



Monthly Chart Book

14 November 2008

Li-Gang Liu

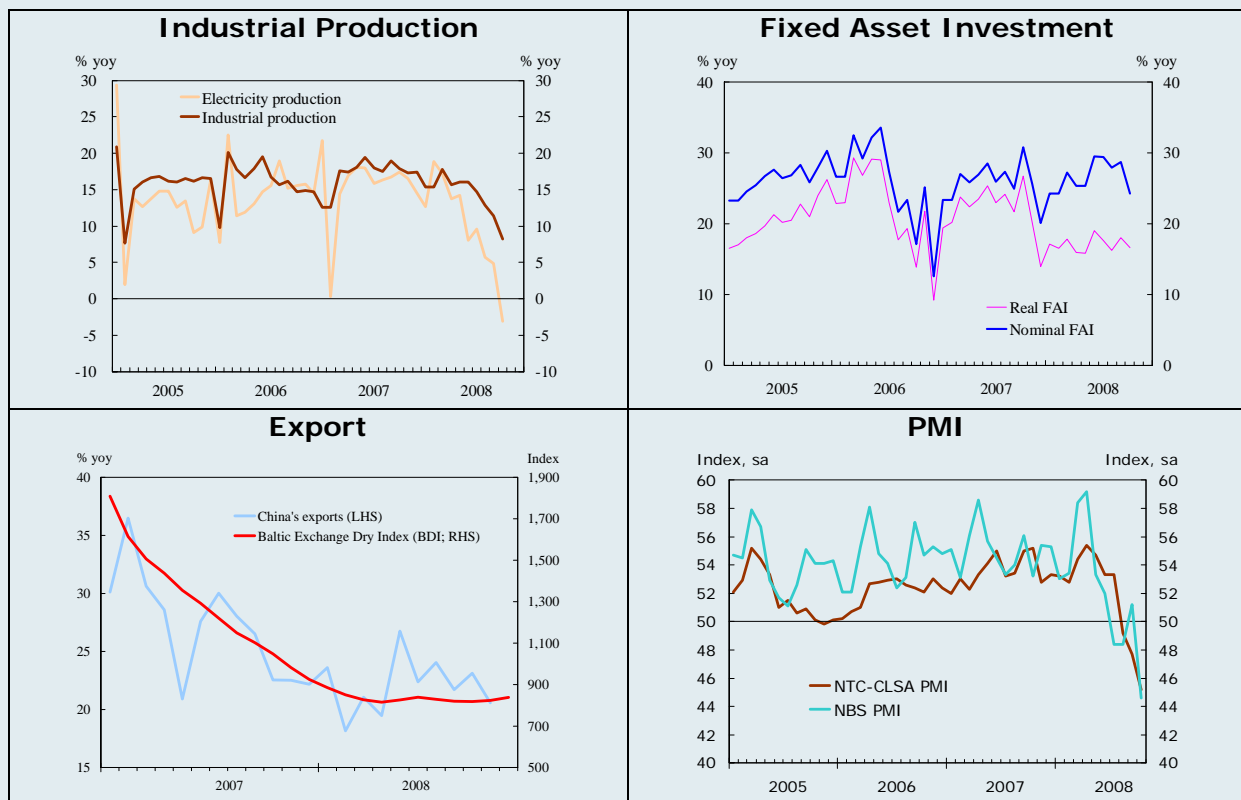
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Highlights of the month: Faster Decelerating Economic Activities

In our September China Monthly Chart Book, we pointed out that China's economic activities may have slowed faster than expected based on some preliminary economic activity indicators. The latest developments have confirmed our earlier observation, as these economic activity measures across board (industrial production, electricity production, fixed asset investment and exports) have fallen sharply. This perhaps is the reason why the authorities have initiated an aggressive fiscal stimulus package of RMB 4 trillion (USD 586 billion, 16% of 2007 nominal GDP) through 2010 in order to prevent a free fall of the economy. To facilitate the implementation of the large fiscal stimulus package, we believe the central bank will have to ease monetary policy by aggressively cutting both interest rate and the reserve requirement ratio going forward. We continue to maintain our view that China will be able to maintain a growth of 8% in 2009 on this potent policy mix.

