Economic Research Department

BBVA

China

Monthly Chart Book

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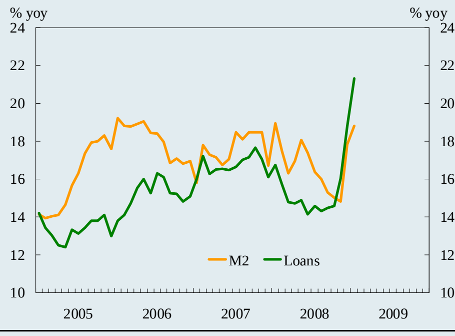
Li-Gang Liu
lliu@bbva.com.hk
Andrew Tsang
andrew.tsang@bbva.com.hk

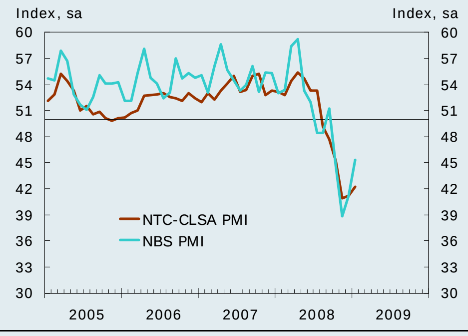
Highlights of the month:
Are Signs of Stabilization in Sight?

We have seen some visible signs of stabilization of the Chinese economy in recent months. Credit growth surged in December and January by 18.8% and 21.3%, respectively, the fastest growth since 2003. PMI has also started to show signs of pick up in December. As credit continues to flow into the real sector in large quantity, we expect the industrial production to rebound quickly. Meanwhile, the January figures for exports and imports contracted further. Though largely owing to the Chinese New Year effect, the sharp fall in intra-Asia trade and the G-3 slowdown do not bode well for a recovery in China's exports any time soon. While the deleverage process by the financial institutions in the US and the EU continues to affect consumption and therefore demand for Chinese exports, the aggressive re-leverage process by both the government and the banking system in China has a high probability to help the Chinese economy cushion the fall in external demand. Looking forward, we believe the central bank will have to ease monetary policy more aggressively in the near future to prevent the risk of deflation and to facilitate the implementation of the fiscal package. We forecast that the central bank is likely to cut interest rate and reserve requirement ratio, respectively, by at least 54bps and 3 percentage points in 2009.

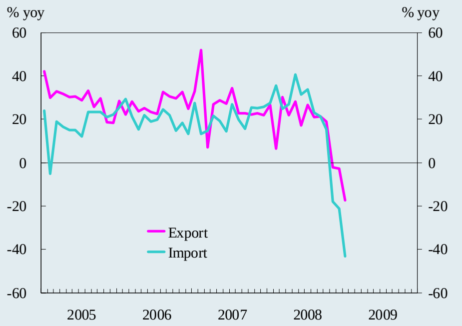
M2 and Loan Growth



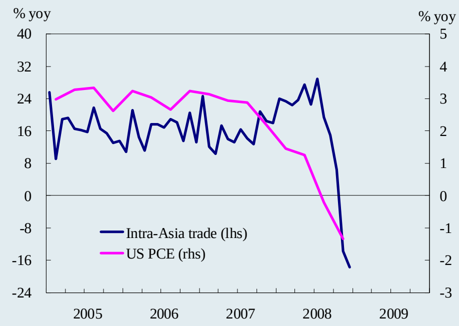
PMI



Growth in Exports and Imports



Intra-Asia Trade and US PCE

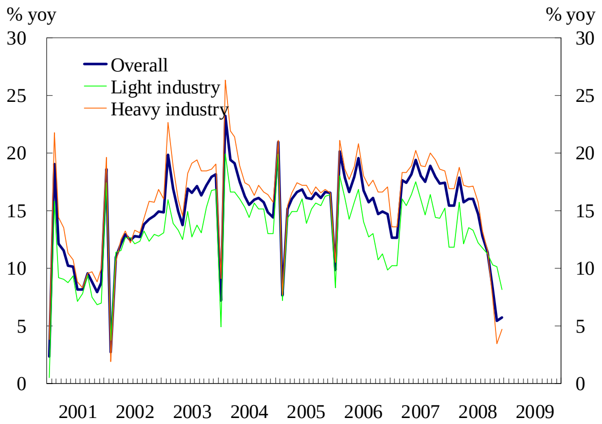


Sources: CEIC, Datastream and BBVA staff estimates.

