WEEKLY UPDATE

China: Growing fears of “japanification” of the economy

While the end of sanitary restrictions at the beginning of the year had resulted in high expectations for China's economic recovery, data in recent months show a very moderate recovery. One of the reasons for this weakness is the continuing difficulties of the real estate sector, the country's main economic and financial sector, which constrains the dynamics of consumption and investment. The risk of this situation is that, without significant restructuring of the sector or a major support package from the government, the Chinese economy will follow Japan's deflationary trajectory after the housing bubble burst.

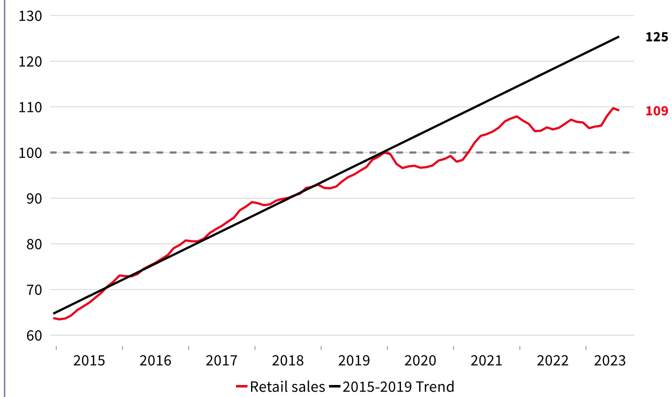
A weak economic recovery despite the end of health restrictions. After almost 3 years of severe health restrictions, the Chinese government lifted most of the restrictions late last year, leading to a significant upward revision of the economic and financial outlook. Indeed, the savings accumulated during the years of confinement were to allow a rapid catch-up of consumption. However, activity and inflation data in recent months show that economic growth remains on a moderate trajectory. Indeed, household consumption is much weaker than expected, with retail sales showing growth of only 2% for this first part of the year, well below the pre-Covid trend. Industrial production and exports are also showing weak growth. In this context, and unlike other major economies, China is experiencing very low inflation. .

Real estate tensions that weigh on activity. One of the reasons for the economic underperformance is the continuing tensions in the real estate sector and concerns about its solvency. Since the Lehman financial crisis, the Chinese authorities have revived the economy with plans largely based on infrastructure and residential real estate development. These stimuli were financed mainly by Chinese banks and local authorities, at the cost of a sharp increase in debt. Thus, private sector debt in China has risen from 111% of GDP in 2008 to 220% at the end of 2022 with the real estate sector becoming the country's main economic sector and financial asset. Fears about the solvency of real estate developers and the fall in real estate prices have resulted in a slowdown in investment but also in a still sluggish household consumption. The explanation is that a significant part of household savings is invested in real estate: the fall in household prices plays as a brake on the spending of Covid savings. As a result of these elements, we decreased our exposure to the Chinese equity market in Q2-23.

A risk of Japanification of the economy. The Chinese authorities have significant leeway to stabilize the real estate sector but seems slow to activate them. In this context, the main fear is that the Chinese economy will follow a similar dynamic to that of the Japanese economy following the bursting of the real estate bubble of the 90s. Indeed, the current economic situation shares many elements with Japan in the 80s and in particular the strong growth of private debt in local currency to finance real estate. The bursting of Japan's housing bubble resulted in a prolonged period of private sector deleveraging, weak private consumption and investment, and price contraction.

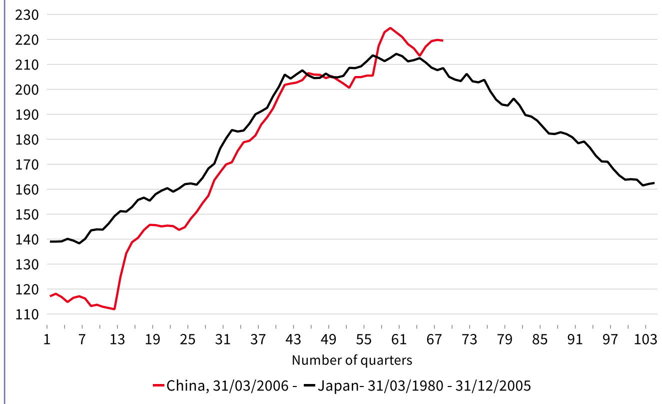
Households' consumption is still on a moderate growth path despite the end of the sanitary restrictions

Retail sales, 100=31/12/2019



Chinese private sector debt is following closely the dynamic of Japanese debt that preceded the deflation period

Private sector debt as % of GDP, Q0= start of the credit cycle



OUR MACRO COMMENTS

Events of the week

August S&P PMI data for the Euro area and the UK show that economic momentum in Europe remains sluggish. The Euro area S&P composite PMI remains in contraction territory at 47 versus 48.6 for July. The manufacturing PMI remains in sharply contracted territory at a level of 43.7 while the services PMI, hitherto still resilient, moved into the contraction zone in August (48.3). In the United Kingdom the trend is also bearish, with the S&P PMI falling to 47.9 from 5.8 for the month of July.

