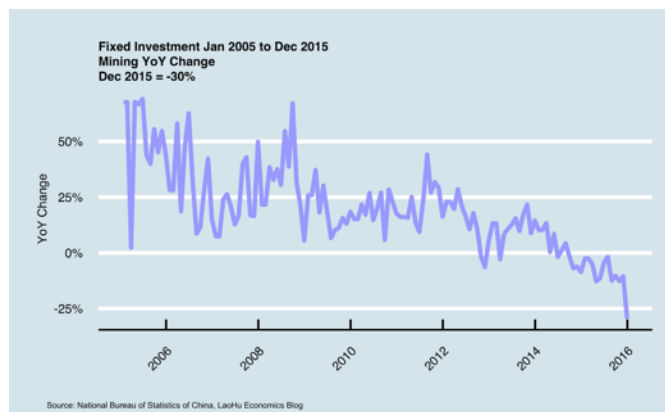
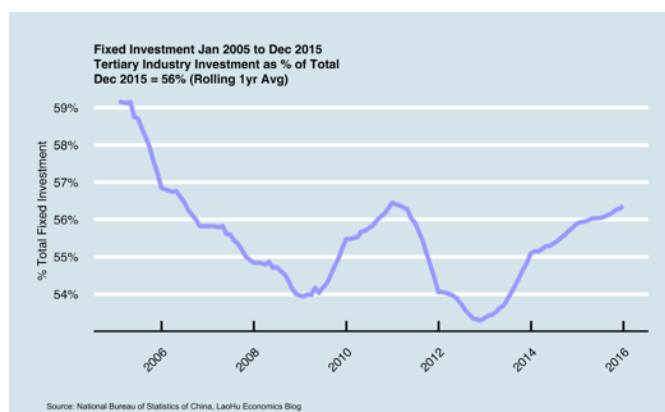
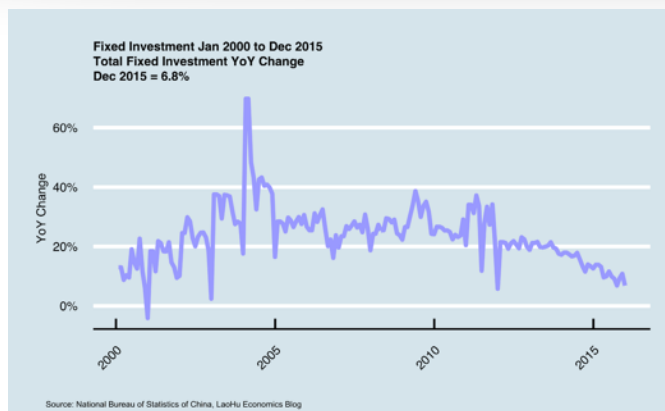


- Q4 GDP came in at 6.8%, with 2015 growing at 6.9% overall. Without the extreme surge in financial services from the spectacular stock market boom/bust, **underlying 2015 GDP growth was probably around 6.4%**.
- Beijing reflation efforts modestly helped the secondary sector (industry and construction). The service sector moderated to 8.1% as the boost to financial services from stock market activity faded.
- The service sector accounted for 50.5% of economic growth in 2015, with secondary falling to 40.5%. As underdeveloped services grow rapidly, employment can remain stable while overall GDP growth slows.
- Next year we will continue to see industry slow more sharply than the overall economy. That will weigh on commodity demand, even as overall GDP growth experiences a stable slowdown in 2016 (See bottom left chart).
- Beijing will probably cut the growth target another 0.50% in 2016, resulting in less reflation effort from Beijing.



