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AT A GLANCE | China

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Bottoming Production and Consumption, Uncertain Real Estate

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China's economy, which has been losing steam since April 2023, is now slowing to a halt. However, the shortage of demand has not been resolved, and the real estate market has been sluggish despite the announcement of a series of measures aimed at easing purchase regulations.

In this report, we will summarize the signs of the bottoming of the economy and the current state of real estate, as well as looking ahead to consider the future prospects of the Chinese economy.

In conclusion, the economy is still struggling against a backdrop of insufficient demand, but fears of a further downward spiral are receding. However, with the economy bottoming out, there is still no sign of a sustained acceleration in the pace of recovery, and no significant acceleration in growth is expected by the end of the year.

Demand Shortfall Continues, but Hopes of Bottoming Out Rise

Recent key data for August 2023 showed that investment was weaker than expected, but both production and consumption exceeded market expectations. Production was expanding, albeit at a low level, and capital investment increased. Consumption is also weak on an overall basis, but many items show improvement from the previous month.

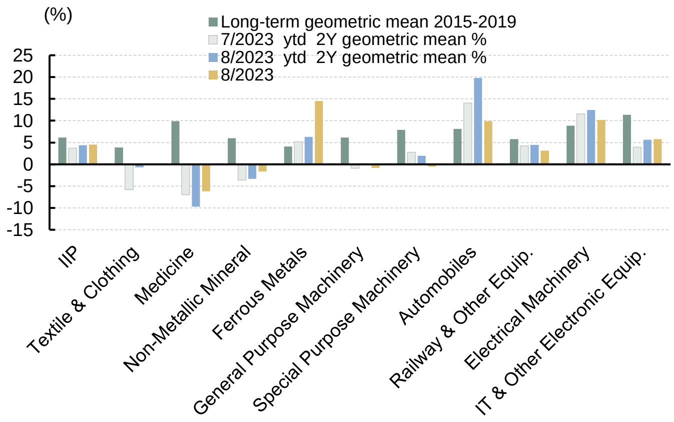
In August 2023, industrial production increased 4.5% year over year (forecast: +3.9%, previous forecast: +3.7%), faster than market expectations. The two-year geometric mean also rose 4.3% from the previous month to 3.7%.

If we look at the breakdown (Figure 1), we note that weak production has continued in many industries. However, the two-year geometric mean growth rate of automobiles, electrical machinery manufacturing, and iron and steel production is higher than the long-term average, and the production of non-metallic minerals (such as concrete), textiles and clothing, and information and communications has also improved from the previous month.

Given the third consecutive month of improvement in the manufacturing Purchasing Managers' Index (PMI) in August and the gradual recovery in new orders, it is unlikely that output will deteriorate further, at least from current levels. Of course, there is little material for a large acceleration in output growth, but the gradual expansion will continue.

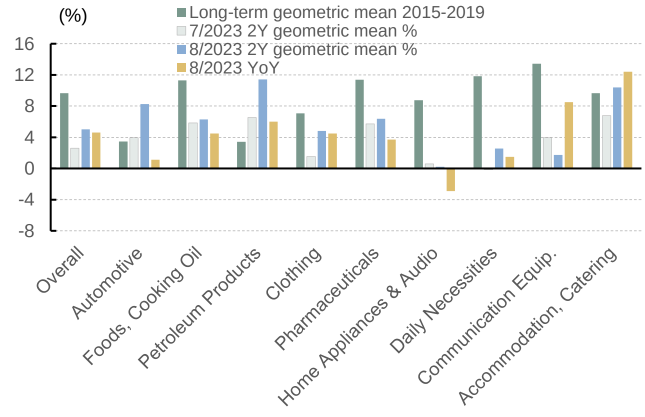
In August 2023, retail sales increased 4.6% year over year (forecast: +3.0%; previous forecast: +2.5%), faster than expected. The two-year geometric mean also increased 5.0% from the previous year (up 2.6% from the previous year), accelerating from the previous month (Figure 2).

Figure 1: Industrial Production (year over year by industry)



Sources: NBSC, Wind, SMBC

Figure 2: Retail Sales (YoY)



Sources: NBSC, Bloomberg, SMBC

Of course, overall retail sales are well below the long-term average and consumption is weak. Weakness remains in many goods when broken down by item.

