



Economic Observatory

12 Nov 2009

Chinese October macro indicators confirms a steady growth momentum

- China's industrial output grew at the fastest pace this year in October, while investment growth moderated from September albeit still at historical high levels. Retail sales accelerated further, confirming that China's economic rebound is likely to stay robust.
- The external sector activities continued to improve thanks to overseas demand gradual recovery.
- New loans issued recorded the lowest level this year partly due to seasonal factors, as Chinese banks traditionally extend less loans in the second half of the year and also due to the maturity of massive short-term bills financing in the first half year.
- The contraction in the consumer price index continued to narrow in October, but inflation risk is not a major concern for the time being.

1. Fastest growth in industrial output

Overall industrial activity continued its solid expansion in October, with **industrial production** rising year-on-year (yoy) at 16.1% even faster than 13.9% yoy in September, partially due to a lower statistical base of comparison. Along with the positive tone from the manufacturing purchasing managers' index (PMIs) released last week and the low base effect, Chinese industrial output will keep its rebound until year end (Chart 1.1).

Heavy industry continued to lead the overall industrial growth, with 18.1% yoy rise driven by demand from investment spending. Light industry continued to exhibit a modest recovery, posting 11.3% yoy in October, slightly lower than the 11.8% in September (Chart 1.2).

2. Fixed asset investment (FAI) growth moderated

During the month, both nominal and real FAI registered a slower growth than September, with nominal growth at

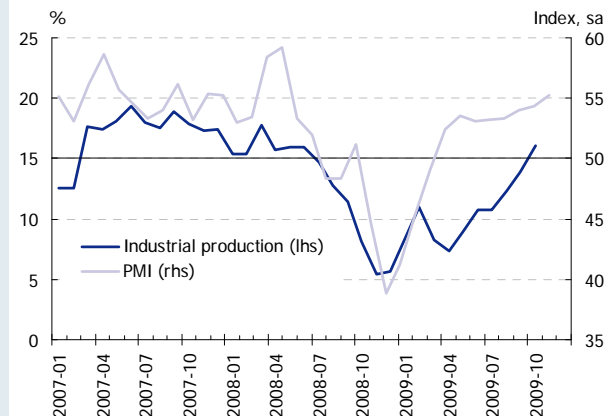
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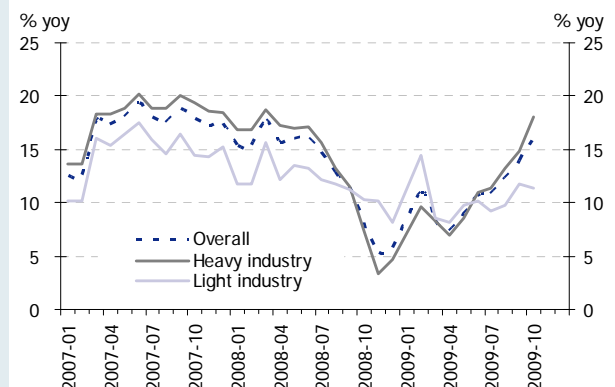
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Chart 1.1: Industrial production and PMI



Source: National statistics and HSBC.

Chart 1.2: Industrial Production by sector



Source: CEIC.

31.6% yoy in October vs 35% yoy in September and real at 39.7% yoy vs 45.1% yoy (Chart 2).

For the period Jan-Oct, nominal **fixed investment** growth came in at 33.1% yoy, compared to 33.3% yoy in Jan-Sep 2009.

However, the pace of growth in fixed asset investment, which has surged sharply this year on the back of the government's aggressive fiscal stimulus, seems to be slowing recently, albeit it remains at historical high levels.

3. Retail sales accelerating

Nominal **retail sales** year-on-year growth picked up from 15.5% in September to 16.2% in October, largely pushed by strong sales of durable goods like auto sales, home decoration and electric appliances which are benefiting from the rise in housing sales (Chart 3).

China's domestic consumption has been functioning well to cushion the decline in external demand and should become a more active driver for China's growth ahead, i.e., relying on more consumption and less investment in the medium-term.

4. External sector mixed

Export growth contraction continued to narrow, posting -13.8% yoy in October from -15.2% in September. The improved exports reflect that overseas demand begins to recover as well as seasonal factors. Meanwhile, **import** year-on-year growth weakened to -6.4% in October from -3.5% in September. This sent China's surplus to US\$24 billion from US\$13 billion last month, its highest level since January. For the first ten months in 2009, trade surplus totaled to US\$160.6 billion.

