

China Economy

China needs demand-side stimulus

China economy has slowed down as 2Q GDP growth fell short of expectations at 4.7%. Deflation pressure persisted as GDP deflator continued to decline. Economic growth was uneven, with fixed investment and industrial output staying elevated with a record-breaking trade surplus, while household consumption and property sales remained weak. We believe China needs demand-side stimulus policies as the major challenge for the economy is demand weakness, supply overcapacity and persistent deflation. But we don't expect strong policy stimulus to come out at the Third Plenum of the Party's leaders this week as the policymakers may still consider high-quality, supply-side development as the priority. They have long maintained their composure, opting for restrained policy support to preserve room for manoeuvre in a future "turbulent winds and rough seas" scenario, especially when Trump seems more likely the winner now. Looking ahead to 2H24, the PBOC may mildly cut RRR by 25bps and LPRs by 15bps. The central bank may also reduce deposit rates to protect banks' NIMs.

■ **Real GDP underperformed, with GDP deflator still mired in negative territory.** China's GDP fell short of expectations in 2Q24 at 4.7% YoY (all on a YoY basis unless otherwise specified) after rising 5.3% in 1Q24. Meanwhile, the seasonally-adjusted QoQ growth of GDP notably dropped to 0.7% in 2Q24 from 1.5%, the lowest reading since 2Q22 when half of the country got locked down. Despite that the CPI stayed in the low positive range in Q2, the GDP deflator remained entrenched in negative territory at -0.6% from -1.3%, indicating the underlying economic weakness as there was a wider range of deflationary pressure in the economy including durable goods, capital goods and exports, despite minimal inflation in consumer prices.

■ **New housing sales moderately rebounded amid policy easing and lower base.** The gross floor area (GFA) sold for commodity buildings mildly improved with the YoY decline narrowing from -20.3% in 5M24 to -19% in 1H24. The GFA started dropped 23.7% in 1H24 after declining 24.2% in 5M24. According to the high-frequency data, the recovery rate of new housing sales in 30 major cities compared to the same period in 2018 & 2019 remained low at 55.2% in June and 50% in the first half of July. However, the recovery rate of second-hand housing sales in 10 select cities continued to improve to 99.4% in June and 101.9% in the first half of July. Second-hand housing sales often leads the property market cycle in history and its continuous recovery may point to a gradual improvement of new housing sales in future. The number of incremental urban population as another leading indicator has also rebounded. It dropped from 20 million in 2019 to only 6.5 million in 2022 and then rebounded to 11.96 million in 2023 thanks to economic reopening. Therefore, we expect a cyclical improvement of urban housing sales with the YoY decline of GFA sold narrowing for commodity buildings in 2H24. Due to high inventory, excessive supply, lagged price decline and low rental yield, however, housing prices may face additional downside pressure in the next two quarters.

■ **Retail sales sharply plunged especially in durable goods.** Retail sales growth fell short of market expectations in June remarkably at 2%, down from 3.7% in May. Durable goods were the major headwinds due to weak consumer income and confidence as well as deflation expectations. Retail sales of autos further dipped 6.2% in June after dropping 4.4% in May. If we exclude the deflation of 5.3%, auto retail sales volume only dropped 0.9% in June. The growth of home appliances, construction & decoration

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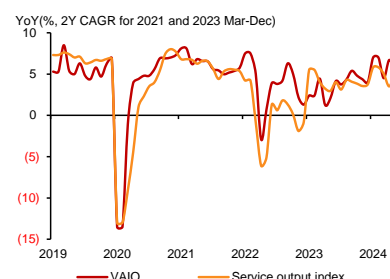
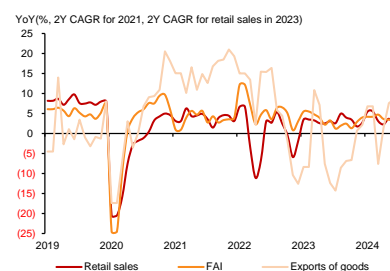
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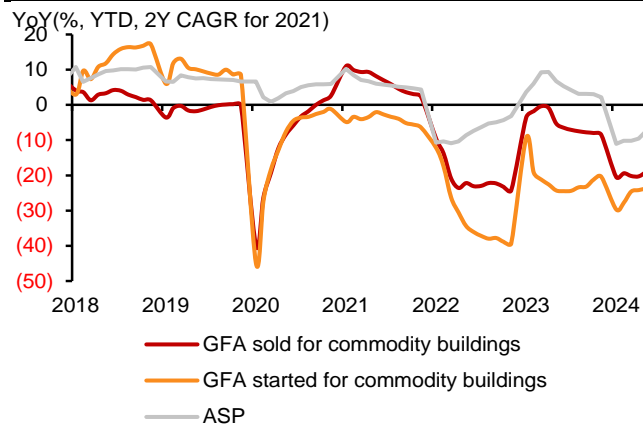
materials, and furniture fell sharply from 12.9%, -4.5% and 4.8% in May to -7.6%, -4.4% and 1.1% in June. Food sales continued to rebound as growth climbed from 9.3% to 10.8%, while the growth rates of cosmetics, cultural & office products and telecom equipment notably dropped to -14.6%, -8.5% and 2.9% from 18.7%, 4.3% and 16.6%. Looking forward, retail sales may mildly improve in 2H24 especially in recreational, small-scale and self-satisfaction items while durable goods may remain muted due to weak consumer income and confidence. We expect retail sales to grow 5.3% in 2024 after rising 7.2% in 2023.

