China Flash

Strong July activity indicators raise confidence that growth is stabilizing

Following yesterday's strong export/import figures, today's release of monthly activity indicators for July (Charts 1-4) provide additional evidence that growth is stabilizing, as projected in our newly released *Q3 China/Asia Outlook*. In particular, industrial production rebounded to 9.7% y/y (consensus: 8.9%), fixed asset investment remained strong (20.1% vs. consensus: 20.0%), and retail sales held up (13.2% vs. consensus: 13.5%). While monthly data are volatile, the key takeaway, in our view, is that production and manufacturing investment (Chart 5) are responding to improving external demand and policy clarity/support. The data support our projection of 7.6% growth in 2013. However, risks remain from rising financial fragilities, and the outlook for GDP growth in 2014 (BBVA: 7.6%) is uncertain. Separately, inflation (2.7% y/y) and credit data were also reported today, the former coming in broadly in line with expectations (Charts 6 & 7), while the latter revealing slowing overall credit growth as the authorities clamp down on shadow banking.

- **The improvement in manufacturing activities is broad-based**, and is consistent with the upturn in official PMI for July (50.3). Today's today show that the improvement was led by the automobile sector and metal refinery sectors, which carry a large weight in overall production and are commodity-intensive, which may help explain for the strong rise in July commodity imports (e.g., iron ore 11% y/y, copper 12% y/y, and coal 18% y/y).
- **Domestic demand is holding up**. Encouragingly, overall investment remained robust, led by further gains in property and infrastructure investment (21.5% y/y and 24.8% y/y, respectively). Significantly, manufacturing (and non-SOE) investment growth, which had previously been weak, picked up to 17.1% y/y from 15.2% y/y in June. Less encouragingly, retail sales growth was lower-than-expected, as catering and restaurant sales lagged behind, possibly due to government efforts to clamp down on lavish public spending.
- **In data reported yesterday, exports and imports surprised to the upside**. The improvement in export growth (5.1% from -3.1% in June) was broad-based by market destination, rising to the US (5.3%), the EU (2.8%), and ASEAN (21.4); exports to Hong Kong increased by 2.3%, suggesting that previous distortions from over-invoicing have dissipated. However, exports to Japan declined by -5.1% y/y. Meanwhile, imports rose by 10.9% y/y (consensus: 1.0%), consistent with improving domestic demand.
- **Headline inflation remains benign, and the decline in the PPI moderated.** CPI inflation stayed flat at 2.7% (consensus: 2.8%) as food price inflation (5.0% y/y) was offset by low non-food price inflation (1.6% y/y). As such, inflation remains well within the government's 3.5% target, providing room for monetary easing if needed. However, we do not expect the authorities to use this room given their keen interest in curtailing domestic financial fragilities. Continued PPI deflation (-2.3% y/y vs. consensus: -2.1%; prior: -2.7%) may be a sign of ongoing excess capacity in certain industries.
- **The latest credit aggregates show success in curtailing shadow banking activities.** New bank loans were a little higher than expected (RMB 699.9 billion vs. consensus: 640.0), while total social financing, a broader aggregate that includes all forms of financing, declined for a fourth consecutive month, to RMB 808.8 billion (consensus: 925.0; prior 1,037.5), its lowest level since October 2011. Taken together, the bank loan TSF credit data, along with higher-than-expected M2 growth (14.5% vs. consensus: 13.9%; prior 14.0%) suggest some movement in financial flows to the formal banking sector (Chart 8).

