Economic Watch

China | Q2 GDP moderated with a more balanced structure

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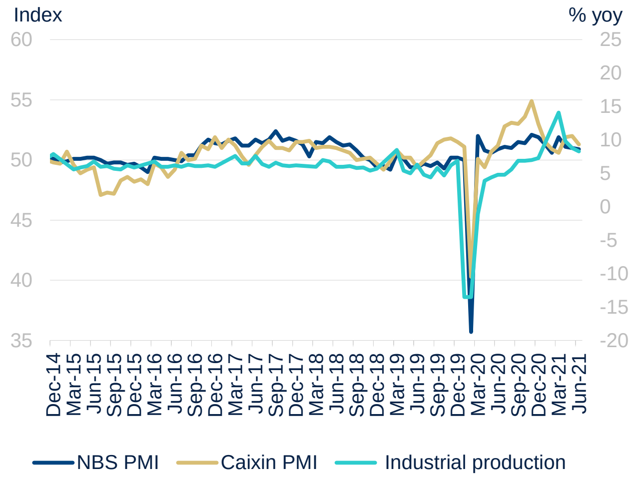
The Q2 GDP figures together with June real economic indicators were released by the National Bureau of Statistics today, confirming a continuing moderated year on year growth momentum. The Q2 GDP slowed to 7.9% y/y after reaching a record-high 18.3% y/y in Q1 2021. On sequential terms, it expanded to 1.3% q/q from 0.6% q/q in Q1 2021. The consumption and manufacturing investment are still weaker-than-expected, although they suggest the supply-demand gap further narrowed. To regain all the lost ground of the demand side, quite a bit of perseverance is still needed. Regarding the June economic activities, industrial production, retail sales and fixed asset investment all registered a decelerating year on year growth from the previous month's readings, in line with our expectations. Looking ahead, we anticipate that the growth rate will slowly fall from the previous high level to its long-term potential growth trend in 2H 2021. The pent-up domestic demand and persistently good performance of the external sector are likely to underpin the growth in the rest of the year. We maintain our 2021 GDP forecasting at 8.2% y/y, which is way above the conservative official target of 6% announced in the "two sessions" this year, but lower than the market consensus of 8.5% and IMF's 8.4%.

On the supply side, the year on year growth of industrial production slowed to 8.3% y/y from 8.8% y/y in the previous month (market consensus: 7.8% y/y) while the seasonal adjusted m/m growth marginally expanded to 0.56% from 0.53% m/m in May. By categories, high-tech and electric vehicle sectors led the industrial production growth. The growth of new energy automobile manufacturing amounted to 205% y/y from 166.3% y/y in the previous month, followed by the industrial robots and integrated circuits which registered 69.8% y/y and 45.6% y/y (prior: 50.1% y/y and 37.6% y/y) respectively, benefiting from the pent-up domestic demand, the carbon neutrality initiatives and ongoing global recovery in the post-pandemic era. (Figure 1)

On the demand side, both FAI and retail sales registered a slowdown on year on year growth. Fixed-asset investment (FAI) trended down to 12.6% ytd y/y from 15.4% ytd y/y in May (market consensus: 12.1% ytd y/y). On sequential term, its seasonal adjusted m/m growth slightly decelerated to 0.35% m/m from 0.36% m/m in the previous month. By components, as we expected, manufacturing FAI surpassed the infrastructure FAI and real estate FAI to lead the investment growth, although all of the components registered a slowdown reading. In particular, manufacturing FAI reached 19.2% ytd y/y (prior: 20.4% ytd y/y), higher than the infrastructure FAI at 7.8% ytd y/y (prior: 11.8% ytd y/y) and real estate at 15% ytd y/y (prior: 18.3% ytd y/y) respectively, amid a continuing accelerating global demand thus enhanced investment sentiments of SMEs. By contrast, the slowdown of infrastructure and real estate investment are dragged by the deceleration of local government bond issuances amid fiscal policy normalization and macro prudential policies on soaring housing market. Looking ahead, the manufacturing FAI is poised to spearhead the FAI growth in 2021. (Figure 2 and 3)

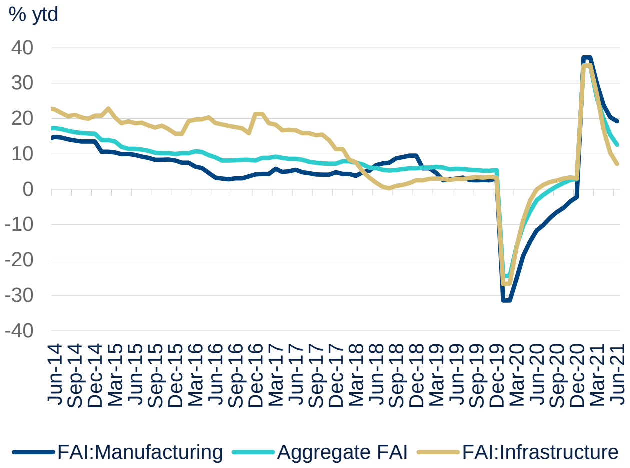
In addition, retail sales' year on year growth is also tumbling to 12.1% y/y from 12.4% y/y in May (market consensus: 11% y/y) while its month on month growth also decelerated to 0.7% m/m from 0.81% m/m previously. By component, the highest growth of retail sales concentrates on the restaurant and luxuries sector which used to be hit most seriously by the pandemic. In particular, jewelry sales led the retail sales recovery which is ballooning to 59.9% ytd y/y (Prior: 37.6% y/y ytd), indicating the ever-rising tide of consumption demand after being constrained by Covid-19 restrictive measures. Following that is restaurant sales, which registered 48.6% y/y ytd (Prior: 40.8% y/y ytd). (Figure 4)

