ChinaPulse: Growth slowed as divergence widened

LIN LI, PHD
Head of Global Markets Research Asia

Global Markets Research
Global Markets Division for Asia
T: +852 2862 7005
E: lin_li@hk.mufg.jp

KHANG SEK LEE
Associate

Global Markets Research
Global Markets Division for Asia
T: +852 2862 7838
E: khangsek_lee@hk.mufg.jp

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MUFG Bank, Ltd.
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Key Points:

- *July data indicates a slowdown in aggregate economic momentum, with growth decline seen in IP, retail sales, FAI and main property activity indicators.*
- *A striking divergence, the "K-shaped" split between the "new economy" (tech and high-end manufacturing) and the "traditional economy" (consumption and real estate), is happening in Chinese economy.*
- *While factors, like the renewed risk of conflict in the Middle East, and natural disasters such as typhoons, heavy rainfall, and extreme heat, exerted some short-term negative pressure on the productions of certain sectors, overall demand remained weak, necessitating further policy stimulus.*
- *Government may accelerate the pace of project pipeline development and the disbursement of funds. We expect infrastructure investment to pick up from September onwards.*
- *We maintain the view of USD/CNY to reach 6.65 by the end of 2026*

China released its key macroeconomic indicators for July yesterday.

July numbers indicated that China continues a two-speed economy, with production significantly outperforming consumption. The 4.5%yoy Industrial value-added expansion was supported by robust gains in high-tech manufacturing, which surged 16.9%yoy. In contrast, the subdued 0.6%yoy retail sales growth underscored the continued weakness in household demand despite solid manufacturing momentum. A significant divergence existed between high-tech FAI investment and overall FAI investment this July: Investment in high-tech industries bucked the trend with a 5.0%yoy ytd growth, whereas total fixed-asset investment fell by 6.7%yoy ytd, hitting a new low since April 2020, and real estate investment plummeted by 19.2%yoy ytd.

July numbers continued to indicate a significant contrast between resilient external demand and weak internal demand. AI-related exports remained robust, but effective domestic demand was insufficient, with household consumption and corporate investment sentiment remaining sluggish.

This "K-shaped" divergence is essentially a typical growing pain associated with the transition from old to new growth drivers. Although the new drivers—exemplified by AI and high-tech industries—are expanding rapidly, their scale is not yet sufficient to fill the massive void left by the slowdown of traditional drivers like real estate.

Short-term factors amplified economic fluctuations in July. Extreme weather, typhoon, heavy rainfall, caused disruptions in both production and consumption in July. And high-frequency data from August indicates that this weather impact persists.

Looking ahead, we still think that the pattern of economic recovery may become clearer from September onwards. The development of the "six networks" remains a key area to support current infrastructure investment. However, judging by the current project pipeline and the pace of fund disbursement, the rate of implementation remains relatively slow. The Politburo meeting held at end-July made it clear that the priority is to speed up the implementation of existing policy measures, and we expect accelerated pace to finish the remaining 44% of annual bond quota.

Positively, the Chinese media reported that nearly 90% of the local government debt-swap quota (RMB 1.79tn out of RMB 2.0tn) had been utilized as of early August. Besides easing local governments' hidden debt repayment burden, the program should also improve liquidity conditions by freeing up capital that can be deployed to support the real economy. The progress made in debt swaps could also allow local governments to shift their focus toward accelerating the issuance of special local government bonds (LGBs) earmarked for infrastructure work.

Details of July macro data are as follows:

Muted retail sales growth highlights lingering weak consumption

July retail sales of consumer goods rose by merely 0.6%yoy, missing market expectations for a mild acceleration to 1.5%. The sequential growth was muted.

By product category for above-designated-size enterprises, a broad-based growth slowdown in retail sales was seen across categories from previous month. The exception was communication appliance (+3.9ppts), medicine (+2.3ppts) and household electric & video appliance (+6.8ppts). That said, 4 out of 6 trade-in related goods categories remained in negative growth and the big-ticket item such as automobile saw growth worsened further to -17.0%yoy.

In YTD term, total retail sales of goods and services (a new indicator introduced in June) increased by 2.6%yoy, edging lowered by 0.1ppts from previous month. In particular, services sales slowed faster by 0.3ppts to 5.0%yoy, whereas good sales growth inched down to 1.2%yoy.

