Monthly Chart Book

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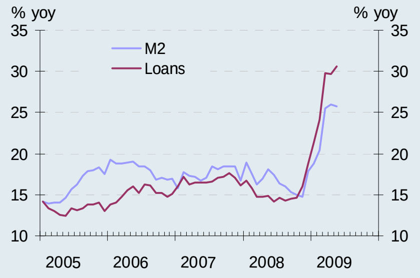
Highlights of the month: Data reinforce a recovery underway

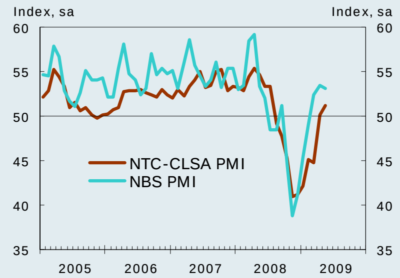
Data in May suggest that economic recovery is gaining pace. While the driver for growth is mainly due to domestic demand led particularly by strong investment growth, facilitated by its massive fiscal stimulus package, favorable monetary conditions and fast implementation of policies, external demand remains weak as falling export growth is yet stabilized.

- Surging investment and resilient domestic consumption provide good cushion for short-term growth.
- But growth in exports is expected to remain sluggish on weak recovery externally. It is difficult to envision a robust recovery in the short term.
- Our baseline forecast for CPI inflation in 2009 is at 0.5%. Although CPI has stayed negative for four consecutive months, protracted deflation is not a risk as credit growth remains rapid and commodity prices are rising fast.
- Property market rebounded strongly as indicated by sharp increases in property transaction volumes and a recovery in prices, suggesting the confidence for an economic recovery has been strengthening.

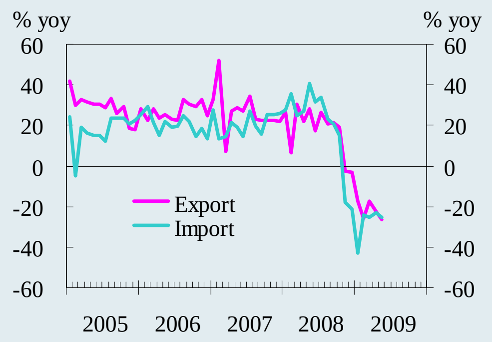
M2 and Loan Growth



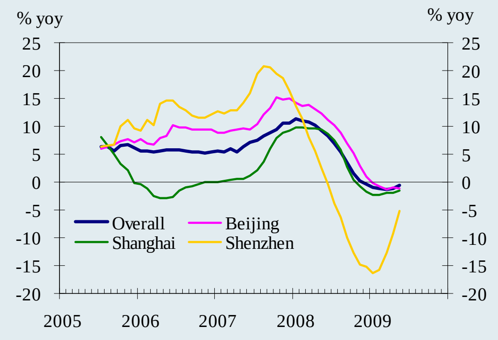
PMI



Growth in Exports and Imports



Housing prices

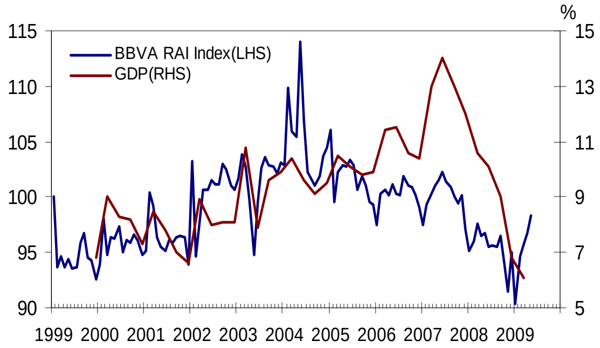


Sources: CEIC, Datastream and BBVA staff estimates.

I. Real Economic Activities

Real Activity Index

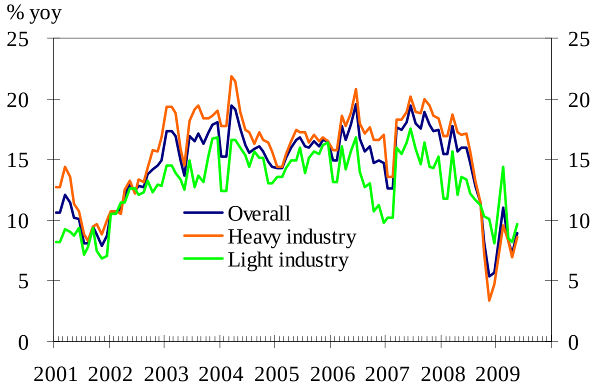
Our Real Activity Index points to a rapid recovery in economy from the beginning of 2009. Although Q1 GDP posted a record low in ten years, we expect a fast pace of growth in Q2 2009. We continue to maintain our forecast of 8.1% on GDP growth made since last December.



