

China Economy

Economy further dipped amid weak confidence

Activity data in July showed a further weakening economy as GFA sold and started, retail sales, FAI, VAIO and service output index all fell short of expectation. Employment concerns are in the spotlight as release of youth unemployment rate was suspended abruptly. Household and private business confidence remains weak amid credit default from national developer giants, missed payments of trust products and local government debt concerns. The PBOC lowered MLF rate by 15bps recently, paving the way for further LPR cuts next week and indicating further monetary policy loosening in future. The central bank may also launch RRR cut and guide banks to increase credit supply in next several months. Meanwhile, more cities including tier-1 cities may further loosen property policy with continuous declines in down-payment ratios and mortgage rates for first-home and second-home buyers. With the recovery in service sector and continuous policy easing, China's GDP growth may mildly improve in next several quarters as it is expected to reach 5.1% in 2023 and 4.8% in 2024.

■ **Property market further deteriorated and may gradually stabilize from September or October.** The gross floor area (GFA) sold and the GFA started for commodity buildings respectively dropped 6.5% and 24.5% in 7M23 after decreasing 5.3% and 24.3% in 1H23. Property development investment further declined 8.5% in 7M23 after dropping 7.9% in 1H23. The continuous slump of housing starts indicates property development investment may further decrease. Property developers remained cautious to purchase land as their financing condition was still tough and their confidence was still low. The sluggish property market further exacerbated developer's revenue which may lead to rising default on debt in 2H23. Breaking down the funding source for property development investment, deposit & advance payment dropped 3.8% and individual mortgage fund dropped 1% in 7M23 after respectively felling 0.9% and rising 2.7% in 1H23. Meanwhile, domestic loan fund further declined 11.5% in 7M23 after dropping 11.1% in 1H23. Potential housing supply has shrunk more significantly than housing demand as the rebalance has started in most cities with excess supply. The significant shrinkage of land-related fiscal system increased local government contingent debt risk and brought downside pressure on local government expenditures. Looking forward, housing sales may see moderate improvement from September or October as policymakers continue to loosen property policy and credit supply and service business recovery improves employment condition. However, property development investment may remain weak with a YoY decline.

■ **Retail sales remained weak as consumers were reluctant to consume especially for durables.** The YoY growth of retail sales declined to 2.5% in July from 3.1% in June. Its 2Y CAGR dropped to 2.6% in July, down from 3.1% in June. Looking into the details, retail sales weakened almost across the board except catering service and petroleum product that mildly rebounded as their 2Y CAGRs respectively rose from 5.6% and 5.9% in June to 6.8% and 6.5% in July. Housing-related durables dipped again in July as home appliance, furniture and construction & decoration materials respectively narrowed to 0.6%, and dropped 3.2% and 9.5% in July after growth of 3.8%, -2.8% and -5.9% in terms of 2Y CAGRs. Staples sales showed mix signals as the 2Y CAGRs of food and medicine respectively dropped to 5.8%, and 5.7% in July from 7.2% and 9.2% in June while beverage and alcohol & tobacco product moderately rose to 3% and 7.4% in July from 2.7% and 7.3%.

Bingnan YE, Ph.D

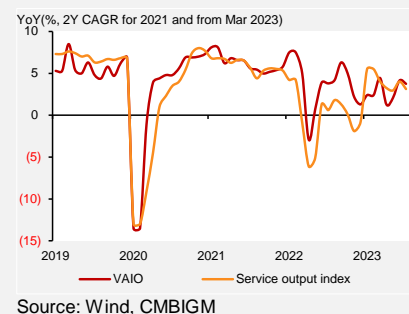
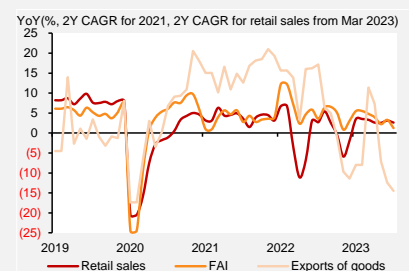
(852) 3761 8967

yebingnan@cmbi.com.hk

Frank Liu

(852) 3761 8957

frankliu@cmbi.com.hk



Recovery of auto sales and telecom equip eased up as the 2Y CAGR edged down to 3.9% and 3.9% in July from 6.1% and 6.6% in June. Newly-released retail services sales rose 20.3% YoY in 7M23 compared to 7.3% growth in goods sales, as service sector became the major contributor in consumption recovery. Looking forward, retail sales may gradually improve in next several quarters as the pro-growth policies start to kick in and boost the overall consumer confidence. We maintain our forecast for the retail sales growth in 2023 at 7.5%.