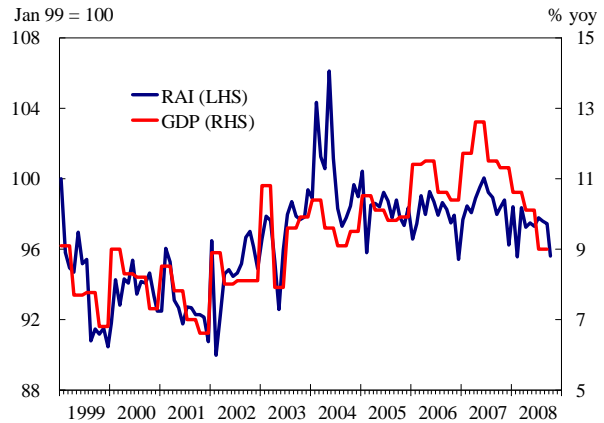


Sources: CEIC, Datastream and BBVA staff estimates.

I. Real Economic Activities

(a) Real economic activities

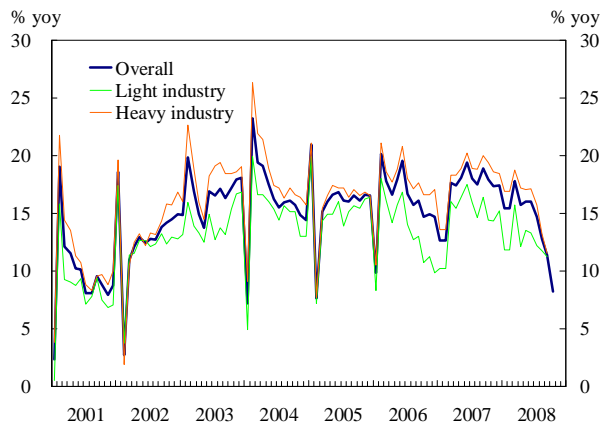
Our real activity index shows that the economic momentum fell steeply in October. The contraction in economic activities would be more substantial in Q4, if there were no fiscal stimulus package. The fiscal stimulus of RMB 100 billion earmarked for Q4 should help reverse the trend.



Sources: CEIC and BBVA estimates.

(b) Industrial production

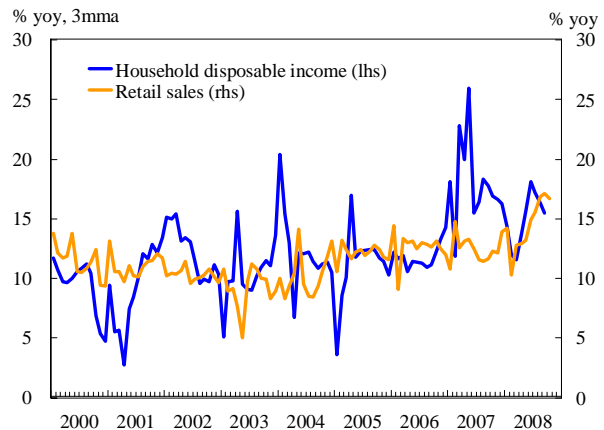
Growth in industrial production contracted sharply to 8.2% in October from 11.4% in September, recording the lowest growth in 7 years (after adjusting for the Chinese new year effect). The sharp slowdown reflects a more moderated export growth.



Sources: CEIC and BBVA estimates.

(c) Household income and real retail sales

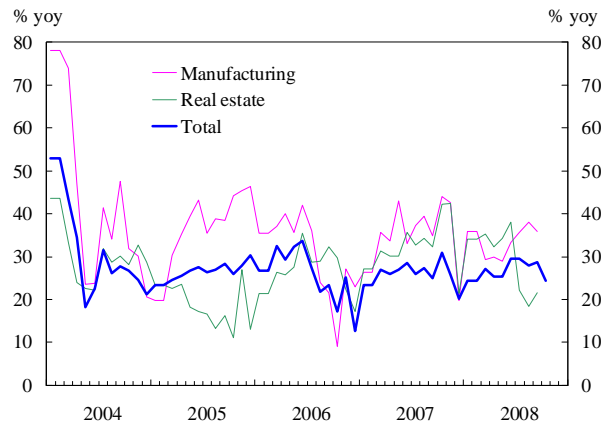
Household disposable income in nominal terms grew at a slower pace, after the rebound in growth in Q2. Growth in real urban income stood at around 9.5% in Q3, almost unchanged from that in Q2. Growth in real retail sales moderated slightly to 16.6% in October, after peaking at 17.0% in September.



Sources: CEIC and BBVA estimates.

