

December 12 2015

China Chartbook

November 2015 Data

Growth Picks Up in November, and the Two-Speed Economy Rolls On

November economic data in a nutshell: Overall growth picked up in November, due primarily to the strong service sector and revved up consumption. Monetary easing has finally put a floor on outstanding credit growth, which has bottomed around 12% after a long march downward. That is a positive development since sinking credit growth has been a positive for slowing China's debt pile accumulation, but has been a major headwind to growth recently. Investment has rebounded, putting a floor on growth prospects for some months to come. Most investment is gravitating to the service sector at the expense of industrial output. Housing sales and prices are still moving higher, but construction activity and real estate investment are still very ugly. Industrial activity improved from October, but remains sluggish. The economy is still running at two speeds: high growth services and consumption, with weak and declining industry.

After seemingly waiting in vain for a meaningful boost from government fiscal and monetary stimulative measures, we are finally seeing those measures bear fruit.

Fiscal expenditures are on the rise. Fiscal expenditures rose over 36% in October vs. last year. As a result, infrastructure investment has rebounded, which will help keep growth at an improved pace for some months to come.

China's consumption continued to rise in November, with retail sales growing at a rapid 11.2% from last year. With industrial production growing well below that pace at 6.2%, economic rebalancing continues to moving forward.

Next Spring 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. Policymakers set the five-year plan and 2016 targets when they met in October. Targets will be announced in the spring. Xi himself has effectively put a 6.5% floor on real GDP growth for the next 5 years in order to meet growth goals.

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November 2015 Summary Data

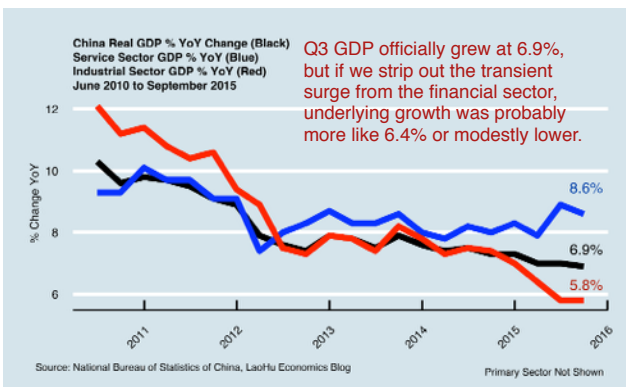
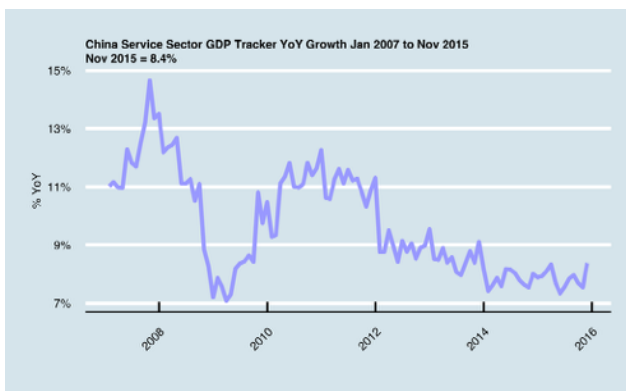
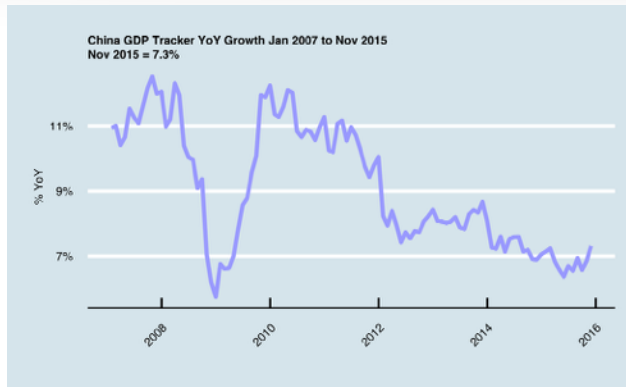
| | Nov '15 | Oct '15 |
|---------------------|---------|---------|
| In Production | 6.2% | 5.6% |
| Retail Sales | 11.2% | 11.0% |
| Real Retail Sales | 11.0% | 11.0% |
| Fixed Inv (month) | 10.8% | 9.35% |
| Exports | -6.8% | -6.9% |
| Imports | -8.7% | -18.8% |
| Manu PMI | 49.6 | 49.8 |
| Service PMI | 53.6 | 53.1 |
| Housing Sales | 7.8% | 5.9% |
| Completed Housing | -2.0% | 35.8% |
| Housing Starts | -20.7% | -24.4% |
| CPI | 1.5% | 1.3% |
| Outstanding Loans | 15.3% | 15.4% |
| Total Financing YoY | 11.9% | 11.8% |
| M2 YoY | 13.7% | 13.5% |

The housing market continues to rebound. Sales and prices - in the top tier cities in particular - have rebounded. Construction still remains in the doldrums and has yet to stem declines, resulting in continued weakness in heavy industries and steel consumption (construction accounts for somewhere between a third to a half of steel consumption).

