PICTET 1805

Flash Note

China: Latest hard data

Strength in fixed investment and industrial production, but consumption weakens

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In the first two months of 2017, FAI grew by 8.9% y-o-y, compared to 6.5% for December 2016 and 8.1% for 2016 as a whole.

The property market has been much more resilient than we had earlier expected, with investment rising 8.9% y-o-y in Jan & Feb compared to 6.9% in 2016.

Industrial production rose by 6.3% y-o-y in January and February, compared to 6% for the entire 2016.

The growth in nominal retail sales for January and February came in at 9.5% y-o-y, compared to 10.9% in December 2016. In real term, the growth was even lower at 8.1%.

The first batch of hard data on domestic activity this year indicates that Chinese GDP growth very likely will remain solid in H1 2017, but we are more cautious about prospects in H2.

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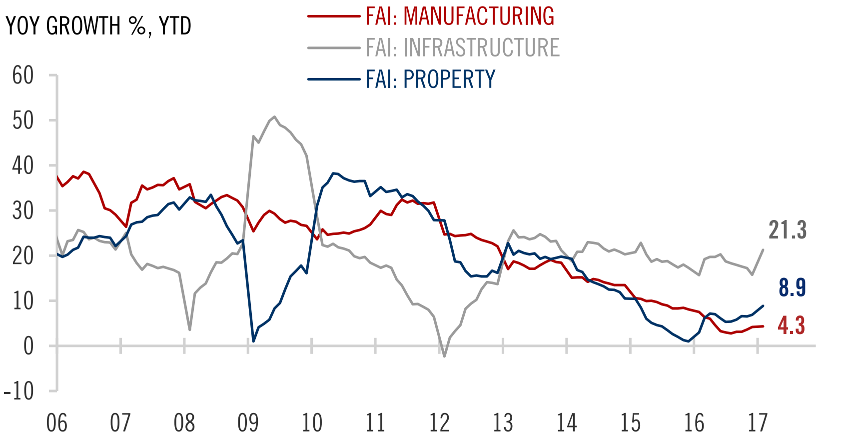
The first batch of hard data for domestic activity in China this year contained mixed messages. Fixed-asset investment (FAI) and industrial production (IP) showed strong growth in January and February, while consumption disappointed, with retail sales weakening. The latest data releases are generally consistent with the upbeat manufacturing PMI figures of recent months, which suggest that the solid growth momentum based on stabilisation in FAI has extended into 2017. This supports our view that Chinese growth may stay fairly stable in H1 2017.

Chart 1: YOY growth in FAI by sector (Jan. 2006-Feb. 2017)

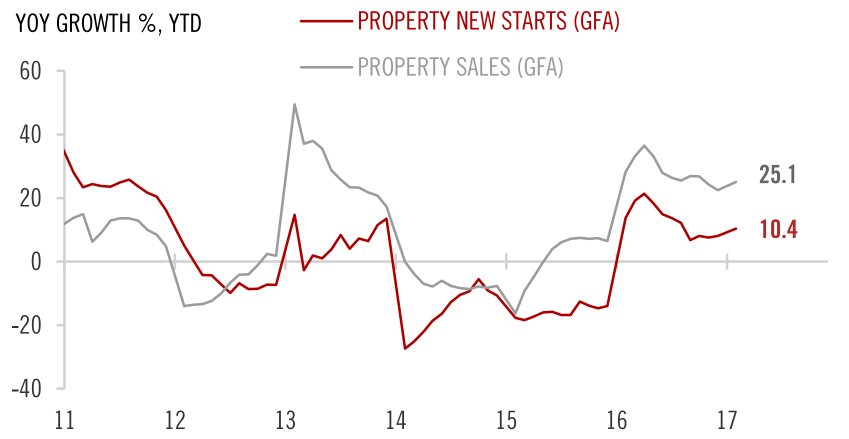


Source: Pictet WM - AA&MR, National Bureau of Statistics of China

In the first two months of 2017, FAI grew by 8.9% year-over-year (y-o-y), compared to 6.5% in December 2016 and 8.1% in 2016 as a whole. Infrastructure investment rebounded strongly, rising by 21.3% y-o-y in January and February 2017, or 5.5 percentage points higher than the full-year growth figure in 2016 (*Chart 1*).

Property investment continued to rise moderately, growing by 8.9% y-o-y in the first two months of the year compared to 6.9% in 2016. Despite the tightening measures introduced late last year, the property market has been much more resilient than we had earlier expected. Property sales (in gross floor area, GFA) rose by 25.1% y-o-y in January and February, compared to 22.5% in 2016 as a whole, and property new starts (in GFA) grew by 10.4%, compared to 8.1% in 2016 (*Chart 2*).

