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Flash Notes

China: Upside Surprise to 2Q15 GDP Growth

- **China's 2Q15 GDP growth came in much better-than-expected at 7%y/y, vs. expectation of 6.8%, while data releases for Jun show signs of stabilization. This improvement could be attributed by PBoC's recent easing actions as well as the rise of the services sector, which is not captured adequately in regular data releases.**

- **In view of the above factors, we are revising up our forecasts for China's growth, with the full year projection now set at 7.1% (from our previous forecast of 6.8%). We keep to our view that there is only one more round of interest rate cuts at the most for 2015, and possibly another 50bps reduction in broad RRR. Our forecast for RMB remains unchanged, at 6.20/USD for end-2015, though the possibility of a band widening remains for this year.**

- **Market reform in China remains on track, including interest rate liberalization and further opening of capital account, which allows for greater participation of foreign players in China's domestic capital markets as China aims for SDR admission by end of 2015.**

Better-than-expected performance in 2Q15

China released its 2Q15 GDP report on Tue morning (15 Jul 2015), with the headline figure coming in at 7%y/y, ahead of market and our expectations of 6.8%, and the same as 7% in 1Q15. In terms of growth momentum, activity accelerated to 1.9%q/q, compared to market estimate of 1.5%, and 1.3%q/q in 1Q15.

Other data released on the same day also showed some stabilization after repeated interest rate and reserve requirement ratio (RRR) cuts by the central bank PBoC over the past 6 months. Industrial production rose 6.8%y/y in Jun, above expectation of 6% and 6.1% in May, which is indicative of stabilization within the sector, along with the official purchasing managers index (PMI) which has been holding above the 50 level during 2Q15. Fixed asset investment held steady at 11.4%y/y YTD in Jun, vs. expectation of 11.2% and 11.4% in May. Retail sales rebounded to 10.6%y/y from 10.1% in May.

Earlier in the week, most of data out from China also showed signs of stabilization. China's aggregate financing rose by RMB1.86 trillion in Jun from RMB1.2 trillion in May and the most since Jan after the government stepped in to boost provincial finances and PBoC took steps to lower funding costs with its fourth interest rate cut since Nov 2014, taking place on 27 Jun (Please refer our report: China: PBoC's Simultaneous Easing Actions, dated 29 Jun 2015). M2 measure of money supply rose 11.8%y/y in Jun, up from 10.8% in May and the biggest gain since Feb. These suggest that relaxed rules for local authorities to get financing and record-low interest rates are boosting demand for credit and that the domestic economy may be at a turning point. However, in total, aggregate financing in first six months of 2015 saw an increase of RMB13.5 trillion, which is close to 20% below the average run rate of RMB16.2 trillion in the same period in 2013 and 2014, as the authorities continue to limit activities in the shadow banking sector.

China's exports rose for the first time in four months in Jun, advancing 2.1%y/y in RMB terms, ahead of market estimate for 1.2% growth. Imports dropped 6.7%y/y from the sharp decline of 18.1% in May, leaving a trade surplus of RMB284.2 billion or US$45.8 billion. This resulted in near record high quarterly trade balance of US$139 billion in 2Q15, 60% above US$86 billion in 2Q of 2014, as imports have shrunk much faster than exports. For the first six months of 2015, China's trade surplus is a record high of US$264 billion, more than doubled the US$103 billion trade surplus in first half of 2014. While the net trade balance will be supportive of headline GDP growth figure, the declines in imports demand, 16%y/y lower in 2Q15 at US$809 billion is a cause for worries as to outlook in the months of ahead.

Implications

With the upside surprise in the 2Q15 GDP report as well as stabilization in data for Jun, the aggressive measures from PBoC appear to be having at least some positive effect in arresting the deterioration in business activities and laying a more solid foundation ahead. These include the surprise simultaneous cuts announced on 27 Jun, which already had three interest rate cuts prior to that. In addition, the announcement on 24 Jun 2015 of the removal of loans-to-deposit ratio cap of 75% is also a positive development for the broader economy, along with a slew of liquidity tools that the PBoC could deploy to ensure reasonable funding costs in the system.

Another factor that explains the surprise in 2Q15 GDP report is the shift away from manufacturing and towards services sector which is playing an increasingly large role and which is not being fully captured in most of the monthly data releases that the market is accustomed to. This could be inferred from the retail sales data where there is a breakdown of both sales in physical stores and online sales. In the 2Q15 report, data show that online sales of physical retail goods account for 9.7% share of total sales of retail goods of RMB1.6 trillion in the first 6 months of 2015, which would have been negligible a few years earlier. What is even more staggering is the rapid growth in the online sector: online sale of goods and services rose by 39%y/y in first half of 2015. These data are not adequately reported on a regular basis and with China moving towards further liberalization of the financial sector and greater emphasis in services sector such as the Internet Plus strategy, the market needs to pay close attention to the developments to have a more complete understanding of China's economy.

