Short Insight

Group Economics

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China's GDP growth humming along

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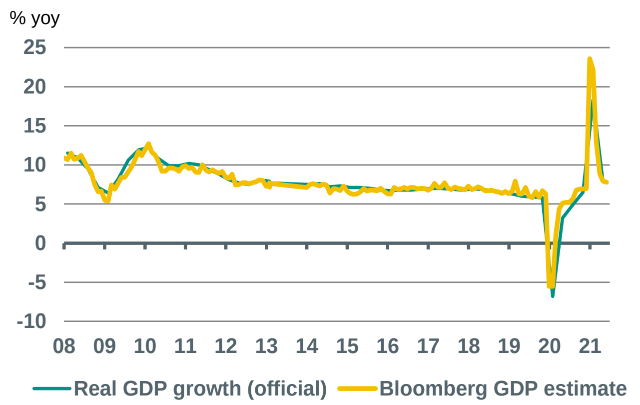
- **Annual growth down to almost 8% in Q2, quarterly growth up compared to Q1**
- **Pick-up in vaccination should facilitate gradual rotation towards consumption**
- **Producer price inflation stabilises, headline inflation remains low**
- **PBoC cuts reserve requirement ratio for banks by 50 bp**

1. Real GDP growth back at almost 8% yoy in Q2

Real GDP growth in Q2 came in slightly below consensus expectations including ours, at 7.9% yoy (consensus: 8.0, Q1: 18.3). The drop in annual growth from Q1 is purely driven by base effects caused by the pandemic shock last year. Quarterly growth rose to 1.3% qoq (consensus: 1.0%). That was up from a downwardly revised 0.4% qoq in Q1, when regional lockdowns and a retightening of mobility restrictions formed a drag around the Lunar New Year break. Meanwhile, the June activity data surprised to the upside. Particularly retail sales did better than expected at 12.1% yoy (consensus: 10.8%, May: 12.4%), after disappointments in previous months. Industrial production grew by 8.3% yoy in June (consensus: 7.9%, May: 8.8%). Urban fixed investment came in at 12.6% yoy ytd (consensus: 12.0%, May: 15.4%). The surveyed jobless rate was stable at 5.0%. Bloomberg's monthly GDP estimate slowed to 7.8% yoy in June (May: 7.9%). We leave our annual growth forecast for the whole of 2021 unchanged at 9.0%, again adding that this relatively high growth pace is mainly driven by the strong base effect in Q1. Quarterly growth will be much lower on average this year than in the last three quarters of 2020, as catch-up effects from the pandemic shock fade. All in all, the latest data will – together with strong June exports - likely help to reduce fears of a sharp slowdown following weak June PMIs and a recent easing step (see below).

Official growth and Bloomberg's monthly GDP estimate



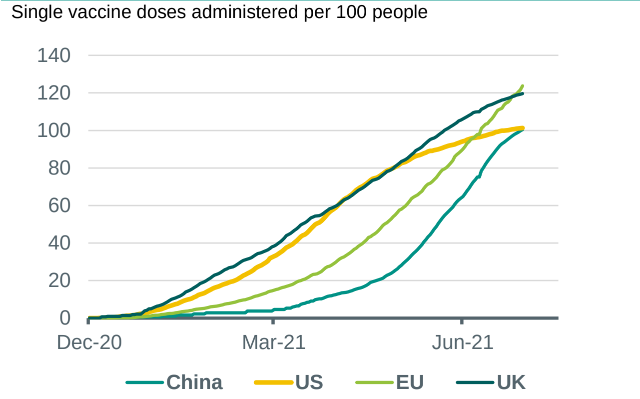
Source: Bloomberg

2. Ramping up vaccinations should help (services) consumption

Although quarterly growth in Q2 surprised to the upside, we have again seen virus flare-ups and a retightening of mobility restrictions, but the drag from this was smaller than in Q1. This partly relates to the fact that, although China was leading in virus control and the economic recovery from the pandemic shock last year, it was lagging compared to advanced economies in term of the vaccination roll-out. This partly explains why the recovery of private consumption (particularly of services) had been lagging, with for instance passenger transport remaining far below pre-corona levels. China's economic recovery so far had been a bit unbalanced, driven by exports, manufacturing and the property sector. That said, the government has recognised this and the vaccination roll-out has clearly accelerated in the second quarter, with for instance a daily average of 20 mln Chinese receiving a single dose in June. Although the efficacy of the vaccines used in China are reported to be lower than the vaccines used in the West, we expect this sharp acceleration in the vaccination roll-out to support a gradual rotation towards consumption.

