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China Economics Update: Soft Oct eco data points to continued policy support

中国经济评论: 10 月数据走弱，料政策持续维稳

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10 月份的经济数据走弱。尽管线上销售有所帮助，但零售数据总体疲软凸显了疫情防控政策的影响。环保措施的收紧则对能源密集行业的生产有所抑制，但高科技产业增速依然强劲。我们预计受疫情等因素影响，未来数月增长将继续承压，但经济表现预计好于第二季度的低谷。

疫情防控政策调整对经济的利好仍有待时日。最近宣布的疫情防控的优化措施将为消费提供一些支持，但由于动态清零政策的总体目标保持不变，我们预计短期内整体效果仍然有限。但政策调整为明年疫情防控政策进一步放宽奠定基础，有利经济的显著改善。

预计宏观政策继续保持支持态势。政府对房地产行业的支持立场预计持续，有利于降低地产行业的金融风险。短期央行的流动性政策预计保持稳定宽松，公共投资有望保持稳健增长，特别是能源转型等行业，对短期经济增长有所支持。

Oct economics data missed expectations across the board, reflecting Covid restrictions and the soft property sector. Disappointing retail sales highlighted the impact of Covid restrictions, despite some offset from online sales. The tightening of environmental restrictions also curbed production of the energy intensive sectors, but high-tech output growth remains strong. We expect the headwinds to growth to continue in the coming months though the economy is likely to be better than it was in the trough in 2Q.

Boost to economic growth from Covid policy relaxation will take time to materialize. Although recently announced measures on fine-tuning Covid controls will lend some support to consumption, we expect the overall effect to be marginal in the near-term as the broad goal of the Dynamic zero-Covid policy remains unchanged. More relaxation could come next year, however, paving the way for significant improvement.

Macro policies to remain supportive. The government's supportive stance towards the property sector is likely to continue, reducing financial risks in the sector amid economic headwinds. Liquidity policy is likely to stay accommodative and public investment to remain solid led by priority areas such as the energy transition.

Softer-than-expected industrial production and retail sales

Industrial production (IP) growth slowed more than expected in Oct (actual: 5%YoY versus consensus: 5.3%YoY). Sequential growth slowed from 0.8% MoM in Sep to 0.3% MoM, slower than historical averages. The slowdown was evident in most sectors except pharmaceuticals and electric machinery (Fig 1).

- Growth in **mining** output moderated to 4%YoY in Oct, the slowest pace since Sep 2021. Growth in **electricity and utility production** output rebounded slightly to 4%YoY, as high base effects in Sep to Oct 2021 caused by electricity shortages, had gradually faded.
- Growth in **manufacturing production** decelerated from 6.4% YoY in Sep to 5.2% in Oct. Despite a broad slowdown, high tech manufacturing, such as electric machinery and computer & electronic equipment, continued to outstrip overall manufacturing, with output growth accelerating to 10.6%YoY, the fastest pace since Mar 2022. Auto manufacturing output growth eased to a still-solid 18.7% YoY in Oct. We expect the boost in production from the recovery in auto supply chains this year to fade in the months ahead.

Retail sales in Oct were weaker than the consensus forecast because of the imposition of Covid restrictions in a growing number of Chinese cities (Fig 2). Total Covid cases have risen since the start of the National Day Holidays (1 Oct). Local authorities responded with rigid pandemic control measures including restrictions on mobility that weighed on consumer spending. Retail sales contracted 0.7% MoM or 0.5% YoY in Oct. Catering services bore the brunt of Covid restrictions, contracting 8.1% YoY, though spending in consumer goods was affected too. Online shopping growth jumped 22%YoY in Oct, offsetting some of the weakness in offline activities.

Fixed Asset Investment (FAI) growth slowed to 5% YoY in Oct by our estimate (Fig 3), with falling real estate investment the main drag. By category:

- **Despite some softening, broad infrastructure investment continued to grow at double-digits** in Oct, **reflecting investment for energy transition and other prioritized areas.** Investment growth in traditional infrastructure such as transportation, water conservancy and postal services, stepped down slightly to 9.4% YoY. Investment growth in broad infrastructure investment, including investment in the utilities sector, remains at a solid 12.6%YoY, pointing to accelerated investment to facilitate the energy transition.
- **Manufacturing FAI growth** dipped to 6.9% YoY in Oct. However, according to the NBS, high-tech investment continued to expand strongly at 20.5% YoY in Oct over the past ten months. The strong push into high tech sectors will remain the medium-term investment theme given industrial upgrades and growing US technology restrictions. This is consistent with our view of a new capex cycle in China, despite macro challenges.
- The contraction in **real estate investment** widened to 16%YoY in Oct, signaling a deepening property downturn and a call for prompt policy support.