I. Real Economic Activities

(a) Industrial production

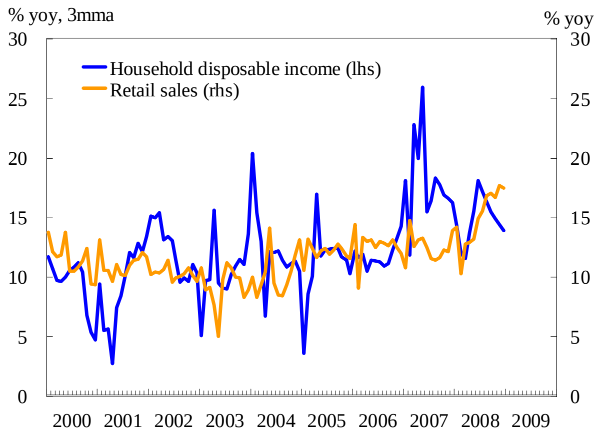
Growth in industrial production rebounded slightly to 5.7% in December, after recording the lowest growth over a decade of 5.4% in November. In particular, the stabilization in heavy industry growth contributed the rebound in industrial production growth, partly continued to be affected by a more moderated export growth. The January and February industrial production data will be released together in March.



Sources: CEIC and BBVA estimates.

(b) Household income and real retail sales

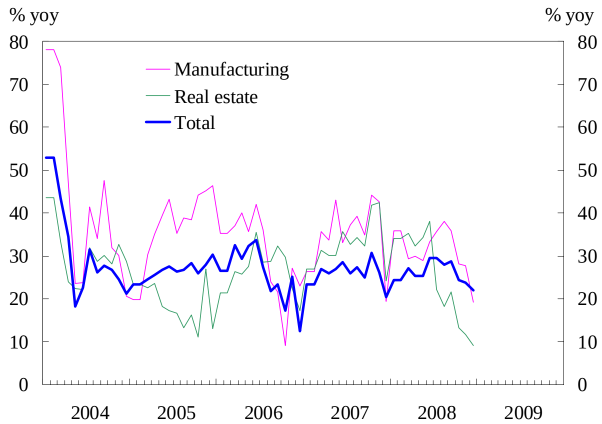
Household disposable income in nominal terms continued to grow at a slower pace, after the rebound in growth in Q2. Growth in real urban income even picked up to 11.0% yoy in Q4 from 9.5% in Q3. Growth in nominal retail sales moderated further to 19% yoy in December from 20.8% in November. However, adjusted for the effect of falling inflation, growth in real retail sales stood at 17.4% yoy in December, compared with 17.6% in November.



Sources: CEIC and BBVA estimates.

(c) Fixed Asset Investments

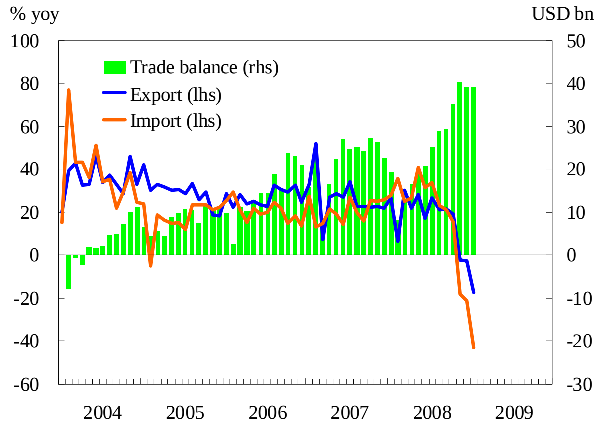
Growth in nominal fixed asset investment (FAI) contracted to 21.9% yoy in December from 23.7% yoy in November, while real growth in FAI picked up to 23.3% from 21.3% in November. It is expected that the growth in real estate investment would decline further in 2009 Q1 as fiscal stimulus package for housing construction takes time to be implemented.



Sources: CEIC and BBVA estimates.

