



## A SLOW SLOWDOWN

26 June 2007

As Beijing's officials meet to consider what, if anything, they need do ahead of the second half it is worth looking at the picture that faces them. It is mixed, meaning no great pressure to act. The most interesting data released for May is steel output growth of just 14.9%. This seems to confirm that overheating is not an issue. Officials should look at their own data on value added in industrial production, their proxy for industrial production, in the second chart below.

### What Happened in May ? Mixed But Looks Like A Slowdown

- Steel Output Growth at Three-Year Low: 14.9%
- Car Sales Rose 23%: But Needed Price Cuts
- Cement Accelerating: 18% Higher y-o-y
- Textile Exports Growth Again 12.3%: Under Half 06 Growth
- Yarn Up 19.7%. Cloth 15.5% Higher, Garments Up 19.4%
- Energy Production Up 8.2% v. 11.6% in 06
- Power Generating Equipment Growth 43.2% v. 23.1% in 06
- Metal Smelting Equipment Down 7.5%
- Tyres Up 32.6% v 39% in 06

### Consumption: Remains Very Firm

- Retail Sales Growth Hits Three-Year High of 15.9%
- Beer Up 12%, White Liquor Rose 31%
- Dairy Growth Again Hits Reality: Only 2.4%

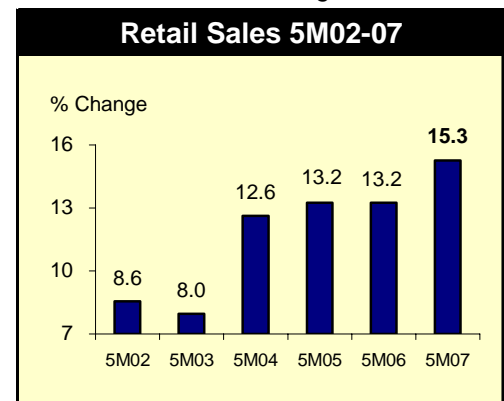
### Inflation: Back On Screens

- CPI 3.4%: Gaining Visibility
- Food Rose 8.3%: Main Cause of Inflation, Temporary ?
- PPI Eased Slightly to 2.8%: Less Pressure on Margins

### Data To Watch: For Signs of Real Overheating

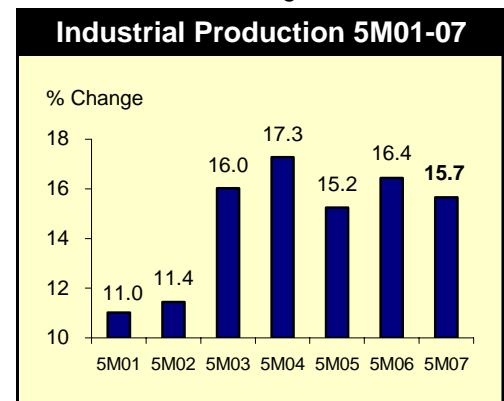
- Bank Loans: Growth Over 18%
- Fixed Asset Investment: Above 30% For Entire Quarter
- Industrial Output: Over 18% - Series Discontinued?
- Retail Sales: Over 16%

### Accelerating



Source: CEIC

### Slowing?



Source: CEIC

### Recommendations

- *Commodities*
- *Asian Equities*
- *H-Shares*

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*At the risk of sounding like a broken record, again we question the official data. The industrial production growth number suggests that growth is again accelerating but closer examination suggest the numbers do not add up. This is a slow, slowdown*

### **Not Reaccelerating**

As we look out to the second half of 2007 and contemplate what measures the government may be tempted to introduce we have to sound our repeated warning. We continue to worry about the quality of the data and do not believe that the economy overall is seeing a re-acceleration of growth that threatens overheating. Indeed it is slowing, slowly.

The best evidence for this is the government's own data on value added of industry, Beijing's proxy for industrial production. This shows that in the first five months of 2007, this very broad indicator rose 15.7% compared with 16.4% in the same period in 2006 and 17.3% in 2004.

The strongest evidence this month of a slowdown is the fall in steel output growth to just 14.9%, the lowest figure in three years, excluding holiday distortions. This is very much in accord with our steel analyst Hafidzah Hassan's recent call on slower demand growth and easier steel prices over the summer months. Our recent visit to Baosteel confirmed it.

Admittedly other bits of data suggest that the economy remains strong. Cement output is recovering firmly from a recent dip. Textiles seem to have had a stronger month though export growth remained unchanged. Passenger car sales recovered to 23% growth but only with help from price cuts.

### **Not Adding Up**

Until November we could look at four sets of data to see if they are telling the same story – industrial production, electricity output, steel production and car sales. They were a pretty good guide to the direction and pace of the economy. Then the absolute value series was discontinued.

Over 40% of steel is consumed by property. Autos are the second largest household expenditure while electricity captures all of manufacturing, especially the energy-intensive heavy industries like steel, autos and cement, as well as household spending on everything from air conditioning to the use of appliances.

Now the Industrial Production series has been abolished and only percentage change is given this is a less useful indicator. At this month's 18.1% this is the highest level since January 2001, except for holiday-distorted months.

However it makes no sense if steel output growth is down to 14.9% from the plateau of 20% it has been on for two years. If this growth rate is down it is hard to see how electricity output should be rising to a record.

The data overall is mixed. Again we have added 28 extra charts to the *China Monitor* to get a better sense of what is happening across the whole economy, especially in manufacturing. This suggests that while the economy is strong it is also slowing slowly.

Quietly Beijing will be pleased but it has decided to beat the drum on overheating ahead of the 17th Congress later in the year (now it is talked of as being in October or November) to strengthen its own position. Hence it will not ease up on the rhetoric, especially while the threat of inflation appears again on their screens.

