

China: 3Q16 GDP Expands Steadily As Expected

Economic Activities Continue to Stabilize

China released its 3Q16 GDP report on Wed morning (19 Oct), with headline at 6.7%/y, the same pace as in 1Q and 2Q of this year. The outcome is right in line with our view and Bloomberg poll forecast. While this is the slowest pace of expansion in more than 7 years, it remains within official growth target of 6.5-7.0% range for the 13th 5-year plan period (2016-2020). On a sequential basis, growth momentum remained respectable at 1.8%/q/q from 1.9%/q/q in 2Q16 (data revised up from 1.8% reported previously) and well above the trough of 1.2% in 1Q16. In terms of sectoral performances, tertiary (services) again came up tops, with 7.6%/y gain (7.5% in 2Q16), ahead of the secondary (manufacturing related) sector's 6.1% (2Q16: 6.3%).

Other data releases for the quarter also largely reflect the stabilization in activities. Retail sales rose by 10.7%/y in Sep from 10.6% in Aug. Industrial production gained less than expected at 6.1%/y vs. 6.3% in Aug, but otherwise is consistent with the lackluster manufacturing purchasing manager index (PMI) data for China which hover just above -50 during 3Q16 for both the official and Caixin measures. Urban fixed assets investment (FAI) edged up slightly to 8.2%/y YTD in Sep, in line with expectation and after two months of 8.1%/y growth, which suggests that the slowdown in FAI may have bottomed and could see some room for faster expansion especially in infrastructure (transport/ utilities), and also real estate-related investment.

4Q Growth Likely To Remain Steady

We remain positive on China's growth outlook into 4Q16 and 2017, as the momentum in tertiary (services) sector should continue to lead and buffer any shortfall that might come from manufacturing sector. In addition, credit creation remains on track that should provide support for growth in the quarters ahead.

Credit creation remains on track to meet official target of 13% rise in aggregate financing (i.e. total social financing) in 2016. Year to date, aggregate financing has increased by RMB13.5tn (to Sep 2016), which leaves about RMB4.5tn for 4Q16 if the full year projection of +RMB18tn is to be achieved. The other question is obviously for how long such pace of increase in credit can be sustained with the focus now debt and leverage in the Chinese system. As China continues to transform and reform and at the same time urbanization activities set to increase further, it is likely that such pace of credit creation is likely to remain for now.

Looking deeper into the data, new loans increase in Sep saw a faster than expected rise at RMB1.22tn in Sep, ahead of expectation of RMB1tn gain and the rise of RMB0.95tn in Aug. As loans form the bulk of aggregate financing, which rose a correspondingly fast pace as well in Sep, with a gain of RMB1.72tn from RMB1.47tn in Aug, and well above RMB1.39tn expectation. These figures again rekindle worries that China is going on a debt binge. However, as shown in the chart below, there is a discernable shift in credit demand since 2015 to households, away from corporates. This mirror pattern is a reflection



of the shift towards a consumption-based economy, as China transforms and restructures. Again, a poor handling of this shift could bury the seed for the next debt worry in China in the years down the road.

All in with the underlying momentum and policy support, we do not expect China's full year growth in 2016 to deviate significantly from our forecast of 6.7%, and this means that 4Q GDP growth is likely to come in at similar pace of 6.7%. Into 2017, we expect the pace of expansion to decelerate somewhat towards 6.6% with deleveraging the main risk factor. There remain significant challenges for China such as high private sector debt and leverage, surge in property prices, excess industrial capacity, and capital outflows, but we believe these are manageable.

Diminishing Risks Of Policy Easing

With activity data pointing to stabilization, concerns over debt and leverage, as well as signs of property prices surging, PBoC's policy is likely to err on the side of caution and therefore we expect at most just one interest rate cut and 2x RRR cuts by end-2016, the probability of easing diminishing by the day.

The USD/CNY pair has since broken above the 6.70 "line in the sand" since markets reopened from the October Golden Week holiday and despite the RMB being included into SDR since 1 Oct. It should be noted that the shift towards use of trade weighted RMB index (NEER) and the G20 Communique's remarks on FX have greatly diminished risks of large RMB devaluation. Having said that, we are keeping for now our end-2016 USD/CNY forecast of 6.68 and mid-2017 call of 6.65, even with the pair hovering around 6.74 level at present, given that the current USD strength appears overstretched considering that there is only one US Fed rate hike being priced in near term.

