

China Macro Flash

Feb Data May Fuel Inflation Fears

- **Inflation may have jumped as expected amid a modest growth rebound** – CPI inflation may have increased from 2.0%YoY in Jan to 3.1%YoY in Feb. While the headline number has been exaggerated by the holiday effects, continued pick-up of seasonally adjusted sequential inflation would raise inflation concerns. PBOC's open market operations during the month may be a response to manage expectations, apart from the need to mop up excessive liquidity injected in Jan and ahead of the Chinese New Year. Inflation may fall back to below 3% in March, and a major tightening of the monetary policy seems premature. However, policies may gradually return to a neutral position unless the growth falters.
- **The data may confirm a modest growth rebound** – Both the official and HSBC manufacturing PMI declined in Feb but stayed above 50, indicating the modest growth recovery continued in the first two months. PPI may have risen by 0.2%MoM, although YoY deflation may have changed little at -1.7%. IP growth may have slowed marginally from 10.3%YoY in Dec to 10.2%YoY in Jan-Feb. YTD FAI growth may have quickened from 20.6% in Dec to 20.8%YoY in Feb, supported by abundant credit and liquidity in the first two months of the year. The retail sales may have decelerated from 15.2% in Dec to 14.4%YoY in Jan-Feb, partly due to the campaign to curb lavish government spending.
- **Trade activity may have retreated following a robust performance in Jan** – Exports and imports surged by 25% and 28.8%YoY in Jan mainly due to a low base last year. The external demand conditions, as reflected in the PMI new export order index, suggest such a pace is not sustainable. We estimate that exports and imports fell by 4.3% and 9.7%YoY in Feb, with a trade deficit of \$22.2bn. Jan and Feb combined, exports and imports may have grown by 12.3 and 7.9%YoY in the first two months, with a surplus of roughly \$7bn.
- **Broad money (M2) growth may have fallen to 14.5%** – Following surprisingly strong growth of money and credit in Jan, PBOC appears to have started mopping up excess liquidity from the economy. PBOC resumed the repos during the month, and withdrew Rmb253bn of liquidity from the banking system through open market operations. As a result, M2 growth may have fallen from 15.9%YoY in Jan to 14.5%YoY in Feb. Based on PBOC's preferred distribution of loans among the quarters, as well as reported new lending by the biggest banks in the first 25 days of the month, we estimate that new RMB lending may have reached 690bn in Feb.

Shuang Ding

+852-2501-2769
shuang.ding@citi.com

Enjiang Cheng

+86-10-5937-6038
enjiang.cheng@citi.com

Minggao Shen

+852-2501-2485
minggao.shen@citi.com

Serena Wang

serena.wang@citi.com

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Figure 1. Economic Data Release for February 2013

	Date	For	Citi Fcst	Mkt Fcst	Prev
Trade Balance (\$bn)	8-Mar	Feb	-22.2	-8.85	29.15
Exports (YoY%)			-4.3	7.6	25.0
Imports (YoY%)			-9.7	-8.2	28.8
CPI (% YoY)	9-Mar	Feb	3.1	3.0	2.0
PPI (% YoY)			-1.7	-1.5	-1.6
IP (% YoY)	9-Mar	Jan-Feb	10.2	10.3	10.3
Retail Sales (% YoY)			14.4	-	15.2
FAI - urban (% YoY ytd)			20.8	20.6	20.6
M0 Supply (%YoY)	10~15-Mar	Feb	8.7	9.0	4.4
M1 Supply (%YoY)			7.5	12.0	15.3
M2 Supply (%YoY)			14.5	14.9	15.9
New Yuan Loans (RMB bn)			690.0	750.0	1070.0

Source: Bloomberg and Citi Research

Mar 9,

CPI

Headline: 3.1%YoY

Food: 5.9%YoY

Nonfood: 1.8%YoY

CPI inflation likely rose to 3.1%YoY on a low base of last year – CPI inflation fell to 2.0%YoY in Jan, but the headline number was distorted by the holiday effect, as the Chinese New Year (CNY) fell on January last year which created a high base. We had expected that as the base effect reversed in Feb, CPI inflation would rebound sharply before it normalizes in March.

