

China Economy

Demand weakness & deflation pressure continue

Activities data in Aug revealed a broad-based deterioration, with all indicators falling short, despite already modest expectations. Housing sales and starts minimally improved in Aug, yet lost momentum again in early Sep. New and second-hand housing prices declined at an accelerated pace. Retail sales further softened dragged by durable goods including autos and furniture. Consumer confidence hit a historic low amid weak employment conditions. Industrial output moderated. FAI slowed down markedly, weighed by shrinking property construction and weaker infrastructure investments. Amid increasing pressure to meet growth targets and the deepening deflationary spiral, policymakers may implement new rounds of policy easing in 4Q24 including possible outstanding mortgage rate cuts. China's monetary policy may remain accommodative with additional cuts by 10-20bps in LPRs, refinancing rates and deposit rates in the remainder of the year, in our view. As the US Fed may start the rate cut cycle in September, a possible weakening of the US dollar may expand the PBOC's policy room heading into next year.

■ **Housing market minimally improved in Aug but high-frequency data showed losing momentum in Sep.** The gross floor area (GFA) sold for commercial buildings moderately declined 18% (YoY unless otherwise specified) in 8M24 YTD after dropping 18.6% in 7M24. The GFA started also saw less contraction of 22.5% in 8M24 after dropping 23.2% in 7M24. However, new home sales seem to lose momentum three months after the June policy easing as the recovery rate of new housing unit sales in 30 major cities compared to the same period in 2018 & 2019 dropped from 42.6% in Aug to 32.7% in first half of Sep, a historical low and broad deterioration across different tiers of cities. The recovery ratio of second-hand housing sales in 11 selective cities compared to 2019 also slowed down, moderating to 92.8% in first half of Sep from 97% in Aug. New and second-hand housing price are experiencing an accelerated decline in both YoY and MoM, across tiers of cities. Looking forward, we expect the new housing market would show limited improvement especially in lower-tier cities due to rigidity of price, elevated real interest rate and worsening income, while second-hand housing market should remain active. Due to high inventory and excessive supply, however, housing prices and investment activities should recover more slowly.

■ **Retail sales fell short of expectation with consumer confidence reaching historic low.** Retail sales growth came in below market expectations (2.76%) at 2.1%, down from 2.7% in July. Consumer confidence reached historic low at 82 in July, dragged by sub-index employment, which dipped to historic low at 71.6, all the way from 80.1 in Feb. Unemployment rate also edged up by 0.1% to 5.3% in Aug, one of the highest since Mar 2023. Consumer staples remained robust, especially the cereal, oil and foodstuffs that increased by 10.1% in Aug from 9.9% in July. Discretionary consumption remained weak as clothing, cosmetics and gold & silver jewelry declined by 1.6%, 6.1% and 12% respectively in Aug from -5.2%, -6.1% and -10.4%. Catering service also remained subdued, edging up to 3.3% from 3%. Durable goods especially autos remained a major drag to retail sales due to weak consumer income & confidence as well as deflation of price. Contraction of autos sales expanded to -7.3% in Aug after dipping 4.9% in July, the largest decline since Feb 2023. Property-related goods further softened as construction & decoration materials and furniture notably dropped 6.7% and 3.7% in Aug after dropping 2.1% and 1.1% in July, while home appliances rebounded 3.4% from -2.4%, possibly thanks to the trade-in programs. Telecom equip, on the other hand, extended its rally to

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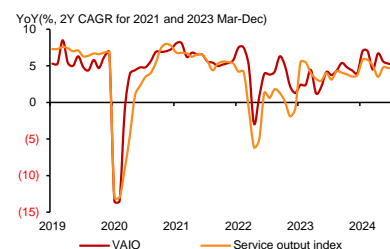
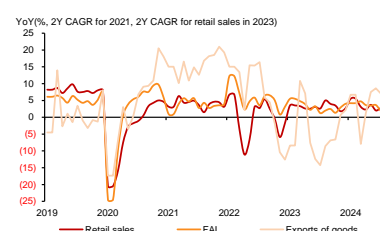
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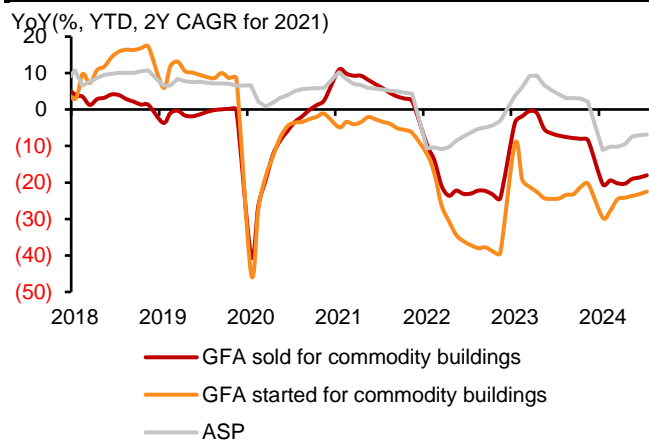
14.8% in Aug from 12.7%. Looking forward, retail sales may remain muted in the near term dragged by decreasing income, confidence weakness and deflation expectations. We revise down our forecast for retail sales growth for 2024 from 5.3% to 4.5%.