(d) External Trade

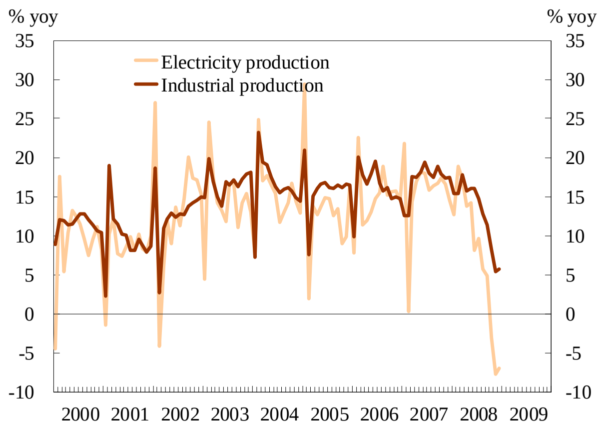
January exports fell sharply by 17.5% yoy from a decrease of 2.8% in December, largely due to the Chinese New Year effect. The monthly trade surplus picked up to US$ 39.1 billion as imports collapsed, declining to a negative 43.1% yoy from a decrease of 21.3% in December. However, trade surplus is expected to fall in the coming months on a sharply falling external demand.



Sources: CEIC and BBVA estimates.

(e) Industrial production and electricity

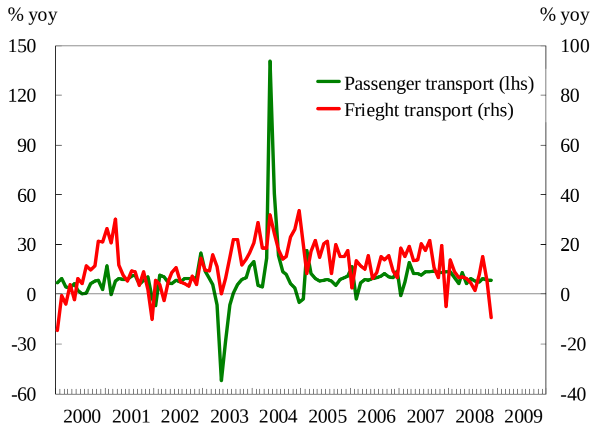
Electricity production fell further by 7.0% yoy in December from 7.8% November, continuing the contraction trend. The decline in electricity production in this year is mostly reflected by a slowing growth in activities of those heavy industries.



Source: CEIC and BBVA estimates.

(f) Transportation

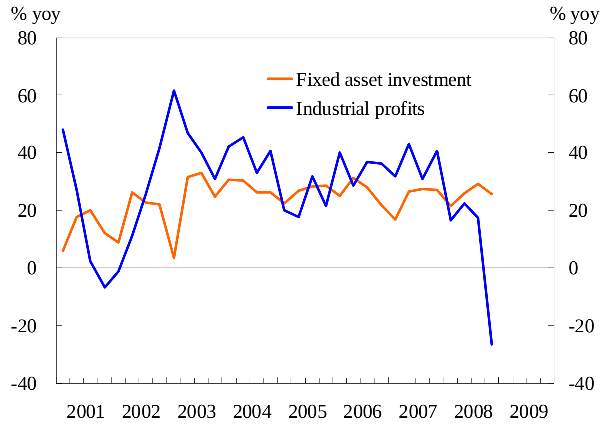
Growth in passenger transport was stable in recent months. However, growth in freight transport fell again and even registered decline after some rebound in the post-Olympic months. It is expected that the transport activity will start to stabilize, as the economic activities start to recover.



Source: CEIC.

(g) General industry profitability

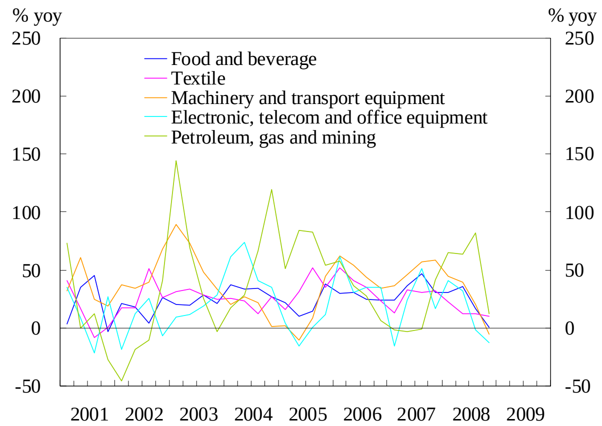
Industrial profits recorded a sharp yoy fall of 26.6% in Q4. The decline in profit growth is expected to continue in Q1 as global slowdown intensifies. However, heavy industry profits may start to rebound possibly benefiting from falling commodity prices and de-inventory of existing products produced on expensive inputs last year.



Source: CEIC.
Note: 2008Q4 figures of industrial profits are up to November 2008.

(h) Profitability by industry

Energy sector continued to experience the fastest growth in profits, although the growth rate decelerated quickly, while profit growth slowed sharply for electronic, telecom, and the office equipment industry.

