China

BBVA

Monthly Chart Book

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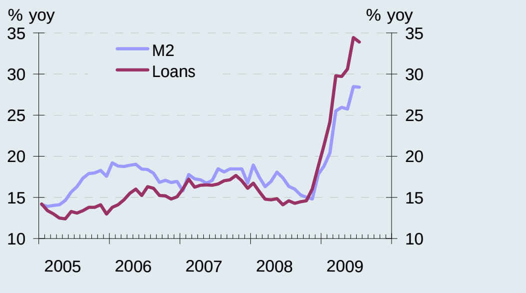
Highlights of the month: fine tuning the growth

China's economic stimulus has clearly worked hugely effective, and the too good recovery has raised the concern that partial investment has piled up capacity to excessive level in some sectors, the over-run credit might jeopardize the asset quality in the future, and rapid surge in property price might set stage for the potential bubble.

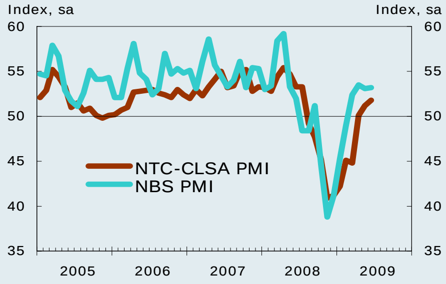
The latest data reflect China's strong economy recovery and 8% target will be achievable in this year, therefore the growth path should be built more on quality than quantity. These scenarios justify government's efforts to fine-tune China's economy.

- July's M2 supply and loan growth moderated from the record high growth in June, reflecting the efforts that banking regulator to curb the aggressive credit growth.
- China foreign trade remains sluggish with exports and imports extending the fall in July, but there is a sign that foreign trade might recover later this year as the drop in China's exports to US is being narrowed.
- Property market rebounds strongly in both property transaction volumes and prices, but fueling the bubble concern, which incurs the tightening on the second home mortgage.

M2 and Loan Growth

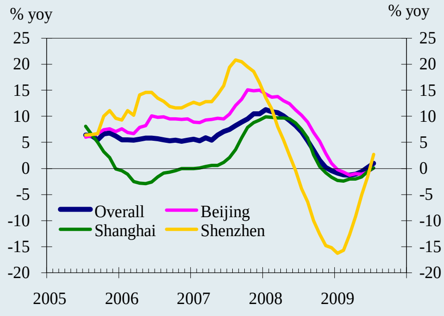


PMI



Growth in Exports and Imports

Housing prices

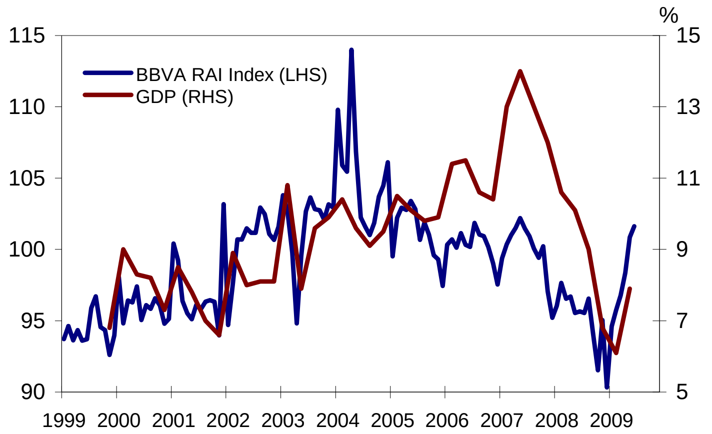


Sources: CEIC, Datastream and BBVA staff estimates.

