CHINA ECONOMICS WEEKLY

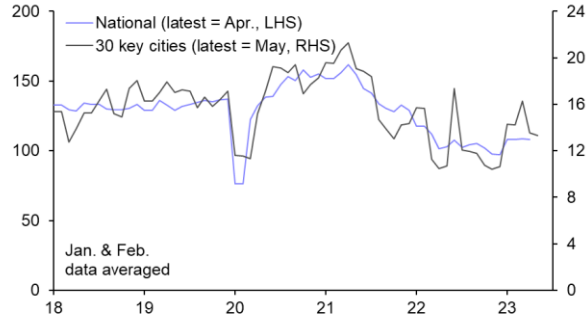
Shift in risk appetite needed to revive property

Property support of limited use in isolation

Stocks of Chinese property developers surged after Bloomberg reported late last Friday that support measures for the sector were being drawn up. The Hang Seng Property Index rose 8.0% this week. Base metal prices have jumped as well.

The rumoured support has yet to materialise but it probably won't be long coming given that the sector is clearly still struggling. After a promising pick-up at start of the year, new home sales quickly flatlined. And high frequency data point to a further loss of momentum in May. (See Chart 1.)

Chart 1: New Home Sales (million sqm, seas. adj.)



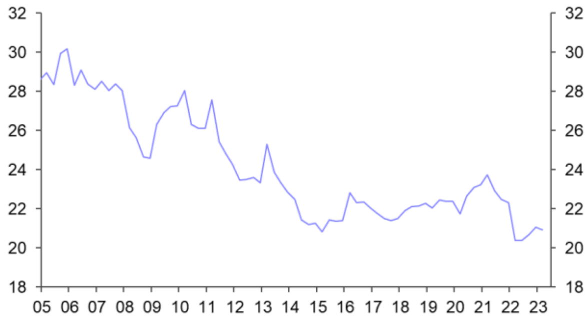
Sources: CEIC, WIND, Capital Economics

The support measures will reportedly focus on shoring up demand and will involve reducing downpayments, relaxing purchase restrictions and lowering agent commissions.

This will boost home sales at the margin but won't be a game changer on its own. Similar measures have been rolled out over the past couple of years to underwhelming effect. It's hard to argue that the main factor holding back potential buyers is cost. New homes prices are already close to a record low relative to incomes. (See Chart 2.) And combined with a decline in mortgage rates and downpayments, as well as easier access to provident fund loans, buying a home from a developer has never been this affordable for the average Chinese household.

A more fundamental constraint is the structural decline in new housing demand amid worsening demographics and slowing rural-to-urban migration. But these headwinds can't fully explain the huge drop in home sales since mid-2021 and even taking them into account, we think there is still some scope for a further cyclical rebound.

Chart 2: Ratio of New House Prices to Urban Incomes



Sources: CEIC, Capital Economics

The sharp rise in household bank balances over the past year suggests there is no shortage of funds that could flow into the housing market. The problem is that households have become far more risk adverse when it comes to managing their wealth.

That may start to change as economic conditions improve. Although the reopening recovery has been widely derided as disappointing, it is still making headway and the labour market is tightening. This should support income growth and boost sentiment.

When household deposits do start to flow back into risky assets, housing will remain the obvious first choice. Although confidence in property has been dented during the past couple of years, that's also true of financial investments such as equities and wealth management products.

Any further recovery in home sales is likely to be modest, however, and may not do much to boost construction. Developers still face a long and painful deleveraging process as they work their way through a backlog of unsold and unfinished homes. Appetite for breaking ground on new projects will stay weak.

The week ahead

We think the MLF rate will be left on hold and that credit and activity data will beat expectations.

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Data Previews

Net New Bank Loans, M2, AFRE (May)

9^{th} – 15^{th} Jun.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Net New Bank Loans (RMB)	-	+719bn	+1,550bn	+1,800bn
M2 (% y/y)	-	(+12.4%)	(+12.0%)	(+12.3%)
Aggregate Financing "AFRE" (RMB)	-	+1,217bn	+1,900bn	+2,800bn

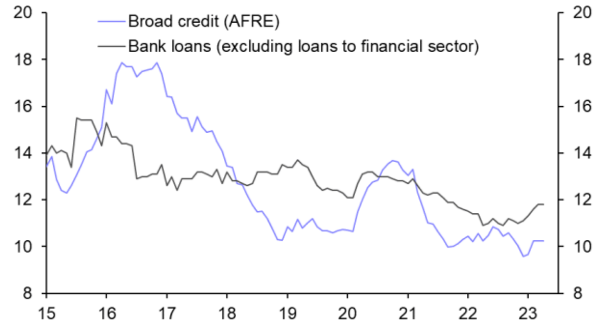
Recovery going into reverse

Broad credit and bank loan growth were unchanged in April, dashing hopes for an acceleration. (See Chart 3.) We think the reopening rebound in credit growth continued to lose momentum in May.

The headline net increase figures will rise, as they almost always do in May. 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 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 3: Broad Credit & Bank Loans (outstanding, % y/y)



Sources: CEIC, Capital Economics

Activity & Spending (May)

Thu. 15^{th} May

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Industrial Production (% y/y)	10.00	(+5.6%)	(+3.9%)	(+4.6%)
Fixed Asset Investment (ytd % y/y)	10.00	(+4.7%)	(+4.4%)	(+4.5%)
Retail Sales (% y/y)	10.00	(+18.4%)	(+13.7%)	(+19.5%)

Services recovery still making headway

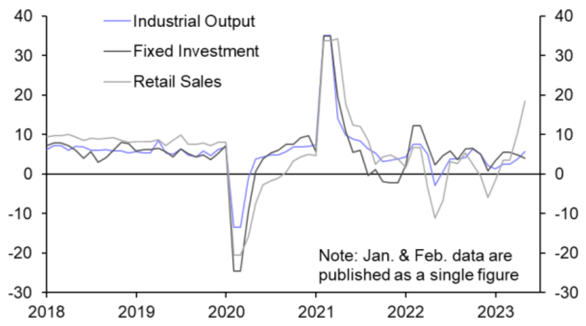
Growth on all activity indicators will have remained distorted in y/y terms in May, a year after Shanghai and several other cities started to emerge from lockdowns. (See Chart 4.) It therefore makes sense to focus as much as possible on the levels data.

