

**Summary:** A batch of economic indicators was released this week showing that 2010 ended on a strong note, albeit with some mixed signals. On the external front, lower-than-expected exports for December resulted in a narrowing of the trade surplus indicating that, with strong domestic demand, the gradual rebalancing of growth toward domestic sources is continuing. At the same time, foreign exchange reserves for the last quarter of 2010 surged, which is likely to keep the heat on for China to accelerate the pace of currency appreciation. On the monetary front, credit and M2 growth exceeded their annual targets, reinforcing expectations of further tightening measures in the coming year. Next week will feature more important data, including fourth quarter GDP growth, December inflation and property price, and key activity indicators.

## Foreign exchange reserves surge, despite a narrowing of the trade surplus

- December **export** growth eased to 17.9% y/y (BBVA: 22.5% y/y; consensus: 23.3% y/y) from 34.9% in November, while **imports** grew faster-than-expected, at 25.6% y/y (BBVA: 22.0%; consensus: 24.9%), on strong domestic demand. As a result, December's **trade surplus** declined to USD 13.1 billion (BBVA: USD 23.3 billion; consensus: USD 20.8 billion) from USD 22.9 billion last month (Chart 1). We do not read too much into the decline in December export growth, as it partially reflects base effects, and is a return to more normal trends compared to November's spike.
- For the full year, **exports** and **imports** increased by 31.3% and 38.7% respectively. The full-year **trade surplus** narrowed to USD 183.1 billion, compared to USD 195.7 billion in 2009; as a percent of GDP, the decline is even larger (current account data are not yet available). A narrowing of the trade surplus is welcome news, in that it provides further evidence that the economy is gradually rebalancing toward reliance on domestic demand, in line with the authorities' stated policy goals, and contributing to global rebalancing.
- **Foreign exchange reserves** increased by USD 199 billion in December, boosting reserves to a record USD 2.85 trillion. Given the narrowing of the trade surplus, the reserves accumulation points to an increase in capital inflows, some of which may consist of hot money flows in anticipation of further RMB appreciation. After accounting for valuation changes (due to currency fluctuations) and projected FDI inflows, we estimate hot money inflows of around USD 95 billion for the quarter.
- **New loans** amounted to RMB 480.7 billion in December, higher than expectations (BBVA: RMB 420.0 billion; consensus: RMB 360.0 billion), and brining full-year credit growth to 19.9%. New loans for the year amounted to RMB 7.95 trillion, exceeding the annual target of RMB 7.5 trillion (Chart 3). **M2 growth** for December was 19.7% y/y (BBVA: 19.7%; consensus: 19.8%), in line with expectations, but above the authorities' annual target of 17%. Rapid loan and monetary growth reinforce our expectations of further tightening measures in 2011.

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Chart 1 Imports outpaced Exports and resulted in a smaller trade surplus

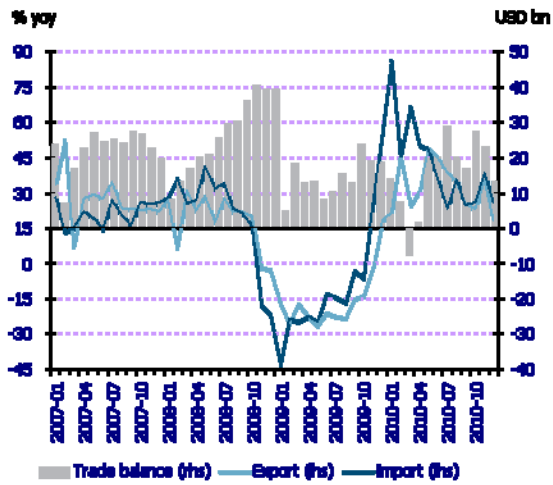


Chart 2 Foreign Reserve increased due to quickened capital inflow

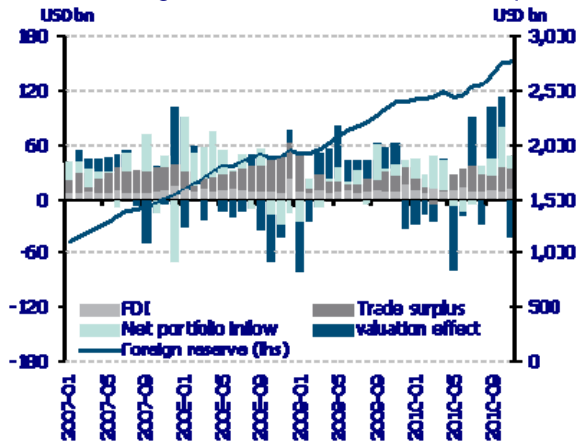


Chart 3 New Loans and M2 growth exceeded their preset annual target

