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Policy easing to stabilize growth

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Highlights

- **Deceleration of July industrial output growth slowing down.** July industrial output rose by 13.4% YoY, 0.3 percent point down from June, in line with expectations. On a seasonally adjusted basis, industrial production rose by 0.7% MoM, with annualized growth rate at approximately 9%. The deceleration of industrial output growth in July slowed down in comparison with the previous two months.
- **Domestic demand continuing to decelerate, while external demand remaining buoyant.** In July, investments grew 22.1% YoY and retail sales rose by 17.9% YoY. Imports in the same month rose by 22.7% YoY, below expected; and exports rose by 38.1% YoY, better than expected. These data indicate that domestic demand continued to decelerate and this was mainly due to the following factors: (1) the impact of natural disasters on infrastructure construction and the supply of consumer goods; (2) the impact of energy conservation and emission reduction policies led to the decline in investments in related industries; and (3) a slowdown in inventory investment due to waning economic expectations.
- **CPI inflation likely to peak in 3Q10.** The CPI inflation was 3.3% in July, which was in line with our expectation and the consensus expectation of 3.3%; the PPI inflation was 4.8%, which was lower than the consensus expectation of 5.8%, but in line with our expectation of 5%. CPI inflation will continue to be boosted by food prices and it is predicted to hit 3.4% in August and 3.4% in 3Q10, whereas PPI inflation is likely to drop to approximately 4.5% in August and 4.4% in 3Q10.
- **Credit to rise in 2H10 pushing M2 to reach the target of 17%.** New loans amounted to RMB 532.8 bn in July, lower than our expectation and the consensus expectation. M1 and M2 growth rates were smaller than expected as well. Financial data show that economic activities continued to weaken in July. Lower interest rates indicate abundant liquidity. We predict that normal monthly loan increment will be approximately RMB500 bn in 2H10, and credit growth for 2010 will reach 18%. M2 growth to date is close to the growth target of 17% for 2010, and the decline in money supply growth will slow down significantly.
- **Policy easing to stabilize growth.** We expect a policy easing in 2H10 as a result of economic restructuring. Our projection is that monetary policy in 2H10 will remain relatively loose with approximately RMB3 trn in credit growth. In terms of fiscal policies, the government is likely to increase expenditure. Policy easing and economic restructuring policies are likely to be rolled out together. The Chinese economy experienced a significant slowdown in 2Q10. However, we predict that the slowdown will ease in 3Q10 and that quarterly GDP growth will pick up in 4Q10.

CS Macro Economic Forecasts (%)

	2007	2008	2009	2010F	2011F
GDP	13.0	9.6	8.7	10.1	9.5
CPI inflation	4.8	5.9	-0.7	3.2	2.5
PPI inflation	3.1	6.9	-5.4	5.1	1.5
Fixed asset investment for the society at large	24.8	25.5	30.1	24.0	21.4
Total retail sales of social consumer goods	16.8	21.6	15.5	18.4	17.2
Export	25.6	17.2	-16.0	22.0	15.6
Import	20.6	18.5	-15.7	24.2	17.1
Interest rate (1-year deposit)	4.14	2.52	2.25	2.52	2.79
Exchange rate (RMB/USD)	7.31	6.83	6.83	6.63	6.40

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11
GDP	11.9	10.3	9.1	8.9	9.0	9.3	9.9	10
CPI inflation	2.2	2.9	3.4	3.3	3.0	2.4	2.3	2.4

Sources: NBS, CS

Disclaimer

Investment rating system

Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	**Remark**
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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