Economic indicators

China | A bumpy recovery amid “zero Covid” and real estate crash

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August 15, 2022

China’s economic recovery path since Shanghai lockdown measures lifted on July 1st seems to have been quite bumpy. In particular, June’s economic activities have recovered from the previous trough in the lockdown period; however, July’s indicators, namely retail sales, industrial production and fixed asset investment, all fell below their previous readings and significantly missed the market expectations, posing challenges to the whole year growth outlook.

The recent growth dip is partially policy-driven, as the authorities in various high-level conferences announced to give up the 5.5% growth target which was set in the March “two sessions” before Shanghai lockdown occurred and to accept a more practical lower growth rate in 2022, indicating the previous easing monetary and fiscal measures may become more prudent going forward. This important policy change also reduces the previous policy-setting “Trilemma” among three policy targets-5.5% growth target, financial stability and “Zero Covid”- to “Dilemma” which is set to balance growth and “zero Covid” policy with challenges. (Economic Watch: “Impossible Trinity” of 2022 Chinese economy) Except for the policy reason, China’s economic recovery also stalls on the real estate crash due to the previous housing market crackdown and weak consumption recovery due to the “zero Covid” restrictive measures imposed in the past almost three years.

That means, the recent growth deceleration, together with the lower-than-expected Q2 GDP figure which dipped to 0.4% y/y, the lowest reading since the recovery from the first pandemic wave, has posed significant challenge to the growth outlook in the whole year. On balance, we believe the authorities’ “zero-Covid” policy will continue to weigh on growth particularly on the consumption recovery while it is difficult to see the lackluster housing market invigorates in 2H 2022. All of these challenges will make the 2022 whole year GDP growth more likely to be lower than 4% (IMF: 3.3% y/y; Bloomberg consensus: 3.8%), although we indeed anticipate a fast recovery in Q3 and Q4 to be above 5% from Q2 trough.

On the supply side, the year-on-year growth of industrial production marginally declined to 3.8% y/y in July from 3.9% y/y in the previous month, lower than the market consensus at 4.6% y/y; while its seasonal adjusted m/m growth also moderated to 0.38% m/m from 0.84% m/m previously. That means, the supply-side recovery, after its significant bounce-back in June after Shanghai lockdown measures lifted, has lost its strong momentum. By categories, the highest growth component continued to be the electric vehicle production which maintained its strong growth at 112.7% y/y compared with 120.8% y/y in the previous month (ytd y/y: 110.7%), supported by the authorities’ priority of green economy and new energy industry to fulfill the carbon neutrality target. Other sectors, although marginally declined from the previous readings, also recorded a continuing recovery. For instance, the general authomobile manufacturing grows at 22.5% y/y, compared with 26.8% y/y in the previous month, power-generated electricity growth also picked up to 5.3% y/y from 1.5% y/y in the previous month, and computure equipment production from -1.3% to 7.1% y/y. (Figure 1) That means, very similar to the recovery in the aftermath of Wuhan lockdown since May 2020, the supply-side industrial production led the growth recovery since Shanghai lockdown measures lifted.

On the demand side, the situation seems to be more worrisome that that of the supply side. Retail sales lost its previous recovery momentum, which decelerated from previous 3.1% y/y to 2.7% y/y in July, significantly below the market consensus at 5% y/y. By component, restaurant sales remained negative at -1.5% y/y, compared with -4% y/y previously, as “zero Covid” restrictive social distancing measures in pandemic affected areas significantly dragged restaurant sales; gaument declined to 0.8% from 1.8% y/y in the previous month and automobiles sales slowed to 9.7% y/y from 13.9% y/y in the previous month amid a lower income expectations and higher surveyed unemployment rate. In sum, we maintain our view that Chinese government’s persistence of “zero tolerance” strategy on Covid-19 pandemic by contrast of other countries’ “co-existence” policy will continue to constrain China’s consumption recovery in the rest of the year. (see our recent Economic Watch: China | Will the country abandon “zero tolerance” strategy on Covid-19?) (Figure 4)