- **Industrial output notably slowed down.** VAIO growth dropped to 4.5% in Aug from 5.1% in July, below market expectation of 4.77%. Mining and manufacturing notably moderated to 3.7% and 4.3% in Aug from 4.6% and 5.3%, while utility rose from 4% to 6.8% in Aug. Non-ferrous metal product and non-ferrous metal further deteriorated to -5.5% and -2.1% in Aug from -2.9% and -1.5%, while chemical product, rubber & plastic product and ferrous metals smelting & pressing further moderated. Transport equip excluding auto and computer & electronic equip remained robust growth at 12% and 11.3%. The YoY growth of service output index inched down to 4.6% in Aug from 4.8%. Looking forward, service and industrial output may remain weak in next few months.
- **FAI slowed down markedly dragged by infrastructure investments despite acceleration in government bond financing.** FAI slowed down to 3.4% YTD in 8M24 compared to 3.6% in 7M24, slightly below market expectation of 3.5%. Infrastructure investments notably diminished to 6.2% in Aug from 10.7% even though government bond issuance continued to pick up in Aug, possibly due to fiscal discipline adhered by the local government. Property development investments remained in a deep contraction at -10.2% in Aug from -10.8% while manufacturing edged down to 8% from 8.3%, as overcapacity pressure and earnings weakness started to restrain capex demand in some manufacturing industries. Breaking down by industries, investments in chemical material & product, non-ferrous metal and other transport equipment further accelerated; while electrical equip, electrical equipment and medicine slowed down. Looking forward, we expect FAI growth to slightly accelerate from 3% in 2023 to 3.6% in 2024, with investment growth rates in manufacturing, infrastructure, and property development respectively at 8%, 7.5% and -9.5% in 2024.
- **Weakening economy may trigger additional policy support.** The activities data in Aug showed a broad-based deterioration across the economy, with further softening of confidence among households and private sector. Amid increasing pressure to meet growth targets and the deepening deflationary spiral, policymakers may implement new rounds of policy easing in 4Q24 including outstanding mortgage rate cuts. China's monetary policy may remain accommodative with additional cuts by 10-20bps in LPRs, refinancing rates and deposit rates in the remainder of the year, in our view. For next year, a possible weakening of the US dollar during the Fed's rate cut cycle may expand the PBOC's policy room as China's credit growth might gradually stabilize.

