China Flash

August activity indicators strengthen on improving external demand and continued policy support

Following robust export (7.2% y/y), inflation (2.6% y/y), and PMI (51.0) outturns announced in recent days, today's release of August activity indicators surprised to the upside, providing a further boost to investor confidence. Industrial production grew by 10.4% y/y (consensus: 9.9%), urban fixed asset investment rebounded to 20.3% y/y ytd (consensus: 20.2%), and retail sales rose by 13.4% y/y (consensus: 13.3%; July: 13.2%) (Charts 1-4). The pickup in investment was underpinned by ongoing infrastructure projects and a further strengthening of manufacturing investment (Chart 5), boosted by strong credit growth (Charts 7-8). With Q3 GDP growth now likely to exceed our previous expectation of 7.5% y/y, our full-year growth projection of 7.6% in 2013 appears well within reach, if not higher. That said, we remain cautious on the growth outlook for 2014 (7.6%) given headwinds from financial fragilities (including rising corporate debt and shadow banking activity) and the constraints they pose to further policy easing.

- **The further improvement in manufacturing activity** is consistent with the upturn in manufacturing PMI for August (NBS: 51.0; HSBC: 50.1). In seasonally adjusted sequential terms, industrial production rose by the fastest pace since May (0.93% m/m sa). The improvement was led by the automobile, metal refinery, and electricity production sectors.
- **Domestic demand is improving on rising investment.** While retail sales remain strong, the pickup appears due to rising investment from public infrastructure projects and strengthening private investment in manufacturing. While this runs counter to economic rebalancing, we believe this is a cyclical trend after the slowdown in manufacturing investment during the first half of the year. Consumer spending remained stable in August, and we expect policies to support rising consumption levels over the medium term (we await details of the medium-term reform agenda at the annual party meeting scheduled in November).
- **August exports exceeded expectations,** as external demand continues to strengthen. Exports (7.2% y/y vs consensus: 5.5%), announced last Sunday, improved in most key markets, led by ASEAN (30.8% y/y), Hong Kong (6.4% y/y), the US (6.1% y/y), and the EU (2.5% y/y), while imports rose by 7.0% y/y (consensus: 11.3%). As a result, the trade surplus widened to 28.6 bn USD (consensus: 20.0 bn USD). Looking forward, we expect exports to continue to benefit the brighter global outlook particular in the US and EU in H2.
- **Headline CPI inflation remains stable, and PPI deflation is moderating.** CPI inflation, announced yesterday, stayed flat at 2.6% in August (consensus: 2.7%), well within the government's 3.5% target (Chart 6). While the benign inflation outturn provides room for policy easing, we do not expect the authorities to make use of this room given the economic pickup, the government's determination to curtail domestic financial risks, and gradually rising inflationary pressures on the horizon. Meanwhile, PPI deflation eased further (-1.6% vs prior -2.3%), helping firms to recover their profit margins.
- **Total social financing (TSF) picked up in August, helping to boost growth but also adding to potential worries about shadow banking activities.** TSF for the month of August, the broadest measure of credit including bank and non-bank forms of financing, increased to 1.57 trillion RMB (consensus: 950 billion RMB), as the impact of the June inter-bank liquidity squeeze receded further. Meanwhile, new bank loans (711.3 billion; consensus: 730.0 billion) were broadly flat.