Sources: CEIC and BBVA estimates

(a) Industrial production

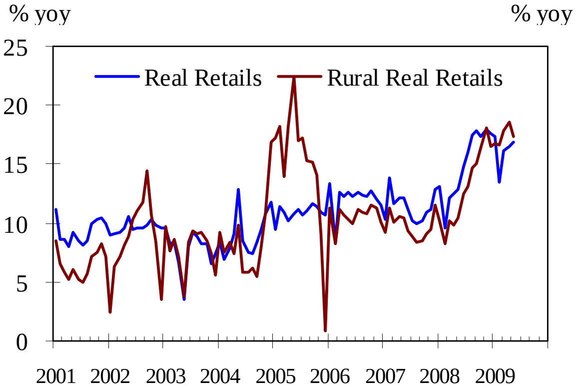
Growth in industrial production improved from 7.3% yoy in April to 8.9% in May. Heavy industry gathered more steam than light industry. The May value-added of heavy industry increased by 8.6%, 1.7 pps higher than that in April; while the light industry grew 9.7%, 1.5 pps higher than that in April. As more signs indicated a recovery in Chinese economy, the industrial production should continue to pick up, benefiting more from the full implementation of the fiscal stimulus package.



Sources: CEIC and BBVA estimates.

(b) Real retail sales

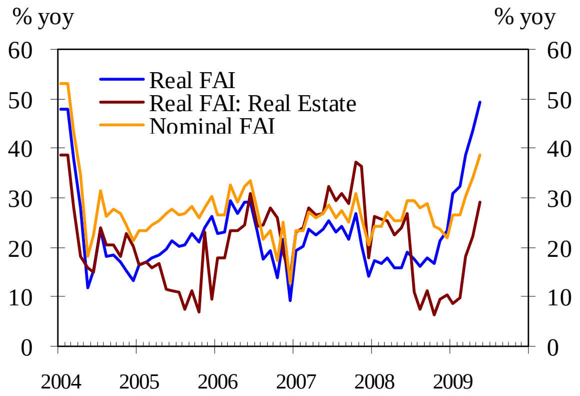
Real retail sales continued to hold up well by growing 16.84% yoy in May. Retail sales remain resilient owing to the household's income increases and increased state subsidies to the rural sector to spur consumption, for example, the 15% increase in grain purchase prices and home appliance and vehicle subsidy program for rural residents. Rural retail sales increased faster than the total ones. Our estimates show that total 25 billion yuan subsidy is expected to lift the total consumption to around 250 billion yuan, as the subsidy accounted for 10% of retail price.



Sources: CEIC and BBVA estimates.

(c) Fixed Asset Investments

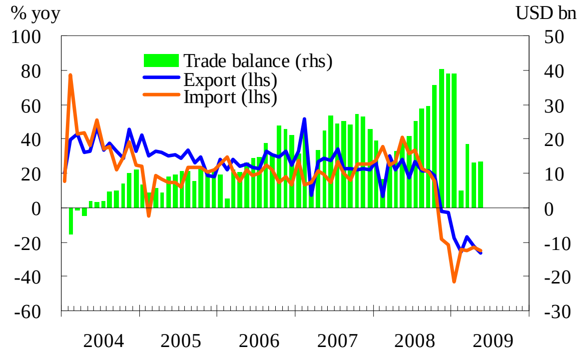
Fixed asset investment continue to hold a fast pace. The nominal growth rate was 38.7% yoy in May, while real growth in FAI grew more sharply by 49.4% yoy, benefiting from the implementation of the fiscal stimulus package.



Sources: CEIC and BBVA estimates.

