China Flash

Q1 GDP disappoints, but room for continued supportive policies should help sustain growth

First quarter GDP growth came in at a weaker-than-expected 7.7% y/y (consensus: 8.0% y/y; BBVA: 8.2%), down from 7.9% y/y in Q4 2012 (Chart 1). In addition, a set of monthly activity indicators for March released today were also below expectations, including industrial production (8.9% y/y vs. consensus: 10.1%) and fixed asset investment (20.9% y/y, ytd vs. consensus: 21.3%), while retail sales growth was in line with expectations (12.6% y/y vs. consensus: 12.6%) (Charts 2-4) and credit growth, released last week, exceeded expectations. We attribute the weak Q1 GDP outturn to policy uncertainty that may have dampened investment, and sluggish domestic demand momentum, signalling that the economic pickup since Q3 of last year is not yet fully self-sustaining. On balance, while the outlook for external demand remains uncertain and downside risks have increased, we believe our 8.0% GDP projection for 2013 remains achievable, given strong credit growth and still-low inflation (2.1% y/y in March). The latter should provide room for policies to remain simulative and reduce prospects of an early tightening as the authorities seek to balance support for the economy against rising risks of domestic financial fragilities.

- **GDP growth slows to 7.7% y/y in Q1 on weak investment**. On a sequential basis, officially reported quarterly growth slumped to 1.6% seasonally adjusted (6.6% annualized), the slowest pace since Q1 2012. According to the National Bureau of Statistics (NBS), domestic consumption (including by the government) led growth in Q1, contributing 4.3 ppts, followed by investment (2.3 ppts), and net exports (1.1 ppts). From this perspective, investment was the weak spot, as its contribution to growth was significantly below previous quarters (3.9 ppts in 2012). Despite ongoing public infrastructure spending, the weak investment outturn may be due to the dampening effect of policy uncertainty from the authorities' efforts to prevent housing prices from accelerating and to curb the growth of local government debt and shadow bank lending. There is also anecdotal evidence that inventory accumulation may be slowing.
- **Activity indicators in March continue to reflect a mixed picture of growth momentum**. Most of the indictors released today were below expectations. On the supply side, industrial output continued to decelerate, and on the demand side, urban fixed asset investment growth slowed, putting an end to encouraging outturns in January/February. Property investment in particular decelerated significantly in March to 12.6% y/y from 22.8% y/y in January/February, while manufacturing investment picked up to 19.9% y/y from 17.0% in January/February.
- **Weaker growth momentum and benign inflation provides room for continued policy support.** Policy uncertainty in the past quarter may have dampened investment spending as the new leadership team was officially installed in March, and as the authorities' have placed emphasis on containing domestic financial fragilities, including measures to slow the pace of housing price increases, shadow banking lending, and build-up of local government debt. Going forward, we expect the authorities to continue to strike a balance between containing risks of financial fragilities while providing fiscal and monetary support for growth. In particular, today's weak growth outturn shifts the policy balance slightly back towards fostering growth in line with the authorities' 7.5% growth target (which has been comfortably exceeded in the past). While we do not currently expect additional stimulus measures in the form of interest rate cuts or stepped up spending, prospects for further tightening have been reduced. Should growth weaken further, however, there would be room for additional policy support.

