CHINA ECONOMICS WEEKLY

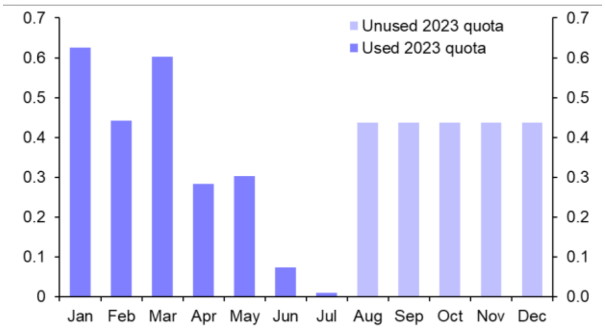
Politburo keeps stimulus hopes alive

China's leadership promises more support

The highlight of the week was Monday's Politburo meeting. Although light on specifics, the readout was dovish in tone and made clear that more policy easing is on its way. While substantial direct support for consumers still appears off the cards, the Politburo did promise measures to resolve local government debt, a step-up in state investment and adjustments to property policy. In response, Chinese equities rallied the most since last November.

With the overall direction of policy now set, a lot will depend on the follow-through. On the fiscal front, it is worth monitoring the extent to which local governments respond to the Politburo's call on them to accelerate bond issuance. This should be achievable in the short run even without any adjustments to the annual quotas. (See Chart 1.)

Chart 1: New Local Govt. Bond Issuance (RMBtrn)



Sources: CEIC, Capital Economics

If greater fiscal support is to be sustained for long, then local governments need to be given more breathing room. An increasing number are applying to participate in a pilot scheme that allows them to swap some LGFV debt for government bonds. This will help reduce their interest burden. More substantial easing, in the form of either higher local debt quotas or greater central government support, isn't out of the question but has yet to be confirmed.

As for the property sector, recent remarks by China's housing minister, published yesterday, suggest that we should expect further declines in mortgage rates and downpayment requirements, as well as continued efforts to ensure that developers have enough funds to complete unfinished projects. The key here will be the extent to which homeownership is made more accessible in tier 1 and tier 2 cities, where pent-up demand is strongest.

All told, we remain of the view that policymakers will do enough to engineer a modest reacceleration in growth during the second half of this year.

A new face at the top of the People's Bank

Pan Gongsheng was named governor of the PBOC on Tuesday. His appointment is unlikely to result in much of a shift in the trajectory of monetary policy. Having been PBOC deputy governor for over 10 years, he was a continuity candidate. His promotion suggests the Party leadership sees no need to shake up the way the PBOC conducts policy.

Compared to his predecessor, Yi Gang, Pan's earlier career in commercial banking may make him more conscious of how policy changes will affect banks, whose profitability has taken a hit from being forced to share the cost of supporting the property sector and wider economy. To help banks cope, Pan may favour RRR and deposit rate reductions, which lower bank funding costs, over cuts to the Loan Prime Rate (LPR), which reduce banks' return on their existing loan book.

That said, all three tools will likely feature to some extent in future PBOC easing. And the more important point is that Pan will not have the final say on major policy decisions. The PBOC is not independent and has to take directions from the State Council and, ultimately, the Party leadership. Pan may have slightly more political clout than Yi given that, unlike his predecessor, he is both governor and PBOC party committee chief. But he will still have less sway over the direction of policy than governors in other major central banks.

The week ahead

We think July's PMIs will signal a further loss of momentum for the Chinese economy. And Hong Kong's GDP data is likely to show slower gains in Q2, as weakness on the mainland held back the recovery of inbound tourism into the city.

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Data Previews

Manufacturing PMIs (Jul.)

Mon 31st Jul. / Tue. 1st Aug.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (31st Jul.)	09.30	49.0	48.9	49.0
Caixin/S&P Global PMI (1st Aug.)	09.45	50.5	50.1	49.5

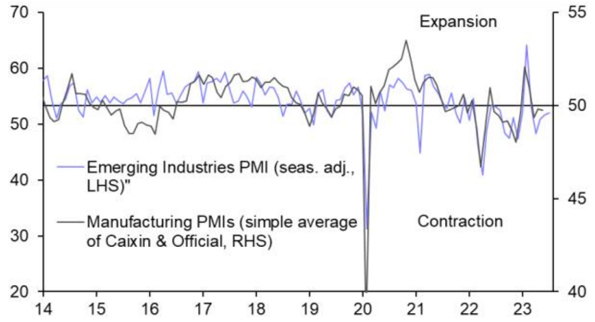
Factory activity remains under pressure

The official manufacturing PMI edged up slightly in June, while the Caixin survey dropped back. Given differences in the composition of the firms surveyed, this suggests that the recent outperformance of smaller firms and those located in export-dependent coastal areas is fading. The average of the two PMIs edged down and is consistent with some deterioration in factory activity.

