CHINA RAPID RESPONSE

GDP (Q2) & Activity (Jun.)

Recovery shifts down a gear

- **GDP slowed more than expected in Q2 due to a fizzling out of the reopening boost. Continued weakness in the property sector, possible loosening in the labour market and few signs of broad-based stimulus suggest few upsides to output over the rest of the year. Given the weaker than anticipated Q2 GDP print, we now think official GDP growth will come in at 5.5% this year.**
- Headline GDP growth accelerated from 4.5% y/y in Q1 to 6.3% last quarter, much weaker than expectations (the Bloomberg median was 7.0%; our forecast was 7.8%). (See Chart 1.) The acceleration largely reflects a weak base for comparison – Shanghai and other large cities were placed under lockdowns in Q2 last year. Growth dropped back in seasonally-adjusted q/q terms from 2.2% to 0.8%. This is discouraging – **the economy started the quarter with plenty of spare capacity and ended with even more.**
- As usual, many will doubt the accuracy of the official figures. Even though our in-house China Activity Proxy points to a dramatic slowdown in q/q terms, it suggests that the official figures overstate the expansion in output since the start of last year. (See Chart 2.)
- The GDP breakdown shows unsurprisingly that industry, construction and services all fared better in Q2 relative to Q1 in y/y terms. But again, this reflects a much weaker base for comparison. **In seasonally-adjusted q/q terms, growth on all measures slowed**.
- The monthly data released alongside the GDP figures were also distorted by base effects. Year-on-year growth in services activity softened from 11.7% to 6.8% in June while retail sales growth weakened from 12.7% to 3.1% (Bloomberg: 3.1% and CE: 6.0%). **But our estimates suggest sales were broadly unchanged in m/m seasonally adjusted terms**. An acceleration in in-person goods and restaurant sales more than offset a contraction in online goods sales. (See Chart 3.)

Chart 1: Official GDP

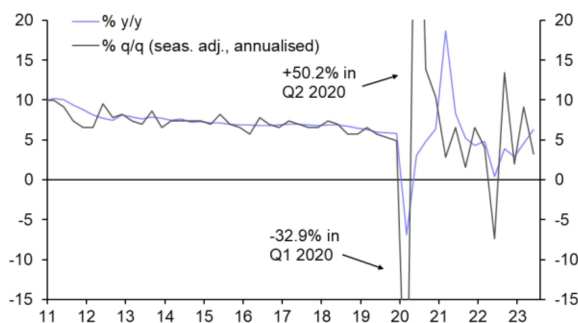


Chart 2: GDP & CE China Activity Proxy (2019=100, seas. adj.)

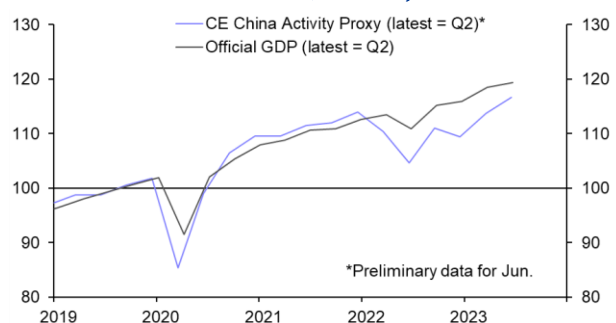


Chart 3: Retail Sales (Dec. 2019=100, seas. adj.)

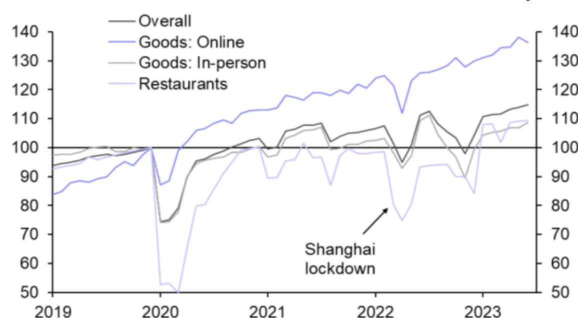
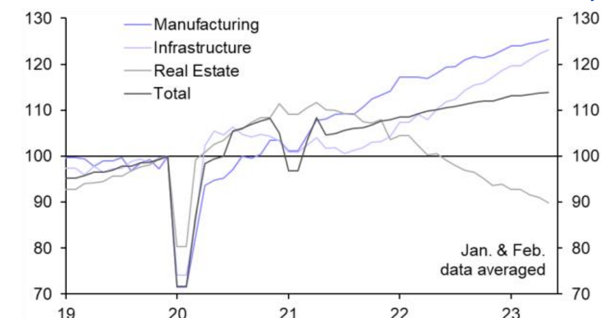


Chart 4: Fixed Investment (Dec. 2019=100, CE seas. adj.)



Sources: CEIC, Refinitiv, WIND, Capital Economics

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- Year-to-date, fixed investment weakened from 4.0% y/y to 3.8% last month. (Bloomberg: 3.4% and CE: 3.8%). That implies an acceleration in monthly y/y growth from 2.2% y/y to 3.3%. We estimate that growth edged up in seasonally adjusted m/m terms too. **Manufacturing and infrastructure investment quickened while the contraction in property investment eased.** (See Chart 4.)
- The wider data on the property sector were particularly weak. Prices fell for the first time this year. Home sales and new housing starts continued to drop and are now roughly at their end-2022 levels. (See Chart 5.) These suggest that sentiment among homebuyers is still low and developers remain cautious.
- Industrial output disappointed last month too. Admittedly, year-on-year growth accelerated from 3.5% y/y to 4.4% (Bloomberg: 2.5% and CE: 3.0%). But after accounting for base effects, **our calculations suggest that output growth edged down in m/m terms. This is consistent with relatively subdued growth in goods demand.** Data published today suggest a further softening in export sales among industrial firms in June and continues to point to a more pronounced downturn in external demand compared to the more noisy customs data. (See Chart 6.)
- **Overall, the data published today suggest that the reopening recovery had slowed to a crawl in Q2 even as it appears to have stabilised in June.** However, signs from high frequency data point to continued weakness during the first half of July. And while the urban unemployment rate remains low compared to much of the past few years, it continued to tick up in June and still points to some renewed softening in the labour market. Of particular concern is that the youth unemployment rate climbed to a record high of 19.7%, after accounting for seasonality.
- Given the bleak backdrop, it is unsurprising that policymakers are becoming increasingly concerned and have made some effort to shore up the economy. But measures so far have fallen short of what is needed to provide a meaningful boost to the economy. And the lack of cut to the interest rate on rolled-over medium-term lending facility loans earlier today suggests there is no urgency by policymakers to provide much additional support. Further ahead, a substantial step up in support is unlikely – we are anticipating only one more 10bps cut to policy rates and 50bps cut to reserve requirements during the rest of this year, as well some additional fiscal support.
- We had been more optimistic than consensus on the economic performance in Q2. Given the weaker-than-expected outturn, however, **we are lowering our annual growth forecast from 6.0% to 5.5%**, into line with the analyst consensus. **But in practice, growth is likely to be higher given that the official GDP figures understated the extent of last year's downturn.**

Chart 5: Real Estate Activity (million sqm, seas. adj.)

Chart 6: Exports & Industrial Export Sales ($, Dec. 2019=100, CE seas. adj.)

Sources: CEIC, Capital Economics

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