

Thursday, 22 January 2009

# Flash Notes

## China: Taking Down 2009 Forecasts

China released the remaining batch of data for 4Q08 and December this morning (Monday, 22 Jan).

Headline real GDP growth figure for 4Q08 decelerated significantly to just 6.8%/y compared to 9.0%/y in 3Q08 and 10.1% in 2Q08, when the first sub-10% reading surfaced in nearly three years. While the quarterly figure is the slowest in 7 years, it translates to a growth rate of 9.0% for the entire 2008, a drastically slower from 9.9% for the first three quarters in 2008 and 4% points down from 13.0% in 2007. The latest quarterly headline figure was in line with consensus forecast but sharply below our expectation of 8.6%, suggesting that the speed and spread of deterioration as a result of the global recession, is far worse than we thought.

In particular, China's exports and external trade data have declined significantly in last two months of 2008, similar to the experience in other export-dominant Asian countries in the same period. The impact of weaker external demand shows up most clearly in the manufacturing sector, as industrial production slowed sharply from its peak in middle of 2007. Today's release indicates that industrial output in December slowing to 5.7%/y, well off the peak of 19.4% growth in June 2007.

Domestic demand is also showing signs of softening, though retail spending and investment spending are expected to be the remaining key growth pillars in the current year given that external demand is set to deteriorate. Urban fixed asset investment rose 26.1% in 2008, implying about 21.6%/y rise in December 2008 which is off the peak growth of 29.5% in June 2008. Retail sales are also easing, with growth of about 19%/y in December compared to 20%+ pace monthly in 2008.

### Implications

The latest data continued to show a broad and deceleration trend in China that has been in place since middle of this year, as the global credit crisis has now morphed into a global economic recession. Contrary to widespread perception, China's net exports constitutes less than 9% of nominal GDP, with the remaining consisting of private consumption (35%), investment (42%), and govt spending (13%). This suggests that there is still room to spur domestic spending, in light of the RMB4tn fiscal stimulus package announced late 2008.

Despite the small share of net exports, the impact of the fall off in external demand is not negligible as it is conceivable that as much as 1/3 of the annual capital formation (directly and indirectly) is tied to the performance of the export sector. In particular, the destruction in external demand has idled plants and capacity in coastal regions, which would take the impetus off capital expenditure in those areas.

With the momentum of growth deceleration likely to continue into the first half of 2009, there is increasing risk that China's growth rate would miss the 8% official target this year. **We are lowering our forecast for China's real GDP growth in 2009 to 6.5% from our earlier projection of 8.3%.** In particular, we expect China's growth in the first half of 2009 slowing sharply to the 3-6% range, then re-accelerating to around 8% in 2H09 as impact from fiscal stimulus kicks in. This has taken into account China's exports to shrink by about 10% for this year and industrial output rising at just about 3% for the year.

On the interest rate front, the decline in headline consumer prices as well as priority in supporting domestic demand has left much room for PBoC to ease interest rates. **We continue to look for PBoC to frontload its rate cuts in 1H09, bringing the benchmark 1Y lending and deposit rates to 2.34% and 1.44% respectively, by end-2009.** For the 1Y lending rate, we expect 108bps move each in 1Q09 and 2Q09, 54bps in 3Q09, and then 27bps in 4Q09. For the 1Y deposit rate, the moves are likely to be more gradual, with 27bps cut each in 1Q09 to 3Q09, as we believe the authorities are wary of excessively low deposit rates for a nation of savers. The PBoC could move by 54bps as soon as today's evening (22 Jan) post the GDP report, though the last interest rate cut was made about a month ago on 22 Dec 2008.

**In terms of exchange rate**, the RMB has remained relative steady at around 6.83/USD level over the past two months. As it did in the 1997/98 Asian financial crisis, we expect the RMB to hold its place despite widespread weakness of other Asian currencies against the USD during the current crisis. In addition, the newly elected Obama government is expected to put pressures on its trading partners to "rebalance" the global imbalances, as evidenced by incoming Treasury Sec Tim Geithner's confirmation hearing at US Congress today, noting that China's "currency manipulation" was a "significant issue" and that he favored major trading partners having a flexible exchange rate system. **As such, we continue to see the RMB on a mild appreciation trend against the USD, to 6.76/USD by end-2009.**

China's Macro Data										
	2005	2006	2007	2008		3Q08				4Q08
Real GDP Growth %y/y	10.4	11.6	13.0	9.0		9.0				6.8
%y/y change	2005	2006	2007	2008	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Industrial Output	15.9	16.6	18.5	12.9	14.7	12.8	11.4	8.2	5.4	5.7
CPI	1.8	1.5	4.8	5.9	6.3	4.9	4.6	4.0	2.4	1.2
PPI	4.9	3.0	3.1	6.9	10.0	10.1	9.1	6.6	2.0	-1.1
Urban FAI	27.2	24.3	25.8	26.1	29.2	28.1	29.0	24.4	23.8	21.6
Retail Sales	12.9	13.7	16.8	21.6	23.3	23.2	23.2	22.0	20.8	19.0

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

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