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Flash Notes

China: Surprisingly Solid Growth In 1Q17

Robust Growth Momentum

China released its 1Q17 GDP report on Mon morning (17 Apr 2017) along with the remainder of data for March. Headline growth number came in stronger than expected at 6.9%y/y in 1Q17, ahead of market expectation of 6.8% (which is also the headline figure in 4Q16). On a sequential basis, however, momentum slowed to 1.3%q/q seasonally adjusted, from 1.7% in 4Q16 and the same reading for that of 1Q16. This is the slowest 1Q in term s of q/q headline (which is generally disrupted by lunar new year holidays) since data series started in 2011.

The surprisingly strong outcome for 1Q17 is primary driven by stronger performances of the secondary sector as well as the tertiary sector. Primary sector rose by 3%y/y, while secondary sector expanded 6.4y/y (ahead of our expectation of sub-6% reading) and tertiary sector output gained 7.7%y/y (better than our forecast of 7.3%).

Consistent with the recovery in external demand, China's industrial output rose 6.8%y/y in 1Q17, with the drop in mining output (-2.4%) fully offset by manufacturing output gain of 7.4% as capability is increasingly being enhanced towards greater technological intensity and value added. Tertiary sector growth is spurred by widespread adoption of information technology and transmission, logistics, among others, just as consumer spending rises and final demand contributed 77% share of the Chinese economy in 1Q17. This has resulted in the enlarged value-added share of tertiary sector to 56.5% of GDP, 17.8% point higher than that of the secondary sector. This is much large than the 51.6% share held tertiary sector and 40% by secondary sector in full year 2016.

The stronger performance in 1Q17 has been foreshadowed by data releases earlier. China's banks made total new loans of RMB4.22tn in 1Q17, the biggest increase on record for a single quarter. In contrast to declines in traditional bank loans, shadow banking activities picked up as total social financing (TSF) rose by RMB6.93tn in 1Q17, well above RMB6.7tn in the same quarter in 2016. However, this pace of increase in TSF is unlikely to continue as policymakers are increasingly scrutinizing banks' and nonbanks' on- and off-balance sheet activities. The restraint from central bank is reflected in the slowdown in broad M2 money supply (M2) in March, which grew 10.6%y/y, the slowest monthly growth since July and below expectation of 11.1%.

On the external trade front, China's export growth accelerated in March in a positive sign for global demand, though import growth cooled. Exports rose 16.4%y/y in Mar to US$180.6 billion, compared to 4%y/y in Jan-Feb. Imports rose 20.3%y/y to US$156.6 billion, down growth in January-February of 26.4%. Trade surplus in Mar contracted 20%y/y to US$23.9bn, with the surplus with the US at US$17.7bn and the gap with Europe at US$7.7 bn. Overall in 1Q17, China's exports (in USD terms) gained for the first time after 7 consecutive of quarterly y/y declines that dated from mid-2015. The recovery in China's imports (in USD terms) is also reflective of improving external and domestic fundamentals, with quarterly growth accelerated for the second quarter after two consecutive years of quarterly y/y declines in imports that began in 4Q14.

Downside Risks Are Still Lurking

Notwithstanding the upbeat performance in 1Q17, downside risks remain that would curb growth upside. For one, the recovery in external demand, as evidenced by exports performances of China, South Korea, and other economies, is at an early stage and whether this pace could be sustainable remains to be seen. Secondly, US President Trump has initiated a 90 day review process of the causes of the US' trade deficits with some of its largest trading partners and order stricter enforcement of US anti-dumping laws to prevent foreign manufacturers from undercutting US companies by selling goods at an unfair price. In addition, China, which accounts for the largest share of US trade deficit, has also started its 100-day review to improve trade imbalances between the two countries. These activities suggest that trade frictions could surface just months from now and are a potential risk factor that should not be ignored.

The other area of concern for China is that credit growth has continued to expand, supporting economic growth momentum. This is likely to reinforce the authorities' determination to curb leverage and asset price bubbles. This means that upside in loans and credit growth would be limited from here, which would dampen economic activities.

