

China Watch

CHINA IN 10 CHARTS

Rory Green

- Policy shifts are a coincident indicator of economic pain and a leading indicator of recovery (often with a long lag)
- More stimulus is needed and is coming; a Q4 L-shaped recovery is on track
- The risk-reward on equities continues to improve, FX less so

August data and policy shifts offer encouraging signs for China macro. Crucially, the start of a fresh stimulus cycle will eventually lead to a cyclical bottom, with base effects turning more positive, too, as the year progresses. But we think that for now, stimulus is more pistol than bazooka and that the economy will continue to struggle with the property sector in contraction. We continue to expect weak stabilization in mid- to late Q4/23 and an “L-shaped” recovery from there onwards. As we have been noting for several weeks now, the risk-reward on China equities has continued to improve and we are reviewing our China stance in Asset Allocation, which is published later today. However, the macro backdrop still points to RMB depreciation, despite increased PBoC intervention.

Beijing is finally worried about growth. In the past few weeks, policymakers have launched concerted efforts to stabilize both activity and financial markets. As we expected, the July Politburo signalled a more expansive fiscal stance and changes on property. Beijing delivered with an acceleration of local government bond issuance and the first national level easing on property since 2016. Policy and mortgage rate cuts, along with the 25bps reduction in RRR this week, have followed (see our monetary policy dashboard and GDP pages on the TS Lombard hub for more details). Authorities, too, have turned to financial markets as confidence boosting mechanisms, making clear attempts to put a floor on equities and a ceiling on USD/CNY.

Chart 1: Fiscal flipping from contraction to expansion



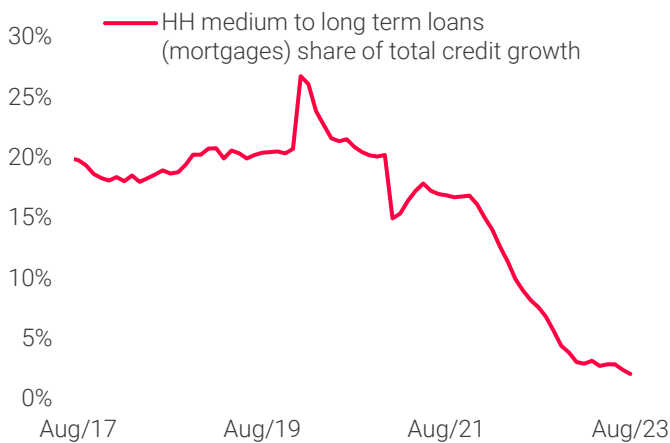
Sources: NUS, NBS, TS Lombard.

Changes in stimulus policy tend to be a coincident indicator of increasing economic and financial stress – it’s never a good sign if Beijing is worried. But they also serve as a leading indicator on the eventual stabilization of activity and improved equity returns. The lag from easing to economic outperformance can be long. We think current policy efforts are more pistol than bazooka and will prove insufficient to put a floor under the economy, particularly home sales. Another round of stimulus will likely be needed to ensure China embarks on an L-shaped growth trajectory. We think fresh easing will come in November/December.

Aggregate financing: Improving but state-driven

Lending data surprised to the upside in August with both headline borrowing and total social financing improving yoy. The rebound was largely driven by increased government bond issuance and short-term lending to corporates. Household demand for credit remained anaemic and savings continued to grow at elevated rates.

Chart 2: Cyclical balance sheet recession



Sources: NBS, PBoC, TS Lombard.

Chart 3: Velocity of money continues to slide



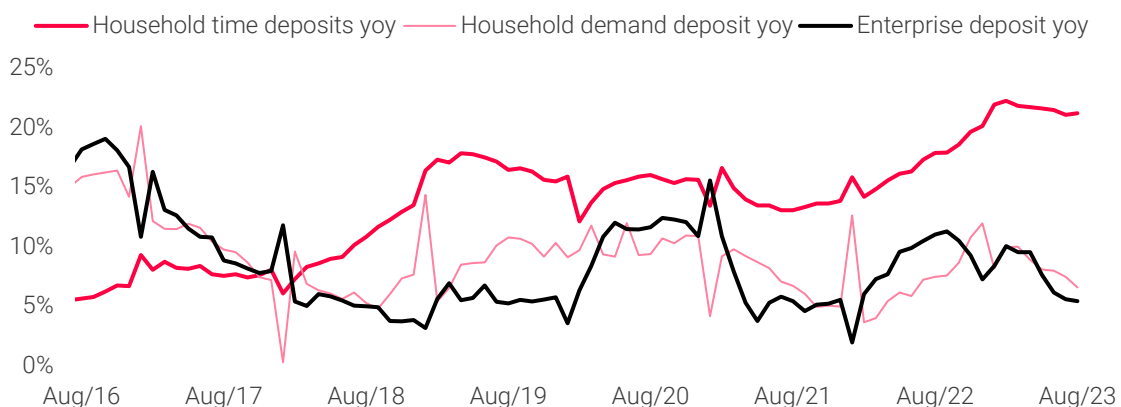
Sources: PBoC, NBS, TS Lombard.

