CHINA ECONOMICS WEEKLY

Targeted rather than broad policy support

Recent measures have been sector-specific

Policymakers have been taking further steps to support the economy this week. But efforts are being directed at struggling sectors rather than the wider economy through broad stimulus measures.

The PBOC and financial regulator on Monday issued a notice encouraging banks to extend and renegotiate outstanding loans to developers to ensure completion of projects under construction. This is a continuation of measures that were part of November's 16-point property support package and includes a one-year repayment extension on bank and trust loans that are due by end-2024.

At a symposium with tech CEOs on Wednesday, Premier Li lauded them as essential to the country's growth and promised to cut red tape in the sector. Later in the day, the NDRC released a statement praising tech firms too. This shift in sentiment came off the back of fines being placed on Ant and Tencent group last Friday, a move that many have interpreted as drawing a line under the tech sector crackdown that started in late 2020.

These moves will help a little with the near-term outlook. Only 34% of properties that had been sold but not yet finished a year ago had been completed by May. Some developers need credit simply to keep working on these projects, while concern that pre-sold properties may not be delivered is also still holding back sales. Relaxation of constraints on the tech sector could boost employment. Both moves should lift confidence too, by signalling that the leadership is more focused right now on growth than on reshaping the economy.

But these are targeted moves rather than broad economic support. The People's Bank has a chance to signal its intentions for wider-ranging support when it sets the interest rate on rolled-over medium-term lending facility loans on Monday. We don't expect a cut this time (see below), but even if there is one, it is likely to be on the scale of June's 10bp move: too small to make much difference when firms are not eager to borrow. As the wait for stimulus has gone on, expectations for this month's Politburo meeting have risen. We still don't know exactly when that will happen. But if the authorities thought that a major support package was needed, they would already have acted by now.

Goods deflation points to industrial overcapacity

The weakness of consumer price inflation in June was in part another reflection of the faltering recovery in services: services inflation dropped back to just 0.7% y/y. But the headline rate has now fallen to 0.0% on the back of a substantial fall in goods inflation, which is now negative for only the fourth time on record. (See Chart 1.)

Chart 1: CPI - Consumer Goods (% y/y)

Sources: CEIC, Capital Economics

What's more, on each of the previous three occasions, volatile food price inflation was pulling goods inflation down. This is the only occasion on record in which goods inflation has been negative with food inflation positive. This is suggestive of excess capacity in manufacturing after a sustained boom in investment in the sector since the start of the pandemic. Measures of industrial capacity utilisation have been dropping in recent quarters. In turn, this suggests that firms will remain reluctant to invest, even if interest rates are lowered further.

The week ahead

While Q2 was without doubt disappointing, we think there's room for an upside surprise in the GDP data due on Monday as we think the consensus has swung too far into pessimism.

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Data Previews

Medium-term Lending Facility Rate/Loan Prime Rate (Jul.)

Mon. 17th/ Thu. 20th

Forecasts	Time (China)	Previous	Consensus	Capital Economics
MLF Rate (1-year) (17th Jul.)	09.20	2.65%	2.65%	2.65%
Loan Prime Rate (1-year) (20th Jul.)	09.15	3.55%	3.55%	3.55%
Loan Prime Rate (5-year) (20th Jul.)	09.15	4.20%	4.20%	4.20%

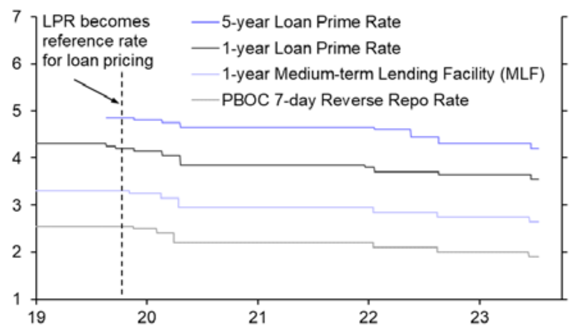
Rate cuts set to continue, but probably not this month

The PBOC signalled at its regular quarterly press conference today that it will continue to provide monetary support in the form of RRR and policy rate cuts. We expect one more of each this quarter. But having lowered policy rates by 10bp in June (see Chart 2), the PBOC probably won't cut again in July.

It typically likes to move slowly and monitor the impact of its moves. Credit growth was stronger last month than expected, which reduces the pressure for another move.

