Economic Analysis

Keep calm: August blip doesn't mean an imminent hard-landing

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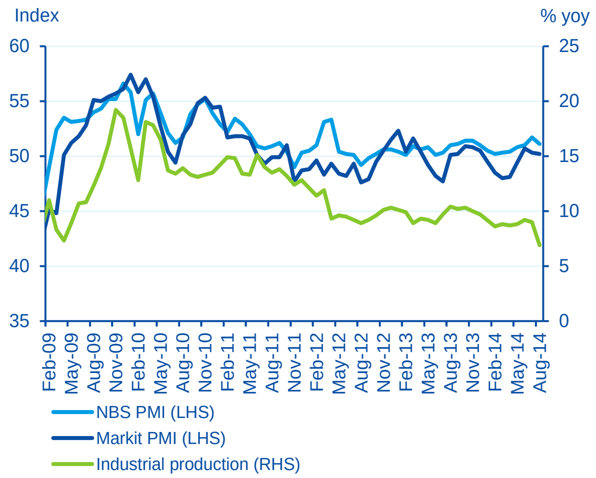
China's government announced a batch of important activity indicators over the weekend, among which, industrial production, retail sales and fixed asset investment, were all below market expectations as well as their growth rates in the previous month. In particular, industrial production fell sharply to 6.9% y/y in August (consensus: 8.8% y/y) from July's 9.0% y/y and registered the lowest reading since December 2009, which has greatly fuelled investors' worries about a growth hard-landing.

Although the slowdown in growth momentum is evident, we believe that the situation might not be as bad as the headline figures showed. A confluence of base effect and certain one-off factors have negatively distorted August outturn of industrial production (see below). Furthermore, credit growth in August, released on last Friday, recovered part of lost ground and gave investors a sigh of relief. With ample options of policy stimulus at their disposal, the authorities can still sustain this year's annual GDP growth above 7.0%. We expect more targeted loosening measures to be deployed in the rest of the year. The probability of the PBoC's adopting universal RRR cuts is increasing too. Overall, we maintain our annual GDP forecast at 7.2% for this year, implying a 7.0% y/y growth for the second half of the year.

Nevertheless, the disappointing August indicators did sound the alarm for the authorities. To a large extent, they show that the stimulus packages tend to become less effective and short-lived after they were frequently used over the past several years to lift growth. That said, the authorities need to accelerate the structural reforms promised in their agenda of the Third Plenum last November, so as to put growth on a sustainable trajectory and to reduce its reliance on short-term policy stimulus.

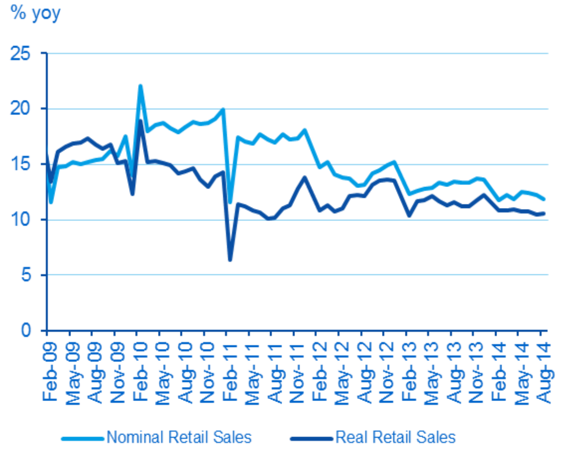
- **Economic activities fell sharply in August due to sluggish domestic demand.** Industrial production slowed to 6.9% y/y in August from 9.0% y/y in the previous month (Figure 1), significantly below expectations (Consensus: 8.8% y/y). Although the print was partially affected by an unfavorable base effect (Industrial production achieved its within-the-year peak in August 2013) as well as the anti-monopoly investigations against foreign automakers, the significant slowdown in growth momentum is still the primary culprit. In particular, the persistently subdued housing market has exerted negative spillover effects on production activities in related industries such as construction materials, furniture and home appliance. On the other hand, the deceleration of retails sales and the total fixed asset investment growth appeared to be mild: retail sales softened to 11.9% y/y in August (Figure 2), compared with 12.2% y/y in July, while the total fixed asset investment fell to 16.5% y/y YTD in August from 17.0% y/y YTD in July. (Figure 3)
- **Credit growth improved in August, staving off a fear of credit crunch.** The total social financing, a broad gauge of credit including bank loans, bond issuance and shadow banking activities, surged to RMB 957.4 billion from RMB 273.1 billion in July; while new bank loans increased to RMB 702.5 billion from RMB 385.2 billion in July (Figure 4). Accordingly, M2 growth dropped to 12.8% y/y from 13.5% y/y in July. As we explained in our previous flash, July credit data was seriously distorted by banks' "mid-year window dressing" so that investors shouldn't read too much into it. In August, credit growth seemed to be back on track and was likely to lend support to growth stabilization in the coming months.

Figure 1
Industry production fell sharply due to sluggish domestic demand



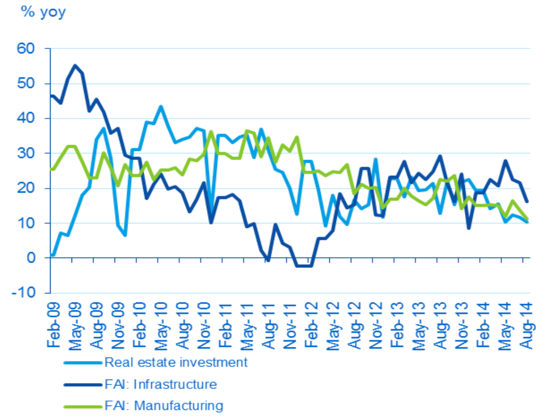
Source: CEIC and BBVA Research

Figure 2
Retail sales moderated in August



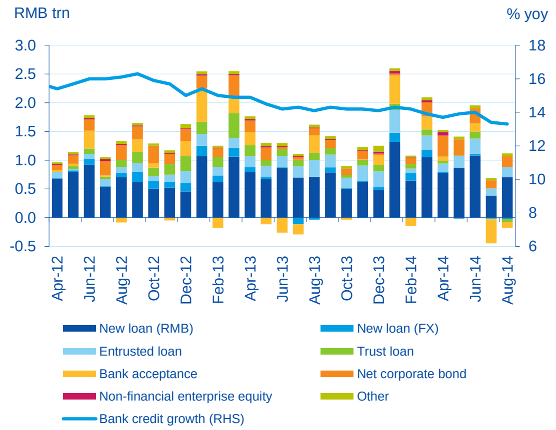
Source: CEIC and BBVA Research

Figure 3
Weakening fixed asset investment was led by the continuous deceleration of the property market



Source: CEIC and BBVA Research

Figure 4
Both bank loans and total social financing bounced back from the last month



Source: CEIC and BBVA Research