Theme

China | The economy maintains recovery momentum in July but still unbalanced

Jinyue Dong / Betty Huang

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A batch of economic activity indicators announced today by the National Bureau of Statistics pointed to a continuing growth recovery in July as the COVID-19 epidemic wanes in China. However, the data outturns reflect that the ongoing recovery still bears its uneven feature as the pickup of the supply side continue outpacing that of the demand side.

In particular, the growth of industrial production came at 4.8% y/y in July which is in line with the reading in the previous month (Bloomberg consensus: 5.2% y/y). (Figure 1) By categories, manufacturing output growth rate rose to 6% from 5.1% in June. For the medical equipment and devices manufacturing, the capacity has been operated in full gear to meet the enormous demands from all around the world. However, energy output declined due to the price effect.

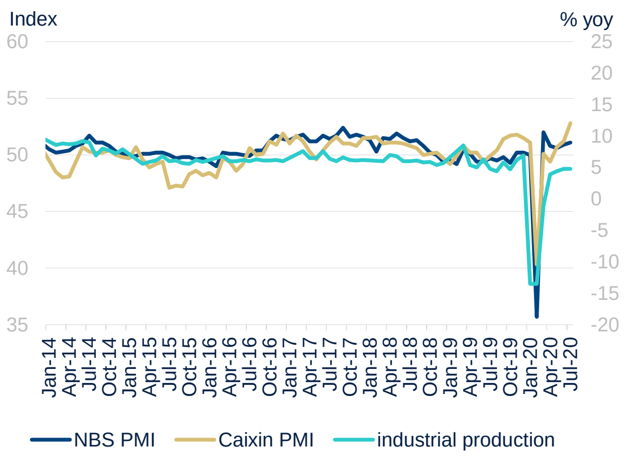
In contrast, the recovery of the demand side was still slower than that of the supply side. Both fixed asset investment and retail sales remained in the contractionary territory and are below the market expectations in July, although they have remarkably improved from their previous readings. In particular, fixed asset investment picked up to -1.6% y/y in July from -3.1% y/y in the previous month (consensus: -1.6% y/y). By component, real estate and to a lesser extent infrastructure already showing positive growth. However, manufacturing FAI remained in contraction territory, reflecting weak external demand. (Figure 2) In terms of ownership, the state-owned enterprises FAI rebounded, leading the FAI recovery, but investment of private companies continued to be in contraction. (Figure 4) Meanwhile, retail sales increased to -1.1% y/y in July, from -1.8% y/y in the previous month (consensus: 0.1% y/y).(Figure 5) The recovery was driven by the catering sector, one of the worst-hit industries by the epidemic, with its contraction narrowed to -10.3% y/y in July from -12.4% y/y in June, although still in contraction.

To deal with the sluggish domestic demand, the “dual circulation” growth model with a focus on “internal-circulation” is the new strategy for Chinese authorities in coping with new global circumstances. The “internal-circulation” has two important perspectives which are “consumption internal-circulation” and “supply-chain internal-circulation”. The former simply means domestic market comes first amid the global expansion of COVID-19 pandemic, indicating China needs to focus on stimulating domestic demand in the near-term. The latter suggests strengthening China’s grip on supply chain and reducing the reliance on foreign suppliers in key technology field amid the decoupling of China and the US.

From the policy perspective, the better-than-expected growth recovery and the control of COVID-19 made the authorities intend to gradually normalize the previous easing monetary policy in the second half of this year. However, the ongoing monetary policy normalization does not necessarily mean the monetary tightening cycle will start. Economic uncertainties ahead such as the possible further rounds of COVID-19 and the escalating China-US conflicts amid global recession still call for monetary policy support in 2H 2020.