Going forward, Chinese exports typically rose in Q4 ahead of the western holiday seasons, so there is a very good chance that yoy export growth will return to positive territory before year-end.

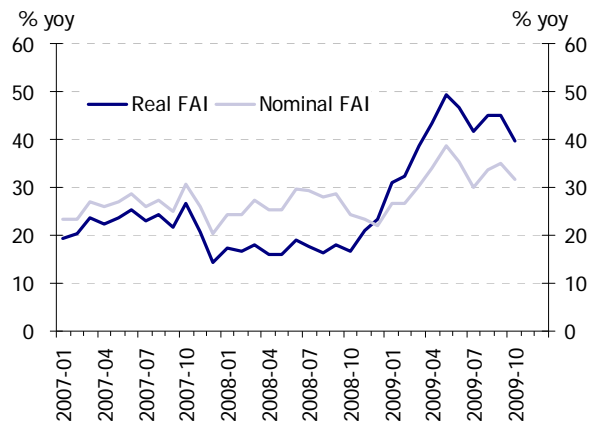
5. Inflation risks remain subdued

Inflation remains in negative territory, but a clear upward trend has been established in recent months. October **consumer price index (CPI)** fell 0.5% yoy, compared to a 0.8% decline in September.

The inflation in food prices remains at the same pace of 0.5% yoy as in September and contributed 0.5 percentage point to overall CPI. As for non-food price, the contraction slowed from -1.3% yoy in September to -1.0% yoy in October, and contributed minus 1 percentage point to overall CPI.

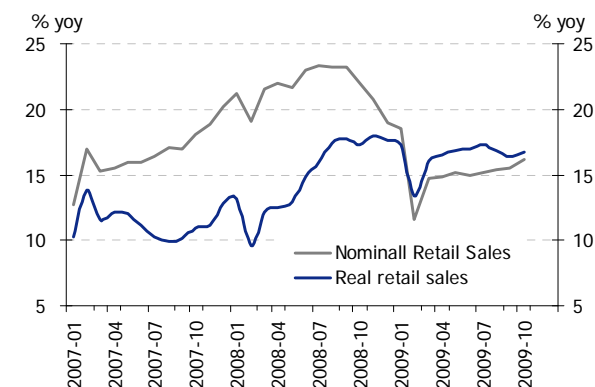
The recent fuel price hike by NDRC also helped to accelerate the inflation pace. The direct effect from fuel price hike in CPI, however, is minimal due to the very low weight for fuels in the CPI basket at around 1.2%. But

Chart 2: Fixed Asset Investment (FAI)



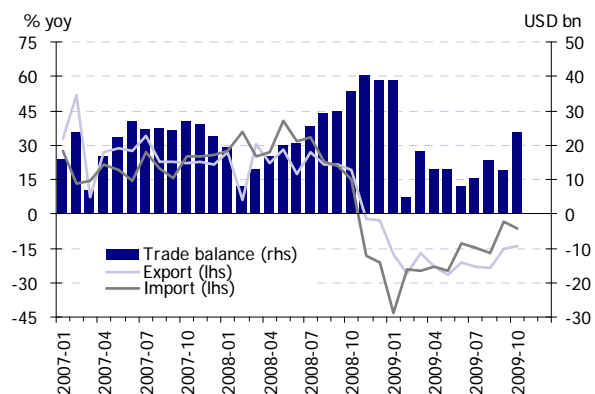
Source: CEIC.

Chart 3: Retail Sales



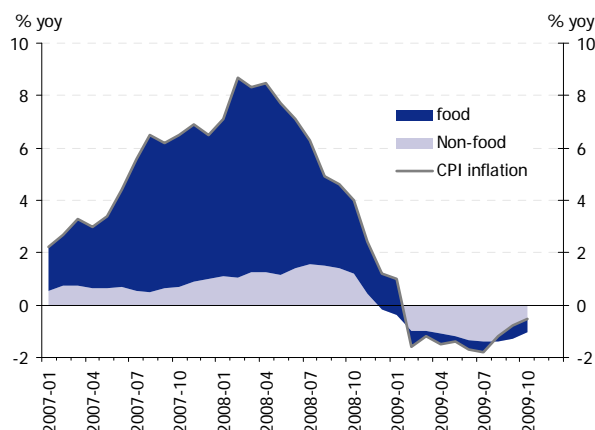
Source: CEIC.

Chart 4: External Trade



Source: CEIC.

Chart 5.1: Consumer price index (CPI)



Source: CEIC.

considering the spillover effect from fuel price rise, the total effect on CPI will be higher.

