China: some improvements

We see some improvement in the Chinese domestic economy despite the damage from the recent flood.

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Growth came mostly from the domestic economy

Retail sales fell 1.1%YoY in July, better than -1.8%YoY a month ago. The main reason for the continued negative yearly growth in retail sales was the -11.0%YoY spending on catering, which results from social distancing measures in China. We do not expect this situation to change particularly over the rest of 2020, or until there is an effective vaccine for Covid-19.

We also observe that high-end spending has returned. Chinese tourists could not travel abroad during the summer holidays because of travel restrictions from other economies. But cross-province travel is now allowed in China. This resulted in growth in spending on cosmetics and jewellery rising by 9.2%YoY and 7.5%YoY respectively.

Industrial production stabilised at 4.8%YoY growth in July from the previous month. Most of the growth came from automobiles, industrial robots, machinery and telecommunication production, at 21.6%YoY, 19.4%YoY, 15.6%YoY, and 11.8%YoY respectively. This production is partly for export, as seen from June's export recovery, and partly for domestic use as some exports and most domestic orders continue to recover from the trough of the production cycle in 1H20.

Fixed asset investment is still showing a contraction of 1.6%YoY YTD, but we do see growth in infrastructure-related areas, e.g. transportation, medical, and education sectors.

Growth in 2H20 will continue to depend on the domestic market

The central government has promoted the idea of domestic growth for the economy. This is reasonable given the Covid-19 situation faced by foreign economies. China can no longer depend too much on exports. And with a trade deal review looming, and a technology war heating up, this situation for exports is not going to disappear in a hurry.

Infrastructure investment and domestic spending are both sources of growth for industrial production if exports are going to take a back seat for a time. Fiscal stimulus has supported infrastructure investment, and this will continue in 2H20 and even into 2021. For domestic consumption, under the situation of Covid-19, Chinese tourists will stay at home and spend locally when they travel in China. This will help support jobs that were lost during the peak of Covid-19. With these two growth engines, industrial production can continue to grow.

That said, economic growth will not be as fast as it would have been if the rest of the world recovered from Covid-19 and export demand picked up.

The flood's damage

The damage caused by the recent flooding is evident in the slower retail sales growth in rural areas, and fixed asset investment also fell 9%YoY YTD in the central area of China, along the Yangtze River where most of the flooding is located.

We expect there will be reconstruction work when the flood is over, but that could be slow given the persistence of tight social distancing measures in China.

Forecast

We continue to monitor our GDP forecast of 0.5% for the full year for a possible amendment, as there are several factors that could cause us to change our view, including Covid-19's spread in the rest of the world, as well as the review of the trade deal and the technology war.