China Flash

October data point to improving growth momentum

Today's release of October activity indicators provides further evidence of a pickup in growth. In particular, fixed asset investment, retail sales, and industrial production all rose from the previous month, by slightly more than expected. The data come after an encouraging set of indicators in September, and last week's release of the official PMI, which rose back to above the 50 threshold for the first time in 3 months. At the same time, October CPI inflation released today came in below expectations at 1.7% y/y (BBVA: 2.0%; consensus: 1.9%) on moderating food prices (Chart 1). While the data suggest that growth has now bottomed out, given downside risks from the uncertain external environment and low inflation, we see room for further policy easing in the coming months, especially after the ongoing leadership transition is completed (the important National Party Congress ends on November 14, with the full transition to be completed in March). Further easing could take the form of another interest rate cut along with further reductions in the RRR, and additional fiscal spending. In the meantime, we await the release of October exports on November 10 (consensus: 10.0% y/y), and loan data due next week.

- **October activity indicators beat expectations.** On the demand side, fixed asset investment (FAI) improved to 20.7% ytd (consensus: 20.6%; BBVA: 20.6%), and retail sales growth increased to 14.5% y/y (consensus: 14.4%; BBVA: 14.4%) (Charts 2 and 3). For the month of October, FAI increased by 22.2% y/y, the same level as September, driven by government-led railway and infrastructure spending. On the supply side, industrial production growth accelerated to 9.6% y/y, in line with our expectation (consensus: 9.4%; BBVA: 9.6%) (Chart 4). While it is encouraging that the indicators are continuing to improve, to the extent that the pickup in FAI has been led by government spending, the upturn in growth momentum is not yet self-sustaining. We therefore expect policy easing to continue.
- **October CPI inflation moderates on lower food prices.** Food prices declined in month-on-month terms by -0.8% m/m, or -0.2% in seasonally adjusted terms, resulting in an increase of 1.5% y/y for October, down from 2.5% y/y in September. Non-food prices increased by 1.7% y/y, the same as in the previous month. We expect inflation to rise to 2.6% y/y in December on base effects and an expected rise in food prices. If growth continues to improve, as in our baseline, inflation is likely to pick up to 3.7% by end-2013, still within the authorities' 4% comfort range.
- **Producer prices (PPI) in October appear to be stabilizing, but are still negative in year-on-year terms at -2.8% (Chart 5)** (Consensus: -2.7% y/y; BBVA: -3.0%). Month on month (non-seasonally adjusted), the PPI decreased by 0.2% in October. This reflects the stabilizing commodity prices.

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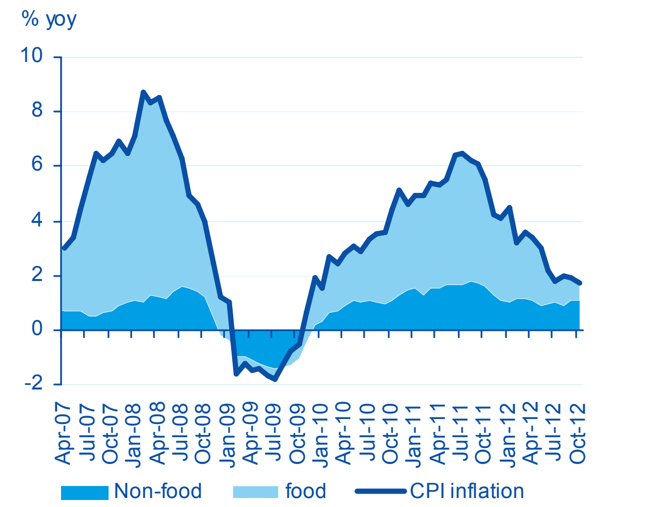
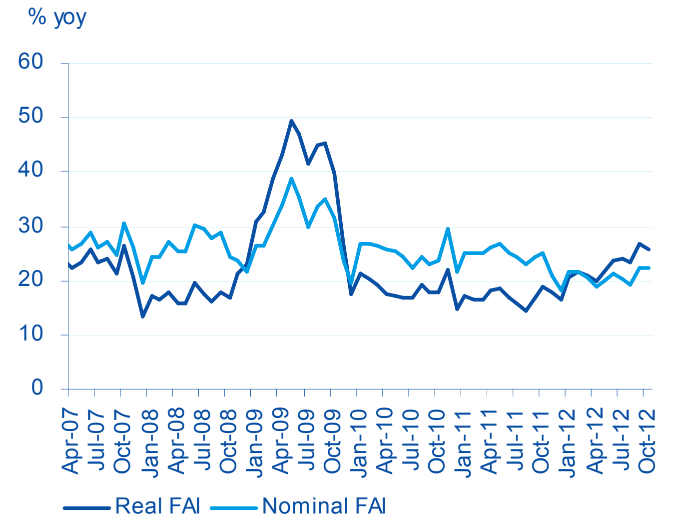
Chart 1
October CPI inflation eases on lower food prices



