CHINA ECONOMICS WEEKLY

Unfinished homes, chipmaking woes

Slow progress tackling construction backlog

New home sales have ticked up since the end of last year, helped by a post-zero-COVID recovery in consumer confidence and large reductions in mortgage rates and downpayment requirements. But the improvement has been modest compared to the huge declines that preceded it.

One constraint is that households are still wary of purchasing presold homes in knowledge that construction work on many projects stalled in recent years. Demand for completed new homes has jumped – sales last month were 12% higher than in April 2021, on the eve of the housing downturn. But such homes are in short supply and the much larger presales market remains depressed – sales are down 30% over the same period.

Popular frustration over stalled projects boiled over last summer, resulting in nationwide mortgage boycotts. Since then, officials have stepped up support for developers in a bid to get construction back on track. Some progress has been made – work on most projects has resumed and monthly housing completions have risen 26% since the middle of last year.

But the scale of the backlog remains daunting. A recent survey by Mysteel found that 34% of stalled projects have now been completed. But this appears to be based on a narrow set of projects identified as targets for government support. The broader national data point to slower progress. At the current rate of monthly completions, it would take over five years to finish the homes currently under construction.

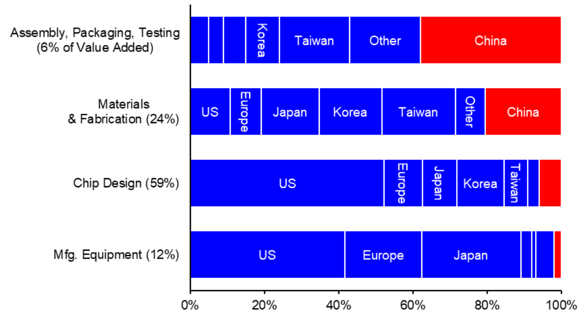
The chipmaking noose tightens

Japan's government formally announced its new export controls on chipmaking machinery this week. They will come into effect in July and appear even broader in scope than US controls, covering a wide range of processes from cleaning and lithography to annealing and etching. There are even reports that Japan's restrictions could encompass machinery for producing mature chips as large as 45nm. By contrast, US controls only target technology needed for 18nm chips or smaller.

Existing restrictions are already having an effect. The share of global semiconductor equipment sales going to mainland Chinese buyers, which had been rising rapidly, dropped from a peak of 33% in Q2 2021 to 23% by the end of last year. This has forced some Chinese chipmakers to delay expansion plans and will set back Beijing's efforts to curb its reliance on foreign chips.

It remains to be seen exactly how far the Japanese controls go and how stringently they are enforced. But China's access to chipmaking equipment is clearly becoming even more restricted. Japan is the world's second largest supplier of such machinery after the US. (See Chart 1.) In third place is the Netherlands, which is due to announce the specifics of its export controls soon.

Chart 1: Share of Semiconductor Supply Chain (%, 2021)



Sources: US Semiconductor Industry Association, Capital Economics

In case you missed it

We held an online drop-in on Thursday to discuss our long-run forecasts for China and followed up with a note today in which we answer questions received during the event, including some we didn't have time to address live.

The week ahead

The PMIs are likely to suggest that post-reopening momentum slowed in May. Services activity should still look strong while manufacturing was struggling.

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Data Previews

Manufacturing PMIs (May)

Wed. 31st May / Thu. 1st Jun.

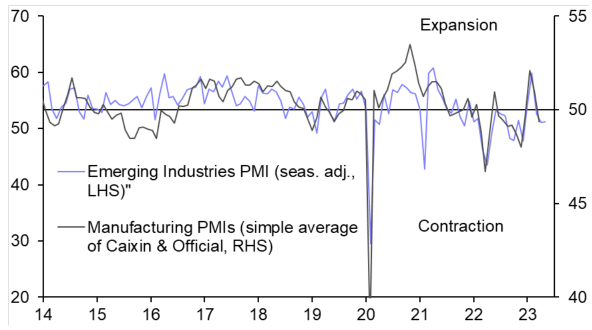
Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (31st May)	09.30	49.2	49.5	49.0
Caixin/S&P Global PMI (1st Jun.)	09.45	49.5	49.5	49.0

Softer demand weighing on factory activity

Both manufacturing PMIs fell below 50 in April. Some decline was inevitable – the immediate post-zero-COVID bounce was never going to be sustained for long. The breakdown suggests the fall in demand led to increased slack in supply chains. Factory activity probably contracted again in May.

Admittedly, flash PMIs for major developed economies suggest that activity in major trading partners continued to hold up well. But that was due to a strong rebound in services. The manufacturing indices point to a further deterioration. Taken together, they suggest consumers' spending patterns are shifting away from goods and back to services. The domestic situation is similar – there's not much lost ground to be made up for goods demand compared to services. Consistent with further weakness in goods demand, the official Emerging Industries PMI – which covers high-tech parts of manufacturing – was largely unchanged below the 50-mark in May. (See Chart 2.)