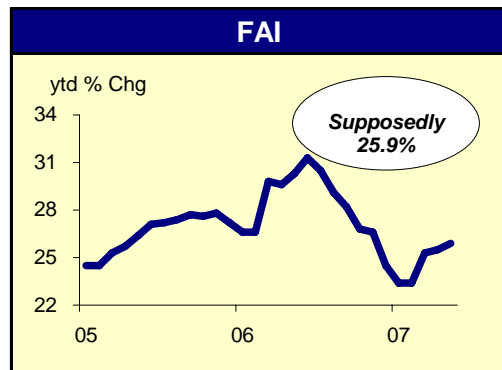
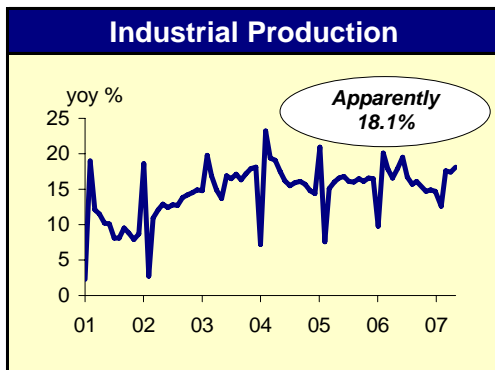
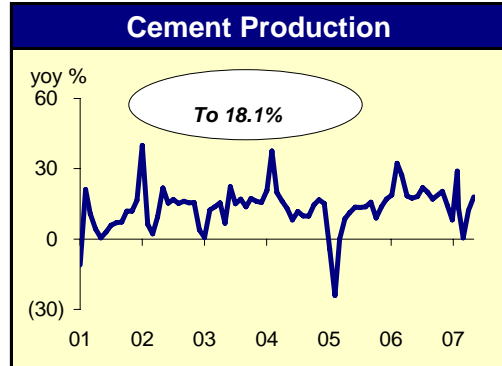
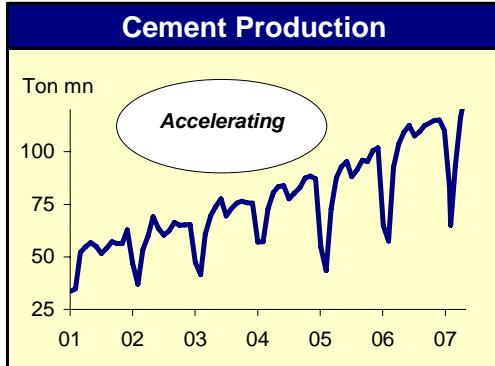
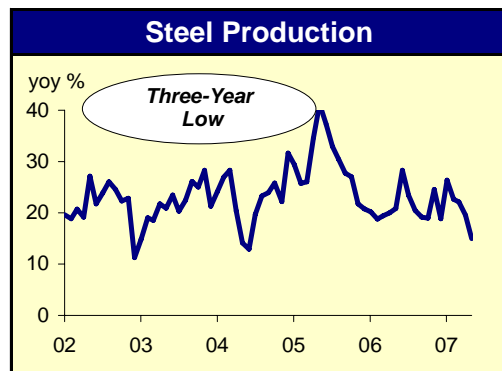
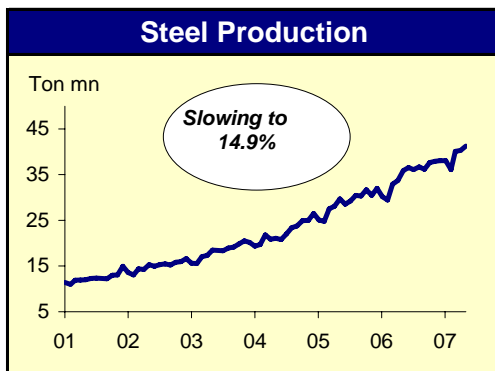
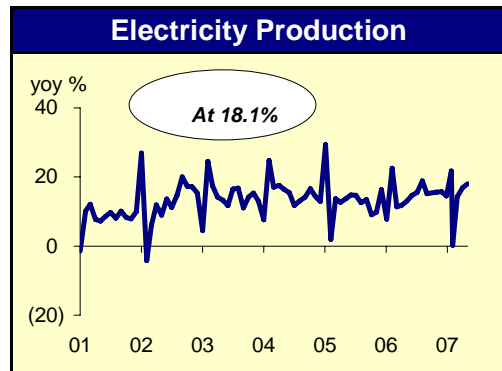
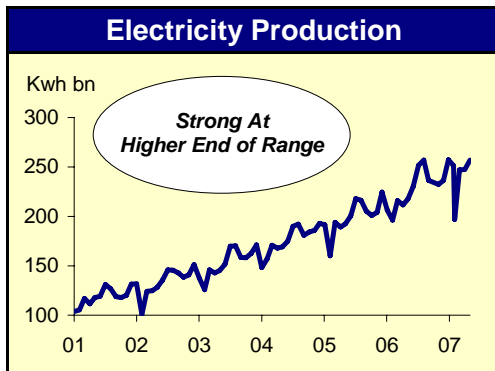
The CPI has risen to 3.4%, the highest level in 15 months. Much is attributed to food, which has risen 8.3%, and much of that to pork that has risen more than 30%. It is assumed that this will be temporary: time will tell. There is some relief on producer prices for the time being but with commodities remaining firm this scare may not be over yet.

### **Second Half Outlook**

We expect the slowdown to continue, even if slowly. This will be led by fixed asset investment, mainly in property. Some areas of manufacturing growth may slow relative to the first half spurt in output ahead of anticipated VAT and export rebate cuts that come into play in July.

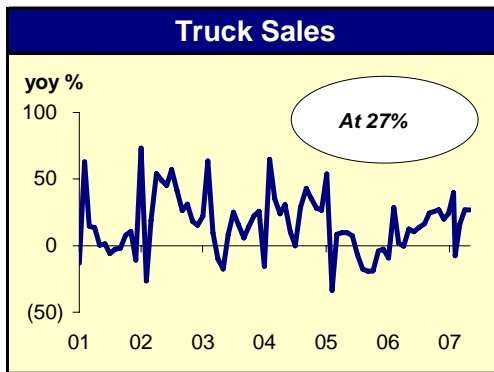
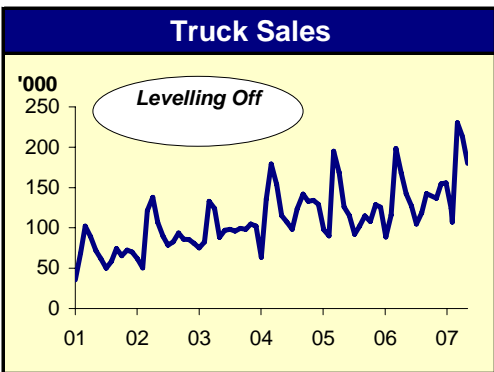
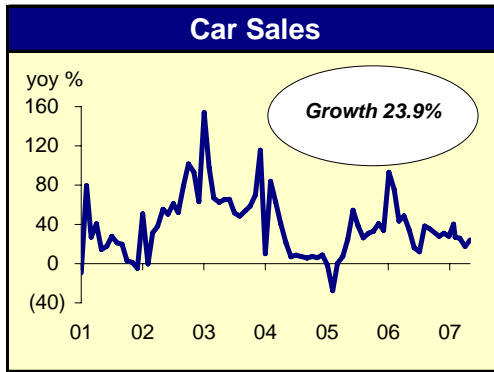
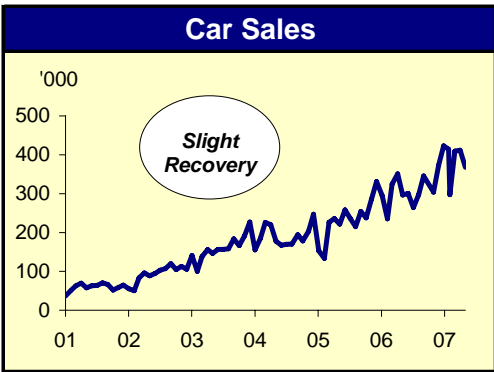
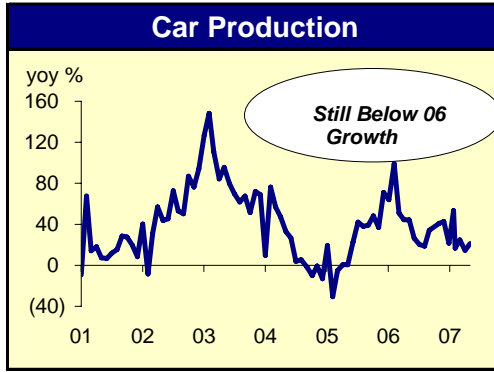
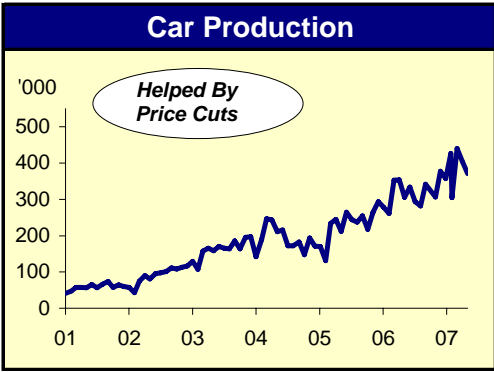
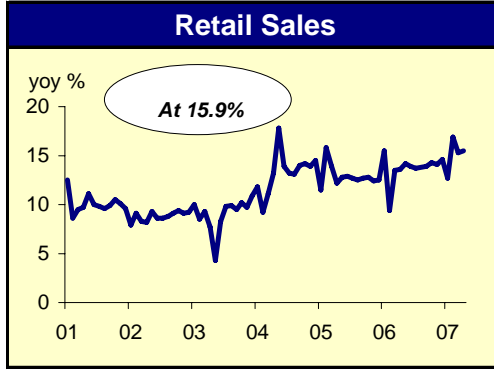
Domestic consumption will remain the main driver, with retail sales reaching a three-year high of 15.9% in May. If this balances any industrial slowdown, Beijing will be relaxed both on interest rates and the currency.