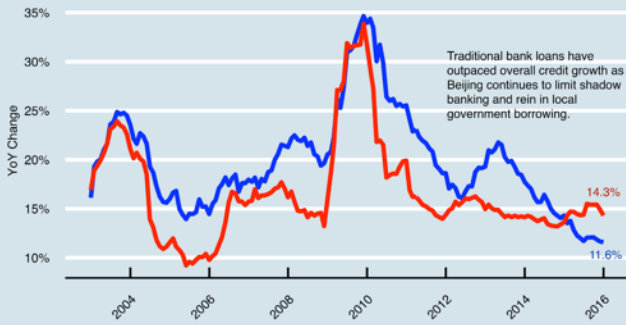


- China's retail sales continued to grow at a rapid pace in December. Consumption will remain a key driver to growth in 2016 as Beijing reforms push for more rebalancing.
- Consumption numbers from foreign firms operating in China supported the positive official numbers. Starbucks is expanding after rising sales. According to Bloomberg, Nike sales in China are up 24% this year. Automakers in Japan and the US saw a surge in auto sales after Beijing support. Ford saw December sales surge 27% from last year. Honda saw 2015 sales jump 32.5% on the year. GM and its joint ventures saw record sales in 2015.
- Retail sales have been improving after the summer's stock market turmoil. That would support the view that stock market turmoil had limited negative pass through to the real economy. It would also indicate that potential spenders who delayed purchases on order to pile cash into the hot stock market in early 2015 have reversed their behavior and are now deploying money into consumer goods having seen the ugly side of a stock market bubble.
- Record-breaking online sales on Nov 11th "singles day" - a once obscure anti-Valentines day style holiday that Alibaba over the last six years has promoted to the largest online retail shopping day on the planet - boosted sales growth. Alibaba alone had \$14.36 billion in sales for the day, up 60% from last year, compared to less than \$3 billion spent with all online retailers on Cyber Monday in the US last year. According to Wired, the company made plans to deploy 1.7 million delivery personnel to handle the business.
- Auto sales improved on support from Beijing via tax breaks.



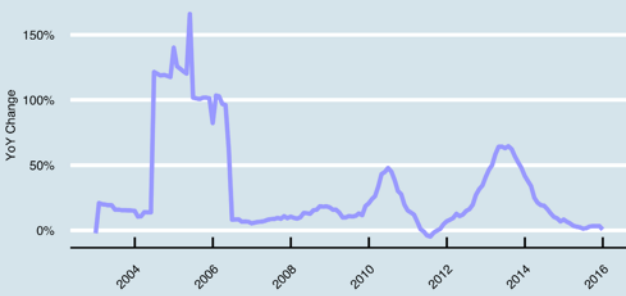
- Investment growth, adjusted for a monthly comparison to last December, shows continued weakness in overall investment.
  - More investment is moving into the service sector, already capturing well over half of investment. That will mean a continuation of China's two-speed economy for some time.
  - Expect that trend to continue into 2016 if Beijing cuts its growth target another 0.50%, and thus cuts back on reflation efforts.
  - Mining has taken the brunt of the investment slowdown, declining 30%.
  - Foreign investment has fallen dramatically with declines in China sentiment and weak global growth.
  - Investment in steelmaking continues its decline of multiple years. Investment growth in heavy industry saw its peak years ago.
  - Investment in manufacturing slowed to 4%, below overall investment, as prospects for global and domestic growth go lower.
- **Going forward:** We may see more infrastructure investment pick up with recent fiscal spending and a rise in bank lending. This will reduce the sharpness in heavy industry declines due to overcapacity issues.

Total Financing YoY Change (blue) and Total Outstanding Bank Loans (red) to Dec 2015



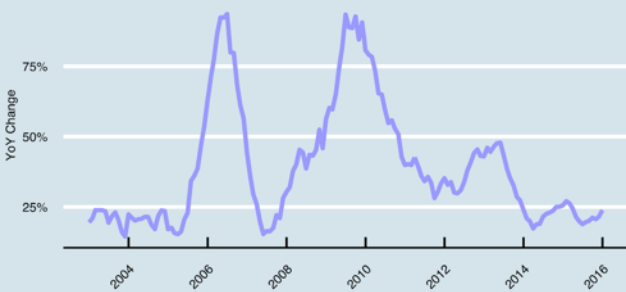
Source: National Bureau of Statistics of China, LaoHu Economics Blog

