Economic Research

Economic Briefing

China – August growth slowed sharply

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The slowdown in the domestic economy was broad-based in August. Not only that growth in industrial production and retail sales slowed, fixed asset investment fell sharply and it was broad-based across industries. Exports were the only bright spot, but their growth also eased. We expect the government to dial up fiscal stimulus again, considering that growth is a key objective for Beijing and local governments.

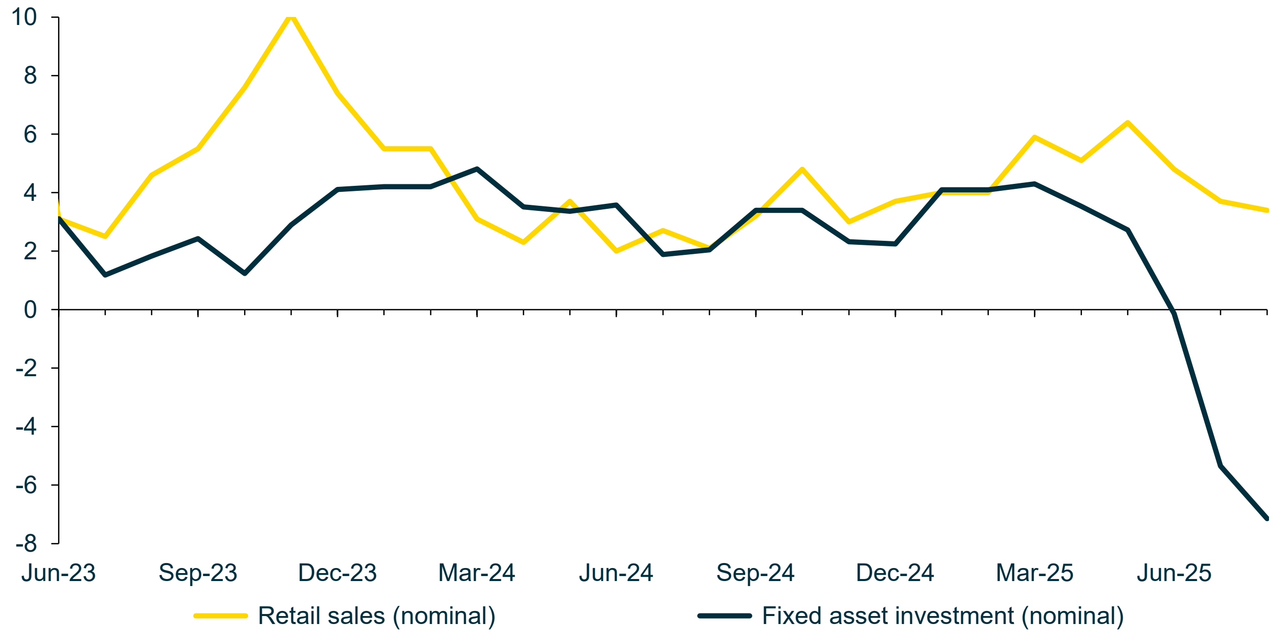
Broad-based domestic weakness

China's economy slowed markedly in August. The domestic slowdown was broad-based, notably with a sharp fall in investment.

- While industrial production still registered a decent growth of 5.2% yoy in August, it was slower than 5.7% in July and 6.4% in H1.
- On the demand side, retail sales growth eased to 3.4% yoy from 3.7% in July and 5% in H1 (Chart 1).
- Fixed asset investment declined 7.1% yoy after -5.3% in June, based on our calculations using the headline year-to-date data (Chart 1). It slowed to just 0.5% yoy year-to-August compared to 1.6% in the first seven months of the year. The decline was broad-based across investment in manufacturing, infrastructure, and real estate. In particular, the decline in real estate investment deepened to almost 20% yoy.

Chart 1 - Sharp fall in investment and a slowdown in retail sales

Year-on-year %



Source: NBS, CEIC, Commerzbank Research

Meanwhile, net government bond issuance slowed for the first time this year. This suggests that the front-loading of government bond issuance to support stimulus measures has probably come to an end. Credit demand for households and businesses has continued to remain poor.

Decent export growth, for now

Similar to July, the only bright spot from this month's data is exports. From the trade data released last week, exports in USD terms rose 4.4% yoy in August. US tariffs have severely hit China's direct exports to the US. Nevertheless, the still-decent overall export growth highlights the resilience in Chinese exports, albeit August growth was the slowest in six months.

Exports to ASEAN continued to expand by double-digit, in part reflecting the rerouting of shipments via third countries to the US. Chinese exporters have continued to diversify into non-US markets, including the EU, Latin America, and Africa.

Interestingly, overall Chinese export prices have not been lowered visibly further in recent months, contrary to conventional thinking. This is likely because Chinese export prices have already been competitive enough.

Meanwhile, imports have remained weak, reflecting domestic demand weakness.

Going forward, Chinese exports will likely slow down.

1. While US tariffs have yet to show significant impact on global trade due to front-loading shipments, the latter eventually will come to an end. A payback effect will become visible due to high inventories in the US and elsewhere.
2. Non-US markets may not be able to absorb all of the demand shortfall from the US.
3. While it is still unclear how the US will implement its "transshipment" tariffs, these tariffs are expected to weigh on the third-country rerouting of Chinese exports to the US, depending on how transshipment will be defined, and the related tariffs will be enforced.

The government tries to fight deflation to rescue confidence…

The government has launched a campaign to fight overcapacity and "involution" (meaning excessive and destructive competition). Beijing has asked local governments to "strictly control" new investment in industries suffering from intense competition or having overcapacity concerns.

…but it will be a tough fight…

While it is likely easier to manage overcapacity and control prices in the commodity industries which are mainly dominated by state-owned enterprises, curbing excessive competition in most other industries where private enterprises play a much more significant role will be more challenging and will require time. This means downward pressure on prices and firms' profitability may persist.

PPI registered -2.9% yoy in August, up from -3.6% yoy in July. However, we have seen improvements in PPI for a few times during the past three years of deflation, but they were only temporary. As such, we would be cautious in saying that the "anti-involution" campaign is having a meaningful success in reining in deflation yet.

What's more, even though core inflation rose to a 18-month high of 0.9% yoy in August, an inflation reading below 1% reflects the weakness in domestic demand.

...and some additional policy stimulus ahead is expected

The "anti-involution" campaign is having a visible impact on investment, as shown in the sharp decline in fixed asset investment. Local governments and firms have been holding back investment.

Beijing may still be taking a less dovish view of the economy given that GDP grew 5.3% yoy in H1. Policymakers probably remain confident that growth could reach the 5% target for the full year. Nevertheless, we expect the government to dial up fiscal stimulus again after a couple more months of weak data, considering that growth is a key objective for Beijing and local governments. This is especially the case when export momentum will sooner or later start to show visible signs of slowdown as the negative impact of tariffs materializes over time.

While further policy efforts are needed to boost the economy, policymakers will likely rely on fiscal stimulus. This is because policymakers are likely concerned that further monetary loosening could lead to overheating in the stock market.

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