

China: still no rate cuts even though retail sales continued to shrink in May

The PBoC kept the 1-year medium-term lending facility (MLF) interest rate on hold even though retail sales and industrial production data remained in contraction. The only engine of economic growth currently is infrastructure investment. Banks may lower the prime rate on 20 June as the possibility of lockdowns remains.



We cannot rule out that lockdowns in China will keep happening

PBoC stays put on rates - but banks may cut 5Y prime rate

The PBoC has kept the 1Y Medium Lending Facility interest rate unchanged at 2.85% since February, even though China experienced a deep economic slowdown in April and May. Unlike most other economies in the region, China is not suffering from high inflation either, though gasoline prices are now going up.

But the central bank's decision does not imply there will be no change in the overall interest rate environment in China. Banks cut the 5Y Loan Prime Rate (LPR) in May by 5bps to 4.45%, and we expect the same on 20 June. Cutting the 5Y prime rate implies interest rates for mortgages and long-term loans will decline. Infrastructure projects may also benefit from lower interest costs.

Data hints at a slow recovery

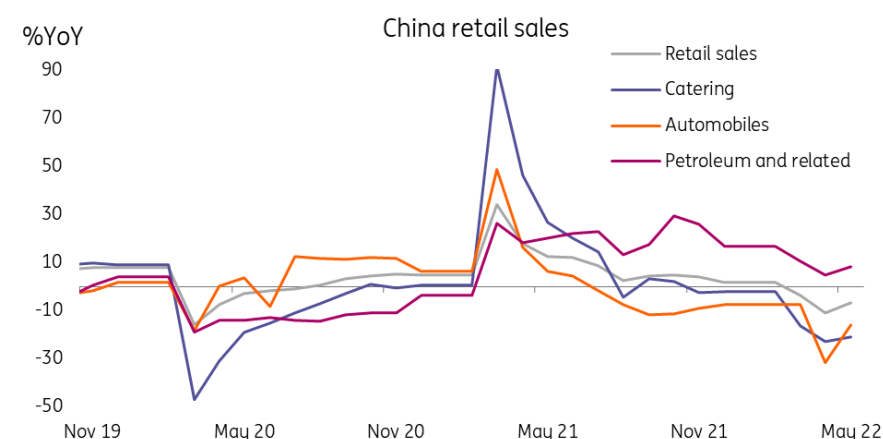
Activity data paints an economic recovery picture in May, but only a slow one.

Retail sales were still the hardest-hit part of the economy, shrinking 6.7%YoY in May after contracting 11%YoY in April. Catering is the worst-performing industry among all retail, shrinking 21.1%YoY in May after -22.7%YoY a month ago. Non-essential items also experienced double-digit contraction. For example, clothing (-16.2%YoY), cars (-16.0%YoY) and jewellery (-15.5%YoY). Food and energy rose 12.3%YoY and 8.3%YoY respectively. This whole picture tells us that consumers are interested in necessities only in May. This paints a dim picture for retail sales.

Industrial production grew at 0.7%YoY in May compared to -2.9%YoY a month ago. There was strong growth in electronics machinery and computation machinery (+7.3%YoY). Coal mining and processing experienced 8.2%YoY growth due to government efforts to guarantee an adequate supply of electricity for economic recovery.

Fixed asset investment grew 6.2%YoY YTD in May after 6.8%YoY YTD a month ago. The growth mainly came from SOEs and construction. Construction growth did not come from the property sector, which shrank 4.0%YoY YTD. Most of the construction growth must therefore be due to infrastructure projects.

China retail sales affected by lockdowns

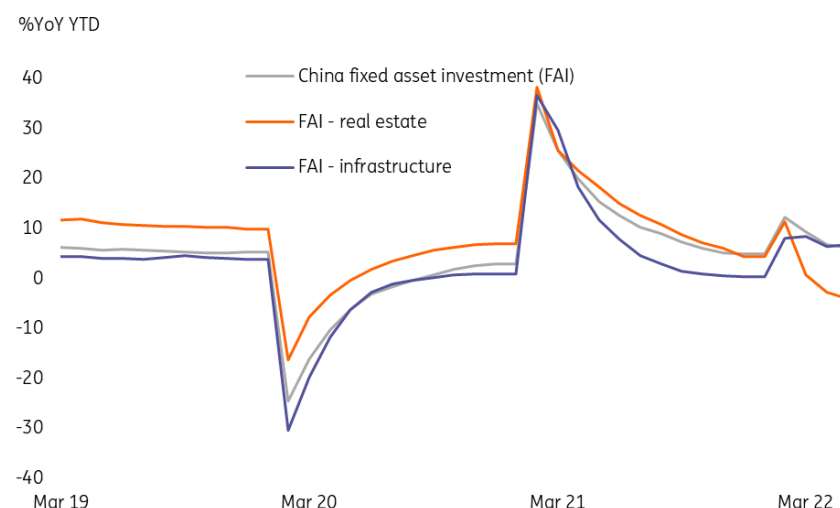


Source: CEIC, ING

China industrial production and PMI new orders



Infrastructure investment is the main growth engine of the Chinese economy



Looking forward

We expect lockdowns in the coming months and quarters will be more flexible compared to those adopted in Shanghai. Beijing is now under semi-lockdown, and the lockdowns are more localised and should also be shorter compared to Shanghai's lockdown of more than 2 months. Even with a more flexible lockdown framework, people and logistics flows continue to be disrupted, albeit less so than a month ago. This disruption will continue to affect some economic activity, especially for cross-city road logistics, which are important for the delivery of materials for production and output for sales. Limited cross-city travel also affects inbound tourism activity, including retail sales and catering.

The government is likely to respond to this economic weakness by delivering more fiscal stimulus. At the same time, to avoid a rapid rise in fiscal leverage, the government may also continue to deregulate some sectors to help promote tax revenue growth and employment.

We maintain our GDP forecast at -1%YoY for 2Q22 as the data just released was very close to our estimates and because we expect small lockdowns will continue to affect the economy in June.