CAPITAL ECONOMICS 凯投宏观

CHINA ECONOMICS WEEKLY

Next in the spotlight: local government debt

Property policy recalibration

The Politburo held its monthly meeting today and, as is usual in April, its focus was the economy. The gist of its statement is one we'd agree with: economic growth in **the immediate rebound from zero-COVID weakness "has been better than expected" but a host of challenges need to be addressed to support the economy further ahead**.

Some of those challenges relate to persistent weakness in demand: the statement talks of the need to boost household incomes, support consumption and stimulate private investment. There are no details on how any of this might be achieved. But one takeaway is that a supportive policy stance will be maintained for a while.

More notable is the section on risks. Once again, "houses are for living in, not for speculation". That phrase was dropped as part of the policy relaxation that allowed credit to start flowing to property developers late last year. Its return doesn't mean that developers will now be throttled again – the statement also notes the importance of making sure that purchased homes are delivered, which signals a recognition that the stringent restrictions that triggered mortgage boycotts last year went too far. But it does underline that **there's no prospect of a return to the easier conditions of a few years ago, when developers could borrow freely, local governments could depend on them to buy land, and property construction could reliably add a percentage point to the rate of growth of GDP**.

Guizhou asks for help

Investors sometimes talk about a ball of speculative money that rolls around China's asset markets. There's a ball of worry too, and it is rolling back into local government debt.

The immediate concerns are about Guizhou, where the authorities have been making unusually public appeals for help dealing with their debt burden. State-owned distressed asset manager Cinda said on Saturday that it was sending a team there.

Guizhou may be an extreme case but it isn't alone in feeling under pressure. Pandemic control measures put huge strains on local finances last year. Revenues from land sales have slumped. They may recover a little as the sector picks itself up but a strong rebound is unlikely. And the central government has swung back to tighter oversight of local borrowing. The quota for special local government bonds in the budget points to a reduction in issuance relative to last year. Borrowing by local government financing vehicles has been reined in. And **the Politburo today signalled that local governments had better get used to it**. The statement has a new line that "It is necessary to strengthen local government debt management and strictly control new hidden debts."

In outline, the problem for local governments is similar to the one that faced property developers. Debt is too high. The Party leadership wants it reined in in a way that shields the wider public to the extent possible while imposing discipline on borrowers and limiting broader financial stress. **That means no explicit bailout but probably a drawn-out process in which some of the excess debt is shifted onto the balance sheets of other parts of the state sector**. In the meantime, borrowing and investment will be restricted. As with the crackdown on developer debt, the focus on limiting local government debt risks will inevitably drag on growth.

The week ahead

The five-day Labour Day holiday starts tomorrow. Data on tourism spending should be published once it ends. The recent high-point was at Lunar New Year when tourism spending reached three-quarters of the 2019 level. We'll be looking for this to be beaten. The key regular releases are of the PMIs, spread out over the coming days. We expect falls across the board – not in itself a concern as the immediate post-reopening surge was always going to slow. We expect services activity still to look strong, but momentum in manufacturing will be much weaker.

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Data Previews

Manufacturing PMIs (Apr.)

Sun. 30th Apr. / Tue. 2nd May

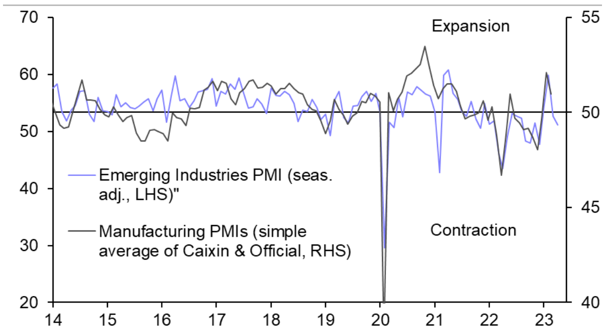
Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (30th Apr.)	09.30	51.9	51.5	51.0
Caixin/S&P Global PMI (2nd May)	09.45	50.0	50.3	49.5

Few tailwinds driving factory activity

Both manufacturing PMIs dropped back in March. Some decline was inevitable – the immediate post-zero-COVID bounce was never going to be sustained for long. But the decline on the Caixin survey, which skews more towards smaller firms and exporters, was sharper than most expected and left it at 50. That has contributed to a sense that China's recovery may falter sooner than had been expected.

