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TD Economics

International Data Commentary: Chinese economy off to a strong start in 2017

- Chinese first quarter real gross domestic product (GDP) rose by 6.9% (year-on-year), broadly in line with consensus (+6.8%). Growth was largely supported by household and government consumption, with much smaller contributions from fixed investment and net trade. Annualized growth on a quarter-over-quarter basis weakened to about 5.3% from 7.0% in the fourth quarter. Consensus expected an expansion of around 6.1% on a quarterly annualized basis.

- Nominal GDP for the first quarter of 2017 rose 11.8% (y/y) – the fastest pace of expansion since the fourth quarter of 2013 – owing largely to strong price growth from firmer commodity prices feeding through to producer prices.

- Economic activity on an industry basis was broad based, with all sectors expanding on a year-on-year basis. Most notable were advances in secondary industries (mining, manufacturing, construction), which rose 6.4% y/y in 17Q1 (16Q4: +6.1% y/y), while tertiary/services-related industries rose 7.7% y/y (16Q4: 8.3% y/y). Service industries comprise the largest share of economic activity in China at around 52%.

- Fixed asset investment (excluding rural areas) rose at about a 9.0% pace (reported on a year-over-year in year-to-date basis) in the first quarter, up from the 8.2% pace in the previous quarter. Fixed asset investment has been slowing consistently since early 2013 when it was rising at a 20% y/y rate, and broadly reflects the shift away from economic dependence on investment and toward services.

- Industrial production rose 7.6% (y/y) in March, stronger than the consensus call for 6.3%. Industrial production in the first quarter picked up slightly from the previous quarter, owing largely to gains in manufacturing and utilities.

Key Implications

- The overnight data shows a Chinese economy that expanded quite strongly, at least on a year-on-year basis. While quarterly growth was weaker than expected, this is not atypical for first quarter growth in China, a period that often includes some economic disruption resulting from the Chinese New Year holiday season. In addition to the usual seasonality, the small car tax increased from 5.0% to 7.5% in January, a move that looks to have slowed auto sales at the start of this year following strong sales in the previous quarter.

- First quarter economic growth was at least partly fuelled by strong expansion in credit, similar to what was observed over the same period last year. Economic growth on the back of strong credit growth is a mixed bag of sorts. On the one hand, the economic feedback loop is working as expected: investment today is typically a function of both recent and expected economic performance, and is often credit intensive. However, a failure to achieve growth expectations can result in borrowers falling behind on payments, risking distress in domestic lending markets.

- Chinese authorities have become increasingly more sensitive to historically high levels of debt in all sectors – corporate, household, and government – and the risks that this poses to its domestic banking sector, particularly in an environment of slowing economic growth. We anticipate that monetary policymakers will continue to seek ways to constrain lending this year, which may include tightening monetary policy and implementing further measures to soften housing market activity.

- Earlier this year Chinese authorities announced a target that GDP growth for 2017 was expected to slow to 6.5% from the 6.7% pace recorded in 2016. Although growth on a year-on-year basis remained strong, the weakness in quarter-on-quarter growth mathematically suggests that quarterly growth will have to average around 7.0% on an annualized basis in order to achieve the 2017 target. It remains to be seen how Chinese authorities will be able to balance its twin objectives of achieving the growth target without relying too heavily on debt-fuelled stimulus to perk up growth as needed. Overall, we see the Chinese economy slowing in 2017 (+6.4% y/y) and 2018 (+6.1% y/y).

- In addition to managing the transition of the economy toward a services-based one, Chinese policymakers will have to combat a number of external risks this year. For one, China will have to react to what is increasingly looking like a more protectionist global trade environment. Another factor is the elevated geopolitical risks arising from a potential military confrontation between North Korea and the United States. Pressure is on China to deescalate the situation in order to avoid a potentially disastrous outcome in its Northeast region. Lastly, China will continue to struggle to restrain capital outflows in an environment of elevated global political and economic uncertainty. Although foreign reserves have held at roughly $3 trillion USD since the start of 2017, there are doubts on the ability of authorities to continue to successfully enforce capital controls.

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