TENSIONS

In China, manufacturing activity has remained dynamic, driven in particular by strong growth in exports of high value-added goods. However, the global market share gains made by Chinese companies, bolstered by public subsidies, have exacerbated tensions with most of its trading partners. The proliferation of protectionist measures is now negatively affecting export prospects. At the same time, China's domestic demand is being undermined by the ongoing crisis in the property sector, and monetary easing measures are failing to stimulate credit activity. Therefore, the authorities are expected to continue to ease cautiously their economic policy in the coming months.

The various components of Chinese economic growth have exhibited varying trajectories since the beginning of 2024. Overall performance is somewhat lacklustre. Following a rebound to +1.6% quarter-on-quarter (q/q) in Q1 2024, real GDP growth is expected to slow in Q2.

In recent months, economic activity has been largely driven by the momentum seen in the export-oriented manufacturing sector, which itself has been supported by the authorities' very ambitious industrial policy. Although slowing slightly in May, growth in industrial production reached +6.2% year-on-year (y/y) over the first five months of 2024 (compared to +5.2% in H2 2023). This growth rate is close to rates posted in pre-Covid years. Meanwhile, investment in the manufacturing sector has increased at a steady pace since the beginning of the year (+9.6% y/y compared to +6.5% in 2023).

Growth in the industrial sector has been largely driven by the production of goods for export in the high-tech and green-technology sectors. For example, chip production and electric vehicle (EV) production jumped by more than +30% y/y over the first five months of 2024. Exports valued in current dollars recorded a modest increase over the first four months of 2024 (+2% y/y), and then rebounded by +7.6% y/y in May. It is worth noting that volumes of exports reached record levels (+10% y/y in Q1 2024), with Chinese companies gaining global market share thanks to lower sale prices. These strategies have led to heightened tensions between China and most of its trading partners. Consequently, while China's export outlook remains positive in the very short term, it could be quickly dampened by the surge in protectionism. In fact, tariff increases are planned or are in the process of being implemented by the European Union (which, from July 2024 onwards, will be imposing tariffs on Chinese EV imports, ranging from 17.4% to 38.1% depending on the automaker), by the United States (which recently increased its customs tariffs on a series of Chinese goods such as EVs, semiconductors and medical devices –presidential candidate Donald Trump even threatened a significant increase in US tariffs on all Chinese goods), and also by several emerging countries (Turkey, for example, has just announced additional tariffs on imports of Chinese vehicles).

In the services sector, activity strengthened in May and increased by +5% y/y over the first five months of 2024 (compared to average growth of +7.6% over the three years preceding the pandemic). The services sectors benefited in May from the strengthening in retail sales growth, which nevertheless remained modest (+3.7% y/y in value). Inflation is still very low: the consumer price index rose by +0.3% y/y in April and May, after a quarter of zero inflation in Q1 2024.

However, the main obstacle to domestic demand growth remains powerful, as the property crisis shows no signs of improvement. Housing sales volumes continued to contract (-24% y/y over the first five months of 2024), as did property starts (-25% over the first five months of 2024). Real estate investment continued to fall (around -10% y/y over the first five months of 2024). In addition, the decline in property prices worsened (-7.5% y/y on average in May for second-hand homes in the 70 main cities, compared to -4.1% y/y in December 2023).

GROWTH AND INFLATION

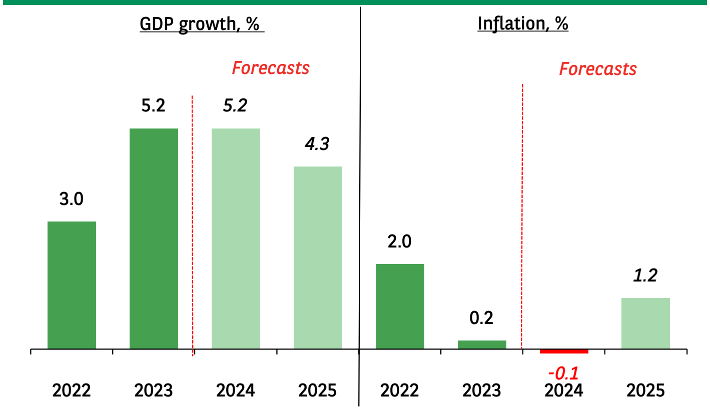

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The package of new support measures announced by the authorities in May (with further easing of mortgage lending conditions and a programme for the purchase of unsold homes by local governments) has not yet been able to have a positive effect on activity in the property sector.

Similarly, despite monetary easing measures, growth in total domestic credit has slowed since the start of the year. Total outstanding Aggregate Financing (TAF) rose by 8.4% y/y in May 2024 compared to +9.8% in December 2023, and total bank loans in local currency (representing 64% of TAF) rose by +8.9% y/y in May, compared to +10.9% in December. Conversely, central government and local government bond issues have increased at a steadier pace since Q4 2023, in order to support the rise in public spending.

Given the persistence of the property crisis, the lack of vigorous activity in services and the emergence of new risks weighing on export prospects, the authorities are expected to ease their fiscal and monetary policies further in the coming months. Their approach will remain cautious. Their room for manoeuvre in order to stimulate credit is still significantly constrained by the excessive level of corporate and local government debt, and the central bank governor recently stated that support for economic activity should involve better credit allocation rather than a faster increase in total outstanding credit. Besides, capital outflows and downward pressure on the yuan are also currently hampering the central bank's ability to act. This pressure should ease once the US Federal Reserve starts its rate cut cycle, i.e. in Q4 2024, according to our forecasts.

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