I. Real Economic Activities

Real Activity Index

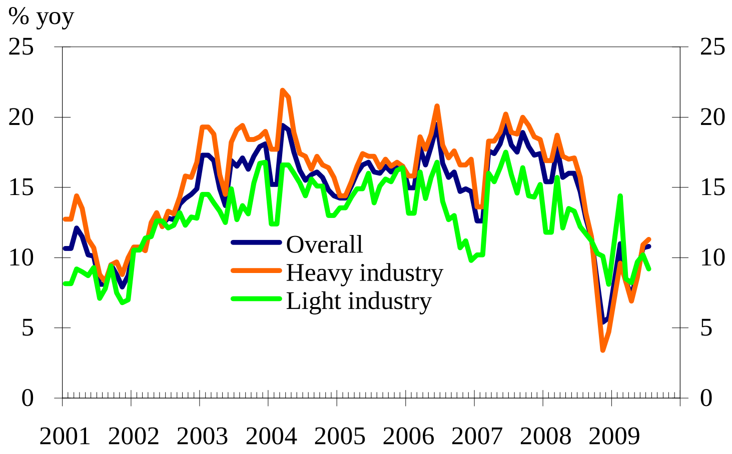
BBVA Real Activity Index continued to grow for the sixth month pointing to a further faster recovery in our economy since this January. The rebound was mainly led by governments' stimulus spending which propped up demand,



Sources: CEIC and BBVA estimates

(a) Industrial production

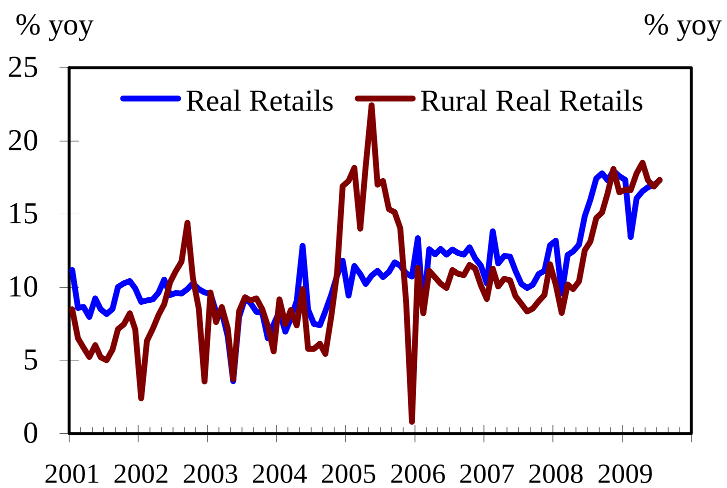
Overall industrial production registered its third consecutive monthly improvement at 10.8% yoy, but the pace was moderated. Growth rate in heavy industry is 11.3%, surpassing light industry by 2.1%, representing that heavy industry production led by infrastructure construction continue to foster the economic rebound. But the recovery in light industry is still fragile given the external demand is still weak.



Sources: CEIC and BBVA estimates.

(b) Real retail sales

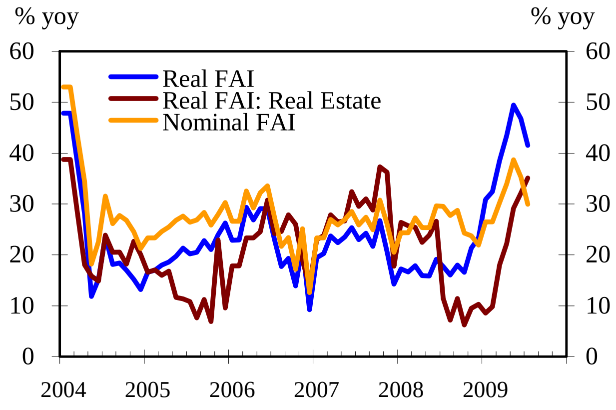
In July, Real retail sales growth rate climbed slightly to 17.31% yoy from 16.99%, stabilized at a relatively high level. Meantime, rural real retails growth rate, it gained to 17.34% from 16.89% in June. This implies that the improved household income starts to boost consumption and, also, policies taken to boost rural consumption functions well, like subsidizing home appliance and automobiles consumption.



Sources: CEIC and BBVA estimates.

(c) Fixed Asset Investments

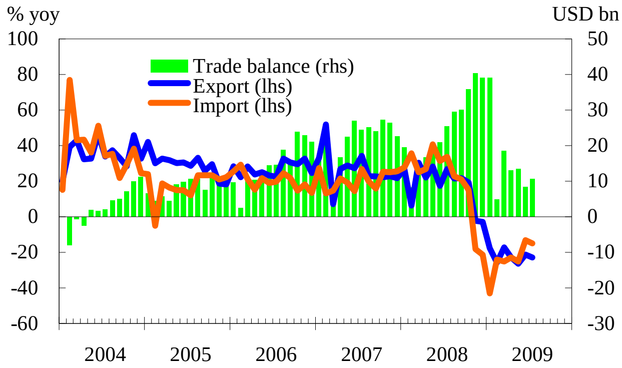
Both real FAI and nominal FAI yoy growth rate slowed than last month with the nominal FAI rising 29.9%, the real FAI increasing by 41.5%. But the real FAI in real estate sector climbed by 35.13% in July from 32.12% a month before led by recent rebound in house sales. The fast rising FAI in the first half raised government's concern that overcapacity might re-visit in some sectors, and it might curb the blind investment, which partially contributed to the slow in FAI growth.



