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Economic Observatory

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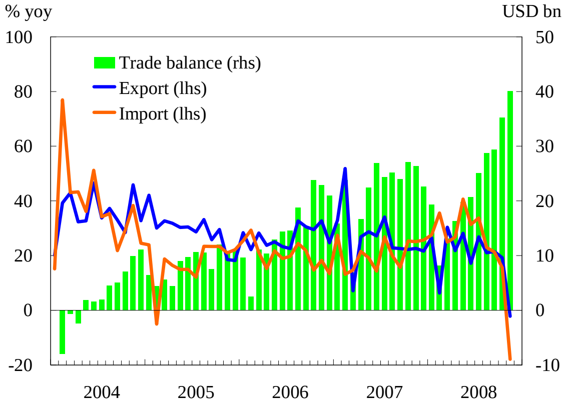
China's Exports Fell by 2.2 % yoy, the First Contraction in 7 years

China's November exports fell for the first time in 7 years, while the monthly trade surplus registered a record-high of US$ 40.1 billion as imports contracted even more sharply.

Looking forward, it is expected that China's exports will continue to fall fast in 2009, on the weakening global demand. Despite falling exports, China´s trade surplus is likely to remain sizable in the coming months, largely because China´s exports in size are much larger than imports. This also suggests that the pressures for the RMB exchange rate to depreciate will continue to remain low in the near term.

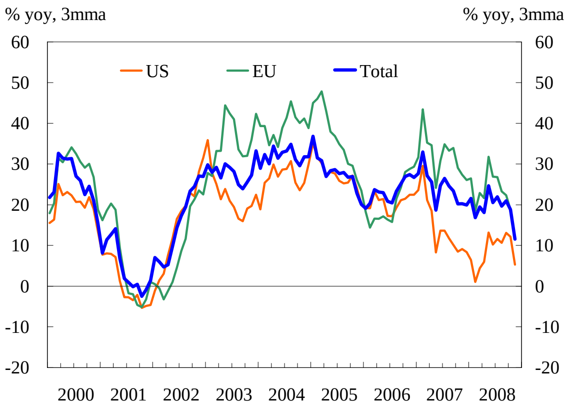
- China's exports registered the first monthly yoy decline of 2.2% in 7 years in November, compared with an increase of 19.7% in October. Imports declined even more sharply by 17.9% yoy, mainly due to the slowdown in domestic demand and falling commodities and oil prices. Meanwhile, trade surplus continued to remain substantial, registering a record-high monthly surplus of US$ 40.1 billion. We think that trade surplus is expected to fall in the coming months on a sharply falling external demand (Chart 1).
- Growth in exports to all major markets declined sharply in November. In particularly, exports to the EU and the US recorded larger declines (Chart 2).
- Trade and foreign direct investment are important sources of economic growth in China. Given the importance of G-3 economy to China´s economic growth, we estimate that a simultaneous G-3 economic slowdown by one percentage point will lead to a slowdown in China's real GDP growth by

Chart 1: Trade performance



Source: CEIC.

Chart 2: Exports by markets

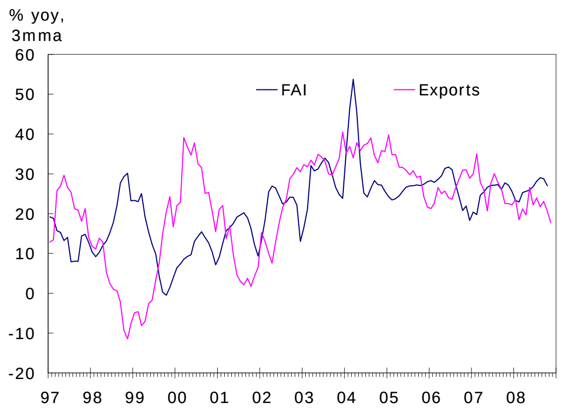


Sources: CEIC and BBVA estimates.

0.73 percentage point one year later (See our China Economic Observatory on October 8).

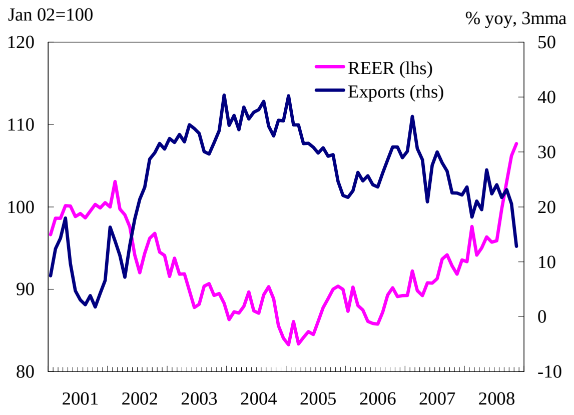
- In addition, China's investment share to GDP appears to be positively related to its ever increasing export share as well, possibly suggesting that China's investment has a lot to do with building up capacities for the export sector. This is also evidenced by China's investment growth has become highly correlated with its export growth after 2001 (Chart 3).
- Looking forward, Chinese export growth is likely to decline further on a slower external demand, the relatively strong RMB, and rising wages. Given the importance of trade, the Chinese economy is therefore not immune to a global slowdown. In particularly, the slowing export sector will lead to a tide of bankruptcies in the coastal region, thus increasing unemployment rate sharply and potentially threatening social stability.
- Given the slowing exports, the market expects China will change its exchange policy recently. Indeed, RMB REER appreciation has started to exert a negative impact on China's export growth since the end of 2007. Combined with slowing external demand, China's export growth should continue to decline in 2009.
- However, as discussed in our China Economic Observatory on December 3, RMB depreciation will invite trade protectionist pressures and limit the ability for PBoC to use the interest rate instrument to ease monetary policy. The RMB exchange rate has become an important reference currency for other East Asian currencies in recent years, largely because of China's growing importance in the region. If the RMB were to depreciate, it might lead to competitive devaluation in Asian currencies. Therefore, we think it is still in China's interest to maintain stable currency.

Chart 3: Exports and Investment



Sources: CEIC and BBVA estimates.

Chart 4: Exports and REER



Sources: BIS, CEIC and BBVA estimates.