Stabilization in FAI requires an acceleration in fiscal rollout

In July, FAI sequential contraction widened to -1.4%mom from -0.6%mom previously, marking the sixth consecutive month of contraction.

In year-to-date term, FAI growth worsened further to -6.7%yoy this July from -5.7%yoy; the growth slowdown was broad-based across sectors too, and the infrastructure investment growth further declined by 1.2ppts to -3.6%yoy. Separately, the overall manufacturing FAI growth worsened to -1.7%yoy. That said, most of the equipment-making sectors still managed a positive FAI growth thus far, except special equipment. Indeed, FAI on equipment purchase maintained a high single-digit growth with also a modest 0.9ppts growth acceleration. Furthermore, computer, communication and other electronic equipment defied the overall downward trend vividly, with growth accelerating by 1.3ppts to 7.8%yoy, highlighting a clear case of K-shape dynamics within the economy.

By ownership, the appetite for investment deteriorated across state-owned and private enterprises, with private FAI worsening to -9.4%yoy YTD and state-owned enterprises FAI growth declining to -3.3%yoy YTD.

Looking ahead, an accelerated fiscal rollout is required to stimulate infrastructure investment and stabilize overall FAI growth. That said, private sectors (ex-tech) are likely to remain under pressure which will limit the broader FAI recovery.

Property market continued to underperform

In year-to-date terms, property investment growth slumped to another new record low of -19.2%yoy, with growth slowdown seen across most other major property indicators including a -11.8%yoy growth of floor space sold and a -24.0%yoy growth of floor space started. For single month of July, some indicators posted year-over-year growth improvement but continued to experience double-digit growth decline.

Prices wise, overall home prices continued to decline, with varied degree of decline across new (-0.18%mom) and secondary home (-0.29%mom). This July, the price decline of new home prices widened slightly while the decline of secondary home prices narrowed somewhat compared to previous month. It is worth noting that home prices in tier-1 cities continued to recover with positive month-over-month gains for both new and secondary homes.

That said, NBS signaled some recovery of home prices expectations ahead. According to NBS survey in June, 63.1% of real estate professionals expected prices of newly built residential properties to remain stable or rise over the next six months. The proportion has remained above 60% for four consecutive months and has recovered by nearly 20ppts from last year's low point.

IP growth slowed more than expected despite strong tech

July IP surprised to the downside with growth moderating to 4.5%yoy versus the market estimates of 5.0%, partly linked to extreme weathers. Sequential momentum was muted with merely 0.1%mom growth. While manufacturing sector IP growth slowed by 0.5ppts to 5.5%yoy, the overall growth level remained healthy nevertheless. Interestingly, equipment-related sectors continued to do well with growth ranging between 9%-19%yoy in July, and especially so for computer, communication & other electronic equipment with 3.4ppts acceleration. Separately, high-tech manufacturing growth further accelerated to 16.9%yoy. On the other hand, more traditional industries such as pharmaceutical, chemical-related or ferrous metal smelting & pressing experienced some growth deceleration from previous month. Beyond manufacturing sector, the utilities (electricity, heat, gas and water) growth moderated from high single-digit growth to 5.0%yoy whereas mining output growth declined further to -4.2%yoy.

Exports of mechanical & electrical products including tech are booming

China's export growth remained robust in July, printing slightly above expectations at 23.9%yoy, although moderating from the previous month's 27%yoy. The uptrend in tech exports remained firmly intact, with combined exports of chips and automatic data processing machines and parts (i.e. tech exports) surging 93%yoy. As a result, the contribution of tech exports to headline export growth rose to 10.0ppts, reaching double digits for the first time (ex- Covid) despite accounting for only 11% of total exports. Beyond tech, mechanical & electrical products growth was firm and evidently in ships, motor vehicles and general machinery, all posting high double-digit growth, with particularly notable acceleration in ship exports (+50ppts) and general machinery exports (+16ppts).

Across destinations, export growth to major trading partners, including the US, remained healthy, ranging between 14% and 38%yoy. Notably, ASEAN share of China's exports gained steadily to currently 19% from 16% prior to Trump 2.0, strengthening its status as the top export destination.

