

Economic Analysis

November activity indicators lag behind the credit performance and “New Normal” is set as 2015 theme in Central Economic Work Conference

Le Xia and Jinyue Dong

Today the government announced a batch of economic activity indicators including industrial production (7.2% y/y), retail sales (11.7% y/y) and fixed asset investment (15.8% y/y YTD). Both industry production and FAI further dropped from their prints in the previous month, suggesting that the economic slow-down has continued in the fourth quarter, although the retail sales signaled some moderate pick-up. Right after the releasing of activity indicators above, the PBOC also released November credit data, among which, aggregate financing and new yuan loans substantially exceeded market consensus and the previous readings. In general, the disappointing activity indicators reflected that the PBOC's interest rate cuts in November still need time to transmit to the real economy, although its effect has been shown in credit performance beforehand. To stimulate the sluggish economy, the authorities should further deploy conventional tools to revive growth. Thus, we project that the PBOC will cut interest rates by one or two times additionally; meanwhile, at least twice Reserve Required Ratio (RRR) cuts between now and the end of next year are also expected.

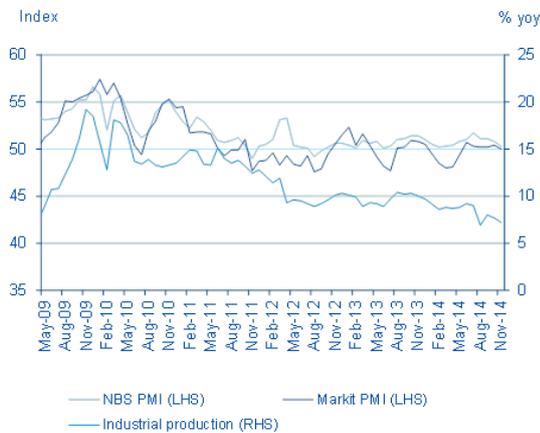
At the same time, China's leaders and senior officials concluded the three-day Central Economic Work Conference, a crucial meeting aiming to set the tone for macroeconomic policies in 2015. In general, the government stated to keep economic policies steady and adapt to the "New Normal" which means to shift from “quantity and speed” to “quality and efficiency” of the growth. Based on this theme, we expect a lower growth target of 7.0% will be set by the authorities for 2015. For 2014, we anticipate that the growth rate can still remain above 7.0% (BBVA: 7.3%) as the authorities are equipped with ample options of conventional and unconventional monetary policy instruments at their disposal. Regarding the outlook of 2015, we maintain our growth forecast of 7.0%. That said, the authorities will set the structural reforms contained in the Central Economic Work Conference as the priority, so as to put growth on a more efficient and high quality trajectory.

- **Activity indicators continued the weakening trend although retail sales picked-up modestly.** In particular, industrial production further slowed to 7.2% y/y in November from 7.7% y/y in the previous month (Figure 1), also below market expectations (Consensus: 7.5% y/y). Despite of the policy easing at end-September which was aimed to revive housing demand, several property-related sectors, such as construction materials, furniture and home appliance, haven't showed significant signals of improvement. On the demand side, FAI outturns remained sluggish. The total fixed asset investment growth decelerated to 15.8% y/y YTD in November from 15.9% y/y YTD in October (Consensus: 15.8%) (Figure 3). On the other hand, retail sales picked-up to 11.7%, which has exceeded both market expectation (Consensus: 11.5%) and the previous print of 11.5%, indicating that domestic consumption turned to be the new engine of growth in November. (Figure 2)
- **The credit outturns substantially exceeded the market consensus and the previous outturns, indicating the effect of interest rate cuts has started to emerge.** The total social financing, a broad gauge of credit including bank loans, bond issuance and shadow banking activities, surged to RMB 1150.0 billion from RMB 662.7 billion in October (Consensus: RMB 895.0 billion); while new yuan loans increased to RMB 852.7 billion (Consensus: RMB

655.0 billion) from RMB 548.3 billion of the last month (Figure 4). However, M2 growth dropped modestly to 12.3% y/y (Consensus: 12.5% y/y) from 12.6% y/y in October. To explain the outperforming credit data, anecdotal evidence showed that banks have increased their lending to local government financing vehicles in anticipation that the lending will be included as public debt next year when local governments are allowed to issue municipal bonds to finance their infrastructure projects. In general, after the PBoC cut the interest rates, credit growth seemed to be back on track and was likely to lend support to growth in the coming months.