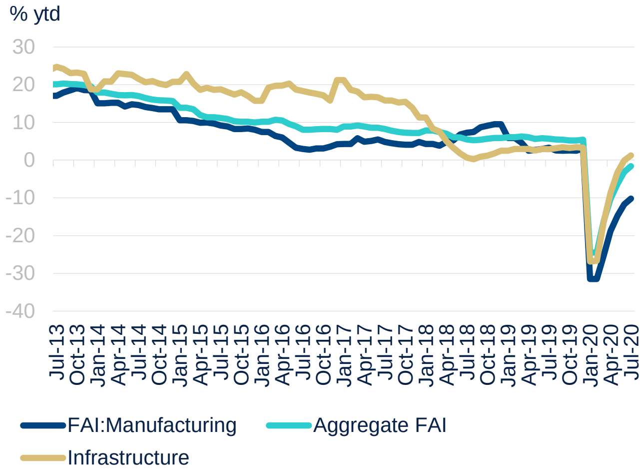
In sum, we expect an unbalanced recovery to continue in the following months and the economy still needs time to go back to the prior-COVID level. The sustainable recovery of Chinese economy in 2H depends on to what extend the authorities' monetary and fiscal easing measures could stimulate the domestic demand. Moreover, the lingering virus inside China in recent weeks signifies that the recovery might be fragile until a vaccine is perfected. On the other hand, the COVID-19 pandemic expansion outside of China continued to undermine the external demand. Looking ahead, we maintain our prediction that the GDP growth rate will steadily climb up to 5% y/y in Q3 and 6% y/y in Q4, concluding 2020 with a full-year growth outturn of 2.2% (higher than the IMF's 1% forecast while generally in line with the market consensus), making China be one the few countries or regions in the world achieving positive growth in 2020.

Figure 1. **Industrial production maintained 4.8% y/y growth in July**



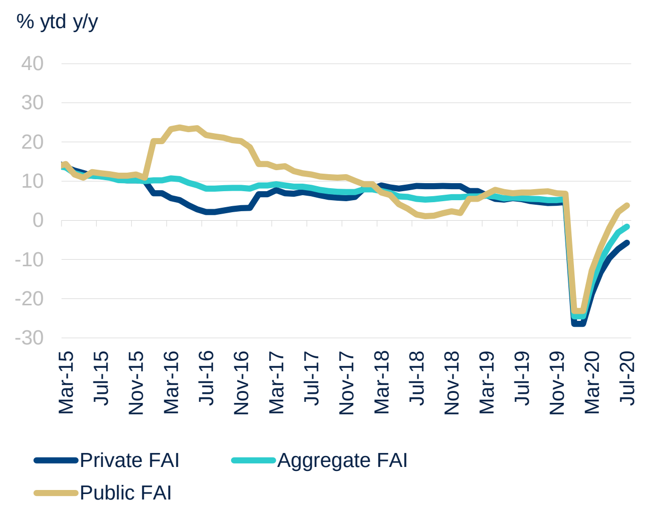
Source: CEIC and BBVA Research

Figure 2. **Infrastructure FAI recovered to positive growth while manufacturing FAI lagged behind**



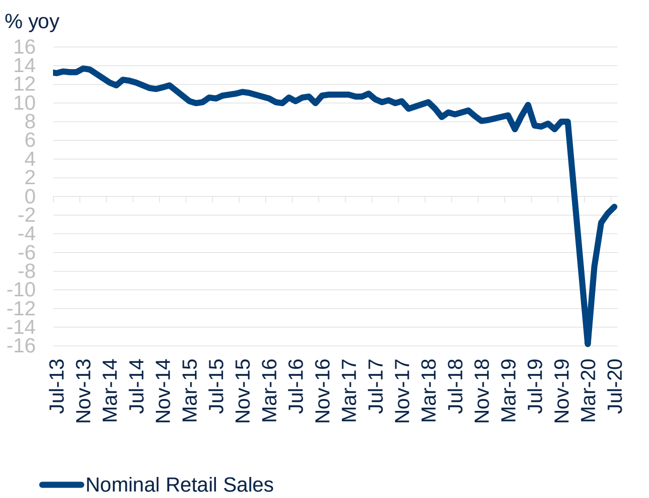
Source: CEIC and BBVA Research

Figure 3 **Public FAI led the FAI recovery**



Source: CEIC and BBVA Research

Figure 4 **Retail sales still in the negative region**



Source: CEIC and BBVA Research

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ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25
bbvaresearch@bbva.com www.bbvaresearch.com