ECONOMIC ACTIVITY PULSE

China | Strong start to 2017 but headwinds abound

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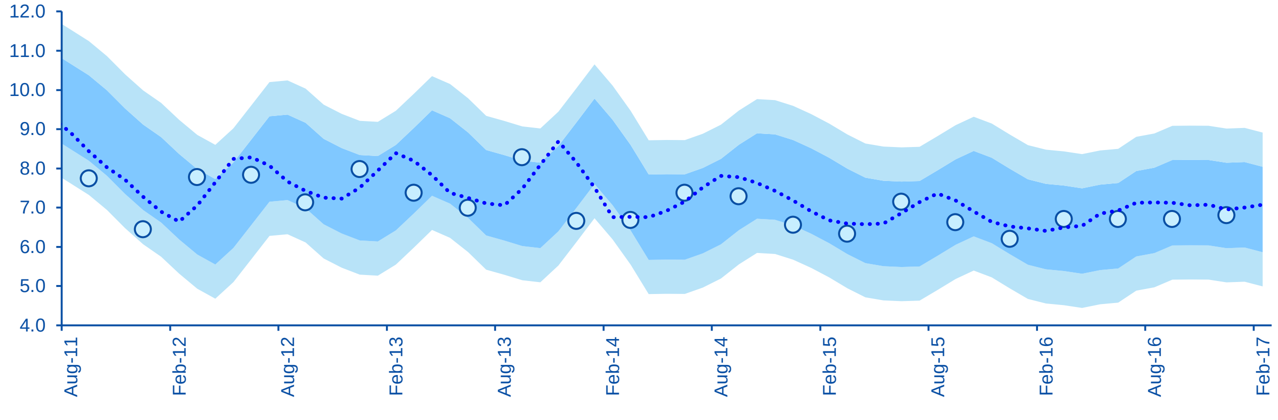
Last year's recovery continued into 2017. The latest data releases point towards another month of strong growth. In particular, fixed asset investments and industrial production strengthened in February, while trade figures improved in line with a pickup in global activity. We expect growth to edge down towards 6.0-6.5% by year-end, as headwinds remain. These include expectations of RMB depreciation in case of a faster rate lift-off by the Fed, mounting levels of corporate debt and a potential correction in housing prices.

Last year's stabilization extended into 1Q17 on the back of IP and FAI

Our monthly GDP model shows a strong rebound in February, leading to growth of around 7.0% y/y (Fig. 1). In particular, IP increased by 6.3% y/y up from 5.8% in the previous month (Fig. 2); while FAI surged to 8.9% y/y, up from 8.3%. Trade figures were also supportive (Fig. 3). Combining data for January and February to account for disruptions around Chinese New Year, we saw exports improve by 3.3% y/y while import growth accelerated to 30% y/y. The former is in line with a significant pickup in global trade while the latter can be traced back to higher commodity prices and infrastructure spending at local level. On the other hand, consumption has shown some signs of weakness, as reflected by retail and auto sales (Figs. 4 and 5), which could weigh on the economy in the months to come. On this note, headwinds have not vanished yet, so we expect growth to edge downwards towards 6.0%-6.5% by year-end. The main risks include expectations of steeper RMB depreciation in case the Fed hikes rates more aggressively than expected, mounting levels of corporate debt and a potential correction in housing prices.

Figure 1
China: BBVA Research Monthly GDP* (YoY%)

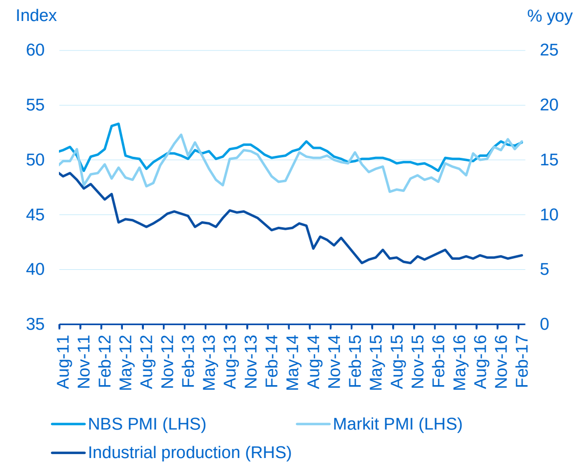


Source: Nowcasting DF Model, BBVA Research
*BBVA Research monthly GDP is dynamic factor model (DFM) synthesizing high-frequency indicators to proxy monthly growth of GDP