However, automobile sales continued to be strong. In addition, the two-year geometric mean growth rate of petroleum products (such as fuel) as well as lodging, eating and drinking exceeded the long-term average. Given that many people were moving between cities during the summer holiday season in August, mobility data suggests that demand for driving and other activities has increased even as fuel prices remain high, and demand for lodging, food and drinks has also increased with the summer holidays. There are also reports that bookings for the next major holiday, the National Day in October, are going strong, and there are signs that consumer demand will be sustained and expanded.

On the other hand, demand for daily necessities and home appliances remained stagnant in August, and sales of information and communication devices such as smartphones continued to be sluggish. Sales of home appliances have also slowed.

However, in addition to reports earlier this month that sales of the latest smartphones from major U.S. electronics manufacturers have been booking well, the latest smartphones from major Japanese electronics manufacturers have also announced models that support 5G, using advanced semiconductors from Japan. Smartphone sales in China have been sluggish since 2022, and potential demand for replacements is expected to be commensurate, so there is still a chance that sales will rebound to normal levels.

Of course, the key to future consumption growth will be income growth, which will require improvements in the employment environment.

The urban unemployment rate improved to 5.2% in August 2023 from the previous month (5.3%) (Figure 3). Although the unemployment rate is higher than the average rate of 5.0% before the pandemic (2017–2019), it has steadily improved from 5.9% in April 2022, when Shanghai was under lockdown.

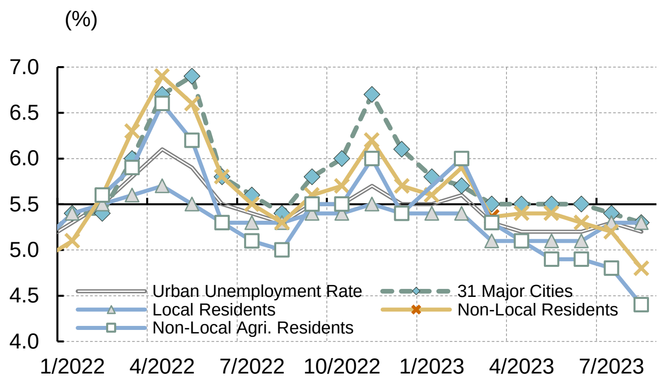
The improvement in the unemployment rate in August was led by the influx of foreign family registers (4.8%, 5.2% last month) into large urban areas to work. Among them, the unemployment rate of peasant workers with peasant family registers (4.4%, 4.8% last month) has also markedly improved, as has the unemployment rate in 31 major cities where migrant workers tend to gather (5.3%, 5.4% last month).

On the other hand, the unemployment rate (5.3%, 5.3% last month) of workers at their registered domicile, who are relatively highly educated and are considered to be naturally favorable for employment, has leveled off.

This suggests that, while the employment of workers, mainly young people (there are many university graduates, and they are more likely to aim for service jobs with higher wages and added value)—who wish to work in their permanent residence in large cities—has continued to decline, the demand for work by employees in service industries such as eating out and lodging has led to the employment of outpatient family registers. (There is a strong tendency to work in manufacturing and service industries with relatively low wages, with many middle school and high school graduates.)

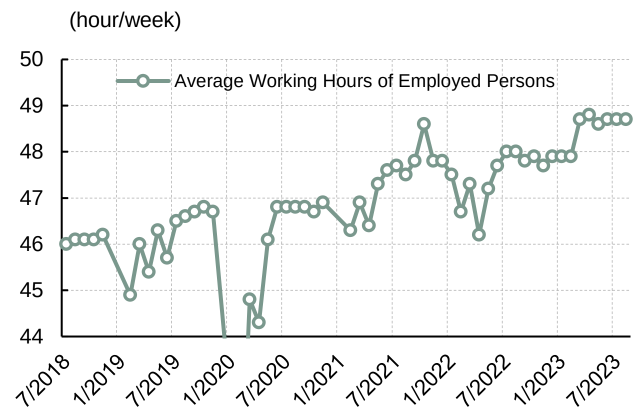
In August, however, the average number of working hours remained unchanged at a high level of 48.7 hours per week (Figure 4). This situation suggests that companies are responding to demand by expecting long working hours from existing employees while hiring only a minimum number of new employees.