Sources: CEIC and BBVA estimates.

(d) External Trade

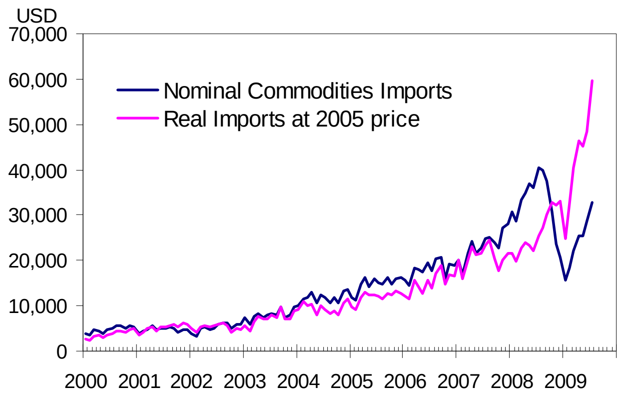
China's Imports and exports fell for the ninth straight month in July. Exports in July fell 23% from a year earlier, extending June's 21.4%% decline. While Imports in July dropped 14.9% from a year earlier, compared to June's 13.2% drop. China's trade surplus in July totaled US$10.63 billion, up from US$8.3 billion in June, but narrowed from a year earlier. As consumption in developed economies rebounds in the second half, China's exports are expected to recover soon.



Sources: CEIC and BBVA estimates.

(e) Commodity Imports

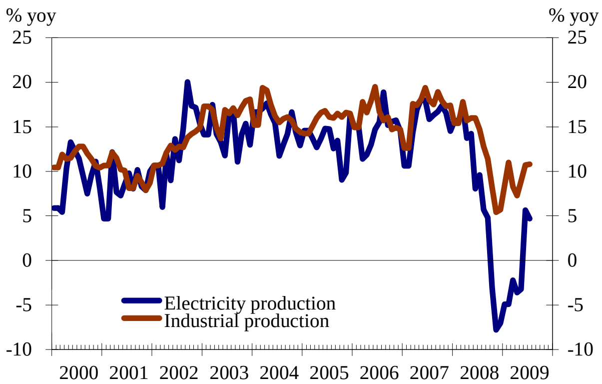
China's real commodity imports continue to surge from the beginning of 2009, which is possibly due to that the pick-up in industrial production consumes more commodities, and China is stocking more commodities against further price hike.



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

(f) Industrial production and electricity

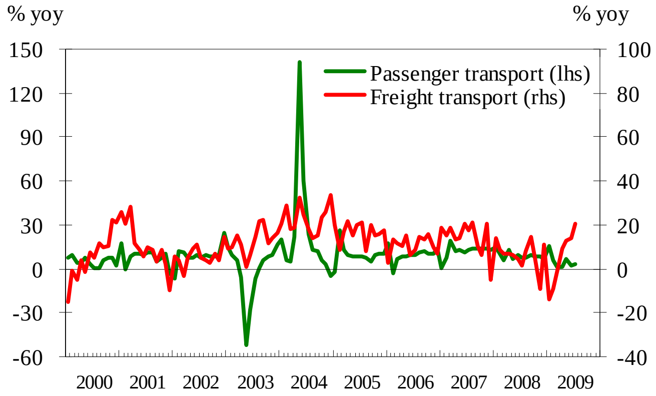
China's electricity output rose 4.7% in July, albeit slower than 5.6% in June, it is the second consecutive month after slumping for eight months since October. The rebound provided evidence that the country's economy is stabilizing and domestic industrial production is recovering.



Source: CEIC and BBVA estimates.

