



2Q10 Macroeconomic Report

Economic slowdown and structural relaxation of policies

Highlights

- ❖ **Economic growth dropped rapidly.** China's GDP grew 10.3% YoY in 2Q10, lower than our forecast of 10.7% and the consensus forecast of 10.6%. On a QoQ basis, seasonally-adjusted annualized (SAAR) GDP growth was 9% in 2Q10. The output gap shrunk rapidly from 0.6% in 1Q10 to around -0.2% in 2Q10. Industrial value-added output (SAAR) dropped from 11% MoM in 5M10 to 8% MoM in 6M10 (about half the normal growth rate), lower than our forecast of 14.8% and the consensus forecast of 15.5%. Considering the changes in economic growth and the lagging effect of policies, we predict that GDP growth will drop to 9% in 2H10.
- ❖ **Growth momentum weakened.** Investment growth was suppressed by regulations on real estate market and the control of investment in new infrastructure projects. Export growth has peaked and began to pull back, while consumption demand has stabilized. Inventory investments have also declined noticeably due to the expectation of economic slowdown.
- ❖ **Inflationary pressure abated.** CPI came in at 2.9% in 6M10, lower than our forecast of 3.2% and the consensus forecast of 3.3%. PPI stood at 6.4%, basically in line with our forecast of 6.3% but lower than the consensus forecast of 6.8%. Looking forward, we expect the CPI to rise in 3Q10 and begin to fall in 4Q10, while PPI will decline sharply.
- ❖ **Growth in monetary credit resumed normal levels.** Growth in monetary credit in 6M10 was close to the historical average level of 17.5%. It has slowed down noticeably compared to 5M10, mainly due to a high base value in 6M09. However, the more rapid decline in M1 reflected that the economy has weakened. In terms of funds outstanding for foreign exchange and foreign exchange reserves, we continued to see capital outflow in 6M10.
- ❖ **Tightening slowed down and the overall policy environment will be loose.** We expect that the policy environment in 2H10 will be relaxed to a certain degree, and the policy direction will likely be adjusted in 4Q10. **In 2H10, the tightening of monetary policies is expected to ease and monetary policies may even be loosened:** open market operations and RRR adjustments will slow down, and the likelihood of rate hikes will be smaller. The RMB is likely to appreciate by 3-5% amid fluctuations. **More structural policies are expected to be released:** the policies on real estate portfolios will remain while those restricting the development of high energy-consumption and highly-polluting industries will be strengthened. Supportive policies will be adopted for strategic emerging industries and investments in infrastructure facilities in Western and Central China will be expanded.

CS macroeconomic forecast (%)

	2007	2008	2009	2010F	2011F
GDP	13.0	9.6	8.7	10.1	9.5
CPI	4.8	5.9	-0.7	3.2	2.5
PPI	3.1	6.9	-5.4	5.1	1.5
Total investment in fixed assets	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	9.0	9.2	9.0	9.3	9.9	10
CPI	2.2	3.0	3.6	3.4	3.0	2.5	2.4	2.5

Source: CS

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