

Asia Demand Watch

How fast is China growing?

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Editor: Richard Martin (richard.martin@imaasia.com)

Regional Economist: Glenn Levine (glenn.levine@imaasia.com)

Charts and tables: Larnie Muirhead (larnie.muirhead@imaasia.com)

Summary

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For information on IMA Asia's services and products please contact:

Larnie Muirhead, Client Support Manager

Email: larnie.muirhead@imaasia.com

P: +61 2 9252 4336 F: +61 2 9252 4339

Catherine Bell, GM, Singapore

Email: catherine.bell@imaasia.com

P: +65 6221 5710 F: +65 6221 3348

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Slower but sustained growth in China is one of the few bright spots in the global economy in 2009. Yet China's data presents a very mixed picture, as is apparent in the summary table below. One of the puzzles is why a dramatic slump in export manufacturing, which many speculate has been accompanied by a jump in unemployment, has had so little impact on local demand and GDP. This odd outcome was confirmed by clients at our June forecasting sessions, most of whom reported good sales growth in China this year.

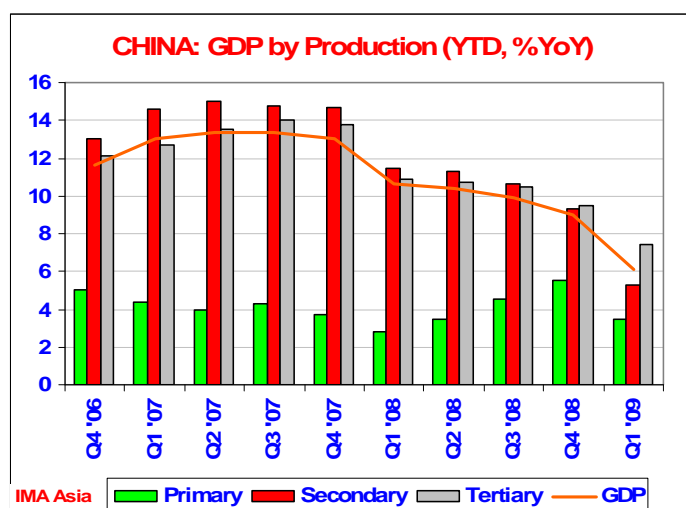
Data Summary, % growth

Measure	2007	2008	2009	Period for 2009 data
GDP	13.0	9.0	6.1	Q1
- Primary (rural & mining)	3.7	5.5	3.5	Q1
- Secondary (industry & construction)	14.7	9.3	5.3	Q1
- Tertiary (services)	13.8	9.5	7.4	Q1
Exports	25.7	17.3	-21.8	May YTD
Imports	20.8	18.4	-27.8	May YTD
Rail freight	7.9	4.7	-5.8	May YTD
Air freight	15.8	1.8	-8.0	May YTD
Electricity production	15.7	6.6	-4.0	May YTD
Industrial sales - total	28.0	22.2	1.5	May YTD
- Light	25.7	19.8	7.5	May YTD
- Heavy	29.0	23.2	-0.8	May YTD
- For export	23.1	10.5	-15.3	May YTD
Automobile production	21.2	4.8	12.2	May YTD
- Cars	21.9	7.1	8.1	May YTD
Motorcycle production	18.1	12.4	-15.0	May YTD
Tractor production	-3.1	20.8	34.8	May YTD
Retail sales, current prices	16.8	21.6	15.0	May YTD
Loans by financial institutions at Dec.	16.1	15.9	28.0	May YOY
Savings deposits at Dec.	6.8	26.3	29.6	May YOY
Fixed asset investment, total	25.6	26.2	32.9	May YTD
- State owned & holding company	15.7	22.6	40.6	May YTD
- Residential building	30.6	22.4	7.5	May YTD
- Central government	17.8	31.0	28.0	May YTD
- Local government	26.6	25.6	33.4	May YTD
- Project under construction	20.6	20.0	33.8	May YTD
- Project newly started	28.7	5.4	95.9	May YTD
Floor space under construction	20.7	14.8	15.9	May YTD
- Residential	21.0	15.7	13.1	May YTD
Floor space complete	13.3	0.8	25.9	May YTD
- Residential	11.3	-0.5	24.7	May YTD

Can we make sense of this data? Read on

What the GDP and industrial sales data tells us about growth

The quarterly GDP data tells us that growth slowed to 6.1%yoy in Q1'09, the slowest pace since quarterly data became available in 1991. This is slower than during SARS (2003), the global tech wreck (2001) or the Asia Crisis (1997-98). It is about half the pace set during 2007 or one third less than the pace set in 2008 as the economy cooled. But it is still, as Clint Laurent noted in our Q1 forecasting conferences, growth, which should be apparent in domestic sales.



