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China's Economy Continues to Face Challenges

Double-dip decline of the economy averted, but real estate remains sluggish

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The Chinese economy continues to be weak, but with some signs of bottoming out

The Chinese economy showed signs of recovery in the January-March 2023 period, right after lifting the zero-Covid policy, but stalled immediately thereafter. Real GDP growth in the April-June period grew by +6.3% year-on-year, the highest jump in eight quarters, but the result lacked strength when taking into account special factors boosted by the rebound from last year's Shanghai lockdown (Chart 1). Nevertheless, no large-scale stimulus measures have been implemented, and the Chinese economy is increasingly slowing down, leading to growing concerns about its future prospects.

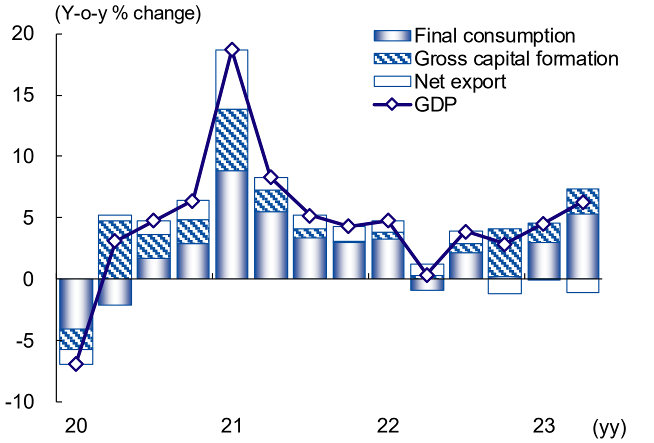
Since July, the Chinese economy has continued to face a difficult situation, especially in the sluggish real estate sector, but some economic indicators are finally showing signs of bottoming out. The August service sector production index rose by +6.8% year-on-year, up from +5.7% in the month before, reflecting a revival in service consumption held back early by the zero-Covid policy. Also, retail sales (real terms) in August accelerated +4.4% year-on-year from +2.3% in the previous month (Chart 2). Although the overall momentum of consumption is not strong amid the lackluster improvement in employment, the recovery in consumption of goods such as automobiles and telecommunication equipment, which had been noticeably weak, is a positive factor, and further deterioration of the economy has been avoided.

Inventory adjustment and improved earnings environment will ease downward pressure on production

We can see signs of an economic bottoming out in production trends in the manufacturing sector. The National Bureau of Statistics' PMI for the manufacturing sector has been improving gradually since cratering at 48.8 in May, after falling below 50 in April, the threshold for expansion or contraction, and recently recovered to a level close to 50 at 49.7 in August. The progress of inventory adjustment continuing since last year is one of the reasons for the manufacturing sector's recovery. The production-inventory balance, which is calculated by subtracting the year-on-year growth rate of inventories from the growth rate of industrial production, has recently begun to improve (production growth > inventory growth), suggesting that production is entering a recovery phase as accumulated inventories are being digested (Chart 3).

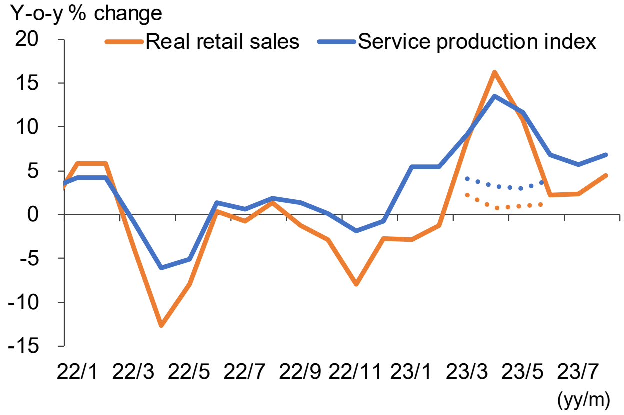
There are also signs of change in the corporate earnings environment. Since 2021, the increase in purchase prices has continued to exceed shipping prices due to soaring resource costs and the terms of trade for companies have been deteriorating. But these factors have recently begun to improve as the surge in resource prices has run its course (Chart 4). The National Bureau of Statistics reports that total profits of industrial companies for the January-August period were down 11.7% year-on-year showing that the business environment is still challenging, but the gradual easing of the impact of higher costs on the back of surging raw material prices should support a gradual pickup in production activity.