(d) Fixed Asset Investments

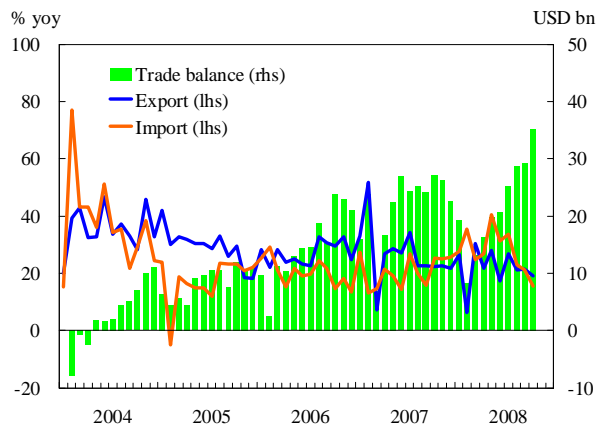
Growth in nominal fixed asset investment (FAI) contracted to 24.3% yoy in October from 28% in September, while real growth in FAI also moderated to 16.6% from 18.0% in September. It is expected that the growth in real estate investment would decline further in remainder of the year.



Sources: CEIC and BBVA estimates.

(e) External Trade

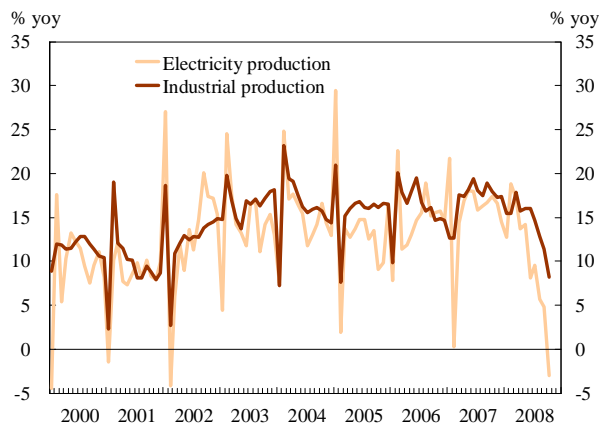
Export growth fell to 19.2% yoy in October from 21.5% yoy, while import growth declined even more sharply to 15.6% yoy, mainly due to the slowdown in domestic demand and falling commodities and oil prices. Trade surplus continued to remain substantial, registering a record-high monthly surplus of US\$ 35.2 billion. However, trade surplus is expected to fall in the coming months on a sharply falling external demand.



Sources: CEIC and BBVA estimates.

(f) Industrial production and electricity

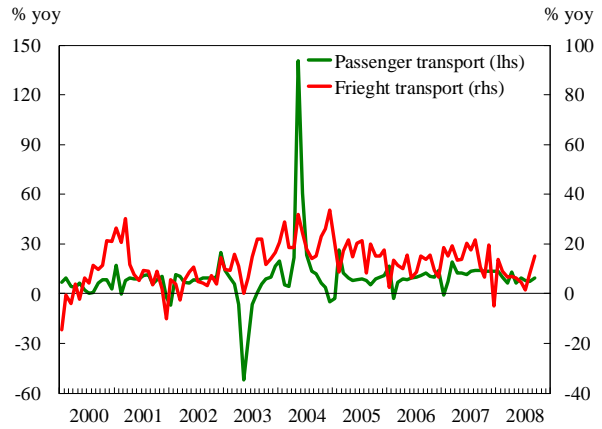
Growth in electricity production registered the first negative growth in 7 years in October, continuing the contraction trend. The sharp decline in electricity production growth in this year is mostly reflected by a slowing growth in activities of those heavy industries.



Source: CEIC and BBVA estimates.

(g) Transportation

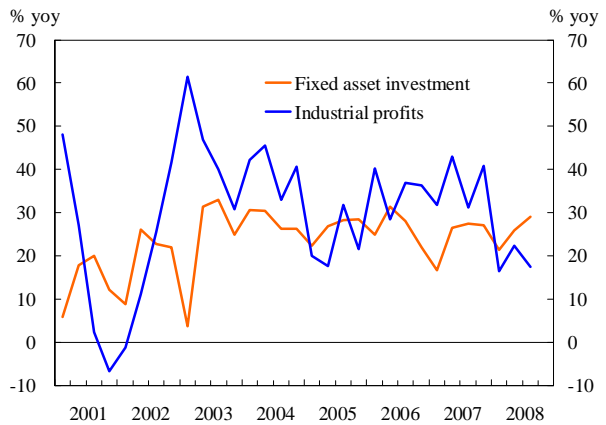
Growth in passenger transport picked up slightly after the Olympic Games in August and first half of September. In addition, growth in freight transport increased sharply in August and September after falling to close to zero percent in July. However, it is expected that the transportation will moderate soon, as the economic activities slow sharply.



Source: CEIC.

(h) General industry profitability

Growth in industrial profits fell again in 2008 Q3, after rebounding in Q2. The decline in profit growth is expected to continue as global slowdown intensifies.

