



# Global Macro Research

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#China

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#Growth

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#Data indicators

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## China's long, sluggish summer

Chinese data disappointed in July, with the economy expanding at a slow pace. Policymakers continue to take an incremental approach to easing, which is unlikely to spark a meaningful upturn in the economy in the near term.

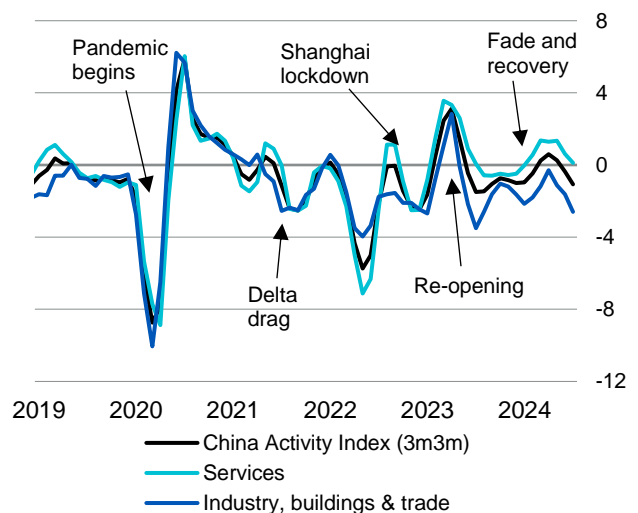
### Key Takeaways

- Mixed economic data revealed that China's economy got off to a sluggish start in Q3, following a disappointing Q2. Our China Activity Indicator is moving lower, suggesting that the chance of growth hitting policymakers' target of "around 5%" is waning.
- Nevertheless, the economy actually performed better than extremely weak credit demand would suggest. Corporate borrowing fell further, with new loans contracting sharply, and only local government and corporate bond issuance rose over the past month.
- Policymakers surprised markets by cutting interest rates earlier than expected in July, helping to ease our China Financial Conditions Index (CFCI) for a second consecutive month.
- However, investors remain unconvinced of a sustained increase in nominal growth. Bond markets are pricing in a low growth and inflation environment, and sentiment among households remains at historically low levels.
- Policymakers have signalled further stimulus is coming. But we expect the incremental approach to easing to continue, given the prioritisation of derisking and national security considerations.

### Summer slumber continues

China's economy continued to grow at a sluggish pace in July, further dampening the prospect of policymakers achieving their target of "around 5%" growth in 2024. The latest activity data flow has seen our China Activity Indicator (CAI) continue to move lower (see Figure 1).

Figure 1: Our China Activity Indicator is turning down



Source: Haver, abrdrn, August 2024

Early indications from the July PMI surveys were somewhat disappointing, with only the Caixin Services PMI surprising to the upside and improving in the month (+0.9pts to 52.1).

Both manufacturing business surveys fell, with output and new orders weakening, and the official non-manufacturing survey continued to struggle amid ongoing problems in the property sector.

Similarly, hard activity data were mixed. Industrial production expanded 5.1% year over year, below consensus expectations of 5.2%. And fixed asset investment also disappointed, coming in at 3.6% year to date in year-over-year terms, against an expected 3.9%.

This was in part due to the continued real estate sector drag, with investment falling and new starts continuing to drop.



But investment was weak across the board, with both manufacturing and infrastructure investment scaled back in July.

Even in what has been the economy's strong point, exports, growth stalled. Stripping out seasonal patterns, exports fell for a second consecutive month, down 1.9% month over month in July.

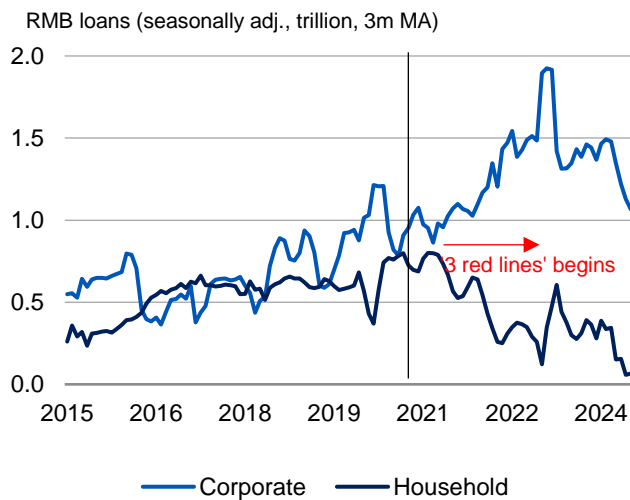
There was an upside surprise from retail sales, which grew 2.7% year over year, slightly above the 2.6% consensus forecast. That said, we estimate that they were up only a tepid 0.1% in July.