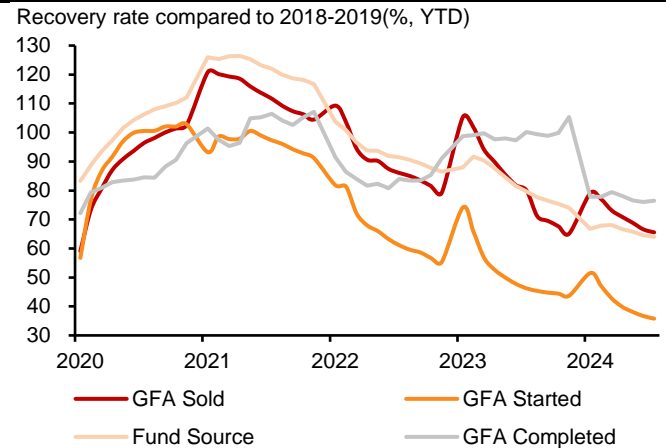
Figure 1: China's economic indicators

YoY(%)	2019	2020	2021	2022	2023	1Q24	2Q24	July	August	2020-2021 CAGR	2022-2023 CAGR
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	5.1	4.5	6.1	4.1
-Mining	5.0	0.5	5.3	7.3	2.3	1.6	3.3	4.6	3.7	2.9	4.8
-Manufacturing	6.0	3.4	9.8	3.0	5.0	6.7	6.3	5.3	4.3	6.6	4.0
-Public utility	7.0	2.0	11.4	5.0	4.3	6.9	5.0	4.0	6.8	6.6	4.6
Delivery value for exports	1.3	(0.3)	17.7	5.5	(3.9)	0.8	6.0	6.4	6.4	8.3	0.7
Service output index	6.9	0.0	13.1	(0.1)	8.1	5.5	4.3	4.8	4.6	6.3	3.9
Retail sales	8.0	(3.9)	12.5	(0.2)	7.2	4.7	2.6	2.7	2.1	4.0	3.4
Exports of goods	0.5	3.6	29.6	5.6	(4.7)	1.1	5.7	7.0	8.7	15.9	0.3
Imports of goods	(2.7)	(0.6)	30.1	0.7	(5.5)	1.6	2.5	7.2	0.5	13.7	(2.4)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	3.0	4.5	3.9	3.6	3.4	3.9	4.0
-Property development	9.9	7.0	4.4	(10.0)	(9.6)	(9.5)	(10.1)	(10.2)	(10.2)	5.7	(9.8)
-Manufacturing	3.1	(2.2)	13.5	9.1	6.5	9.9	9.5	9.3	9.1	5.4	7.8
-Infrastructure	3.3	3.4	0.2	11.5	8.2	8.8	7.7	8.1	7.9	1.8	9.9
GFA sold for commodity building (YTD)	(0.1)	2.6	1.9	(24.3)	(8.5)	(19.4)	(19.0)	(18.6)	(18.0)	2.2	(16.8)
GFA started for commodity building (YTD)	8.5	(1.2)	(11.4)	(39.4)	(20.4)	(27.8)	(23.7)	(23.2)	(22.5)	(6.4)	(30.5)

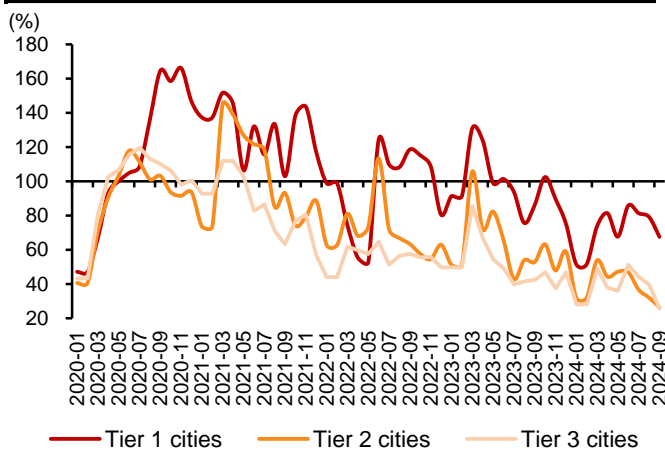
Source: Wind, CMBIGM estimates

Figure 2: Property sales growth

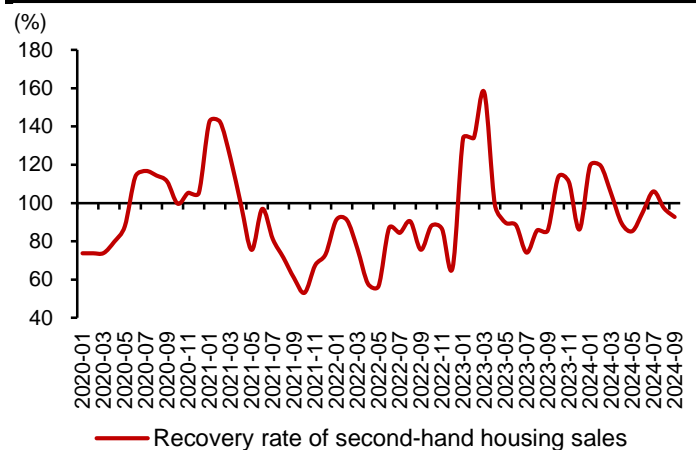
Source: Wind, CMBIGM

Figure 3: Recovery rates compared to 2018-2019

Source: Wind, CMBIGM

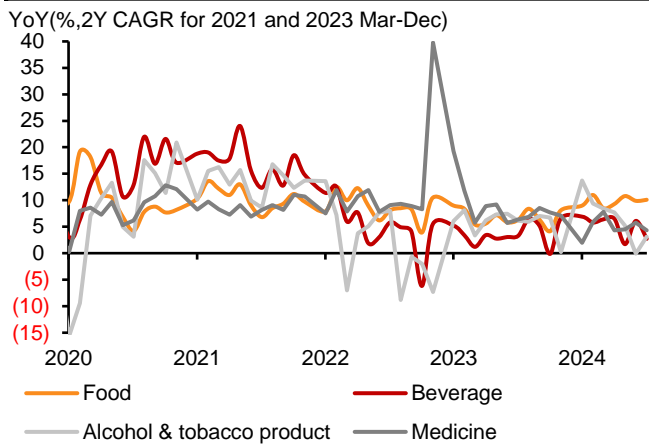
Figure 4: New housing sales recovery rates compared to 2018-2019 in 30 cities