New targets for 2017 point towards continued focus on growth

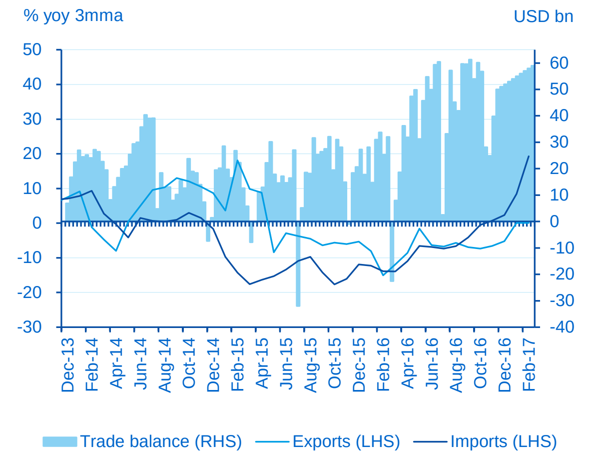
During the National People's Congress, the authorities lowered their growth target for 2017 to "around 6.5%". We welcome this move and believe that a more flexible range between 6.0-6.5%, in-line with our forecast for 2017, would be more adequate in order to reign in financial vulnerabilities while simultaneously ensuring stability ahead of October's Communist Party Congress.

Figure 2
Stable PMI and better IP figures



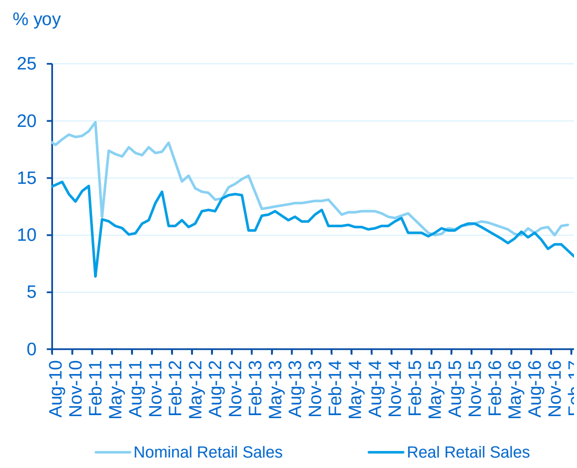
Source: BBVA Research and CEIC

Figure 3
Trade data reflective of global pick-up



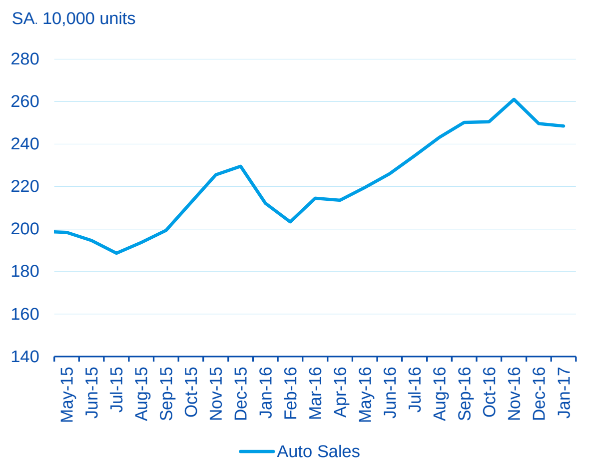
Source: BBVA Research and CEIC

Figure 4
Real retail sales deteriorate



Source: BBVA Research and CEIC

Figure 5
Auto sales subdued on weak consumption



Source: BBVA Research and CEIC

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