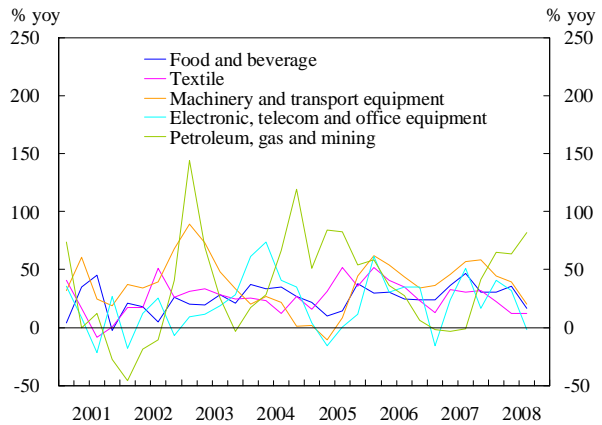


Source: CEIC.

Note: 2008Q3 figures of industrial profits are up to August 2008.

(i) Profitability by industry

Energy sector continued to experience the fastest growth in profits, while profit growth slowed sharply for electronic, telecom, and the office equipment industry.



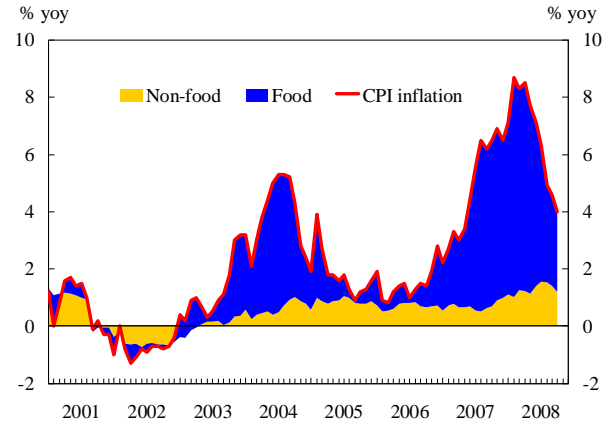
Source: CEIC.

Note: 2008Q3 figures of industrial profits are up to August 2008.

II. Price Developments

(a) Consumer price inflation

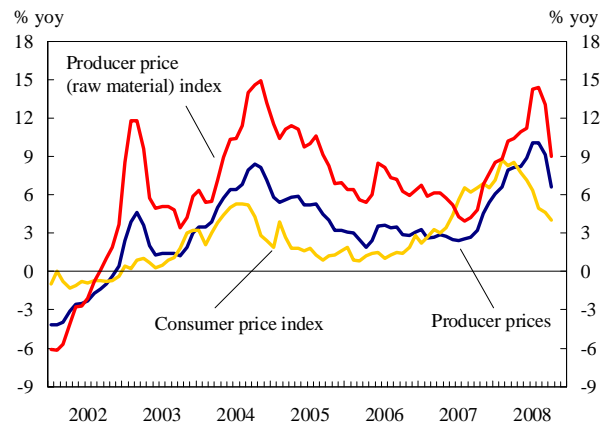
China's inflationary pressure eased further in October. CPI inflation fell to 4.0% yoy in October from 4.6% in September, the slowest rise in the recent 17 months (Chart 1). The fall in CPI was led by falling food prices while imported inflation from international energy and commodity prices eased sharply. If inflation follows the current trend, deflation will set in next year.



Sources: CEIC and BBVA estimates.

(b) Producer prices

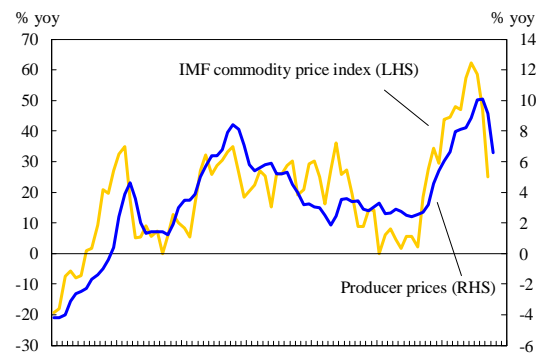
Slower domestic demand, together with falling commodity prices, China's PPI inflation eased by 2.5 percentage points to 6.6% yoy in October from that in September.



Sources: CEIC and BBVA estimates.

(c) Commodity prices and PPI

China's PPI inflation is highly correlated to price changes in international commodity prices. As the year-to-date price increases in international commodities eased sharply from 62% yoy in June to -6% in October, the pass-through effect on PPI inflation will attenuate in the near term, but with a lag of 2 to 3 months.

