GDP Observatory

China

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China's real GDP growth decelerated to 6.8% yoy in Q4, led by sharp contraction in external demand. The economy still grew by 9.0% in 2008.

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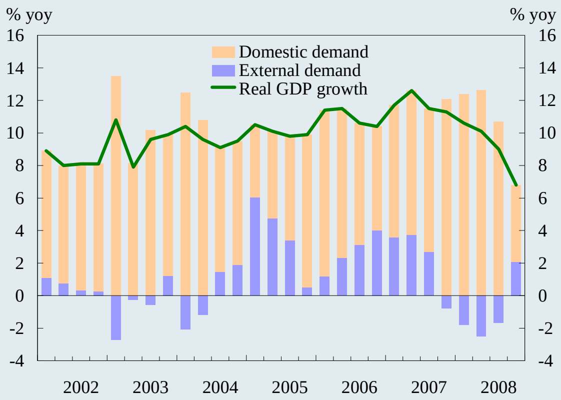
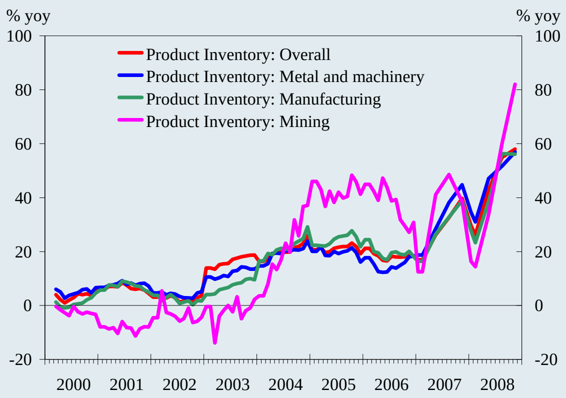
- China's real GDP growth decelerated to 6.8% in Q4, compared to 9.0% in Q3, led by a sharp fall in external demand, which depressed both economic activities and industrial profits, while domestic consumption and net exports remained solid. For the year as a whole, the economy grew by 9.0%, still the highest growth rate among the major economies in the world.
- Today's announcement is exactly the same as reported by the Bloomberg a few days earlier (BBVA, Q4, 7.3%; 2008, 9.3%), suggesting economic momentum continued to decelerate in the last quarter of 2008, despite the recent rebound in credit growth. Given today's announcement on the GDP figure, we expect the PBOC will cut interest rate and RRR, possibly by 27 bps and RRR by at least 50 bps within days.
- According to our estimates, net exports' contribution to growth reverted to positive 2.1 percentage points (Chart 1) after a consecutive 4-quarter negative contribution, led by a surprising large trade surplus in Q4 2008 of USD 114 billion, owing to sharp import contraction. While private consumption expenditure and the FAI remained solid, the continued deceleration of growth may be led by a large inventory build up that may have suppressed industrial production in the last quarter (Chart 2).
- Looking forward, we expect export growth will continue to be battered by a sharp contraction in external demand in G-3 economies, while import growth will gradually pick up as inventories are drawn down and fixed asset investment picks up. The growth momentum will then led by domestic demand with fixed asset investment returning to the driving seat.
- Given the massive fiscal stimulus package and ample room for further monetary ease, we are optimistic that China can still grow close to its potential. We continue to maintain our 2009 GDP forecast at 8.1%.

Chart 1: Real GDP growth



Sources: CEIC and BBVA estimates.

Chart 2: Inventory build up



Sources: CEIC and BBVA estimates

Details

- For the year as a whole, the economy grew by 9.0%, 4.0 percentage points lower than the revised 13.0% growth in 2007. It is 2.9 percent points lower than the pre-revised 2007 GDP growth figure at 11.9. This is the first single digit-growth ever since 2003.
- In addition to Q4 GDP figure, there are several new data release on December industrial production, retail sales, fixed asset investment (FAI), PPI, and CPI figures.
- Growth in industrial production picked up somewhat to 5.7%, from the November low of 5.4%, suggesting that economic activities may have started to rebound, benefiting from the much relaxed credit conditions.
- Retail sales slowed to 19.0% from 20.8% in November on slowing household income growth, which moderated to 13.8% in Q4 from 15.4% in Q3. However, real retail sales remain robust, staying roughly the same as in November.
- Fixed asset investment grew by 21.9% in December, about 1.9 percentage points lower than that in November, while growth in real FDI grew by 23.3% largely benefiting a falling prices in industrial costs.
- Producer price index experienced a fall of 1.1% in December on sharp falls of oil and commodities prices. For the year as a whole, it is 6.9% or 3.8 percentage points increase from 2007. Meanwhile, CPI inflation continues to slow, reaching 1.2% in December, which is 1.2 percentage point drop from November.
- Released earlier, 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.
- 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 18.5% 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.
- While looking at proxies of GDP by expenditure, it appears the economy continues to perform solidly. This is in contrast to the Q4 production-based GDP figure. Indeed, there is a high probability that the production-based GDP measures, led by a sharp fall in industrial production and much slowed profitability of industrial firms, may have downwardly biased the GDP figure for Q4. Given the large discrepancies between production based and expenditure based GDP for previous years, we believe the 2008 GDP may be revised higher later this year (Table 1).

Table 1: GDP figures in different approaches

	Production-based				Expenditure-based
	Preliminary		Final		
	Nominal GDP (RMB bn)	Real GDP (% yoy)	Nominal GDP (RMB bn)	Real GDP (% yoy)	Nominal GDP (RMB bn)
2005	18,232.1	(9.9)	18,386.8	(10.4)	18,869.2
2006	20,940.7	(10.7)	21,192.3	(11.6)	22,165.1
2007	24,661.9	(11.4)	25,730.6	(13.0)	26,324.3
2008	30,067.0	(9.0)	n.a.	n.a.	n.a.

Source: China's National Statistical Bureau.

- Given the expected implementation of the large fiscal stimulus package, we are still optimistic that the Chinese economy will rebound after Q2. Pending on the estimates for fiscal elasticity, we find that the fiscal stimulus package will be able to generate additional growth by at least 3 percentage points. Indeed, our upper bound estimate suggests that the fiscal stimulus package will be able to generate up to 5 percentage point growth in 2009.

- On top of it, China also has very favorable monetary conditions that will facilitate the implementation of the fiscal stimulus package. We calculate that the PBOC may be able to cut interest rate further by a range of 108 to 378 bps, pending on the outlook of the RMB exchange rate. Should the RMB remain stable, a rate cut of 378 bps points will be possible over 2009.
- In addition, if additional cuts in RRR of 5.5-7.5 percentage points were implemented, this would be equivalent to injecting liquidity of RMB 4 trillion into the banking system. Even after these massive cuts, the RRR would still be as high as 8%, the level in mid-2006. The increased liquidity conditions in the banking system will certainly ease the pressure of interest rate rises caused by the expected large government debt issuances.
- Given today's announcement on the GDP figure, we expect the PBOC will cut interest rate and RRR soon, possibly by 27 bps and RRR by at least 50 bps within days.
- Despite the deteriorating global financial and economic conditions, we continue to maintain that China will remain a bright spot of the global economy in 2009, largely because its solid macroeconomic fundamentals, sound banking system, and favorable fiscal and monetary policy conditions. We therefore continue to maintain our growth forecast for 2009 at 8.1%.