Economic Analysis

China's growth outlook is still subject to mounting headwinds despite the achieved soft-landing in 2014

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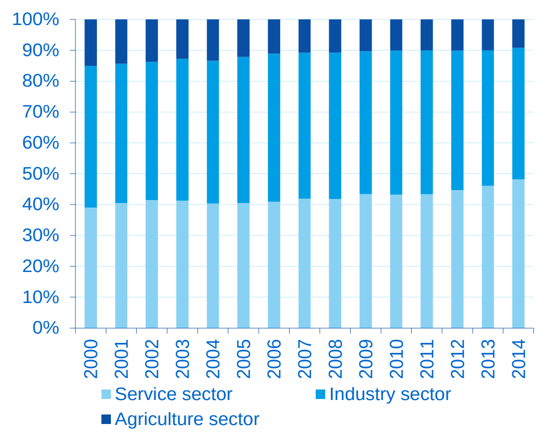
China's fourth quarter GDP growth came out at 7.3% y/y, flat with that of the previous quarter and broadly in line with market expectation (Consensus: 7.2% y/y). In sequential terms, Q4 GDP expanded at a pace of 1.5% q/q sa, decreasing from 1.9% q/q sa in Q3. As a consequence, 2014 GDP increased by 7.4%, registering the lowest growth rate since1991. A number of activity indicators in December were also released today, including industrial production, urban fixed asset investment and retail sales, which are broadly in line with market expectations. All in all, a soft-landing is achieved again in 2014 thanks to the authorities' pro-growth measures. Nevertheless, we believe that the growth outlook is still subject to a number of headwinds such as the sluggish property market, increasing indebtedness of local governments and firms as well as the continuous expansion of the shadow banking sector. In view of them, our 2015 GDP projection is kept at 7.0% as before. On the policy front, we anticipate more conventional monetary easing will be implemented in 2015 to sustain domestic demand and prevent a hard-landing.

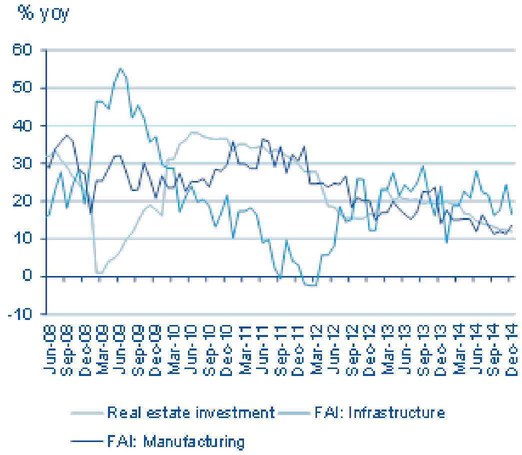
- **2014 GDP outturns indicate that economic rebalancing is on the track.** According to the press briefing right after the GDP data release today, consumption expenditure contributes 51.2% of GDP growth in 2014, increasing by 3 ppt compared to the last year. Moreover, industry structure is improving as the tertiary industry accounted for 48.2% of total output, increasing by 1.3 ppt from the last year. In the meantime, the contribution of the secondary industry decreased to 42.6% of GDP in 2014 from 44.2% in 2013. (Figure 1) More importantly, household income growth in real term increased by 8.0% from the last year, surpassing the growth rate of GDP, which is one of important goals for the authorities.
- **December economic activity indicators released today are broadly in line with market expectations.** Industrial production growth rebounded to 7.9% y/y in December, up from 7.2% in the previous month, beating the market expectations of 7.4%. On the demand side, urban fixed asset investment edged down to 15.7% YTD y/y from 15.8% in November (Consensus: 15.7% YTD y/y), mainly led by anemic investment in real estate sector. (Figure 2) Meanwhile, retail sales growth climbed up to 11.9% y/y, compared to 11.7% y/y in the previous month, which also outperform the consensus of 11.7% (Figure 3).
- **Looking ahead, we anticipate more monetary easing policies to be implemented in 2015.** The 2014 GDP outturn has slightly missed the government's growth target 7.5%. We expect that the government will tolerate more of economic growth and downward adjust the growth target to 7.0% for 2015, as the authorities want to push forward the structural reforms and promote "New Normal" growth. (Figure 4) On the policy front, the PBoC cut interest rates in last November, which was very likely to set off a series of conventional monetary loosening measures in the coming months as the authorities are keen to sustain domestic demand and prevent an economic hard-landing. We project two additionally interest rates cuts in the first half of this year. In the meantime, we forecast that the authorities will trim the Required Reserve Ratio (RRR) at least twice between now and the end of 2015.

Figure 1
2014 GDP outturns show economic rebalancing is on the track



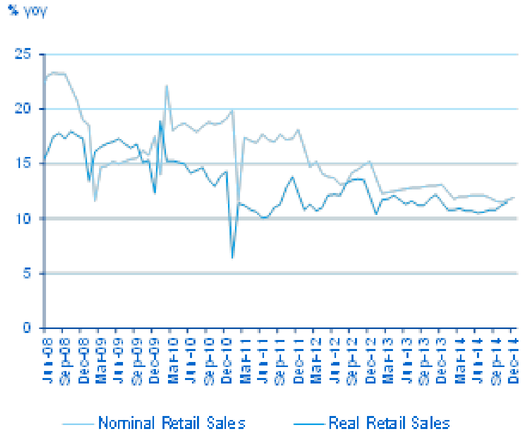
Source: CEIC and BBVA Research

Figure 2
FAI further moderated led by anemic investment in real estate



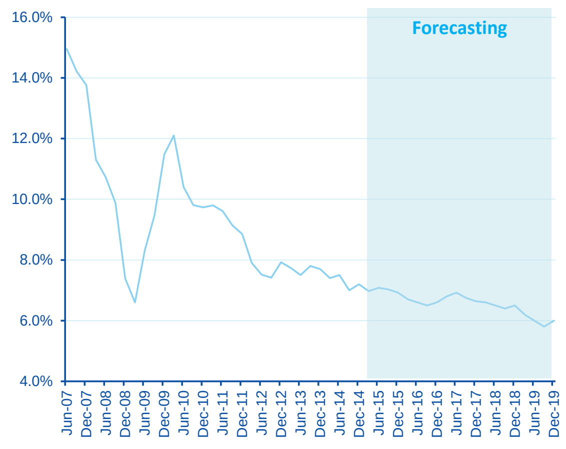
Source: CEIC and BBVA Research

Figure 3
Retail sales growth is still resilent



Source: CEIC and BBVA Research

Figure 4
2015 GDP is projected to expand by 7.0%



Source: CEIC and BBVA Research

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