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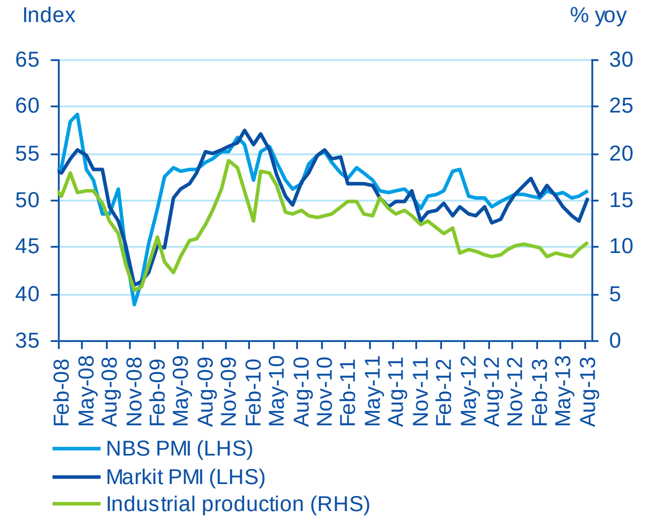
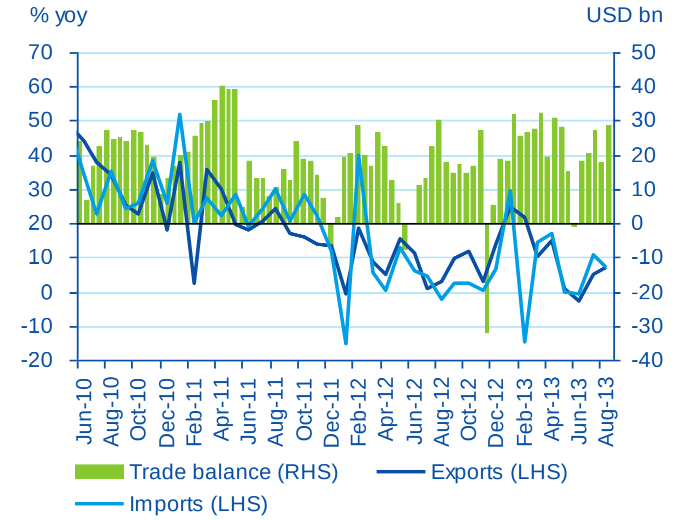
Chart 1
Industrial production has accelerated for three consecutive months…



