

China: slower than expected growth in Q1, but may mark the bottom for this year

Friday, April 13, 2012

Highlights:

China's economic growth slowed further in Q1 to 8.1% yoy lower than market expected 8.4% (OCBC: 8.3%). The falling economic activity was mainly due to slower growth in both consumption and investment.

China's export outlook may remain uncertain this year due to two reasons. First, the global economic outlook remains unclear. Second, Chinese exporters are facing rising trade protectionism from developed economies. Nevertheless the impact of weak external demand on the Chinese economy is likely to be limited, as net exports has not been the driver for Chinese growth since 2009 following the global financial crisis. Weak global demand has been priced in the slowing Chinese growth and is unlikely to be a surprise factor to China's GDP this year.

The downward trend of fixed investment suggests that the government's previous tightening measures have been taking effect. Nevertheless, the decline in consumption is a bit worrying. This is partly due to the withdrawal of previous policy support, eg, expiry of "trading in old home appliance for new one" policy and new restriction on car registration in some cities.

We think Q1 is likely to be the bottom and the economy is likely to improve going forwards albeit at a slower pace on the back of the government's easing credit and fiscal policies. We have spotted three green shoots including a more supportive credit policy, rising investment demand in Central and Western China, and rising income growth.

First, although monetary policy easing paused in March with no further reserve requirement ratio cut announced, there are signs that China has tweaked its previously tight credit policy. Second, investments in Central China and Western China remained strong despite investments in Eastern China slowed further in the first quarter. Third, China's disposable income in urban area grew steadily at 14% in the first quarter, outpacing nominal GDP growth pace.

The higher than expected consumer inflation suggested that it is still too early for China to lower its guard against inflationary pressure, although our forecast for CPI to trend down gradually remains intact.

We reiterate our view on no interest rate cut this year. Nevertheless, we still expect China to lower its RRR given unclear capital flow outlook. However, the next RRR cut is likely to happen only in May given there are huge amount of central bank bills maturing in April.

Corporate FX &
Structured Products
Tel: 6349-1888 / 1881

Fixed Income &
Structured Products
Tel: 6349-1810

Investments &
Structured Product
Tel: 6349-1886

Interest Rate Derivatives
Tel: 6349-1899

Treasury Research &
Strategy
Tel: 6530-4887

Tommy Xie Dongming

+(65) 6530 7256

xied@ocbc.com

China's economic growth slowed further in Q1 to 8.1% yoy from 8.9% yoy in Q4 2011, lower than market expectations of 8.4% (OCBC: 8.3%). The falling economic activity was mainly due to slower growth in both consumption and investment as shown on chart 1 below.

Chart 1: Both retail sales and fixed investment slowed in Q1

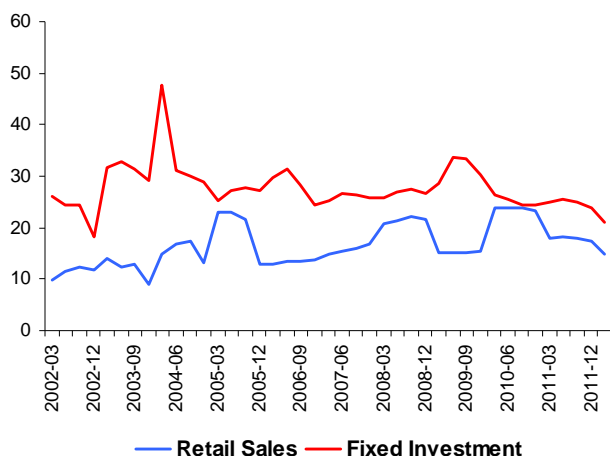
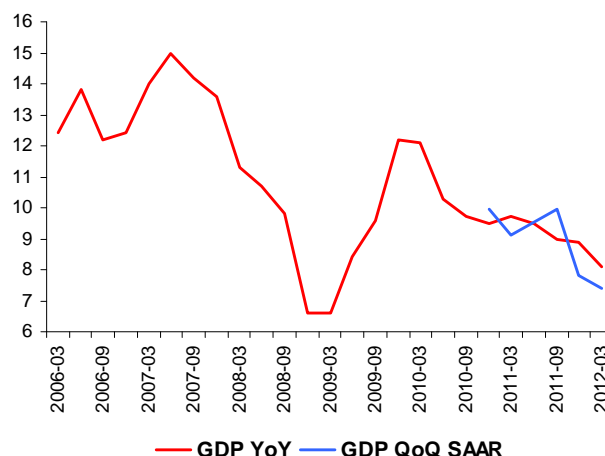