On the import side, growth moderated and undershot expectations, coming in at 27.5%yoy (vs. consensus 29.7%). The slowdown was driven by a sharp deceleration in non-tech imports, where growth eased by 11ppts to 12%yoy. By contrast, tech imports continued to strengthen as China is ramping up its tech capability.

Weaker-than-expected inflation highlights reflation challenges

China's headline and core CPI inflations came in lower than prior month and below market expectations again in July, to 0.5%yoy and 0.9%yoy respectively. While the 0.5ppts decline in headline CPI from prior month was mainly driven by lower gasoline prices, the continued moderation in core CPI inflation since May is more concerning. Meanwhile, services CPI also edged lower by 0.2ppts to 0.7%yoy during the same period, consistent with a broad-based weak domestic demand. Bright spot was however the communication facility prices (e.g., mobile phones) which likely benefited from higher chip prices, rising by 8.3%yoy.

For PPI, the headline reading moderated to 3.5%yoy in July from June's 4.1%yoy. On month-on-month basis, it declined further by 0.7%mom due to sharper decline in the prices of refined petroleum, coal and other fuels products (-6.0%mom). Separately, both ferrous and non- ferrous metal mining/ smelting and pressing also recorded prices decline, with the former affected by adverse weathers and the latter weighed down by lower global prices. Lastly, consumer goods PPI remained largely stable.

Aggregate financing growth stabilized with faster government bond issuance

In July, the new increase in aggregate financing picked up to RMB 1.4tn from RMB 1.13tn same period last year. The closely watched government bond issuance matched the size last year at around RMB 1.3tn, marking also a sequential pick-up from RMB 0.77tn in previous month. Net corporate bond financing increased to RMB 454bn from RMB 275bn last year, helping to offset the larger local currency loan contraction. Stock wise, aggregate financing growth stabilized at 7.4%yoy following recent decline.

Bank loan wise, the picture of weak loan demand remained intact. The household loan reversed to seasonal contraction but the magnitude suggests continued subdued demand (-RMB 460bn). For corporates, overall loan stock declined dragged by contraction in medium & long-term loan (a gauge of investment appetite) and smaller increase in bill financing compared to previous year. Lastly, M2 growth slowed to 7.7%yoy with M1 growth flat at 4.0%yoy.

Recently, the PBoC played down the focus on seeing loans as a sole-financing channel and encouraged a broader metric to gauge corporates' financing demand, which includes bond/ equity financing. Combining YTD corporate new loan, bond and equity financing, the size has reached RMB 13.9tn, around RMB 0.6tn higher than same period last year. However, excluding short-term loans and bill financing, which better reflect firm's longer-term investment plan, the total stood at RMB 8.2tn, around RMB 0.3tn lower than a year earlier, still pointing to a weaker investment appetite.

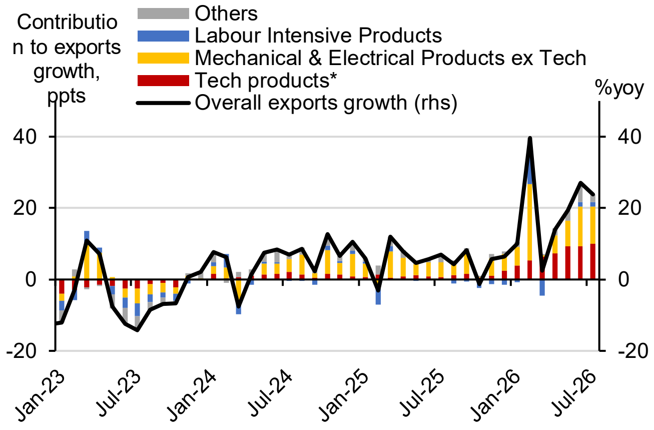
Looking ahead, a potential higher pace of fiscal stimulus implementation may help support the overall aggregate financing growth. A 44% of annual bond quota, or equivalent to RMB 6.1tn, remains as of July.

USD/CNY: Directionally positive on CNY

Month-to-date, CNY gained 0.2% against US dollar, reflecting softer DXY index. Notably, market's strong appreciation bias on CNY has seemed to reappear with the USD/CNY spot now trading away (lower) from the daily fixing level again since late July as market likely took the message from July's Politburo meeting somewhat positively and also against the backdrop of broader equity market rebound following July tech sell-off.