# 2005 PRODUCTION & CONSUMPTION 2007



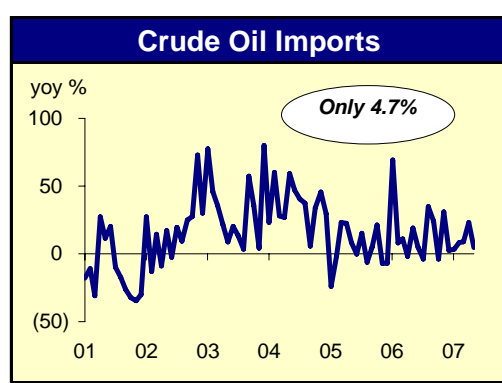
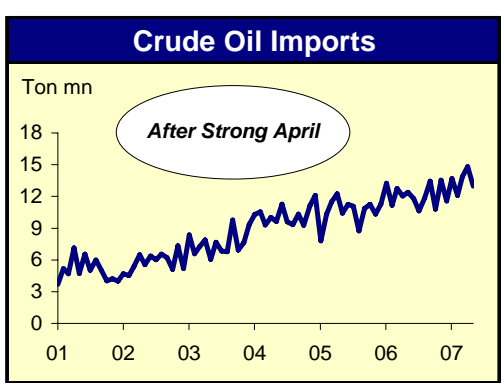
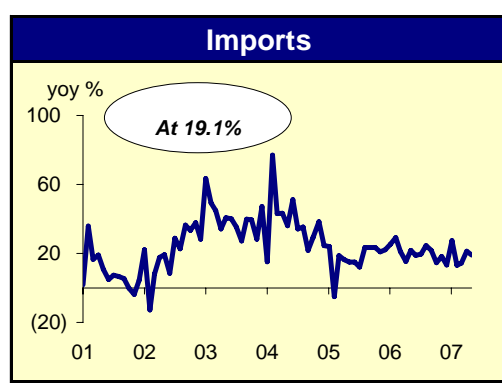
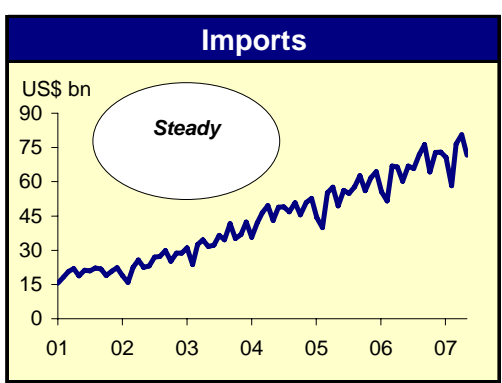
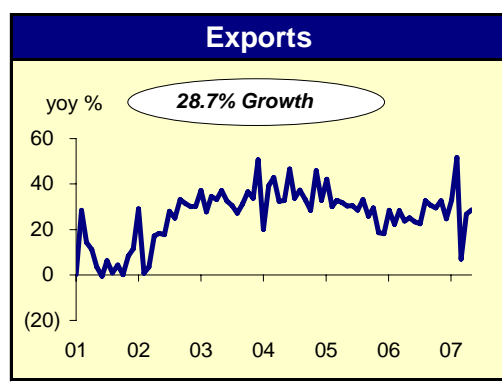
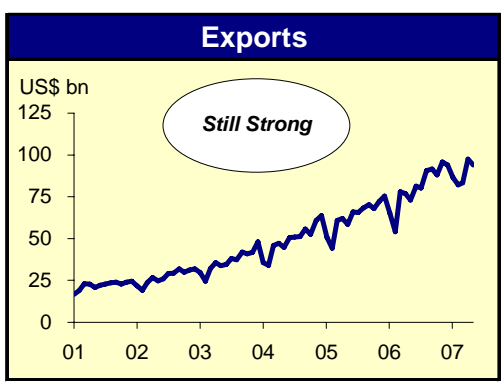
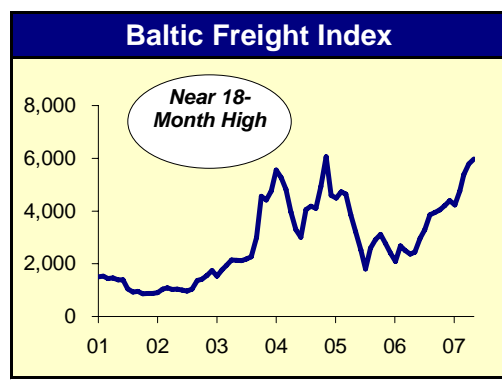
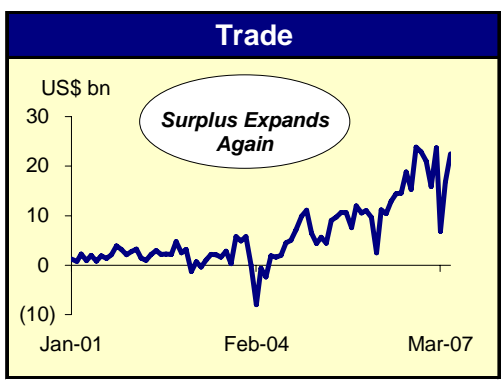
Source: CEIC

# PRODUCTION & CONSUMPTION



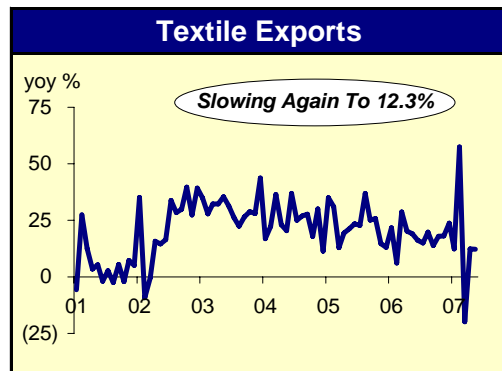
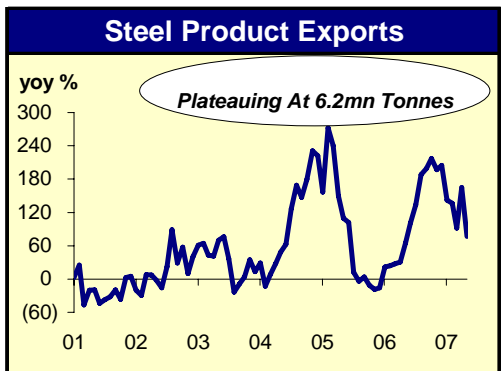
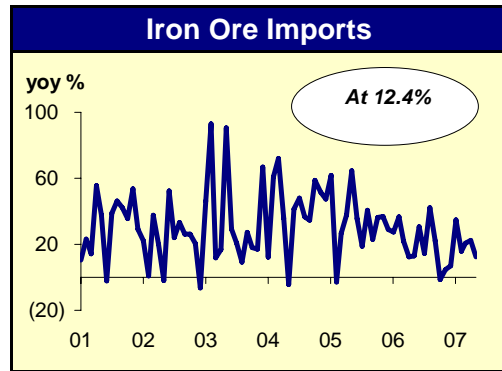
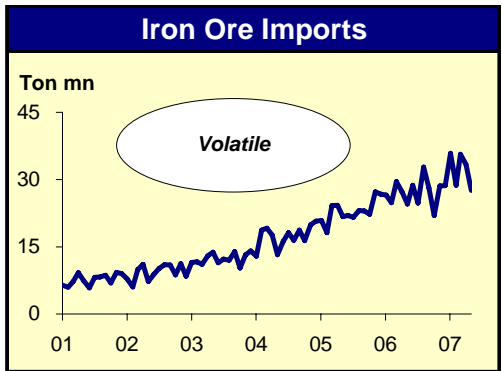
Source: CEIC

