China

BBVA

Monthly Chart Book

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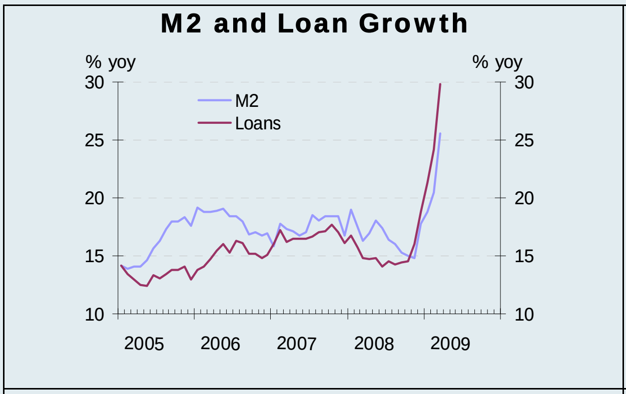
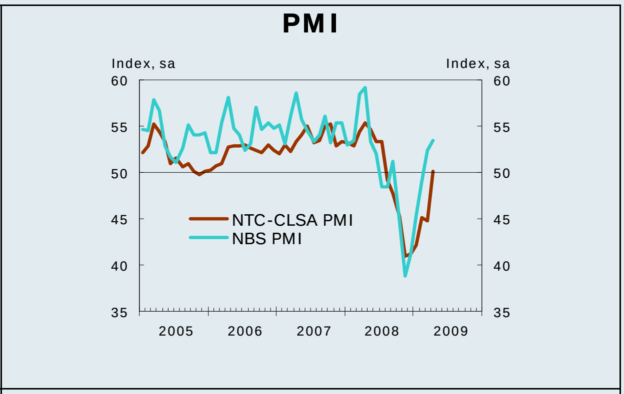
Highlights of the month: Data point to a recovery underway

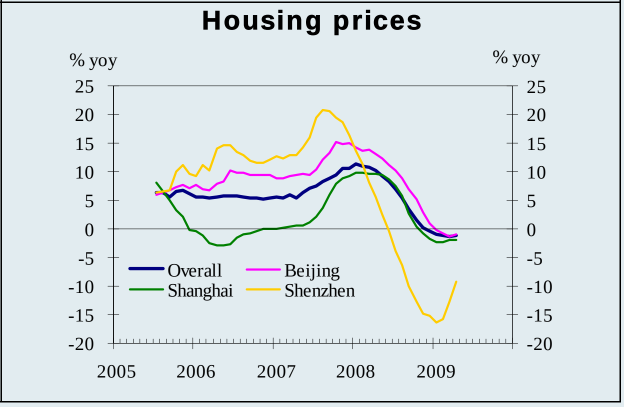
China's real GDP grew by 6.1% in Q1 2009 amidst a sharp global recession and continued to weaken from 6.8% in Q4 2008, but we think the economy has been bottoming up and a relatively vigorous recovery can be expected in Q2, as domestic policies gain more traction, inventory depletes, and the difficult external environment stabilizes.

Data released in May also reinforced our expectation:

- Favorable monetary conditions remained conducive for economic recovery, as banks have pumped in a huge amount of credit into the economy to accommodate the stimulus package.
- Economic activities continued to show positive readings: PMI showed stronger signs of production rebound; real growth in FAI picked up rigorously; and retail sales continued to hold up well. However, exports remained weak in April, despite some signs of stabilization in the G-3 markets.
- The housing market also warmed up with sharp increases in property transaction volumes, reinforcing the expectation of an economic recovery.





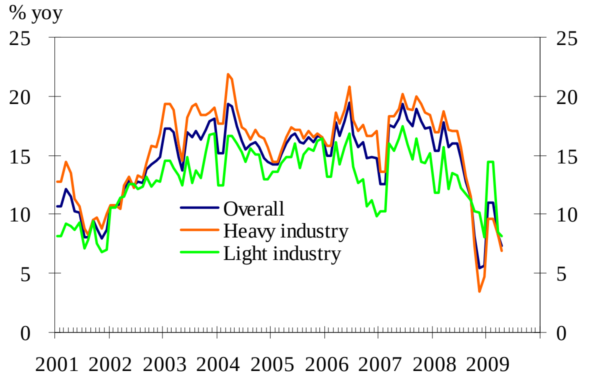


Sources: CEIC, Datastream and BBVA staff estimates.

