Economic indicators

China | The economy shows resilience amid policy support

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Chinese economy shows resilience in August after a bumpy recovery path since Shanghai lockdown lifted on July 1st. In particular, unlike the previous month, August's economic indicators, namely retail sales, industrial production and fixed asset investment, all bounced back from their previous readings and the market expectations, amid the continuous accommodative monetary and fiscal policy support. However, due to the persistence of "zero Covid" strategy which is anticipated to be progressively eased in next March as well as the housing market crash, we lowered our 2022 whole year prediction from previous 4.5% to 3.6% (IMF: 3.3%, Bloomberg consensus: 3.5%) and anticipate growth will gradually recovery from Q2 trough of 0.4% y/y in Q3 and Q4 to above 5% y/y.

The pace of economic recovery in the rest of the year depends on several factors: (i) whether further large-scale lockdown will be imposed again in large cities and the length of the lockdown; (ii) how large is the policy room for monetary and fiscal easing, as the recent trending-up inflation due to pork price surge, RMB sharp depreciation to above 7 and capital outflows may shrink the room for easing measures; (iii) how effective the easing measures, in particular, how effective of the monetary transmission mechanism to direct the liquidity to households and enterprises; and (iv) how to rebuild market sentiments in real estate and secure a soft-landing.

On the supply side, the year-on-year growth of industrial production in August picked up to 4.2% y/y from 3.8% y/y in July, higher than the market consensus at 3.8% y/y, although its seasonal adjusted m/m growth moderated to 0.32% m/m from 0.38% m/m previously. By categories, the highest growth component continued to be the electric vehicle production which maintained its strong growth momentum at 117% y/y compared with 112.7% y/y in the previous month (ytd y/y: 110.1%), supported by the authorities' priority of green economy and new energy sector to fulfill the carbon neutrality target in 2030. Other sectors also recorded recovery of growth. For instance, the general automobile manufacturing growth increased to 30.5% y/y from 22.5% y/y in the previous month and power-generated electricity growth also picked up to 9.9% y/y from 5.3% y/y in the previous month. (Figure 1) That means, very similar to the recovery in the aftermath of Wuhan lockdown, the supply-side industrial production led the growth recovery since Shanghai lockdown was lifted.

On the demand side, both retail sales and fixed-asset investment (FAI) also picked up from the previous readings. Retail sales accelerated from previous 2.7% y/y in July to 5.4% y/y, significantly higher than the market consensus at 3.5% y/y. By component, restaurant sales ticked up significantly from -1.5% y/y in July to 12.9% in August, given that "zero Covid" restrictive social distancing measures in pandemic affected areas persists, I believe the strong figure in August is mostly due to the high base effect (2021 August: -4.5% y/y). Other high growth sectors of retail sales also include petrol oil related products (17.1% y/y) and automobile sector (15.9% y/y). However, several sectors remain negative, such as communication equipment (-4.6%), furniture (-8.1%), cosmetics (-6.4%) amid a lower income expectation and higher surveyed unemployment rate, particularly in 16-24 age group at 20%. 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)

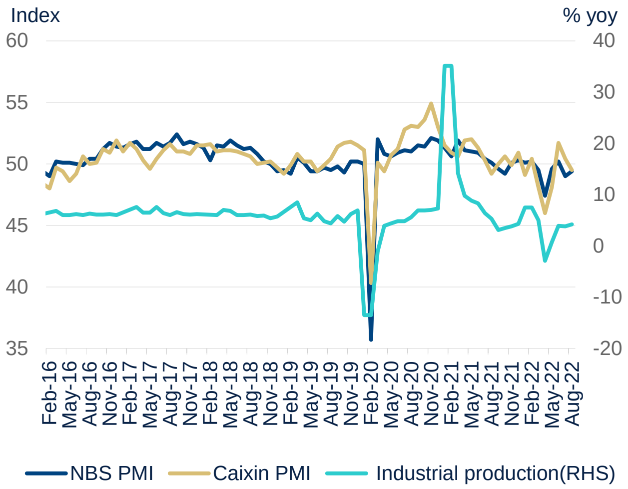
In addition, fixed-asset investment (FAI) also marginally picked up to 5.8% ytd y/y from 5.7% ytd y/y in the previous month, higher than the market consensus of 5.5% ytd y/y, while its month-on-month growth also ticked up to 0.36% m/m from 0.15% m/m. By components, manufacturing FAI marginally picked up to 10% ytd y/y from 9.9% ytd y/y previously, which surpassed the infrastructure FAI at 8.3% ytd y/y (prior: 7.4% ytd y/y) and real estate FAI at -7.4% (prior: -6.4% ytd y/y) to lead the investment growth recovery. It also indicates that 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?) while real estate crash remains to be the largest headwind to drag China's economic growth and at the same time to threaten financial stability in banking sector.

