



GDP Observatory

January 21, 2010

China's Q4 GDP growth registered a stronger-than-expected 10.7% year-on year, bringing full-year growth to 8.7% for 2009, well ahead of the authorities' original 8.0% growth target. Such high growth and higher-than-expected inflation raise the likelihood of further monetary tightening measures, including curbs on bank lending and additional increases in the reserve requirement ratio, followed by interest rate hikes beginning in Q2 and some currency appreciation. We expect growth momentum to continue into 2010 on a rebound in net exports and further strength in private consumption and investment but still remain at reasonable levels (9.3%) thanks to the prompt response of monetary authorities and bank regulators.

Yuande Zhu

yzhu@bbva.com.hk

Jenny Zheng

Jenny.zheng@bbva.com.hk

Stephen Schwartz

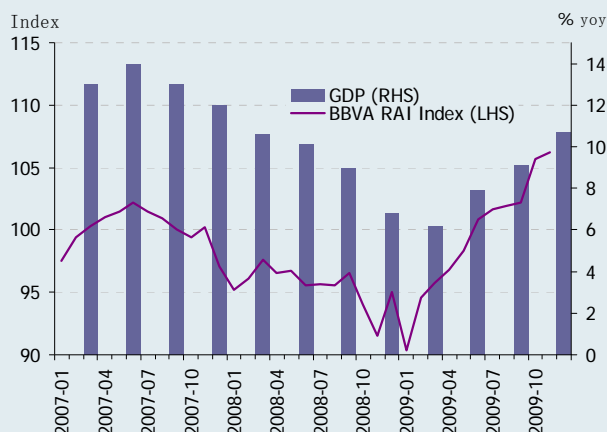
stephen.schwartz@bbva.com.hk

- China's economic growth accelerated in Q4 to 10.7% year-on-year (yoy) (BBVA: 9.9% in 2009, consensus: 10.5%) amidst rapid credit growth and an improvement in external demand with full-year growth registering 8.7% (BBVA: 8.3% in 2009, consensus: 8.5%), well ahead of the government's original annual target of 8.0%. Growth was driven by the government's massive stimulus package and record-high credit growth, which helped support strong fixed asset investment and domestic consumption. Meanwhile, exports rebounded as external demand improved. A low comparison base in Q4 2008 also contributed to the high GDP growth outturn.
- Inflationary pressures increased, with the consumer price index rising 1.9% yoy in December, well above our forecast of 1.4% and the market consensus of 1.7%. Producer prices also increased, to 1.7% yoy. Besides the strong economic recovery, the rise in inflation was driven by weather-related disruptions, changes in utility and energy prices, and rising commodity prices. Annual inflation rates are likely to rise in coming months due to base effects.

Table1: Contribution by GDP Components

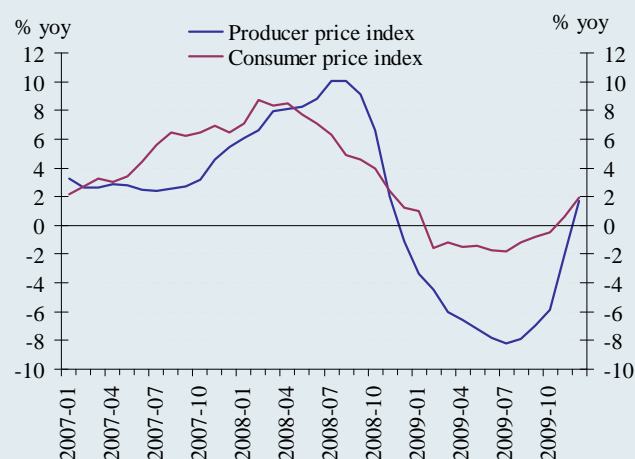
Real Growth by GDP Components			
	2009F	2010F	2011F
GDP	8.7	9.3	8.9
Consumption	4.3	4.4	4.7
Private C	2.9	3.1	3.5
Public C	1.4	1.3	1.2
Investment	7.5	4.4	2.3
Net Exports	-3.1	0.5	1.5