Chart 2: GDP slowed in both YoY and QoQ term



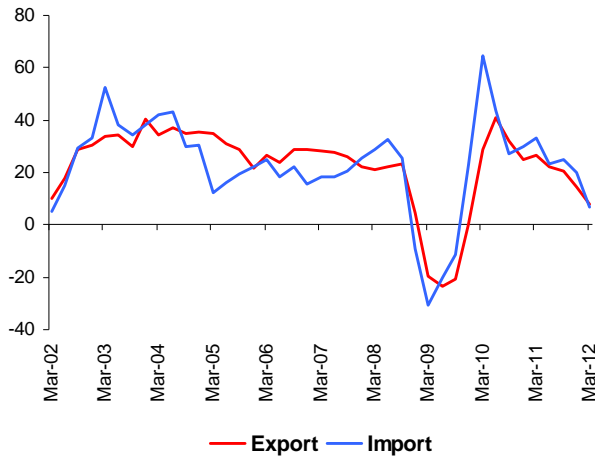
Source: CEIC, OCBC

External demand remained weak

China's export only grew 7.6% yoy in the first quarter. However, China managed to clock a small trade surplus in the first quarter, an improvement from a small deficit same period last year, as import growth also slowed to 6.8%. Although the trade surplus is expected to widen going into the second quarter, China's export outlook may remain uncertain this year due to two reasons. First, the global economic outlook remains unclear. Second, Chinese exporters are facing rising trade protectionism from developed economies.

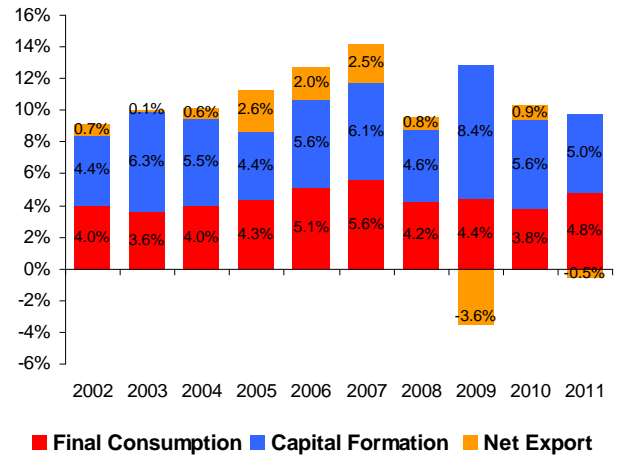
Nevertheless the impact of weak external demand on the Chinese economy is likely to be limited, as net exports has not been the driver for Chinese growth since 2009 following the global financial crisis. Weak global demand has been priced in the slowing Chinese growth and is unlikely to be a surprise factor to China's GDP this year.

Chart 3: Both export and Import growth slowed



Source: CEIC, OCBC

Chart 4: External demand has no longer been the driver to China's economic growth since 09

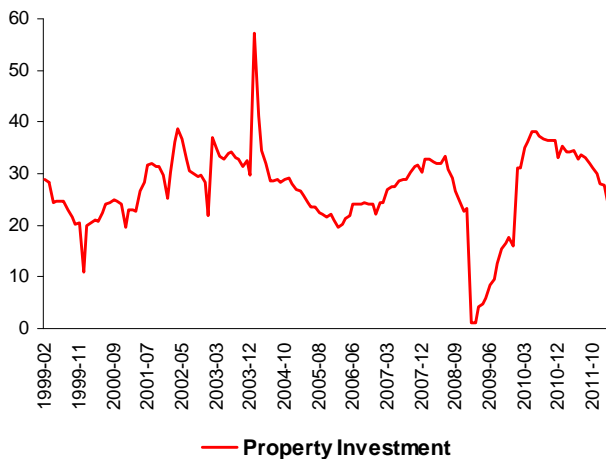


Tightening measures are taking effect

The downward trend of fixed investment suggests that the government's previous tightening measures have been taking effect. Taking infrastructure investment for example, it fell 2.1% yoy in Q1. Meanwhile, property investment growth slowed to 23.5%, down from the pace of 27.8% in February.

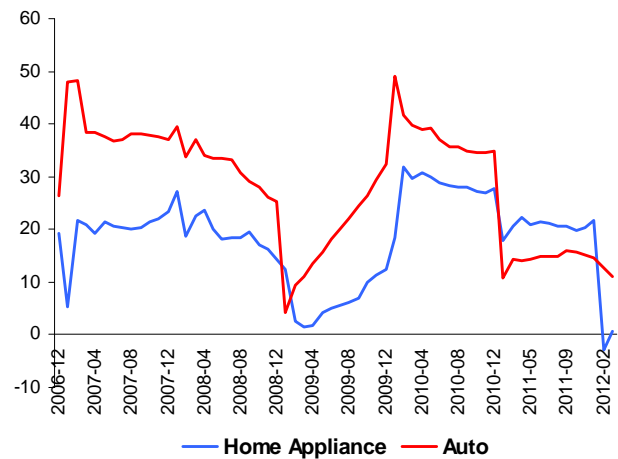
Nevertheless, the decline in consumption is a bit worrying. Retail sales in the first quarter grew 14.9% yoy down from 17.3% yoy in Q4 2011, and below the 10-year average of 16.9%. Both auto sales and electronics appliance sales slowed significantly to 11% and 0.6% in Q1 respectively down from 14.6% and 21.6% last year. This is partly due to the withdrawal of previous policy support, eg, expiry of "trading in old home appliance for new one" policy and new restriction on car registration in some cities.