I. Real Economic Activities

(a) Industrial production

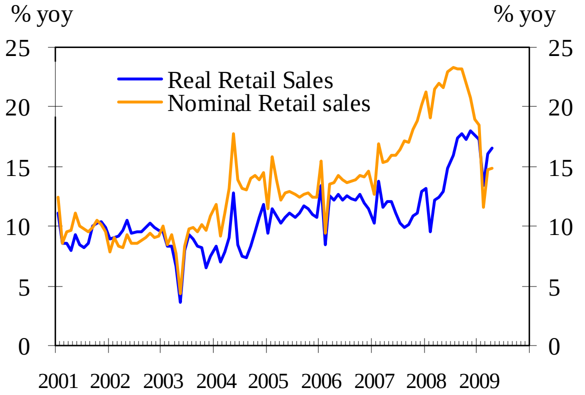
Growth in industrial production improved to 7.3% yoy in April from 3.8% in January-February 2009, but a slight drop from 8.3% in March. In particular, the further contraction in heavy industry growth is more severe than light industry, contributing to the decline of the overall industrial production growth. In Q2, the slowing Industrial production should stabilize as PMI continues to pick up. And the heavy industry would benefit more from the full implementation of the fiscal stimulus package.



Sources: CEIC and BBVA estimates.

(b) Real retail sales

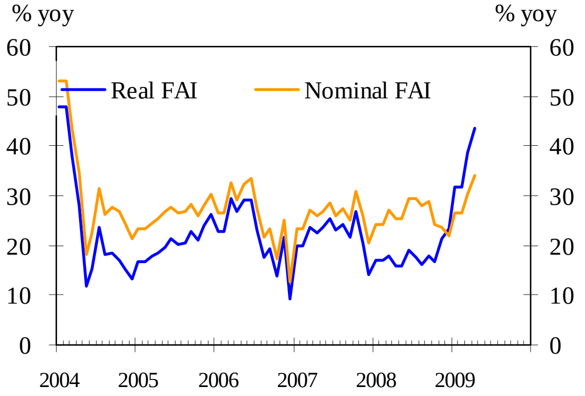
Retail sales grew 16.55% yoy in April, compared to 16.9% in March. Adjusted for the effect of falling inflation, growth in real retail sales continued to hold up well.



Sources: CEIC and BBVA estimates.

(c) Fixed Asset Investments

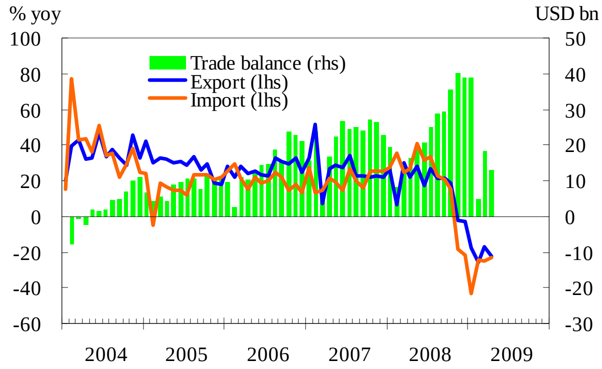
Growth in nominal fixed asset investment (FAI) picked up sharply to 33.9% yoy in April, while real growth in FAI picked up even more to 43.4% yoy from 38.6% in March, benefiting from the implementation of the fiscal stimulus package.



Sources: CEIC and BBVA estimates.