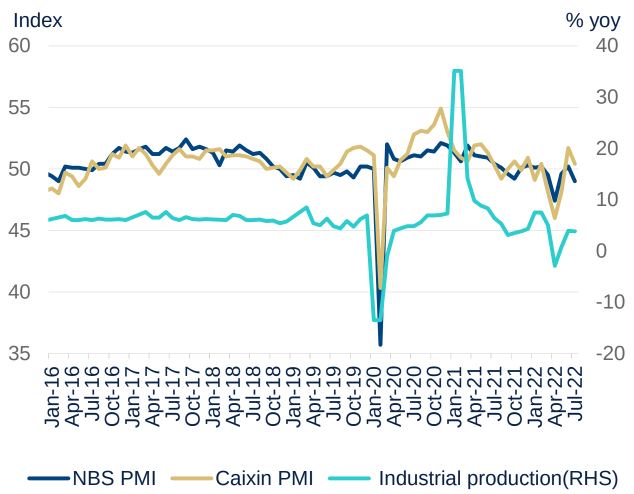
In addition, also from the demand side, fixed-asset investment (FAI) also moderated to 5.7% ytd y/y from 6.1% ytd y/y in the previous month, which is lower than the market consensus of 6.2% ytd y/y, while its month-on-month growth slided to 0.16% m/m from 0.93% m/m in June. By components, manufacturing FAI slowed to 9.9% ytd y/y from 10.7% ytd y/y previously, which surpassed the infrastructure FAI at 7.4% ytd y/y (prior: 7.1% ytd y/y) and real estate FAI at -6.4% (prior: -5.4% ytd y/y) to lead the investment growth. On the other hand, infrastructure FAI achieved significant improvement due to the recent expansionary fiscal measures. (see our recent Economic Watch: China | Will infrastructure investment become a key growth stabilizer in 2022?)

However, it is noteworthy that the main drag of fixed-asset investment is real estate FAI which further expanded its negative growth to -6.4% ytd y/y from -5.4% ytd y/y previously due to the previous crackdown measures in housing sector back to 2021 amid regulatory storms. It indicated that once the housing price decline expectation is formed, it is very difficult to change people’s expectation of housing price, although the authorities have already eased financing conditions this year for both developers and home-buyers to secure a soft-landing of housing sector. That means, real estate sector needs more time to achieve a soft-landing in the second half of this year. (See our recent China Economic Watch: China | Real estate sector needs a soft-landing) (Figure 2 and 3)

Except for the above July economic activity indicators, credit indicators also trended down significantly from the previous readings and sharply missed the market consensus, suggesting a weak demand amid growth slowdown, a real eastate crash and the PBoC’s more prudential measures since giving up the 5.5% growth target. In particular, July’s new yuan loans drastically dipped to RMB 679 billion from RMB 2,810 billion in the previous month (consensus: RMB 1,100 billion), and total social financing also dropped to RMB 756.1 billion from RMB 5,170 billion (consensus: RMB 1,300 billion). Moreoever, outstanding loan growth declined to 11% y/y from 11.2% y/y, although M2 growth revved up to 12% y/y from 11.4% y/y.

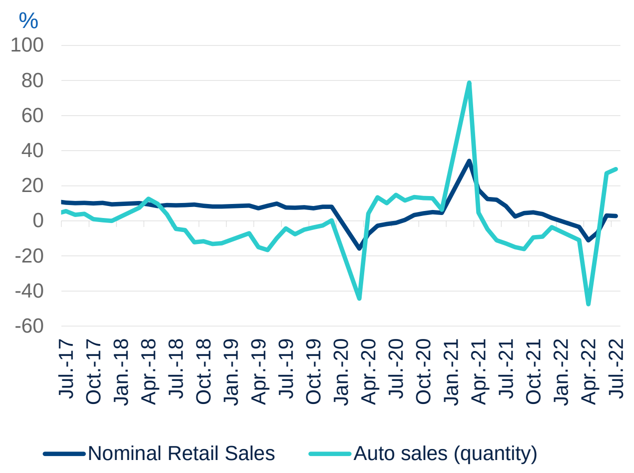
Amid the plummeting credit data in July and growth deceleration, the PBoC cut the median-term lending facilities rate (MLF) and Repo rate both by 10 bps today, signaling the determination of the central bank to continue to stimulate growth but will be in a more prudent way. However, the impact of today’s MLF and repo rate cut may be more likely to be a signal effect instead of indicating a start of an aggressive easing cycle. As we discussed intensively before, the policy setting of this year faces “Impossible Trinity” among growth target, financial stability and zero COVID policy. That means, the monetary stimulus has to be moderate amid FED’s aggressive interest hike, as the PBoC has to balance between stimulating growth and financial stability. If cutting interest rate too aggressively in the rest of the year which unsynchronized with the FED hike, there will be massive capital flight and currency sharp depreciation.