Source: Wind, CMBIGM

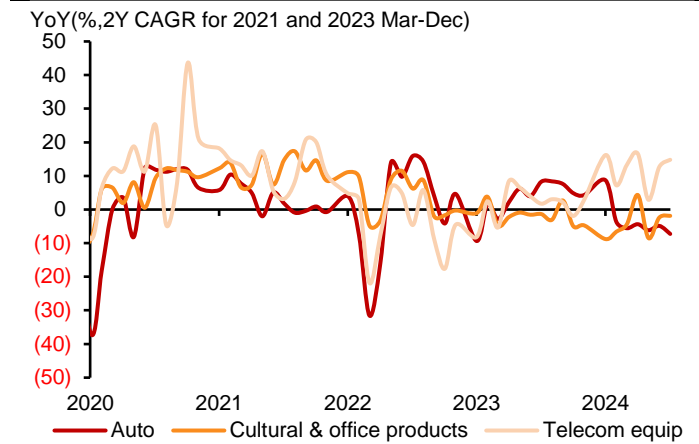
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities

Source: Wind, CMBIGM

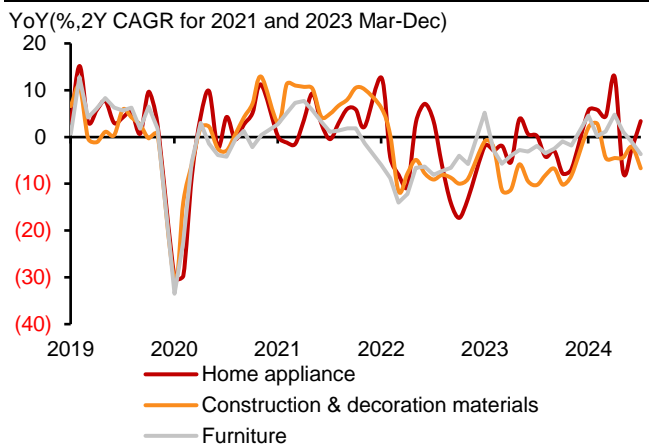
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples

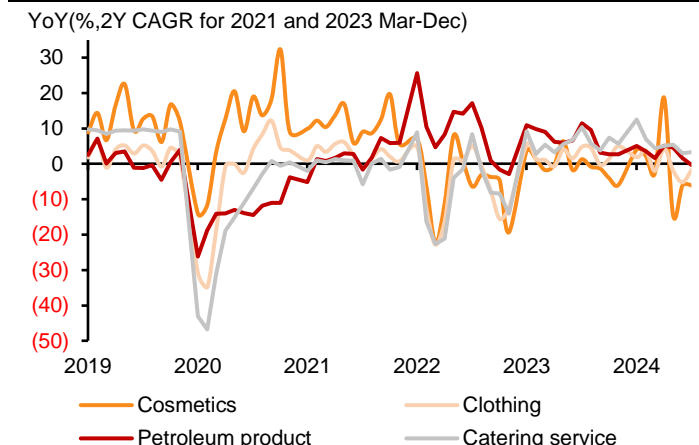
Source: Wind, CMBIGM

Figure 7: Retail sales of auto & electronics

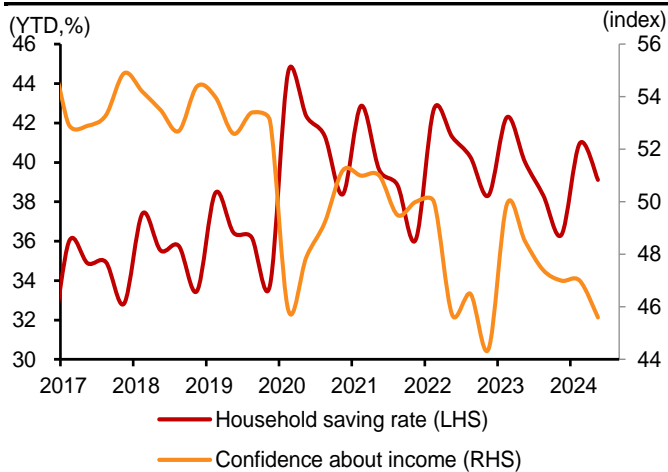
Source: Wind, CMBIGM

Figure 8: Home appliance & furniture retail sales

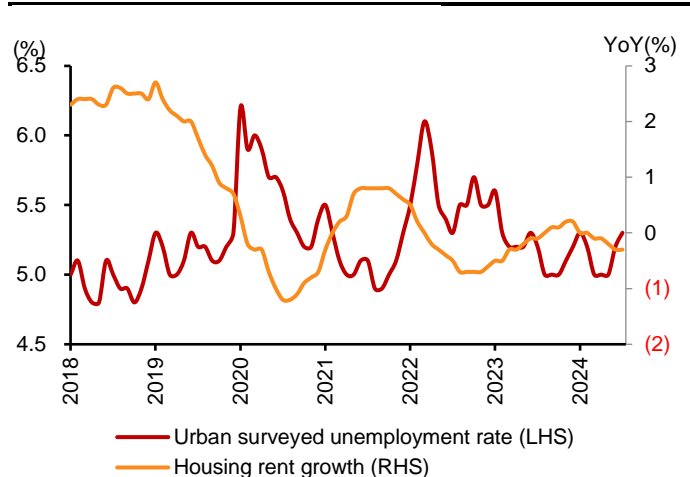
Source: Wind, CMBIGM

Figure 9: Retail sales related to outgoing activities

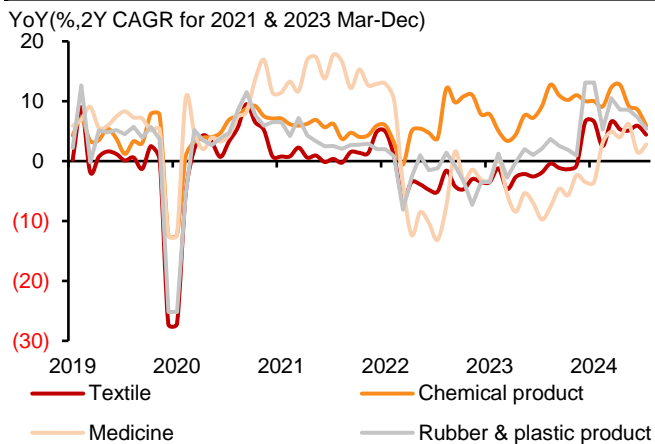
Source: Wind, CMBIGM

Figure 10: Consumer confidence

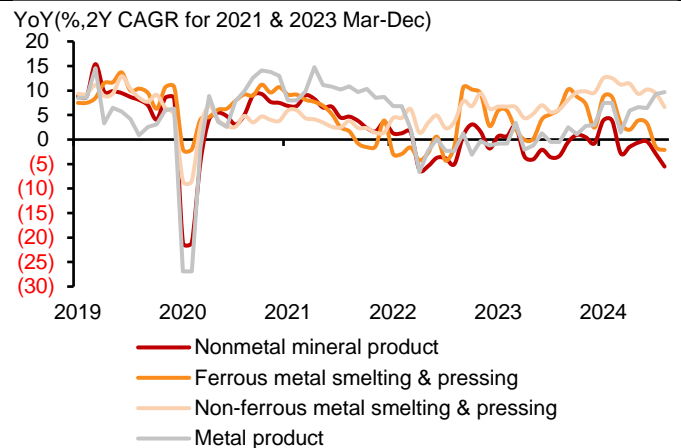
Source: Wind, CMBIGM

