China Flash

Q2 GDP growth slows in line with expectations, and shows some signs of stabilizing from increased policy support

China's GDP growth slowed to 7.6% in Q2, down from 8.1% y/y in Q1, broadly in line with expectations (consensus: 7.7%; BBVA: 7.4%) (Chart 1). Underlying the outturn was a decline in the contribution of consumption and a pickup in investment, consistent with government efforts to step up the pace of infrastructure spending as private activity slows. June activity indicators, also released today, paint a similar picture with signs that the slowdown may be stabilizing. In particular, June fixed asset investment (21.2% y/y) and retail sales (13.7%) maintained their momentum, although industrial production (9.5% y/y) continued to slow. We expect GDP growth to accelerate in the second half of the year as the government steps up its stimulus measures. Following the June and July interest rate cuts, we expect up to two more rate cuts during the remainder of the year, along with another 150bps of cuts in the RRR. Fiscal policy is also providing support through stepped up investment projects. We anticipate that full-year GDP growth will be short of our previous 8.3% projection by around a half percentage point.

- **Q2 GDP growth eased to 7.6% y/y from 8.1% y/y in Q1 (Chart 1).** On a sequential basis, official quarterly growth actually rose to 1.8%, seasonally adjusted (7.4% annualized rate), from a revised 1.6% seasonally adjusted in Q1. Our own seasonal adjustment suggests that quarterly growth was about 1.7% in both quarters.
- **Activity indicators in June were mixed, but taken together show signs of stabilization**. On the demand side, retail sales growth came out to 13.7% y/y, down slightly from 13.8% in May, but above expectations (consensus: 13.4%: BBVA: 13.6%) (Chart 2). Urban fixed asset investment growth ticked up to 20.4% (ytd) in June, slightly above expectations (consensus: 20.0%) (Chart 3). In addition, trade data released earlier in the week showed better-than-expected exports, increasing by 11.3% y/y (consensus: 10.6%), although import growth fell to 6.3% y/y, much lower than expected (consensus: 11.0%). On the supply side, industrial output grew by 9.5% y/y in June, slightly below expectations (consensus: 9.8%; BBVA: 11.0%) (Chart 4). While the data present a mixed picture, we believe that, taken together, they suggest that the growth slowdown is bottoming out as the authorities step up their stimulus measures (see directly below on credit growth).
- **Credit growth in June accelerates.** Data on new loans, released yesterday, show a faster-than-expected rise to RMB 920 billion from RMB 793 billion in May (consensus: RMB 880 billion), bringing total new loans in 1H 2012 to RMB 4.86 trillion, broadly consistent with the full-year informal target of RMB 8.0-8.5 trillion (the bulk of lending is done in the first half). Meanwhile, Total Social Financing (TSF), a broader measure of credit growth also accelerated (Chart 5). The rise in credit growth suggests that government efforts to stimulate lending are beginning to work.
- **Foreign exchange reserves decline by $65 billion in Q2, despite trade surplus**. Despite a larger trade surplus in Q2 (Chart 6), foreign reserves declined slightly, to USD 3.24 trillion as of end-June from USD 3.31 trillion at end-March, suggesting some modest capital outflows during the period.

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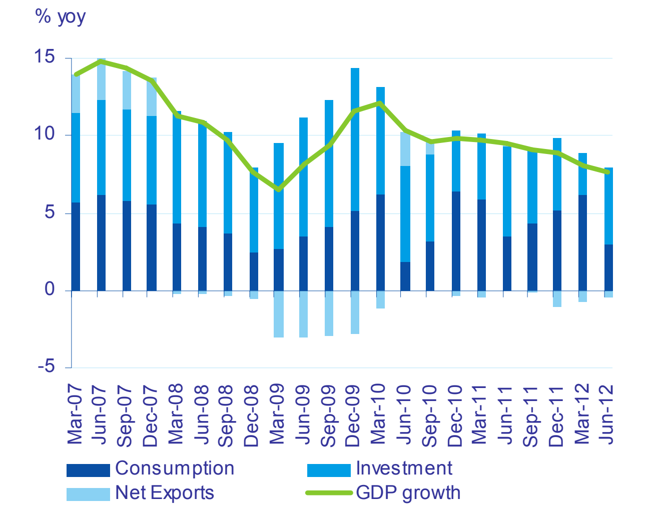
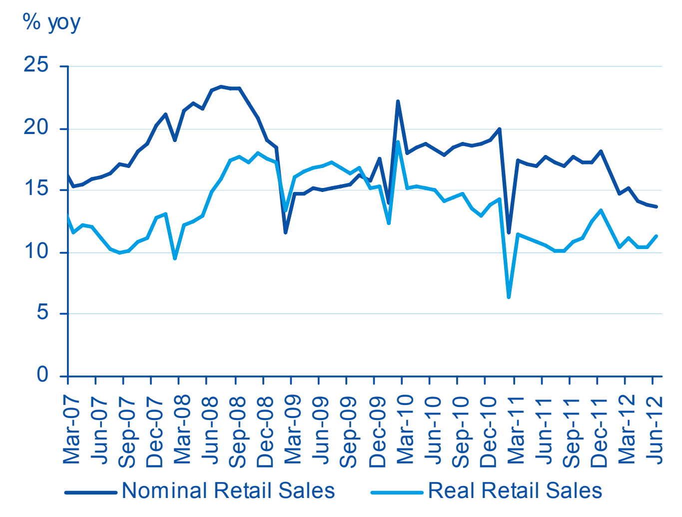
Chart 1
GDP growth falls to a three-year low



