

## China: Growth Edges Higher In 4Q16

### 2016 Expansion Decelerates To 6.7% As Expected

China released its 4Q16 and 2016 GDP report on Fri morning (20 Jan 2017), with headline slightly higher at 6.8%/y/y, compared to the 6.7%/y/y pace seen in 1Q to 3Q 2016. The outcome is slightly ahead of Bloomberg poll and our forecast of 6.7%, and after registering 3 quarters of slowest pace of expansion in more than 7 years. On a sequential basis, growth rate slowed to 1.7%, after acceleration of 1.8%q/q in 3Q16 and 1.9% in 2Q16. For full year 2016, China's economy expanded by 6.7%, its sixth year of decelerating growth rate, the "new normal" economic environment.

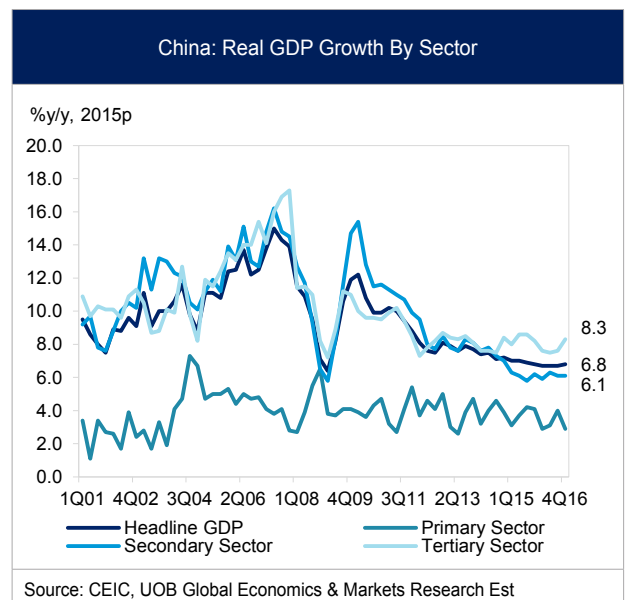
Earlier, notable data releases include both consumer and producer prices rebounding, with CPI rising 2.1%/y/y in Dec, slightly down from 2.3% rise in Nov. For the whole of 2016, the CPI rose 2% compared to 1.4% in 2015 but well below the government's 3% annual target. However, factor gate prices continued on its uptrend on higher commodity prices, slower inventory builds, and ongoing capacity rationalization in the manufacturing sector (the statistics bureau reported that steel capacity reduction target for 2016 has been met while coal production fell by 9.4% in 2016). PPI rose 5.5%/y/y in Dec, the fastest in more than 5 years and the 4th consecutive positive reading after 54 months of contractions, which is the longest stretch on record.

Another ongoing development is that industrial output increased by just 6%/y/y in Dec from 6.2% in Nov, as growth of industrial output hovered around 6% for the second consecutive year due to weak global demand, domestic capacity rationalization, economic restructuring and shifting of production to lower cost countries. This has led to the tertiary sector now accounting for 51.6% share of China's economy in 2016 (vs. 39.8% share for secondary sector), from 50.2% share in 2015. The statistics bureau noted that due to improvements in innovations in areas such as aerospace and aviation, quantum communications, and high speed computing, output from China's strategic new industries increased by 10.5%/y/y, 4.5% point higher than overall industrial output.

### Comments

The marginally higher reading for 4Q16's headline reading, while a positive development, is not large enough to alter China's slower growth trajectory into 2017. A culmination of factors including domestic deleveraging and economic restructuring/reform, uncertainty of global growth and trade, and shifting of investment flows will add downward pressure to China's economy. The recent Central Economic Work Conference (CEWC) in Dec took note of high financial leverage, especially the in the corporate sector. Among other things, deleveraging is likely to be one of the key tasks for the central bank in 2017.