**TRADE**



Source: CEIC

**TRADE**



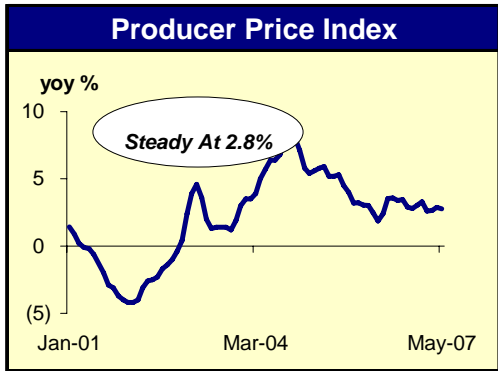
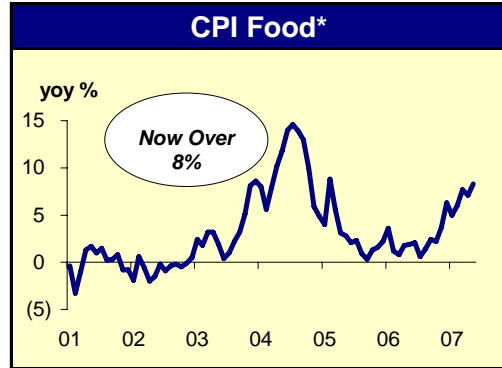
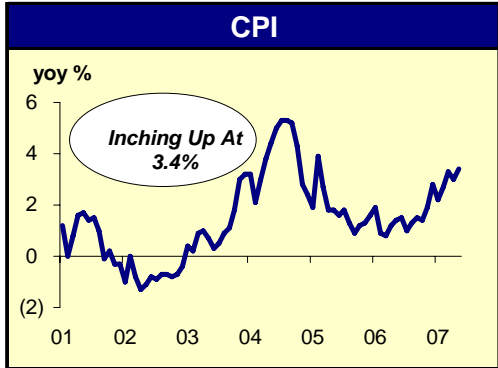
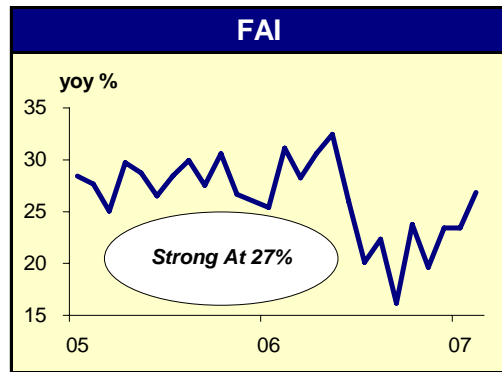
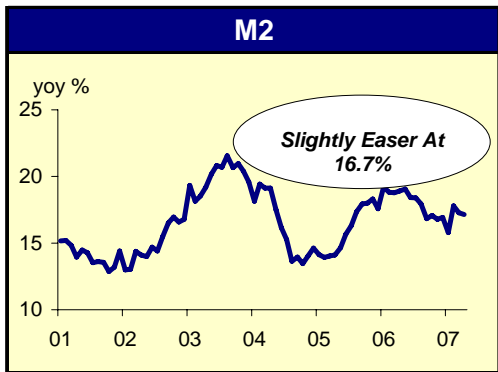
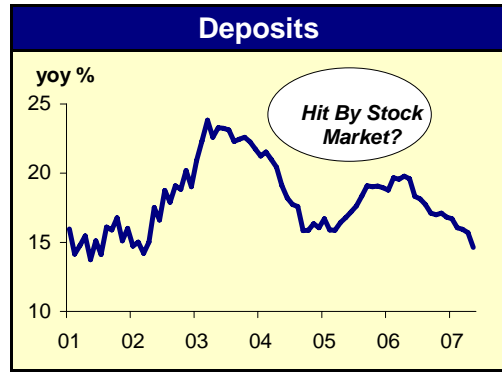
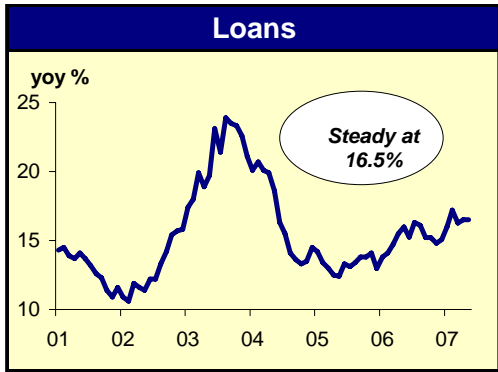
Source: CEIC

**All data is for May, except for Baltic and Market Indices which are June 22nd and Visitor Arrivals which is for April**

**NB When we talk of highs we exclude Jan/Feb numbers that are distorted by the changing Lunar New Year holiday**

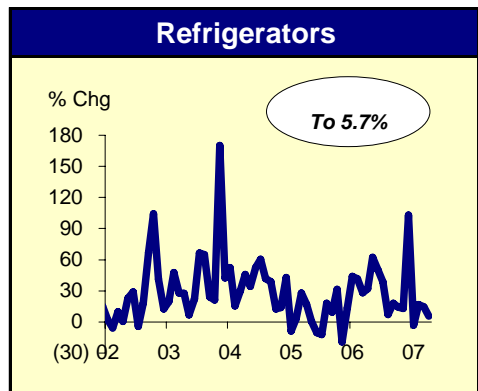
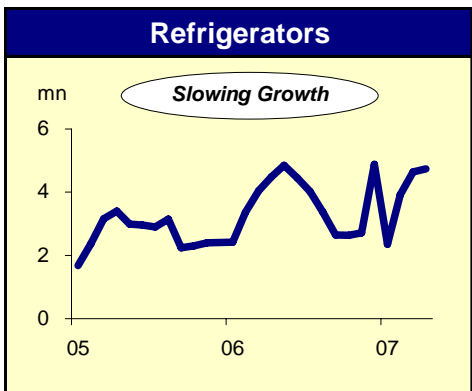
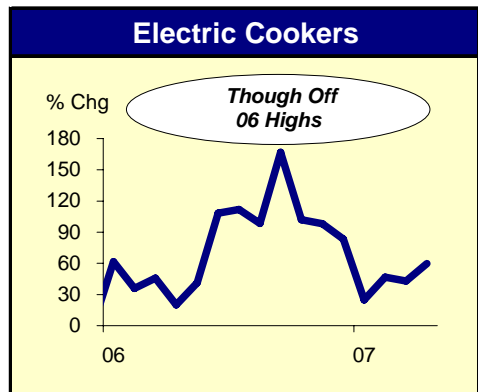
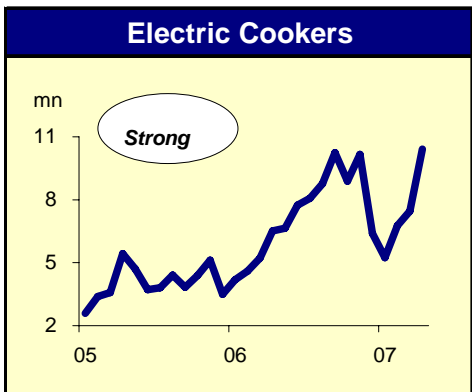
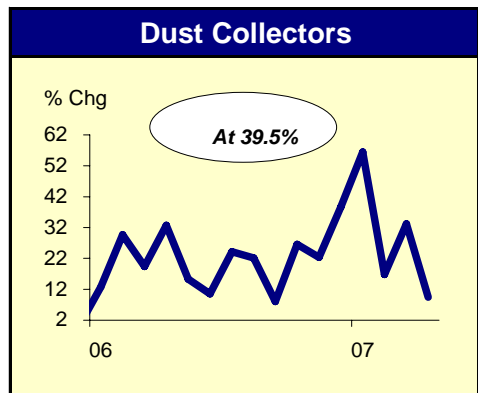
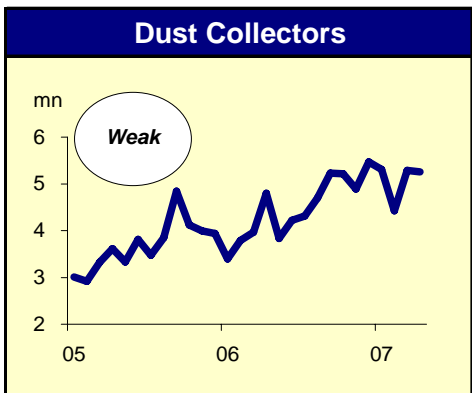
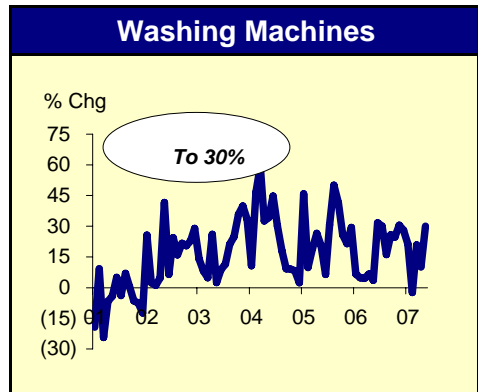
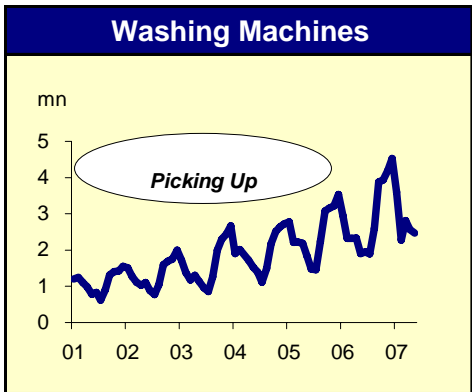
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**MONEY & FINANCE**



