China Flash

Q2 GDP slows in line with expectations, as authorities reiterate 7.5% growth target

Second quarter GDP growth registered 7.5% y/y (BBVA: 7.6%; consensus: 7.5%; previous 7.7%), continuing the gradual slowdown in place over the past 4-6 quarters (Chart 1). The outturn brings growth for the first half of the year to 7.6% y/y, just above the official full-year target of 7.5%. Regarding the latter, China's official news agency Xinhua over the weekend reiterated the 7.5% growth target after confusion over a reported quote by the Finance Minister last Friday suggesting the target may have been lowered. Meanwhile, a set of monthly activity indicators for June released today (Charts 2-4) suggest that industrial production (8.9% y/y vs consensus: 9.1%) continues to weaken, while investment (20.1% y/y ytd; consensus: 20.2%) and retail sales (13.3% y/y; consensus: 12.9%) are holding up, the former due to public spending. Looking ahead, we expect full-year growth to remain at or slightly above the government's target on continued public spending and a gradual improvement in external demand and exports (which have weakened so far, Chart 5). In contrast, while we expect growth to maintain its momentum in 2014, the outlook is uncertain in light of declining potential growth and as we evaluate the government's reluctance for stimulus measures in view of their preference for curtailing financial fragilities.

- **GDP growth of 7.5% y/y in Q2 was sustained by public investment.** Official q/q growth data (which in our view is less reliable than the year-over-year data) registered 1.7% q/q sa (7.0% annualized) from 1.6% in Q1 (6.6% annualized). According to NBS officials, for the first half of the year investment led growth, contributing 4.1 ppts, followed by total consumption (3.4 ppts), and net exports (0.1 ppts). Detailed analysis for Q2 is difficult because of the lack of demand side data. Nevertheless, the reported figures would imply a very large contribution of investment in Q2 (5.7ppts by our preliminary estimates), which would reflect strong public spending on infrastructure and social housing
- **Activity indictors for June continued to weaken**. On the supply side, industrial production growth declined (8.9% y/y from 9.2% in May), although electricity consumption growth – an alternative indicator of underlying industrial activity -- rose to 6.3% y/y (from 5.2% in May). On the demand side, urban fixed asset investment growth slowed further on weak manufacturing (see Chart 3), although investment in infrastructure and the property sector held up relatively well; meanwhile, nominal retail sales increased more than expected.
- **Policies are expected to remain mildly supportive of growth, in line with the 7.5% full-year GDP target.** The delicate tradeoff continues between supporting near-term growth on the one hand, while refraining from stimulus so as to curtail financial fragilities (shadow banking activity, local government debt, and rising housing prices). If growth slows further, we would expect the balance to shift slightly in favor of support for near-term growth, which could take the form of front-loaded fiscal spending and tax cuts. With inflation low (2.7% y/y in June), there is also room for monetary easing, although we do not expect it at the current juncture given the focus on curtailing shadow banking activities. We will look for further details of the government's policy intentions in the forthcoming Mid-Year Economic Conference later this month (not yet scheduled) and the Annual Party Meeting in October.

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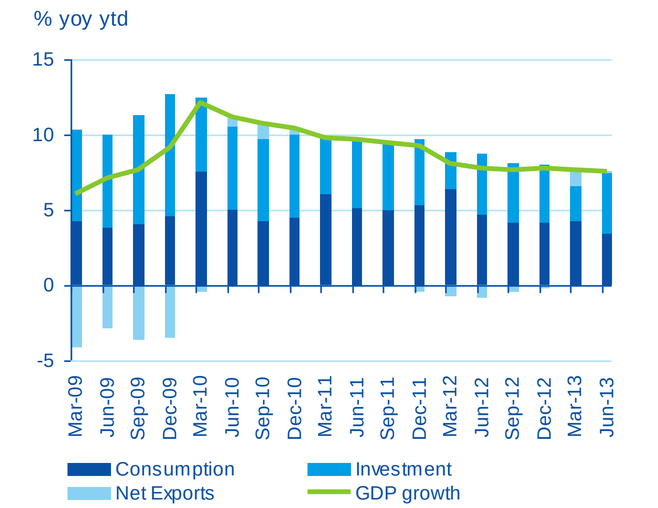
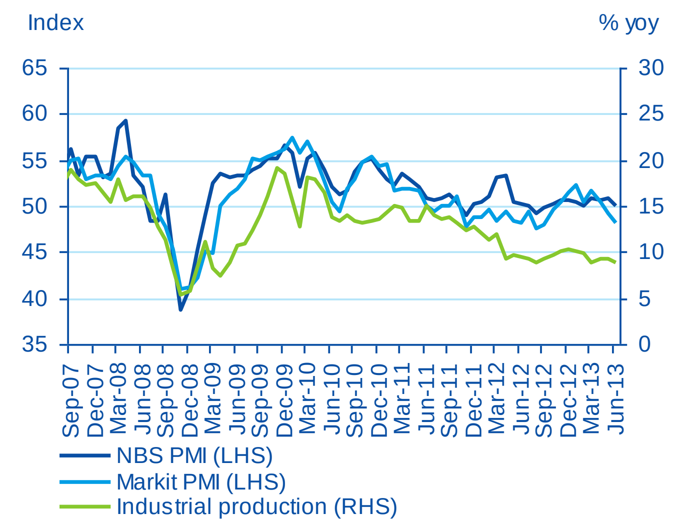
Chart 1
GDP growth continued to slow in Q2…



