CHINA Insights

OCBC Bank

Moving away from the costly stability

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Highlights:

- **The incredible stability in China's economic growth may fuel speculation on the data quality. But we think the recovery since the second half of 2016 was genuine.**
- **The stability, supported by booming property market, easing monetary policy and proactive fiscal policy, came with costs as risk of asset bubbles heightened.**
- **Looking ahead, containing financial risk will be the key task for China in 2017. The change of focus to contain asset bubbles in 2017 shows that the economy is likely to find less support from the property market and monetary policy.**
- **Chinese policy makers have increasingly shown higher tolerance for a slower growth. As such, China is likely to lower its growth target to around 6.5% in 2017.**
- **We expect China's fiscal policy to remain proactive, which may be carried out via PPP. The increasing participation of SOEs in PPP may raise concern that the PPP may be used as channel to by-pass the regulation on local government funding vehicles.**
- **This is not the concern for 2017, as such, we expect China to grow 6.4%. But we need to monitor the potential credit risk arising from PPP, which could be the focus in 2-3 years' time.**

China's GDP growth edged up slightly to 6.8% yoy in December after a steady reading of 6.7% yoy for three consecutive quarters. For the whole year, the economy grew by 6.7% yoy in 2016, well on track to achieve its growth target of 6.5-7%.

The incredible stability in China's economic growth may fuel speculation on the data quality again in particular after the Governor of Northeast China's Liaoning province admitted this week that some officials fabricated data from 2011 to 2014. We think there is no need for us to over-read this news as this is not the first time for Liaoning officials to admit the data fabrication. Back in late 2015, this scandal has already emerged. The Northeast China has been the main loser to China's economic restructure due to its heavy reliance on secondary industries. This is probably the key reason behind the data fabrication.

Chart 1: Private investment continued to recover

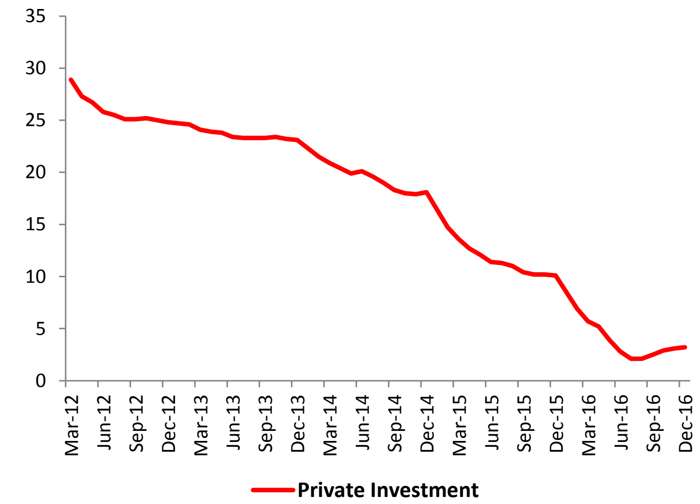
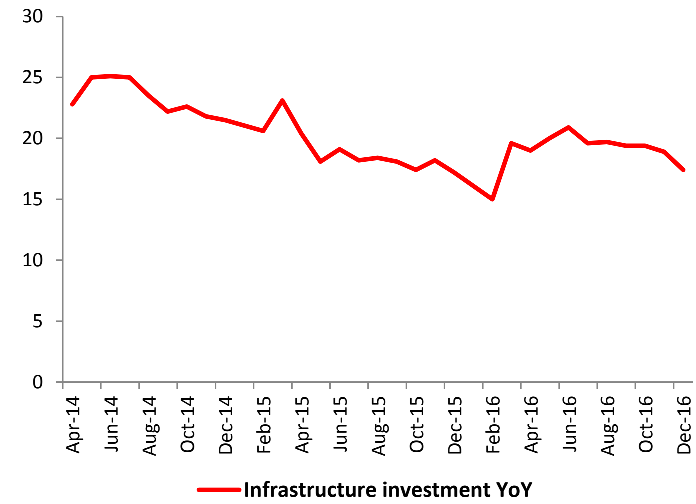


Chart 2: Infrastructure investment remains the key support



Source: Bloomberg, OCBC

Despite the concern about the credibility of data, we think the recovery since the second half of 2016 was genuine. The stable growth in 2016 despite uncertain global environment was mainly attributable to three factors including booming property market, easing monetary policy and proactive fiscal policy. Looking at today's data, private investment continued to recover despite the deceleration of headline fixed asset investment. This signals the return of private confidence. In addition, infrastructure investment grew by 17.4% yoy in 2016 as a result of proactive fiscal policies.

The stability came with costs

However, the stability came with costs as risk of assets bubbles has emerged in both property and bond market after the burst of equity bubble in 2015. Since late September 2016, some Chinese cities have launched two rounds of property tightening measures, which led to the mild decline of property prices in December.

On bond front, PBoC started to replace the short end liquidity via net withdrawal from open market operation with more expensive medium term liquidity via MLF injection. As a result, bond prices have declined since late October. In the latest Central Economic Working Conference, China has changed its monetary policy tone to prudent and neutral from prudent. This sounds quite similar at a first glance. However, after reading between the lines, it clearly shows a tight bias monetary policy framework.

Slower growth expected

Looking ahead, containing financial risk will be the key task for China in 2017. The change of focus to contain asset bubbles in 2017 shows that the economy is likely to find less support from the property market and monetary policy. Chinese policy makers have increasingly shown higher tolerance for a slower growth. As such, China is likely to lower its growth target to around 6.5% in 2017 from 6.5-7% range.

Kicking the can down the road

We expect China's fiscal policy to remain proactive. As such, this will set the floor for GDP growth, which is expected to slow to 6.4% in 2017 in our view. The proactive fiscal policy is likely to be carried out via public private partnership (PPP). Since 2014 after China tightened its regulation on local government funding vehicles, local governments have explored funding infrastructure via PPP models. According to government estimation, PPP funded local projects worth about CNY13 trillion.

PPP is a good initiative, however, with the increasing participation of SOEs in PPP projects. The concerns that PPP may be used as the channels to bypass the regulation on local government funding vehicles heightened again. This is unlikely to be the problem for 2017, however, it is worthwhile monitoring the potential credit risk arising from the PPP.

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