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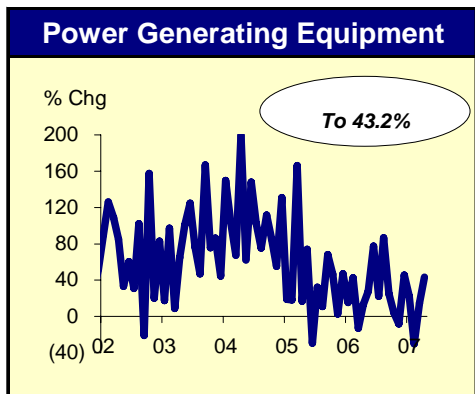
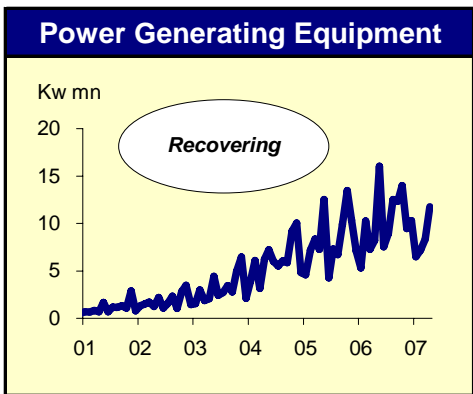
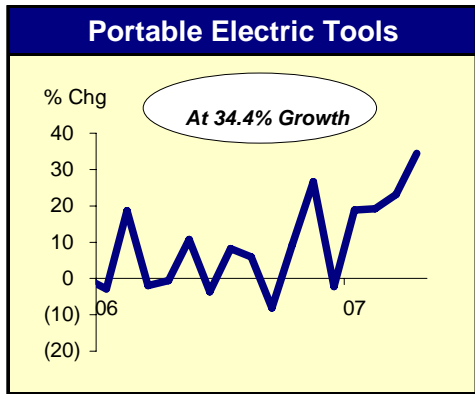
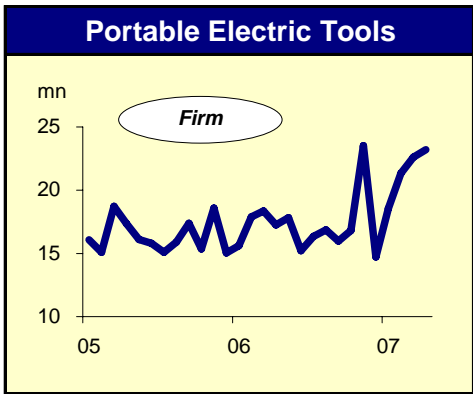
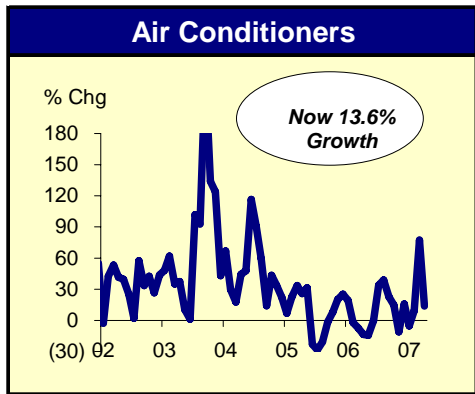
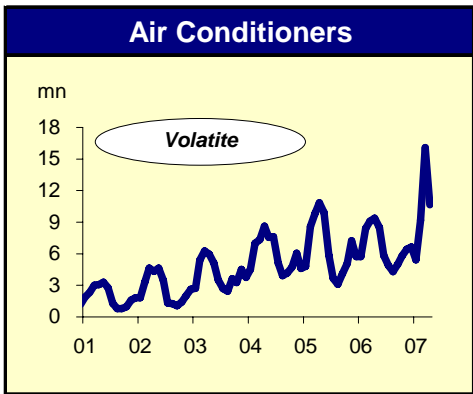
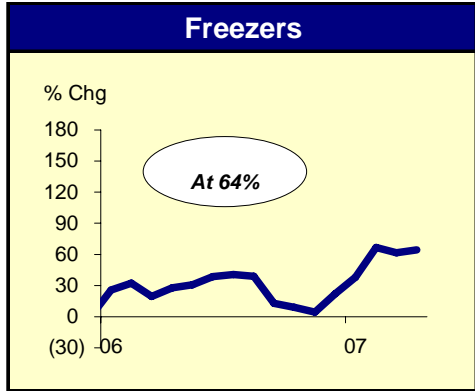
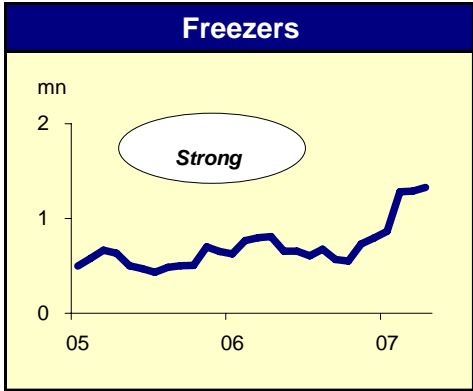
**PRODUCTION**