(g) Transportation

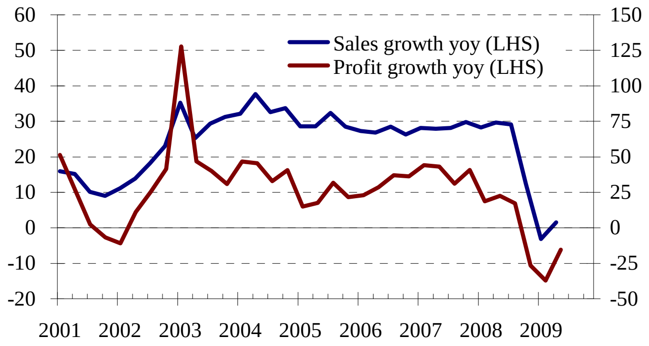
The growth rate for freight transport continued its strong growth at 20.3% in July, while an mild increase of 3.6% is recorded for passenger transport. Since the transportation is a leading indicator for the economy, its rebound might represent further strong and active economic activities.



Source: CEIC.

(h) General industry profitability

Both industrial profits and sales finally stop its precipitous fall in the second quarter of 2009. Industrial companies were still facing falling profits but decline was narrowed, as the industrial sector in 22 regions saw a 17.3% fall from Jan to July, improved from 21.2% drop in the first half. Later in this year, the industrial production would keep growing steadily as foreign trade showed signs of an upturn in the second half year and would continue the trend up with the economic upswing in developed countries.

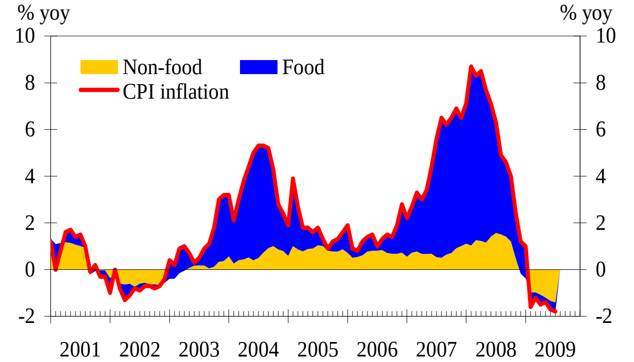


Source: CEIC.

II. Price Developments

(a) Consumer price inflation

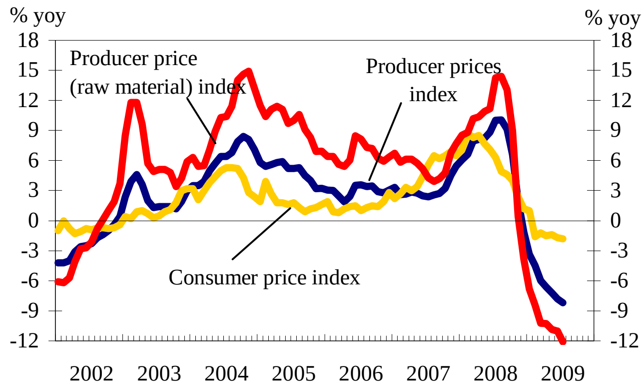
CPI dipped 1.8 percent in July from a year earlier, with food prices contributing -0.39% and non-food prices -1.40%. This marked the 6th consecutive decline since February. The index was almost unchanged compared with June in which fell by 1.7 percent yoy. Although the CPI continues to fall, the deflation risk is minimal as the economy is on track to recovery and ample liquidity is injected into economy.



Sources: CEIC and BBVA estimates.

(b) Producer prices

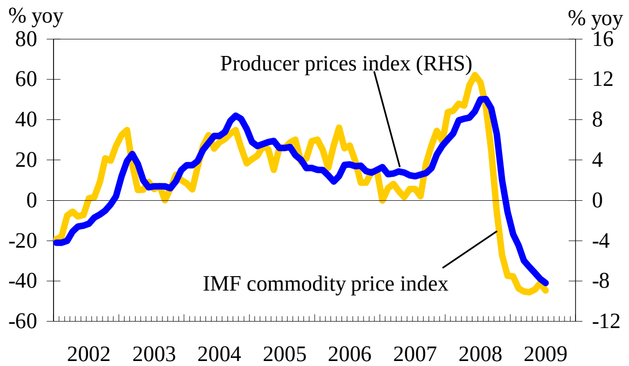
The producer price index (PPI) fell 8.2 percent yoy in July, 0.4% deeper than that in June The PPI of raw materials slump by 12.1% in July and 11.0% in June. The favorable monetary condition would help to push up prices. Indeed, on a mom basis, PPI rose 1%.



