



Economic Observatory

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Some updates of economic activities of the third largest economy in the world

China revised its 2007 real GDP growth from 11.9% yoy to 13.0%. This revision has formally made China the third largest economy in the world, surpassing Germany, while still distantly behind the US and to a less extent, Japan.

The December exports registered the second consecutive month of decline, while the monthly trade surplus remained large at USD 39 billion on a sharp contraction in imports and falling exports. The large trade surplus in the last three months of 2008 implies that the contribution of net exports to GDP growth in Q4 will likely to remain large.

While economic activities continued to show signs of deceleration, bank loans and M2 have rebounded sharply. The banking system appears to have started to respond positively to the aggressive monetary policy eases since mid-September.

Given the massive fiscal stimulus package and ample room for further monetary ease, we are optimistic that a growth target of 8% for 2009 will be obtainable.

Revision of 2007 GDP figures

- China revised its 2007 GDP figures. The nominal GDP was revised upward from RMB 24.9 trillion (USD 3.28 trillion) to RMB 25.7 trillion (USD 3.38 trillion). After the revision, China has become the third largest economy in the world, still distantly behind the US and to a less extent, Japan.
- The upward revision thus led to a revision in real GDP growth. It was revised up by 1.1 percentage

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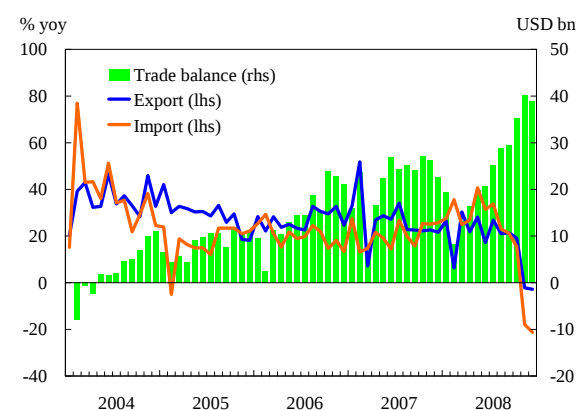
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Table 1: Revision of 2007 GDP figures

	Nominal GDP (RMB billion)	Real GDP (% yoy)
Figures before revision	24,953	11.9
Finalized figures	25,731	13.0

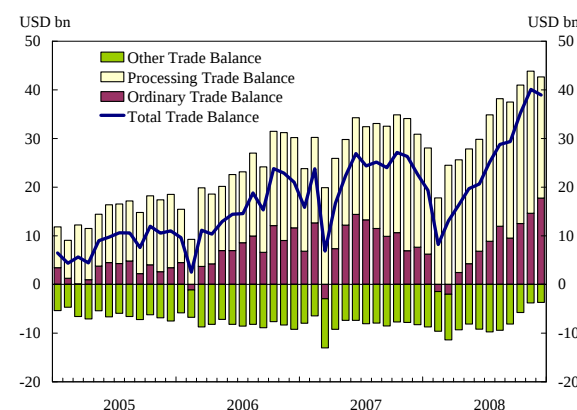
Sources: National Bureau of Statistics.

Chart 1: Trade performance



Source: CEIC.

Chart 2: Trade by customs regime



Sources: CEIC and BBVA estimates.

points from 11.9% to 13.0% yoy. This revision will also affect the yoy real GDP growth rate for 2008, which is to be released next week.

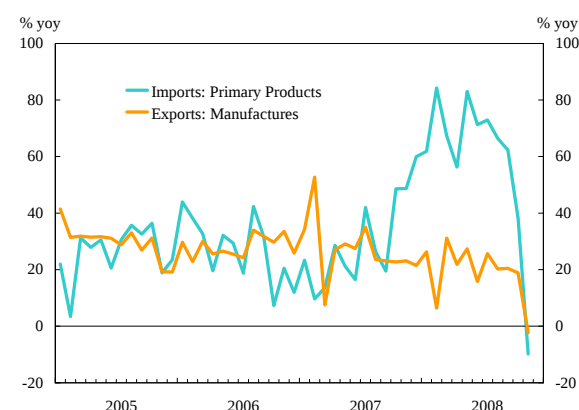
Large trade surplus, despite export slowdown

- China's exports contracted further by 2.8% yoy in December from a decline of 2.2% in November. However, imports dropped even more sharply by 21.3%. Trade surplus thus continued to remain substantial at USD 39 billion (Chart 1). For the year as a whole, China's exports grew by 17.2% yoy, lower than 25.8% in 2007. Meanwhile, the 2008 import growth slowed to 18.8% yoy from 20.5% in 2007, largely reflecting the falling oil and commodity prices at the second half of 2008. Nevertheless, trade surplus climbed to USD 295.5 billion in 2008, which is USD 30.3 billion higher than that in 2007. It is expected that the contribution of net exports to GDP growth should be a highly positive figure in Q4, despite export slowdown.
- The sharp fall in commodity prices after 2008 H1 helps explain import contraction (Chart 3). Since China imports primary products mainly from ASEAN and Latin America, import growth from these economies dropped sharply, particularly from ASEAN economies (Chart 4).
- Meanwhile, export growth to all major markets all declined considerably in December. In particular, exports to the EU and the US recorded larger declines, due to the second round impact of the financial turbulence on the real economy (Chart 5). Moreover, the spread of financial crisis to emerging market economies has also dimmed the prospect of China's export performance further.