Chart 2: YOY growth in property sales and new starts (Jan. 2011-Feb. 2017)



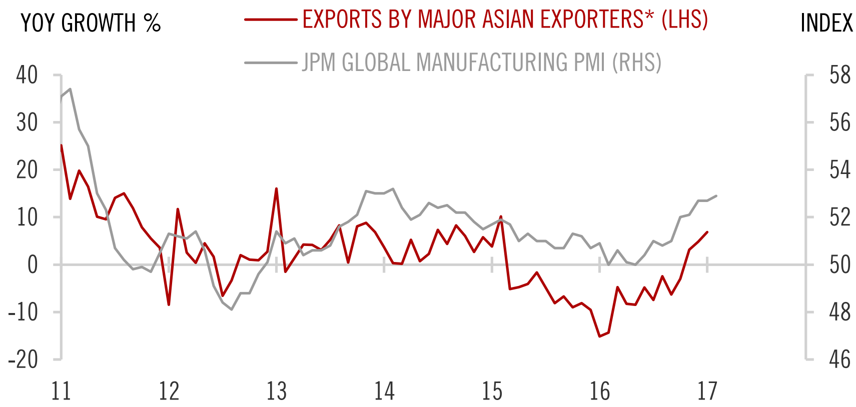
Source: Pictet WM - AA&MR, National Bureau of Statistics of China

Investment in the manufacturing sector was fairly stable in the first two months of 2017, coming in at 4.3% y-o-y, similar to the growth rate of last year.

In line with the upbeat investment data, industrial production also came in on the stronger side, rising 6.3% y-o-y in January and February, compared to 6% for the entire year of 2016. In particular, production in the manufacturing sector rose by 6.9% y-o-y, reversing the downward trend that started in H2 2016.

In addition to the rise in investment activity, improving global demand, especially in the developed world, may have contributed to the recovery in China's industrial sector. Recent data have pointed to a broad-based rebound in exports from Asian countries, including China, in line with the pick-up in global PMI figures (*Chart 3*). The 1.3% y-o-y fall in Chinese exports in February was mainly due to a base-year distortion caused by the date change of the Chinese New Year, which moves between January and February each year according to the lunar calendar. After adjusting for this, China's exports posted solid growth of 4% in the first two months of 2017, compared to a decline of 5.2% in Q4 2016.

Chart 3: YOY growth in Asian exports and global PMI index (Jan. 2011-Feb. 2017)

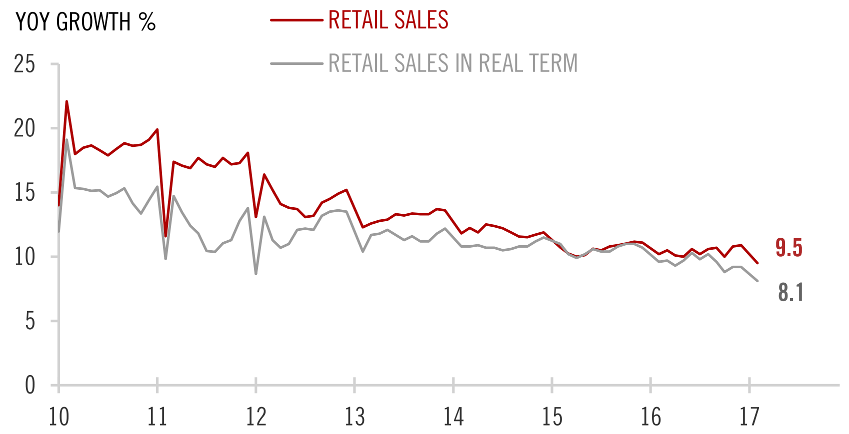


** Average of China, Japan, Korea and Taiwan*

Source: Pictet WM - AA&MR, Wind

However, consumption data in the first two months of 2017 have been disappointing. The growth in nominal retail sales for January and February came in at 9.5% y-o-y, compared to 10.9% in December 2016. This was the first time that China's nominal retail sales growth fell below 10% since late 2003 when SARS (Severe Acute Respiratory Syndrome) hit the country. In real terms, the growth was even lower—8.1% in January and February compared to 9.2% in December 2016 *(Chart 4)*.

Chart 4: YOY growth in Chinese retail sales (Jan. 2011-Feb. 2017)



Source: Pictet WM - AA&MR, National Bureau of Statistics of China

One major weak spot in the latest consumption data is automobile sales, which declined by 1% y-o-y in January-February. The China government introduced a tax break of 5% for cars with a smaller engine in late 2015, which led to a surge in auto sales throughout 2016. But this tax benefit was reduced to 2.5% at the beginning of this year. With a much higher base and reduced tax benefit, auto sales will likely continue to show weakness in 2017.

In summary, the first batch of hard data on domestic activity for 2017 point to strong momentum in investment and industrial production, while consumption has been on the weak side. As FAI has been the key variable that drives China's growth in recent years, this data indicate that GDP growth very likely will remain solid in Q1 2017 and that the momentum could last through Q2 as well.

Looking further ahead, however, we are more cautious about China's growth outlook in the second half of this year. As the data clearly show, the current strength in the Chinese economy is to a large extent related to the rebound in FAI, which, in our view, is not sustainable in the medium term. While infrastructure will continue to be an important driver of growth, the support that the government may offer through fiscal spending is unlikely to be significantly larger than last year. In addition, we remain sceptical about the sustainability of the continued growth in property investment in China. As the market still faces structural oversupply on a national level, property construction will have to slow down at a certain point, especially in third- and fourth-tier cities. As a result, we expect to see more notable deceleration in China's growth in the second half of this year as FAI starts to lose steam. For the moment, we have decided to maintain our GDP growth forecast of 6.2% for China in 2017.