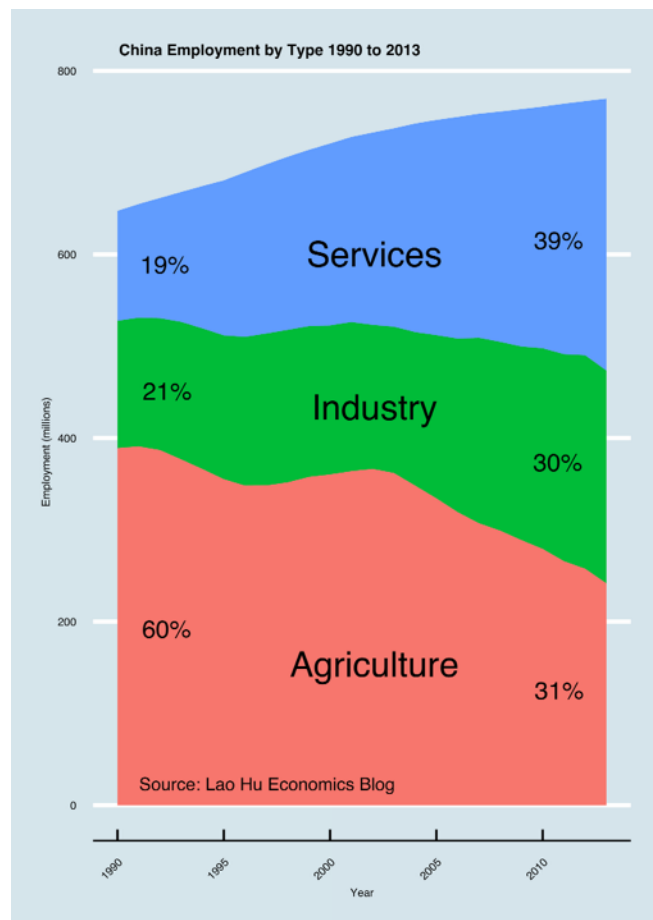
The IMF voted to include the yuan in the Special Drawing Rights (SDRs). The SDR's yuan addition will take place in October of 2016. This is the first change in the SDR currency make-up since 1999. The yuan weight will be nearly 11%, compared to roughly 8% for the JPY and GBP. The USD and EUR will be roughly 42% and 31% respectively. For more info on the yuan see my past blog posting ***5 Important Things You Should Know About The Chinese Yuan***. As mentioned in previous blog postings, recognition by IMF as a reserve currency in the SDR gives the yuan significantly improved credibility among central banks as a reserve currency. Beijing's end goal is not to become a small slice of the \$280 billion SDRs. The end goal is to become a large slice of the \$11 trillion reserve asset market for both political and economic reasons. The IMF's stamp of approval will also potentially facilitate inflows from sovereign wealth funds and other institutional money managers. The decision will most likely result in yuan inflows over the next five years. Goldman Sachs estimates \$1 trillion flowing into China's bond market. Standard Chartered expects the IMF endorsement to lead to \$1 trillion in reserve assets to be shifted to yuan over five years.