Property indicators continued to fluctuate at recent bottoms in Oct. The contraction in property starts and property under construction narrowed slightly. However, the contraction in the volume of property completions and property sales widened. High frequency data showed the recent rebound in property sales lost momentum, probably because of tighter Covid restrictions (Fig 4).

Our view:

The softer data in Oct points to slowing economic momentum as Covid cases began resurging in early Oct, with consumption and housing remaining weak. Northern China tends to tighten environmental restrictions in winter, curbing production in some upstream industries. We expect this to weigh on the growth recovery in coming months, although downside pressure is unlikely to be as severe as it was in 2Q22. While Chinese trade growth moderated as global manufacturing expansion slowed (Fig 7), trade momentum remained benign and closer trade integration between China and regional partners provided an offset that supported overall trade growth (Fig 8).

On 11 Nov, the Chinese government announced a set of 20 measures to optimize its Covid policy, likely reflecting concerns over the rising cost of pandemic controls. The 20 measures include shortening quarantine requirements for travelers and close contacts, ending the screening of secondary close contacts, minimizing the number of people subject to lockdowns or health monitoring, and curbing excessive Covid policy responses by local governments.

Although less rigid Covid restrictions at the local level may boost consumption at the margins, we expect the overall impact from the new measures on near-term growth to be limited. Health authorities have re-emphasized that the updated policy is designed to improve anti pandemic measures rather than loosen virus controls. The bulk of the existing Covid restrictions, such as centralized quarantine, remain in place.

The new guidelines lay the groundwork for a further relaxation in Covid policy next year, however. For example, the health authorities are calling for an increase in vaccination rates among the elderly and expanded intensive care capacity. This will help to lay the ground for more meaningful economic recovery in 2023.

Continued policy accommodation

On the housing front, policymakers announced 16 new measures to improve funding for cash strapped property developers on 14 Nov 2022. Some of the key measures include allowing the extension of existing construction/trust loans by a year, supporting bond issuance of high-quality developers facing tight liquidity, and encouraging trust companies to support developers' reasonable financing demands. Previously, banks cut financing to property developers even if the developers had no cash flow pressure after the introduction of the "Three Arrows" policy (details from our property analyst here).[1] Furthermore, on 8 Nov, the National Association of Financial Market Institutional Investors (NAFMII) announced measures to support bond issuances by private property developers backed by refinancing loans from the PBoC.

The Oct data shows overall funding for the property sector remains tight. Funding for the current year contracted by 26% YoY. The latest policy measures are likely to alleviate some of the financial stress faced by developers amid a sluggish housing market exacerbated by pandemic controls. Despite lower mortgage rates and cash incentives offered by local governments, the outlook for housing demand remains dim because of the soft outlook for employment and income among households. China's urban surveyed unemployment rate was unchanged in Oct at 5.5% for the second consecutive month. By contrast, youth unemployment remained elevated at 17.9% in Oct (Fig 5). Targeted measures should reduce financial risk and prevent the liquidity crunch faced by developers from spreading.

Public investment growth should remain solid for the remainder of 2022F. Media reports suggest some provinces have started to issue early batches of the 2023 bond issuance quota, likely to support infrastructure investment, which has registered strong growth in recent months.

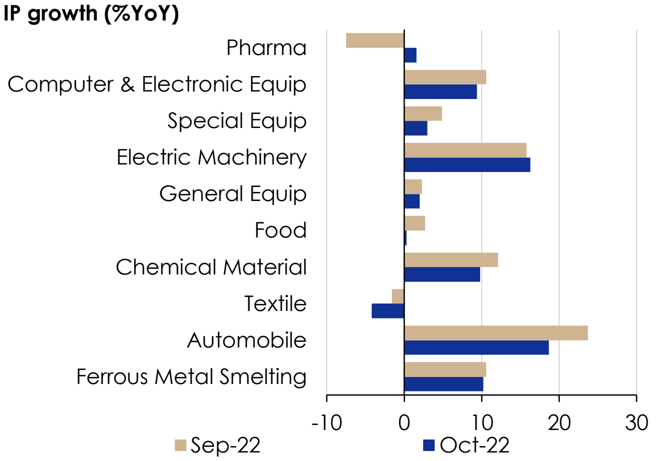
Accommodative monetary policy is expected to continue. The PBoC rolled over RMB850b of RMB1t in maturities of the Medium-term Lending Facility (MLF) through Open Market Operations (OMOs) today while leaving the MLF rate unchanged at 2.75%. The PBoC attributed the partial MLF rollover to a large long-term liquidity injection of RMB320b through PLS and other re-lending facilities earlier this month. We expect the PBoC will focus on increasing credit demand while maintaining current policy interest rates in the near term.