[Chart 1: Real GDP growth rate (contribution breakdown)]



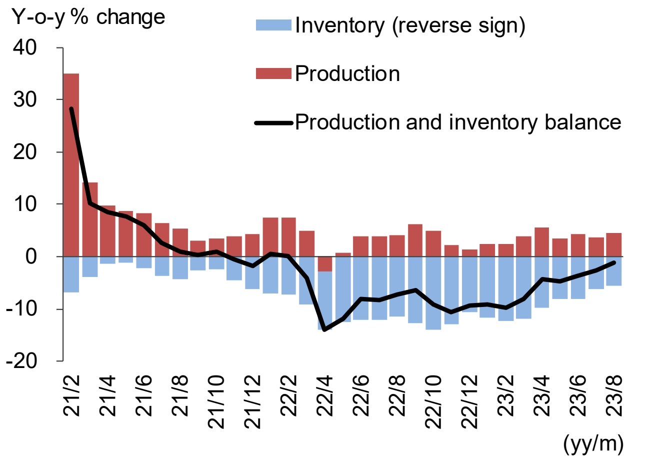
Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

[Chart 2: Real retail sales and service production index]



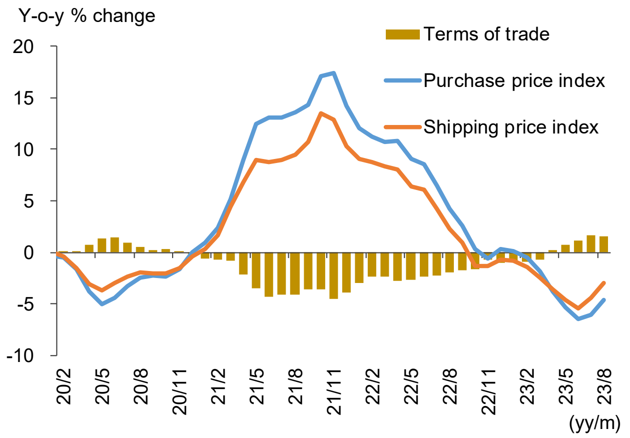
Note: Real retail sales are converted into real value by subtracting the rate of increase in CPI (consumer goods).
Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

[Chart 3: Production-inventory balance (production y-o-y minus inventory y-o-y)]



Note: Inventories are converted into real value by subtracting the year-on-year growth rate of business shipment prices (PPI).
Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

[Chart 4: Company terms of trade (shipping price y-o-y minus purchase price y-o-y)]



Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

The real estate sector continues to slump. The government is prepared to support property deliveries to prevent sentiment from deteriorating

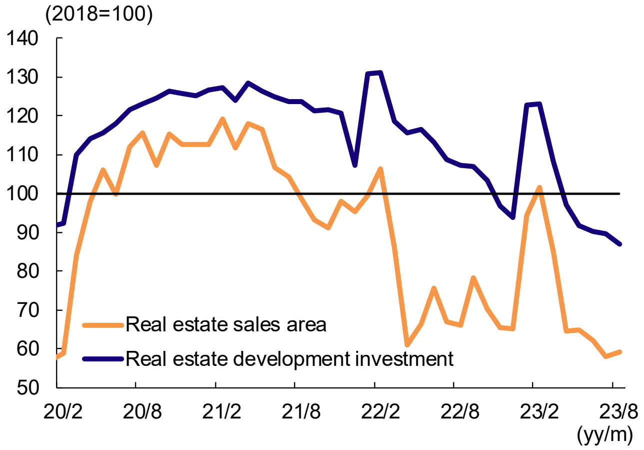
Meanwhile, the real estate sector continues to perform poorly. The real estate sales area increased for the first time in three months in August, but the degree of increase was small and the trend remains weak (Chart 5). Against the backdrop of sluggish sales, new home prices have also been negative month-on-month since June (70-city average), raising concerns that households anticipating price declines will be even more reluctant to buy homes and giving rise to a vicious cycle of "sales decline -> price decline -> reluctance to buy -> and further sales declines."

