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China Economics Update: Ongoing soft recovery, increased policy support

中国经济评论: 温和复苏持续，政策支持加码

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Mixed Oct economic data reflects an uneven recovery. Resilient industrial production (IP) growth was underpinned by China's rising electric car industry and related industries. Stronger-than-expected headline retail sales were driven by low base effects as underlying spending growth remained soft. Nevertheless, car sales were a bright spot. Real estate investment continued to drag down overall investment growth.

Increased fiscal and monetary support will help sustain the recovery. Fiscal policy has turned more supportive and is expected to aid growth and ease debt pressure on cash-strapped local governments. The PBoC injected long-term liquidity equivalent to a 25bp RRR cut today in a bid to maintain sufficient interbank liquidity. We expect monetary policy to stay accommodative to facilitate a continued recovery.

十月数据喜忧掺半，反映了经济的非均衡复苏。新能源汽车及相关产业支撑工业产出增长。社会零售同比增长超预期，主要受低基数效应影响。环比消费增速仍显疲软，但汽车销售依然保持坚挺。固定投资则继续受房地产投资低迷拖累。

更积极的财政和货币政策有助于推动经济复苏。预计更为积极的财政政策将提振增长势头，并纾解地方政府的债务压力。央行今天注入了相当于降准 25 个基点的长期流动性，以保持银行间流动性充裕。 我们预计货币政策保持宽松，以促进经济的进一步复苏。

Better-than-expected IP and retail sales

IP growth beat expectations in Oct (4.6%YoY actual versus 4.5%YoY forecast). China's National Bureau of Statistics (NBS) estimates seasonal adjusted sequential IP growth was steady at 0.4% MoM, while remaining below the monthly average of 0.6% MoM during the pre-pandemic period. Resilient IP growth should help ease concerns about a sharp slowdown after manufacturing production sub-PMI for Oct fell sharply.

Growth in manufacturing output outstripped overall IP growth as electricity output slowed and growth in mining output remained soft. The rising electric car industry continues to underpin IP growth and growth in related industries such as electric machinery & equipment, and nonferrous metals (Fig 1). Output growth in computers and communication equipment picked up to 4.8% YoY, reflecting recovering global demand for consumer electronics. However, the contraction in pharmaceuticals output worsened.

Year-on-year retail sales growth jumped from 5.5% YoY to 7.6% in Oct (7.0% YoY expected) driven by the low comparison base in 2022. Seasonally adjusted sequential growth was almost unchanged at 0.07% MoM, suggesting muted growth momentum in consumption.

By category, growth in catering spending, consumer goods and car sales all rebounded in Oct (Fig 2). By contrast, online sales growth slowed from 6.6% YoY to 3.7% YoY in Oct after strong growth in online shopping during the lockdown last year. To smooth out base effects, we used a two-year comparison of the data for Oct 2023 and that from Oct 2021. Growth in consumer goods and catering spending slowed 0.6ppt and 4.3ppt to 7.1% and 7.6%, respectively, in Oct in the past two years. Car sales maintained strong momentum with steady two-year growth of around 24% in Oct. The two-year contraction in housing-related spending narrowed 4.7ppt to 7.7%.

Fixed-asset investment (FAI) growth slowed to 1.3% YoY in Oct by our estimate (Fig 3). Slightly slower manufacturing investment and still-weak real estate investment dragged down overall investment growth. By category:

- **Broad infrastructure investment growth rebounded slightly to 8.2% YoY in Oct.** Growth in traditional infrastructure investment, such as railways, highways, and industrial parks, decelerated to 3.7%YoY, the slowest pace since Apr 2022. However, thanks to the Chinese government's decarbonisation initiative, investment in the power sector was very strong at 25% YoY in Oct, pushing up broad infrastructure investment growth.
- **Manufacturing investment growth eased** by 1.7ppt to 6.2% YoY in Oct. Industrial upgrades remain the driver of manufacturing investment. Year-to-date high-tech manufacturing investment growth remained robust at 11.3% YoY. In particular, growth in electrical machinery & equipment and car manufacturing of 38.6%YoY and 18.7%YoY, respectively, led manufacturing investment growth in Oct. By contrast, investment in traditional low-end manufacturing, such as textiles, continued to contract as supply chains shifted to other nations in recent years.
- **The contraction in real estate investment was almost unchanged at 11.3% YoY in Oct.** Funding remains challenging, with a year-on-year contraction in funding for the current year down 17% YoY in Oct. Diminishing self-raised funds are the main drag on property funding.

Volume-based property indicators deteriorated in Oct. The year-on-year contraction in property starts widened to 21% YoY in Oct, putting the breaks on three months of narrowing. The contraction in property sales also widened slightly to 20% YoY in Oct after regulatory relaxation of the property market led to better sales in Sep. Growth in housing completions was down from 24.0% to 13.4% in Oct. Nevertheless, housing completions continue to grow as policymakers have placed high priority on completions.

Consumer inflation dipped below zero on falling pork prices while PPI deflation deepened amid lower global oil prices in Oct. Headline consumer inflation eased more-than-expected in Oct (down 0.2% YoY actual versus a 0.1% YoY decline expected; 0.0% previously). Pork prices were down 2% in the month. The annual falling pace widened to 30.1%, cutting 0.55ppt off headline CPI. Core inflation, excluding food and energy, dipped to just 0.6% YoY in Oct, reflecting overall soft domestic demand. Looking forward, we expect inflation will gradually rise on policy support and easing pork inflation amid diminishing pork supply (Fig 5). Overall inflation pressure remains benign amid the current soft recovery. We expect easing PPI deflation ahead because energy prices are likely to remain supported by a tight supply outlook and a resilient global economy.

Oct Total Social Financing (TSF) data slightly missed market expectations (RMB1.85t actual versus RMB1.95t expected). However, credit growth accelerated to 9.6%YoY in Oct, the fastest pace since May 2023. Accelerating government bond issuance has been the key contributor to overall TSF expansion. Outstanding government bonds increased RMB1.56tn in Oct, accounting for 84% of new additions to the TSF. The renminbi loan breakdown suggests mortgage demand increased RMB71b in Oct, better than the RMB33b increase in Oct 2022. However, overall mortgage demand remains soft compared with double-digit growth prior to Apr 2022. Corporate loans have also been soft (Fig 6).

Our view:

The Oct data points to a continued soft recovery. Emerging growth drivers have sustained resilient IP growth in manufacturing investment. Meanwhile, we have seen signs that the global downturn in manufacturing and consumer electronics has turned a corner, which will support demand for Chinese goods. A pickup in retail sales YoY growth in part reflected the low base while sequential growth remained soft. We maintain our 2023F growth forecast of 5.3%.

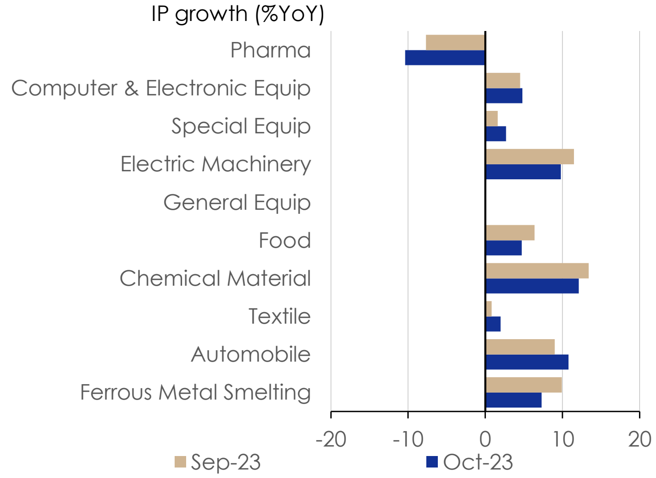
China's property sector continues to weigh on economic growth, though various indicators have stabilized at low levels, including high frequency property sales (Fig 4). Bloomberg reported that policymakers are mulling an offer in the neighborhood of RMB1t in new funding (0.8% of Chinese GDP or 7.5% of 2021 real estate investment) to support urban village renovation and affordable housing programs. If confirmed, new funding initiatives will give a modest boost to the domestic property sector.

