

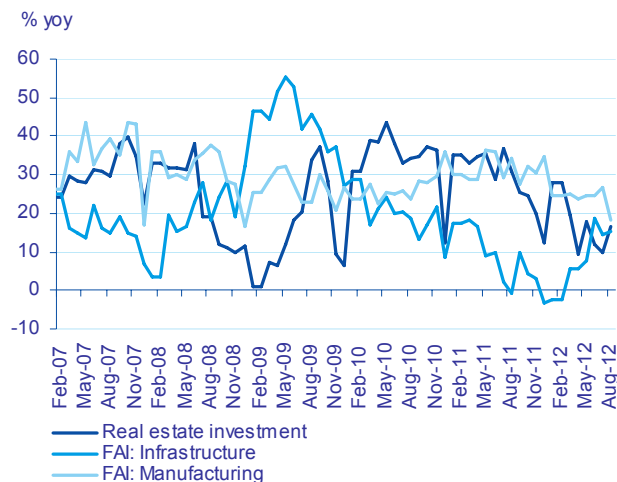
China Flash

August activity data confirm ongoing slowdown, as policy stimulus lags

August activity indicators confirm that growth continues to weaken. The outturns were broadly in line with expectations, following last week's disappointing August PMI outturn (49.2). Specifically, industrial production growth slowed to 8.9% y/y (consensus: 9.0%; BBVA: 8.4%), fixed asset investment moderated to 20.2% ytd (consensus: 20.4%; BBVA: 20.6%), import growth fell by -2.6% (consensus: 3.5%; BBVA: -3.0%), and export growth remained sluggish at 2.7% y/y (consensus: 2.9% y/y; BBVA: 0.5% y/y). Encouragingly, retail sales growth stabilized at 13.2% y/y (consensus: 13.2%; BBVA: 13.1%), and there are signs that property investment and government infrastructure spending are picking up. Meanwhile, August CPI inflation rose, as expected, to 2.0% y/y on base effects and higher food prices, from last month's bottoming out at 1.8% y/y. All told, while our full-year 2012 and 2013 growth projections of 7.8% and 8.3%, respectively, are at downside risk, with an expected pick up in Q4, growth should remain above the authorities' 7.5% target in 2012. Meanwhile, with inflation remaining well below the authorities' 4% tolerance level, there is room for further policy easing during the remainder of the year and in early 2013. We expect at least 100bp cuts in the RRR, and 1-2 interest rate cuts during this timeframe, with the timing somewhat uncertain due to the ongoing leadership change which may explain why recent policy easing has been less aggressive than previously expected..

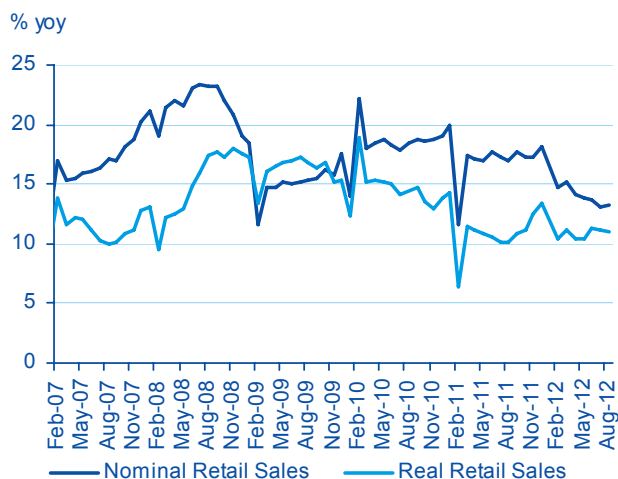
- **August activity indicators see broad-based weakness.** On the demand side, despite sustained retail sales and a pick up in public spending and property investment, private sector investment and FDI have continued to slow (Charts 1 and 2). On the supply side, industrial output growth has slipped to its lowest level 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, however, we expect these indicators to trend upward gradually during the remainder of the year.
- **Exports stabilize in August while imports underperform (Chart 4).** Exports grew by 2.7% y/y (consensus: 2.9%; BBVA: 0.5%), up from 1.0% in July. By destination, sluggish demand from the EU and Japan are the main reasons behind the weakness. Meanwhile, imports declined by -2.6% y/y (consensus: 3.5%; BBVA: -3.0%), on weak final products, reflecting sluggish domestic demand, as well as sluggish processing inputs. As such, the trade balance came out at a hefty surplus of \$26.7 billion for the month, in line with recent monthly outturns.
- **August CPI inflation rebounds as expected on base effects (Chart 5).** Food prices increased by 1.5% m/m (0.7% m/m in seasonally adjusted terms), resulting in a year-over-year increase of 3.4% y/y in August, up from 2.4% y/y in July. Non-food prices increased by 1.4% y/y, slightly down 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 August dropped to -3.5% (Chart 6)** (Consensus: -3.2% y/y; BBVA: -3.4%), down from -2.9% y/y in July. Month on month (non-seasonally adjusted) the PPI decreased by -0.5% in August, on falling commodity and raw materials prices. The decline in producer prices should, in principle, keep inflationary pressures at bay in the coming months.

