

CHINA ECONOMIC MONITOR

Treasury Division



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Mainland China's Economic Growth Likely to Rebound in the Second Quarter

- Mainland China's real GDP growth slowed to 6.1% in the first quarter of 2009 from 6.8% in the fourth quarter of 2008 as demand from the country's major trading partners continued to worsen. Strong domestic demand was the main driving force for growth in the period.
- While there is no sign yet of any recovery in the external horizon, the strong credit growth of close to 30% in the first quarter and the launch of more government projects in the months ahead bode well for a rebound of economic activities on the Mainland, to about 7% in the second quarter.
- Consumer prices dipped by 1.2% in March after contracting 0.3% in the first two months, implying that the spectre of deflation is here to stay, at least for a while.
- With interest rates unlikely to fall in the near term given the record rate of credit expansion, real interest rates will remain high for some time to come, which is not conducive to the government's effort of reviving growth. Overall, the Mainland's 8% growth target for this year is still within reach, though actually achieving it remains a challenge.

Exhibit 1: Economic Forecast

Growth, %	2008	2009F
Real GDP	9.0	8.0
Fixed asset investment (real)	15.8	22.0
Retail sales (real)	14.8	12.0
RMB loans outstanding	18.8	18.0
Consumer price	5.9	1.0
Exports	17.3	-5.0
RMB per US dollar	6.84	6.80

Source: Hang Seng Bank



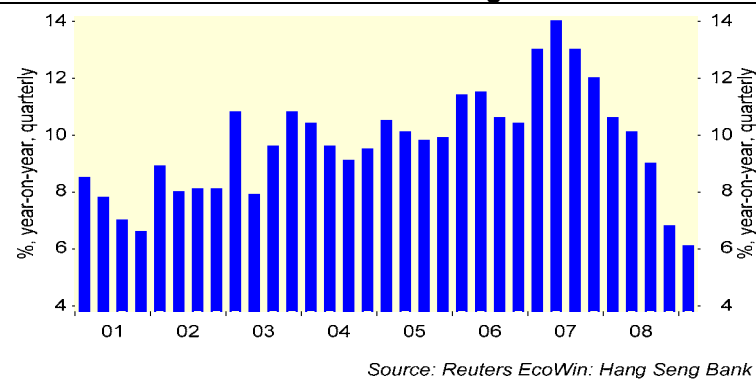
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Mainland China's real GDP growth slowed to 6.1% ⁽¹⁾ in the first quarter of 2009 from 6.8% in the fourth quarter of 2008 in the face of rapidly deteriorating external demand (Exhibit 2).

Exhibit 2: Mainland China's real GDP growth



The Mainland's exports dropped 17.1% in March after falling 21.1% in the first two months as demand from the country's two biggest trading partners, the European Union and the US, plunged. Exports to the European Union contracted by 20.2% in March after sliding 22.9% in the first two months, and those to the US plummeted 12.6% following a drop of 16.1% in January-February.

Strong domestic demand provided much of the driving forces for the Mainland's economic growth in the first quarter. Fixed asset investment soared by 30.3% in March after climbing 26.5% in the first two months as the government's stimulus measures started to take effect. Retail sales of consumer goods also held up well, rising by 16.4% in March and 15.9% in the first quarter, both in real terms.

In terms of contribution, consumption accounted for 4.3 percentage points of the first quarter's GDP growth, investment two percentage points, and net exports minus 0.2 percentage point. That investment's contribution was only two percentage points was due mainly to the run down of inventory during the period, according to officials.

Domestic demand will remain the chief growth driver

Looking ahead, there is no sign yet of any recovery in the external horizon. In its latest economic report released on 22 April, for instance, the International Monetary Fund (IMF) said that the global recession would be deeper and the recovery slower than previously thought. The Fund downgraded its world GDP forecast to a contraction of 1.3% in 2009, compared with its January projection of a 0.5% growth (Exhibit 3). At the same time, it revised downward its forecast for 2010 to a growth of 1.9% from 3%.

