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UOB Economic-Treasury Research

China: 3Q09 Data and Policy Implications

China's Key Macro Data											
%y/y change	2007	2008	1Q09			2Q09			3Q09		
Real GDP Growth	13.0	9.0	6.1			7.9			8.9		
	2007	2008	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Industrial Output	18.5	12.9	-	11.0	8.3	7.3	8.9	10.7	10.8	12.3	13.9
CPI	4.8	5.9	1.0	-1.6	-1.2	-1.5	-1.4	-1.7	-1.8	-1.2	-0.8
PPI	3.1	6.9	-3.4	-4.5	-6.0	-6.6	-7.2	-7.8	-8.2	-7.9	-7.0
Urban FAI	25.8	26.1	26.5	26.5	28.6	30.5	32.9	33.6	32.9	33.0	33.4
Retail Sales	16.8	21.6	18.5	11.6	14.7	14.8	15.2	15.0	15.2	15.4	15.5
Source: CEIC, National Bureau of Statistics; UOB Economics-Treasury Research. All data for individual months except noted											

- China's 3Q GDP growth rate of 8.9% is largely in line within expectations. With 7.7%y/y expansion penciled in for the first three quarters, official target of 8% is within reach.
- Beyond the headlines, China's growth quality and lack of balance is still a concern. This is particularly clear in the divergence between consumer and producer price data, as well as muted retail activity data, on the back of strong investment and credit data.
- This dichotomy in data could dampen PBoC's "exit strategy", which should also be a coordinated affair with other central banks in view of the global nature of the current recession and recovery.
- As outlined in our earlier piece on Asian central banks, we continue to expect the PBoC to stay put on interest rate policy and FX front until mid-2010.
- We look for China's key 1Y lending rate to hold steady at least through mid-2010 at 5.31%, and then to 5.85% by end-2010.
- We maintain our USD/RMB forecast for end 2009 at 6.82; and at 6.77 for end-2010, from current level of around 6.827. We will watch for US President Obama's meeting in Beijing with China's leaders in November, with trade and currency issues likely to be high on the agenda.

China's 3Q GDP Data Reaffirm Growth Target

China issued its usual batch of economic data for 3Q09 and for September this morning (Thursday, 22 October).

China's headline GDP growth rate in 3Q09 came in largely in line with expectations at 8.9%y/y, from 7.9% in 2Q09 and the trough of 6.1% growth in 1Q09. Taken together, for the first 9 months of 2009, China's economy has expanded about 7.7%y/y. This means that China's growth target of 8% for 2009 is largely in the bag, and making it the fastest growth rate at least in Asia, if not globally.

The key driver behind China's strong growth momentum could be attributed to the fiscal stimulus package announced last year and the impact is largely channeled through fixed asset investment (FAI), industrial output, and credit/money statistics. China's FAI continued to accelerate in September, rising 33.4%y/y year-to-date, compared to 33.0% growth in August, and the trough of 22% in December last year. Industrial output expanded at more than twice the 5% pace seen in earlier this year. The speed of China's credit creation has been widely reported, with the YTD new loans of RMB8.7tn, which is more than doubled the RMB4.2tn extended in all of 2008.

The dichotomy between PPI and CPI continues in September, where the producer price index extended its declining streak at -7%y/y vs. -7.9% in August, though declines in consumer prices moderated to -0.8%y/y in September from -1.2% in August.

Another anomaly is between retail sales data investment spending, where retail spending was steady at 15.5%y/y, maintaining at the 15% pace for the past 5 months and was below the 22% average growth rate in retail sales in 2008 and 17% growth in 2007, just as FAI continued to streak higher.

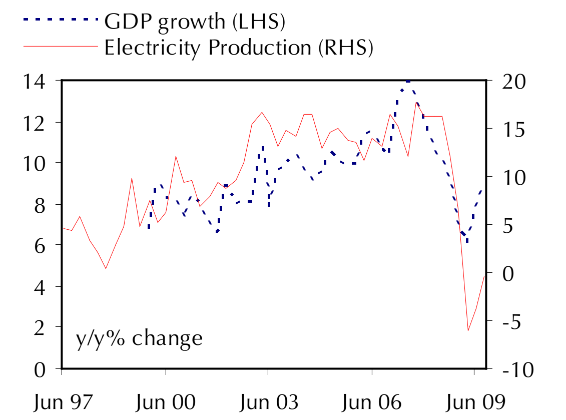
Policy Implications

Despite China having the fastest economic growth rate in the world and is set to at least achieve its objective of 8% growth this year, the latest data suggest that growth quality may be somewhat imbalanced, which could mean that "exit strategy" may be later rather than sooner.

