

12 August 2016

## China Economics: Breaking the code of silent acceptance

- Growth slowed across the board in July. China's economy has been trapped in a cycle of retreat and regroup since 2010.
- Industrial production, fixed asset investment and retail sales grew 6% yoy, 3.9% and 9.8% in July, respectively, in real terms.
- A housing downturn and moderating consumer expenditure are expected to weigh on China's growth in H2.
- With fiscal budget already reaching 4% of GDP (budget: 3.0%), we expect the PBoC to ease monetary policy again in 2016.

Growth in China slowed across the board in July. Industrial production growth decelerated to 6.0% yoy (consensus: 6.2%) from 6.2% in June. Retail sales grew 10.2% yoy (consensus: 10.5%) in nominal terms, compared with 10.6% previously. Fixed asset investment growth dropped further to 8.1% ytd yoy (consensus: 8.9%) from 9.0% last month.

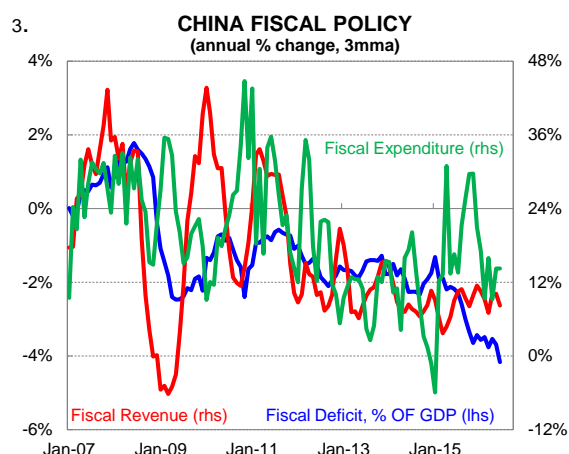
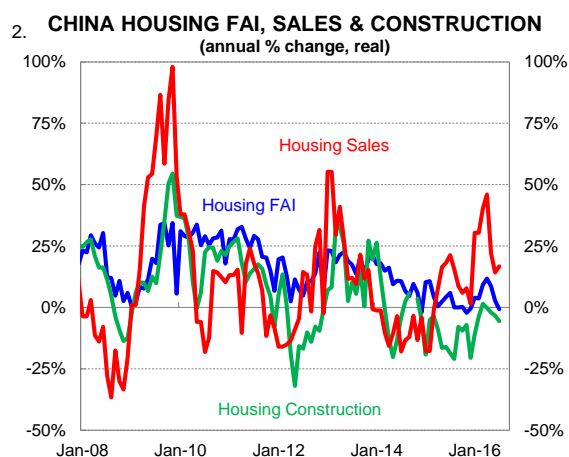
The slowdown in China is in line with our view. China's economy has been trapped in a cycle of retreat and regroup since 2010 after the global financial crisis (GFC). After four rounds of economic downturns (chart 1), China's GDP growth has fallen from 12.2% yoy in Q1 2010 to 6.7% yoy in Q2 2016, looking soon to slip through the low during the GFC in 2009.

Headwinds in China are building up. We have identified two key sources that could drag China's growth lower in H2. First, China's housing market has entered a downturn (see 26 May 2016, [CBA China Economics: China's housing market: About to enter a typical downturn](#)). In real terms, real estate investment fell 0.8% yoy in July, compared with growth of 2.7% in June (chart 2). Housing construction activity fell 7.5% yoy, while housing sales growth remained on a downtrend, at 16.7% yoy in July.

Second, China's consumer market is softening (see 19 July 2016, [CBA China Economics: Consumer spending appetite is falling](#)). Retail sales growth decelerated to 9.8% in July from 10.3% yoy in June in real terms. Urban household consumption growth moderated to 5% yoy in Q2, down from 5.6% in Q1. Both manufacturing and service job markets are in contraction. Wage growth for migrant workers slowed to 6.7% yoy in Q2 from 9.1% in Q1.

Weaker demand, both domestic and external (see 8 August 2016, [CBA China Economics: Contracting imports reflect badly on China's domestic demand](#)), slowed overall industrial production growth to 6.0% yoy in July, from 6.2% in June. Cement production, which is closely related to ongoing investment activity, saw growth moderated to 0.9% yoy from 2.6% previously. Production of steel product rose 4.9% yoy in July, up from 3.2% in June. However, the housing downturn in China does not bode well for the future steel demand.

Against such a backdrop, we expect the People's Bank of China (PBoC) to cut interest rates again before end-2016. There are four key reasons for this: (1) China's economy is under renewed pressure from a housing downturn and slower consumer spending; (2) inflation has peaked and is expect to hover below the official target of 3.0% in 2016; (3) the effect of interest rate cuts in 2014/15 is wearing; and (4) China's fiscal deficit has reached 4% of GDP (chart 3), against an official target of 3.0% for 2016, suggesting it is hard for the Chinese government to increase fiscal stimulus further.



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