CAPITAL ECONOMICS 凯投宏观

CHINA ECONOMICS WEEKLY

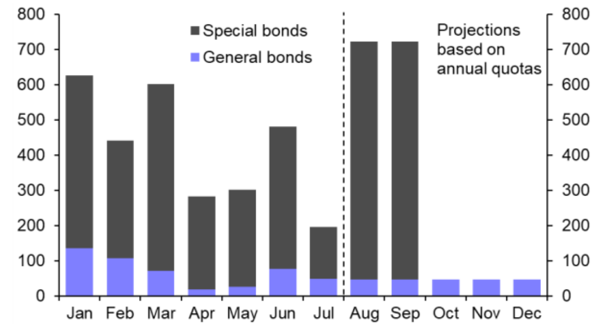
Near-term fiscal boost, follow-up measures needed

Speeding up bond issuance is a start but not enough

Following last week's dovish Politburo meeting readout, regulators have reportedly told local officials that they have until the end of next month to fully utilize their annual issuance quotas for special bonds, which are used to finance infrastructure spending. They have also been instructed to spend the proceeds by end-October.

This implies a near-term ramp-up in government borrowing (see Chart 1), which will bring forward spending, but it doesn't alter the annual fiscal stance. As such, other measures will be needed to avoid a premature withdrawal of support later in the year.

Chart 1: New Local Govt Bond Issuance (RMBbn)



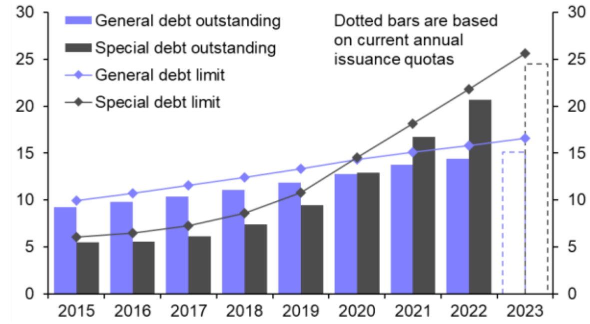
Sources: CEIC, WIND, Capital Economics

One option is to squeeze a bit more out of existing debt limits. Even after local governments fully utilize their current bond issuance quotas, their special debt will still be RMB1.15trn below the legal limit for this year. (See Chart 2.) But rumours suggest that if this is tapped to allow extra issuance, the proceeds will be used to pay off local government financing vehicle (LGFV) debt rather than fund new spending.

This would free up some fiscal room by reducing interest payments, but the gains would be small. The lowest-rated RMB1.15trn in LGFVs bonds carry a weighted average yield of 5.3% whereas the equivalent for local government bonds is 2.8%. A debt swap would therefore reduce annual interest costs by around RMB30bn, a mere 0.02% of GDP.

If this is all we get in terms of additional fiscal support this year, that would be underwhelming. It would also be a marked contrast with the second half of last year, when local governments were allowed to issue an additional RMB500bn (0.4% of GDP) in special bonds to finance new spending (though in the event, they only issued RMB321bn).

Chart 2: Local Government Debt (RMBtrn)



Sources: CEIC, Capital Economics

A debt swap doesn't preclude other forms of fiscal easing, however. In theory, the debt limits could be raised. But there are bureaucratic hurdles and history suggests that the bar for doing so is high – mid-year adjustments to budget limits have only taken place three times, most recently, to fund reconstruction following Sichuan's devastating 2008 earthquake.

More plausible is that local governments could also be allowed to issue more general bonds, which are used to fund tax cuts and day-to-day outlays. The legal limit for 2023 allows up to RMB1.43trn in extra issuance beyond what was planned in the annual budget. (See Chart 2 again.) If utilized, this could provide up to 1.1% of GDP in extra fiscal support.

In addition, policymakers may want to lean more heavily on the three big policy banks. Last year, they provided RMB740bn in capital for infrastructure projects via special financing instruments. A similar injection of cash in the coming months would go some way to shoring up growth.