Sources: CEIC and BBVA estimates.

(c) Commodity prices and PPI

China's PPI inflation is highly correlated to 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. After a sign of stabilization emerged in commodity price recently, domestic PPI would probably stopped its steep drop soon.

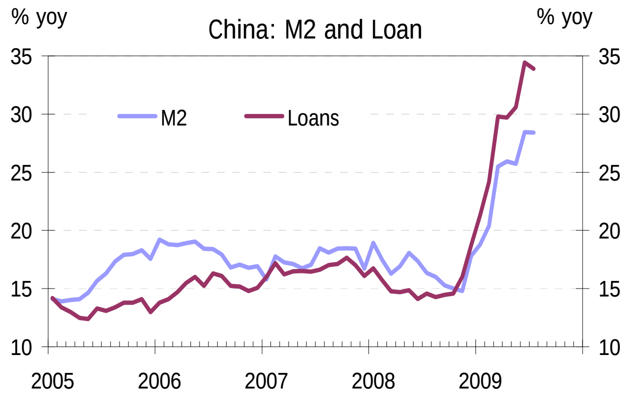


Sources: IMF, CEIC and BBVA estimates.

III. Monetary Conditions

(a) Money supply and credit

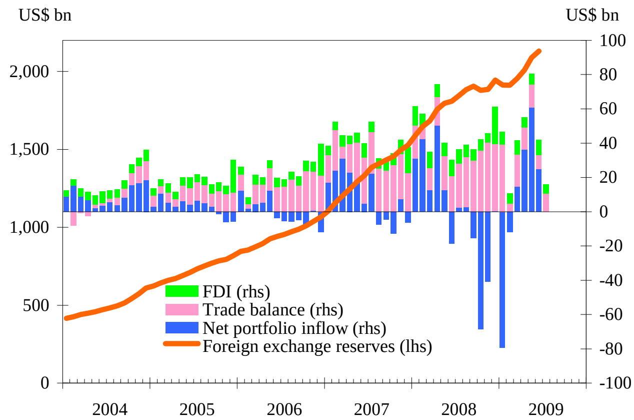
Both banking credit and broad money (M2) rose sharply since last November, but the pace seems to slow down in July. China's money supply rose 28.42% yoy, which was lower than 28.46% recorded in June. New loans grew 360 billion RMB in July with the growth rate of loans dropped a little from 34.4% to 33.9%. China's banking regulator started to fine tune credit market, warned of the asset quality risk and urged banks to improve capital adequacy ratio. This caused the credit growth in July slowed down.



Sources: CEIC and BBVA estimates.

(b) External capital inflows

The foreign trade posted a surplus of USD$10.6 billion and FDI inflow increased USD$5.4 billion. It is expected capital inflow continued in July,

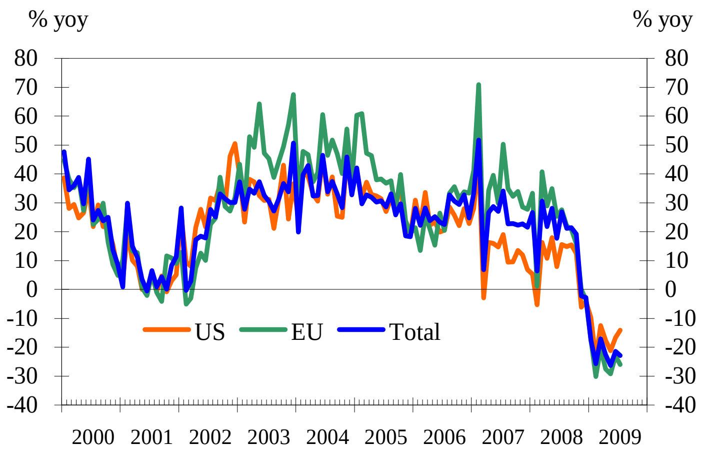


Sources: CEIC and BBVA estimates.