Figure 11: Urban unemployment rate & housing rent

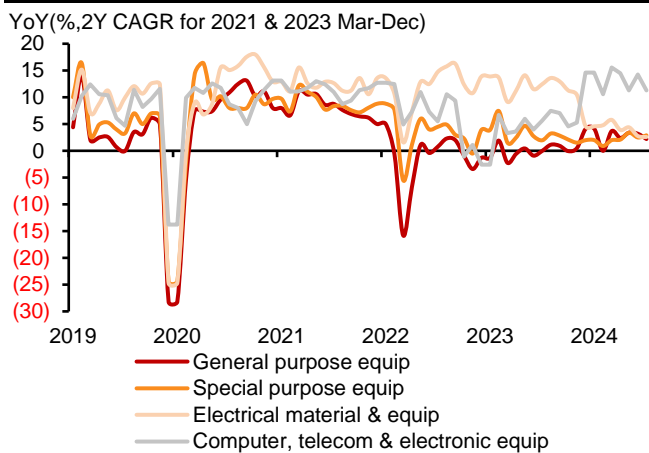
Source: Wind, CMBIGM

Figure 12: VAIO in textile & chemical products

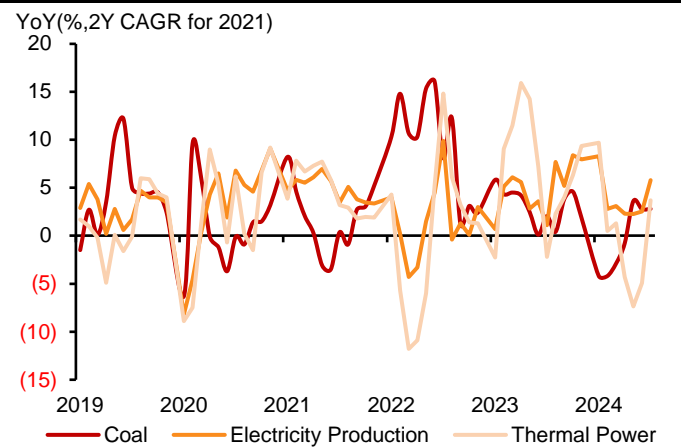
Source: Wind, CMBIGM

Figure 13: VAIO in mineral & metal products

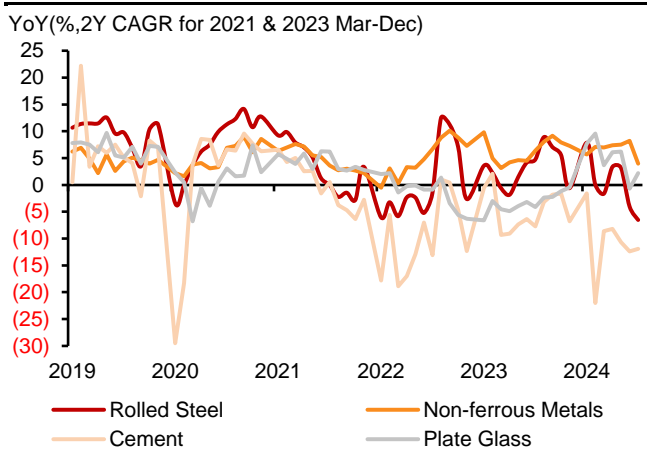
Source: Wind, CMBIGM

Figure 14: VAIO in equipment

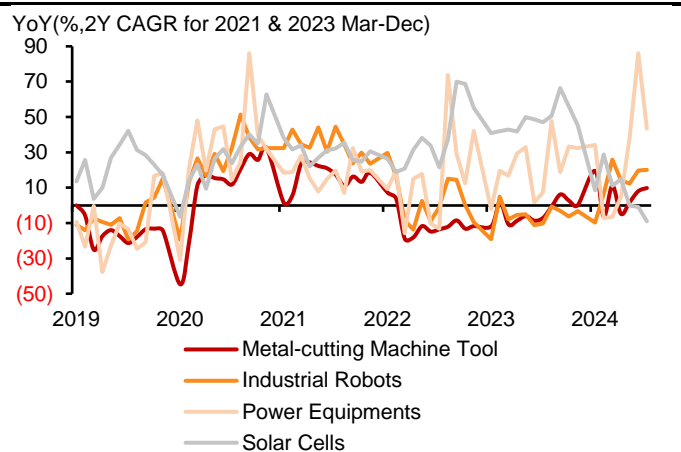
Source: Wind, CMBIGM

Figure 15: Output in energy and electricity

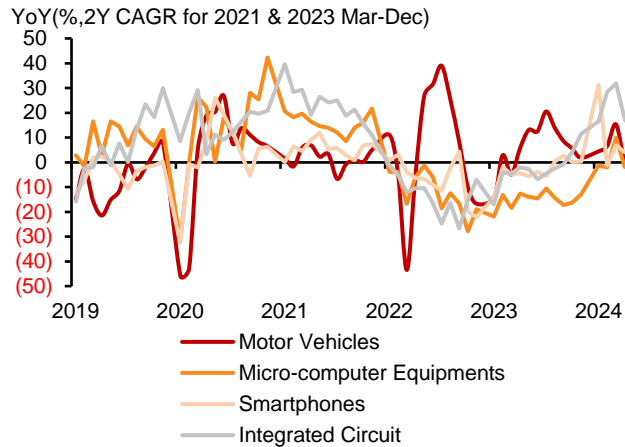
Source: Wind, CMBIGM

