China Flash

May indicators point to gentle growth moderation and scope for more policy stimulus

The latest batch of monthly activity indicators for May, released over the weekend, show continuing growth moderation, with some outturns exceeding expectations. Indeed, the outturns were better than pessimists might have feared following last week's interest rate cut which was taken by some observers as an indication that the data release would be on the weak side. Both investment and retail sales continued to moderate, but at a slower pace than in recent months. Exports and imports both surprised to the upside, resulting in a larger-than-expected trade surplus. Importantly, inflation eased by more than expected, to 3.0% y/y in May (consensus: 3.2%; BBVA: 3.3%), providing room for further policy stimulus in the months ahead to support growth. We expect additional 100-150bps cuts in the RRR, and at least one more 25bp interest rate cut, most likely in Q3. We are revisiting our full-year 8.3% growth projection in light of the weaker than expected growth outturns in the first half of the year, although with momentum expected to increase in the second half of the year, any downward revisions should be modest.

- **Activity indicators for May suggest that the deceleration in growth momentum continues, but at a slower pace (Chart 1).** Industrial output improved slightly to 9.6% from 9.3% y/y in April, but still below expectations (consensus 9.8%; BBVA: 10.5%). Electricity usage also strengthened slightly, to 2.7% y/y from 0.7% y/y April. On the demand side, retail sales growth moderated further to 13.8% y/y in May from 14.1% y/y in April, in line with our expectations (consensus: 14.2%; BBVA: 13.8%) (Chart 2). Urban fixed asset investment (YTD) declined slightly, to 20.1% y/y in May from 20.2% y/y in April, broadly in line with expectations (consensus: 20.0%) (Chart 3).
- **May trade data were stronger than expected (Chart 4),** with exports and imports growing by 15.3% and 12.7% y/y, respectively (consensus: 7.1% y/y and 5.5% y/y), rebounding from a weak month in April (4.9% y/y and 0.3% y/y, respectively). The rise in exports by destination was broad based. Meanwhile, imports of both processing inputs (for reassembly in export goods) and final products increased. We are cautious, however, in interpreting whether these outturns suggest a meaningful improvement in external demand, given recent volatility in the data and the ongoing weak external environment.
- **May CPI inflation fell more than expected to 3.0% y/y** (consensus: 3.2% y/y; BBVA: 3.3%), from 3.4% y/y in April. Food inflation continued to decline to 6.5% y/y (from 7.0% y/y in April on lower meat and vegetable prices). Meanwhile, non-food inflation fell to 1.4% y/y from 1.7%, due to lowered domestic oil prices. At the same time, producer price inflation (PPI) in May declined also declined by more than expected, to -1.4% y/y (Chart 5) (Consensus: -1.1% y/y), down from -0.7% y/y in April. Looking ahead, we now expect headline inflation to bottom out at below 3% in June and July, before rising modestly in the second half of the year, but remaining below the authorities 4% comfort range. This should provide room for further policy stimulus, including additional monetary easing.
- **We will watch the outturn of May credit growth closely in the coming days, as a sign of loan demand** (consensus: 705 bn RMB; BBVA: 680 bn RMB). Sluggish credit growth, together with the easing inflation pressure, may prompt an increasingly proactive policy response by the authorities, including further cuts in the RRR. We expect new loans for May to be broadly similar to the previous month, based on lending indicators of the four largest banks.

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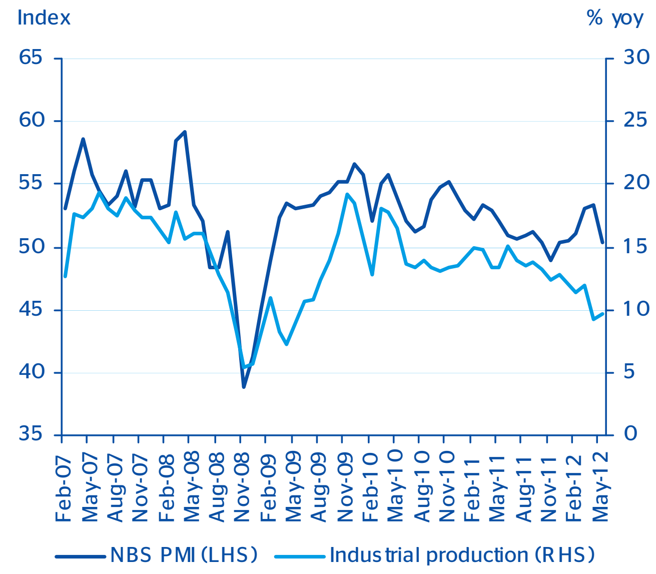
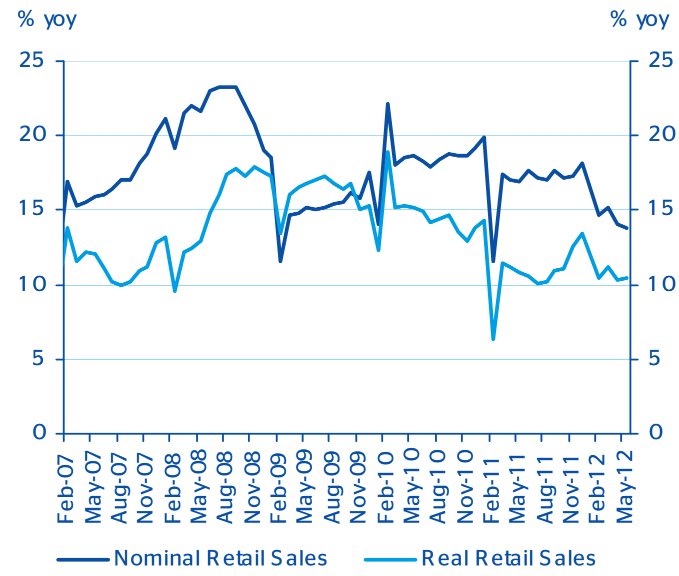
Chart 1
Industrial production improved slightly



