China: the economy is getting better but we maintain our GDP forecasts

China's activity data shows that the economy is recovering, albeit slowly. The details of the data show some common factors causing slowness in different aspects of the recovery.

Passengers cheer up for Wuhan while waiting to take train K81 at Wuchang Railway Station in Wuhan, central China's Hubei Province, late April 7, 2020.

Source: Shutterstock

Recovering

From the activity data published by the National Bureau of Statistics, it is evident that the Chinese economy is recovering.

Retail sales shrank less thanks to the long holiday in May

Retail sales shrank 2.8%YoY in May from a contraction of 7.5%YoY the previous month. Almost all items recorded positive year-on-year growth in May.

But there were exceptions, and most of them were related to Covid-19. Social distancing measures still caused an 18.9%YoY contraction in catering businesses. And, even though May is the month of a long holiday, discretionary spending on clothing (i.e. not for essential clothing), continued to shrink 0.6%YoY.

We believe that the unstable job market and healthcare concerns are the main factors slowing down the recovery. This means that even during the long holiday month of May, people were still spending carefully. So May's sharp drop in the contraction of retail sales could be a one-off from the Golden Week holiday. We need to keep an eye on June's data to confirm whether the trend of spending really continues to improve.

Industrial production grew faster from advanced technology and infrastructure

Industrial production grew 4.4%YoY in May after 3.9%YoY growth in April.

Most of the growth was in advanced technology and equipment, which grew 8.9%YoY and 9.5%YoY, respectively. Industrial robot production increased by 16.9%YoY.

Infrastructure activity led to growth in the production of construction machinery, which increased by 62.1%YoY.

Fixed asset investments contracted but Covid pushed forward some investments

Fixed asset investment shrank 6.3%YoY YTD in May after diving 10.3%YoY YTD in April. There was a 5.9% MoM growth in investment in May.

Covid-19 has boosted China's investment in pharmaceutical and public health industries, which rose 6.9%YoY YTD and 8.9%YoY YTD, respectively.

The only investment that grew in May that was not really related to Covid-19 was advanced technology, telecommunication, and other electronic equipment, which rose 6.9%YoY YTD, which could be a result of China pushing itself to be more self-reliant on advanced technology.

The picture of investments is a mixed one.

1. We don't see the 'bricks and mortar" infrastructure investment growing even though the production of construction machinery picked up according to industrial production data. That could imply that growth in construction activity is mainly for property markets instead of infrastructure. This is inevitable, property developers need to keep selling properties to keep up their cash flow. And to keep sales moving, they need new construction. But this property is probably not shopping malls and is more likely to be residential properties.
2. There were improvements in production and investment in advanced technology. This is a sign that China is trying to find a solution to the looming technology war. We believe this will continue to be the new engine of growth of the Chinese economy.

Improvements in economic recovery is still too slow

We are keeping our GDP forecasts unchanged due to the confirmation in these figures of the slow recovery of the Chinese economy.

Our forecasts for GDP are -3.1%YoY for 2Q20 and -1.5% for full-year 2020.

We also prefer to keep our USDCNY forecasts at 7.15 for the end of 2Q20 and 7.05 for the end of 2020 as the trade war, technology war and a possible second wave of Covid-19 could weaken the yuan against the dollar.

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