China Economy

In a mild recovery cycle

China's economy showed signs of bottoming out in 3Q23 as GDP, retail sales, industrial output and service activities came in above market expectation and continued its mild recovery. The improvement of social financing flow and alleviation of deflation showed similar implications. Property sector remained the major drag on the economy, but may narrow its YoY declines in next few months. The PBOC will maintain accommodative monetary policy with additional cuts in RRR, deposit rates and LPRs next year. The cabinet may mildly increase broad deficit ratio for 2024 and allow local governments to swap their hidden debts with special refinancing bonds. The latest policy easing cycle may become the strongest one since 2017. China's economy may gradually improve in next four quarters. We revise our forecast for GDP growth for 2023 from 5.1% to 5.2% and maintain the GDP growth forecast for 2024 at 4.8%.

- **GDP growth came in above market expectation as economy stabilized in 3Q.** China's GDP rose 4.9% YoY (all on a YoY basis unless otherwise specified) in 3Q23 after growing 6.3% in 2Q23, higher than the market consensus. Meanwhile, the SA QoQ growth of GDP accelerated to 1.3% from 0.8%, and the 2Y CAGR of GDP edged up to 4.4% from 3.3%. In 3Q23, property sales & development investment remained sluggish while both exports and retail sales mildly rebounded from its trough in July. Infrastructure investment gradually softened as mounting LG debt limited its fiscal resource while manufacturing investment mildly picked up. The household saving rate reached its lowest since early 2022. Although the data shows a clear pattern of seasonality, it is far below the level in 3Q22 and almost below 4Q22. Economy in 3Q shows signs of bottoming out as illustrated in credit, trade and service output data, although aggregate demand remained soft domestically and internationally, which will weigh on the future growth. The 5% growth target for 2023 seems achievable as it only requires 4.4% growth in 4Q.

- **Property sector remained in deep contraction with continuous improvement in second-hand housing sale.** The gross floor area (GFA) sold and the GFA started for commodity buildings respectively dropped 7.5% and 23.4% YoY (all in YoY terms unless specified) in 9M23 after decreasing 7.1% and 24.4% in 8M23. Property development investment further declined 9.1% in 9M23 after dropping 8.8% in 8M23. 30 major cities continued to see declining recovery ratio of commercial housing unit sales compared to the same period in 2019 in Sep, driven by the deterioration in tier-2 and 3 cities even though there is a huge rebound in tier-1 cities due to the loosening of property policy. However, when looking into the data in the first half of Oct, tier-1 and -2 cities further dropped with the lower policy momentum. The recovery ratio of second-hand housing unit sales in 11 major cities stayed unchanged in Sep but significantly improved in the first half of Oct, with divergent performance across cities. Breaking down the funding source for property development investment, deposit & advance payment and individual mortgage fund both further dropped 9.6% and 6.9% in 9M23 after falling 7.3% and 4.3% respectively in 8M23. Meanwhile, domestic loan fund declined 11.1% in 8M23 after dropping 12.8% in 7M23. Policymakers have loosened property policy and expanded credit supply to support the collapsing housing market, as we have seen the rebound in tier-1 cities recently and tier-2 cities earlier. However, the momentum from policy easing seems to fade away quickly after just one month or two. Moreover, the resurgence in sales in higher tier cities

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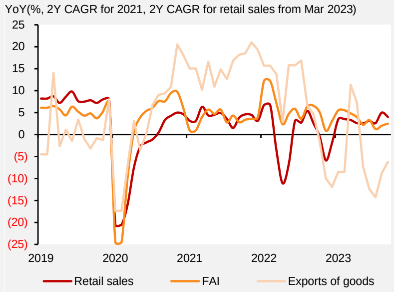
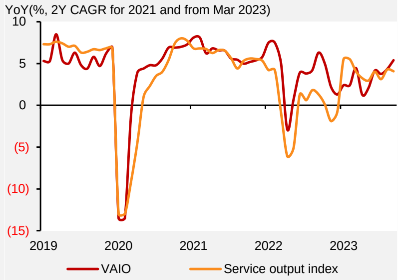


Source: Wind, CMBIGM



Source: Wind, CMBIGM

seems to deploy a crowding-out effect on the lower tier cities, especially the tier-3 cities where most of the assets of troubled property giants like Ever Grande and Country Garden located, which will further harm their revenues. Looking forward, housing sales may see tentative stabilization in October and November as stimulation carries on. However, the short-lived recovery may quickly dwindle without further and stronger policies support.

- **Retail sales continued to recover amid high energy price and robust summer demand.** Retail sales came in above the market expectation by rising 5.5% in Sep after climbing 4.6% in Aug. Its 2Y CAGR dropped to 4% in Sep, down from 5% in Aug. Looking into the details, food, beverage, daily used goods, medicine and auto continued to surge with their 2Y CAGRs respectively rose from 6.3%, 3.3%, 2.5%, 6.4% and 8.2% in August to 8.4%, 6.4%, 3.1%, 6.9% and 8.4% in Sep, while catering service and petroleum product slowed down to 5.8% and 9.5% from 10.4% and 11.4%. Housing-related durables remained weak as furniture and home appliance respectively grew 0.5% and -2.3% YoY with their 2Y CAGR at -3.5% and -4.2%. Construction & decoration materials narrowed its YoY decline to 8.2% from 11.4%, but its 2Y CAGR remained negative at –8.2%. Recovery of telecom equip rebounded as the 2Y CAGR edged up to 3.1% in Sep from 1.7% in Aug. Looking forward, retail sales may maintain mild to moderate recovery as employment and confidence slowly improve. We maintain our forecast for the retail sales growth in 2023 at 7.5%.