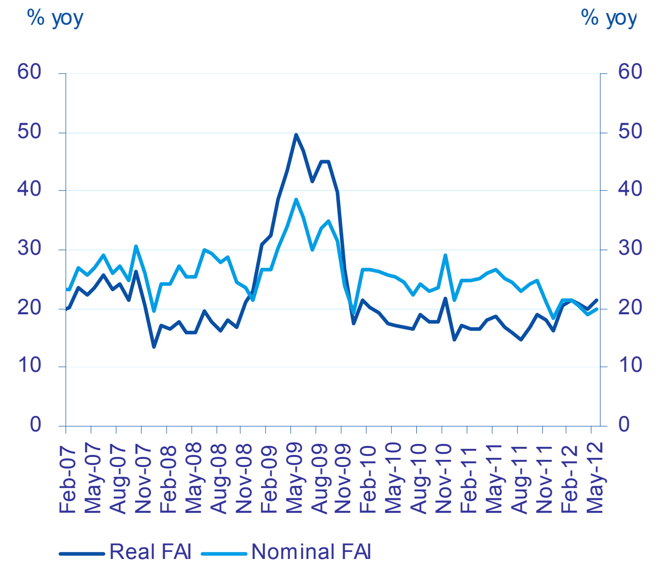
Source: CEIC and BBVA Research

Chart 2
Retail sales further moderate



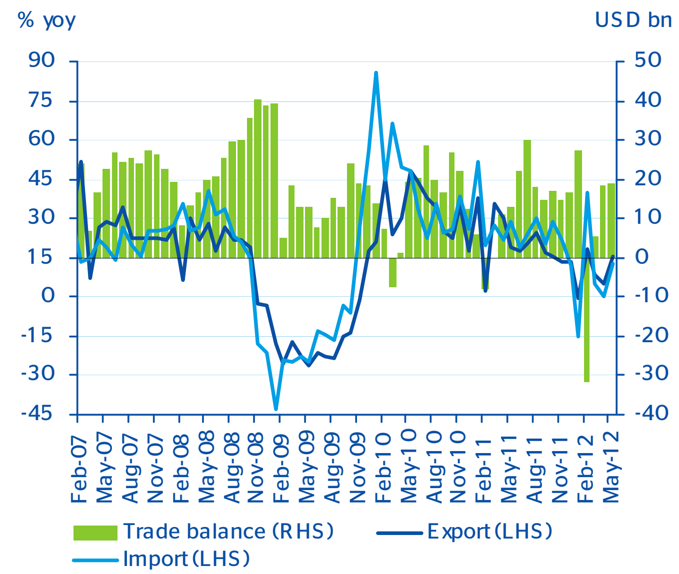
Source: CEIC and BBVA Research

Chart 3
FAI yoy growth held up



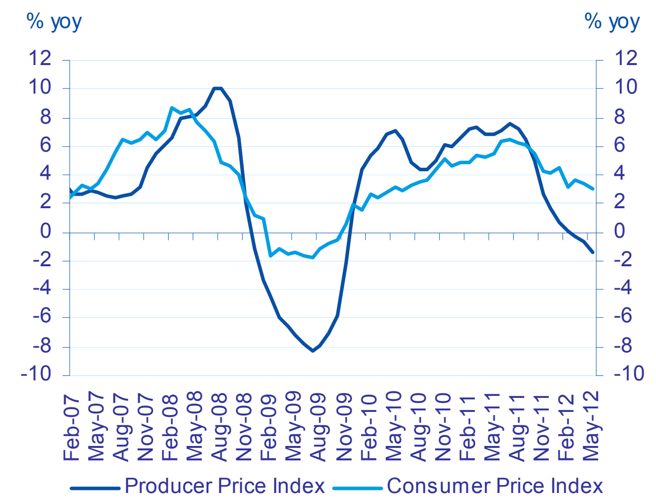
Source: CEIC and BBVA Research

Chart 4
Export and import picked up



Source: CEIC and BBVA Research

Chart 5
PPI growth declined continuously



Source: CEIC and BBVA Research

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