Economic Analysis

Lackluster August activity indicators call for more policy easings

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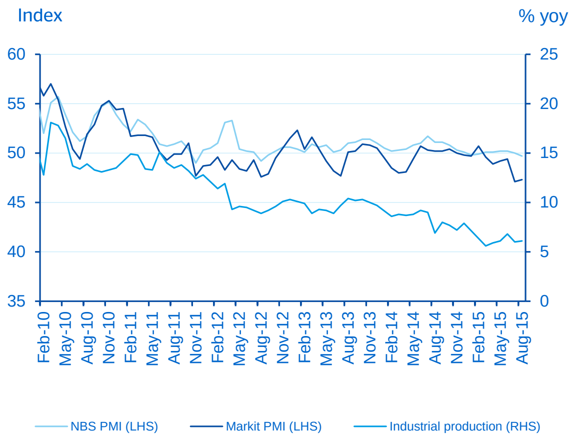
China's National Bureau of Statistics (NBS) yesterday announced a batch of economic activity indicators for August, including industrial production (IP), retail sales and urban fixed asset investment (FAI, ytd). No significant pick-up signal has been shown by the August outturns yet. In particular, FAI, which indicates the confidence of investors, further slipped to 10.9% y/y in August from 11.2% y/y in July. In addition, the industrial production's marginal pick-up is still weak. Looking ahead, we anticipate that the authorities will deploy more policy easings (in particular more cuts in Required Reserve Ratio and fiscal spending) to spur domestic demand. We maintain our recently adjusted growth projection to 6.7% for this year, and 6.2% for 2016.

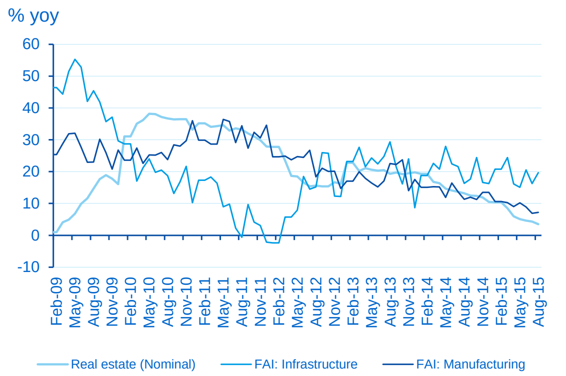
- **Industrial production and FAI are both lower than market expectations.** Industrial production (Figure 1) marginally picked up to 6.1% y/y in August from 6.0% y/y in July, but was still below the market expectation of 6.5% y/y. A number of factors contribute to this marginal increase, including electric power sector, the chemical sector and especially, the high-tech sector. However, the pick-up is still weak given the base effect. In the meantime, urban total fixed asset investment growth declined to 10.9 % y/y ytd (Consensus: 11.2% y/y ytd), down from 11.2% ytd y/y in July (Figure 2). The drop of FAI is mainly due to the de-stocking process of the real estate sector, thus new property investment has been sluggish. Moreover, manufacturing investment is still lackluster in the midst of weak external demand and over-capacity problems in several industries.
- **Retail sales picked up, but price effect plays its role.** Among the economic headwinds, the only silver lining comes from retail sales, which increased to 10.8% y/y in August (Prior: 10.5% y/y; Consensus: 10.6% y/y). The main driver of retail sales is the significant increase of online shopping and communication equipment, both of which maintained around 30% y/y growth. However, we should also notice that the "retail sales" is a nominal indicator, subject to the movement of price levels. After excluding the price effect, we find that the growth rate of real retail sales is flat with the outturn in the previous month.
- **On the policy front, we expect more easing measures throughout the rest of 2015 to sustain growth.** On the front of monetary policy, the prospective FED's interest rate hike and China's RMB devaluation have given rise to new uncertainties in the financial markets and constrain the PBoC from trimming interest rate. Therefore, the PBoC is likely to rely on the quantitative tools such as the RRR cuts and a number of unconventional monetary tools (namely selective RRR cuts, short-and-medium term liquidity facility, the Central Bank refinancing to commercial banks, etc) to spur domestic demand. On the fiscal front, the thrust should be to avoid sharp fiscal consolidation at the local government level. The authorities could further relax some tightening measures imposed on local government borrowing as well as expand the central government's fiscal deficit in the second half of the year. In addition to infrastructure investment, the authorities could consider more tax cuts for the corporate sector and increase public spending on social welfare. (Figure 4)

Figure 1
Industrial production marginally picked up but still of weak foundation to recover



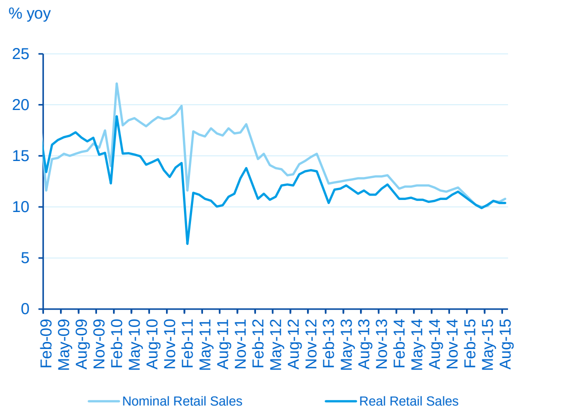
Source: CEIC and BBVA Research

Figure 2
FAI dropped significantly, both real estate and manufacturing investment are sluggish



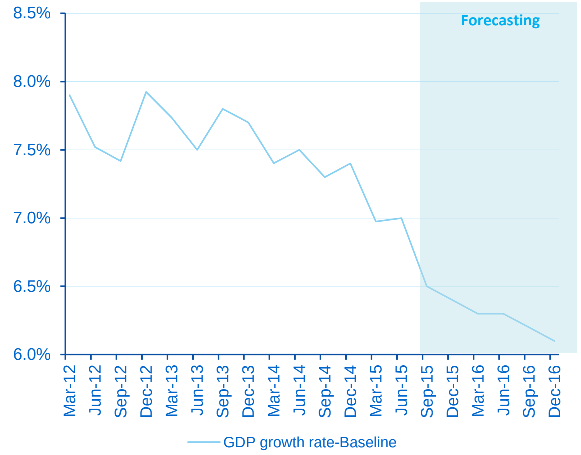
Source: CEIC and BBVA Research

Figure 3
Retail sales is beating both market expectation and the prior reading



Source: CEIC and BBVA Research

Figure 4
We maintain our 2015 growth forecasting at 6.7%, and 6.2% for 2016



Source: CEIC and BBVA Research