(d) External Trade

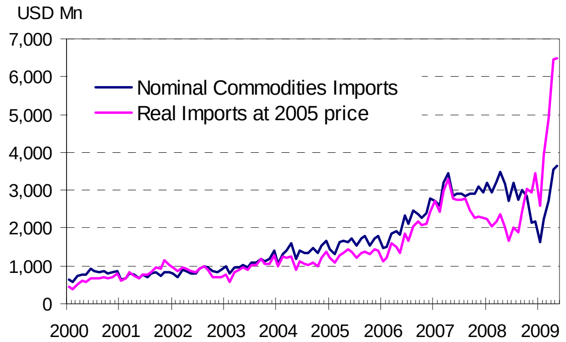
The weak external demand still weighed on export sector. May's exports continued to weaken, falling 26.3% yoy from a decrease of 22.6% in April. Given a more contraction of 25.2% in imports, the monthly trade surplus remained sizeable at US$ 13.4 billion. Exports continue to weaken and are difficult to have a robust recovery on weak external demand.



Sources: CEIC and BBVA estimates.

(e) Commodity Imports

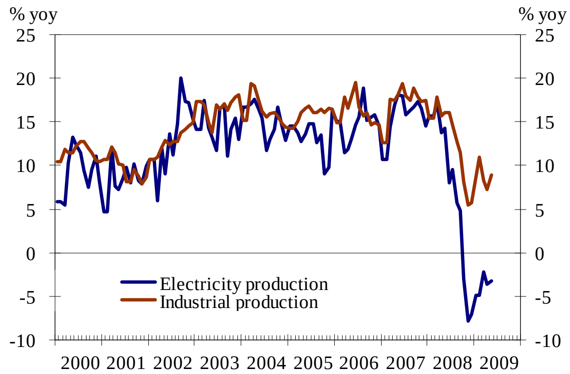
Commodity imports surged to a new high, implying the destocking process is ending and China is again importing large amount of commodities for both domestic demand and reserve when prices are low.



Note: Commodities: crude materials, fuels, ferrous and non ferrous metals, etc.
Real commodity imports are adjusted with IMF commodity index with base year 2005.
Source: CEIC

(e) Industrial production and electricity

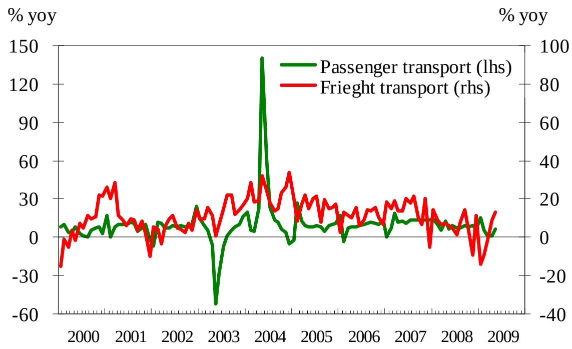
As the industry production gained a moderate growth in May, the fall in electricity production stabilized to -3.2% yoy from a decrease of 3.6% in April. The free fall trend was reversed, and the decline in electricity production in this year is mostly reflected by a slowing growth in activities of those heavy industries and the industrial de-stocking process. When industries started to produce again, the electricity production should rise accordingly.



Source: CEIC and BBVA estimates.

(f) Transportation

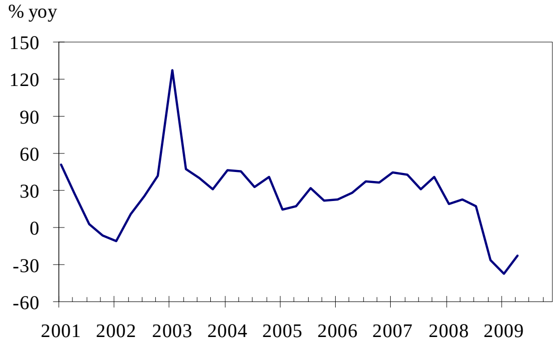
The growth rates for both passenger and freight transport rose further in May. Since transportation is a leading index for economic recovery, its stabilization suggests the recovery is under way.



Source: CEIC.

(g) General industry profitability

Industrial profits finally stop its precipitous fall in the second quarter of 2009. The fall was moderated to -22.9% from 37% in Q1. The narrowed decline of profit is being attributed to improved domestic demand, reduced operating costs and more stable producer prices. The profit growth is expected to perform better in Q3 as the de-inventory progress is over and product prices rise.

