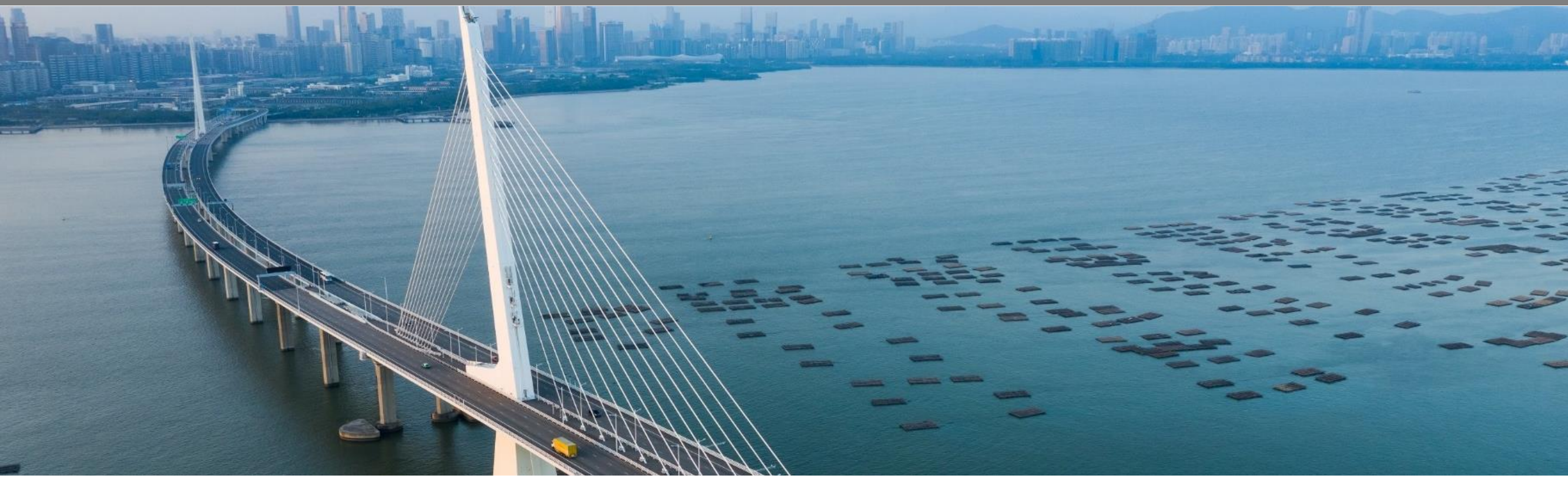
Economic Research

August 2022

Market Monitor – Mainland China

Growth Likely to Gain Momentum with Stronger Policy Support



Growing economic pressure leads to rising expectation of greater policy support

Mainland China's economy weakened significantly in Q2 amid regional Covid-19 outbreaks and stringent pandemic control measures, which disrupted consumer activity and production. Since June 2022, the government has been gradually relaxing Covid-related curbs and implemented further fiscal and monetary policy measures so as to revitalise domestic demand and stabilise employment and the hardest-hit sectors in 2H 2022. Nevertheless, property market woes are one of the most significant headwinds against economic recovery. Going forward, industrial production, manufacturing, and infrastructure investment will likely play a dominant role in driving economic growth, while consumption and pandemic-sensitive service sectors are likely to lag behind.

Mainland China's economy grew by a mere 0.4% year-on-year (YoY) in Q2, down significantly from 4.8% in Q1. In 1H 2022, the mainland economy expanded by 2.5% YoY. In a recent politburo meeting, the country's top leaders stated that they aim to achieve the "best possible results" for economic growth this year, downplaying the pre-established economic goal of around 5.5% growth. Provinces in a stronger position are encouraged to strive to meet set targets. Local governments now have greater responsibility for boosting demand, and are encouraged to make full use of special bonds and the property policy toolbox as well as ensuring the delivery of new housing.

The government has rolled out a series of specific policies aimed at shoring up the economy, especially bolstering infrastructure investment further. As well as issuing nearly all of its budgeted CNY 3.65 trillion worth of special bonds in 1H 2022, the policies also include new credit quotas for policy banks (CNY 800 billion), railway construction bonds (CNY 300 billion), and financial bonds (CNY 300 billion), etc.

