

Macro Note

China: Settling Into Slower Growth, June Economic Data Turned Out Stronger Than Expected

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- China's 2Q21 GDP growth was marginally below expectation at 7.9% y/y as it moderated from 18.3% y/y in 1Q21 but underlying momentum has remained fairly strong at 1.3% q/q (Bloomberg est. 8.0% y/y, 1.0% q/q SA), picking up from downwardly revised 0.4% q/q in 1Q21 (from 0.6% q/q previously). Overall, the economy grew by 12.7% y/y in 1H21.
- June economic indicators showed growth in retail sales, industrial production (IP) and urban fixed asset investment (FAI) slowing but were all above expectations. The month-on-month growth for these indicators have also kept up with gains in May, suggesting that the outlook has remained largely stable.
- China's GDP growth rate will continue to normalise in the coming quarters as the favourable base effect diminishes. The greater concern is the uneven growth recovery. China's internal circulation growth strategy is dependent on stronger recovery in domestic consumption. This will reduce its vulnerability to external risks. We maintain our GDP growth forecast for China at 9.1% this year, which factors in further moderation in the headline growth rate to around 6.0% in 2H21.
- The latest 50 bps cut to banks' Reserve Requirement Ratio (RRR) announced last Friday (9 July) comes into effect today. This is the first monetary policy move in more than a year following the previous RRR cut implemented on 15 May 2020. Part of the CNY1 trillion of liquidity released are used by financial institutions for the repayment of medium-term lending facility (MLF) loans that matured today. The People's Bank of China's (PBoC) injected CNY100 billion 1Y MLF at 2.95% today, less than CNY400 billion that were due, resulting in a net liquidity injection of CNY700 billion from the RRR cut.
- With another CNY3.75 trillion of MLF maturing in the rest of the year, the PBoC may need to cut the RRR further to pump more liquidity back into the system. However, we maintain our expectation for the PBoC to keep its benchmark 1Y LPR and the 5Y & above LPR unchanged at 3.85% and 4.65% respectively for the rest of the year.

China Settles Into Slower Growth As Low Base Effect Diminishes

China's 2Q21 GDP growth was marginally below expectation at 7.9% y/y as it moderated from 18.3% y/y in 1Q21 but underlying momentum has remained fairly strong at 1.3% q/q (Bloomberg est. 8.0% y/y, 1.0% q/q SA), picking up from downwardly revised 0.4% q/q in 1Q21 (from 0.6% q/q previously). Overall, the economy grew by 12.7% y/y in 1H21.

Despite the moderation in GDP growth rate from 1Q21, the economy has continued to recover though still remaining at below pre-pandemic rate. The National Bureau of Statistics said that the 2-year average GDP growth in 2Q has risen to 5.5% y/y from 5.0% y/y in 1Q.

Growth has moderated across the industries in 2Q21 with the sharpest slowdown seen in the secondary industry to 7.5% y/y from 24.4% y/y in 1Q21. In the tertiary industry, growth was lower at 8.3% y/y compared to 15.6% y/y in 1Q21 but the recovery has continued to take hold given the rebound in the 2-year average 2Q growth to 5.1% y/y from 4.7% y/y in 1Q. Primary industry growth has stabilised at 7.6% y/y in 2Q21 from 8.1% y/y in 1Q21.

Sentiment Improves On Stronger Than Expected Retail Sales In June

June economic indicators showed growth in retail sales, industrial production (IP) and urban fixed asset investment (FAI) slowing but were all above expectations. The month-on-month growth for these indicators have also kept up with gains in May, suggesting that the outlook has remained largely stable. The surveyed jobless rate was unchanged at 5.0% in June, the lowest since May 2019 when it was at the same rate. The sustained improvement in the labour market and household income growth are the bedrocks for stronger consumption recovery in 2H21.

Retail sales strongly outperformed market's expectation at 12.1% y/y in June (Bloomberg est: 10.8%, May: 12.4%) following a rather disappointing turnout in the two preceding months. In 1H21, retail sales were up 23.0% y/y with the average 2-year growth at 4.4% for the period which is still a distance from the 7-8% monthly growth rate prior to the pandemic. In comparison, e-commerce sales rose 23.2% y/y in 1H21 with 2-year average growth of 15.0% in the period.

In June, restaurant sales rose 28.6% y/y compared to 40.8% y/y in May, with 1H21 gains at 56.3% y/y. Other retail segments that saw relatively faster pace of growth include beverages (+29.1% y/y), jewellery (+26.0% y/y), petroleum & related products (+21.9% y/y) and building & decorative materials (+19.1% y/y).