**Soft credit demand is a concern**

If there is a silver lining, it's that the real economy is doing better than credit demand would suggest. Chinese credit fell below consensus expectations in July, coming in at RMB 0.7 trillion versus an expected 1.1 trillion. The miss was driven by a rare RMB 77 billion contraction in new bank loans, the first decline since 2005.

Corporate lending continued its sharp drop, with the three-month average flows to July falling RMB 0.1 trillion. This, when combined with close to zero household lending, reflects a lack of appetite for credit across the private sector (see Figure 2).

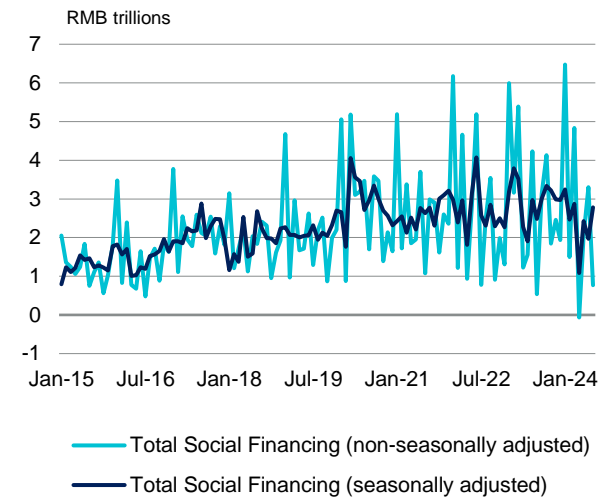
**Figure 2: Corporate credit demand falls further as household demand remains extremely weak**



Source: Haver, abrdrn, August 2024

However, stripping out seasonal patterns, the flow of credit was better than the headlines imply. Total social financing (TSF) bounced to RMB 2.8 trillion in July, its strongest level since March. This was in part due to a pick-up in local government special bond and corporate bond issuance (see Figure 3).

**Figure 3: Seasonally adjusted total social financing bounced back in July**



Source: Haver, abrdrn, August 2024

Nevertheless, this stimulus is not yet boosting activity to the level policymakers are targeting. Indeed, in an interview following the July data disappointments, People's Bank of China (PBoC) Governor Pan Gongsheng signalled that implementation of already announced stimulus measures would be strengthened, and that further – although not “drastic” – steps would be taken.

The PBoC then surprised markets in July, cutting interest rates earlier than expected. The seven-day reverse repo and one-year and five-year loan prime rates (LPR) were cut 10bps, down to 1.70%, 3.35% and 3.85% respectively.

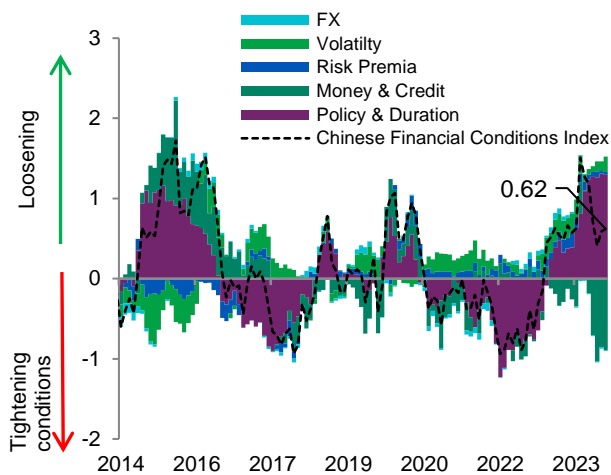
Still, these rate cuts are keeping with the incremental approach policymakers have adopted, and there is little indication of a move to “big bang” stimulus.

**Accommodative financial conditions continue**

Ongoing easing helped improve our China Financial Conditions Index (CFCI) for a second consecutive month in July, edging up to 0.62 standard deviations looser than average (See Figure 4).



**Figure 4: Financial conditions eased recently**



Source: Bloomberg, Haver, abrDN, August 2024

Marginal improvements in market volatility and risk premia, alongside a strengthening of the yuan, helped ease financial conditions.

However, a more notable improvement would have occurred if not for the continued drag from money supply, weak credit demand and the slump in equity markets. M1 money supply disappointed again, shrinking 6.6% year over year in July, worse than the 5.0% contraction in June.

