China: Robust Q2 GDP in line with a soft landing, with inflation still a concern

Second quarter GDP was released today along with other activity indicators, pointing to a moderation in growth momentum, but still strong enough to allay concerns of a hard landing. The outturn of 9.5% y/y was in line with our expectations, but above many analysts' forecasts (consensus: 9.3% y/y). Meanwhile, rising prices remain a concern, with June inflation, which was released last Saturday, reaching a higher-than-expected 6.4% y/y on account of higher food (especially pork) prices. The outturns are in line with our previous growth projection of 9.4% for 2011 and 9.1% in 2012, although the higher inflation print poses modest upside risks to our 5% year-average inflation outlook. We anticipate one more rate hike and another 50bp hike in the required reserve ratio during the remainder of the year, as the authorities take a more cautious approach to policy tightening in view of moderating growth indicators.

- Q2 GDP growth eased to 9.5% y/y (BBVA: 9.5%; consensus: 9.3%) from 9.7% y/y in the first quarter (Chart 1). According to the National Bureau of Statistics' (NBS), the economy grew by 8.8% q/q (SAAR), up from 8.4% q/q (SAAR) in Q1. The moderation in year-on-year growth suggests that the authorities' tightening measures are working toward a soft landing. Slowing indicators in recent months have led some analysts to increase their expectations of a hard landing, although we continue to believe that such risks remain low, as confirmed in today's data.
- Robust growth momentum is also reflected on the readings of other activity indicators in June. On the demand side June retail sales rise to 17.7% y/y (consensus: 17.0%), up from the reading of 17.4% y/y in May (Chart 2). Urban fixed asset investment grew by 25.6% y/y for June (consensus: 25.6%) broadly unchanged from 25.8% y/y in May.(Chart 3) On the supply side, industrial output surged to 15.1% y/y in June from the previous month reading of 13.3% y/y, well above the market expectation (consensus 13.2%).
- As anticipated, headline CPI inflation rose in June, reaching 6.4% y/y from 5.5% in May (Chart 4), slightly above expectations (BBVA: 6.1%; Consensus: 6.2%). The main driver continues to be food prices, especially pork, which rose by 57.1% y/y in June up from 40.4% y/y in May, and the prices of fresh vegetables, rising by 7.3% y/y in June up from 7.1% y/y in May. Producer price inflation (PPI) in June also edged up to 7.3% y/y from 6.8% y/y in May on rising the prices of commodities, especially metal. This reading marks the first increase in the PPI since March, and could add further upward pressure on headline CPI in the period ahead.
- Although inflation for June was higher than expected, we continue to project a moderation during the remainder of the year as food and commodity prices ease, and on base effects from last year. That said, we expect inflation to remain in the 5-6% range during Q3, before declining to around 4% by the end of the year.
- Previously released credit data slightly increased but still under control. New loans in June came in at RMB 633.9 billion (consensus: RMB 622.5 billion), up from RMB 551.6 billion in May, implying year-on-year credit growth of 16.9%. The higher than expected reading could raise concerns about the authorities' ability to slow lending, especially given recent attention to the issue of central government debt. That said, new loans for first half year were RMB 4.2 trillion, broadly in line with what we believe to be the authorities' (unannounced) full-year target of RMB 7.0-7.5 trillion. M2 growth in June quickened to 15.9% y/y in June from 15.3% y/y in May, still within the official comfortable zone of below 16%.

- On the external front, trade data in June release early this week registered a higher-than-expected trade surplus of USD 22.3 billion (consensus: USD 14.4 billion), mainly due to the weaker-than-expected imports. The growth of imports was only 19.3% y/y in June (consensus: 28.0% y/y), sharply down from the previous month strong reading of 28.4% y/y. The main commodity imports slowed on oil and iron. However, we interpret it as a temporary phenomenon given the domestic demand is still strong and the monthly variation of imports data is notoriously volatile. Export growth in June is 17.9% y/y (consensus: 22.0%) also slightly lower than expected, mainly due to the weakened demand from US and EU.

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Chart 1: Q1 GDP growth remains strong