¹ All growth rates are year-on-year unless specified otherwise





Exhibit 3: IMF Forecast on world economic growth (%)

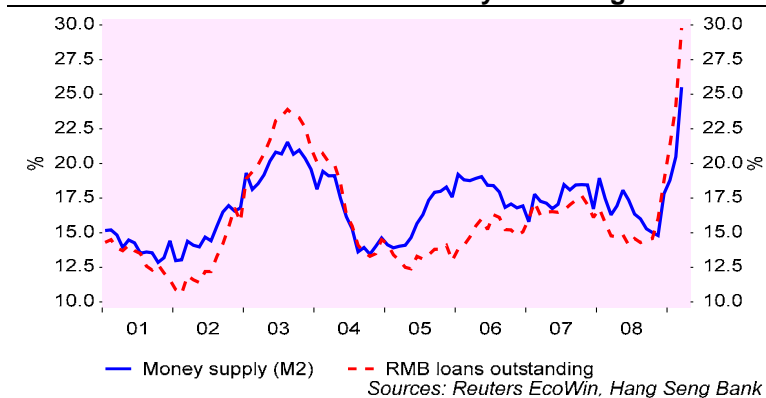
	2008 Actual	2009 forecast		2010 forecast	
		Jan 2009 Projection	Apr 2009 Projection	Jan 2009 Projection	Apr 2009 Projection
World output	3.2	0.5	-1.3	3.0	1.9
- USA	1.1	-1.6	-2.8	1.6	0.0
- Euro zone	0.9	-2.0	-4.2	0.2	-0.4
- Japan	-0.6	-2.6	-6.2	0.6	0.5
- Mainland China	9.0	6.7	6.5	8.0	7.5

Source: World Economic Outlook, April 2009, IMF

For mainland China, however, steady domestic demand should be able to help underpin the country's economic growth. Indeed, the strong monetary and credit growth in the first quarter and the launch of more government projects in the months ahead bode well for a rebound of economic growth, to about 7% in the second quarter.

In the first quarter, broad money supply (M2) jumped 25.5% after rising 17.8% in the fourth quarter of 2008, well above the government's 17% target growth for the year (Exhibit 4). In the same period, renminbi loans outstanding soared 29.8%, the highest on record, as banks strived to extend credit under the government's encouragement.

Exhibit 4: Mainland China's monetary & credit growth



While the growth of renminbi deposit outstanding also surged to 25.7% in the first quarter from 19.7% in the fourth quarter of 2008, private consumption is unlikely to be much affected given the strong income growth across the country. In the first quarter, per capita income in urban areas gained by a real 11.2% after a real increase of 11.3% in the fourth quarter of 2008, while that in rural areas rose 8.6% following a real growth of 2.5% in the previous quarter.

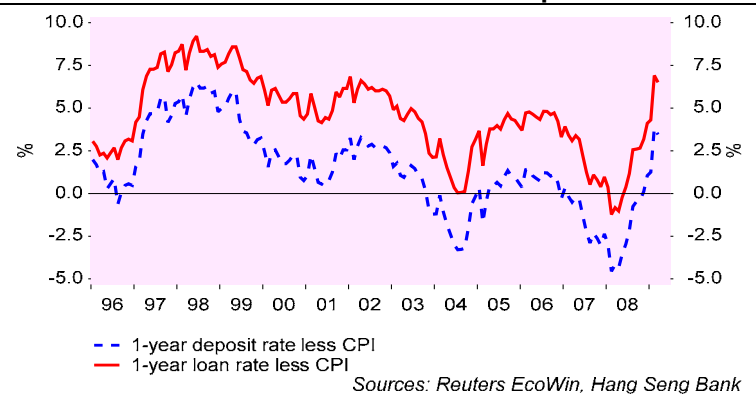


Real interest rates to remain high for some time

The only concern is that non-food consumer prices dipped further by 1.3% in March after falling 1.0% in the first two months, implying that the spectre of deflation is here to stay, at least for a while. In March, consumer prices dropped 1.2% after contracting 1.6% in February, resulting in an overall fall of 0.6% in the first quarter. One consequence of deflation is higher cost of borrowing in real terms.

With credit expanding at a record rate, it is unlikely that the People's Bank of China, the Mainland's central bank, will cut interest rates and the required reserve ratio any time soon, or at least until both the credit and monetary growth rates are back to more moderate levels. But with consumer prices contracting, this means that real interest rates will stay high for some time. In February, the one-year loan rate adjusted for consumer price inflation reached 6.9%, the highest in more than 10 years. It has since retreated to about 6.5%, but is still high compared with levels of the past 10 years (Exhibit 5).

