
China: 2Q10 Data Show Growth Pace Easing

- *In contrast to the runaway 1Q report previously, China's 2Q real GDP growth pace slowed to 10.3%/y, as tightening policy begins to exert impact on domestic economic activity, in particular a pronounced shift in growth compositions.*
- *We expect this easing pace to extend into second half of 2010 to 9-9.5% range, which are still respectable in their own right, as base comparisons become another hurdle. We still expect China's real GDP growth for the year at around 10%, slowing to 8.3% in 2011, which is a far more important year in terms of sustainability in the current global recovery.*
- *While slowing data in 2Q suggests that monetary policy stance may not be tightened significantly, we still see room for interest rate hikes, as well as higher reserve requirement ratios, in the second half based on loans data and CPI trend. Given the uncertainty on the European debt front and pace of global recovery, we still see low risk of aggressive appreciation on the RMB, and continue to look for USD/RMB at 6.77 at end-2010 and 6.58 at end-2011.*

Shifts in Growth Compositions

China released this morning (Thur, 15 July) its data for Jun and 2Q10 GDP report, which shows first half growth of 11.1%/y, which means that headline growth number has decelerated from the gangbuster 11.9%/y in 1Q10, to 10.3% in 2Q10. On a seasonally adjusted basis, the pace has also eased to an estimated 8-8.5%q/q annualized, from 9.5-10% annualized in 1Q10, a sharp contrast to Singapore's 2Q data released yesterday.

Looking beyond the headlines, the more worrying change was the shifts in contributions from various GDP components. According to the stats bureau, investment spending accounted for the bulk of the 11.1% growth in 1H, at 59% share, followed by private consumption at 35.1% and net exports at 5.8% share. Working back on the figures indicate that investment spending contributing 60% of 2Q GDP growth (largely similar to 1Q), but private consumption share fell sharply to 15% (from 52% share in 1Q10), and net exports' portion rose sharply to 24% (vs. -10% share in 1Q). This suggests that China's tightening measures are beginning to exert pressures especially on private consumption, and growth momentum would have been a lot more slower if not because of the jump in exports and trade balances in 2Q.

Other monthly data also reflect a similar picture of softer demand activity that is consistent with the GDP report as tightening measures take hold. In particular, slowing trend is seen in consumer and producer prices, as well industrial output, while retail sales have largely maintaining flattish growth pace. M2 money supply slowed sharply to below 19%/y in Jun, and is essentially back to the pace seen in early 2009 before the run-up began. However, new loans cumulatively stand at RMB4.6tn to Jun 2010 (or an average of RMB770bn per month). If the official full year new loans target of RMB7.5tn were to be met, this would mean new loans would need to fall by one-third on average, to RMB480bn per month in 2H. This also means that monetary policy tightening is still not done yet.

Implications

Overall, the second quarter GDP report as well June data releases have a slight negative tone, at least for the next 6-12 months, in view of the shifts of its growth compositions, as well as the downward moves seen in a number of key monthly data. However, on a historic basis, China's 11.1% growth in 1H is still in "overheating" territory since its potential growth rate is at the 8% range. The slowing momentum suggests that headline growth range of 9-9.5% is likely, with base comparisons another hurdle to overcome. **For now, we still expect China's real GDP growth for the year at around 10%, slowing to 8.3% in 2011**, which is a far more important year in terms of sustainability in the current global recovery.

Despite this negative backdrop, monetary policy tightening may still need to proceed on account of negative real interest rate and the fact that loans growth remains ahead of official target. As such, we still see risks for interest rate hikes, as well as higher reserve requirement ratios (RRR), in the second half. **We look for just two more moves on the RRR this year to 18%, from 17% currently. On the interest rate front, we expect PBoC to join the likes of BoT, BoK, Bank Negara Malaysia, India's RBI, and Taiwan's CBC, with two increases this year to bring the 1Y working rate to 5.85% (from 5.31% currently) and 1Y deposit rate to 2.79% (from 2.25%) by end-2010.** Given the uncertainty on the European debt front and pace of global recovery, and despite the shift to a more "flexible" exchange rate policy on 19 Jun, **we still see low probability of aggressive appreciation on the RMB, and continue to look for USD/RMB at 6.77 at end-2010 and 6.58 at end-2011.**

China's Key Macro Data										
	2006	2007	2008	2009	1Q10					2Q10
Real GDP Growth %y/y	12.7	14.2	9.6	9.1	11.9					10.3
%y/y change	2010	2011	2012	2009	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Industrial Output	16.6	18.5	12.9	11.0	-	12.8	18.1	17.8	16.5	13.7
CPI	1.5	4.8	5.9	-0.7	1.5	2.7	2.4	2.8	3.1	2.9
PPI	3.0	3.1	6.9	-5.4	4.3	5.4	5.9	6.8	7.1	6.4
Exports	27.2	25.7	17.3	-15.9	21.0	45.7	24.3	30.5	48.5	43.9
Imports	19.9	20.8	18.4	-11.3	85.6	44.7	66.0	49.7	48.3	34.1
Trade Balance (US\$ bn)	177.5	262.0	297.3	198.2	\$ 14.2	\$ 7.6	-\$ 7.2	\$ 1.7	\$ 19.5	\$ 20.0
New Loans (RMB bn y/y chg)	3,065.7	3,634.4	4,170.4	9,629.0	1,393.4	700.1	510.7	774.0	639.4	603.4
M2	16.9	16.7	17.8	27.7	26.1	25.5	22.5	21.5	21.0	18.5
Urban Fixed Asset Investment YTD	24.5	25.8	26.1	30.5	26.6	26.6	26.4	26.1	25.9	25.5
Retail Sales	13.7	16.8	21.6	15.5	14.0	22.1	18.0	18.5	18.7	18.3

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

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