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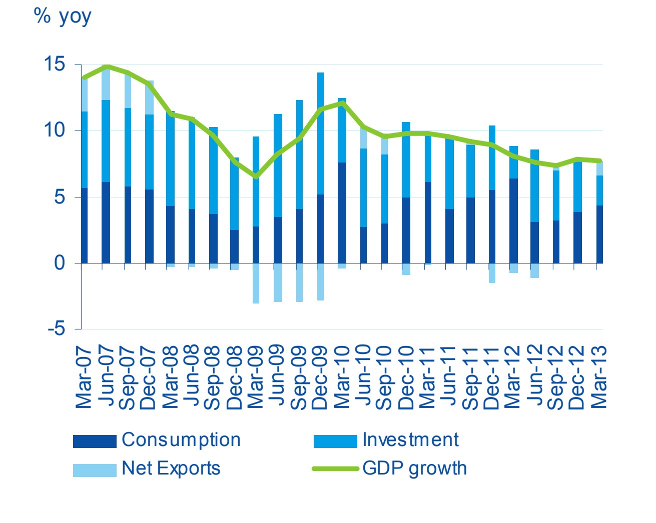
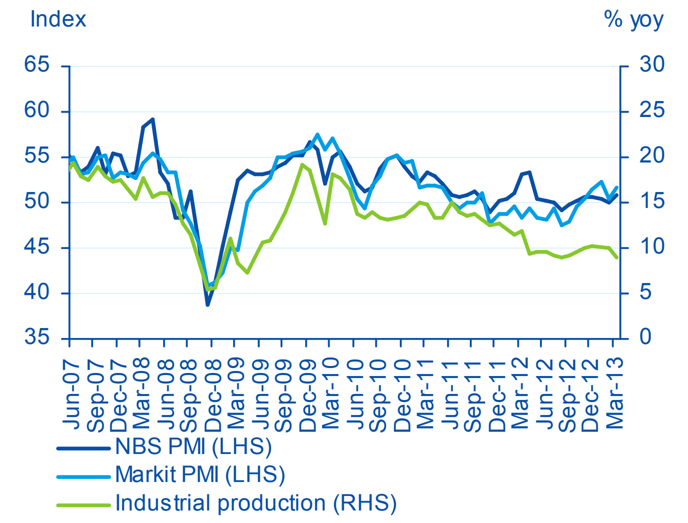
Chart 1
GDP growth slows in Q1 on weaker investment



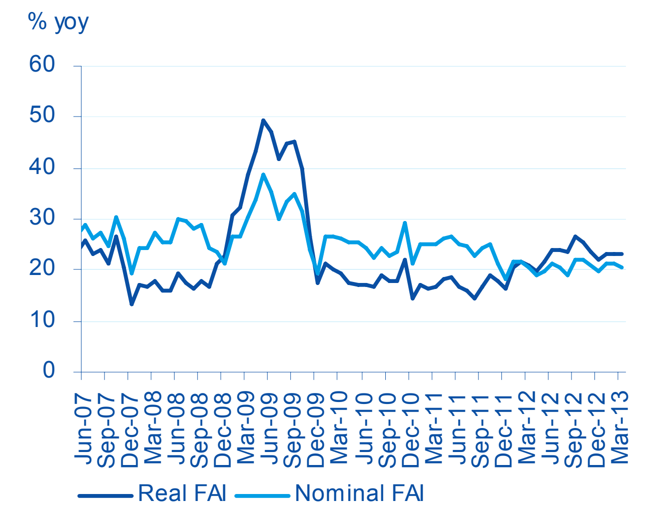
Source: CEIC and BBVA Research

Chart 2
Industrial production falls, while PMIs hold up



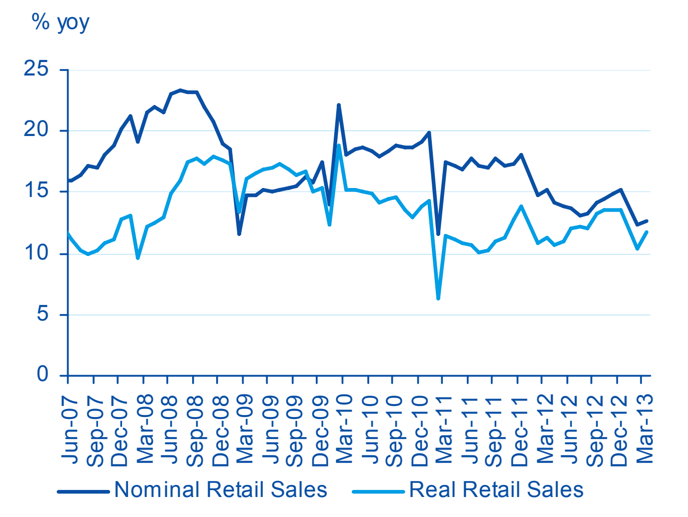
Source: Wind and BBVA Research

Chart 3
…while fixed asset investment edges down…



Source: CEIC and BBVA Research

Chart 4
… and retail sales tick up in March



Source: Wind and BBVA Research

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