While a crackdown on fraudulent loans and depositors shifting money to wealth management products has factored into this, soft credit demand remains a major drag.

Another explanation for why the policymakers' incremental approach to support for the economy has failed to gain the sort of traction needed is that China's  $r^*$  may be slightly higher than previously thought. Indeed, our estimate for  $r^*$  shifted upwards, resulting in a weaker contribution from bond spreads and policy rates.

Overall, this means that policymakers will need to ease more than previously expected to support the economy. The CFCI has been in accommodative territory since May 2023, but authorities are finding that this is gaining less traction than in previous cycles.

### Markets bet on "low-flation"

Policy announcements, including those from the Third Plenum and the Politburo meeting held in July, have so far failed to turn around market sentiment.

Markets remain priced for a weak inflation environment. Bond yields have continued to fall, despite efforts by policymakers to intervene both verbally and with policy measures to stem the decline in longer dated yields (see Figure 5).

**Figure 5: Bond yields continue trending lower**



Source: Haver, abrDN, August 2024

Chinese inflation actually surprised to the upside in July. Headline inflation came in at 0.5% year over year, against consensus expectations of 0.3% and up from 0.2% in June.

Core inflation eased 0.2ppts to 0.4%, but month-over-month moves offered some relief, with services prices rising 1.3% month over month annualised. And despite producer prices remaining in deflation (-0.8% year over year), core goods prices expanded, helping to prop up underlying inflation.

China remains very much stuck in "lowflation" – with the GDP deflator still in negative territory in Q2 – but the latest prints show that at least the consumer side of the economy has not fallen into deflation.

Much turns on whether policymakers address the malaise in private sector confidence, and in particular, consumer demand. President Xi highlighted the need to promote consumption following the Politburo meeting, but policymakers face a challenging task.

### Consumers not convinced

Consumer confidence and expectations remained at historically weak levels in June, according to the latest survey from the National Bureau of Statistics.

Media reports have pointed to the possibility of consumer vouchers or cash handouts being introduced to boost consumption. But there has been a reluctance to use such direct forms of stimulus under President Xi, even in response to the outbreak of Covid.

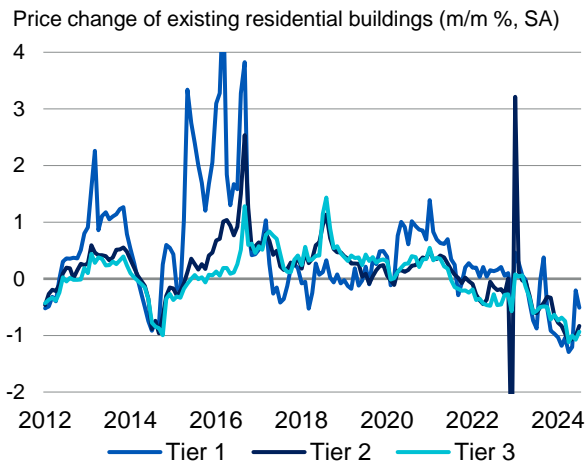
Indeed, such short-term stimulus measures could boost growth closer to target but are unlikely to tackle the structural issues weighing on consumer confidence.



Households' saving rate remains elevated, suggesting a lack of household liquidity is not the issue holding back consumer spending.

Instead, the negative wealth effect from house price falls continues to be a major drag on consumer confidence. House prices fell further in July, with prices in Tier 1 cities falling at a faster rate than in Tier 2 and Tier 3 cities (see Figure 6).

**Figure 6: House price decline slows in July**



Source: Haver, abrdn, August 2024

Policymakers are hoping steps to lower mortgage costs and a programme for local governments to purchase unsold

**Author:**

Michael Langham

properties can address some of the housing drag. Shenzhen became the first Tier 1 city to join the home-purchase scheme in August, and traction from such measures may start to yield results in the coming months.

However, given the purchases are funded through further public borrowing, it remains to be seen how willing some of the most indebted local governments will be to utilise the scheme given already strained balance sheets.

**De-risking is still prioritised over short-term growth**

Overall, July provided little assurance that China's stimulus has led to a rebound in the economy. Confidence remains low, among corporates, households and in markets, while the incremental approach to easing has only done enough to avoid a more severe slowdown.

However, it appears unlikely policymakers will diverge from this path, prioritising 'de-risking' and national security over near-term growth.



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