The March activity data by contrast generally outperformed expectations. And upbeat flash PMIs for major developed economies suggest that, for now at least, major trading partners are still performing well, which should be good news for large parts of Chinese manufacturing. But there's still a nagging sense that this can't last given the policy tightening in the pipeline abroad. Domestically too, there's not much lost ground still to be made up for goods demand (in contrast to services). And with the the official Emerging Industries PMI – which covers high-tech parts of manufacturing – dropping back below the 50-mark in April, we think the balance of probability is towards further falls on both of China's manufacturing PMIs. (See Chart 1.)

Chart 1: Manufacturing & Emerging Industry PMIs



Sources: CEIC, S&P Global, Capital Economics

Non-manufacturing PMIs (Apr.)

Sun. 30th Apr / Thu. 4th May

Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (30th Apr.)	09.30	58.2	57.0	57.0
Caixin/S&P Global PMI (2nd May)	09.45	57.8	57.3	57.0

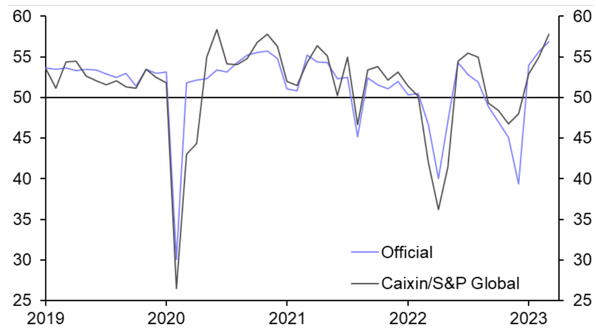
Rebound still strong but boost fading

The services PMIs rose even higher in March. (See Chart 2.) That was probably the peak.

Much of the rebound to normality has happened. For example, mobility data have been back at pre-COVID levels since the end of January. There was no further increase in retail sales in March, after the earlier surge. And since the PMIs are measuring the breadth of changes in activity – i.e. the share of firms seeing a rise or fall in sales – they are likely to have dropped back.

The construction index reached a record high in March. That's hard to square with more direct measures which show no great pick-up in construction activity. Infrastructure spending has risen but, while property sales have lifted from last year's slump, developers are not yet confident enough to launch new projects.

Chart 2: Services PMIs



Sources: CEIC, S&P Global, Capital Economics

Hong Kong GDP (Q1, Adv.)

Tue. 2nd May

Forecasts	Time (China)	Previous	Consensus	Capital Economics
GDP q/q (y/y)	16.30	0.0% (-4.2%)	+3.0% (+0.5%)	+2.0% (0.0%)

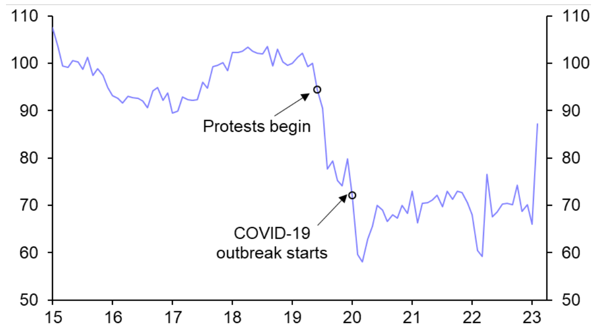
Exports and tourism driving the economic recovery

Hong Kong's economy stagnated in Q4 as a further decline in exports offset a pick-up in consumption. Most signs suggest that an economic rebound started in earnest in Q1 although a higher base for comparison will mask the improvement in the y/y growth rate.

Across the quarter as a whole, monthly data show that goods exports picked up slightly in seasonally-adjusted terms, the first expansion since Q4 2021. Given that trade logistics account for a fifth of output, this will have been a welcome boost to the economic recovery.

The mobility data suggest that there was a further improvement in consumer activity last quarter. Monthly data show that retail sales jumped to roughly 15% below their pre-protest level in February. (See Chart 3.) This was largely thanks to the return of mainland visitors following the reopening of the border in early January. Mainland arrivals had reached nearly half the pre-protest level at the end of Q1, up from 2% at the end of last year.