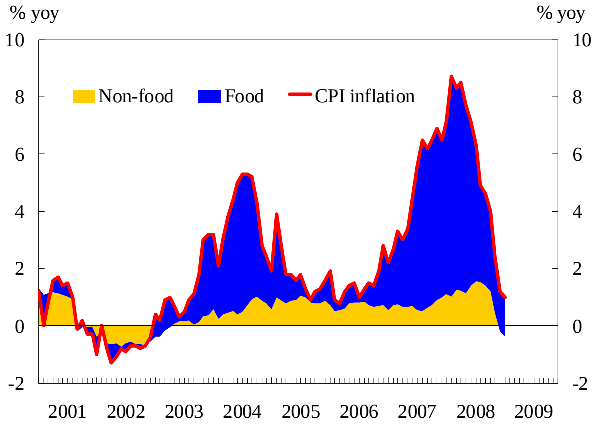


Source: CEIC.
Note: 2008Q4 figures of industrial profits are up to November 2008.

II. Price Developments

(a) Consumer price inflation

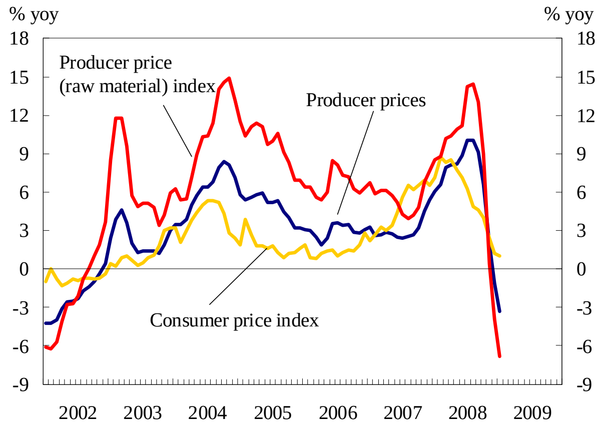
China's disinflationary process accelerated in January. CPI inflation fell to 1.0% yoy in January from 1.2% in December, the slowest rise in the recent 30 months. The fall in CPI was led by falling food prices and a high base effect while imported inflation from international energy and commodity prices eased sharply.



Sources: CEIC and BBVA estimates.

(b) Producer prices

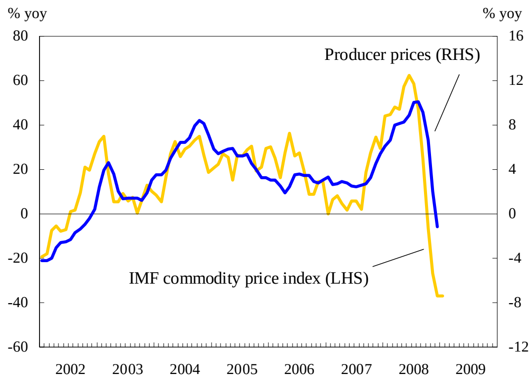
Given the slower domestic demand and sharp commodity price deflation, PPI dropped further 2.2 percentage points to minus 3.3% yoy in January from that in December, continuing the rapid slide in PPI.



Sources: CEIC and BBVA estimates.

(c) Commodity prices and PPI

China's PPI inflation is highly correlated to price changes in international commodity prices. As the year-to-date price increases in international commodities eased sharply from 62% yoy in June 2008 to -37% in January 2009, the pass-through effect led to a sharp fall in PPI inflation.

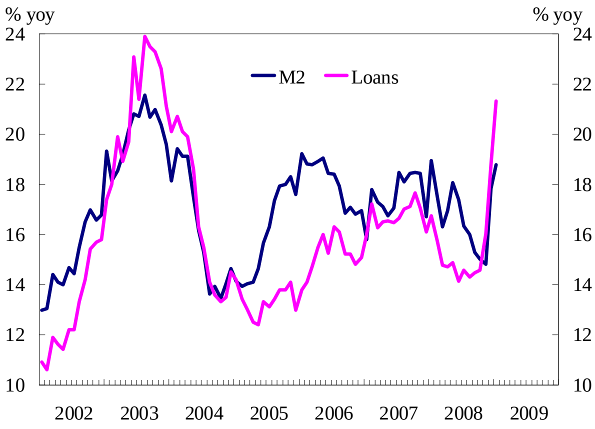


Sources: IMF, CEIC and BBVA estimates.

