

China Economics**Growth is stabilising, while inflationary threat continues**

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- China's headline GDP growth has reached 9.6%. On an annualised QoQ basis, our calculation suggests that growth has accelerated to 8.9% from 7.3% in the previous quarter.
- The better-than-expected growth figure was supported by retail sales (up 18.8% YoY) and a widening trade surplus. Fixed asset investment grew 22.8% YoY in September. Industrial production grew 13.3% YoY in the month, and was up 0.9% MoM, s.a.
- CPI inflation, which is the focus of the market, was at 3.6% YoY and 0.6% MoM. Food prices remain the biggest driver of inflation, up 8% YoY in September. Housing and healthcare are the other two drivers.
- The Chinese economy seems to be showing signs of bottoming out, though the upward momentum is still very mild. We do not expect any policy changes based on this set of data.

The Chinese economy seems to be showing signs of bottoming out, though upward momentum is still very mild. Our judgment on stabilisation is based on an improved property outlook (though policy uncertainty remains large) and largely completed inventory correction. Fixed asset investments may pick up soon, as new infrastructure investment starts. However, export growth is likely to soften to single-digit level next year and the housing sector may face greater policy uncertainties next year.

No policy changes ...

We do not expect any policy changes based on this set of data. High inflation is clearly a cause for concern. In fact, the People's Bank of China raised interest rates two days ago in an effort to narrow the negative real interest rates. A stabilising growth momentum would give more leeway to Beijing to normalise monetary conditions, but we believe the process will be managed slowly. We look for another rate hike and one more reserve requirement ratio hike by end of 1Q11. Bank lending is expected to remain tight for the remainder of this year, but new credit expansion may start from first day next year as the 12th Five-Year Plan kicks in.

Figure 1: Summary of 3Q10 economic data release

(% YoY)	4Q09	1Q10	2Q10	3Q10	Jul-10	Aug-10	Sep-10
GDP	10.7	11.9	10.3	9.6	-	-	-
Gross fixed investment	23.3	25.6	24.7	22.4	-	-	-
Urban fixed investment	24.2	26.4	25.1	23.1	22.2	24.2	22.8
Real private consumption	-	-	-	-	-	-	-
Nominal retail sales	16.5	18.0	18.5	18.4	17.9	18.4	18.8
Industrial production	18.0	20.0	15.9	13.5	13.4	13.9	13.3
CPI	0.5	2.2	2.9	3.5	3.3	3.5	3.6
Exports	0.2	28.7	41.0	32.2	38.0	34.4	25.1
Imports	22.6	64.7	44.1	27.4	22.7	35.2	24.1
Trade balance (US\$ bn)	60.6	14.5	41.2	65.6	28.7	20.0	16.9
Actual FDI (US\$ bn)	26.3	23.4	28.0	N.A.	6.9	7.6	N.A.

Source: National Bureau of Statistics, Credit Suisse

Growth is stabilising...

China's headline GDP growth reached 9.6%, versus 9.5% for consensus and 10.3% for 2Q10, while on an annualised QoQ basis, our calculation suggests that growth has accelerated to 8.9% from 7.3% in the previous quarter. The better-than-expected growth figure was supported by retail sales (up 18.8% YoY) and a widening trade surplus. Fixed asset investment grew by 22.8% YoY in September, moderating from the 24.2% YoY reported in August, though improving from the 22.2% YoY seen in July. Industrial production grew 13.3% YoY for September, versus 13.9% in the previous month, and was up 0.9% MoM, s.a. (+1.4% MoM, s.a. in August). Anecdotally, there are signs that inventory correction in many sectors have stabilised. However, the impact of power supply curb by the local governments to meet the energy saving target may be a swing factor for production over the next few months.

Inflation remains a threat ...

CPI inflation, which is the focus of the market, was at 3.6% YoY and 0.6% MoM, in line with market expectation and slightly below our 3.7% projection. Food prices remain the biggest driver of inflation, up 8% YoY in September, further accelerating from the 7.5% YoY in August. Housing is the second major factor, up 4.3% YoY. Healthcare was up by 3.4% while inflation in most of other sectors is non-existent.

Signs of economy bottoming?

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