Economic Analysis

China | Growth deceleration is set to continue amid increasing volatility but no hard-landing in sight

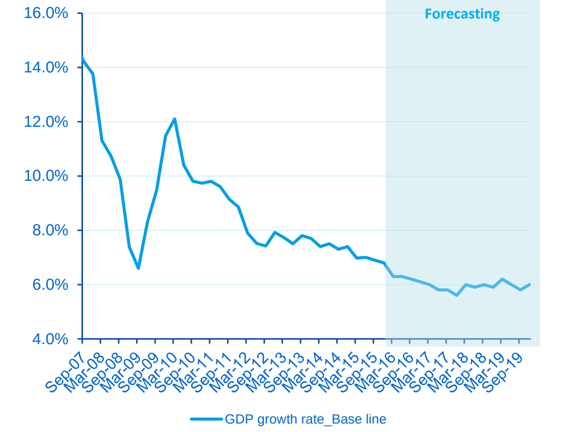
Jinyue Dong / Le Xia

Today's announced Q4 GDP and a number of December activity indicators suggest an economic soft-landing has been achieved in 2015, despite a series of financial disruptions including the stock market selloffs and the unexpected devaluation of the RMB in the second half of the year. In particular, Q4 GDP expanded at 6.8% y/y (BBVA: 6.8% y/y versus Consensus: 6.9% y/y), edging down from the Q3 outturn of 6.9% y/y and registering the lowest since Q1 2009. In sequential terms, growth pace slowed down to 1.6% q/q sa in the fourth quarter from 1.8% q/q sa previously, indicating that growth downtrend continues. For 2015 as a whole, GDP growth amounted to 6.9%, broadly in line with the government target of around 7%.

Nevertheless, it is more important to realize that the headwinds to China's growth haven't abated yet as evidenced by a number of December activity indicators announced with Q4 GDP figure. The authorities therefore need to continue their pro-growth measures to avoid a hard-landing in 2016. We maintain our growth projections of 6.2% and 5.8% for 2016 and 2017 respectively, while highlight the rising risks in financial markets and their adverse spill-over effect to the real economy. (Figure 1)

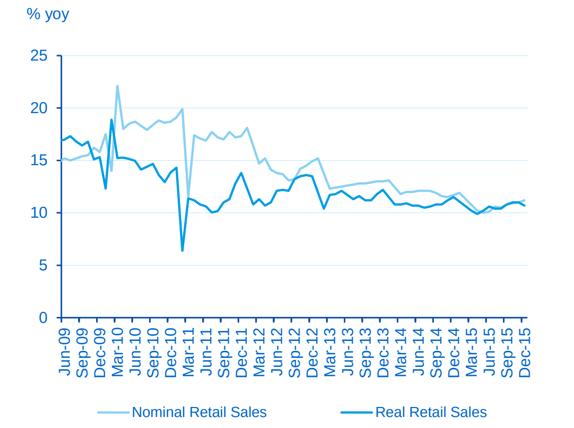
- **December activity indicators are lower than both market expectations and the previous readings.** Retail sales growth modestly declined to 11.1% y/y in December (consensus: 11.3% y/y) from 11.2% y/y in November, indicating people are more reluctant to consume due to the wealth effect of the financial market turmoil. (Figure 2) Growth of industrial production declined to 5.9% y/y in December from 6.2% y/y in the previous month, below the market expectation of 6.0% y/y. (Figure 3) It indicates that the pressure on the manufacturing sector is still large due to the prevalent overcapacity problem. Following a similar trend, urban fixed asset investment decreased to 10.0% YTD y/y in December (Consensus: 10.2% YTD y/y; Prior: 10.2% YTD y/y). The sluggish investment is led by the real estate sector, in which a large chunk of property inventory and passive market expectations keep hindering new investment.
- **The economic rebalancing is continuing.** The three sector decomposition suggests that China's economy is undergoing a rebalancing toward the service sector in 2015. The ratio of service sector to total GDP reached 50.5%, increasing by 2.4% from the previous year. (Figure 4) By expenditure, final consumption accounted for 66.4% of GDP growth in the 2015, significantly higher than the level of 51% registered in the previous year.
- **Looking ahead, we anticipate more easing measures to be deployed to support growth.** The headwinds to China's growth haven't abated yet as evidenced by a number of December activity indicators announced with Q4 GDP figure. That being said, the authorities need to deploy more easing measure to spur growth and avoid a hard-landing scenario in 2016. On the monetary policy front, the FED's interest rate hike and China's RMB devaluation may constrain the PBoC from trimming interest rate. Therefore, we project four RRR cuts with 50 bps each time and more asymmetric interest rate cuts in 2016. At the same time, some other unconventional monetary measures will also be deployed. On the fiscal front, the central government is likely to substantially expand fiscal budget deficit to above 3% in 2016 and 2017. The thrust should be to avoid sharp fiscal consolidation at the local government level. Moreover, in addition to infrastructure investment, the authorities could consider more tax cuts for the corporate sector and increase public spending on social wellbeing.

Figure 1
We maintain our GDP forecasting at 6.2% for 2016 and 5.8% for 2017 in our baseline scenario



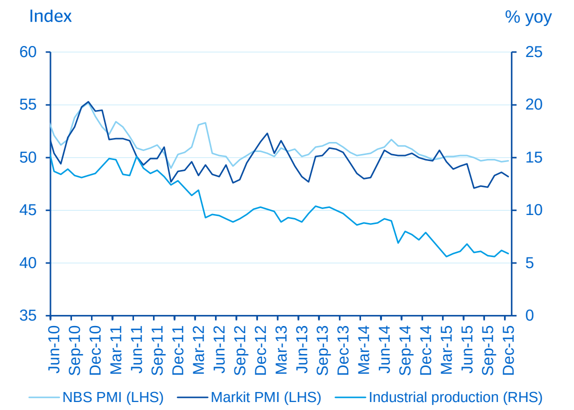
Source: CEIC and BBVA Research

Figure 2
Retail sales modestly slowed down, reflecting the wealth effect of financial market turmoil



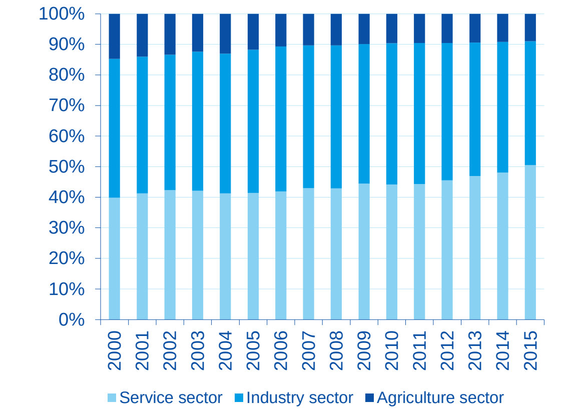
Source: CEIC and BBVA Research

Figure 3
Industry production surprised the market to the downside in December



Source: CEIC and BBVA Research

Figure 4
Q4 GDP outturns show economic rebalancing is on the track



Source: CEIC and BBVA Research

DISCLAIMER