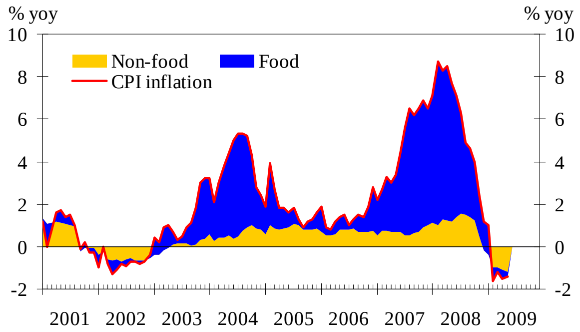


Source: CEIC.
Note: 2008Q4 figures of industrial profits are up to November 2008.

II. Price Developments

(a) Consumer price inflation

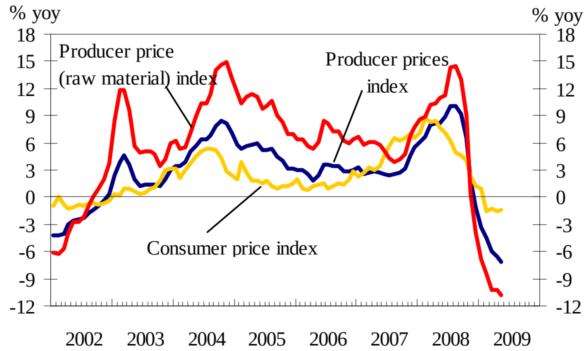
CPI continued to fall 1.4% yoy in May for the four straight months. The pace of the price-drop slowed slightly from April's 1.5% decline. May price drops mainly reflect much higher prices in the first half of last year. Although CPI remains negative, protracted deflation is less likely on rising commodity price and fast credit growth.



Sources: CEIC and BBVA estimates.

(b) Producer prices

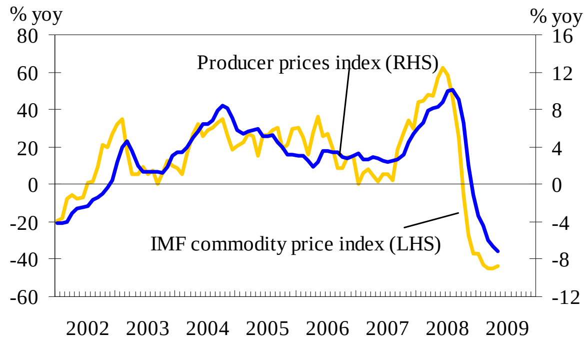
PPI dropped further by -7.2% in May from -6.6% in April, continuing the rapid slide in PPI. The prices of fuel, power and other raw materials had stopped declining month on month since April. However, the odds of a swift price rebound are slim, as an oversupply of industrial products will continue in the short term.



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 sharply from the peak, the pass-through effect led to a sharp fall in PPI inflation. But commodity price has stabilized and even risen in May; this might translate positive impact into domestic PPI in coming months.

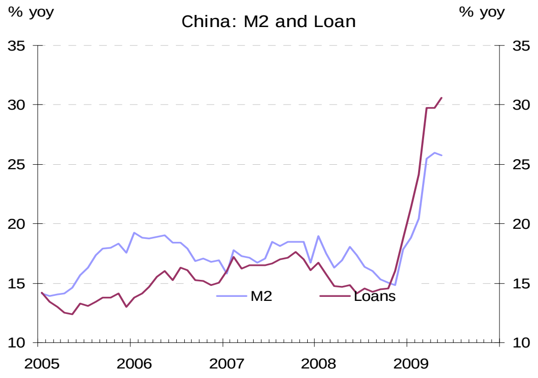


Sources: IMF, CEIC and BBVA estimates.

III. Monetary Conditions

(a) Money supply and credit

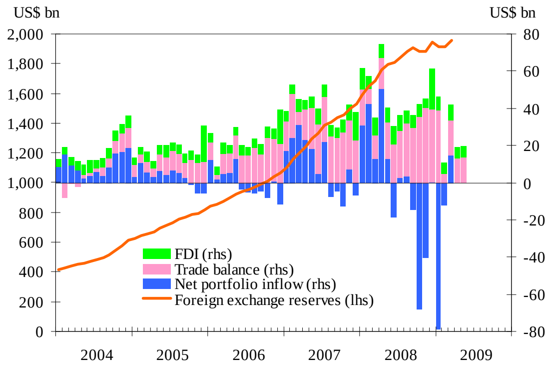
Growth in broad money (M2) rose to 25.74% yoy in May, eased from 25.95% in April. The credit growth in May is 30.6%, compared to 29.7% in April, representing the pace of lending in May was well off monthly record high new loans in the first quarter, but is still high compared with last year. The recent surge in bank credit may signal future problems if without risk control increase.