- **Service activities and industrial output both stayed almost unchanged.** Service output index and VAIO growth almost stayed flat as they respectively rose 6.9% and 4.5% in Sep after growing 6.8% and 4.5% in Aug, indicating a slowdown in recovery. In terms of 2Y CAGRs, VAIO increased to 5.4% from 4.4% in Aug while service output index decelerated to 4.1% from 4.3%. In the service sector, lodging and dining, information transmission, internet & IT service and transportation saw higher YoY growth and transportation, postal service, and telecom service showed good sentiment. In the manufacturing sector, auto sector continued to be the highlight in the economy with elevated 11.4% YoY growth in 9M23 amid strong export and domestic performance. Output in chemical products, rubber & plastic product, food production, ferrous & non-ferrous metal smelting & pressing, and electronic equipment saw robust growth while textile, nonmetal mineral products, medicine, non-metal product and general purpose equip remained weak as domestic and foreign demand remained weak. Looking forward, we may see a gradual recovery of service sector and VAIO as domestic consumer demand continues to improve and exports further narrow the declines.

- **FAI slightly recovered with strong recovery in manufacturing despite further weakening in property investment.** FAI picked up 2.5% in Sep after rising 2% in Aug. Property sector remained sluggish as property development investment fell by 11.3% after declining 10.9% in Aug. The liquidity condition of most private developers remained restricted as some of them started to commit credit default and re-organize their foreign debt. We do not see any signs of substantial change in the trend of deterioration. The YoY growth of FAI in manufacturing further rebounded from 7.1% in Aug to 7.9% in Sep, the highest since the past 12 months. Looking forward, chemical product, auto and electrical material & equipment may maintain strong FAI growth as the energy transition and smart technology revolution boosts business capex in these sectors. However, most other manufacturing industries are likely to see a gradual slowdown in FAI due to continuous slowdown in demand growth as well as uncertainty in domestic policy and geopolitics. Infrastructure YoY growth mildly recovered at 6.8% in Sep from 6.2% as local government expanded the fiscal support amid an acceleration in local government bond issuance. The YoY growth of FAI in public utility, transportation, storage & post service, and railway transportation remained elevated while fixed investment in public facility management and health & social welfare remained weak. Looking forward, we expect infrastructure investment may continue to expand since the new trend in credit data showed that the government is picking up debt to offset the deficit of private credit demand. We maintain our forecast on the FAI growth in 2023 at 3.8%.

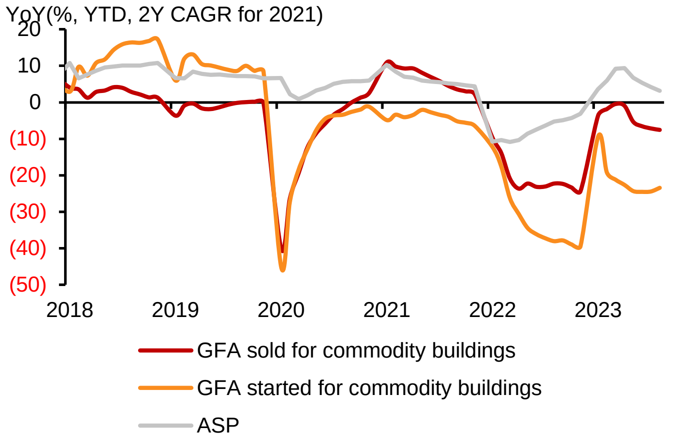
- **China needs continuous accommodative policy in 2024.** China is likely to maintain 5% GDP growth target for 2024. However, the tumbling property market still casts a shadow on the economic growth and business & consumer confidence remains low. As the comparison base rises, it may become even more difficult to achieve the 5% growth target next year. Therefore, China needs continuous accommodative policy in 2024. The PBOC is likely to maintain easing monetary policy with additional cuts in RRR, deposit rates and LPRs and guide banks to further expand credit supply. The central bank may also use special lending facility to support policy banks to make special low cost loans to facilitate the inner-city renewal projects. Meanwhile, municipal governments may further loosen property policy to stabilize property sector. In addition, the cabinet may increase broad fiscal deficit from 6% of GDP in 2023 to 6.4% of GDP in 2024. Provincial governments will be allowed to issue special refinancing bonds within quotas to replace some matured hidden debts. We expect a mild recovery in China's economy with GDP growth expected to reach 5.2% in 2023 and 4.8% in 2024.