- **Service activity and industrial output missed market expectation in July.** Service output index and VAIO growth both fell short of expectation and slowed down to 5.7% and 3.7% respectively in July from 6.8% and 4.4% in June. In terms of 2Y CAGRs, VAIO and service output index respectively dropped to 3.7% and 3.1% from 4.1% and 4% in June. In service sector, transportation, telecom service and internet & IT service had good sentiment while capital market service and real estate service were weak. In manufacturing sector, output in textile, medicine, nonmetal mineral product, metal product and general purpose equip was weak as exports sharply slowed and housing market activity and business capex remained sluggish. Output growth in chemical products, rubber & plastic product, non-ferrous metal, special purpose equip and electronic equip dwindled. However, output in ferrous metal, auto and public utility improved as related industries benefited from the energy transition revolution in the worldwide. Looking forward, the continuous recovery of service sector should support a gradual improvement of employment condition and consumer confidence. The service sector has absorbed over 60% of SMEs and urban employment in China.
- **FAI deteriorated sharply as property investment continued to free fall.** The YoY growth of FAI dropped to 1.2% in July from 3.3% in June. Property sector continued to plunge as property development investment fell by 12.2% in July after declining 10.2% in June. After “lied flat” and stopped land purchasing due to a very slow recovery of property market, some private developers started to default on interest payment of domestic and foreign debt, marking an even worsening stage of the collapse of property sector. The YoY growth of FAI in manufacturing decelerated to 4.3% growth in July from 6% in June. 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 those sectors. However, most other manufacturing industries are likely to see a gradual slowdown of FAI due to continuous slowdown in demand growth as well as uncertainty in domestic policy and geopolitics. Infrastructure YoY growth slowed notably to 5.3% in July from 11.7% as a result of shrinking land sales and tight fiscal conditions due to mounting debt of local government and LGFVs. The YoY growth of FAI in public utility, transportation, storage & post service, railway transportation and water conservancy remained elevated while fixed investment in public facility management and health & social welfare remained weak. Looking forward, we expect infrastructure investment may remain sluggish before the central government bails them out with trillions of Treasury note in pipeline. We cut our forecast for the FAI growth in 2023 from 5% to 4%.
- **China may continue to loosen monetary policy and property policy in next several quarters.** Interest rate and down payment requirement of mortgage have been lowered and first-home purchase restrictions have been eased in tier-2 cities while government officials in tier-1 cities are discussing with developers with possible adjustment. PBOC delivered 15bp rate cut of MLF to 2.5% and 10bp cut of 7-day reverse repo rate to 1.8% yesterday to address the continuous deflation pressure and weakening economy in recent

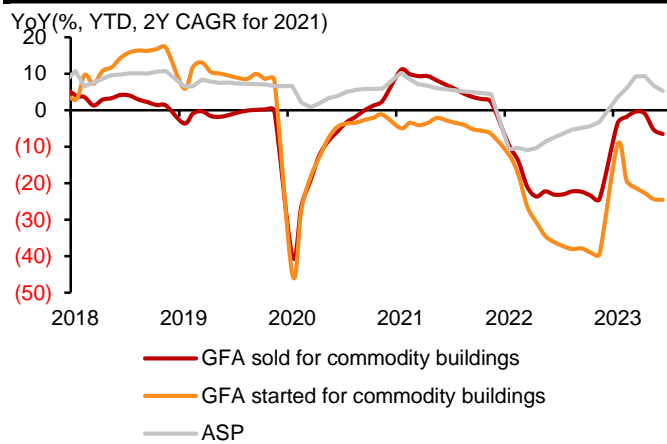
three months. The policymakers may further loosen credit supply with additional cuts in RRR, deposit rates and LPRs. Meanwhile, most cities may loosen property policy with continuous declines in down-payment ratios and mortgage rates for first-home and second-home buyers. In addition, credit and fiscal support for hard-technology and high-end manufacturing sectors may further increase. However, the current policy pace seems to fall behind the speed of downward spiral of economy and a more drastic and unconventional stimulation package is needed before it is too late to mend.

Figure 1: China Economic Indicators

	YoY (%)										2Y CAGR (%)				
	2019	2020	2021	2022	1Q23	May	Jun	Jul	Aug(F)	1Q23	May	Jun	Jul	Aug(F)	
GDP	6.0	2.3	8.4	3.0	4.5					4.6					
VAIO	5.7	2.8	9.6	3.6	3.0	3.5	4.4	3.7	3.0	4.7	2.1	4.1	3.7	3.6	
-Mining	5.0	0.5	5.3	0.6	3.2	(1.2)	1.5	1.3	4.3	6.9	2.8	5.0	4.6	4.8	
-Manufacturing	6.0	3.4	9.8	(2.0)	2.9	4.1	4.8	3.9	3.1	4.5	2.1	4.1	3.3	3.1	
-Public utility	7.0	2.0	11.4	(2.2)	3.3	4.8	4.9	4.1	2.8	4.7	2.5	4.1	6.8	8.1	
Delivery value for exports	1.3	(0.3)	17.7	5.5	(5.3)	(5.0)	(9.5)	(6.4)	(4.0)	4.1	2.7	2.1	1.4	0.6	
Service output index	6.9	0.0	13.1	(0.1)	6.7	11.7	6.8	5.7	5.0	4.6	3.0	4.0	3.1	3.4	
Urban FAI (YTD)	5.4	2.9	4.9	5.1	5.1	4.0	3.8	3.4	3.1	7.2	5.1	4.9	4.5	4.4	
-Property development	9.9	7.0	4.4	(10.0)	(5.8)	(7.2)	(7.9)	(8.5)	(8.9)	(2.6)	(5.6)	(6.7)	(7.5)	(8.2)	
-Manufacturing	3.1	(2.2)	13.5	9.1	7.0	6.0	6.0	5.7	5.5	11.2	8.3	8.2	7.8	7.7	
-Infrastructure	3.3	3.4	0.2	11.5	10.8	9.5	10.2	9.4	9.2	10.6	8.8	9.7	9.5	9.8	
GFA sold for commodity building (YTD)	(0.1)	2.6	1.9	(23.3)	(1.8)	(0.9)	(5.3)	(6.5)	(6.8)	(8.0)	(13.0)	(14.2)	(15.2)	(15.3)	
GFA started for commodity building (YTD)	8.5	(1.2)	(11.4)	(38.9)	(19.2)	(22.6)	(24.3)	(24.5)	(24.5)	(18.4)	(26.7)	(29.5)	(30.5)	(31.1)	
Retail sales	8.0	(3.9)	12.5	(0.2)	5.8	12.7	3.1	2.5	0.0	4.5	2.5	3.1	2.6	2.7	
Exports of goods	0.5	3.6	29.9	7.0	(1.5)	(7.1)	(12.4)	(14.5)	(4.5)	6.5	3.8	0.9	0.1	0.9	
Imports of goods	(2.7)	(0.6)	30.1	1.1	(7.0)	(4.5)	(6.8)	(12.4)	(10.0)	1.4	(0.6)	(3.6)	(5.8)	(5.4)	