Sources: CEIC and BBVA estimates.

(b) External capital inflows

The foreign trade posted a surplus of USD13.4 billion and FDI inflow was USD6.4 billion, both improved from April's data. The latest released credit balance sheet of financial institutions showed a significant rebound of the RMB equivalent of official foreign exchange holdings. The increase reached its highest level in 2009. In recent months, China's economy has showed notable signs of recovery. That has fueled the expectation of RMB appreciation once again, which in turn boosted the capital flow to China.

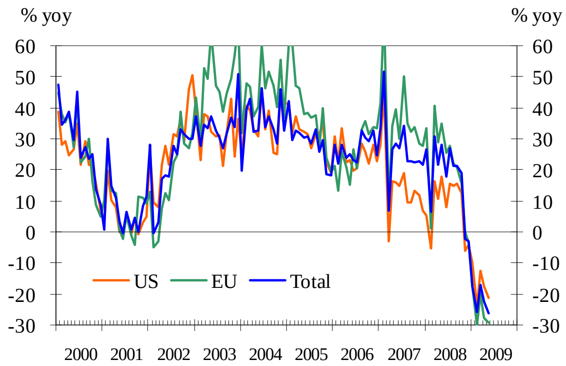


Sources: CEIC and BBVA estimates.

IV. External Trade

(a) Exports by region

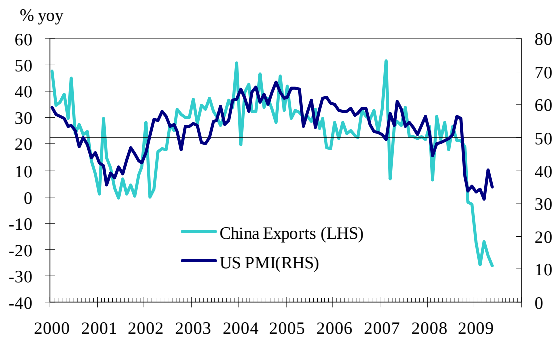
China's exports plunged by a 26.4 percent in May from the same month of 2008. Growth in exports is expected to remain sluggish on weak recovery externally. It is difficult to envision a robust recovery in the short term.



Source: CEIC.

(b) Exports and US PMI

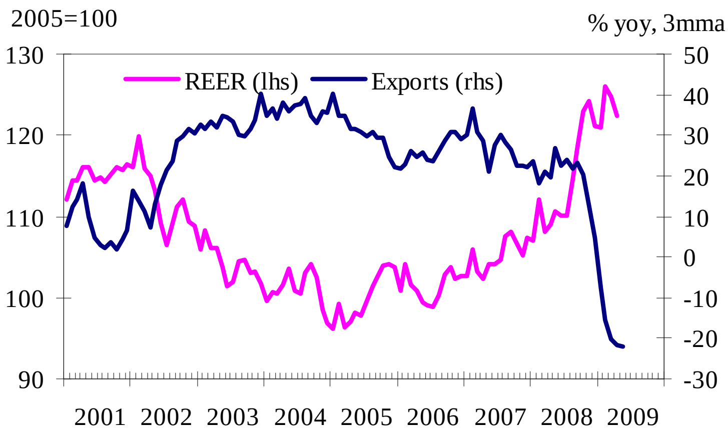
In line with the economic outlook of the US--shown by the US PMI, Chinese export growth has been on a declining trend since 2007. There are still little signs that US economy will recover quickly, as its PMI worsen gain in May. Given the close relation between China's exports and US PMI, it is still too early to predict a fast rebound in Chinese exports.



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. However, the REER started to fall from March, since Chinese yuan is de facto pegged to USD which followed a depreciation path since March. A lower REER might help the slowing export growth in China.