Figure 1. **INDUSTRIAL PRODUCTION MODERATED ITS Y/Y GROWTH MOMENTUM**



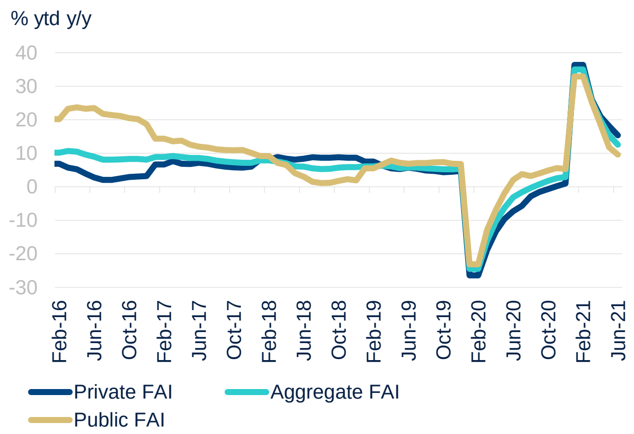
Source: CEIC and BBVA Research

Figure 2. **MANUFACTURING FAI SURPASSING INFRASTRUCTURE AND REAL ESTATE TO LEAD THE FAI GROWTH**



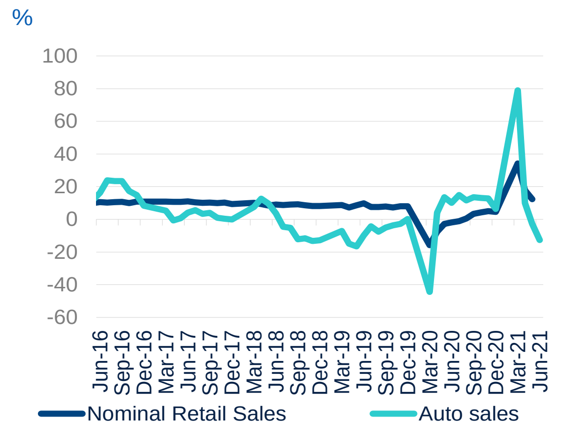
Source: CEIC and BBVA Research

Figure 3. **PRIVATE FAI SURPASSING PUBLIC FAI AMID FISCAL POLICY NORMALIZATION**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES PARTICULARLY AUTO SALES ALSO DECELERATED IN Y/Y GROWTH**



Source: CEIC and BBVA Research

Altogether, Chinese economy, after achieving a complete V-shape recovery in Q4 2020, displayed a moderated growth momentum but with a more balanced structure. Our basic story is not changed significantly so far: exports will maintain its strong momentum in 2H 2021 to support growth as the world is still grappling with the pandemic; the recovery of retail sales and manufacturing FAI, will be the new growth engine in the rest of 2021 although some perseverance still needed to regain all the lost ground of 1H 2020; real estate investment, despite of the tightening regulations on the housing market, remains resilient to support growth given its large spillover effect to other sectors, while the infrastructure investment might accelerate in 2H due to the authorities' roll-out of unallocated local government bond quotas.

On the policy front, although the recent RRR cut in July ignited the markets hope of a loosening monetary policy in 2H 2021, we anticipate a neutral but still accommodative monetary policy stance "without a sharp turnaround" will remain. Several factors decide this year's monetary policy normalization should avoid "sharp turnaround", neither a turnaround to aggressive easing nor to aggressive tightening. Uncertainties of global economic recovery, unsatisfactory vaccine coverage, China-US confrontations and potentially fading exports momentum etc. added more headwinds on growth thus there will be "no sharp turnaround to aggressive tightening". On the other hand, there will be also "no sharp turnaround to aggressive easing" as China has already achieved the "first-in, first-out" of the pandemic with the recovery still on a right track; moreover, it is not realistic to start another easing cycle when the US FED started to discuss QE Tapering, which will further enlarge interest differential and trigger capital outflows. All in all, the 2H 2021 policy will be neutral but still accommodative, and there needs to be some balance between stimulating growth and defusing financial risks, thus the macro prudential policy will be further enhanced to curb these risks going forward.

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