The week ahead

We expect next week's data releases to add to concerns surrounding China's economy. Exports and credit growth are likely to disappoint, while headline CPI will slip into deflationary territory.

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Data Previews

Tue. 8th Aug. – Trade (Jul.)

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Exports (USD, % y/y)	-	(-12.4%)	(-12.6%)	(-15.0%)
Imports (USD, % y/y)	-	(-6.8%)	(-5.3%)	(-3.0%)
Trade Balance (USD)	-	+71bn	+67bn	+57bn

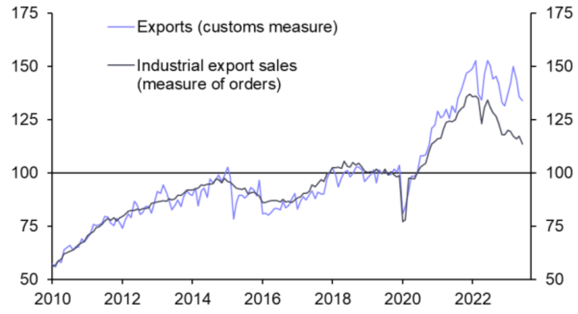
Exports haven't bottomed out yet

Export values contracted year-on-year in June by the most since March 2020. But that still leaves exports looking strong – they remain above their pre-pandemic trend, and well above the level of demand implied by firms' exports orders. (See Chart 3.)

Most signs suggest that foreign demand continued to soften in July. The export orders components of the official and Caixin PMIs, when averaged, fell to their lowest since reopening, consistent with a drop in exports. And early trade data from other countries in the region point to a decline too.

Base effects pulled down headline import growth in June, but inbound shipments edged up in seasonally-adjusted m/m terms. This rise was supported by record-high energy imports, amid a further recovery in passenger travel. We think this trend persisted in July, with fuel imports probably picking up further thanks to the recovery in international travel to and from China.

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



Sources: CEIC, Capital Economics

9th – 15th Aug. – Net New Bank Loans, M2, AFRE (Jul.)

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Net New Bank Loans (RMB)	-	+3,050bn	+750bn	+1,300bn
M2 (% y/y)	-	(+11.3%)	(+10.8%)	(+11.0%)
Aggregate Financing "AFRE" (RMB)	-	+4,220bn	+1,120bn	+600bn

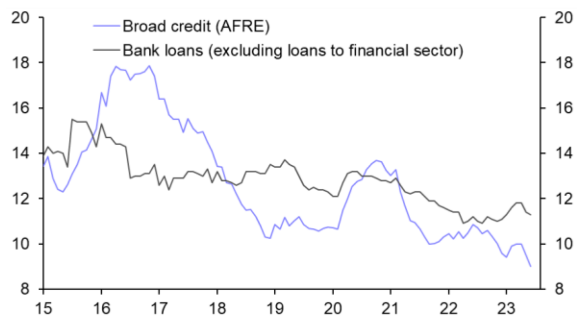
Credit demand still weak

Although stronger than most had expected, bank loan growth still fell to its lowest in five months in June, while broad credit growth dropped to a record low. (See Chart 4.) We think borrowing slowed further in July.

Admittedly, local governments have been told to accelerate bond issuance, and we are expecting a spike in their borrowing in the coming months. But preliminary data suggest that both government and corporate bond issuance were still slowing in July.

Mortgage demand probably cooled too, following further decline in new home sales. And although lending rates were lowered in June, the decline was small and won't have had much impact on private sector demand for bank loans.

Chart 4: Broad Credit & Bank Loans (outstanding, % y/y)



Sources: CEIC, Capital Economics

Wed. 9th Aug. – CPI, PPI (Jul.)