Figure 1: China economic indicators

	YoY (%)										2Y CAGR (%)					
	2019	2020	2021	2022	1Q23	1H23	Jul	Aug	Sep	Oct(F)	1Q23	1H23	Jul	Aug	Sep	Oct(F)
GDP	6.0	2.3	8.4	3.0	4.5	5.5			4.9		4.6	4.0			4.4	
VAIO	5.7	2.8	9.6	3.6	3.0	3.8	3.7	4.5	4.5	4.7	4.7	3.6	3.7	4.3	5.4	4.8
-Mining	5.0	0.5	5.3	0.6	3.2	1.7	1.3	2.3	1.5	4.0	6.9	5.5	4.6	3.8	4.3	4.0
-Manufacturing	6.0	3.4	9.8	(2.0)	2.9	4.2	3.9	5.4	5.0	5.3	4.5	3.5	3.3	4.2	5.7	5.2
-Public utility	7.0	2.0	11.4	(2.2)	3.3	4.1	4.1	0.2	3.5	2.8	4.7	4.0	6.8	6.7	3.2	3.4
Delivery value for exports	1.3	(0.3)	17.7	5.5	(5.3)	(4.8)	(6.4)	(4.5)	(3.6)	(1.5)	4.1	2.7	1.4	0.4	0.6	0.5
Service output index	6.9	0.0	13.1	(0.1)	6.7	8.7	5.7	6.8	6.9	8.2	4.6	4.1	3.1	4.3	4.1	4.1
Retail sales	8.0	(3.9)	12.5	(0.2)	5.8	8.2	2.5	4.6	5.5	8.5	4.5	3.7	2.6	5.0	4.0	3.9
Exports of goods	0.5	3.6	29.9	7.0	(1.8)	(3.4)	(14.3)	(8.7)	(6.2)	(1.5)	6.2	4.5	0.0	(1.4)	(0.9)	(1.6)
Imports of goods	(2.7)	(0.6)	30.1	1.1	(7.0)	(6.9)	(12.2)	(7.3)	(6.3)	(3.0)	1.3	(0.9)	(5.7)	(4.0)	(3.4)	(2.2)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	5.1	3.8	3.4	3.2	3.1	3.0	7.2	4.9	4.5	4.5	4.5	4.4
-Property development	9.9	7.0	4.4	(10.0)	(5.8)	(7.9)	(8.5)	(8.8)	(9.1)	(8.8)	(2.6)	(6.7)	(7.5)	(8.1)	(8.6)	(8.8)
-Manufacturing	3.1	(2.2)	13.5	9.1	7.0	6.0	5.7	5.9	6.2	6.1	11.2	8.2	7.8	7.9	8.1	7.9
-Infrastructure	3.3	3.4	0.2	11.5	10.8	10.2	9.4	9.0	8.6	8.1	10.6	9.7	9.5	9.7	9.9	9.7
GFA sold for commodity building (YTD)	20.8	(20.9)	0.0	0.0	(1.8)	(5.3)	(6.5)	(7.1)	(7.5)	(7.0)	(8.0)	(14.2)	(15.2)	(15.4)	(15.2)	(15.0)
GFA started for commodity building (YT	0.0	0.0	0.0	0.0	(19.2)	(24.3)	(24.5)	(24.4)	(23.4)	(22.0)	(18.4)	(29.5)	(30.5)	(31.1)	(31.1)	(30.3)

