

China Economy

Confidence remained weak amid property slump and deflation

The economic data in December 2023 showed a clear picture of overcapacity and deflation pressure in China's economy as housing sales and consumption were much weaker than industrial output and fixed asset investments. Housing sales continued to slump, retail sales remained weak while VAIO and FAI saw a modest rebound. The major challenge for the economy is weak demand instead of supply-side issues. What China needs to do is strong fiscal support to households and significant mortgage rate cut for home buyers to boost housing sales and consumption demand. However, the focus of China's fiscal policy is still on investment and production. Meanwhile, the authority has a fear of floating on exchange rates, restraining the room of interest rate policy. Looking forward, China's broad fiscal deficit may reach 7.5% of GDP in 2024 with over half focusing on fixed investments. The PBOC is likely to maintain a moderate easing of monetary policy with 1-2 times of RRR cuts and one LPR cut in 2024. We maintain our forecast on the GDP growth at 4.8% for 2024 after 5.2% in 2023.

- Economic growth came in roughly in line with expectations.** China's GDP rose 5.2% YoY (all on a YoY basis unless otherwise specified) in 4Q23 after growing 4.9% in 3Q23. Meanwhile, the SA QoQ growth of GDP eased to 1% from 1.5%, and the 2Y CAGR of GDP edged down to 4% from 4.4%. GDP growth in 2023 was slightly higher than the 5% government goal. In 4Q23, property sales & development investments further plunged; while both service output and retail sales moderately picked up with much lower base last year. Infrastructure investment growth slowed down while manufacturing investment mildly picked up. The economic data in December showed a clear picture of overcapacity and deflation pressure in China's economy as housing sales and consumption were much weaker than industrial output and FAI.
- Retail sales remained sluggish.** Retail sales growth slowed down to 7.4% in December after rising 10.1% in November, while its 2Y CAGR rose from 1.8% to 2.7%. Cosmetics, daily used goods, home appliance, cultural & office products, furniture and construction & decoration materials continued to slump as their 2Y CAGRs dropped from -4.1%, -3%, -5%, -1.8% and -10.2% in November to -5.9%, -7.6%, -4.7%, -1.8% and -8.2%. There were three reasons for the weak consumption. Firstly, people tend to lower their current propensity to consume while their future income and economic expectations deteriorated. Youth employment remained challenging as newly-released unemployment rate of age 16-24 and 25-29 reached 14.9% and 6.1% in December. Secondly, deflation pressure still lingered, increasing real debt burden and discouraging durable consumption, while deflation expectation indicates higher buying power in the future, hurting current consumption. Lastly, housing sales continued to contract, weakening consumer confidence and related consumption. Looking forward, consumption may mildly improve in 2024 thanks to a gradual recovery of employment in service and public sector, consumer price and second-hand home sales in large cities. We expect retail sales to grow 5.3% in 2024 after rising 7.2% in 2023.
- New housing market continued to slump with promising rebound in second-hand housing sales.** The gross floor area (GFA) sold and the GFA started for commodity buildings respectively dropped 8.5% and 20.4% in 12M23 after decreasing 8% and 21.2% in 11M23. Property development investment further declined 9.6% after dropping 9.4% in 11M23. The recovery

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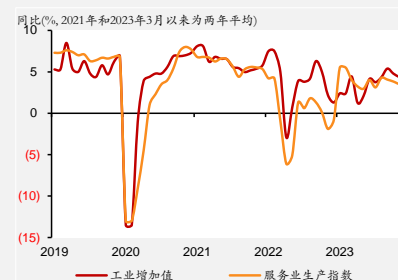
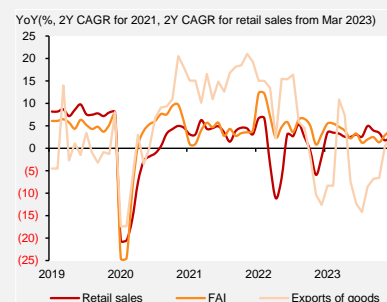
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ratio of housing sales in 30 major cities compared to the same period in 2029 reached 58.5% in December. Second-hand housing market performed much better as its recovery ratio in 11 selective cities reached 115.3% in first half of January. As housing market remained in deep contraction, we expect additional loosening of property policies in 2024. Policymakers may gradually loosen housing purchase restrictions in large cities and further lower down-payment ratio and mortgage rates especially for the second-home buyers. Housing sales may see some tentative stabilization with additional policy loosening and release of upgrading demand in large cities. In the medium term, however, housing sales may continue to face downward pressure as young population shrinks and urbanization process slows.

