

CHINA

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A WEAKER ECONOMY AHEAD OF THE PARTY CONGRESS

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. The 20th Congress of the Communist Party, which will open in Beijing on October 16th, will thus take place in a fragile economic environment.

A MARKED SLOWDOWN IN ECONOMIC GROWTH

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 remain significant 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. As a matter of fact, the "new export order" sub-indices of the latest PMIs published at the end of September fell, highlighting the difficulties of the export sector. While exports of goods have been a key driver of Chinese economic 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).

A PROPERTY SECTOR IN CRISIS

Secondly, the crisis in the property and construction sectors continues. Property sales, construction projects and construction starts continued to fall rapidly in August (chart 1). The average house price (in the 70 largest cities) has fallen by 3.4% over the past year, a surprisingly moderate drop given the collapse in the volume of activity.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	6.0	2.2	8.1	3.0	5.3
Inflation, CPI, year average, %	2.9	2.5	0.9	2.3	3.1
Official budget balance / GDP, %	-2.8	-3.7	-3.1	-2.8	-3.2
Official general government debt / GDP, %	38.6	45.9	46.9	50.5	51.5
Current account balance / GDP, %	0.7	1.7	1.8	1.9	1.7
External debt / GDP, %	14.5	16.3	15.5	16.4	16.9
Forex reserves, USD bn	3 108	3 217	3 250	3 220	3 200
Forex reserves, in months of imports	14.9	16.2	12.6	11.5	10.7

E: ESTIMATIONS ET PRÉVISIONS

TABLE 1

SOURCE : BNP PARIBAS RECHERCHE ECONOMIQUE GROUPE

CHINA: PERSISTING CRISIS IN THE REAL ESTATE SECTOR

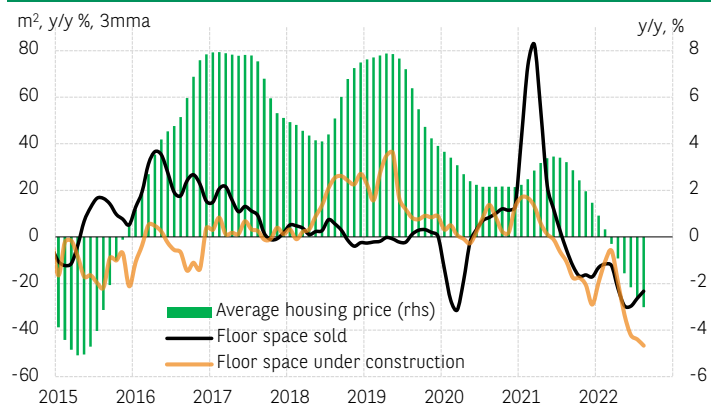


CHART 1

SOURCE: NBS, REFINITIV, BNP PARIBAS

In recent weeks, the authorities have stepped up their efforts to contain the property crisis. Firstly, some measures have been aimed at encouraging mortgage lending and housing demand (lower interest rates, especially on mortgage loans; easing of prudential rules with, in particular, an increase in the maximum loan/value ratio in certain provinces). Secondly, the authorities have sought to improve the cash flow of property developers and to complete housing construction projects that are still ongoing. One of the main objectives is to reassure buyers who have prepaid their homes, but have not yet received them and, in some cases, have stopped repaying their loans.



The main local banks have therefore been asked to meet “reasonable” financing needs of property developers, and the public company China Bond Insurance Co. Ltd has provided guarantees to a few private developers issuing bonds in the local market. In addition, local governments have set up rescue funds and taken administrative measures to help accelerate the completion of housing construction projects. State policy banks also have to provide new funding to help developers complete certain unfinished projects.

