Economic Analysis

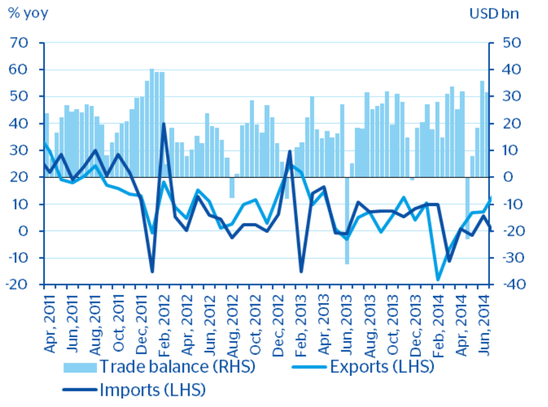
July activity indicators and credit data suggest that the ongoing recovery hasn't gained a strong foothold yet

Le Xia and Jinyue Dong

Today the government announced a batch of activity indicators and credit data, which, together with previously reported trade data, suggest that the growth momentum has moderated in July as strong external demand can't fully offset softened domestic demand. Credit growth in July gave a significantly downside surprise to the market. Both new bank loans and the total social financing, which is a broad gauge of credit capturing bank loans and shadow banking activities; have declined dramatically from the previous month, which doesn't bode well for growth in the coming months. This have added more uncertainties to the economic outlook, which indeed had become sanguine in the past few weeks after the upbeat Q2 GDP report. That said, the ongoing recovery is still fragile and needs more policy support. The authorities are likely to roll out more stimulus measures going forward to sustain growth during the remainder of this year. In view of this, we maintain our full-year growth projection of 7.2% for 2014.

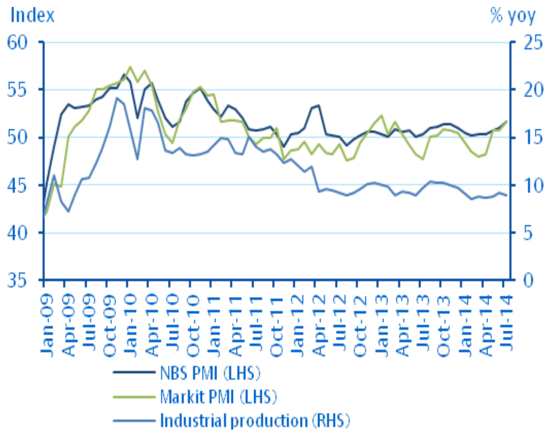
- **Economic activity moderated in July due to softened domestic demand.** Industrial production slowed to 9.0% y/y in July from 9.2% y/y in the previous month (Figure 1), slightly below expectations (BBVA: 9.3% y/y; consensus: 9.2% y/y). The moderation is driven by softened domestic demand. In particular, the growth of retails sales in July declined to 12.2% y/y compared with 12.4% y/y in June while the continuous deceleration of real estate investment dragged the total fixed asset investment down to 17.0% y/y YTD in July from 17.3% y/y YTD in June. (Figure 2) On the external front, July exports growth jumped astoundingly to 14.5% y/y from 7.2% y/y in June, which was boosted by the ongoing recovery in advanced countries but not sufficient to offset the headwinds from domestic demand. (Figure 3)
- **Credit growth surprised to the downside substantially.** The total social financing decreased dramatically to 273.1 billion RMB (consensus: 1500 billion) in July from 1974.5 billion RMB in June; while new bank loans declined to 385.2 billion RMB (780 billion) compared with 1079.3 billion RMB in June (Figure 4). Accordingly, M2 growth dropped to 13.5% y/y from 14.7% y/y in June. Apart from certain seasonal effects, the sharp decline in credit stemmed from the weak loan demand of the real economy and banks' increasing risk appetite. The authorities' clampdown on the shadow banking sector also led to the decline in the total social financing.
- **On the policy front, we expect the authorities to unveil more stimulus policies to sustain growth momentum**. Although the economy can continue to benefit from the improving external environment, the headwinds from domestic demand, including the subdued property market and the elevated debt level of local governments, will weigh on the growth prospect in the coming months. Therefore, we envisage that new easing policies will center on (i) providing financial support SMEs and reducing their financing costs; (ii) cutting red tape to create a better business environment and expanding investment access to more areas; and (iii) relaxing tightening measures on the property market to spur housing demand. On the monetary front, the PBoC is likely to employ various monetary tools to achieve a full-year loan growth of around 14%.

Figure 1
Strong exports and weak imports lead to a ballooning trade surplus in July



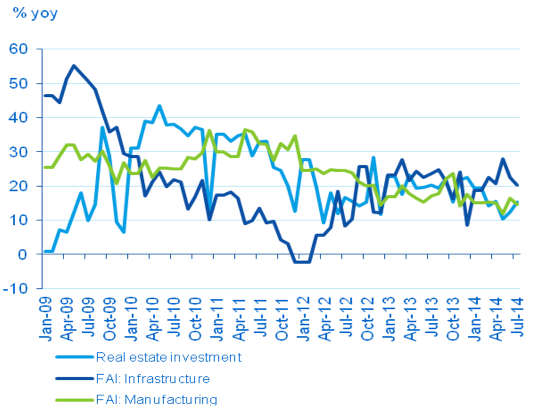
Source: CEIC and BBVA Research

Figure 2
Industry production are lower than expected despite the upbeat PMI outturn



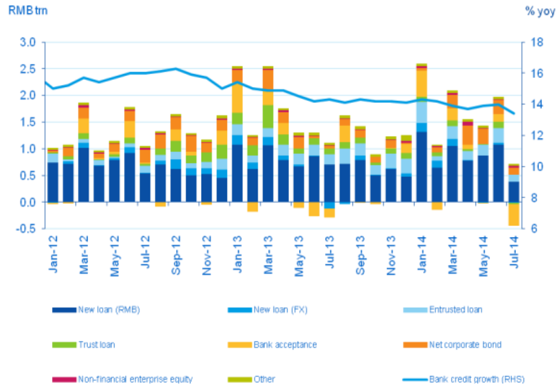
Source: CEIC and BBVA Research

Figure 3
FAI is still weak primarily due to real estate investment



Source: CEIC and BBVA Research

Figure 4
Both bank loans and total social financing decline sharply in July



Source: CEIC and BBVA Research