Vaccination rates in key economies

Single vaccine doses administered per 100 people

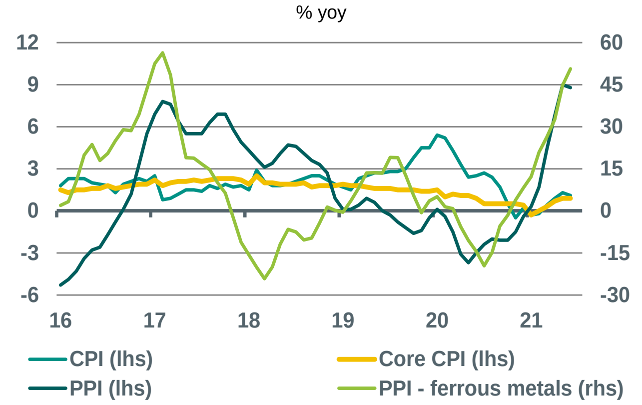


Source: Bloomberg, ABN AMRO Group Economics

3. Producer price inflation stabilises in June

After accelerating sharply in recent months (to a post-global-financial-crisis high of 9.0% yoy in May), producer price inflation (PPI) seem to have stabilised in June, dropping slightly to 8.8% yoy. This was in line with market expectations including ours, as the government has taken measures to contain the surge in commodity prices (the key driver of the PPI rise). Easing food prices and base effects also play a role. Earlier this month, the respective subindices of the manufacturing PMIs for June had already signalled an easing of cost-push inflation in China. All this should take away some of the fears over a rising contribution from China to global goods inflation, which had risen over the past few months due to the acceleration in PPI. Meanwhile, headline inflation dropped back to 1.1% yoy in June (May: 1.3%), while core inflation was stable at 0.9% yoy. This confirms that there is hardly any pass-through from higher cost prices into consumer price inflation (CPI). All in all, the stabilisation of PPI and the subdued levels of CPI have increased the room for the PBoC to add targeted support to the economy (see below).

Producer price inflation stabilises at high level



Source: Bloomberg, Refinitiv

4. Beijing shifts to piecemeal easing

Last week, the State Council signalled that monetary instruments, such as cuts in the reserve requirement ratio (RRR) for banks, could be used to reduce financing costs for corporates, particularly those for SMEs. The PBoC followed up quickly, by announcing a 50 bp RRR cut per 15 July. In our view, this move should not be seen as the start of a significant monetary easing cycle, given that policy makers will likely stick to their overall goal of containing overall leverage (by capping credit growth to nominal GDP growth). Rather this step should be seen as reducing the side-effects of the authorities' previous tightening approach. In that sense, one could speak of a return to 'piecemeal monetary easing' that the PBoC has adopted before. This move will give some breathing space to companies that are faced with rising interest rates, partly driven by rising cost push inflation. Since the State Council's signalling, China's 10-year government bond yield has dropped by around 15 bps. Previously, the authorities had reacted to rising cost push pressures by taking measures to stop the surge in commodity prices. More broadly, as policy focus shifted from macro-economic stabilisation to financial de-risking, China's credit cycle had already started turning since end-2020. Moreover, the authorities have continued with curtailing shadow banking and intensified a crackdown on fintech firms, online platforms and bitcoin.

China's 10-year government bond yield

Source: Refinitiv

Key forecasts for the economy of China

	2018	2019	2020e	2021e	2022e
GDP (% yoy)	6.6	6.1	2.3	9.0	5.5
CPI inflation (% yoy)	1.9	2.9	2.5	1.5	2.5
Budget balance (% GDP)	-4.1	-4.9	-5.4	-4.5	-4.5
Government debt (% GDP)	16	17	20	22	25
Current account (% GDP)	0.2	0.7	1.9	2.5	2.5
Gross fixed investment (% GDP)	43.0	42.4	41.4	41.0	41.0
Gross national savings (% GDP)	44.1	43.8	43.9	44.5	44.1
USD/CNY (eop)	6.9	7.0	6.5	6.4	6.2
EUR/CNY (eop)	7.8	7.8	8.0	7.4	6.8

Budget balance and current account balance for 2021 and 2022 are rounded figures

Source: EIU, ABN AMRO Group Economics