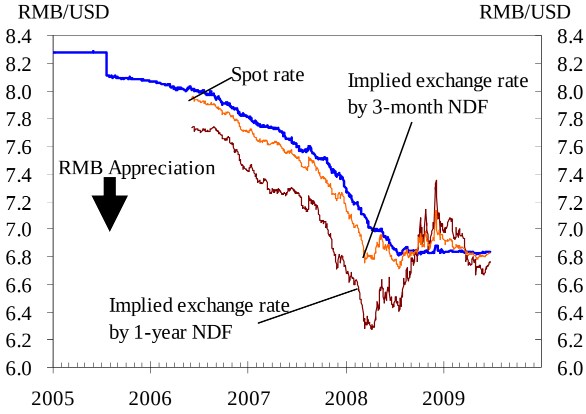


Sources: CEIC and BBVA estimates.

V. Exchange Rate

(a) Spot rate and RMB NDF

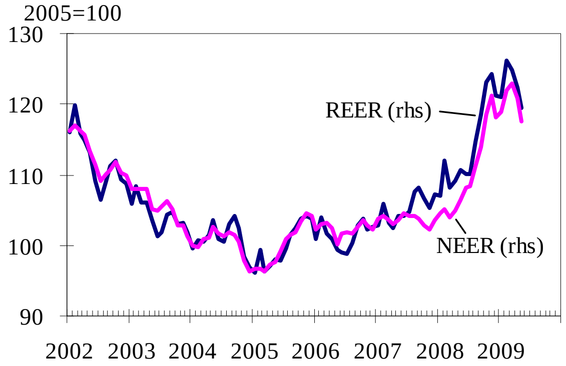
The renminbi stabilized at around the RMB/USD 6.83 level, despite the market had priced in some appreciation currently. As indicated by 1-year non-deliverable futures rate of CNY/USD, the market expects the renminbi to appreciate by 1.05 percent in 1 year time, representing the speculation on RMB appreciation starts again as China's recent signs of recovery will boost the capital flow to China. We maintain our forecast that the renminbi exchange rate to remain stable in 2009.



Sources: CEIC and BBVA estimates.

(b) REER and NEER

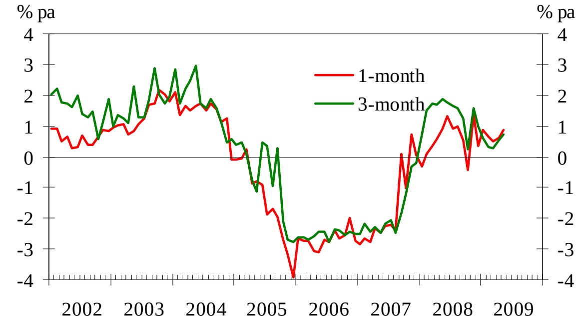
China's REER and NEER of the renminbi started to depreciate from February, after a continuous appreciation, partially reflecting recent weak performance of USD.



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 started to pick up again, which is mainly driven by further normalization in Libor market as financial stress continues to lessen.

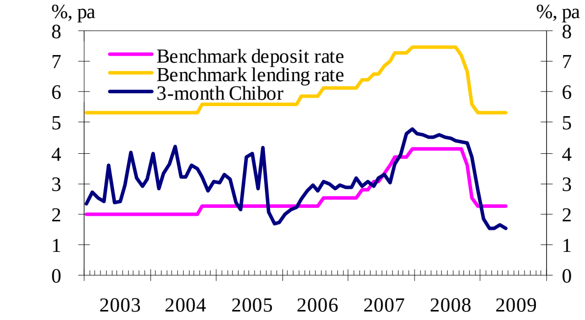


Sources: CEIC and BBVA estimates.

VI. Financial Markets

(a) Benchmark interest rates and Chibor

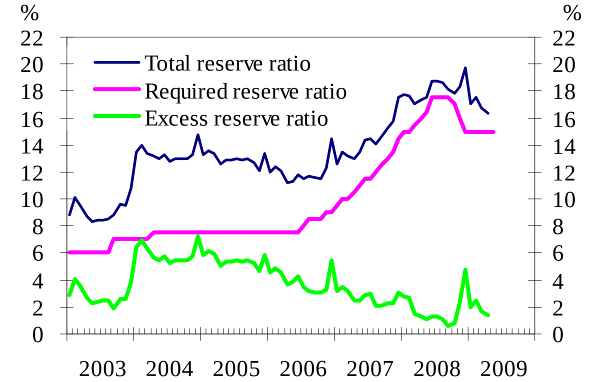
The 3-month Chibor, continued to fall, and is lower than the benchmark deposit rate, reflecting the expansionary credits during recent months have dragged the Chibor down.