Credit Growth Dec 2002 to Dec 2015  
Trust Loans YoY Change  
Dec 2015 = 0.64%



Source: PBOC, LaoHu Economics Blog Estimates

Credit Growth Dec 2002 to Dec 2015  
Non Financial Bonds YoY Change  
Dec 2015 = 23.91%



Source: PBOC, LaoHu Economics Blog Estimates

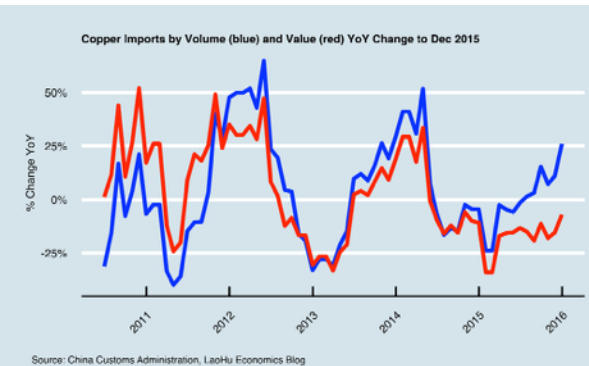
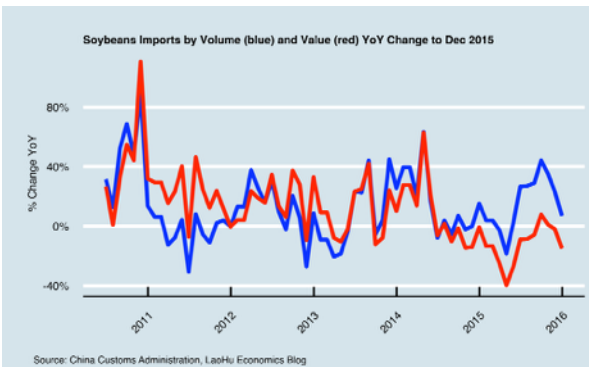
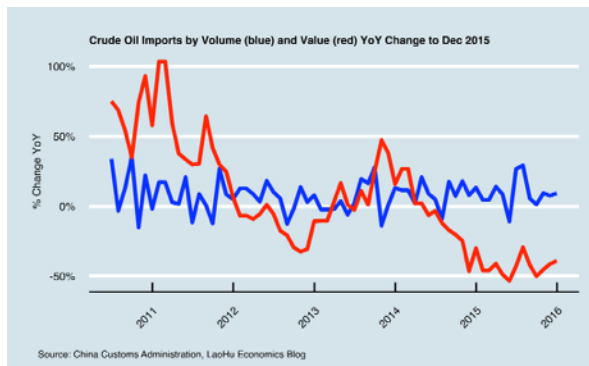
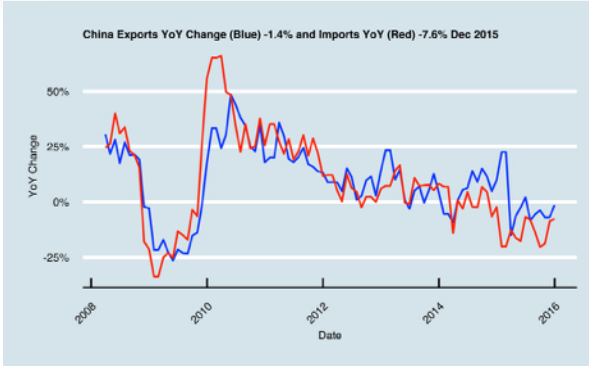
12 Month Shibor Minus Inflation to Nov '15



- **After a year of easing measures, credit growth seems to have stabilized over the last couple of months.** Overall credit growth was on a downward trajectory when Beijing started to rein-in shadow banking. We have possibly seen the bottom for the time being, somewhere around 12% or so.
- Credit is still growing faster than nominal GDP, albeit at a much slower pace. That means the debt to GDP number will continue rising.
- More transparent credit growth (bond issuance, for example) is outpacing less transparent forms of credit (trust loans, for example).
- Interest rates relative to inflation are still higher than in previous easing cycles. Either more easing is on the way, the PBOC expects higher inflation going forward, or the PBOC is more concerned with reining in debt excesses than boosting credit beyond what is needed for growth targets. My money is on a combination of all three.