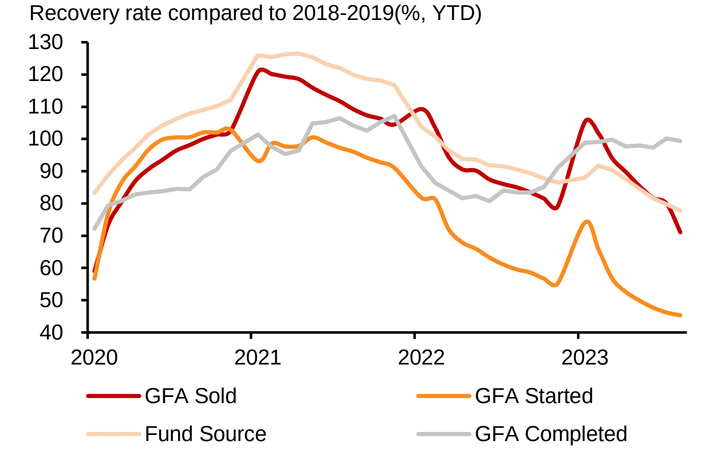
Source: Wind, CMBIGM estimates

Figure 2: Property market indicators



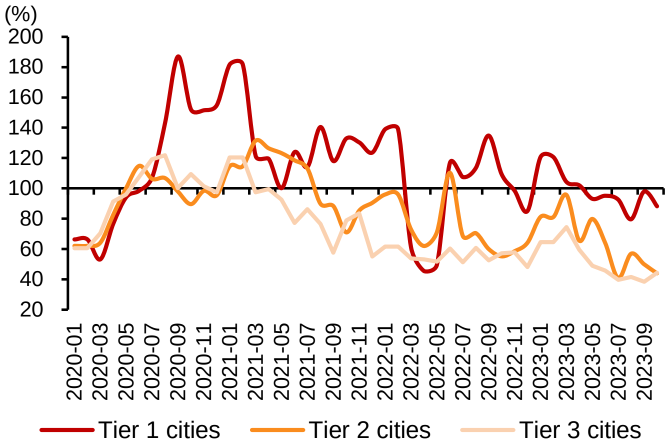
Source: WIND, CMBIGM

Figure 3: Recovery rates compared to 2019



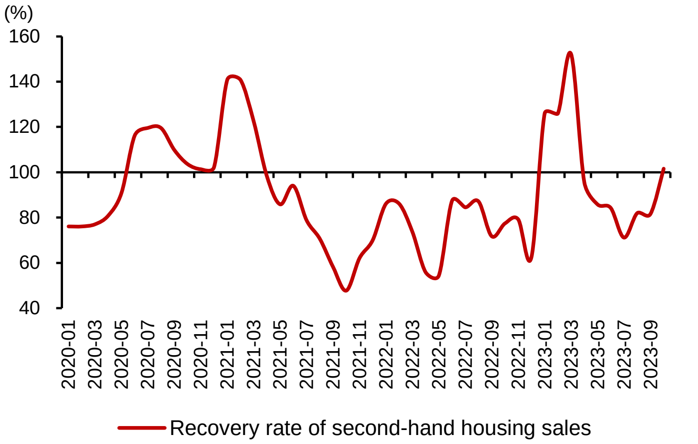
Source: WIND, CMBIGM

Figure 4: Housing sales recovery rates to 2019 in 30 Cities



Source: WIND, CMBIGM

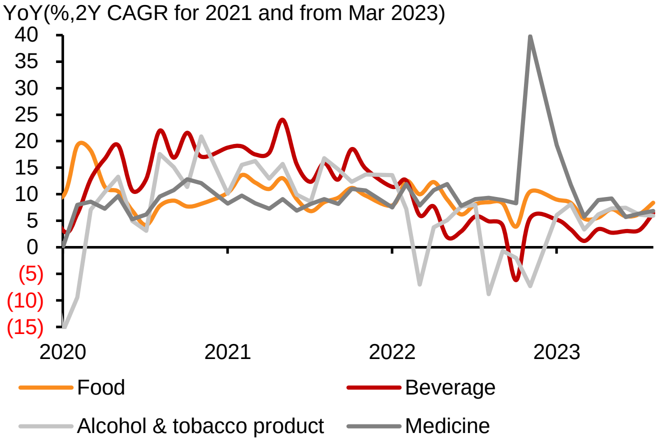
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: WIND, CMBIGM

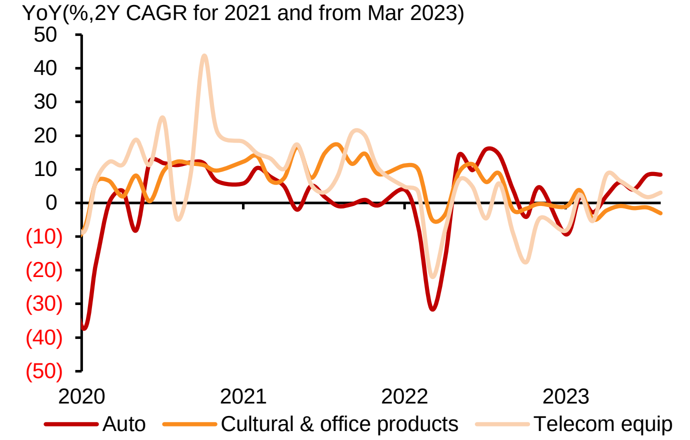
11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples



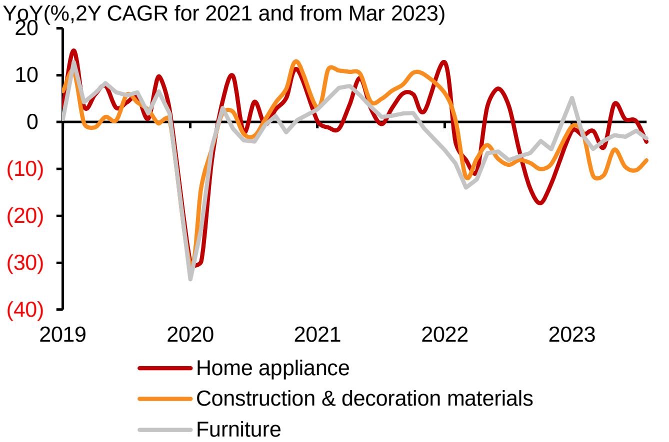
Source: WIND, CMBIGM

Figure 7: Retail sales of auto & electronics



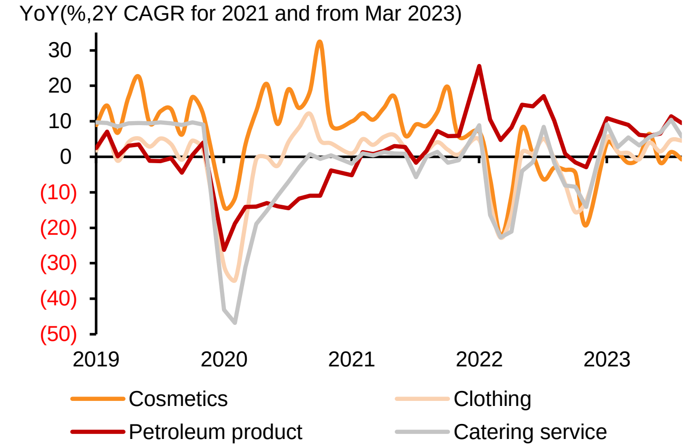
Source: WIND, CMBIGM

Figure 8: Home appliance & furniture retail sales



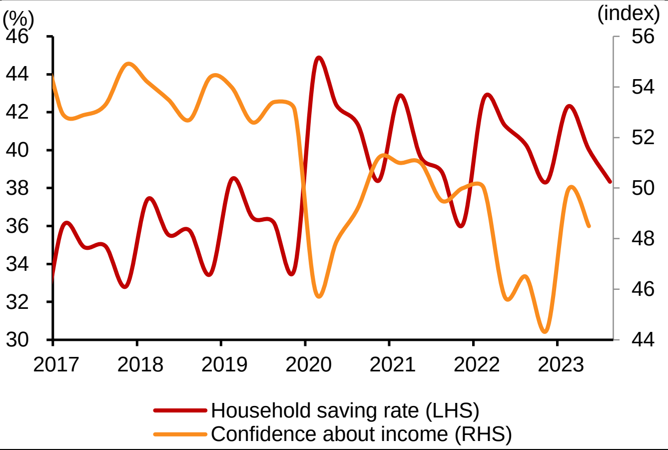
Source: WIND, CMBIGM

Figure 9: Retail sales related to outgoing activities



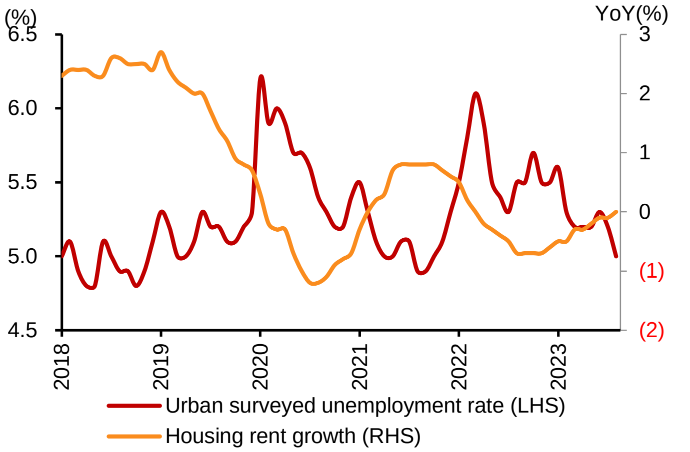
Source: WIND, CMBIGM

Figure 10: Consumer confidence



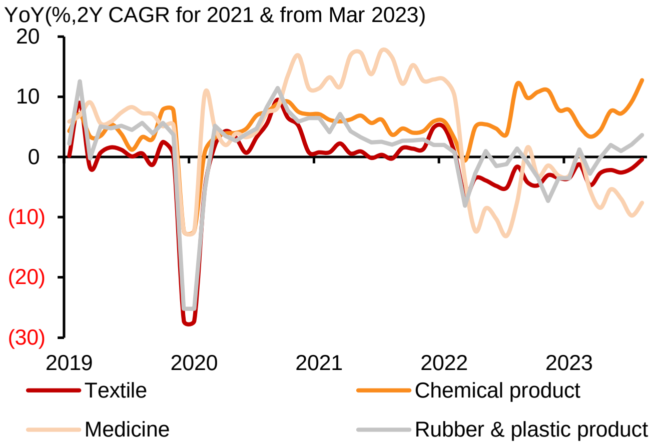
Source: WIND, CMBIGM

Figure 11: Urban unemployment rate & housing rent



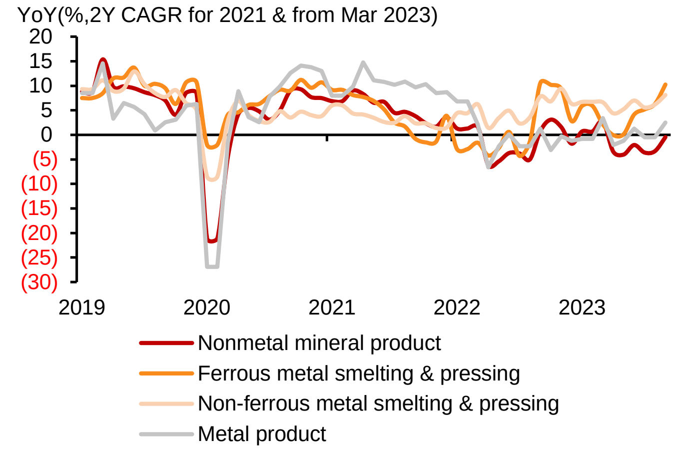
