



Demand gradually slowing, inflation to mitigate

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Relatively stable retail sales. China's retail sales registered growth of 17.2% YoY (all on a year-on-year basis unless specified otherwise) in October, down from the increases of 17.7% in September and 17% in August. Deducting the price factor, however, real-term growth of retail sales remained steady at 11.3% in October compared to 11% in September. Due to the ongoing tightening policies, most durables have seen growth slowdowns over the past few months. Household electric & video appliance sales increased 15.3%, construction & decoration materials rose 26.1%, and auto sales climbed 12.6% in terms of sales value in October, coming down from the growth of 19.5%, 26.5% and 18.7% in September. Furniture sales increased 33.3% in October after rising 33.6% in September, while the sales growth of petroleum & related products decelerated from 38.7% to 34.2%. Communication devices maintained relatively steady growth of 24.5% in October after climbing 24.8% in September, partially supported by consumption upgrades. Most basic consumer goods maintained relatively stable increases but some growth rates mitigated due to MoM price declines. Food, beverage and tobacco grew 22.7% and daily-used goods rose 20.4%, versus the increases of 24.4% and 22% in September. Although loan tightening and the correction in property sales may continue to have a negative effect on related durable sales, the consecutive employment expansion and significant increase in wages will provide strong support on basic consumer goods. Looking ahead, we expect the retail sales will maintain growth above 16% in next few months.

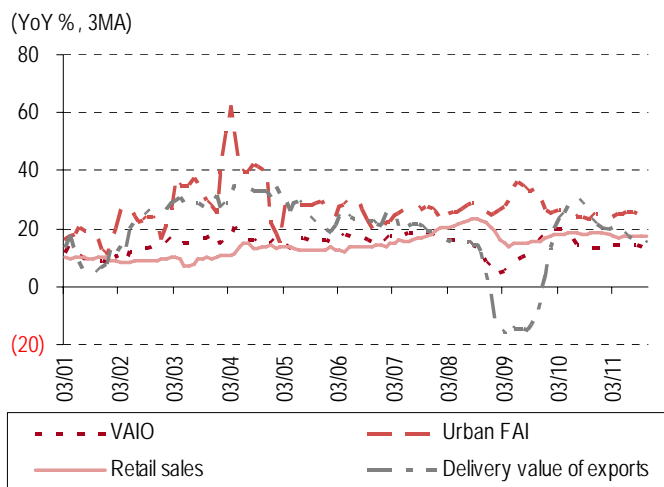
Slowdown in VAIO. China's value-added industrial output (VAIO) climbed 13.2% in October, down from 13.8% in September and 13.5% in August. The VAIO in light industries and heavy industries respectively grew 12.1% and 13.7%, compared to the increases of 12.8% and 14.3% in September. The deceleration of VAIO growth, in line with our expectation, was mainly due to the consecutive mitigation of demand as well as constraints from energy and labour supply. In September, the VAIO of smelting & pressing of ferrous metals grew 10.7%, and that of raw chemical materials & chemical products increased 13.1%, down significantly from the rises of 13.6% and 14.8% in September. The VAIO in transportation equipment, electric equipment and communication & electronic equipment also experienced some growth slowdown, from 12.2%, 13.3% and 17.7% in September to 11.3%, 10.8% and 15.6%, respectively, in October. In October, cement production continued to post steady growth of 16.5% after rising 15.7% a month earlier, while the growth of production in steel and electricity respectively came down from 18.8% and 11.5% to 13.4% and 9.3%. As export growth has slowed in recent months, output growth in textiles also mitigated from 8.3% in September to 8.1% in October. Going forward, we expect the output in both light industries and heavy industries to follow a mitigation trend thanks to the consecutive slowdowns in exports and property-related industries.