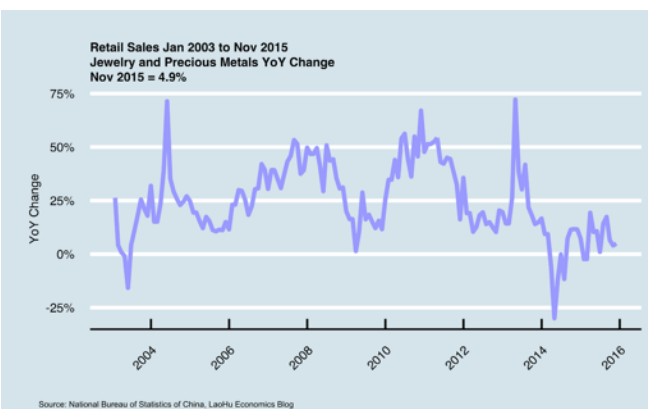
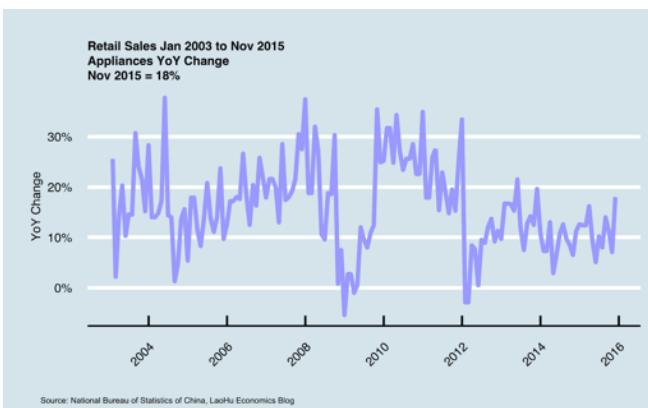
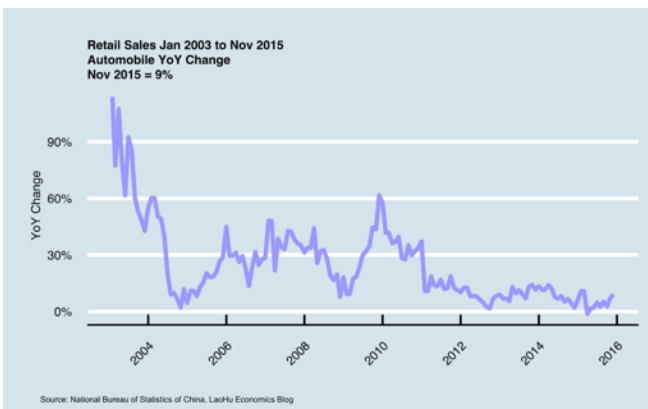
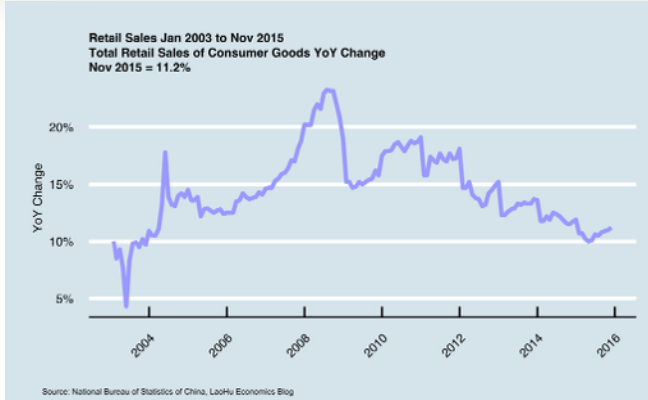
Never before have China's economic reforms been so precariously balanced between keeping prosperity robust for the masses and reining in excesses and imbalances from a supercharged decades-old industrial policy. **Policymakers are attempting to fulfill two often diverging goals.** Beijing is trying to stimulate growth just enough to hit around the target and keep employment stable without going too far and adding to the debt pile. And, at the same time Beijing is going through the often messy job of pushing reform and rebalancing policies that sink traditional growth drivers and risk crushing the economy. **November data shows that these two goals are sufficiently being met for now.**

That being said, while restructuring and stable growth is good for China, consumption and service booms cannot fill the void in global demand left by China's faltering industrial behemoth. China's contribution to global GDP at a robust 7% growth is a positive one mathematically, but the country's transition will continue to be a drag on growth for many economies worldwide.