Effects of these support measures have so far been very limited. After three years of slowdown, growth in bank loans to property developers has only recovered slightly and remains low (+1.5% y/y in Q2 2022 compared to 0.8% at the end of 2021). Developers continue to be financially strangled due to both the lack of financing and falling sales. Growth in mortgage loans to households continued to slow in H1 2022 (+5.6% y/y in Q2 compared to 6.6% at the end of 2021). More generally, China’s monetary policy easing over the past few months has been cautious and has not led to an acceleration in domestic credit: growth in “total social financing” to the economy remained almost stable at 10.5% y/y in August 2022, compared to 10.3% at the end of 2021 (mostly driven by local governments’ bond issues), and growth in total bank loans declined from 11.6% y/y at the end of 2021 to 10.8% in August (chart 2).

Activity in the property and construction sectors shows no sign of recovery. The confidence of investors, creditors and households has been undermined by the decline in property prices, delays in the delivery of prepaid housing and the rise in the number of payment defaults by developers on bank and bond loans. The effects of the property market crisis on the rest of the economy are exacerbated by this significant, and probably lasting, loss of confidence.

CHOICES TO BE MADE

A more wide-ranging support plan could become essential to help take the property market (and the economy) out of the current gloom – at the cost of an interruption in the process of deleveraging developers. At the same time, however, the authorities’ room for manoeuvre is constrained, principally due to the already excessive debt of the economy and the increasing fragility of local government finances.

Local governments, which already have large debt, have been hit hard by the drop in their budgetary revenues (-6.5% year-on-year over the first eight months of 2022) due to the economic growth slowdown and, most importantly, by the fall in their land sales proceeds (-28.5% y/y).

The central bank’s actions are also being hampered by the rise in the differential between US and Chinese interest rates – while inflationary pressures remain moderate in China. Consumer price inflation reached 2.5% y/y in August 2022, compared to 1.5% in March.

The 20th Congress of the Chinese Communist Party, which will be held in Beijing from 16 to 22 October, will therefore take place in a fragile and complex economic environment. The Congress will appoint the 25 new members of the Party’s Politburo and the 7 members of its Standing Committee, and Xi Jinping is expected to be appointed General Secretary of the Party for a third term of five years. The 20th Congress is also expected to provide new insight on the development strategy and the direction of economic policies for the next five years – even though the economy’s new leaders will only be appointed at the National People’s Congress in March 2023.

CHINA: MONETARY EASING HAS LITTLE EFFECT ON CREDIT ACTIVITY

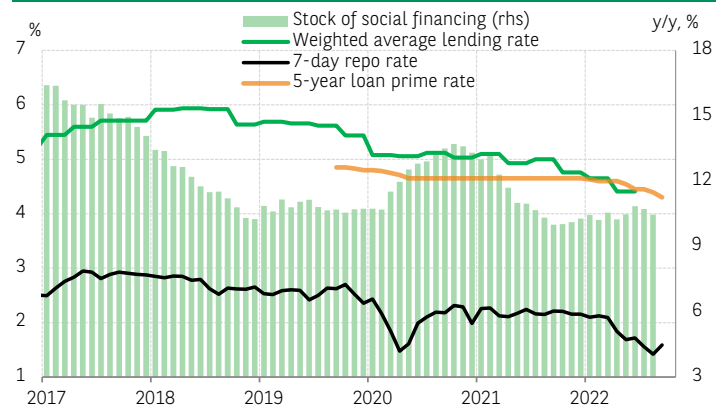


CHART 2

SOURCE: PBOC, CEIC, REFINITIV, BNP PARIBAS

Given the scale of the economic growth slowdown since the beginning of the year, the weakness of domestic demand and the recent weakening in external trade, the country’s economic development is likely to be put back at the top of the agenda for China’s leaders. An easing of the zero Covid policy and further measures to support the property market are likely to be implemented by the beginning of 2023. In addition, Xi Jinping could revive his strategy aimed at promoting: (i) the concept of “dual-circulation”: the domestic market and private consumption should be strengthened as much as export-oriented activities, and “national security” must be ensured (access to essential resources, self-sufficiency of the technological sectors); and (ii) “Common Prosperity”, with particular focus on improving social protection and reducing inequalities.

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