### Going forward:

- Expect modest easing measures going forward, probably less than consensus as the PBOC sees policies finally bearing enough fruit to get to 6.9% and is worried about stoking excesses. But, as seen in the chart on the bottom left, monetary policy may be too restrictive still, and some easing will come.
- Stable credit growth should mean at least stable investment, which should put a floor on growth for some months.



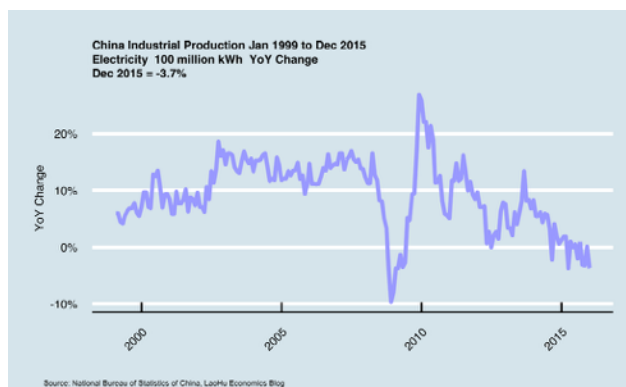
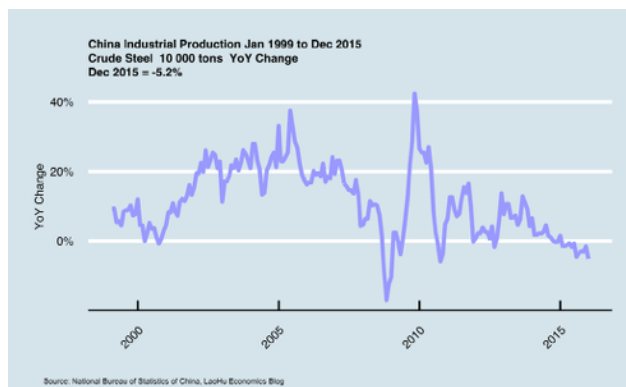
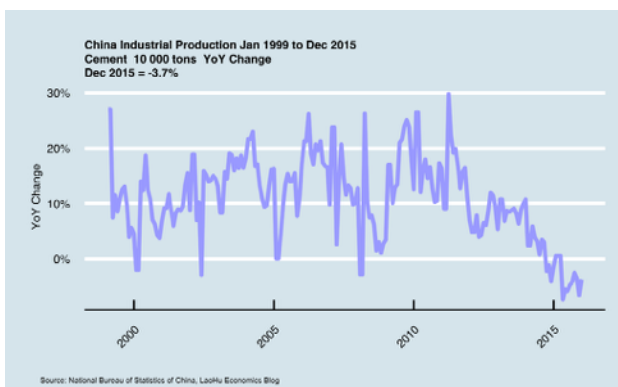
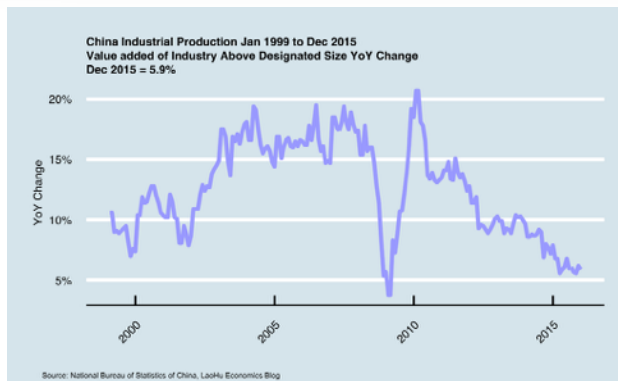
- Trade data came in better than expectations. A weaker yuan might have helped contribute to the better numbers after declining around 4% vs. both the USD and JPY. But, the yuan is still almost 8% higher against the EUR, China's largest trading partner currency. So, a weaker yuan has probably only contributed a modest improvement to the trade data.
- Trade for processing and exports was much weaker than trade for domestic use. Exports for processing declined 10% from last year. That points to weak global trade in general.
- Key commodity imports by volume increased from last year. On the year, crude oil imports rose 9%, with copper and iron ore -0.3% and 2% due to declines early in the year. Commodity demand has increased going into 2016.
- China's share of total global exports is still rising, and the trade surplus continues to hit new record highs. Those two factors leave little reason for an engineered fx devaluation from Beijing meant to make exports more competitive. Exports are already competitive, and growth stimulus needs to come from domestic tools.
- **Going forward:** Expect trade numbers to remain weak due to: yuan strength vs some key trading partners over the last year, weak global demand, slower domestic industry, and negative commodity prices baked into the numbers.