We still see a low probability of an economic "hard landing" scenario for China as rising personal income and increased share of private consumption will help to sustain growth momentum. For 2017, we expect a further and gradual shift down in economic growth in China, to 6.6%, which nonetheless remains within the current growth target



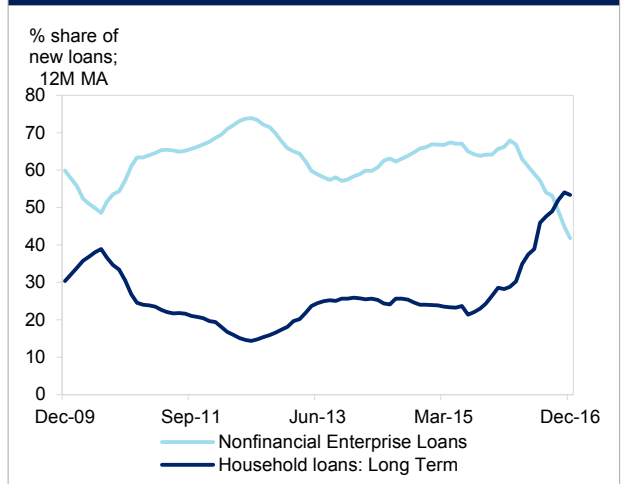
of 6.5 to 7%. We note that there is scope for this growth target to be adjusted or widened - to say, 6-7% - to further shape expectations of the “new normal” economic environment and provide room for policy flexibility to deal with a multitude of economic issues in China. Any changes to official growth and policy targets will be reflected at the upcoming National People’s Congress in Mar.

Despite the recent rebound of the RMB, led by a massive clear out of offshore CNH shorts in early Jan which has persisted until now, we expect to see depreciation pressure on the currency creeping back like it did in 2016. This is partly due to the US dollar, which we expect to stay higher through 2017 under a “macro shift” environment sparked by US President-elect Trump, as well as increased tendency by Chinese businesses to invest overseas (e.g. for diversification purposes, market expansion, and under the One Belt One Road initiative) and by individuals (for travel and education). As such, we maintain our end-2017 for USD/CNY is at 7.16.

One area to note is US President-elect Trump’s position on trade tariffs and “currency manipulation” with respect to Asia. Going by existing metrics, China does not fit the “manipulator” label, though there might still be ways to get around that. In any case, it remains to be seen how exchange rates would be impacted from such an accusation by the US.

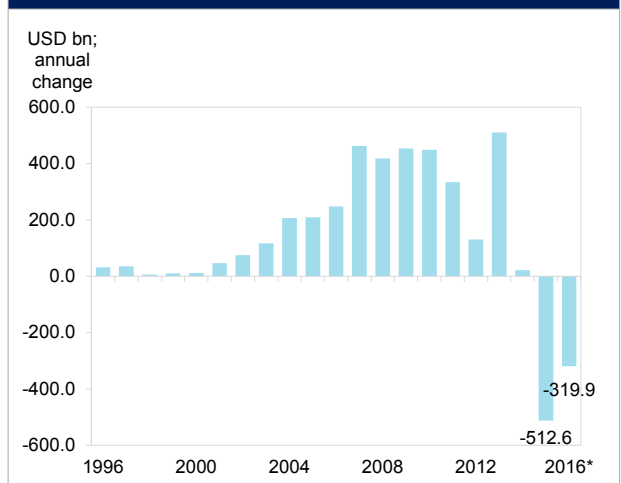
In line with the tone set in CEWC, PBoC’s policy stance is likely to stay prudent and we expect the central bank to maintain its current benchmark interest rates unchanged at 4.35% (1Y lending) and 1.50% (1Y depo), as well as the RRR intact at 17.0% for now. In domestic financial markets, interest rates are already reflecting the deleveraging tone and “macro shift” mentioned earlier in this report. Liquidity conditions have turned tighter since late 2016, pushing up domestic interbank interest rates (3-month SHIBOR has broken out from a narrow range of 2.8-3.0% in 2015-2016, to 3.7% by mid-Jan 2017) and longer term yields (10Y China government bond yield range has been at 3.1-3.4%, well above the sub-3% range in 2016).