China provides quarterly GDP real growth on the production side of the economy broken out into three main sectors: primary (rural and mining); secondary (mostly industry and construction); and tertiary (services). Quarterly expenditure data (consumer, government, fixed investment, exports and imports) is not available. China releases its GDP data so quickly that many see it more as a political statement than an economic measure. It tends to overstate growth when the economy slows and to understate growth when the economy is running too fast. Quarterly GDP is measured on a year-to-date (YTD) basis.

Breaking out the GDP components: All three sectors measured by production GDP slowed in Q1'09. The "primary" sector (11.3% of GDP in 2008, which covers mining and agriculture) slowed to 3.5%yoy after a strong finish to 2008 as rising commodity prices boosted incomes. The 3.5% result for Q1 isn't bad on past trends and suggests continued moderate growth.

Industrial sales just grew through to May. The biggest of the three GDP production sectors is "secondary" (48.6% of 2008 GDP), with Q1'09 growth of 5.1%yoy being the slowest rate since quarterly data started in 1991. There's no breakout under "secondary" in quarterly data but annual data shows the two main components to be "industry" (43% of 2008 GDP) and "construction" (5.7%). If you look at the industrial sales growth in our Data Summary on page 1, which drops from 22.2% for 2008 to just 1.5% for the first five months of 2009, it seems that overall "industry" has experienced little growth this year. The industrial sales data breakout tells us that roughly 16.5% of all industrial sales were "for export" last year and that such sales in the first five months dropped 15.3%ytd. But that also means that some 83% of all industrial sales were for the domestic market and a quick calculation suggests such sales are up 4.9%ytd by May. So despite the collapse in exports much of China's industry is still selling more in 2009 based on domestic demand.

The point is that China's factories overwhelmingly manufacture for the domestic market. If you are selling to domestic-focused manufacturers your customers have had sales growth in the 5-10% range through to May. By contrast, if you are selling to export-focused firms then these customers have, on average, suffered sales declines of around 15%ytd.

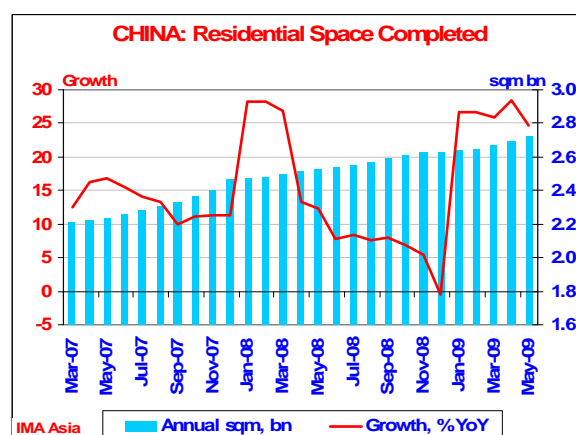
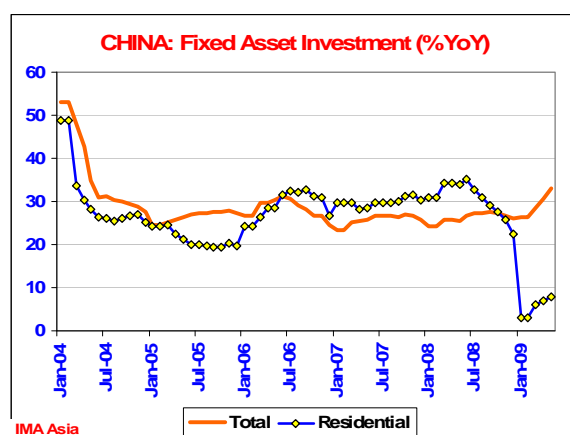
A quick double check on whether China's "industrial sales for export" makes sense is to cross-check it to China's export data. Industrial sales for export equal a very stable 78-82% of total exports of manufactured goods from 2002 to 2007 before rising to 84.7% in 2008. So while China's

US\$1,351bn in manufactured exports (94.5% of all exports) is a dauntingly large number it represents just 16.5% of industrial sales, which in 2008 were worth Yuan 48,069bn or US\$6,918bn.