There are quite a number of reasons to explain real estate investment dip which has maintained in the negative territory for more than half a year. Chinese authorities cracked down the housing market in 2021, taking use of the precious time-window to press ahead "common prosperity" and regulatory reforms. In addition, lower income expectation and high unemployment rate particularly in age 16-24 group (20%) significantly deteriorate house purchase demand. Although the authorities eased housing policy from demand and supply side, as the principle of "housing is to live not to speculate" remains, a soft-landing will take some time. As long as the housing price increase expectation (which lasted for the past 20 years) is broken, it is difficult to re-build market sentiments, no matter how low the interest rate is. That means, real estate sector needs more time to achieve a soft-landing going forward. (See our recent China Economic Watch: China | Real estate sector needs a soft-landing) (Figure 2 and 3)

Except for the above August economic activity indicators, credit indicators also recovered from the previous drop, suggesting the resilience of the demand together with economic recovery. In particular, new RMB loans increased to RMB 1,250 bn from RMB 679 in the previous month; total social financing also accelerated to RMB 2,430 bn from RMB 756 previously; the M2 growth picked up to 12.2% from 12% y/y, reflecting the recent easing monetary measures such as August's asymmetric LPR cuts, although outstanding loan growth marginally dropped to 10.9% y/y from 11% y/y previously.

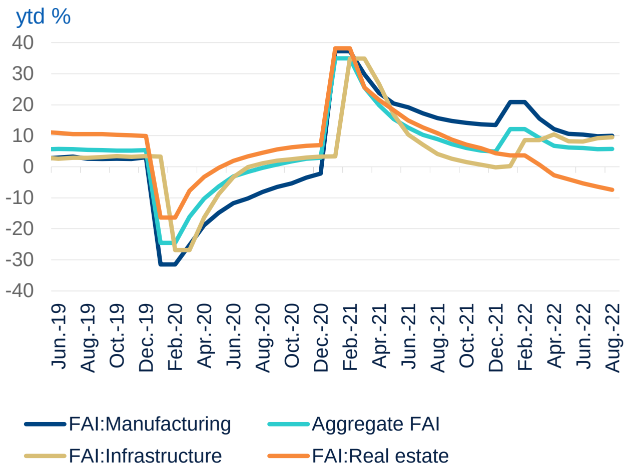
In sum, August economic indicators show the resilience of Chinese economy after the plummeting data in July, amid the continuous easing monetary and fiscal policy support. In August, the PBoC cut the median-term lending facilities rate (MLF) and Repo rate both by 10 bps together with asymmetric cut in 1-year and 5-year LPR, signaling the determination of the central bank to continue to stimulate growth. However, it is noteworthy the interest rate cut does not indicate a start of a continuous interest rate cut cycle, as the PBoC has never ever continuously cut interest rate amid FED rate hike cycles in history balancing between stimulating growth and financial stability. In addition, the authorities also beefed up fiscal expansionary measures to early use up local government bond issuance quota in 1H 2022 to the total scale of more than RMB 5.2 trillion, together with tax cut, fee reduction, State's Financing Guarantee Fund and the recent funding through policy bank to support infrastructure investment etc. Going forward, it is challenging that the authorities have to strike a balance between "zero Covid" and a decent growth figure and at the same time secure a housing sector soft-landing.

Figure 1. **INDUSTRIAL PRODUCTION BOUNCED BACK FROM THE PREVIOUS MONTH**



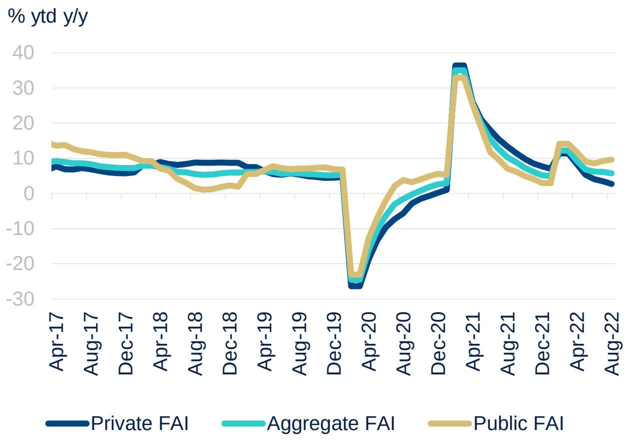
Source: CEIC and BBVA Research

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



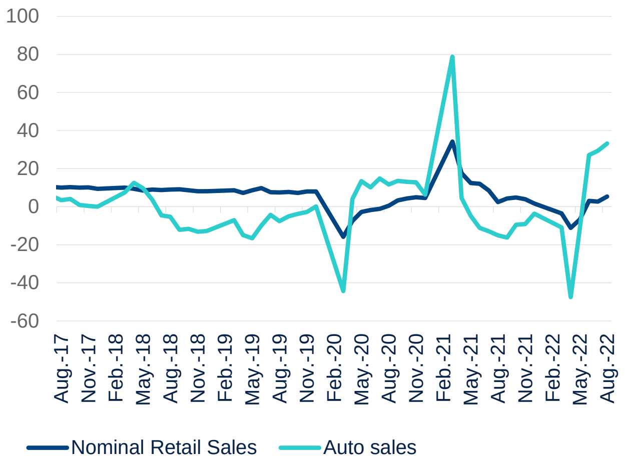
Source: CEIC and BBVA Research

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



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES PICKED UP IN AUGUST**



Source: CEIC and BBVA Research

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