

One Year On, the Evolving Evergrande Saga: Macro overview

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What we'll cover

- The headlines
- The numbers
- The breakdown
- The policy prescription
- The big questions
- The bottom line

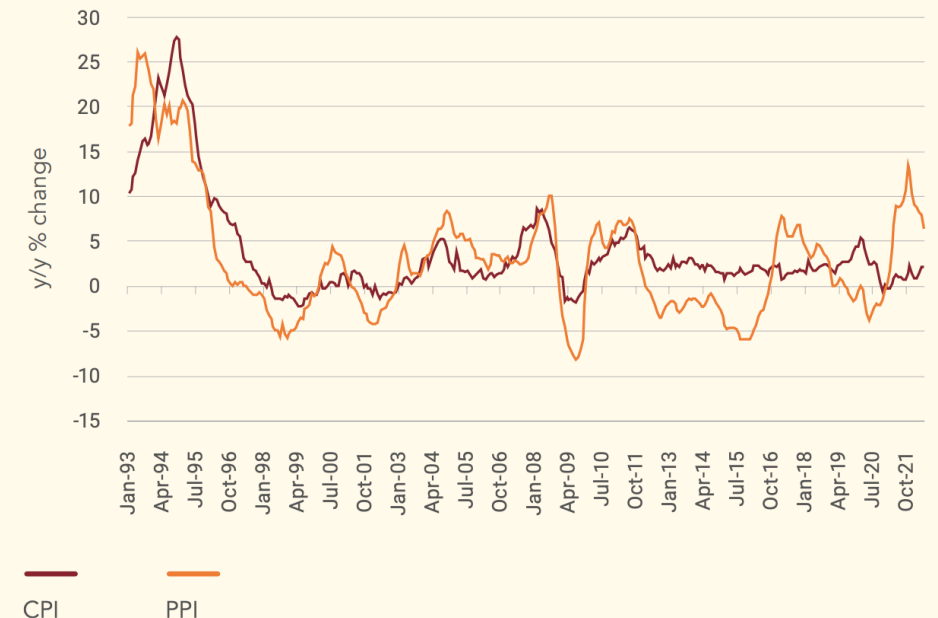
The headlines: Uncertainty abounds

- **The never-ending pandemic**
 - Tight COVID policy continues to loom over China's economic recovery
- **Geopolitical upheaval**
 - Russia-Ukraine, US-China, Taiwan
- **Property problems**
 - Price pressure, developer defaults, downstream impacts
- **No respite for big tech**
 - Re-regulation of tech sector ongoing

The numbers: top line macro

- Q2 GDP growth: 0.4% y/y – way below expectations of 1%
 - Down for 4.8% growth in Q1
 - Slowest in modern history (ex Q1 2020)
- June unemployment: 5.5%
 - Youth unemployment (16-24): 19.3% (number pre-college graduation)
- June inflation: in control
 - CPI rose 2.5% y/y in June, up from 2.1% in May.
 - PPI rose 6.1% y/y in June, down from 6.4% in May.
 - Fuel and pork prices stand out
 - Driven by poor consumption