Outlook for GDP: China's official goal this year is to lift growth back to 8%. The IMF's 2009 forecast is 6.5% (April '09 WEO) while a more recent World Bank forecast is for 7.2% (June '09). Meanwhile, private sector forecasters have also been edging their 2009 GDP numbers higher: UBS from 6.5% (Feb'09) to 7.5% (Jun '09), Barclays from 7.2% to 7.8%, and Standard Chartered from 6.8% to 7.4%. IMA Asia's forecast at June was 7.0% and we may lift this in July.

What the fixed investment and construction data tells us about growth

As noted above construction is classified under "secondary" GDP and is around 5.7% of total GDP (it is about the same share in most economies). Our Data Summary on page one has two pointers to likely developments this year in construction. The first is "fixed asset investment", which is a peculiar number in China that has little relation to fixed investment in GDP as it includes, among other variations, the cost of land.



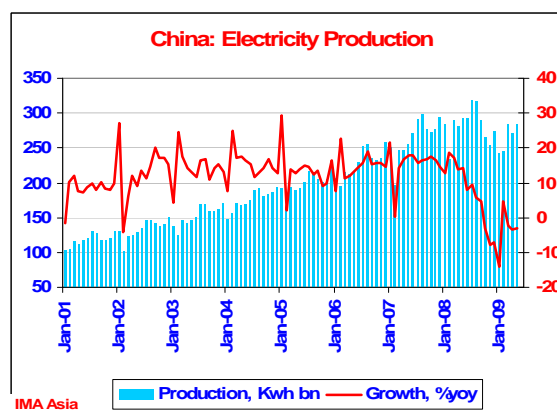
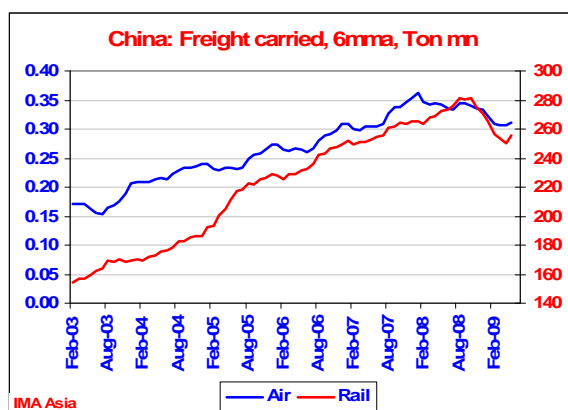
Two stories are apparent in the construction-related data. First, China's fiscal stimulus kicked in from the start of 2009 in a big way. Overall fixed asset investment jumped, with "newly started projects" (see Data Summary table) up 96%ytd through to May. The big increase has been under "state owned and holding companies", up 41%ytd by May, about double the pace of growth in 2007 and 2008. By contrast, residential building investment grew just 7.5%ytd through to May after growth of 23% in 2008 and 31% in 2007. But as the left-hand chart above shows, a big fall in residential investment occurred in January '09 and a weak recovery has been underway since March '09. January '09 also saw a sharp jump in residential floor space completions (our second chart above). This may well represent a strategy by developers to slow completions last year as demand and prices fell and then accelerate completions as the fiscal stimulus provided a lift in demand in 1H'09. Reuters reports that home sales in first and second-tier cities have jumped more than 20% in the past three months following cuts to interest rates and stamp duty as well as a policy change to allow reduced mortgage down payments. Paul Cavey at Macquarie Bank argues that the government is using property price reflation in 2009 to lift economic growth. Nationwide property prices fell 8.8% in 2008 but the trend in recent months has been steadily up.

China exceeds the US in fixed investment in 2009: IMA Asia does calculate gross fixed investment within GDP and on our numbers the current value of fixed investment in China in 2009, at US\$1,993bn, will, for the first time, exceed the current value of fixed investment in the US, at US\$1,918bn. As China's economy, measured in standard GDP, was just 31% of the size of the US in 2008 this highlights the extent to which China is an investment driven economy (while the US has been a consumer driven economy). Our analysis suggests that fixed investment will play an even bigger role in driving China's growth in 2009 and 2010, with most of the lift coming from the public sector. China's fixed investment will continue to exceed that of the US in 2010 and 2011.

What the trade, transport and electricity data tell us about growth

If China is suffering a recession in 2009 it is in its export sector. We've noted above that "industrial sales for export" are down 15.3%ytd by May. The falls in exports and imports are even bigger – 21.8%ytd for exports and 27.8%ytd for imports (see Data Summary table).

While the industrial sales data suggests this affects less than 20% of industrial output the impact can still be seen in China's transport data. The slide in rail freight has only just eased in May with a decline in air freight bottoming out two months earlier. Reports from our clients in China suggest both these indicators should rise steadily in the next few months as factories lift their production.