Source: WIND, CMBIGM

Figure 12: VAIO in textile & chemical products



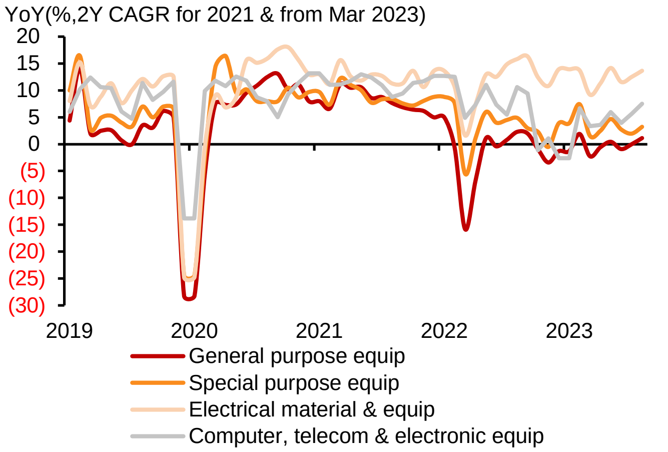
Source: WIND, CMBIGM

Figure 13:VAIO in mineral & metal products



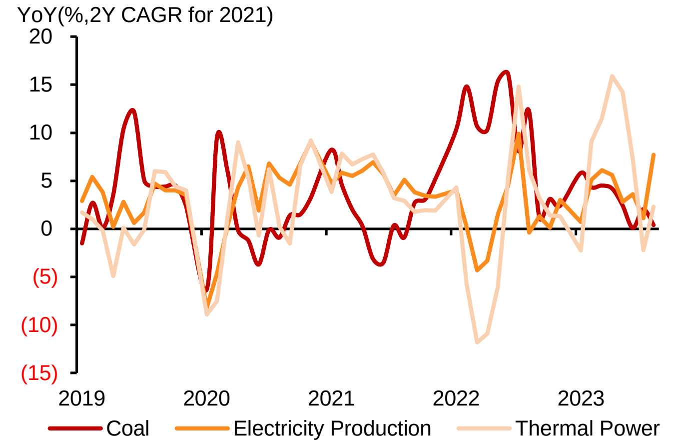
Source: WIND, CMBIGM

Figure 14: VAIO in equipment



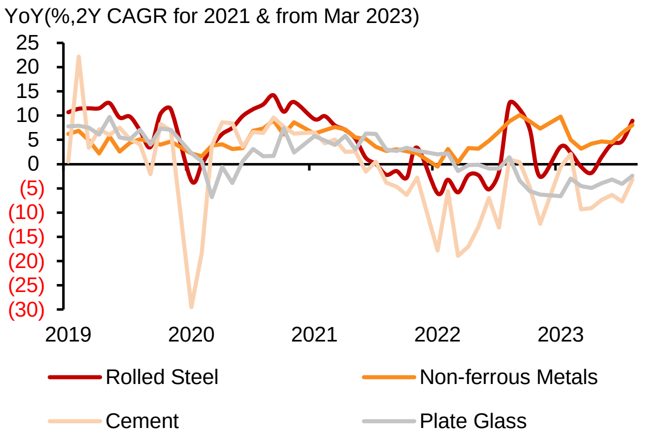
Source: WIND, CMBIGM

Figure 15: Output in energy and electricity



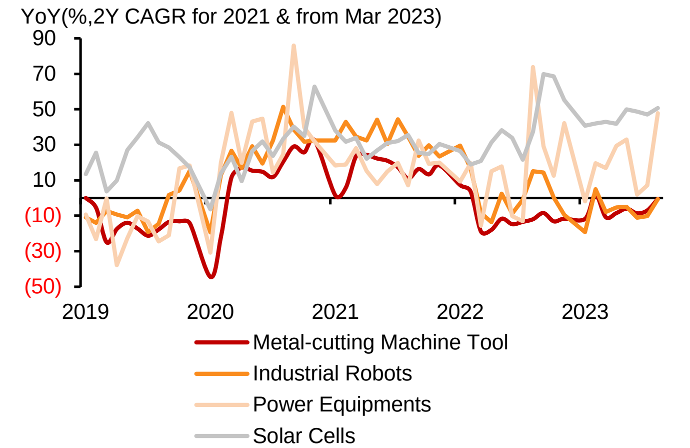
Source: WIND, CMBIGM

Figure 16: Output in steel & construction material



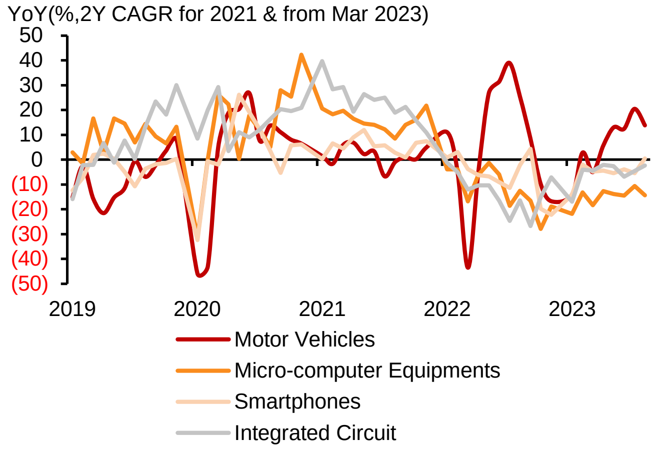
Source: WIND, CMBIGM