Monetary policy ease started to work

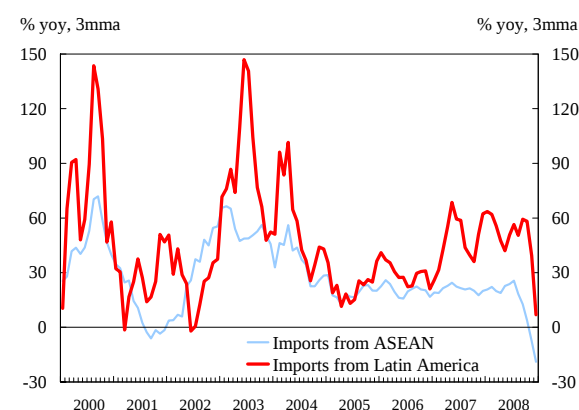
- Broad money (M2) growth picked up considerably to 17.82% yoy in Q4 from 15.29% yoy in Q3, while credit growth rose sharply to 18.76% yoy from 14.48% in Q3 (Chart 6).
- The surge in money supply and loans can be explained by the aggressive monetary policy eases of the People bank of China (PBoC) since mid-September. Our analysis suggests that the PBoC still has ample room to ease should China's economic growth decelerate further.
- Chinese banks, unlike their western counterparts, appear to have high incentive to lend because of their ownership structure and profitability concerns. The earmarked spending of RMB 100 billion in 2008

Chart 3: Primary imports and manufacturing exports



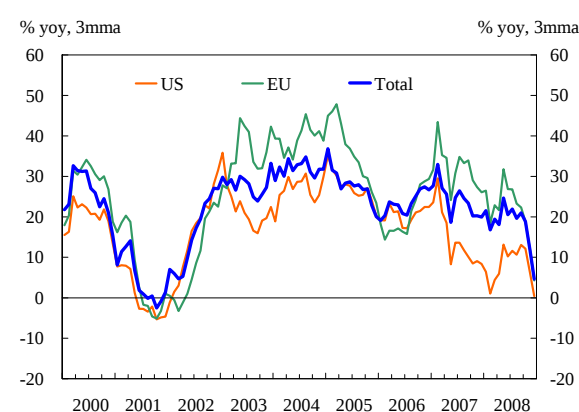
Sources: CEIC and BBVA estimates.

Chart 4: Sharp declines in import growth



Sources: CEIC and BBVA estimates.

Chart 5: Exports by markets



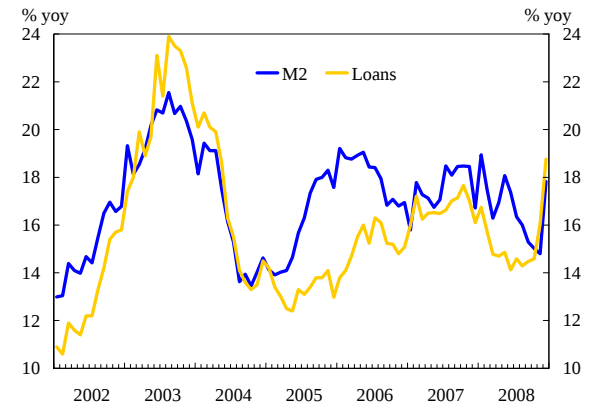
Sources: CEIC and BBVA estimates.

Q4 may have also provided new opportunities for banks to lend.

Foreign Exchange Reserves continued to rise

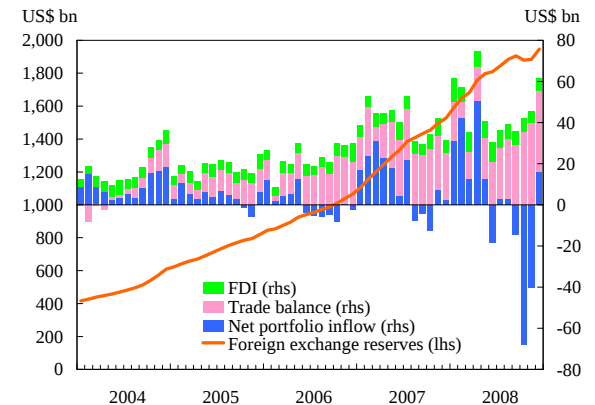
- Net capital inflows have moderated after strong inflows in H1. In particular, portfolio capital experienced some large outflows from September to November, before registering an inflow again in December. The net portfolio inflows decreased by USD 100 billion in H2, compared with an increase by USD 131 billion in H1, possibly reflecting profit repatriation motives as some FDI firms may need liquidity in their home markets on worsening global credit conditions.
- Nevertheless, China's foreign exchange reserves continued to increase, rising by USD 40 billion in Q4 alone on large trade surplus and FDI inflows. On a quarter on quarter basis, the size of reserve increase in Q4 slowed substantially, compared to an increase of USD 154, 127, and 97 billion in Q1, Q2, and Q3, respectively. At the end of 2008, China's FX reserves Reached to USD 1.946 (Chart 7).

Chart 6: M2 and Loans



Sources: CEIC and BBVA estimates.

Chart 7 Fund Flows



Sources: CEIC and BBVA estimates.