(d) External Trade

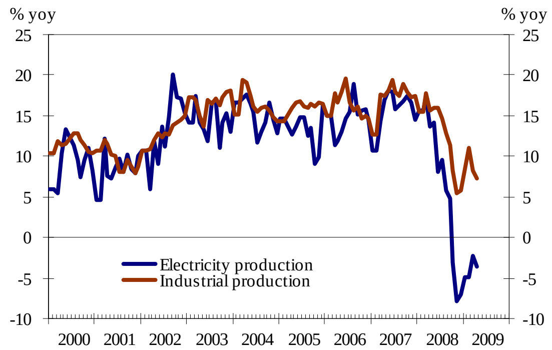
April's exports continued to weaken, falling 22.6% yoy from a decrease of 17.2% in March. Given a more contraction of 23% in imports, the monthly trade surplus remained sizeable at US$ 13.1 billion. It shows the sluggish external demand still weighed on exports sector.



Sources: CEIC and BBVA estimates.

(e) Industrial production and electricity

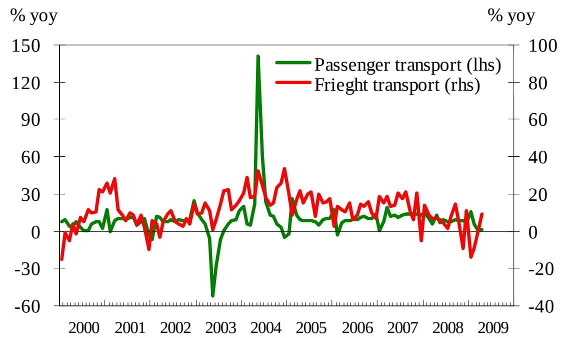
The fall in electricity production was moderated to -3.6% yoy in April from a decrease of 3.9% in the first two months. Albeit the free fall trend was reversed, it is still early to confirm a recovery. The decline in electricity production in this year is mostly reflected by a slowing growth in activities of those heavy industries and the industrial de-stocking process.



Source: CEIC and BBVA estimates.

(f) Transportation

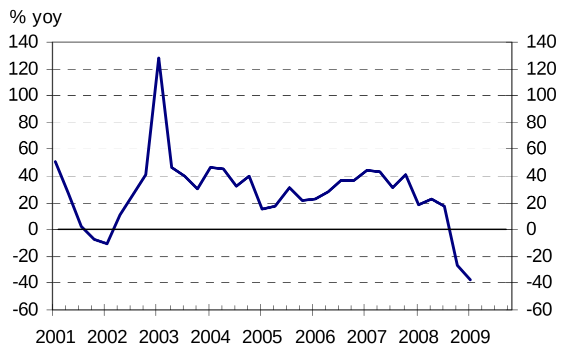
Growth in passenger transport slowed down in recent months after the peak season of January. However, growth in freight transport rebounded again in April. The freight transport is a leading index for economic recovery, whose stabilization might represent the recovery is under way.



Source: CEIC.

(g) General industry profitability

Industrial profits continued its sharp yoy fall of 37.1% in Q1 from 26.6% in Q4 on weak demand. The decline in profit growth is expected to level off in Q2 as global slowdown is moderated and the de-inventory progress is over for the existing products produced on expensive inputs last year.

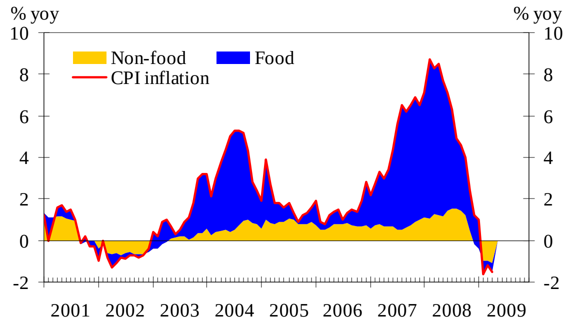


Source: CEIC.
Note: 2008Q4 figures of industrial profits are up to November 2008.