In light of the 2Q15 data as well as the recent slew of monetary policy easing, we are revising up our forecasts for China's growth, with the full year projection now set at 7.1% (from our previous forecast of 6.8%), with 3Q15 and 4Q15 growth expectations at 7.2%y/y for now (from previous forecasts of 6.7% and 6.9%, respectively).

The stabilization in activities means that PBoC would be less inclined to continue its aggressive interest rate cuts in the months ahead. We keep to our view that there is only one more round of interest rate cuts at the most for 2015. Similarly for the systemwide RRR, we think that there is at most 100bps reduction for 2015, and we think the probability is in favour of just another 50bps cut in broad RRR.

As for the RMB, China's aim in achieving the admission to IMF's Special Drawing Rights (SDR) basket of currencies should keep the currency broadly stable. We are keeping our end-2015 USD/RMB forecast of 6.20 and maintain our view that further widening of the RMB trading band this year remains a possibility.

China's focus on financial market reforms will remain on track this year, in addition to the SDR ambition. This is reflected in PBoC's 2Q15 monetary policy report released on Tue (14 Jul) which reaffirmed the further liberalization such as interest rates and reform of exchange rate mechanism. The central bank also said it will keep RMB exchange rate basically stable as well as to lower financing costs, and to achieve reasonable credit, aggregate financing growth.

In addition, PBoC also announced on 14 Jul easier access by foreign investors to its RMB35.3 trillion (outstanding bonds as at end-May 2015) interbank bond market, as foreign central banks, sovereign wealth funds and global financial organizations will no longer need pre-approval to trade bonds, interest-rate swaps and conduct repurchase agreements. Note that only 2% of the bonds are held by foreign institutions in China, including central banks which are significantly below the figures for emerging markets such as Malaysia and Indonesia which routinely see share of foreign holdings in the 30-40% range. This move is in line with lowering the hurdles of foreign participation in China's capital markets.

PBoC's Noteice on participation of foreign central banks, sovereign wealth funds and global financial organizations in interbank bond market, 14 July 2015
中国人民银行关于境外央行、国际金融组织、主权财富基金 运用人民币投资银行间市场有关事宜的通知
http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2015/20150714154753677115588/20150714154753677115588_.html

China's Key Macro Data

	2012	2013	2014			4Q14			1Q15			2Q15
Real GDP Growth %y/y	7.7	7.7	7.4			7.3			7.0			7.0
Real GDP Growth %q/q SA						1.5			1.4			1.7
%y/y change except noted	2012	2013	2014	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Industrial Output	10.8	9.7	8.3	7.7	7.2	7.9	-	6.8	5.6	5.9	6.1	6.8
NBS PMI	50.6	51.0	50.1	50.8	50.3	50.1	49.8	49.9	50.1	50.1	50.2	50.2
HSBC PMI	51.5	50.5	49.6	50.4	50.0	49.6	49.7	50.7	49.6	48.9	49.2	49.4
CPI	2.7	2.6	2.0	1.6	1.4	1.5	0.8	1.4	1.4	1.5	1.2	1.4
PPI	-1.7	-1.9	-1.9	-2.2	-2.7	-3.3	-4.3	-4.8	-4.6	-4.6	-4.6	-4.8
Exports	7.9	7.8	6.1	11.6	4.7	9.5	-3.3	48.3	-15.0	-6.5	-2.8	2.8
Imports	4.3	7.2	0.5	4.6	-6.7	-2.3	-20.0	-20.8	-12.9	-16.4	-17.8	-6.3
Trade Balance (US$ bn)	$ 230.3	$ 259.0	$ 382.5	$ 45.4	$ 54.5	$ 49.6	$ 60.0	$ 60.6	$ 3.1	$ 34.1	$ 58.9	$ 46.5
New Loans (RMB bn chg)	¥ 8,203.8	¥ 8,891.7	¥ 9,781.5	¥ 548.3	¥ 852.7	¥ 697.3	¥ 1,470.0	¥ 1,020.0	¥ 1,180.0	¥ 707.9	¥ 900.8	¥ 1,271.3
Aggregate Financing (RMB bn chg)	¥ 15,763.1	¥ 17,316.8	¥ 16,460.0	¥ 680.7	¥ 1,145.9	¥ 1,694.5	¥ 2,046.9	¥ 1,356.4	¥ 1,240.7	¥ 1,055.7	¥ 1,219.6	¥ 1,860.0
M2	13.8	13.6	12.2	12.6	12.3	12.2	10.8	12.5	11.6	10.1	10.8	11.8
Urban Fixed Asset Investment YTD	20.6	19.6	15.7	15.9	15.8	15.7	13.9	13.9	13.5	12.0	11.4	11.4
Retail Sales	14.4	13.1	12.0	11.5	11.7	11.9	-	10.7	10.2	10.0	10.1	10.6

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