Imports from YoY Change Dec 2015

Vietnam	287 %
Hong Kong	65 %
ASEAN	31 %
Brazil	19 %
Canada	-1 %
Taiwan	-3 %
Thailand	-3 %
Korea	-3 %
Indonesia	-5 %
Malaysia	-5 %
US	-7 %
India	-8 %
Japan	-9 %
Italy	-11 %
New Zealand	-11 %
Philippines	-12 %
Russia	-14 %
UK	-15 %
Netherlands	-18 %
EU	-18 %
Australia	-19 %
Germany	-20 %
South Africa	-21 %
Singapore	-24 %
France	-33 %

Exports to YoY Change Dec 2015

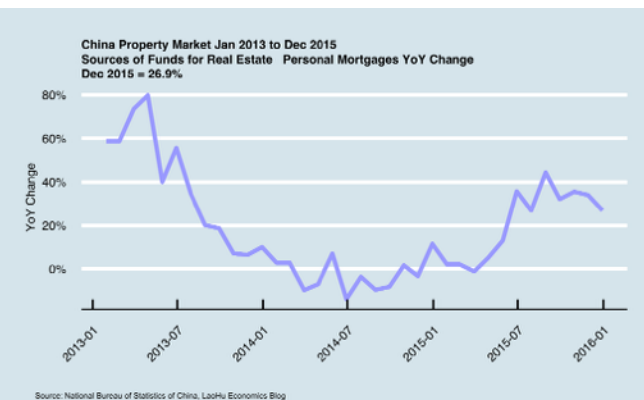
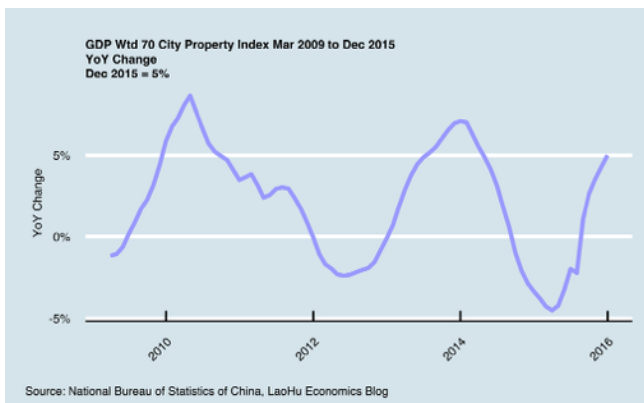
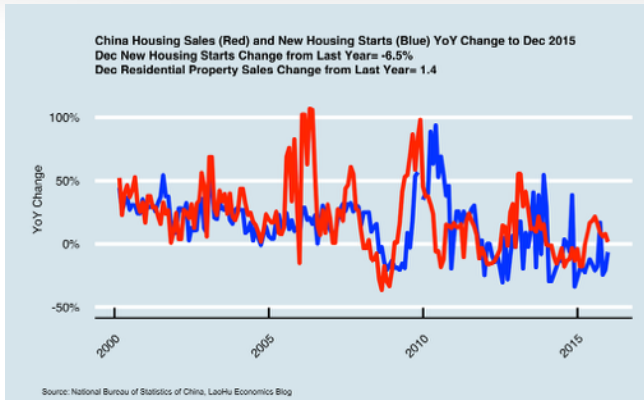
Philippines	26 %
UK	19 %
Hong Kong	11 %
Australia	7 %
India	5 %
New Zealand	3 %
EU	2 %
Italy	0 %
Korea	0 %
Germany	0 %
Taiwan	-1 %
France	-1 %
US	-3 %
Thailand	-4 %
Japan	-5 %
Singapore	-5 %
ASEAN	-6 %
Netherlands	-6 %
Vietnam	-7 %
South Africa	-10 %
Canada	-10 %
Malaysia	-20 %
Indonesia	-21 %
Russia	-27 %
Brazil	-36 %