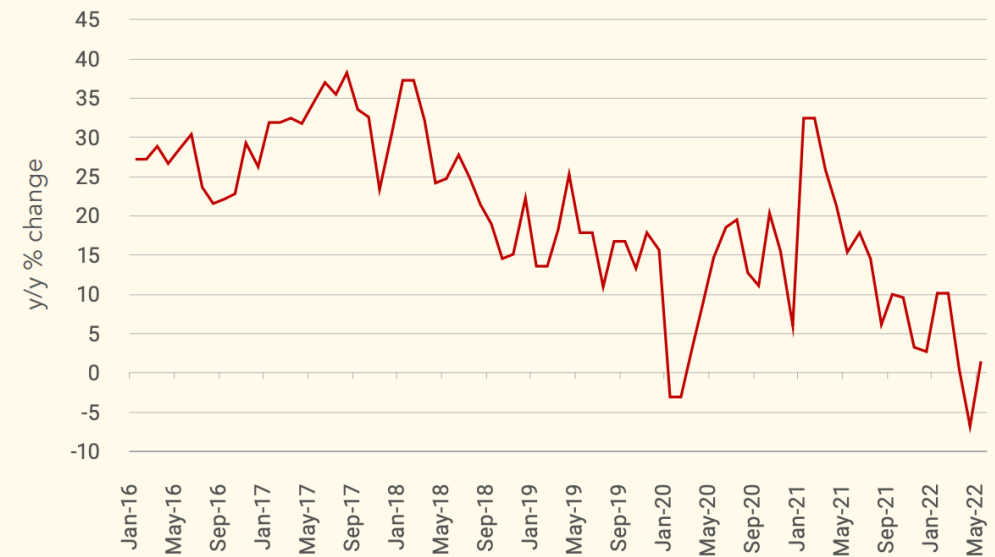
Fig. 5 – CPI vs PPI



The numbers: line by line

- **Export-led growth**
 - Net exports of goods and services accounted for 1.1pp of the 0.4% real GDP growth in Q2.
- **An uptick in infrastructure**
 - GCF contributed 0.3pp of Q2 growth
 - In June, infrastructure spending was up 12% y/y, including a 10.9% y/y increase in SOE FAI
- **Consumption continues to be a major drag**
 - Consumption was a 225% drag on GDP growth in Q2.
 - Retail sales increased a disappointing 0.53% m/m in seasonally adjusted terms in June.
- **Real estate**
 - Economic activity in the real estate sector dropped 6.9% y/y in nominal terms in Q2 – the largest drop on record
 - Land sales revenue down 31.4% in H1

Fig. 1 – Online sales of goods and services



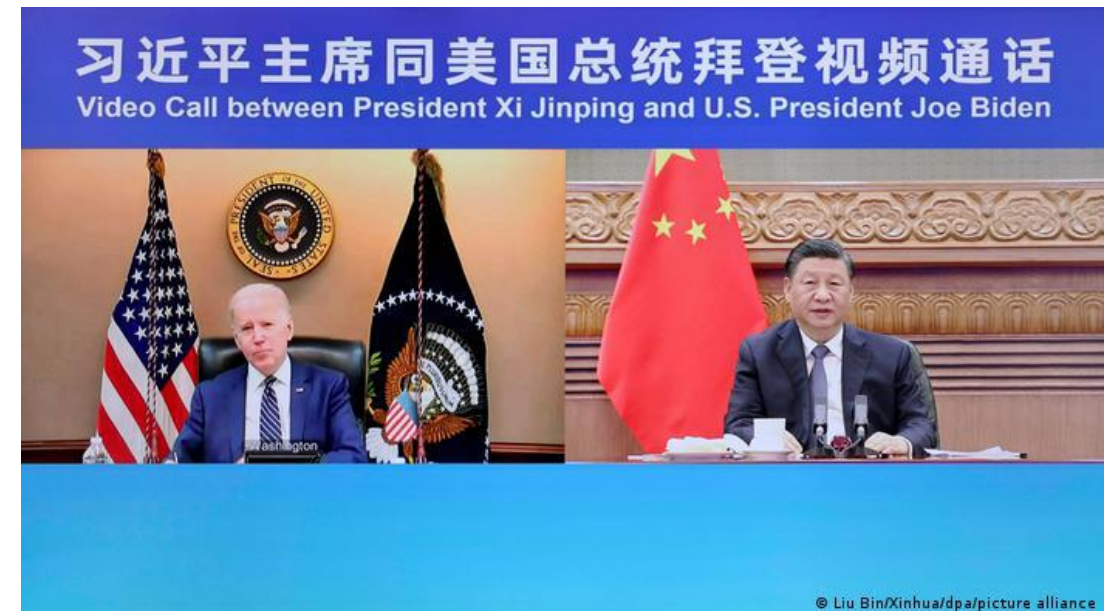
The never-ending pandemic

- From July's politburo meeting
 - *"When an outbreak occurs, we must immediately and strictly prevent and control it."*
- Lockdowns and outbreaks continue, with varied responses
 - Two month lockdown in Shanghai (outlier)
 - Notable outbreaks in Beijing, Guangzhou, and Changchun
- Marginal easing
 - Inbound quarantine reduced to 10 total days
 - Controls for secondary contacts reduced to 7 days of home quarantine



Geopolitical upheaval

- Russia-Ukraine
 - China continues to play it down the middle
 - China-Russia energy trade up (but it's not so straightforward)
 - Secondary sanctions risk has tempered
- US-China
 - US view: Competitor, threat
 - Uyghur Forced Labor Prevention Act
 - Holding Foreign Companies Accountable Act
 - Numerous trade and investment blacklist actions
 - Taiwan rhetoric heating up



Property problems

- Debt constraints
 - Three red lines
- Slowing demand
 - Sales down 29% m/m, 40% y/y in July
- Developer defaults
 - Dozens have defaulted, mostly on offshore debt
- Local government land sales
 - Down 31.4% y/y in H1
- Mortgage boycotts
 - 335 developments and counting
- Downstream implications
 - Construction, services, savings