- **Industrial output and service activity both beat expectations.** VAIO growth edged down to 5.3% in June from 5.6% in May, higher than market expectation of 5%. Upstream resource sectors like mining and government-led sectors like public utilities continued their recovery to 4.4% and 4.8% from 3.6% and 4.3%, while manufacturing moderated to 5.5% from 6%. Non-ferrous metal, transport equipment excluding auto, and computer, telecom & electronic equipment extended their rapid growth above 10%, in line with strong export sectors; while auto, ferrous metal and textile product slowed down to 6.8%, 3.3% and 9.2% from 7.6%, 3.9% and 12.7%. The YoY growth of service output index slightly dropped to 4.7% in June from 4.8%. Looking forward, we believe service and industrial output may moderately improve in 2024 thanks to a recovery in service consumption, pro-production policy support and improvement in exports.
- **FAI growth ticked up, with infrastructure investments notably surging.** FAI grew by 3.6% in June compared to 3.5% in May, in-line with expectations. The contraction of property investments narrowed to -10.1% in June from -11%. Infrastructure investments surged to 10.2% from 3.8% as governments accelerated bond issuance and new starts of infrastructure projects. We expect the infrastructure investment to extend its rapid growth given weakened economic growth momentum in 2H24. Investments in manufacturing stayed almost flat at 9.3% in June as deflation pressure persisted with much higher growth of fixed investment than retail sales. Investments in general equipment, non-ferrous metals, and computer & electronics further accelerated while transportation equipment other than vehicles and electrical equipment notably slowed down. Looking forward, we expect FAI to accelerate from 3% in 2023 to 4.2% in 2024, with growth in manufacturing, infrastructure, and property development respectively at 7.5%, 8% and -9% in 2024.
- **China needs demand-side stimulus policies, although supply-side development may continue to be prioritized.** Economic growth remained uneven as industrial output and exports were stronger than retail sales and imports. Meanwhile, deflation pressure persisted as demand was weaker than supply. China needs demand-side stimulus policies as we believe the major challenge for the economy is demand weakness, supply overcapacity and persistent deflation pressure. But we don't expect strong policy stimulus to come out at the Third Plenum of the Party's leaders this week. The policymakers may continue to focus on high-quality development with an emphasis on new productive forces, technology innovation and high-end manufacturing industries. They have maintained their composure, opting for restrained policy support to preserve room for manoeuvre in a future "turbulent winds and rough seas" scenario, especially when Trump seems more likely the winner now. Looking forward, we expect the PBOC may mildly cut RRR by 25 bps and LPRs by 15 bps in 2H24. The central bank may also reduce deposit rates to protect banks' NIMs.