That said, the fall in consumer price inflation to a 28-month low of 0% in July raises concerns about deflation. And downward pressure on the renminbi, one recent constraints on the PBOC's ability to cut rates, has eased. It wouldn't be a major surprise if the PBOC acted next week, with another small 10bp reduction, particularly if the activity data for July and Q2's GDP disappoint again.

Chart 2: Policy Rates (%)



Sources: CEIC, Capital Economics

Activity & Spending (Jun.)

Mon. 17th Jul.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Industrial Production (% y/y)	10.00	(+3.5%)	(+2.5%)	(+3.0%)
Fixed Asset Investment (ytd % y/y)	10.00	(+4.0%)	(+3.4%)	(+3.8%)
Retail Sales (% y/y)	10.00	(+12.7%)	(+3.1%)	(+6.0%)

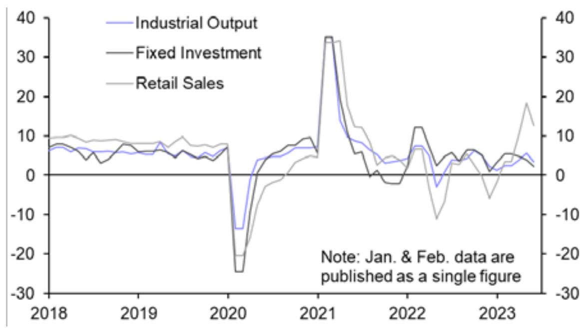
Recovery slowing as consumers turn more cautious

Growth on all the main activity indicators dropped back in May. (See Chart 3.) We think the slowdown continued in June.

Most signs, including express deliveries and services PMIs, suggest that the recovery in retail sales and other indicators for the services sector fizzled out in June. In fact, they point to a *contraction* in m/m retail sales growth.

Industry appears to have struggled as well. The manufacturing PMIs and export data point to further weakness in demand, especially from overseas. This will have been a drag on output and will have weighed on capital spending intentions of manufacturers. Together with signs pointing to still depressed property investment and softening infrastructure spending now that fiscal support has largely run its course, investment spending probably failed to make much headway. While credit growth beat expectations in June, in y/y terms it continued to slow.

Chart 3: Activity & Spending (% y/y)



Sources: CEIC, Capital Economics

GDP (Q2)

Mon. 17th Jul. / Tue. 18th Jul.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
GDP % q/q (% y/y)	10.00 (17th)	+2.2%(+4.5%)	+0.8%(+7.0%)	+1.0%(+7.8%)
Full sectoral breakdown	09.30 (18th)	-	-	-

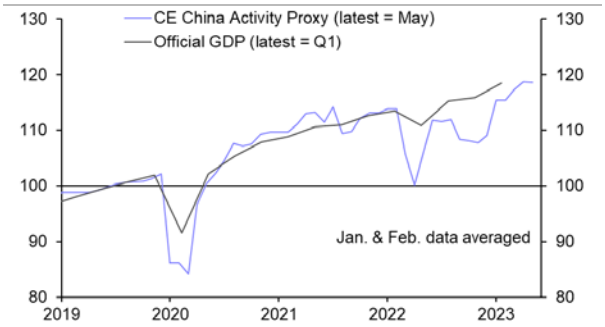
Recovery running out of steam in Q2

The economy rebounded more quickly than most had anticipated in Q1 thanks to a rapid return to normality following reopening. Favourable base effects from the lockdown in Shanghai and other large cities a year ago will have ensured that growth surged in y/y terms in Q2.

But the weakness of data in April and May, which, as discussed above, seems to have continued into June, means that growth will have slowed dramatically in q/q terms. That's already evident in the China Activity Proxy (CAP), our proprietary alternative to the official GDP data. (See Chart 4.) We've pencilled in 1.0% q/q growth on the official figures, which would be disappointing since the economy started the quarter with plenty of spare capacity.

Of course, there's no guarantee that the official data will reflect this weakness. By our estimate though, even tepid growth of 1.0% q/q would translate into growth of 7.8% y/y – above the current consensus. The recovery is struggling but is perhaps not quite as depressed as many currently think.

Chart 4: GDP & CE CAP (2019 = 100, seas. adj.)