Source: CEIC

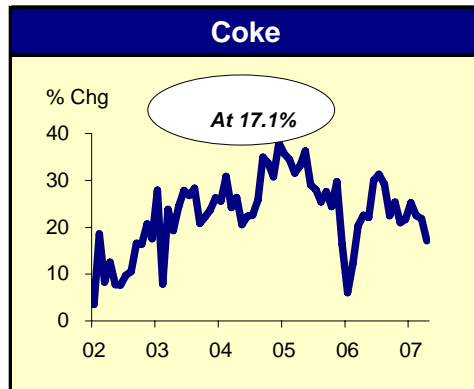
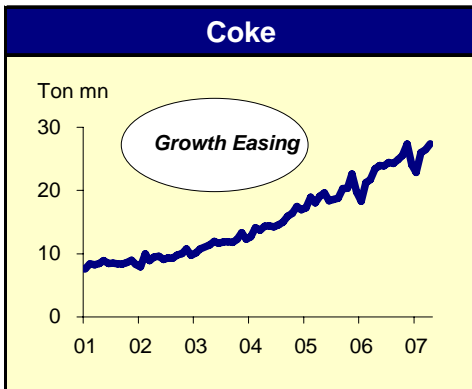
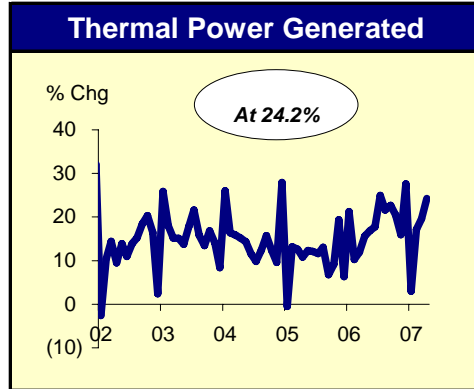
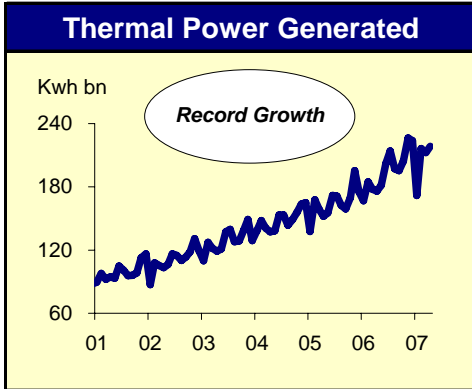
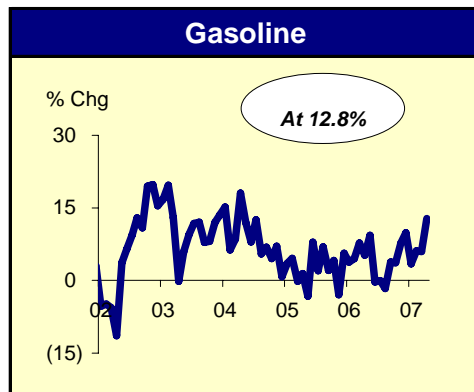
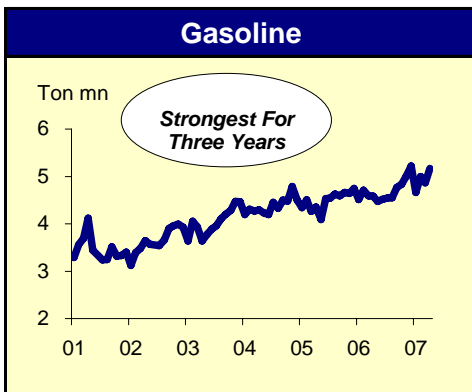
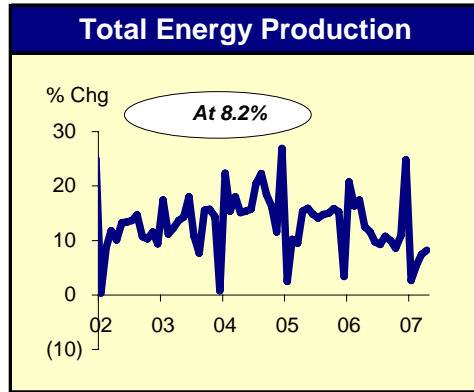
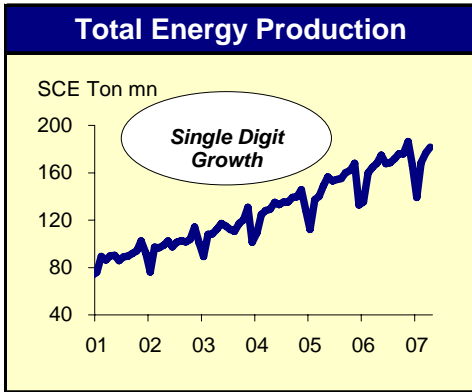


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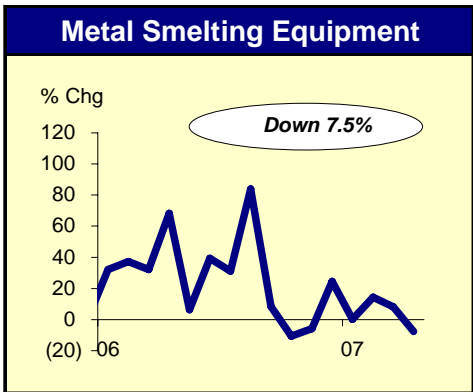
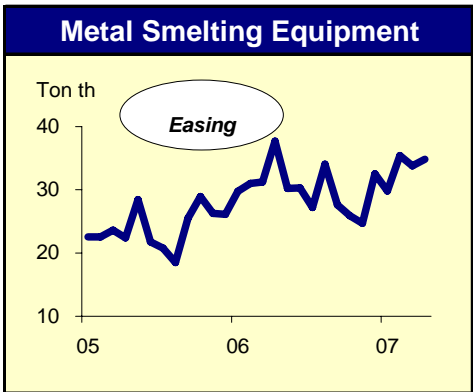
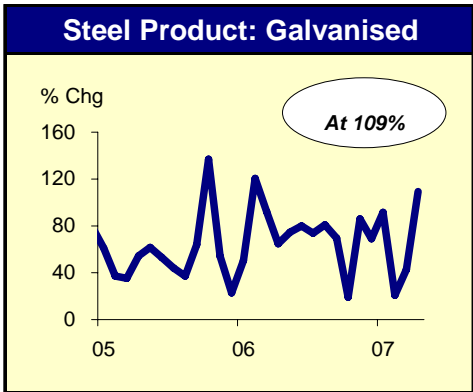
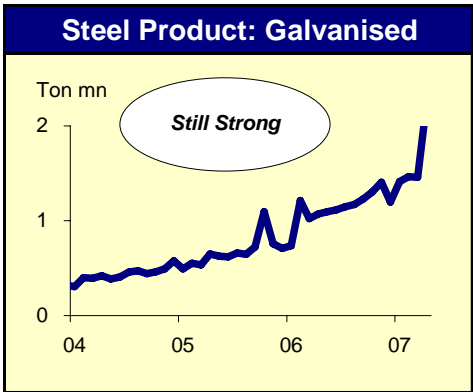
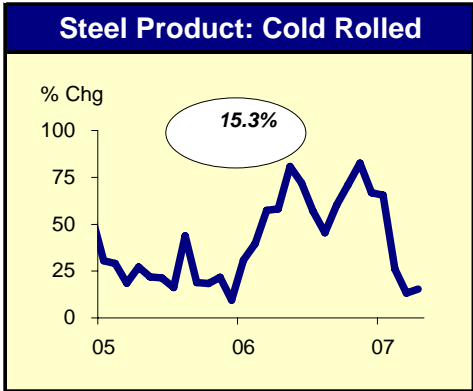
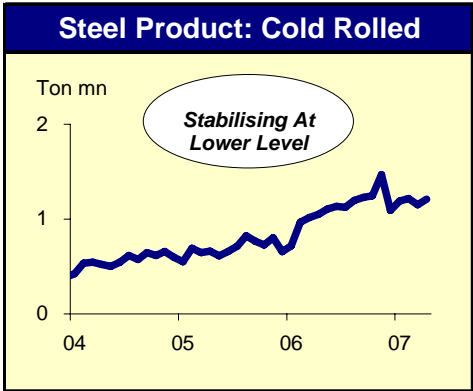
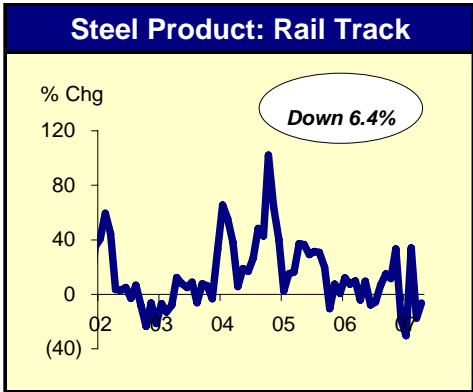
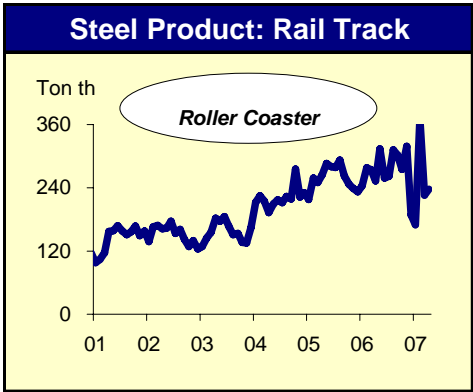
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**PRODUCTION**