Early indicators for July have so far been mixed. Steel output has picked up, but cement inventories have continued to climb and freight traffic looks to have stagnated. What's more, flash PMIs for major developed economies suggest that demand in key export markets has continued to soften.

Consistent with this, the Emerging Industries PMI – which covers high-tech parts of industry – remained under 50 in July and suggests the manufacturing PMIs likely remained weak too. (See Chart 2.)

Chart 2: Manufacturing & Emerging Industry PMIs



Sources: CEIC, S&P Global, Capital Economics

Non-manufacturing PMIs (Jul.)

Mon. 31st Jul. / Thu. 3rd Aug.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
"Official" PMI (31st Jul.)	09.30	53.2	53.0	52.0
Caixin/S&P Global PMI (3rd Aug.)	09.45	53.9	52.7	52.0

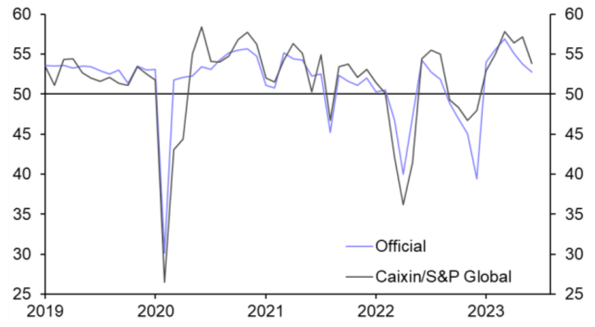
Services recovery has fizzled out

The services PMIs dropped back in June. (See Chart 3.) While they were still above 50, wider evidence suggests that the service sector was struggling to gain ground last month and may even have contracted.

The high frequency data suggest that July could be even worse. The downturn in home sales has deepened, while car sales appear to have reversed their June pick-up. Service sector job posting also continued to slide.

Construction activity, which is part of the official non-manufacturing PMI, probably softened too. With home sales still falling, it's almost certain that developers have continued to pare back new housing starts. Meanwhile, the recent slowdown in local government bond issuance may have weighed on infrastructure spending this month.

Chart 3: Services PMIs



Sources: CEIC, S&P Global, Capital Economics

Hong Kong GDP (Q2, Adv.)

Mon. 31st Jul.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
GDP q/q (y/y)	16.30	+5.3% (+2.7%)	(+3.5%)	+1.5% (+4.0%)

Recovery losing momentum

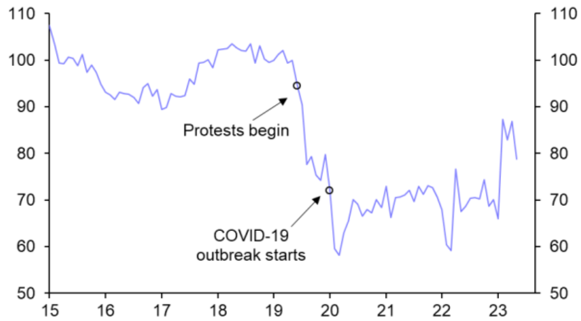
Hong Kong's economy expanded rapidly in Q1 thanks to a surge in inbound visitors, which boosted services exports and consumption. Favourable base effects will have ensured that y/y growth accelerated in Q2. But most signs suggest that the recovery softened in q/q seasonally-adjusted terms.

Across the quarter as a whole, monthly data show that goods exports picked up slightly in seasonally-adjusted terms, while goods imports contracted. Given that trade logistics account for a fifth of output, this larger surplus will have helped to shore up the economic recovery.

However, the boost looks to have been offset by softer consumption. The mobility data suggest consumer activity dropped back last quarter. And retail sales declined roughly 5% between the end of Q1 to May. (See Chart 4.)

