China Flash

Disappointing May activity indicators point to slowing growth

Ahead of a 3-day national holiday in China, a broad set of indicators released over the weekend suggest that growth momentum has continued to slow in Q2. The data come after a series of mixed indicators in recent months, and taken together imply that Q2 and full-year GDP growth may be ¼-½ ppts lower than our previous projection of 7.9% y/y and 8.0% respectively. In particular, industrial production decelerated to a weaker-than-expected 9.2% y/y (BBVA: 9.5%; consensus: 9.4%; previous 9.3%) (Chart 1), and export and import growth fell sharply to 1.0% y/y and minus 0.3% y/y (consensus: 7.4% and 6.6%, respectively) (Chart 2). It should be noted that the part of the decline in export growth may be due to statistical factors (see below), and that growth of retail sales (12.9% y/y vs. consensus: 12.8% y/y) (Chart 3) and investment (20.4% ytd y/y vs. consensus: 20.5%) held up relatively well (Chart 4&5). Credit aggregates, meanwhile, decelerated reflecting a combination of weaker demand and efforts by the government to curtail shadow bank lending (Chart 6&7). And finally, CPI inflation slowed by more-than-expected to 2.1% y/y (BBVA and consensus: 2.5%) from 2.4% in April (Chart 8), providing room for some limited further monetary easing if necessary.

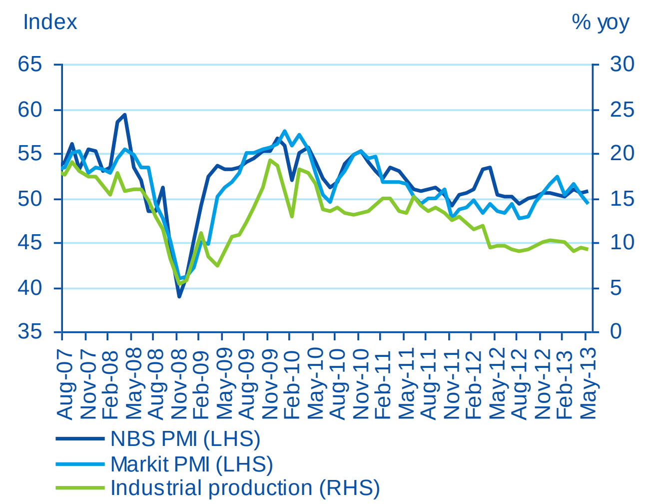
- **The slowdown in industrial production growth** is in contrast to last week's official NBS PMI outturn for May (and more in line with the weaker outturn of the private HSBC PMI). Light industry such textile manufacturing led the slowdown, decelerating to 8.0% y/y in May from 8.5% in April, while heavy industry picked up slightly to 9.8% y/y from 9.6% on higher steel production.
- **Domestic demand is nevertheless holding up**, based on retails sales, which strengthened slightly in May, and investment. With respect to the latter, infrastructure investment accelerated to 24.3% y/y from 21.5%, on continued supportive fiscal policy; in contrast, private investment remains sluggish, evidenced by a slowing of manufacturing investment to 16.5% y/y from previous 17.9% in April. Meanwhile, real estate sector investment remains robust.
- **The external sector remains fragile,** as both exports and imports surprised to the downside. Exports growth declined across the board: sales to ASEAN economies (accounting for 10% of total exports in 2012) declined to 10.5% y/y from 37.2% in April, sales to the EU (16% of 2012 total exports) fell to -9.7% from -6.4%, to the US (17% of 2012 total exports) to -1.6% from -0.1%, and to Japan (7% of 2012 total exports) to -5.7% from -1.2% in April. It is important to note, however, that part of the overall slowdown in exports is attributed to measures taken to prevent over-invoicing and hot money inflows, which have been evident in an unrealistically surge in recorded exports to HK in recent months; consequently, exports to HK slowed to 7.7% y/y in May from 57.2% in April. Imports contracted in May, on a combination of lower imports of components and sluggish manufacturing investment.
- **Credit aggregates also softened** as total social financing (TSF), a broader gauge of credit, declined to 1.2 trn RMB (consensus: 1.6 trn; April: 1.7 trn). The slowdown in TSF is evidence of the authorities' efforts to curtail shadow banking. New RMB loans fell to RMB 667 bn (consensus: RMB 815 bn vs. RMB 793 bn in April), while M2 growth slowed to 15.8% y/y (consensus: 15.9%) from 16.1% in April.
- **Inflation fell by more than expected in May** on lower food prices. Producer prices fell by more than expected, at -2.9% y/y (consensus: -2.5%). The softer inflation provides some room for further monetary easing if needed, although concerns about domestic financial fragilities and an expected pickup in inflation later in the year is a constraint on the magnitude of easing.

Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

Fielding Chen
Fielding.chen@bbva.com.hk
+852-2582-3297

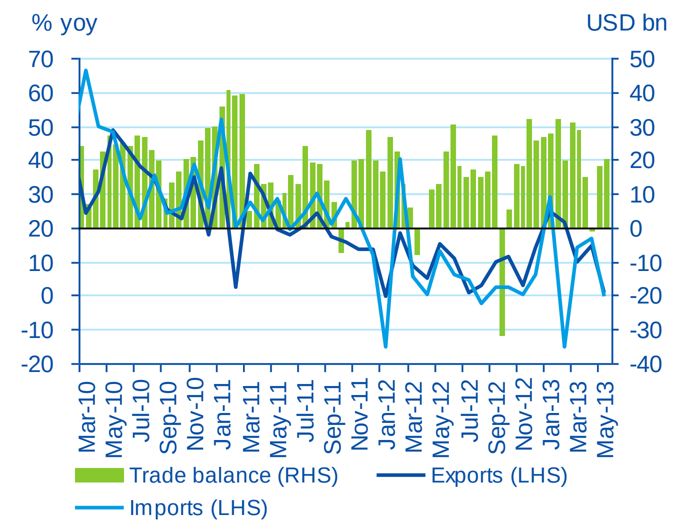
George Xu
george.xu@bbva.com.hk
+852-2582-3121