IV. External Trade

(a) Exports by region

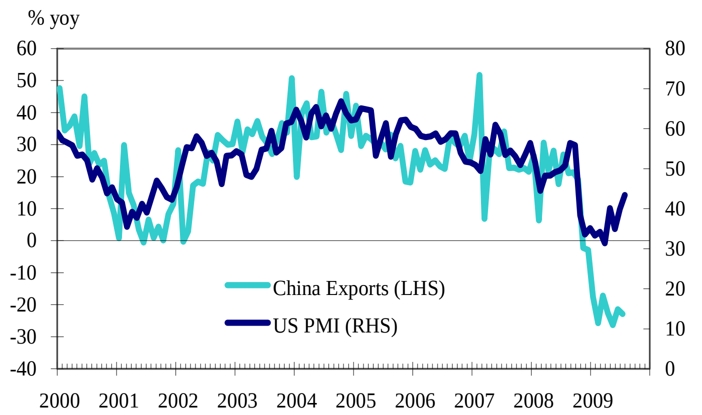
July's total exports reached $US105.42 billion, and fell 22.9% from -21.4% in June. However, the negative growth rate of exports to US is narrowed to -14.13% in July (-16.64% in June) while that to Europe is enlarged to -26.01% (-23.00% in June). This may suggests that the economy of US is running ahead of Europe on the recovery road.



Source: CEIC.

(b) Exports and US PMI

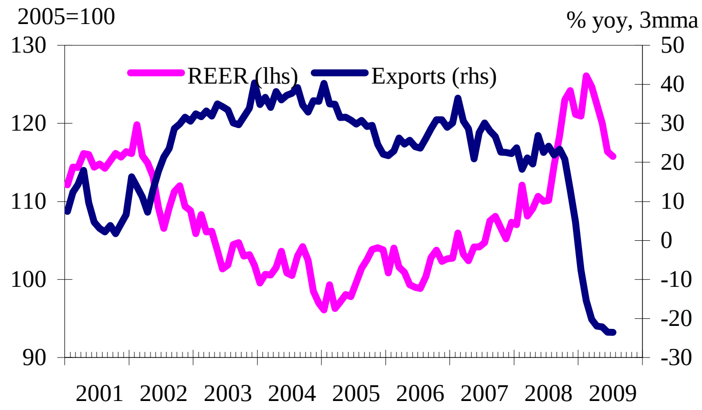
Despite signals of the economic recovery in US is still weak, the purchase manager's index (PMI), an indicator of the economic health of the manufacturing sector, has been picking up to 43.4 in July from its bottom of 33.6 last November. In line with the economic outlook of the US--shown by the US PMI, the growth rate of Chinese exports to US gave a rebound signal in July. It is expected that the exports of China might return to positive by the end of this year or early 2010.



Source: OECD, CEIC and BBVA estimates.

(c) Real exchange rate and exports

REER had been depreciated for 5 months since this February (from 126.1 to 115.8). Since RMB is de facto pegged to USD, a lower REER might relief China's exports from the hardest period and lead it to a moderate growth in the future.

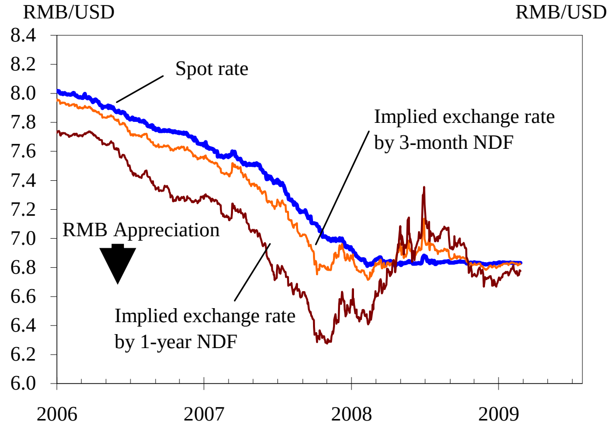


Sources: CEIC and BBVA estimates.

V. Exchange Rate

(a) Spot rate and RMB NDF

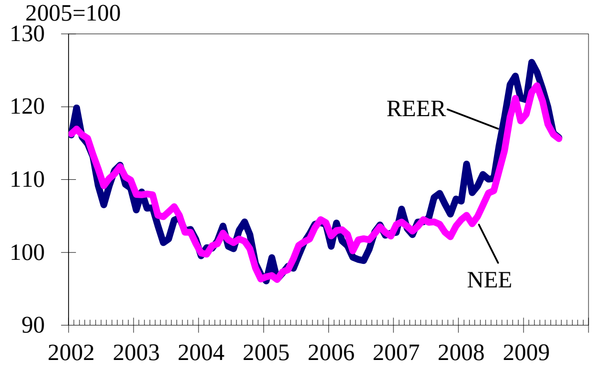
Since July 2008, when the global financial crisis broke out, the RMB has slowed its pace of appreciation and stayed trading within a narrow band of CNY 6.83 to the dollar. The market expected that RMB would remain unchanged in the near future, which could be shown in the 3-month non-deliverable futures (NDF) rate of CNY/USD. Although 1-year NDF dropped a little below 6.83, We still maintain our forecast that the RMB exchange rate to remain stable in 2009.



