Economic Analysis

May activity indicators show no significant pick-up signal

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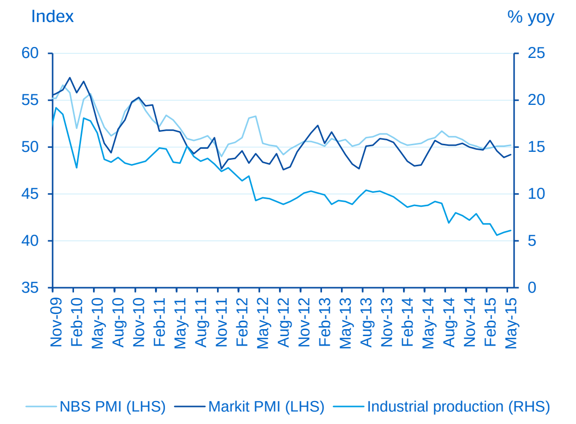
Today, China's National Bureau of Statistics (NBS) announced a batch of economic activity indicators for May, including industrial production, retail sales and urban fixed asset investment (YTD). While retail sales and industry production were both in line with market consensus and last month's readings, FAI remained sluggish. This suggests that China's economy continues its downward trend and has shown no significant signs of a pick-up in activity, despite some marginal pick-up appeared. In order to achieve the official growth target 7.0% for 2015, we anticipate more easing measures in the second half of 2015, including local government debt swap and interest rate cuts.

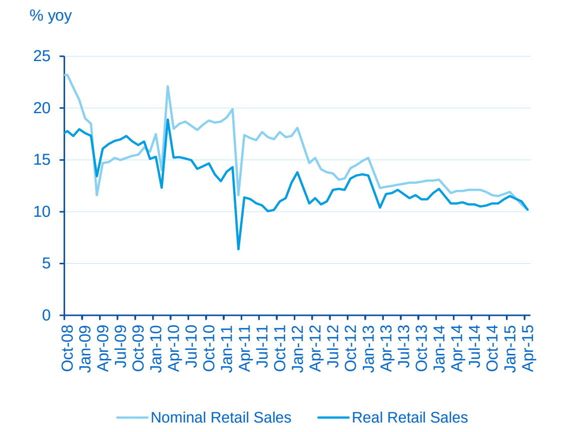
- **Both retail sales and industry production marginally picked up…** In particular, industrial production (Figure 1) came out higher than both market expectations and last month's reading (Actual: 6.1% y/y; Consensus: 6.0% y/y; Prior: 5.9%). By categories, the largest increases were found in consumer products (6.7% y/y, a 0.9% increase vis-à-vis April) and the high-tech sector (9.3% y/y, 3.2% higher than the industry average). On the demand side, retail sales (Figure 2) climbed up marginally to 10.1% y/y in May (Prior: 10.0% y/y; Consensus: 10.1% y/y), on the back of strong online retail sales growth, which reached 38.5% y/y ytd, 28.1% higher that retail sales' average growth.
- **…while FAI remained sluggish.** However, urban total fixed asset investment growth declined to 11.4% y/y ytd (Consensus: 11.9% y/y ytd), down from 12.0% ytd y/y in April (Figure 3). From the perspective of fund resources, fiscal budget growth ytd y/y increased by 3.1%, but domestic loans growth ytd y/y dropped by 6.3% and FDI growth ytd y/y decelerated by 36.1%. This hints that both FDI and banking loans have not boosted investment effectively, although the authorities have taken efforts by expanding fiscal spending. Additionally, whereas we saw a slight pickup in property trading, this has not been sufficient to boost real estate investment significantly. This is because property inventories remain obstinately high, which is hurting investor confidence in real estate.
- **On the policy front, we expect more local government debt swap and interest rate cuts in the remainder of 2015.** China will allow local governments to issue an additional one trillion RMB (161 billion USD) in bonds in an effort to help local governments refinance their hefty debt burdens. The amount, which is double the size of the initial quota initially implemented by the authorities, will help local governments refinance 1.86 trillion RMB in debt due in 2015. Local government bonds could be used by commercial banks as collateral for central government loans, which is equivalent to a liquidity injection to commercial banks. For this reason, we believe that further RRR cuts will be less likely than interest rate cuts, but this will depend on the specific circumstances, such as capital flows. We do envisage that the PBoC will implement additional interest rate cuts equivalent to a total of 50 bps in the third quarter. Also, the PBoC may resort to unconventional monetary policy tools that aim to inject liquidity into the banking system – also known as "Chinese Quantitative Easing". All in all, we maintain our growth projection of 7.0% for this year, although risks remain to the downside (Figure 4).

Figure 1
Industrial production marginally picked up



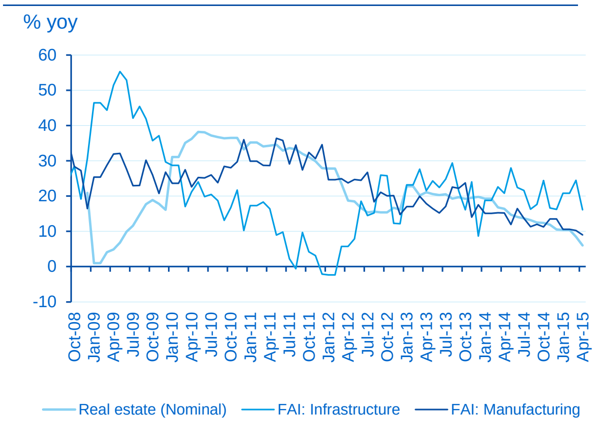
Source: CEIC and BBVA Research

Figure 2
…so did retail sales



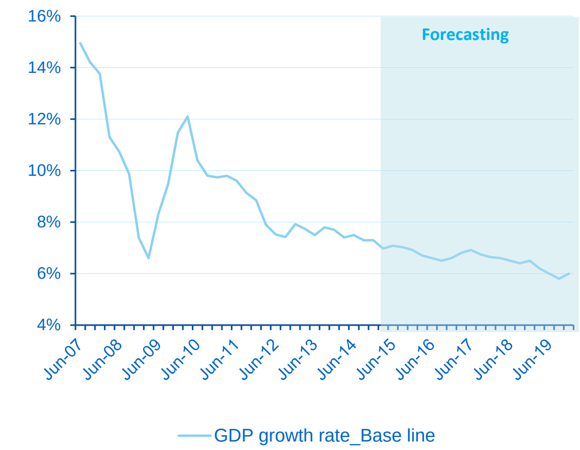
Source: CEIC and BBVA Research

Figure 3
FAI was below both market expectation and the prior reading



Source: CEIC and BBVA Research

Figure 4
We maintain our 2015 growth forecasting at 7.0%, with some downside risk



Source: CEIC and BBVA Research

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