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CHINA

# China’s second-quarter slowdown underway amid soft consumption

Soft Chinese domestic activity data is likely an omen of decelerating growth in the second quarter, even as external demand remains strong. While there appears to be limited urgency for now, China still has room for monetary easing this year if it s needed

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## Slowdown underway amid soft consumption and investment

China’s April data came in well below market expectations. Retail sales slowed to just 0.2% year-on-year in April, the softest month since 2022. Sales look likely to tip into negative territory in May. We are now seeing the negative side of front-loaded consumption from the trade-in programmes of previous years. Beneficiary categories are seeing big year-on-year drops.

Investment remains soft, with fixed‑asset investment slipping back into negative growth and new RMB lending continuing to contract – clear signs that firms are still holding back. Elevated uncertainty is likely weighing on investment, but the deeper issue is that, outside strategic sectors like tech and advanced manufacturing, investment appetite has been weak for a long stretch, even with low interest rates.

Risks to our full-year growth forecast remain relatively balanced but are more tilted towards the downside than they were a month ago. We've likely not yet seen the full impact of higher energy prices on the economy. Higher input prices will likely be passed on to consumers in the coming months.

## Tighter controls on capital outflows

There have been reports of tighter controls out of China over the past month. First, the China Securities Regulatory Commission (CSRC) announced a crackdown on offshore trading platforms popular among Chinese citizens for investing in overseas assets.

Second, the State Council published new regulations on outbound investment at the start of June. There will be a greater focus on national security and tighter monitoring and oversight. While outbound investment is still generally encouraged, sensitive sectors will likely be impacted, with controls on tech, data, and talent transfers. This could potentially add a new hurdle for Chinese outbound investment.

Policymakers may have tightened controls due to concerns about bubble risks in global markets. Tightening rules on outbound investment, meanwhile, may reflect a more uncertain global geopolitical backdrop. Fewer capital outflows could support the yuan, which has already shown solid appreciation momentum. More capital staying in domestic markets could support both domestic equity and bond markets, though the impact may be incremental.

## Rate cuts aren’t off the table for China

China stands apart from many global central banks; others have shifted from expected cuts to renewed hikes as Iran‑driven energy shocks lift inflation, but Beijing is unlikely to follow suit this year.

The main reason is that China is shifting from fighting deflation to positive inflation, albeit at low levels. We’ve seen inflation recover in the past few months, but it's still below the 2% target set at this year’s Two Sessions. Even if we see inflation overshoot for a few months, it’s unlikely to prompt policy tightening. This is especially the case considering that investment and borrowing demand are already very soft at current rates.

Policymakers have shown little urgency to ramp up stimulus, opting instead to stick with their existing policy playbook rather than launch new, aggressive measures. A stronger-than-expected first-quarter GDP reading, combined with rising inflation, prompted many in the market to call for rates to remain unchanged the rest of the year. But if the deterioration in activity continues, this could swing in the other direction even as the reflation trend solidifies. We maintain our call for a single 10bp rate cut in the fourth quarter.

## Author

**Lynn Song**
Chief Economist, Greater China
lynn.song@ing.com

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