

MANAGING THE RISKS THAT ARE HAMPERING GROWTH

The crisis in the real estate sector, the “zero Covid” strategy in the midst of a resurgent pandemic, and the persistent fragility of household consumption are some of the main risk factors straining China’s economic growth. In the short term, the authorities are expected to cautiously step up monetary and fiscal policy support while maintaining their focus on rebalancing the property market, reducing financial risks and tightening the regulatory environment.

THE PROPERTY CRISIS SPREADS THROUGHOUT THE ECONOMY

Economic growth has stalled since the summer months. Industrial activity has been hampered by major supply constraints resulting from both supply-chain disruptions and the electrical power outages that hit factories in September and October. The authorities have reacted swiftly, ordering coal mines to boost production and allowing energy producers to increase consumer sales prices by up to 20% above regulated prices. This has stimulated electricity production, and industrial growth was able to accelerate again before the end of October. The recovery is expected to continue. In the manufacturing sector, production and investment remain supported by the still solid performance of exports. Export growth averaged 26% year-on-year in the six-month period May to October, driven by the rebound in global demand and China’s market share gains.

In the services sector, activity has initially been handicapped by the regulatory tightening in what Beijing considers to be the most sensitive sectors (such as digital services and tutoring). Moreover, activity was hit again by new restrictions introduced in August to combat a new wave of the pandemic. Most importantly, the property market crisis has spilled over to the rest of the economy. Because of the tightening in prudential regulations and credit conditions, property developers began encountering rising financing and cash-flow problems in recent months. Real estate investment has contracted. Construction projects, new building starts and real estate transactions have all collapsed since July. Average house prices have begun to decline, and this trend is expected to continue in the short term.

Under this environment, private consumption remains sluggish. Retail sales volumes increased by less than 2% year-on-year in the period August-October, curbed by the “zero Covid” strategy and the impact of declining house sales. Moreover, the difficulties encountered by some service-sector companies (notably SMEs) and the real estate crisis have strained the labour market and constrained household income growth in Q3 2021.

CAUTIOUS FISCAL AND MONETARY POLICY EASING

The economic slowdown can be largely attributed to the tightening of economic policy, the regulatory environment and prudential rules in the real estate sector over the past year. These measures fit within the authorities’ medium-term strategy of corporate deleveraging, reducing financial risks, cleaning up the real estate market and promoting “common prosperity”. These objectives should be maintained by Beijing going forward, despite their impact on economic growth. Yet without changing the prudential limits imposed on developers, the authorities are expected to proceed with some policy adjustments in order to avoid a devastating collapse in the real estate market. In the past few days, mortgage lending conditions and developers’ access to certain types of short-term financing have already started to be eased. Moreover, the authorities are expected to increase cautiously their monetary and fiscal support measures in order to stimulate domestic demand, mainly via a moderate rebound in public investment and targeted measures

GROWTH AND INFLATION

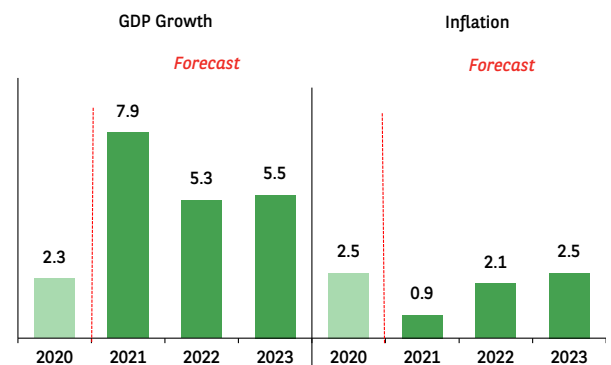


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

ECONOMIC GROWTH LOSING MOMENTUM

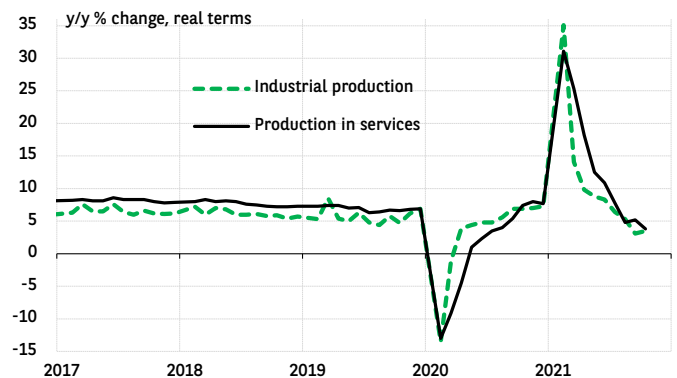


CHART 2

SOURCE: NBS

to ease credit conditions. For example, the authorities have recently launched special lending programmes benefiting SMEs and others aimed at accompanying corporate efforts to reduce greenhouse gas emissions. Domestic credit growth, which had slowed between year-end 2020 and September 2021, levelled off in October and is projected to pick up slightly again in the short term.

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