

Economic Analysis

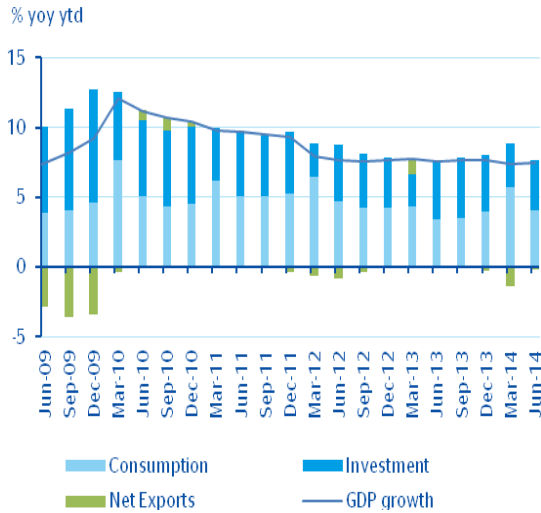
Q2 GDP figures point towards a recovery of China's economy

Le Xia, Jinyue Dong and Carlos Casanova

China's second quarter GDP figures surprised on the upside, increasing to 7.5% y/y, from 7.4% y/y in the previous quarter (Chart 1). This was slightly higher than market expectations (BBVA: 7.3% y/y; Consensus: 7.4% y/y), showing signs of stabilization. In sequential terms, Q2 GDP was 2.0% q/q sa, increasing from 1.5% q/q sa in Q1. The stabilizing trend is due to the authorities' mini-stimulus policies, which were first implemented in March this year, as well as improving external demand. Other June economic indicators further confirm this trend, including improving industrial production which is 9.0%; compared with previous 8.8%, and stabilizing retail sales which is 12.4%, compared with previous 12.5%. Despite large-scale interventions are unlikely, we expect the Chinese government to continue to implement growth-supportive measures (such as the mini-stimulus policies) to sustain moderate growth in the coming quarter, providing momentum to the current stabilizing trend in the second half of the year.

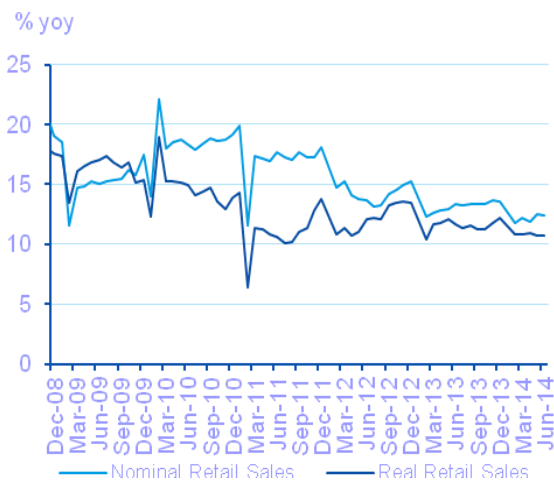
- **Second quarter GDP growth has stabilized, as have other economic indicators.** Official data indicates that Q2 GDP growth is slightly higher than that of Q1 (Chart 1). Detailed analysis of expenditure components is difficult because the NBS is still working on verifying demand side data. Nonetheless, June activity indicators are hinting towards economic stabilization. Export data suggests a gradually improving external environment, while industrial production growth accelerated to 9.2% y/y in June, up from 8.8% in Q1. June's urban fixed asset investment growth was 17.3% y/y, also a notch higher than that of May (17.2%), primarily due to stable infrastructure and rising manufacturing investment (Chart 2), although real estate investment is decreasing. Meanwhile, retail sales growth slowed down marginally to 12.4 % y/y, compared to 12.5% in previous month (Chart 3).
- **Credit growth in June was solid and broad-based, as the authorities use monetary instruments to ensure stable liquidity to support growth.** The "total social financing", the broadest gauge of credit, increased to 1970.0 billion RMB in June from 1404.5 billion RMB in May; while new bank loans increased to 1.08 trillion RMB in June compared to 870.8 billion RMB in May (Chart 4). Meanwhile, M2 growth rose to 14.7% (versus 13.4% in May), due to increasing loan growth as well as capital inflows, reducing fears of a potential liquidity squeeze. On balance, the increasing in credit growth has reflected stronger demand from the real sector as well as the government's modest supportive policies of credit growth to sustain economic growth.
- **On the policy front, we expect authorities will maintain modest mini-stimulus policies instead of implementing large-scale stimulus.** The Chinese authorities have indicated that they are determined to move forward long-term structural reforms at the expense of short-term growth; provided that a healthy employment rate is maintained. We anticipate that the authorities will continue to implement modest mini-stimulus policies in the second half of 2014 to prevent growth momentum from falling below their tolerance level, as well as in order to maintain social stability. Based on these factors, we believe that the Chinese authorities will be capable of avoiding an economic hard landing, promoting the current stabilization trend in the quarter ahead.

Figure 1
GDP growth has been stabilizing in Q2



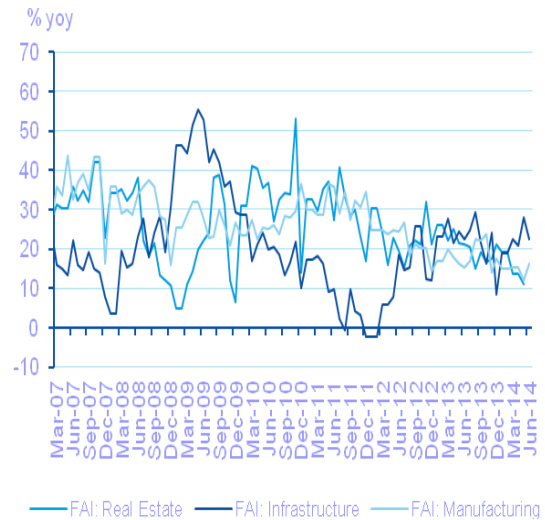
Source: CEIC and BBVA Research

Figure 3
Retail sales growth decreases slightly



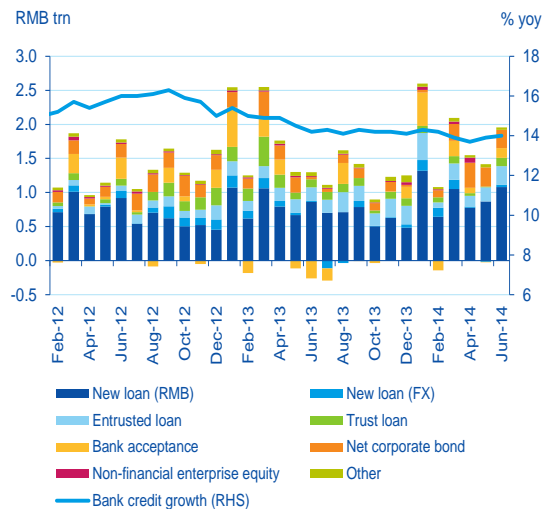
Source: CEIC and BBVA Research

Figure 2
FAI increases due to rising infrastructure and stable manufacturing investment



Source: CEIC and BBVA Research

Figure 4
Solid broad-based credit growth in June



Source: CEIC and BBVA Research

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