Still-high FAI growth. In 10M11, China's non-farm fixed asset investment (NFFAI) increased 24.9%, the same as in 9M11. The FAI growth was a bit higher than expectation as the market expected it to decelerate due to the slowdown in infrastructure construction as well as consecutive tightening in property sector. In fact, property investment growth remained high at 31.1% in 10M11 despite some mitigation compared to previous months. The FAI in some infrastructure industries maintained a deceleration trend thanks to the ongoing curbs on the financing of local-government-related vehicles and the significant cooling of the land market. The NFFAI in railway transportation declined 21.9% in 10M11 after dropping 19% in 9M11, while investment in electricity & heating power rose only 3.3% after increasing 3.4% in 9M11. FAI growth in most manufacturing industries remained high or even accelerated. The investment in ordinary equipment grew 30.5%, that in non-metal mineral products rose 29.6%, and that in electric equipment increased 48.2% in 10M11, compared to the corresponding growth of 30.5%, 28.2% and 50% in 9M11. Looking ahead, property and manufacturing investment is likely to post relatively high growth despite some mitigation, while investment in railway and other transportation services may show a declining trend in the next few months. We maintain our forecast for the full-year NFFAI growth at 21-22% in 2011.

Gradual mitigation in inflation. China's Consumer Price Index (CPI) rose 5.5% YoY (all on a year-on-year basis unless otherwise specified) in October, after rising 6.1% in September and 6.2% in August, according to the National Bureau of Statistics (NBS). The CPI growth was basically in line with the market expectation and marked the third consecutive month of slowing. The CPI registered a MoM rise of 0.1%, with food items down 0.2% and non-food items up 0.2% in October. The 0.2% MoM decline in the food price was mainly contributed by the price drops for pork, eggs and aquatic products. The prices of these three items decreased 1.8%, 3.8% and 1.5%, respectively, in October. Most other food prices maintained MoM increases but with slower growth rates. Due to the slowdown of the global economy as well as the significant correction of global commodity prices in recent months, both the Producer Ex-factory Price Index (PEFPI) and Producer Purchasing Price Index (PPPI) saw a significant MoM decline of 0.7% in October, extending the months-long slide. The YoY growth of the PEFPI and PPPI respectively plummeted from 6.5% and 10% in September to 5% and 8% in October. CPI growth is expected to mitigate to about 4.4-4.8% while PEFPI growth might decline to below 4% in November and December.

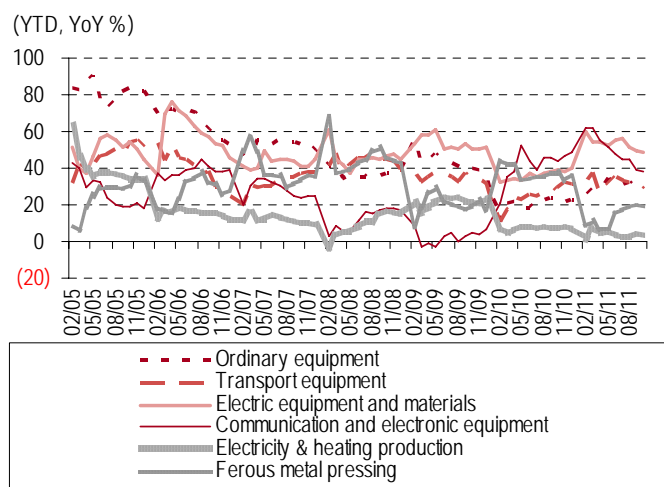
Increase in policy flexibility with gradual changes in policy operations. The October figures indicate that the mitigation of final demand and industrial production is still occurring in a mild and gradual fashion. Meanwhile, inflation figures have started to see more significant softening, with corrections in most commodities and food prices. Looking forward, the global economy is likely to see weak growth in the short term, while the negative impact of property tightening may further emerge after December. Meanwhile, inflation is expected to gradually slow in the next six months. Against this backdrop, authorities will improve policy flexibility while adjusting policy operations according to the dynamic changes of the economic situation. We expect the government to launch more preferential policies to support agriculture, small and medium enterprises (SMEs) and livelihood projects in the future.

