Economic Analysis

Weak activity indicators could prompt the authorities to reconsider shelved conventional monetary tools

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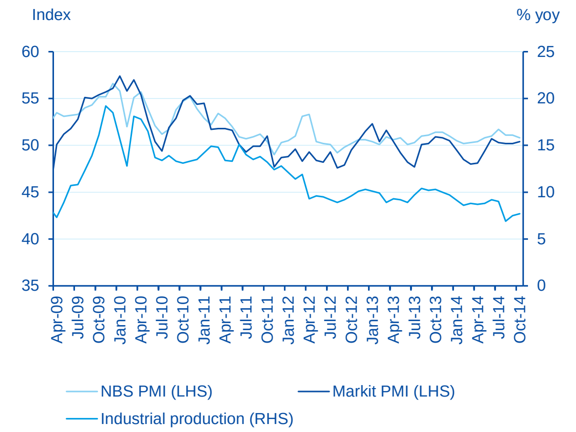
Today the government announced a batch of economic activity indicators including industrial production (7.7% y/y), retail sales (11.5% y/y) and fixed asset investment (15.9% y/y YTD). Notably, all the outturns undershot market expectations and slowed from their prints in the previous month, suggesting that the economic downturn continue at the beginning of the fourth quarter. The disappointing October indicators did ring the alarm for the authorities since they have already deployed a number of "targeted" easing measures in September and October to underpin growth, including two rounds of Medium-Term Lending Facility (MLF) and the lift of tightening measures in the property market. To a certain degree, October's lackluster outturns reflect that the effectiveness of the targeted measures is waning. The authorities should consider reinstating some of shelved conventional tools to revive growth.

Nevertheless, we anticipate that the growth rate in 2014 can still remain above 7.0% (BBVA: 7.3%) as the authorities are equipped with ample options of policy stimulus at their disposal. Regarding the growth outlook of 2015, we maintain our growth projection of 7.0% while flag some downside risk. That said, the authorities need to accelerate the structural reforms contained in their blue map of the Third Plenum last November, so as to put growth on a sustainable trajectory and to reduce its dependence on short-term stimulus measures.

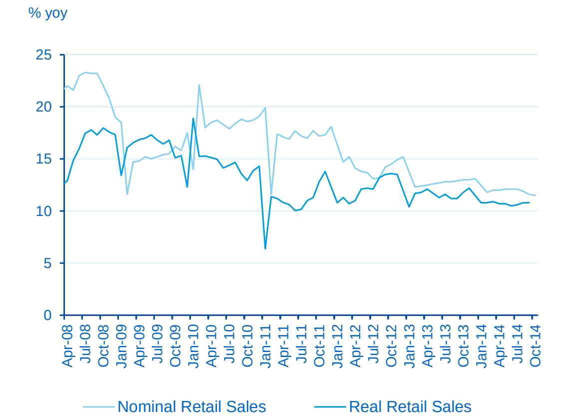
- **Economic activities further moderated in October due to weak domestic demand.** In particular, industrial production slowed to 7.7% y/y in October from 8.0% y/y in the previous month (Figure 1), also below market expectations (Consensus: 8.0% y/y). Despite the policy easing at end-September which was aimed to revive housing demand, several property-related sectors, such as construction materials, furniture and home appliance, haven't showed clear signals of improvement. On the demand side, both consumption and investment demand remained sluggish. Retail sales softened to 11.5% y/y in October (Figure 2), compared with 11.6% y/y in September (Consensus: 11.6%) while the total fixed asset investment growth decelerated to 15.9% y/y YTD in October from 16.1% y/y YTD in September (Consensus: 16%) (Figure 3). By category, real estate investment fared worse than investment in manufacturing sector and infrastructure.
- **On the policy front, we expect the authorities will beef up their efforts to support growth through 2015.** Although the authorities are likely to stick to their "targeted easing" commitment in the next couple of months, its policy stance could switch to "universally loose" early next year. In this respect, we expect the PBoC to cut RRR by up to 200 basis points (likely in four times) next year, so as to spur bank lending and lower financing costs of corporate and households. Compared to the adjustment of RRR, interest rate cuts are less likely to be adopted because lending rates have already been liberalized, which renders the adjustment of the benchmark lending rate ineffective. On the fiscal front, the central government is expected to beef up their efforts to support infrastructure investment, particularly in shanty-town renovation programs, high-speed railways, water conservancy and environmental projects, in a bid to sustain growth and offset the adverse impact of the prospective fiscal consolidation at the local government level.

Figure 1
Industrial production further stabilized due to sluggish domestic demand



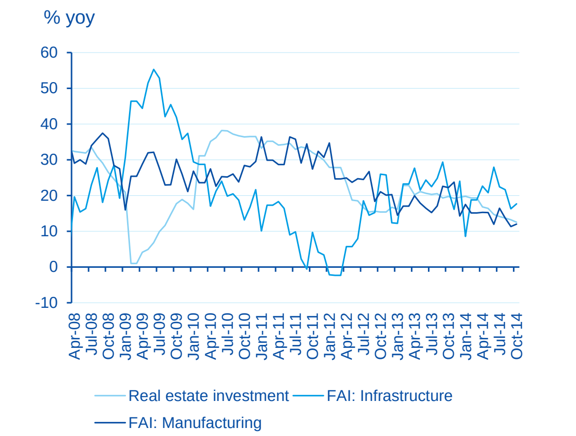
Source: CEIC and BBVA Research

Figure 2
Retail sales edged down marginally in October



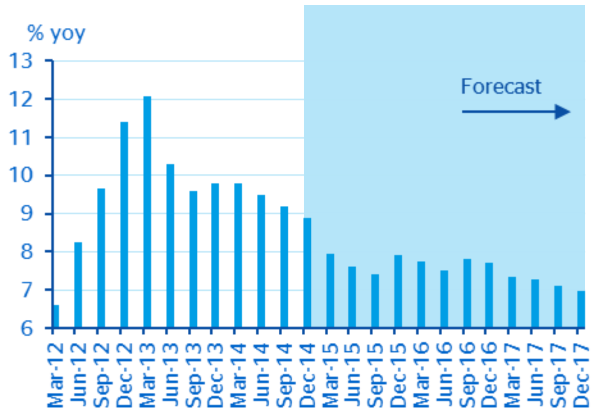
Source: CEIC and BBVA Research

Figure 3
Anemic investment was led by the property market's deceleration



Source: CEIC and BBVA Research

Figure 4
Our growth projections are 7.3% and 7.0% for 2014 and 2015 respectively



Source: CEIC and BBVA Research