CHINA

MALAISE

The recovery in activity since the end of the lockdowns imposed in Shanghai in the spring has been very gradual. It picked up in August, notably supported by public investment and tax measures, but it is likely to lose steam again in September. As exports begin to suffer from weaker global demand, the continuation of the zero-Covid strategy and the serious crisis in the property sector continue to weigh heavily on confidence, private consumption and investment. An easing of the health policy and more wide-ranging actions to support the property market seem to be the only measures capable of lifting the Chinese economy out of its current gloom.

Activity has recovered slowly since the end of May, when the lockdowns imposed in major economic centres such as Shanghai started to be relaxed. The rebound has been gradual in the industrial sector, and more sluggish in the services sector. However, the growth figures in August surprised on the positive side. The recovery strengthened both in industry (+4.2% year-on-year after +3.8% in July and +0.6% in Q2 2022) and the services sector (+1.8% y/y after +0.6% in July and -3.3% in Q2) despite numerous headwinds (new restrictions on mobility, drop in hydro-electric production and rationing in several provinces, slowdown in exports). Support policy measures by the authorities contributed significantly to this improvement. In particular they led to a rebound in car sales (driven by tax measures) and new public investment in infrastructure projects.

However, the upturn in activity is likely to be interrupted again in September: internal obstacles to growth continue to persist and the external environment is deteriorating. The slowdown in export growth in August was substantial and widespread (+7% y/y after +17% on average over the previous three months). It is expected to continue in the short term given the expected weakening in global demand. While the export sector has been a key driver of Chinese growth over the past two years, activity driven by the domestic market will struggle to fill the gap.

Firstly, the zero-Covid policy continues to be very strict (although it was adjusted slightly at the beginning of July) and is likely to be maintained until at least the end of 2022. The number of new Covid cases rose over the summer and the average level of restrictions on mobility in the country increased again. Admittedly it is still far from its April-May level and disruptions as severe as occurred in Shanghai last spring are now unlikely. However, the continuing threat of new restrictions is weighing heavily on people's confidence. The lockdowns imposed in Chengdu and Shenzhen in the first half of September were in fact relatively short-lived but strict, and they hampered activity, particularly in the services sector. Retail sales, which recovered in August, may slow down again in September (in real terms, sales increased by around 3% y/y in August, after they stagnated in July and fell by 7% in Q2).

Secondly, the crisis in the property and construction sectors continues. Property sales, construction projects and construction starts continued to fall rapidly in August, and the average house price has lost 3.4% over the past year. In recent weeks the authorities have increased their efforts to boost mortgage lending and housing demand (through interest rate cuts or an increase in loan-to-value ratios in some provinces) as well as to improve property developers' cash flow and complete housing construction projects (new financing has been granted by state policy banks, rescue funds have been created by local governments). For the time being the effects of these support measures have remained limited and many developers remain financially strangled. The effects of the property market crisis on the rest of the economy are exacerbated by the significant loss of investor and household confidence which accompanies the decline in property prices, delays in the delivery of prepaid housing, the rise in the number of payment defaults on the part of developers and, more generally, the deterioration in income prospects. A broader support plan could become essential to lift both the property market and the economy out of the current gloom.

GROWTH & INFLATION

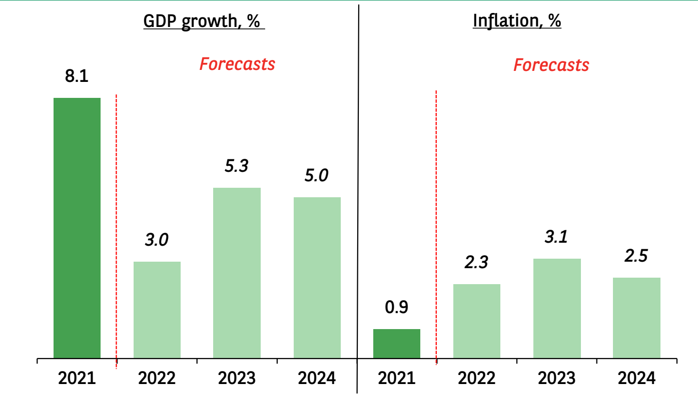

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

CHINA: PERSISTING CRISIS IN THE REAL ESTATE SECTOR

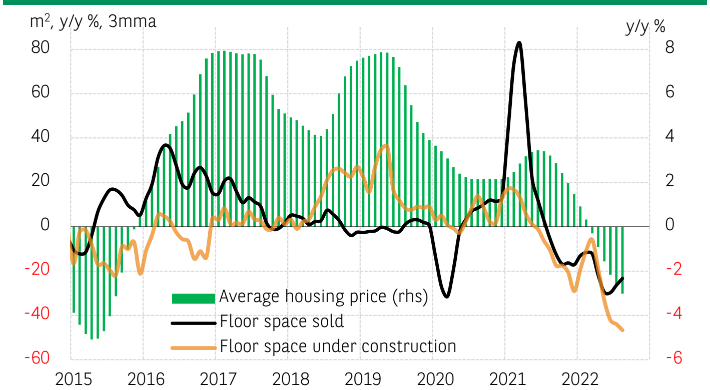

CHART 2 SOURCE: CEIC, BNP PARIBAS

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