Figure 1. Demand-side Growth



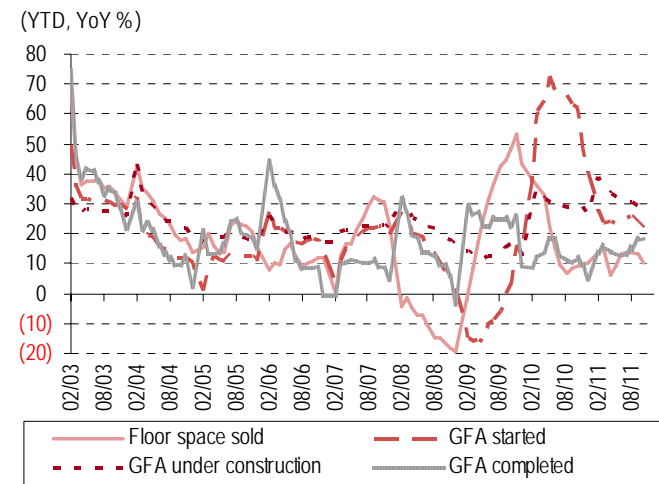
Source: NBS, BOCI Research

Figure 2. FAI in Key Industries



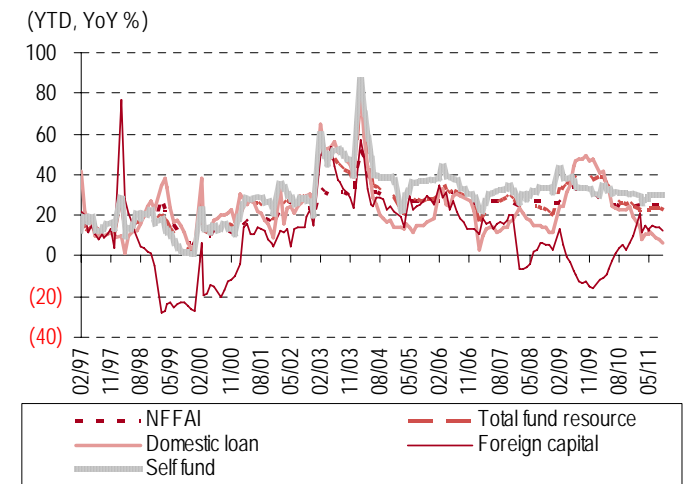
Source: NBS, BOCI Research

Figure 3. Property Indicators



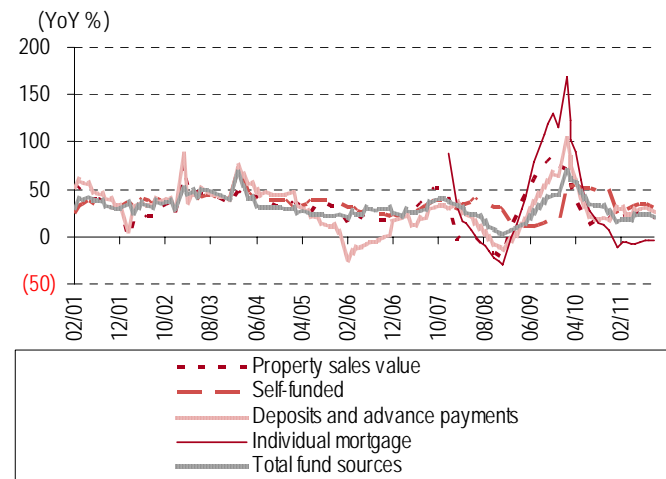
Source: NBS, BOCI Research

Figure 4. Funding Source for FAI



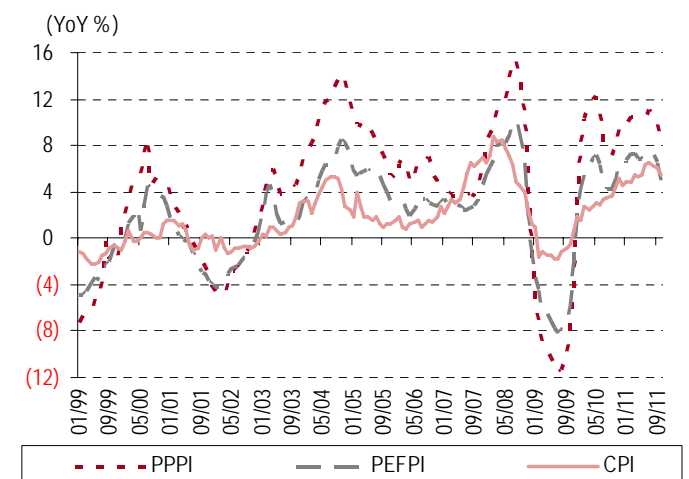
Source: NBS, BOCI Research

Figure 5. Funding Source for Property Investment



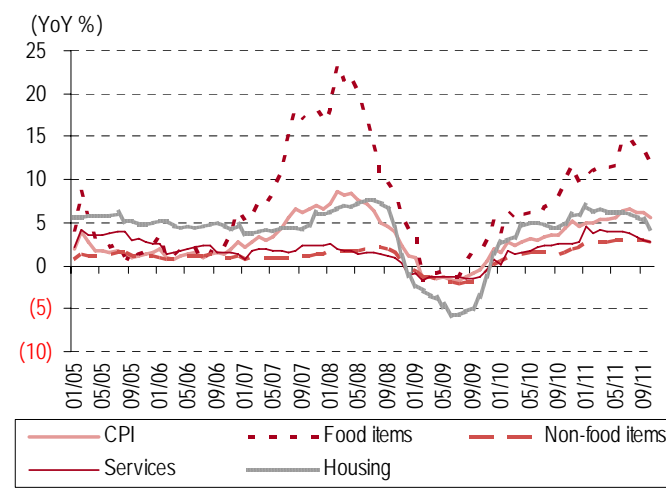
Source: NBS, BOCI Research

Figure 6. China Inflation



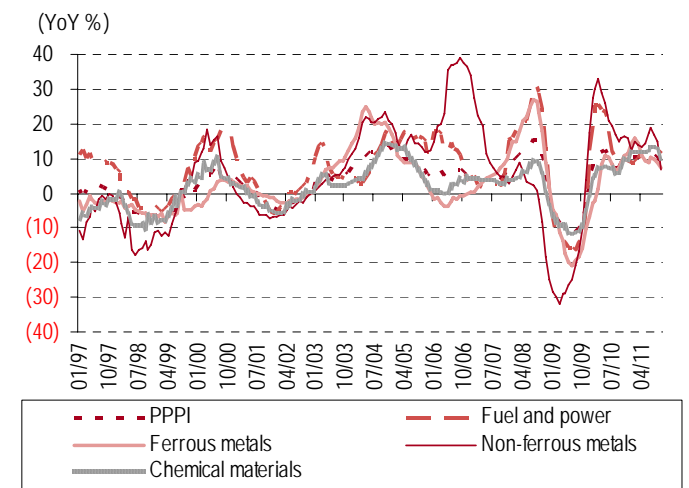
Source: NBS, BOCI Research

Figure 7. Growth of CPI



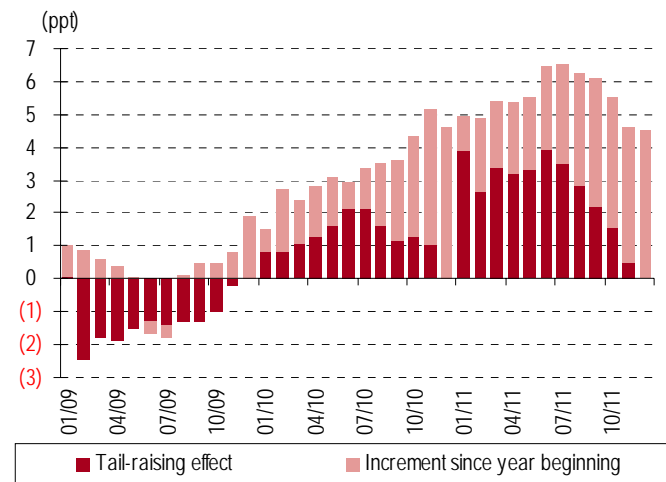
Source: NBS, BOCI Research

Figure 8. Growth of PEFPI



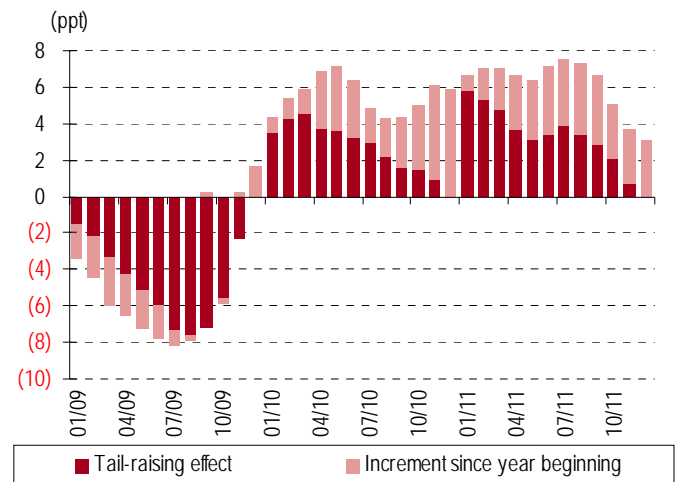