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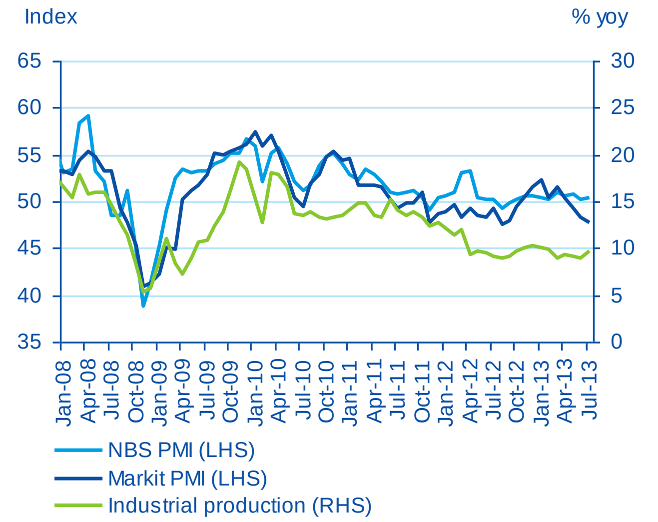
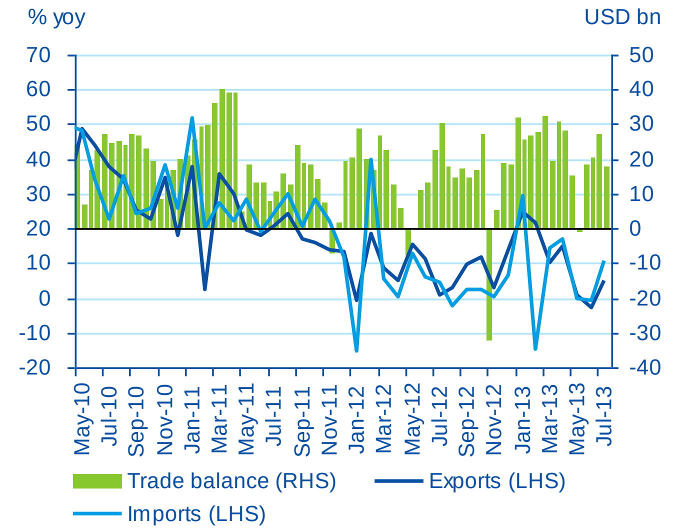
Chart 1
Industrial production ticked up in July…