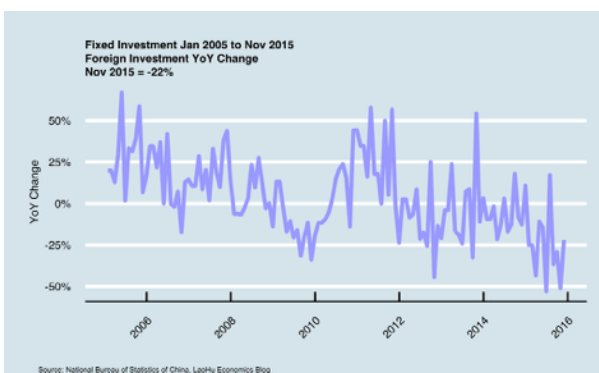
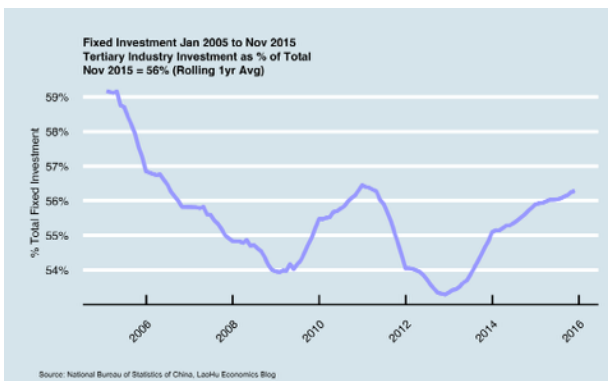
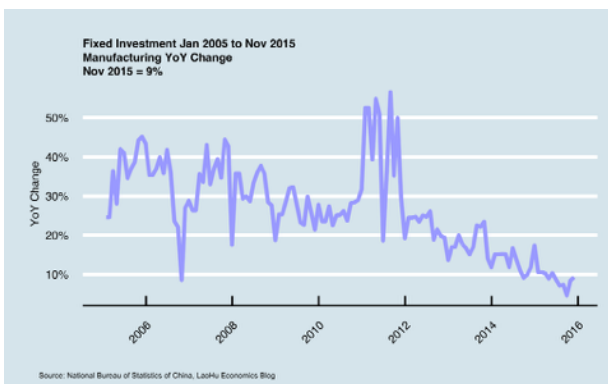
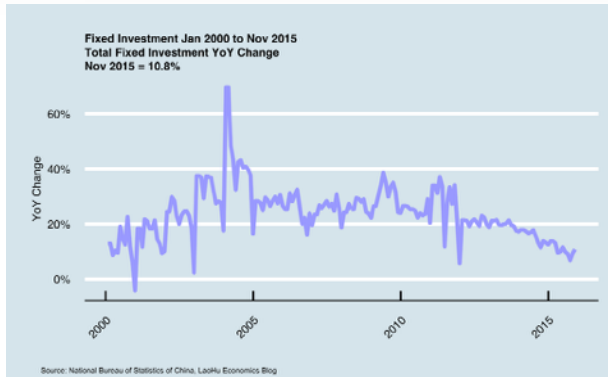


- My GDP tracker index shows November probably grew at the equivalent of 7.3% overall - a significant upturn. Once again the main drivers were the fast growing service sector and rising consumption.
- The improved economic activity was most likely a result of fiscal spending plans and monetary easing finally bearing fruit. Money supply grew at 13.7%. Fiscal stimulus has finally kicked in, with fiscal spending up over 36% in October. Investment rebounded and credit growth has stabilized.
- 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.
- Beijing will probably cut the growth target another 0.50% in 2016, resulting in less reflation effort from Beijing, and therefore more uneven two-speed growth with strong services and weaker industry.
- In October, Xi announced a 6.5% floor on growth until 2020.





- China's consumption continued to rise in November, with retail sales growing at a rapid 11.2% from last year. With industrial production growing well below that pace at 6.2%, economic rebalancing continues to moving forward.
- 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.
- Retail sales have been improving post-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 in order to pile cash into the hot stock market earlier this year have reversed their behavior and are now deploying money into consumer goods having seen the ugly side of a stock market bubble.
- Auto sales improved on support from Beijing via tax breaks.
- **Going forward:** Continued restructuring efforts by Beijing will benefit consumption, which has become the key driver to growth in 2015. Expect a positive wealth effect from rebounding property prices into 2016 as well.



- Investment has finally picked up after a long slow downtrend, rising 10.8% from November of last year.
- More investment is moving into the service sector, already capturing over half of investment (see the third chart from the bottom). 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 11%.
- 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.

