MARKET COMMENTARY

China – PBoC cuts rates amid poor data

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- **China's growth path remains bumpy. Except for exports, July monetary and real data disappointed, following deteriorating manufacturing PMIs released earlier. Fresh Covid related local lockdowns, the headwinds in the real estate sector together with weather-related effects (and partially resurfacing power supply problems) contributed to this slowing.**
- **The People's Bank of China (PBoC) cut interest rates just hours before the data were released. It reduced the 7-day reverse rate and the 1y MLF rate by 10 bps to 2% and 2.75%. The Loan Prime Rates will most likely follow next week.**
- **Looking ahead, the government would want to make sure that the July softness will not mark the beginning of a longer-term weakness. While the current interest rate cut was anticipated, we now see another 15 bps until the end of the year. We do not expect the Covid policy to change (at least not before the 20th Party Congress in autumn) which implies a continued risk for more (local) lockdowns. However, fiscal policy looks less likely to rely on heavy spending due to the already high debt-to-GDP ratio. To put the real estate sector again on a sounder footing, cuts in mortgage interest rates, lower down payments or even a broader real estate developer debt restructuring program could come under consideration.**

China's recovery stayed bumpy as July data came in below consensus expectations across the board. Industrial production (IP) failed to continue its uptrend (consensus expectation was 4.6% yoy which had become a bit unrealistic after manufacturing PMIs softened and the NBS reading even fell to 49.0 index points), softening to 3.8% yoy, after 3.9% yoy in the month before. The slowing took place against the background of an even stronger export growth rate (18% yoy compared to a 15% consensus expectation), while imports (2.3% yoy) weakened to below forecast (3.7% yoy). Both results suggest some softness in domestic demand, independent from the above-mentioned supply-side issues.

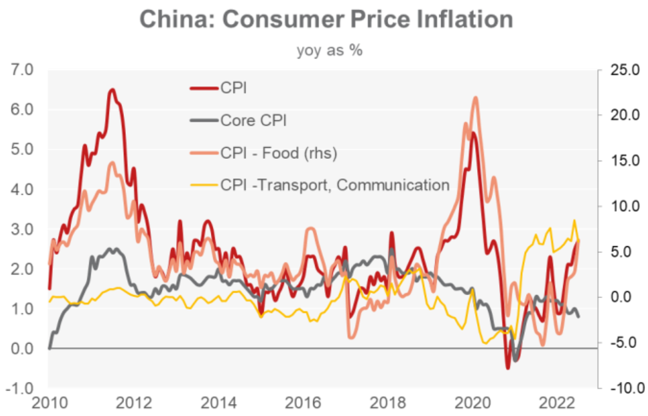
Retail sales growth dipped to 2.7% yoy, after 3.1% yoy in June. Catering continued to narrow its contraction from -4% yoy to -1.5% yoy, while goods sales softened. Covid lockdowns (especially also in tourist areas) have contributed, but as the weakening goods demand was centred on daily items, previous Covid-fears related hoarding may also have levelled off.

Official numbers show that **urban investment weakened** to 5.7% yoy ytd, after 6.1% yoy ytd in June. In yoy terms, fixed asset investment growth declined from 5.8% yoy in June to 3.6% yoy in July. Infrastructure held up, supported by government outlays, but **concerns on the property downturn deepened**. On a monthly basis, property investment contracted by 12.3% yoy, down from (an improved) -9.4% yoy in June. Floorspace under construction also receded even faster with -3.8% yoy in July vs -2.9%yoy in June. The **"mortgage strike"** (compare Market Perspectives) could well contribute to a vicious circle of more delays, lower sales, and an even more stressed debt situation of developers. Given the overall high importance of the sector of about 25% of GDP, the government would want a stabilisation. Without relying on government coffers, the smoothness of credit supply, acceleration of construction, but also a wider effort to restructure developers' debt or lowering down payment ratios come to mind.

Meanwhile, **infrastructure investment will remain an important government tool**. Accordingly, its growth strengthened to 7.4% yoy ytd in July. However, overall fiscal support is likely to remain "measured". July's politburo meeting did not mention to step up government bond issuance quotas, neither at central nor local levels. Advancing 2023 parts of the special Local Government Bonds (LGB) quota already to this year (which had been suggested by an unconfirmed Bloomberg article) does not look to materialise. Instead, local governments are "*to make full and good use of the special debt cap*," which implies a maximum RMB 1.5 tn extra LGB issuance this year. In sum, fiscal support has remained more reluctant compared to previous crisis instances. This may be due to efforts not to raise the already high non-financial-debt-to-GDP ratio, thus to end the growth reliance on ever more debt. However, the looming autumn 20th Party Congress may also make officials reluctant to position beforehand.

The PBoC cut the 7-day reverse rate and the 1y MLF rate by 10 bps to 2% and 2.75%. Before, credit and Total Social Financing (TSF) data had surprised on the downside, coming in nearly 50% below expectations. TSF growth receded from 10.8% yoy to 10.7% yoy and total credit growth fell from 9.1% yoy to 8.7% yoy. The monetary impulse nevertheless marginally improved. The PBoC recently also warned that inflation could surpass the target of 3% yoy later in the year and that it will "*monitor domestic and external inflation changes while balancing economic growth and price stability*." July CPI inflation came in lower than expected with 2.7% yoy but is on a rising trend since February 2022. At the same time, producer price inflation is on a downward path, meaning that pipeline pressures are receding. Moreover, core inflation diminished to 0.8% yoy in July, while food prices (mainly pork) rose significantly to 6.3% yoy. The low core inflation is another sign of weak domestic demand. CPI inflation could indeed temporarily surpass the 3% yoy target from September on. However, given that this relies mainly on base and food effects, the PBoC looks likely to look through this price spike not hindering further monetary policy easing.

Source: Datastream, GIAM calculations



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