Economic indicators

China | An unbalanced economic structure with shrinking credit growth

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China’s 2024 May economic activity indicators are announced today, continuing to display an unbalanced economic structure with strong supply and weak demand, although retail sales mildly picked up. The supply side indicated by industrial production continues to be much stronger than the demand side such as investment and retail sales, although its year-on-year growth also decelerated from the previous month. In addition, fixed asset investment continues its deceleration, mainly dragged by the real estate investment, suggesting that housing market continues to be one of the prime risks of Chinese economy.

There are potentially many perspectives to explain China’s ongoing unbalanced economic structure. The supply side is supported by national policy of prioritizing high-end manufacturing, national security and green economy. By contrast, from the demand side, the consumption was dragged by the adverse impact of Covid-19 pandemic on SMEs, previous regulatory storms during 2021 which clamped down many technology and real estate firms, the “wage cap campaign” in public institutions and financial sector etc., high young age unemployment, as well as the wealth effect from dipping housing and stock market and weak sentiments etc.; while the investment continued to be significantly dragged by housing market crash. The unbalanced structure is also the important reason to understand the current deflationary environment in China as the headline CPI has been around 0% for many months in the past.

In recent months, there are many reports surging from western media in FT, WSJ etc., blaming Chinese government does not support domestic consumption but only focus on production side stimulus, such as subsidizing high-end manufacturing, green economy and national security related sectors, which leads to overcapacity for Chinese products that eventually creates large trade imbalance with advanced economies.

We agree some certain sectors exist overcapacity in China, but we cannot agree the authorities do not prioritize consumption recovery. By sharp contrast, Chinese government indeed plans to foster the economic model transformation from investment and exports driven to consumption driven and emphasized this strategy in various circumstances high-level meetings. (see our previous Economic Watch: China | Understanding China’s new growth model). Thus, we call for a more balanced view on why Chinese economy is still investment driven but not consumption driven and what is the difference between Chinese-style consumption stimulus and western style cash injection stimulus. (More detailed analysis will be found in our internal notes: China | Do Chinese authorities not intent to prioritize consumption stimulus?)

At the same time, we also observe a quite weak credit market data in both April and May. The credit shrinking reflects the weak domestic growth and particularly weak market sentiments so that households and enterprises significantly reduced their borrowing behavior and slowdown their economic activities. On the other hand, the shrinking credit also reflects a conservative central bank stance of the PBoC. Presumably, the PBoC should be conducting easing monetary measures to stimulate growth during the economic downward cycle, however, as the US FED hiked the US rate historical high, the PBoC has to be particularly cautious about conducting aggressive interest rate cuts which will easily trigger capital outflows and sharp RMB depreciation under the historical large of China-US rate reversion. (see our recent Internal Notes: China | What does China-US interest rate reversion mean for China's credit market?) The other reason for a conservative central bank in China is to take the lesson from the large RMB 4 trillion stimulus during 2008-2009 Global Financial Crisis, which led to debt overhang in both local government and SOEs and housing bubbles in the past decade.

Risks remain to focus on real estate market, local government debt, supply chain relocation outside China (see our recent Economic Watch: China | Should we worry about the falling FDI?) and geopolitics, but the systemic financial risks do not exist in China at the current stage, given the prudent monetary policy and a series of precautionary financial regulation measures. Housing market remains the top priority of the risk, which completely breaks the miracle of one-way increasing of Chinese housing price. The recent housing stimulus include: (i) Lower the First house purchase down payment ratio to 15% and second house purchase to 25%; (ii) To move the lower bound of mortgage rate for home buyers. (iii) PBoC will set RMB 300 billion re-lending pool, and to encourage local SOEs and government to purchase unsold houses as low-income housing. (iv) Only 6 cities have not lifted limited-purchasing. (v) Gov could get back the land that sold to real estate developers.

