Economic Research Department

GDP Observatory

China

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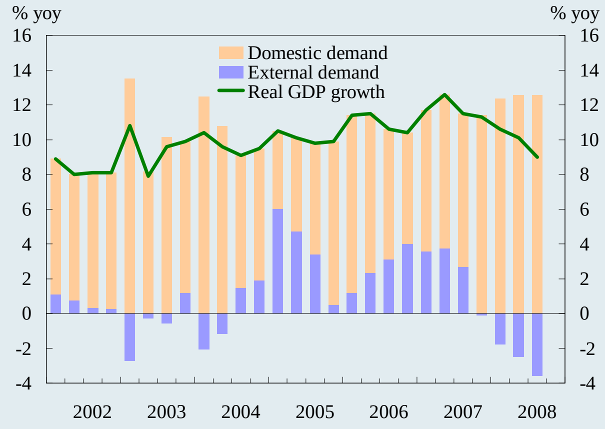
China's real GDP growth slowed further to 9.0% yoy in Q3 on weaker external demand

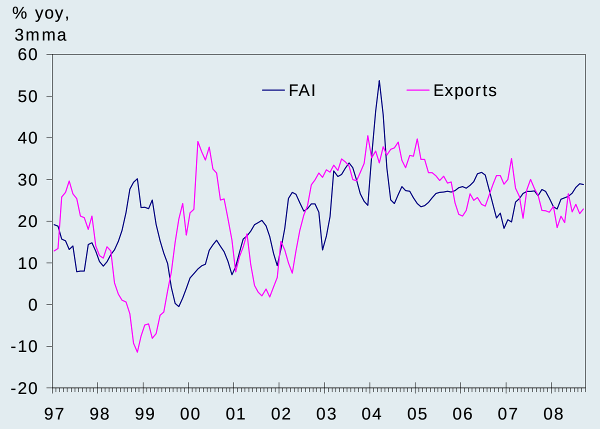
- China's GDP growth slowed to 9.0% in Q3. This entails a fall of 1.1 percentage points from that in Q2. This is also 0.7 percentage point slower than the market consensus.
- It marks the first time China's quarterly GDP growth has fallen below 10 percent since the end of 2005, fuelling expectations of a slowdown in the in Q4 and 2009.
- The moderation in GDP growth was broadly based, led by contracting net exports and moderating domestic demand (Chart 1).

Chart 1: Real GDP growth



Sources: CEIC and BBVA estimates.

Chart 2: Growth in Investment and Exports



Sources: CEIC and BBVA estimates

- For the three quarters as a whole, the economy grew by 9.9%, still a rapid pace relative to other emerging market economies.
- Given the close relationship between China's investment and export growth, falling external demand is likely to depress investment (Chart 2). Looking forward, domestic investment is likely to slow as well, absent from stimulative fiscal and monetary policy.
- As the G-3 economies are possible to enter recession simultaneously and China's high dependence on international trade, we expect Chinese economy will continue to moderate in 2009.
- We forecast the real GDP to grow by 9.5% in 2008 and 8.4% in the 2009. Inflation, on the other hand, is expected to fall from 6.0% in 2008. Given the expected large fall of external demand and the recent sharp falls of oil and commodities prices, China's inflationary pressure will start wane. We forecast CPI inflation in 2009 to reach 2.0%. Both of our GDP and inflation forecasts are at the lower end of the consensus forecasts.

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- Because of the rapidly deteriorating global economic conditions, China is expected to move quickly to ease monetary policy and to start fiscal stimulus policies. Indeed, Premier Wen has already announced a 10-point plan that has a focus on raising farmers' income to stimulate domestic consumption, providing guarantees to ease small and medium enterprises to access credits; and raise export rebates for textiles and electrics industries.
- On monetary policy front, we believe PBOC will ease monetary policy further in the coming months by reducing both interest rate and the reserve requirement ratio. In addition, lending restrictions on certain sectors such as property market are also expected to be eased soon. Given the risk of deflation has started to set in, the monetary authorities should start to ease more aggressively now because of the lag of monetary policy transmission.
- Despite the deteriorating global financial and economic conditions, we continue to maintain that China will remain a bright spot of the global economy, largely because its solid macroeconomic fundamentals, sound banking system, and favorable fiscal and monetary policy conditions coming into the crisis.