The 20th Party Congress Report laid out a medium-term development blueprint (details here).[2] The Central Economic Work Conference (CEWC), typically held in Dec, should shed light on the policy agenda for 2023.

[1] *CCBIS–China Property: Financials to support property* (14 Nov 2022)

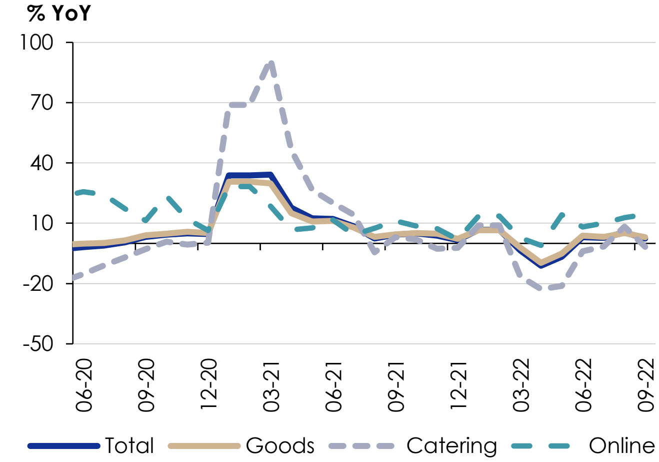
[2] *CCBIS– China Economics Update: 20th Party Congress – focused on high quality growth while aiming for modernization with Chinese characteristics* (16 Oct 2022)

