Short Insight

Group Economics

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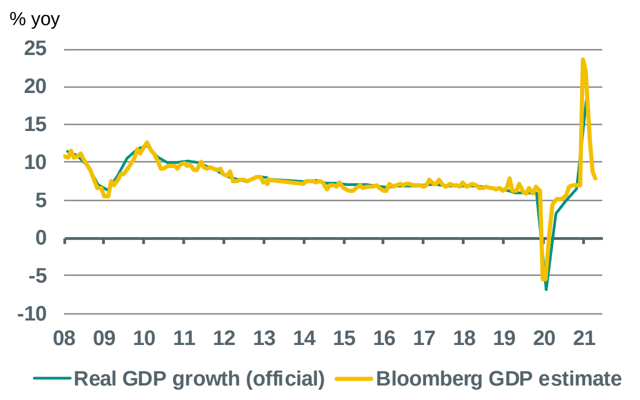
China: Trying to take off the heat

- **May activity data weaker than expected**
- **A gradual rotation going forward**
- **Producer price inflation at 11-year high; China intervenes in commodity markets**
- **Crackdown on shadow banking continues**

1. May activity data weaker than expected

China's monthly activity data for May published today generally came in weaker compared to April and to consensus expectations. Industrial production growth slowed to 8.8% yoy (April: 9.8%, consensus: 9.2%). Fixed investment growth dropped to 15.4% yoy in January-May (consensus: 17.0%), versus 19.9% yoy in January-April. In annual terms, private investment continues to grow faster than state-led investment so far this year. Retail sales slowed to 12.4% yoy (April: 17.7%, consensus: 14.0%). However, on a monthly basis the total value of retail sales picked up again (+8.4% mom), after having dropped by 6.6% mom in April. Meanwhile, the surveyed unemployment rate in urban areas fell further below pre-corona levels, to 5.0% in May (versus 5.2% in December 2019). Bloomberg's monthly GDP annual growth estimate dropped to 7.9% (April: 8.9%). We should add that annual growth numbers are still to a large extent impacted by base effects, reflecting the sharp swings in activity following the initial covid-19 shock last year. In sequential terms, we expect quarterly growth to pick up somewhat in Q2, after a retightening of mobility restrictions and new regional lockdowns formed a drag on activity in Q1.

Official growth and Bloomberg's monthly GDP estimate

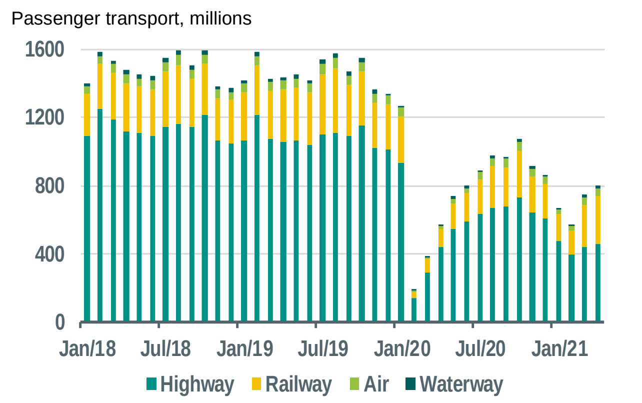


Source: Bloomberg

2. A gradual rotation going forward

China's sharp recovery from the covid-19 shock has been led by exports, industry and the property sector, with consumption lagging. China's strong virus control has helped the economy to normalise relatively quickly, with flare-ups of the virus having been contained quickly due to stringent and targeted policies taming potential contagion. That said, consumers still seem to be a bit cautious, even though the official unemployment is back to below pre-pandemic levels. For instance, tourism spending and travel during two recent festivities (Labor Day break in May, Dragon Boat Festival mid-June) was around 25% lower compared to pre-pandemic levels. And while passenger transport has started to pick up again (in particular railway and air traffic), in April it still was at only 55% of the levels seen on average in 2019. Highway traffic was still at only 42% of 2019 levels in April, although that likely also reflects the fact that more people are working from home compared to before the covid-19 crisis. Also with China's vaccination programme being ramped up, we expect the rotation towards consumption to continue in the course of this year.