Source: NBS, BOCI Research

Figure 9. CPI Growth Forecasts



Source: NBS, BOCI Research

Figure 10. PEFPI Growth Forecasts



Source: NBS, BOCI Research

Figure 11. China Economic Indicators

(YoY %)	2010							2011								
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
VAIO	13.7	13.4	13.9	13.3	13.1	13.3	13.5	14.1	14.8	13.4	13.3	15.1	14.0	13.5	13.8	13.2
- Light industry	12.0	13.5	13.1	13.0	12.9	12.7	13.0	13.3	12.8	11.9	12.9	13.9	12.8	13.4	12.8	12.1
- Heavy industry	14.5	13.3	14.2	13.4	13.2	13.6	13.7	14.4	15.6	14.0	13.5	15.6	14.5	13.5	14.3	13.7
Delivery value of exports	31.4	27.9	26.7	21.5	21.6	20.8	18.3	20.2	21.1	20.1	14.9	16.3	16.6	17.2	13.9	13.6
Urban FAI (YTD)	25.5	24.9	24.8	24.5	24.4	24.9	24.5	24.9	25.0	25.4	25.8	25.6	25.4	25.0	24.9	24.9
- Primary	17.8	18.9	18.6	17.7	17.2	16.6	18.2	6.9	10.8	12.6	15.6	20.6	22.8	23.0	25.5	28.2
