China Macro Flash

Data for 1Q May Confirm a Modest Recovery and Benign Inflation

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- **Growth may have stayed close to 8% alleviating short-term inflation concerns** – Official PMI increased from 50.1 in Feb to 50.9 in Mar, but the improvement paled in comparison with the historical pattern. The sentiment index remained in the 50-51 range in the past six months, suggesting slow expansion of manufacturing activity. IP may have grown by 10.2%YoY in 1Q, consistent with GDP growth of around 8%YoY. The modest recovery has helped to contain commodity prices, and CPI inflation may have stayed below 2.5%YoY in 1Q. Abundant liquidity and credit at present may continue to sustain growth momentum in 2Q, but growth may head down in 2H as the easing bias of policies is gradually removed. We maintain our annual growth forecast of 7.8%.

- **CPI inflation likely fell to 2.1%YoY due to a post-holiday price decline** – The MOC and NBS data both pointed to a sharp decline in food prices after the Chinese New Year. Overall price level may have decreased by 0.9%MoM, and YoY inflation likely dropped sharply from 3.2% in Feb to 2.1% in Mar. PPI deflation may have intensified from -1.6%YoY in Feb to -2.2% in Mar, further reducing inflationary pressures. CPI inflation will likely exhibit an upward trend from 2Q, but excess capacity and generally weak domestic recovery should help keep CPI inflation below 3%YoY in 2Q, thus reducing the prospect of an immediate policy tightening.

- **Net export may have offset the weakness in consumption** – Relative to 4Q12, investment growth appears to be stable, but consumption growth has suffered from the government campaign to cut wasteful spending. Trade surplus surprised significantly on the upside, suggesting external demand has contributed positively to growth. IP growth may have accelerated from 9.9%YoY in Jan-Feb to 10.6%YoY in March (10.2%YTD), reflecting increased production activity after the holiday. YTD FAI growth likely slowed from 21.2% in Jan-Feb to 20.9%YoY in March, reflecting slightly tighter credit conditions and intensification of PPI deflation. We estimate a rebound in retail sales growth from 12.3%YoY in Feb to 13.5% in Mar (12.7%YTD) based on the surge in property sales, which may have boosted sales of building materials, furniture, household electronics and cars.

- **M2 growth may have fallen to 14.5% and new credit risen to Rmb850bn –** PBOC appears to have intervened actively in the FX market to slow the pace of RMB appreciation, expanding the monetary base. Meanwhile, the central bank is mopping up excess liquidity through repos in order to bring down broad money growth to the annual target of 13%. M2 growth may have fallen from 15.2%YoY in Feb to 14.5%YoY in Mar reflecting the net impact of these operations. Based on PBOC's preferred distribution of loans among the quarters, as well as reported new lending by the biggest banks in the first 24 days of the month, we estimate that new RMB lending may have reached 850bn in Mar.

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Figure 1. Economic Data Release for March / 1Q 2013

	Date	For	Citi Fcst*	Mkt Fcst	Prev
CPI (% YoY)	9-Apr	Mar	2.1 (2.4)	2.5	3.2
PPI (% YoY)			-2.2 (-1.8)	-1.7	-1.6
Trade Balance ($bn)	10-Apr	Mar	15.00	15.40	15.23
Exports (YoY%)			11.8 (19.0)	10.1	21.8
Imports (YoY%)			6.2 (5.5)	4.2	-15.2
M0 Supply (%YoY)	10~15-Apr	Mar	11.2	13.0	17.2
M1 Supply (%YoY)			8.0	9.8	9.5
M2 Supply (%YoY)			14.5	14.2	15.2
New Yuan Loans (RMB bn)			850	875.0	620.0
GDP	15-Apr	1Q	8.0	8.0	7.9
IP (% YoY)		Mar	10.6 (10.2)	10.0	9.9
Retail Sales (% YoY)			13.5 (12.7)	12.6	12.3
FAI - urban (% YoY ytd)			20.9	21.3	21.2

Note: *YoY growth for 1Q in parenthesis

Source: Bloomberg and Citi Research

Apr 9,
CPI
Headline: 2.1%YoY
Food: 3.4%YoY
Nonfood: 1.5%YoY

CPI inflation likely fell to 2.1%YoY due to a post-holiday price decline – Consumer prices rose 1.1%MoM and 3.2%YoY in Feb as a result of seasonal price increases during the Chinese New Year. As expected, prices (especially food prices) fell after the holidays, easing concerns over inflation.