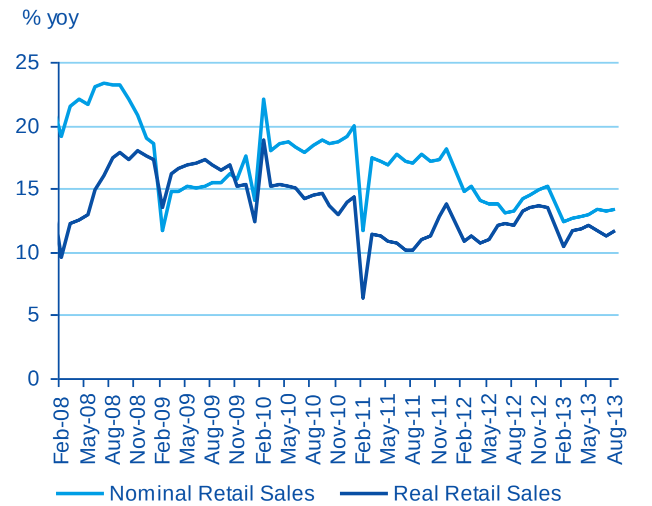
Source: CEIC and BBVA Research

Chart 2
…as exports pick up on improving external demand



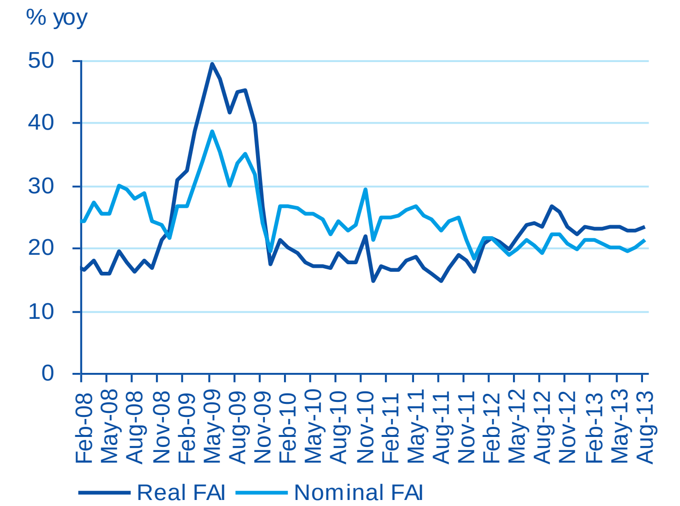
Source: CEIC and BBVA Research

Chart 3
On the domestic side, retail sales remain robust …



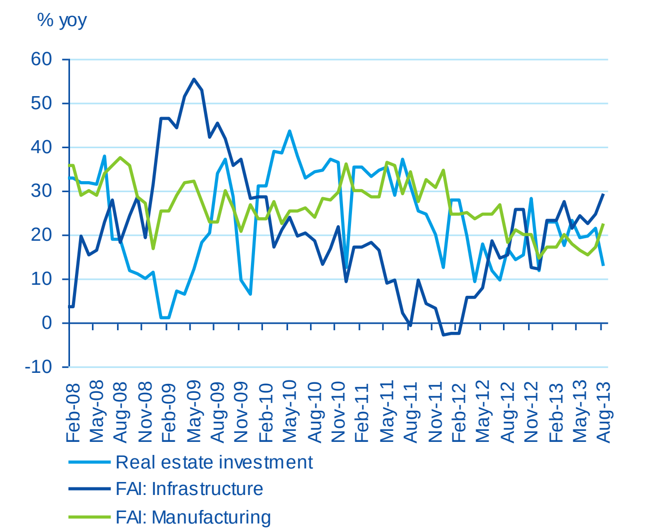
Source: Wind and BBVA Research

Chart 4
… and investment trends are healthy



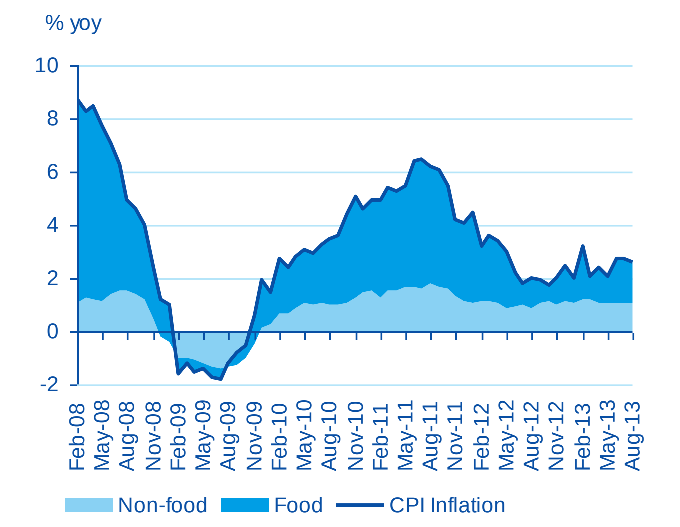
Source: CEIC and BBVA Research

Chart 5
Manufacturing investment is strengthening



Source: CEIC and BBVA Research

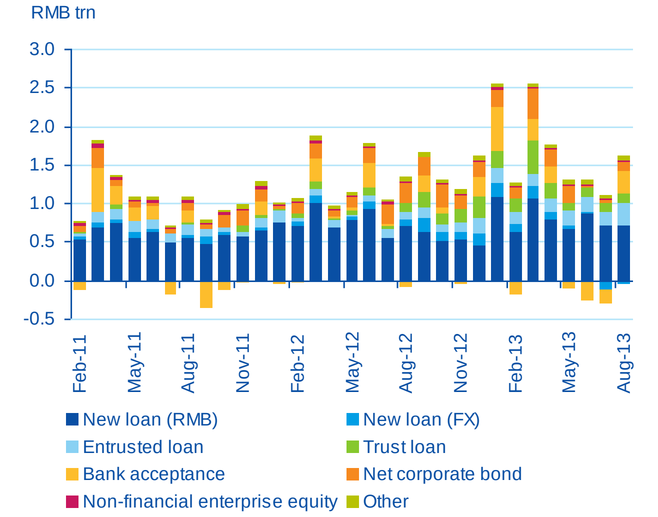
Chart 6
Inflation remains subdued



Source: CEIC and BBVA Research

Chart 7

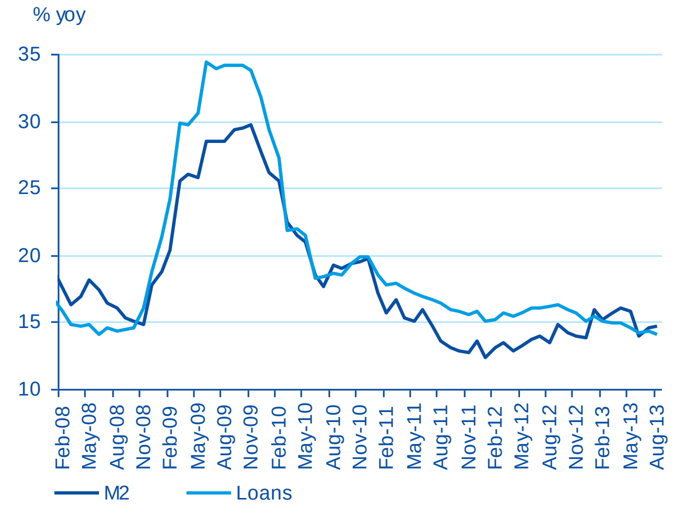
Total social financing picked up in August…



Source: CEIC and BBVA Research

Chart 8

…even though bank loan growth declined



Source: CEIC and BBVA Research

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