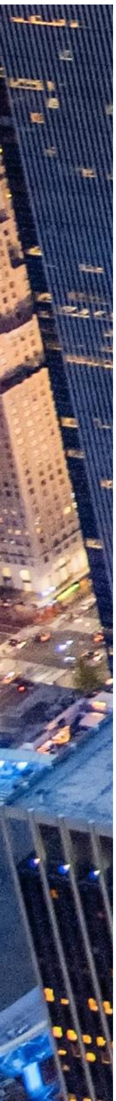
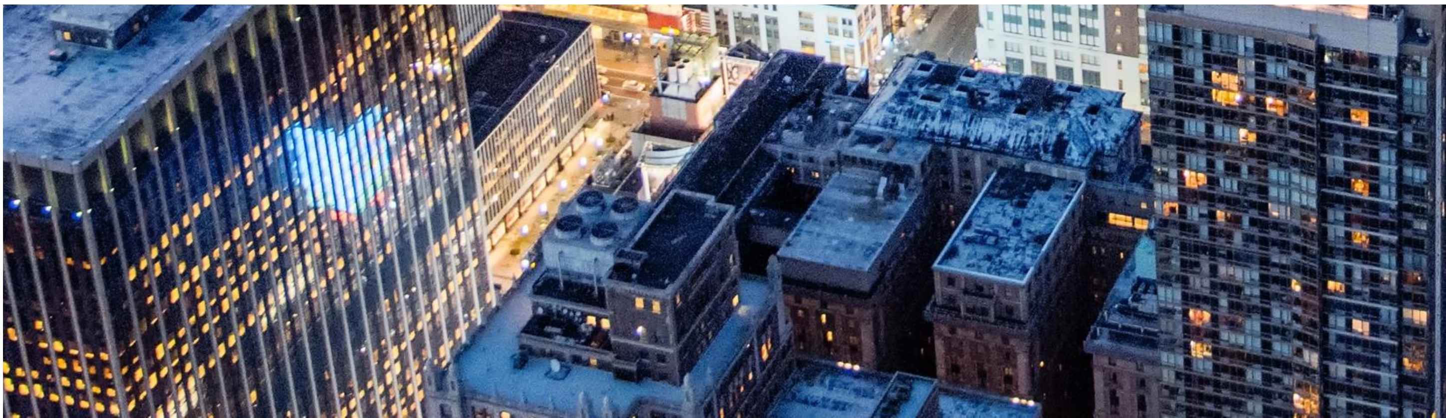
China Economic Quarterly Q3 2024

December 2024





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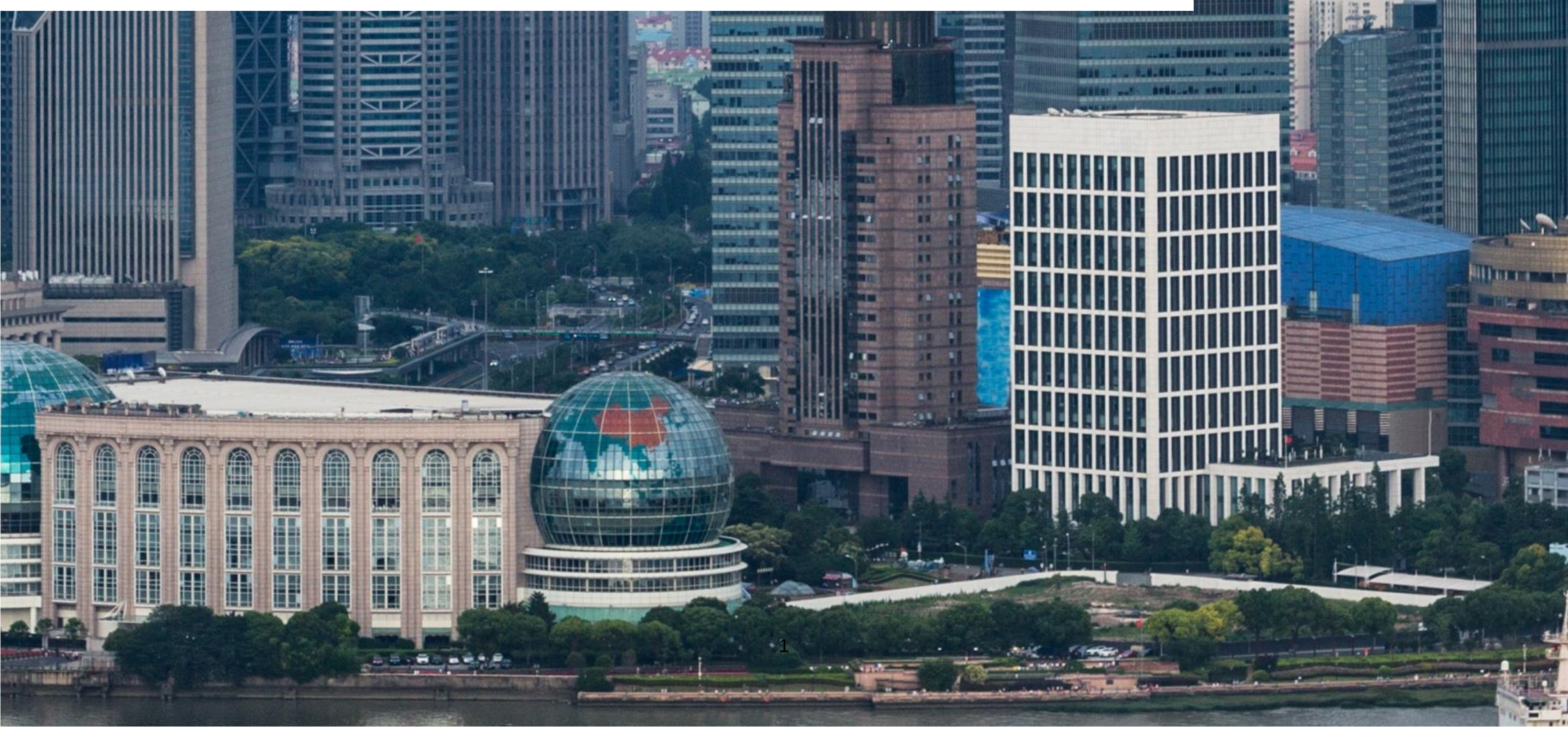


In Brief

China’s Economic Momentum: Key Takeaways from Q3 Data

- China's GDP grew by 4.6% in Q3, moderating slightly from 4.7% in Q2 and 5.3% in Q1, resulting in a 4.8% growth rate for the first three quarters. This puts the government's 5% annual target within reach, supported by intensified stimulus measures aimed at accelerating growth.

