

Greater China Data Watch 0326

China: officials hinted merchandise trade slipped into deficit in March; even if true, deficit unlikely to last

Hong Kong: February CPI picked up, rising 2.8%oya, mainly on Lunar New Year effect

Taiwan: central bank keeps policy rates unchanged; policy normalization begins on quantity front
Strong momentum in IP carried through February; broad-based improvement in labor market

Further complicating the CNY policy debate among Chinese and US officials, this week both the Commerce Minister and the Premier commented that China's merchandise trade balance might have moved into deficit in March (see research note "China: CNY to resume a gradual appreciation trend" in this *GDW*). In our view, if this is the case, the deficit will likely be only temporary; it may reflect some payback for the significant surge in exports since December, while the total value of imports may have been boosted by price effects. The structural factors that led to China's surplus remain intact. Indeed, the expected steady global economic recovery through the course of this year should provide firm support to China's export sector. Meanwhile, as we expect China's fixed investment growth to moderate this year (see "China: investment to moderate, but still grow at a solid pace," *GDW*, January 29), the pace of growth in imports of raw materials/commodities is likely to ease somewhat in coming quarters.

Hong Kong: Lunar New Year effect on CPI

Hong Kong's February headline CPI rose 2.8%oya, compared to a 1.0% rise in January. Netting out the effects of all government one-off relief measures, the underlying inflation rate picked up to 1.6%oya in February, from 0.0%oya in January, translating into a rise of 0.9% m/m sa. The spike in February headline CPI was driven by the Lunar New Year effect, with surges in the prices of package tours, fresh vegetables, and poultry. As the impact of various government relief measures gradually fades, and as the economic recovery picks up momentum, Hong Kong's underlying CPI inflation is likely to continue a gradual uptrend in 2010.

In the details, February food prices rose 2.5%oya, compared to the 0.5%oya fall in January, partly reflecting the impact of the Lunar New Year holidays. Prices for miscellaneous services, including package tours, rose a notable 2.7%oya in February, in sharp contrast to the 2.0%oya fall in January, similarly reflecting the Lunar New Year effect. Housing prices fell a modest 0.2%oya in February, compared to 0.0%oya in January. For manufactured goods, %oya deflation in durable goods eased modestly in February, with prices falling 1.4%oya.

Taiwan: policy rates on hold as expected

At this week's monetary policy meeting, the Taiwan central bank left its major policy rates unchanged, in line with J.P. Morgan and consensus expectations. The discount rate, which is the key policy rate in Taiwan, was maintained at the record low of 1.25%.

On growth, the central bank highlighted the steady recovery of the global economy, but stressed that its sustainability remains uncertain, especially given the prevalent high unemployment rates and fiscal problems in various economies. The bank recognized that major economic indicators in Taiwan, especially for exports and IP, have recovered significantly, with solid expansion in manufacturers' capex investment. Meanwhile, as the unemployment rate remains high (5.65% sa in February) and wage growth is still modest, the recovery in private consumption has been moderate.

On the inflation front, the central bank noted that while the January-February average CPI rose 1.3%oya, the rise in headline CPI was largely driven by the recovery in global commodity prices; core CPI remained tame, at -0.06%oya in the same period. The Directorate General of Budget, Accounting, and

Statistics (DGBAS) forecasts that headline CPI inflation will remain moderate to average 1.27% this year.

Overall, the central bank stated that with the steady recovery in the economy and the moderate inflation outlook, the previous quantitatively loose monetary policy has been adjusted (as reflected in the surge in central bank certificates of deposit, or CDs, issuance to withdraw excess liquidity), and the monetary policy stance is now returning to normal. Indeed, the bank noted M2 growth has moderated (5.25% oya in January-February, in the middle of the central bank's 2010 M2 growth target range of 2.5%-6.5%), and overnight interbank rates have turned up gradually.

With regard to the property market, the central bank stressed that it has implemented a series of "targeted prudential measures," especially on commercial banks' mortgage policy, since October last year. In addition, in quoting comments from the IMF and BIS that "central banks should take into consideration credit growth and asset prices in their monetary policy implementation," the Taiwan central bank stressed that, in addition to maintaining general consumer price stability, fostering financial stability has always been one of its major policy objectives.

Looking ahead, our forecast calls for the Taiwan economy to show a broad-based recovery, with real GDP rising 7.0% for full-year 2010 and average CPI inflation forecast at 1.9%. On the monetary policy outlook, in the near term, as the central bank highlighted, the focus will continue to be managing overall liquidity conditions through CD issuance (outstanding central bank CDs have risen notably by 44.1% since January last year). Indeed, while the central bank comments that it will continue to focus on issuing CDs, it also suggests that the operation would likely include increasing the issuance of longer-dated duration, in order to better manage liquidity conditions in the banking system.

Further ahead, with solid recovery in external demand continuing, we expect to see a more meaningful feed-through to Taiwan's domestic economy, with steady improvement in the labor market. In addition, as headline CPI inflation picks up steadily, real interest rates are gradually falling into negative territory. This could become a concern for the central bank, especially considering the potential impact of negative real interest rates on asset markets and hence on overall financial stability.

We now expect the central bank to begin raising policy rates, by 25bp, at its 3Q monetary policy meeting (previously we were looking for a smaller, 12.5bp hike to come later, in December).

Solid momentum in IP through February

Taiwan's IP expanded further in February, rising 35.2% oya, compared to the upwardly revised 70.1% oya growth in January. Seasonally adjusted, IP expanded 2.8% m/m in February, adding to the 1.8% m/m gain in January, with the sequential trend rising 41.3% 3m/3m saar. The continuous, impressive growth momentum in Taiwan's industrial activity in recent months has been consistent with the solid uptrend in global manufacturing, especially in the tech sector. In particular, IP for information and electronics again rose solidly at 4.6% m/m sa in February (up 71.9% 3m/3m saar). Meanwhile, non-tech IP rose at a more modest pace of 0.3% m/m sa in February (up 30.1% 3m/3m saar). Looking ahead, the steady broadening of the global recovery, the constructive outlook for global capex, and the promising outlook for the tech sector should all support solid growth in Taiwan's export sectors, and hence IP, in the coming months.

With regard to the inventory cycle, details through January show that the Taiwanese manufacturing sector's overall inventory and shipments conditions continued to improve. Total inventory fell 1.0% m/m sa in January, on the back of the 1.0% decline in December, with the sequential trend edging down 0.1% 3m/3m saar. With the inventory consolidation and as shipments continued to rise significantly, the overall inventory to shipments ratio had fallen markedly in recent months, to the lowest level in decades

(second chart). This suggests that as final global demand improves, the inventory cycle should shift to being a positive factor for headline GDP growth.

Broad-based improvement in labor market

Taiwan's unemployment rate edged down to 5.65% sa in February, compared to 5.73% in January. Total employment rose solidly at 0.23% m/m sa, adding to the 0.20% gain in January, with the sequential trend rising 3.0% 3m/3m saar. Total employment registered its seventh consecutive monthly increase in February, in line with the broad-based recovery in the overall economy. Taiwanese manufacturers, especially tech producers, are set to boost their capex plans notably and increase hiring through the course of this year, on the back of an improving outlook for external demand, especially given the constructive outlook for global capex (for example, equipment investment in the US is expected to expand at a solid 10%-12% annualized pace). On the domestic front, general confidence in the overall economic outlook has turned up notably, with steady improvement in the services sectors. As such, the labor market will likely continue to improve steadily, supporting private consumption demand in the coming quarters.

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