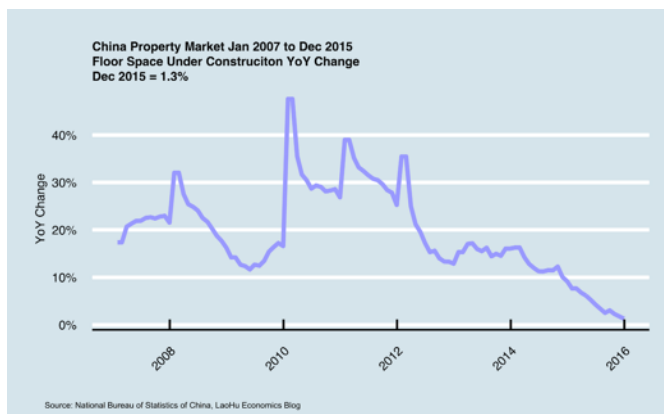
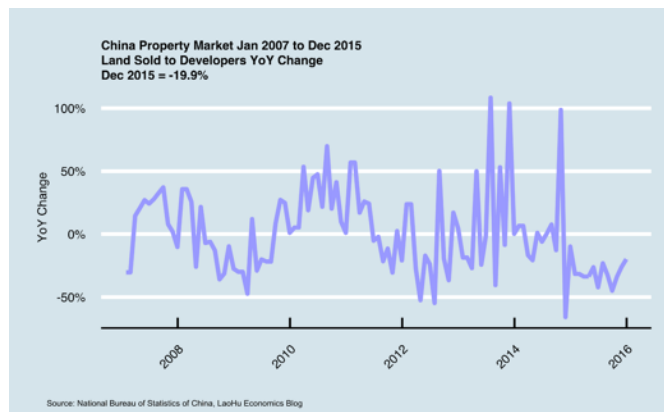
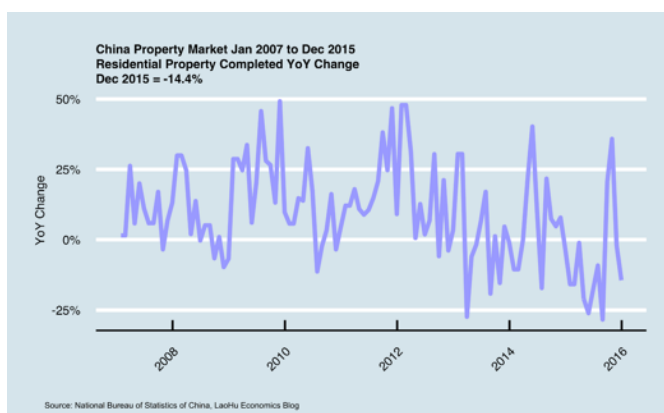
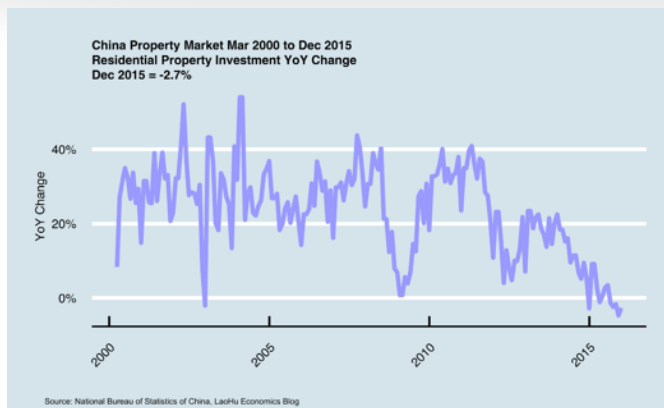
- The industrial sector continues to slow. December industrial production grew at a relatively weak 5.9% from last year, primarily driven by declining heavy industry.
- Steel and cement output are still falling.
- Xi Jinping has targeted fixing overcapacity as a key policy objective going into 2016. That will push many heavy industries, like steelmaking, even lower.
- 2016 fiscal support will come in the form of tax breaks over spending, meaning a lower chance of targeted stimulus supporting tradition production sectors.
- 60% of electricity output goes into heavy industries, like metal smelting. Electricity production has fallen 3.7% from last year.

