

Short Insight

Group Economics

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Supply-demand gap will narrow

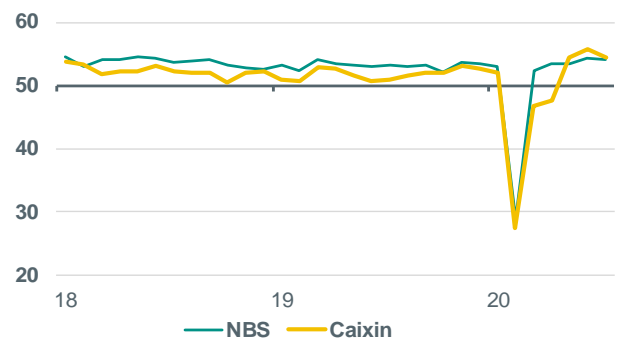
- **PMIs point to solid industry and ongoing catch-up services**
- **Exports hold up well in Q2 thanks to medical and tech goods**
- **A supply-driven rebound, but supply/demand gap to narrow in second half**
- **2020 growth forecast unchanged, but 2021 forecast raised on base effects**

1. PMIs point to solid industry and ongoing catch-up services

The PMIs for July published over the past days confirm that China's industrial recovery from the covid-19 shock continues, and that second waves of new infections and floods are not a big game changer so far. The manufacturing PMIs for July from both NBS and Caixin came in better than expected. The 'official' PMI published by NBS last Friday has risen from an all-time low of 35.7 in February to a two-year high of 51.1 in July (June: 50.9; consensus expectation: 50.8). Caixin's manufacturing PMI for July jumped by 1.6 point to 52.8 (June: 51.2; consensus expectation: 51.1), the highest level in almost ten years and 12.5 points higher than its February trough. Meanwhile, the services PMIs from both NBS and Caixin remain at even higher levels (around 54), confirming the ongoing catch-up of this sector that was hit relatively hard by the covid-19 shock. That said, both the services PMIs for July fell compared to June, particularly Caixin's index (from 58.4 to 54.1). This drop reflects the fact that PMIs are mainly a reflection of monthly changes in conditions (so the marginal improvement from the post-covid-19 collapse was better in June than in July). As a result of all of this, the official composite PMI was more or less stable in July (at 54.1), while Caixin's composite PMI fell from 55.7 to a still quite high 54.1.

Composite PMIs confirm gradual normalisation

Composite PMIs, 50 = neutral mark



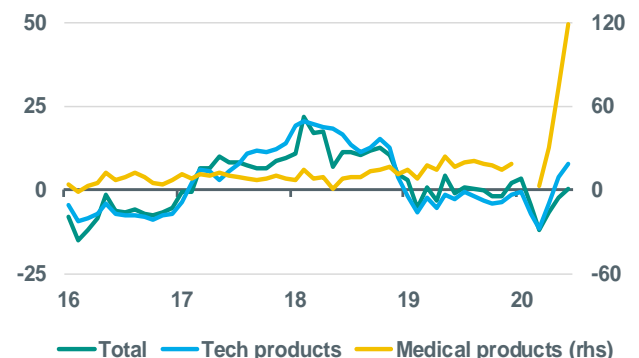
Source: Thomson Reuters Datastream

2. Exports hold up well in Q2 thanks to medical and tech goods

China's exports held up well in the second quarter, despite the covid-19 induced collapse in global growth and trade. Exports of goods in dollar values were up by 30% in Q2 compared to the weak first quarter and stable compared to Q2-2019 (June: +0.5% yoy). This strong export performance was supported by a sharp, covid-19 related acceleration in exports of medical equipment and appliances. Tech exports also outperformed in the second quarter, suggesting that China too has profited from the acceleration in digitalisation that has gone hand in hand with the spread of the covid-19 crisis. These developments are also visible in the improvement of the export PMIs over the past months. Still these indices from both NBS and Caixin remain below the neutral 50 mark, indicating that the external environment remains uncertain and challenging (due to the covid-19 and the re-escalation of US-China tensions). Meanwhile, goods imports in Q2 goods was down almost 10% yoy, reflecting the lagging of domestic demand (see below) and the drop in commodity prices. That said, import growth clearly improved in June (+2.7% yoy).

