

## China: 2Q14 GDP Report Shows Growth Gathering Momentum

- China's economic growth pace quickened in 2Q14, with headline coming in at 7.5%y/y from 7.4% in 1Q14. Acceleration of the q/q figures is even more evident, rising a seasonally adjusted 2%q/q, a turnaround from 1.5%q/q gain in 1Q14.
- The headline figures are also consistent with other monthly releases, which are benefitting from the targeted loosening from PBoC as well as increased public spending on infrastructure sector, and these conditions should remain favourable into second half of 2014.
- Taking into account of all these, we are upgrading our forecast for China's GDP growth for 2014 to 7.6% from our previous forecast of 7.3%. For 2015, we are also ratcheting up our projection for China to 7.5% from 7.3% previously. The positive story on China's growth consistent with our view on the RMB, and we reiterate our end-2014 forecast of 6.15/USD and 6.03/USD for end-2015.

### Growth Acceleration In 2Q14

China released its 2Q14 GDP report this morning (Wed, 16 July) along with the remainder of data for June. Headline GDP growth came in much faster than expected, at 7.5%y/y, from 7.4% in 1Q14, ahead of our expectation of 7.3% and consensus view of 7.4%. In particular, a q/q acceleration is very much evident, with 2Q14 turning in a seasonally adjusted gain of 2%q/q, turning around from 1.5%q/q gain in 1Q14, which was also the slowest pace since more than 2 years. The sharply higher growth pace is likely to be contributed by the loosening policy in place in much of the second quarter such as the two rounds of targeted cuts in reserve requirement ratios (RRR) and renewed fiscal spending on infrastructure investment.

Other data released this morning also showed signs of economic recovery, particularly for industrial production which gained 9.2%y/y in June, from 8.8% in May and ahead of expectation of 9%. This is the best showing so far this year for China's manufacturing sector and the first 9%+ reading in six months, and in line with the recent releases of China's PMI reports. Both the official and HSBC Purchasing Managers' Indexes were consistent, suggesting a renewed growth momentum in China. The official PMI edged up to 51.0 in June from 50.8 in May, a six-month high, boosted by new orders and export orders. HSBC China manufacturing PMI index rose in tandem, to 50.7 in June, from 49.4 in May and the first time this year that it stood above 50.

On the somewhat negative side though, is external trade remains weak as exports barely expanded y/y in the first half of the year, and imports gained just 2.4%y/y in the first six months. In contrast, China's exports and imports rose 8.6% and 7.6%, respectively, in 2013, putting this year's official trade growth target of 7.5% out of reach. While lackluster demand may be a main contributor to China's dismal trade performance this year, supply factors domestically such as rising wages and land costs, currency appreciation, environmental concerns, among others, are further pressuring competitiveness of the exports sector. The external sector could prove to be one drag factor in the generally more optimistic macro backdrop.

### Upgrading Our Growth Forecasts For 2014 and 2015

PBoC's selective loosening measures in recent months and increased fiscal spending are providing a relatively more favourable economic backdrop for China in the second half of this year. Over the past 3 months, PBoC had made two rounds of targeted RRR cuts as well as adjusting the calculation of LD ratio, to accommodate lending to the SME sector, agricultural sector. This is already reflected in the rebound in credit and money supply data in June that saw M2 rising 14.7%y/y, the first 14%+ increase in 8 months and new RMB loans rising RMB1.08 trillion in June, faster than the RMB870.8bn increase seen in May, and first RMB1 trillion+ increase in 3 months.

With the first half of 2014 coming in at 7.4% average growth, and a faster growth pace likely in the second half of the year, **we are upgrading our forecast for China's GDP growth for 2014 to 7.6% from our previous forecast of 7.3%. For 2015, we are also ratcheting up our projection for China to 7.5% from 7.3% previously.**

Nevertheless, it should be noted that the Chinese economy is transitioning away from the "growth-at-all-cost" model, as the new leaders focus their attention on market reforms, restructuring and rebalancing - the "New Normal" for China. This means that an annual growth trend around the current target 7.5% would be appropriate and those days of "high flying" growth are truly behind us. Therefore, it is likely that the PBoC will continue to pursue neutral monetary policy with a targeted easing approach instead of the broad-based change in interest rates as in the past. As such, we expect China's benchmark policy interest rates such as the 1Y deposit and 1Y lending to remain unchanged at 3% and 6%, respectively.

### Growth Outlook Strengthens Case for RMB

With stability returning to economic growth, the stronger-than-expected 2Q14 GDP report further strengthens our case for the RMB, as we remain positive on the RMB over the mid-to-long term horizon. While the worst of the depreciation for the RMB seen in 1Q14 should be over, it should be clear that the currency could still face some downward pressure and greater volatility near term, as financial market and broad economic restructuring and reform continue on.

We reiterate our end-2014 forecast of 6.15/USD and 6.03/USD for end-2015, as we expect the unit to recover from current levels of around 6.20-6.21/USD with improvements of broader domestic environment and policymakers react to risks of sharp economic deteriorations. Nevertheless, this still represents a 1.5 % fall from 6.05/USD at end-2013, marking the first annual depreciation since 2009 in the aftermath of the global financial crisis. Beyond that, we expect the currency to rise at a more moderate pace of 1-3% annually on average in future years, compared to an annualized appreciation of 3.8% from 2005-2013.

China's Key Macro Data											
	2012	2013	4Q13			1Q14			2Q14		
Real GDP Growth %y/y	7.7	7.7	7.7			7.4			7.5		
Real GDP Growth %q/q SA			1.7			1.5			2.0		
%y/y change	2012	2013	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
Industrial Output	10.8	9.7	10.3	10.0	9.7	-	-	8.8	8.7	8.8	9.2
NBS PMI	50.6	51.0	51.4	51.4	51.0	50.5	50.2	50.3	50.4	50.8	51.0
HSBC PMI	51.5	50.5	50.9	50.8	50.5	49.5	48.5	48.0	48.1	49.4	50.7
CPI	2.7	2.6	3.2	3.0	2.5	2.5	2.0	2.4	1.8	2.5	2.3
PPI	-1.7	-1.9	-1.5	-1.4	-1.4	-1.6	-2.0	-2.3	-2.0	-1.5	-1.1
Exports	7.9	7.9	5.6	12.7	4.3	10.6	-18.1	-6.6	0.8	7.0	7.2
Imports	4.4	7.3	7.6	5.3	8.3	10.8	10.4	-11.3	0.7	-1.7	5.5
Trade Balance (US\$ bn)	232.8	261.4	31.1	33.8	25.3	31.9	-23.0	7.7	18.5	35.9	31.6
New Loans (RMB bn chg)	8,203.8	8,891.9	506.0	624.6	482.4	1,319.0	644.8	1,049.7	774.7	870.8	1,080.0
Aggregate Financing (RMB bn chg)	15,760.5	17,290.0	864.5	1,231.0	1,253.2	2,597.7	937.0	2,093.4	1,549.9	1,404.5	1,970.0
M2	13.8	13.6	14.3	14.2	13.6	13.2	13.3	12.1	13.2	13.5	14.7
Urban Fixed Asset Investment YTD	20.6	19.6	20.1	19.9	19.6	17.9	17.9	17.6	17.3	17.2	17.3
Retail Sales	14.4	13.1	13.3	13.7	13.6	-	-	12.2	11.9	12.5	12.4

Source: CEIC, Bloomberg, National Bureau of Statistics; UOB Economics-Treasury Research estimates. All data for individual months except noted

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