- **Going forward:** Industrial production will continue to weaken slowly, driven mainly by declines in heavy industries until investment picks up. Xi Jinping has targeted fixing overcapacity as a key policy objective going into 2016. That will push many heavy industries, like steelmaking, even lower.





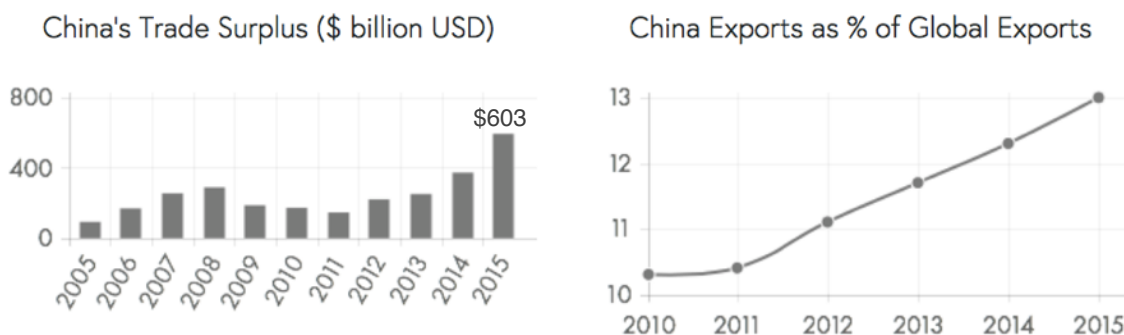
- China's housing market continues to rebound. But, construction activity continues to decline, limiting the positive effects on the overall economy.
- Beijing has supported the housing market, lowering borrowing rates and reducing the down payment required for first-time buyers (from 30% to 25%). This has resulted in a rise in mortgage issuance. Some local leaders have begun to institute their own policies to stimulate housing sales.
- Most of the rebound has taken place in the top-tier, wealthier cities, especially on the coast. The hinterlands (where most overcapacity and ghost cities have been built) are still negative. A housing rebound in the larger more economically vibrant provinces will add to broad growth prospects.
- New housing inventory has contracted this year - more than any time in the last few decades. I calculate that this amounts to about 1.5 million fewer housing units on tap to be finished this year compared with last year. After a surge in sales, at the current pace demand is probably outstripping supply this year.
- **Going forward:** Tighter inventory in the wealthier and larger tier 1 and 2 cities where activity has rebounded will help keep housing prices positive into 2016. Most ghost towns were constructed in the lower-tier hinterlands according to the IMF. When inventory runs down in the top-tier cities, construction should begin to rebound.