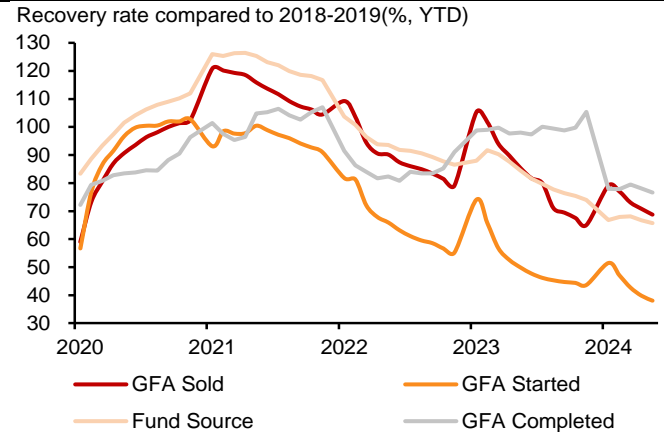
Figure 1: China's economic indicators

YoY(%)	2019	2020	2021	2022	2023	1Q24	2Q24	May	June	2020-2021 CAGR	2022- 2023
GDP	6.0	2.2	8.4	3.0	5.2	5.3	4.7			5.3	4.1
VAIO	5.7	2.8	9.6	3.6	4.6	6.1	5.9	5.6	5.3	6.1	4.1
-Mining	5.0	0.5	5.3	7.3	2.3	1.6	3.3	3.6	4.4	2.9	4.8
-Manufacturing	6.0	3.4	9.8	3.0	5.0	6.7	6.3	6.0	5.5	6.6	4.0
-Public utility	7.0	2.0	11.4	5.0	4.3	6.9	5.0	4.3	4.8	6.6	4.6
Delivery value for exports	1.3	(0.3)	17.7	5.5	(3.9)	0.8	6.0	4.6	3.8	8.3	0.7
Service output index	6.9	0.0	13.1	(0.1)	8.1	5.5	4.3	4.8	4.7	6.3	3.9
Retail sales	8.0	(3.9)	12.5	(0.2)	7.2	4.7	2.6	3.7	2.0	4.0	3.4
Exports of goods	0.5	3.6	29.6	5.6	(4.7)	1.4	5.9	7.6	8.6	15.9	0.3
Imports of goods	(2.7)	(0.6)	30.1	0.7	(5.5)	1.5	2.5	1.8	(2.3)	13.7	(2.4)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	3.0	4.5	3.9	4.0	3.9	3.9	4.0
-Property development	9.9	7.0	4.4	(10.0)	(9.6)	(9.5)	(10.1)	(10.1)	(10.1)	5.7	(9.8)
-Manufacturing	3.1	(2.2)	13.5	9.1	6.5	9.9	9.5	9.6	9.5	5.4	7.8
-Infrastructure	3.3	3.4	0.2	11.5	8.2	8.8	7.7	6.7	7.7	1.8	9.9
GFA sold for commodity building (YTD)	(0.1)	2.6	1.9	(24.3)	(8.5)	(19.4)	(19.0)	(20.3)	(19.0)	2.2	(16.8)
GFA started for commodity building (YTD)	8.5	(1.2)	(11.4)	(39.4)	(20.4)	(27.8)	(23.7)	(24.2)	(23.7)	(6.4)	(30.5)

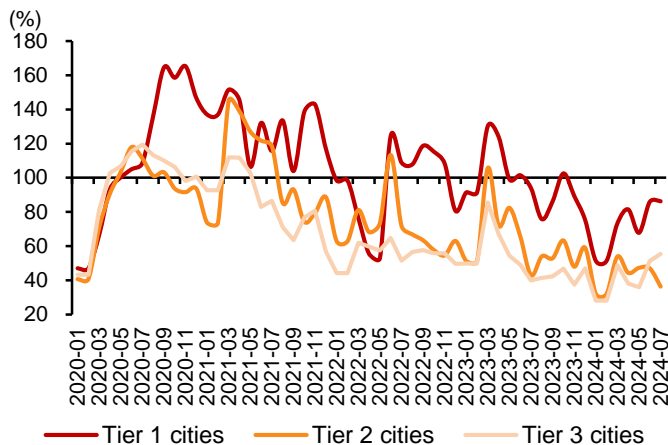
Source: Wind, CMBIGM estimates

Figure 2: Property sales growth

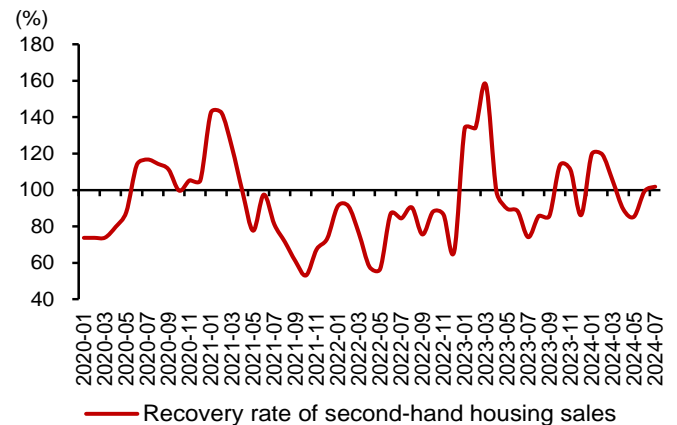
Source: Wind, CMBIGM

Figure 3: Recovery rates compared to 2018-2019

Source: Wind, CMBIGM

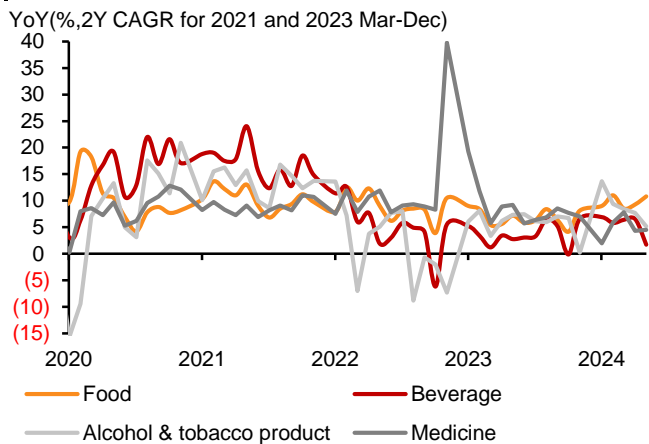
Figure 4: New housing sales recovery rates compared to 2018-2019 in 30 cities