The recent ramp-up in fiscal support will boost growth in coming quarters, notwithstanding caution among private businesses and households. The Ministry of Finance announced RMB1t of special central government bonds (0.8% of GDP), increasing the budget deficit from 3.0% to 3.8% on 24 Oct. The fund will be distributed to local governments in two equal batches of RMB500b in 4Q23 and 2024. The purpose is to support post-flood infrastructure investment in central China. We expect larger fiscal spending to add 0.4ppt to Chinese GDP, offsetting the negative fiscal drag experienced earlier in the year.

Also in Oct, special refinancing bond issuance picked up, resulting in a cumulative total of over RMB1t. Funds raised will be put towards lowering local debt risk and easing local government fiscal constraints, especially for local governments facing mounting refinancing pressure and diminishing revenue streams.

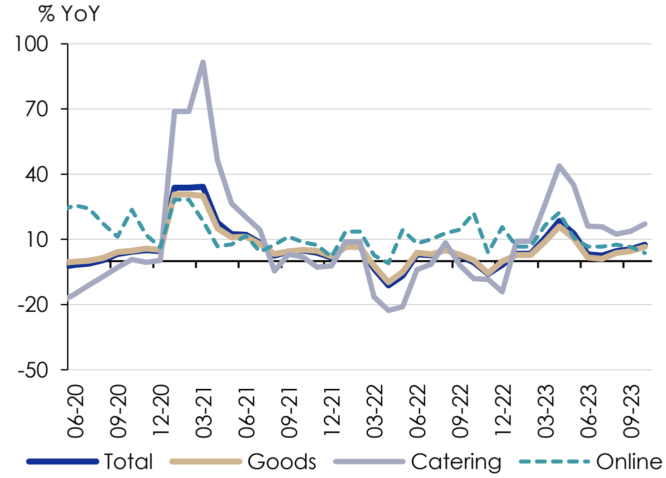
Monetary stance is likely to stay accommodative. On 15 Nov 2023, the PBoC injected a total of RMB600b via the 1-year medium-term lending facility (MLF), the largest amount in a single month since Dec 2016. The injection was comparable to the amount of liquidity released by a 25bp cut to the RRR. It should ease current tight interbank liquidity conditions amid tax payments and ample government bond issuance. We maintain our call of an additional 10bp cut to policy interest rates. Furthermore, additional RRR cuts cannot be ruled out.