- Food inflation likely dropped to 3.4%YoY from 6.0%YoY in Feb. Interim data from the Ministry of Commerce (mostly wholesale prices) showed that food prices fell almost across the board, with average meat, fish and vegetable prices declining 2.1%, 2.2% and 12.3%MoM. The NBS interim data (mostly retail prices) showed even faster price declines. As CPI inflation is more related to retail prices, we assign a heavy weight to the NBS data, and estimate that food prices fell by 2.3%MoM, and rose 3.4%YoY.

- Non-food inflation may have fallen to 1.5%YoY from 1.9%YoY in Feb. The fuel prices were cut by about 3.5% on Mar 27, effectively reversing the price hike on Feb 25, but the impact on inflation should be very limited for Mar. Seasonally, non-food prices tend to decline in Mar, and we estimate that non-food prices declined by 0.1%MoM also reflecting the post-holiday effect. The base effect would take another 0.3ppt off, bringing non-food inflation to 1.5%YoY in Mar.

- Overall price level may have decreased by 0.9%MoM, and YoY inflation likely dropped sharply from 3.2% in Feb to 2.1% in Mar. Quarterly inflation may have increased to 2.4%YoY from 2.1%YoY in 4Q12.

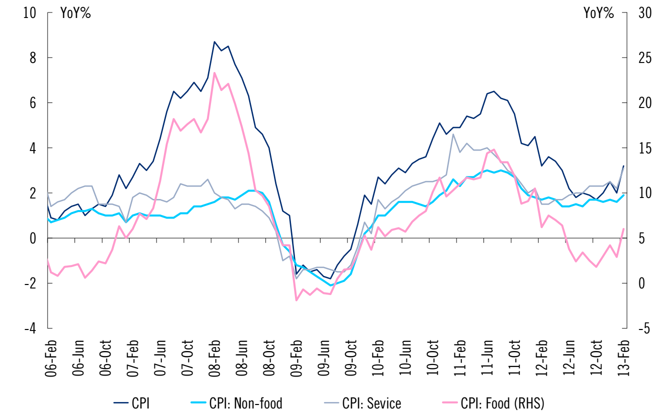
- CPI inflation will likely exhibit an upward trend following volatilities associated with the Chinese New year in 1Q. However, excess capacity in the manufacturing sector and generally weak domestic recovery should prevent inflation from becoming a threat, as long as PPI deflation continues. CPI inflation is likely to stay below 3%YoY in 2Q, and rise to around 3.5% by year-end, taking into account the effects of possible price reforms.

Apr 9,
PPI
Headline: -2.2%YoY

PPI deflation may have intensified to -2.2%YoY – The international commodity prices as measured by the CRB index declined by about 1.6%MoM. Interim data from the Ministry of Commerce showed that producer good prices for raw materials generally declined during the month, especially for mineral products (about -2%), non-ferrous metal (about -1.8%) and rubber (about -4.8%). The PMI input price index fell by 4.9ppts although it stayed above 50 at 50.6 in Mar. Based on the

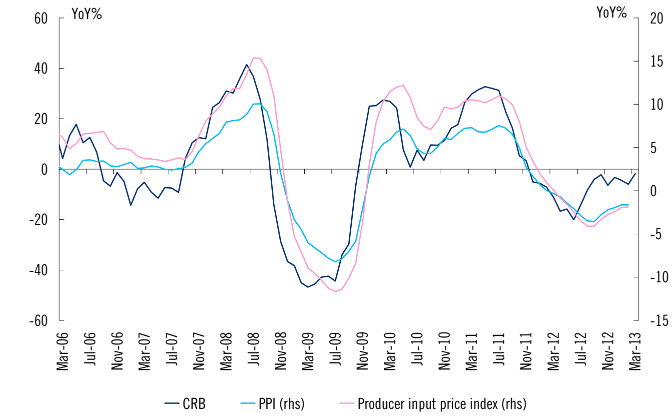
relationship between PPI and MOC interim data, we estimate the overall PPI may have dropped by 0.3%MoM, and YoY deflation likely intensified from -1.6% to -2.2%, as the base effect removed roughly 0.3ppt from the YoY inflation. Quarterly deflation may have eased to -1.8%YoY from -2.3%YoY in 4Q12.