Source: Wind, CMBIGM

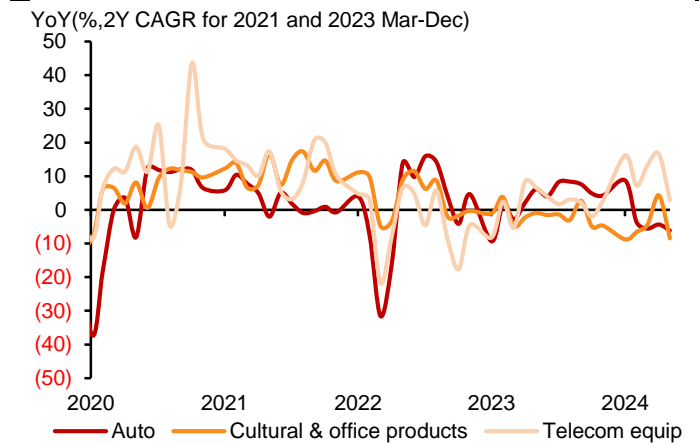
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 select cities

Source: Wind, CMBIGM

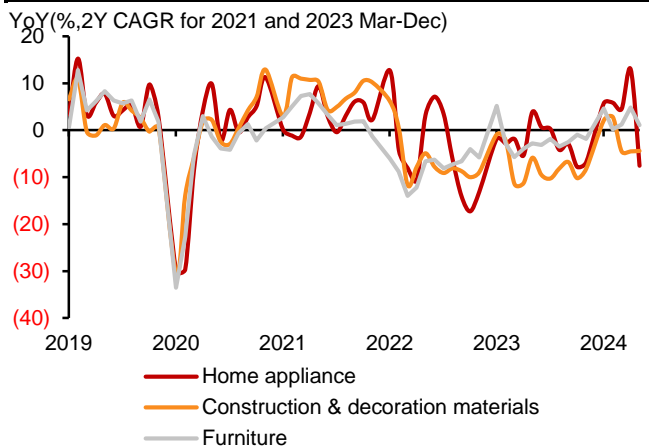
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples

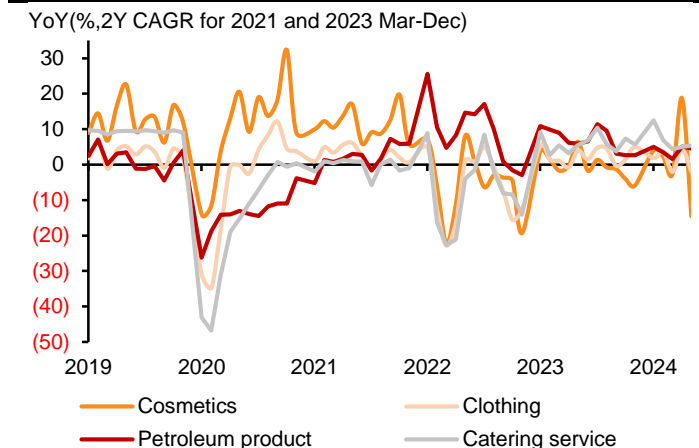
Source: Wind, CMBIGM

Figure 7: Retail sales of auto & electronics

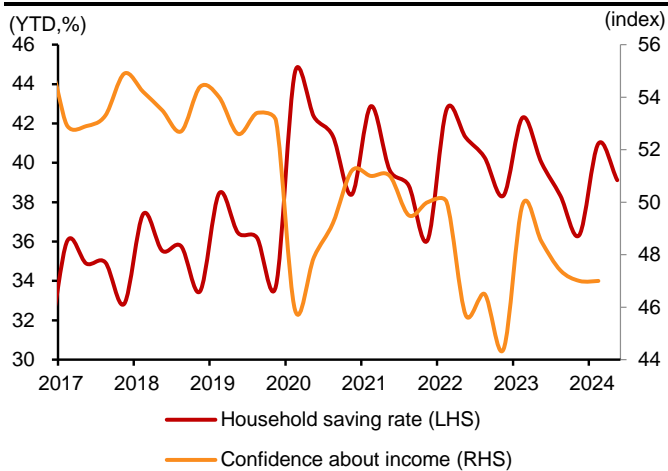
Source: Wind, CMBIGM

Figure 8: Home appliance & furniture retail sales

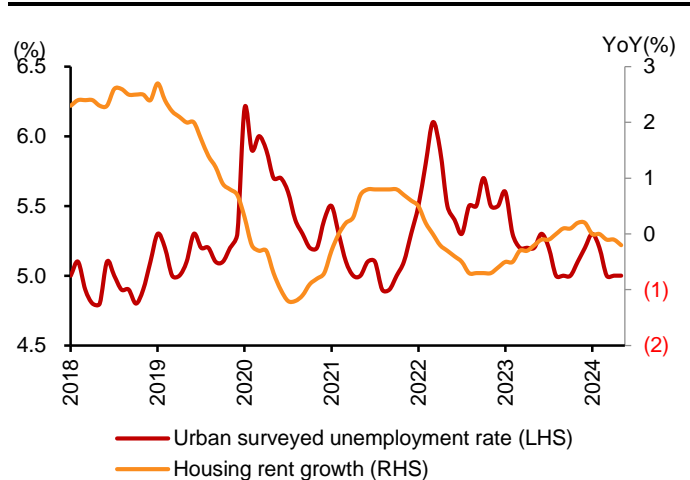
Source: Wind, CMBIGM

Figure 9: Retail sales related to outgoing activities

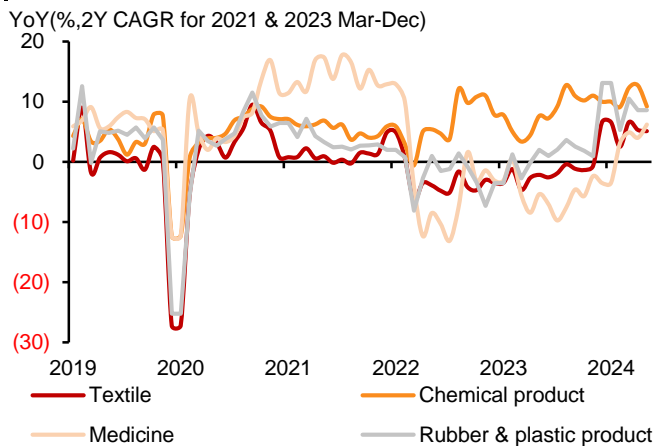
Source: Wind, CMBIGM

Figure 10: Consumer confidence

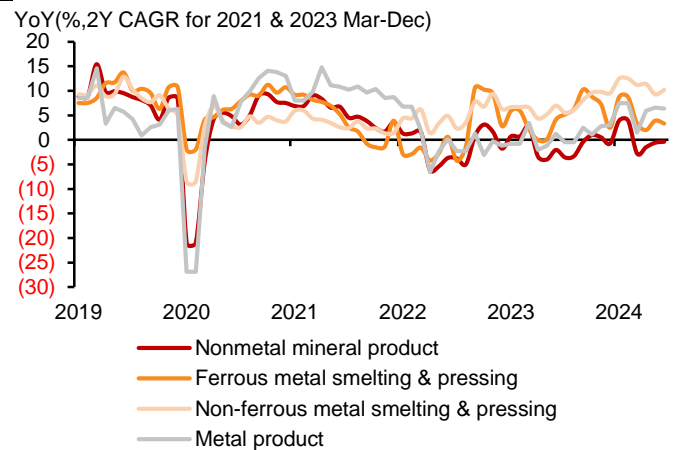
Source: Wind, CMBIGM

Figure 11: Urban unemployment rate & housing rent