Chart 1
Industrial production has been flat



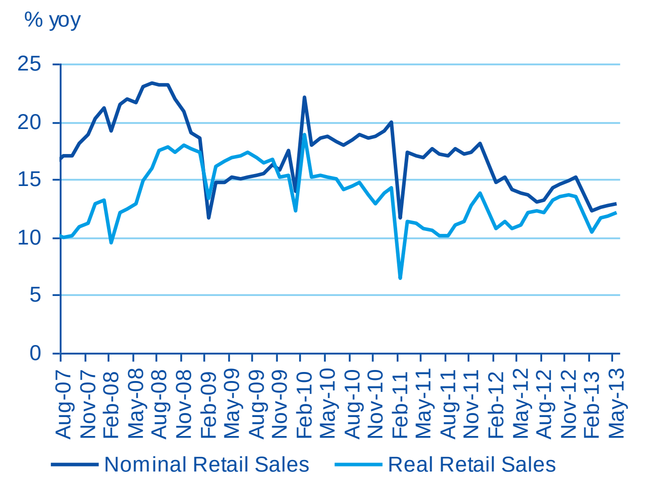
Source: CEIC and BBVA Research

Chart 2
Trade data disappointed to the downside



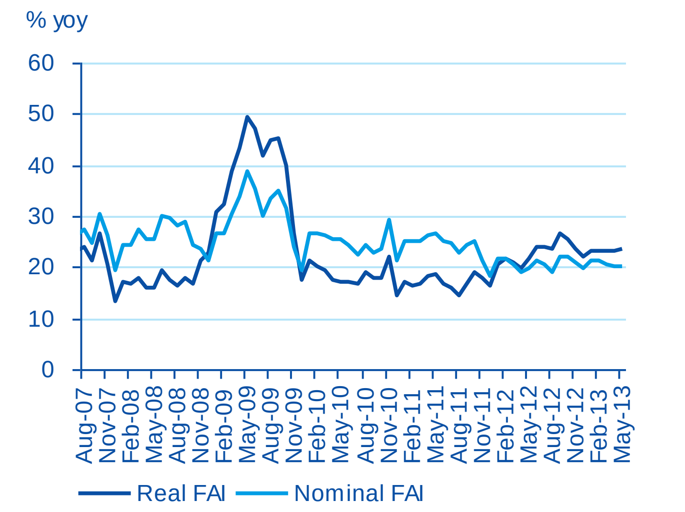
Source: CEIC and BBVA Research

Chart 3
Retail sales have held up



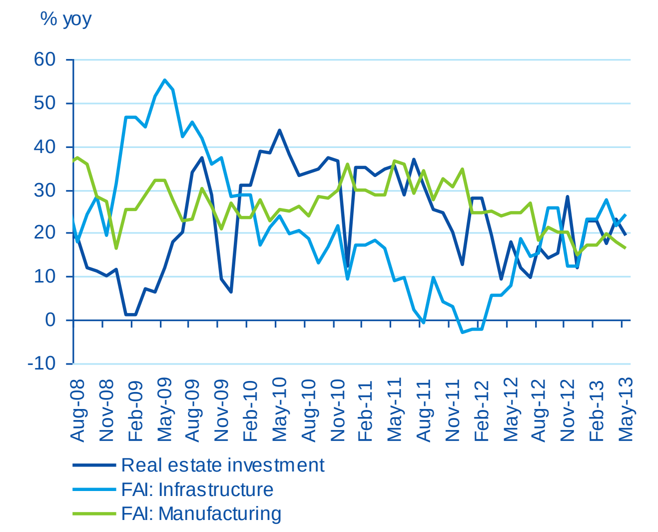
Source: Wind and BBVA Research

Chart 4
… as has fixed asset investment



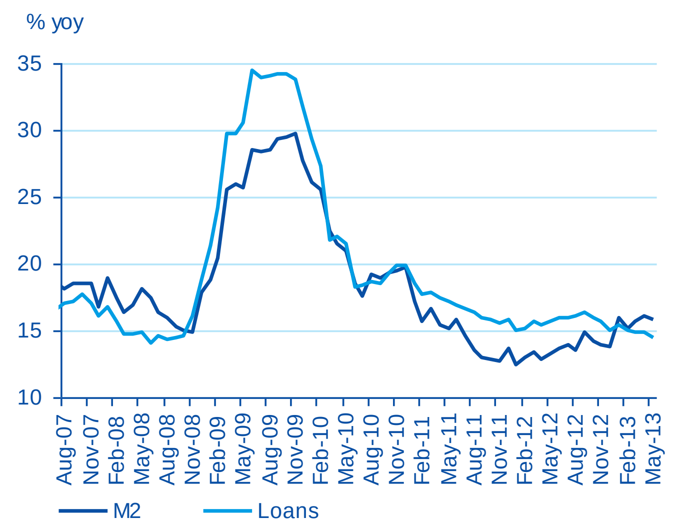
Source: CEIC and BBVA Research

Chart 5
…while manufacturing investment remains sluggish



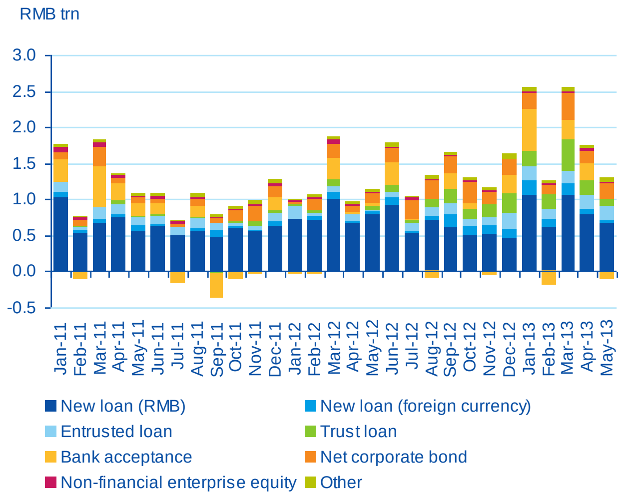
Source: CEIC and BBVA Research

Chart 6
M2 growth decreased slightly



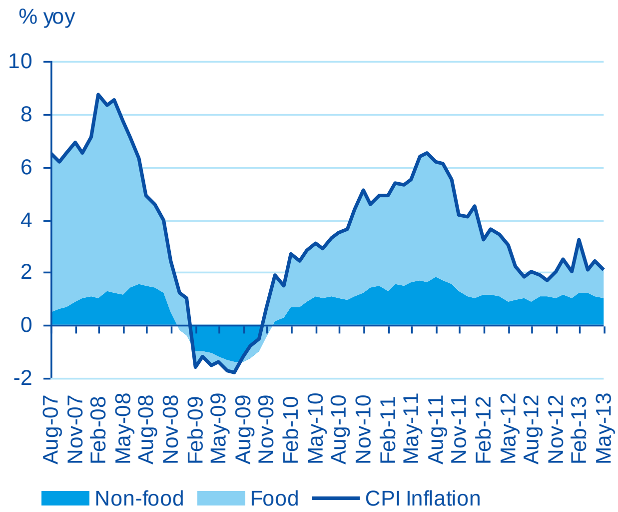
Source: CEIC and BBVA Research

Chart 7
…and total social financing declined on measures to slow the growth of shadow banking



Source: CEIC and BBVA Research

Chart 8
Inflation remains subdued



Source: CEIC and BBVA Research

BBVA RESEARCH | 43/F., Two IFC, 8 Finance Street, Central, Hong Kong | Tel.: +852 2582 3111 | www.bbvaresearch.com