II. Price Developments

(a) Consumer price inflation

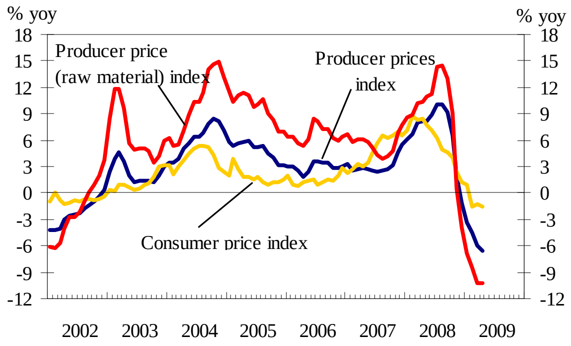
Falling prices started from February and CPI continued to fall 1.5% yoy in April from a drop of 1.2% in March. The fall in CPI was led by falling food prices and a high base effect while imported inflation from international energy and commodity prices also played a role. Although the inflation rate temporarily turned to negative, we expect the price will increase again given the demand is boosted by the massive fiscal stimulus package and ample credits.



Sources: CEIC and BBVA estimates.

(b) Producer prices

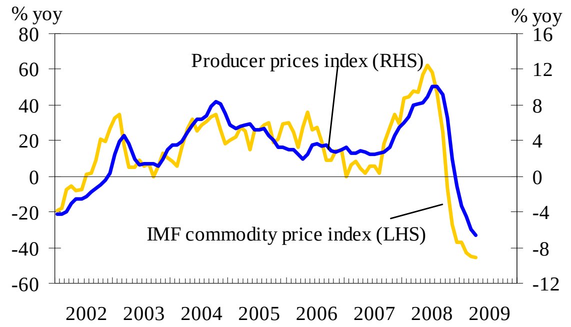
Given the slower domestic demand and sharp commodity price deflation, PPI dropped further by -6.6% in April from -5.99% in March, continuing the rapid slide in PPI.



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 international commodities price plummeted 53% from the peak, the pass-through effect led to a sharp fall in PPI inflation.

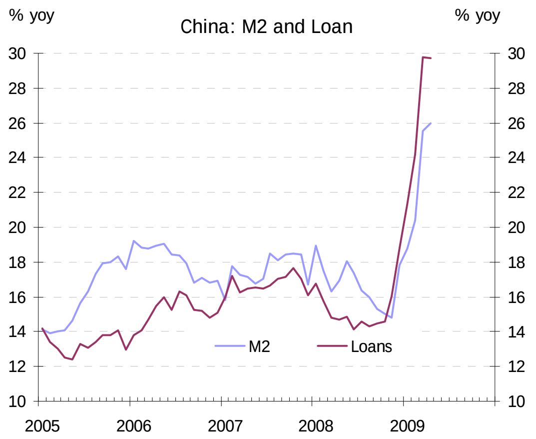


Sources: IMF, CEIC and BBVA estimates.

III. Monetary Conditions

(a) Money supply and credit

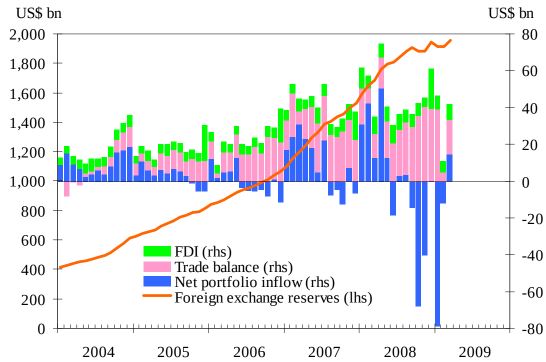
Chinese banks have pumped in a huge amount of credit into the economy to accommodate the stimulus package in the first four months. Growth in broad money (M2) rose to 25.9% yoy in April. But the credit surge in April is eased compared to March. Meanwhile, growth in credit picked up to 29.7% in April, a little bit lower than the record high 29.78% in March.



Sources: CEIC and BBVA estimates.

(b) External capital inflows

China's foreign exchange reserves continued to increase, rising by USD 41.7 billion in April on large trade surplus and FDI inflows. The net portfolio inflow also reversed its outflow trend and recorded a positive number of USD14.7 billion. The net portfolio outflows occurred in January possibly reflected profit repatriation motives, as some FDI firms may need liquidity in their home markets on worsening global credit conditions. The valuation change of foreign exchange reserve could be another reason, as the fluctuation of USD could cause the value of non-USD assets in the reserve to move in the opposite direction, thus changing the nominal value denominated by USD. At the end of Q1, China’s FX reserves reached to USD 1.953 trillion.