- The economy showed signs of a turnaround towards the end of Q3, with industrial output, consumption, and fixed asset investment stabilising in September.

- Despite the improvement, consumption has remained a weak link in the economy, with retail sales growth, PPI and CPI all highlighting the ongoing shortfall in aggregate demand.

- Robust exports remained a bright spot, mitigating the effects of sluggish domestic demand.

Topic in Focus: China’s New Stimulus to Revive Growth

- A suite of aggressive monetary easing measures has been rolled out, marking the most substantial monetary stimulus since the COVID-19 pandemic. These measures include cutting the reserve requirement ratio and policy interest rate, stabilising the housing market, and fortifying the financial sector.

- The initial round of fiscal stimulus features a RMB 10 trillion debt swap programme aimed at tackling the long-simmering structural challenge of local government debt. The immediate impact on growth is anticipated to stem from savings on interest payments and the extension of debt maturities for local governments.

- At the Central Economic Work Conference that concluded on 12 December, Chinese leaders pledged further support to maintain economic growth through stronger fiscal and monetary policy. Future stimulus measures are poised to invigorate domestic demand and counteract the adverse effects of rising geopolitical tensions. Additional measures will also include financing local governments' acquisition of idle land and unsold apartments, and bolstering state bank capital.

Key Takeaways from Q3 Economic Data

China's GDP grew by 4.6% in the third quarter, cooling off from 4.7% in the second quarter and 5.3% in the first quarter. This brings GDP growth to 4.8% for the first three quarters, placing the government's 5% growth target within striking distance. Recent stimulus efforts have been instrumental in boosting momentum in the final quarter.

September showed signs of stabilisation, particularly in industrial output and consumption. However, domestic demand remains subdued, with persistent downward pressure on factory and consumer prices. Strong export performance has helped to pick up the slack from weak consumer demand at home, but faces increasing headwinds from trading partners. While manufacturing investment remains a bright spot, the property sector continues to struggle, highlighting the uneven recovery across different sectors of the economy.

The economy is expected to benefit from the government's stimulus measures, including monetary easing and the swap of local governments' off-balance-sheet debt. Additional measures are anticipated to revive domestic consumption and stabilise the property sector, especially amid escalating trade tensions with the U.S. However, these measures are likely to be rolled out in stages, as China's policymakers keep some fiscal powder dry.

China’s Economic Momentum: A Snapshot

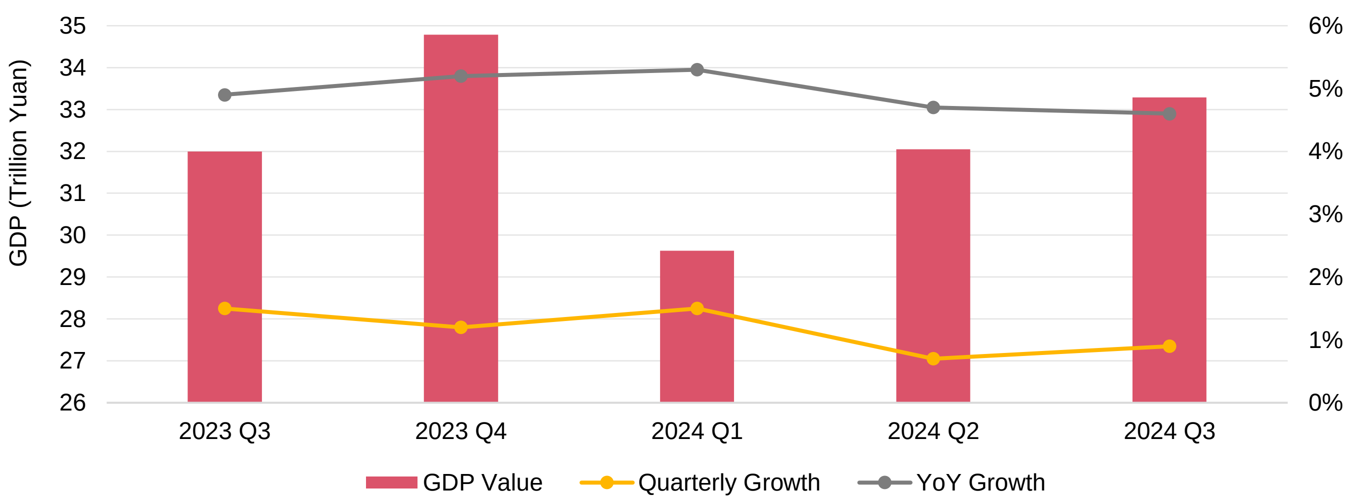
GDP

China’s GDP growth decelerated to 4.6% year-on-year in the third quarter, down from 4.7% in the previous quarter. The secondary industry experienced a slowdown, with growth easing to 4.6% from 5.6% in Q2, primarily due to a deceleration in manufacturing, which grew by 5.0% year-on-year in Q3, compared to 6.2% in Q2.

On the other hand, the tertiary industry saw an uptick in growth, rising to 4.8% in Q3 from 4.2% in Q2. This increase was driven by robust performances in sectors such as information transmission, software and information technology services (10.0%), leasing and business services (10.8%), transport, storage and postal services (6.6%), as well as hotels and catering services (5.9%).

In an effort to achieve the annual growth target of “around 5%,” Chinese policymakers have rolled out a series of measures to strengthen the economy. These initiatives aim to counteract the uncertain export outlook, boost domestic demand, and stabilise the sluggish property sector.

Quarterly GDP Values and Quarterly and Annual GDP Growth Rate



Source: Unless otherwise stated, economic data are from the National Bureau of Statistics of China, the People's Bank of China, and Wind.