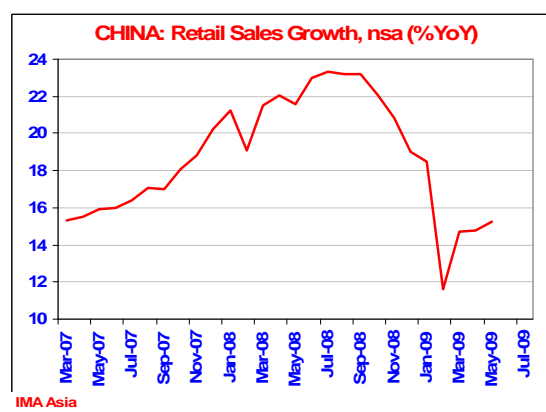
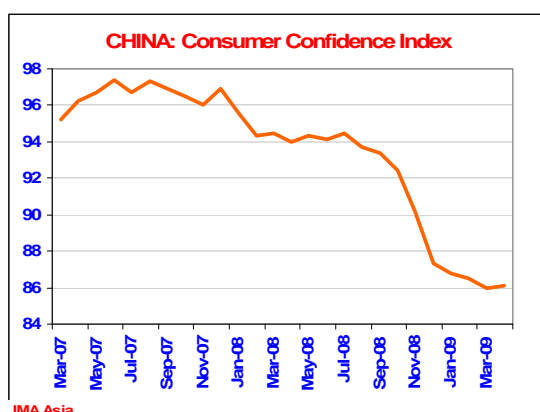
Electricity production has also been notably weak through the last six months. Analysts who have looked closely at this data think that the fall is due to big cuts in power-intensive heavy industry and that the fall in production is not representative of a broader reduction in industrial activity.

What the consumer data tells us about growth

China doesn't release quarterly data on consumer expenditure in GDP. Its annual data puts consumer spending at a relatively low 35.3% of GDP in 2008 (at current prices) with growth last year of 15.8% in current prices and around 10% in real terms (our estimate).

The Data Summary table shows conflicting trends. On one hand, savings deposits grew a strong 29.6%yoy in May '09, suggesting that households are more focused on saving than spending at the moment. This trend emerged during 2008, when growth in savings deposits jumped to 26.3% for the year from 6.8% in 2007. China's consumer sentiment survey, which we've found to be quite a useful guide, shows a steady fall in sentiment through 2008 that accelerated sharply at the end of the year.

This didn't have an impact on retail sales until Q3'08 when retail sales growth slowed sharply, dropping from 22%+yoy in mid 2008 to around 12-14%yoy in early 2009. But from March onwards the pace has edged up, exceeding 15%yoy in May as consumers responded to the fiscal stimulus. This helped lift car sales through to May by 8.1%yoy while overall vehicle sales rose 12.2%ytd. The 15%ytd fall in motorcycle sales may well reflect substitution as the fiscal stimulus incentives were targeted at boosting sales of entry-level four wheel vehicles in place of two and three wheel transport.



Consumer outlook. Our current forecast for real growth in consumer spending is for a slowdown to 6.5% growth in 2009 from around 10% in 2008. On balance we'll leave it at that rate. This still makes China one of the fastest growing consumer markets in the world in 2009.

So how fast is China growing in mid-2009?

China is suffering an export recession, not a domestic recession in 2009. While the massive scale of exports suggests that export production dominates this is far from the case. Export manufacturing is less than 20% of industrial production. Once this is understood two important aspects of China's current economic performance are clearer. First, the jump in unemployment in the export manufacturing sector is not as disastrous as it might seem as we can assume employment across some 80% of the manufacturing sector that serves the local market has remained reasonably steady. Second, it is easier to understand how government stimulus measures can help much of manufacturing, which is focused on local demand. That appears to be the case in vehicle production and, according to our clients, in many other manufacturing areas tied to local consumption. Manufacturing tied to the construction sector will have received a giant boost from accelerated infrastructure spending and manufacturers in this sector should also benefit from a soft but steady lift in the housing sector.

Overall this suggest that China's growth in Q2'09 should lift above 7% from 6.1% in Q1'09 and that the second half of this year should see stronger growth that could well put China within reach of its 8% GDP growth goal for 2009.

Richard Martin, IMA Asia
 Email: richard.martin@imaasia.com
 Tel: +61-2-9252 4336

Glenn Levine, IMA Asia
 Email: glenn.levine@imaasia.com
 Tel: +61-2-9252 4336

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