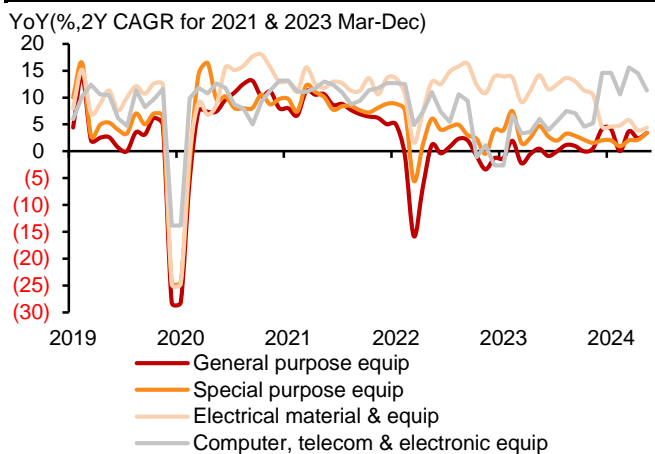
Source: Wind, CMBIGM

Figure 12: VAIO in textile & chemical products

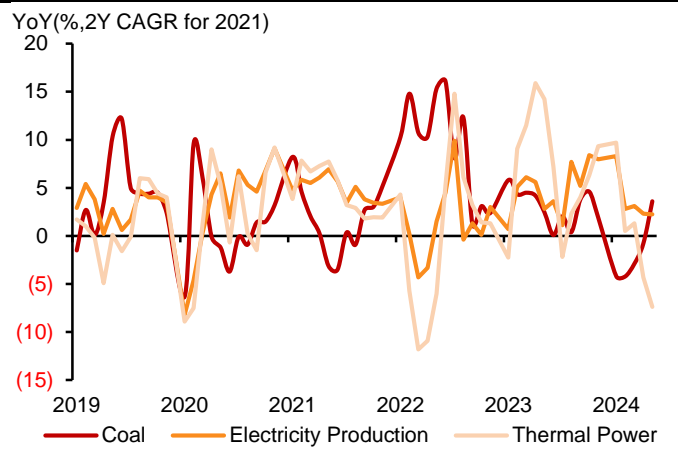
Source: Wind, CMBIGM

Figure 13: VAIO in mineral & metal products

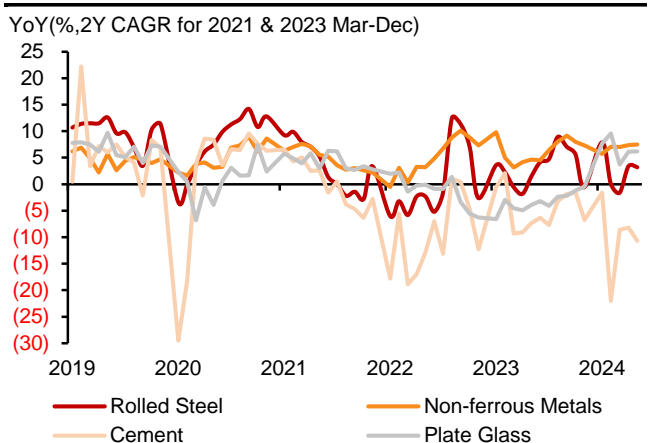
Source: Wind, CMBIGM

Figure 14: VAIO in equipment

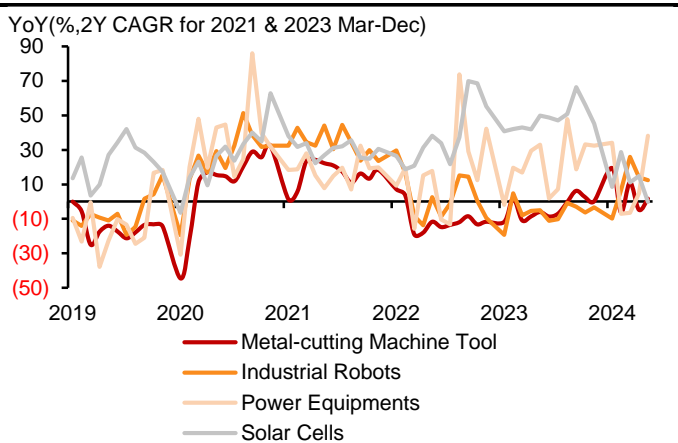
Source: Wind, CMBIGM

Figure 15: Output in energy and electricity

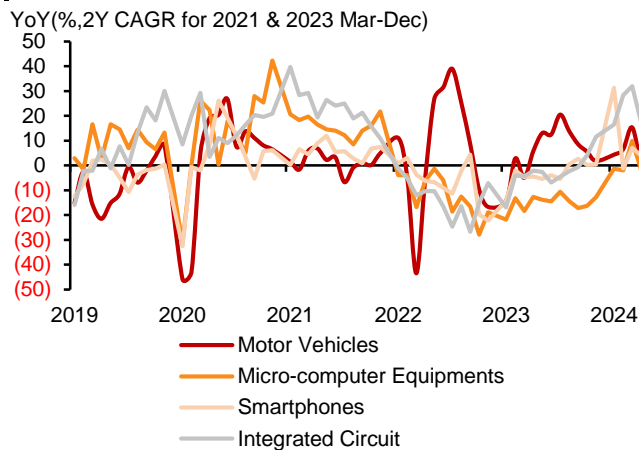
Source: Wind, CMBIGM

Figure 16: Output in steel & construction materials

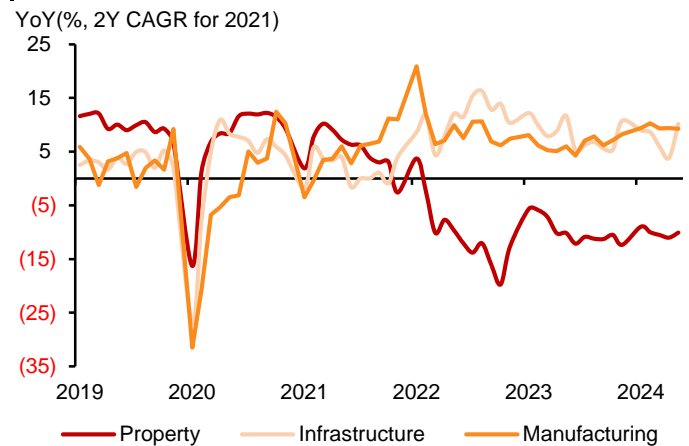