Fig. 2 – Value-added output in the real estate sector, nominal growth

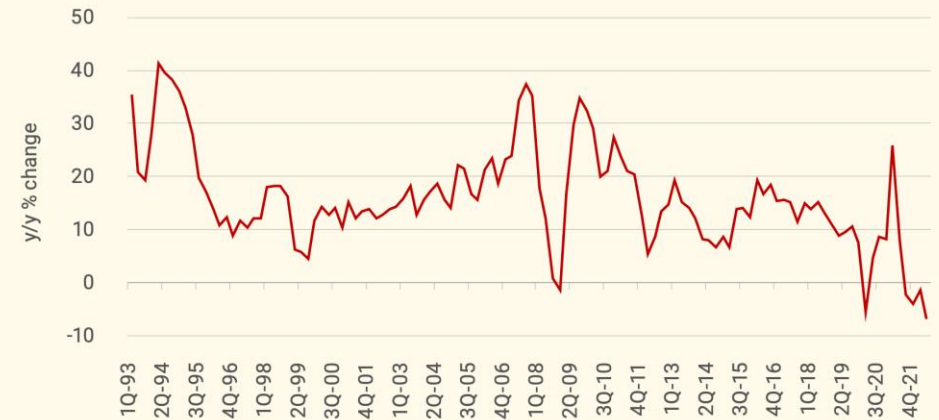
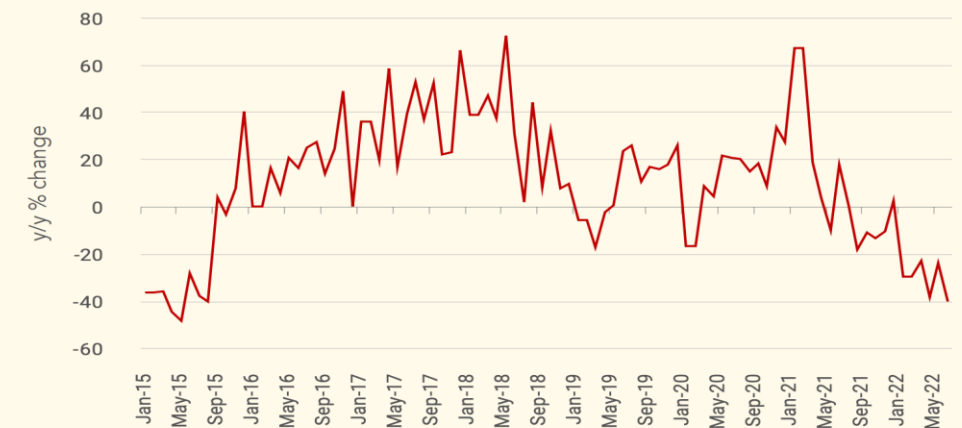


Fig. 2 – Fiscal revenue from land sales



The policy prescription

- Covid first
 - *“The relationship between epidemic prevention and control and socio-economic development should be viewed holistically, systematically, and in the long-term.”*
- Backing off 5.5%
 - *“[M]aintain economic operations in a reasonable range and strive to achieve the best results.”*
 - *“Provinces in the position to do so should strive to achieve the expected economic and social development goals.”*
- Stimulate, within reason
 - *“Monetary policy should maintain reasonable and sufficient liquidity, increase credit support for enterprises, and make good use of new credit from policy banks and infrastructure construction investment funds.”*
 - *“[We] must not overdraft the future and increase the debt burden for later, let alone return to the traditional debt-driven growth model”*
- Getting consumption back on track
 - *“Consumption is closely related to people’s livelihoods and should remain the driving force of the economy.”*
- Geopol
 - *“[A] certain non-regional power has continued to increase its input into the region [and] deliberately escalated conflicts and provoked tensions.”*
 - *“The United States is hollowing out, blurring out the ‘One China’ policy.”*



The big questions

- How and on what timeline will COVID policy evolve?
 - Covid containment will continue to be the top priority.
 - No significant changes until at least 2023.
- Will there be enough shovel-ready projects to absorb stimulus spending?
 - Stimulus will struggle to find productive outlets.
 - Some stimulus spending will be diverted to fight fiscal fires.
- How will provincial and municipal governments fill their revenue gaps?
 - Local governments will continue make budget cuts.
- Who foots the property bill?
 - State involvement in the property sector will increase dramatically.



The bottom line

- All the economic headwinds from H1 will remain.
 - However, the likelihood of another Shanghai is low.
- No surprises at the Party Congress
- Growth will pick up, but disappoint, in H2.



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