China Flash

Moderation in Q4 growth is in line with expectations, but remains strong enough to press ahead with reforms

Fourth quarter GDP growth was in line with expectations at 7.7% y/y (BBVA: 7.7% y/y; Consensus: 7.6% y/y), slowing from 7.8% in the previous quarter (Chart 1). In sequential terms the slowdown was more pronounced at 1.8% q/q sa from 2.2% q/q sa in Q3, according to official data. The outturn brings full-year growth to 7.7% for 2013, the same level as in 2012, and ahead of the official growth target of 7.5% (which appears likely to be maintained in 2014). We view the outturn as encouraging, especially considering the worries earlier last year about a hard landing. In particular, growth momentum, which was boosted in 2013 by "mini" stimulus measures and public infrastructure investment, appears to be strong enough to provide comfort for the government in implementing reforms announced at the Third Plenum in November (link to *Flash*). We expect growth of 7.6% in 2014 as a strengthening external demand offsets headwinds from new regulations and reforms aimed at curtailing financial risks from shadow banking, local government debt, rising housing prices, and overcapacity in some sectors.

- **Fourth quarter GDP growth led by consumption and investment**. Based on full-year figures provided by the NBS at its press conference today, we estimate that Q4 growth was led by consumption (4.6 ppts), followed by investment (3.9 ppts). Given strong import growth, the contribution of net exports was negative (-0.9 ppts), more so than in Q3 (-0.5 ppts). For the full year, the contributions of consumption, investment, and net exports are, respectively, 3.9 ppts, 4.2 ppts, and -0.3 ppts (Chart 2).
- **However, December activity indicators moderated** as the impact of stimulus waned, liquidity conditions tightened, and as efforts were undertaken to curtail domestic financial fragilities and improve air quality (production was curtailed in view of exceptionally severe air quality problems throughout China). On the supply side, industrial production growth eased to 9.7% y/y (consensus: 9.8%) from 10.0% in November (Chart 3). On the demand side, urban fixed asset investment growth declined to 17.1% y/y from 18.2% in November as infrastructure spending, partially offset by rising manufacturing and property investment (Chart 4). Meanwhile, retail sales growth edged down to 13.6% y/y (consensus: 13.6%) from 13.7% in November (Chart 5).
- **Credit growth continues to be driven by shadow bank lending** (Chart 6), adding to rising financial risks. Credit data released last week, revealed that "total social financing", the broadest gauge of credit, increased by a faster-than-expected RMB 1.23 trillion (consensus: 1.14 trillion; November: 1.23 trillion), equivalent to 18.8% y/y growth (November: 19.5%), as rapid shadow banking lending (i.e., entrusted loans, trust loans, and bank acceptances) exactly offset a slowdown in bank loans (RMB 482.5 billion vs. consensus: 570.0 billion and November: 624.6 billion). While supportive of economic activity, the continued rapid growth of shadow bank lending is leading to higher risks and is contributing to financial stress, as seen in recent volatility in the interbank market (link to *Flash*). In response, the government appears to be broadening regulations on shadow banking and stepping up enforcement. Further efforts can be expected in 2014, which could lead to slower credit growth and weigh on economic activity, especially in H2.

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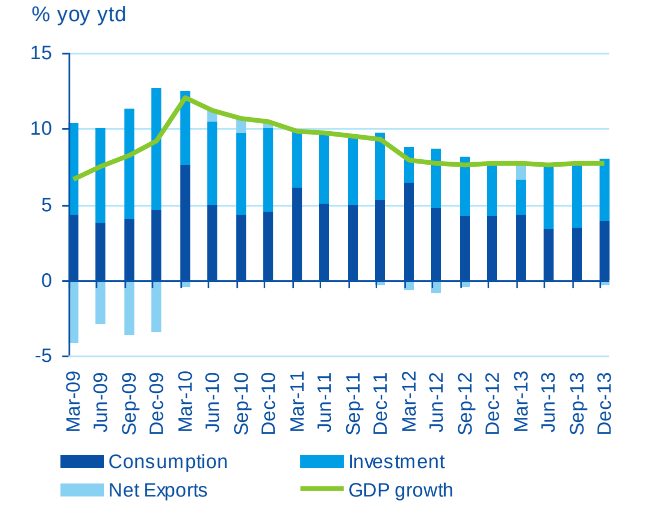
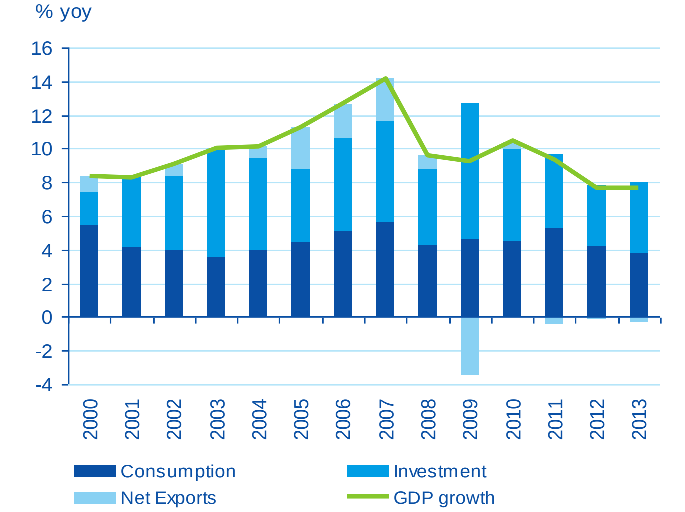
Chart 1
GDP growth has picked up after bottoming in Q2…