Chart 1

FAI moderates, especially in manufacturing

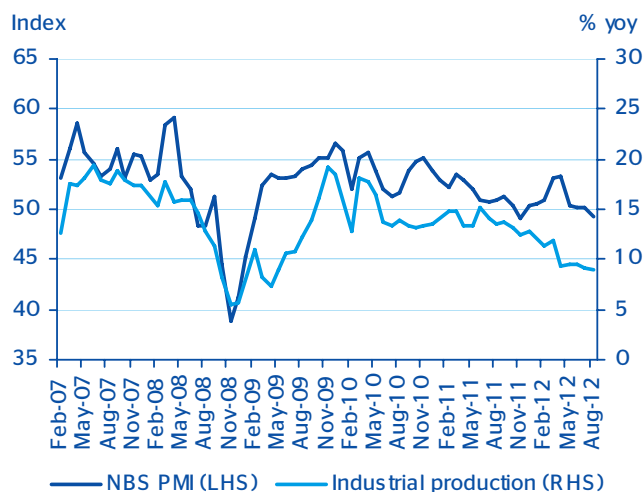
Source: CEIC and BBVA Research

Chart 2

Retail sales growth remains resilient

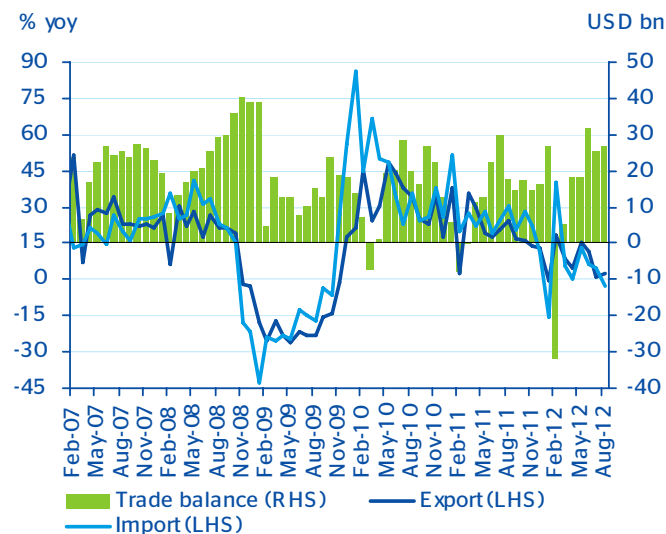
Source: CEIC and BBVA Research

Chart 3

Industrial production and PMI are continuing to weaken

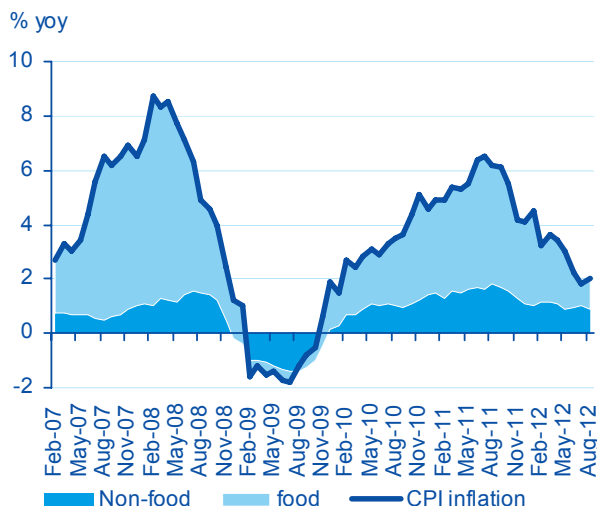
Source: CEIC and BBVA Research

Chart 4

Exports are weighed down by weak external demand

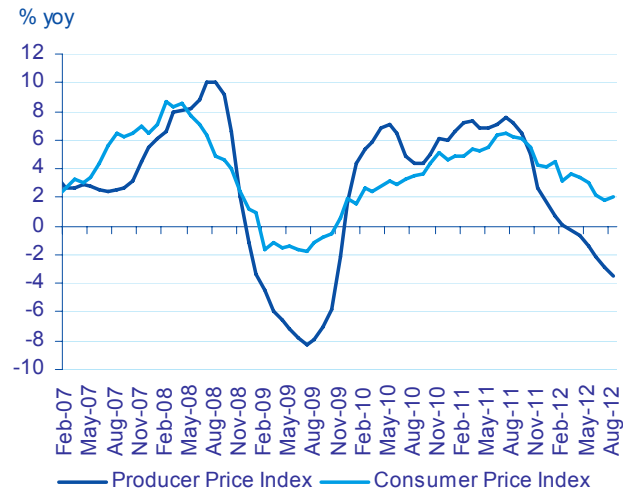
Source: CEIC and BBVA Research

Chart 5

Inflation rebounds to 2.0% in August

Source: CEIC and BBVA Research

Chart 6

PPI declines further

Source: CEIC and BBVA Research