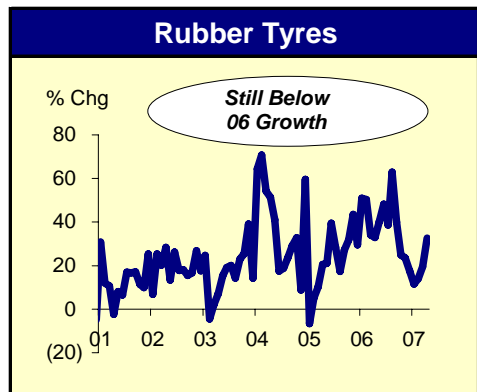
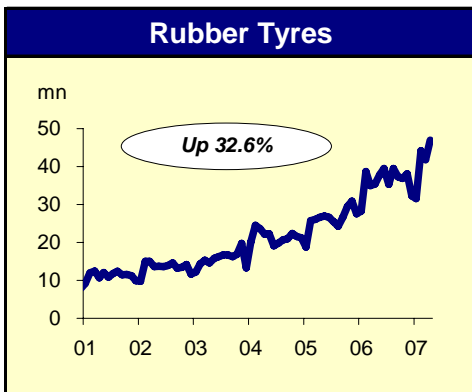
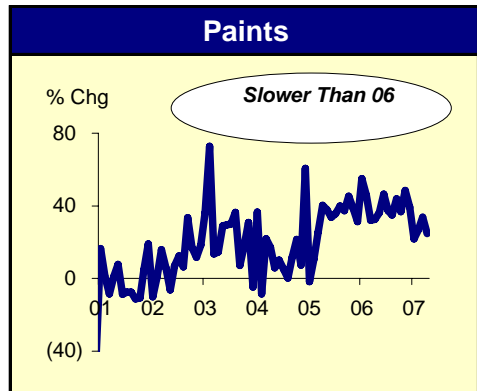
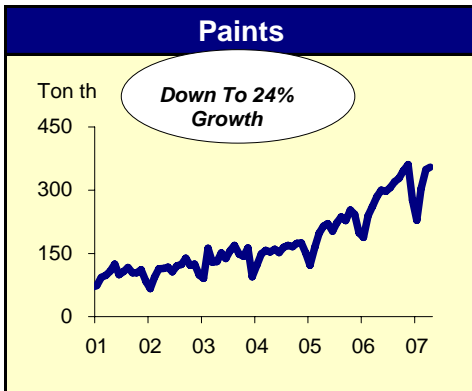
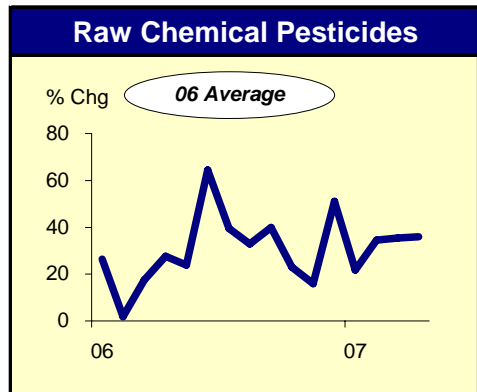
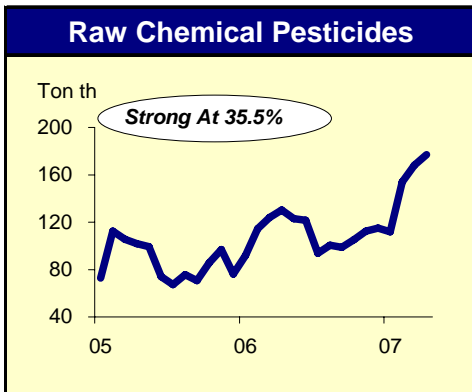
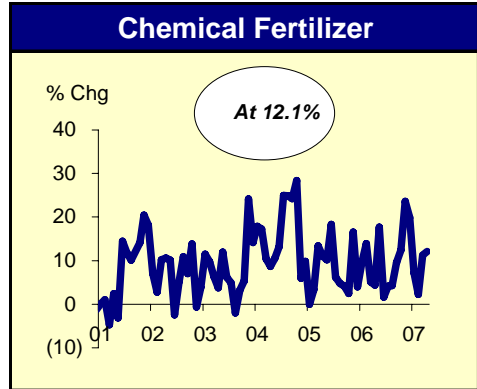
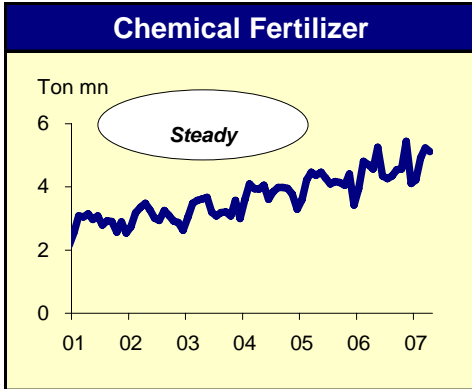
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**PRODUCTION**