Passenger transport remains far below pre-corona levels



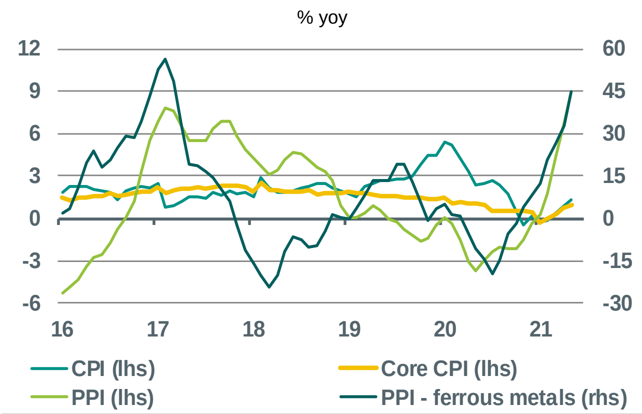
Source: CEIC

3. Producer price inflation at 11-year high

Last week, China's inflation figures for May were published. Particularly eye-catching is the acceleration of producer price inflation (PPI). After having been mostly in negative territory between mid-2019 and late 2020, PPI accelerated sharply in recent months, and hit a post-global-financial-crisis high of 9.0% yoy in May. This (coupled with yuan appreciation versus USD since mid-2020) adds to some extent to concerns over a rising contribution from China to a pick-up in global goods inflation. We should place this a bit into perspective, though. First, the acceleration in China's PPI is strongly driven by a surge in commodity prices and – given that China is the largest importer of commodities worldwide – the rise in PPI is to a large extent driven by global factors. What is more, China's PPI needs to remain high for a sustained period to have a meaningful impact on global goods price inflation, while consensus expectation including ours is for an easing thereof in the second half of this year (partly reflecting base effects). In addition, Chinese producers typically do not fully pass on higher cost prices (and exchange rate movements) to their customers. Although China's consumer price inflation (CPI) and core inflation have picked up in recent months, their pace (at 1.3% and 0.9% yoy in May, respectively) is still quite low.

Last but not least, policy makers are already reacting to contain price pressures. Beijing has for instance taken steps to stem a further rise in domestic commodity prices and fight speculation. State firms have been told to reduce their exposure to overseas commodity markets. Moreover, the authorities have announced to start selling from state reserves in metals, which have already pushed metal prices lower. Furthermore, the People's Bank of China has intervened to slow the yuan's appreciation versus USD. Meanwhile, China's credit cycle has already started turning (see below).

China's producer price inflation at 11-year high

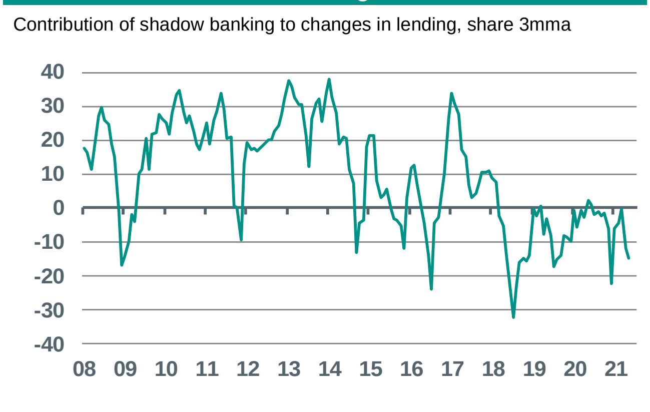


Source: Bloomberg, Refinitiv

4. Gradual, targeted lending slowdown continues

China's May data on lending and monetary aggregates published last week point to stabilisation compared to April. Money supply growth (M1 and M2) more or less stabilised in May, after a clear deceleration in the first months of this year. Lending aggregates (total financing and new bank loans) grew by similar amounts as in April, and – on balance – came in quite close to consensus expectations. In annual growth terms, aggregate financing continued its gradual slide, dropping to a 15-month low of 12.2% yoy (April: 12.3%). Looking beneath the surface of the headline numbers, the crackdown on shadow banking continues, with the negative contribution of shadow banking components to total financing picking up again over the past few months – see chart. All in all, the slowdown of credit growth continues to behave in a gradual manner, and suggests that the government is on its way to reach the goal of capping the pace of credit growth to that of nominal GDP growth this year. All this fits to Beijing's stronger focus on financial de-risking, with the credit cycle having turned now that China's economy has largely recovered from the pandemic shock.

Crackdown on shadow banking continues



Source: ABN AMRO Group Economics, 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