Global Macro Research - Insight

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China: Activity firms while policy eases

October data add to the stronger picture painted by the September and August activity releases. Policy appears to be increasingly gaining traction and property could get further support.

Key Takeaways

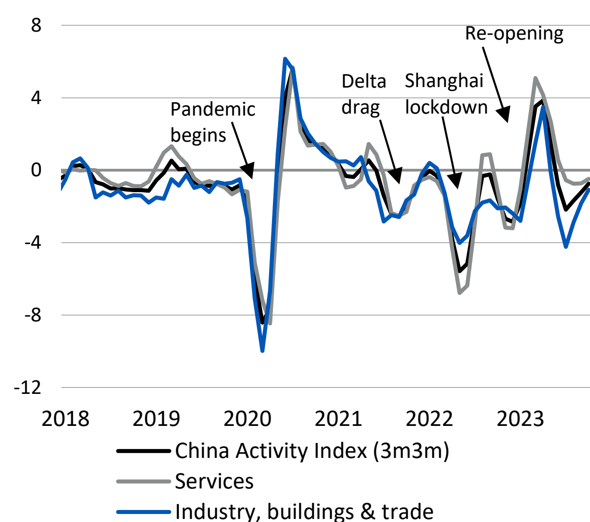
- China's latest hard data were a mixed bag, but they were more encouraging than the PMIs. Retail sales and services saw notable improvement, and, on balance, the three-month data flow has become more reassuring.
- The property sector remains a major vulnerability, but a range of key activity metrics have at least stabilised over the past four to five months. Similarly, funding for developers has stopped falling.
- A rumoured RMB 1 trillion funding programme for urban redevelopment would help provide a firmer foundation, but it remains unclear as to what steady-state we should expect. Indeed, even a stabilisation of 'pipeline' indicators could still imply a sizeable drag via fixed investment on GDP.
- Policy now appears to have gained more traction than we had previously estimated. Our China Financial Conditions Index (CFCI) has been revised up – partly reflecting an updated real equilibrium interest rate (r*) estimate – suggesting that easing to date should do more to support growth heading into 2024.
- Confirmed further stimulus – via an RMB 1 trillion issuance of special central government debt – and November's injection of medium-term lending facility (MLF) liquidity – estimated to be roughly equivalent to a 25bps reserve requirement ratio (RRR) cut – will help ease financial conditions more. This could be amplified by urban redevelopment spending, if confirmed.
- As a result, while we remain somewhat cautious about the outlook for 2024 and beyond, our latest 2024 growth forecast has been revised up (4.4%, +0.2ppts).

Growth momentum improves

Retail sales beat expectations in October, expanding 7.6% year over year – versus 7% pencilled in by consensus. And we estimate that sales volumes may have increased by 13% month over month annualised, helping to counter the falls recorded over June and July.

Industrial production also firmed up modestly in sequential terms, rising from 4.4% to 4.8% month over month annualised, although it remains somewhat lacklustre, perhaps reflecting a still tough external environment.

Figure 1: Smoothing through the volatility, our China Activity Indicator implies activity has recovered



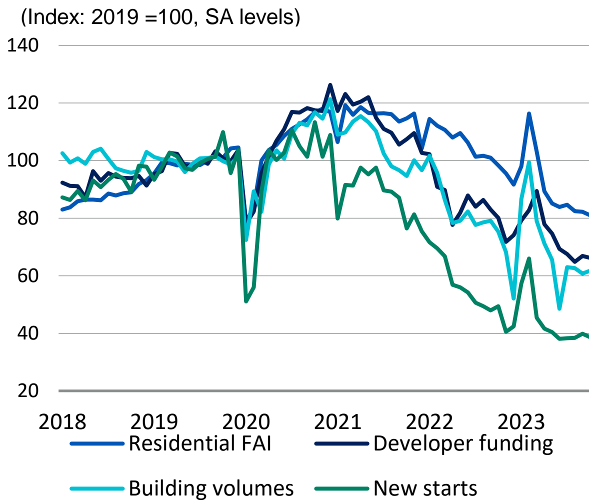
Source: Haver, Refinitiv, abrdn (November 2023)

Putting it all together, our China Activity Indicator (CAI) backs up the conclusion that momentum has picked up from the summer trough (see Figure 1).