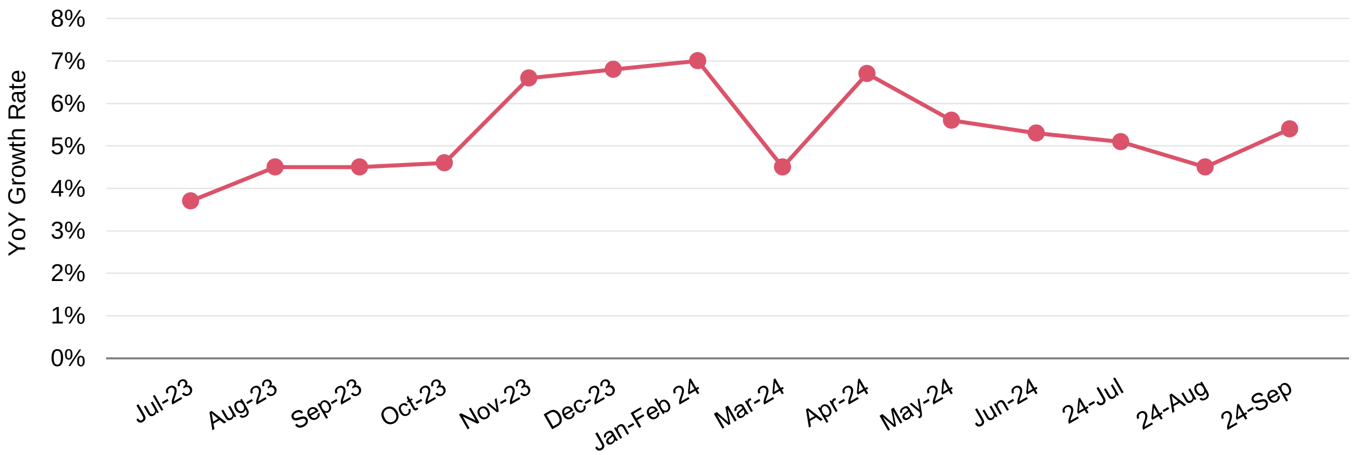
Industrial Output

Industrial output growth continued its slowdown from Q2, registering 5.1% in July and 4.5% in August year-on-year. However, it showed signs of stabilisation by picking up to 5.4% in September, with the value added of 36 out of 41 major industries posting year-on-year growth.

Industrial output contributed nearly 40% to economic growth in the first three quarters. Propelled by stimulus policies, the equipment manufacturing sector surged 7.5% in the January-September period, accounting for one-third of the overall industrial output. Other drivers included new energy vehicles (33.8%), integrated circuits (26%), and 3D printing equipment products (25.4%).

High-tech manufacturing continued to drive growth, aligning with China's push for high-quality development through the cultivation of new productive forces. High-tech manufacturing grew 9.1% year-on-year in the first three quarters, outpacing the overall manufacturing sector's growth of 6% and marking an increase from the first half's growth of 8.7%.