Sources: People Bank of China and CEIC.

(b) RRR & Excess reserves

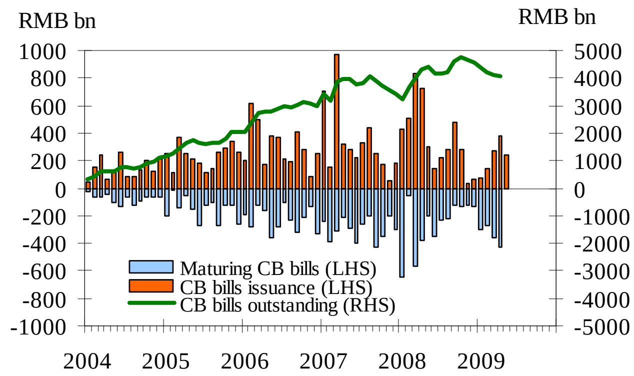
While the RRR has remained unchanged since December, excess reserve ratio continued to fall. Since banks extended loans aggressively in the first 5 months, they have to use the excess reserves in central banks for the new loans. It caused the excess reserve ratio to decline continuously.



Sources: CEIC and BBVA estimates.

(c) Open market operations

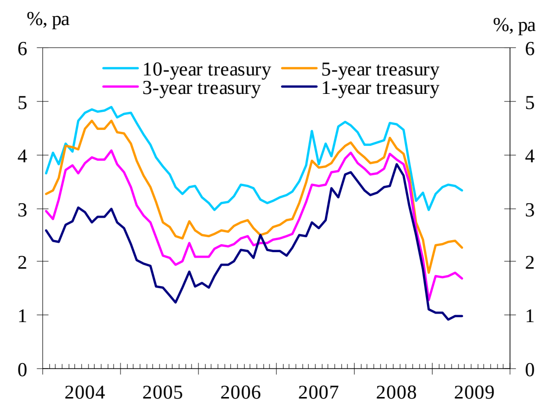
PBoC's open market operations reduced sharply since 2008 Q2 as net capital inflows eased. As more CB bills matured in the first quarter, the central bank increased the issuance to withdraw the liquidity.



Source: CEIC.

(d) Treasury yields

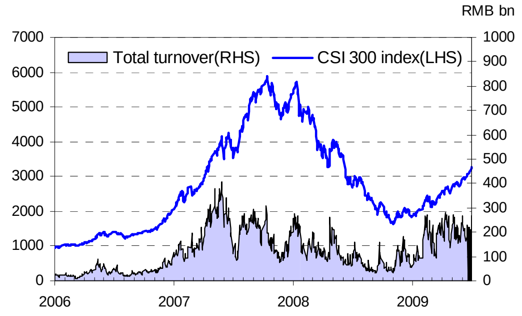
Treasury yields with middle and long term maturities continued to pick up from February to April, after falling drastically in the last quarter in 2008 due to benchmark interest rate cut. But in May, the yield rate decreased a little bit due to the ample liquidity in the market.



Source: CEIC.

(e) Stock Market Performance

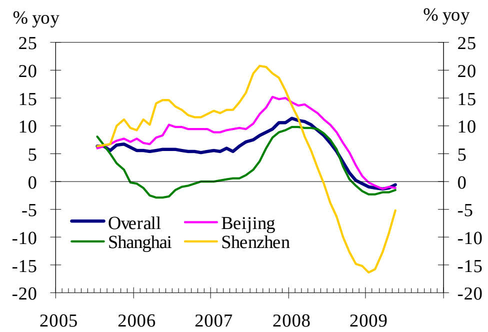
The stock prices continued to rise since Q4. Meanwhile, trading value also picked up by more than 100% from the bottom. The market has rebounded by more than 46% so far this year, one of the best performing market in the world. The good performance is attributed to the positive expectation on Chinese economic outlook.



Source: CEIC.

(f) Property market

The May data reinforce the view that the property market is rebounding. Although all indexes remained negative, but the extent of decline were all narrowed in May. Meanwhile, the increase in property transaction may strengthen economic recovery, as the housing and construction sectors have important implications for many other industries.



Source: CEIC.