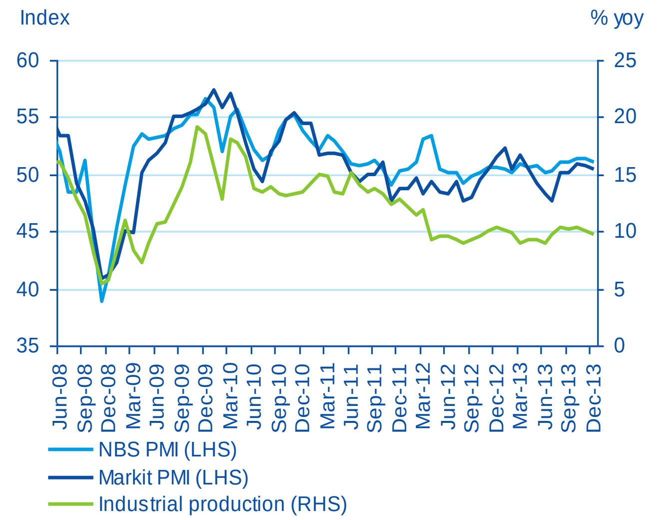
Source: CEIC and BBVA Research

Chart 2
investment was the largest contributor of growth in 2013



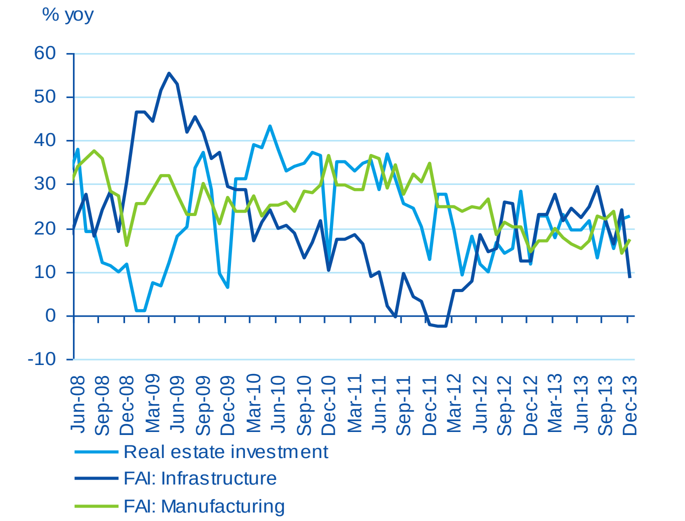
Source: CEIC and BBVA Research

Chart 3
Industrial production eased in December



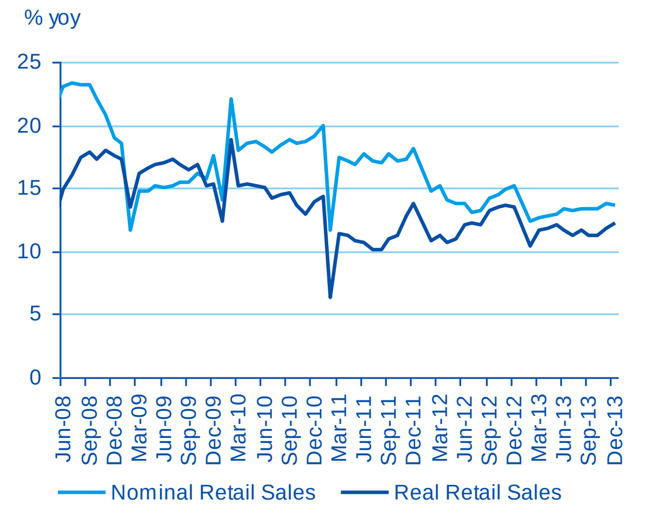
Source: Wind and BBVA Research

Chart 4
Manufacturing investment has offset a recent decline in infrastructure spending



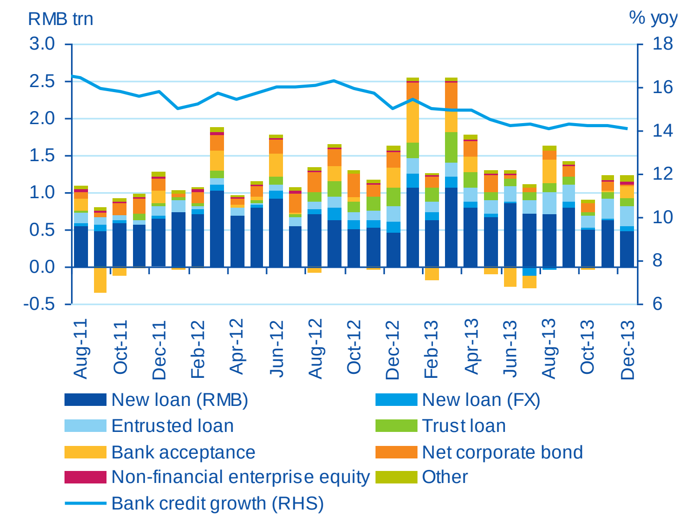
Source: CEIC and BBVA Research

Chart 5
Retail sales growth remains robust – good news for rebalancing



Source: Wind and BBVA Research

Chart 6
Broad credit growth remains strong despite a slowdown in bank lending



Source: CEIC and BBVA Research

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