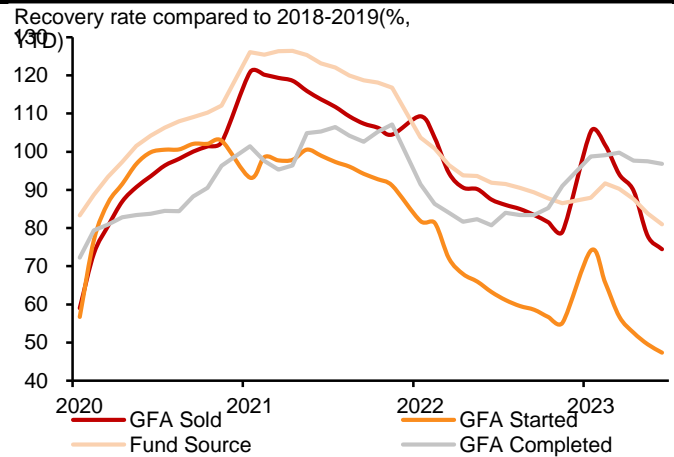
Source: Wind, CMBIGM estimates

Figure 2: Property Market Indicators



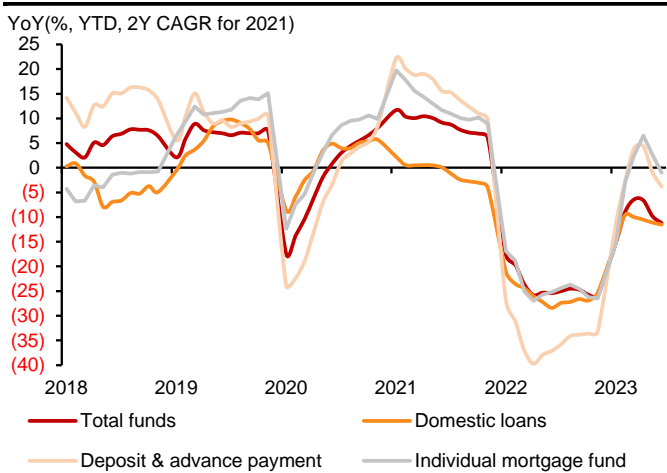
Source: WIND, CMBIGM

Figure 3: Recovery Rates Compared to 2019



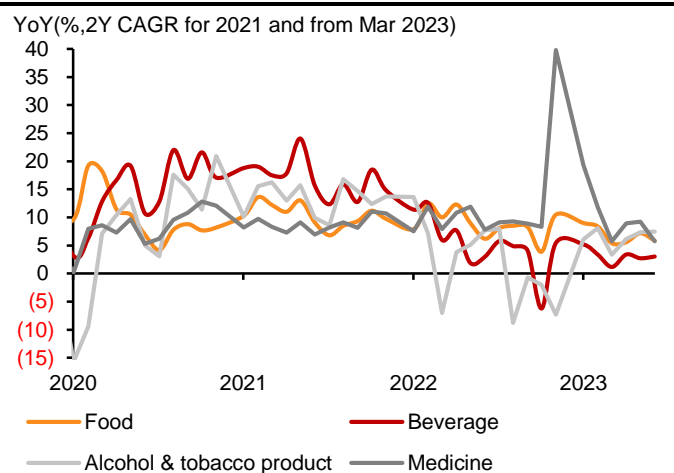
Source: WIND, CMBIGM

Figure 4: Funding Source for Property Investment



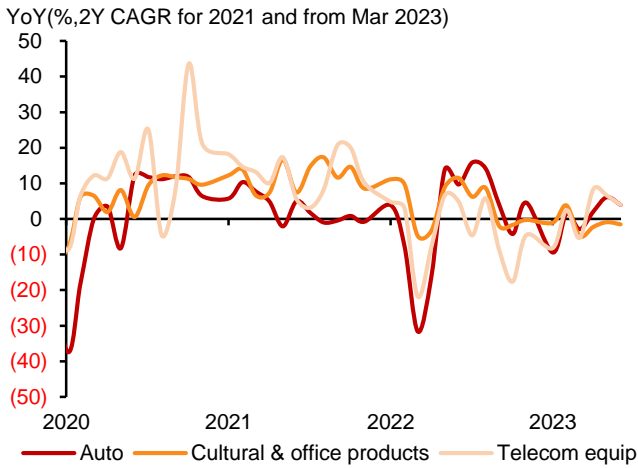
Source: WIND, CMBIGM

Figure 5: Retail Sales of Staples



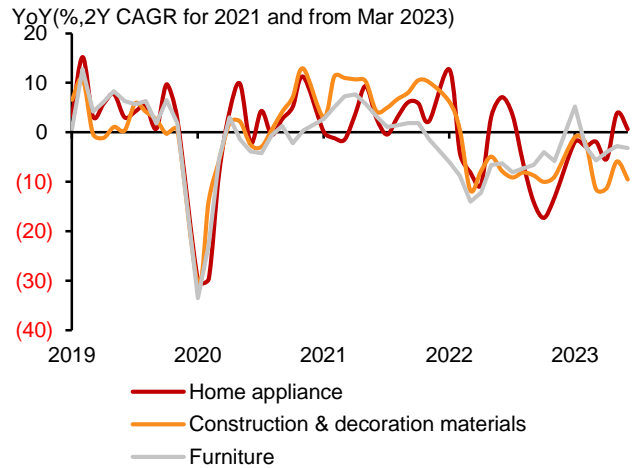
Source: WIND, CMBIGM