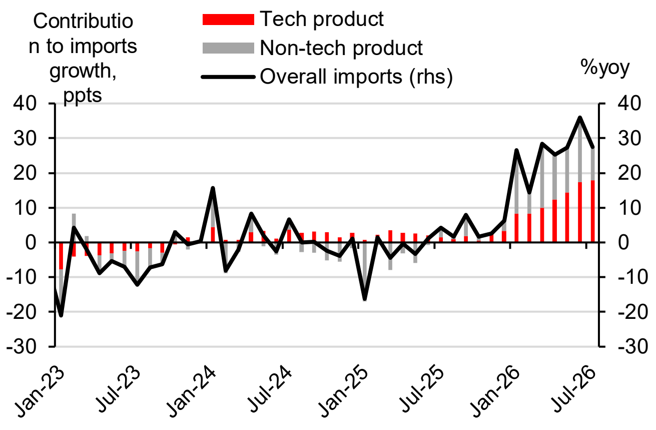
We remain constructive on CNY through year-end, forecasting USD/CNY at 6.65 by Q4. CNY should benefit from the continued strength in exports/ trade surplus, recurring tech-led China's asset revaluation theme which may help to attract portfolio inflow. The pace of appreciation however will likely be gradual given the intense domestic growth headwind. In the absence of growth improvement in coming months, CNY could face downside risk if the PBoC delivers policy rate cuts, which could widen the negative yield spread with the US. External factors like Fed rate path, US yields and US dollar trend may create renewed volatility on USD/CNY pair.

M&E INCLUDING TECH PRODUCTS ARE DRIVING GROWTH



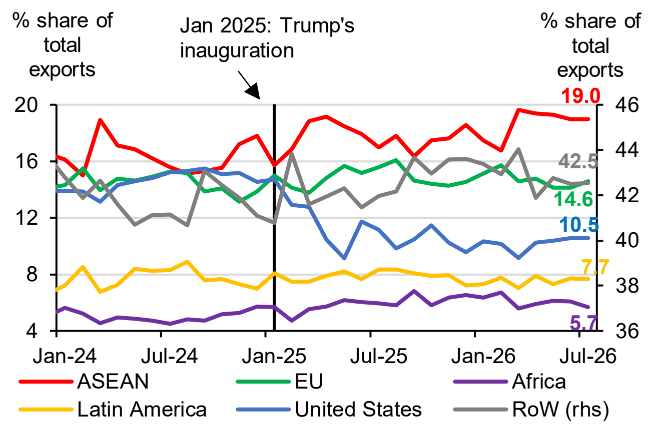
Source: CEIC, Bloomberg, MUFG GMR. *Tech refers to chips + automatic data processing machine & part

NON-TECH PRODUCT IMPORTS GROWTH SLOWED NOTABLY IN JULY



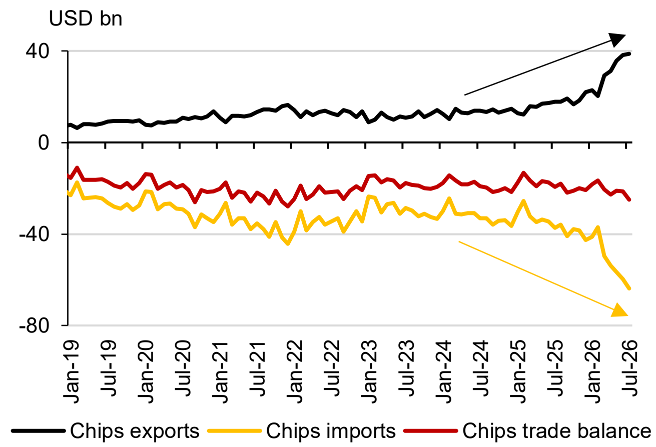
Source: CEIC, Bloomberg, MUFG GMR. *Tech refers to chips + automatic data processing machine & part

CHINA'S EXPORTS MIX HAS GRADUALLY CHANGED SINCE TRUMP 2.0



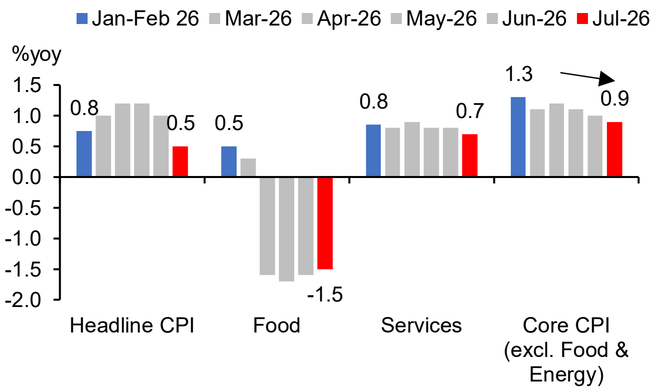
Source: CEIC, Bloomberg, MUFG GMR.

