Mizuho China Macro

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July activity slips, eyes on LPR

China's domestic activity data for July showed widespread softness. Fixed asset investment delivered the biggest downside surprise, dragged by poor weather and deepening property sector weakness. Both property investment and sales deteriorated notably for the second consecutive month. The slower industrial value-added increase suggests July's solid exports were driven by destocking rather than production.

Looking ahead, we see a higher chance of a 5-year Loan Prime Rate cut this Wednesday, even as the PBoC holds its benchmark rate, reflecting efforts to ease financing costs and support housing demand.

Fig 1 China's major indicator releases

Indicators	Apr	May	Jun	Jul (actual)	Jul (consensus)
VAI (YoY %)	6.1	5.8	6.8	**5.7**	6.0
Retail sales (YoY %)	5.1	6.4	4.8	**3.7**	4.6
FAI (YTD YoY %)	4.0	3.7	2.8	**1.6**	2.7

Source: Bloomberg, Mizuho

Disappointing investment. While China's July activity indicators all missed market expectations, the biggest downside surprise came from fixed asset investment (FAI) amid adverse weather conditions and renewed weakness in the property sector. FAI rose just 1.6% YoY in the first seven months of the year, implying a sharp monthly decline of 5.3% YoY. The decline was broad-based, with manufacturing and services investment falling 0.2% and 9.4% YoY, respectively, worsening from June's 5.1% increase and 3.0% decline. FAI by the private sector posted a YTD drop of 1.5% YoY, marking the steepest decline since 2020 (Fig 2).

Deepening property slump. The property sector saw further deterioration in July. Residential property investment and sales fell 14.1% and 13.7% YoY, respectively (Fig 3). New home prices also declined at a faster pace, dropping 0.31% MoM following a 0.27% fall in June. In comparison, property starts and sales declined at a slower pace in volume terms (floor space) but still worsened from their declines in June.

Fig 2 A broad-based decline in July's FAI

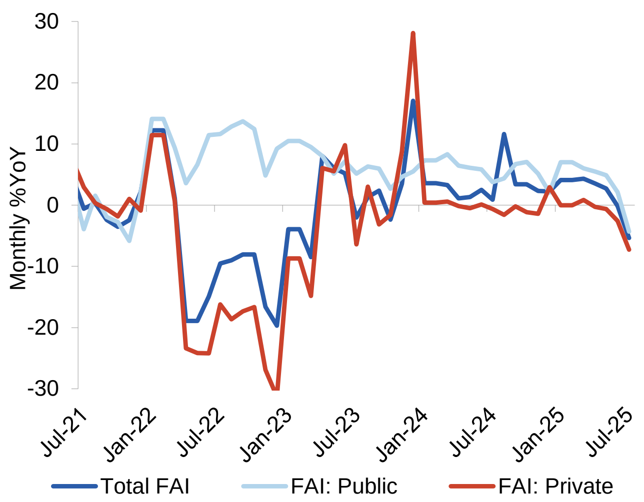
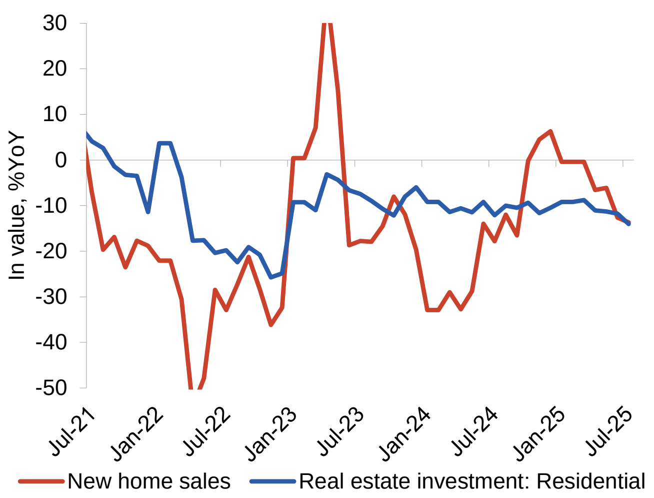


Fig 3 Home sales and investment both fell at a faster pace



Source: CEIC, Mizuho

More property support ahead? In response to the persistent weakness, China is reportedly considering measures to encourage central state-owned enterprises (SOEs) to purchase unsold homes from distressed developers. These

SOEs would be allowed to access the RMB300b relending fund earmarked by the PBoC for this program, which has seen minimal progress since its launch in May last year.