In addition, **production price index (PPI)** was up from -10.1% yoy in September to -8.4% yoy in October. The fast recovery in raw materials prices will continue to drive PPI higher in the months ahead.

6. New loans lowest monthly issuance this year

Chinese banks extended CNY253 billion of new loans in October, well below the CNY516.7 billion in September and also the lowest level in this year. The M2 growth rate was steady at 29.4% yoy from the 29.3% yoy rise at the end of September. Outstanding yuan loans at the end of October were up 34.19% from a year earlier, almost unchanged from the 34.16% rise at the end of September (Chart 6.1).

New lending tends to drop off in both traditional loans and bill financing, mainly due to seasonality as Chinese banks traditionally extend less loans in the second half of the year and also due to the massive maturity of short-term bills financing in the first half. (Chart 6.2)

7. Policy direction

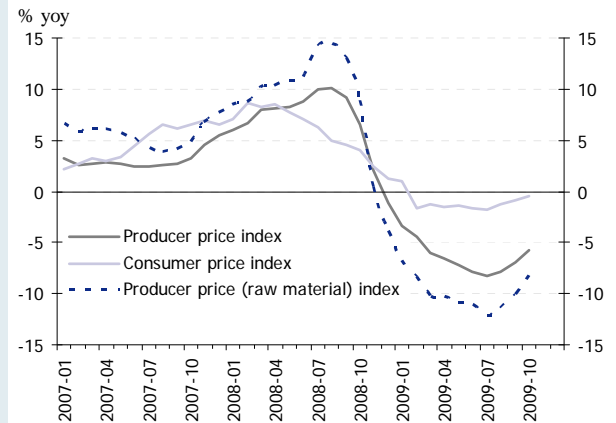
The State Council has mentioned policy direction to keep a balance between supporting growth and managing inflation expectations. The signs of inflation and rapid price increases in the asset markets (especially housing reaching new record prices in large cities) have drawn attention from top authorities.

Although the central bank (PBOC) has reiterated that the moderately loose monetary policy won't change at present, the slower pace in new loans issuance has already functioned as a de facto tightening. Further policy direction, however, will depend on the discussions during the Central Economic Working Conference which will be held this month.

We believe that monetary tightening measures will help to contain the pace of price rises, while non-conventional monetary measures such as specific directives are necessary to keep the housing market from overheating in the near term.

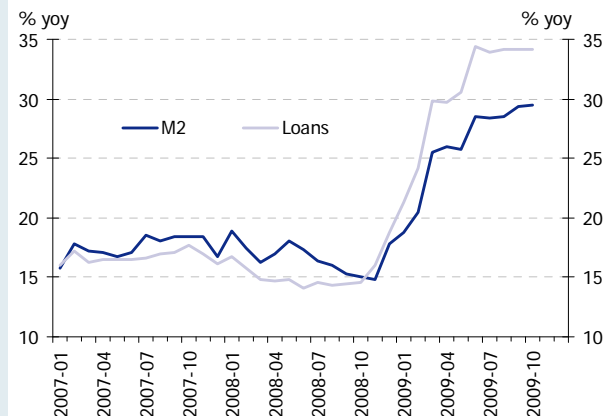
As for the exchange rate policy, in the short term the markets expect that the Chinese yuan will regain its appreciation path after US president Obama's visit to China next week. We still expect the Chinese yuan to resume its appreciation trend against the US dollar starting from 2010, with a non-negligible risk of earlier appreciation if the economic data surprises Chinese authorities on the upside.

Chart 5.2: Production price index (PPI)



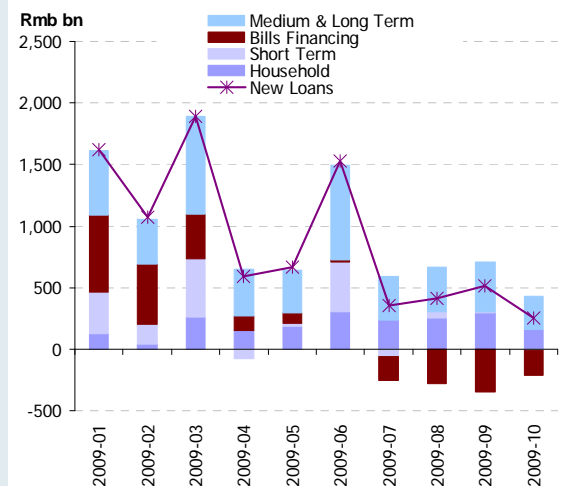
Source: CEIC.

Chart 6.1: M2 and Loans



Source: CEIC.

Chart 6.2: Composition of monthly new loans



Source: CEIC.