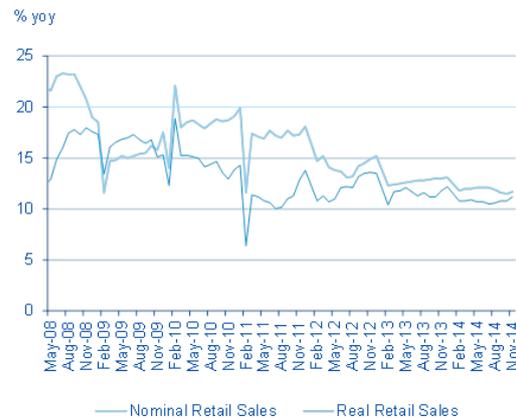
- **The Central Economic Work Conference set “New Normal” as the theme of 2015, indicating a slower growth target might be set ahead.** Key points of the conference could be summarized as follows: (i) Chinese economy has entered the “new normal”, featuring a transition from high speed growth to a medium-to-high one. Thus, the focus of economic growth will be shifting from “quantity and speed” to “quality and efficiency”. (ii) China will put the transformation of economic model and restructuring as the first priority on the agenda. (iii) Continuity and stability are crucial to macroeconomic policies. (iv) The proactive fiscal policy should be stronger and the prudent monetary policy should be more focused on striking a proper balance between being tight and loose. (v) Regional integration and development policies should be improved, while the government will continue improving people's livelihood with necessary and timely support, especially for those with low incomes.

Figure 1
Industrial production further moderated



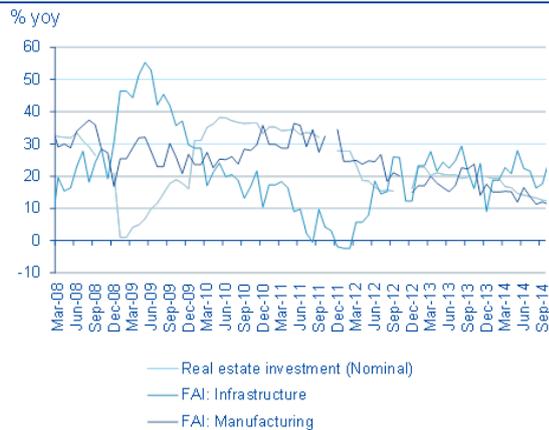
Source: CEIC and BBVA Research

Figure 2
Retail sales picked up modestly in November



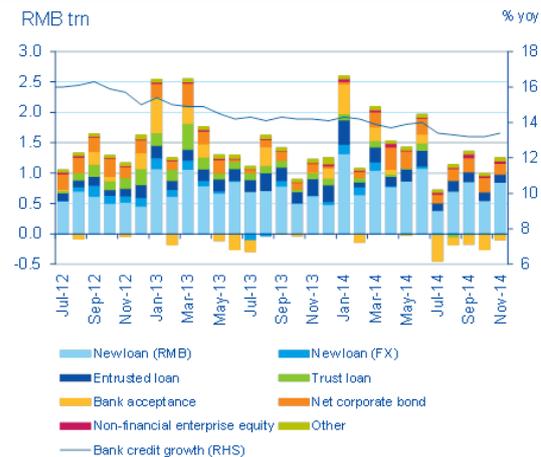
Source: CEIC and BBVA Research

Figure 3
Anemic investment was led by the property market's deceleration



Source: CEIC and BBVA Research

Figure 4
New yuan loans and aggregate financing substantially exceeded the market consensus



Source: CEIC and BBVA Research

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