Economic indicators

China | Q3 GDP shows some bottomed-out signals

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There are some positive signals in 2023 Q3 GDP figures announced today, together with other September economic indicators, suggesting Chinese economy might pass the worst amid a series of recent policy support, although there will still be a long haul for the economy to achieve sustainable growth momentum going forward.

In particular, Q3 2023 GDP year-on-year growth bounced back to 4.9%, higher than the market consensus at 4.4% y/y and also our BBVA forecast at 4.1% y/y. The 2022-2023 two-year average Q3 GDP achieved 4.2% y/y, which is also higher than two-year average of Q2 GDP at 3.35% y/y, suggesting some upside bias to our whole year forecast of 4.8%.

Amid the recent housing market crash, deflation environment and weak enterprises and households' sentiments, and after all of July economic activity indicators missed the market consensus and previous readings due to the fading effect of reopening from three years' lockdown, the market has recently raised two hot debates of Chinese economy recently: (i) In the long term, whether Chinese economy will enter into "Japanization" and "balance sheet recession"? (which we will issue another China Economic Watch next week to analyze this topic); and (ii) In the short term, whether Chinese economy will go into "hard-landing" or is the soft-landing achievable?

The Q3 2023 GDP and September economic activities outturns seem to answer the second question in a rapid manner that the economy is still resilient amid the authorities' policy support to achieve soft-landing against the backdrop of a very challenging domestic and international environment: housing market crash, weak household and enterprises sentiments, deflationary environment, dipping external demand and ever-escalating China-US tensions.

The recent monetary and fiscal support of Chinese authorities, although still weaker-than-expected in order to avoid flooding massive stimulus with the financial stability concerns, to a certain extent, helped to rebuild the sentiments of household and enterprises and paved the way for a more sustainable recovery going forward. Chief among the recent stimulus is the 10 bps one-year LPR cut on August 21 and September's 25 bps unexpected RRR cut, as well as the recently announced easing housing market measures: lowering existed mortgage's interest rate, lowering down-payment rate and ease the conditions for 2nd housing purchase in various cities, etc.

In particular, the bottomed-out signals in September seem to be broad-based, from both supply and demand side. Except for still weak fixed-asset investment which was slightly missed previous readings which was primarily dragged by housing market crash, all of the other indicators such as industrial production, retail sales, exports and imports, as well as credit indicators recorded further improvement from the previous month.

In more details:

On the supply side, the year-on-year growth of industrial production maintained at the previous growth rate at 4.5%, higher than the market consensus at 4.3% y/y, although its seasonal adjusted m/m growth marginally decelerated to 0.36% m/m from 0.5% m/m in the previous month.

By categories, the pillar of China's industrial production remained in the green economy transformation sectors, such as solar lithium battery which recorded 65.4% y/y (prior: 77.8% y/y) growth, the highest among all the industrial sectors; following that is hydraulic power generation 39.2% y/y (prior:18.5% y/y), and EV cars which achieved 13.8% y/y in September, in line with the policy initiatives of nation's 2060 carbon neutrality target.

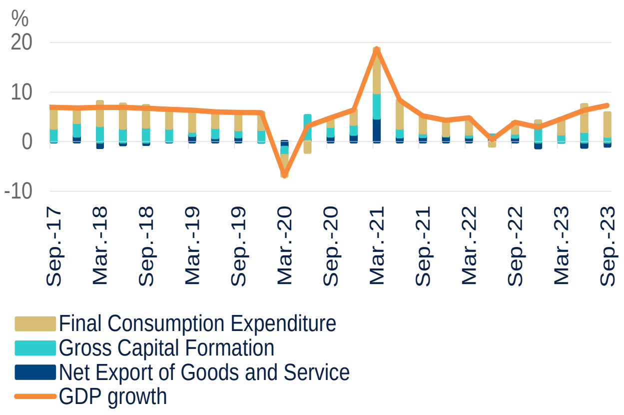
Other traditional industries also achieved growth recovery, for instance, electricity generation equipment (25.6%; prior: 32.4% y/y), chemical fiber (12.1%; prior 17.3%) and steel production (5.5%; prior: 11.4%) as China's trade sector is experiencing forced imports substitution industrialization among rising conflicts with the US and global value chain relocation. (see our recent China Economic Watch: China | Structural change of the international trade: forced imports substitution industrialization for more details) (Figure 1)

On the demand side, September retail sales rebounded to 5.5% y/y from 4.6% in the previous month (market consensus: 4.9%), although the month-on-month growth decelerated to 0.02% from 0.22% m/m in the previous month.

