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China: A Solid Set of 4Q09 Data

China's Key Macro Data										
%/y change	2006	2007	2008	2009	3Q09			4Q09		
Real GDP Growth	11.6	13.0	9.6	8.7	8.9			10.7		
	2006	2007	2008	2009	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Industrial Output	16.6	18.5	12.9	11.0	10.8	12.3	13.9	16.1	19.2	18.5
CPI	1.5	4.8	5.9	-0.7	-1.8	-1.2	-0.8	-0.5	0.6	1.9
PPI	3.0	3.1	6.9	-5.4	-8.2	-7.9	-7.0	-5.9	-2.1	1.7
Urban FAI	24.3	25.8	26.1	30.5	32.9	33.0	33.3	33.1	32.1	30.5
Retail Sales	13.7	16.8	21.6	15.5	15.2	15.4	15.5	16.2	15.8	17.5

Source: CEIC, National Bureau of Statistics; UOB Economics-Treasury Research. All data for individual months except noted

- China's 4Q GDP growth rate of 10.7% is largely in line within expectations and full year growth of 8.7% exceeded official target of 8%.
- Beyond the headlines, China's lack of balance in its growth is still a concern. This is particularly clear in the divergence between investment and consumer spending. Another risk is that inflation is building up in the pipeline as both consumer and producer prices are likely to edge higher on low base last year.
- With China's data ending in a high note in 2009, outlook for 2010 should remain positive especially in the first half of the new year and we continue to maintain forecast for China's growth rate at 8.5%, with inflation rate likely to hover within 2-4% through the year.
- In terms of monetary policy, we see PBoC proceeding cautiously, with reserve requirement ratio and interest rate hikes ahead. FX policy is likely to remain unchanged for the year despite calls for revaluation from various quarters.
- Do note risk events ahead which include National Peoples' Congress meeting in March, US-China summit in May/June and US mid-term elections which could see US Pres Obama under renewed pressure after losing supermajority in Senate recently.

China reported its remainder batch of economic data for 4Q09 and for December this morning (Thursday, 21 January).

China's headline GDP growth rate in 4Q09 came in largely in line with expectations at 10.7%/y/y (vs. Bloomberg survey of 10.5%), which is the fastest since the 12% pace recorded in 4Q07. The 4Q headline figure is also substantially above the 8.9%/y/y rate in 3Q09. All in, for 2009 China's economy managed to reverse the gloom earlier in the year and grew a remarkable 8.7%, ahead of official projection of 8%, and the fastest growth rate at least in Asia, if not globally.

A look at the data releases this morning show that investment spending continued to be the key driver as in the quarters past, fueled by RMB4tn stimulus package announced back in 4Q08, which will continue into 2010. Urban fixed asset investment (FAI) accelerated 30.5% for the year in 2009, or 4.4%pt higher compared to 2008, and is the fastest annual gain in more than a decade. In contrast, retail sales data have been more measured, rising 15.5% in 2009, down from the 21.6% pace in 2008, with December month seeing 17.5% gain. This "imbalance" between investment and consumer spending is a key risk for China especially during policy tightening period.

Another risk worth watching is consumer prices have largely shaken off the deflationary period and moving into positive territory, with CPI in December rising 1.9%/y/y from 0.6% in November. At the same time, producer price index (PPI) has also moved out of its deflationary trend earlier than expected, rising 1.7%/y/y in December vs. -2.1% in November. These two indexes suggest that inflationary pressures may be building in the pipeline along with economic growth, although our central scenario is for the CPI inflation rate to gradually build up through the year at 2-4%/y/y pace. This means that any substantial rise away from this range could result in some adverse policy reaction on the part of PBoC, which is already grappling with "asset price bubble".

Other data show similar trend of "normalization" and towards recovery. Industrial production rose 18.5%/y/y in December, although full year production rose only 11% vs. 12.9% in 2008. Earlier, external trade report showed a robust import demand in December, rising 56%/y/y and exports gained about 17.6%/y/y, the first monthly increase after 13 months of declines. Loans demand chalked up another strong month in December, with new loans increase of RMB379.8bn, compared to RMB294.8bn in November. For full-year 2009, new loan increased by RMB9.59tn, nearly twice the RMB4.91tn increase in 2008.

Implications

With China's data ending in a high note in 2009, outlook for 2010 should remain positive especially in the first half of the new year. Low base in various data such as trade and production should help to deliver upbeat figures, although this means that price data are likely to show up strongly as well. The risk is that if inflation rate ventures outside the 2-4% range for the year, this could force the hands of PBoC in terms of policy interest rate. For headline growth in 2010, we continue to maintain our forecast of 8.5%, as outlined in our 1Q2010 Quarterly Global Outlook report.

Of more interest is the focus of future monetary policy risk given the earlier-than-expected reserve requirement ratio (RRR) hike announced last week (Tuesday, 12 January). It is clear that China is concerned about the impact of property price increases (and consumer price increases as well) on social stability and has taken its first step in unwinding its loose policy. We continue to expect the pace to be cautious, given that the PBoC needs to balance among growth objective, liquidity withdrawal, and an orderly asset price deflation. As such we see PBoC to gradually tighten on the RRR front to restrict credit supply, bringing to 18.5% by end of 2010 from 16% currently. From mid-2010, the price of credit is likely to face increase as we expect the PBoC to begin raising benchmark interest rates in a measured way to 5.85% by end-2010, from 5-year low of 5.31% for the 1Y lending rate. All in, we see PBoC to proceed in a cautious manner this year in terms of policy reversal given that it needs to balance its various factors as mentioned above.

On the currency front, the RMB is likely to remain relatively benign in the 3-6 month horizon, despite pressure building up again from various quarters for revaluation of the RMB. We continue to expect the USD/RMB pair to ease slightly towards 6.81 by mid-2010 and then to 6.77 by end-2010, from current 6.827 level.

We do note various risk events ahead, namely the China's annual National Peoples' Congress meeting in March, the US-China semiannual meeting in May/June, and the mid-term elections in the US, which could see US Pres Obama under renewed pressure after the loss of the supermajority in Senate recently.

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