

China: slower activity growth in July to continue in August

We see slower growth in economic activity in July mainly the result of flooding. But slower growth is here to stay. More floods, tighter social distancing measures affecting port operations and people flows are all going to weigh on growth in August.



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Very weak growth in July

Let's do a count of all the weak growth elements in July.

Retail sales growth dropped to 8.5% in July after 12.1% in June. Clothing and smartphones were badly hit. Clothing sales growth dropped to 7.5%YoY from 12.8% in June. Smartphone sales dropped to almost no growth at 0.1%YoY from 15.9%YoY. This reflects that demand for new smartphone models has not persisted from the previous month as consumers are not as keen to upgrade their phones as before. The same applies to weak automobile sales. Dismal retail sales growth reflects softer consumer confidence. The clampdown on technology companies and education centres has led to an unemployment rate increase from 5.0% to 5.1%. These sudden job losses may make it difficult for those affected to regain employment in the same industries. Switching to a new industry probably means a longer job search.

Industrial production grew only 6.4%YoY in July after 8.3% in June. One factor is slower coal mining to reduce pollution. But the policy has changed to speed up some mining activity to supply electricity to meet demand during the hot summer. Automobile manufacturing contracted 8.5%YoY in July, which was due to the semiconductor chip shortage. Production for technology and computers continued to grow but at a slightly slower pace of 13.0%YoY in July from 13.4% in June. We don't believe this growth will be sustained in the coming months because the chip shortage is a global issue. China cannot escape from it.

Railway infrastructure investment was also weak in July, coming in at -4.4%YoY YTD. Local government debt is one obstacle to the financing of infrastructure projects. There is occasionally some news on the tightening of local government debt slowing down infrastructure growth. The central government has tried to address this, as such, I believe growth in infrastructure will improve in August.

Even slower in August

Looking forward, we see few positive factors for the economy, instead, we see more risk factors. There have been more floods in China. The Delta Covid-19 variant is spreading in the Mainland, although the number of cases remains fewer than 200 per day. Strict social distancing measures have affected the ports in Ningbo and Shanghai, which are close to each other. This will negatively affect import and export activity around the area of Shanghai. We expect terminal congestion might take several months to clear. Strict social distancing measures also limit people flows around the Mainland, which limits domestic leisure travel and spending during the summer holidays.

The chip shortage is likely to linger for at least two years, according to reports, which will gradually be reflected in slower production growth and related exports.

Reforms are ongoing for real estate developers, which continues to put pressure on home prices and land-bidding activity. Data privacy, anti-trust, company structure, ESG are all shadowing the growth of technology companies. We see these policies as curtailing growth in the sector in the short term but bringing more sustainable growth in the long term.

The China-US relationship is not going to improve anytime soon. There are many disagreements between the two on international politics. Furthermore, there remains a technology war between the two countries.

Looking towards 4Q21, there should be more activity from construction to rebuild areas affected by the recent floods.

Policies

We expect fiscal policies to be more proactive at pushing belated infrastructure projects. There is no need for policy interest rate cuts as the RRR cut has pushed down market lending rates. Another RRR cut should happen in 4Q21 if there are more incidents and dramatic policy actions.

Our China GDP forecast is currently 4.5%YoY for 3Q21 and 5.0%YoY for 4Q21.