China Flash

Weakening activity indicators may prompt policy support measures

Monthly activity indicators released today (for January/February combined) disappointed to the downside (Charts 1-3). Growth of industrial production slowed to 8.6% y/y (consensus: 9.5%; December: 9.7%), urban fixed asset investment (year-to-date) came in at 17.9% y/y (consensus: 19.4%; December: 17.1%), and retail sales fell to 11.8% y/y (consensus: 13.5%). The data confirm a slowing trend, coming on the heels of sluggish exports, softer inflation, and weaker credit growth (Charts 4-6). The data are difficult to interpret given distortions from the shift in Chinese New Year timing and other one-off and seasonal factors. Nevertheless, it appears that recent government efforts to curtail domestic fragilities and financial risks, by slowing credit growth, and measures to address over-capacity and worsening air quality may be creating headwinds to growth. Given the government's 7.5% growth target as announced last week at the opening of the National People's Congress (NPC) – albeit less firm than in previous years – we would expect policies, especially fiscal, to turn more growth supportive in the coming months. Among the available policy tools are an acceleration of public infrastructure spending, maintaining low and stable interbank rates, and slowing the pace of currency appreciation. Pro-growth reforms such as streamlining public administration and opening state-dominated sectors to private participation are also likely. At today's conclusion of the NPC, Premier Li Keqiang indicated that, while the growth target is still achievable, what matters more is employment, implying that it would be acceptable to miss the target. This underscores the downside risks to our 7.6% growth projection in 2014 as the government tackles financial fragilities and implements the reform agenda.

- **Manufacturing activity has weakened,** with industrial production for January/February declining to 8.6% y/y from 9.7% y/y in December. According to the NBS, in seasonally adjusted terms, industrial production growth was essentially flat from December at 0.60% m/m. Steel production fell to 4.9% y/y in January/February from 10.3% y/y in December, while cement production declined to 2.4% y/y from 10.8% y/y previously.
- **Domestic demand was weaker than expected.** While import growth has remained robust (10.1% y/y in February) retail sales decelerated in January/February, due in part to the ongoing anti-graft campaign and sluggish household appliance demand. In a reversal of recent trends, investment growth slowed due to weaker private spending, while public infrastructure investment picked up.
- **Exports slumped in November,** falling by -18.1% y/y (consensus: 7.5% y/y) in February from +10.6% in January as reported in data released on March 8. For the combined January/February period, exports declined by -1.6% y/y after increasing by 4.2% y/y last December. Nevertheless, looking ahead we expect exports to improve under our global baseline scenario of stronger US and EU demand.
- **Headline CPI inflation remains subdued,** and PPI deflation persists. As reported in data released on March 8, CPI inflation fell to 2.0% y/y in February from 2.5% y/y in January on a weather-related decline in food prices, while PPI inflation declined to -2.0% y/y from pervious -1.6% y/y. Continued low inflation provides room for policy easing, although we do not currently expect significant monetary loosening given efforts to curtail financial risks.

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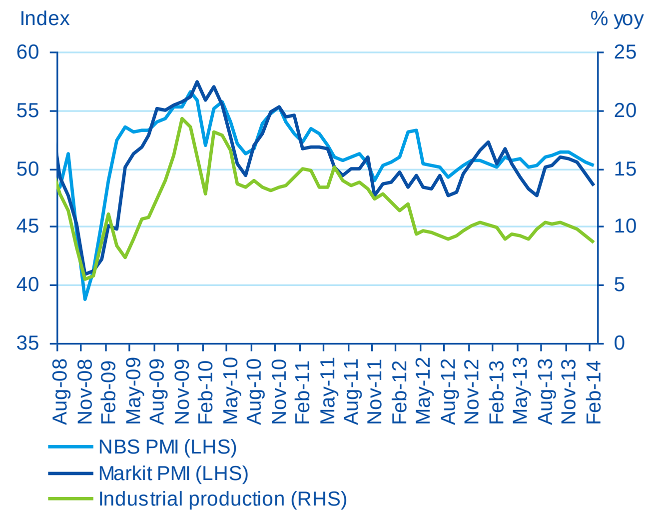
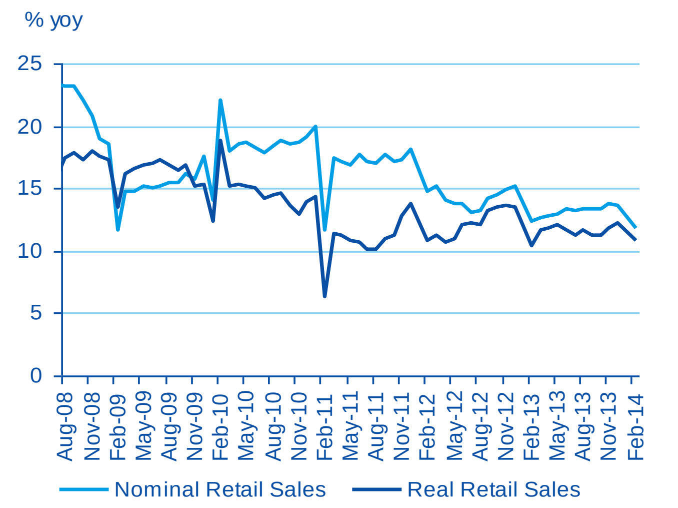
Chart 1
Industrial production is softening in line with PMIs outturns