The Federal Reserve's Jackson Hole Symposium begins on Friday, August 15 and will bring together the heads of major central banks. At this conference, central bankers address structural topics, and their discussions often have an impact on financial markets. The theme addressed this year is the equilibrium interest rate in the post-Covid crisis economic context.

Figures of the week

	Actual	Forecast	Previous
Retail sales (July, YoY)	-2,10%	-	-2%
S&P IHSH PMI manufacturing August	43,7	42,7	42,7
S&P IHSH PMI services August	48,3	50,5	50,9
S&P IHSH PMI composite August	47	48,5	48,6
S&P IHSH PMI manufacturing August	42,5	45	45,3
S&P IHSH PMI services August	48,7	51	51,5
S&P IHSH PMI composite August	47,9	50,4	50,8
S&P IHSH PMI manufacturing August	49	47	49
S&P IHSH PMI services August	51	52,2	52,3
S&P IHSH PMI composite August	51,5	50,4	52
Orders of durable goods (July, M/M)	-4%	-5,20%	4,40%

Sources : Macrobond, 25 August 2023

The week ahead

Vendredi 25 août

Jackson Hole Symposium

Lundi 28 août

Monetary data July

Mardi 29 août

Consumer confidence

JOLTS employment data

Mercredi 30 août

Spain & Germany inflation August

August confidence indices

Jeudi 31 août

France, Italy, Euro area inflation August

PMI August

Households accounts July

Vendredi 1 septembre

Employment survey

MARKET PERFORMANCES

Interbank rates	Last.	-1W	-3M	YTD	-12M
€STER O/N	3,65	3,65	3,15	1,91	-0,08
USD SOFR O/N	5,30	5,30	5,05	4,30	2,27
JPY TONAR O/N	-0,06	-0,06	-0,05	-0,02	-0,03
GBP SONIA O/N	5,18	5,18	4,43	3,43	1,69
CHF O/N	1,76	1,76	0,80	0,80	0,10

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	82,96	-0,4%	6,1%	-3,5%	-18,4%
Or, USD/oz	1 916	1,2%	-2,1%	4,9%	9,4%
Copper, USD/metric ton	8 404	2,6%	5,6%	0,1%	4,8%
Platinium, USD/oz	926	3,5%	-11,5%	-13,1%	4,8%
Palladium, USD/oz	1 271	2,3%	-11,9%	-28,9%	-36,1%
Silver, USD/oz	23,75	4,6%	1,4%	-0,8%	25,0%

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	3,05	3,18	3,03	2,98	1,98
10Y Bund	2,52	2,64	2,45	2,44	1,36
10Y BTP	4,17	4,34	4,32	4,55	3,67
10Y JGB	0,66	0,62	0,40	0,41	0,22
10Y Bonos	3,54	3,69	3,51	3,51	2,56
10Y Swiss	0,97	1,01	1,05	1,57	0,77
10Y Gilt	4,47	4,62	4,19	3,66	2,68
10Y USTnote	4,19	4,28	3,73	3,88	3,11

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,08	-1,0%	0,2%	1,1%	8,8%
EUR/CHF	0,95	-0,5%	-2,0%	-3,3%	-1,1%
USD/GBP	0,79	0,5%	-2,5%	-5,1%	-6,9%
USD/JPY	144,76	-0,7%	4,1%	10,7%	5,8%
USD/BRL	4,89	-1,6%	-1,4%	-8,5%	-4,2%
USD/CNY	7,21	-1,1%	2,3%	4,6%	5,2%
USD/RUB	94,38	0,4%	17,5%	29,3%	55,9%

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	3,36	3,43	3,43	3,12	2,21
EUR Corporate Baa	4,53	4,59	4,62	4,65	3,38
GBP Corporate Baa	5,46	5,57	5,27	4,59	3,80
USD Corporate Aaa	4,88	4,99	4,55	4,62	4,02
USD Corporate Baa	5,98	6,07	5,78	5,70	5,04
USD EM aggregate	7,74	7,72	7,61	7,52	6,96

Equity indices	-1W	-3M	YTD	-12M
Developped markets	-0,2%	-0,2%	3,4%	1,7%
Euro area	-0,4%	-0,4%	0,1%	10,6%
Germany	-0,4%	-0,4%	-0,7%	11,8%
France	-0,2%	-0,2%	-0,1%	9,9%
United Kingdom	-0,5%	-0,5%	-4,0%	-1,8%
Switzerland	-0,2%	-0,2%	-3,6%	2,3%
United States	0,7%	0,7%	7,8%	15,5%
Japan	0,7%	0,7%	5,8%	20,4%
Brazil	2,2%	2,2%	8,6%	11,1%
Hong Kong	-2,6%	-2,6%	-6,6%	-9,8%
India	-0,2%	-0,2%	5,9%	7,0%
China	-3,2%	-3,2%	-4,2%	-4,5%

Source: Bloomberg, on 24 August 2023.
-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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