Source: Wind, CMBIGM

Figure 17: Output in capital goods

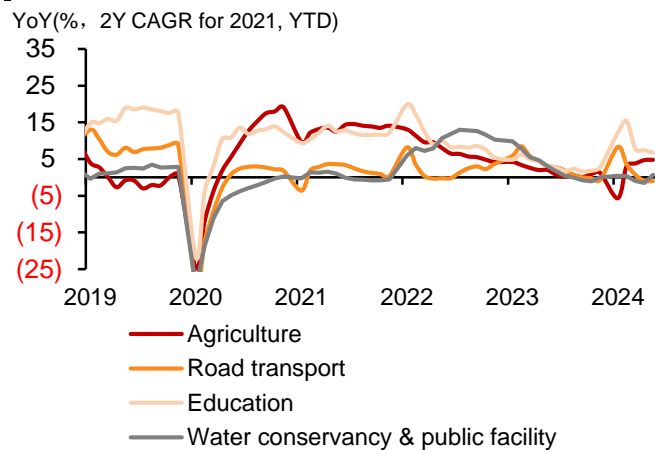
Source: Wind, CMBIGM

Figure 18: Output in auto, computer & smartphone

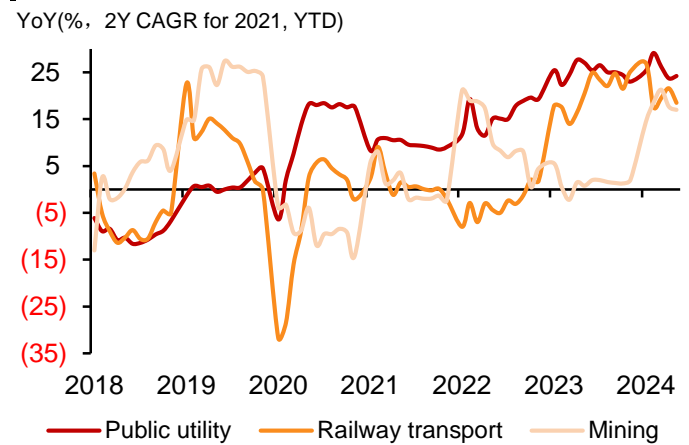
Source: Wind, CMBIGM

Figure 19: FAI by sector

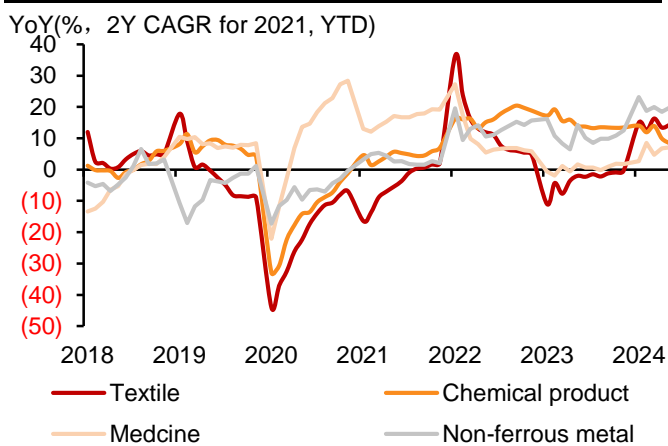
Source: Wind, CMBIGM

Figure 20: FAI in agriculture & local infrastructure

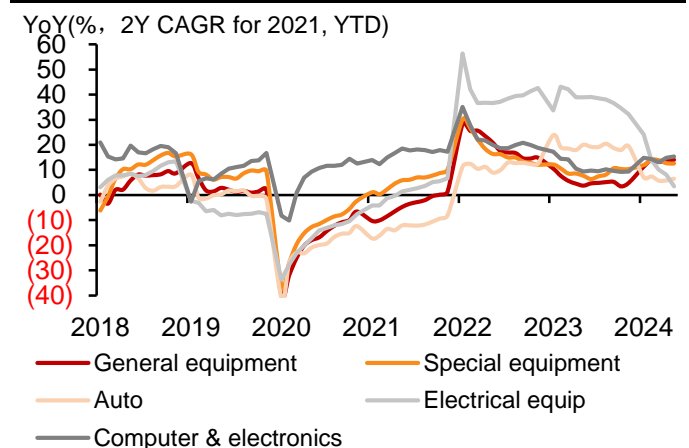
Source: Wind, CMBIGM

Figure 21: FAI in central infrastructure & mining

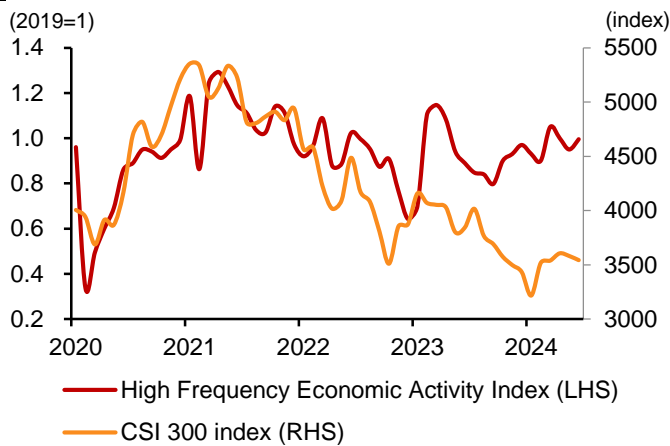
Source: Wind, CMBIGM