Now that the most rapid phase of reopening has passed, slower sequential growth in retail sales and other indicators for the service sector where the surge was strongest is inevitable. But most signs, including robust service PMIs, suggest that there were still some further gains in May.

In contrast, industry looks to have struggled last month. The manufacturing PMIs and export data point to weakness in demand, especially from overseas. This will have been a drag on output.

Investment spending probably failed to make much headway too. The support to infrastructure spending from the front-loading of fiscal support had largely run its course by May. And all the signs are that property investment remained depressed.

Chart 4: Activity & Spending (% y/y)



Sources: CEIC, Capital Economics

Medium-term Lending Facility Rate (Jun.)

Thu. 15th Jun.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
MLF Rate (1-year)	09.20	2.75%	2.75%	2.75%

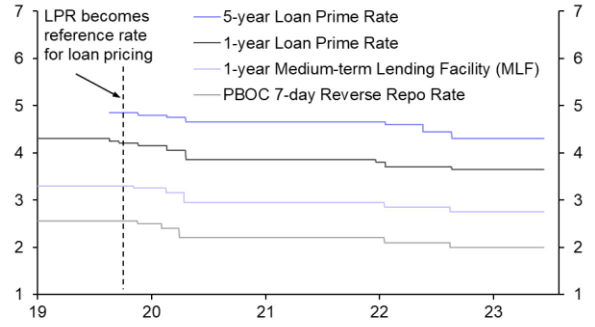
A hold still more likely than a cut

The PBOC has refrained from adjusting its main policy rates since the move away from zero-COVID. (See Chart 5.) We think this will remain the case for the foreseeable future.

Concerns about the health of China's reopening recovery have fuelled calls for greater monetary support. But policy rate cuts would hurt banks' net interest margins, which are already at record lows.

Instead, we think the PBOC will favour other tools. This includes RRR cuts and further window guidance directing the banks to lower deposit rates.

Chart 5: Policy Rates (%)



Sources: CEIC, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
June						
Thu 15th		**Chn** 1-Year Medium-Term Lending Facility (Jun.)	(09.20)	2.75%	2.75%	2.75%
		Chn Home Prices (70 Cities)	(09.30)	+0.3%	-	-
		Chn Retail Sales (May)	(10.00)	(+18.4%)	(+13.7%)	(+19.5%)
		Chn Industrial Production (May)	(10.00)	(+5.6%)	(+3.9%)	(+4.6%)
		Chn Fixed Asset Investment (May, ytd y/y)	(10.00)	(+4.7%)	(+4.4%)	(+4.5%)
		Chn Property Investment (May, ytd y/y)	(10.00)	(-6.2%)	(-6.7%)	(-9.0%)
		Chn Surveyed Unemployment Rate (May)	(10.00)	5.20%	5.20%	5.20%
		Chn Foreign Exchange Net Settlement and Receipts (May, RMB)	-	+32.4b	-	-
Also expected during this period:						
9th – 15th		**Chn** Aggregate Financing “AFRE” (May, RMB)	-	+1217b	+1900bn	+2800b
		Chn M2 Money Supply (May, RMB)	-	(+12.4%)	(+12.0%)	(+12.3%)
		Chn Net New Lending (May, RMB)	-	+719b	+1550bn	+1800b
11th – 18th		**Chn** Foreign Direct Investment (May)	-	(+2.2%)	-	-

Selected future data releases and events:

June

Mon 19th		**HK** Unemployment Rate (May)
Tue 20th		**Chn** 1-Year Loan Prime Rate (Jun.)
		HK Consumer Prices (May)
Thu 22nd		**HK** Dragon Boat Festival (National Holiday)
22nd – 24th		**Chn** Dragon Boat Festival (National Holiday)
Also expected during this period:		
TBC		**Chn** Government Revenue and Expenditure (May)
TBC		**Chn** CBRC Data on Assets and Liabilities of Financial Institutions (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)*	(11.5)	(7.5)	(10.5)	(5)	(-2.5)	(8.5)	(4.5)	(4.0)
Consumer Prices	(+0.2)***	(0.7)	(1.1)	(1.5)	(2.1)	(2.0)	(1.0)	(2.0)	(1.5)
Producer Prices	(-4.6)***	(-2.8)	(-0.6)	(0.5)	(1.3)	(4.2)	(-1.1)	(1.2)	(0.5)
Broad Credit (AFRE)	(+10.0)**	(10.1)	(10.1)	(10.7)	(9.2)	(9.6)	(10.7)	(8)	(7.7)
Exports (US$)	(-7.5)***	(-15.5)	(-19.0)	(-8.0)	(-12.5)	(7.0)	(-11.0)	(-2.5)	(2.5)
Imports (US$)	(-4.5)***	(-4.0)	(-8.0)	(0.5)	(1.5)	(1)	(-4.5)	(3.5)	(1)
RMB/$†	7.11	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† %	2.71	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†	3,819	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†	19,299	19,500	19,900	20,250	21,185	19,781	20,250	24,000	27,500

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

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