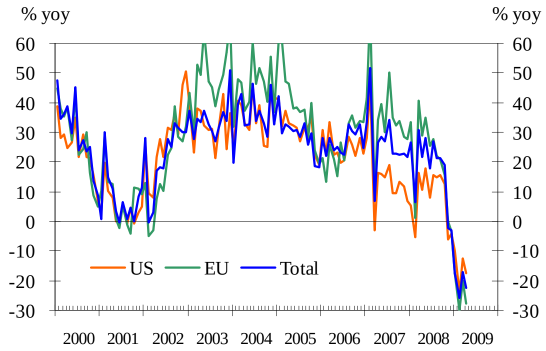


Sources: CEIC and BBVA estimates.

IV. External Trade

(a) Exports by region

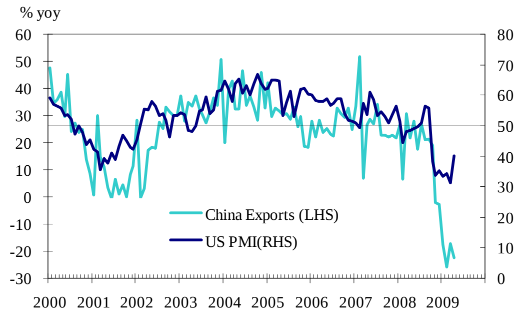
Export growth declined sharply since November, and it registered -22.5% in April. Declines in exports appeared to be across all markets, particularly for the G-3 markets, but the free fall seemed easing, benefiting from the stabilization of a rapid fall in external demand.



Source: CEIC.

(b) Exports and US PMI

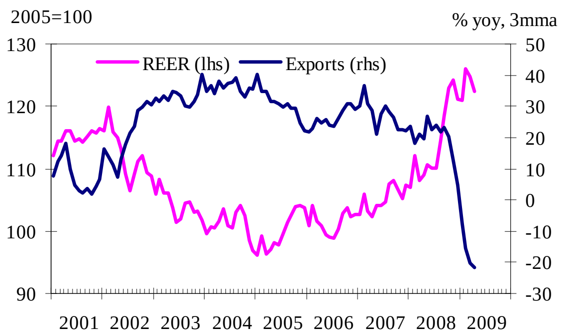
In line with the economic outlook of the US--shown by the PMI for the US, Chinese export growth has been on a declining trend since 2007. Although the decline in China's exports was narrowing, the outlook for a quick rebound remains remote as the developed countries still show little signs that their economy will recover quickly any time soon in spite of some recovery in US PMI in April. Given the close relation between China's exports and US PMI, we expected the exports to stabilize and even rebound somewhat in Q2.



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.

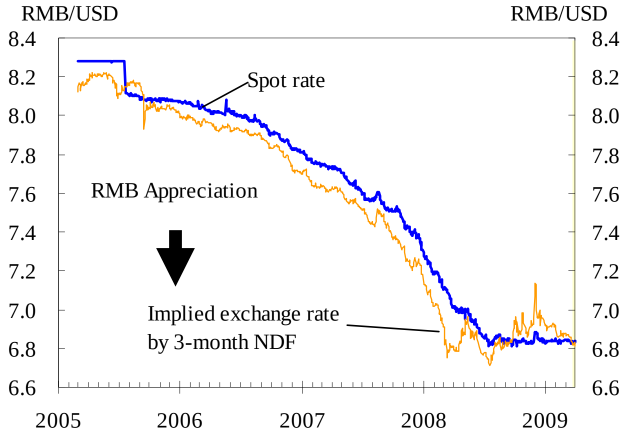


Sources: CEIC and BBVA estimates.