Fig 1: Output from car production accelerates



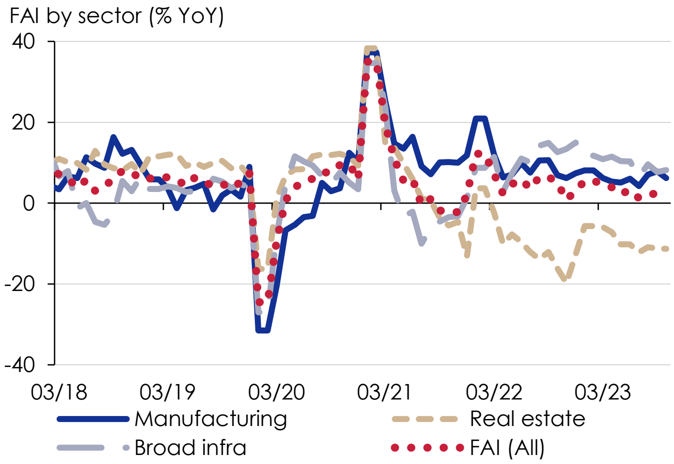
Source: NBS, CCBIS

Fig 2: Retail sales jumped in Oct on a low base last year



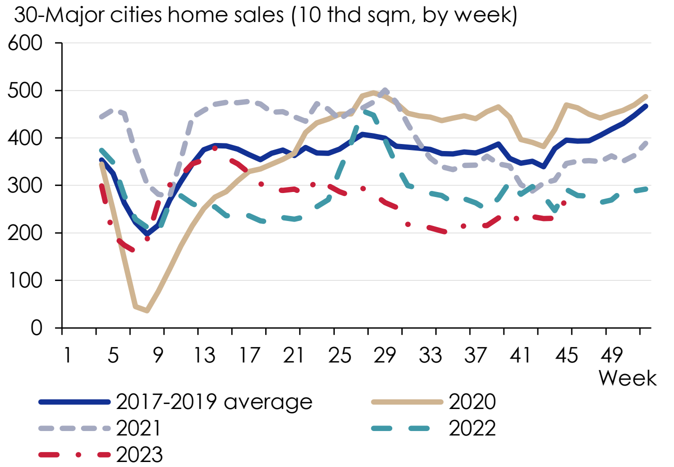
Source: NBS,CEIC, CCBIS

Fig 3: Broad infrastructure investment rebounded slightly, while property investment remains depressed



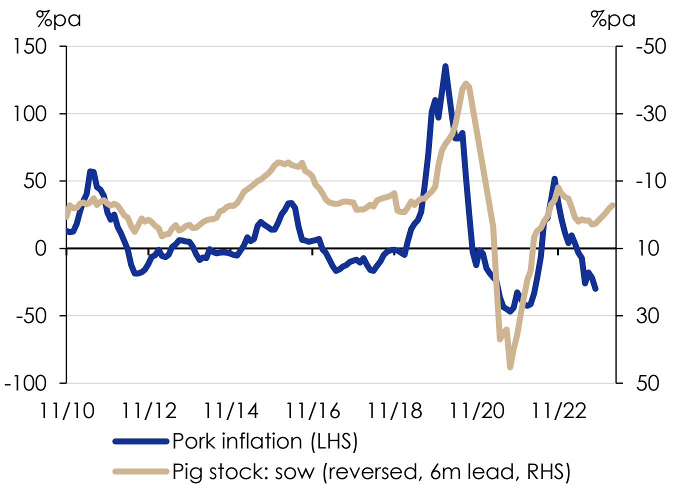
Source: NBS, CCBIS

Fig 4: Property sales stabilized in recent weeks



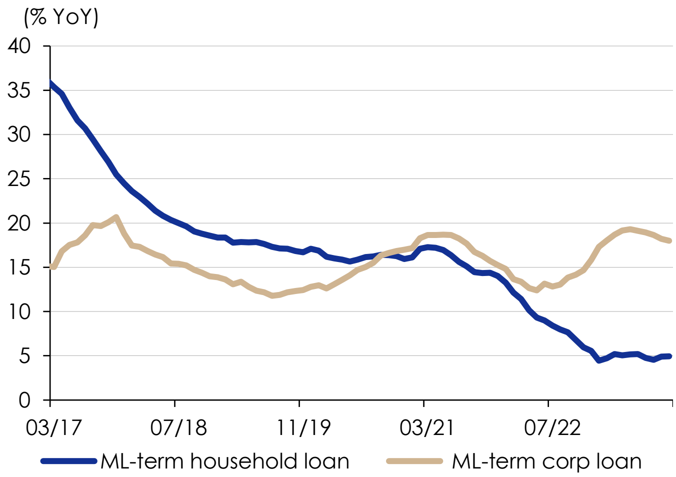
Source: NBS,Wind, CCBIS

Fig 5: Expect easing pork deflation



Source: NBS, CCBIS

Fig 6: Businesses remain cautious as mortgage loan demand growth sits at a recent bottom



Source: CEIC,Wind, CCBIS

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