CHINA RAPID RESPONSE

Activity & Spending (Jul.)

Growth has slowed to a crawl

- **All the main activity indicators undershot consensus expectations in July, with most either stagnant or barely expanding in m/m terms. And with financial troubles at developers such as Country Garden likely to weigh on the housing market in the near-term, there is a real risk of the economy slipping into a recession unless policy support is ramped up soon – today's rate cut won't cut it.**
- Growth in retail sales continued to soften last month, dropping back from 3.1% y/y in June to 2.5% in July (the Bloomberg consensus was 4.0% and our forecast was 2.0%). After accounting for base effects and seasonality, **our calculations suggest that sales remained stagnant in m/m terms.** The breakdown showed that all sectors were flat last month. (See Chart 1.) It's hard to estimate m/m growth in wider services activity given that the statistics bureau only publishes y/y figures. But based on a decline in those, it seems the loss of momentum wasn't only confined to retail sales. (See Chart 2.)
- Industrial output struggled to make any gains, with growth falling from 4.4% y/y to 3.7% (Bloomberg: 4.3%, CE: 4.4%). In seasonally-adjusted terms, our estimates suggest **output growth slowed to just 0.1% m/m.** (See Chart 3.) **Factories have not only had to content with an underwhelming domestic recovery but also a pullback in foreign demand**. Admittedly, data published today suggest there was a slight uptick in export sales among industrial firms in July. But the bigger picture is that it continues to point to a pronounced downturn in external demand which has yet to be fully reflected in the customs data. (See Chart 4.)
- **Fixed investment disappointed too.** Year-to-date, fixed investment growth dropped back from 3.8% to 3.4% (Bloomberg and CE: 3.7%). That implies a slowdown in monthly y/y growth from 3.3% y/y to 1.2%. That said, by our estimates, the pace of expansion softened to just 0.1% m/m in seasonally-adjusted terms. The contraction in property investment deepened, but that was offset by a pick-up in spending in other sectors. Manufacturing and infrastructure investment were flat. (See Chart 5.)
- **The wider data on the property sector were also weak.** Home sales edged down, and new housing starts continued to drop. (See Chart 6.) The latter is now below the low it reached at the end of last year, which suggests that developers are as pessimistic as ever. We don't get the official survey of house prices until tomorrow. Implied prices calculated based on the sales values and volumes reported by developers have been rising recently, but this may reflect the collapse of sales in tier 3 and 4 cities where average prices are lower. (See Chart 7.)
- **Overall, the data published today suggest that the economy was still struggling at the start of Q3.** And signs from high frequency data do not point to a turnaround during the first half of August. While the urban unemployment rate remains low compared to much of the past few years, it continued to tick up in July. Hours worked also declined in seasonally-adjusted terms. (See Chart 8.) Both point to some renewed softening in the labour market. And a decision to discontinue the youth unemployment figures just after they hit a record high doesn't inspire confidence. Troubles at Country Garden and state-owned Sino-Ocean, will also sap confidence among homebuyers and creditors, adding more gloom to the property outlook.
- **Officials appear to be stepping up efforts to support the flagging economy.** Earlier today, the PBOC cut its 7-day reverse repo rate by 10bps and lowered the rate on its medium-term lending facility (MLF) by a larger 15bps. This should be followed by reductions to the loan prime rates next week – the 5-year rate is the benchmark for pricing most mortgages. We anticipate additional monetary easing during the rest of the year and more targeted support to the housing market.
- **However, rate cuts are likely to remain too small to revive credit demand, while policymakers have so far been slow to roll out meaningful fiscal support.** Unless officials act more forcefully soon, our expectation for a modest policy-driven reacceleration in growth later this year may prove too optimistic.

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Chart 1: Retail Sales (Dec. 2019 = 100, seas. adj.)