Figure 3: Urban Unemployment Rate by Family Register



Sources: NBSC, CEIC, SMBC

Figure 4: Average Working Hours per Person (hours/week)



Sources: NBSC, Wind, SMBC

Naturally, improving the employment of outpatient family registers will support consumption.

However, the labor of outpatient family registers has been problematic for a long time, and it has often been pointed out that they are forced to work long hours at wages below the minimum wage. If the adoption of outpatient family registers is merely used as a means to reduce labor costs, the supporting effect of consumption will be limited.

In addition, it is unlikely that consumption will fall further from the current level, given the lack of improvement in employment for the relatively highly educated permanent resident workers who are supposed to be in the middle class. However, it is unlikely that household income growth will be sufficient to promote consumption expansion on a macro basis.

Thus, although the risk of further deterioration in production and consumption is diminishing, it is premature to expect significant growth in the near future.

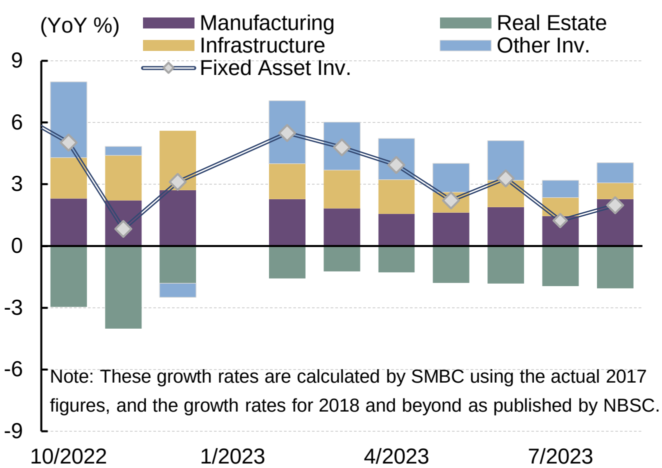
Effect of Real Estate Purchase Deregulation Has Not Been Confirmed

As for investment, which is a pillar of domestic demand along with consumption, manufacturing and infrastructure investment accelerated in August 2023, but real estate investment continued to be a key factor.

In the January-August period of 2023, fixed asset investment slowed down more than the previous month, to +3.2% (forecast: +3.3%; previous forecast: +3.4%) from the previous year, but the growth in August 2023 alone showed an increase of 2.0% from the previous month, to +1.2% (Figure 5). Real estate continued to make a significant negative contribution, but manufacturing investment, mainly capital investment, and a rise in government-led infrastructure investment from the previous month contributed positively.

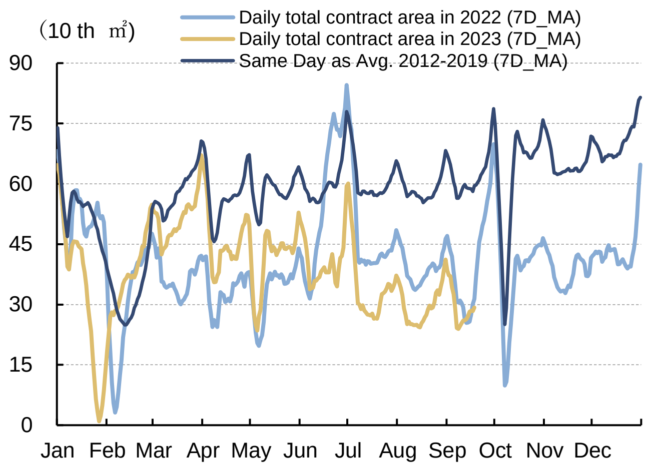
In addition to the recent moves to eliminate restrictions on home purchases in many cities, the government is easing regulations on real estate-related matters, such as a reduction in the ratio of down payments for real estate purchases and a policy of “non-authorized leasing” including in first-tier cities.[1] However, the area covered by real estate contracts, based on the high-frequency data, did not show much positive momentum even in mid-September (Figure 6).