Figure 16: Output in steel & construction material

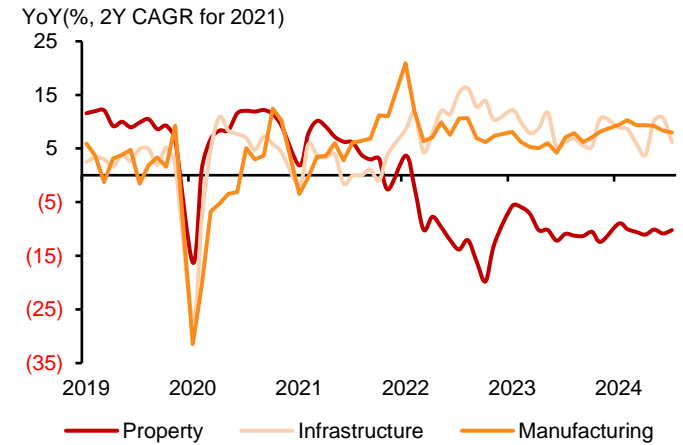
Source: Wind, CMBIGM

Figure 17: Output in capital goods

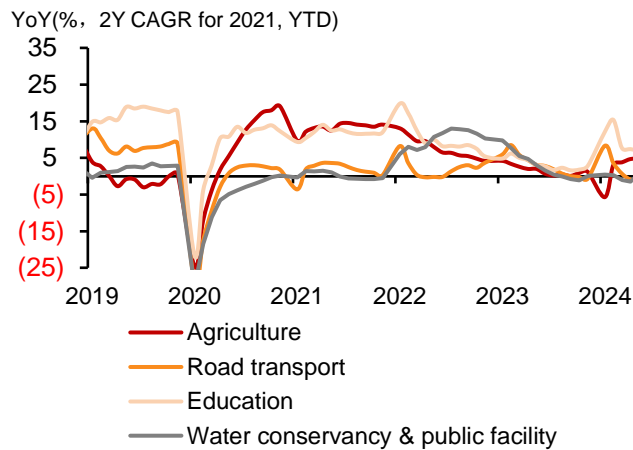
Source: Wind, CMBIGM

Figure 18: Output in auto, computer & smartphone

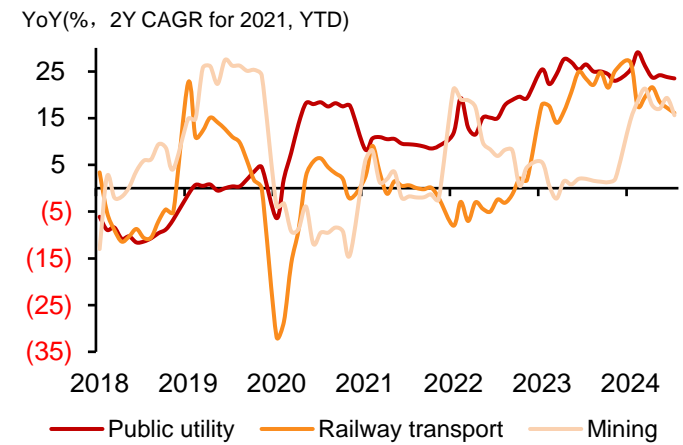
Source: Wind, CMBIGM

Figure 19: FAI by sector

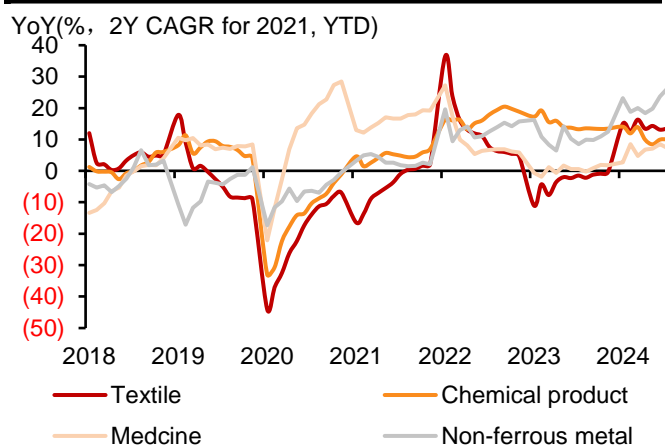
Source: Wind, CMBIGM

Figure 20: FAI in agriculture & local infrastructure

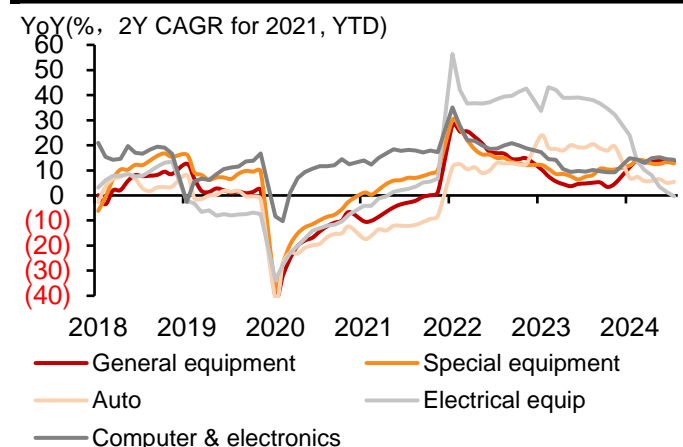
Source: Wind, CMBIGM

