CHINA ECONOMICS WEEKLY

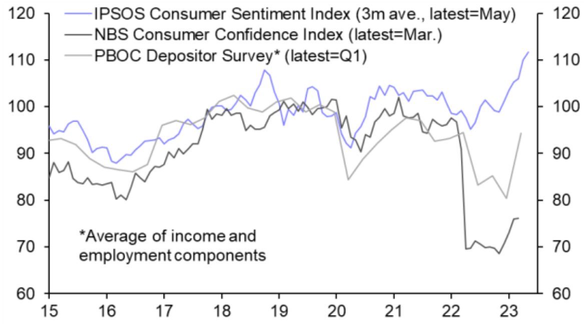
Don't give up on the Chinese consumer just yet

Second-round effects from reopening still in play

Investors have become increasingly bearish on the outlook for household spending in China. Onshore-listed consumer discretionary stocks have now reversed almost all of their reopening gains and those listed in Hong Kong haven't fared much better.

This pessimism is overdone in our view. Consumers themselves appear less downbeat. The confidence measure published by the National Bureau of Statistics (NBS) was still weak as of March. But a survey by the People's Bank pointed to a much greater improvement in sentiment in Q1. And a timelier measure of confidence compiled by IPSOS hit a record high this quarter. (See Chart 1.)

Chart 1: Consumer Confidence Indices (2019 = 100)



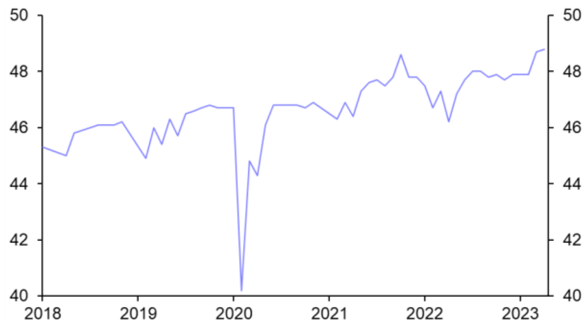
Sources: CEIC, Refinitiv, Capital Economics

Of course, actions speak louder than words and it's true that retail sales came in below expectations for April. But sales still improved relative to March. And the recovery looks to have continued in May given that the official services PMI remained above its 5-year average, and that travel and spending during the Labour Day holiday was robust.

More fundamentally, it seems unlikely to us that the tailwind from reopening has been fully exhausted. The immediate snap back in consumer activity is over. But the second-round effects are still playing out. In particular, as those who retained their jobs during the pandemic disruptions have returned to the stores, restaurants and hotels, this has provided employment opportunities for jobseekers, bringing down the unemployment rate.

This process probably has further to run. Average hours worked hit a record high in April, suggesting that firms are suffering from staff shortages and will continue to step up hiring. (See Chart 2.)

Chart 2: Average Weekly Hours Worked



Sources: CEIC, Capital Economics

As such, we expect the urban unemployment rate to drop to 5.0% before long. The rate among the youth may continue to edge up for a few more months due to the usual seasonal pattern amid the summer graduation period. But young jobseekers will also benefit from a cyclically tight labour market – the unemployment rate for older workers is already at a joint-record low of 4.2% so firms will have to start hiring more graduates instead.

The household savings rate returned to pre-pandemic levels in Q1, suggesting that households felt confident enough to resume their usual spending patterns. Instead, the main impediment to a stronger rebound in consumption was the lacklustre 1.0% q/q rise in urban disposable income. A tighter labour market should help to address this source of weakness and support a further recovery in consumer spending over the rest of this year. It won't match the post reopening splurge seen in some other countries. But the prevailing pessimism means the bar for an upside surprise is low.

The week ahead

We expect inflation data to be very soft amid lower energy prices. Trade volumes will likely have declined further due to weak foreign demand. And credit growth probably slowed as well.

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Data Previews

Trade (May)

Wed. 7th Jun.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Exports (USD, % y/y)	-	(+8.5%)	(-2.1%)	(-2.7%)
Imports (USD, % y/y)	-	(-7.9%)	(-8.0%)	(-12.0%)
Trade Balance (USD)	-	+90bn	+92bn	+97bn

Exports probably dropped back

Export values partially reversed March's jump in April. But they remained far higher than what is implied by other measures of foreign demand. The value of export sales reported by industrial firms is at a 28-month low. (See Chart 3.) And other countries in the region have reported much weaker exports recently. Freight rates out of China and the new exports orders component of the PMIs are both depressed. It's not clear why the customs data are defying wider evidence of a downturn. But it suggests the risks to headline export growth are skewed to the downside.

In contrast, there are few signs of any such distortions to the import data, which have stayed weak recently. This is because the consumer-facing sectors that have benefited the most from reopening are not import-intensive. The main exception is passenger transportation. But China stockpiled crude oil during the pandemic and its refineries have been tapping those onshore supplies, reducing the impact of reopening on imports. This probably remained the case in May too.

Chart 3: Exports & Industrial Export Sales ($, 2019=100, CE seas. adj.)

Sources: CEIC, Capital Economics

CPI, PPI (May)

Fri. 9th Jun.