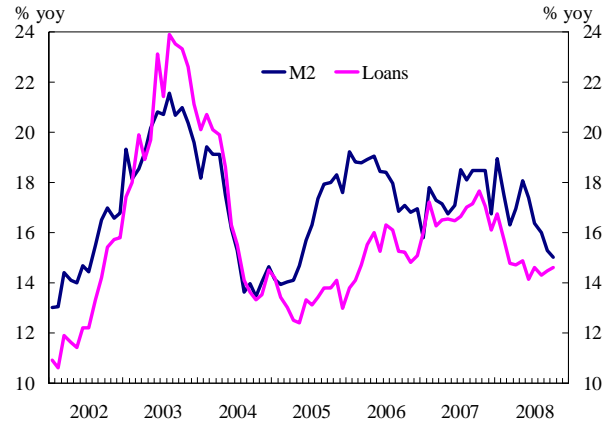


Sources: IMF, CEIC and BBVA estimates.

III. Monetary Conditions

(a) Money supply and credit

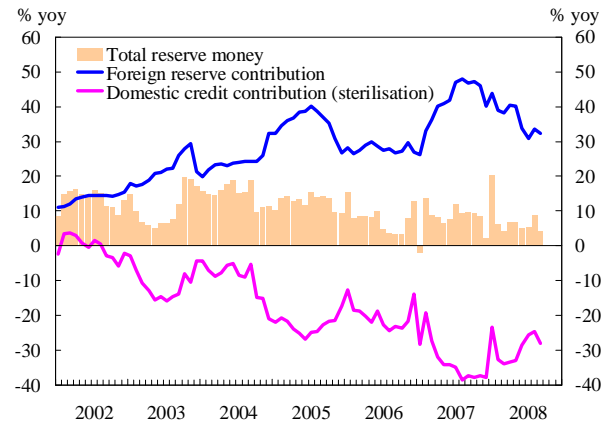
Growth in broad money (M2) continued to fall to 15.02% yoy in October from 15.3% in September, despite the recent monetary policy ease. Meanwhile, growth in domestic credit picked up slightly to 14.58% from 14.5% in September.



Sources: CEIC and BBVA estimates.

(c) Reserve money

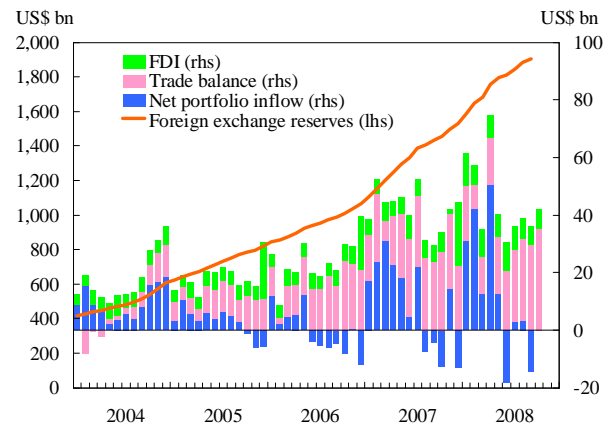
Reserve money growth has fallen sharply after February due to increased sterilization measures by the monetary authorities. However, the cut in interest rates and reserve requirement ratio signaled that monetary policy has started to ease.



Sources: CEIC and BBVA estimates.

(d) External capital inflows

China's FX reserves continued to increase, rising by US\$97 billion in Q3 alone on large trade surplus and FDI inflows. Though still large, the pace of reserve accumulation has slowed, compared to an increase of US\$ 154 and 127 billion in Q1 and Q2, respectively. Portfolio investment experienced another large outflow in September. By the end of September 2008, China's FX reserves stood at US\$1.906 trillion.

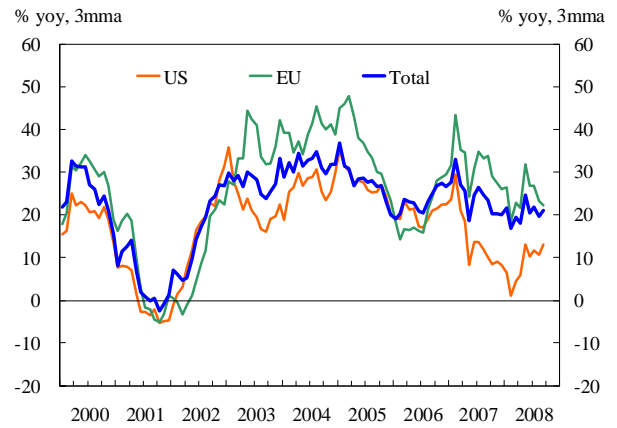


Sources: CEIC and BBVA estimates.