Figure 17: Output in capital goods



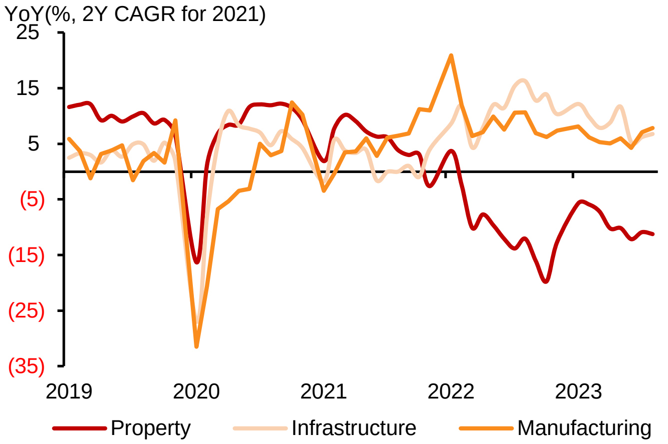
Source: WIND, CMBIGM

Figure 18:Output in auto, computer & smartphone



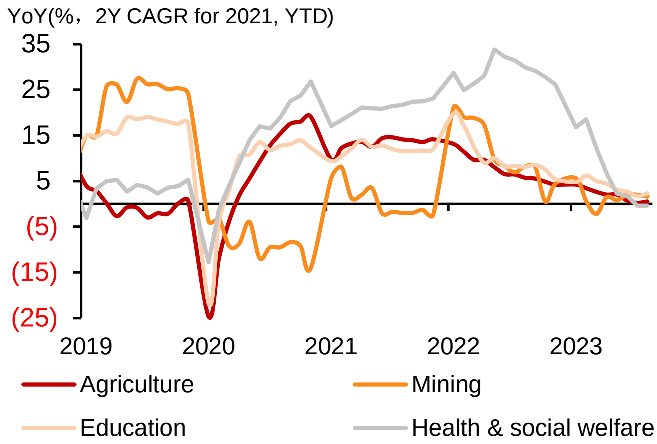
Source: WIND, CMBIGM

Figure 19: FAI by sector



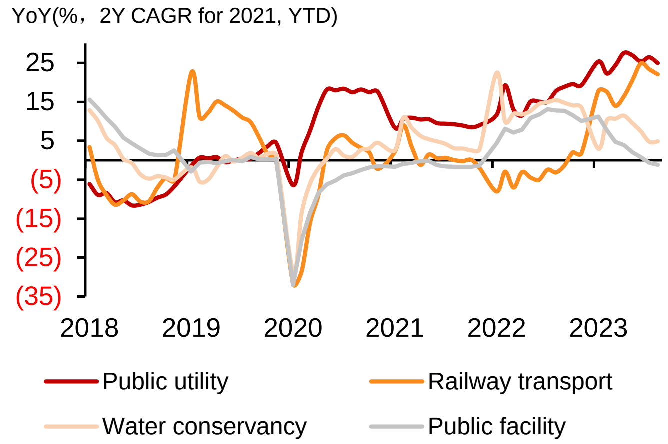
Source: WIND, CMBIGM

Figure 20: FAI in agriculture, mining & public service



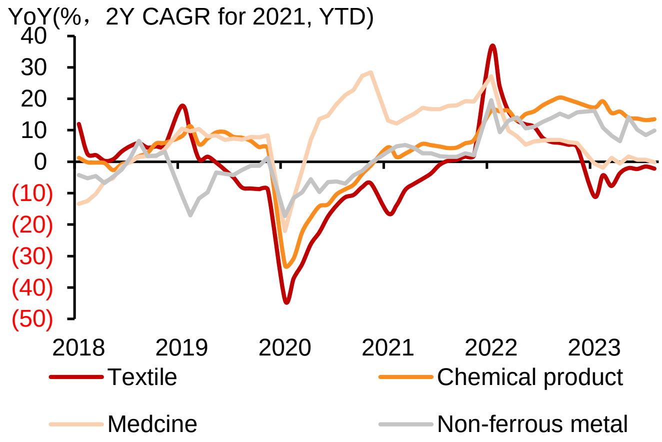
Source: WIND, CMBIGM

Figure 21: FAI in infrastructure sectors



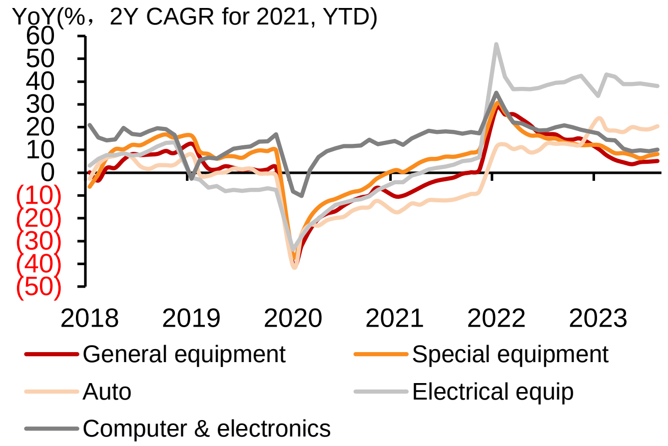
Source: WIND, CMBIGM

Figure 22: FAI in chemical product & non-ferrous metal