Chart 5: Property investment slowed further



Source: CEIC, OCBC

Chart 6: Auto and home appliance sales slowed



Green shoots are emerging

We think Q1 is likely to be the bottom and the economy is likely to improve going forwards albeit at a slower pace on the back of the government’s easing credit and fiscal policies. We have spotted three green shoots including a more supportive credit policy, rising investment demand in Central and Western China, and rising income growth.

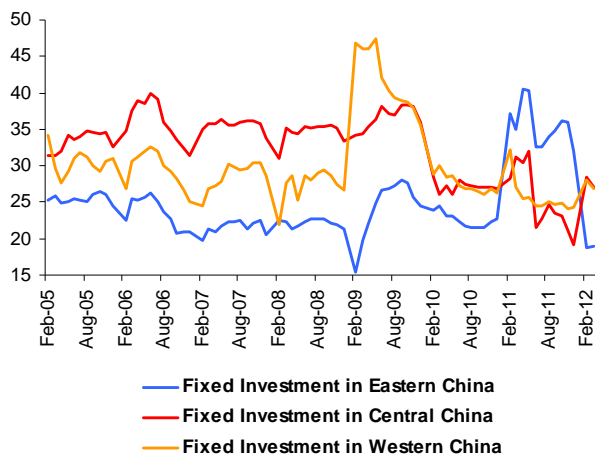
First, although monetary policy easing paused in March with no further reserve requirement ratio cut announced, there are signs that China has tweaked its previously tight credit policy. For example, China allowed banks to roll over their loans to certain local government projects. As a result, new Yuan loan rebounded unexpectedly to CNY1tn, which completely reversed the previously weak credit picture for the first two months. As a result, China’s money supply M2 rebounded to 13.4%.

The positive credit data suggested that the transmission mechanism from liquidity to credit in China is much smoother than the Euro zone where policy makers find it difficult to channel its massive liquidity generated from two LTROs to real economy. As such, we expect China’s credit data to normalize should Chinese policy makers loosen their lending restrictions. Therefore, we think Chinese new Yuan loan is likely to hit CNY8tn this year, which in turn will support the Chinese economy.

Second, investments in Central China and Western China remained strong, although investments in Eastern China slowed further in the first quarter. This rising investment demand in Central and Western China is likely to provide a buffer to the Chinese economy in our view.

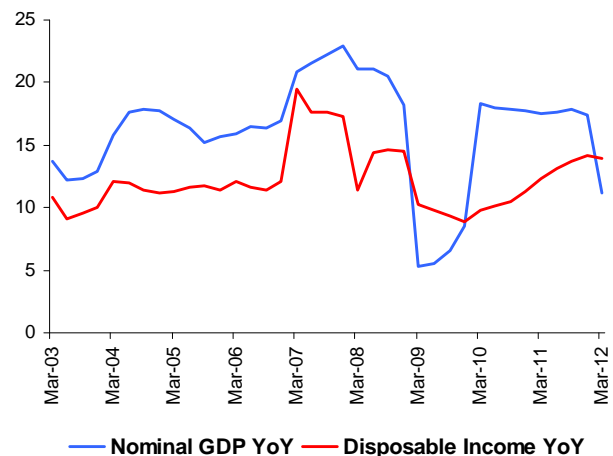
Third, China’s disposable income in urban area grew steadily at 14% in the first quarter, outpacing nominal GDP growth pace, for the first time in normal times (with the exception of the global recession period in 2009). The faster income growth was supported by government’s policy to raise threshold for income tax and minimum wages. The rising income level is likely to support domestic consumption going forward.

Chart 7: Fixed investment in Central and Western China remained strong



Source: CEIC, OCBC

Chart 8: Disposable income growth picked up supported by government policy



Monetary easing may be on hold after inflation surprised on the upside

China's CPI rose 3.6% in March, beating market expectations. Both food and non food components rose in a sequential basis. The impact of higher oil prices on China's inflation kicked in after China hiked its fuel prices in March. The higher than expected consumer inflation suggested that it is still too early for China to lower its guard against inflationary pressure, although our forecast for CPI to trend down gradually remains intact.

The stronger than expected credit data also down plays the odds of an interest rate cut as it is quite clear that China's loan demand is more sensitive to government's credit policy rather than price (interest rate). As such, we reiterate our view on no interest rate cut this year. Nevertheless, we still expect China to lower its RRR given the unclear capital flow outlook. However, the next RRR cut is likely to happen only in May given there is a huge amount of central bank bills maturing in April.

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