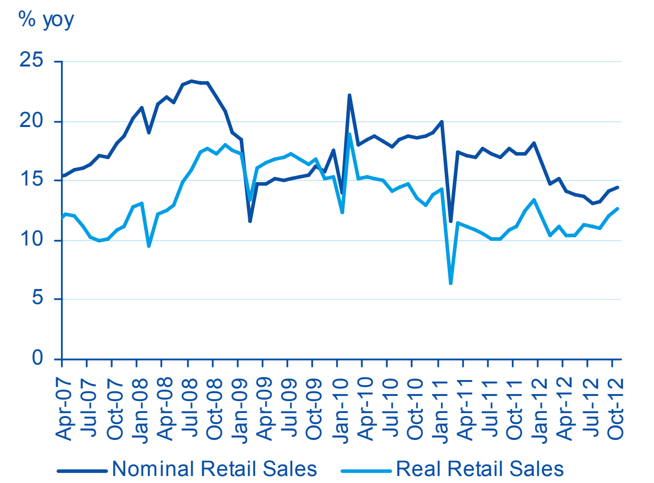
Source: CEIC and BBVA Research

Chart 2
Fixed asset investment is strengthening



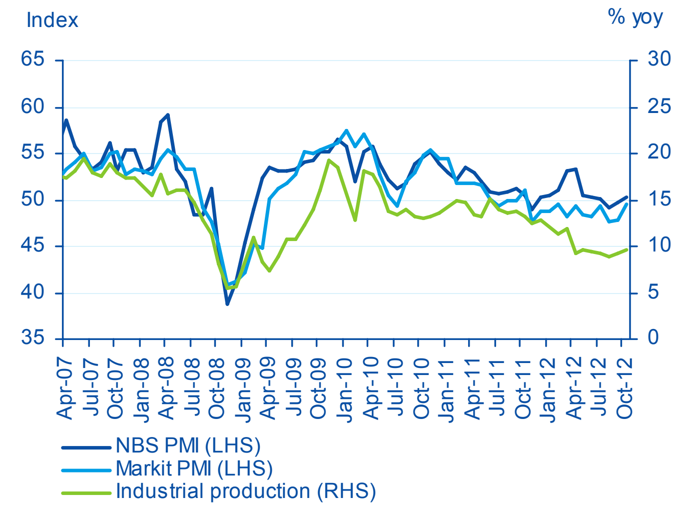
Source: CEIC and BBVA Research

Chart 3
Retail sales growth is improving



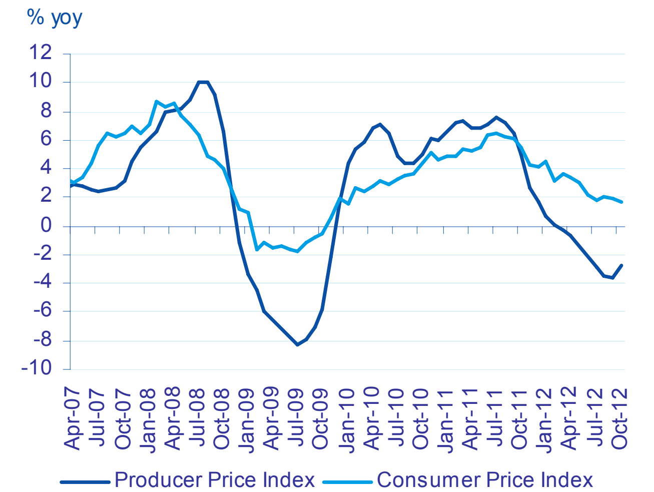
Source: CEIC and BBVA Research

Chart 4
Industrial production ticks up, in line with improving PMI



Source: CEIC and BBVA Research

Chart 5
PPI deflation has bottomed out



Source: CEIC and BBVA Research

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