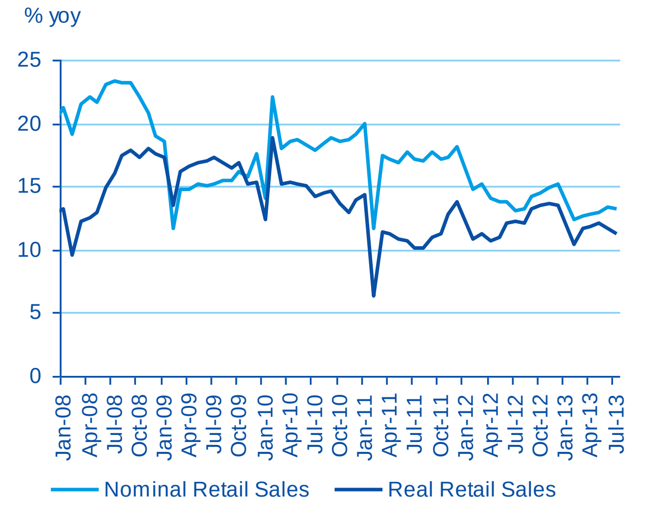
Source: CEIC and BBVA Research

Chart 2
…and exports and imports rebounded



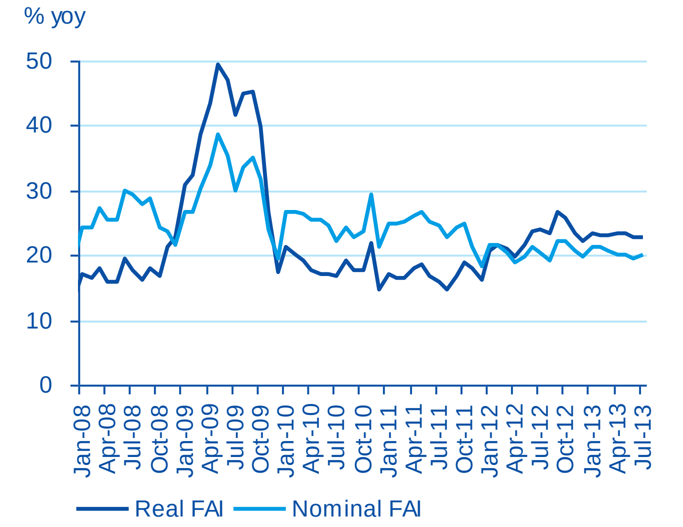
Source: CEIC and BBVA Research

Chart 3
Retail sales moderated slightly in July…



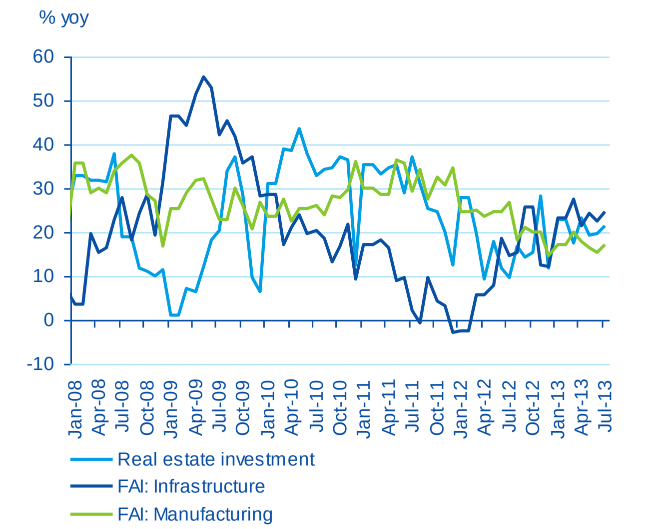
Source: Wind and BBVA Research

Chart 4
… but investment indicators improved…



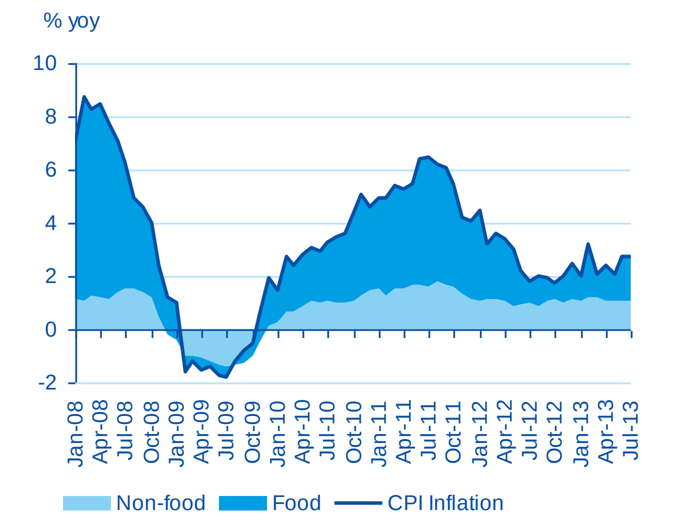
Source: CEIC and BBVA Research

Chart 5
…as manufacturing investment finally pick up



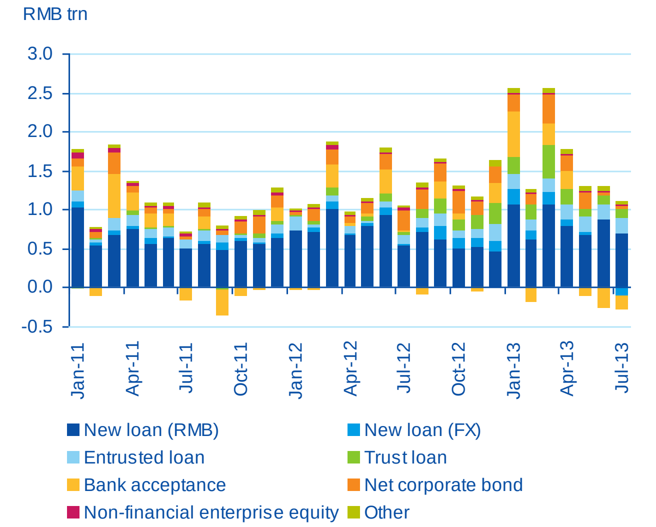
Source: CEIC and BBVA Research

Chart 6
Inflation remains subdued



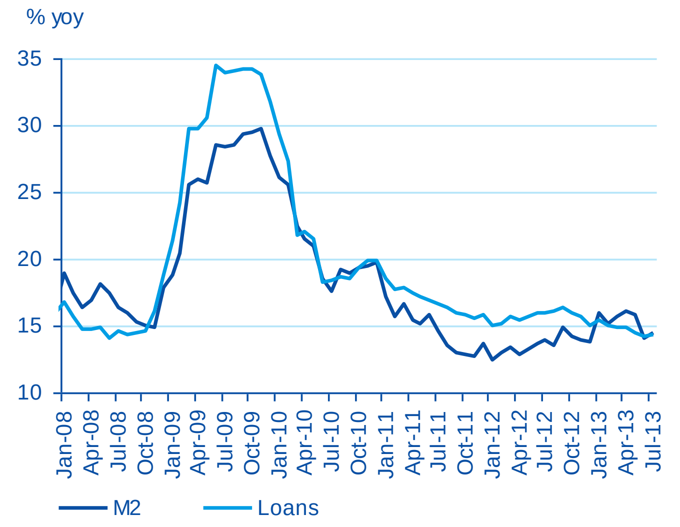
Source: CEIC and BBVA Research

Chart 7
Total credit slowed for a fourth straight month…



Source: CEIC and BBVA Research

Chart 8
…as flows shifted to the formal banking system



Source: CEIC and BBVA Research

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