Figure 6: Retail Sales of Auto & Electronics



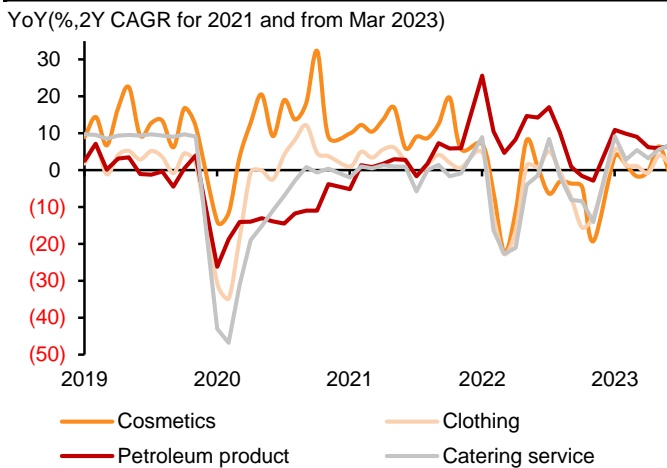
Source: WIND, CMBIGM

Figure 7: Home Appliance & Furniture Retail Sales



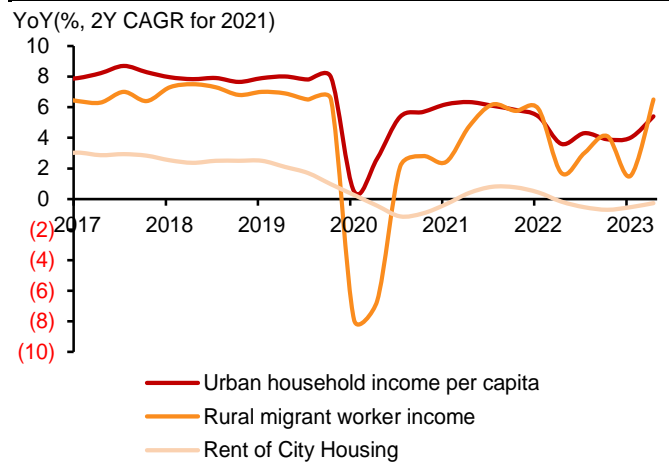
Source: WIND, CMBIGM

Figure 8: Retail Sales Related to Outgoing Activities



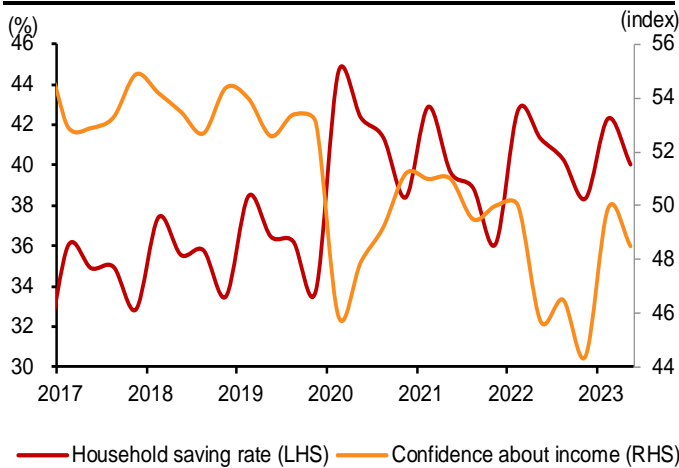
Source: WIND, CMBIGM

Figure 9: Household Income & Housing Rent



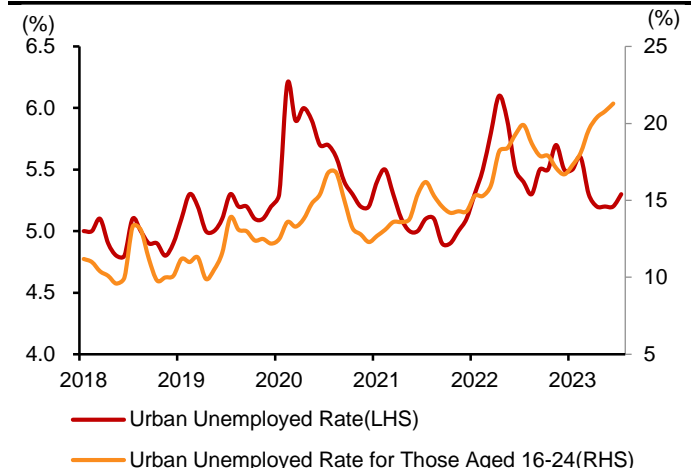
Source: WIND, CMBIGM

Figure 10: Consumer Confidence



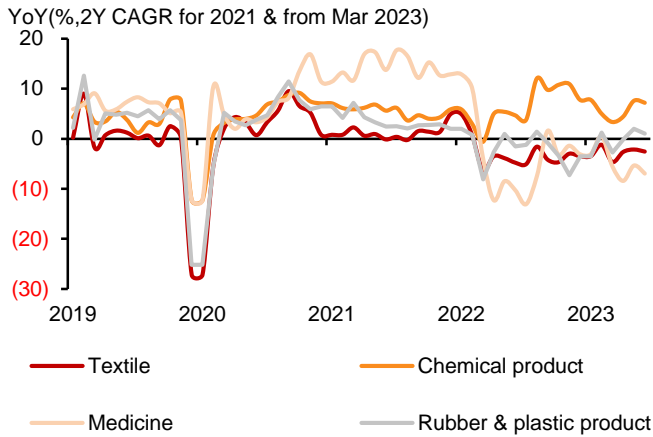
Source: WIND, CMBIGM