Figure 21: FAI in central infrastructure & mining

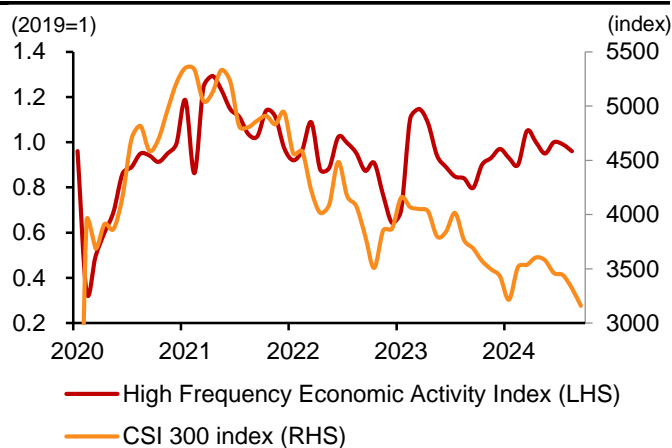
Source: Wind, CMBIGM

Figure 22: FAI in chemical products

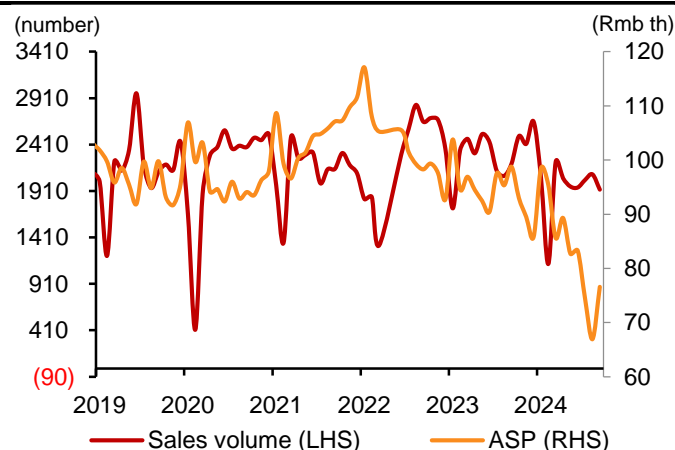
Source: Wind, CMBIGM

Figure 23: FAI in equipment

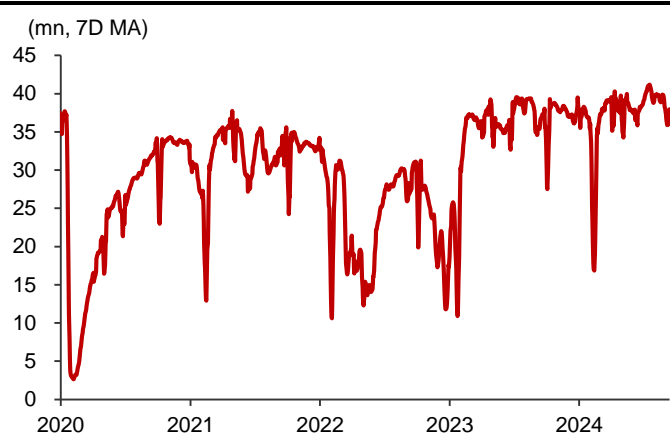
Source: Wind, CMBIGM

Figure 24: Economic activity & A-share index

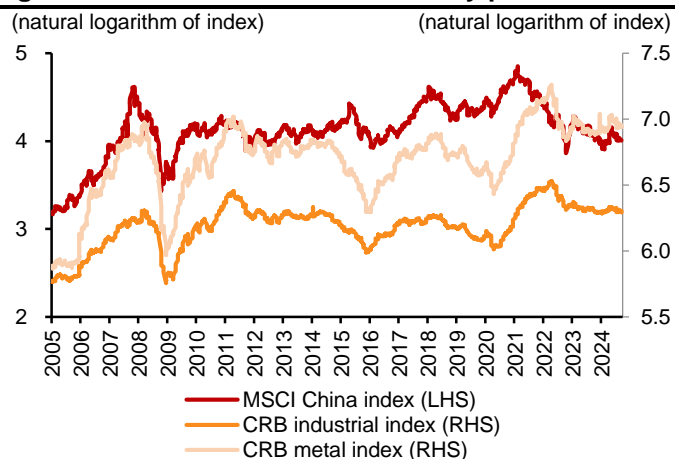
Source: Wind, CMBIGM

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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