Why China's economy should remain strong

We believe that China's GDP should continue to be strong at 6.8% YoY in 1Q, better than consensus of 6.7%. We have good reasons for our strong call

Source: Shutterstock

We expect 6.8% YoY GDP growth in 1Q18

China's GDP should continue to be strong at 6.8% YoY in 1Q. China has experienced the same growth rate since 3Q17. Consensus is now at 6.7% YoY.

We have good reasons to expect the Chinese economy to grow as fast as in the last two quarters.

6.8%

GDP forecast

YoY in 1Q18

Better than expected

Consumption to be the main engine of growth

Growth engines include consumption from 5%-15% wage growth, depending on the industry. Higher purchasing power should also be reflected in the strong growth in inbound tourism due to the Chinese New Year holiday. The service sector should continue to grow to over 50% of the GDP.

Supported by high-tech manufacturing

Solid wage growth should come from the strong growth in the high-tech sectors, including high-tech manufacturing of industrial robots, semi-conductors and intergrated circuits; and also high-tech service sectors, including online shopping platforms and fintechs.

Infrastructure investment as a supporting pillar

We also think that infrastructure investments should continue to be a supporting pillar of the economy. Infrastructure investments would mostly be in water management, energy and transport networks.

Property development investment though should grow in the low-single digits, as it continues to support demand for raw materials in the economy.

Trade deficit in March not going to make a critical change in 1Q GDP growth

Though China had a trade deficit in March, it would only account for 0.16% of GDP (if the economy grows at 6.8% YoY in 1Q), which is too small to have a negative impact on GDP.

Moreover, the first quarter trade balance was USD48.39bn, which was still a trade surplus, and would continue to contribute as a positive component for the economy.

If there were a hindrance it could be inflation

The factor that could make our forecast look too strong is the GDP deflator. Inflation in China has climbed slowly to an average of 2.17% YoY in 1Q18 compared with 1.4% YoY in 1Q17. Higher inflation requires real GDP to grow even stronger to offset the inflation effect.

But in our baseline scenario, we believe that wage growth, which has been much higher than CPI inflation, should continue to push consumption higher, which is the main engine of the Chinese economy.

Focusing on trade tensions for the coming quarters

Nothing is impossible when economics is mixed with politics. We are monitoring the trade tensions between China and the US. The US government's interest in rejoining the Trans Pacific Partnership, an Asia-Pacific trade group, may re-ignite trade tension between China and US.

If there is any material trade restrictions imposed by the US, China would most likely retaliate. And we believe that retaliation could go beyond merchandise trade.

This would be damaging to both economies. And therefore, the GDP of both economies would be affected negatively.

But we believe that both sides are restrained enough not to turn trade threats into any material policies.

We therefore maintain our China GDP forecasts at 6.8% YoY in 2Q, 6.7% in 3Q and 4Q.

We also keep our forecast of USD/CNY at 6.25 by the end of 2Q and 6.10 by the end of 2018.