Medical and tech support Chinese exports

% yoy, 3mma



Source: ABN AMRO GE, Thomson Reuters Datastream, Bloomberg

3. A supply-driven rebound, but supply-demand gap set to narrow

So far China's rebound from the covid-19 shock is led by the production side, with domestic demand lagging somewhat. However, the gradual recovery of domestic demand is ongoing, helped by fiscal 'pandemic' support and targeted monetary easing. We expect this supply-demand gap to narrow in the second half of this year. The annual, cumulative contraction of fixed investment is getting shallower by the month (June: -3.1% yoy ytd, versus -6.3% in May and -24.5% in Jan/Feb). That is mainly due to a pick-up of public investment, reflecting the stepping up of infrastructure spending by the central and local governments. On the consumption side, retail sales keep improving, although annual growth is also still in negative territory (-1.8% yoy in June, versus -2.8% in May and -15.8% in March). Consumer-related, 'social distancing sensitive' sectors such as catering continue to lag, but are also regaining some ground (e.g. catering: -12% yoy in June versus -46% in March). Passenger transport is gradually recovering, but is still at only 55% of pre-corona levels.

4. 2020 growth forecast unchanged, but 2021 forecast raised

As the Chinese economy is showing a solid recovery from the covid-19 shock, we expect macro-economic policy to become more targeted and peacemeal again, following the stepping up of specific 'pandemic stimulus' earlier this year. Fiscal support will likely become more targeted to where it is most needed, while there is also still room for infrastructure spending from the previously raised quota for local government bond issuance. Monetary easing will likely become more selective, although we still expect some RRR cuts and mini cuts of some policy interest rates.

We expect the recovery from the covid-19 shock to continue in the second half of this year. Following the sharp contraction in the first quarter (-6.8% yoy and -10% qoq), the rebound in Q2 (+3.2% yoy; +11.5% qoq) was even a bit stronger than market expectations including ours. That said, as we expect some payback from this strong rebound and a slight moderation in the government's stimulus policy, we have left our 2020 annual growth forecast unchanged at 2%. We have raised our 2021 growth forecast from 7% to 8%. This expected return to above trend annual growth next year is mainly due to base effects (given that the historically sharp covid-19 related contraction will have faded out from the figures by then). In our base case we assume US-China tensions to remain tense, but without a major revival of the tariff war.

Retail sales gradually improving

Chinese retail sales by product category, % yoy

	February	March	April	May	June
Sports & recreation		-6.0	12.7	18.2	24.3
Communication appliances	-9.6	7.4	14.5	13.8	20.8
Books, newspapers, magazines		4.8	-10.8	12.3	18.0
Household articles (daily use)	-10.7	-0.8	7.5	16.9	17.5
Cultural & office appliances	-11.3	6.0	8.3	3.0	8.6
Electronic & video	-33.5	-30.7	-11.1	1.2	6.5
Food, beverages, tobacco	-4.0	7.3	10.1	6.1	5.7
Total consumer goods	-21.1	-16.6	-7.9	-3.0	-1.0
Clothing	-34.2	-36.3	-20.1	-2.5	-2.9
Construction & decoration	-42.4	-20.9	-14.6	-7.6	-8.9
Medicine	-16.0	10.8	-12.2	-12.9	-10.0
Furniture	-44.7	-33.5	-19.6	-11.3	-13.8
Petroleum & related products	-26.1	-18.1	-13.3	-13.2	-12.3
Catering	-42.2	-46.0	-29.7	-17.0	-12.4
Furniture	-44.7	-33.5	-19.6	-11.3	-13.8

Source: ABN AMRO Group Economics, Thomson Reuters Datastream

China's quick comeback



Source: Bloomberg

Key forecasts for the economy of China

	2017	2018	2019e	2020e	2021e
GDP (% yoy)	6.8	6.6	6.1	2.0	8.0
CPI inflation (% yoy)	1.5	1.9	2.9	3.0	2.5
Budget balance (% GDP)	-3.7	-4.1	-4.9	-6.5	-5.0
Government debt (% GDP)	16	16	17	23	26
Current account (% GDP)	1.6	0.2	1.0	0.5	0.5
Gross fixed investment (% GDP)	42.0	43.0	42.4	40.7	41.9
Gross national savings (% GDP)	44.8	44.1	44.1	42.2	42.8
USD/CNY (eop)	6.5	6.9	7.0	7.0	7.0
EUR/CNY (eop)	7.8	7.8	7.8	7.8	8.4

Economic growth, budget balance, current account balance for 2020 and 2021 are rounded figures

Source: EIU, ABN AMRO Group Economics

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