

China: Some Positivity in 2Q GDP and June Numbers

China's economy grew in 2Q, compared to the previous quarter

Retail sales was the outperformer in June, with industrial production also resilient

Maintain full year GDP growth forecast at 9.2%

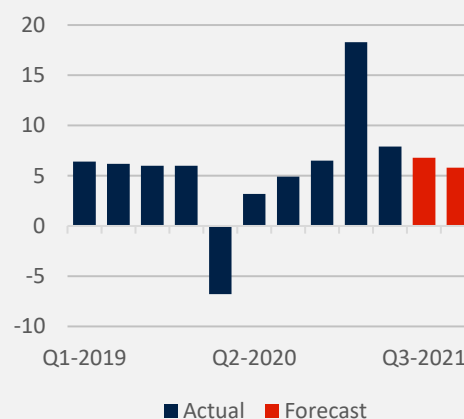
Summary

China's GDP growth numbers showed some resilience in 2Q, with a 7.9% y/y and 1.3% q/q expansion (Figure 1). This compares well with the 18.3% y/y (inflated by base effects from 2020 Covid-19 lockdowns) and 0.6% q/q increase a quarter ago.

June results showed some positive outperformances in retail sales, alongside some resilience in industrial production and fixed asset investment. Overall, these indicate that the economy continues to expand steadily. Although growth numbers are likely to come off in 2H-2021, China pursuit of quality growth is on track.

Examining our heatmap, GDP growth looks healthy and is supported by both domestic demand (retail sales and imports) and external demand. China's trade surplus is at levels slightly higher than three-year averages. At the same time, property price increases look contained. One area of concern is a downtrend in freight activity, although it is partly due to base effects. Chip shortages are also affecting the auto industry, according to China officials.

Figure 1: China GDP (% y/y)



Source: Bloomberg, HL Bank

Heatmap on Key China Economic Metrics

2019						2020												2021						
Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	
-1.2	-1.2	-1.3	-1.3	-1.3	-1.0	-1.0	-5.7	-3.3	-2.2	-1.5	-1.0	-0.7	-0.5	-0.3	-0.2	0.0	0.0	0.1	3.6	2.3	1.6	1.1	0.8	FAI
-1.5	-1.7	-1.8	-1.9	-1.7	-1.3	-1.0	-1.1	-1.5	-1.9	-1.9	-1.6	-1.3	-1.1	-1.1	-1.1	-0.8	-0.3	0.0	0.6	1.7	2.5	2.9	2.6	PPI
-1.5	-1.1	-0.8	-0.6	-0.6	-0.6	-0.6	-4.6	-2.5	-1.2	-0.1	0.3	-0.7	0.7	0.6	0.4	1.1	1.1	1.0	2.8	2.6	1.3	1.2	1.1	Energy Use
-0.8	-0.9	-0.9	-0.7	-0.6	0.3	-1.7	-0.6	-2.0	-2.6	-1.2	0.1	0.4	0.1	-0.2	-0.2	-0.3	-0.4	2.6	3.1	2.0	2.4	0.7	-0.7	Freight
-1.4	-1.5	-1.2	-1.6	-0.6	-0.6	-0.8	-5.5	0.6	0.2	0.1	0.3	0.3	0.3	0.5	0.5	0.7	0.7	0.4	0.2	0.6	0.3	0.3	0.3	Manufacturing PMI
-2.0	-2.3	-0.4	-1.8	0.1	1.0	0.9	0.9	-4.9	-1.3	-0.9	-0.6	-0.6	0.0	0.8	0.8	0.9	1.0	1.0	1.0	3.9	1.7	1.2	0.9	Ind. production
-0.2	-0.6	-0.9	-0.7	-0.7	0.2	-0.9	-3.7	-0.9	-0.1	-0.6	-0.3	0.2	0.4	0.4	0.5	1.3	1.0	1.5	5.3	0.8	0.8	0.6	0.8	Exports
0.7	0.1	0.4	0.6	0.3	0.9	1.4	-4.5	-0.6	0.6	1.4	0.6	1.2	1.1	0.1	1.0	1.7	1.7	1.1	0.0	-1.0	0.2	0.3	0.5	Trade balance
-1.3	-1.3	-1.4	-1.3	-0.7	0.5	-1.7	-0.1	-0.7	-1.7	-1.7	-0.3	-0.5	-0.6	0.6	0.0	0.0	0.2	1.9	1.1	2.5	2.6	2.8	1.8	Imports
-1.8	-1.8	-1.4	-1.8	-1.1	-1.0	-1.0	-0.9	-5.7	-3.1	-1.9	-1.6	-1.4	-1.1	-0.5	-0.3	-0.2	-0.2	-0.2	-0.2	3.9	1.5	0.8	0.7	Retail sales
-1.3	-1.2	-1.4	-2.8	0.0	-1.4	-0.4	-5.8	-0.3	-0.1	0.0	0.2	0.2	0.4	0.6	0.6	0.7	0.5	-0.3	-0.5	0.6	0.3	0.4	0.0	Non-manuf. PMI
0.6	0.1	-0.1	-0.3	-0.6	-0.8	-0.9	-1.1	-1.2	-1.3	-1.3	-1.3	-1.2	-1.2	-1.2	-1.3	-1.4	-1.4	-1.4	-1.2	-1.0	-1.0	-1.0	-1.0	Property prices
-1.6	-1.5	-1.8	-1.5	-0.9	-1.3	-0.9	-5.6	0.4	0.5	0.3	0.3	0.2	0.3	0.5	0.5	0.4	0.4	0.0	0.0	0.7	0.4	0.3	0.2	Employment
1.7	1.6	1.8	2.8	3.2	2.7	3.1	2.6	1.7	0.7	-0.2	-0.1	0.1	-0.2	-0.9	-2.0	-2.6	-1.9	-2.1	-1.9	-1.4	-1.0	-0.7	-0.8	CPI
-1.7	-2.1	-1.6	-1.8	-1.7	-1.7	-2.1	-2.1	-0.5	0.5	0.7	0.6	0.2	0.1	0.1	0.0	-0.2	-0.3	-0.5	0.0	-0.7	-1.4	-1.6	-1.3	Loan