Industrial Output

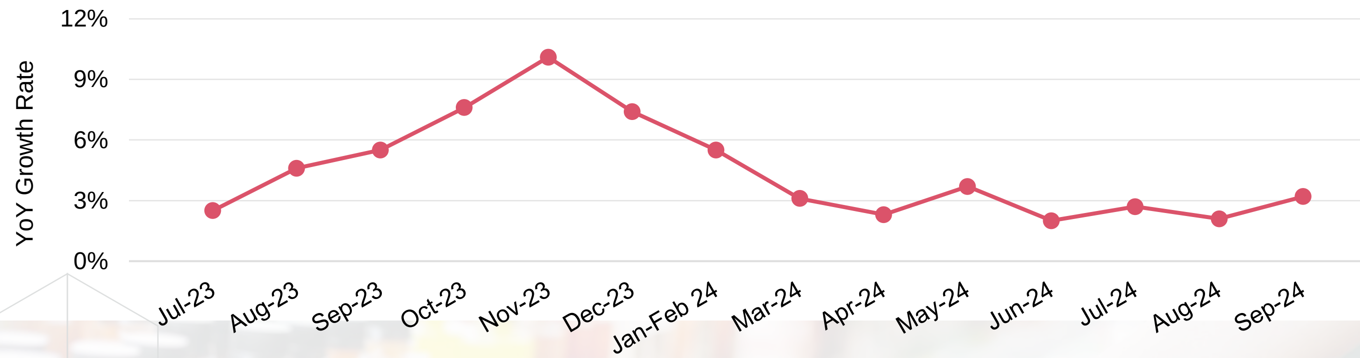


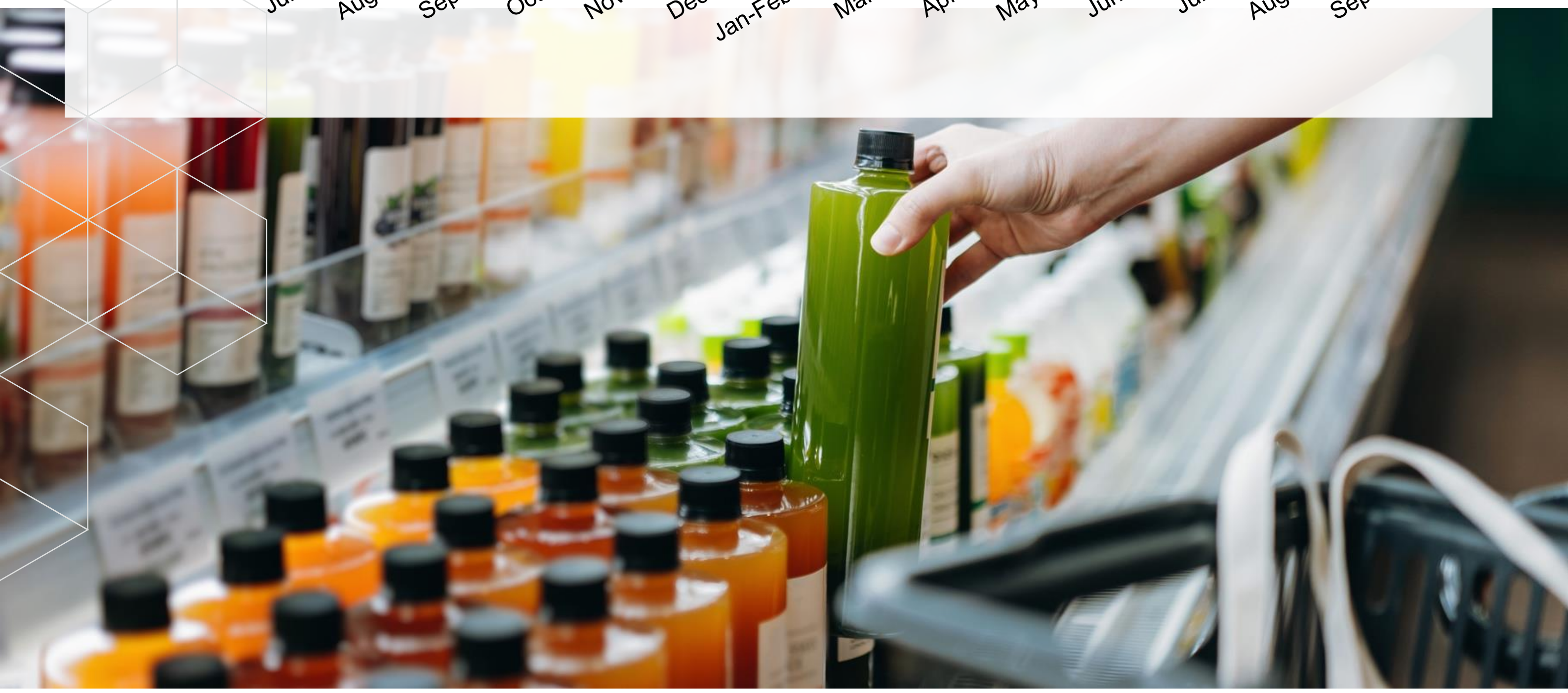
Retail Sales

Retail sales growth remained subdued through the third quarter but showed signs of stabilising in September, accelerating to 3.2% year-on-year from 2.1% in August and 2.7% in July. The improvement reflects the impact of the trade-in programme, especially within the household appliances and automotive sectors. Initially launched in March, the programme saw a significant expansion in July, bolstered by an allocation of RMB 300 billion from ultra-long special sovereign bonds. Auto sales grew by 0.4% in September, reversing a six-month decline, including a 7.3% drop in August. Retail sales of household appliances surged by 20.5% in September, a significant jump of 17.1 percentage points from August. This positive momentum is expected to persist as stimulus policies, including trade-in programmes, continue to be rolled out in the coming months.

Despite the improvement, recent data underscores cautious spending among Chinese consumers. Catering (3.1%) and alcohol & tobacco (-0.7%) underperformed compared to overall growth, while sports and recreation (6.2%) continued to perform well. During the recent Golden Week holiday from October 1 to 7 this year, 765 million domestic trips were made, according to the Chinese Ministry of Culture and Tourism. This represents a 5.9% year-on-year increase and a 10.2% rise compared to 2019. However, spending only increased by 7.9%, indicating that per capital spending remains about 2.1% below pre-pandemic levels.

Retail Sales of Consumer Goods



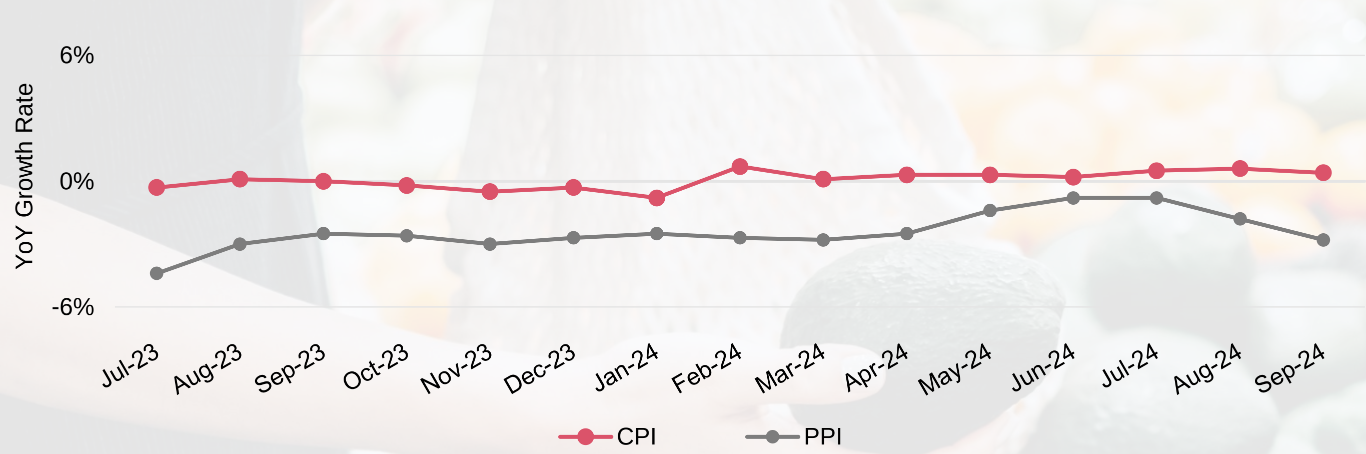


Consumer Price Index (CPI) and Producer Price Index (PPI)

Weak domestic demand, coupled with rising output, continued to exert downward pressure on inflation during the third quarter. China's CPI saw a modest improvement to 0.5% in July and 0.6% in August, before slipping back to 0.4% in September. Core inflation, which excludes volatile food and fuel prices, declined to 0.4% in July, 0.3% in August, and 0.1% in September.

Amid persistent deflationary pressures driven by weak domestic demand, the PPI experienced its steepest decline in six months, falling 2.8% year-on-year in September. This follows a 1.8% decrease in August and a 0.8% drop in July. Extended factory-gate price declines squeezed industrial firms' profits, with industrial profits at large Chinese companies plummeting 27.1% year-on-year in September, after a 17.8% drop in August .

