China Flash

Pickup in September credit and export growth allay hard landing concerns, while low inflation provides room for policy easing

Overall credit growth for September (released last Friday) and export growth (released on Saturday) were stronger than expected suggesting that, while the economy continues to slow, growth is far from stalling. Meanwhile, September CPI inflation today came in line with expectations at 1.9% y/y (BBVA: 1.8%; consensus: 1.9%) down from 2.0% y/y in August on moderating vegetable prices (Chart 1). We expect inflation to rise to around 2.6% y/y by end-year on a combination of food price increases and base effects, but still within the authorities' 4% comfort level well into 2013. With inflation staying low, and with slowing growth momentum not yet convincingly turning the corner, we expect additional policy easing, especially after the leadership transition decision in November. Though policy easing so far has been less forceful than anticipated, we still expect up to 100bp cuts in the RRR and one interest rate cut in the next 1-2 quarters, accompanied by stepped up fiscal support. We await Thursday's release of Q3 GDP and September industrial production, investment, and retail sales for a further reading on growth momentum.

- **September CPI inflation moderates on lower vegetable prices.** Food prices increased by 0.2% m/m but declined by -0.1% in seasonally adjusted terms, resulting in an increase of 2.5% y/y in September, down from 3.4% y/y in August. Non-food prices increased by 1.7% y/y, slightly up from 1.4% in the previous month. Given these trends and weaker demand pressures from the slowdown in growth momentum, we believe the inflation outlook for the rest of the year is benign.
- **Producer price inflation (PPI) in September eased to -3.6% (Chart 2)** (Consensus: -3.5% y/y; BBVA: -4.0%), slightly down from -3.5% y/y in August. Month on month (non-seasonally adjusted) the PPI decreased by -0.1% in September. We are not unduly concerned by the PPI deflation, as monthly trends are stable, and the main driver of the year-over-year decline in the PPI is lower commodity prices.
- **Export growth strengthened in September (Chart 3).** Exports grew by a better-than-expected 9.9% y/y (consensus: 5.5%; BBVA: 5.0%), from 2.7% in August. By destination, export growth to the US picked up to 5.5% y/y and to the EU contracted by -10.7% y/y. Given the volatility in monthly export outturns, and the ongoing sluggish pace of external demand, however, we are not yet ready to conclude that the pickup is sustainable (although there have also been encouraging outturns this past month in Korea and Taiwan).
- **Import growth also rose, but domestic demand still shows weakness.** Overall import growth rose to 2.4% y/y from -2.6% y/y growth in August (consensus: 1.9%; BBVA: 3.5%), underpinned by a rise in processing imports of 5.3% y/y (up from 1.5% in August) which may reflect an improvement in export orders (as was signaled in the September PMI export orders component).
- **M2 growth and broad credit aggregates picked up in September (Chart 4).** Although new loans in September increased by a modest RMB 623 billion (consensus: RMB 700 billion; BBVA: RMB 650 billion), below the RMB 703 billion recorded in August, "total social financing" (a broader aggregate that includes bank loans, off-balance-sheet lending, and corporate bond issuance), increased more than expected. M2 growth in September also accelerated to 14.8% y/y (consensus: 13.7% y/y; BBVA: 13.7%), from 13.5% y/y in August.
- **Q3 foreign reserve increase slightly on increased trade surplus, capital inflows, and valuation effects (EUR appreciation)**. Foreign reserves increased to USD 3.29 trillion as of end-September from USD 3.24 trillion at end-June (consensus: USD 3.23 trillion; BBVA: USD 3.26 trillion). A rise in inflows may be one factor for the recent RMB spot appreciation.
- **The data calendar for the remainder of the week is packed with important economic indicators due out on Thursday,** including Q3 GDP (BBVA: 7.4% y/y vs. 7.6% y/y in Q2), industrial production (BBVA: 8.6% vs. August 8.9%), retail sales (BBVA: 13.3%), and fixed asset investment (BBVA: 20.3%).

