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China Economics Update: Recovery continues, though still at a modest pace 中国经济评论: 复苏持续, 但依旧温和

May data suggests a continued modest recovery. Despite an unexpected slowdown in production, we expect industrial production to remain solid, supported by structural industrial upgrades and foreign demand. Investment growth disappointed in May, largely because of the property downturn. Better-than-expected May retail sales were underpinned by continued strength in offline consumption and trade-in policy measures, a sign of resilient consumption.

We continue to expect a supportive fiscal stance for the remainder of the year. A 25bp cut to the Required Reserve Ratio (RRR) in Jun remains our baseline forecast, perhaps 3Q at the latest. However, rate cuts remain off the table for the time being.

5月数据表明经济仍在温和复苏。 尽管工业产意外放缓, 但我们仍预计未来工业产出将在产业升级和海外需求回暖的支撑下继续保持稳健增长。5月份投资增长不及预期, 持续低迷的地产投资是主要拖累项。得益于线下消费的强劲与消费品以旧换新政策, 社会零售表现优于预期, 显示出消费的韧性。

我们预计保增长的政策在年内持续。 6月下调存款准备金率 25 个基点仍是我们的基准预测, 但有可能推迟到 3 季度。降息目前概率较小。

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A mixed performance in May

Industrial production (IP) growth slowed to 5.6% YoY in May (previous: 6.7% YoY; consensus: 6.2% YoY). Seasonally adjusted sequential growth edged down to 0.3% MoM in May (versus 1.0% MoM in Apr). By industry (Fig 1), Auto output experienced a sharp slowdown, probably reflecting elevated inventories. Meanwhile, output growth in chemicals and ferrous metal smelting inched up, partially due to higher commodity prices. Output in hi-tech related industries such as computer & electronics equipment remains solid, thanks to recovering overseas demand.

Retail sales growth rebounded from 2.3% YoY to 3.7% YoY in May, above the consensus expectation of a 3.0% YoY rise. Seasonally adjusted sequential growth rebounded to 0.5% MoM. Despite fading base effects, growth in catering spending picked up slightly, indicating resilience in offline consumption. Despite the slowdown, spending growth on fuel remained solid at 8% YoY in May, thanks to travel demand. Spending growth on electric appliances continued to accelerate, likely due to trade-in policies; however, growth in nominal car sales eased to 3.2% YoY, in part reflecting hefty price cuts.

Fixed-asset investment (FAI) growth slowed for the second consecutive month to 3.5% YoY in May by our estimate (Fig 3) because of a larger drag from real-estate investment and slower infrastructure investment.

By category:

- **Broad infrastructure investment growth slowed slightly to 7.7% YoY in May.** Traditional infrastructure investment growth eased to 4.9% YoY. Despite a step-down, investment in China's power sector remained solid at 18% YoY in May. We retain our positive outlook for green investment amid structural industrial upgrades and policy support.
- **Manufacturing investment growth stayed strong at 9.4% YoY.** Robust growth in manufacturing investment underscores the theme of industrial upgrades, especially in key sectors such as transportation equipment, electrical machinery & equipment, and nonferrous metals. Furthermore, the food manufacturing industries has displayed stronger investment momentum lately, in contrast to food manufacturing during Covid-impacted periods, which has been supported by recovering consumer spending.
- **The contraction in real-estate investment widened slightly to 11% YoY in May** by our estimate, the steepest year-on-year decline this year. The year-on-year contraction in funding remains wide at just over 20% YoY amid broad-based weakness.

Other property measures indicate a continued downturn. All volume-based property indicators pulled back again in May after improvement had been made in Apr thanks to the low base effect. In particular, property under construction was down 30% YoY for the Apr-May period. The contraction in property starts and property completions widened in May as well, bringing the two-month year-on-year decline to 18% and 17%, respectively. High frequency data suggests average weekly property sales in 30 Chinese large cities have remained soft in recent weeks, albeit with a smaller year-on-year decline than the major decline seen early in the year (Fig 4). The decline in the average price of new properties in the 70 largest Chinese cities accelerated to 0.7% MoM in May, marking the steepest monthly decline on record.

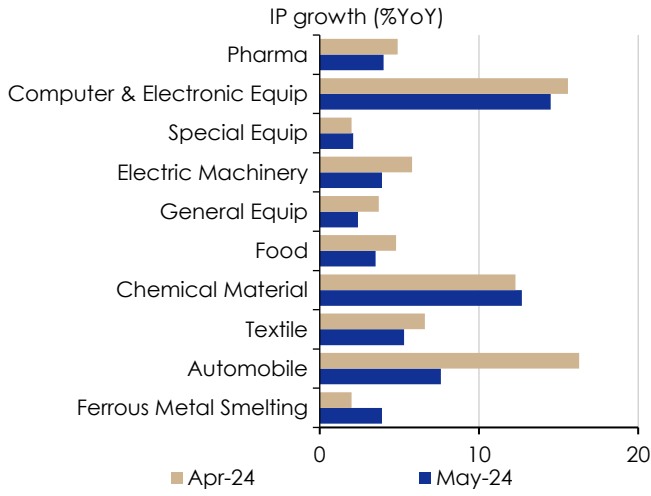
The surveyed jobless rate was steady at 5% in May, a small improvement on 1Q 2024. The gradual recovery in offline consumption is likely to lift employment in services.