CHINA REMAINS DEPENDENT ON CHIPS IMPORTS



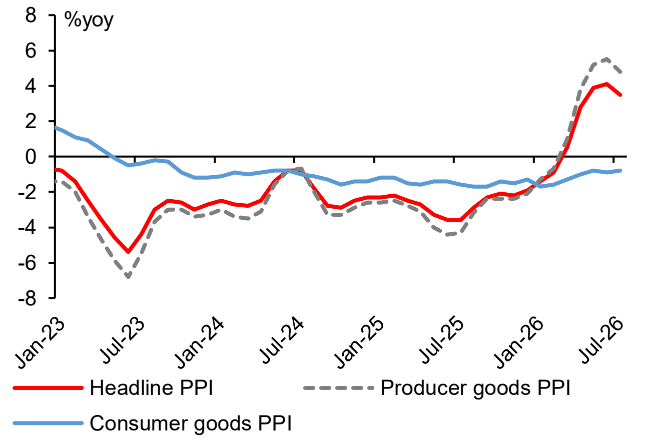
Source: CEIC, Bloomberg, MUFG GMR.

CORE CPI INFLATION IS GRINDING LOWER



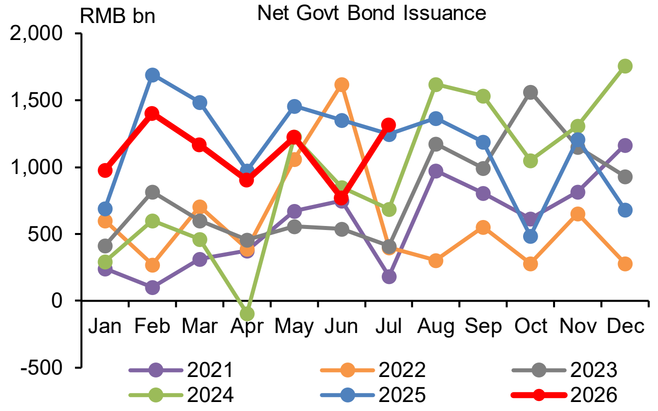
Source: CEIC, Bloomberg, MUFG GMR.

PRODUCER GOODS PPI INFLATION LIKELY PEAKED



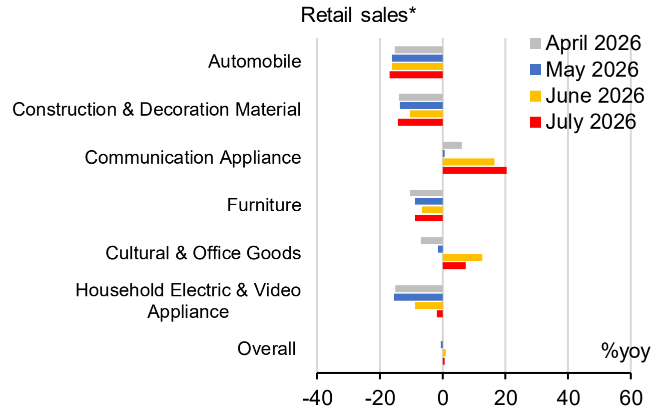
Source: CEIC, Bloomberg, MUFG GMR.