Industrial production (IP) growth moderated to 8.3% y/y in June (Bloomberg est: 7.9%, May: 8.8%). In 1H21, IP rose 15.9% y/y with the average 2-year growth at 7.0% for the period. Helped by strong electronics demand and the reopening of economies, China's IP is already above its pre-COVID growth pace. Although external demand outlook remains positive, supply bottlenecks and higher commodity prices may dampen the gains.

Pharmaceutical manufacturing (+32.5% y/y), electrical machinery & equipment manufacturing (+15.0% y/y) and computer, communications & other electronic equipment manufacturing (+13.4% y/y) continued to rise at a relatively fast pace but cars manufacturing fell 4.3% y/y in June.

Fixed asset investment (FAI) was above expectation at 12.6% y/y YTD (Bloomberg est: 12.0%, May: 15.4%) with the average 2-year growth was 4.4% for 1H.

In 1H21, primary industry, secondary industry and tertiary industry recorded FAI growth of 21.3%, 16.3% and 10.7% respectively, compared to a year ago. Within the secondary industry, manufacturing FAI rose 19.2% y/y YTD, signalling strong outlook for production and exports.

Property investment slowed to 15.0% y/y YTD (Bloomberg est: 16.0%, May: 18.3%) while infrastructure investment also eased sharply to 7.8% y/y YTD in June from 11.8% y/y YTD in May, reflecting largely the weaker investment growth in railway transportation.

Above Expectation Export Growth In June

In USD-terms, China's export growth strengthened to 32.2% y/y in June (Bloomberg est: 23.0%; May: 27.9%) with 1H21 growth at 38.6% y/y. Its trade with the US had recovered more strongly during the period with its 1H21 exports and imports to/from the US rising 42.7% y/y and 55.9% y/y respectively despite the tensions. The stronger-than-expected export growth was despite shipping delays at ports in Shenzhen and Guangzhou due to the increase in COVID-19 infections in the Guangdong province in June. The sustained strength in external demand will provide the buffer against any slowdown in its consumption growth in 2H21. (Link to report: [External Demand Stayed Buoyant In June](#), 13 July 2021)

Inflation Abated In June

China's Producer Price Index (PPI) and Consumer Price Index (CPI) inflation have moderated in June. Domestic measures to contain commodity price gains may have helped to stabilize the PPI but elevated global crude prices and higher freight costs as pick-up in seasonal demand towards year end exacerbate the tight supply chain which in turn may further contribute to the price pressure. The PPI inflation is likely to stay elevated in 2H21 and we maintain our full-year forecast of 7.5% (2020: -1.8%).

However, the pass-through to CPI may continue to stay muted due to a more gradual recovery in demand. The headline inflation may slip slightly below 1.0% y/y in 3Q21 before rebounding in 4Q21. With 1H21 CPI inflation averaging just 0.5%, we now see full-year 2021 CPI averaging 1.1%, down from our earlier forecast of 1.9% (2020: 2.5%). (Link to report: [Inflation Abated In June](#), 09 July 2021)

COVID-19 Continues To Pose Risk To Growth

China's GDP growth rate will continue to normalise in the coming quarters as the favourable base effect diminishes. The greater concern is the uneven growth recovery. China's internal circulation growth strategy is dependent on stronger recovery in domestic consumption. This will reduce its vulnerability to external risks.

There are also concerns of a resurgence in COVID-19 infections (as seen in Guangdong between May and June), slowing momentum in domestic demand recovery, US-China tensions and the durability of global demand strength.

We maintain our GDP growth forecast for China at 9.1% this year which factors in further moderation in the headline growth rate to around 6.0% in 2H21.

PBoC Steps Up Policy Support

The latest 50 bps cut to banks' Reserve Requirement Ratio (RRR) announced last Friday (9 July) has come into effect today. This is the first monetary policy move in more than a year following the previous RRR cut implemented on 15 May 2020. The timing and magnitude (broad-based rather than targeted) of the cut indicate deeper concerns about the economic slowdown in 2H21 and perhaps is also aimed to reverse some of the credit tightening so far.

New renminbi loans have moderated in 2Q21 from record high level in the preceding quarter due to seasonal factors but managed to keep pace with the same period a year ago. However, the loans and M2 growth rates have both been on a moderating trend since 2H20 and are likely to slow further. This implies a slowdown in economic activities ahead.

