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Flash Notes

China: Further Deceleration In 1Q15

- China's 1Q15 GDP growth rate slowed to 7%y/y, the weakest pace since 1Q09, from 7.3%y/y in 4Q14 and 7.4% for all of 2014
- The optimistic headline figure however is inconsistent with high frequency data in 1Q15, suggesting that downside pressure on the economy remains and there is room for further, but targeted, policy support
- With downside risks ahead, we are maintaining our full year forecast for China at 6.8% for 2015 and continue to look for at least at another round of interest rate/reserve requirement ratio cuts. We are also keeping our view that the RMB could stay tepid against the USD for now but with higher volatility

Further Growth Deceleration

China reported on Wednesday morning (15 April) its 1Q15 GDP report along with the remainder of data releases for March. On the headlines, 1Q15 GDP growth rate slowed to 7%y/y, the weakest pace since 1Q09 (which expanded at 6.6%y/y), compared to 7.3%y/y in 4Q14 and 7.4% expansion for all of 2014. On a sequential basis, China's growth pace also decelerated, to the slowest since data began, at 1.3%q/q seasonally adjusted in 1Q15, down from 1.5%q/q in 4Q15 and below the previous low of 1.4% recorded in 1Q12.

While the 1Q15 headline figure appears to be in line with official full year growth target of 7%, various monthly data releases in 1Q15 seem to be painting a somewhat different and downbeat picture. Industrial production for March came in worse than expected at 5.6%y/y. This is the weakest since November 2008 and less than half the average monthly increase of 13%y/y from 1995 to 2013, as the manufacturing faces challenges of rising land and labour costs and a strong RMB, amidst a "new normal" economy.

Elsewhere, retail sales for March also turned in a surprisingly weak figure of 10.2%y/y, the weakest since 2006 and comparable to the Jan-Feb reading of 10.7%, suggesting that there are more underlying factors than just seasonal effects from Spring Festival that caused such poor performance in retail sales. While the data series is not a true reflection of consumer spending, a continued downward trend would certainly raise some concern.

Earlier, the external trade report also painted a downbeat picture of China's economy. To recap, China's exports in March fell more than expected at 15%y/y in USD terms, vs. forecast of +9% and +48.3% in February. Imports dropped nearly 13%y/y in USD terms, vs. forecast of -10% and -20.5% in February, resulting in trade balance of +US$3.08bn vs. expectation of US$40.1bn and February trade balance of US$60.62bn. The latest China trade report reflects poor external demand and the "new normal"/slow growth in domestic demand (imports). One reason the February export number had surged was due to low base for exports in 2014 (2015 February exports: US$169.19 billion vs. 2014 February at US$114.05 billion). For January 2015, China's exports were quite consistent with 2014, at US$200.26bn. Looking at the March exports, the performance was certainly disappointing as it failed to improve and came in at just US$144.57bn vs. March 2014 of US$170.0bn.

China's Key Macro Data										
Indicators	2013	2014	3Q14			4Q14			1Q15	
Real GDP Growth %y/y	7.7	7.4	7.3			7.3			7.0	
Real GDP Growth %q/q SA			1.9			1.5			1.3	
%y/y change	2013	2014	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15
Industrial Output	9.7	8.3	9.0	6.9	8.0	7.7	7.2	7.9	-	6.8	5.6
NBS PMI	51.0	50.1	51.7	51.1	51.1	50.8	50.3	50.1	49.8	49.9	50.1
HSBC PMI	50.5	49.6	51.7	50.2	50.2	50.4	50.0	49.6	49.7	50.7	49.6
CPI	2.6	2.0	2.3	2.0	1.6	1.6	1.4	1.5	0.8	1.4	1.4
PPI	-1.9	-1.9	-0.9	-1.2	-1.8	-2.2	-2.7	-3.3	-4.3	-4.8	-4.6
Exports	7.8	6.1	14.5	9.4	15.1	11.6	4.7	9.5	-3.3	48.3	-15.0
Imports	7.2	0.5	-1.5	-2.1	7.2	4.6	-6.7	-2.3	-20.0	-20.8	-12.9
Trade Balance (US$ bn)	$ 259.0	$ 382.5	47.3	49.8	31.0	45.4	54.5	49.6	60.0	60.6	3.1
New Loans (RMB bn chg)	8,891.7	9,781.5	385.2	702.5	857.2	548.3	852.7	697.3	1,470.8	1,020.0	1,180.0
Aggregate Financing (RMB bn chg)	17,316.8	16,460.0	273.7	957.7	1,135.5	680.7	1,145.9	1,694.5	2,063.1	1,353.2	1,180.0
M2	13.6	12.2	13.5	12.8	12.9	12.6	12.3	12.2	10.8	12.5	11.6
Urban Fixed Asset Investment YTD	19.6	15.7	17.0	16.5	16.1	15.9	15.8	15.7	13.9	13.9	13.5
Retail Sales	13.1	12.0	12.2	11.9	11.6	11.5	11.7	11.9	-	10.7	10.2

