



Policy relaxation is yet to come

Highlights

- ❖ **Weaker-than-expected economic slowdown.** China's GDP grew 9.7% YoY and 2.1% QoQ in 1Q11, with seasonally adjusted annualized QoQ growth rate reaching 8.7%. Output gap reached 0.3%, moving from negative into positive territory. The yearly growth rate in 1Q11 is higher than our forecast of 9.2% and market expectations of 9.4%. Nevertheless, the official quarterly GDP growth rate in 1Q11 could have been underestimated. We expect the recovery in economic growth to kick off in 3Q11. Policy tightening efforts will likely be eased in 2H11, during when China's welfare housing construction will reach a substantive stage. In addition, restrictive measures imposed to curb certain consumption will also likely be corrected to some extent in 2H11. All these factors will lead a kick-off in economic recovery starting in 3Q11.
- ❖ **Aggregate demand likely to slow down modestly in 2Q11.** Domestic demand will remain strong, which will be accompanied by a pickup in consumer demand. Meanwhile, investment growth rate will continue to pick up in a robust fashion. Strong domestic demand and high import prices will lead to a basic balance between imports and exports. The aggregate demand will likely slow down in 2Q11 with the impact of policy tightening.
- ❖ **Inflation at its peak level, CPI inflation expected to rise around 5% in 2Q11.** CPI inflation reached 5.4% in March, slightly higher than our and market expectations of 5.2%. PPI inflation reached 7.3%, higher than our forecast of 6.7% and market expectation of 7.2%. The seasonally adjusted annualized quarterly rise in CPI reached 5.8% in 1Q11, down from 7.9% in 4Q10, marking a slowdown in its rise. The monthly rise in CPI may have topped out in March for the year. We expect its rise to ease to about 5% in April. We expect the inflation rate to remain at around 5% in 2Q11, before falling down to 3-4% in 3Q11 and 4Q11.
- ❖ **Fast pace of credit expansion in 1Q11.** The total national financing to GDP ratio reached 43.5% in 1Q11, higher than the average level of about 33% for the same quarter over the past. Given higher-than-expected money and credit growth rates, there is still room for money supply growth to decline. To meet the targeted growth rate of 16% in M2 set early in the year, policymakers still need to step up controls over total money supply.
- ❖ **Policy tightening likely to continue throughout 2Q11.** Given relatively strong domestic demand and persistently heavy inflationary pressure in 2Q11, it is not the right time to relax policy yet. We believe that policy tightening will continue throughout 2Q11. Despite the interest rate hike and upward adjustment in reserve requirement ratio in April, we believe that the benchmark interest rate will be raised by another 25 bp going forward and the reserve requirement ratio will be further hiked. Specifically, the reserve requirement ratio will likely be hiked by 50 bp in May. Meanwhile, the central bank will continue to drain liquidity via its open market operations. As policymakers will likely adjust their control efforts appropriately to reflect changes in inflation, policy tightening will likely be relaxed to some extent in 2H11.

CITICS Research macroeconomic forecast (%)

	2008	2009	2010	2011F(Earlier Forecast)	2011F(Latest Adjustment)
GDP	9.6	9.2	10.3	9.6	9.9
CPI inflation	5.9	-0.7	3.3	3.9	4.2
PPI inflation	6.9	-5.4	5.5	5.9	6.4
Fixed asset investment for the society at large	25.5	30.1	23.8	23.4	24.6
Total retail sales of social consumer goods	21.6	15.5	18.4	18.5	17.5
Exports	17.2	-16.0	31.3	18.7	19.7
Imports	18.5	-15.7	38.7	20.4	24.6
Interest rates (1-year deposit)	2.52	2.25	2.75	3.5	3.5
Exchange rate (RMB/USD)	6.83	6.83	6.62	6.22	6.22

	1Q2010	2Q2010	3Q2010	4Q2010	1Q2011(F)	2Q2011(F)	3Q2011(F)	4Q2011(F)
GDP	11.9	10.3	9.6	9.8	9.7	9.7	9.9	10.1
CPI inflation	2.2	2.9	3.5	4.7	5.0	4.9	4.2	3.0

Source: CS forecasts Note: Historical data released by National Bureau of Statistics

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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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