Economic Research Department

BBVA

China

GDP Observatory

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Q2 GDP growth surged to 7.9% on a sharp rebound in investment, powered by rapid credit growth. While the massive stimulus has produced marvels so far, monetary tightening may be required to guard against a potential asset bubble.

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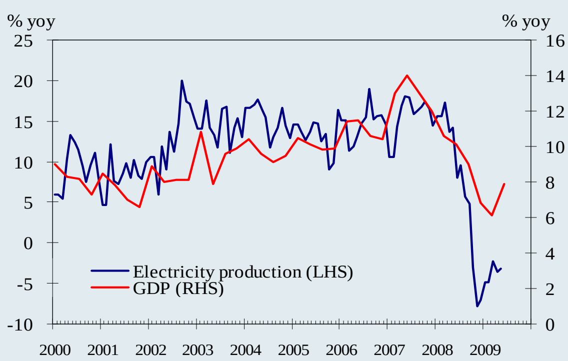
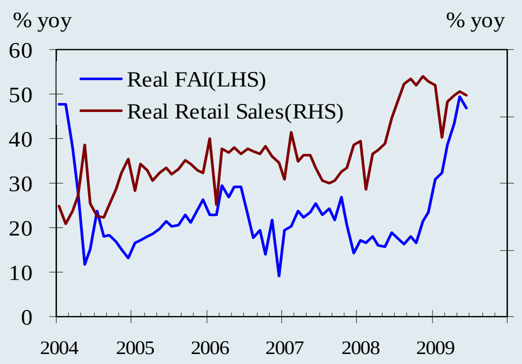
- China's economy raced ahead amidst stronger signs of global economic stabilization. Q2 GDP surged to 7.9% year-on-year (BBVA, 7.7%) on a sharp rebound in fixed asset investment, propelled by rapid credit growth. For the first half of the year, the economy grew 7.1%, one of the fastest growth rates registered in the world.
- The Q2 growth was led by a strong growth in fixed asset investment, while domestic consumption continues to remain supportive. However, export growth, despite showing some signs of stabilization, continued to fall in double digit and it is likely to remain sluggish going forward on weak external demand. According to the National Statistic Bureau, consumption, investment and net export contributed 3.8%, 6.2%, and -2.9%, respectively, to the Q2 GDP growth.

Chart 1: Real GDP growth



Sources: CEIC and BBVA estimates.

Chart 2: Domestic demand

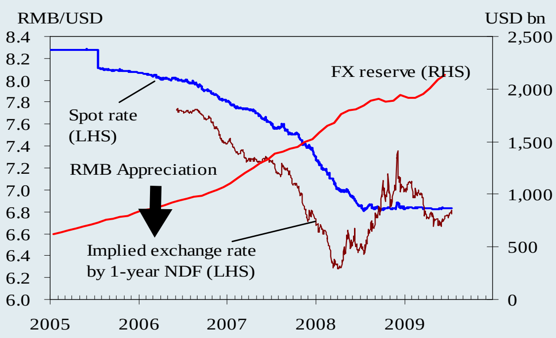


Sources: CEIC and BBVA estimates

Chart 3: Money and Credit

Sources: CEIC and BBVA estimates.

Chart 4: FX Reserves and RMB



Sources: Datastream and BBVA estimates

- In addition to the Q2 GDP figure release, other economic activities data continued to show positive readings: PMI showed a sustained sign of production rebound; real growth in FAI picked up vigorously; and retail sales continued to hold up well. However, exports continued to remain weak, despite some signs of stabilization in the G-3 markets. These data suggest that the economy was primarily led by a strong rebound in domestic demand. As external demand recovers, we expect the Q3 growth to remain strong in Q3, therefore a “V” shaped recovery is possible.
- Specifically, growth in industrial production picked up to 10.7% in June, from an averaged 7% in the first half year, showing impact of stimulus and monetary ease has been gaining full traction.
- Real retail sales held up well, increasing by 16.6% yoy in H1, rising by 3.7 percentage points from a year ago. Rural retail sales increased faster than the overall level and certain durable consumption goods and large ticket items such as passenger cars and electronics enjoyed robust increases, benefiting from the household’s income increases and increased state subsidies to the rural sector to spur consumption.
- Fixed asset investment continued to accelerate, increasing by 33.5% in the first half. Investment growth in primary, secondary, and tertiary sector increased by 68.9%, 29%, and 36.6%, respectively. Infrastructure investment increased 57%, primarily led by increases in railway (126.5%), highways (54.7%), public facilities (54.5%), and medical and social welfare related projects (71.3%). It appears the Middle and Western regions continue to see rapid growth in infrastructure spending.
- Despite a domestic demand led economic growth, CPI and PPI inflation continued to fall. For H1, CPI declined by 1.1%. The just released June CPI figure continued a falling trend, declining by 1.7%, a further drop of 0.5% compared to May. Price declines in clothing, dwelling, and transportation are the major contributors. However, we do not think these price developments will necessarily lead to a protracted deflation in China, as M2 and credit growth have been growing at an unprecedented rate and the economy is expected to expand vigorously going forward. In fact, such price falls could have expansionary effect for both private consumption and production.
- The weak external demand still weighed on export sector. Released earlier, June’s exports continued to weaken, falling 21.4% yoy, but improved from a decrease of 26.4% in May. Given a less contraction of 13.2% in June imports, the monthly trade surplus was reduced to US$ 8.2 billion. We foresee exports to continue to weaken in the coming months, though the pace of fall will continue to moderate.
- Looking forward, given the full implementation of the large fiscal stimulus package, we expect the Chinese economy to recover strongly in Q3. We therefore continue to maintain our call that China will be able to achieve a growth rate of 8.1% on the massive fiscal stimulus package, ample room for further monetary ease, and credible institutions.
- However, the rapid credit growth in H1 also raises alarm that an asset bubble may be building up, as reflected in a 75% rebound in stock price and a rebound in both transaction volumes and prices. We therefore expect some monetary tightening measures will be contemplated in order to guard against a potential asset bubble.