Economic Research **October 2022**

Market Monitor – Mainland China

Momentum Improves Slightly in August

Better than expected performance in August amid a bumpy road to recovery

The pace of mainland China's economic recovery was somewhat stronger than expected in August despite continuous Covid-19 outbreaks, property market weakness, regional power shortages, and a drought. Most economic indicators showed further recovery from the pandemic trough in Q2, but the property market has not yet recovered from its recent decline. Infrastructure investment, fuelled by strengthening government stimulus measures and policy emphasis, is still the bright spot driving economic growth and stabilising China's employment market. However, the rapid growth in merchandise exports has also been losing steam amid weakening global demand due to elevated geopolitical tensions and a rapidly changing monetary environment.

As a result of softening external demand, merchandise exports grew at a slower rate in August. The prolonged Russia-Ukraine conflict and rapid rate hikes by major central banks resulted in high uncertainty and weaker global demand for merchandise from mainland China, which grew by 7.1% YoY in August – marking an end to three consecutive months of double-digit growth. The trade surplus in August also narrowed to USD 79.39 billion, down from USD 101.27 billion previously, further weakening the overall support to the economic growth.

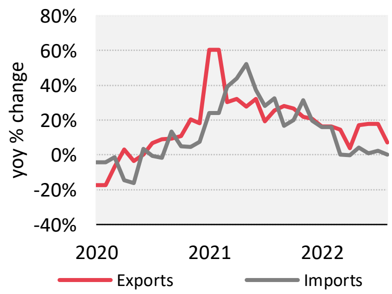
The extreme hot weather had divergent impacts on industrial production in different regions. Some provinces heavily reliant on hydroelectric power supply, such as Sichuan – which is a manufacturing centre for computers, communications, and other electronic equipment, were impacted by power shortages and drought. On the other hand, the heatwave increased demand for air conditioners in other regions. The national production and supply of electricity and heat accelerated significantly from 10.4% YoY in July to 15.3% in August. Government measures to support the automobile sector remain in place, resulting in an accelerating growth of automobile production from 22.5% YoY to 30.5% in August. Overall, industrial production registered a better-than-expected 4.2% YoY growth in August, up from 3.8% in July.

Despite multiple headwinds, economic indicators across the board are somewhat stronger than expected in August.

Property market remains under pressure, with a further relaxation of housing policy expected at the city level.

Full normalisation of China's economy is expected to take longer, with the government set to continue rolling out supportive measures.

Exports and Imports



Note: Figures for January and February are the average of the two months.
Source: General Administration of Customs, data as of 30/9/2022

The policy stimulus of frontloading the issuance of special bonds is feeding through to the real economy, but credit demand continues to slide amid the gloomier economic outlook. M2 money supply accelerated from a 12.0% YoY growth in July to 12.2% in August, the fastest growth since April 2016. With slower government financing and weak credit demand from the corporate sector, the outstanding amount of total social financing grew by 10.5% YoY in August, down from 10.7% YoY in July. In September, M2 money supply registered at 12.1% YoY. The outstanding amount of total social financing grew by 10.6% YoY, still lower than the growth rate in July. Infrastructure investment, fuelled by the issuance of special bonds, grew again from 7.4% YoY in January-July to 8.3% YoY in January-August, and momentum is likely to be sustained for the rest of 2022. However, the YoY contraction of property investment has continued to widen from 6.4% in January-July to 7.4% in January-August, weighing on overall fixed asset investment (FAI). In general, FAI registered 5.8% YoY growth in the first eight months of 2022, a slight improvement from the 5.7% recorded in the first seven months of 2022.

Retail sales accelerated at a faster than expected pace of 5.4% YoY in August, on the back of a low base of comparison. Revenue for the restaurant sector recovered to a positive growth of 8.4% YoY in August, marking an end to five consecutive months of YoY decline. Sectors benefitting from policy stimulus recorded strong YoY growth. For example, sales of automobiles recorded a 15.9% YoY increase in August, up significantly from a 9.7% gain in July. Despite a favourable headline retail sales figure in August, retail sales and consumer sentiment remain under pressure, weighed down by local Covid-19 outbreaks and stringent pandemic control measures.

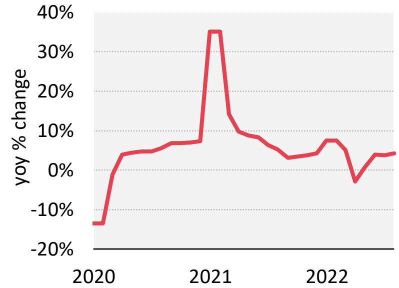
Property market remains under pressure

The liquidity issue of developers and mortgage suspension incident continue to dampen property market confidence, with enhanced government efforts to ensure project delivery, lower mortgage rates, and relax home purchase restrictions in order to restore homebuyer confidence and demand. Commercial residential building sales by floor space registered another double-digit decline of 26.8% YoY in January-August. Investment in commercial residential buildings dropped by 6.9% from January to August, furthering the YoY drop of 5.8% seen in January-July. Local governments continue to call for property developers to resume construction of unfinished housing projects, supported by financial support through targeted relending and property funds. Reportedly, President Xi has instructed high level officials to implement more supportive measures and policy relaxation to boost the property market (excluding first-tier cities). More recently, the PBOC has allowed eligible cities to decide whether to maintain, lower, or scrap the minimum mortgage rate for first-time home buyers, and reportedly calls for the banks to accelerate property-related loans. Sales performance (especially second hand housing) could likely stabilize, driven by mortgage rate cuts, the relaxation of city-level restrictions, and other supportive measures, while investment in commercial residential building might take more time to recover.