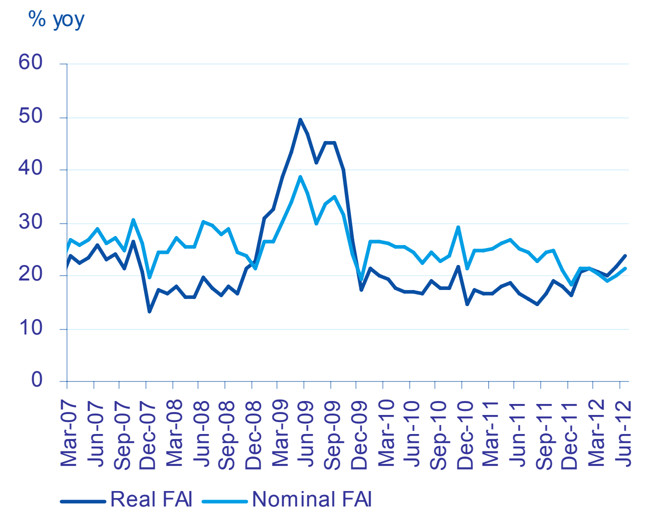
Source: CEIC and BBVA Research

Chart 2
Retail sales growth has weakened



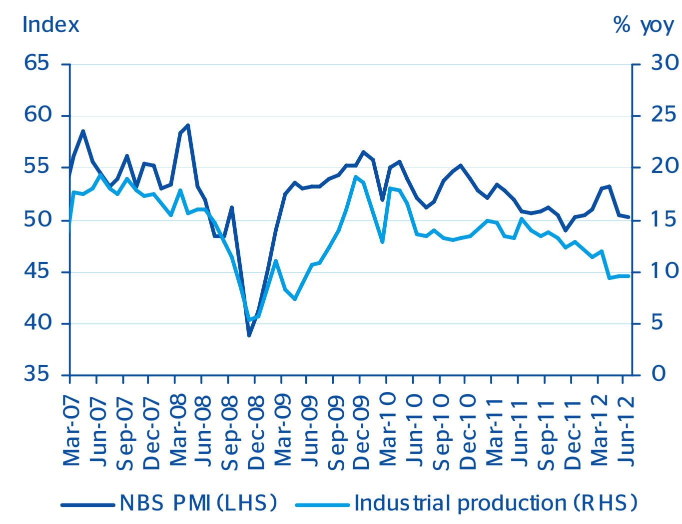
Source: CEIC and BBVA Research

Chart 3
Fixed asset investment is picking up



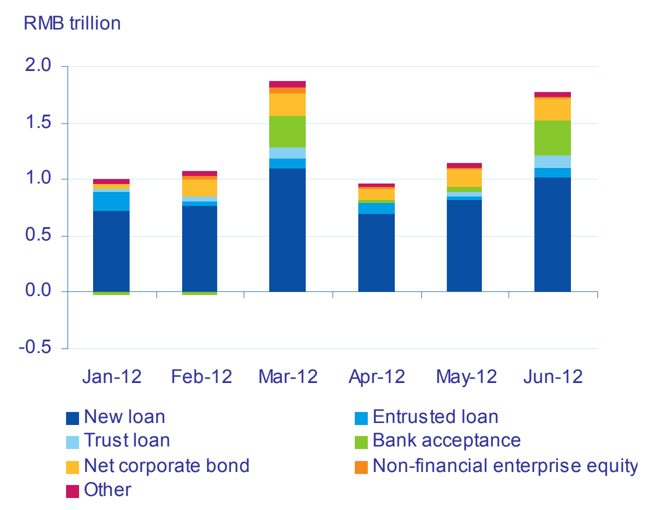
Source: CEIC and BBVA Research

Chart 4
Industrial production and PMI are soft



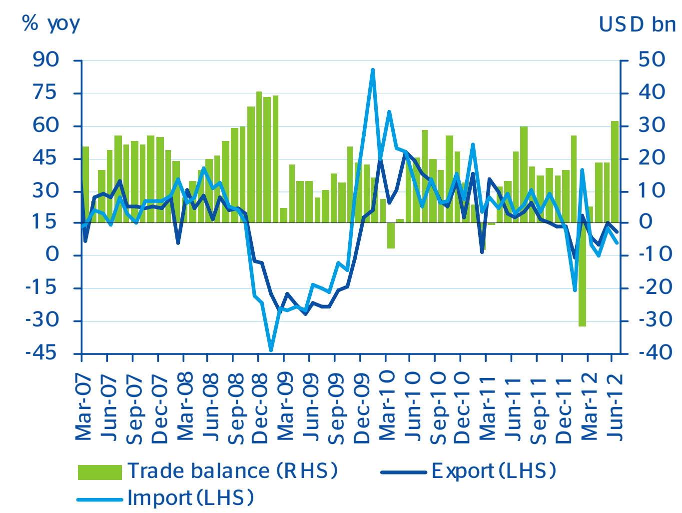
Source: CEIC and BBVA Research

Chart 5
Total social financing expanded in June



Source: CEIC and BBVA Research

Chart 6
The trade surplus has increased on low imports



Source: CEIC and BBVA Research