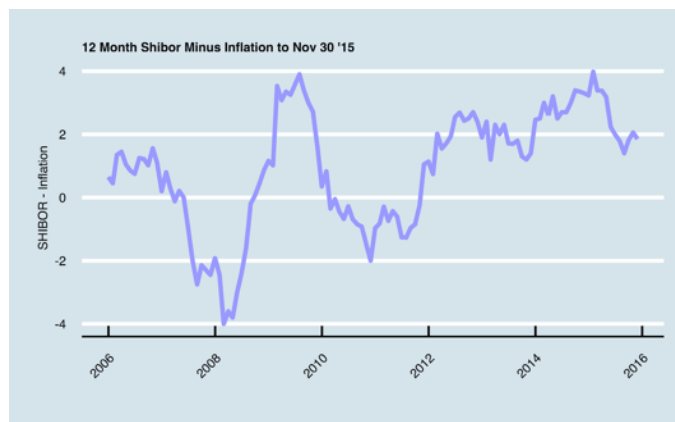
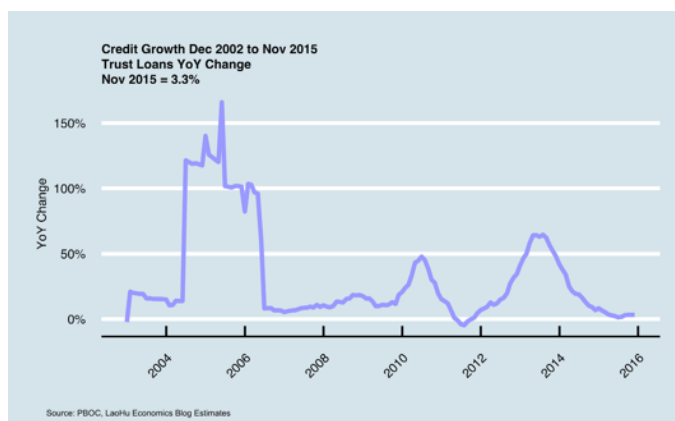
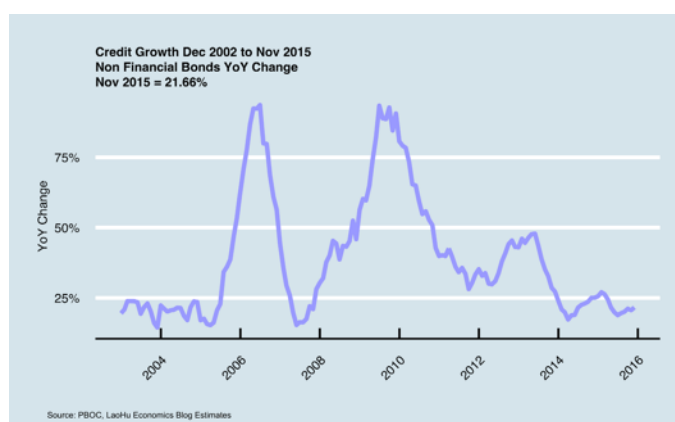
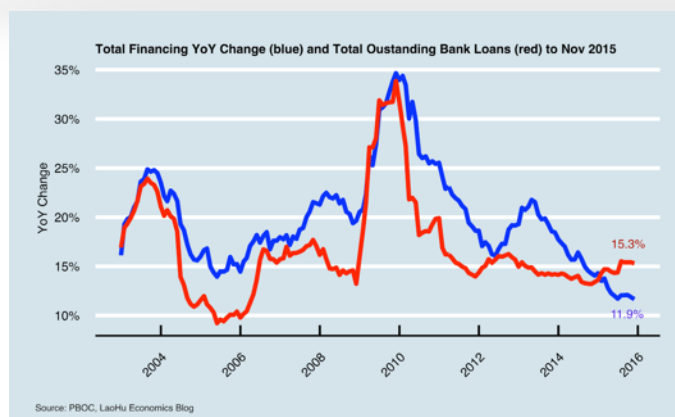
- **Going forward:** We may see more infrastructure investment pick up with recent fiscal spending. The better investment numbers will put a bottom on growth over the next few months.

Credit and Finance

The Credit Slowdown Finally Stabilizes After A Year Of Easing

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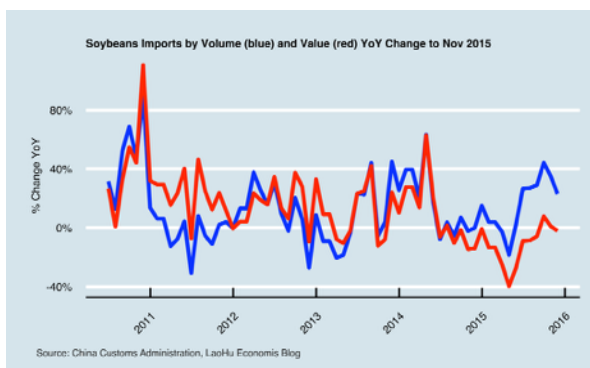
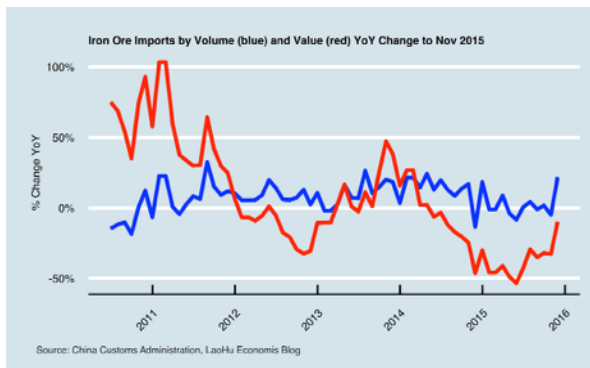
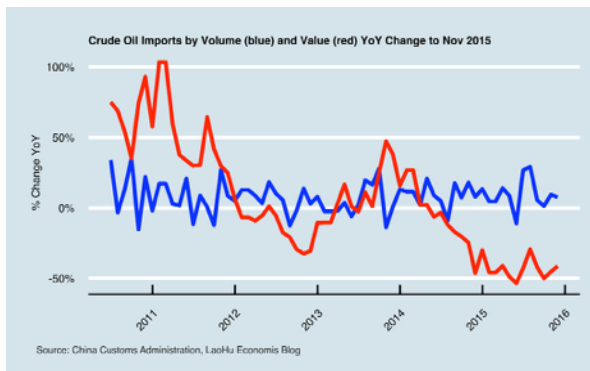
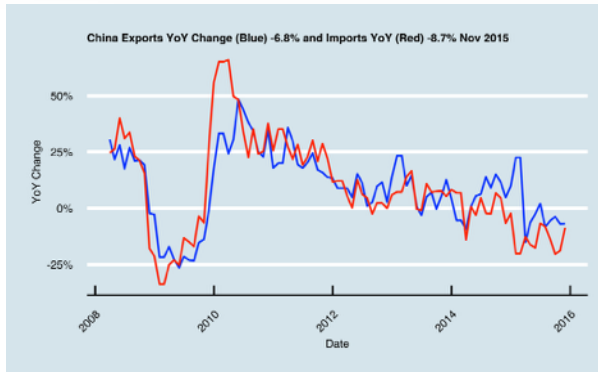
- **After a year of easing measures, credit growth seems to have stabilized over the last couple of months.** Overall credit growth was on a downward trajectory when Beijing started to rein in shadow banking. We have possibly seen the bottom for the time being - somewhere around 12% or so.
- The headline broad credit number surged in November. But, credit is seasonal and increases into the year end. Compared to last year, the number is stable but sluggish by China standards.
- 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 7% 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 to come.