- Secondary	22.3	22.1	22.2	22.0	22.3	22.7	23.2	24.7	24.8	24.6	26.3	27.1	26.7	27.0	26.9	26.9
- Tertiary	28.4	27.4	27.0	26.7	26.4	26.9	25.6	25.6	25.6	26.5	25.9	24.7	24.5	23.6	23.4	23.3
- Property	38.1	37.2	36.7	36.4	36.5	36.5	33.2	35.2	34.1	34.3	34.6	32.9	33.6	33.2	32.0	31.1
Retail sales	18.3	17.9	18.4	18.8	18.6	18.7	19.1	15.8	17.4	17.1	16.9	17.7	17.2	17.0	17.7	17.2
- City	18.7	18.2	18.8	19.1	18.6	19.0	19.5	15.9	17.5	17.3	17.0	17.8	17.3	17.1	17.8	17.2
- Under city level	15.9	16.1	15.9	17.0	18.9	17.0	17.0	15.4	16.7	16.3	16.5	16.8	16.4	16.4	17.3	17.4
CPI	2.9	3.3	3.5	3.6	4.4	5.1	4.6	4.9	5.4	5.3	5.5	6.4	6.5	6.2	6.1	5.5
PEFPI	6.4	4.8	4.3	4.3	5.0	6.1	5.9	7.2	7.3	6.8	6.8	7.1	7.5	7.3	6.5	5.0
PPPI	10.8	8.5	7.5	7.1	8.1	9.7	9.5	10.4	10.5	10.4	10.2	10.5	11.0	10.6	10.0	8.0