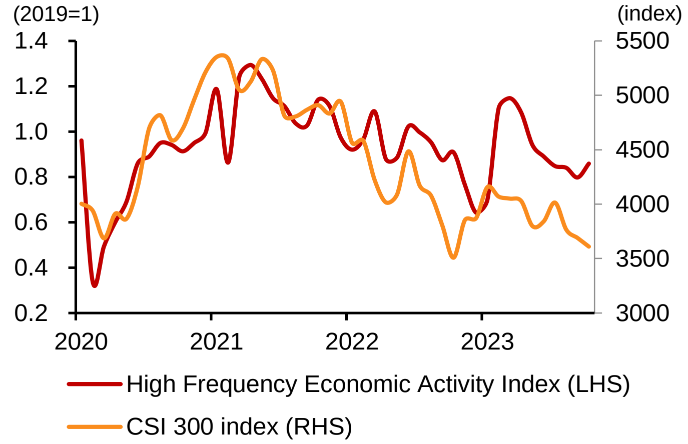
Source: WIND, CMBIGM

Figure 23: FAI in equipment



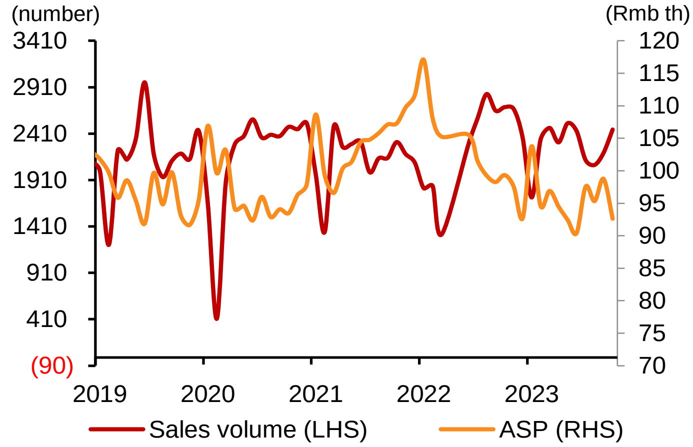
Source: WIND, CMBIGM

Figure 24: Economic activity & A-share index



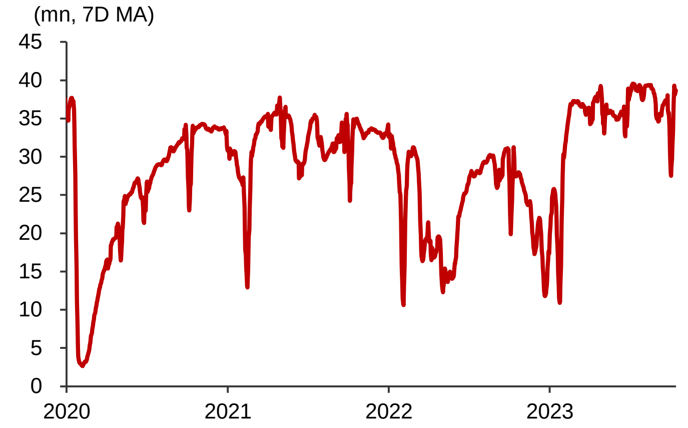
Source: WIND, CMBIGM

Figure 25: Used vehicle sales in Shanghai market



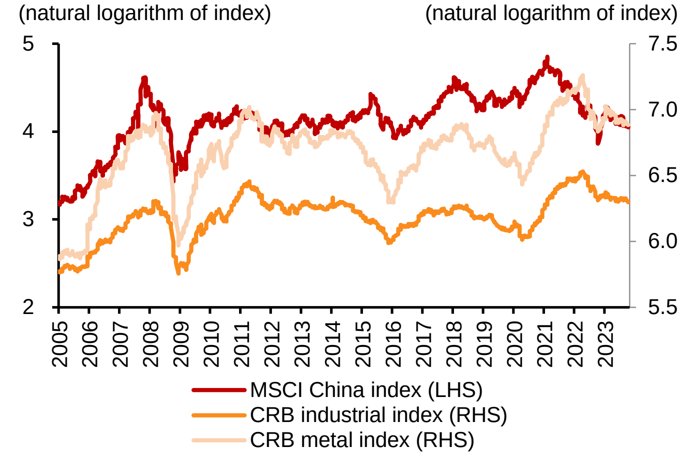
Source: WIND, CMBIGM

Figure 26: Subway passenger flow in tier-1 cities



Source: WIND, CMBIGM

Figure 27: MSCI China and Industrial& Metal Index



Source: WIND, CMBIGM

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