Sources: CEIC and BBVA estimates.

(b) REER and NEER

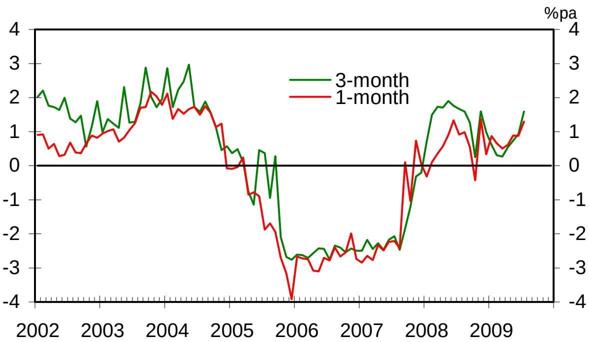
China's REER and NEER of the RMB started to depreciate from March, after a continuous appreciation, partially reflecting recent weak performance of USD.



Sources: BIS, CEIC, Datastream and BBVA estimates.

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

The interest rate differentials between 1-month and 3-month Chibor and Libor had been swinging up for the fifth month to 1.29% and 1.58%, which is mainly driven by further normalization in Libor market as financial stress continues to lessen and recent interest rate rise in Chinese credit market.

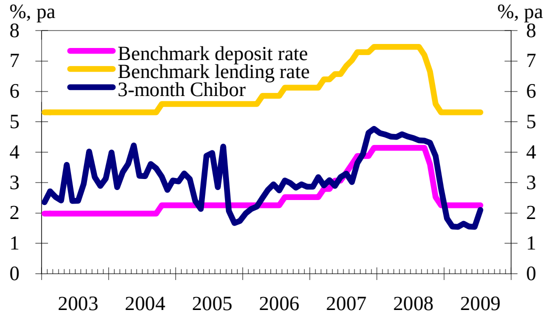


Sources: CEIC and BBVA estimates.

VI. Financial Markets

(a) Benchmark interest rates and Chibor

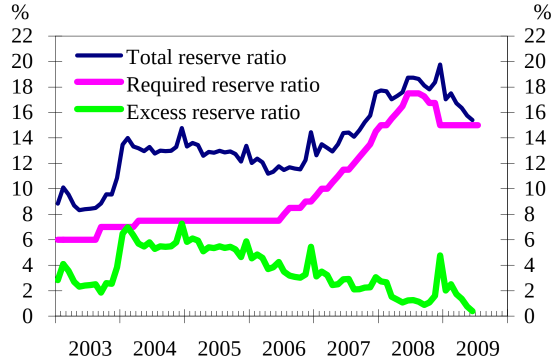
The 3-month Chibor rose towards the benchmark deposit rate (2.25%) to 2.10%, reflecting the expansionary monetary policy during recent months has been relatively tightened in July.



Sources: People Bank of China and CEIC.

(b) RRR & Excess reserves

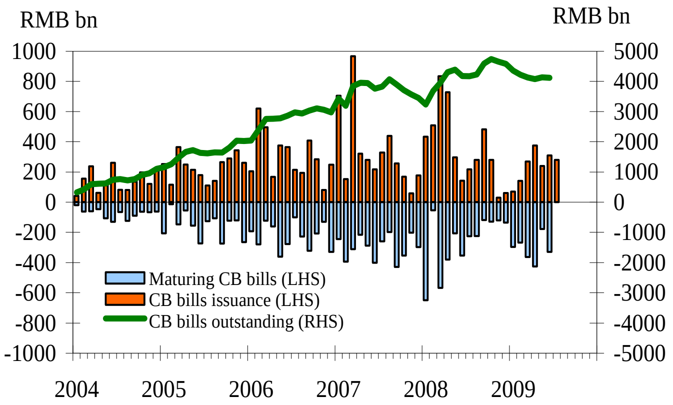
While the RRR has remained unchanged since December, excess reserve ratio began to dip since this January. Since banks extended loans aggressively in these 7 months, they have to use the excess reserves in central banks for the new loans. It caused the excess reserve ratio to decline continuously.



