China will struggle to hit its 5% growth target this year

Momentum in the Chinese economy has softened in the past few months as pessimism becomes increasingly entrenched. That suggests further supportive policy measures are needed

President Xi Jinping meeting members of China's Olympic delegation

Industrial activity is moderating after a strong first half

China's manufacturing provided a pleasant surprise in the first half of the year as a mild recovery of export demand along with domestic technology self-sufficiency and hi-tech drives supported industrial activity.

However, recent developments indicate this engine of growth slowed in the second half of the year. Recent manufacturing PMI data has been sluggish, remaining in contraction for four consecutive months. Additionally, after driving growth in the last few years, auto production dropped sharply in the last few months, falling below headline industrial production growth in July for the first time since 2022.

Overcapacity in the auto industry could be concerning as domestic sales slow and tariffs come into play in Europe and North America. There is a real risk that the auto sector could swing from a growth tailwind to a headwind before long.

Weak sentiment continues to drag on investment and consumption

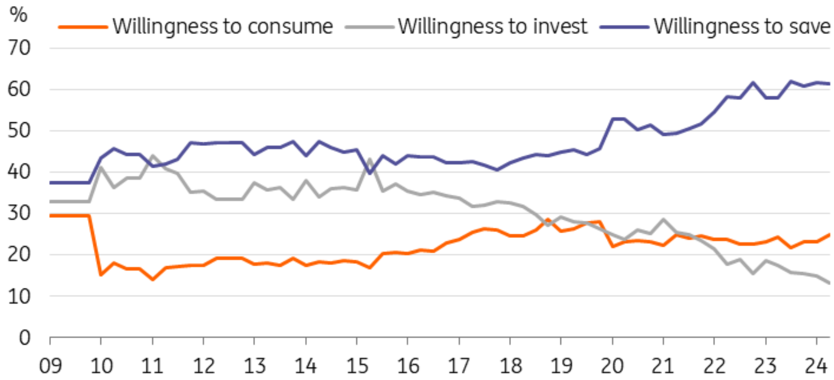
Despite the general acceleration of a supportive policy rollout, the piecemeal nature of most of these measures has yet to stabilise sentiment. Weak confidence is now the biggest overhang on the Chinese economy. And we believe the clearest effects of this can be seen in two categories.

The first is private sector investment, where growth has continuously decelerated this year and is now stagnant at 0.0% YoY through the first seven months of the year.

The second is household consumption, where retail sales of 3.5% YoY, year-to-date, mark the lowest level on record, excluding the pandemic-impacted years. A negative wealth effect and low wage growth continue to suppress consumption.

A PBOC quarterly survey has shown that the willingness to save is at near record highs while the propensity to invest has dropped to an all-time low.

Households' willingness to save near record highs amid weak sentiment



Source: PBOC, CEIC, ING

Rebound of the yuan will give policymakers more room to ease

So, all that is creating a significant challenge for China to successfully hit its 5% growth target this year. We will need to see continued policy rollout to reverse the momentum, particularly as base effects turn less supportive for growth in the second half of the year.

Fortunately, dovish developments abroad could allow for more aggressive easing. Amid China's monetary policy reform, policymakers finally delivered rate cuts in July. We expect to see an additional cut by the end of the year, and the odds are rising we'll see still more. The main impediment to earlier easing was a focus on currency stability.

We've also seen more fiscal side measures be deployed, with discussions that local governments would be allowed to issue special bonds to use for property stabilisation measures. High-level meetings indicate that measures to support consumption "through multiple channels" could also be on the way.

The road to hitting 5% growth looks increasingly challenging with every passing month. Piecemeal measures have had some success on a smaller scale but have yet to result in a broader turnaround. With policymakers indicating no "drastic" measures coming, we'll have to see if rate cuts and increased fiscal support will be enough to restore growth dynamism.

Author

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

Disclaimer