

MARKET COMMENTARY

PBoC eases monetary policy amid disappointing data releases

Christoph Siepmann

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- The People's Bank of China (PBoC) today cut the Medium-term lending facility (MLF) rate by 15 bps and the 7-day reverse repo rate by 10 bps. The move came just before disappointing real activity data were published. Fiscal policy has so far released only a range of incremental measures which failed to lift sentiment.
- Real activity had a poor start into Q3, with all data coming in weaker than expected after last week's trade data already showed new lows. Property was still a major drag. China's largest property developer "Country Garden", seeking to delay onshore bond repayment, was adding to market worries.
- Headline inflation also turned negatively with a rate of -0.3% yoy, mainly driven by food prices while core inflation "doubled" to 0.8% yoy.
- Looking ahead, unless fiscal policy becomes more supportive, we see weakness to remain. This will likely prompt the PBoC to more action. We still await a 25 bps reserve requirement rate (RRR) cut and expect another 15 bps reduction in the MLF rate and reverse repo rate by year-end. We see the 5% growth target under threat.

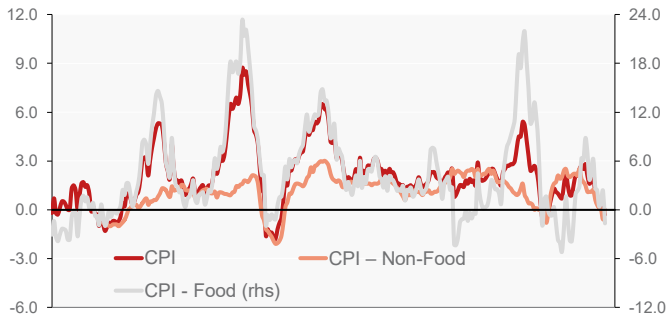
Despite ongoing weakness in the yuan exchange rate, the PBoC today cut the MLF rate by 15 bps and the 7-day reverse repo rate by 10 bps. The move was likely intended to shore up the mood before real activity data were released. They came all in below consensus forecasts, giving China a weak start into the third quarter. Industrial production (IP) growth decelerated from 4.4% yoy in June to 3.7% yoy in July, although PMIs had stabilised on average at the beginning of the month. IP growth dynamics shrank to almost naught. Year-to-date (ytd) fixed asset investments (FAI) grew 3.4% yoy ytd in July, after 4.8% yoy ytd in the month before. Within the subcomponents, property investment remained the major drag (-12.2% yoy ytd). Regarding the demand side of the real estate sector, property sales fell by 24% yoy, a bit better than last month due to base effects. That said, financial stress at private developers seems to continue. Chinese property giant "Country Garden" is seeking to delay onshore bond repayment, which is feared to elicit a deterring effect on homebuyers again. Regarding the other investment subcomponents, infrastructure investment growth (incl. utilities) slowed significantly. This will likely lead Beijing to demand an acceleration of special local government bond issuance. Manufacturing capex held up relatively better, but also eased from 6.0% to 4.3% yoy, not least due to weak exports, which dropped by 14.5% yoy (imports by 12.4% yoy) in July.

On the monetary side of the economy, total social financing came in at only half of the expected amount. Accordingly, the credit impulse stayed deeply in the red. M2 growth decreased from 11.3% yoy in June to 10.7% yoy in July (the lowest since April 2022). Moreover, inflation diminished to -0.3% yoy, stocking market fears that China could drop into a deflationary period. However, inflation details were better than the headline number. Core CPI "doubled" to 0.8% yoy (a six month high). In fact, food (esp. meat) inflation was the main culprit behind the negative headline figure. That said, also retail sales growth weakened further to a growth

rate of 2.5% yoy, after 3.1% yoy in June, and missing consensus expectations (4.5% yoy) by a wide margin. The catering component slowed, but is still on a high level of 15.8% yoy. Today, the National Bureau of Statistics (NBS) also introduced a new measure, covering “service retail sales” which were previously statistically underrepresented. The measure showed a 20.3% yoy ytd rise for the first seven months in 2023.

China: Consumer Price Inflation

yoy as %



Source: Datastream, GIAM

China: Retail Sales

yoy as %



Source: Datastream, GIAM calculations

Looking ahead, while fiscal policy has introduced a range of incremental measures, it seems reluctant to resort to an outright package. Hopes for such a move have largely vanished. One natural target would be the real estate sector. However, this would also amount to somewhat counteracting its previous deleveraging policy (and thus might fear to even increase problems in the longer run). Thus, we see it more likely that policy will be stuck with local supporting measures. Another candidate could be private consumption. Given, that the global manufacturing cycle will stay weak for a while and elicits headwinds for exports, a stronger household demand could be helpful. However, traditionally China’s fiscal policy only support production (investment) but not consumption. There is currently no evidence that this might change. Thus barring a surprise, we expect China’s overall demand to stay weak, with fiscal policy to continue to resort to small steps. Therefore, we expect monetary policy to deliver more easing, in the form of a 25 bps RRR cut and a 15 bps reduction in the MLF rate and reverse repo rate by year-end. We see the official 5% growth target to be under threat.