Investment: Still waiting for infrastructure

Predictably, real estate investment continued to slump in line with the H1/23 trend. Manufacturing picked up in what is a reflection of improving domestic new-orders, which has begun to show in recent PMIs. Infrastructure surprised to the downside as increased local

Chart 4: Households still in saving mode

Rise in time deposits decrease flow of HH funds



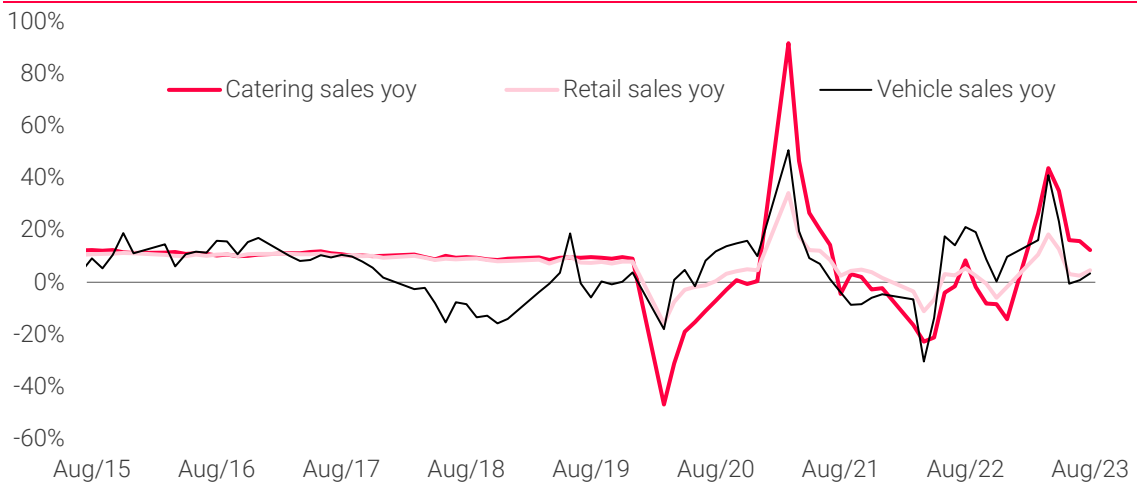
Sources: PBoC, TS Lombard.

government bond issuance has yet to feed through to the real economy. We expect this to change and infrastructure FAI to average 10% yoy in H2/23.

Consumption: Services are strong and will remain so

Vehicle purchases – which account for approximately 25% of the retail sales index – delivered a boost to sales growth, aided by EV subsidies and consumption vouchers. Ex-auto, consumer durable spending was muted, especially that tied to property. Services spending remains strong, with catering 10.4% yoy and air travel 74.5% yoy benefiting from post-pandemic demand and low base effects. The services rebound has further to run, with travel operators reporting strong sales ahead of the October holiday season. Durables spending, meanwhile, will remain subdued.

Chart 5: Services and vehicles drive spending

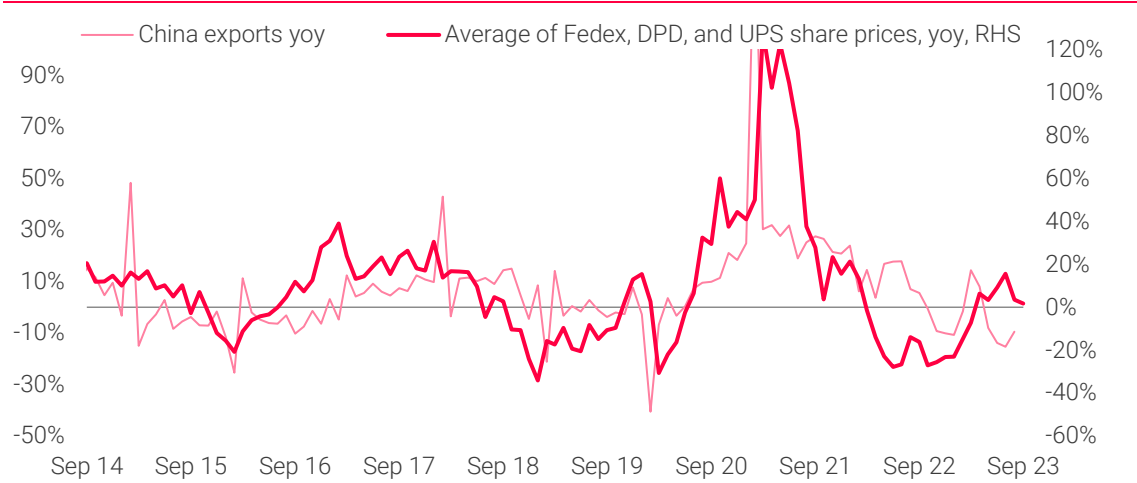


Sources: NBS, TS Lombard.