Note: Measured in standard deviations from mean over the past three years (June 2018 to May 2021). Positive (negative) number indicates higher (lower) than mean. Source: Bloomberg, HL Bank

Examining the Breakdown

China's underlying GDP growth picked up in 2Q, compared to 1Q. Between the period of 2019 to 2021, 2Q growth was an annualised 5.5%, compared to the 5.0% in 1Q. Growth has been supported by secondary industries (manufacturing and construction) during this period, outpacing 2019 numbers. In contrast, third industry (services) growth was positive but more subdued.

China flagged that high-tech manufacturing sector, including new energy vehicles, industrial robotics and integrated circuits, supported growth. It expanded by 22.6% y/y in 1H-2021. China produced a record high of 30.8bn integrated circuits in June, intending to reduce reliance on US technology and build a domestic semiconductor industry.

Underlying retail sales growth picked up to 4.9% CAGR (2019 to 2021) in June, compared to 4.5% in May. This was supported by improvements in consumer goods items – such as food and beverages, household electronics, communication devices, and office supplies. In contrast, automobiles sales continue to come off, and growth in restaurants/catering eased slightly (albeit staying high).

Household income growth for 2019 and 2020 grew an annualised 5.2%. At the same time, the surveyed jobless rate stayed stable compared to a month ago, at 5%. These, including rising Covid-19 vaccination rates, are supportive of private consumption.

For industrial production, underlying growth was steady at 6.5% CAGR (2019 to 2021) in June, versus 6.6% in May. Resilient manufacturing and power supply performances mitigated a slump in mining. Auto manufacturing was down from chip shortages.

Fixed asset investment growth staged a rebound in June, after a slump in May. According to our calculations, fixed asset investment growth fell by only 1.4% y/y in June, compared to the 2.6% y/y decline in May (Figure 3). Private fixed asset investments outpaced the public sector in 1H-2021.

Implications

We maintain our full-year GDP growth forecast at 9.2%, given that first half growth of 12.7% y/y is relatively more inflated by base effects. External demand continues to look strong, although this may fade from some setbacks in Asia demand in 2H-2021.

China's recent cut in the reserve requirement ratio appears to be targeted at reducing financial sector risks, instead of as a result of needing to support the economy. We maintain our view of a neutral monetary policy stance by the People's Bank of China for the next 12-month period. This comes after the PBOC kept the 1-year medium-term lending facility unchanged at 2.95%.

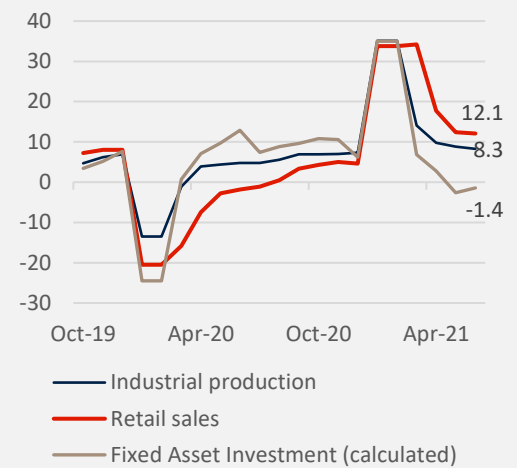
Rising energy prices are a potential risk factor for China's economy, although slightly mitigated by a strengthening currency (compared to trade partners) over the past twelve months (see Figure 4). Elevated producer prices are another potential banana skin,

Figure 2: Key forecasts

	2021F	2022F
GDP	9.2	5.7
Inflation (avg)	1.3	2.5
USD/CNY (end-period)	6.40	6.55 (June 2022)

Source: HL Bank

Figure 3: China's key monthly metrics (% y/y)



Source: Bloomberg, HL Bank

Figure 4: China's CFETs RMB Index (based on BIS currency basket) shows that the yuan has been strengthening.



