China Flash

Easing February inflation and activity indicators reinforce expectations of policy loosening

Headline inflation for February declined to 3.2% y/y (Chart 1), at the lower end of expectations (BBVA: 3.2%; consensus: 3.4%), on falling food prices and strong base effects from the Chinese New Year (which occurred in February this year as opposed to January last year). Meanwhile, retail sales and industrial production for the combined months of January/February (released together to strip out New Year seasonality) moderated by more than expected, while fixed asset investment also moderated, but beat expectations. Taken together, the outturns reinforce our expectations of further policy loosening, including an additional 100-150bp cuts in the RRR in coming months, up to two 25bp interest rate cuts around mid-year, and fiscal support as announced at the ongoing National People's Congress (see yesterday's China Flash). While the data should be interpreted cautiously due to the seasonality effects, they are nevertheless consistent with our inflation and growth outlook: we expect inflation to pick up to around 3.5% y/y in the next few months due to base effects, before moderating to around 3.0% by June. We expect full-year growth of 8.3%.

- **February CPI inflation eases on falling food prices and base effects, driven by the timing of the Chinese New Year (CNY).** On declining demand after the CNY, food prices fell by -0.3% m/m, resulting in an increase of 6.2% y/y in February, down from 10.5% y/y in January. The year-over-year increases for January and February were heavily influenced by base effects from the CNY. Non-food prices increased by 1.7% y/y, from 1.8% in January. If we combine the January and February inflation data to strip out the CNY seasonality, we find that inflation for the two-month period was 3.9%, down from 4.1% in December, providing some reassurance that inflation is on a downward trend.
- **Producer price inflation (PPI) in February eased to 0.0% (Chart 2)** (Consensus: 0.1% y/y; BBVA: 0.1%), down from 0.7% y/y in January. Month on month (non-seasonally adjusted) the PPI increased by 0.1% in February, on rising commodity prices.
- **Activity and credit indicators for January/February confirm a continuation in moderating growth trends.** On the supply side, industrial output eased to 11.4% y/y (BBVA: 11.5%; consensus 12.5%) from 12.4% y/y in December. These trends are consistent with a moderation in electricity usage, which increased by 7.1% y/y, down from 9.7% in December. Perhaps more of a concern, on the demand side, retail sales growth moderated to 14.7% y/y from 18.1% y/y in December, below expectations (consensus: 17.3%; BBVA: 17.5%) (Chart 3). Data released today on new loans, of RMB 710.7 billion (BBVA: RMB 650.0; consensus: 750.0) also suggest weak demand. In contrast, however, urban fixed asset investment (YTD) rose by a better-than-expected 21.5% y/y (BBVA: 19.0%; consensus: 20.3%), from 23.8% y/y in December (Chart 4). Although mixed, taken together we view the activity outturns as consistent with our previous growth outlook.
- **Newly released real estate market data show further weakening in demand trends, while investment is holding up.** Total sales of residential housing for January/February declined by -20.9% y/y, down from a full-year average of 12.1% y/y in 2011. Part of the decline was driven by lower sales volumes, which declined by -14.0% y/y for the first two months of 2012. This could indicate a steeper fall in housing prices than in recent months, of around -6% y/y (although also based on NBS data, these housing figures may be compiled on a different sample base from the NBS monthly price data for 70 cities). On the supply side, real estate investment continued to grow strongly, by 27.8% for January-February, similar to the 2011 growth momentum.
- **Markets will be watching for trade data due out tomorrow.** We expect exports to rebound to 30% y/y from -0.5% y/y in January mainly on seasonal effects from the Chinese New Year.