Altogether, we maintain our 2024 GDP forecast at 4.6% but we highlight the upside bias (Bloomberg consensus: 4.8%, IMF: 5%), in line with the 2024 growth target of "around 5%" set by Chinese government in the March 2024 "two sessions". The better-than-expected 2024 Q1 GDP makes our forecast easier to achieve. We also maintain our 2025 forecast at 4.2%. (See our recent China Economic Watch: China | Understanding 2024 Government Work Report)

Here are some analyses in more details regarding the May 2024 economic activities, reflecting the continuing unbalanced economic recovery with a strong supply side and weak demand side:

On the supply side, the year-on-year growth of industrial production decelerated to 5.6% from 6.7% y/y in the previous month, lower than the market consensus at 6% y/y. Its seasonal adjusted m/m growth also decelerated to 0.3% m/m from 0.97% m/m in the previous month.

By categories, the pillars of China's industrial production remain the green economy transformation sectors, including the EV cars which achieved 33.6% y/y (prior: 39.2% y/y), favored by the national policy support of green transformation and high-end manufacturing, solar lithium battery which recorded 14.8% (prior: 11.1% y/y) growth, solar electricity generation 29.1% (prior: 21.4% y/y), in line with the policy initiatives of nation's 2060 carbon neutrality target. Beyond these high-growth sectors, the main drop is cement (-8.2%) and steel (3.4%, prior: -8%), reflecting a significant slowdown in housing sector.

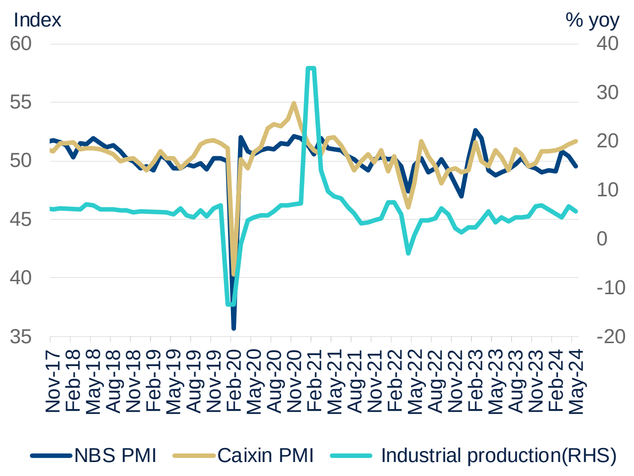
On the demand side, retail sales modestly picked up to 3.7% y/y from 2.3% in the previous month but still remains lower growth than that of the supply side, (market consensus: 3%), and its month-on-month growth also picked up to 0.51% m/m from 0.06% m/m in the previous month. The reasons for the lackluster retail sales are multi-faceted: 2021 regulatory storms which crashed down many technologies and educational firms, the lagged effect of Covid-19 on affected sectors, the "salary cap campaign" in financial and public sector, high unemployment rate in young age group dampened the sentiments of consumers, the wealth effect of dipping housing price and stock price etc. In addition, the retail sales growth is unbalanced which is tilting toward service sector and non-durable goods but not for durable goods. The fading effect of opening-up from Covid-19 also count for the consumption slowdown.

By component, the largest growth of retail sales is P.E.& entertainment etc. which achieved 20.2% (prior: 12.7% y/y) and communication equipment (16.6%, prior: 13.3%), reflecting the people resume these activities from Covid-

19 lockdown. However, restaurant sales accelerated to 5% y/y (prior: 4.4% y/y); jewelry sales -11% (prior: -0.1% y/y), etc., reflecting the adverse wealth effect as we mentioned above. (Figure 4)

