Economic Research

July 2023

Market Monitor – Mainland China

A Steady Recovery with Enhanced Policy Support

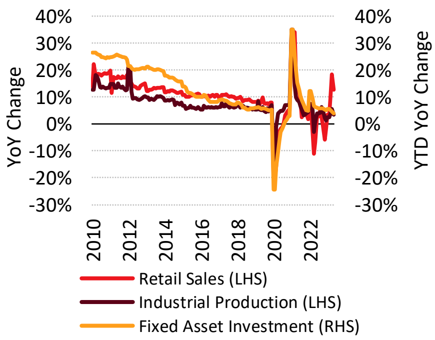
- Retail sales and services spending posted a faster growth driven by pent up demand and the normalization of economic activity after reopening.
- The investment and industrial sector maintained a steady growth led by the infrastructure and high-end manufacturing industries.
- The Mainland authorities have stepped up its policy efforts which will likely sustain a steady recovery momentum ahead.

Domestic consumption remained a key growth driver

Mainland China's economy further recovered, driven by sustained expansion in domestic consumption and steady investment and industrial activity. Monthly indicators in May showed a steady expansion, albeit at a pace slightly softer than market expectations. Pent-up demand, a normalization of economic activity and high levels of saving have powered a solid expansion in the domestic consumption market. Meanwhile, the growth of fixed asset investment and industrial production moderated. A slowing global economy also weakened external demand, dragging on trade performance.

Domestic consumption maintained a rapid expansion, fuelled by spending in services and automobiles. The services production index continued to register a double-digit growth at 11.7% year-on-year (YoY) in May, reflecting the boost from pent-up demand for travel and an increase in social activity. Production of accommodation services surged by 39.5% YoY in May, in line with the strong tourism rebound during the Golden Week Holiday. Retail sales increased by 12.7% YoY in May. Catering maintained a rapid growth at 35.1% YoY in May, being the biggest growth contributor to headline retail sales. Notable growth was recorded in the sales of automobiles at a pace of 24.2% YoY in May. This likely reflected the efforts of promotion discounts offered by car dealers and tax incentives. Other fast growing retail sectors included gold, silver & jewellery, which increased by 24.4% YoY in May, reflecting the return of large-scale social activities such as wedding

Retail Sales, Industrial Production and Fixed Asset Investment



Source: CEIC

banquets and birthday celebrations. In January - May, the services production index and retail sales jumped by 9.1% and 9.3% YoY respectively.

Fixed asset investment (FAI) and industrial production maintained a steady growth. In January – May, FAI grew by 4.0% YoY. Infrastructure investment continued to take a lead in FAI with a growth of 7.5% YoY in January – May, led by railway transportation (+16.4% YoY) and water conservancy management (+11.5% YoY), reflecting the impetus from policy-led mega projects. Manufacturing investment went up by 6% YoY in January – May, of which innovative technology and policy-supported sectors continued to receive rapid fund inflows. Property investment remained in consolidation with a YoY decline of 7.2% in January – May. Moreover, industrial production increased by 3.5% YoY in May, reflecting the diminishing impacts from the low base last year. Production in automobile and electric machinery & equipment continued to benefit from a surge in automobile consumption and industrial upgrade, rising by 23.8% and 15.4% YoY respectively, in May.

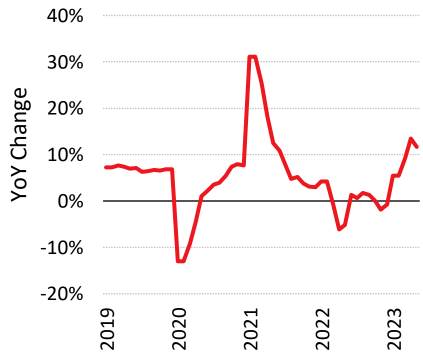
The property market maintained a gradual recovery. Sales value of property increased by 8.4% YoY in January – May, largely unchanged from the 8.8% YoY growth in January – April. As of May 2023, new home prices in 70 major cities stayed stable rising by around 1.4% when compared to end-2022. On the supply side, developers generally maintained a cautious sentiment as the floor space of newly started residential buildings is yet to rebound. Recently, certain local governments implemented policy relaxation through subsidies, reducing the down payment ratio, and raising the cap of provident fund loan for house purchases, etc. In addition to the policy support on house purchases, it is expected that more could be done on easing financial conditions and liquidity injection to higher-quality property developers to lower their financing costs and to ensure a stable housing market development.