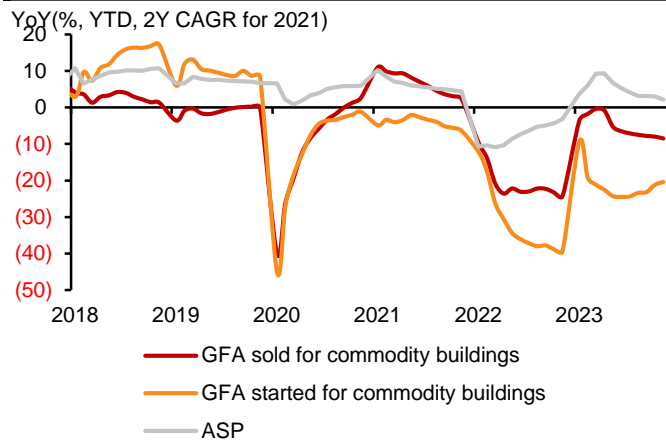
- **Service activity weakened while industrial output rebounded.** The YoY growth of service output index declined from 9.3% in November to 8.5% in December. Output growth rates in most industries slowed in terms of 2Y CAGRs. The 2Y CAGRs of VAIO in nonmetal mineral product, ferrous metal, special equipment, auto and electrical material & equip respectively dropped from 0.5%, 7.2%, 2.1%, 12.5% and 11.3% in November to -0.8%, 2.4%, 1.5%, 6.3% and 10.4% in December. The industrial output grew on a YoY basis thanks to lower base and recovery in exports. Looking forward, service and industrial output may mildly improve in 2024 thanks to a recovery in service consumption, an end of de-stocking cycle and an alleviation of deflation.
- **FAI growth expanded backed by robust manufacturing and infrastructure investments.** FAI rose 3% in 2023, slightly higher than 2.9% in 11M23. Property development investment further declined; while investment growth in manufacturing and infrastructure sector accelerated to 6.5% and 8.2% in 12M23 from 6.3% and 8%. Infrastructure investment dominated by central SOEs, like that in power generation & supply, railway transportation and air transportation, maintained strong growth. Infrastructure investment dominated by local SOEs, like that in water conservancy, environmental protection & public facility management, remained weak with gradual rebound. As funding from local government bonds continue to kick in, liquidity pressure of local governments mildly improved. However, significant shrank in land sales and strict control over incremental hidden debt should restrain infrastructure investment dominated by local SOEs. Looking forward, we expect FAI in manufacturing and infrastructure sectors to grow 6.5% and 7.8% in 2024 after rising 6.5% and 8.2% in 2023, while the decline of property investment to moderate to 7% in 2024 from 9.6% in 2023.
- **China needs to ramp up policy support to demand side instead of supply side.** The economic data in December shows a clear picture of overcapacity and deflation pressure in China's economy. The major challenge for China's economy is in the demand side instead of the supply side. What China needs to do is large fiscal transfer to households and significant mortgage rate cuts to boost housing sales and consumer demand. However, the focus of China's fiscal policy is still on the supply side. Meanwhile, the central bank has a fear of floating on exchange rates, restraining the room for interest rate policy. Looking forward, China's broad fiscal deficit may reach about 7.5% of GDP in 2024 with over half on fixed investment. The PBOC may moderately ease monetary policy with possible RRR cuts by 50bps, 1-Y LPR cut by 10bps and 5-Y LPR cut by 20bps. Meanwhile, municipal governments may further loosen property policy. We expect a mild improvement of China's economy with GDP growth expected to rise from 5.2% in 2023 to 4.8% in 2024.