Sources: CEIC, WIND, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
July						
Sat 15th	**Chn**	Home Prices (70 Cities, Jun.)	(09.30)	+0.1%	-	-
Mon 17th	**Chn**	1-Year Medium Term Lending Facility Rate (Jul.)	(09.20)	2.65%	2.65%	2.65%
	Chn	GDP (Q2, q/q(y/y))	(10.00)	+2.2%(+4.5%)	+0.8%(+7.1%)	+1.0%(+7.8%)
	Chn	Industrial Production (Jun.)	(10.00)	(+3.5%)	(+2.5%)	(+3.0%)
	Chn	Retail Sales (Jun.)	(10.00)	(+12.7%)	(+3.2%)	(+6.0%)
	Chn	Fixed Asset Investment (Jun., ytd y/y)	(10.00)	(+4.0%)	(+3.4%)	(+3.8%)
	Chn	Surveyed Unemployment Rate (Jun.)	(10.00)	5.20%	5.20%	5.30%
	Chn	Property Investment (Jun., ytd y/y)	(10.00)	(-7.2%)	(-7.4%)	(-12.0%)
Tue 18th	**HK**	Unemployment Rate (Jun.)	(16.30)	3.00%	-	3.00%
Thu 20th	**Chn**	1-Year Loan Prime Rate (Jul.)	(09.15)	3.55%	3.55%	3.55%
	Chn	5-Year Loan Prime Rate (Jul.)	(09.15)	4.20%	4.20%	4.20%
	HK	Consumer Prices (Jun.)	(16.30)	(+2.0%)	-	(+1.8%)
Fri 21st	**Chn**	Foreign Exchange Net Settlement and Receipts (Jun., RMB)	-	+29.1bn	-	-
Also expected during this period:						
TBC	**Chn**	Government Revenue and Expenditure (Jun.)	-	-	-	-
TBC	**Chn**	PBOC Balance Sheet Data (Jun.)	-	-	-	-

Selected future data releases and events:

July

Tue 25th	**HK**	Trade Data (Jun.)
Thu 27th	**Chn**	Profits of Large Industrial Firms (Jun.)
Also expected during this period:		
TBC	**Chn**	CBRC Data on Assets and Liabilities of Financial Institutions (Jun.)

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)*	(7.8)	(5.3)	(5.9)	(4.8)	(3.0)	(6.0)	(4.6)	(4.2)
GDP (CE CAP-derived estimates)	+7.0(+4.2)*	(11)	(7.6)	(11.2)	(4.8)	(-2.5)	(8.5)	(4.5)	(4.0)
Consumer Prices	(0.0)**	(0.2)	(0.0)	(0.5)	(1.7)	(2.0)	(0.5)	(2.0)	(1.5)
Producer Prices	(-5.4)**	(-4.1)	(-2.6)	(-1.9)	(-1.2)	(4.2)	(-2.5)	(-0.7)	(-0.9)
Broad Credit (AFRE)	(+9.0)**	(9.9)	(10.0)	(10.8)	(9.5)	(9.6)	(10.8)	(8.9)	(8.3)
Exports (US$)	(-12.4)**	(-10.0)	(-16.0)	(-5.5)	(-10.0)	(7.0)	(-8.0)	(-3.0)	(2.5)
Imports (US$)	(-6.8)**	(-6.0)	(-11.0)	(-3.0)	(15.5)	(1)	(-7)	(7.5)	(1.5)
RMB/$†	7.15	7.15	7.05	6.90	6.80	6.95	6.90	6.50	6.40
7-day PBOC reverse repo† %	1.90	1.90	1.80	1.80	1.80	2.00	1.80	1.80	1.80
1-year Loan Prime Rate† (LPR) %	3.55	3.55	3.45	3.45	3.45	3.65	3.45	3.45	3.45
1-year MLF Rate† %	2.65	2.65	2.55	2.55	2.55	2.75	2.55	2.55	2.55
10-year Government Bond Yield† %	2.69	2.75	2.80	2.80	2.70	2.85	2.90	2.70	2.60
RRR (major banks)† %	10.75	10.75	10.50	10.25	10.25	11.00	10.25	10.25	10.25
CSI 300 Index†	3,897	3,910	3,930	3,950	4,088	3,872	3,950	4,500	5,100
Hong Kong GDP	(+2.7)*	(4.0)	(9)	(10.5)	(7)	(-3.5)	(6.5)	(7.5)	(6.5)
Hang Seng Index†	19,351	19,400	19,575	19,750	23,500	19,781	19,750	23,500	27,000

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