III. Monetary Conditions

(a) Money supply and credit

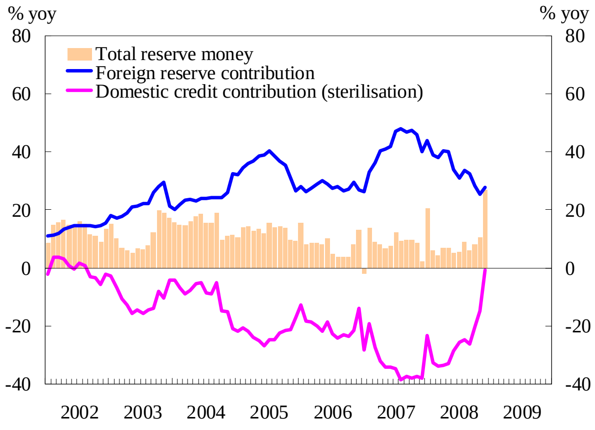
Growth in broad money (M2) picked up to 17.82% yoy in December from 14.8% in November, thanks to the recent monetary policy ease. Meanwhile, growth in domestic credit picked up further to 18.76% in December from 16.03% in November. The loans issued in January are RMB 1,600 billion, thus registering a yoy growth of 21.33%, the highest since 2003. This indicates that the relaxed credit policy has started to work through the banking system.



Sources: CEIC and BBVA estimates.

(b) Reserve money

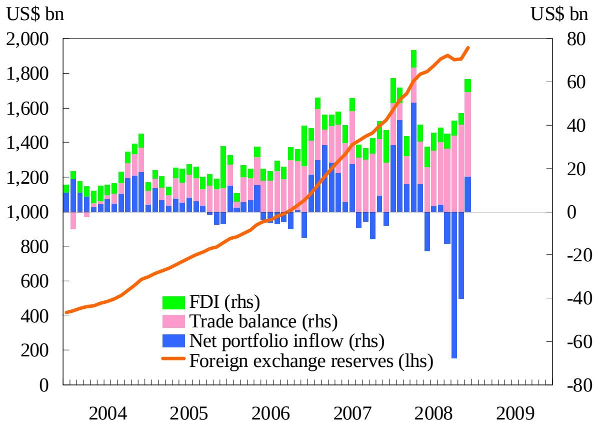
Reserve money growth has increased sharply after February due to much eased sterilization process by the monetary authorities. This shows that the cut in interest rates and reserve requirement ratio have worked well to stimulate money growth.



Sources: CEIC and BBVA estimates.

(c) External capital inflows

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.

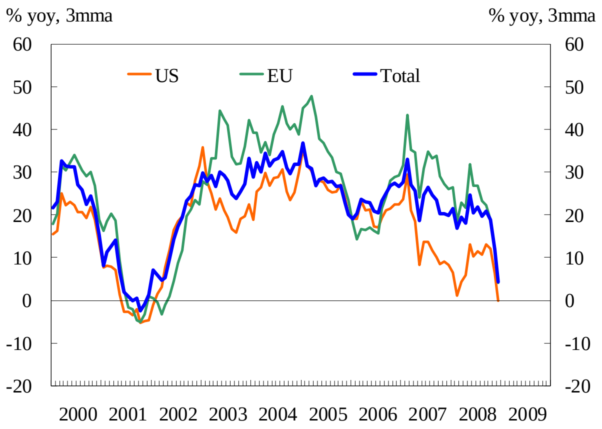


Sources: CEIC and BBVA estimates.

IV. External Trade

(a) Exports by region

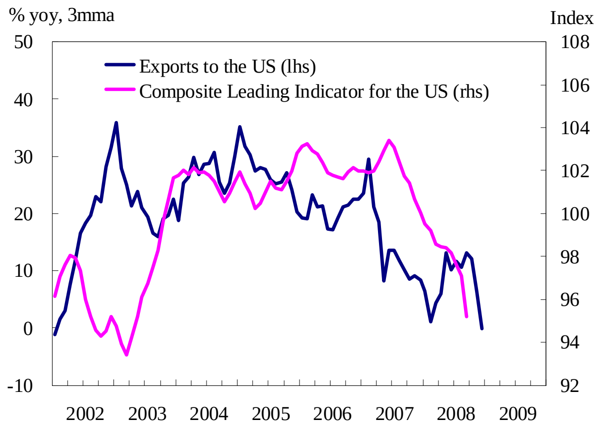
Export growth declined sharply in November, on a 3-month moving average basis. Declines in exports appeared to be across all markets, particularly for the G-3 markets.