Consumer Price Index and Producer Price Index



Trade

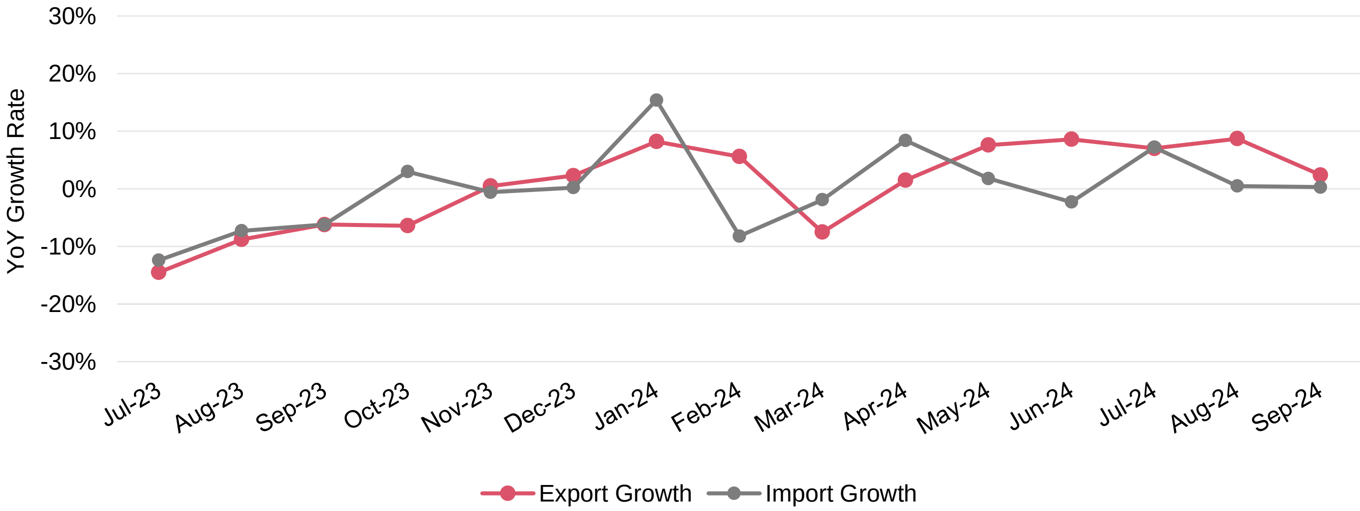
China's export growth decelerated in September, with a year-on-year increase of 2.4% in USD terms, down from 8.7% in August and 7% in July. The recent imposition of higher tariffs by the U.S. and Europe on Chinese electric vehicles and other products has cast a shadow over the country's trade outlook. Despite this, China's exports rose by 4.3% year-on-year over the first three quarters, with ASEAN remaining China's largest export destination, followed by the EU and the U.S.

China's export product structure continued to evolve during the first three quarters. Mechanical and electrical products remained dominant, comprising nearly 60% of total exports. High-end equipment, integrated circuits, automobiles, and home appliances experienced robust growth, with increases of 43.4%, 22%, 22.5%, and 15.5%, respectively.

In a bid to capture greater market share, Chinese manufacturers are slashing prices, a strategy reflected in the rising volume of shipments outpacing their value. From January to September, China experienced a notable surge in exports across various sectors. Motor vehicle exports accelerated by 26.7%, reaching 4.7 million units. Mobile phone shipments edged up by 3.5%, totalling 579.74 million units. Home appliances saw a significant leap of 21.8%, hitting 3.33 billion units. Meanwhile, ship exports sailed ahead by 24.6%, amounting to 4,303 units.

On the import side, China's imports rose by 0.3% year-on-year in September, slightly down from the 0.5% growth in August, indicating weak domestic demand. Over the first three quarters, imports increased by 2.2% year-on-year.

Exports and Imports



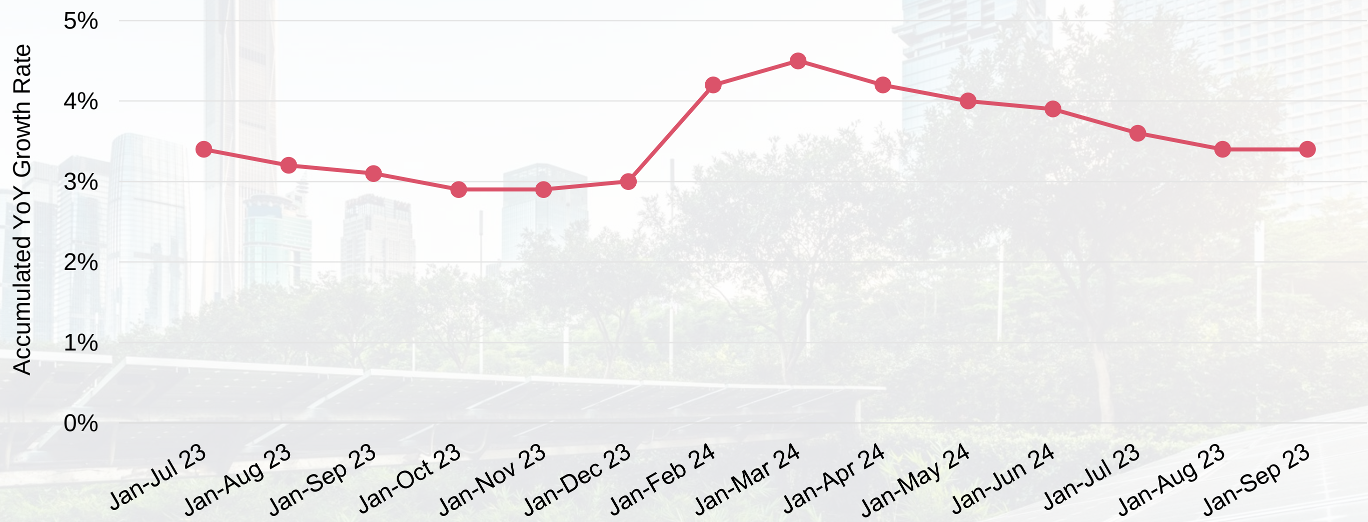
Fixed Asset Investment

China's fixed-asset investment rose by 3.4% year-on-year in the first nine months of 2024, maintaining the same growth rate as the January-August period but slightly below the 3.6% recorded in January to July. Despite the drag from property development investment, fixed-asset investment excluding the property sector climbed 7.7% in the first three quarters. Aligned with national policy to foster new productive forces, investment in high-tech manufacturing (9.4%) and high-tech services (11.4%) both outpaced overall growth.

China's equipment makers received a boost from recent government policies supporting equipment upgrades. In March, the State Council launched a plan to promote large-scale equipment upgrades and trade-ins of consumer goods, followed by an additional allocation of around RMB 300 billion in long-term special government bonds to expand these initiatives. The effects of the policy have begun to emerge, with investment in the purchase of equipment and tools growing by 16.4% year-on-year in the first three quarters, outpacing overall fixed-asset investment growth by 13 percentage points and contributing 61.6% of total investment growth. The equipment upgrade programmes this year are estimated to lead to a total investment of nearly RMB 800 billion.

From January to September, the private sector's investment dipped by 0.2%, trailing the state sector, which grew by 6.1%. However, when excluding the property sector, private investment actually rose by 6.4%. Notably, private manufacturing investment surged by 11.6%, outpacing the overall growth in manufacturing investment.