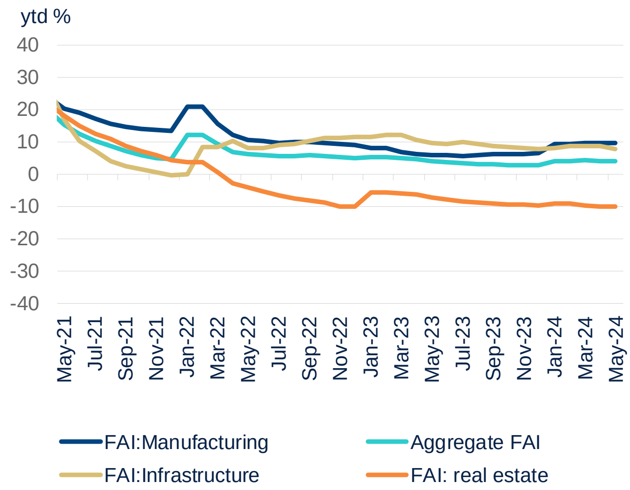
Also from the demand side, fixed-asset investment (FAI) further slowed to 4% ytd y/y from 4.2% ytd y/y previously (market consensus: 4.2% ytd y/y), while its month-on-month growth marginally improved to -0.04% m/m from -0.29% m/m in the previous month.

Figure 1. **INDUSTRIAL PRODUCTION DECELERATED**



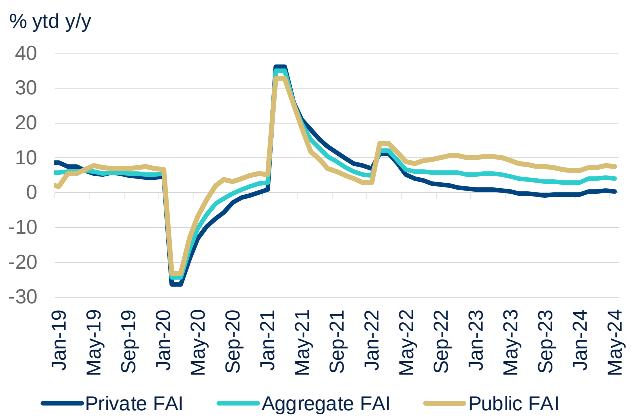
Source: CEIC and BBVA Research

Figure 2. **REAL ESTATE INVESTMENT REMAINED THE MAIN DRAG ON FAI**



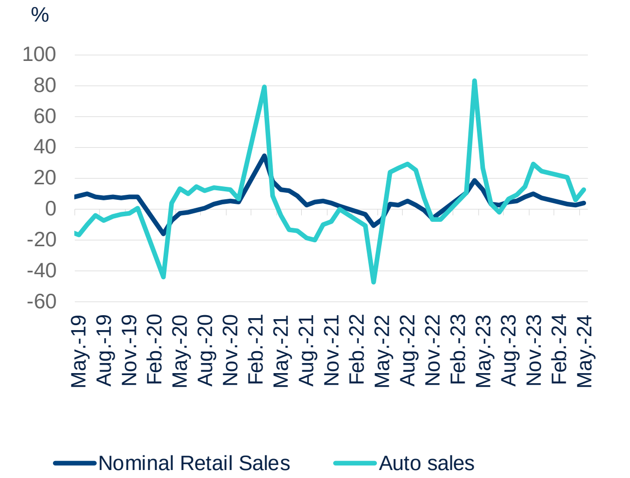
Source: CEIC and BBVA Research

Figure 3. **THE MULTIPLIER EFFECT FROM THE PUBLIC TO PRIVATE FAI IS LIMITED**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES MARGINALLY PICKED UIP TOGETHER WITH AUTO SALES**