Figure 2. CPI inflation likely fell to 2.1%YoY due to post-holiday effect



Source: NBS and Citi Research

Figure 3. PPI deflation may have intensified to -2.2%YoY



Source: NBS, Bloomberg and Citi Research

Apr 15,
Industrial Value Added
Headline: 10.6%YoY

Industrial production (IP) growth may have risen to 10.6%YoY – Both the official and HSBC manufacturing PMI stayed in the expansionary territory and increased in March. However, the improvement of the official PMI in Mar (0.8ppt) was significantly smaller than the average increase for Mar since 2005 (roughly 3ppts), and the index has been in the 50-51 range in the past six months, indicating the recovery of the manufacturing activity has been lackluster. The official PMI production index increased by 1.5ppts in Mar, also weaker than the average improvement for Mar (roughly 5ppts). Meanwhile, the PBOC 1Q survey shows that entrepreneurs and bankers both feel the economy is warming up, with economic heat index and confidence index higher than 4Q12. We estimate that IP growth may have accelerated from 9.9%YoY in Jan-Feb to 10.6%YoY in March. For 1Q, IP may have grown 10.2%YoY, relative to 10.0%YoY in 4Q12.

Apr 15,
Urban FAI, YTD
Headline: 20.9%YoY

YTD Fixed asset investment (FAI) growth may have slowed to 20.9% YoY – FAI growth rose from 20.6% in 2012 to 21.2%YoY in Jan-Feb 2013, facilitated mainly by favorable funding conditions including budget funding and bank credit especially in Jan. Money and credit growth slowed in Feb, and is likely to slow further in Mar, and CBRC has introduced more regulations on wealth management products, which could slow the expansion of the shadow banking credit. On the other hand, property investment appears to be supported by increased sales volume. We estimate a retreat of YTD FAI growth from 21.2% in Jan-Feb to 20.9%YoY in March, reflecting slightly tighter credit conditions and intensification of PPI deflation.

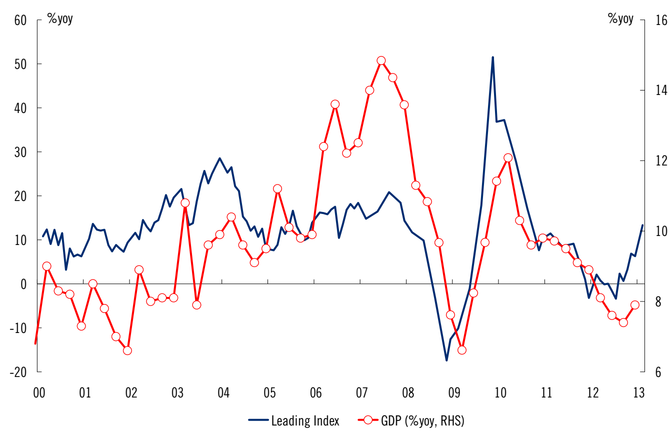
Apr 15,
Retail Sales
Headline: 13.5%YoY

Retail sales may have accelerated to 13.5%YoY in March – Nominal retail sales growth decelerated from 15.2%YoY in Dec 2012 to 12.3% in Jan-Feb, mainly due to the curb on government lavishing spending. The PBOC 1Q depositor survey shows employment index and current income index further improved, which should help maintain healthy private consumption growth. We estimate a rebound in retail sales based on the surge in property sales which may have boosted sales of building materials, furniture, household electronics and cars. However, lower CPI inflation in Mar relative to Feb may have prevented a more significantly acceleration. Quarterly retail sales may have grown by 12.7%YoY, compared with 14.5%YoY in 4Q12.

Apr 15
Real GDP
Headline: 8.0%YoY

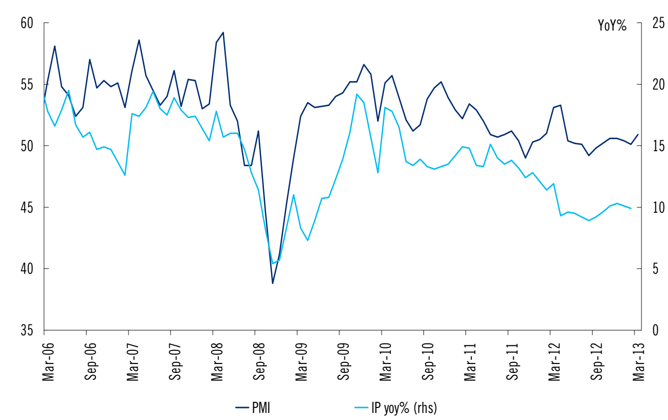
Growth likely accelerated slightly to 8%YoY in 1Q – Relative to 4Q12, investment growth appears to be stable as reflected in the FAI data at the beginning of the year. Consumption growth, on the other hand, may have slowed as a result of the government campaign to cut wasteful spending and crack down on corruption. However, trade surplus reached $44bn in Jan-Feb, compared with a deficit of $4bn for the same period last year, suggesting net export (external demand) may have contributed positively to growth and offset the weakness in consumption in 1Q. Based on the correlation between GDP and its production components (especially IP), we estimate that growth quickened from 7.9%YoY in 4Q12 to 8.0% in 1Q.

