

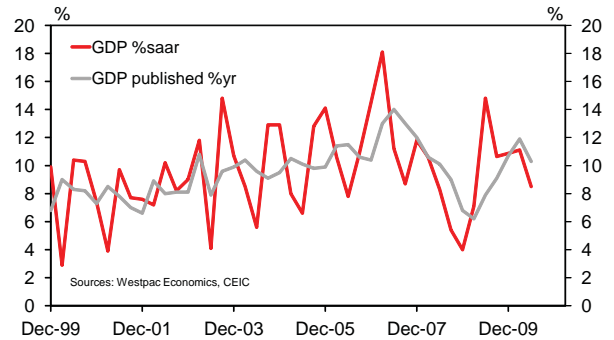
15 July 2010

- The economy reportedly expanded 10.3%yr in Q2 (11.1% in the first half), which **Phat Dragon** estimates is an 8.5%saar pace. The market was looking for a 10.5% outcome. The annualised pace is the first outcome below 10% since 2009Q1. Overall, the preliminary reading of the GDP and the accompanying month-of-June data are basically consistent with an economy losing momentum on a broad front.
- Industrial value added (IVA) slowed more than anticipated in the month of June and can only be described as soft. The published number came in at 13.7%yr (down from a March-May average of 17.5%), which implies a 0.4% seasonally adjusted decline versus May, driving 6mth annualised growth down to a meagre 10.5% (March-May average of 16.3%). The PMI and the leading indicator have been pointing to a deceleration in IVA for some months now. **Phat Dragon's** modelling has indicated that IVA growth looked vulnerable coming in to this announcement: and July is unlikely to see a reprieve.
- Fixed investment was slightly firmer than expectations (25.5%ytd from 25.9% in May, market forecast 25.2%). We back out the year-on-year figure as 24.7%yr from 25.4% in May. The arithmetic of the investment slowdown is simple: the contribution of infrastructure activity has almost halved from a peak of 12ppts in May 2009. Real estate has doubled its contribution to 8ppts over that time, but will struggle going forward as private developers see inventories of unsold stock rising. Heavy industry has responded to this mix of trends by shedding 2ppt from its peak contribution rate. So,  $-6 +4 -2 = 4$ ppt lower contribution from the core sectors even before real estate slows down in earnest. The potential replenishment of the infrastructure pipeline, the observed rebound in profit growth buoying capex plans and newly prioritised public rental housing are the possible offsets. Each is partial relative to trends in their relevant sectors and thus they are cumulatively insufficient to stave off an aggregate slowdown.
- As for the other month-of-June indicators (very accurately leaked by the Chinese Securities Journal yesterday evening) prices lost some altitude (CPI 2.9% from 3.1% in May; PPI 6.4% from 7.1%) and tertiary activity was relatively steady (18.3% from 18.7%). The inflation data confirm **Phat Dragon's** long held view that the 2010 inflation outlook was not alarming. Just to refresh memories, **Phat Dragon** eschews monetary explanations of Chinese inflation, preferring to prioritise resource utilisation levels.
- Exports were the exception, as they did better than most expected in June, expanding by 43.9%yr, assisted by a pull forward of shipments to beat the expiring rebates on various industrial products. However, irrespective of this factor, **Phat Dragon's** analysis of imports retained in processing centres pointed to a resilient June export print. To quote directly from the July 5 chronicle, "... despite softness in both the imports and new export orders sub-indices of the PMI, it is too early to expect a capitulation in export growth ... **Phat Dragon's** model yielded a May estimate of 3mma export growth of 34.9%, against the actual of 34.3%. The pure prediction for June ... is a jump in the 3mma to 41%, implying a spot outcome of 44%yr."
- **Stats of the week:** The local government's share of total government revenues is 46.7% and its share of outlays is 78.7%.

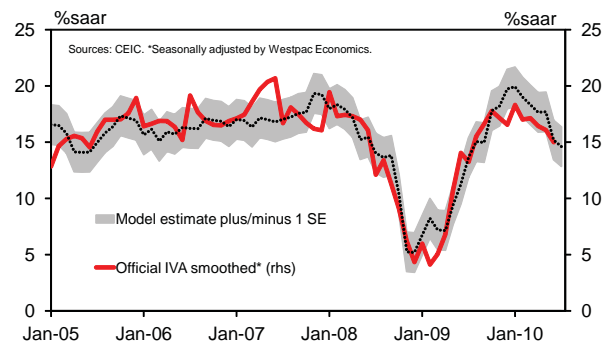
# Phat dragon

a weekly chronicle of the Chinese economy

## Chinese GDP growth



## Industrial value added to keep slowing



## A simple model of Chinese CPI inflation