Forecasts	Time (China)	Previous	Consensus	Capital Economics
CPI (% y/y)	09.30	(-0.0%)	(-0.5%)	(-0.9%)
PPI (% y/y)	09.30	(-5.4%)	(-4.0%)	(-4.3%)

Doubling up on deflation

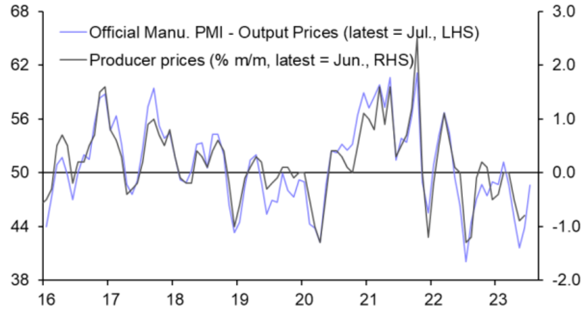
Factory-gate fell year-on-year at the fastest pace in more than seven years in June. Consumer prices were flat, the softest reading in 28 months.

Energy price deflation will have eased last month, as the higher base for comparison due to the Russia's invasion of Ukraine has started to fade. And the manufacturing PMIs suggest that factory gate prices declined at a slower pace last month. (See Chart 5.)

But headline producer price inflation will still have remained deeply negative in July. And consumer prices look to have slipped into deflationary territory as well. The main culprit will be a decline in food inflation, caused by a surge in pork prices a year ago. But core inflation will probably have softened further amid weakening demand.

Outside of a single month in 2020, this would mark the first bout of joint consumer and producer price deflation since the Global Financial Crisis.

Chart 5: Producer Prices & PMI Output Prices



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*
August						
Mon 7th		**Chn** Foreign Exchange Reserves (Jul.)	-	+$3193.0bn	-	-
Tue 8th		**Chn** Exports (Jul., USD)	-	(-12.4%)	(-12.6%)	(-15.0%)
		Chn Imports (Jul., USD)	-	(-6.8%)	(-5.3%)	(-3.0%)
		Chn Trade Balance (Jul.)	-	+$70.6bn	+$67.0bn	+$57.0bn
Wed 9th		**Chn** Consumer Prices (Jul.)	(09.30)	(+0.0%)	(-0.5%)	(-0.9%)
		Chn Producer Prices (Jul.)	(09.30)	(-5.4%)	(-4.0%)	(-4.3%)
Fri 11th		**HK** GDP (Q2, q/q(y/y), Fin.)	(16.30)	-1.3%(+1.5%)p	-	-1.3%(+1.5%)
Also expected during this period:						
9th – 15th		**Chn** Aggregate Financing "AFRE" (Jul., RMB)	-	+4220bn	+1,120bn	+600bn
		Chn Net New Lending (Jul., RMB)	-	+3050bn	+750bn	+1300bn
		Chn M2 Money Supply (Jul., RMB)	-	(+11.3%)	(+10.8%)	(+11.0%)
11th – 18th		**Chn** Foreign Direct Investment (Jul., RMB)	-	(-2.7%)	-	-

Selected future data releases and events:

August

Tue 15th		**Chn** 1-Year Medium-Term Lending Facility (MLF) Auction (Jul.)
		Chn Spending and Activity Data (Jul.)
		Chn Foreign Exchange Net Settlement and Receipts (Jul.)
Wed 16th		**Chn** Home Prices (70 Cities) (Jul.)
Thu 17th		**HK** Unemployment Rate (Jul.)

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)	(4.0)	(-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)	(1.0)	(-7.0)	(7.5)	(1.5)
RMB/$†	7.18	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† %	2.68	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†	4,020	4,000	3,950	4,088	4,225	3,872	3,950	4,500	5,100
Hong Kong GDP	(+1.5)*	(7.0)	(10.5)	(7.0)	(10.5)	(-3.5)	(5.5)	(9.0)	(6.0)
Hang Seng Index†	19,540	19,600	19,750	24,375	25,250	19,781	19,750	23,500	27,000

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

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