Source: Bloomberg, HL Bank

possibly causing uneven growth between upstream and downstream firms.

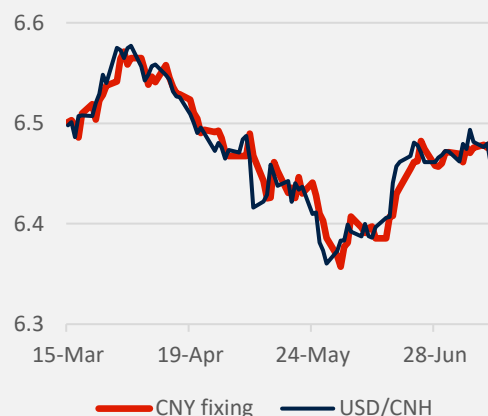
The National Bureau of Statistics also flagged that unemployment pressures remain, with youth unemployment an issue. Its spokesperson noted that 9.09 million college graduates are about to enter the job market in summer.

China's inflation view is similar to most other major economies, anticipating some reduced pressures in the coming months, perhaps as energy prices stabilise and base effects turn. Given that inflation has been 0.65% in 1H-2021, we maintain our 1.3% forecast for 2021.

In contrast, PPI has been at an elevated 4.7% y/y in 1H-2021. This should remain a concern to downstream firms, although supportive of industrial profits in 2021. However, the headline y/y numbers should fade sometime by end-2021.

USD/CNY and USD/CNH has been little affected by China's data releases. We see the currency being primarily affected by USD strength. Near-term, the pairs may see some downsides if the USD temporary tanks from previous rallies. However, USD strength will likely lead to higher USD/CNY over a 1-year period. Our current forecast is for USD/CNY to climb to 6.55 in 2Q-2022, from 6.40 in 4Q-2021.

Figure 5: USD/CNH, compared to PBOC fixings



Source: Bloomberg, HL Bank

Hong Leong Bank Berhad

Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my

DISCLAIMER

This report is for information purposes only and does not take into account the investment objectives, financial situation or particular needs of any particular recipient. The information contained herein does not constitute the provision of investment advice and is not intended as an offer or solicitation with respect to the purchase or sale of any of the financial instruments mentioned in this report and will not form the basis or a part of any contract or commitment whatsoever.

The information contained in this publication is derived from data obtained from sources believed by Hong Leong Bank Berhad ("HLBB") to be reliable and in good faith, but no warranties or guarantees, representations are made by HLBB with regard to the accuracy, completeness or suitability of the data. Any opinions expressed reflect the current judgment of the authors of the report and do not necessarily represent the opinion of HLBB or any of the companies within the Hong Leong Bank Group ("HLB Group"). The opinions reflected herein may change without notice and the opinions do not necessarily correspond to the opinions of HLBB. HLBB does not have an obligation to amend, modify or update this report or to otherwise notify a reader or recipient thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

HLB Group, their directors, employees and representatives do not have any responsibility or liability to any person or recipient (whether by reason of negligence, negligent misstatement or otherwise) arising from any statement, opinion or information, expressed or implied, arising out of, contained in or derived from or omission from the reports or matter.

Potential and actual conflict of interest may arise from the activities of HLB Group. HLB Group constitute a diversified financial services group. These entities engage in a wide range of commercial and investment banking, brokerage, funds management, hedging transactions and other activities for their own account or the account of others. In the ordinary course of their business, HLB Group may effect transactions for their own account or for the account of their customers and hold long or short positions in the financial instruments. HLB Group, in connection with its business activities, may possess or acquire material information about the financial instruments. Such activities and information may involve or have an effect on the financial instruments. HLB Group have no obligation to disclose such information about the financial instruments or their activities.

The past performance of financial instruments is not indicative of future results. Whilst every effort is made to ensure that statements of facts made in this report are accurate, all estimates, projections, forecasts, expressions of opinion and other subjective judgments contained in this report are based on assumptions considered to be reasonable as of the date of the document in which they are contained and must not be construed as a representation that the matters referred to therein will occur. Any projections or forecasts mentioned in this report may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information. No assurance can be given that any opinion described herein would yield favorable investment results. Recipients who are not market professional or institutional investor customer of HLBB should seek the advice of their independent financial advisor prior to taking any investment decision based on the recommendations in this report.

HLBB may provide hyperlinks to websites of entities mentioned in this report, however the inclusion of a link does not imply that HLBB endorses, recommends or approves any material on the linked page or accessible from it. Such linked websites are accessed entirely at your own risk. HLBB does not accept responsibility whatsoever for any such material, nor for consequences of its use.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation. This report is for the use of the addressees only and may not be redistributed, reproduced or passed on to any other person or published, in part or in whole, for any purpose, without the prior, written consent of HLBB. The manner of distributing this report may be restricted by law or regulation in certain countries. Persons into whose possession this report may come are required to inform themselves about and to observe such restrictions. By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.