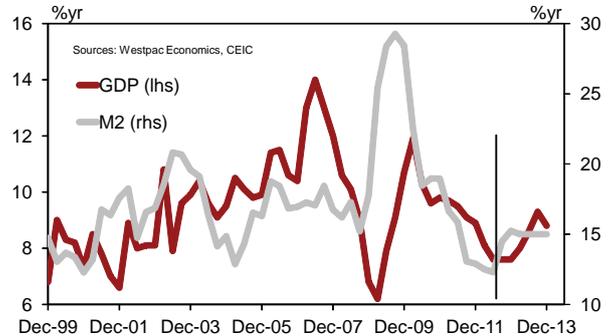


13 July 2012

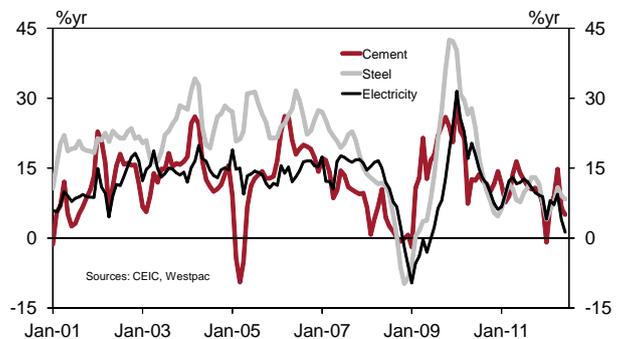
a weekly chronicle of the Chinese economy

- The economy reportedly expanded by 7.6%yr in the June quarter versus 8.1% in March and 9.3% over 2011. The NBS puts the quarterly pace at a modest 1.8%, up a little from a downwardly revised 1.6% in Q1. **Phat Dragon** estimates that nominal activity expanded just 9.6%yr, down from 11.2%, with the implied deflator decelerating to 2.0% from 3.1% (cf CPI and PPI at 2.2%yr and -2.0% respectively in June). Besides the crisis period, it is exactly ten years since nominal GDP last recorded growth in the single digit range. Along with the majority of the enlightened commentariat, **Phat Dragon** thinks that the first half of 2012 was the bottom of the cycle for domestic demand. The partial data for the month of June, some of which become available today, some earlier in the week, is consistent with that position.
- Nominal fixed investment consolidated in June, ending the quarter up 20.4%ytd, up a touch from May. In Q2 real fixed investment was up 0.2ppt in ytd terms, with the 0.5ppt slowing in the nominal growth rate more than fully explained by further weakness in the deflator (now just 1.6%yr, a 4ppt decline in six months). At this time a year ago (i.e. following the release of 2011Q2 GDP), **Phat Dragon** wrote that “Information on project starts has been volatile, presumably reflecting the interplay of still strong housing activity and the weaker infrastructure pipeline.” This year, the same words just need to be re-arranged a little: “... reflecting the interplay of **weakening** housing activity and the **newly replenished** infrastructure pipeline.”
- Industrial value added grew 10.5% over the half. The month of June saw a negative surprise relative to consensus expectations of a modest improvement to 9.8%, with headline growth decelerating to 9.5%yr from 9.6% in May. Core IVA (4.5%yr, 5.3%yr for the June quarter) continues to come in substantially below the headline growth rate, with oil, cement, non-ferrous metals, ethylene and electricity production all plodding along in the low to mid single digits. Steel is a little better, but not that much.
- Real household consumption was up marginally, from 8.6%yr to 8.7%yr, registering a second consecutive quarter of growth outperformance relative to GDP. **Phat Dragon** joins the administration in crossing his talons in the hope that we get another decade or so of this sort of relativity: GDP around 7½% and consumption about 1ppt higher. Partial indicators of consumption for the month of June were mixed. Nominal retail sales slowed a little to 13.7%yr (14.4% in the half year), real retail improved from 10.8%yr to 11.5% (noting that the annual CPI rate shed 0.8ppts in June) while auto sales fell to 1.578 million units from an average of 1.690 million in the preceding three months. That final comparison is much better than it looks on the surface. Seasonally adjusted, **Phat Dragon** puts the annualised sales rate above 20 million, and the smoothed growth rate back in double digits (from 7% to 10%). Recall that the government re-instituted a green vehicle subsidy as part of its efforts to support growth.
- FX reserves fell by \$US65bn in Q2, with May seeing a substantial rundown. In that month reserve changes not accounted for by trade or FDI was -\$US120bn: the largest such outflow on record. Valuation effects would have weighed on the outcome to a degree, but the major force was weak investor sentiment. **Phat Dragon** has noted many times that weak FX inflows have been a headwind for deposit growth in the banking system in the year to date. Overall deposits are expanding at a 12% annual

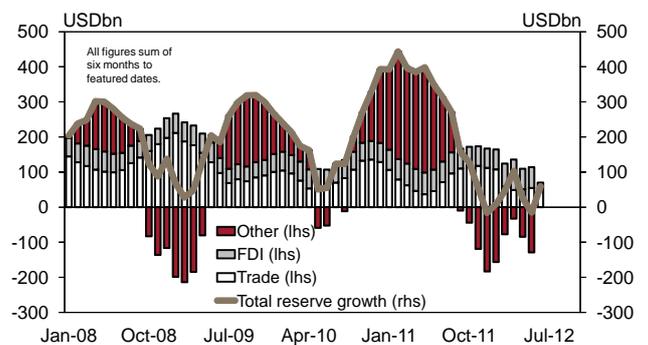
### Chinese GDP & the money supply



### Aggregate activity proxies: volume



### Contributions to FX reserve growth



clip, with enterprise deposits the weak link. Household savers are not chasing capital gains at present (surveys indicate they have a strong preference for safety right now) and are growing their deposit assets accordingly. Urban disposable income rose by 9.7%yr in June while savings deposits are up 17%yr. **Phat Dragon** is being just a little irresponsible putting those figures next to each other like that - the savings deposit number is solid but the estimates extracted from the household survey are known to be rubbery. Alternatives estimates of the financial means of the highest income cohorts three times higher than the official data.

- **Stats of the week: China's divorce rate is 0.79/1000 people. The US' is 4.95, Aust 2.52, Russia 3.36 & Italy 0.27.**



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