China: Interest Rate and RRR Forecasts								
%	1Q16	2Q16	3Q16	4Q16F	1Q17F	2Q17F	3Q17F	4Q17F
1-year Benchmark Lending Rate	4.35	4.35	4.35	4.10	4.10	4.10	4.10	4.10
1-year Benchmark Deposit Rate	1.50	1.50	1.50	1.25	1.25	1.25	1.25	1.25
Reserve Requirement Ratio	17.00	17.00	17.00	16.00	16.00	16.00	16.00	16.00

Source: UOB Global Economics & Markets Research Estimates

China's Key Macro Data											
Indicators	2014	2015	1Q16			2Q16			3Q16		
Real GDP Growth %y/y	7.3	6.9	6.7			6.7			6.7		
Real GDP Growth %q/q SA	-	-	1.2			1.9			1.8		
%y/y change except noted	2014	2015	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16
Industrial Output	8.3	6.1	--	--	6.8	6.0	6.0	6.2	6.0	6.3	6.1
NBS Manufacturing PMI	50.1	49.7	49.4	49.0	50.2	50.1	50.1	50.0	49.9	50.4	50.4
Caixin-Markit Manufacturing PMI	49.6	48.2	48.4	48.0	49.7	49.4	49.2	48.6	50.6	50.0	50.1
CPI	2.0	1.4	1.8	2.3	2.3	2.3	2.0	1.9	1.8	1.3	1.9
PPI	-1.9	-5.2	-5.3	-4.9	-4.3	-3.4	-2.8	-2.6	-1.7	-0.8	0.1
Exports (USD terms)	6.0	-2.6	-11.2	-25.4	11.5	-1.8	-4.1	-4.8	-4.4	-2.8	-10.0
Imports (USD terms)	0.7	-14.4	-18.8	-13.8	-7.6	-10.9	-0.4	-8.4	-12.5	1.5	-1.9
Trade Balance (US\$ bn)	380.1	602.4	63.3	32.6	29.9	45.6	50.0	47.9	50.2	52.0	42.0
New Loans (RMB bn chg)	9,781.5	11,720.0	2,510.0	726.6	1,370.0	555.6	985.5	1,380.0	463.6	948.7	1,220.0
Aggregate Financing (RMB bn chg)	16,413.4	15,410.0	3,475.8	831.2	2,393.1	780.9	677.0	1,647.9	479.1	1,469.7	1,720.0
M2	12.2	13.3	14.0	13.3	13.4	12.8	11.8	11.8	10.2	11.4	11.5
Urban Fixed Asset Investment YTD	15.7	10.0	10.2	10.2	10.7	10.5	9.6	9.0	8.1	8.1	8.2
Retail Sales	12.0	10.7	--	--	10.5	10.1	10.0	10.6	10.2	10.6	10.7

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

FX Outlook	19-Oct-16	End 4Q16F	End 1Q17F	End 2Q17F	End 3Q17F
USD/JPY	103.8	106	109	110	111
EUR/USD	1.099	1.10	1.09	1.09	1.08
GBP/USD	1.230	1.28	1.24	1.22	1.20
AUD/USD	0.769	0.76	0.78	0.80	0.80
NZD/USD	0.723	0.73	0.75	0.75	0.76
USD/SGD	1.386	1.38	1.41	1.42	1.41
USD/MYR	4.186	4.15	4.10	4.08	4.00
USD/IDR	13,017	13,200	13,300	13,400	13,300
USD/THB	34.96	35.5	35.8	36.0	36.3
USD/PHP	48.17	46.0	45.0	43.0	41.0
USD/INR	66.73	68.9	70.4	71.9	70.5
USD/TWD	31.54	31.8	31.5	31.2	31.4
USD/KRW	1,124	1,150	1,160	1,170	1,160
USD/HKD	7.76	7.80	7.80	7.80	7.80
USD/CNY	6.742	6.68	6.66	6.65	6.63

Source: Bloomberg, UOB Global Economics & Markets Research



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