Figure 5: Investment in Fixed Assets (monthly, YoY)



Sources: NBSC, Wind, SMBC

Figure 6: Area of Real Estate Acquired in 30 Major Cities



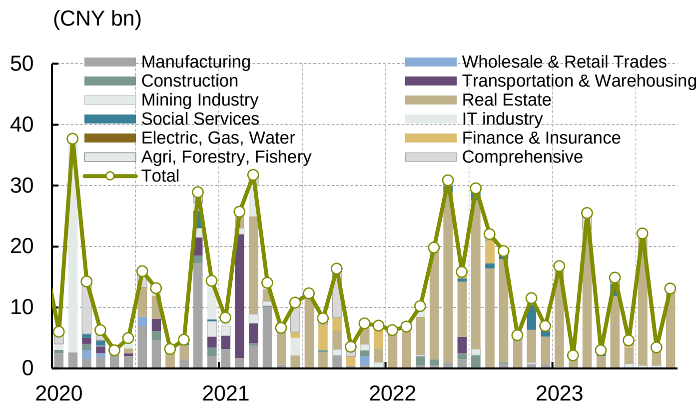
Sources: Wind, SMBC

Of course, the timing of deregulation is changing depending on the city, so we need to wait a little longer to see the overall effect of the policy. However, at the end of July, the authorities announced a specific policy to ease the credit standards on housing loans and in early August, the Zhengzhou province and others introduced the easing policies. In addition, at the end of August, the People’s Bank of China announced other support measures, such as easing the down payment ratio of housing loans.

On the other hand, we cannot rule out that the credit uncertainty has limited the recovery in housing demand due to the policy effects, since the cash flow of real estate companies is still tight and corporate bond defaults are frequent (Figure 8).

1 This is a policy that allows borrowers who do not own a home at the time of loan borrowing to use the loan for the purchase of a first home, even if they have borrowed on a home in the past. (In the past, if you had a mortgage history, you borrowed on the condition of the second unit or more regardless of the home ownership.) This makes it possible to meet the demand for housing replacement.

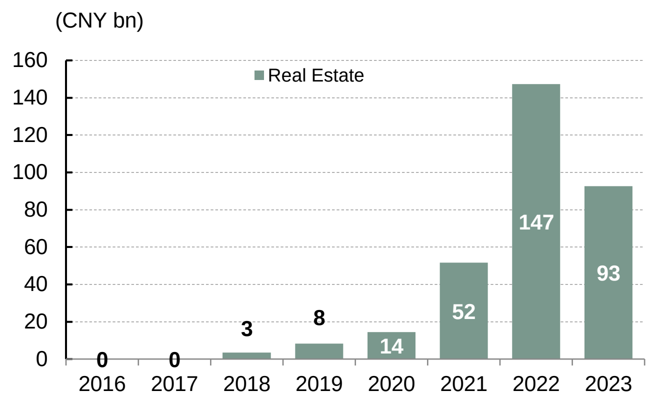
Figure 7: Corporate Bond Defaults (monthly, by industry)



Note: Data as of September 19, 2023

Sources: Wind, SMBC

Figure 8: Total Amount of Corporate Bond Defaults by Real Estate Agents



Note: Data as of September 19, 2023

Sources: Wind, SMBC

An increasing number of cities have also decided to remove the floor on the sale price of existing homes. As a result, it is positive that housing prices will fall to levels commensurate with demand and that inventory adjustments by developers will proceed. However, as long as housing prices continue to fall, a full-scale recovery in housing demand is unlikely. Therefore, it is not highly probable that the effects of deregulation by the authorities will be realized very soon.

In terms of infrastructure investment, the National People's Congress (NPC) has been steadily implementing the budget it approved in March. However, given the Politburo's meeting at the end of July, additional fiscal stimulus is unlikely, and growth is not expected to complement other investments.

With regard to capital investment in the manufacturing industry, electric machinery manufacturing (in particular, semiconductors and lithium-related products) is expected to remain strong, specifically in areas where investment is encouraged as a national policy. In addition, demand for automobile manufacturing is expanding, particularly for electric vehicles, and related investment is expected to expand.