- **Food inflation likely jumped to 5.9%YoY due to holiday price increases** – Interim data from the Ministry of Commerce (mostly wholesale prices) showed that food prices increased across the board, with average meat, fish and vegetable prices rising 1.2%, 1.7% and 5.5%MoM. The NBS interim data showed even faster price increases. In addition, the base effect would add 0.3ppts to the YoY food inflation. We estimate that food prices rose 2.6%MoM, and 5.9%YoY.
- **Non-food inflation may have risen to 1.8%YoY** – The fuel prices were raised by about 3.5% on Feb 25, but the impact on inflation should be very limited in Feb. Seasonally, non-food prices tend to increase in Feb, especially when the CNY falls in the month. Excessive liquidity for most part of the month and the economic recovery would cap the downside risks. We estimate that non-food prices rose 0.2%MoM and 1.8%YoY.
- Overall price level may have risen 1.0%MoM, and YoY inflation likely rose from 2.0% in Oct to 3.1%. Price level tends to fall the month after the CNY, and headline inflation may fall back to below 3% in Mar.

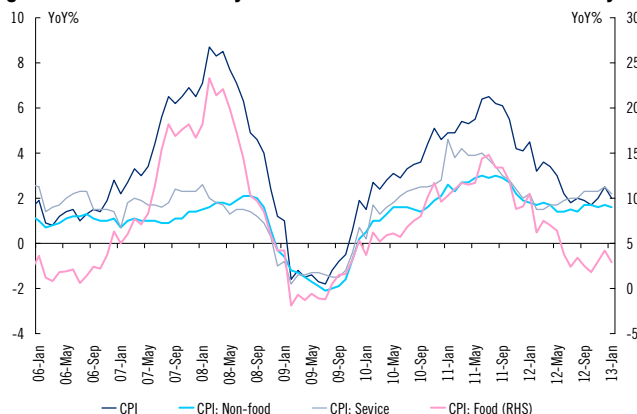
Mar 9,

PPI

Headline: -1.7%YoY

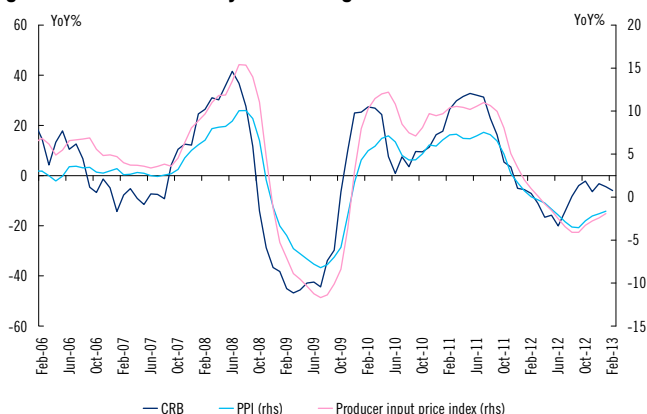
PPI deflation may have changed little at -1.7%YoY – The international commodity prices as measured by the CRB index were little changed during the month. Interim data from the Ministry of Commerce showed that producer good prices for raw materials continued to increase on average during the month. The PMI input price index fell by 1.7ppts but stayed high at 55.5 in Feb, indicating quite rapid price increases. Overall PPI may have risen by 0.2%MoM, but YoY deflation likely intensified slightly from -1.6% to -1.7%, as the base effect removed roughly 0.3ppt from the YoY inflation.

Figure 2. CPI inflation likely rose to 3.1%YoY on a low base of last year



Source: NBS and Citi Research

Figure 3. PPI deflation may have changed little at -1.7%YoY



Source: NBS, Bloomberg and Citi Research

Mar 9,
Industrial Value Added
Headline: 10.2%YoY

Industrial production (IP) growth may have remained stable at 10.2%YoY –

Both the official and HSBC manufacturing PMI declined in Feb but stayed above 50, indicating modest growth recovery continued in the first two months. The official PMI production index fell only 0.1ppt in Feb to reach 51.2, suggesting the industrial production continued to expand MoM. We estimate that IP growth may have slowed marginally from 10.3%YoY in Dec to 10.2%YoY in Jan-Feb.