Sources: CEIC and BBVA estimates.

(c) Open market operations

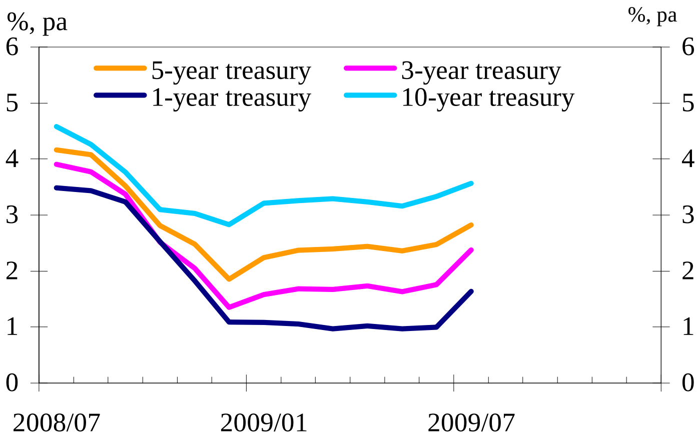
China has pushed up money-market rates in open market operations in June, increased the bill issuance to withdraw the liquidity and resumed one-year bill sales as policy makers seek to restrict funds for stocks and real-estate investment without derailing a 4 trillion-yuan economic stimulus plan.



Source: CEIC.

(d) Treasury yields

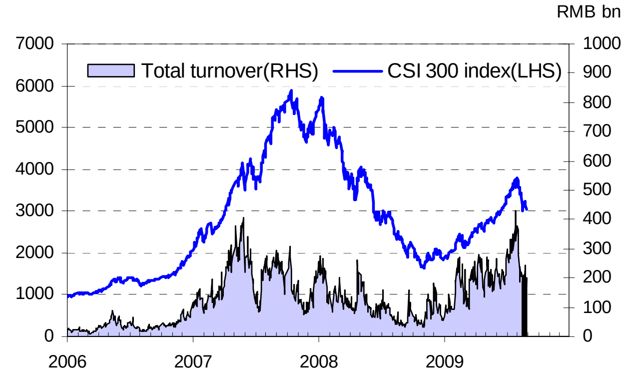
Treasury yields with different maturities continued their upward trend in July in response to that China might fine-tune its monetary policy, therefore, resulting in relatively tightening credit condition than before.



Source: CEIC.

(e) Stock Market Performance

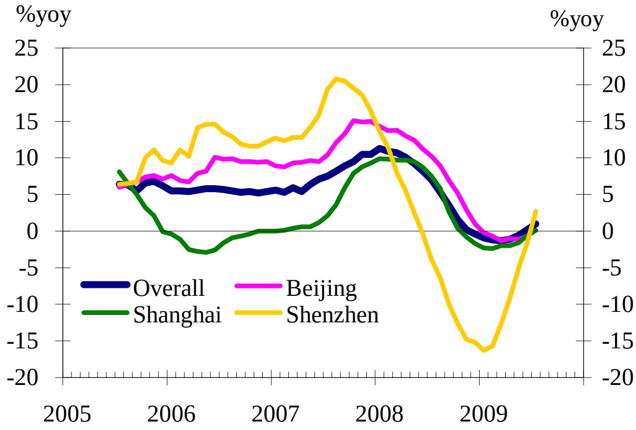
The CSI 300 registered a record high of 3734.62 on the end of July, but followed with a sharp correction in August with the fears that credit market will not issue enough liquidity to support the index going further.



Source: CEIC.

(f) Property market

In July, the rebounding speed in property market was quicker than people's expectation, with Beijing up 0.1%, Shanghai 0.1% and Shenzhen 2.7% yoy. As the property price rose up, the worry about the property bubble emerged again. Furthermore, the second home mortgage in some major cities has been tightened. Some cautious home buyers have retreated to the sidelines on concerns the government may tighten credit in the real estate market and will slow price growth in some cities. The housing price surge might be moderated later this year.



Source: CEIC.