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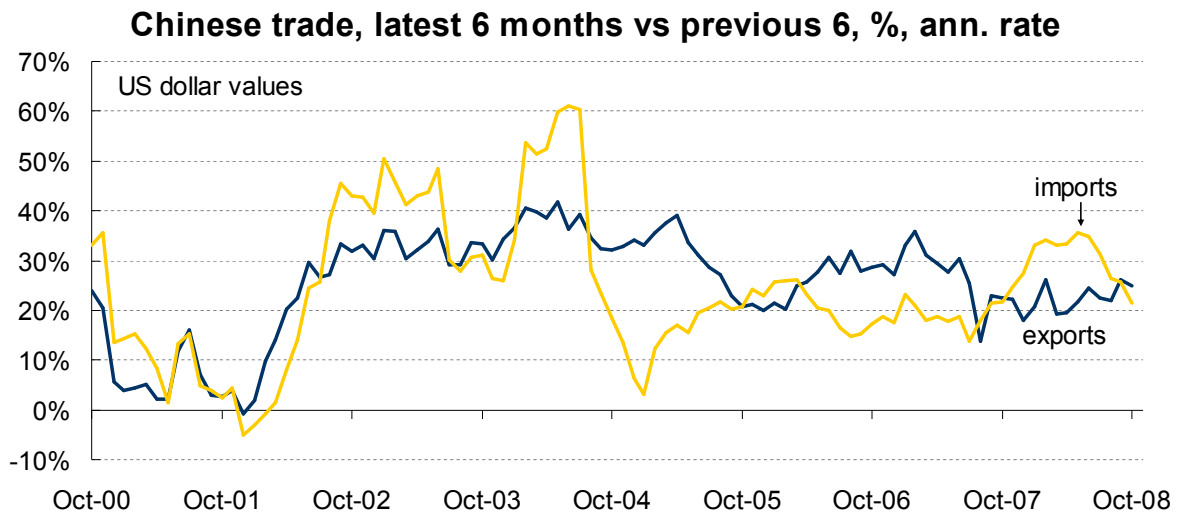
Daily Note: 11 November 2008

Chinese data imply slowdown, no collapse (yet)

WE SUGGEST: Yuan still undervalued, but probably stuck for a while vs \$

SUMMARY: Real GDP growth below 10% seems to be confirmed by nominal October imports, and the volume data through September. A strong inventory run-off is also indicated. Export volume is still growing well into double figures, 12-15%, and (if anything) accelerating. This means net export volume is rising and domestic demand has been weak, the reverse of what is needed.

October's Chinese trade data, out this morning, show clear evidence in the import numbers of an economic slowdown. Only approximate analysis is possible, as the sharp fall in oil prices has distorted both the trade numbers and the CPI, which was also out today.



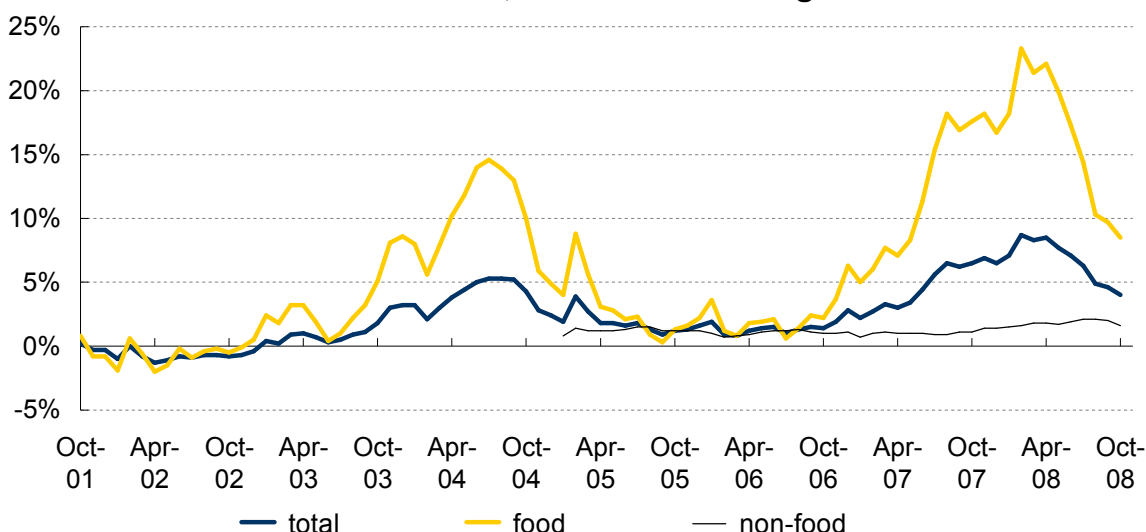
For all the fuss about the world slowdown, China's is not that much driven by weak exports, at least on the evidence here. Exports in dollars have been growing at about a 25% pace during this year, with the rate mildly accelerating, perhaps reflecting the appreciation until early summer in the yuan/dollar rate. But that rate of appreciation is well down into single figures now on a six-monthly basis, implying export growth in yuan of 15-20%. As the goods price inflation in yuan is still very low (see CPI commentary below) the volume of exports would appear to be growing at about 15%. Anecdotal evidence of a severe export industry slowdown is not consistent with these data.