Figure 1: China's economic indicators

	YoY (%)										2Y CAGR (%)					
	2019	2020	2021	2022	1Q23	1H23	3Q23	2023	Nov	Dec	1Q23	1H23	3Q23	2023	Nov	Dec
GDP	6.0	2.3	8.4	3.0	4.5	5.5	5.2	5.2		5.2	4.6	4.0	4.1	4.1		4.0
VAIO	5.7	2.8	9.6	3.6	3.0	3.8	4.0	4.6	6.6	6.8	4.7	3.6	3.9	4.1	4.4	4.0
-Mining	5.0	0.5	5.3	0.6	3.2	1.7	1.7	2.3	3.9	4.7	6.9	5.5	5.0	4.8	4.9	4.8
-Manufacturing	6.0	3.4	9.8	(2.0)	2.9	4.2	4.4	5.0	6.7	7.1	4.5	3.5	3.8	4.0	4.3	3.6
-Public utility	7.0	2.0	11.4	(2.2)	3.3	4.1	3.5	4.3	9.9	7.3	4.7	4.0	4.5	4.6	4.0	7.1
Delivery value for exports	1.3	(0.3)	17.7	5.5	(5.3)	(4.8)	(4.8)	(3.9)	(3.0)	(3.2)	4.1	2.7	2.1	0.7	(4.8)	(5.8)
Service output index	6.9	0.0	13.1	(0.1)	6.7	8.7	7.9	8.1	9.3	8.5	4.6	4.1	3.9	3.9	3.5	3.7
Retail sales	8.0	(3.9)	12.5	(0.2)	5.8	8.2	6.8	7.2	10.1	7.4	4.5	3.7	3.7	3.4	1.8	2.7
Exports of goods	0.5	3.6	29.9	7.0	(1.9)	(3.4)	(5.7)	(4.6)	0.5	2.3	6.0	4.3	2.4	0.4	(5.1)	(5.4)
Imports of goods	(2.7)	(0.6)	30.1	1.1	(7.2)	(7.1)	(7.6)	(5.5)	(0.6)	0.2	1.2	(1.0)	(2.2)	(2.4)	(6.0)	(3.7)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	5.1	3.8	3.1	3.0	2.9	3.0	7.2	4.9	4.5	4.0	4.1	4.0
-Property development	9.9	7.0	4.4	(10.0)	(5.8)	(7.9)	(9.1)	(9.6)	(9.4)	(9.6)	(2.6)	(6.7)	(8.6)	(9.8)	(9.6)	(9.8)
-Manufacturing	3.1	(2.2)	13.5	9.1	7.0	6.0	6.2	6.5	6.3	6.5	11.2	8.2	8.1	7.8	7.8	7.8
-Infrastructure	3.3	3.4	0.2	11.5	10.8	10.2	8.6	8.2	8.0	8.2	10.6	9.7	9.9	9.9	9.8	9.9
GFA sold for commodity building (YTD)	20.8	(21.1)	0.0	0.0	(1.8)	(5.3)	(7.5)	(8.5)	(8.0)	(8.5)	(8.0)	(14.2)	(15.2)	(16.8)	(16.0)	(16.8)
GFA started for commodity building (YTD)	0.0	0.0	0.0	0.0	(19.2)	(24.3)	(23.4)	(20.4)	(21.2)	(20.4)	(18.4)	(29.5)	(31.1)	(30.5)	(30.6)	(30.5)