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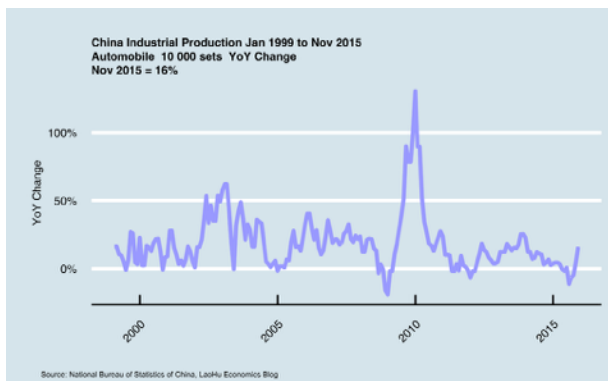
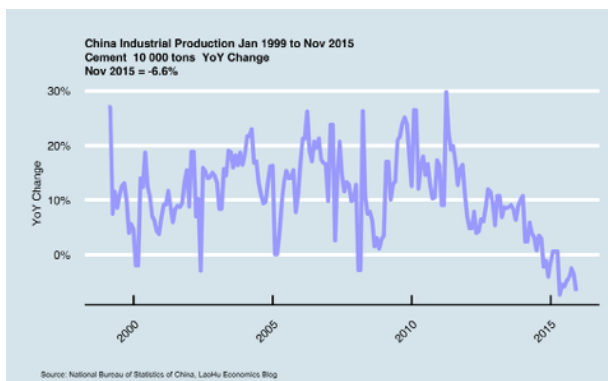
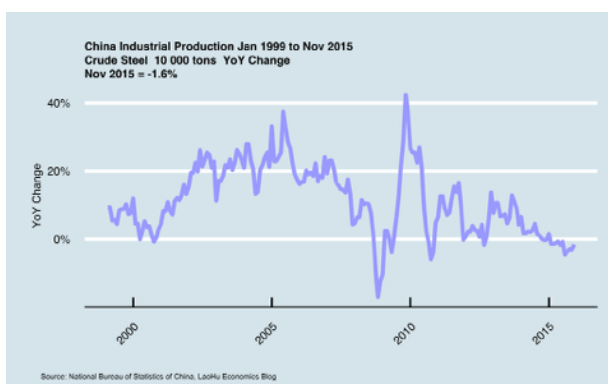
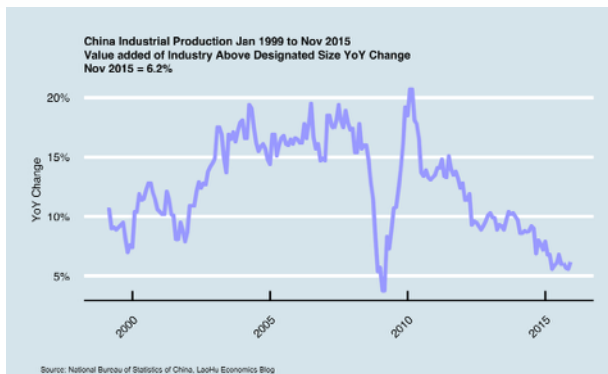
- There were three important factors at work in the numbers:
 - Slow global growth has pushed down trade for processing and re-export.
 - Manufacturing imports overall declined as a result of slowing investment.
 - Commodity import volumes surged for some key commodities.
- Trade for processing was down much more than trade for domestic use. Imports for processing dropped 16% from last year in a bearish sign for the global trade supply chain.
- Exports to the larger EM countries dropped 30 - 40% in a bearish sign for growth in those economies.
- Iron ore, crude oil, copper, natural gas, palm oil, and soybean imports by volume are all up meaningfully from last year
- China's currency vs. most trade peers has been strong over the last year (up 8% on the EUR and double digits vs. most BRICS), but the yuan is now modestly lower vs. both the USD and JPY.
- Going forward:** Expect trade numbers to remain weak due to: yuan strength vs. most trading partners over the last year, weak global demand, slower domestic industry, and negative commodity prices baked into the numbers.