Exhibit 5: Mainland China's real loan & deposit rates



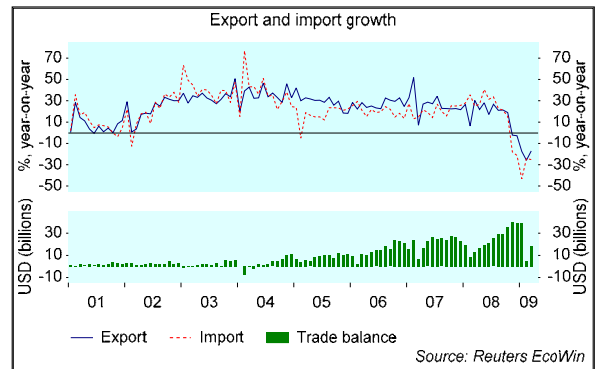
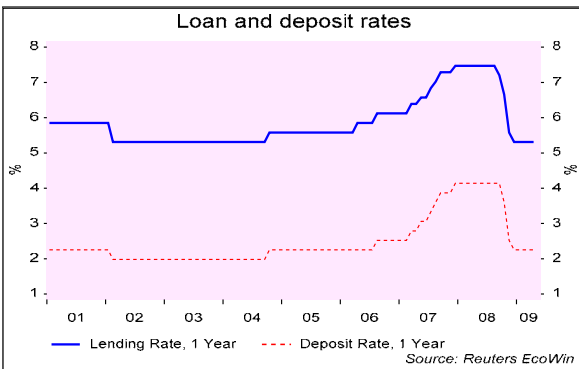
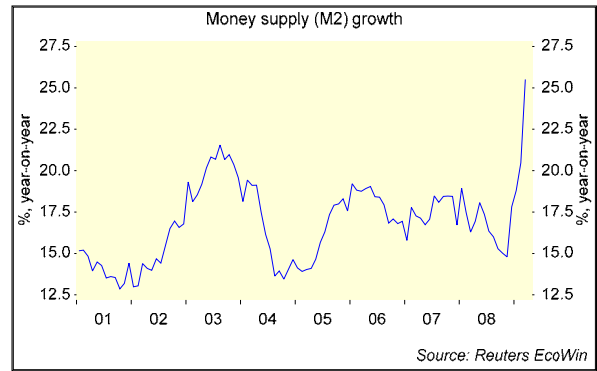
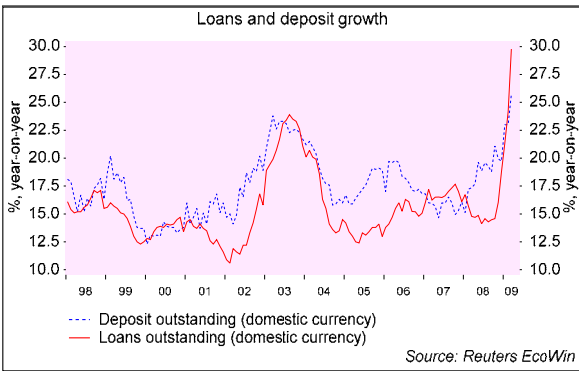
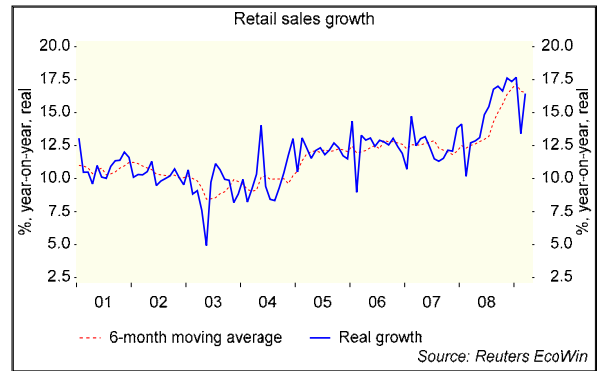
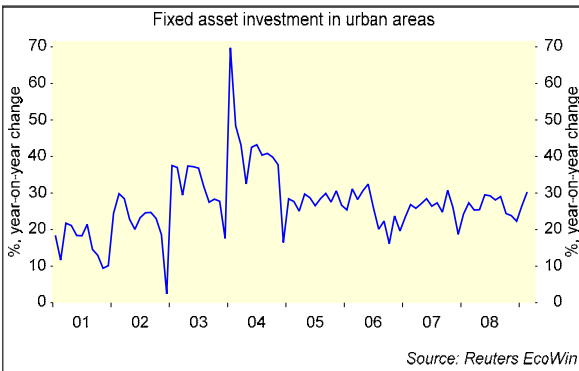
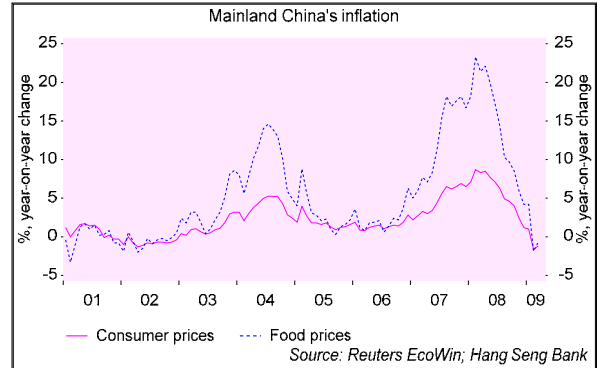
High real interest rates will in theory make investment more costly, dampening private investment and weakening the government's effort of reviving growth. To be sure, real interest rates on the Mainland are expected to fall in the second half of this year as consumer prices resume rising and interest rates falling, but they are unlikely to drop below zero before the end of 2010.