By component, the largest growth is tobacco and wines which achieved 23.1% y/y, the highest among all categories; following that is restaurant sales which achieved 13.8% (prior:12.4% y/y), reflecting consumers' pent-up demand of outside dinning activities from the three-year lockdown still remains the main pillar of retail sales. Following that is physical and entertainment products (10.7% y/y), clothes (9.9%) and jewelry sales (7.7% y/y). However, automobile sales remain sluggish at 2.8% y/y (prior: 1.1% y/y), so does other durable goods categories, indicating people are spending on service with "contact" characters but have weak sentiments to spend on durable products.

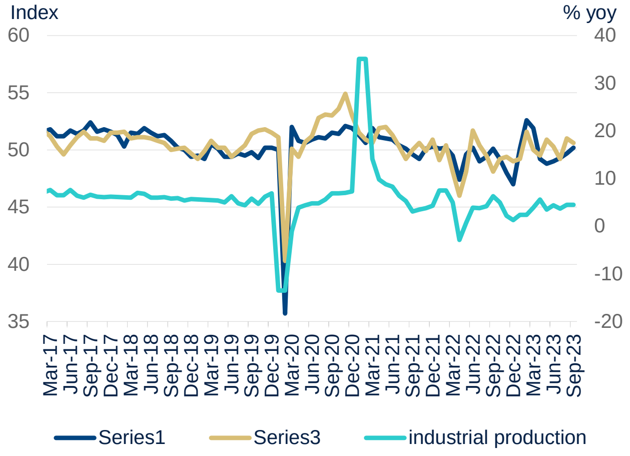
Going forward, the retail sales recovery, including not only restaurant service but also durable goods consumption, depends on the recovery pace of market sentiments, income expectation and young people unemployment rate. (Figure 4)

Figure 1. **Q3 GDP IS HIGHER THAN MARKET CONSENSUS**



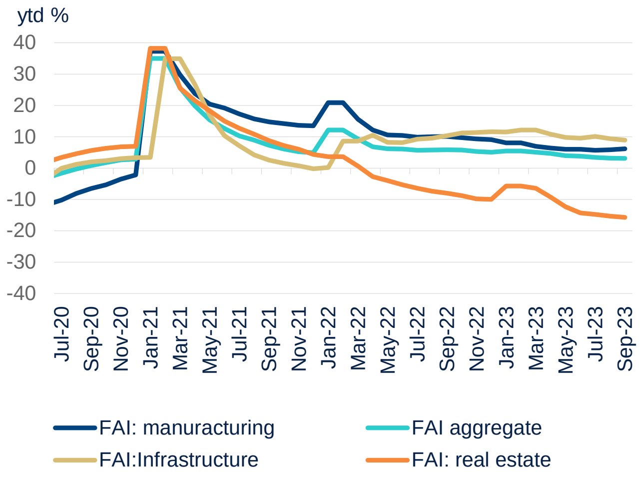
Source: CEIC and BBVA Research

Figure 2. **INDUSTRIAL PRODUCTION MAINTAINED AS OF THE PREVIOUS MONTH, WHILE PMIS IMPROVED**



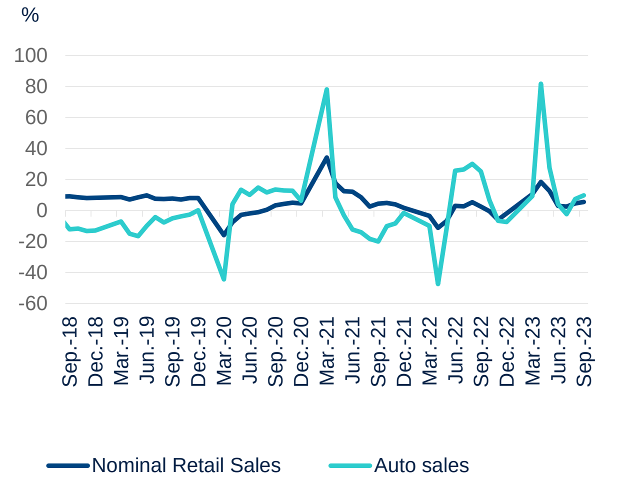
Source: CEIC and BBVA Research

Figure 3. **FIXED ASSET INVESTMENT STILL WAS SIGNIFICANTLY DRAGGED BY HOUSING INVESTMENT**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES ALSO BOUNCED BACK**