PBoC Is Likely To Harden Posture Further

The robust growth momentum in 1Q17 is likely to spur PBoC to stay vigilante in its policy stance. The risk is that this stance could be hardened further after the upbeat report in 1Q17. Recall that the central bank has raised its open market operation (OMO) interest rates during the quarter via reverse repos and lending facilities. At the same time, administrative measures such as macroprudential assessment (MPA) for the banking sector are also being pursued to manage and prevent systemic risks.

We anticipate further tightening via the OMO route in the months ahead in steps of 10bps as before, with the timing expected to be close to US Fed interest rate hike ahead. **As for hiking of policy interest rates, we believe these would be on hold for now and would likely to be "tool of last resort"** to ensure that borrowing costs remain reasonable for end borrowers. We are keeping our forecasts for 1Y lending rate at 4.35% and 1Y deposit rate at 1.50%.

With the latest US Treasury's FX report (released on 14 Apr) not naming China as a currency manipulator, it opens up the potential of more flexibility for the RMB and could mean further room for strengthening of the currency as both sides assess their bilateral trade relations in the 100-day plan. The daily USD/CNY fixing would thus provide clues as to policymakers' intention on the currency. Pending further developments, we maintain our USD/CNY forecasts of 7.02 for mid-2017 and 7.16 for end-2017.

As for how 2Q17 would shape up for China's economy, we are taking a more cautious stance in anticipation of further PBoC tightening although **headline GDP growth is likely to bias towards the lower end of 6.7-6.9% range after a strong 1Q17**, keeping in mind the growth target for 2017 is only "around 6.5%" and that there is an important political Congress in the autumn of 2017. We are keeping our full year growth forecast for 2017 at 6.6% for now.

China's Key Macro Data

Indicators	2014	2015	2016	3Q16			4Q16			1Q17		
Real GDP Growth %y/y	7.3	6.9	6.7	6.7			6.8			6.9		
Real GDP Growth %q/q SA	-	-	-	1.8			1.7			1.3		
%y/y change except noted	2014	2015	2016	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
Industrial Output	8.3	6.1	6.0	6.0	6.3	6.1	6.1	6.2	6.0	--	--	7.6
NBS Manufacturing PMI	50.1	49.7	51.4	49.9	50.4	50.4	51.2	51.7	51.4	51.3	51.6	51.8
Caixin-Markit Manufacturing PMI	49.6	48.2	51.9	50.6	50.0	50.1	51.2	50.9	51.9	51.0	51.7	51.2
CPI	2.0	1.4	2.0	1.8	1.3	1.9	2.1	2.3	2.1	2.5	0.8	0.9
PPI	-1.9	-5.2	-1.4	-1.7	-0.8	0.1	1.2	3.3	5.5	6.9	7.8	7.6
Exports (USD terms)	6.0	-2.6	-7.7	-4.4	-2.8	-10.0	-7.3	0.1	-6.1	7.9	-1.3	16.4
Imports (USD terms)	0.7	-14.4	-5.5	-12.5	1.5	-1.9	-1.4	6.7	3.1	16.7	38.1	20.3
Trade Balance (US$ bn)	380.1	602.4	547.2	50.2	52.0	42.0	48.8	44.2	40.7	51.3	-9.1	23.9
New Loans (RMB bn chg)	9,781.5	11,720.0	12,645.9	463.6	948.7	1,220.0	651.3	794.6	1,040.0	2,030.0	1,170.0	1,020.0
Aggregate Financing (RMB bn chg)	16,413.4	15,410.0	17,802.3	479.1	1,460.5	1,711.5	886.5	1,832.8	1,626.0	3,720.2	1,147.9	2,120.0
M2	12.2	13.3	11.3	10.2	11.4	11.5	11.6	11.4	11.3	11.3	11.1	10.6
Urban Fixed Asset Investment YTD	15.7	10.0	8.1	8.1	8.1	8.2	8.3	8.3	8.1	8.9	8.9	9.2
Retail Sales	12.0	10.7	10.4	10.2	10.6	10.7	10.0	10.8	10.9	-	-	10.9

Source: CEIC, Bloomberg, National Bureau of Statistics; UOB Global Economics & Markets Research estimates. All data for individual months except noted