V. Exchange Rate

(a) Spot and expected appreciation of renminbi

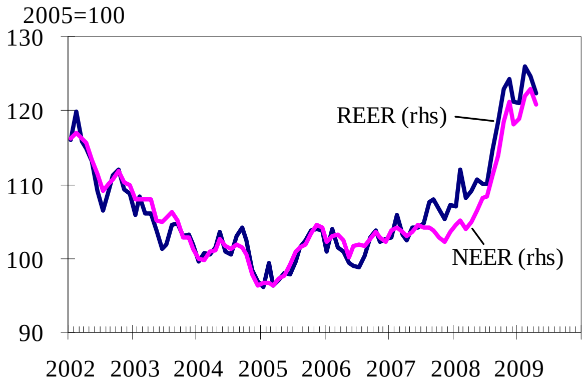
The renminbi stabilized at around the RMB/USD 6.8 level. The renminbi exchange rate has stabilized since August 2008 (Chart 18), despite the market had priced in some depreciation in 2008 Q4. As indicated by 3-month non-deliverable futures rate of CNY/USD, the market expects the renminbi to depreciate by 1.2 percent in 3 month time at the end of 2008. Now, the NDF rate has converged to the current spot exchange rate, representing the speculation on RMB depreciation has diminished. We forecast that the renminbi exchange rate to remain stable in 2009.



Sources: CEIC and BBVA estimates.

(b) REER and NEER

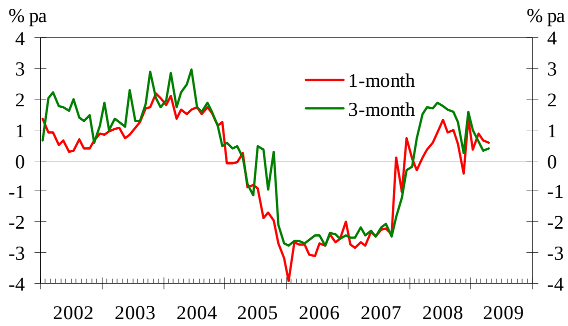
China's REER and NEER of the renminbi started to depreciate from February, after a continuous appreciation, partially reflecting recent weak performance of USD.



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 50 bps from around 150 bps in December. Both exhibit a falling trend, reflecting the ample credit in Chinese banking system and the moderation of stress in the LIBOR market led by credit crunch in Western banks.

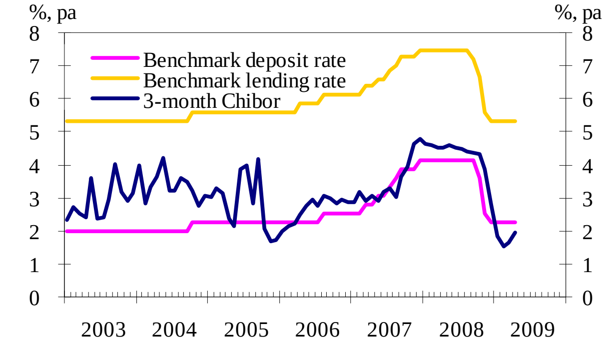


Sources: CEIC and BBVA estimates.

VI. Financial Markets

(a) Benchmark interest rates and Chibor

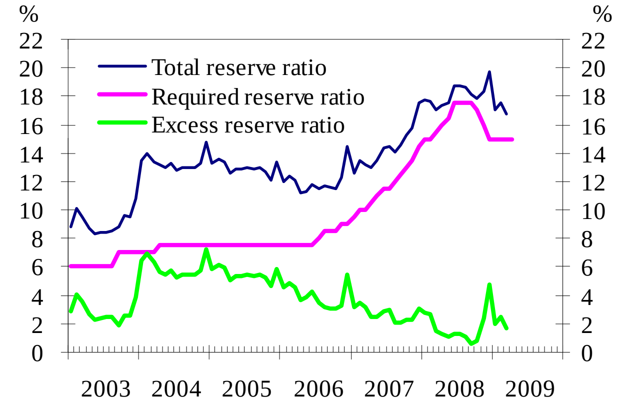
The 3-month Chibor, continued to fall, and is lower than the benchmark deposit rate, reflecting the expansionary credits during recent months have drag the Chibor down.



Sources: People Bank of China and CEIC.