Full normalisation of China's economy taking time to achieve

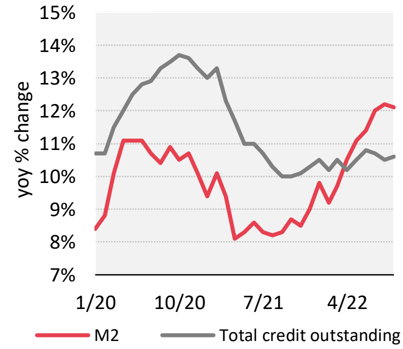
Looking ahead, the sustainable recovery of mainland China's economy will still hinge on the evolving Covid-19 situation, pandemic control measures, and property market conditions, as well as the global economic outlook. However, the mainland authorities

Industrial Production



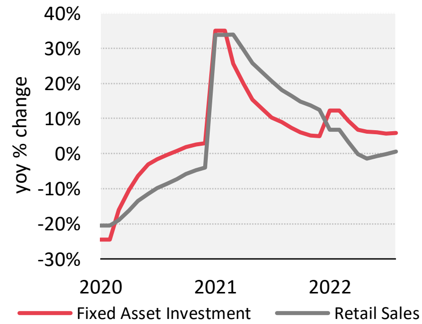
Note: Figures for January and February are the average of the two months.
Source: National Bureau of Statistics of China, data as of 30/9/2022

Credit Growth



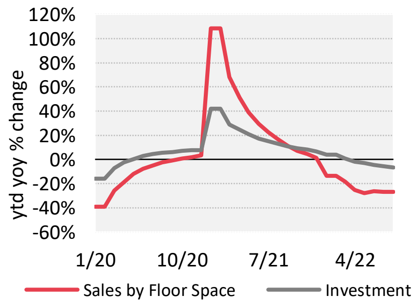
Source: The People's Bank of China, data as of 12/10/2022

Cumulative Fixed Asset Investment and Retail Sales



Source: National Bureau of Statistics of China, data as of 30/9/2022

Sales and Investment of Commercial Residential Building



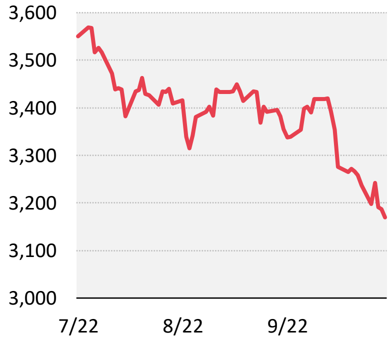
Source: National Bureau of Statistics of China, data as of 30/9/2022 have further bolstered their policy support on both the monetary and fiscal fronts. Moderate inflationary pressure should continue to provide room for policy actions to stabilise China's economic performance, which means that a further reduction of the reserve requirement ratio (RRR) cannot be ruled out entirely. On the fiscal front, the State Council will defer tax payments for manufacturing SMEs and has urged local governments to fully issue their existing quota of more than RMB 500 billion in special bonds by the end of October.

Bleaker global economic outlook exacerbates financial market volatility

In the face of rapid monetary tightening by global major central banks and escalating geopolitical tensions, the market is increasingly concerned about a global economic recession or even stagflation; leading to significant volatilities in mainland China and global financial markets. Amid the widening divergence of monetary policies between mainland China and the US, the exchange rate of RMB against the US dollar recorded some weakening. The US Federal Reserve raised the fed fund rates by 75 basis points for the third consecutive month, while policy rates in mainland China are expected to remain unchanged or slightly lower against the backdrop of ongoing Covid-19 conditions and property market correction. However, the PBOC cut the foreign exchange reserve requirement ratio and raised the reserve requirement on short yuan forward position since mid-September. They further emphasized on the two-way volatility of RMB and warned against betting on one-way appreciation or depreciation of the currency, as to better manage market expectations of a steady RMB exchange rate.

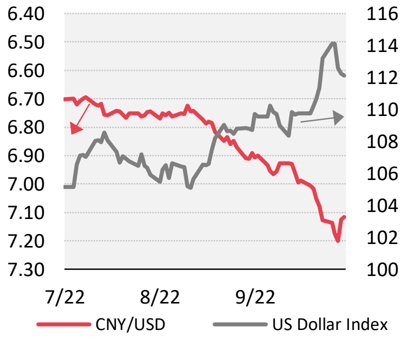
In the stock market, A-shares dropped by 7.0% in September. In the foreign exchange markets, the CNY depreciated by 3.17% against the US dollar during the same period, trading at CNY 7.116 per US dollar, while the CNH depreciated by 3.29%.

A Share Index



Source: Bloomberg, data as of 30/9/2022

RMB/USD vs US Dollar Index



Sources: People's Bank of China, Bloomberg, data as of 30/9/2022

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