Mar 9,
Urban FAI, YTD
Headline: 20.8%YoY

Fixed asset investment (FAI) growth may have accelerated to 20.8% – There are signs that investment activity has been supported by abundant credit and liquidity in the first two months of the year. M2 growth reached 15.9% in Jan, the highest pace since Aug 2011. New RMB lending exceeded 1tn during the month. What is more, total social financing (TSF) reached a record monthly high of Rmb2.54tn in Jan, suggesting flow of credit to infrastructure and property sector through off-balance-sheet activity and bond market. Meanwhile, increases in input prices may have raised the price tag for investment. Taking these factors into consideration, we estimate that YTD FAI growth may have quickened from 20.6% in Dec to 20.8%YoY in Feb.

Mar 9,
Retail Sales
Headline: 14.4%YoY

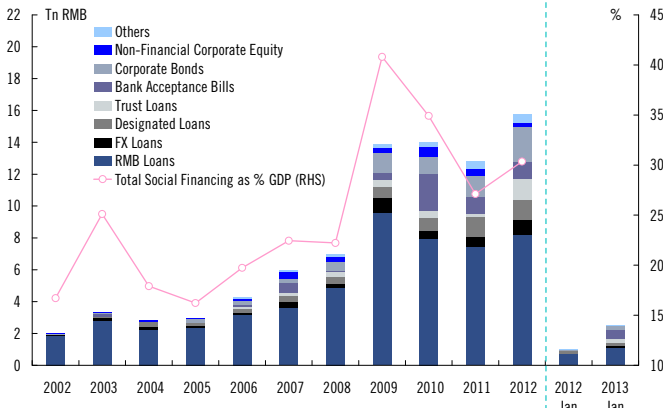
Retail sales growth may have fallen to 14.4%YoY – Nominal retail sales growth accelerated to 15.2%YoY in Dec. We expect steady growth in retail sales in early 2013, given continued income growth, increased demand for building materials and furniture following the property market recovery. However, the growth in retail sales in Jan-Feb may have been affected by the government campaign to reduce extravagant government spending and the Golden Week retail sales growth dropped from 16.2% in 2012 to 14.7%. In particular, it is reported that high-end catering was hit hard before and during the CNY. We estimate that the nominal retail sales grew by 14.4%YoY during Jan-Feb.

Figure 4. PMI indicates modest growth recovery continued



Source: CEIC and Citi Research

Figure 5. Investment activity has been supported by abundant credit



Source: CEIC and Citi Research

Mar 8,

Trade

Balance: **-\$22.2bn**

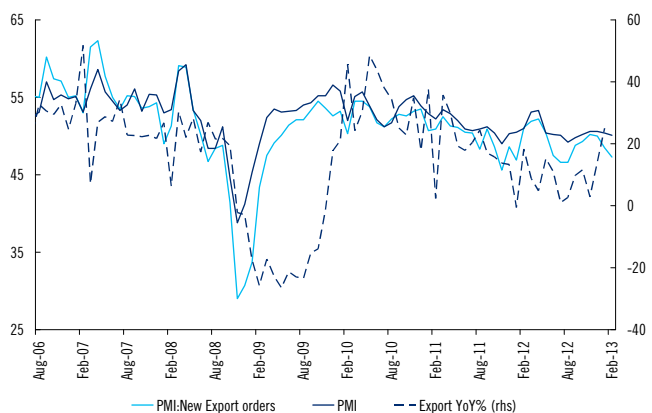
Exports: **-4.3%YoY**

Imports: **-9.7%YoY**

Trade activity may have retreated following a robust performance in Jan –

Exports and imports surged by 25% and 28.8%YoY in Jan mainly due to a low base last year (less working days since the CNY fell in Jan last year). The external demand conditions suggest such a pace is not sustainable. The official PMI new export order index in Feb declined further by 1.2pts to 47.3 and import index declined by 1 ppt to 48.1, both in the contracting territory. We estimate that exports and imports fell by 4.3% and 9.7%YoY in Feb, with a trade deficit of \$22.2bn. If we combine the Jan and Feb data, exports and imports grew by 12.3 and 7.9%YoY in the first two months, with a surplus of roughly \$7bn. The weakening external demand, reflecting the fiscal drag in the US and continued recession in the euro zone, may slow China's foreign trade in the months ahead.

