

## China GDP beats forecasts

China real GDP grew 6.8% in the fourth quarter and 6.9% in 2017, beating our forecasts. We think 2018 will be another good year for China but continue to monitor the risk from financial deleveraging reform



Source: istock

# 6.9%

China GDP 2017

Forecast 6.7% in 2018

### Middle class consumption and high-tech manufacturing drive growth

China real GDP grew 6.8% year-over-year in the fourth quarter and 6.9% in 2017, beating our forecasts at 6.7% and 6.8%, respectively. The discrepancy could come from December's lower growth imports, which was partly a result of tighter solid waste import restrictions, and also from lower inflation in 2017 (1.6%) compared to 2016 (2.0%).

The biggest driver of growth was the consumption of goods and services, fuelled by a 9% rise in disposable income. Spending on cosmetics was 13% higher, healthcare at 11%, and housing at 9.6%. There was a small downward surprise on retail sales in December, at 9.4%YoY versus our forecast of 10.4%. This came from the low growth of automobiles at 2.2% from 14.4% Dec 2016.

Fixed asset investment grew 7%YoY in 2017, in line with our forecast. As expected, most of the growth came from state-owned enterprises (10%YoY) as infrastructure investment was the main engine, rising 19%YoY. Local projects rose 7.7% while central projects fell 5.7% in 2017. These highlighted the strong demand for local infrastructure for water management and other facilities.

Industrial production grew 6.2%YoY in Dec 2017, higher than our forecasts of 6.1%.

Overall, manufacturing was balanced by the robust growth in new sectors designated by government policies. Specifically, China produced 68% more industrial robots and 50% more new energy cars in 2017.

All this points to the fact that China is moving towards a consumption based economy and is expanding high-tech in the manufacturing sector.

## 2018 could be another strong growth year

With projected GDP growth of 6.7%, 2018 could be another good year for China, supported by consumption of goods and services and infrastructure investments. We expect the manufacturing of high-tech products and parts to grow by more than 50%. That should support the loss of production from overcapacity cuts in non-ferrous metals, shipbuilding and building materials.

## Financial deleveraging reform poses a risk

Financial deleveraging will present opportunities and risks in 2018. Interest rates could be pushed up by tighter liquidity. We believe that financial regulators would need to handle this very carefully because banking and non-bank financial sectors are intertwined via wealth management products and other shadow banking products, and the financial sector is related to corporate and household credit as well as investments.

Our view is that a policy rate hike should be mild regardless of the momentum from the Federal Reserve. We expect three hikes, the same as the Fed, but the Chinese central bank would likely make smaller steps, with hikes in five basis point increments. The Yuan will continue to appreciate mildly at 3% to 6.30 to attract net capital inflows.

We also think that the fiscal deficit would increase from the target of 3-4% in 2017 % to 4-5% in 2018. Although government debt is not an imminent risk in 2018, the accumulation of government debt could become a concern after a few years.

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