CHINA Insights

OCBC Bank

Growth may have peaked in 1Q

Monday, April 17, 2017

Highlights:

- **China kicked off 2017 with a strong start partly due to base effect as on the sequential basis the GDP growth slowed to seasonally adjusted 1.3% QoQ, lowest since China released the QoQ data from 2010.**
- **The recovery in the first quarter was genuine despite favourable base effect and was mainly attributable to two factors including steady global growth and improving private sentiment.**
- **The Chinese economy has benefitted from the resilient global recovery, which led to re-stock cycle.**
- **The still strong medium to long term loan demand from both corporate and household sectors shows that the optimism may continue in the second quarter.**
- **However, our call for a slower growth in the second half remained unchanged due to two reasons including less support from property sector as well as impact of tighter monetary policy as China is moving deeper into its de-leverage campaign as well as its intention to curb asset bubble in both equity and property markets.**

China's economic growth accelerated further to 6.9% yoy in 1Q 2017 from 6.8% yoy in 4Q 2016 although on the sequential basis the GDP growth slowed to seasonally adjusted 1.3% QoQ, lowest since China released the QoQ data from 2010. As such, the recovery of economic growth in 1Q was partially driven by base effect. Nevertheless, all three key growth data surprised the market on the upside. Industrial production and retail sales accelerated to 7.6% yoy and 10.9% yoy in March while fixed asset investment growth in the first quarter rebounded to 9.2% from 8.8% in the first two months.

We think the recovery in the first quarter was genuine despite favourable base effect and was mainly attributable to two factors including steady global growth and improving private sentiment.

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Chart 1: China's economic growth accelerated further

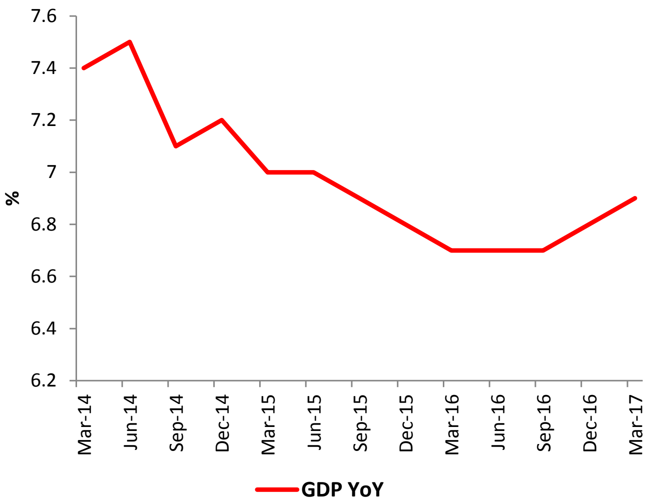
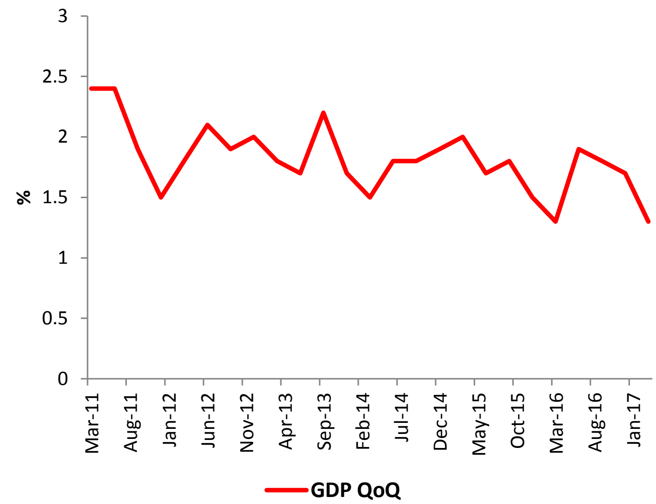


Chart 2: However, GDP fell on the sequential basis



Source: Bloomberg, OCBC

Steady global recovery

The heightening political uncertainty since 2016 has failed to disrupt the global recovery. JP Morgan global manufacturing PMI continued to pick up in the past few months to multi-year high. Clearly, the Chinese economy has also benefitted from the resilient global recovery, which led to re-stock cycle.

Manufacturing output continued to recover to 8% yoy in March together with improving export, which surged by 16.4% yoy in dollar term. The improving external demand was across board with exports to both advanced economies and emerging markets rose significantly.

Chart 3: Manufacturing output accelerated on the back re-stock cycle thanks to resilient global recovery

