

China Flash

July indicators weaken, bolstering the likelihood of more policy support

Today's batch of inflation and activity indicators were on the weak side (charts below), indicating that the hoped-for pickup in growth momentum has not yet occurred. Growth of July Industrial production and retail sales were lower-than-expected at 9.2% y/y and 13.1% y/y respectively (consensus: 9.7% and 13.5%, respectively), while other indicators were closer in line with expectations, including fixed asset investment (20.4% vs. consensus: 20.6%) and CPI inflation (1.8% vs. consensus: 1.7%). The data follow a soft PMI outturn on August 1, which had hinted at inventory destocking in the month of July; this could be a factor for the softer industrial production. Inflation continued its steady decline on base effects and falling food prices; looking ahead, we believe that inflation has now bottomed out, and should gradually pick up to 2-3% during the remainder of the year, still below the authorities' 4% tolerance level. Together with weak growth momentum, this should provide space for further policy easing, including 150bps of further cuts in the RRR, up to two more interest rate cuts, and a step-up in public investment projects. These policies should sustain GDP growth in line with our full-year 7.8% projection, as detailed in our just-released [Asia Outlook](#).

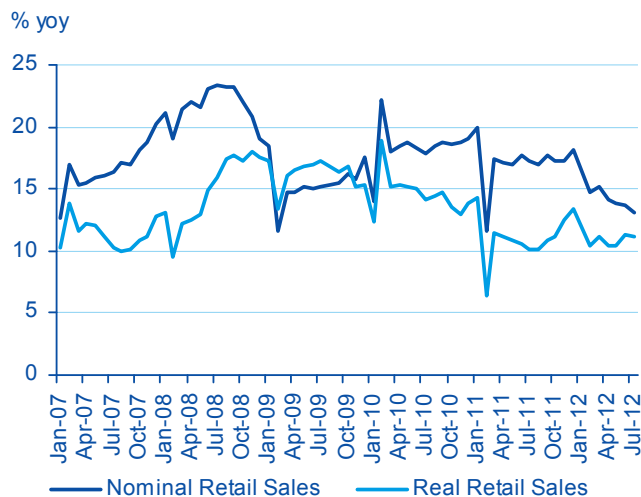
- **Activity indicators in July were weaker than expected.** On the demand side, nominal retail sales growth moderated to 13.1% y/y (consensus: 13.5%; BBVA: 13.8%) from 13.7% in June, although in real terms retail sales appear to be holding up somewhat better (Chart 1). Urban fixed asset investment growth remained flat at 20.4% (ytd) in July (consensus: 20.6%; BBVA: 20.5%) (Chart 2). On the supply side, industrial output grew by 9.2% y/y in July, below expectations (consensus: 9.7%; BBVA: 9.9%), one of the weakest since May 2009 (Chart 3). Taken together, the data suggest that the hoped-for pickup in growth momentum has not yet occurred. Given the ongoing policy response, we expect these indicators to trend upward gradually during the remainder of the year.
- **July CPI inflation declines further on falling food prices (Chart 4).** Food prices fell by -0.1% m/m (but remained flat in seasonally adjusted terms), resulting in a year-over-year increase of 2.4% y/y in July, down from 3.8% y/y in June. Non-food prices increased by 1.5% y/y, slightly up from the previous month. Looking ahead, we expect inflation to rise gradually to around 3% by end-2012, on base effects and gradually rising demand pressures.
- **Producer price inflation (PPI) in July dropped to -2.9% (Chart 5)** (Consensus: -2.5% y/y; BBVA: -2.7%), down from -2.1% y/y in June. Month on month (non-seasonally adjusted) the PPI decreased by -0.8% in July, on falling commodity and raw materials prices. The decline in producer prices should, in principle, keep inflationary pressures at bay in the coming months.
- **We will be watching for data on trade and credit due out in the next few days.** We expect July export growth, due to be released tomorrow, to remain weak at 8.0% y/y, down from 11.3% y/y in June, while credit growth to moderate slightly based on partial monthly data of the 4 largest banks.