Source: NBS, BOCI Research

Figure 12. VAIO of Main Industries

YoY (%)	2010							2011								
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan-Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Overall VAIO	13.7	13.4	13.9	13.3	13.1	13.3	13.5	14.1	14.8	13.4	13.3	15.1	14.0	13.5	13.8	13.2
Textile industry	9.9	11.1	11.6	11.5	10.5	8.9	7.8	7.7	6.6	5.9	7.0	8.2	8.6	7.6	8.3	8.1
Raw chemical materials & chemical products	13.9	13.7	12.9	12.5	13.3	11.0	10.5	15.3	14.7	13.9	13.0	15.8	14.9	13.9	14.8	13.1
Non-metal mineral products	18.1	18.5	18.8	16.7	17.0	18.0	19.3	17.8	20.2	18.1	18.5	19.8	18.8	17.6	18.0	17.0
Smelting & pressing of ferrous metals	8.8	6.0	8.1	20.2	4.6	4.9	5.9	8.6	9.3	8.5	9.0	12.8	10.9	10.2	13.6	10.7
Ordinary equipment	19.7	21.0	20.1	14.4	18.8	19.0	23.9	22.4	20.3	19.9	18.9	18.5	15.8	15.7	14.7	15.8
Transportation equipment	19.0	15.9	16.6	18.2	16.4	18.1	16.6	14.4	13.7	9.7	7.8	10.7	11.2	12.4	12.2	11.3
Electric equipment & material	18.3	18.9	18.3	11.6	16.3	17.4	16.4	17.7	17.3	14.3	14.2	16.2	12.9	13.4	13.3	10.8
Communication & electronic equipment	15.1	13.8	14.9	8.6	13.3	14.0	12.2	14.3	16.1	14.6	11.4	15.6	15.0	16.9	17.7	15.6
Production & supply of electricity & heat power	11.1	10.4	11.6	5.8	6.8	7.1	5.9	13.0	13.5	11.7	10.9	11.3	10.5	7.7	8.9	8.0
Production:																
-Steel products	15.9	9.7	11.5	4.5	4.1	4.6	3.5	14.5	13.7	8.3	10.6	14.8	14.9	12.9	18.8	13.4
-Cement	14.6	16.6	12.8	10.3	10.5	17.3	16.4	9.1	29.8	22.4	19.2	19.9	16.8	12.8	15.7	16.5
-Autos	18.4	17.1	13.1	17.8	23.0	27.6	23.9	10.3	9.9	(1.6)	(1.9)	3.6	(1.3)	9.5	2.5	1.3
-Electricity	11.4	11.5	12.6	8.1	5.9	5.6	5.1	11.7	14.8	11.7	12.1	16.2	13.2	10.0	11.5	9.3