Fixed Asset Investment



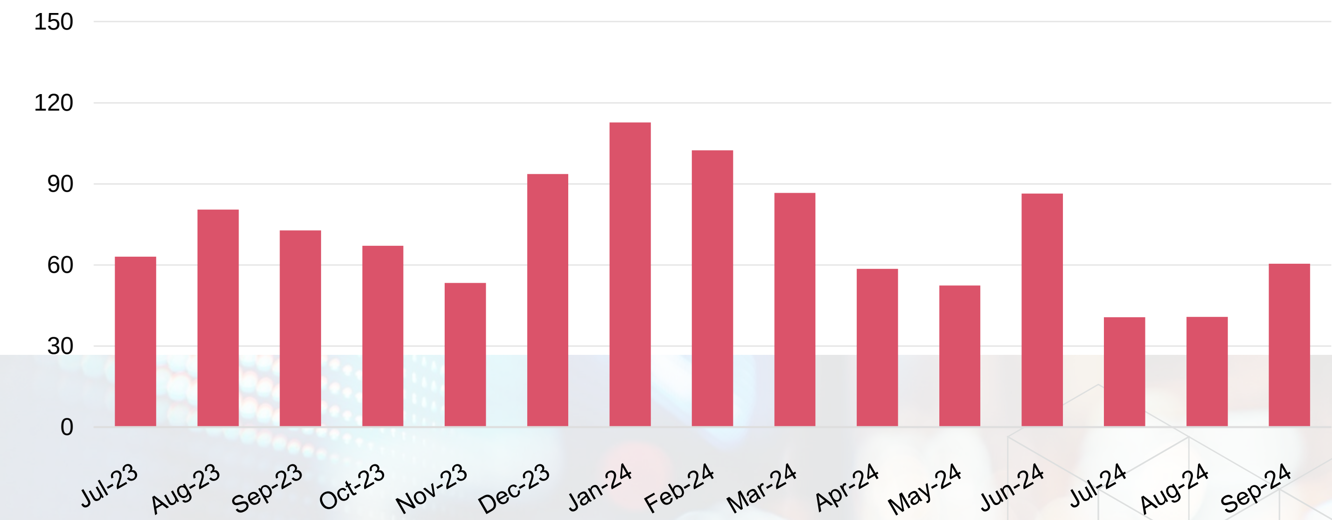
Foreign Direct Investment (FDI)

FDI inflows into China totalled RMB 640.6 billion in the first nine months of the year, a 30.4% decline from the previous year, according to data from the Ministry of Commerce. This represents an improvement from the 31.5% decline recorded from January to August, though it is slightly larger than the 29.6% drop through January to July. Despite the overall slowdown, the high-tech manufacturing sector showed resilience, posting a 1.5% increase and accounting for 12% of total FDI inflows. Notably, the medical equipment and instrument manufacturing sector surged by 57.3% from a year ago, while the computer and office device manufacturing sector grew by 29.2%.

FDI from Germany and Singapore showed notable increases, rising by 19.3% and 11.6% year-on-year, respectively. Additionally, the number of new foreign-invested firms established in China rose by 11.4% year-on-year, with 42,108 new entities set up in the first nine months of 2024.

FDI Inflows

RMB billion



Source: Ministry of Commerce, PwC Analysis

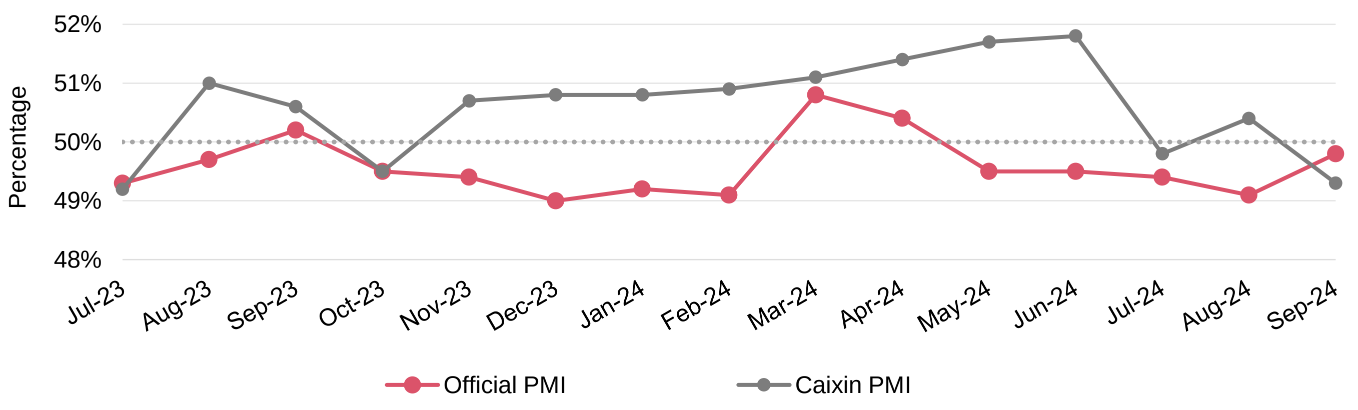
Purchasing Managers Index (PMI)

China's manufacturing PMI edged up to 49.8 in September, recovering from 49.1 in August and 49.4 in July. Despite remaining in contraction territory, the September reading is the highest in the past five months, snapping a two-month decline. The high-tech manufacturing sector showed more robust growth, with its PMI rising to 53 in September from 51.7 in August. Additionally, the equipment manufacturing sector reported a PMI of 52, reflecting the boost from the equipment upgrade policy.

