China’s economic weakness goes beyond real estate

Real estate property construction, home sales and mortgages are just part of the weaknesses we have seen in the Chinese economy. Export demand could also weaken in the coming months. This will derail job growth in China, creating a vicious cycle on consumption and economic growth despite Covid measures becoming more flexible

We are downgrading China's GDP growth to 4% in 2022, from 4.4%

Central bank policy rate cut

China's central bank, the People's Bank of China (PBoC), has lowered the Medium Lending Facility 1Y policy rate (MLF) to 2.75% from 2.85% and the PBoC 7D reverse repo rate to 2% from 2.1%. This is the first cut since January, in a move that indicates the re-emergence of China's downward economic cycle.

We expect banks to cut the Loan Prime Rate for 1Y to 3.6% from 3.7%, and for 5Y to 4.30% from 4.45%.

Weaknesses in the economy go beyond real estate

The economy's downward cycle is not just coming from lower demand for home sales and fewer home-building activities. It is due to a broad-based slowing in retail sales, industrial production and fixed-asset investments.

Retail sales only grew at 2.7% year-on-year in July compared to 3.1% in June. As the surveyed jobless rate was still high at 5.4%, consumption could continue to grow slowly in the coming weeks. My preferred gauge of an average consumer's retail behaviour – clothing sales – grew at a mere 0.8%YoY in July. This is lower than the headline, which indicates that the general public is spending only a little more than last year.

Industrial production grew slower at 3.8%YoY from 3.9%, mainly from weaker growth in materials for home-building activities. Semiconductor production fell 16.6%YoY, which confirms that the industry is entering a downward cycle as global demand for smart devices is going to be lower than in previous years. This makes up a big part of exports not only for Mainland China but also for other Asian economies. Textiles contracted 4.8%YoY, which could reflect not only weak domestic demand but also high inflation which is affecting export demand.

Fixed-asset investments growth slowed to 5.7%YoY year-to-date in July from 6.1%. The weakness was mainly from the slow growth in private-owned enterprise investments, which only grew 2.7%YoY YTD, compared to state-owned enterprise investments of 9.6%YoY YTD. The bright spot was electrical machinery and equipment manufacturing, which should form part of state investments for infrastructure projects.

Forecasts

Due to this set of activity data and the PBoC's rate cuts, we are downgrading China's 2022 GDP growth from 4.4% to 4%.

A further downgrade is still possible, depending on export demand, which is suffering from high inflation, the ongoing Covid situation, and unemployment growth in Mainland China.

Author

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com