Source: CEIC and BBVA Research

Also from the demand side, fixed-asset investment (FAI) further marginally moderated to 3.1% ytd y/y from 3.2% ytd y/y in the previous month (market consensus: 3.2% ytd y/y). The main drag of FAI remained as the sluggish housing investment (-9.1% ytd y/y; vs. prior: -8.8% ytd y/y) which further expanded its decline from the previous reading.

By components, infrastructure FAI which is supported by easing fiscal measures (expansionary local government bond issuance) reached 6.2% ytd y/y (prior: 6.4% ytd y/y) (see our recent Economic Watch: China | Will infrastructure investment become a key growth stabilizer?), while the manufacturing FAI improved to 6.2% ytd y/y, (prior: 5.9% ytd y/y), showing some resilience of China's manufacturing sector as well as exports sector. This further verified it still has room for the public infrastructure investment by issuing more local government bond and infrastructure special bond. However, the multiplier effect from public FAI to private FAI is still very weak, dragged by weak sentiments of private enterprises after experiencing 2021 regulatory reforms and housing market crash. (Figure 2 and 3)

Going forward, the real estate sector remains the main drag on economic growth and seems to need more time to achieve a soft-landing. (See our previous China Economic Watch: China | Real estate sector needs a soft-landing) However, we have to realize that the current round of real estate crash is driven by supply side but not the demand side. The recent default case of Country Garden Holding, the largest China's real estate developer, following the Evergrande Group crisis back to 2021, indicate the intrinsic vulnerability and unsustainability of China's real estate developers' business model with very high leverage. But this is a typical supply issue while housing demand in China, particularly in tier-1 and tier-2 cities remain strong.

To reverse the malaise of housing market, the authorities have recently promulgated a series of easing measures, such as lowering the existed mortgage rate, the down-payment rate and ease conditions for second-house purchase etc. Look forward, we anticipate more supportive moves to be announced to circumvent the adverse spillover effect of the Country Garden Holding's default to other upstream and downstream sectors which will help to underpin market sentiments.

Beyond the economic indicators of September, we also would highlight the trade data and credit data to further display the economic bottomed-out signals. In particular, both exports and imports shrank their negative growth. Export growth shrank its decline to -6.2% y/y from -8.8% in the previous month, while imports also improved to -6.2% y/y from -7.3% in the previous month, suggesting China's resilience in trade sector amid growth slowdown in the US and Europe.

In addition, credit data also significantly improved due to a series of recent monetary easing and expansionary measures in the housing market mentioned above. In particular, total social financing which is an aggregate gauge of China's credit environment significantly jumped to RMB 4,120 billion from RMB 3,120 billion in the previous month, while new RMB loans also accelerated to RMB 2,310 billion from RMB 1,360 billion, indicating the ease of credit conditions and the willingness to re-leverage among households and enterprises.

In sum, Chinese economic recovery momentum after lifting "zero Covid" policy seems to come to a halt from Q2 2023 as the reopening effect faded, dragged by weak household and enterprises' sentiments, real estate market crash as well as decelerating external demand. However, the most recent Q3 GDP and September economic data sent out some bottomed-out signals amid recent policy stimulus and seem to suggest that the worst time has already passed.

However, we cannot ignore that the Chinese economy still faces a series of challenges going forward, thus there will still be a long haul to sustain a robust growth momentum. These challenges are particularly focusing on housing market, deflationary environment and weak market sentiments. The key point to reverse the current situation, we believe, is to implement further larger-scale monetary and fiscal stimulus at the central government level to help reverse market sentiments, although Chinese authorities currently conduct easing measures in a more conservative way than market expected due to the financial stability concerns.

Based on the above, we believe Chinese economy could gradually bottom out in the rest of this year amid a series of recent monetary and fiscal stimulus, but how to balance growth stimulus and financial stability, particularly the local government debt overhang, capital outflows and RMB depreciation (for instance due to diverging monetary policy with the US), is always a constant challenging job for Chinese authorities going forward.

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