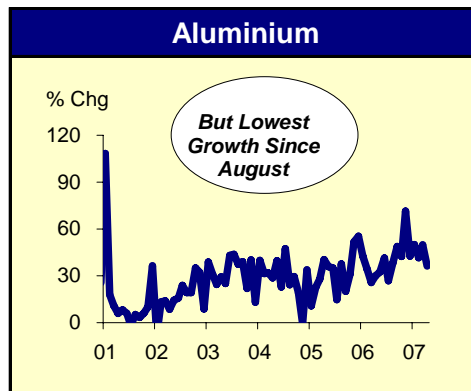
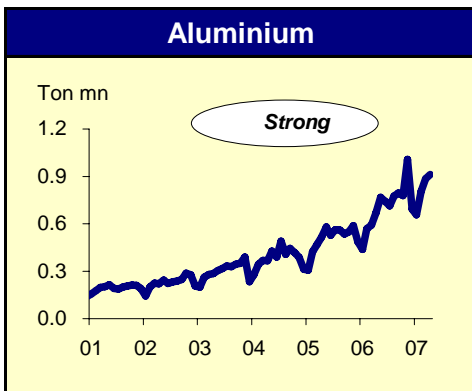
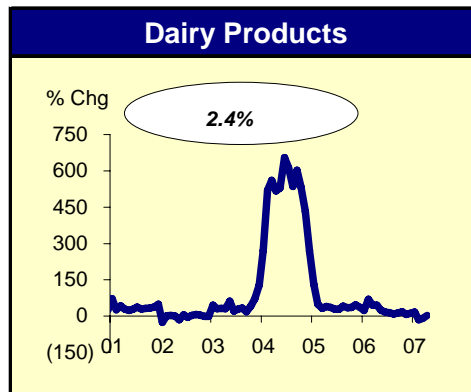
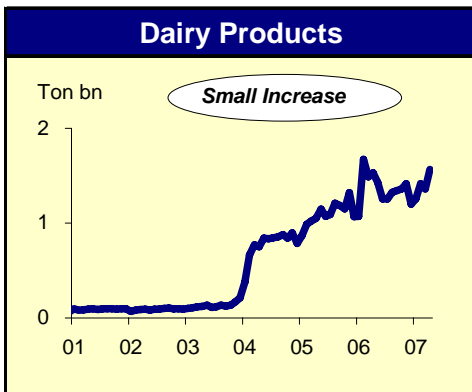
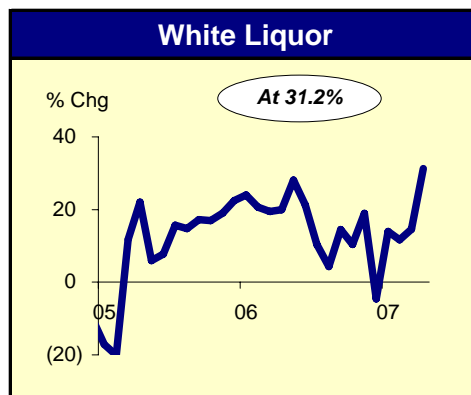
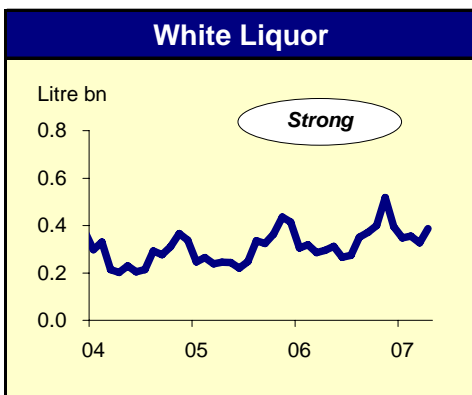
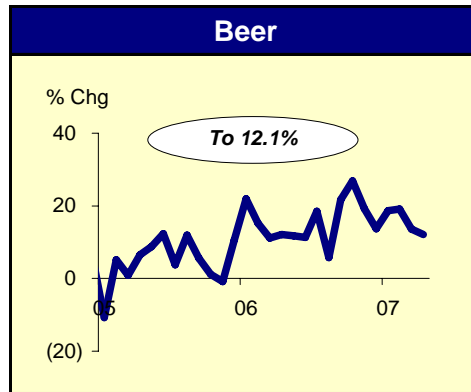
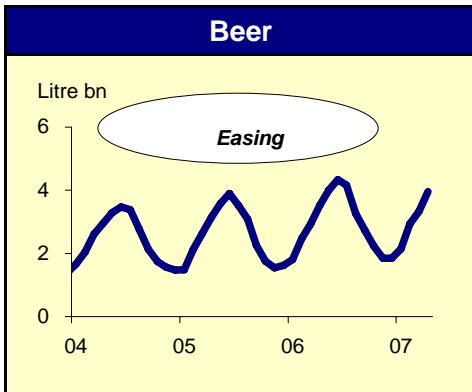
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**PRODUCTION**



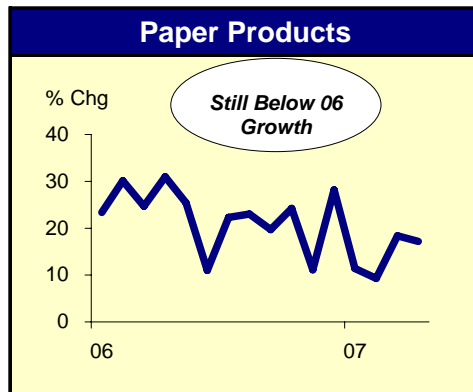
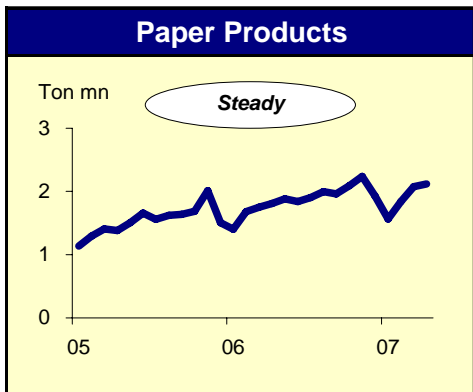
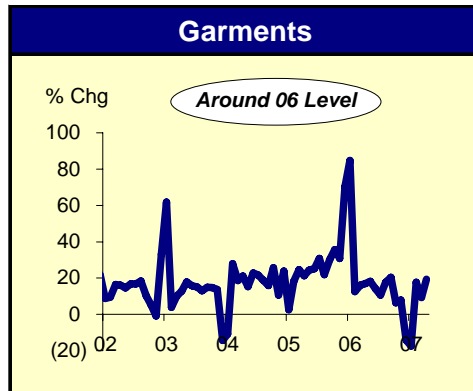
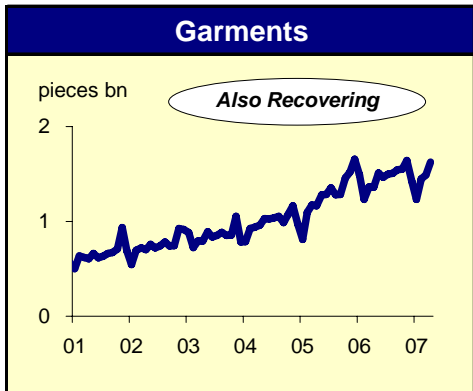
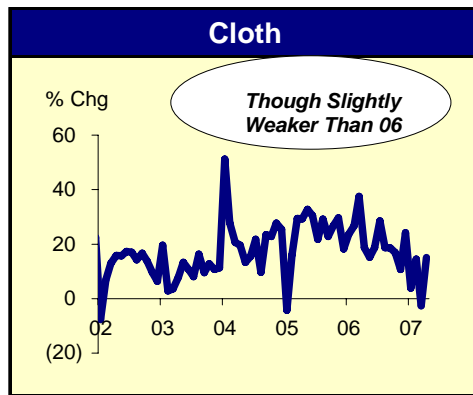
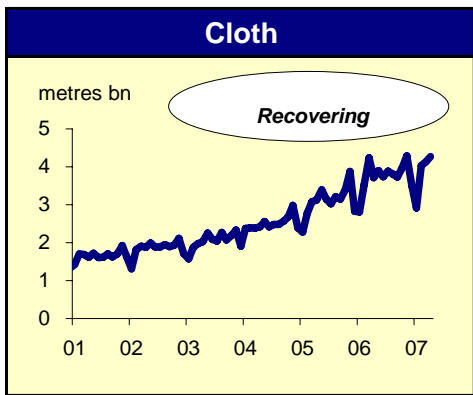
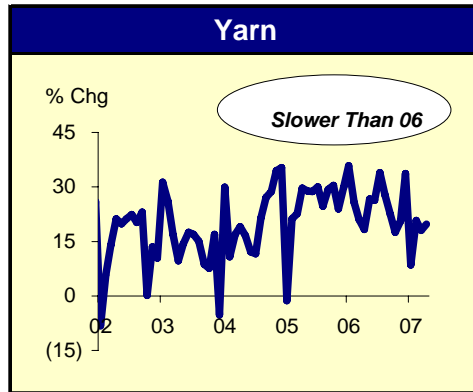
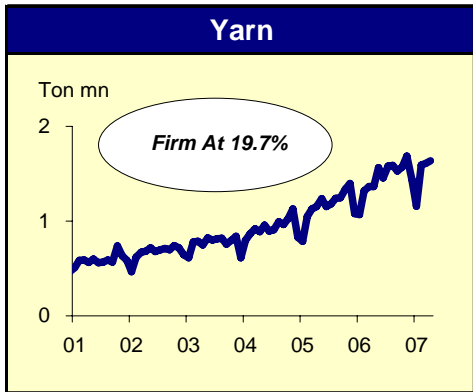
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**PRODUCTION**



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# PRODUCTION



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