GOVT BOND ISSUANCE PICKED UP IN JULY



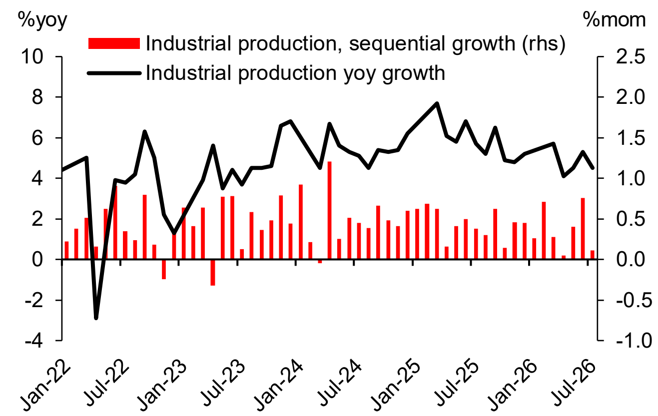
Source: CEIC, Bloomberg, MUFG GMR.

MOST OF TRADE-IN PROGRAM GOODS REMAINED IN NEGATIVE GROWTH TERRITORY



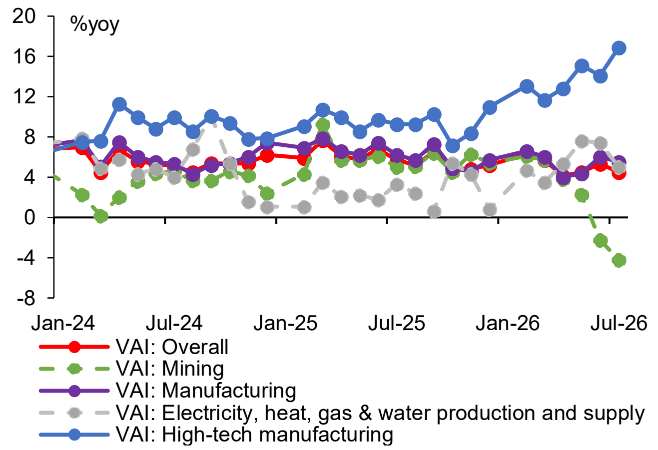
Source: CEIC, Bloomberg, MUFG GMR. *For product breakdown, the sales refer to above designated sized enterprises

RESILIENT IP GROWTH IS SUPPORTING THE ECONOMY



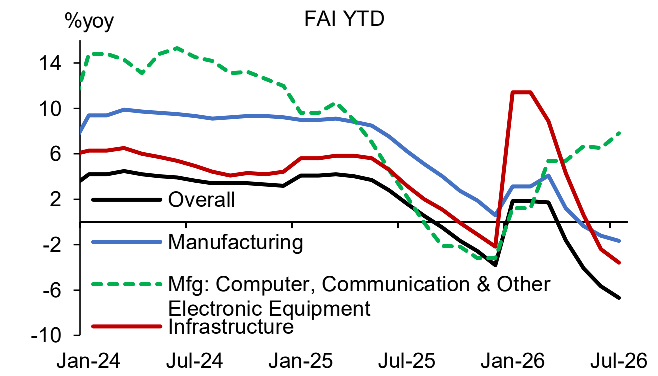
Source: CEIC, Bloomberg, MUFG GMR.

RISING HIGH-TECH MANUFACTURING IP GROWTH



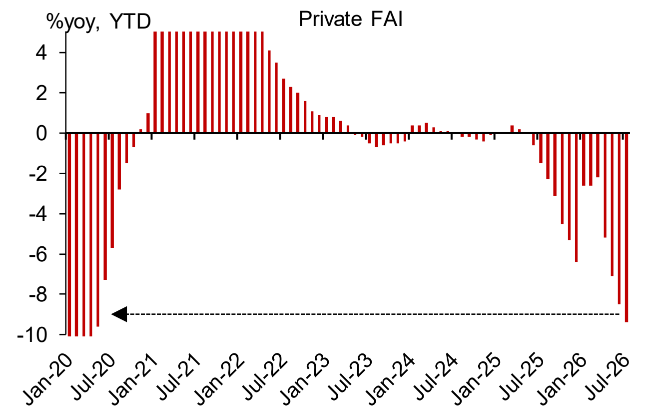
Source: CEIC, Bloomberg, MUFG GMR.

