CHINA

NEW IMPETUS

In China, economic activity data of the last few weeks has been bad enough to shock the authorities into action. While support for domestic demand had remained stubbornly cautious for several months, the last week of September saw a succession of announcements of new monetary easing and then fiscal stimulus measures. This change in policy direction reduces, but does not eliminate, the downside risks to short-term economic growth. If the fiscal expansion plan, the precise content of which has yet to be specified, is implemented quickly, the growth target of "around 5%" set by Beijing for 2024 could be achieved.

LACK OF VIGOUR

China's economic growth remained sluggish over the summer. The slowdown seen in August, in both the industrial and services sectors, is likely to have continued into September, given the latest PMI indices. Industrial activity (+4.8% y/y in July-August, after +6% in H1 2024) was hampered by the slight fall in automobile production and by the more severe decline in heavy industries such as steel and cement. In contrast, electronic goods production remained buoyant, driven by the still rapid rise in exports. However, the outlook for exports is starting to look bleaker, due to the tariff barriers applied to Chinese goods by a growing number of developed and emerging countries.

In services, activity grew by +4.7% y/y in July-August, compared to 4.9% in H1 2024. Household consumption and private investment have remained depressed, and the crisis in the property sector has continued, despite the support measures implemented last spring. These measures have not revived demand for housing: mortgage lending has continued to fall slightly, and floor space sold has continued to fall (-18% y/y in the first eight months of 2024). Households are suffering negative wealth effects as a result of the fall in house prices (property assets accounted for 70% of the wealth of urban households at the start of the crisis in 2021). Added to this is the deterioration in conditions on the labour market. The urban unemployment rate rose to 5.3% in August, compared to 5% in June, and the unemployment rate for 16-24-year-olds rose sharply (from 13.2% in June to 18.8% in August) as a new crop of university graduates entered the labour market.

Against this backdrop, deflationary pressures have persisted, fuelled by the imbalance between weak domestic demand and industrial production overcapacity, falling property prices, slower wage growth and declining global commodity prices. In August, the consumer price index rose 0.6% y/y, but core inflation hit a low of 0.3%, and the production price index fell (-1.8% y/y) for the 23rd consecutive month.

WILL THE NEW STIMULUS MEASURES BE ENOUGH?

The authorities' strategy of very gradual economic policy easing has become clearly insufficient due to the weak confidence in the private sector (including households, enterprises, and financial investors), continued deflationary pressures, the pressing problem of youth unemployment, and the prospects of a slowdown in goods exports. After deciding on 20 September to leave policy rates unchanged, four days later the authorities announced a package of monetary easing measures (including cuts in the reserve requirement ratios and benchmark interest rates), support for the property sector (reduction in the mortgage minimum downpayment ratio and cuts in new and existing mortgage rates, increased financing to state entities for the purchase of unsold homes), and support for the equity markets (financing facilities to financial institutions and companies for the purchase/buyback of shares).

These measures are in line with previous ones and are not, on their own, likely to reinvigorate private consumption or reverse the property market correction and the credit growth slowdown. Household pessimism, large stocks of unsold or unfinished homes, and the solvency or liquidity problems of many property developers remain powerful brakes. However, the monetary and financial measures were followed by the announcement of a (still to come) fiscal support plan, which could be a turning point if it is implemented quickly and effectively focuses on stimulating private consumption.

GROWTH AND INFLATION

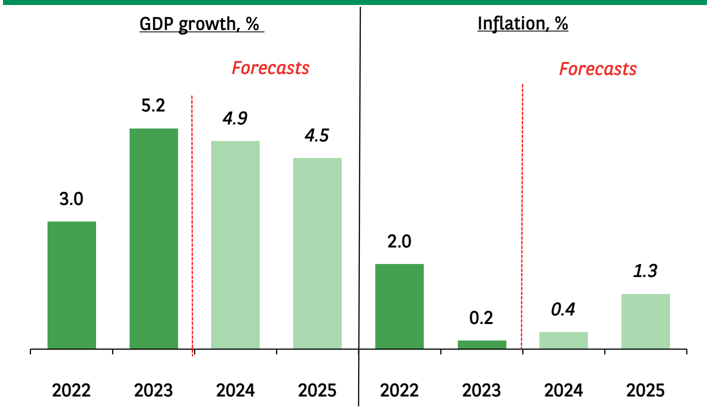

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The central government may be considering issuing additional bonds totalling between RMB 2,000 billion and RMB 3,000 billion (1.5% to 2.3% of GDP) to finance various measures to help households, support local governments and recapitalise state-owned banks. The timetable and details of the measures are yet to be specified. If confirmed, the direct support given to household incomes and consumption (for example, through living subsidies and consumption vouchers) would represent a change of direction in fiscal policy, which has traditionally relied on property and investment projects to stimulate activity.

In addition, by announcing all the measures in the same week, the authorities also broke with their usual incremental approach and surprised the markets. The markets reached a low point in mid-September and then rebounded strongly. Between 20 and 30 September, the CSI 300 stock market index rose 26%, returning to its average level for H1 2023 (still 20% below its average level for 2021). The yuan also appreciated rapidly against the USD, approaching the threshold of RMB 7 per USD on 30 September, its strongest level for sixteen months. This rebound in the markets may bode an improvement in Chinese business and consumer sentiment. If it is implemented effectively and quickly, the authorities' new stimulus plan could have a positive impact on incomes and confidence, which is a prerequisite for stabilising, or even strengthening, economic activity in the short term.

Christine Peltier
christine.peltier@bnpparibas.com