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China: Signs of easing inflation in August and resilient growth indicators

An encouraging set of indicators was released today in China, which should help allay concerns about the need for a change in the broad policy stance. In particular, headline inflation moderated to 6.2% y/y for August, in line with expectations, and down from 6.5% y/y in July. The outturn is in line with our view that inflation has probably peaked, and should reduce the pressure for further monetary tightening, as policies gradually shift to supporting growth in view of the sagging global economy. At the same time, today's figures show that the trends of fixed asset investment, industrial production, and retail sales are holding up, in line with expectations and the economy's soft landing, at 25.0%, 13.5%, and 17.0%, respectively. While our baseline incorporates one more rate hike during the remainder of the year, the likelihood is diminishing given downside risks to the global economy and signs that monetary policy is now on hold.

- As anticipated, headline CPI inflation eased in August, to 6.2% y/y from 6.5% in July (Chart 1), in line with expectations (Consensus: 6.2%; BBVA: 6.1%;). The main driver continues to be food prices, especially pork, which rose by 45.5% y/y in August down from 57.1% y/y in July. Month on month, food prices rose by 0.6%, mainly driven by seasonal factors. Producer price inflation (PPI) in August also edged down to 7.3% y/y from 7.5% y/y in August on falling commodities prices.

- The August inflation readings mark the first declines in the CPI and PPI since April, and are consistent with our expectation that inflation has peaked. We project a moderation during the remainder of the year as food and commodity prices ease, and on base effects from last year. That said, we expect inflation to remain in the 5-6% range during Q3, before declining to around 4% by the end of the year.

- Robust growth momentum is also reflected on the readings of other activity indicators in August. On the demand side, August retail sales eased to 17.0% y/y (consensus: 17.0%), down from the reading of 17.2% y/y in July (Chart 2). Urban fixed asset investment grew by 25.0% y/y for August (consensus: 25.2%), slightly down from 25.4% y/y in July. On the supply side, industrial output moderated to 13.5% y/y in August from the previous month reading of 14.0% y/y, in line with the market expectation (consensus 13.7%) (Chart 3).

- Additional data is scheduled next week on a series of important economic indicators, including data on trade and FDI, credit, money supply, which we will be monitoring closely. We expect the data to come in line with our soft landing scenario, as domestic demand remains strong, despite signs of weakening external prospects.

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Chart 1: Upward inflation trend turns around in August

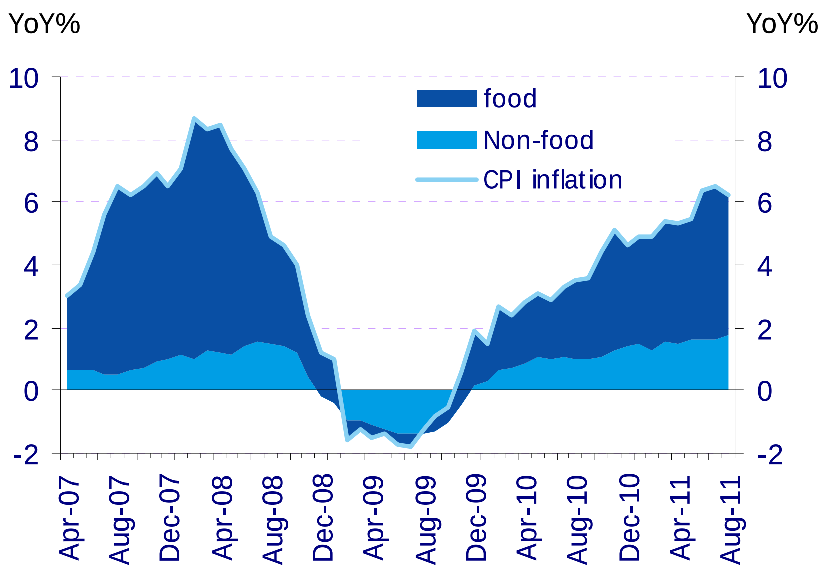


Chart 2: Retail sales moderate

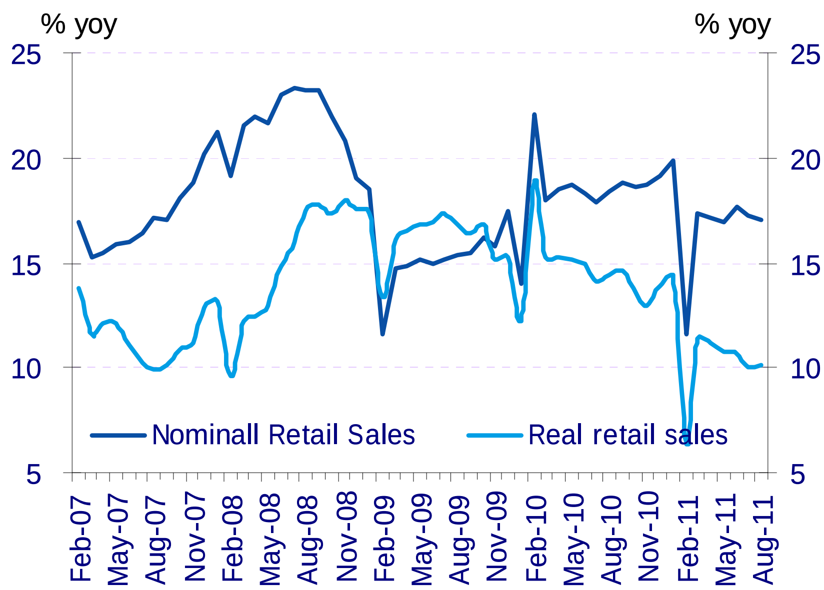
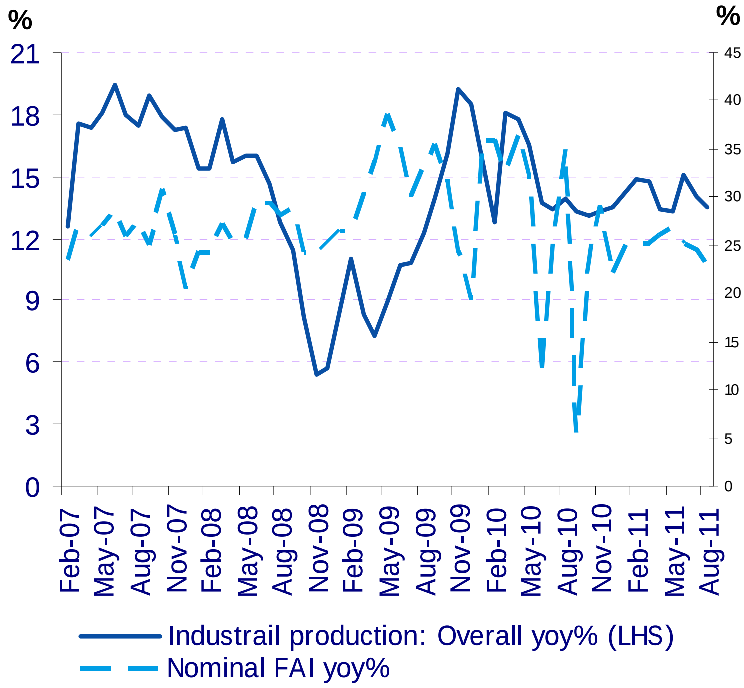


Chart 3: IP and FAI outturns moderate in line with expectation



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