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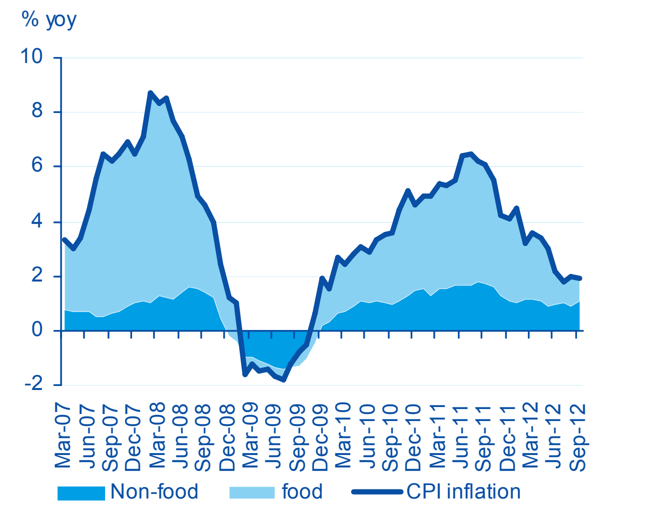
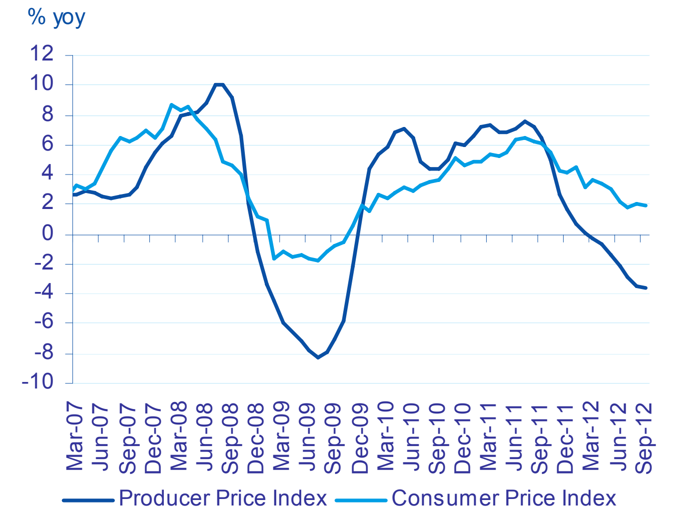
Chart 1
September headline CPI inflation eases to 1.9% y/y



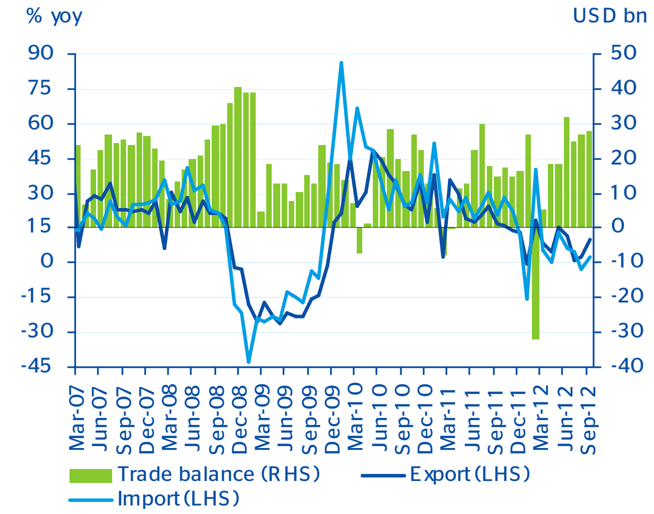
Source: CEIC and BBVA Research

Chart 2
...and PPI inflation continues to decline



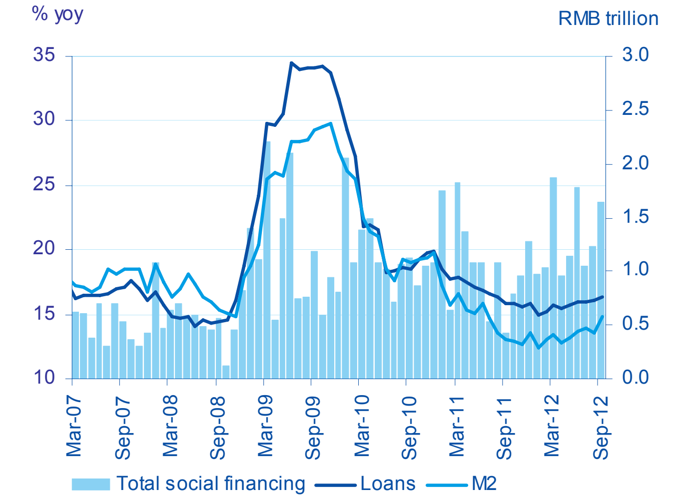
Source: CEIC and BBVA Research

Chart 3
Exports and imports both tick up in September



Source: CEIC and BBVA Research

Chart 4
M2 and credit growth also picked up in September



Source: CEIC and BBVA Research

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