Economic Analysis

Sluggish activity indicators in January-February affirms that China's easing cycle is not over yet

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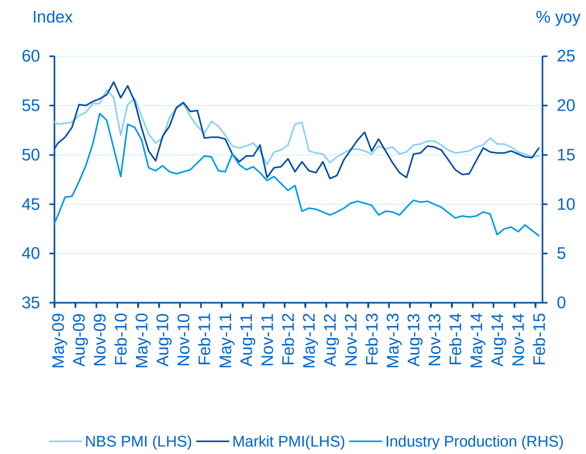
Today China's National Bureau of Statistics (NBS) announced a batch of economic activity indicators for the period of January-February, including industrial production, retail sales and urban fixed asset investment (YTD). Notably, all the outturns in January-February were below both market expectations and their levels of last year-end, indicating that the growth deceleration continues despite a number of recently enacted monetary easing measures, such as January's cut in the Required Reserve Ratio (RRR), February's interest rate cut as well as other unconventional measures. That being said, the disappointing prints of these economic activity indicators have made this year's economic prospective look dimmer. Without further easing measures on both monetary and fiscal fronts, more investors will put a big question mark on the official 7.0% growth target for 2015, which was just announced at the opening of the annual session of National People's Congress (NPC) last week.

Nevertheless, the authorities are still equipped with an ample arsenal of policy options. The headline inflation rate remains tame and the producer price increase stays in negative territory (yesterday the NBS reported that CPI and PPI were 1.4% y/y and -4.8% y/y in February respectively). The authorities could enact more cuts in both interest rates and the RRR to spur domestic demand. Moreover, the lackluster performance of the property market requires more targeted measures to revive housing demand. In this respect, the authorities are likely to further relax some tightening measures on the property market including second-home purchase restrictions and high down-payment requirements. On the fiscal front, this year's fiscal deficit budget target (2.3% as announced in the NPC as well) is not bold enough to tally with a 7.0% growth target at such a juncture. The authorities should expand it to around 3.0% to offset the fiscal consolidation effects at the local government level and bolster growth. All in all, we maintain our growth projection of 7.0% for this year, with some downside risk.

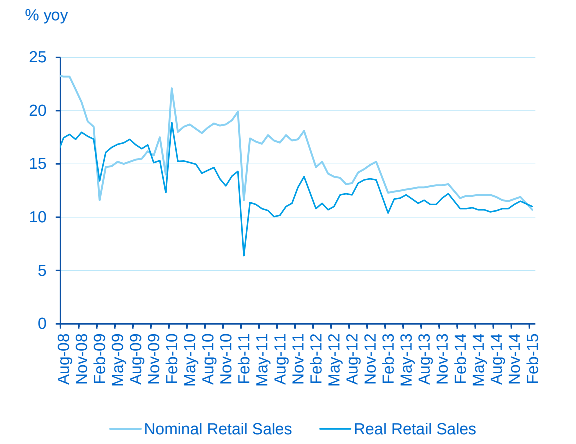
- **Economic activity at the beginning of the year fell short of expectations.** In particular, industrial production dipped to 6.8% y/y (consensus: 7.7% y/y) in the period of January-February from 7.9% y/y in December (Figure 1). Sectors which are closely related to the property market or suffering from overcapacity problems have been hit the hardest. On the demand side, both consumption and investment demand remained sluggish. Retail sales softened to 10.7% y/y in January-February, compared with 11.9% y/y in December (Consensus: 11.6%) while the total fixed asset investment growth decelerated to 13.9% y/y YTD from 15.7% y/y YTD in December (Consensus: 15.0% YTD) (Figure 2 and 3). Moreover, nationwide land sales plummeted to -31.7% in January-February from -14.0% in December, which doesn't bode well for property-related investment in the coming months.
- **Deflation risk is on the rise.** The February headline CPI came out yesterday at 1.4% y/y (versus: 0.8% y/y in January) while the PPI growth rate dropped to -4.8% y/y (versus: -4.3% y/y in January). The pickup in CPI was mainly due to the different timing of Chinese New Year (CNY) between 2014 and 2015. Strong food demand around the CNY holidays always tends to boost consumer prices for a short period. That being said, the deflation risk of CPI is still on the rise because the continuous PPI decline, which even deteriorated of late due to falling commodity prices, will unavoidably translate into more downward pressure on consumer prices in the future.

Figure 1
Industrial production dropped further



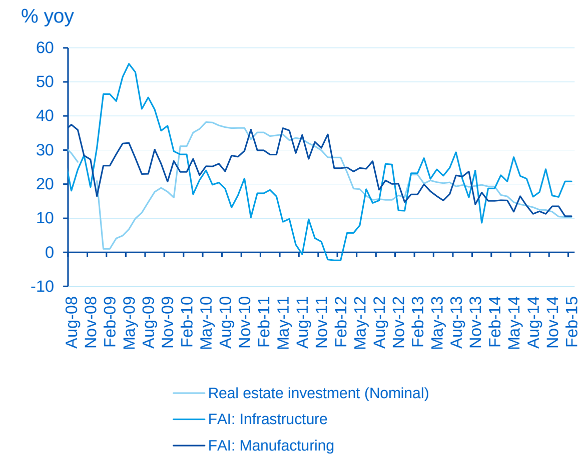
Source: CEIC and BBVA Research

Figure 2
Retail sales weakened too



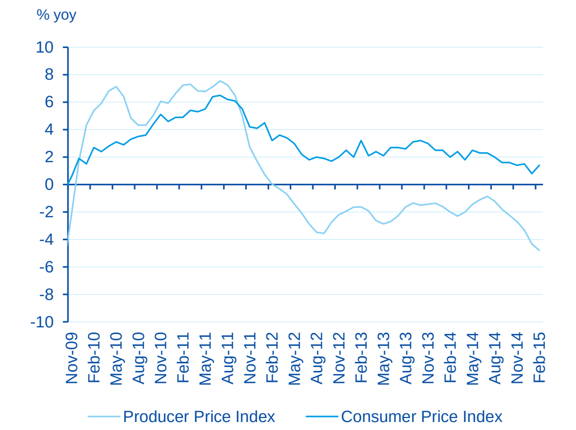
Source: CEIC and BBVA Research

Figure 3
Property market is the biggest drag on investment



Source: CEIC and BBVA Research

Figure 4
Deflation risk is on the rise



Source: CEIC and BBVA Research