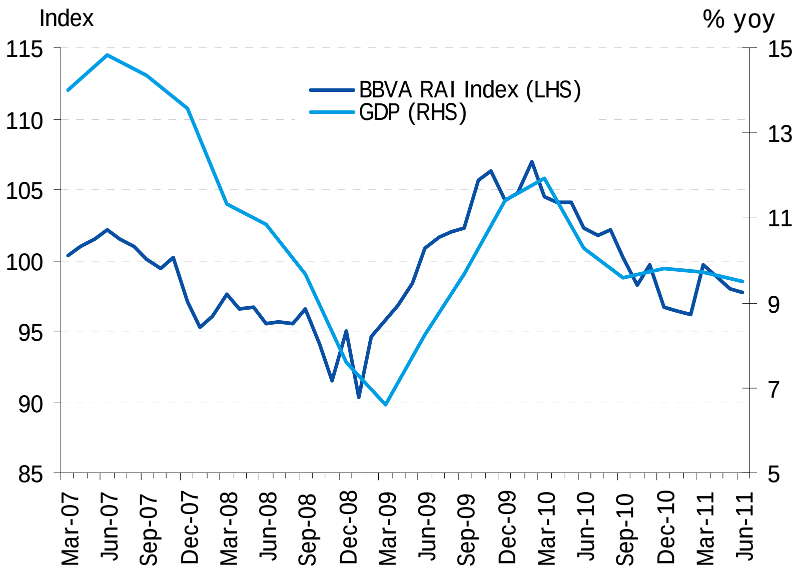


Chart 2: Retail sales stabilized

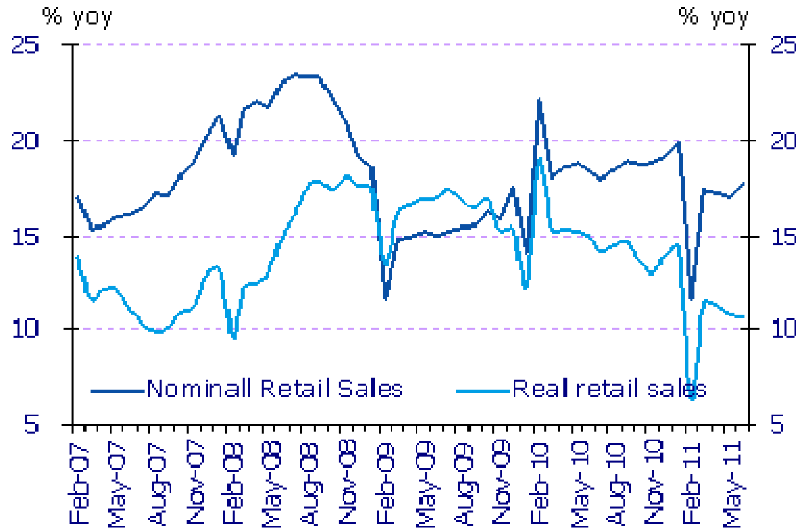


Chart 3: IP outturn surprised to upside and FAI was in line with expectation

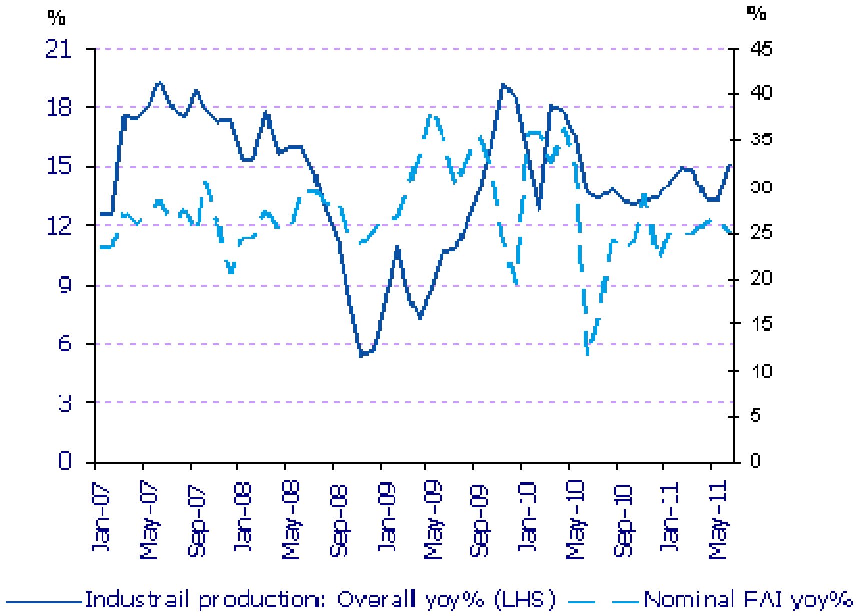
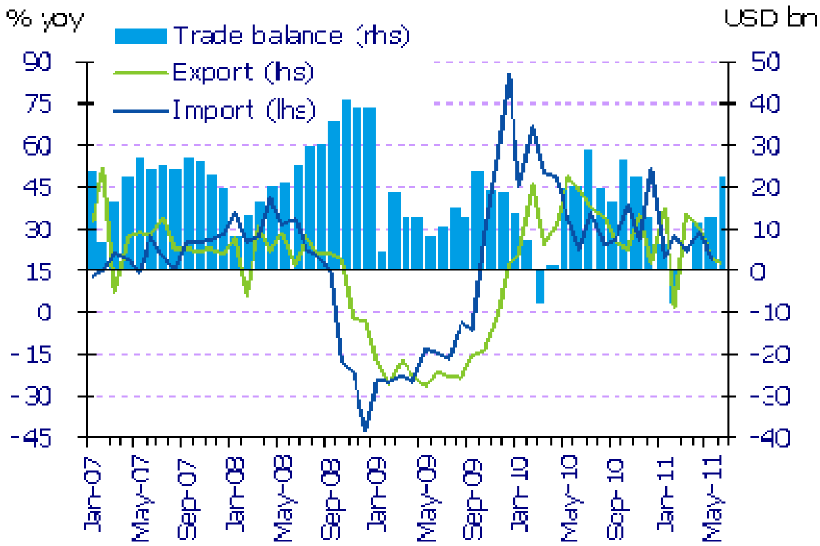


Chart 4: Trade surplus increased on weaker-than-expected imports



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