Source: CEIC.

(b) Exports to US

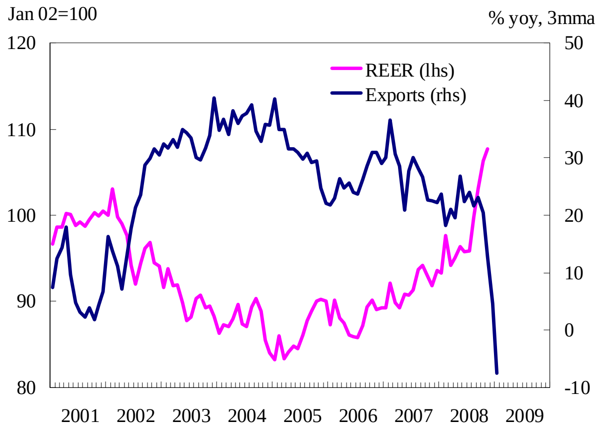
In line with the economic outlook of the US--shown by the leading indicator for the US, the export growth to US has been on a declining trend since 2007.



Source: OECD, CEIC and BBVA estimates.

(c) Real exchange rate and exports

REER appreciation continued 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. We estimate that export growth in China is likely to decline by 21% this year.

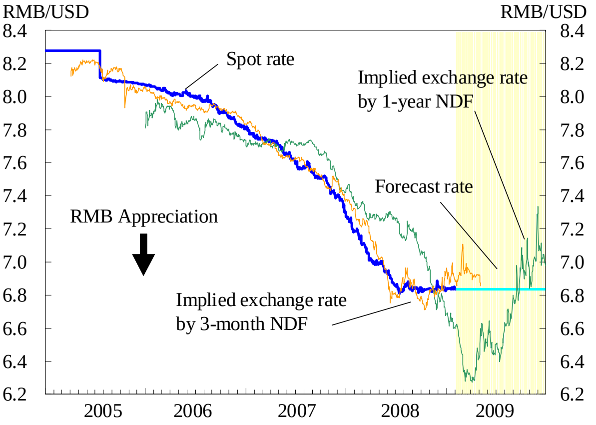


Sources: CEIC and BBVA estimates.

V. Exchange Rate

(a) Spot and expected appreciation of renminbi

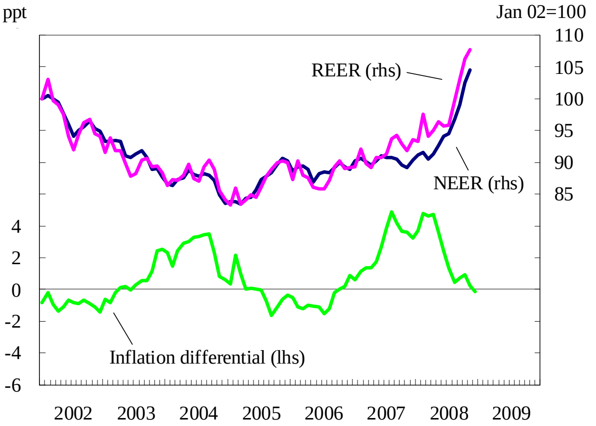
Renminbi stabilized at around the RMB/USD 6.8 level. A sizeable rebound of US dollar recently may explain the stabilization of the RMB since July. To avoid the protectionist pressures and facilitate the transformation of growth pattern, we forecast that the renminbi exchange rate to remain stable in 2009.



Sources: CEIC and BBVA estimates.

(b) REER, NEER, and inflation differential with trading partners

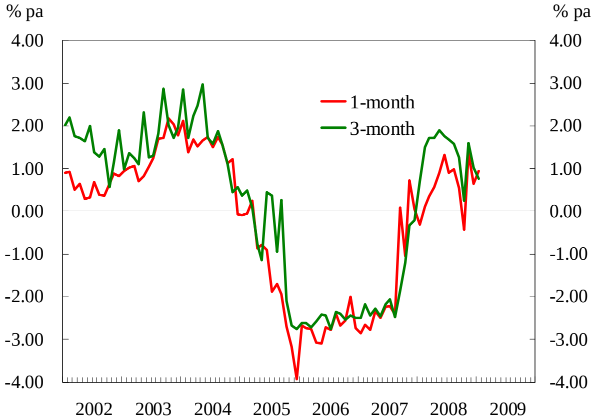
China's REER and NEER of the renminbi continued to appreciate reflecting large depreciation in some key trading partners' currencies and China's very low inflation rate to relative to its key trading partners.