Overall, the Mainland government's 8% growth target for this year is still within reach, though actually achieving it remains a challenge. The rebound of the Mainland's manufacturing purchasing managers' index (PMI) to above 50, the threshold dividing expansion and contraction of economic activity, in April for the second month in a row is encouraging (53.5 versus 52.4 in March). Any recovery in external demand in the months ahead, no matter how slight, will help.



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China Economic Monitor Statistics

May 2009

	GDP		Industrial output*	Fixed asset investment**		Retail sales	Foreign direct investment (utilised)@		Foreign trade				Consumer prices	
	Nominal RMB bn	real growth yoy(%)	real growth yoy(%)	growth, yoy, %		real growth yoy(%)	US\$bn	yoy(%)	Export growth		Import growth		Trade balance US\$bn	yoy(%)
				nominal	real (e)				nominal yoy(%)	real yoy(%)	nominal yoy(%)	real yoy(%)		
2003	13,517	10.0	17.0	29.1	26.3	9.2	53.5	1.4	37.1	NA	39.8	NA	25.4	1.2
2004	15,988	10.1	16.7	28.8	22.0	10.2	60.6	13.3	35.7	NA	36.0	NA	32.1	3.9
2005	18,322	10.4	16.4	27.2	25.2	12.0	60.3	-0.5	28.4	25.0	17.6	13.8	101.9	1.8
2006	21,192	11.6	16.6	24.5	22.7	12.6	63.0	4.5	27.2	24.0	20.0	16.8	177.5	1.5
2007	25,731	13.0	18.5	25.8	21.5	12.5	74.8	18.6	25.7	20.2	20.8	13.4	262.2	4.8
2008	30,067	9.0	12.9	26.1	15.8	14.8	92.4	23.6	17.3	7.9	18.5	3.3	295.5	5.9
2009F	32,770	8.0	10.5	26.0	22.0	12.0	70.0	-22.2	-5.0	-7.0	0.0	-2.0	224	1.0
Q3 2007	6,197	13.0	18.5	26.1	21.2	11.5	17.2	NA	26.2	20.8	20.6	13.7	73.0	6.1
Q4	8,288	12.0	18.5	24.0	17.2	12.8	29.5	NA	22.3	14.8	25.5	15.6	76.0	6.6
Q1 2008	6,347	10.6	16.4	25.9	16.0	12.3	27.4	61.2	21.4	11.2	28.6	10.1	41.4	8.0
Q2	7,125	10.1	15.9	27.2	14.3	13.6	25.0	31.6	22.4	10.7	32.4	9.4	57.6	7.8
Q3	7,330	9.0	13.0	28.8	16.0	16.4	22.0	27.9	23.0	13.3	25.7	4.0	82.3	5.3
Q4	9,264	6.8	6.4	23.3	17.7	17.2	18.0	-16.6	4.3	-1.9	-8.9	-9.6	114.3	2.5
Q1 2009	6,575	6.1	5.1	28.6	30.2	15.9	21.8	-20.6	-19.7	-18.1	-30.9	-18.1	62.3	-0.6
Nov	NA	NA	5.4	23.8	NA	17.6	5.3	-36.5	-2.2	-7.2	-17.9	-19.4	40.1	2.4
Dec	NA	NA	5.7	22.3	NA	17.3	6.0	-5.6	-2.8	-7.5	-21.3	-12.5	39.0	1.2
Jan 2009	NA	NA	-3.4	NA	NA	17.7	7.5	-32.6	-17.5	-19.3	-43.1	-36.3	39.1	1.0
Feb	NA	NA	11.0	NA	NA	13.4	5.8	-15.8	-25.7	-23.8	-24.1	-7.9	4.8	-1.6
Mar	NA	NA	8.3	30.3	NA	16.4	8.4	-9.5	-17.1	-12.2	-25.1	-8.1	18.6	-1.2
Year-to-date	6,575	6.1	5.1	28.6	30.2	15.9	21.8	-20.6	-19.7	-18.1	-30.9	-18.1	62.3	-0.6