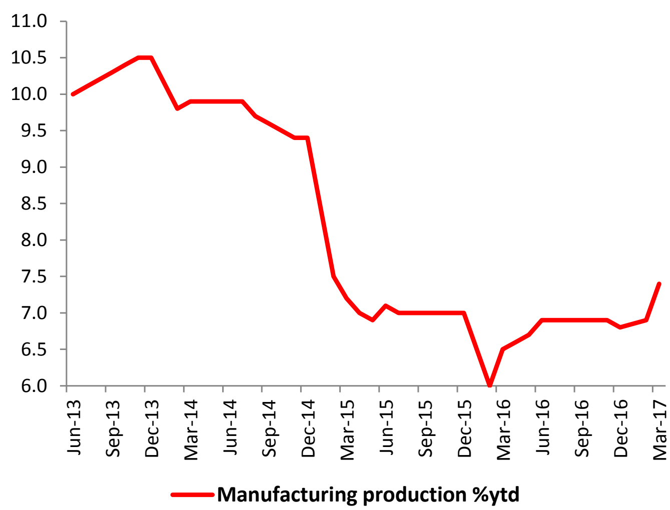
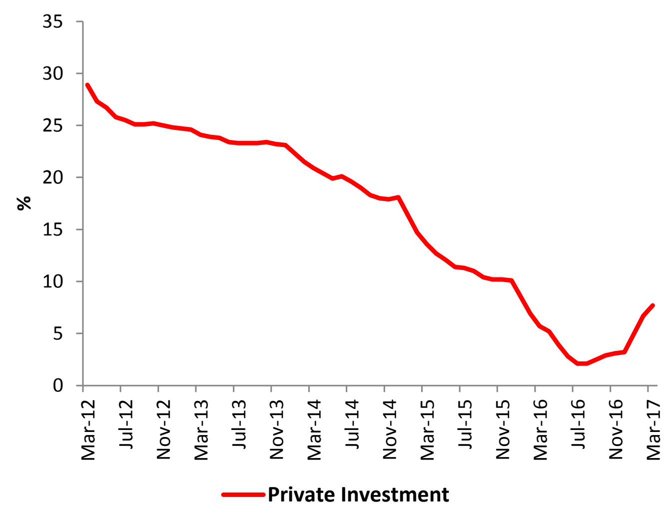


Chart 4: Private investment further accelerated to 7.7% in the first quarter, up from 3.2% in 2016.



Source: Bloomberg, OCBC

Improving private sentiment

Confidence from private sector also showed signs of improvement thanks to steady global recovery as well as confidence in domestic reform. Private investment growth, for example, accelerated further to 7.7% yoy in the first quarter from 3.2% in 2016. In addition, the stability in currency further helped boost private confidence.

Challenges ahead

Given a strong start in the first quarter, we think it is not a problem for China to achieve its "around 6.5%" growth target for 2017. The still strong medium to long term loan demand from both corporate and household sectors shows that the optimism may continue in the second quarter although GDP growth may have peaked in the first quarter. We expect China's GDP to stay above 6.5% in the second quarter. However, our call for a slower growth in the second half remained unchanged due to two reasons including less support from property sector as well as impact of tighter monetary policy.

Total property sales by value decelerated further to 25.1% in the first quarter while sales by size decelerated to 19.5% from 25.1% in the first two months due to further tightening measures. We expect property investment and sales to slow down further in the coming months. This may start to drag on the growth in the second half onwards.

In addition, de-leverage is the key focus for this year as China is working towards tackling high corporate debt problem. Therefore, asset growth in China's financial sector may decelerate in the coming months in particular after China's banking regulator released a number of regulations to keep bank's financial innovation in check recently. As such, both loan growth and money supply growth may slow further. This may eventually slow the economic growth in our view.

Chart 5: Property sales started to decelerate

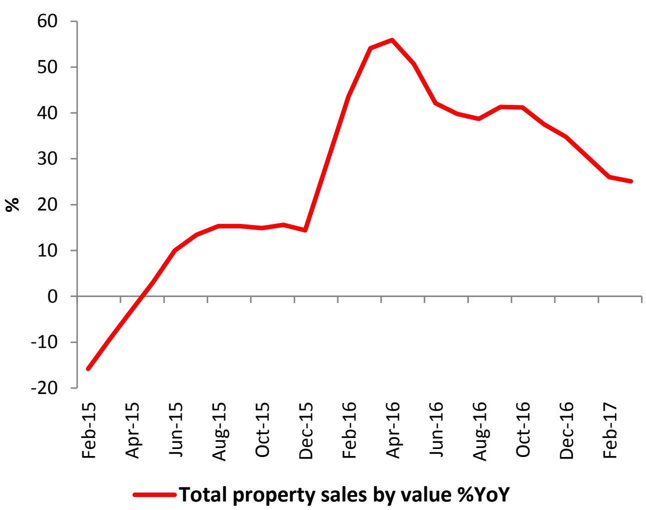
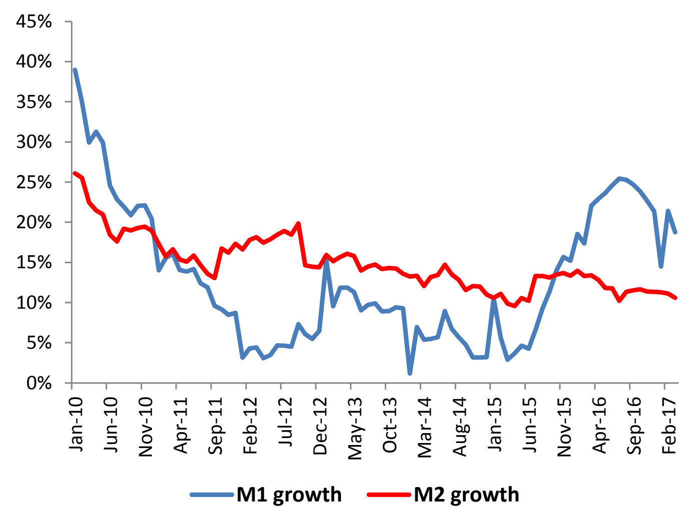


Chart 6: Money supply growth also slowed



Source: Bloomberg, OCBC

To conclude, we think it is a good and strong start for 2017. Nevertheless, it does not change our expectation for slower growth in the second half as China is moving deeper into its de-leverage campaign as well as its intention to curb asset bubble in both equity and property markets.

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