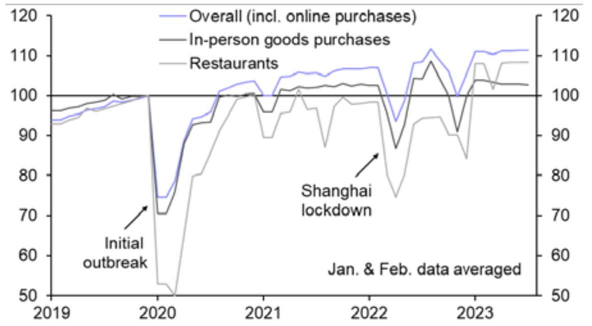


Chart 2: Retail Sales & Services Production (% y/y)

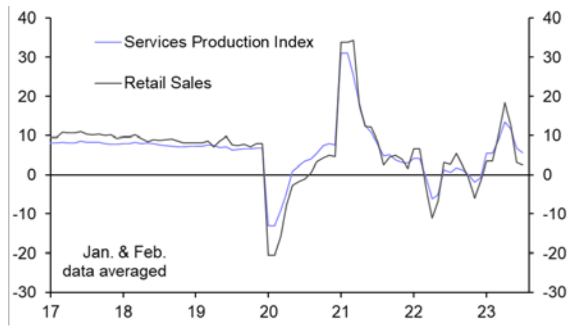


Chart 3: Industrial Output (% m/m annualised, CE seas. adj., Jan. & Feb. averaged)

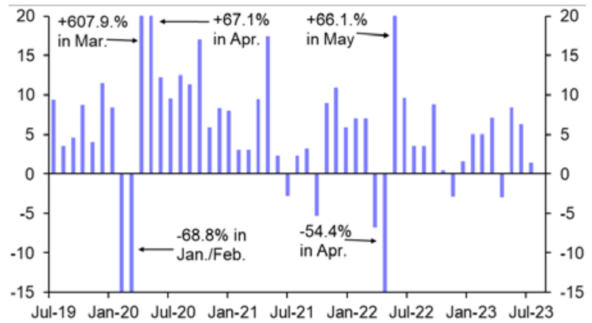


Chart 4: Exports & Industrial Export Sales ($, Dec. 2019=100, CE seas. adj.)

Chart 5: Fixed Investment (Dec. 2019 = 100, seas. adj.)

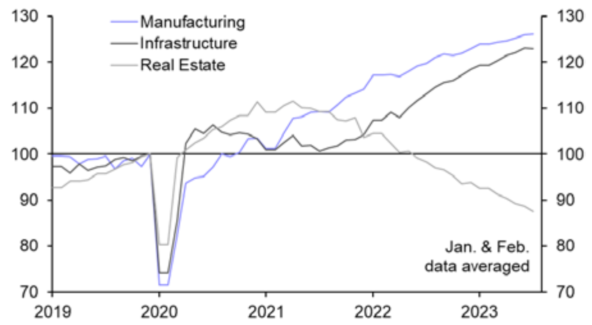


Chart 6: Residential Real Estate Activity (seas. adj.)

Chart 7: Residential Property Prices (3m, % y/y)

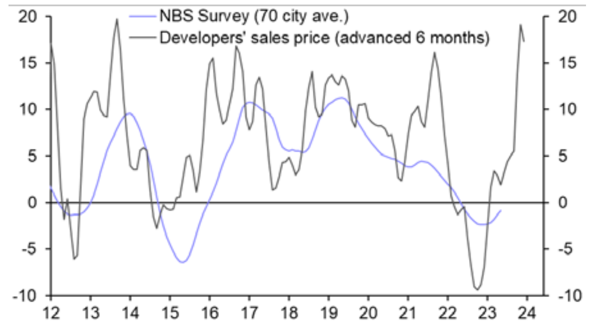
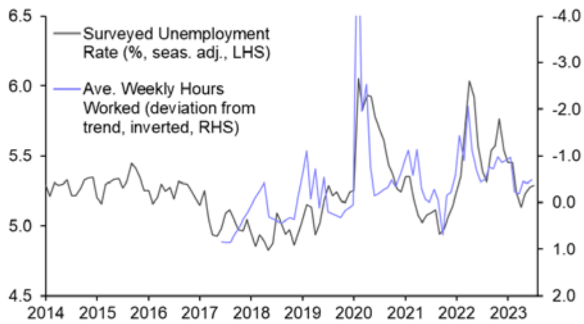


Chart 8: Unemployment Rate & Hours Worked



Sources: CEIC, WIND, Capital Economics

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