TECH-RELATED FAI DEFIED THE OVERALL SLOWDOWN



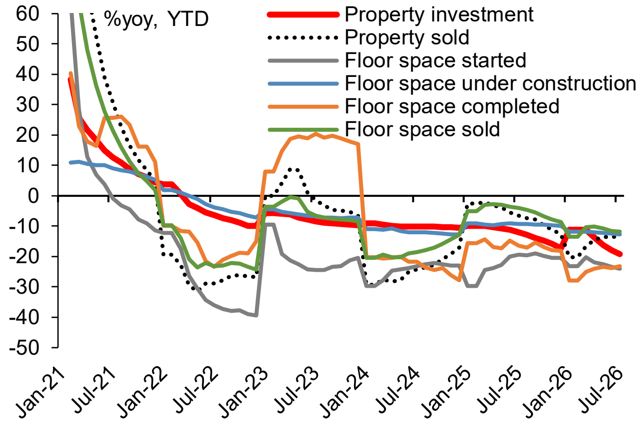
Source: CEIC, Bloomberg, MUFG GMR. Note: 2026 Infrastructure includes "electricity, heat, gas & water production and supply" category

PRIVATE FAI IS STUCK IN NEGATIVE GROWTH



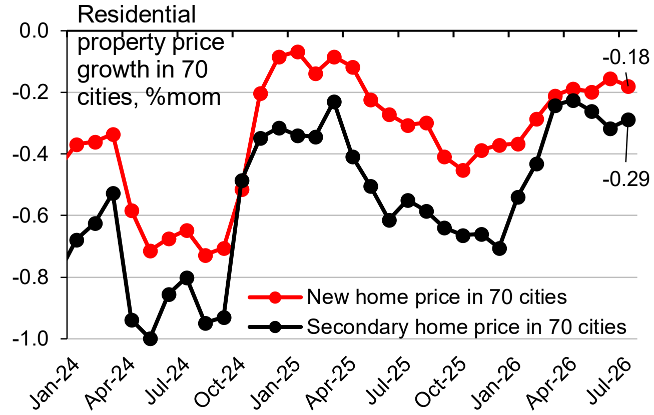
Source: CEIC, Bloomberg, MUFG GMR.

PROPERTY ACTIVITY INDICATORS REMAINED DEPRESSED



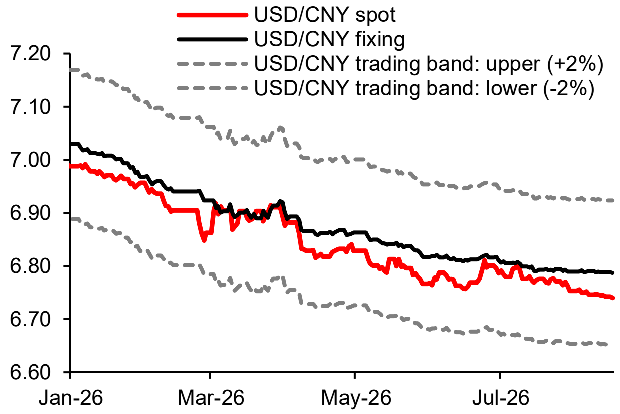
Source: CEIC, Bloomberg, MUFG GMR.

OVERALL HOME PRICES REMAINED ON DECLINE, WITH PACE DIFFERED BY HOME TYPE



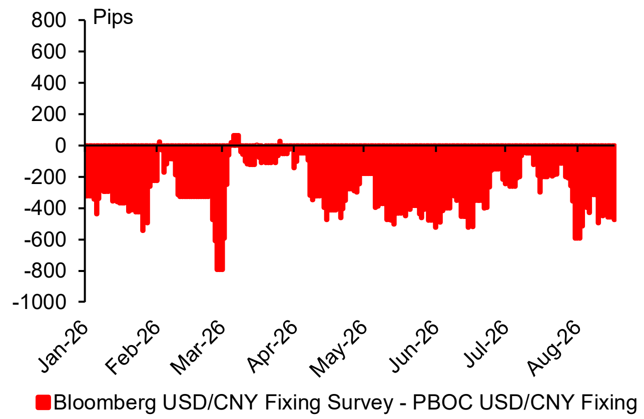
Source: CEIC, Bloomberg, MUFG GMR.

CNY APPRECIATION TREND REGAINED MOMENTUM



Source: CEIC, Bloomberg, MUFG GMR.

PBOC APPEARED TO HAVE SLOWED DOWN THE PACE OF CNY APPRECIATION AGAIN



Source: CEIC, Bloomberg, MUFG GMR.