- Declining new housing starts, weak real estate investment, and declining steel and cement demand all show that construction activity is still in the doldrums in spite of rebounding sales and prices.
- About a third to a half of iron ore goes to housing construction, with another third to infrastructure, and the rest to other activities.

Going forward we can expect to see a tug-of-war play out in the short- and near-term between market forces putting downward pressure on a technically overvalued yuan, and policymakers on the other side looking to keep the currency stable and strong for economic restructuring and political purposes. The changes to the yuan price fixing mechanism in August and the introduction of the new trade partner broad currency index at the end of 2015 have given market forces more influence over the yuan than anytime in the last few decades. As a result, we will continue to see the occasional PBOC intervention, more volatile foreign fx reserve activity, and larger ups and downs than in the past.

China's share of total global exports is still rising, and the trade surplus continues to hit new record highs. Those two factors leave little reason for an engineered fx devaluation from Beijing meant to make exports more competitive. Exports are already competitive, and growth stimulus needs to come from domestic tools. Downward pressure on the yuan comes from market pressure, not fundamental economic reasons.



Below are some factors putting pressure on the yuan. On balance, you probably mix these factors together and the result will be a modestly weaker yuan over the next year, with very low probability of a major devaluation. I have highlighted what I think are the most important points.

#### Upward pressure

- **A stable or strong currency is important to rebalancing efforts. A policy shift to a meaningfully weak currency is effectively forcing households to subsidize the export industry and goes against the push for consumption rebalancing.** China has massive foreign exchange reserves to support the currency and thus the rebalancing agenda for years, regardless of the outflow pressures. That is a factor of major importance, perhaps more than many analysts recognize.
- Bond market inflows from central bank reserves and sovereign wealth funds post-IMF endorsement will eventually increase yuan demand.

#### Downward pressure

- **The primary culprit for yuan weakness has been capital outflow pressures, rising roughly \$140 billion in December.** Most outflows appear to be driven by sentiment and expectations of the inevitability of a weaker yuan. Sentiment has been driven by poor currency policy communication, mishandling of the stock market boom/bust, and skepticism over Beijing's ability to manage the growing economic problems.
- The yuan is the most overvalued major currency in the world on a trade weighted basis.
- The PBOC is easing and the Fed is hiking.
- China is becoming an exporter of investment capital.

#### Stable

- Beijing's global credibility would be at risk with a sizable devaluation now that it has been officially endorsed as a reserve currency and wants to attract foreign capital.
- China is hosting the G20 next year and probably does not want to be viewed as setting off a currency war ahead of the meeting.
- Beijing might want to mitigate US election year criticism and potential US congressional backlash.
- Although voted into the SDRs, the yuan will not officially be a part of the SDRs until the end of 2016. A major devalue may draw bad attention from the IMF.
- Beijing wants to open the capital account and free float the currency over 5 years. It will have a difficult time with that with momentum pushing too far one way or another. Having given up some control over setting the fixing, moves too far in either direction can have a spiraling effect and get out of the PBOC's control quickly. Big efforts to keep the fx in a tight range now will help keep the fx from running away later.

**Don't count on Chinese consumers to replace the hole in global demand left by declining demand from China's once rapidly growing industrial and construction sectors.** China's industry and construction sectors drive demand for commodities and industrial machinery, the economy's primary imports.

China, being the main producer of the world's consumer goods, needs few imports from the rest of the world. By my calculation, using 2013 data from the National Bureau of Statistics of China, only 2% of China's total imports are consumer goods. Roughly 5% of all imports are edible agricultural products and foodstuffs. Another 5% of imports are all vehicles to transport people; planes, trains, and autos. The rest of China's imports are primarily meant for its massive industry and construction.

China's restructuring towards consumption and services will not fill the gap in overseas demand left by declining industry. Stable Chinese growth equals lower overall commodity demand.

### CHINA CONSUMPTION OF KEY COMMODITIES AS A PERCENT OF GLOBAL CONSUMPTION

LaoHu Economics Blog