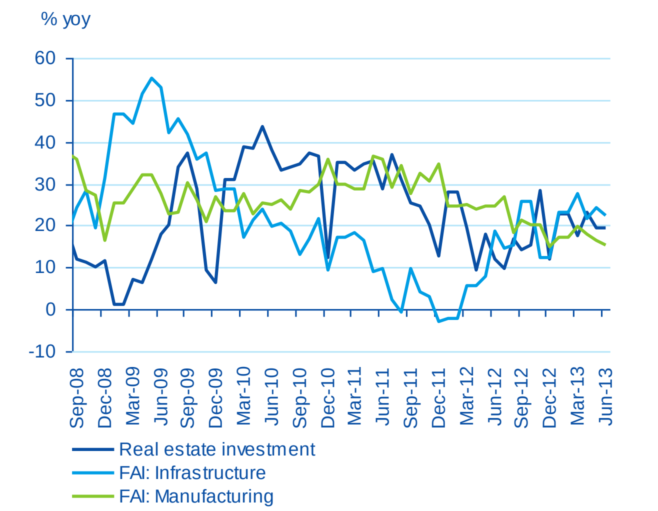
Source: CEIC and BBVA Research

Chart 2
…as industrial production eases



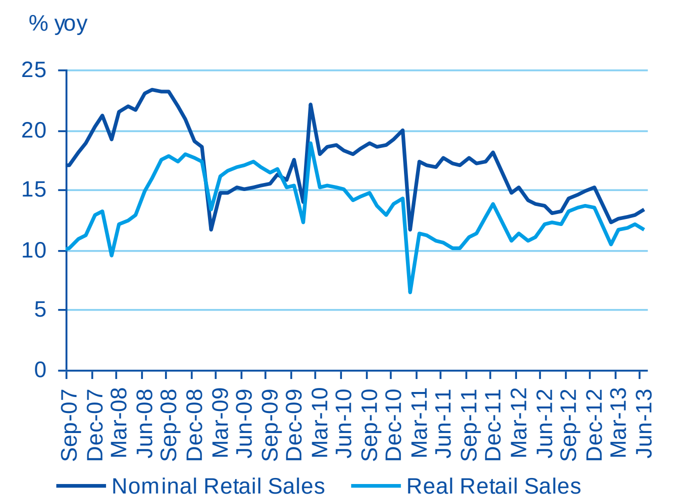
Source: Wind and BBVA Research

Chart 3
Weak manufacturing investment is offset by infrastructure and housing investment…



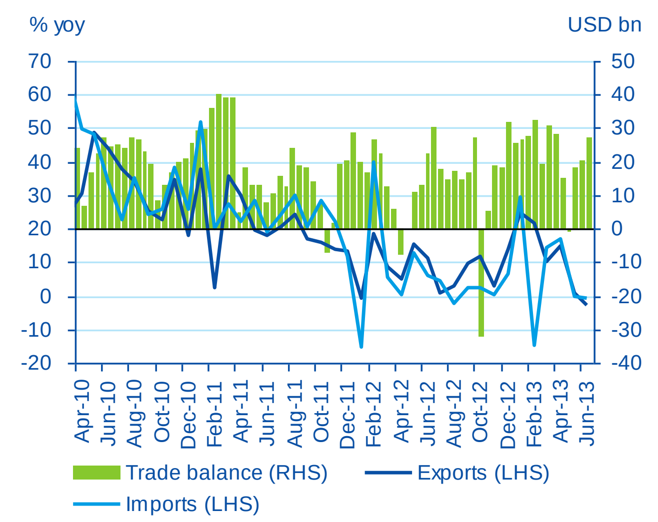
Source: CEIC and BBVA Research

Chart 4
… and nominal retail sales have held up well



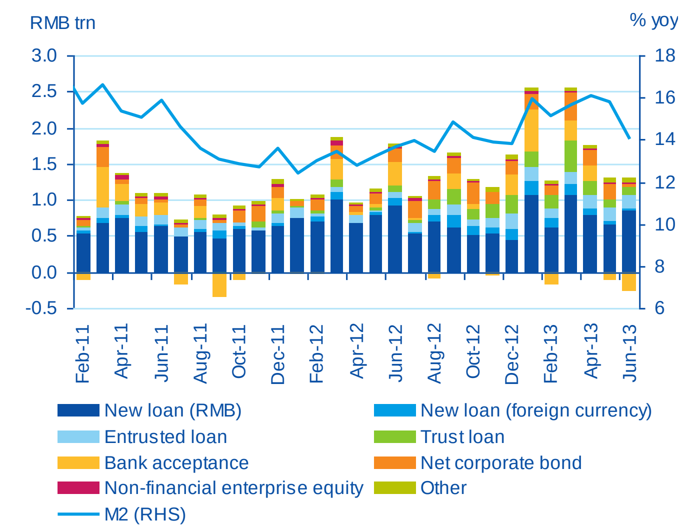
Source: Wind and BBVA Research

Chart 5
Exports growth turned negative in June



Source: CEIC and BBVA Research

Chart 6
June credit aggregates softened after the temporary interbank credit squeeze



Source: CEIC and BBVA Research

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