Figure 11: Urban Unemployment Rates in Survey



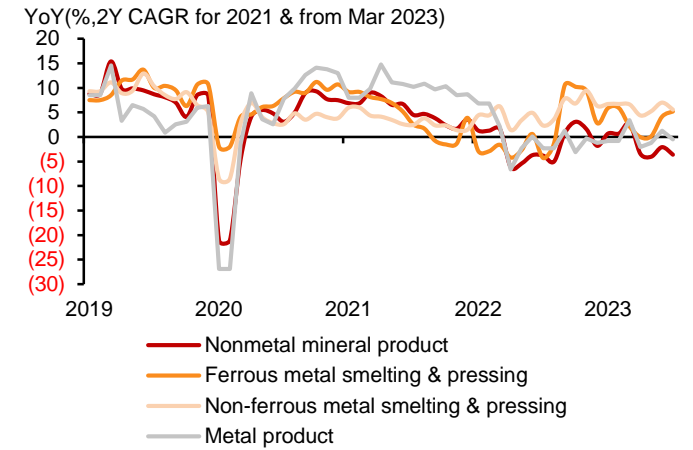
Source: WIND, CMBIGM

Figure 12: VAIO in Textile & Chemical Products



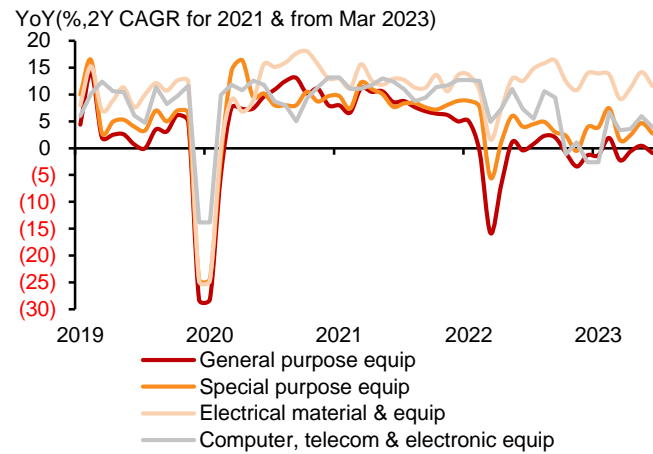
Source: WIND, CMBIGM

Figure 13: VAIO in Mineral & Metal Products



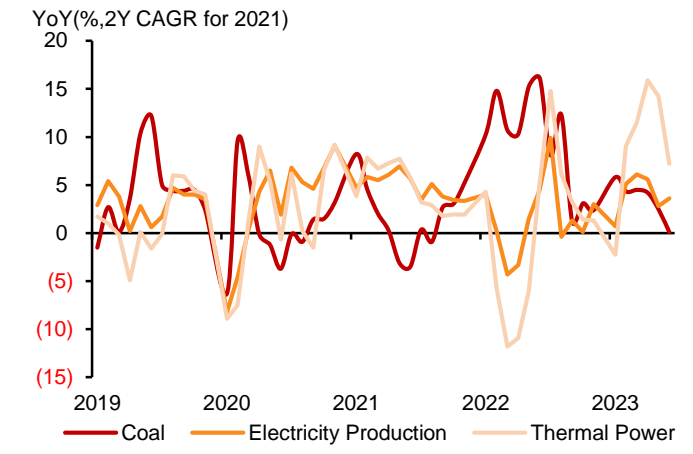
Source: WIND, CMBIGM

Figure 14: VAIO in Equipment



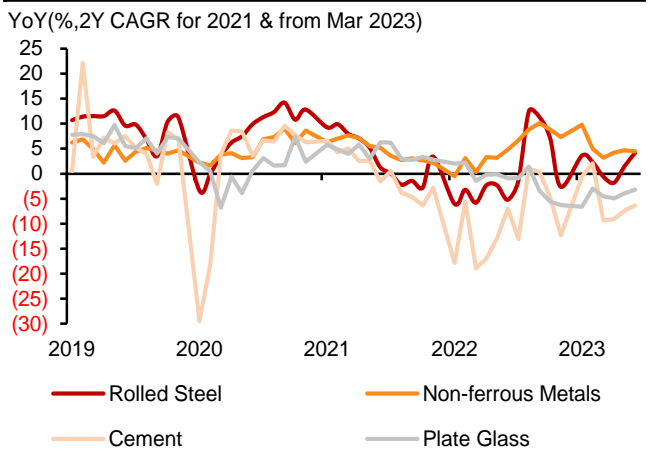
Source: WIND, CMBIGM

Figure 15: Output in Energy and Electricity



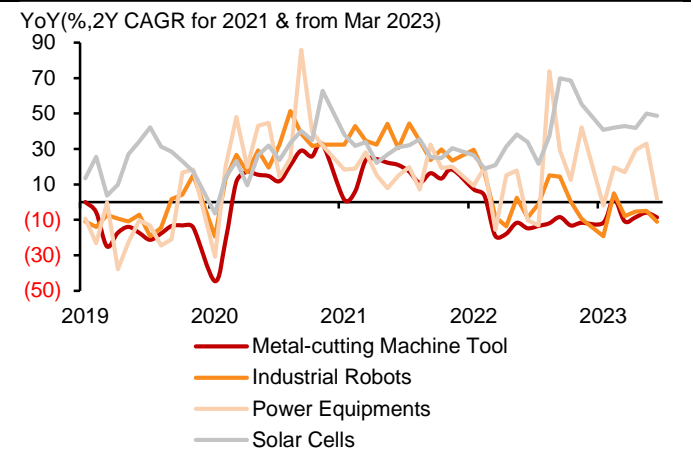
