CHINA

WEAKENING ECONOMIC GROWTH OUTLOOK

China's economic activity contracted in April and May 2022 because of stringent mobility restrictions introduced in major industrial regions such as Shanghai. Since late May, restrictions have eased gradually and activity has started to rebound. As downside risks remain high, the authorities continue to ease their fiscal and monetary policies. While credit demand stays weak in spite of the decline in interest rates, the current global environment and the risk of capital outflows may constrain the central bank's room for maneuver.

Economic activity has recovered since late May as mobility restrictions have eased gradually in Shanghai and across the country. Industrial production started to rebound, notably encouraged by reviving exports, while activity in the services sector and retail sales still contracted in May. Investment growth reaccelerated, driven by infrastructure projects.

In the short term, economic growth is expected to pick up but downside risks are high. First, the health situation remains uncertain and the authorities should maintain a tough anti-Covid strategy until late 2022. Second, private consumption will also struggle to recover because of the slack in the labour market. The unemployment rate rose from 5.1% at end-2021 to 5.9% in May 2022. It increased faster in the 31 major cities (6.9% in May). More worryingly, the unemployment rate of young people between 16 and 24 years of age reached a record high of 18.4% in May.

Meanwhile, the impact of higher consumer price inflation on household purchasing power should be moderate. CPI inflation was only 2.1% y/y in April and May. Core inflation is low (0.9% y/y) given weak domestic demand while inflation in food and energy prices remains limited despite global pressures, due to the continued fall in meat prices and partial controls on grain and energy prices.

The crisis in the real estate and construction sectors continues (volumes of property transactions fell by 24% y/y in the first five months of 2022), which acts as a strong drag on employment, domestic investment and consumption of durable goods. Measures have been introduced to encourage transactions, and access to mortgage loans and short-term financing for property developers has been eased cautiously. However, the authorities keep their objective of moderating housing price inflation and deleveraging property developers.

Finally, export growth rebounded in May (+16.8% y/y vs. 3.7% in April) and may continue to recover in the short term due to fewer logistics disruptions. However, exports are unlikely to be as strong an engine of growth in 2022 as in 2021 given the slowdown in global trade.

As a consequence of large downside risks, policy easing continues. On the fiscal front, support measures focus on new infrastructure investment and on corporates, notably SMEs and manufacturing firms (through tax cuts, subsidies, or the deferred payment of social security contributions). A reduction in the passenger car purchase tax, which was part of the new package announced in late May, is one of the few measures targeting private consumption. While some provinces have also given out cash subsidies to consumers, the total amounts are small.

Domestic lending rates and money market rates have declined since late 2021. However, the central bank (PBOC)'s leeway for further rate cuts is narrowing in the current global environment and due to the risk of capital outflows. Meanwhile, the authorities have made a large use of credit policy instruments such as bank loan quotas and targeted loan programs (to support SMEs, rural areas and crisis-hit sectors). However, policy effectiveness is much constrained by weak credit demand. Indeed, domestic credit growth acceleration has so far remained limited.

GROWTH & INFLATION

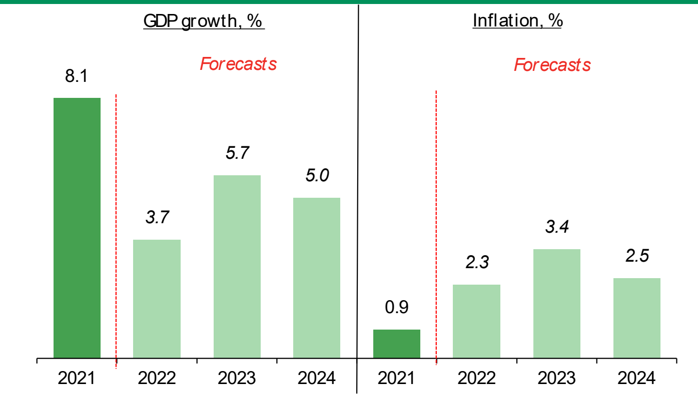

CHART 1 — SOURCE : BNP PARIBAS GLOBAL MARKETS

CHINA: RESTARTING

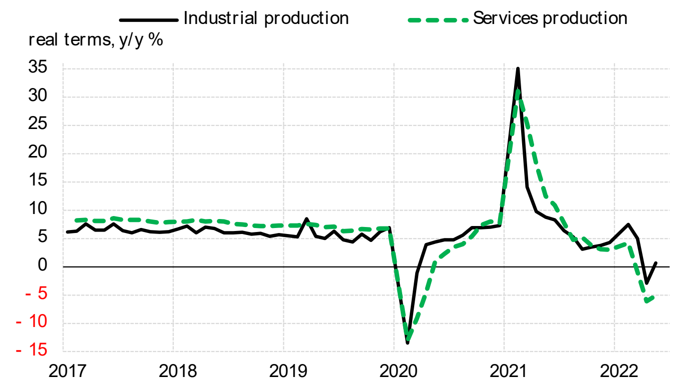

CHART 2 — SOURCE: NBS, BNP PARIBAS

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