Economic Research

September 2022

Market Monitor – Mainland China

Modest Momentum Clouded by Covid-19 and Property Woes

Modest growth momentum amid subdued domestic sentiment

After a 2.5% YoY expansion in 1H 2022, mainland China's economy has continued to see modest growth momentum amid a supply-side resumption and enhanced stimulus measures, but regional Covid-19 outbreaks and the mortgage payment suspension incident are weighing on consumer activity and the property sector's recovery. Most economic indicators stayed in modest expansionary territory in July. The services sector is expected to lag somewhat behind, amid a regional Covid-19 outbreak in Hainan and other regions that led to another round of Covid-related curbs and impacted consumer and tourism-related activity again. Furthermore, the spread of the mortgage suspension has not only prolonged the property market correction, but will also impact the finances of developers, upstream suppliers and contractors, etc.

In the face of a gloomier global economic outlook, export performance and manufacturing activity still saw positive growth, but at a slower pace. Merchandise exports in mainland China rose by 7.1% YoY in August, after recording double-digit growth consecutively during May and July. With moderate import growth, the trade surplus in August registered at USD 79.39 billion, down from USD 101.27 billion in July. Industrial production increased by 3.8% YoY in July, slightly down from a 3.9% YoY uptick in June.

Against the background of slowing growth momentum, President Xi Jinping called for an "all-out" effort to build infrastructure. Growth in infrastructure investment shot up to 7.4% YoY between January and July, partially offsetting a worsening performance for the property investment. All in all, fixed asset investment (FAI) rose 5.7% YoY in the first seven months of 2022.

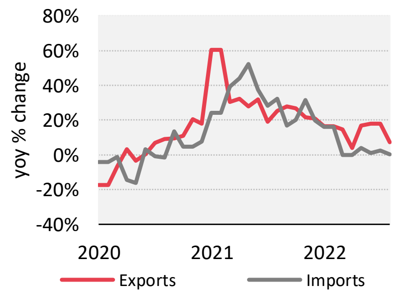
Even though the mainland authorities have offered further consumer incentives, the pace of recovery for consumer activity has remained sluggish amid more local Covid-19 outbreaks and a subdued outlook in terms of employment market. The YoY growth of retail sales eased moderately from 3.1% in June to 2.7% in July. Sales of household appliances accelerated, up from 3.2% YoY growth in June to 7.1% YoY in July, driven in

Regional Covid-19 outbreaks and prolonged property woes weaken domestic sentiment, leading to a slower pace of recovery.

Shrinkage in property sales and investment may add to pressure on property-related sectors.

Economic stability will be the government's priority in the near term, and stronger policy measures cannot be ruled out.

Exports and Imports



Note: Figures for January and February are the average of the two months.
Source: General Administration of Customs, data as of 8/9/2022

part by the government's policy initiatives for green/smart home appliance purchases. On the other hand, the restaurant sector still recorded a 1.5% YoY drop in receipts in July. Separately, the core consumer price index (CPI) declined slightly from 1.0% YoY in June to 0.8% YoY in August, indicating subdued consumer sentiment, although the headline CPI was once driven higher to 2.7% YoY by rising food prices, followed by 2.5% YoY in August.

In July, credit and financing indicators reflected ongoing policy stimulus and special bond issuance, but its momentum was impacted by a slowdown in credit demand. Alongside a front-loading of special bonds and accelerating tax refunds on the fiscal front, M2 money supply accelerated to 12.0% YoY in July. Nevertheless, the YoY growth of outstanding amount of total social financing edged down by 0.1% from previous month to 10.7% in July. In response to weak credit and economic readings in July, on 22nd August, the People's Bank of China (PBOC) reduced the 1-year loan prime rate (LPR) by 5 bps and the 5-year LPR by 15 bps. The larger reduction of the long-term LPR is expected to further ease mortgage rates with the aim of alleviating a property market downturn.

Looking ahead, the PBOC's monetary policy is expected to help the real economy recover, but not to develop into excessive stimulus. The Q2 Monetary Policy Report stressed the importance of balancing growth and price stability and achieving domestic and external equilibrium, and pledged to avoid large-scale flood-like easing.

Prolonged property woes may spill over into property-related sectors

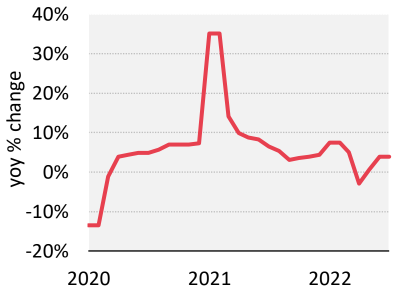
Property developers are now increasingly facing a vicious cycle of softening sales performance and construction delays. The decline of commercial residential building sales by floor space widened from 26.6% in 1H to 27.1% YoY in January-July, with the monthly growth of new home prices in tier-1 cities narrowing in July and that of tier-3 cities declining 0.3% month on month (MoM). With weaker market momentum, investment in commercial residential building declined 5.8% YoY from January to July. The ongoing property woes could pose a challenge to wider property-related sectors, such as construction materials and engineering enterprises, or even credit quality for the banking sector, meaning that stronger policy support is needed to drive a more meaningful recovery.