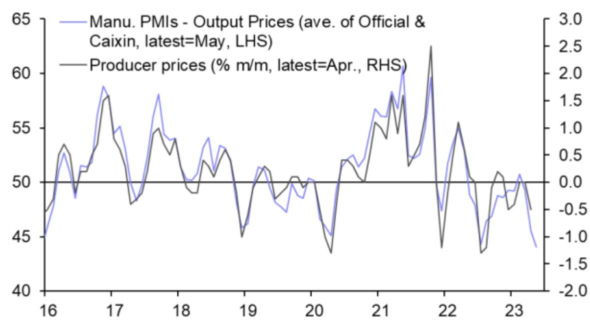
Forecasts	Time (China)	Previous	Consensus	Capital Economics
CPI (% y/y)	09.30	(+0.1%)	-	(+0.1%)
PPI (% y/y)	09.30	(-3.6%)	-	(-4.5%)

Energy price volatility mask impact of reopening

Factory-gate deflation reached a 35-month low in April. We think it will have deepened in May, reaching its lowest level in seven years. This will partly be driven by a higher base for comparison – global commodity prices was elevated a year ago amid the Russian invasion of Ukraine. But commodity prices have also dropped back in recent weeks and the manufacturing PMIs point to a m/m decline in output prices. (See Chart 4.)

After falling to its lowest in more than two years in April, high frequency data suggest consumer price inflation was unchanged in May. The inflationary impact of reopening probably put some upward pressure on services inflation. And food prices rose too. But this will have been offset by a further decline in energy inflation.

Chart 4: Producer Prices & PMI Output Prices



Sources: CEIC, S&P Global, Capital Economics

Net New Bank Loans, M2, AFRE (May)

9th – 15th Jun.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Net New Bank Loans (RMB)	-	+719bn	-	+1,800bn
M2 (% y/y)	-	(+12.4%)	-	(+12.3%)
Aggregate Financing "AFRE" (RMB)	-	+1,217bn	-	+2,800bn

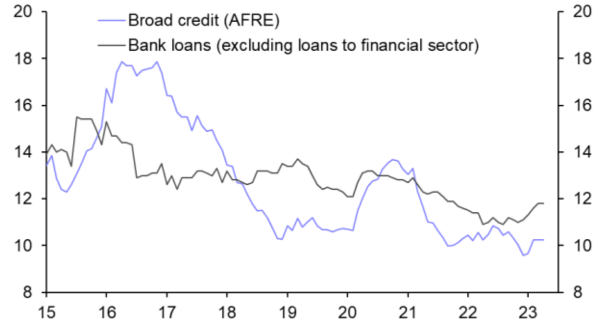
Recovery going into reverse

Broad credit and bank loan growth were unchanged in April, dashing hopes for an acceleration. (See Chart 5.) We think the reopening rebound in credit growth continued to lose momentum in May.

The headline net increase figures will rise but this simply reflects the usual seasonal pattern. Year-on-year growth in outstanding bank loans is likely to have edged down. This will largely reflect shifting base effects as lending picked up when Shanghai and other large cities re-emerged from lockdowns a year ago. In seasonally-adjusted m/m terms, we think lending held steady, helped by the lagged impact of the earlier pick-up in home sales on mortgage disbursements.

Growth in other forms of borrowing look to have slowed last month. High frequency data point to softer corporate and government bond issuance, with the latter dropping back as the boost from the front-loading of fiscal borrowing has started to fade.

Chart 5: Broad Credit & Bank Loans (outstanding, % y/y)



Sources: CEIC, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
June						
Mon 5th		**Chn** Caixin Services PMI (May)	(09.45)	56.4	55.2	56.0
Wed 7th		**Chn** Foreign Exchange Reserves (May, USD)	-	+3204b	-	-
		Chn Trade Balance (May, USD)	-	+90.2b	+92.0b	+97bn
		Chn Exports (May, USD)	-	(+8.5%)	(-2.1%)	(-2.7%)
		Chn Imports (May, USD)	-	(-7.9%)	(-8.0%)	(-12.0%)
Fri 9th		**Chn** Consumer Prices (May)	(09.30)	(+0.1%)	-	(+0.1%)
		Chn Producer Prices (May)	(09.30)	(-3.6%)	-	(-4.5%)
Also expected during this period:						
9th – 15th		**Chn** Aggregate Financing “AFRE” (May, RMB)	-	+1217bn	-	+2800bn
		Chn M2 Money Supply (May, RMB)	-	(+12.4%)	-	(+12.3%)
		Chn Net New Lending (May, RMB)	-	+719bn	-	+1800b

Selected future data releases and events:

June

Thu 15th		**Chn** 1-Year Medium-Term Lending Facility (Jun.)
		Chn Spending and Activity Data (May)
		Chn Foreign Exchange Net Settlement and Receipts (May)
Also expected during this period:		
11th – 18th		**Chn** Foreign Direct Investment (May)

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/$†	7.12	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† %	2.70	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†	3,807	3,850	3,900	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†	18,217	18,750	19,500	20,250	21,185	19,781	20,250	24,000	27,500

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

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