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

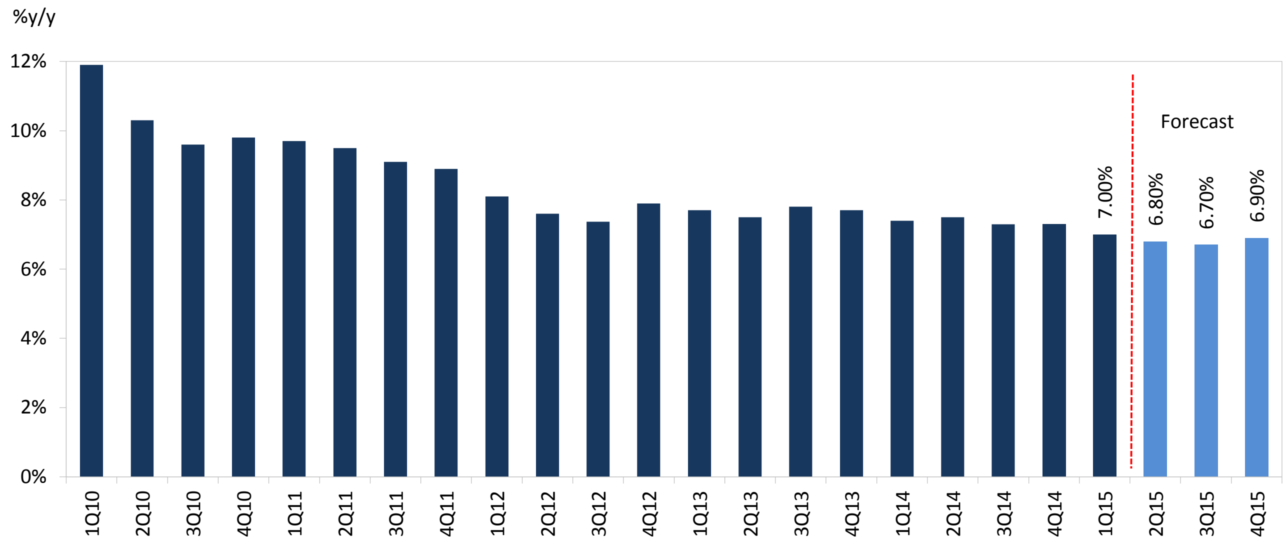
Implications

Looking at these high frequency data releases mentioned above, it would not be surprising if headline growth had come in below 7%. As such **it was remarkable that the headline 1Q15 GDP figure managed to hold up reasonably well at 7.0%**, in line with market expectation and well ahead of our call of 6.7-6.8%. One explanation could be the increasingly large role played by services sector, which accounts for about 48% of the economy, and a key area of government focus in the "new normal" of reform, rebalance, and restructure of China's economy to look for expanded business and employment opportunities.

Nevertheless, given headwinds from various sectors, near term challenges remain significant for the government to achieve this year's 7% growth target and new job creation of 10 million. We expect some policy support to continue, but unlikely to be the same massive scale seen in the Global Financial Crisis era, and more along the line of targeted measures and acceleration of infrastructure spending.

As we had mentioned in previous publications, even with a growth rate of 6.5-7% in China, the annual goal of 10 million new jobs should be attainable, assuming that every 1% point of GDP growth rate is able to generate 1.2-1.5% million jobs as in the past two decades (1994-2014). This means that the Chinese government will tolerate slower growth trend but will be on the look out for sharp deviation from such a path. **After taking into account 1Q15 data and GDP report, we are keeping unchanged our 2015 growth forecast for China at 6.8% and would highlight that risks of downward pressure on the economy would likely to intensify in 2Q and 3Q of this year.**

China: Real GDP Growth



Source: CEIC, UOB Global Economcis & Markets Research

Keeping these factors in mind, we continue to expect at least one more round of interest rate/reserve requirement ratio (RRR) reductions sometime in the current quarter (2Q15), bringing the 1Y lending rate down to 5.10% from 5.35% currently, the headline 1Y deposit rate down to 2.25% from 2.50%, and the RRR down to 19.00% from 19.50% at present. Note that China will implement the deposit insurance system from 1 May, which means that we could see deposit rate ceiling raised by just one or two more times before doing away with such ceiling totally as interest rate environment is fully liberalized in the country (for more details on this development, please refer to "China Focus: Deposit Interest Rate Liberalization Looming" in the UOB Quarterly Global Outlook 2Q 2015 report).

As for the RMB, as we maintain our view that the US Fed would begin its interest rate normalization at the June FOMC, USD strength should stay for now before trailing off somewhat toward end of the year. This should see the **RMB weakening slightly to 6.22/USD by end-2Q15 and to end the year at 6.20/USD similar to the end-2014 value. We remain cautious that the Chinese currency is likely to see significant volatility in the meantime** (the first three months of 2015 already saw the RMB moving in volatile fashion), and maintain our view that a band widening could still take place this year. We see fairly low risks of significant depreciation or devaluation for the RMB as, among other things, the Chinese government continues to push forward its RMB internationalization agenda as well as eyeing the inclusion of the RMB into the IMF's Special Drawing Rights (SDR) basket of currencies, a decision of which should be due by end-2015.