### China: Uses of New Increase in Loans



Source: CEIC, UOB Global Economics & Markets Research Est

### China: Change in Foreign Reserves



Source: CEIC, UOB Global Economics & Markets Research Est

### China's Key Macro Data

Indicators	2014	2015	2016	2Q16			3Q16			4Q16		
Real GDP Growth %y/y	7.3	6.9	6.7	6.7			6.7			6.8		
Real GDP Growth %q/q SA	-	-	-	1.9			1.8			1.7		
%y/y change except noted	2014	2015	2016	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
Industrial Output	8.3	6.1	6.0	6.0	6.0	6.2	6.0	6.3	6.1	6.1	6.2	6.0
NBS Manufacturing PMI	50.1	49.7	51.4	50.1	50.1	50.0	49.9	50.4	50.4	51.2	51.7	51.4
Caixin-Markit Manufacturing PMI	49.6	48.2	51.9	49.4	49.2	48.6	50.6	50.0	50.1	51.2	50.9	51.9
CPI	2.0	1.4	2.0	2.3	2.0	1.9	1.8	1.3	1.9	2.1	2.3	2.1
PPI	-1.9	-5.2	-1.4	-3.4	-2.8	-2.6	-1.7	-0.8	0.1	1.2	3.3	5.5
Exports (USD terms)	6.0	-2.6	-7.7	-1.8	-4.1	-4.8	-4.4	-2.8	-10.0	-7.3	0.1	-6.1
Imports (USD terms)	0.7	-14.4	-5.5	-10.9	-0.4	-8.4	-12.5	1.5	-1.9	-1.4	6.7	3.1
Trade Balance (US\$ bn)	380.1	602.4	547.2	45.6	50.0	47.9	50.2	52.0	42.0	48.8	44.2	40.8
New Loans (RMB bn chg)	9,781.5	11,720.0	12,645.9	555.6	985.5	1,380.0	463.6	948.7	1,220.0	651.3	794.6	1,040.0
Aggregate Financing (RMB bn chg)	16,413.4	15,410.0	17,802.3	780.9	677.0	1,647.9	479.1	1,460.5	1,711.5	886.5	1,832.8	1,626.0
M2	12.2	13.3	11.3	12.8	11.8	11.8	10.2	11.4	11.5	11.6	11.4	11.3
Urban Fixed Asset Investment YTD	15.7	10.0	8.1	10.5	9.6	9.0	8.1	8.1	8.2	8.3	8.3	8.1
Retail Sales	12.0	10.7	10.4	10.1	10.0	10.6	10.2	10.6	10.7	10.0	10.8	10.9

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

FX Outlook	20-Jan-17	End 1Q17F	End 2Q17F	End 3Q17F	End 4Q17F
USD/JPY	114.7	115	117	119	120
EUR/USD	1.068	1.04	1.03	1.02	1.02
GBP/USD	1.236	1.20	1.18	1.16	1.16
AUD/USD	0.758	0.73	0.73	0.72	0.72
NZD/USD	0.721	0.68	0.68	0.67	0.67
USD/SGD	1.425	1.45	1.46	1.47	1.48
USD/MYR	4.446	4.42	4.35	4.45	4.50
USD/IDR	13,379	13,800	13,900	14,100	14,300
USD/THB	35.32	36.3	36.5	36.8	37.0
USD/PHP	49.88	49.8	50.2	50.6	50.9
USD/INR	68.07	70.4	71.9	72.8	73.8
USD/TWD	31.50	32.5	32.9	33.3	33.7
USD/KRW	1,170	1,190	1,200	1,210	1,220
USD/HKD	7.76	7.80	7.80	7.80	7.80
USD/CNY	6.867	6.95	7.02	7.09	7.16
USD/MMK	1,355.5	1,325	1,350	1,375	1,400
USD/VND	22,670	22,700	22,700	22,750	22,750

Source: Bloomberg, UOB Global Economics & Markets Research



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