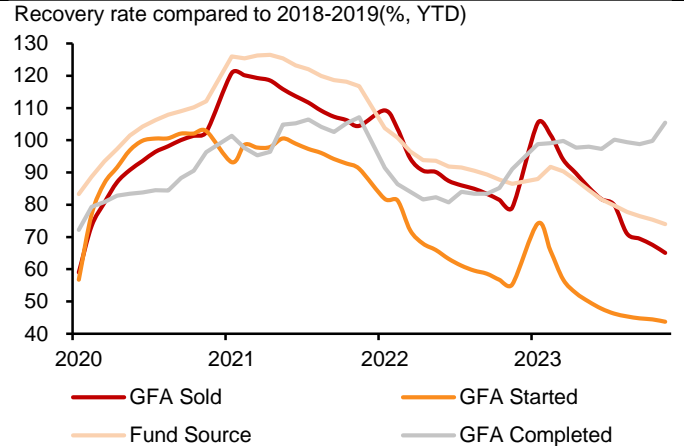
Source: Wind, CMBIGM estimates

Figure 2: Property market indicators



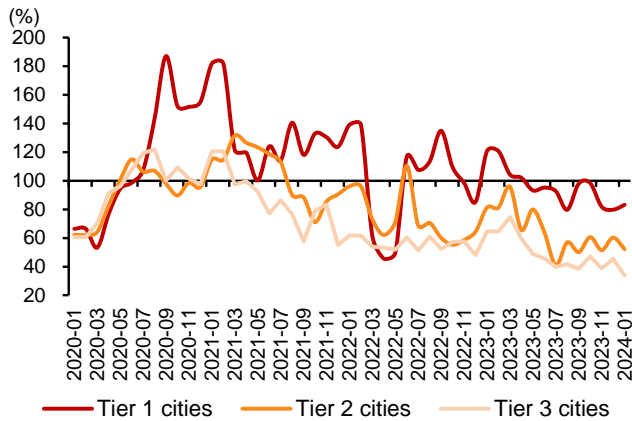
Source: WIND, CMBIGM

Figure 3: Recovery rates compared to 2019



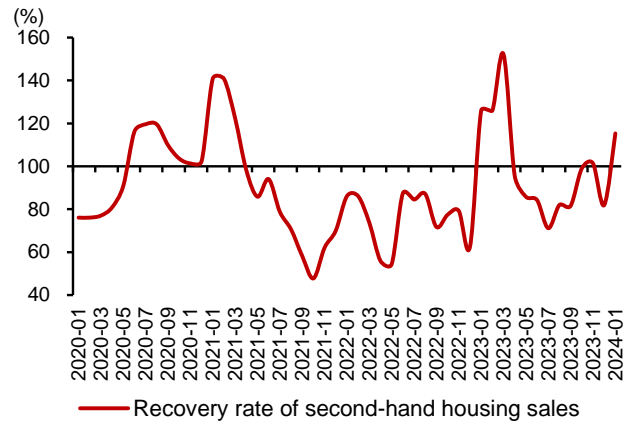
Source: WIND, CMBIGM

Figure 4: Housing sales recovery rates compared to 2019 in 30 cities



Source: WIND, CMBIGM

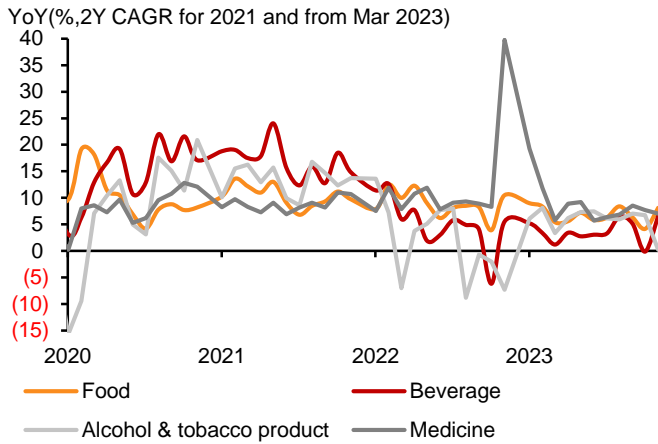
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: WIND, CMBIGM

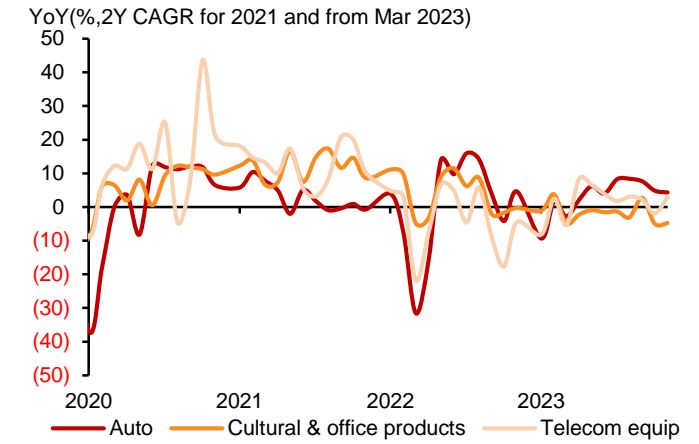
11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples



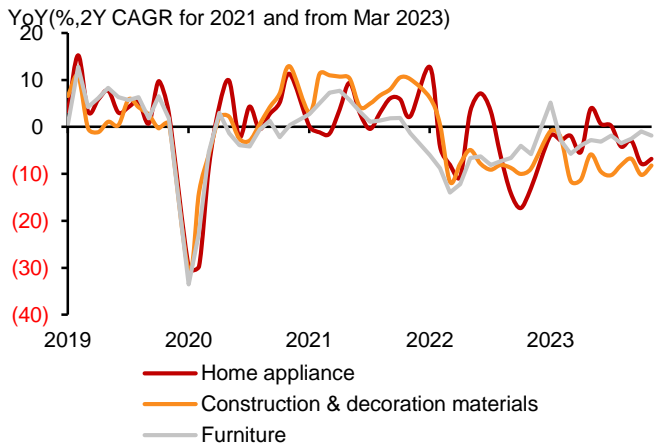
Source: WIND, CMBIGM

Figure 7: Retail sales of auto & electronics



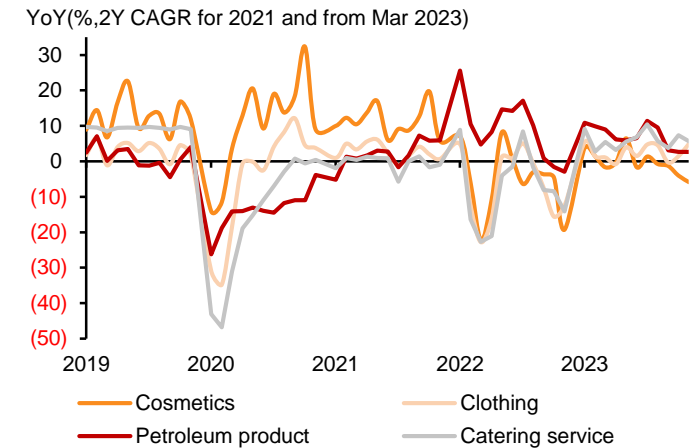
Source: WIND, CMBIGM

Figure 8: Home appliance & furniture retail sales



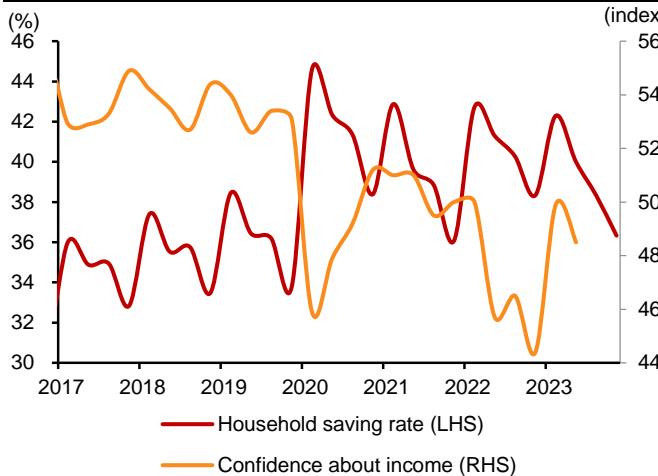
Source: WIND, CMBIGM

Figure 9: Retail sales related to outgoing activities



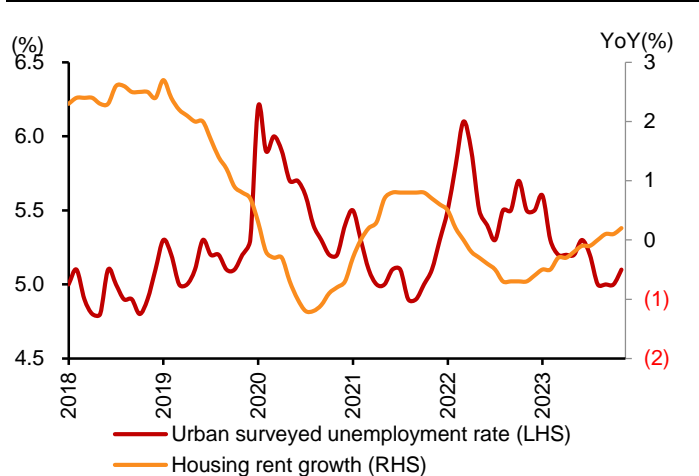
Source: WIND, CMBIGM

Figure 10: Consumer confidence



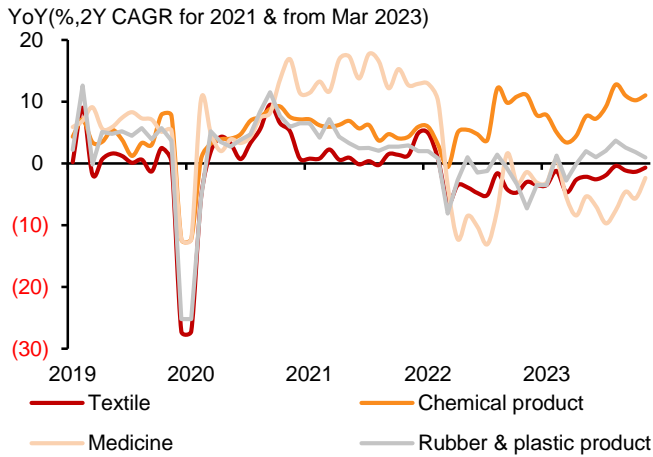
Source: WIND, CMBIGM

Figure 11: Urban unemployment rate & housing rent