On the other hand, if domestic household consumption expansion is limited while external demand growth is not expected, capital investment related to domestic products such as daily necessities and home appliances cannot be expected to grow. If housing sales continue to stagnate, demand for construction materials and housing equipment will be limited, and the recovery of related capital investment will be delayed.

As a result, real estate investment remains vulnerable to downside risks, though manufacturing and infrastructure investment are unlikely to fall below current levels, but there is little evidence to suggest a quickening in the pace of recovery. Thus, overall investment growth is unlikely to accelerate.

Based on the above, the risk of further economic deterioration appears to be receding, but there is little material data serving to spur the pace of economic recovery, and it is unlikely that economic growth will accelerate significantly toward the end of the year.

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	−0.6	3.2	2.6	2.0	2.1	2.5	1.2	0.6	1.0	1.2	1.7	6.0	2.1	2.1	1.2
	Inflation	5.0	5.0	4.8	4.7	4.4	4.0	3.6	3.0	2.7	2.6	2.5	3.3	5.0	4.2	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.6	3.7	3.9	4.2	4.4	4.4	4.5	5.4	3.7	3.7	4.4
Euro Area	Real GDP	0.8	0.3	−0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.3	0.4	5.6	3.4	0.5	0.8
	Inflation	8.0	9.3	10.0	8.0	6.2	5.1	3.2	3.3	3.2	3.0	2.8	2.6	8.4	5.6	3.1
	Unemployment	6.7	6.7	6.7	6.6	6.4	6.5	6.6	6.7	6.8	6.8	6.8	7.7	6.7	6.5	6.8
Japan	Real GDP	5.3	−1.2	0.2	3.2	4.8	0.9	0.8	0.9	0.9	1.1	1.1	2.2	1.0	1.5	1.0
	Inflation	2.1	2.7	3.8	3.5	3.2	2.9	2.5	2.9	2.8	2.5	2.1	−0.2	2.3	3.0	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	4.4	4.8	3.7	4.1	4.6	5.0	8.4	3.0	5.0	4.4
	Inflation	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.25 ~ 4.50	5.25 ~ 5.50	4.75 ~ 5.00
	2yr	4.43	4.03	4.90	5.00	5.00	5.00	4.75	4.75	4.75	4.43	5.00	4.75
	10yr	3.87	3.47	3.84	4.50	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	Policy rate	2.50	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	2.50	4.50	4.00
	Deposit rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.50	2.00	4.00	3.50
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	Policy rate	−0.10	−0.10	−0.10	−0.10	−0.10	−0.10	0.10	0.10	0.10	−0.10	−0.10	0.10
	2yr	0.04	−0.06	−0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.65	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr	2.39	2.41	2.11	2.05	2.00	2.08	2.15	2.25	2.35	2.39	2.00	2.35
	10yr	2.83	2.85	2.64	2.50	2.45	2.50	2.55	2.60	2.65	2.83	2.45	2.65

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 152.00	133.00 ~ 147.00	131.00 ~ 145.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 142.00	113.47 ~ 151.95	127.23 ~ 152.00	126.00 ~ 145.00
	End of quarter	131.12	132.86	144.31	145.00	140.00	138.00	133.00	135.00	135.00	131.12	140.00	135.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0806 ~ 1.1033	1.0635 ~ 1.1095	1.0300 ~ 1.1300	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1300	1.0000 ~ 1.1100
	End of quarter	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81 ~ 148.40	124.40 ~ 145.67	142.55 ~ 158.00	149.00 ~ 163.00	144.00 ~ 158.00	138.00 ~ 152.00	133.00 ~ 147.00	136.00 ~ 150.00	136.00 ~ 150.00	124.40 ~ 150.00	137.39 ~ 163.00	133.00 ~ 152.00
	End of quarter	140.41	144.01	157.43	155.15	148.40	144.90	139.65	143.10	143.10	140.41	148.40	143.10
Crude Oil Prices (WTI)		82.64	75.99	73.67	80.00	82.00	82.00	76.00	77.00	78.00	98.74	77.92	78.25

※ Crude oil prices are averages for each period. Source: SMBC.

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