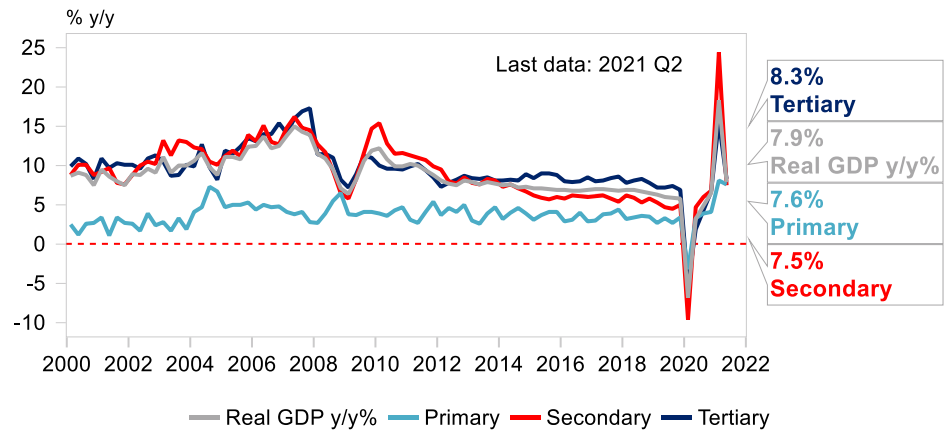
Part of the CNY1 trillion of liquidity released from today's RRR cut are used by financial institutions for the repayment of medium-term lending facility (MLF) loans that matured. The People's Bank of China's (PBoC) injected CNY100 billion 1Y MLF at 2.95% today, less than CNY400 billion that were due, resulting in net liquidity injection of CNY700 billion which could be used partly to offset tax payments later this month. With another CNY3.75 trillion of MLF maturing in the rest of the year, the PBoC may need to cut the RRR further to pump more liquidity back into the system. However, we maintain our expectation for the PBoC to keep its benchmark 1Y LPR and the 5Y & above LPR unchanged at 3.85% and 4.65% respectively for the rest of the year. (Link to report: [PBoC Announced Broad-Based RRR Cut](#), 12 July 2021)

China's Key Macro Data												
	2018	2019	2020	4Q20			1Q21			2Q21		
Real GDP Growth %y/y	6.7	6.0	2.3	6.5			18.3			7.9		
Real GDP Growth %q/q SA	-	-	-	3.0			0.4			1.3		
%/y change except noted	2018	2019	2020	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
Industrial Output	6.2	5.7	2.8	6.9	7.0	7.3	-	-	14.1	9.8	8.8	8.3
CFLP Manufacturing PMI	49.4	50.2	51.9	51.4	52.1	51.9	51.3	50.6	51.9	51.1	51.0	50.9
Caixin-Markit Manufacturing PMI	49.7	51.5	53.0	53.6	54.9	53.0	51.5	50.9	50.6	51.9	52.0	51.3
CFLP Non-Manufacturing PMI	53.8	53.5	55.7	56.2	56.4	55.7	52.4	51.4	56.3	54.9	55.2	53.5
CPI	2.1	2.9	2.5	0.5	-0.5	0.2	-0.3	-0.2	0.4	0.9	1.3	1.1
PPI	3.5	-0.3	-1.8	-2.1	-1.5	-0.4	0.3	1.7	4.4	6.8	9.0	8.8
Exports (USD terms)	9.9	0.5	3.6	11.4	21.1	18.1	24.8	154.9	30.6	32.3	27.9	32.2
Imports (USD terms)	15.8	-2.8	-1.1	4.7	4.5	6.5	26.6	17.3	38.1	43.1	51.1	36.7
Trade Balance (USD bn)	\$ 350.9	\$ 421.1	\$ 526.9	\$ 58.4	\$ 75.4	\$ 78.2	\$ 65.4	\$ 37.9	\$ 13.8	\$ 42.9	\$ 45.5	\$ 51.5
New Loans (RMB bn chg)	¥ 16,170	¥ 16,814	¥ 19,634	¥ 690	¥ 1,430	¥ 1,260	¥ 3,580	¥ 1,360	¥ 2,730	¥ 1,470	¥ 1,500	¥ 2,120
Aggregate Financing (RMB bn chg)	¥ 22,492	¥ 25,674	¥ 34,863	¥ 1,393	¥ 2,136	¥ 1,719	¥ 5,184	¥ 1,724	¥ 3,371	¥ 1,850	¥ 1,921	¥ 3,670
M2	8.1	8.7	10.1	10.5	10.7	10.1	9.4	10.1	9.4	8.1	8.3	8.6
Urban Fixed Asset Investment YTD	5.9	5.4	2.9	1.8	2.6	2.9	-	35.0	25.6	19.9	15.4	12.6
Retail Sales	8.8	8.0	-3.9	4.3	5	4.6	-	-	34.2	17.7	12.4	12.1