Figure 4. Growth likely accelerated slightly to 8.0%YoY in 1Q



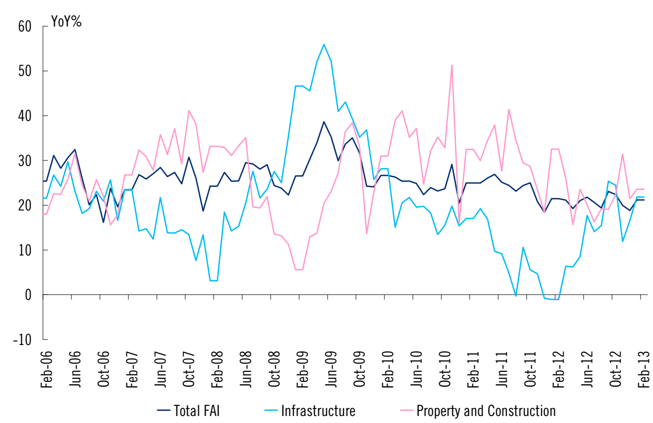
Source: CEIC and Citi Research

Figure 5. IP growth may have accelerated to 10.6%YoY in Mar



Source: CEIC and Citi Research

Figure 6. YTD FAI growth may have fallen slightly to 20.9% due to slightly tighter credit condition



Source: CEIC and Citi Research

Figure 7. Retail sales growth may have accelerated due to rising home sales

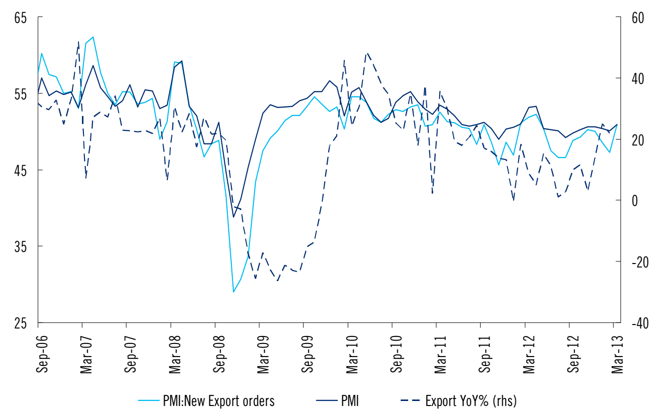
Source: CEIC and Citi Research

Apr 10,
Trade
Balance: $15.0bn
Exports: 11.8%YoY
Imports: 6.2%YoY

Export growth may have slowed reflecting weak export order – China's export growth accelerated from 9.4%YoY in 4Q12 to 23.6% in Jan-Feb and import growth accelerated from 2.8%YoY in 4Q12 to 5.1% in Jan-Feb. We think it would be difficult to sustain the Jan-Feb export growth, given the weak international demand and uncertainty in EU countries. PMI new export order index stayed below 50 in Jan-Feb (48.5 and 47.3 respectively) and the rebound in Mar (3.6ppts) was milder than the average for Mar since 2005 (4.5ppts). Other indicators, including growth of export cargo (7.5%YoY in Jan-Feb) and export delivery value (7.8%YoY in Jan-Feb)

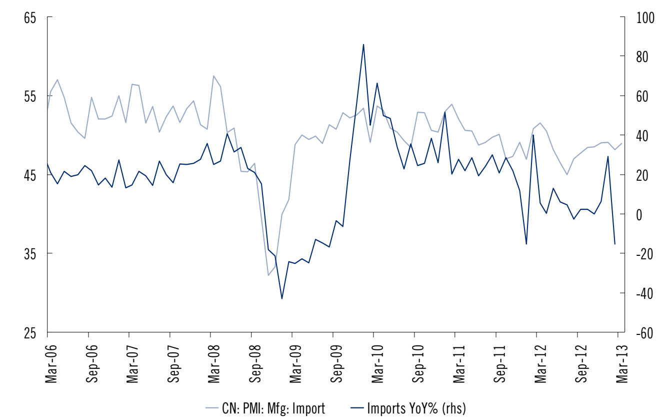
indicate the export growth in Jan-Feb may have been exaggerated. We estimate export growth rate to fall from 23.6% in Jan-Feb to 11.8%YoY in March. Export may have grown by 19.0%YoY in 1Q as a result. Quarterly import growth may have continued to accelerate slowly, from 1.6%YoY in 3Q12 to 2.8%YoY in 4Q12 and 5.1%YoY in Jan-Feb, reflecting weak economic recovery. We estimate imports grew by 6.2%YoY in March, and 5.5%YoY in 1Q. Trade surplus may have reached $15bn in Mar, and roughly $60bn in 1Q.