Source: WIND, CMBIGM

Figure 16: Output in Steel & Construction Material



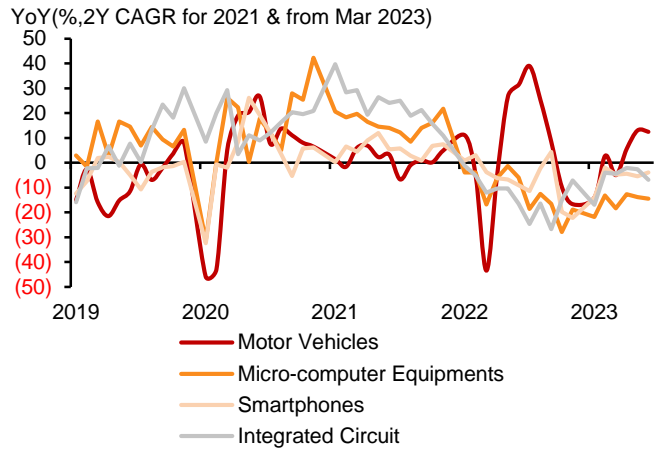
Source: WIND, CMBIGM

Figure 17: Output in Capital Goods



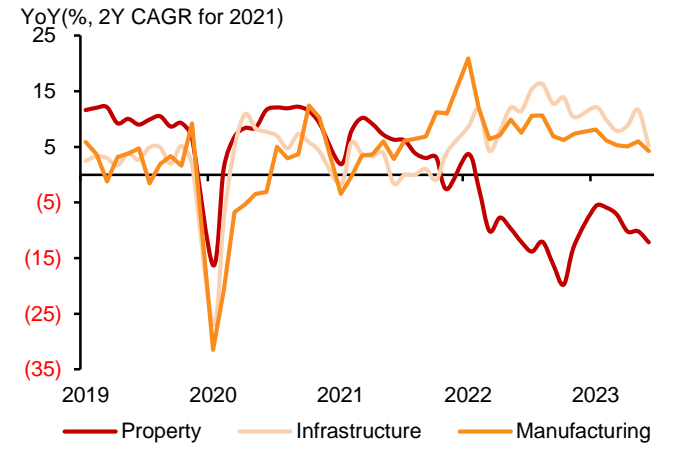
Source: WIND, CMBIGM

Figure 18: Output in Auto, Computer & Smartphone



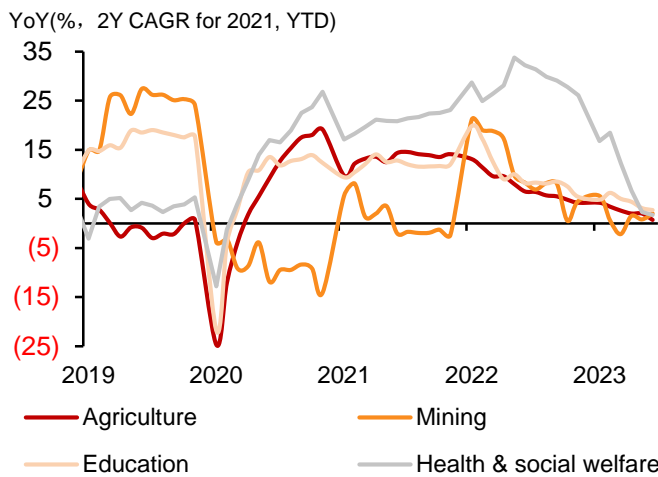
Source: WIND, CMBIGM

Figure 19: FAI by Sector



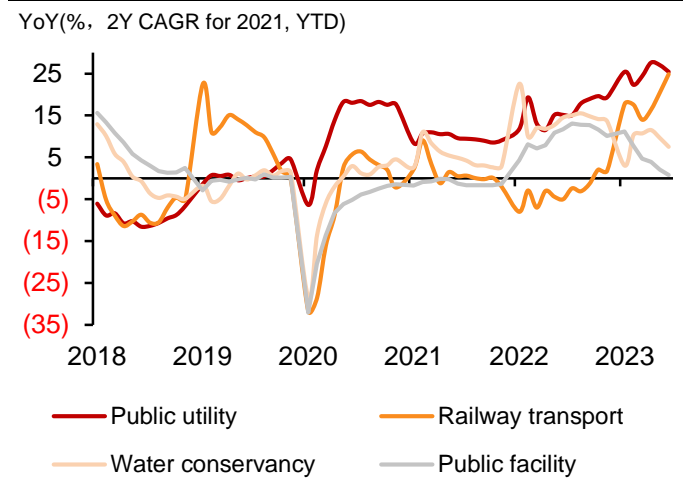
Source: WIND, CMBIGM

Figure 20: FAI in Agriculture, Mining & Public Service