Source: BBVA estimates

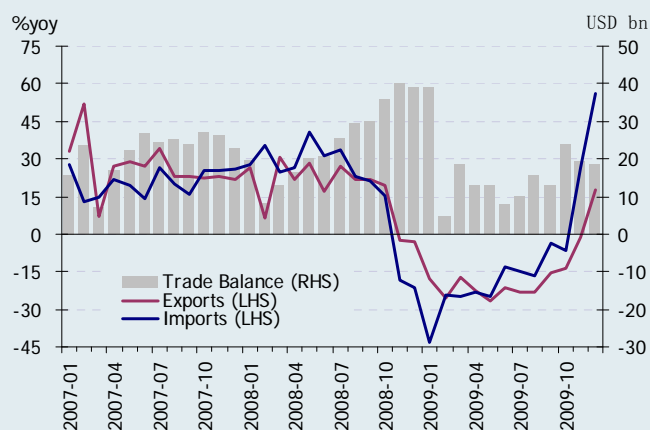
Chart 1: Real GDP growth and BBVA Real Activity Index

Note: BBVA Real Activity Index is a composite real activity index constructed with several monthly economic activity indicators, to monitor the momentum of China's aggregate economic performance before the official release of the quarterly GDP data.

Sources: CEIC and BBVA ERD

Chart 2: Inflation

Sources: CEIC and BBVA ERD

Chart 3: External Activity

Sources: CEIC and BBVA ERD.

Chart 4: Money and Credit

Sources: CEIC and BBVA ERD

- Total retail sales, a rough proxy for consumption, maintained a steady growth rate of 15.5% in 2009, with an accelerated growth of 17.5% yoy in December, boosted by the government's stimulus package and rise in household incomes (real urban household disposable income was up 9.8% for the year). Among durable goods and large purchases, auto sales surged 32.3% to 10.3 million vehicles in 2009, reflecting a strong momentum in private consumption demand.
- The strong momentum of fixed asset investment was maintained at nominal 30.1% yoy for the year, and for the single month of December, the nominal growth of fixed investment rose at 20.8% yoy, lower than 24.3% growth in November, representing growth in fixed asset investment is moderating.
- Industrial output gained an annual increase of 11% in 2009, with growth in December reaching 18.5% yoy, slightly below expectations (consensus: 19.6%), and compared to 19.2% in November.
- Previously released data on new loan creation hit a record level of RMB 9.59 trillion in 2009, leading to overall credit growth of 31.7% for the year. Surging credit growth has raised government concern over risks of asset price bubbles and rising inflationary expectations, triggering an earlier-than-expected tightening of monetary policy through a recent increase in the RRR by 50bps and measures to restrain bank lending. More such measures are likely to follow. We expect interest rate increases to begin in Q2, along with the resumption of some modest currency appreciation against USD.

- Previously released trade data for December indicated that China's exports are rebounding, up by 17.7% yoy for the month, while imports jumped by 55.9% yoy from a 26.66% yoy growth rate in November. The rebound in exports was more rapid than expected, although not a complete surprise given the collapse in trade at the end of 2008. As a result, the trade surplus for December was US\$18.4 billion. For the whole year, China's exports fell by 16% yoy and imports declined by 11.2% yoy, leading to a trade surplus of US\$196.1 billion.
- Looking forward, we expect China's strong growth momentum to continue into 2010, led by a rebound in net exports and further strength in private consumption and investment. We expect full-year growth of 9.3%, assuming the authorities are successful in restraining the strong Q4 growth momentum. Upside risks to the forecasts could materialize if credit growth is not restrained or if our expectations of sluggish global demand prove on the low side. The strong growth momentum reinforces our expectation of further monetary tightening measures, including more hikes in the RRR and measures to curb bank lending, followed by increases in interest rates beginning in Q2 and some currency appreciation (4% against the USD for the full year). The policy challenge will be to manage risks from the still-uncertain global outlook through continued policy support, while guarding against asset price bubbles and rising inflation.