Figure 6. Exports may have grown 12.3%YoY in Jan-Feb



Source: CFLP, NBS and Citi Research

Figure 7. Imports may have grown 7.9%YoY in Jan-Feb



Source: China Custom, CFLP, NBS and Citi Research

Mar 10-15

Money

M0: **8.7%YoY**

M1: **7.5%YoY**

M2: **14.5%YoY**

New RMB Loans: **690.0bn**

Broad money (M2) growth may have fallen to 14.5% – Following surprisingly strong growth of money and credit in Jan, PBOC appears to have started mopping up excess liquidity from the economy, against the background of rising inflation. The following factors affected M2 growth during the month:

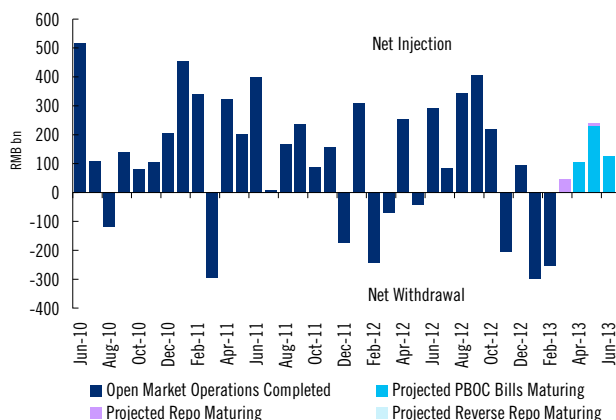
- PBOC withdrew Rmb253bn of liquidity from the banking system through open market operations. In particular, PBOC issued Rmb860bn of reverse repos, more

than offset by the maturing reverse repos of Rmb1058bn and new issuance of repos of Rmb55bn.

- Trade account may have run a sizable deficit (about \$22bn by our estimate), but the net FDI inflows and other capital inflows may have offset the deficit. We assume that PBOC only intervened slightly, purchasing FX from the market to slow down the appreciation of RMB.
- Government deposits at the PBOC may have increased by about Rmb170bn in Feb, mainly due to slow spending relative to revenue early in the year. This is equivalent to liquidity withdrawal.
- Taking these factors into consideration, M2 growth may have fallen from 15.9%YoY in Jan to 14.5%YoY in Feb. M1 growth may have slowed to 7.5%YoY, more consistent with the M1 growth rate in 4Q last year. M0 growth may have normalized to 8.7%YoY.

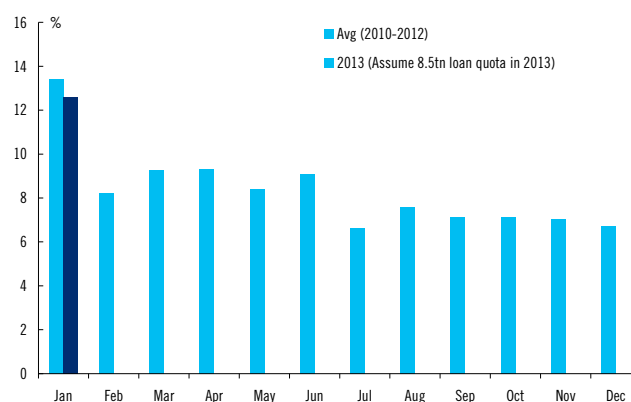
New RMB lending may have fallen to Rmb690bn – In Jan, new RMB lending reached Rmb1.07tn, broadly in line with our estimated annual loan quota of Rmb8.5tn. The PBOC's monetary policy report for 2012 indicates that the central bank favors the distribution of annual loans among the four quarters at the ratio of 3:3:2:2. Based on this ratio and reported new lending by the biggest banks in the first 25 days of the month, we estimate that new RMB lending may have reached 690bn. The smaller banks may have continued to be constrained by the loan-to-deposit ratio (LDR) unless the requirement is loosened.

Figure 8. PBOC withdrew liquidity through OMOs in February



Source: PBOC and Citi Research

Figure 9. Historical distribution of annual loans implies lower new loans



Source: PBOC and Citi Research

Appendix A-1

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