

China to see weak growth and limited stimulus

China's recovery has been narrowly focused on consumer spending, and in particular on catering. But even that looks like it will moderate in the months ahead. The stimulus response so far has been modest, and will probably remain so. Further rate cuts will likely follow which should weaken China's yuan. We are revising our GDP forecasts lower and CNY weaker



Source: Shutterstock

The recovery is very narrow

China's recovery continues to underwhelm. In the chart below, we summarise the activity data released over the last three months. All measures are shown as cumulative year-to-date, year-on-year.

The first four columns show industrial production and its three sub-components, manufacturing, mining and extraction, and electricity generation (often used in alternative measures of GDP estimation). What these data points show is a very feeble growth rate of production in the region of 3-4% and not showing much tendency to increase. Mining is weaker at less than 2% and losing

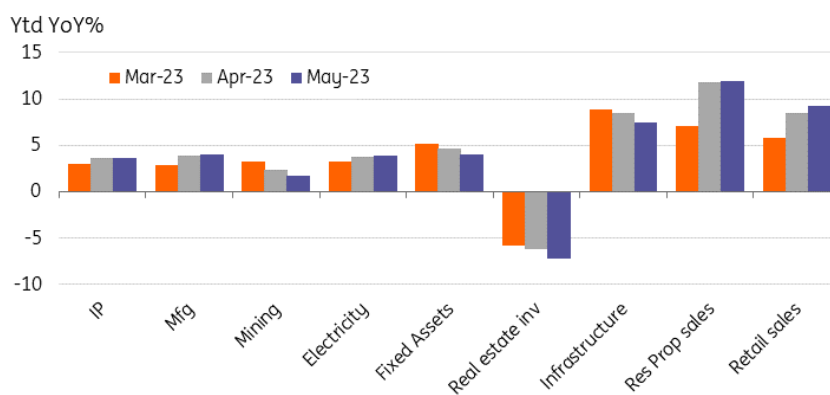
momentum. Electricity production is growing, and showing a very slight tendency to firm. Viewing the series as monthly growth rates, sequential growth to May 2023 is slower than it was over the first five months of last year.

What often comes to the rescue of an ailing Chinese economy is fixed asset investments, with government stimulus programmes boosting infrastructure spending. Yet currently, fixed asset investment growth is clearly slowing. The worsening story in real estate investment is clearly doing most of the damage and is worse than we had expected at this point of the year when we had hoped for more of a flatline than continued deterioration. Infrastructure investment is helping to offset the drag from property but seems to be losing the battle at the moment, not helped by weak local government finances.

On a slightly more positive note, residential property sales are growing at a decent rate, though the recent increase may be topping out. Moreover, at this time last year, these sales were falling at about a 35% pace (YTD, YoY), so the current growth of just under 12% still means sales are very weak.

Not shown in the chart below are residential house prices. These have risen over the last four months, though the May reading was only just positive, slowing from March and April. Seasonally adjusted, this data would likely have shown a return to falling house prices. And with consumers' willingness to part with their money for property partly a function of how well they think it will perform as an asset class, this is not an encouraging sign.

China activity summary (YTD YoY%)



Source: CEIC, ING

Retail sales offer some hope

The other 'bright' spot in the data is retail sales. Like residential property sales, the current growth of retail sales of 9.3% (YTD, YoY) is flattered by weakness in 2022. Even within the retail sales figure itself, the greatest contributor to year-on-year sales is catering, driven by reopening and pent-up demand that has found an outlet in domestic travel and food and beverage-related activities. We are fairly confident that this won't last. Recent data on holiday expenditure, for example, was disappointing. And with the exception of spending on autos, nothing else is really moving the needle on retail sales currently.

We have estimated a real seasonally-adjusted series for retail sales, from which it appears that the level of sales remains well above its trend growth rate, helped by pent-up demand. We expect

retail sales to drift lower towards their historical trend over the coming months, reducing the boost to growth coming from consumer spending in the subsequent quarters of the year.

All of this suggests that second-quarter GDP will struggle to increase from the first quarter as weak production is offset by contractions in construction. It also suggests that momentum need not necessarily accelerate in the second half of the year – as many forecasters seem to assume. A flat quarter would still deliver 6.8% YoY growth, though just like much else in 2Q23, this is flattered by weakness in 2022.

With the second quarter looking weaker than we had expected, and the outlook for subsequent quarters also looking challenged, we are revising our full-year GDP growth rate to 5.2% from 5.7%. That still achieves the government goal of "about 5%" GDP growth in 2023, though it illustrates just how unambitious that target really was.

Stimulus hopes may not be met

So far, the authorities' response has been quite modest. A few weeks ago, we saw a raft of China's numerous interest rate levers being nudged lower. But none were moved more than 10bp, and even with further reductions (at this stage, we believe we will see at least another two rounds of this), this is simply not enough to do more than provide a very minor offset to the economic weakness.

Some markets are bracing for the sort of bazooka stimulus response that we have seen at times in the recent past when China has been struggling economically. But we are not at all sure we will see that this time. For one thing, it does not look as if the weakness in the property sector is causing too much anxiety at a political level. This was a debt-fuelled sector in an economy which is already sitting on large amounts of debt. Allowing this sector's weakness to run its course may hurt growth now, but this is probably viewed as a price worth paying for more sustainable crisis-free growth ahead. Moreover, even with the current backdrop, the 2023 GDP target could still be achieved, so more aggressive stimulus may be saved for when it is really needed.

Instead of a bazooka, therefore, we expect we will see more of a shot-gun approach to stimulus, with many smaller and more targeted measures adopted. More of a micro response than a macro one, including a combination of further very modest monetary policy easings, extended subsidies and tax breaks, but no wall of money.

Part of this policy approach will likely include more tolerance for a weaker yuan. We have already seen the CNY break up through 7.24 during this latest phase of weakness, and 7.30 seems a plausible near-term target. 7.40 would take the CNY to a level not seen since 2007. But while we aren't quite ready to add that level to our forecasts, we are keeping an open mind. There is certainly no inflation concern to prevent bolder currency moves like this from being adopted.

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