Even real estate is looking a bit better. Not being in freefall is of course a low bar, but it is reassuring that we have seen a stabilisation across a range of key metrics.

New starts have been stable over the past five months, while building volumes and developer funding are little changed over the past four months (see Figure 2).

Figure 2: We have had false dawns before, but property is showing tentative signs of stabilising



Source: abrdn, Haver, October 2023

Policy may be about to ease, which could help put property on slightly firmer foundations. Bloomberg has reported that the government is considering an RMB 1 trillion package for social housing and redevelopment. Even if we judge that the full effect of the property market slowdown is unlikely to have been felt yet it should help support activity and reduce downside risks to the economic outlook at a minimum.

Policy now appears to have gained more traction than we had previously estimated

Our China Financial Conditions Index (CFCI) has been revised up, suggesting that conditions are somewhat looser than we had previously thought.

The CFCI level has been revised up from 0.41 to 0.76 standard deviations, implying that the policy easing enacted thus far by authorities has been somewhat more successful at making its way through the financial system and economy (see Figure 3).

Policy & Duration factors continue to be a key driver of accommodative financial conditions and remain so with our latest estimate of real equilibrium interest rates (r*), which have been revised up. Indeed, Policy & Duration factors are now pushing up on the CFCI by 32bps more than we had estimated last month.

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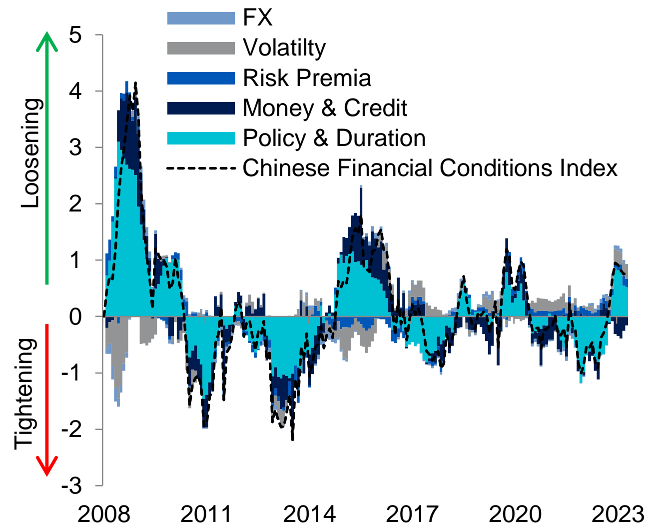
Figure 3: Financial conditions should get a further boost by policy easing not yet captured



Source: Bloomberg, Haver, abrdn, November 2023

The CFCI was little changed between October and September, but it should get support from the government bond issuance and the recent MLF liquidity boost going forward.

Indeed, the central government has already announced an RMB 1 trillion special central government debt issuance to help local governments, which are still struggling with funding in the aftermath of the pandemic and property market slowdown. If it is confirmed, the rumoured RMB 1 trillion for social housing would add additional momentum to credit growth.

The key question remains: is policy doing enough?

More adverse outcomes are limited by our expectation that policymakers will ease further and would also accelerate easing should the economy falter.

But it is still difficult to have confidence that enough has been done to turn market confidence, even if fears of an economic freefall seem increasingly far-fetched.

Investor concern about geopolitics at least got a reprieve, with the meeting between Presidents Xi Jinping and Joe Biden on 15 November signalling that channels of communication are more open. A clearer signal that growth is being prioritised over de-risking and signs that households are drawing down pent-up savings would be key waymarks that market confidence could return.

As a result, we remain somewhat cautious on China's growth outlook heading into 2024, but we do now expect that growth will be stronger: our latest forecast is for 4.4% GDP growth (+0.2ppts).

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