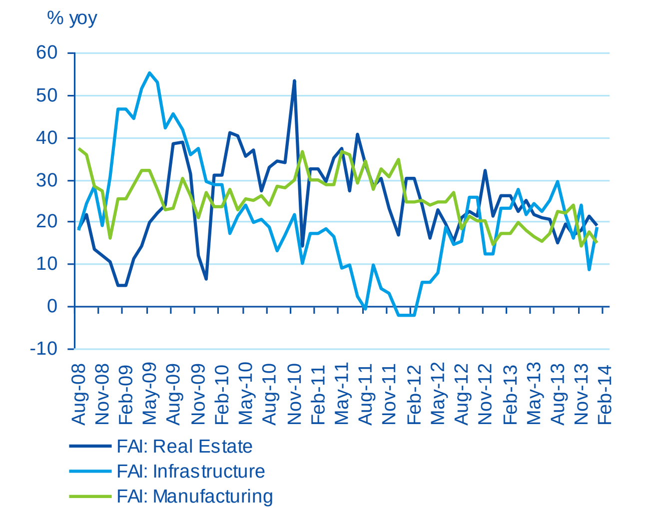
Source: CEIC and BBVA Research

Chart 2
Retail sales are also weakening after being stable for several months



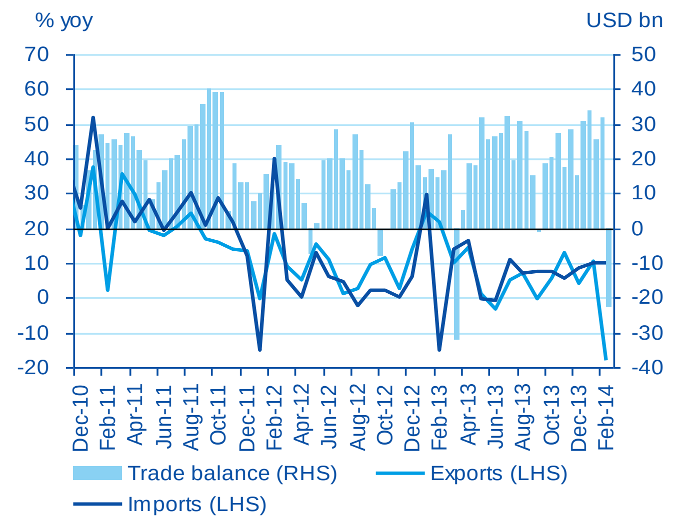
Source: Wind and BBVA Research

Chart 3
Investment indicators, while volatile, are showing a weakening trend in recent months



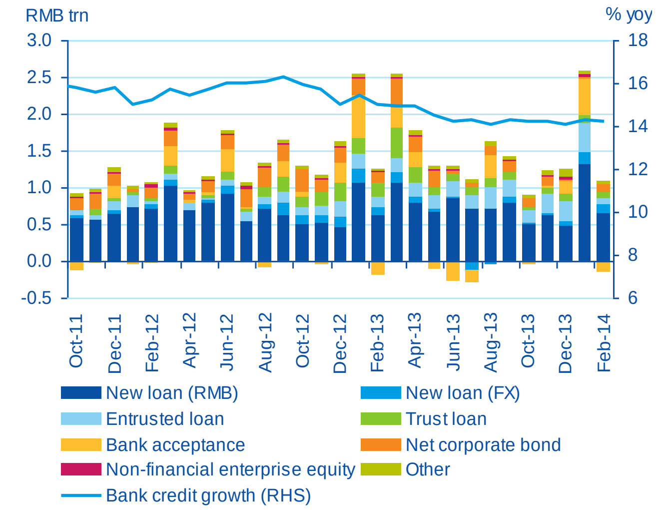
Source: Wind and BBVA Research

Chart 4
Exports disappointed in February, but may be temporary



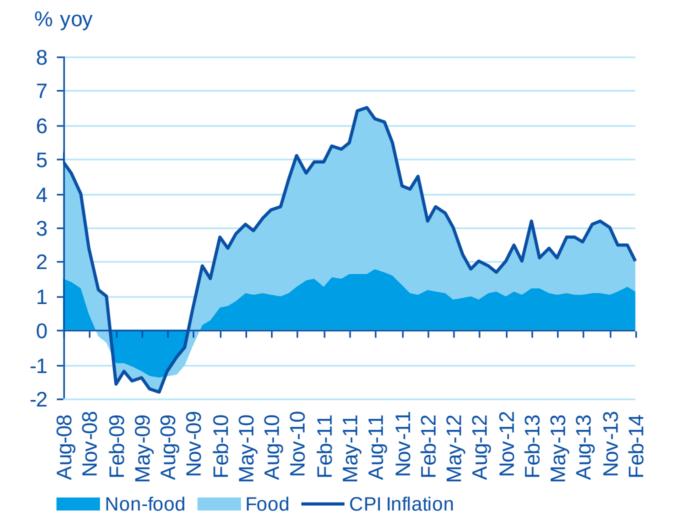
Source: CEIC and BBVA Research

Chart 5
A seasonal slowdown in credit growth in February



Source: CEIC and BBVA Research

Chart 6
Inflation remains subdued on lower food prices



Source: CEIC and BBVA Research

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