Our view:

May data suggests the modest recovery continues. Despite an unexpected slowdown, we expect IP growth to remain solid, supported by structural industrial upgrades and foreign demand. The May data suggests resilient consumption despite soft spending trends and the sluggish property market. [We believe](#) cyclical conditions are conducive to a further recovery, though still at a modest pace.

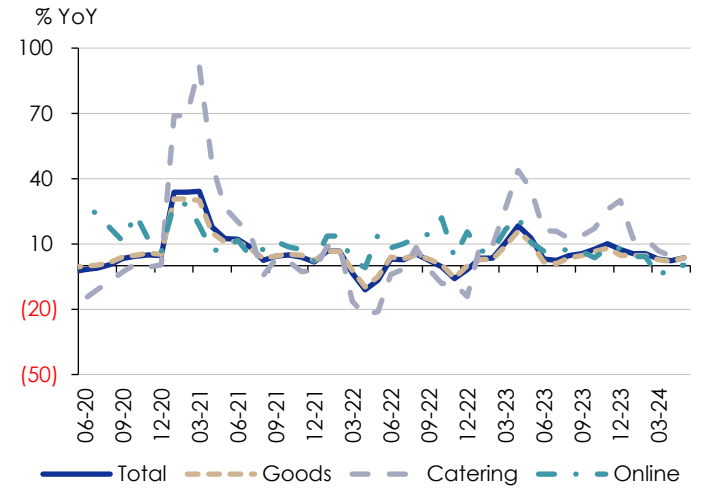
We expect fiscal support to continue in the remainder of the year. We maintain our forecast of a 25bp cut to the Required Reserve Ratio (RRR) in 2Q24F or 3Q at the latest. The PBoC withdrew RMB55b via the One-year Medium-term Lending Facility (MLF) on 17 Jun, confounding market expectations of a flat net liquidity injection. In our view, such a small change would not be enough to alter the PBoC's focus on ensuring sufficient liquidity. Meanwhile, the PBoC maintained policy interest rates unchanged this month. We retain our view that interest rate cuts have become less likely given the improving macro picture.

Fig 1: Output growth in auto slowed, but output growth in chemicals and ferrous metals accelerated



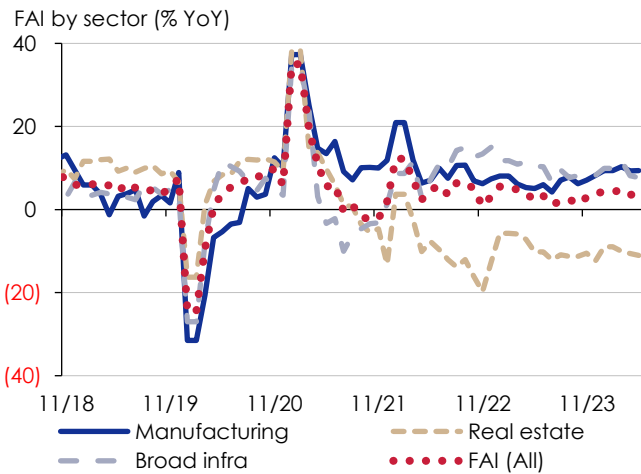
Source: NBS, CCBIS

Fig 2: Retail sales growth rebounded in May



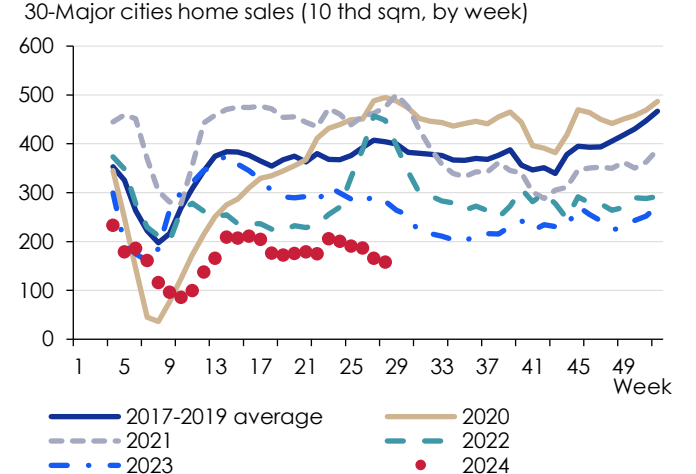
Source: NBS, CEIC, CCBIS

Fig 3: Solid manufacturing investment growth



Source: NBS, CCBIS

Fig 4: Still sluggish property sales, but getting better



Source: NBS, Wind, CCBIS

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