Chart 2: Manufacturing & Emerging Industry PMIs



Sources: CEIC, S&P Global, Capital Economics

Non-manufacturing PMIs (May)

Wed. 31st May/ Mon. 5th Jun.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (31st May)	09.30	56.4	55.0	56.0
Caixin/S&P Global PMI (5th Jun.)	09.45	56.4	55.1	56.0

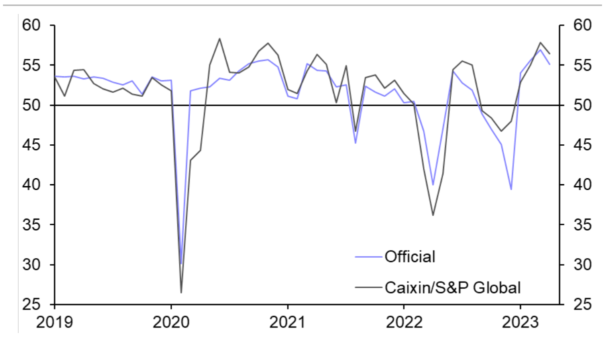
Services recovery continues albeit at a slower pace

Despite dropping back slightly, the services PMIs still pointed to a rapid expansion in activity in April. (See Chart 3.) We think this trend continued in May.

Much of the return to normality has already happened. For example, mobility data have been back at pre-COVID levels since the end of January. That said, sales data among large retailers showed it only returned to its pre-pandemic trend over the Labour Day holiday earlier this month. This suggests the services recovery was still going strong in May.

The construction index dropped back in April but remains above its five-year average. That's hard to square with more direct measures which show no great pick-up in construction activity. Infrastructure spending has risen but the tepid recovery in home sales following reopening appears to have levelled off. As such, developers are turning cautious again and are unlikely to launch new projects.

Chart 3: Services PMIs



Sources: CEIC, S&P Global, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
May						
Sat 27th	**Chn**	Profits of Large Industrial Firms (Apr., ytd y/y)	(09.30)	(-21.4%)	-	-
Mon 29th	**HK**	Trade Balance (Apr., HKD)	(16.30)	-40.4b	-	-31.5b
	HK	Exports (Apr., HKD)	(16.30)	(-1.5%)	-	(-15.0%)
	HK	Imports (Apr., HKD)	(16.30)	(-0.6%)	-	(-14.8%)
Wed 31st	**Chn**	"Official" Manufacturing PMI (May)	(09.30)	49.2	49.5	49.0
	Chn	"Official" Non-manufacturing PMI (May)	(09.30)	56.4	55.0	56.0
June						
Thu 1st	**Chn**	Caixin Manufacturing PMI (May)	(09.45)	49.5	49.5	49.0
	HK	Retail Sales (Apr.)	(16.30)	(+40.9%)	-	(+10.0%)

Selected future data releases and events:

June

Mon 5th	**Chn**	Caixin Services PMI (May)
Wed 7th	**Chn**	Foreign Exchange Reserves (May)
Fri 9th	**Chn**	Trade Data (May)
	Chn	Inflation Data (May)

Also expected during this period:

9th – 15th	**Chn**	Aggregate Financing "AFRE" (May, RMB)
	Chn	M2 Money Supply (May, RMB)
	Chn	Net New Lending (May, RMB)

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)*	(8.7)	(5.9)	(6.6)	(5.2)	(3.0)	(6.5)	(4.7)	(4.2)
GDP (CE CAP-derived estimates)	+7.0(+4.2)*	(10)	(9)	(11)	(4.5)	(-2.0)	(8.5)	(4.5)	(4.0)
Consumer Prices	(+0.1)**	(0.7)	(1.1)	(1.5)	(2.1)	(2.0)	(1.0)	(2.0)	(1.5)
Producer Prices	(-3.6)**	(-2.8)	(-0.6)	(0.5)	(1.3)	(4.2)	(-1.0)	(1.1)	(0.3)
Broad Credit (AFRE)	(+10.0)**	(10.1)	(10.1)	(10.7)	(9.2)	(9.6)	(10.7)	(8)	(7.7)
Exports (US$)	(+8.5)**	(-15.5)	(-19.0)	(-8.0)	(-12.5)	(7.0)	(-11.0)	(-2.5)	(2.5)
Imports (US$)	(-7.9)**	(-4.0)	(-8.0)	(0.5)	(1.5)	(1)	(-4.5)	(3.5)	(1)
RMB/$†	7.07	6.95	6.90	6.90	6.80	6.95	6.90	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† %	2.72	2.80	2.90	2.90	2.85	2.85	2.90	2.70	2.60
RRR (major banks)† %	10.75	10.50	10.50	10.50	10.50	11.00	10.50	10.50	10.50
CSI 300 Index†	3,622	3,750	3,850	3,950	4,085	3,872	3,950	4,500	5,100
Hong Kong GDP	(+2.7)*	(4.0)	(9.0)	(11.0)	(7.5)	(-3.5)	(6.5)	(7.5)	(6.5)
Hang Seng Index†	18,747	19,250	19,750	20,250	21,185	19,781	20,250	24,000	27,500

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