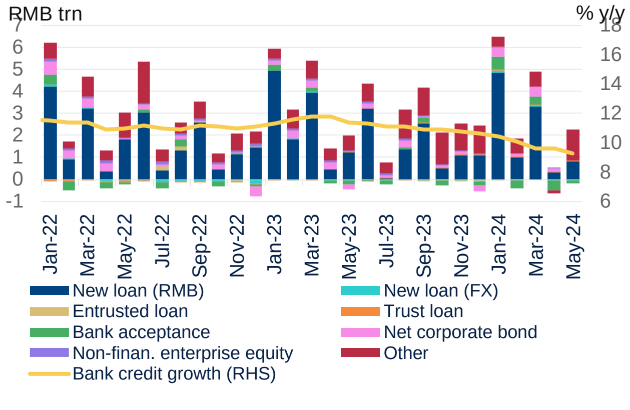
Source: CEIC and BBVA Research

By components, the main drag of FAI remained the very sluggish housing investment at -10.1% ytd y/y in May compared with -9.8% ytd y/y in the previous month. By contrast, infrastructure FAI which is supported by easing fiscal measures marginally declined to 5.7% ytd y/y from 6% ytd y/y previously, while the manufacturing FAI declined marginally to 9.6% y/y from 9.7%, surpassing infrastructure investment to lead FAI growth, showing resilience of China's manufacturing and the exports sector. However, the multiplier effect from public FAI to private FAI is still very weak, dragged by weak sentiments of private enterprises after experiencing 2021 regulatory reforms and the ongoing housing market crash. (Figure 2 and 3)

Beyond the above real economic activities, we also observe a shrinking total credit growth in both April and May. In particular, M1 growth in May even dipped to the negative territory at -4.2% y/y (prior: -1.2%), the first time going to negative in the past decades. In addition, M2 also decelerated to 7% from 7.2%. In May, total social financing reached RMB 2070 billion from prior reading at RMB -72 billion, new RMB loans marginally improved to RMB 950 billion from RMB 730 billion, still remaining at comparatively low level. Altogether, the outstanding loan growth also decelerated to 9.3% from 9.6%. (Figure 5 and 6)

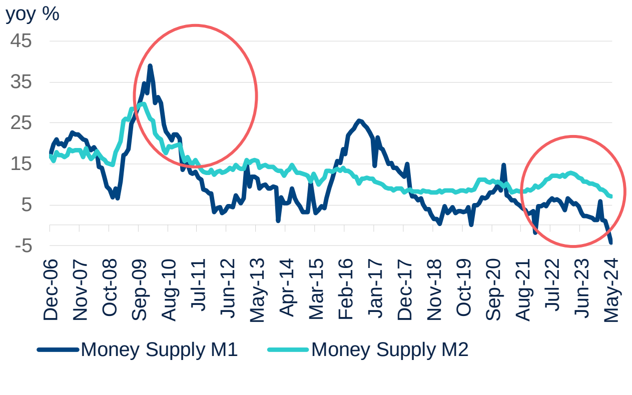
The credit shrinking reflects the weak domestic growth and particularly weak market sentiments so that households and enterprises significantly reduced their borrowing behavior and slowdown their economic activities. On the other hand, the shrinking credit also reflects a conservative central bank stance of the PBoC. Presumably, the PBoC is conducting easing monetary measures to stimulate growth during the economic downward cycle, however, as the US FED hiked the US rate historical high, the PBoC has to be particularly cautious about conducting aggressive interest rate cuts which will easily trigger capital outflows and sharp RMB depreciation under the historical large of China-US rate reversion. (see our recent Internal Notes: China | What does China-US interest rate reversion mean for China's credit market?) The other reason for a conservative central bank in China is to take the lesson from the large RMB 4 trillion stimulus during 2008-2009 Global Financial Crisis, which led to debt overhang in both local government and SOEs and housing bubbles in the past decade.

Figure 5. **A SHRINKING TOTAL CREDIT GROWTH IN BOTH APRIL AND MAY**



Source: CEIC and BBVA Research

Figure 6. **M1 DIPPED TO THE NEGATIVE REGION**



Source: CEIC and BBVA Research

In sum, the May economic activities show that Chinese economic recovery in the post-pandemic time continues to be unbalanced with a strong supply side and weak demand side. This recalls us the recent "overcapacity" criticism from the western medial. At the same time, we cannot ignore that the Chinese economy still faces a series of challenges going forward, chief among them is the deep adjustment of real estate market, local government debt overhang, deflationary environment and geopolitical risks. Thus, there will still be a long haul to sustain a robust growth momentum and to reverse the market sentiments going forward.

Based on the above, we believe Chinese economy could achieve soft-landing in 2024 with some limited and marginal bounce-back of the real estate sector. Going forward, how to reverse the real estate malaise and to balance stimulus measures and financial stability amid the high interest rate environment in the US, is always a constantly challenging job for Chinese authorities.

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