Figure 8. Export growth may have slowed to 11.8%YoY in Mar



Source: CFLP, NBS and Citi Research

Figure 9. Imports may have grown 6.2%YoY in Mar



Source: China Custom, CFLP, NBS and Citi Research

Apr 10-15
Money
M0: 11.2%YoY
M1: 8.0%YoY
M2: 14.5%YoY
New RMB Loans: 850.0bn

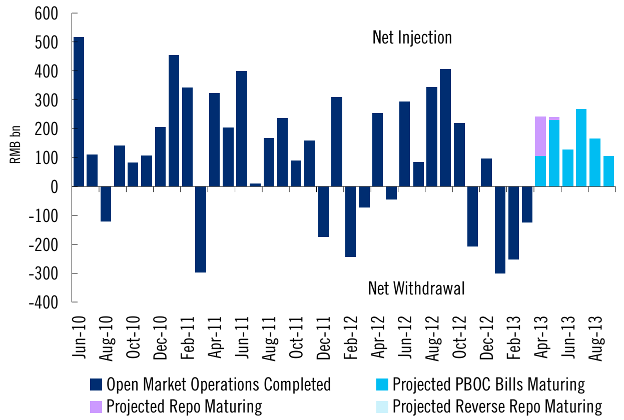
Broad money (M2) growth may have fallen to 14.5% – In response to sizable trade surplus and renewed capital inflows, PBOC appears to be intervening actively in the FX market by purchasing FX to slow the pace of RMB appreciation. In Jan, PBOC purchased more than $50bn. The central bank may have purchased significant amount also in Feb and Mar, expanding the monetary base. Meanwhile, PBOC has been sterilizing the liquidity created by FX purchase, in order to bring down broad money growth to the annual target of 13%. The following factors may have affected monetary growth in Mar:

- PBOC withdrew Rmb153bn of liquidity, on a net basis, from the banking system through open market operations.
- Trade account may have run a surplus of about $15bn, and the net FDI inflows and other capital inflows may have continued. We assume that PBOC purchased $20bn FX during the month.
- Government deposits at the PBOC may have declined by about Rmb400bn in Mar, as government spending tends to accelerate in Mar. This is equivalent to liquidity injection.
- Taking these factors into consideration, M2 growth may have fallen from 15.2%YoY in Feb to 14.5%YoY in Mar. M1 growth may have slowed to 8.0%YoY, consistent with a modest economic recovery in 1Q. M0 growth may have normalized to 11.2%YoY.

New RMB lending may have increased to Rmb850bn – The pace of credit extension in Jan-Feb appears to be in line with our estimated annual loan quota of Rmb8.5tn. The PBOC's monetary policy report for 2012 indicates that the central bank favors the distribution of annual loans among the four quarters at the ratio of 3:3:2:2. Based on this ratio as well as reported new lending by the biggest banks in

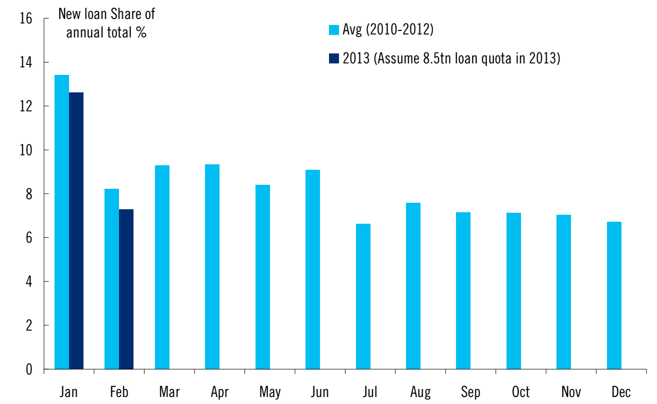
the first 24 days of the month, we estimate that new RMB lending may have reached 850bn, implying total credit in 1Q of Rmb2.54tn.

Figure 10. PBOC withdrew liquidity through OMOs in Mar



Source: PBOC and Citi Research

Figure 11. Historical distribution of annual loans implies an increase in new lending in Mar



Source: PBOC and Citi Research

Appendix A-1

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