Figure 22: FAI in chemical products

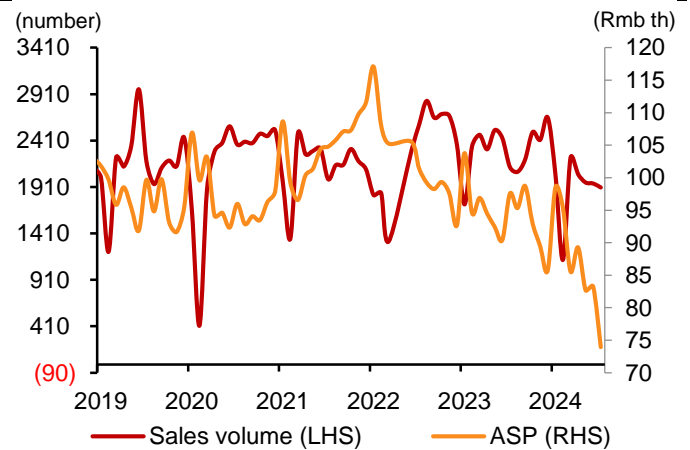
Source: Wind, CMBIGM

Figure 23: FAI in equipment

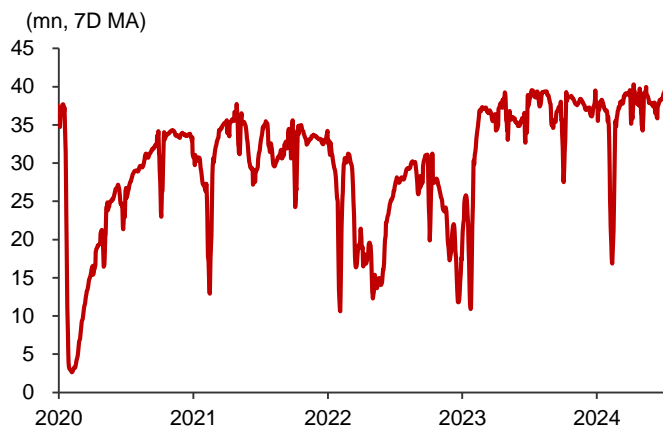
Source: Wind, CMBIGM

Figure 24: Economic activity & A-share index

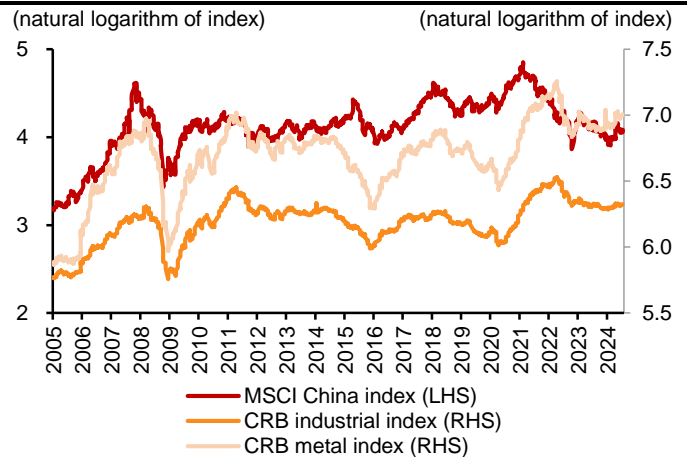
Source: Wind, CMBIGM

Figure 25: Used vehicle sales in Shanghai market

Source: Wind, CMBIGM

Figure 26: Subway passenger flow in tier-1 cities

Source: Wind, CMBIGM

Figure 27: MSCI China and commodity prices

Source: Wind, CMBIGM

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