Figure 1. **INDUSTRIAL PRODUCTION AND PMIS MODERATED IN JULY**



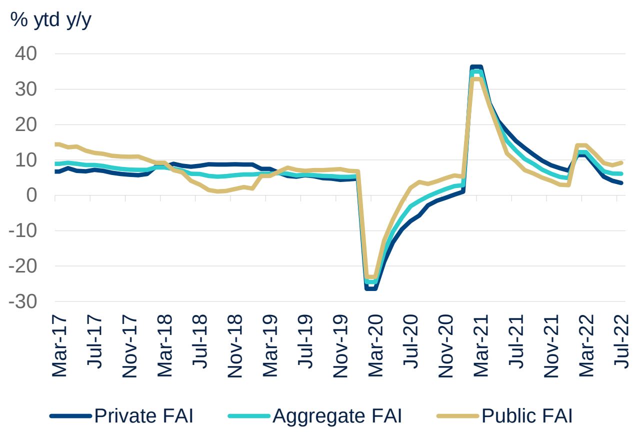
Source: CEIC and BBVA Research

Figure 2. **INFRASTRUCTURE INVESTMENT PICKED UP DUE TO THE EASING FISCAL MEASURES BUT REAL ESTATE REMAINS NEGATIVE**



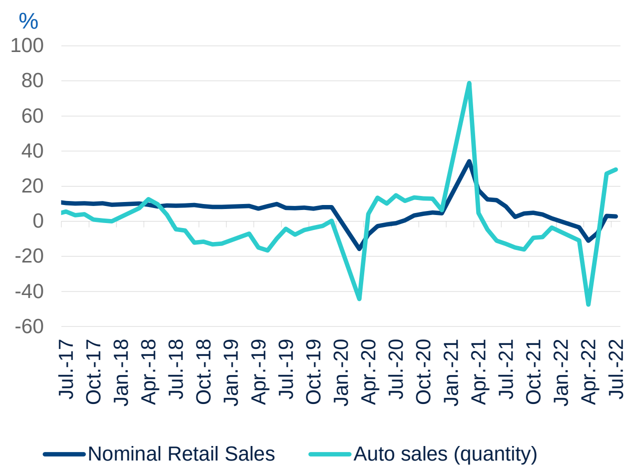
Source: CEIC and BBVA Research

Figure 3. **PUBLIC FAI LED THE FAI GROWTH DUE TO EXPANSIONARY FISCAL MEASURES**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES DECELERATED AMID "ZERO COVID" POLICY**



Source: CEIC and BBVA Research

In sum, July economic activity figures which missed both market consensus and previous readings suggest the recovery path of Chinese economy after the lift of Shanghai lockdown is still very bumpy ahead. The pace of economic recovery from Shanghai lockdown depends on several factors: (i) whether further large-scale lockdown will be imposed again in large cities, such as Beijing, Shenzhen or Guangzhou etc.; (ii) how large is the policy room, as the recent trending-up inflation and RMB depreciation shrink the room for easing measures; (iii) how effective of the easing measures, i.e. the monetary transmission mechanism; and (iv) how to rebuild market confidence in the real estate sector after the crackdown in 2021.

Given that Chinese government will continue to stick on “zero Covid” policy in the rest of the year and at the same time give up the 5.5% growth target which was set in the March’s “two sessions” based on their announcement in the recent high-level conferences, the challenge of the authorities become how to balance the “zero Covid” policy and a decent growth figure. Considering the adverse impact of “zero Covid” restrictions on consumption recovery and the current real estate sector crash which has a significant adverse spillover effect to its upstream and downstream industries, we expect the growth figure will likely miss 4% for whole year, although growth is anticipated to significantly bounce back in Q3 and Q4 to above 5% y/y. (Bloomberg market consensus: 3.8%, IMF: 3.3%).

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