IV. External Trade

(a) Exports by region

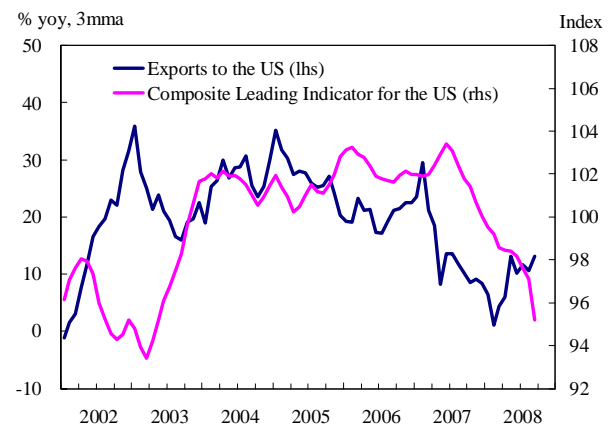
Export growth picked up moderately in September, on 3-month moving average basis. Growth in exports to the EU continued to fall in September, while that to the US increased slightly. We expect the growth in exports to all markets will moderate in October.



Source: CEIC.

(b) Exports to US

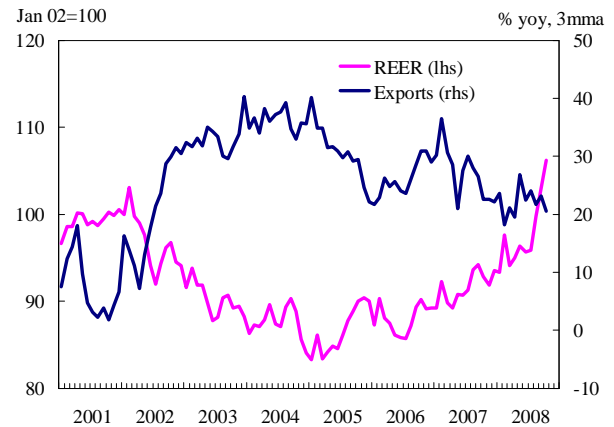
In line with the economic outlook of the US--shown by the leading indicator for the US, the export growth to US was on the declining trend since 2007.



Source: OECD, CEIC and BBVA estimates.

(c) Real exchange rate and exports

REER appreciation continued to exert a negative impact on China's export growth since the end of 2007. Combined with slowing external demand, China's export growth should continue to decline in the rest of 2008.

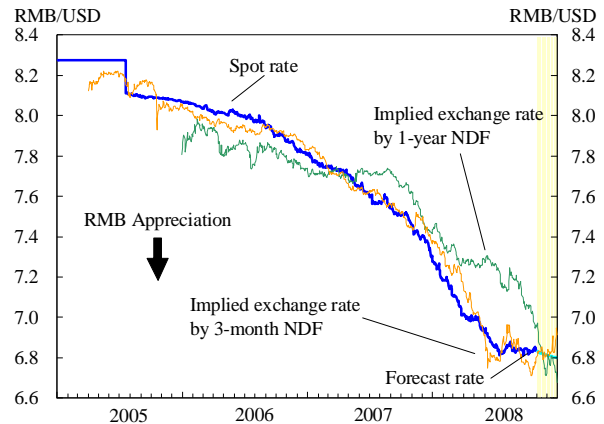


Sources: CEIC and BBVA estimates.

V. Exchange Rate

(a) Spot and expected appreciation of renminbi

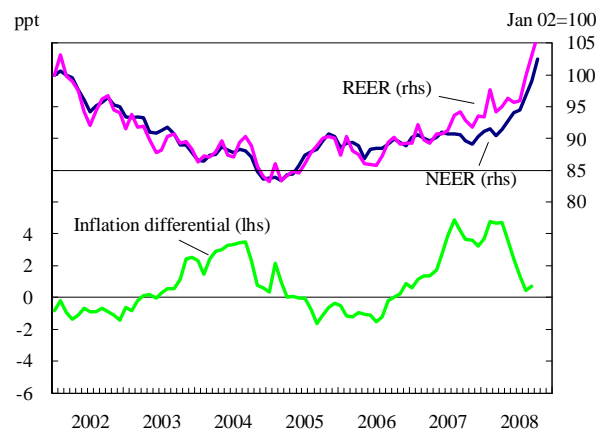
Renminbi stabilized at around the RMB/USD 6.8 level. A sharp rebound of US dollar recently may explain the stabilization of the RMB since July. Our forecasts suggest that the renminbi exchange rate will stay at around 6.8 per US dollar by the end of 2008.



Sources: CEIC and BBVA estimates.