Fig 1: High-tech manufacturing growth remains strong



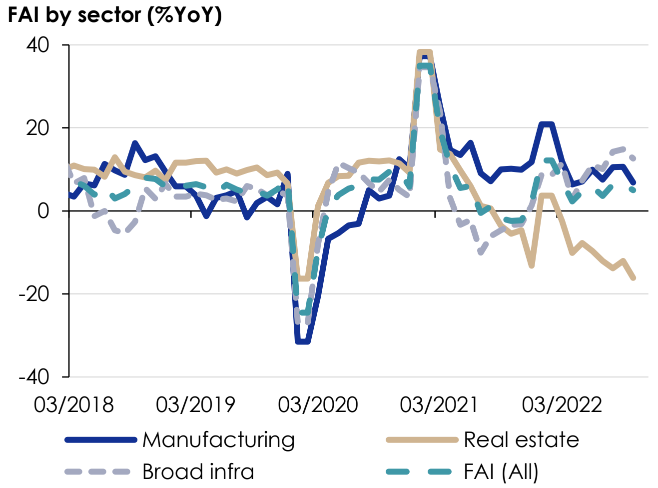
Source: NBS, CCBIS

Fig 2: Weak retail sales growth reflects Covid impact



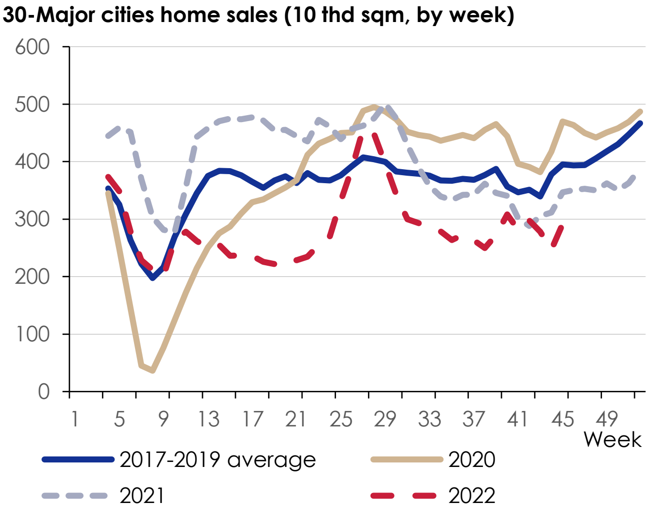
Source: NBS, CCBIS

Fig 3: Infrastructure investment remains supportive



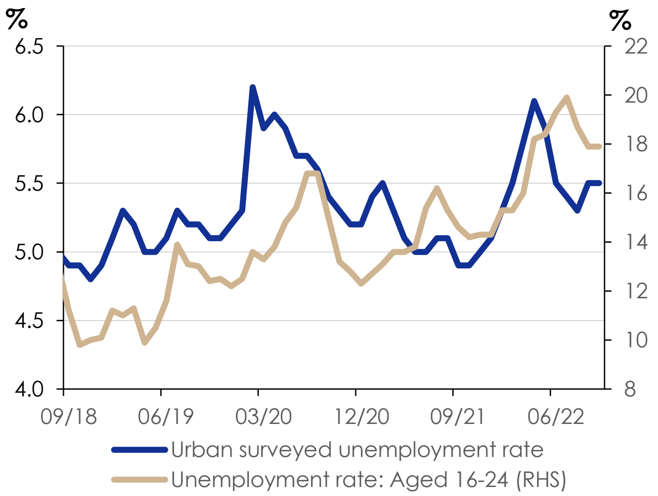
Source: NBS, CCBIS

Fig 4: Housing sales move sideways



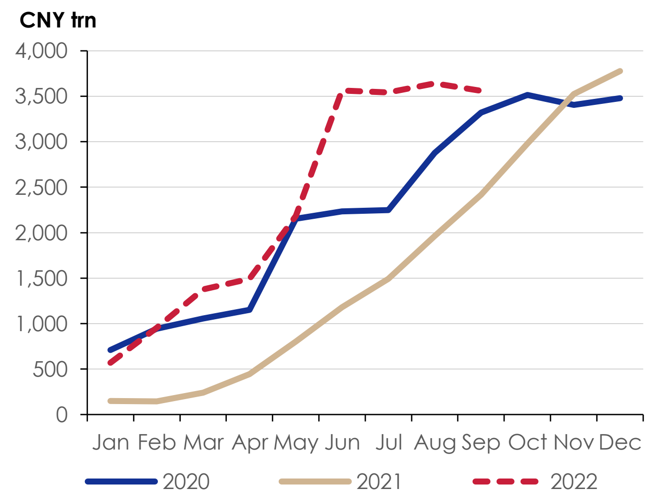
Source: NBS, CCBIS

Fig 5: Youth unemployment remains elevated



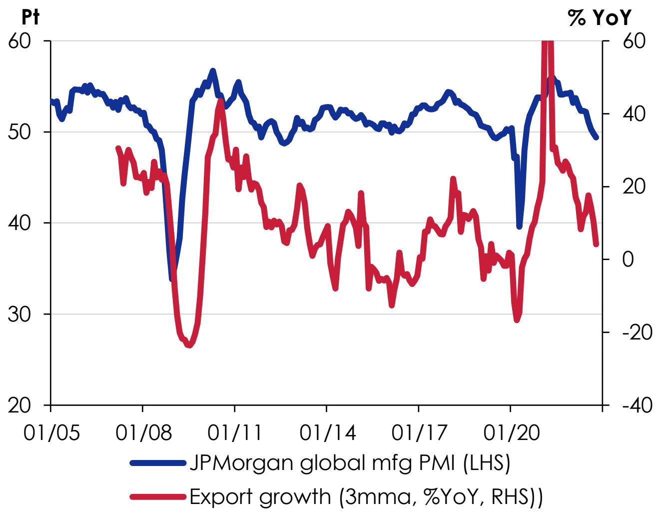
Source: NBS, CCBIS

Fig 6: 2022 special bond issuance has completed



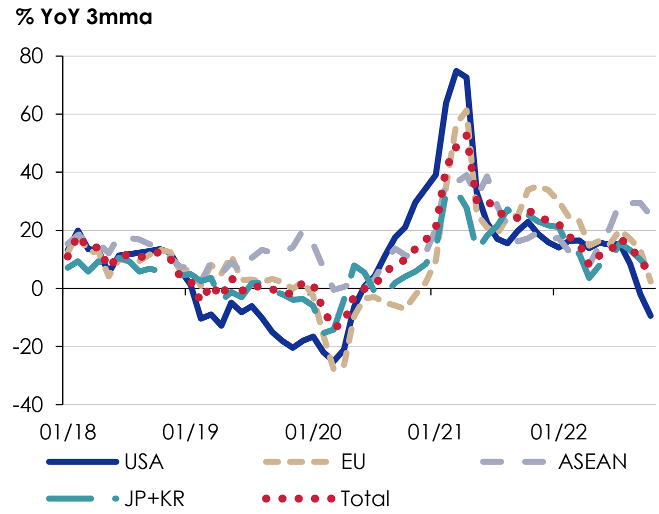
Source: CEIC, CCBIS

Fig 7: Softening growth outlook for Chinese exports



Source: CEIC, CCBIS

Fig 8: Chinese exports to the US and EU slowed, but exports to ASEAN held up



Source: Wind, CEIC, CCBIS

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