Imports from YoY Change Nov 2015

| | |
|--------------|-------|
| Brazil | 35 % |
| Vietnam | 30 % |
| Hong Kong | 20 % |
| France | 11 % |
| Netherlands | 7 % |
| Thailand | 7 % |
| Korea | 5 % |
| India | 4 % |
| Taiwan | 1 % |
| ASEAN | -1 % |
| Indonesia | -3 % |
| Malaysia | -4 % |
| US | -7 % |
| EU | -9 % |
| Singapore | -9 % |
| New Zealand | -9 % |
| Japan | -10 % |
| Italy | -11 % |
| Canada | -11 % |
| Australia | -14 % |
| Philippines | -15 % |
| Germany | -16 % |
| Russia | -20 % |
| UK | -28 % |
| South Africa | -36 % |

Exports to YoY Change Nov 2015

| | |
|--------------|-------|
| Philippines | 15 % |
| Thailand | 7 % |
| Vietnam | 3 % |
| Korea | 1 % |
| India | 0 % |
| New Zealand | -1 % |
| Australia | -1 % |
| ASEAN | -3 % |
| Singapore | -3 % |
| Hong Kong | -3 % |
| Taiwan | -3 % |
| UK | -4 % |
| US | -6 % |
| EU | -9 % |
| Italy | -10 % |
| Germany | -10 % |
| Japan | -11 % |
| Netherlands | -12 % |
| France | -13 % |
| Canada | -14 % |
| Malaysia | -18 % |
| Indonesia | -23 % |
| South Africa | -28 % |
| Russia | -39 % |
| Brazil | -45 % |



- The industrial sector remains weak, dragged down by declining heavy industries like smelting and construction materials. If Beijing cuts the growth target another 0.50%, expect industrial production to potentially slow into the 5% range or lower in 2016.
- Heavy industries in particular have been hit hard as infrastructure building slows from an extremely rapid pace. Cement and steel production are both in decline.
- Heavy industry uses 60% of China's electricity output. The sluggish electricity output numbers (up only 0.1% on the year) are another indicator of just how weak industrial output has become.

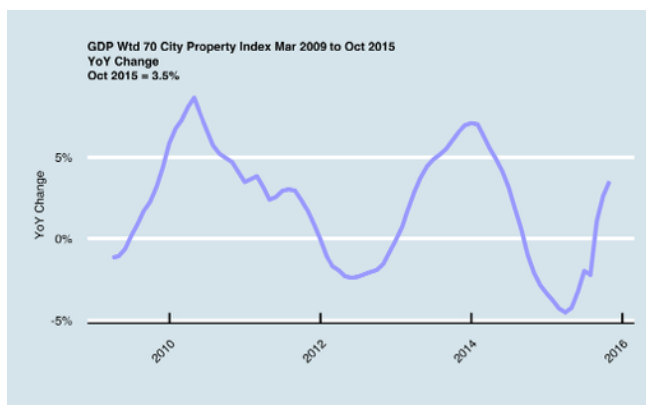
- **Going forward:** Industrial production will continue to remain relatively sluggish, driven mainly by declines in heavy industries as restructuring takes place and the growth target is cut. If we see a bounce from reflation efforts or an improved property market, expect those gains to be short-lived in 2016. That should keep commodity demand subdued for some time.

