

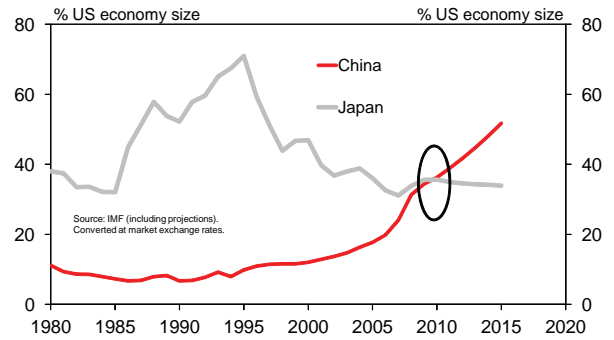
17 August 2010

- China has surpassed Japan as the world's second largest economy on a nominal (market exchange rate) basis. In volume terms (PPP) it has been #2 since 2001. **Phat Dragon** will be very impressed if any reader knows when Japan became #2 and who it surpassed (using GK PPPs - and if that doesn't sound like a hint, then it won't serve as one).
- Phat Dragon** was not surprised by the announcement that insurance companies are being encouraged to add to their equity holdings. The cap on their combined A-share and security fund holdings has been raised from 20% to 25%. In unrelated news (chortle) ICBC and CITIC have announced fund raising initiatives worth just over 50 billion yuan while Everbright Bank has a 20 billion yuan IPO in the works. The impact will be limited though given that insurers are holding only 15% of their funds in equity right now: i.e. they are not constrained by the existing threshold. Total portfolio investment by insurance firms was just short of 3 trillion yuan as of June, 82% in fixed income.
- Phat Dragon's** reading of the sectoral investment data for July brings out the same anxieties that have dominated this chronicle for six months. Infrastructure spending continues to slow and real estate has definitively come off the boil. The likelihood of a simultaneous trough for these two bellwether sectors late this year or early next remains a very real concern. Add in an inauspicious outlook for auto sales after a policy induced first half splurge and the portents for heavy industrial demand are not particularly healthy.
- The iron ore spot market was under considerable downward pressure in the wake of the property market tightening measures of April 16. The peak to trough move in prices was both considerable and swift. **Phat Dragon** called the bottom back on July 27 and prices have since recovered to the mid \$US140/t area where the Q3 contracts have apparently settled. In addition to rising extraction costs for local producers putting a floor under prices, India's tax increase and subsequent export ban have been a further positive for prices. Weak Brazilian supply has also been a factor. The beneficiaries have been Australian producers, whose share of import volumes rose from 36% in April to 45% in June. So it is developments on the supply side that has driven the price improvements - and not firmer underlying demand. Indeed, the inventory to import ratio clocked in at 1.6 in July (cycle low of 1.09 in December), the highest level since April 2009.
- Deregulation of RMB business in Hong Kong continues apace. Free flows and creation of RMB assets within HK; liberalisation of corporate remittances between HK and the Mainland; and free holding of RMB assets for all firms, not just those engaged in trade are all material changes that will boost RMB activity. However, Chinese capital controls clearly still bind: there is a huge and much remarked upon divergence between HK and onshore NDF pricing and RMB deposit rates in the two jurisdictions are also wide apart.
- Residents of Da'an in Guangdong province have been told to steer clear of local tap water, which has been found to contain highly dangerous levels of heavy metals. That is no problem for **Phat Dragon** of course, who prefers a *baijiu* only liquid diet. Google it.
- Stats of the week: China became a net importer of corn in 2010H1 for the first time since 1996.**

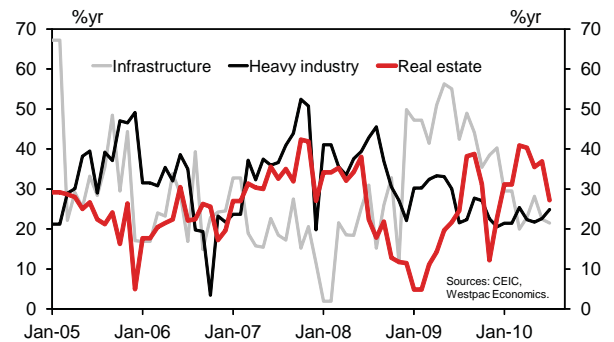
# Phat dragon

a weekly chronicle of the Chinese economy

## The race for silver: China & Japan



## Chinese investment: who is to lead now?



## China: iron ore imports by source