Chart 3: Retail Sales Volumes (May 2019 = 100, seas. adj.)



Sources: CEIC, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
April						
Sun 30th		**Chn** "Official" Manufacturing PMI (Apr.)	(09.30)	51.9	51.5	51.0
		Chn "Official" Non-Manufacturing PMI (Apr.)	(09.30)	58.2	57.0	57.0
May						
1st – 3rd		**Chn** Labour Day (National Holiday)	-	-	-	-
Mon 1st		**HK** Labour Day (National Holiday)	-	-		-
Tue 2nd		**Chn** Caixin Manufacturing PMI (Apr.)	(09.45)	50.0	50.3	49.5
		HK GDP (Q1, Adv., q/q(y/y))	(16.30)	0.0%(-4.2%)	+3.0%(+0.5%)	+2.0%(0.0%)
Thu 4th		**Chn** Caixin Services PMI (Apr.)	(09.45)	57.8	57.3	57.0
		HK Retail Sales (Mar.)	(16.30)	(+31.3%)	-	(+55.0%)

Selected future data releases and events:

May

Date	Country	Release/Indicator/Event
Sun 7th		**Chn** Foreign Exchange Reserves (Apr.)
Tue 9th		**Chn** Trade Data (Apr.)
Thu 11th		**Chn** Inflation Data (Apr.)
Fri 12th		**HK** GDP (Q1, Fin.)
		Chn Current Account Balance (Q1, Preliminary)

Also expected during this period:

Date	Country	Release/Indicator/Event
9th – 15th		**Chn** Aggregate Financing "AFRE" (Apr., RMB)
		Chn Net New Lending (Apr., RMB)
		Chn M2 Money Supply (Apr., RMB)
11th – 18th		**Chn** Foreign Direct Investment (Apr., RMB)
TBC		**Chn** Vehicle sales (Apr.)

Main Economic & Market Forecasts

%q/q annualised (%y/y), unless stated	Latest	Q2 2023	Q3 2023	Q4 2023	Q1 2024	2022	2023f	2024f	2025f
Official GDP	+2.2(+4.5)***	(8)	(5.5)	(6)	(5)	(3.0)	(6.0)	(5.0)	(4.5)
GDP (CE CAP-derived estimates)	+7.0(+4.2)***	(10)	(9)	(11)	(4.5)	(-2.0)	(8.5)	(4.5)	(4.0)
Consumer Prices	(+0.7)**	(1.5)	(1.7)	(1.9)	(2.4)	(2.0)	(1.5)	(2.0)	(1.5)
Producer Prices	(-2.5)**	(-2.7)	(-0.5)	(0.5)	(1.0)	(4.2)	(-1.2)	(0.9)	(0.4)
Broad Credit (AFRE)	(+10.0)**	(10.1)	(10.1)	(10.7)	(9.2)	(9.6)	(10.7)	(8)	(7.7)
Exports (US$)	(+14.8)**	(-15.5)	(-19.0)	(-8.0)	(-12.5)	(7.0)	(-11.0)	(-2.5)	(2.5)
Imports (US$)	(-1.4)**	(-4.0)	(-8.0)	(0.5)	(1.5)	(1)	(-4.5)	(3.5)	(1)
RMB/$†	6.92	6.90	6.80	6.70	6.65	6.95	6.70	6.50	6.40
7-day PBOC reverse repo† %	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
1-year Loan Prime Rate† (LPR) %	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65
1-year MLF Rate† %	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
10-year Government Bond Yield† %	2.79	3.10	3.15	3.20	3.10	2.85	3.20	2.90	2.60
RRR (major banks)† %	10.75	10.75	10.75	10.75	10.75	11.00	10.75	10.75	10.75
CSI 300 Index†	3,988	4,225	4,500	4,770	4,855	3,872	4,770	5,110	5,468
Hong Kong GDP	(-4.2)*	(3.5)	(8)	(9.5)	(8)	(-3.5)	(5.5)	(7.5)	(4.5)
Hang Seng Index†	19,840	20,550	21,300	22,000	23,000	19,781	22,000	26,000	30,000

Sources: Bloomberg, Refinitiv, CEIC, Capital Economics *Q4; **Mar.; ***Q1; † End of period

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