Housing Market

Rebounding sales, falling construction

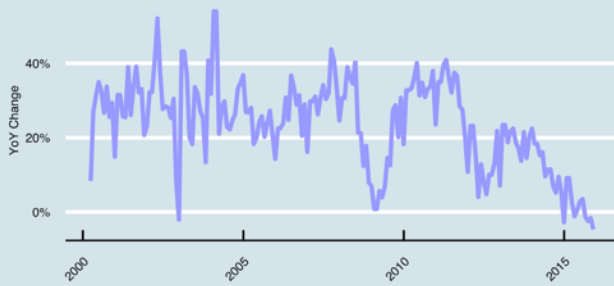
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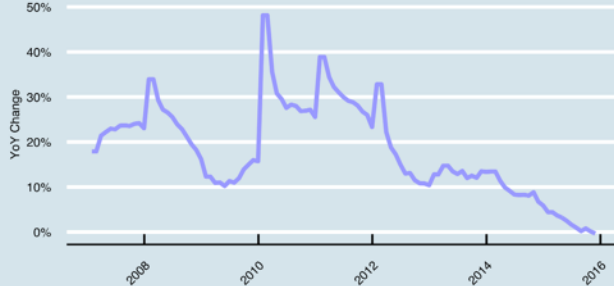
- China's housing market continues to rebound with sales increasing and prices rising. But, construction activity continues to decline, limiting the positive effects on the overall economy.
- Beijing has supported the housing market, lowering borrowing rates and reducing the down payment required for first-time buyers (from 30% to 25%). That 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.

China Property Market Mar 2000 to Nov 2015
Residential Property Investment YoY Change
Nov 2015 = -4.7%



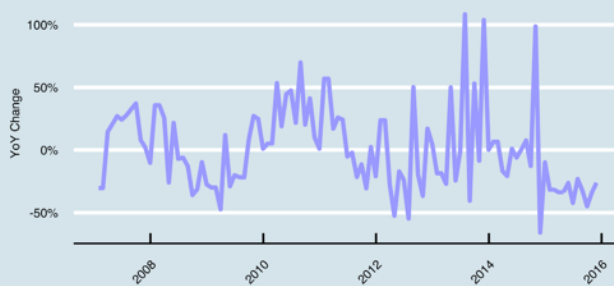
Source: National Bureau of Statistics of China, LaoHu Economics Blog

China Property Market Jan 2007 to Nov 2015
Residential Property Under Construction YoY Change
Nov 2015 = -0.3%



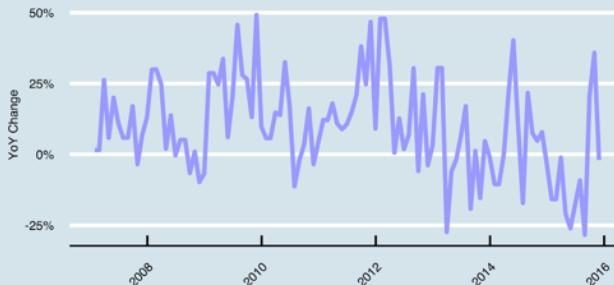
Source: National Bureau of Statistics of China, LaoHu Economics Blog

China Property Market Jan 2007 to Nov 2015
Land Sold to Developers YoY Change
Nov 2015 = -26.1%



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

China Property Market Jan 2007 to Nov 2015
Residential Property Completed YoY Change
Nov 2015 = -2%



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

- 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 an overvalued yuan, and policymakers on the other side looking to keep the currency stable and strong for economic restructuring and political purposes. 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.

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 a lower probability of a major devaluation.

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. This is 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.

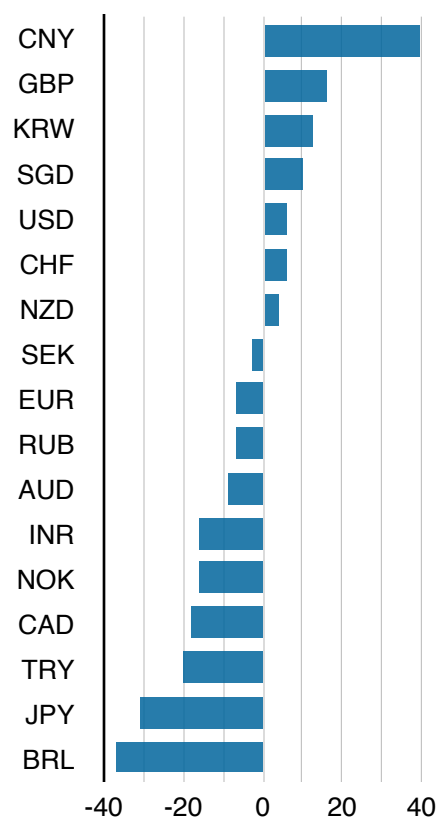
Downward pressure

- The yuan is the most overvalued major currency in the world (see the chart on the right).
- The PBOC is easing and the Fed ready to hiking.
- China is becoming an exporter of investment capital.
- Exporters are feeling the squeeze, putting pressure on Beijing.

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.

■ REER % 5YR Change



China's Commodity Consumption

China's Consumers and Service Industry Can't Fill the World Growth Void Caused by Slowing Industry

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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

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