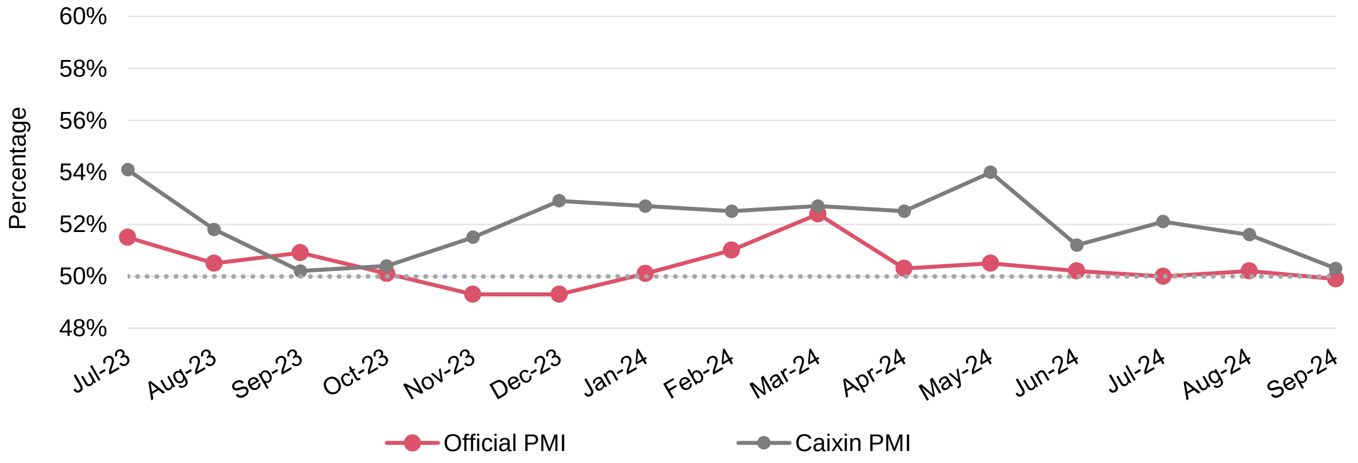
At the end of the third quarter, the PMI for China's non-manufacturing sector, which includes the services and construction sectors, stood at 50 in September, down from 50.3 in August and 50.2 in July. In particular, the services PMI fell to 49.9 in September, marking its first contraction since December last year. In contrast, the construction PMI edged up to 50.7 from 50.6 in August, indicating signs of stabilisation after four consecutive months of decline.

The Caixin PMI readings indicated that China's manufacturing activity contracted at the fastest rate in 14 months in September, while the services sector also slowed.

Manufacturing PMI



Services PMI



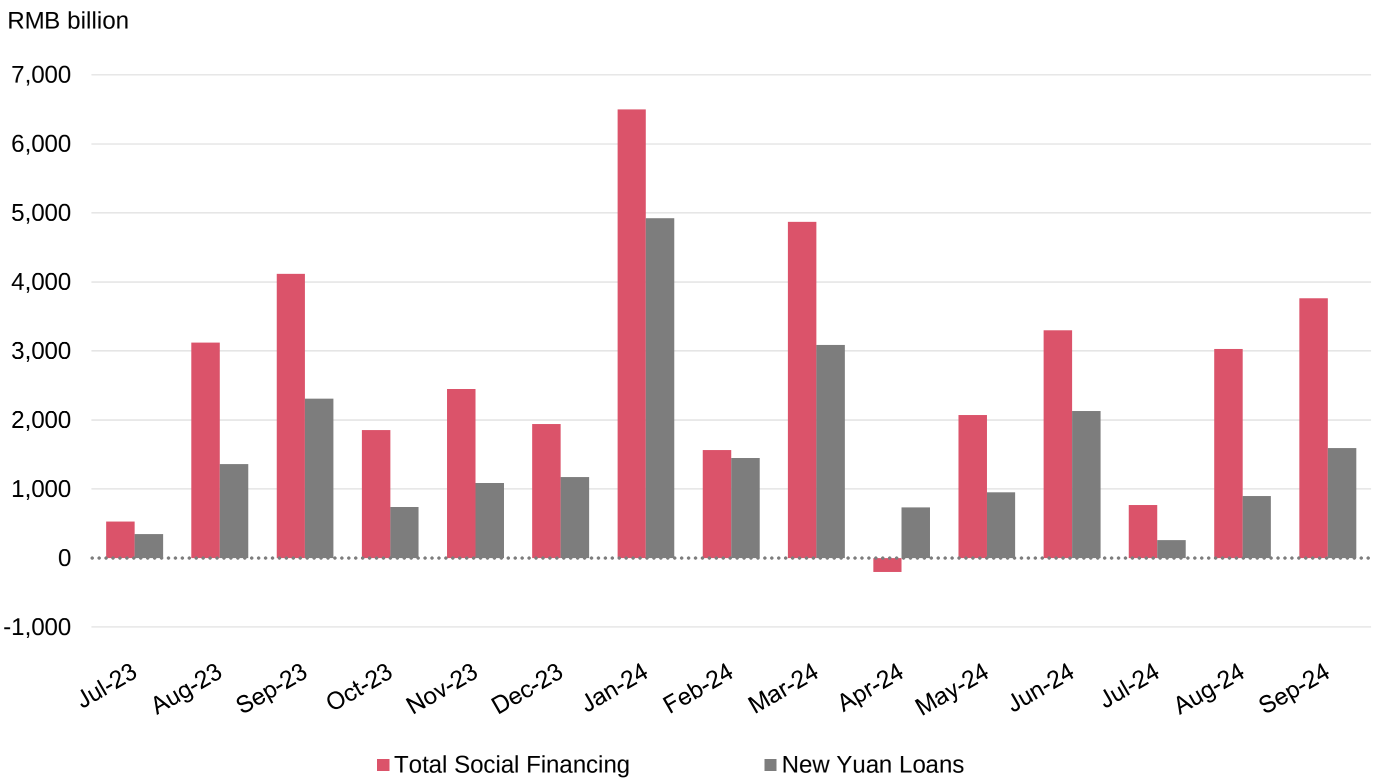
Total Social Financing (TSF) and New Bank Loans

Aggregate financing to the real economy for the first three quarters totalled RMB 25.66 trillion, a decrease of RMB 3.68 trillion compared to the same period last year. In September, credit growth improved from the previous month, thanks to a surge in government bond sales.

Yuan-denominated loans rose by RMB 16.02 trillion in the first three quarters. The M2, a broad measure of money supply that includes cash in circulation and all deposits, increased by 6.8% year-on-year to RMB 309.48 trillion at the end of September.

Looking ahead, government bond issues will continue to be a key support for growth in aggregate financing. September saw a jump in government bond sales, which exceeded RMB 1.5 trillion. Businesses and households remained cautious in borrowing despite the PBOC's repeated efforts to loosen monetary policy, but confidence is expected to improve in the coming months as a slew of recent stimulus policies, including easing of mortgage rules, begin to take effect.

Credit Growth



Source: People's Bank of China, PwC Analysis

China's New Stimulus to Revive Growth

Monetary policy

On September 24, the People's Bank of China (PBOC), in conjunction with top financial regulators including the National Administration of Financial Regulation and the China Securities Regulatory Commission, unveiled a suite of aggressive policies marking the most substantial monetary stimulus since the COVID-19 pandemic.