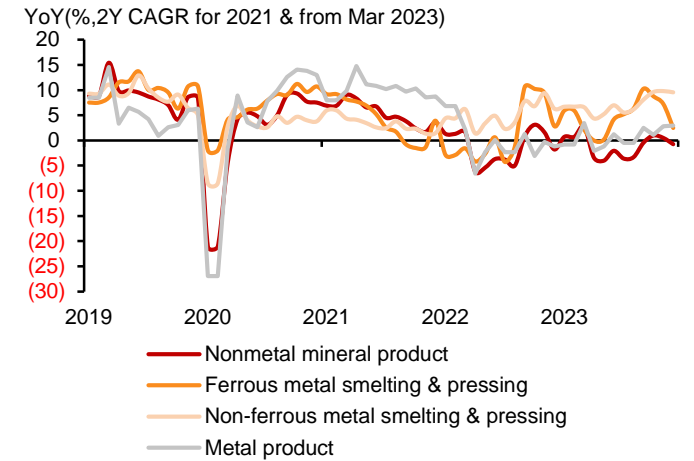
Source: WIND, CMBIGM

Figure 12: VAIO in textile & chemical products



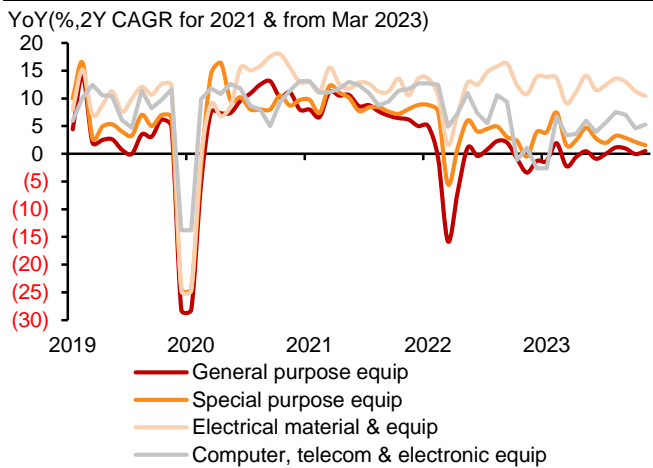
Source: WIND, CMBIGM

Figure 13:VAIO in mineral & metal products



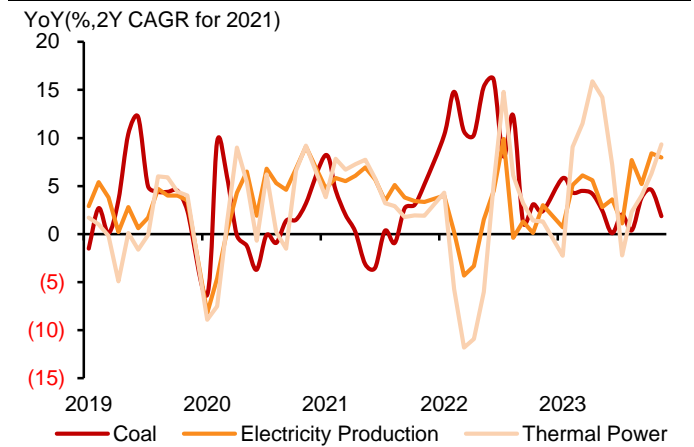
Source: WIND, CMBIGM

Figure 14: VAIO in equipment



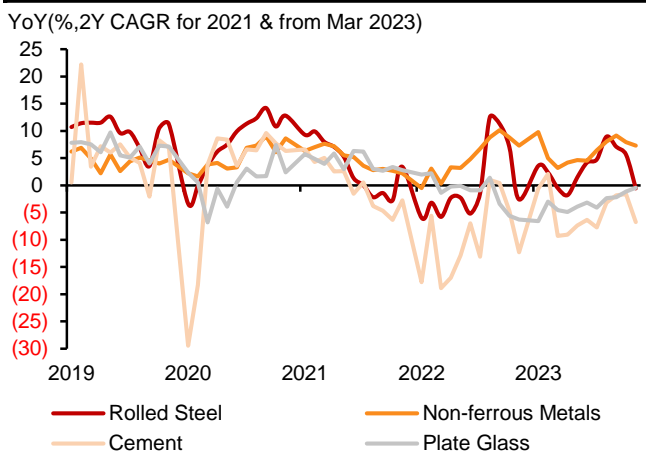
Source: WIND, CMBIGM

Figure 15: Output in energy and electricity



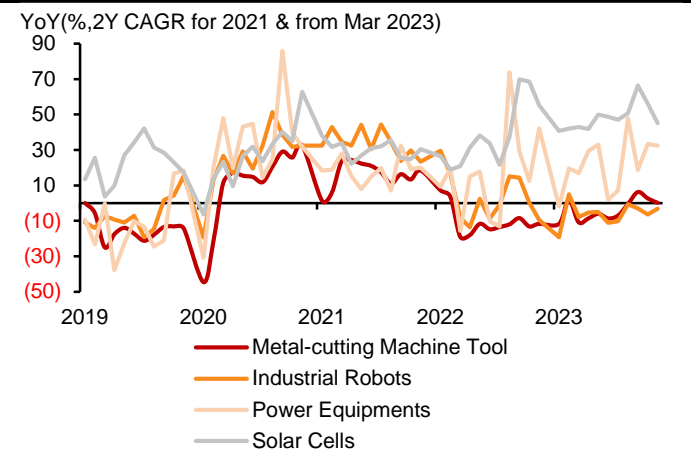
Source: WIND, CMBIGM

Figure 16: Output in steel & construction material



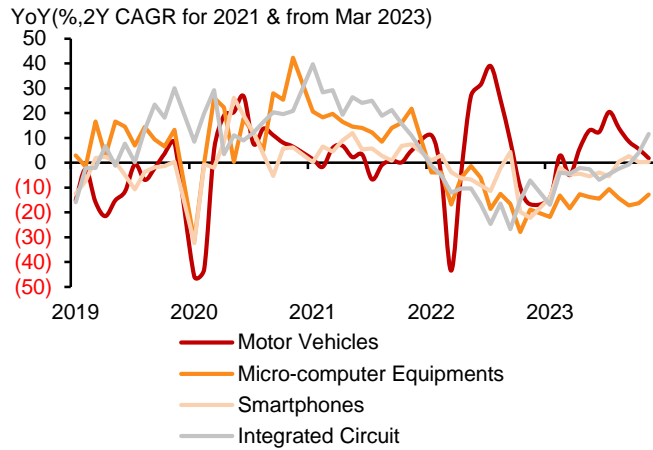
Source: WIND, CMBIGM