Source: NBS, BOCI Research

Figure 13. Retail Sales

YoY %	2010							2011									
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan-Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	
Total	18.3	17.9	18.4	18.8	18.6	18.7	19.1	15.8	17.4	17.1	16.9	17.7	17.2	17.0	17.7	17.2	
City	18.7	18.2	18.8	19.1	18.9	19.0	19.5	15.9	17.5	17.3	17.0	17.8	17.3	17.1	17.8	17.2	
County and under-county level	15.9	16.1	15.9	17.0	16.8	17.0	17.0	15.4	16.7	16.3	16.5	16.8	16.4	16.4	17.3	17.4	
Above designated size enterprises	28.3	26.0	28.1	29.3	29.6	30.7	33.0	18.5	25.3	23.8	23.0	25.8	23.6	22.5	25.1	21.5	
Food, beverage and tobacco	25.4	22.7	25.5	31.9	27.3	31.8	32.1	22.9	21.8	23.1	24.2	27.9	26.6	24.0	24.4	22.7	
Clothing and textile products	26.6	24.4	22.1	26.7	32.6	20.4	27.3	22.2	21.9	26.8	21.8	24.6	24.1	21.9	27.6	19.5	
Cosmetics	16.8	16.9	17.7	16.7	15.4	15.0	21.3	16.1	21.2	23.3	20.3	19.8	19.5	14.8	19.5	15.5	
Gold, silver and jewellery	56.2	44.2	36.2	54.9	45.6	67.0	47.7	51.4	52.4	54.3	43.0	42.2	45.0	44.4	38.5	32.3	
Daily-use goods	23.3	24.1	22.6	28.9	26.0	23.6	27.4	24.1	19.8	24.2	22.8	26.3	22.5	26.9	22	20.4	
Sport & recreational goods	28.3	14.6	11.9	24.9	20.6	20.9	36.0	21.6	13.0	13.5	10.5	14.3	10.4	8.2	1.3	9.8	
Household electric & video appliances	23.4	25.6	25.6	28.5	22.6	22.6	34.9	17.9	26.0	27.6	15.4	22.9	18.9	14.8	19.5	15.3	
Chinese and western medicine	23.0	21.6	21.3	20.6	23.9	31.3	24.3	21.2	18.6	17.4	17.8	18.7	17.2	22.0	18	24.6	
Cultural & office goods	29.8	22.7	24.8	31.3	24.4	25.9	23.6	20.7	18.5	14.6	19.8	25.9	27.1	26.2	35.3	35.7	
Furniture	40.9	35.9	40.4	39.6	35.8	33.6	34.5	20.4	31.9	30.6	26.1	35.8	33.1	29.5	33.6	33.3	
Communication devices	15.5	11.2	21.9	14.8	23.3	26.8	49.4	23.2	21.3	29.5	24.8	36.0	33.6	27.8	24.8	24.5	
Petroleum & related products	33.7	29.1	26.6	29.3	31.0	34.4	32.7	33.7	43.8	39.7	42.3	39.5	40.6	38.4	38.7	34.2	
Construction & decoration materials	34.0	28.2	28.3	39.0	30.1	33.5	37.8	20.8	33.0	22.9	23.9	35.8	32.4	25.4	26.5	26.1	
Autos	28.3	27.6	35.2	29.7	32.2	33.6	37.2	10.9	18.7	13.2	13.6	16.9	11.9	12.4	18.7	12.6	

Source: NBS, BOCI Research

Figure 14. Consumer Price Index (CPI)

YoY (%)	2010							2011									
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
CPI	2.9	3.3	3.5	3.6	4.4	5.1	4.6	4.9	4.9	5.4	5.3	5.5	6.4	6.5	6.2	6.1	5.5
Non-food	1.6	1.6	1.5	1.4	1.6	1.9	2.1	2.6	2.3	2.7	2.7	2.9	3.0	2.9	3.0	2.9	2.7
Services	2.1	2.3	2.4	2.5	2.5	2.6	2.8	4.6	3.8	4.2	3.9	3.9	4.0	3.7	3.4	3.0	2.8
Food	5.7	6.8	7.5	8.0	10.1	11.7	9.6	10.3	11.0	11.7	11.5	11.7	14.4	14.8	13.4	13.4	11.9
Tobacco, liquor & related articles	1.7	1.6	1.5	1.4	1.5	1.6	1.8	1.8	1.9	2.1	2.4	2.6	2.7	2.8	2.9	3.4	3.7
Clothing	(1.0)	(0.8)	(1.2)	(1.5)	(1.3)	(0.7)	0.1	(0.2)	0.4	0.8	1.4	1.8	2.1	2.2	2.9	3.2	3.7
Household facility & maintenance services	0.0	0.2	0.4	0.4	0.5	0.7	1.2	1.4	1.4	1.9	2.1	2.5	2.5	2.7	2.8	3.0	3.1
Medicine & personal care	3.2	3.3	3.3	3.4	3.7	4.0	4.0	3.2	3.0	3.2	3.2	3.2	3.4	3.6	4.1	4.1	3.5
Transportation and communication	(0.3)	(0.7)	(0.6)	(0.7)	(0.5)	(0.7)	(0.7)	(0.1)	(0.3)	0.1	0.5	0.7	0.9	0.9	1.0	1.0	0.8
Recreational, educational and cultural articles & services	0.9	1.1	1.2	1.2	0.9	0.6	0.7	1.0	0.3	0.5	0.5	0.6	0.6	0.5	0.4	0.0	0.0
Housing	5.0	4.8	4.4	4.3	4.9	5.8	6.0	6.8	6.1	6.6	6.1	6.1	6.2	5.9	5.5	5.1	4.4

Source: NBS, BOCI Research

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