Source: CEIC, Bloomberg, National Bureau of Statistics; UOB Global Economics & Markets Research estimates. All data for individual months except noted

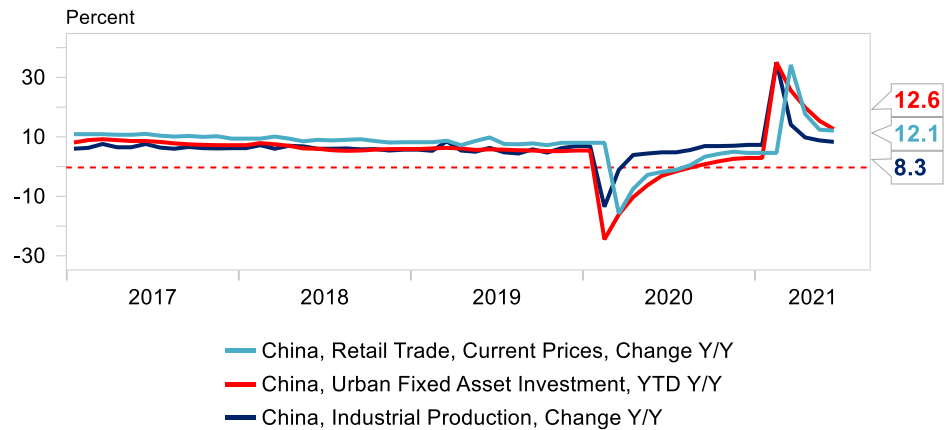
China, Quarterly Real GDP Growth, By Sector

Source: Macrobond, UOB Global Economics & Markets Research



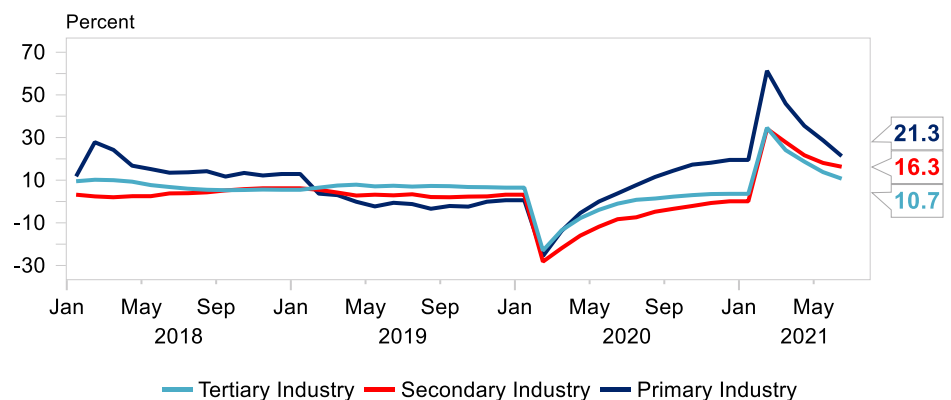
China: Slowdown In Economic Indicators

Source: Macrobond, UOB Global Economics & Markets Research



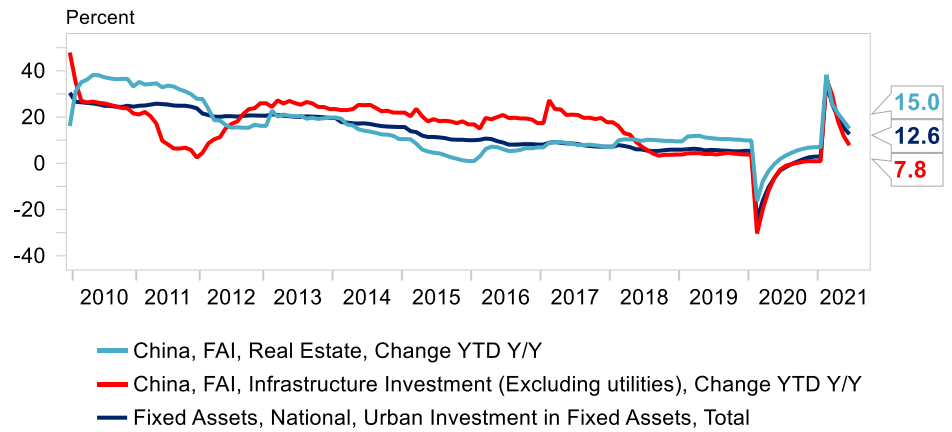
China, Fixed Assets, National, Urban Investment in Fixed Assets, Change YTD Y/Y