Figure 17: Output in capital goods



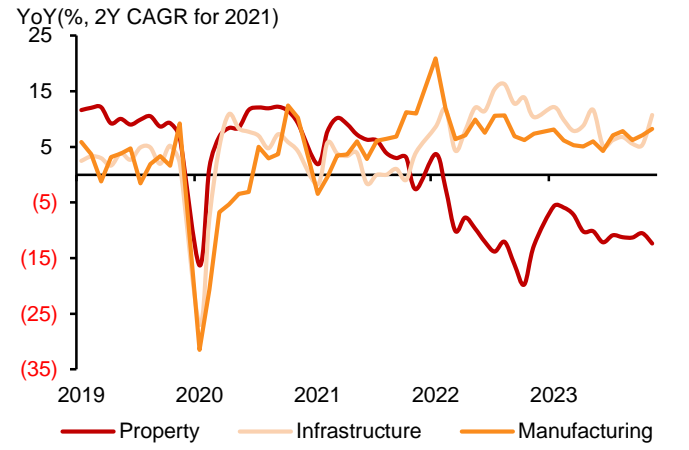
Source: WIND, CMBIGM

Figure 18: Output in auto, computer & smartphone



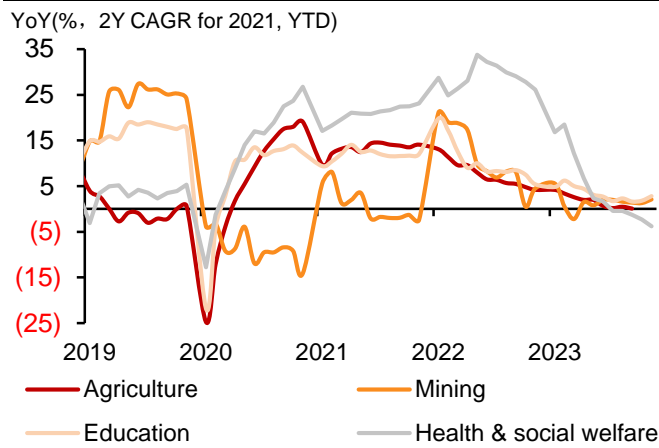
Source: WIND, CMBIGM

Figure 19: FAI by sector



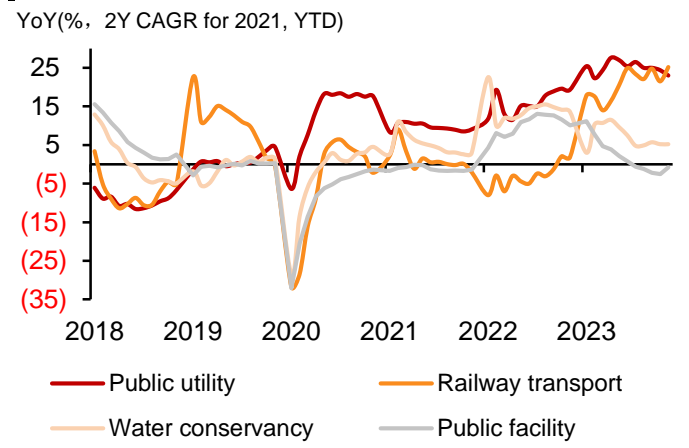
Source: WIND, CMBIGM

Figure 20: FAI in mining & public service



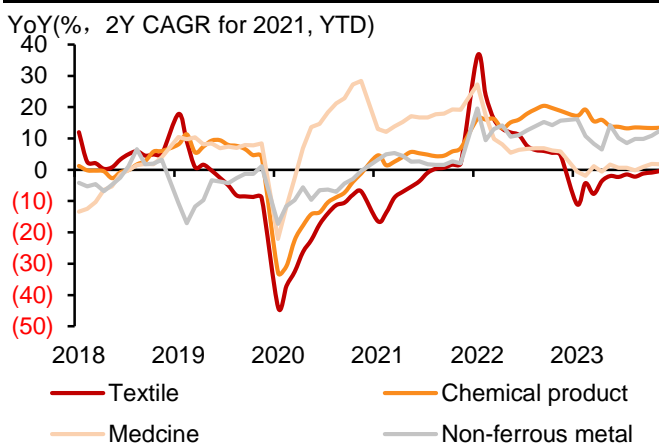
Source: WIND, CMBIGM

Figure 21: FAI in infrastructure sectors



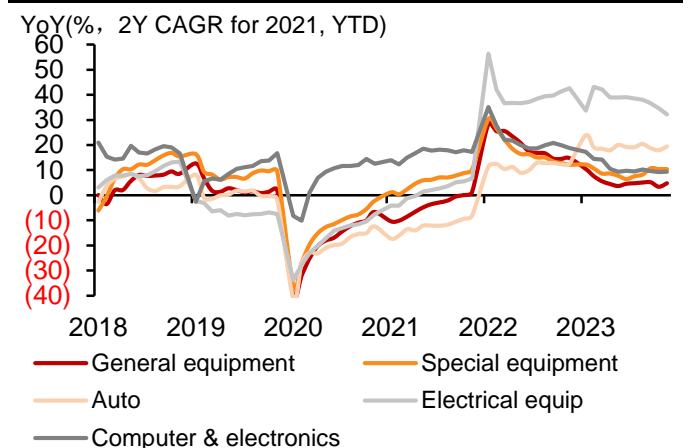
Source: WIND, CMBIGM

Figure 22: FAI in chemical products