The dichotomy between producer prices and consumer prices mean that underlying inflationary pressure may be less than feared, as producers continue to face with declining prices. At the same time, public spending appears to have little impact on retail sales activity, or at least the effect has yet to be cascaded down.

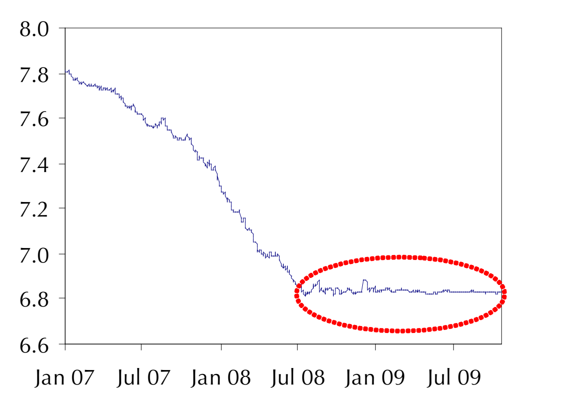
At the same time, rapid money supply and loans growth rates are clearly at the top of central bank concerns. In the context of a global financial crisis and the subsequent recession/recovery, the withdrawal of fiscal stimulus and central bank policy normalization is likely to be a coordinated affair among the global authorities. For instance, former HKMA chief Joseph Yam wrote in his 20 Aug articles about the need for a coordinated policy move that "[t]here is also an international dimension, which is particularly important given the huge amount of liquidity in the global financial system constantly searching for a safe home and a decent rate of return… Singapore and Malaysia also introduced similar deposit guarantees last summer… [t]here is therefore a need for close co-ordination with these two jurisdictions [to exit from the deposit guarantee program]."

China: GDP Growth vs. Electricity Production



Source: CEIC, UOB Estimates

China: USD/RMB Trend



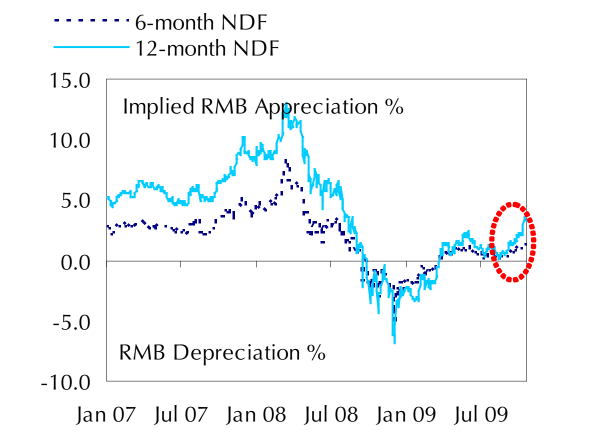
Source: Bloomberg, UOB Estimates

This line of thinking on coordination of policy moves is likely to be one consideration on the part of PBoC as well. Along the same line of argument that we presented in our report dated 7 September ("Monetary Policy Trajectory in Asia"), we continue to expect the PBoC to keep its monetary policy unchanged for now at least until late 1H of 2010, when it becomes clearer as to the extent and speed of the global economic recovery. **We still look for China's key 1Y lending rate to hold steady at least through mid-2010 at 5.31%, and then to 5.85% by end-2010 as PBoC begins its rate hike cycle.**

On the FX front, RMB has turned to de facto peg to the USD since July 2008 as the global financial system surged toward a full blown credit crisis.

The USD/RMB Non-deliverable Forward (NDF) prices are now stirring again and ratcheting up expectations of RMB gains, pricing in around 3.3% appreciation for the RMB against USD over the next 12 months, more than twice the 1.3% pace embedded just a month ago.

USD/RMB Non-deliverable Forward Implied Change



Source: Bloomberg, UOB Estimates

While we note the increased expectations on the RMB against a backdrop of weak USD, there is still a need for caution when looking to the USD/RMB NDF prices for guidance on future RMB movements. Their track record has not been exactly stellar as overshooting/undershooting has been quite a common occurrence. For instance, back in May 2008 the USD/RMB NDF prices were factoring in nearly 12% gain for the RMB over the following 12 months just as the US economic recession was deepening, and these expectations reversed by end-2008 to as much as 7% depreciation for the RMB as the global credit market froze and just as the USD/RMB hardened to the 6.83 level. Against the background of PBoC holding policy steady until mid-2010, we remain skeptical of any sharp appreciation for the RMB into 2010. **We maintain our USD/RMB forecast for end 2009 at 6.82; and at 6.77 for end-2010, from current level of around 6.827. This implies about 0.8% gain for the RMB in 2010. We will watch for the next key sign post which is US President Obama's meeting in Beijing with China's leaders in mid-November, with trade and currency issues likely to be high on the agenda.**