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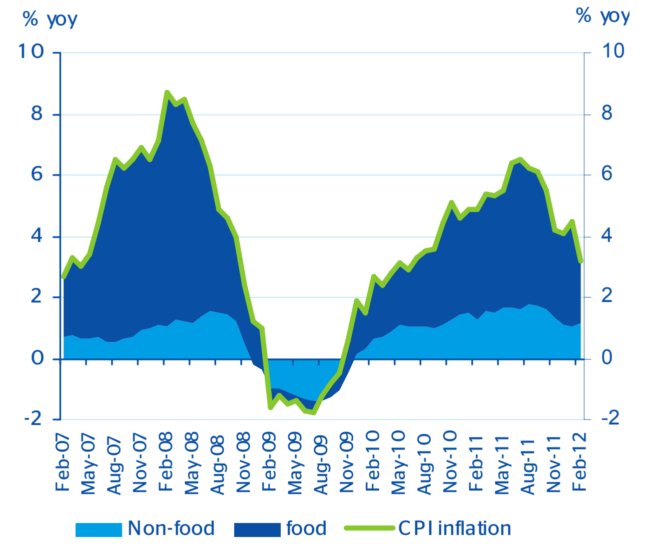
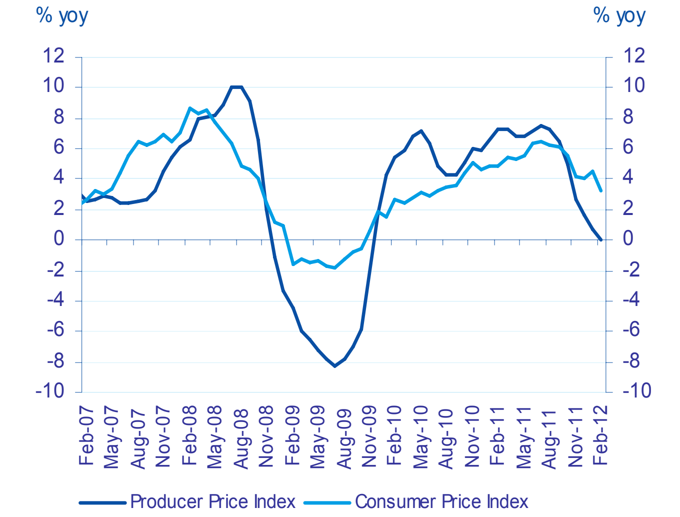
Chart 1
February inflation fell on strong base effects



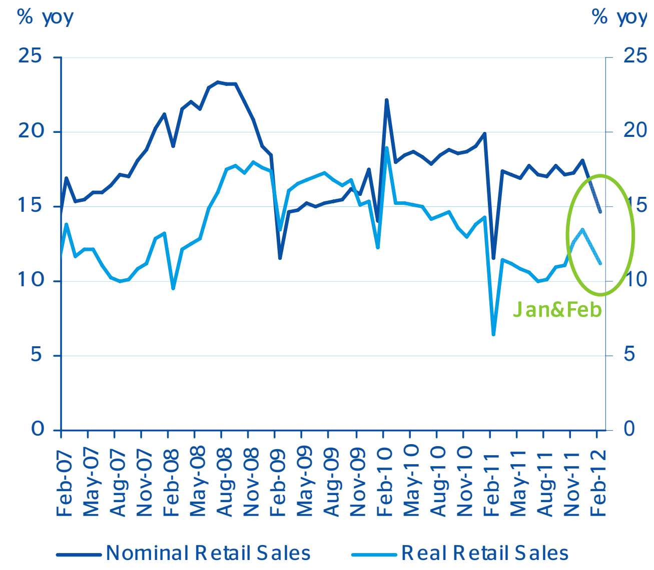
Source: CEIC and BBVA Research

Chart 2
February PPI inflation continued to moderate



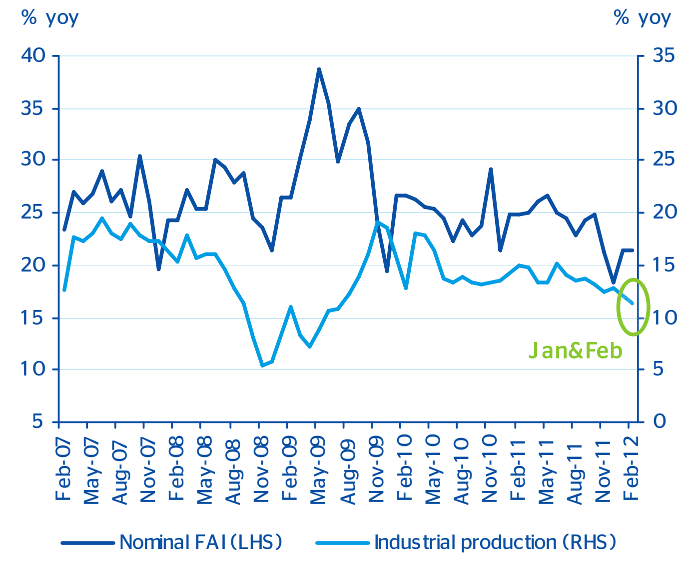
Source: CEIC and BBVA Research

Chart 3
Retail sales were weaker than expected



Source: CEIC and BBVA Research

Chart 4
FAI help up, while IP weakened



Source: CEIC and BBVA Research

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