Trade: A few green shoots

Korea and Taiwan, global trade bellwethers, are showing some signs of relative improvement, with exports contracting less sharply. China, too, is benefiting from the slow end of global inventory destocking and more favourable base effects. Exports will continue to contract albeit less severely in H2/23.

Chart 6: Trade starting to bottom but still a growth headwind

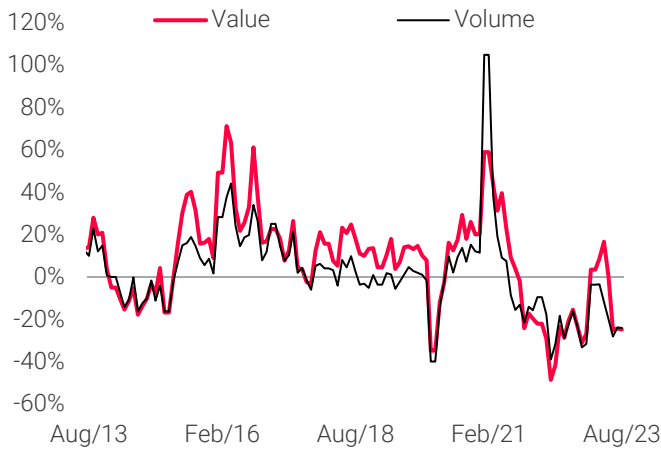


Sources: BBG, TS Lombard.

Property – Under pressure

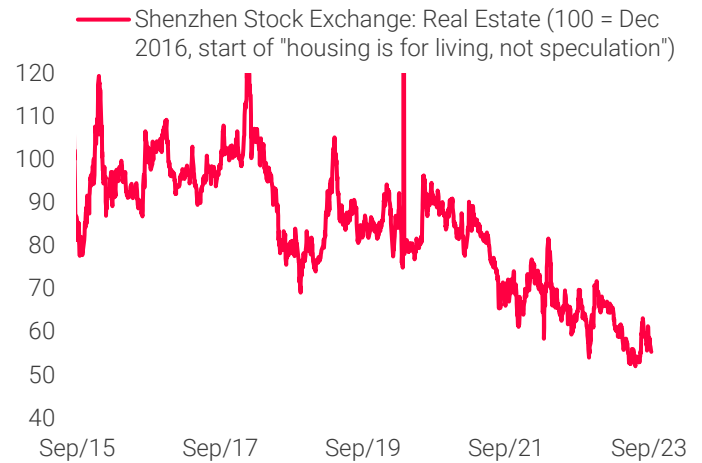
Can China stabilize with ~20% of the economy contracting? Our answer in July, was “yes,” albeit with great difficulty. Recent easing measures are helping sales in Tier 1 and 2 cities, but the acute problem has always been Tier 3 and below cities, which account for 70% of the market by volume and generate most of the economic spillovers from construction activity to land sales and wealth effects. After a brief uptick in confidence, consumers are cautious once again and will need more stimulus from Beijing to return to the market. The property slump will continue.

Chart 7: Low tier cities pull down home sales



Sources: NBS, TS Lombard.

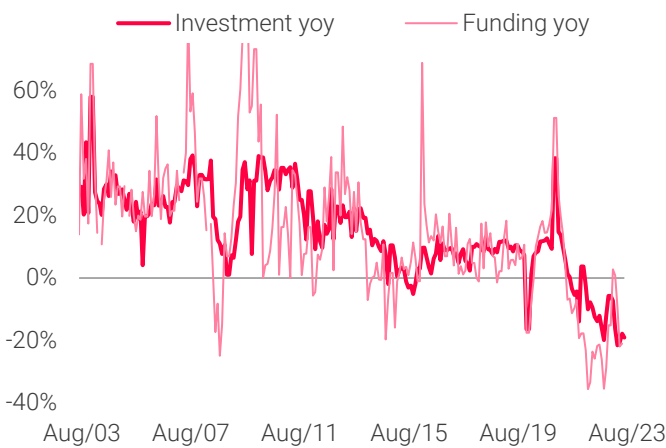
Chart 8: Property sentiment proxy rolls over



Sources: CEIC, TS Lombard.

The belated start to stimulus is welcome but the stimulus itself is insufficient to revive household confidence and property transactions. Activity will struggle to bottom with real estate in contraction and more will be needed – it is most likely to come in November/December. We stick with our “L-shaped” economic growth path from Q4/23 onwards. For markets, the risk-reward on China equities is becoming more attractive as assets near a cyclical nadir on sentiment, followed by either economic stabilization or more forceful government action.

Chart 9: Funding leads property investment lower



Sources: NBS, TS Lombard.

Chart 10: PBoC FX ceiling aims to boost confidence



Source: BBG.

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