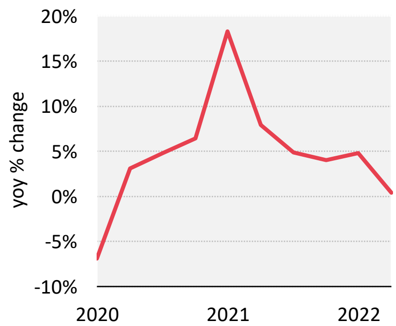
In 2H 2022, government-led infrastructure investment is expected to take the lead in the recovery, boosted by frontloading special bonds and the issuance of additional bonds. The increase in capital and infrastructure investment will drive up demand for industrial

Mainland China's economy slows sharply in Q2 amid Covid-19 outbreaks and disruption from related control measures.

Ramped-up policy support is expected to feed through to the real economy in 2H 2022.

Construction delays and associated problems will likely constrain market confidence and further weaken the property market.

Mainland China GDP Growth



Source: National Bureau of Statistics of China, data as of 15/7/2022 goods. On the other hand, households will remain somewhat cautious on discretionary spending amid evolving Covid-19 conditions, likely dampening retail sales and service sector recovery. Overall, the pace of economic recovery still hinges on the pandemic situation, related control measures, and the strength of policy support.

Favourable policies feeding through to the real economy

With the gradual relaxation of pandemic control measures, supportive measures on automobile consumption, an increasing emphasis on infrastructure investment, etc., recent economic indicators improved across the board compared to April and May.

Retail sales increased by a better-than-expected 3.1% YoY in June, after recording negative growth for 3 months in a row. Automobile sales rebounded to 13.9% YoY growth in June, after a 16.0% decline in May, amid tax incentives to buy cars.

Industrial production continued to recover from pandemic disruption, with a growth rate accelerating from 0.7% YoY in May to 3.9% in June. Resumption of industrial operations together with an easing of port congestion and supply chain disruptions has led to an accelerated 18.0% YoY growth of merchandise exports in July. Meanwhile, imports increased by lower-than-expected 2.3% YoY in July, resulting in a huge trade surplus of USD 101.27 billion.

Fixed-asset investment continued to grow by a steady 6.1% YoY in 1H 2022, though performance diverged between sectors. Manufacturing investment rose by a higher-than-average 10.4%, while real estate investment remained lacklustre with a 5.4% YoY drop in January-June. After President Xi called for an "all-out" effort to build infrastructure, infrastructure investment saw an overall increase of 7.1% YoY in 1H, up from 6.7% in January-May.

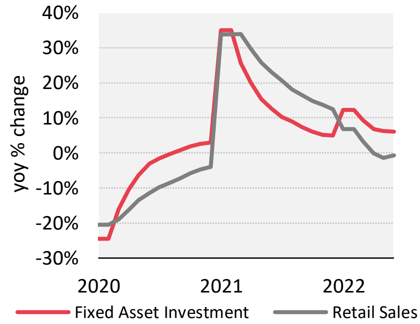
Improved financing by local governments and enterprises also boosted monetary and credit expansion in June. The growth of M2 money supply accelerated further to 11.4% YoY in June, compared to 11.1% in May, while the outstanding amount of total social financing expanded by 10.8% YoY in June, up from 10.5% YoY in May.

Unresolved property market woes further threaten market confidence

Gradual relaxation of Covid-related curbs and policy stimulus measures such as cuts in mortgage rates and the loosening of purchase restrictions facilitated an initial market recovery in June, but a series of mortgage payment suspensions highlighted the fact that property market woes continue to weigh on market confidence going forward.

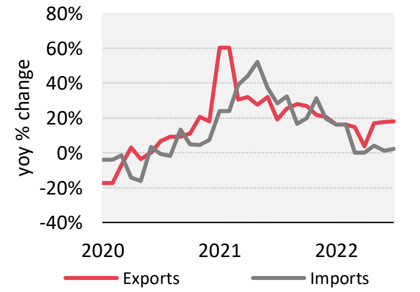
Construction delays and worries over inappropriate use of pre-sale funding by property developers have resulted in an increasing number of homebuyers suspending their mortgage repayments for unfinished construction projects, which has further dampened market confidence, constraining funding conditions for property developers and local governments as well as negatively affecting the credit quality of the financial sector. In order to prevent the situation deteriorating any further, the authorities will reportedly enhance credit support to property developers to facilitate timely completion of