SUMMARY OF CHINA ECONOMIC DATA

	Jul-26	Jun-26	May-26	Apr-26	Mar-26	Feb-26	Jan-26
GDP							
Value, RMB bn		36,151			33,419		
%yoy (real)		4.3			5		
%qoq (real), sa		0.9			1.3		
%yoy (nominal)		5.9			4.9		
Contribution to GDP growth							
Final Consumption Expenditure		1.9			2.3		
Gross Capital Formation		1.5			1.9		
Net Export of Goods and Service		0.9			0.8		
Surveyed unemployment rate, %	5.2	5.0	5.1	5.2	5.4	5.3	5.2
Industrial Production							
%yoy ytd	5.3	5.4	5.4	5.6	6.1	6.3	
%yoy	4.5	5.3	4.5	4.1	5.7	6.3	
%mom	0.11	0.76	0.40	0.05	0.28	0.71	0.26
Retail sales							
%yoy ytd	1.2	1.3	1.4	1.9	2.4	2.8	
%yoy	0.6	1	-0.6	0.2	1.7	2.8	
%mom	0.06	0.35	-0.15	-0.27	0.1	0.23	0.18
Fixed asset investment, %yoy ytd							
Total	-6.7	-5.7	-4.1	-1.6	1.7	1.8	1.8
Domestic Enterprise	-6.4	-5.5	-3.9	-1.3	2.1	2.1	2.1
Manufacturing	-1.7	-1.2	-0.4	1.2	4.1	3.1	3.1
Tertiary Industry: Real Estate		-18	-15.9	-13.4	-10.6	-10.7	-10.7
Infrastructure	-3.6	-2.4	0.6	4.3	8.9	11.4	11.4
%mom	-1.42	-0.60	-1.14	-2.74	-0.35	-0.26	0.58
Real Estate, %yoy ytd							
Property Investment	-19.2	-18	-16.2	-13.7	-11.2	-11.1	-11.1
Building Sold(value)	-13.8	-14.2	-13.9	-14.9	-17.0	-20.2	-20.2
Floor Space Sold(area)	-12.7	-12.5	-11.3	-10.6	-10.7	-13.5	-13.5
Floor Space Started (area)	-24.2	-23.5	-22.7	-22.1	-20.2	-23.1	-23.1
Floor Space under Construction(area)	-12.7	-12.5	-12.2	-12.1	-11.7	-11.7	-11.7
Residential property Price, %yoy ytd avg	-0.5	-1.4	-2.2	-3.9	-6.2	-6.9	-6.9
Trade							
Export(USD), %yoy	23.9	27.0	19.4	14.1	2.5	39.6	9.8
Import(USD), %yoy	27.5	36.0	27.4	25.3	27.8	13.8	25.9
Trade Balance, USD bn	112.5	125.6	105.4	84.8	51.1	91.0	122.6
PMI							
Composite	49.3	50.6	50.5	50.1	50.5	49.5	49.8
Manufacturing	49.2	50.3	50	50.3	50.4	49.0	49.3
Non-manufacturing	49	50.2	50.1	49.4	50.1	49.5	49.4
Inflation							
CPI, %yoy	0.5	1	1.2	1.2	1	1.3	0.2
Core CPI, %yoy	0.9	1	1.1	1.2	1.1	1.8	0.8
CPI, %mom	-0.1	-0.3	-0.1	0.3	-0.7	1	0.2
PPI, %yoy	3.5	4.1	3.9	2.8	0.5	-0.9	-1.4
PPI, %mom	-0.7	-0.3	0.5	1.7	1	0.4	0.4
Money							
M2, %yoy	7.7	8	8.6	8.6	8.5	9	9
Aggregate Financing, %yoy	7.4	7.4	7.7	7.8	7.9	8.2	8.2
Loan, %yoy	5.1	5.2	5.5	5.6	5.7	6	6.1
Rates							
7D Reverse Repo, %	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Loan Prime Rate: 1 year, %	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Treasury Bond Yield: 10 year, %	1.7	1.7	1.7	1.8	1.8	1.8	1.8
FX							
USD/CNY, monthly avg.	6.80	6.82	6.84	6.87	6.90	6.95	7.00
CFETS RMB Index	102.2	102.6	100.7	100.2	100.9	98.6	97.0

Source: CEIC, MUFG GMR.

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