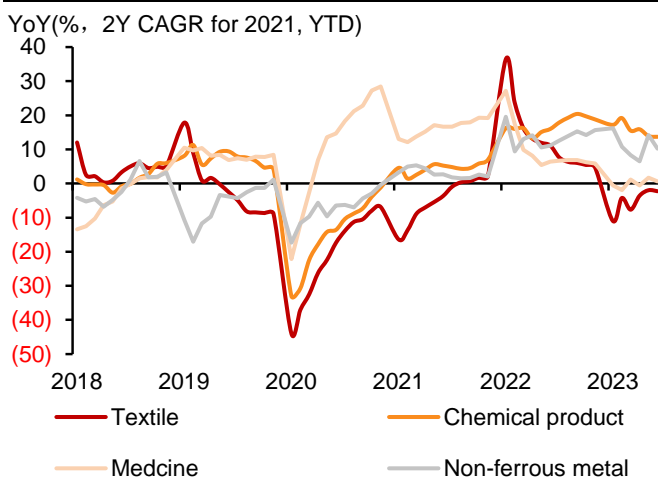
Source: WIND, CMBIGM

Figure 21: FAI in Infrastructure Sectors



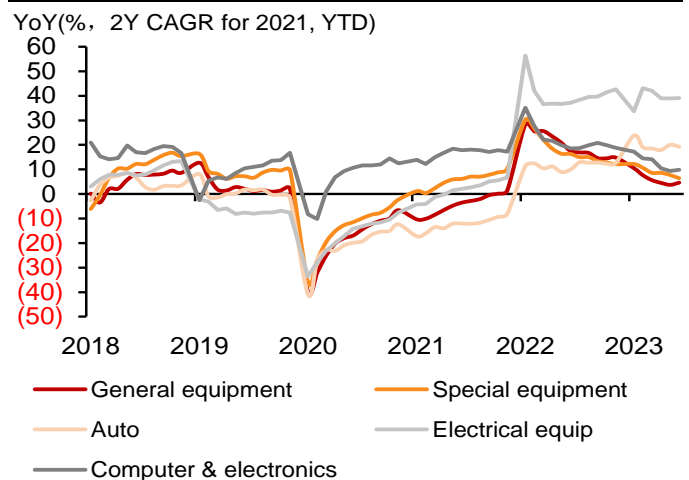
Source: WIND, CMBIGM

Figure 22: FAI in Chemical Product & Non-ferrous Metal



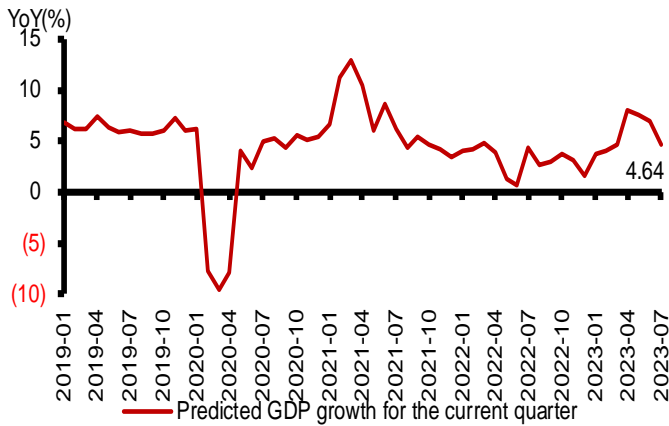
Source: WIND, CMBIGM

Figure 23: FAI in Equipment



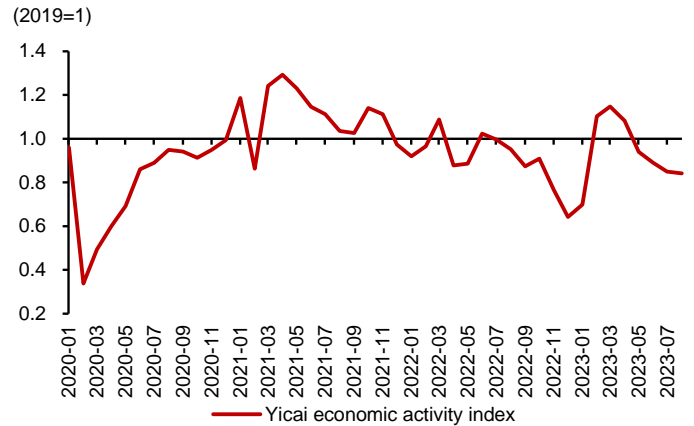
Source: WIND, CMBIGM

Figure 24: Predicted GDP for Current Quarter



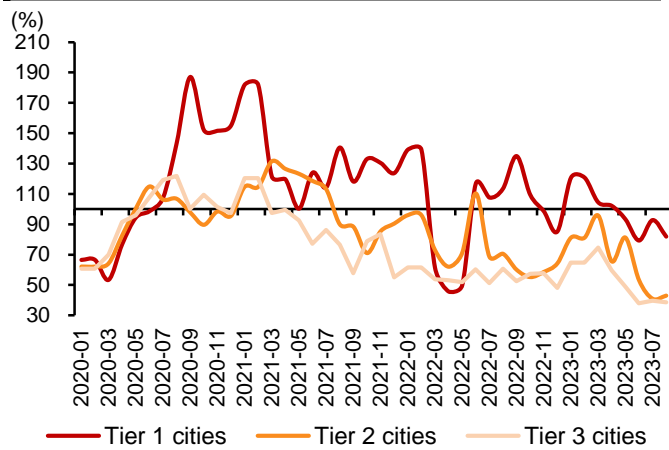
Source: WIND, CMBIGM

Figure 25: Yicai Economic Activity Index