The key initiatives are aimed at monetary easing, stabilising the housing market, and bolstering the financial sector. Notably, the monetary easing measures include a 20-basis-point cut to the policy rate and a 50-basis-point reduction in the reserve requirement ratio (RRR). Additionally, mortgage repricing will lower outstanding mortgage rates to 30 basis points below the loan prime rate.

To support the financial market, the central bank will introduce a swap programme enabling securities, funds, and insurance companies to secure liquidity through asset collateralisation. Furthermore, a special re-lending facility will be established to guide banks in providing loans to listed companies and their major shareholders for share buybacks.

The plan also includes capital replenishment for large state-owned banks, with an increase in tier-1 capital for six major commercial banks.

PBOC's monetary stimulus measures

Monetary easing	• Cutting policy rate (7-day reverse repo rate) by 20 bps • Cutting the reserve requirement ratio (RRR) by 50bps • Forward guidance on another RRR cut of 25bps to 50bps
Housing market	• Cutting outstanding mortgage rates by 50bps • Cutting the minimum down-payment ratio on second-home purchases to 15% from 25% • Ramping up the re-lending programme for state-owned firms to acquire unsold property inventory and provide 100% of the principal of bank loans for such purchases up from 60%
Capital market	• A swap facility allowing securities firms, funds and insurance companies access to PBOC funding (initially RMB 500 billion, with a possible expansion to of RMB 1.5 trillion) to purchase stocks • A re-lending facility providing loans to listed companies and their major shareholders for share buybacks and increasing stock holdings (initially RMB 300 billion, with a possible expansion to RMB 900 billion) • A possible stock stabilisation fund

Analysis

The simultaneous rollout of multiple measures underscores the urgency felt by officials to counteract economic headwinds with more aggressive monetary easing. Specifically, the RRR cut is expected to inject about RMB 1 trillion in long-term liquidity into the financial market. PBOC's forward guidance suggests another RRR cut of 25 to 50 basis points within the year. This move signals the central bank's commitment to maintaining ample liquidity in the financial system.

Monetary easing also sets the stage for fiscal stimulus, as Chinese policymakers have vowed to coordinate monetary and fiscal policy. So far, increasing liquidity alone has had limited effect due to weak credit demand from households and businesses.

Stabilising the housing market is now a top priority. The property sector still accounts for a significant portion of the country's GDP, with an estimated 70% of household wealth tied up in real estate[1]. By stabilising home prices, policymakers aim to reverse the negative wealth effect that has been dragging consumption. Additionally, mortgage repricing is expected to slash total interest expenses for households by approximately RMB 150 billion per year on average, which will help to boost consumption.

Furthermore, a stock market rally not only creates an immediate wealth effect but also ensures that the financial market continues to channel capital into productive sectors and companies to support investment and growth. This aligns with China's long-term goals to foster strategic emerging sectors.

In a decisive move signalling stronger policy support, Chinese leaders committed to shifting from "prudent" to "moderately loose" monetary policy at December's Central Economic Work Conference. This marks the first significant pivot since the 2008-09 financial crisis and hits at imminent reductions in required reserve ratio and interest rates.

1:People's Bank of China. (2019). Survey on the Assets and Liabilities of Urban Households in China in 2019. China Finance.

Fiscal policy

Following the announcement of the monetary measures, China's Politburo has reaffirmed its commitment to achieving this year's economic growth target of around 5% through "necessary fiscal spending." This includes initiatives to boost household consumption and arrest the decline in the struggling property sector.

On November 8, China's top legislative body, the Standing Committee of the National People's Congress, approved a RMB 10 trillion programme to help local governments swap their off-balance-sheet debts. This package includes the issuance of RMB 6 trillion worth of local government special-purpose bonds over the next three years to repay "hidden debts." Consequently, the debt ceiling for special local government debt will increase from RMB 29.52 trillion to RMB 35.52 trillion by the end of 2024. Additionally, the restructuring programme allows local governments to tap RMB 800 billion per year from special-purpose bonds already approved for infrastructure projects, totalling RMB 4 trillion over the next five years.

Local governments in China have amassed significant hidden debt through local government financing vehicles (LGFVs) to fund infrastructure projects, which is increasingly seen as a major financial risk. Chinese officials revealed that the outstanding hidden debt stood at RMB 14.3 trillion at the end of 2023, with plans to reduce it to RMB 2.3 trillion by 2028. The International Monetary Fund estimates this hidden debt at around RMB 60 trillion.

Analysis

The debt swap aims to address debt risks without increasing overall leverage while lowering aggregate interest costs. The restructuring will shift LGFV liabilities onto local governments' balance sheets. Unlike typical stimulus measures involving increased government borrowing and spending, this debt restructuring programme targets medium-to-long-term structural challenges to contain financial risk. The immediate impact on growth is expected to be indirect and modest, primarily through saved interest payments and extended debt maturities. As local governments grapple with declining land sales and fiscal revenue, savings in interest payments—estimated to amount to around RMB 600 billion over five years—will free up resources for payments to private contractors, public services, and new investments.

However, the absence of more direct fiscal stimulus measures, such as those to stabilise the housing market and boost consumption, suggests the package aims to contain economic and financial risks rather than stimulate the economy through increased public spending.

Policymakers have signalled further stimulus measures are on the horizon. Following efforts to address local debt issues, Chinese leaders at December's Central Economic Work Conference pledged a more proactive fiscal policy, including raising the fiscal deficit target and issuing more ultra-long special treasury bonds and special-purpose bonds. Notably, policymakers vowed to "vigorously boost consumption", only the second time in a decade. Efforts to spur consumer demand will likely include expanding trade-in programmes and equipment upgrades, stabilising employment, increasing household incomes, and strengthening social safety nets in healthcare and pensions. Continued investment in strategic sectors aligned with new quality productive forces will also help boost domestic demand.

Overall

The recent round of stimulus is expected to help China achieve its 5% growth target but falls short of fully reflating the economy. This cautious approach likely reflects policymakers' intention to keep their fiscal powder dry and prepare to cushion potential impacts from U.S. trade policy, as Trump has threatened 60% tariffs on Chinese imports.

At the Central Economic Work Conference, Chinese leaders pledged further support to maintain economic growth through stronger fiscal and monetary policy. This includes measures to spur domestic demand, particularly consumption, to counter the uncertainty in external demand. Policymakers are set to unveil more details in the coming months. The direction of their strategy will likely come into sharper focus during China's National People's Congress in March.

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