Sources: BIS, CEIC, Datastream and BBVA estimates.

(c) Interest rate differentials (spreads of Chibor over Libor)

The interest rate differentials between 3-month Chibor and Libor contracted to below 100 bps from around 150 bps November, reflecting the continued stress in the LIBOR market led by credit crunch in Western banks.

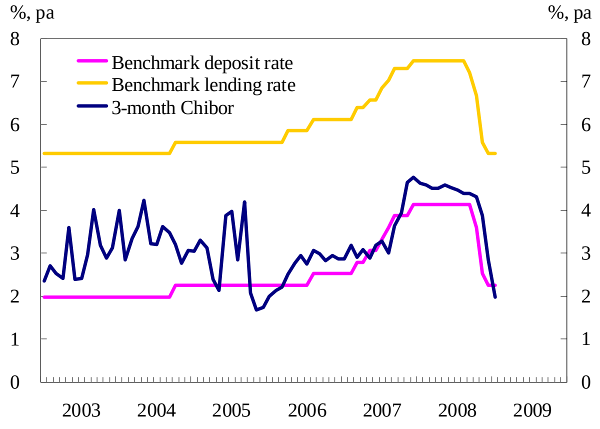


Sources: CEIC and BBVA estimates.

VI. Financial Markets

(a) Benchmark interest rates and Chibor

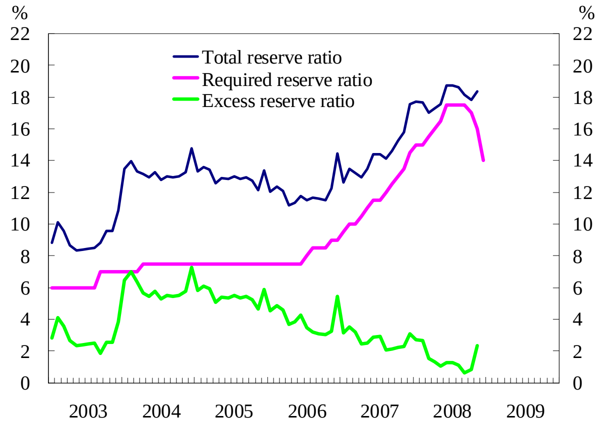
To ease external slowdown, PBoC lowered the benchmark (one-year) lending rate by 27 bps to 5.31% again in late December, while the deposit rate was also cut by 27 bps to 2.25%. Meanwhile, the 3-month Chibor, continued to fall, but still higher than the benchmark deposit rate.



Sources: People Bank of China and CEIC.

(b) RRR & Excess reserves

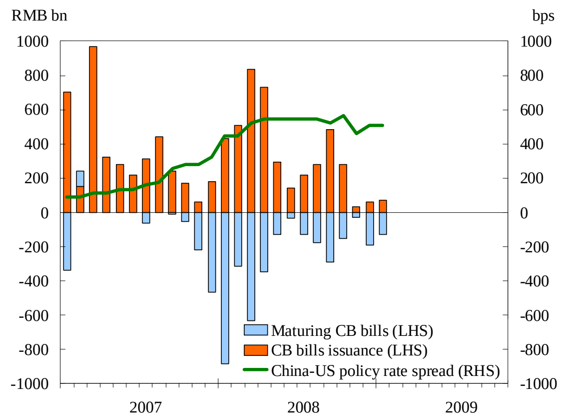
To inject liquidity to the banking system, PBoC also cut the reserve requirement ratio (RRR) for all banks effective on December 25. The required reserve ratio (RRR) is cut by 0.5 percentage point. Hence RRR for small- and medium-sized financial institutions reached 13.0%, and for the six largest banks (the Big Four (ABC, BOC, CCB, and ICBC), Bank of Communications, and Postal Savings Bank of China) is 15.5%.



Sources: CEIC and BBVA estimates.