Government will take the lead to ensure stability against headwinds

As well as downplaying the growth target in the politburo meeting in late July, the mainland authorities are expected to prioritise economic and employment stability ahead of the 20th National Congress of the Chinese Communist Party on 16th October, with strengthening its policy support measures. The government has called for 6 economically important provinces should take the lead in stabilising the economy, and local governments are to take greater responsibility to ensure homes are completed and social welfare protected.

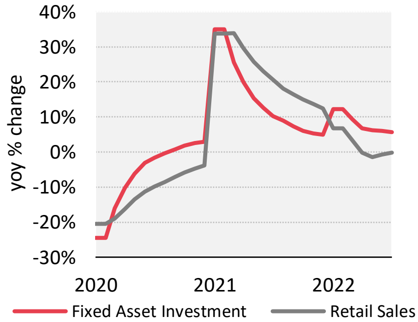
Specifically, stronger policy measures are expected to alleviate the financial pressure of enterprises, stimulate consumer confidence, and support infrastructure investment to drive economic recovery. In late-August, the State Council announced 19 new measures to bolster economic growth, including an additional quota on policy financing tools by

Industrial Production



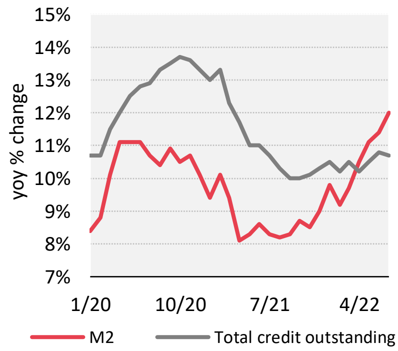
Note: Figures for January and February are the average of the two months.
Source: National Bureau of Statistics of China, data as of 15/8/2022

Cumulative Fixed Asset Investment and Retail Sales



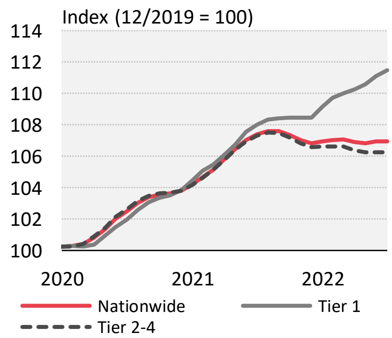
Source: National Bureau of Statistics of China, data as of 15/8/2022

Credit Growth



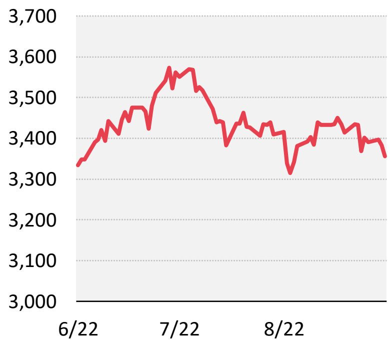
Source: The People's Bank of China, data as of 12/8/2022

New Commercial Home Prices Index by Tiers



Sources: National Bureau of Statistics of China; BEA Economic Research Department, data as of 15/8/2022 more than 300 billion yuan, support for state-run power generation companies to issue 200 billion yuan in special debt, and urging local governments to use their full limit of 500 billion yuan in existing special bonds by the end of October. Supervision and working groups will be sent by the State Council to ensure implementation of the measures at the local government level. Looking forward, economic recovery will hinge on the Covid-19 situation, pandemic control measures, property market performance, the global economy, and the geopolitical outlook.

A Share Index



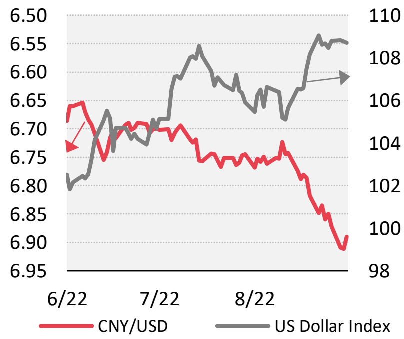
Source: Bloomberg, data as of 31/8/2022

Bleak economic outlook exacerbates weakness in financial markets

The government's policy support has been overshadowed by multiple headwinds over the past month, leading to weakening financial market sentiment. The regional Covid-19 outbreak, a prolonged property market correction, accelerating monetary tightening by major central banks, unresolved geopolitical tensions, and other factors, have induced to investors to take a conservative stance, with a stronger preference for safe-haven assets such as the US dollar. Accordingly, mainland's authorities have introduced additional measures and rate cuts in order to stabilise market sentiment. Looking forward, the trend of the mainland financial markets will likely depend on the strength of domestic stimulus measures and financial market sentiment as well as any signs of improvement in the global economic outlook.

In the stock markets, A-shares declined by 1.6% between end-July and end-August. In the foreign exchange markets, the CNY depreciated by 2.12% against the US dollar during the same period, trading at CNY 6.8904 per US dollar, while the CNH also depreciated by 2.27% (highlighting US dollar strength), fuelled by increasingly risk-averse sentiment and a divergence of monetary policy stances between mainland China and the US.

RMB/USD vs US Dollar Index



Sources: People's Bank of China, Bloomberg, data as of 31/8/2022

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