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Economics Group

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Chinese GDP Growth Slowed Further in Q1

Real GDP growth in China continues to downshift, and we look for further slowing in coming quarters. That said, we do not expect the wheels to come completely off the Chinese economy either.

Investment Spending Continues to Decelerate

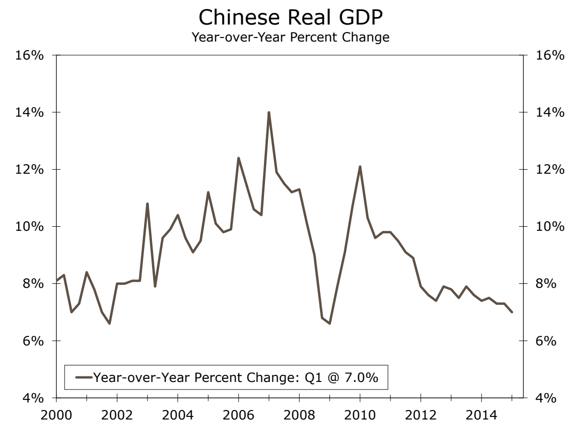
Data released today showed that economic growth in China continues to slow. As shown in the top chart, real GDP rose 7.0 percent on a year-ago basis in Q1-2015, which matched the consensus forecast. On a sequential basis, real GDP rose 1.3 percent (not annualized), the smallest increase in overall economic output since seasonally adjusted data became available four years ago.

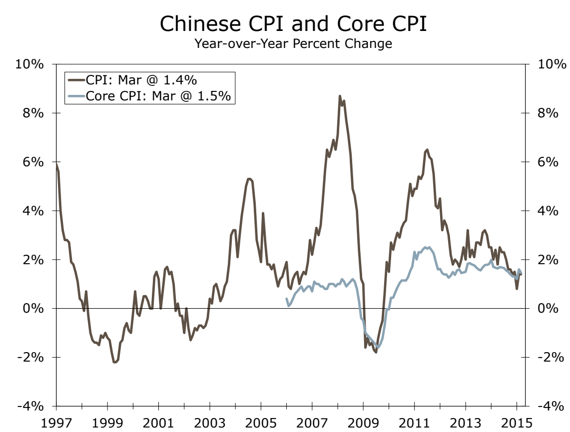
A breakdown of real GDP into its underlying demand components is not available at this time, so it is difficult to pinpoint the precise reason for the downshift in overall GDP growth in Q1. That said, recent monthly data show that fixed investment spending, which has weighed on overall GDP growth in recent quarters, decelerated further in Q1 (middle chart). The property boom in China, which led to a surge in residential investment, is now reversing, thereby weighing on growth in overall investment spending. House prices continue to decline, so it appears that weakness in residential investment has further to run.

In addition, growth in consumer spending also appears to have downshifted a bit as growth in retail sales slowed from 11.7 percent in Q4 to 10.2 percent in Q1. However, inflation is very low at present (bottom chart), so growth in real consumer spending appears to be increasing at a solid clip, providing support to overall GDP growth.

In our view, real GDP growth in China will slow further in coming quarters. As noted above, the property downturn appears to have further to run, which will weigh on growth in investment spending. That said, we do not expect the wheels to come completely off the Chinese economy either. With economic growth in the United States remaining generally solid and with a modest cyclical upswing in the Eurozone appearing to be underway, growth in Chinese exports should remain supported. In addition, growth in consumer spending in China generally appears to be solid at present.

Moreover, we would expect Chinese authorities to support growth with expansionary macroeconomic policies, should it prove necessary. The central bank has already cut its benchmark lending rate by 65 bps since November, and it has eased its required reserve ratio by 50 bps. The central bank has ample room to cut both policy variables further, and we look for more policy easing in coming months. Moreover, the government has the flexibility to turn on the fiscal taps if needed because the debt of the central government is less than 20 percent of GDP at present. Although we do not expect wholesale easing of policy *à la* 2008-2009, we do expect the government to enact more stimulative policies at the margin in an effort to pull off a macroeconomic "soft landing."





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