Cumulative Fixed Asset Investment and Retail Sales



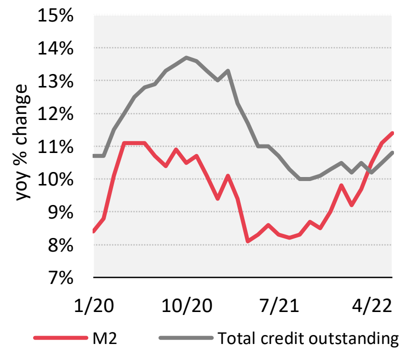
Source: National Bureau of Statistics of China, data as of 15/7/2022

Exports and Imports



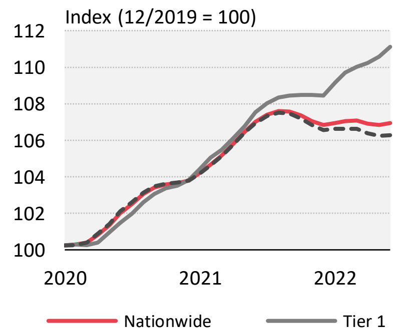
Note: Figures for January and February are the average of the two months.
Source: General Administration of Customs, data as of 7/8/2022

Credit Growth



Source: The People's Bank of China, data as of 11/7/2022

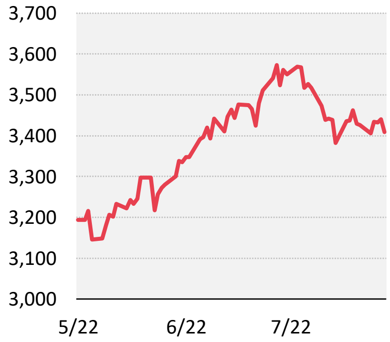
New Commercial Home Prices Index by Tiers



Sources: National Bureau of Statistics of China; BEA Economic Research Department, data as of 15/7/2022 constructions, while at the same time allowing homeowners to temporarily suspend mortgage payments on unfinished projects. A real estate fund worth up to CNY 300 billion is also reportedly to be launched to help to finish construction and resolve debt problems. While the current mortgage payment suspension incident cannot compare to the US subprime crisis, property market recovery in the mainland China will still hinge on how quickly market confidence can be restored, driven by government measures to ensure a steadier, healthier development of the sector.

New home prices in 70 major cities were stable in June, after falling 0.2% month on month (MoM) in April and 0.1% in May. Home prices in tier-1 cities still performed better, and prices in tier-2 cities also rebounded 0.1% MoM, up from a 0.1% decline in May. However, the recovery of home prices will likely be set back by the recent mortgage payment suspensions.

A Share Index



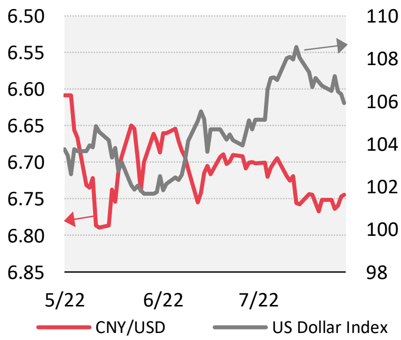
Source: Bloomberg, data as of 29/7/2022

Financial markets weighed down by weakening market sentiment

Rising pressure from fresh outbreaks of the Omicron sub-variant and property market turmoil weighed on financial market sentiment in July, impacting the performance of equities and the renminbi. The renewed spread of the Omicron sub-variant has stoked market fears about the potential reintroduction of stringent pandemic control measures, especially after Shanghai announced new rounds of mass Covid-19 testing over a 3-day period in early July. Moreover, the news of a rash of mortgage payment suspensions exacerbated market concerns about the property market and the potential for its related debt problems to spill over into the financial sector, putting greater pressure on banking and property stocks.

In the stock markets, A-shares declined by 4.3% between end-June and end-July. In the foreign exchange markets, the CNY depreciated by 0.67% against the US dollar during the same period, trading at CNY 6.7473 per US dollar, while the CNH also depreciated by 0.83%, highlighting the divergence of monetary policy stance between the mainland China and the US.

RMB/USD vs US Dollar Index



Sources: People's Bank of China, Bloomberg, data as of 29/7/2022

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