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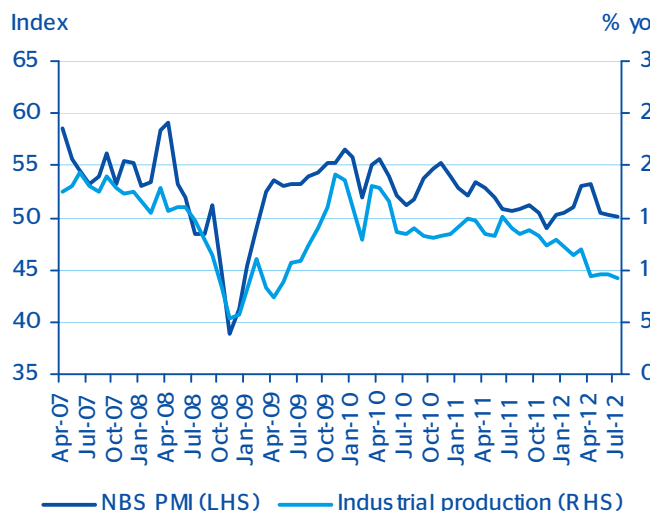
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Chart 1

Retail sales growth remains resilient

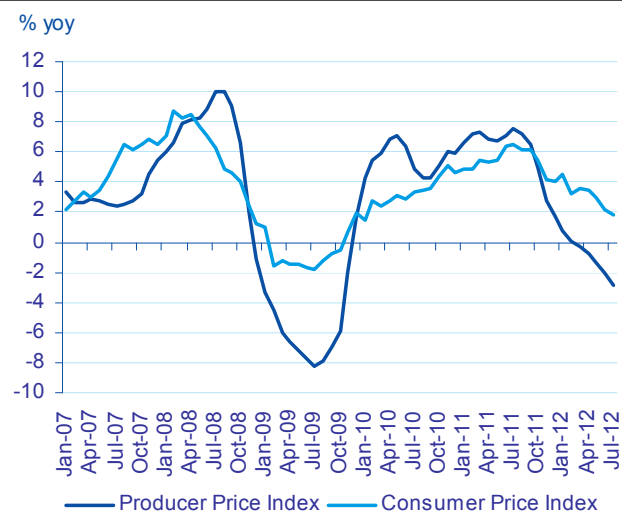
Source: CEIC and BBVA Research

Chart 3

Industrial production and PMI soften

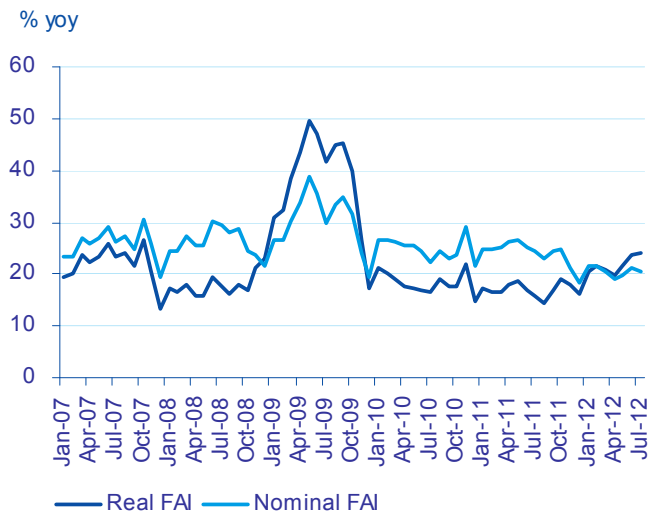
Source: CEIC and BBVA Research

Chart 5

PPI further dropped

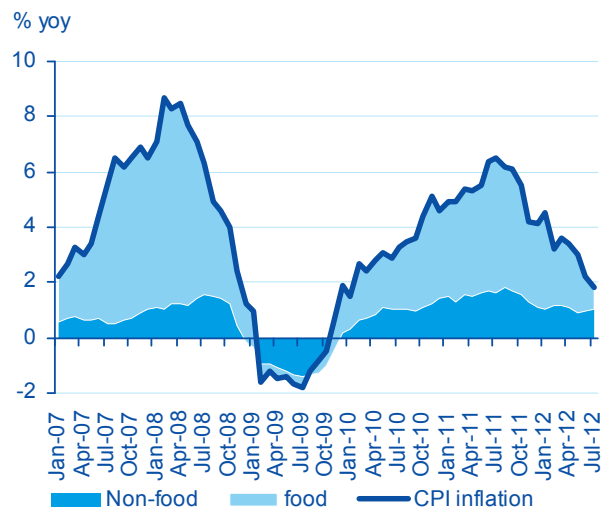
Source: CEIC and BBVA Research

Chart 2

Fixed asset investment stabilizes

Source: CEIC and BBVA Research

Chart 4

Inflation eases to 1.8% in July

Source: CEIC and BBVA Research