THE Westpac GROUP

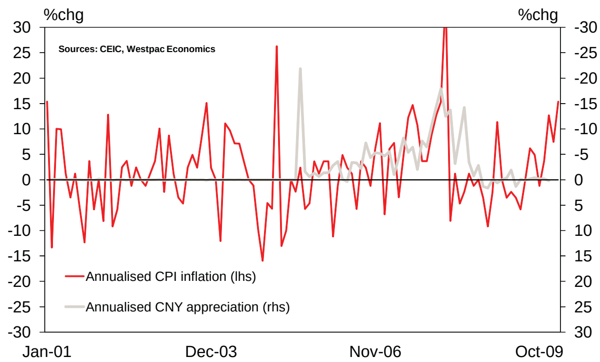
11 March 2010

Phat dragon

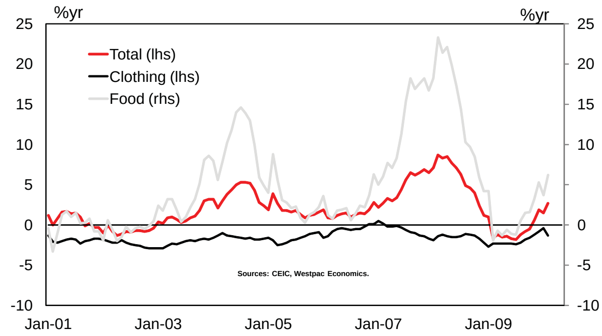
a weekly chronicle of the Chinese economy

- The National Peoples' Congress (NPC) has been underway since March 5 and will conclude on the 14th. The NPC is the forum for announcing the annual growth target (8%); the inflation target (3%); the central budget (social spending up 8.8%, rural spending up 12.8%) and the stance of monetary ("appropriately easy") and fiscal ("active") policy. All nice and clear: policy is shifting incrementally, not abruptly.
- Where was the lack of clarity? The exchange rate of course! Premier Wen, who is the ultimate authority on such matters, chose the phrase "basically stable" in his forward looking comments. Commerce Minister Chen (the chap dealing with the export lobby) chose the phrase "gradual and controlled", while simultaneously painting a picture of external demand that was sombre to a fault. PBoC Governor Zhou departed from the cautious line by describing the policy of USD/CNY stability as a "special measure", then arguing that "these kinds of policies sooner or later have to be withdrawn." These words were of sufficient import that they awoke **Phat Dragon** with a jolt, interrupting a most peaceful slumber in the backstalls.
- The translation of this range of commentary is that there is not yet a binding consensus among the key policy makers that would enable **Phat Dragon** to credibly predict that the highest probability scenario is a dramatic exit from the stable USD/CNY position. However, the return of grinding appreciation in the relatively short term, guided by the inflation trajectory, would fit the comments of Zhou, Chen and Wen. It also has the aroma of sensible policy making, a scent that **Phat Dragon** often encounters in Beijing, but rarely in the provinces.
- The February monthly data round (including raw February reads in some instances, and Jan/Feb totals in others) is severely distorted by the working day effect. This was evident in the PMI releases earlier in the month and it shows up again today. Retail sales reflect this issue clearly, with the nominal series rising to 22.1%yr from 18.1% in January. Industrial value-added and fixed investment data (both Jan/Feb composites) are difficult to interpret. For the record, the former came in at 20.7%ytd from 19.5% previously and the latter grew 26.6%ytd, up from 25.6%. No Chinese administration has ever taken a policy decision based on real activity data from this time of year. Monetary and inflation data are a different story. Both upstream and downstream price indices beat expectations in February (CPI 2.7% vs 2.5% [a forecast with apparent downside risk given weekly food price info]; PPI 5.4% vs 5.1%), with CPI now clearly running ahead of the 1-year deposit rate of 2.25%. This development is a very important "tick" on the rate hike checklist. On the monetary side, new loans rose 700 billion yuan in February. **Phat Dragon** estimates that new loans are still on a ~41% of GDP trajectory for the first half, splitting the difference between the 2009H1 outcome and the 2010 target.
- On policy checklists, **Phat Dragon** has encountered some very timely research from the HKMA on the Mainland's monetary policy reaction function. The authors argue that the stance is most responsive to actual growth and inflation outcomes and relatively unresponsive to employment, money or credit data.
- **Stats of the week:** A McKinsey survey claims that China's city dwellers spend 70% of their leisure time on the internet.

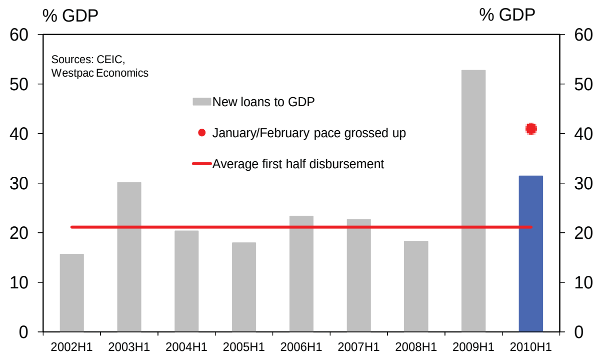
The exchange rate & inflation



Chinese consumer prices



New lending: lower in 2010 but still ample



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