(b) REER, NEER, and inflation differential with trading partners

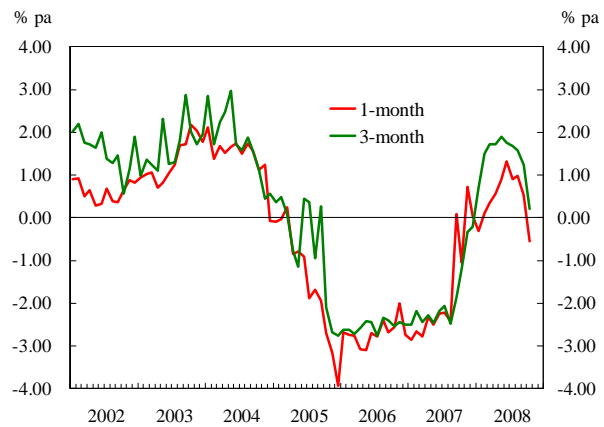
China's REER and NEER of the renminbi continued to appreciate reflecting large depreciation in some key trading partners' currencies and China's relatively low inflation rate to its key trading partners.



Sources: BIS, CEIC, Datastream and BBVA estimates.

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

The interest rate differentials between 3-month Chibor and Libor contracted sharply to zero from around 150 bps in August, reflecting the surges in LIBOR due to the global financial turbulence.

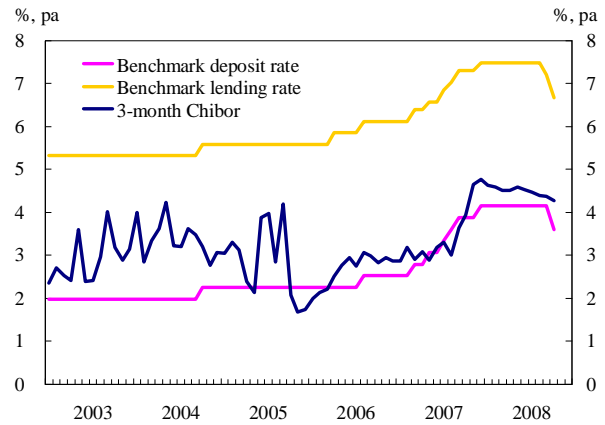


Sources: CEIC and BBVA estimates.

VI. Financial Markets

(a) Benchmark interest rates and Chibor

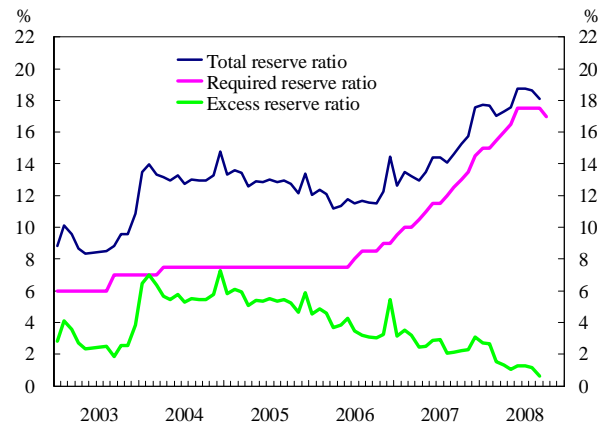
To ease external slowdown, PBoC lowered the benchmark (one-year) lending rate twice by 54 bps to 6.66% in October, while the deposit rate was also cut by 54 bps to 3.60%. Meanwhile, the 3-month Chibor, continued to fall, but still higher than the benchmark deposit rate.



Sources: People Bank of China and CEIC.

(b) RRR & Excess reserves

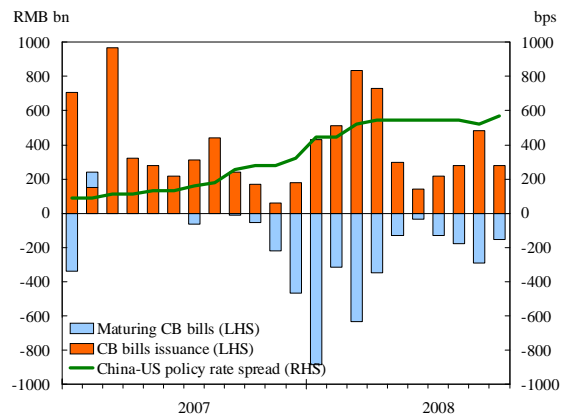
To inject liquidity to the banking system, PBoC also cut the reserve requirement ratio (RRR) for all banks by 0.5 percentage point effective on October 15. The required reserve ratio (RRR) for small- and medium-sized financial institutions is 16.0%, and 17.0% for the six largest banks (the Big Four (ABC, BOC, CCB, and ICBC), Bank of Communications, and Postal Savings Bank of China).



Sources: CEIC and BBVA estimates.