(b) RRR & Excess reserves

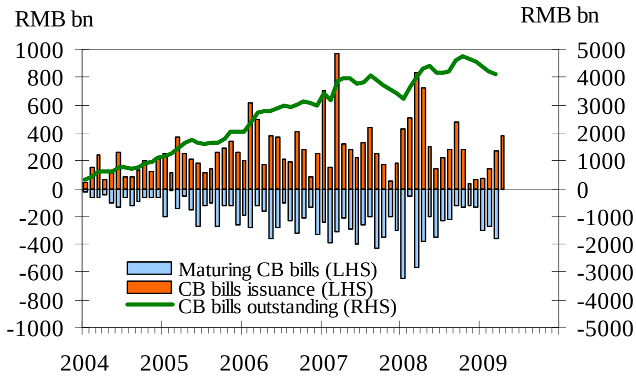
While the RRR has remained unchanged since December, excess reserve ratio continued to fall. The PBoC still has ample room to relax monetary policy if the Q2 economy doesn't recover as expected. RRR cut will be a preferred option.



Sources: CEIC and BBVA estimates.

(c) Open market operations

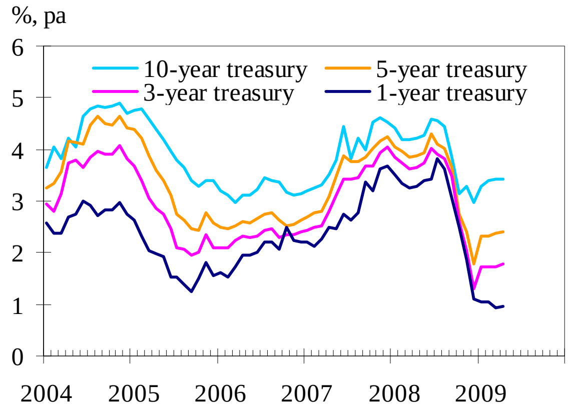
PBoC's open market operations reduced sharply since 2008 Q2 as net capital inflows eased. As more CB bills matured in the first quarter, the central bank increased the issuance to withdraw the liquidity.



Source: CEIC.

(d) Treasury yields

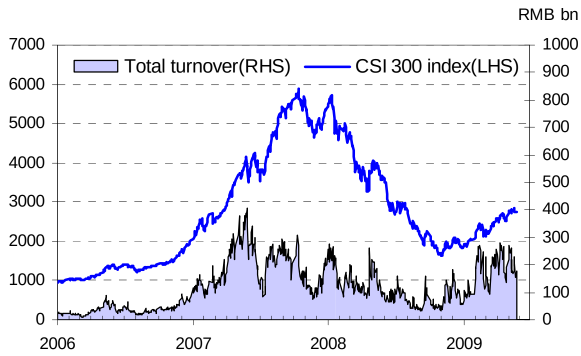
Treasury yields with middle and long term maturities continued to pick up from February, after falling drastically in the last quarter in 2008 due to benchmark interest rate cut, reflecting the latest expectations of economic recovery and rising stock market prices.



Source: CEIC.

(e) Stock Market Performance

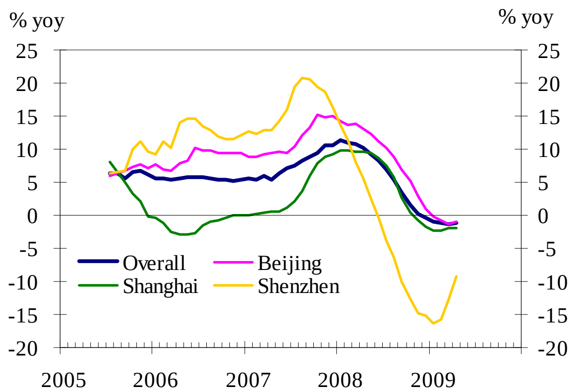
The stock prices have stabilized and rebounded since Q4. Meanwhile, trading value also picked up by more than 100% from the bottom. The market has rebounded by more than 46% so far this year, one of the best performing market in the world.



Source: CEIC.

(f) Property market

The property prices stabilized and even resumed rebounding in Shenzhen since February. 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 15.7% in February, but the fall was narrowed to -9.2% in April. Meanwhile, the trading volume also picked up and the increase in property transaction may reinforce economic recovery, as the housing and construction sector is linked with many other industries.



Source: CEIC.