This can be partly attributed to the lack of further gains in mainland arrivals last quarter. Economic weakness on the mainland is keeping most tourists at home. And the few that are travelling now have more options amid the resumption of many flight routes out of China.

Chart 4: 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*
July						
Mon 31st	**Chn**	"Official" Manufacturing PMI (Jul.)	09.30	49.0	48.9	49.0
	Chn	"Official" Non-manufacturing PMI (Jul.)	09.30	53.2	53.0	52.0
	HK	GDP (Q2, q/q(y/y), Adv.)	16.30	+5.3%(+2.7%)	+0.6%(+3.5%)	+1.5% (+4.0%)
August						
Tue 1st	**Chn**	Caixin Manufacturing PMI (Jul.)	09.45	50.5	50.1	49.5
	HK	Retail Sales (Jun.)	16.30	(+18.4%)	(+18.6%)	-
Thu 3rd	**Chn**	Caixin Services PMI (Jul.)	09.45	53.9	52.4	52.0
Fri 4th	**Chn**	Current Account Balance – Preliminary (Q2)	-	+$81.5bn	-	-

Selected future data releases and events:

August

Mon 7th	**Chn**	Foreign Exchange Reserves (Jul.)
Tue 8th	**Chn**	Trade Data (Jul.)
Wed 9th	**Chn**	Inflation Data (Jul.)
Fri 11th	**HK**	GDP (Q2)

Also expected during this period:

9th – 15th	**Chn**	Aggregate Financing "AFRE"
	Chn	Net New Lending
	Chn	M2 Money Supply
11th – 18th	**Chn**	Foreign Direct Investment

Main Economic & Market Forecasts

%q/q annualised (%y/y), unless stated	Latest	Q3 2023	Q4 2023	Q1 2024	Q2 2024	2022	2023f	2024f	2025f
Official GDP	+0.8(+6.3)*	(4.7)	(5.3)	(4.2)	(4.5)	(3.0)	(5.5)	(4.5)	(4.0)
GDP (CE CAP-derived estimates)	+2.5(+11.3)*	(5.8)	(8.3)	(5.6)	(4)	(-3.4)	(7.0)	(4.0)	(3.5)
Consumer Prices	(0.0)**	(0.0)	(0.5)	(1.7)	(1.7)	(2.0)	(0.5)	(2.0)	(1.5)
Producer Prices	(-5.4)**	(-2.6)	(-1.9)	(-1.2)	(-0.5)	(4.2)	(-2.5)	(-0.7)	(-0.9)
Broad Credit (AFRE)	(+9.0)**	(10.0)	(10.8)	(9.5)	(9.3)	(9.6)	(10.8)	(8.9)	(8.3)
Exports (US$)	(-12.4)**	(-16.0)	(-5.5)	(-10.0)	(-4.0)	(7.0)	(-8.0)	(-3.0)	(2.5)
Imports (US$)	(-6.8)**	(-11.0)	(-3.0)	(15.5)	(6.5)	(1)	(-7)	(7.5)	(1.5)
RMB/$†	7.17	7.05	6.90	6.80	6.70	6.95	6.90	6.50	6.40
7-day PBOC reverse repo† %	1.90	1.80	1.80	1.80	1.80	2.00	1.80	1.80	1.80
1-year Loan Prime Rate† (LPR) %	3.55	3.45	3.45	3.45	3.45	3.65	3.45	3.45	3.45
1-year MLF Rate† %	2.65	2.55	2.55	2.55	2.55	2.75	2.55	2.55	2.55
10-year Government Bond Yield† %	2.67	2.80	2.80	2.70	2.70	2.85	2.90	2.70	2.60
RRR (major banks)† %	10.75	10.50	10.25	10.25	10.25	11.00	10.25	10.25	10.25
CSI 300 Index†	3,899	3,920	3,950	4,088	4,225	3,872	3,950	4,500	5,100
Hong Kong GDP	(+2.7)***	(9)	(10.5)	(7)	(7)	(-3.5)	(6.5)	(7.5)	(6.5)
Hang Seng Index†	19,456	19,600	19,750	24,375	25,250	19,781	19,750	23,500	27,000

Sources: Bloomberg, Refinitiv, CEIC, Capital Economics *Q2; **Jun.; ***Q1; † End of period

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