(c) Open market operations

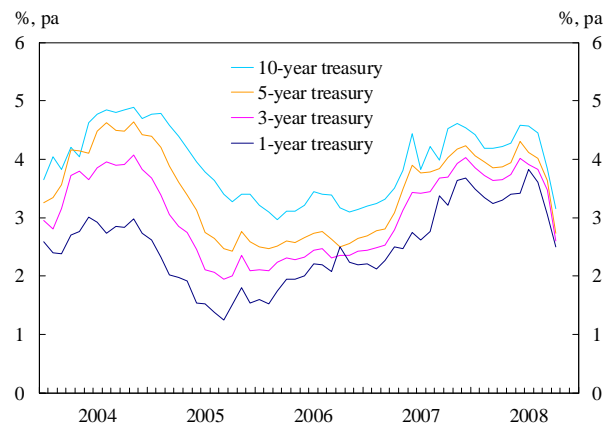
PBoC's open market operations reduced sharply since Q2 as net capital inflows eased. The costs of sterilization, measured as the spread of Chinese policy rate over US fed fund target rate, remained high after 2007 H2.



Source: CEIC.

(d) Treasury yields

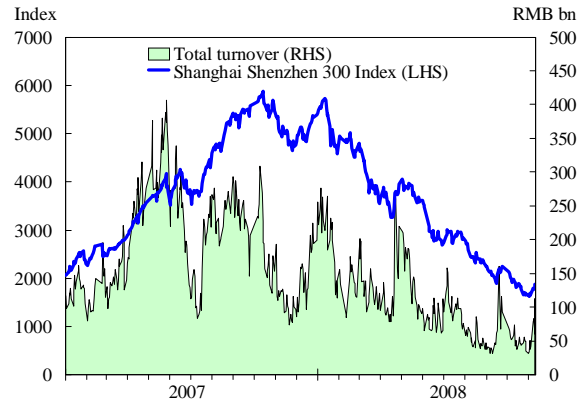
Treasury yields across different maturities decreased slightly in recent months, reflecting the falling inflation rate in recent months.



Source: CEIC.

(e) Stock Market Performance

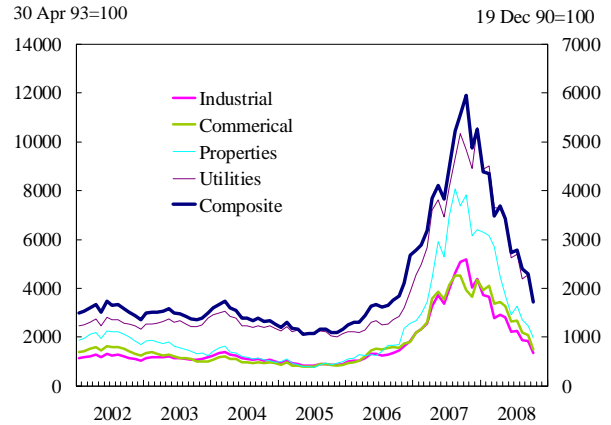
China's stock prices fell by close to 70% from the peak in last October. The decline in stock prices was particular large since September before the stabilization in this month, led by global market falls. Meanwhile, trading value also fell to about one-eighth of the turnover at the peak level.



Source: CEIC.

(f) Shanghai Stock Exchange Index

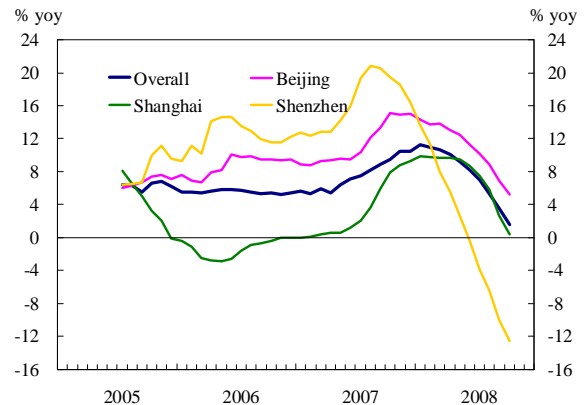
Stock prices fell across board. Compared with the peak in October 2007, various indices in Shanghai Stock Exchange Index have fallen by over 70%.



Source: CEIC.

(g) Property market

Growth in real estate prices has experienced a fall nationwide since 2007 Q3. It turned negative sharply in Shenzhen since June. Tight monetary policy since the end of 2007 has contributed to the slowdown in price rises in the real estate market nationwide. Although the monetary policy has been relaxed recently, the moderated income growth and the uncertain expectation may continue to restrain the growth in property prices.



Source: CEIC.