Economic Research Department

BBVA

China

GDP Observatory

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China's GDP realized a V-shape rebound at 8.9% year-on-year growth in Q3 2009, and it is set to achieve at least its objective of 8% this year. GDP growth has been fueled by the government stimulus spending, and largely channeled thru fixed asset investment and bank credit. With the rapid money supply and bank loan growth rates at the top of the central bank concerns, the policy emphasis must be switched to China´s growth quality and balance.

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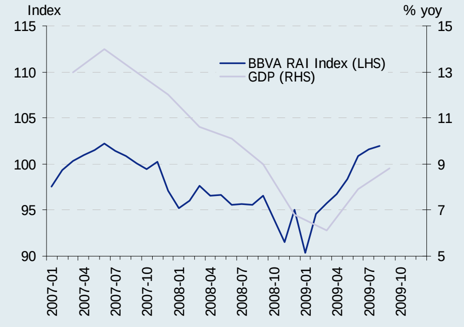
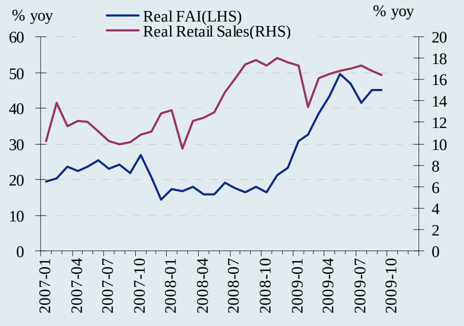
- China's GDP growth further accelerated to 8.9% year-on-year (yoy) in Q3 from 7.9% yoy in Q2, and in line with our (BBVA: 8.3% yoy) and market expectations. The accumulated GDP growth for the first three quarters is 7.7% yoy, making government's annual goal of 8% and our full-year forecast of 8.3% in 2009 highly achievable. The sharp rebound of China's economy mainly benefits from the leverage effect of the government's 4-trillion-yuan stimulus package announced last November and the continuously growing credit under the current "moderately loose" monetary policy.
- Fixed asset investment kept on serving as the main drive for GDP growth, followed by domestic consumption. The better-than-estimated export growth indicates the external sector is on the track of recovery, which could help to mitigate the over-reliance of growth on government-supported investment in the following quarters. According to the National Statistic Bureau, consumption, investment and net exports contributed 4, 7.3, and -3.6 percentage points, respectively, to the GDP growth in the first three quarters.

Chart 1: Real GDP growth and BBVA RAI Index



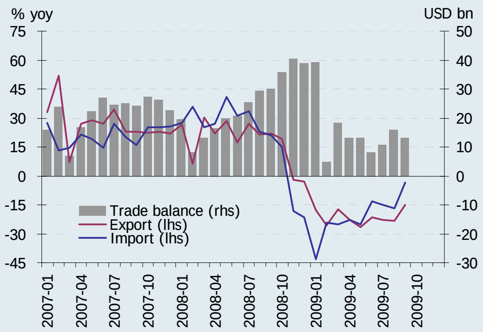
Sources: CEIC and BBVA estimates.

Chart 2: Domestic demand



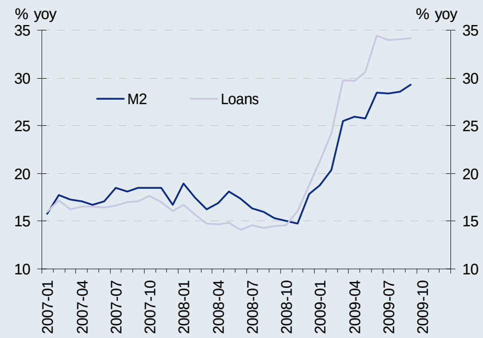
Sources: CEIC and BBVA ERD

Chart 3: External Activity



Sources: CEIC and BBVA ERD.

Chart 4: Money and Credit



Sources: CEIC and BBVA ERD

Apart from the Q3 GDP figure release, other economic data released today also signal a strong growth momentum in China's economy:

- Total fixed asset investment kept on growing fast, increasing by 33.4% yoy in the first three quarters, close to the 33.5% yoy posted in the first half year. The fast pace of growth is due to the effect of China´s massive fiscal stimulus package and the continuously expanding credit. Among it, the investment in railway transportation jumped 87.5% yoy, while that in road transportation rose 50.7% yoy, and spending in health and social welfare was up 72.9% yoy. Up to now, China's economic stimulus plan functions well and will remain on track (NDRC: RMB 380 bn out of RMB 1.12 trillion two-year central government planned investment have been spent by end July 2009, remaining 66% until 2010), but to achieve a quality growth, greater efforts will be made to curb industrial overcapacity, more restrictions are likely to be put on industries that are of high pollution, high energy consumption, and natural resource-based.
- Retail sales, a rough proxy for consumption, climbed 15.1% yoy in the first three quarters, slightly higher than 15% yoy in the first half, thanks to household income increases (real urban household disposable income up 10.5% yoy) and government policies to promote consumption. Among durable goods and large items consumption, China's auto sales has surged 24.5% yoy to 9.7 million vehicles in the first nine months of the year, which reflects a strong momentum in private consumption.
- Industrial output rose 8.7% yoy in the first three quarters of the year, lifted by a 12.4% yoy expansion in Q3, and primarily led by the rebound in domestic demand.
- As released earlier, China's exports decline seems to be slowing down as global recovery strengthens. Chinese exports fell 15.2% yoy in September, the slowest pace in nine months, and imports declined the least by 3.5% yoy since last September. China's domestic demand recovery is the main reason for the narrowing gap between exports and imports, leading to a narrowed-down trade surplus of USD12.93 billion in September from USD15.7 billion in August. The recovering exports will also help to mitigate the overcapacity problem in certain industrial and manufacturing-related sectors.
- Accompanied with economic recovery, the contraction in consumer prices (CPI) and production prices (PPI) continued to slow down. CPI shrank 0.8% yoy in September, improving from the 1.2% yoy contraction in August. The decline in PPI further eased to -7% yoy, from August's -7.9% yoy. On a month-on-month (mom) basis, consumer and producer prices have been rising since September.
- The unprecedented surge in new lending this year has increased the concern of inflationary pressures next year. Consequently, China´s State Council stated that policy should focus both on managing inflationary expectations as well as securing stable growth -- the first time it has mentioned inflation since the global economic crisis hit China last year, implying a tighter monetary policy if there are signs of a sharp rebound in price inflation.
- We expect the central bank will raise the interest rate 27 bps by mid-2010 to manage the inflation expectation, our forecast for inflation is 2.7% for 2010 and it will reach 3.1% at the end of 2010. Meanwhile, RMB will appreciate to 6.59 against USD, conducive to manage the inflation.
- In this round of investment and credit cycle, the rapid credit expansion has raised concerns that credit risks are accumulating and a sharp increase in non-performing loans might emerge from next year,. This is clearly at the top of Chinese authorities concerns and hence, non-interest measures to tighten domestic liquidity are expected in early 2010.
- Looking forward, the Chinese government focus must shift to the economy´s growth quality and balance. Given the ample domestic liquidity conditions and the large fiscal stimulus spending not yet disbursed, we expect the Chinese growth to accelerate in Q4 (BBVA: 9.9% in Q4, 8.3% in full 2009) and peak around 10% yoy in 2010Q1. For the rest of 2009, we expect that the announced fiscal stimulus package could be maintained, and that the central government would keep the current "moderately loose" monetary policy until 2010Q1, while more restrictive guidelines would be expected to fine-tune the liquidity in the economy.