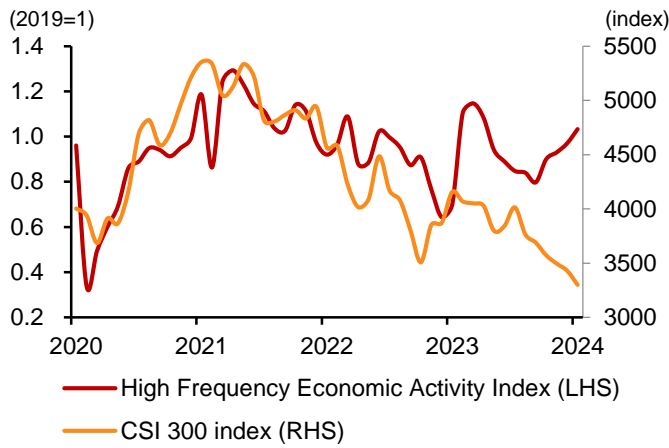
Source: WIND, CMBIGM

Figure 23: FAI in equipment



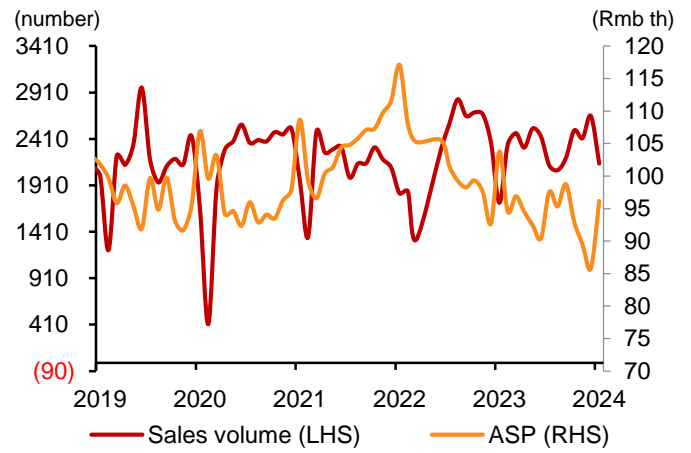
Source: WIND, CMBIGM

Figure 24: Economic Activity & A Share Index



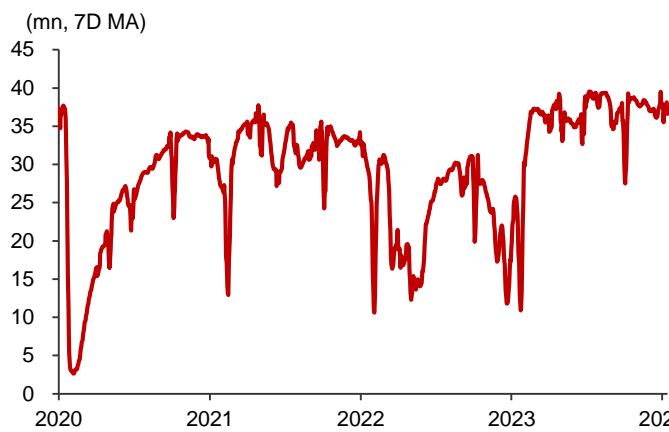
Source: WIND, CMBIGM

Figure 25: Used vehicle sales in Shanghai market



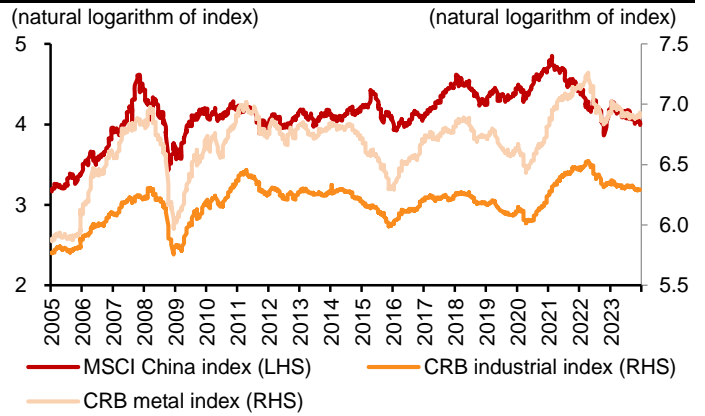
Source: WIND, CMBIGM

Figure 26: Subway passenger flow in tier-1 cities



Source: WIND, CMBIGM

Figure 27: MSCI China and Industrial& Metal Index



Source: WIND, CMBIGM

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