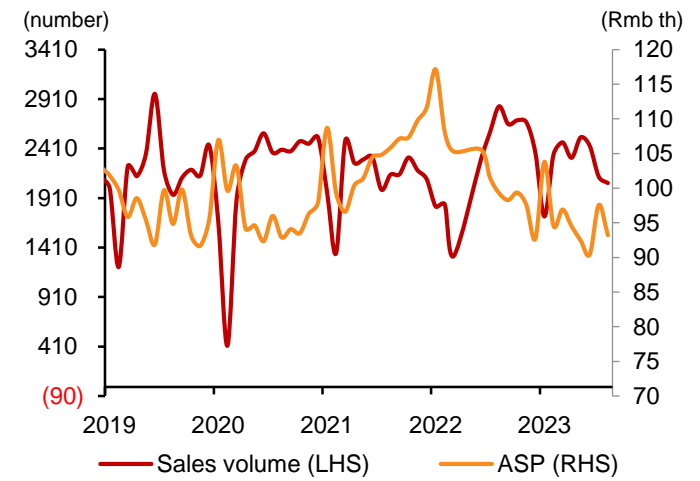
Source: WIND, CMBIGM

Figure 26: Housing Sales Recovery Rates to 2019 in 30 Cities



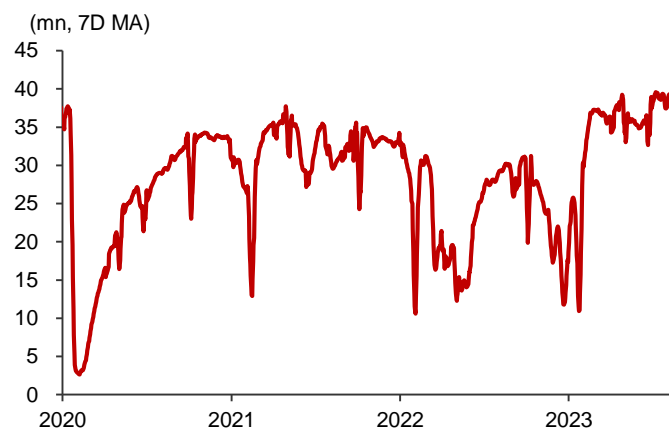
Source: WIND, CMBIGM

Figure 27: Used Vehicle Sales in Shanghai Market



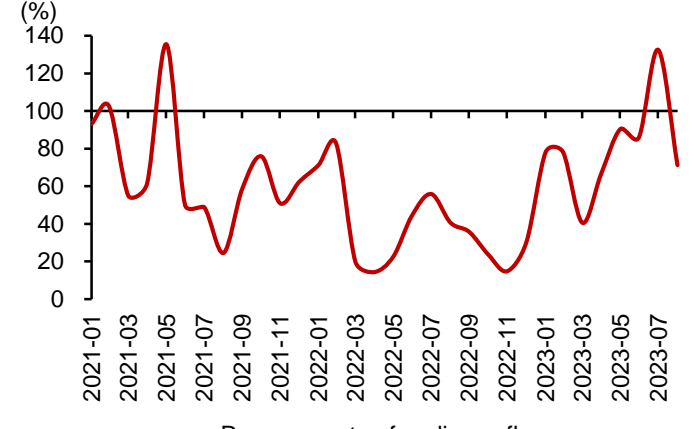
Source: WIND, CMBIGM

Figure 28: Subway Passenger Flow in Tier-1 Cities



Source: WIND, CMBIGM

Figure 29: Audience Flow Recovery Ratios to 2019



Source: WIND, CMBIGM

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.