In addition, smoldering business uncertainty among developers, as seen in a major real estate developer's announcement that its bond interest payments would be postponed due to the downturn in real estate market, has also contributed to the downward pressure on the willingness to purchase homes. In China, selling properties before completion is a common practice, and a halt in building construction due to a developer's business downturn leads to growing alarm that properties purchased by loan will not be handed over, along with spiraling concerns about a pernicious cycle of "sales decline -> developers' business uncertainty -> reluctance to buy -> further decline in sales."

Amid slumping sales, investment in new development has also continued to decline. Adjusting excessive housing inventories built up due to overheated speculative development investment in the past has been held back by the current sales slump, and this has been a factor in restraining new development investment. As Kamata (2023) pointed out, pressure to adjust excess inventory will remain at least through 2024, with new development investment in real estate expected to be restrained.

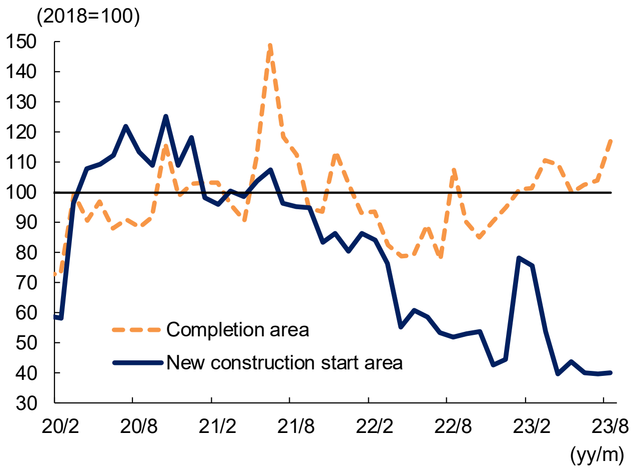
Under such difficult circumstances, the government is working to rebuild the real estate market by providing financial support to troubled real estate developers whose operations have deteriorated. Helping developers continue construction will not only solve the problem of purchased properties not being delivered, but will also help overcome the reluctance of new buyers to purchase properties. Progress, albeit slow, is seen in the resumption of housing construction and deliveries to buyers of properties whose construction had been suspended, and the "completed" area, which captures the completion and delivery of uncompleted properties, is increasing in contrast to the "new construction starts" area (Chart 6). Progress in construction of such existing projects is supporting overall real estate investment.

[Chart 5: Real estate sales area and development investment]



Note: Seasonally adjusted by MHRT.
Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

[Chart 6: Real estate new construction starts and completed area]



Note: Seasonally adjusted by MHRT.
Source: Made by MHRT based on the National Bureau of Statistics of China and CEIC.

The economy will slow to +4.8% in 2023. Adjustment in the real estate sector will exert downward pressure on the economy

Mizuho Research & Technologies expects China's economic growth rate to be +4.8% in 2023. While adjustment in the real estate sector will exert downward pressure on the economy, we believe the government’s target of "around +5%" will be narrowly achieved, supported by (1) government measures to support the real estate sector, (2) resilient service consumption, (3) progress in inventory adjustment in the manufacturing sector, and (4) government-led infrastructure investment. The government has set the issuance limit for local government bonds, the main source of infrastructure investment funds, at RMB3.8 trillion, a similar level to last year's record RMB4.04 trillion, and this will likely be a factor supporting the economy.

We anticipate the economic growth rate in 2024 to slow further to +4.4%, as the adjustment of excess inventory in the real estate sector is expected to be prolonged and the revamping of service consumption runs its course. Weak household and business sentiment due to uncertainty over the policies of the Xi Jinping administration, which has made "national security" its top priority, will also continue to be a factor weighing down economic growth in China.

Reference

Refer to the original Japanese report by clicking the URL below for the reference material

https://www.mizuho-rt.co.jp/publication/report/research/express/2023/express-as-230929.html