	Per capita income				Deposits outstanding (domestic currency)#		Loans outstanding (domestic currency)#		Interest rate (end-period)		Money supply (M2)	Forex reserves (end-period)	RMB per USD mid-rate (end of period)	Urban unemployment rate (end-period)
	Urban		Rural		RMB bn	yoy %	RMB bn	yoy %	1-year deposit %	1-year loans %	yoy(%)	US\$ bn	US\$ bn	%
	RMB	real growth yoy(%)	RMB	real growth yoy(%)										
2003	8,472	9.0	2,622	4.3	20,806	21.7	15,900	21.1	1.98	5.31	19.6	403	8.2767	4.3
2004	9,422	7.7	2,936	6.8	24,142	16.0	17,820	14.5	2.25	5.58	14.6	610	8.2765	4.2
2005	10,493	9.6	3,916	6.2	28,716	19.0	19,469	13.0	2.25	5.58	17.6	819	8.0702	4.2
2006	11,760	10.4	4,302	7.4	33,546	16.8	22,535	15.1	2.52	6.12	16.9	1,066	7.8087	4.1
2007	13,786	12.2	4,958	9.5	38,940	16.1	26,170	16.1	4.14	7.47	16.7	1,528	7.3046	4.0
2008	15,781	8.4	5,701	8.0	46,620	19.7	30,350	18.8	2.25	5.31	17.8	1,946	6.8400	4.2
2009F	17,020	7.0	6,144	6.5	52,397	20.0	35,813	18.0	1.98	5.04	17.0	2,300	6.80	4.5
Q3 2007	3,294	11.1	1,210	17.3	38,298	16.8	25,897	17.1	3.87	7.29	18.5	1,434	7.5108	4.0
Q4	3,440	9.3	1,638	-0.9	38,940	16.1	26,170	16.1	4.14	7.47	16.7	1,528	7.3046	4.0
Q1 2008	4,386	3.4	1,494	9.1	41,570	17.4	27,500	14.8	4.14	7.47	16.3	1,682	7.0190	4.0
Q2	3,679	9.9	1,034	12.1	43,900	18.9	28,620	14.1	4.14	7.47	17.4	1,809	6.8591	4.0
Q3	3,800	9.8	1,443	12.8	45,490	18.8	29,650	14.5	4.14	7.20	15.3	1,906	6.8183	4.0
Q4	3,916	11.3	1,730	2.5	46,620	19.7	30,350	18.8	2.25	5.31	17.8	1,946	6.8350	4.2
Q1 2009	4,834	11.2	1,622	8.6	52,260	25.7	34,960	29.8	2.25	5.31	25.5	1,954	6.8359	4.3
Nov	NA	NA	NA	NA	46,240	19.9	29,570	16.0	2.52	5.58	14.8	1,885	6.8350	NA
Dec	NA	NA	NA	NA	46,620	19.7	30,350	18.8	2.25	5.31	17.8	1,946	6.8350	NA
Jan 2009	NA	NA	NA	NA	48,160	23.0	31,990	21.3	2.25	5.31	18.8	1,914	6.8380	NA
Feb	NA	NA	NA	NA	49,810	23.0	33,060	24.2	2.25	5.31	20.5	1,912	6.8380	NA
Mar	NA	NA	NA	NA	52,260	25.7	34,960	29.8	2.25	5.31	25.5	1,954	6.8359	NA
Year-to-date	4,834	11.2	1,622	8.6	52,260	25.7	34,960	29.8	2.25	5.31	25.5	1,954	6.8359	4.3

NA not available; (A)= actual; (e)= HASE estimate; yoy= year-on-year;

* Includes output by SOEs and non-SOEs with annual output sales of over RMB5 million. It accounts for about 88% of national industrial output.

**Only covers fixed asset investment in urban areas. It accounts for about 85% of national fixed asset investment

@ Also covers FDI in financial sectors since January 2008

Accounting for about 95% of total deposits and loans

Source: State Statistical Bureau; China Statistical Yearbook; CEIC



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