On the import side, the six-monthly growth rate in our chart has slowed from 35% to just over 20% since the spring. Yet the peak months for oil prices are still in the May-Oct

numerator, though now joined by the lower prices of the past couple of months. It is not possible to do a precise non-oil import calculation, but the best analysis I have been able to do suggests that excluding oil, the growth rate of imports has eased from the 25-30% range six months ago to about 10% now. Given dollar (non-oil) inflation rates, this implies 5-7% or so for the growth rate of import volume. The latter would be heavily down because of the end of the inventory accumulation implied by its earlier, faster growth, so GDP would be expected to have fallen by less. Two thoughts that follow from this are:

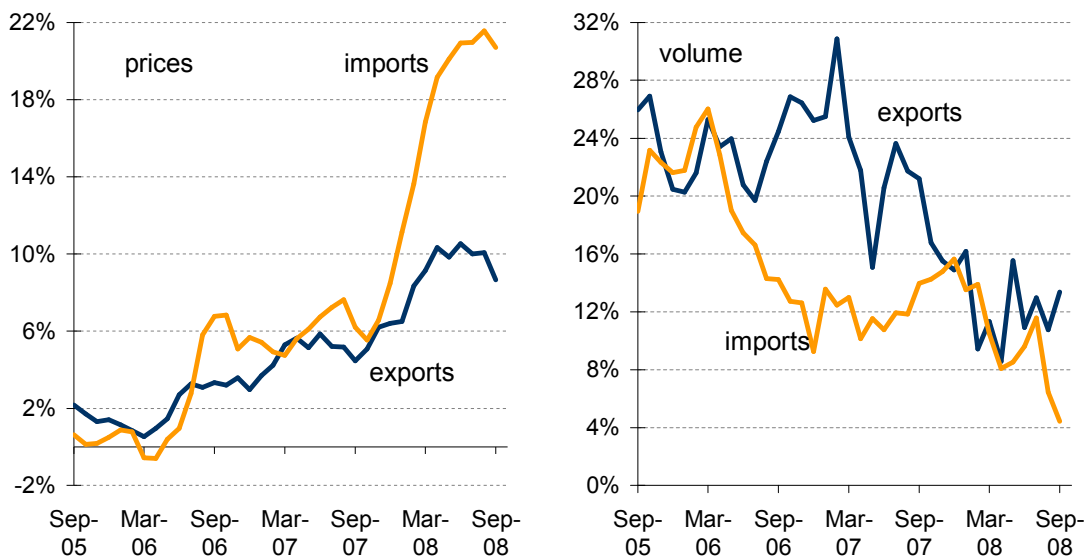
- GDP could still be growing at or close to its 10% potential rate. (The 9% real Q3 growth rate recently published compared with 18.3% for nominal GDP, implying an 8½% inflation rate that looks exaggerated relative to the CPI at about 4% and the non-consumer prices rising only at 2% or so. So real GDP growth could well be understated, even if most of the discrepancy is in the inflation rate.)
- Exports are still pretty vigorous and now growing faster than imports again, after a year of the reverse. Given the parlous state of the developed world economy, this suggests the yuan remains heavily undervalued against the major currencies.

Chinese CPI, 12-month % change



The slowing of CPI inflation to 4% in October included a further deceleration of food price inflation to 8.5%, and the first serious easing of non-food inflation to 1.6%. The latter is probably chiefly driven by the cut in oil and other commodity prices, some of which may have come down, even though they have been heavily controlled in China. That said, the first bullet-point above implies that Chinese inflation is higher than these data indicate, since there is a five percentage-point discrepancy that has to be allocated between growth or inflation: one or the other, or both, higher than admitted. Contributory factors to the slowing of inflation are falling commodity prices for food and the lagged benefit of the past year's yuan appreciation. Since food prices started their upward shift two years ago, they are up nearly 30%, only a portion of that owing to the precipitating factor, pig disease. Buoyant output in the relatively free-market Chinese farm sector should continue to hold down food price inflation. But the yuan effect could soon wear off.

Prices (in US\$) & volume of imports & exports latest 3 months, % change from the year earlier



The official data for export and import prices roughly vindicate these conclusions, but at a slightly slower rate for both exports and imports. They are only given as the month's change from the year earlier, and only run to September, a month behind the nominal data. The import price data peaked in August, as the oil shipped at July's peak prices arrived. The export price index was up nearly 9% in September, having been 10% up in Q2 and July-August. This is about 1% behind the 12-month appreciation rate of the yuan in these respective months, suggesting yuan prices are still just falling. Export volume growth is in the 11-13% range, and import growth is slowing fast, representing a combination of lesser GDP growth and inventory run-off. These price and volume data are only given in terms of growth from the year before, so that the levels are not available, precluding the intra-year comparisons that are normal for advanced economies, and are attempted for China (seasonally adjusted) in the first part of this note.

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