Source: Macrobond, UOB Global Economics & Markets Research



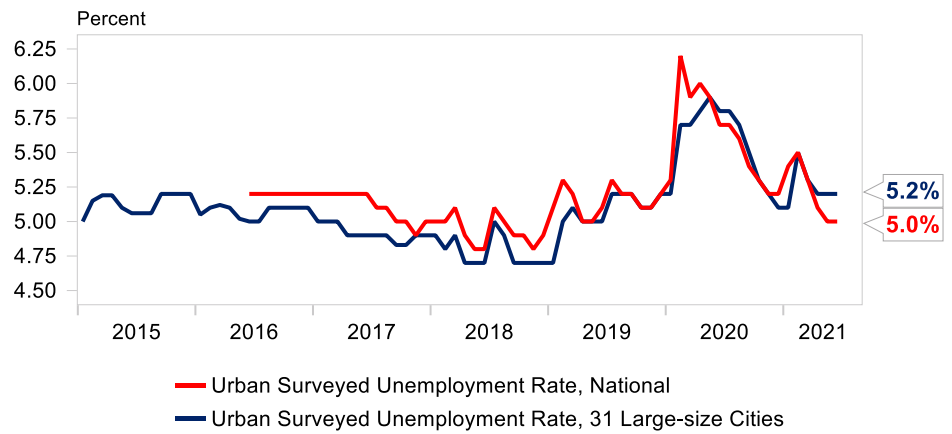
China, Urban Investment in Fixed Assets, Change YTD Y/Y

Source: Macrobond, UOB Global Economics & Markets Research



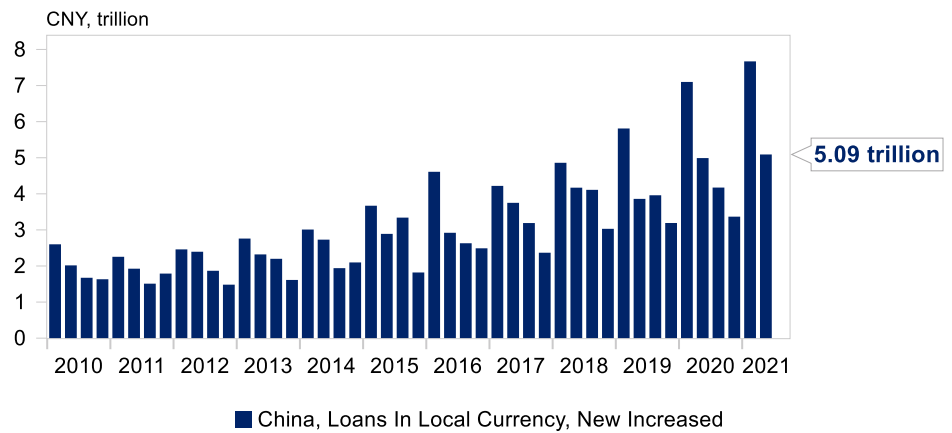
China: Labour Market Continues To Improve

Source: Macrobond, UOB Global Economics & Markets Research



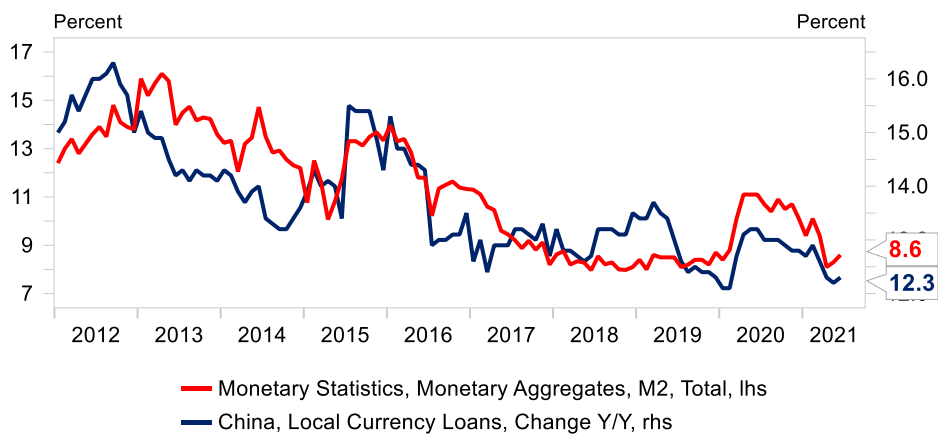
New CNY Loans Slowed In 2Q21

Source: Macrobond, UOB Global Economics & Markets Research



China: Loans And M2 Growth Slowing

Source: Macrobond, UOB Global Economics & Markets Research



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