China’s growth drivers are shifting

We predicted we'd see a shift in growth drivers for China this year, that policy would become more supportive, and that weak confidence would be an ever-increasing factor. For the most part, we got it right

There are as many ups and downs for Beijing Guoan football supporters as there are for the Chinese economy

The half-time review

China’s economic developments have mostly proceeded in line with our key calls, notably that we'd see a shift in growth drivers, that policy would become more supportive, and that weak confidence would be the biggest headwind for the year. Consumption, last year’s main growth driver, has weakened. A recovery in manufacturing amid the continued strong performance of electric vehicles and a push for technology self-sufficiency has filled the void, with industrial production up 6.2% year-on-year year-to-date and manufacturing fixed asset investment up 9.6% YoY YTD.

Stabilisation has been the key goal for policymakers this year, leading to a slew of supportive policy measures. We saw the People’s Bank of China ease policy in February, followed by the Two Sessions in March taking a supportive tone. Eventually, we saw an acceleration of policy rollout starting in late April, with numerous moves made to shore up the property market.

Weak confidence is now the main headwind to the economy, dragging down both investment and consumption and threatening the recovery. Fears of a property market or a local government debt crisis have calmed somewhat amid policy support.

1 Second-half prediction: Policymakers to keep their foot on the pedal

After a very active second quarter, it is unclear whether policymakers will be content to sit back and observe the impact of their policies. We think they'll likely remain active, as the recovery is fragile, and manufacturing growth could moderate amid tariff action.

We are looking for the People's Bank of China to further ease policy in the second half of the year with cuts to both interest rates and the Reserve Requirement Ratio. Given the goal to maintain currency stability, it is likely that the PBoC has been resisting rate cuts to avoid adding to depreciation pressure on the renminbi, preferring to utilise the RRR as a policy tool. However, despite the earlier 50bp RRR cut, credit data has stayed very weak year to date, and real interest rates remain too high.

Fiscal stimulus could also accelerate in the second half after the proceeds of the RMB 1tn of ultra-long-term bonds are put to use. This will become increasingly urgent if manufacturing and exports take a hit from impending tariff action. We expect these efforts will allow China to reach its goal of around 5% GDP growth in 2024.

2 Second-half prediction: We'll see property problems bottoming out

In our view, the first big step to restoring confidence is stabilising asset prices, starting with property. Property represents a major proportion of household wealth, so stemming the decline is the first move toward halting the negative wealth effect on the economy and avoiding a deflationary mindset. As property support measures continue to roll out, we expect prices in tier 1 cities to hit a trough before the end of the year, which will mark a milestone in slowing the excessive pessimism that has set in over the past few years. Prices are likely to see an L-shaped recovery rather than a return to the old property market boom.

The road to recovery will be long. Stabilising prices is only the first step, as unsold housing inventories remain high, and sales have been slow. As long as inventories remain elevated, new investment and building activity will remain depressed, and the drag on growth will persist.

Author

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com