(c) Open market operations

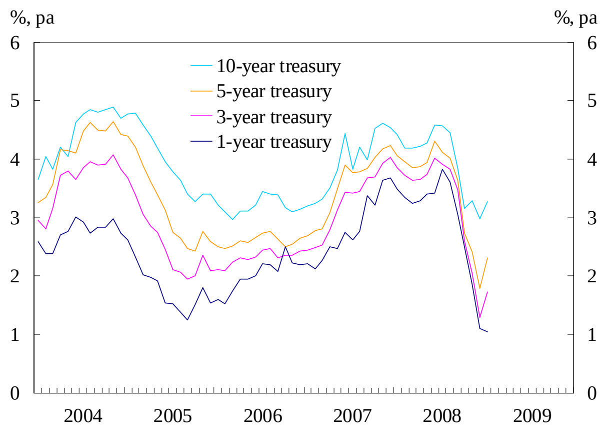
PBoC's open market operations reduced sharply since Q2 as net capital inflows eased. The costs of sterilization, measured as the spread of Chinese policy rate over US fed fund target rate, remained high after 2007 H2.



Source: CEIC.

(d) Treasury yields

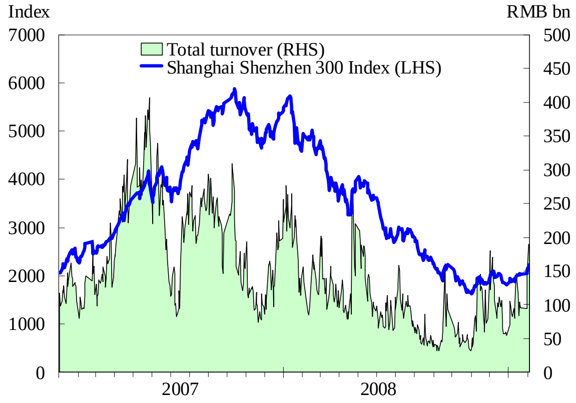
Treasury yields across different maturities picked up slightly in January, after falling drastically in the last quarter in 2008, reflecting the latest expectations of easing inflationary pressures in Q4 because of economic deceleration and falling commodities prices.



Source: CEIC.

(e) Stock Market Performance

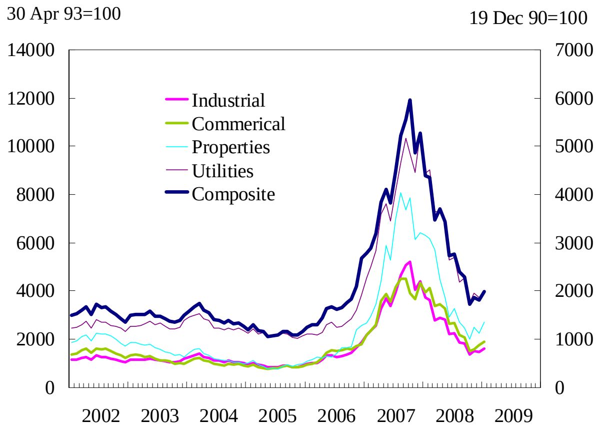
China's stock prices fell by close to 70% in 2008 from the peak in October 2007, while the decline in stock prices was particularly large in September, partly affected by the global financial crisis. The PE ratio also returned to a more sustainable level, declining to around 18 times from a peak of 70 times in October 2007. However, the stock prices have stabilized since Q4. Meanwhile, trading value also picked up by 100% from the bottom.



Source: CEIC.

(f) Shanghai Stock Exchange Index

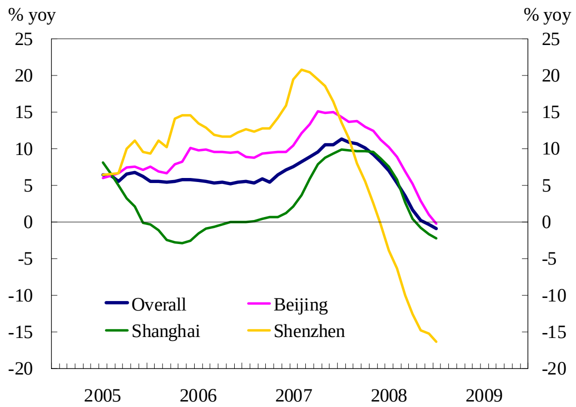
Stock market rebound considerable in the first two months in 2009, gaining by x% since the trough reached in 2008. At this moment, the Chinese market is one of the best performing markets in the world.



Source: CEIC.

(g) Property market

The property prices declined further by 0.9% yoy in January 2009, following a decline of 0.4% in December. Since the beginning of 2008, property prices have started to cool, after a sharp increase in property prices in 2007. Housing price growth in Shenzhen recorded a large negative yoy growth of 16.3% in January. The sharp fall in property price prices may reinforce economic downturn, as the negative wealth effect will affect private consumption further.



Source: CEIC.