Weaker industrial growth. Industrial value-added growth slowed more than expected in July, rising 5.7% YoY, an eight-month low. The slowdown was broad-based, suggesting that July's solid export performance was driven more by inventory clearance than new production. That said, ferrous metals (8.6% YoY) and general equipment (8.4% YoY) bucked the trend, recording their fastest growth in several months.

Fading retail sales momentum. Retail sales also missed expectations, rising just 3.7% YoY, the slowest pace this year. Automobile sales fell 1.5% YoY, likely impacted by the government's campaign against excessive price competition. In late May, authorities warned carmakers against engaging in aggressive price wars. Excluding automobiles, retail sales rose 4.3% YoY in July. Petrol sales dropped 8.3% YoY, reflecting a 9.0% decline in vehicle fuel prices during the month. Meanwhile, items supported by government trade-in subsidies continued to see double-digit growth (Fig 4). The Ministry of Finance confirmed that the third tranche of trade-in subsidies, totaling RMB69 billion, was distributed in late July.

On the policy front. We see slightly increased likelihood of a cut to the 5-year Loan Prime Rate (LPR), despite no reduction in the PBoC's benchmark rate, as the central bank aims to lower social financing costs. Currently, the 5Y LPR stands 0.5ppt above the 1Y LPR, while the term spread between 5Y and 1Y China Government Bonds has hovered between 0.1 to 0.2 percentage points in recent months (Fig 5). Note that nearly all mortgage rates in China are now linked to the 5Y LPR.

Fig 4 Solid sales in sectors supported by government subsidies

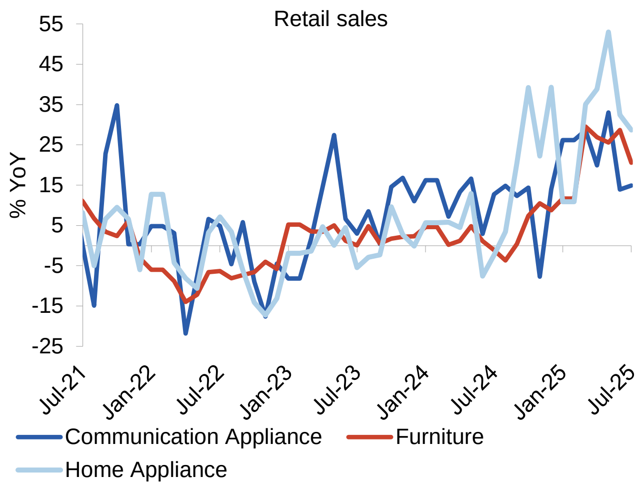
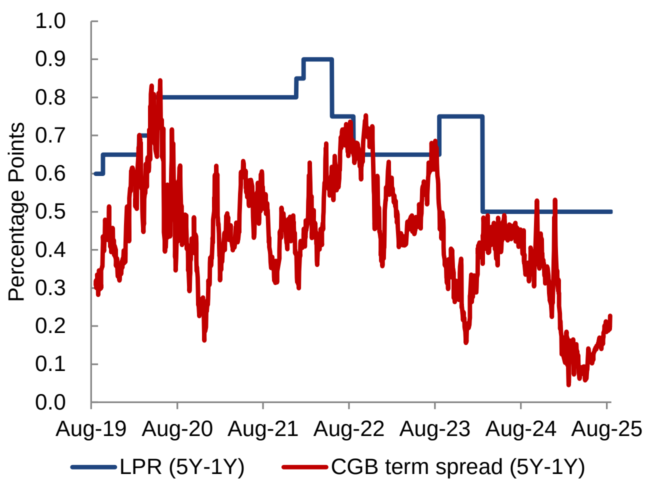


Fig 5 Potential room for the 5Y LPR to go lower



Source: CEIC, Mizuho

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