Enhanced macro-policy stimulus to sustain steady recovery

Despite no large scale stimulus measures expected, the Mainland authorities have stepped up its policy support in the face of softening growth momentum. In mid-June, the People's Bank of China (PBoC) lowered several key interest rates in a bid to spur both consumption and investment activities. The state-owned banks, etc. lowered their interest rates on demand deposits and time deposits, while the 1-year medium-term lending facility (MLF), 1-year and 5-year loan prime rates were all reduced by 10 basis points to 2.65%, 3.55% and 4.2%, respectively. Moreover, the Mainland authorities announced an extension of the favourable tax-and-fee policies, including tax incentives on the purchase of new energy vehicles, targeted policy support to small enterprises and corporates specializing in innovative technology and major goods supply, as well as cost reduction and strong financing measures for corporations to revitalize confidence and boost employment, etc. Finally, the State Council executive meeting also unveiled plans to enhance financing for technology enterprises and to promote home appliances consumption. These policies reflected a measured and targeted approach to stabilize growth and to further support long term high quality development.

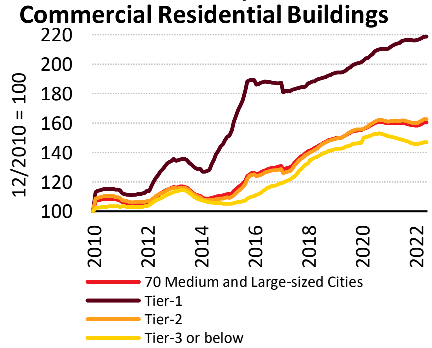
Looking ahead, the Mainland's economy is expected to sustain a steady pace of recovery. The coming Politburo meeting in July will likely assess the economic development condition in 1H 2023 and lay out an economic plan for 2H 2023. Given benign inflationary pressure, further supportive measures such as a slight reduction of the reserve requirement ratio and policy rates remain a possibility. With a focus on high quality development, upcoming policy support will likely be focused on expanding

Services Production Index



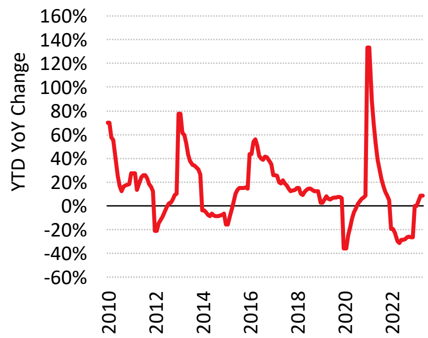
Source: CEIC

Sales Prices of Newly Constructed Commercial Residential Buildings



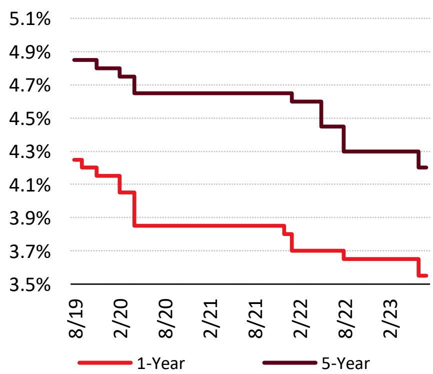
Source: National Bureau of Statistics of China, BEA Economic Research Department

Sales Value of Commercial Buildings



Source: CEIC

Loan Prime Rates



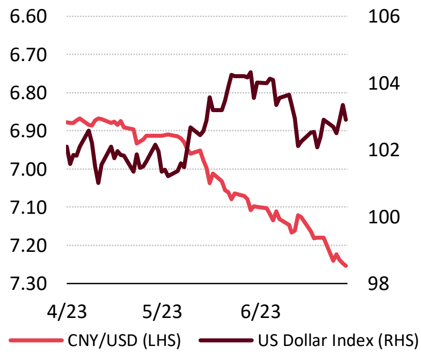
Source: CEIC

domestic consumption and further fostering technological advancement.

Investors remained cautious amid the uncertain economic and interest rate outlook

Financial markets remain volatile, largely driven by a wait-and-see sentiment. The expectations for stronger policy support and the PBoC's rate cuts in June has once boosted market sentiment. However, the softer-than-expected pace of economic recovery and rising expectations for renewed US rate hikes have reinforced a cautious sentiment. Meanwhile, the widened differential between China and the US's monetary policy has weighed on RMB performance. In June 2023, both onshore and offshore RMB depreciated by 2.0% against the US dollar compared to the previous month with CNY and CNH closing at 7.2537 and 7.2677 per US dollar respectively, while the A-shares index slightly decreased by 0.1%.

RMB/USD vs US Dollar Index



Sources: Bloomberg, data as of 30/6/2023

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