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China trade review

February 2009

Contents

1. Overview

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- China's customs trade surplus hit US$295bn in 2008, up 13% from 2007, and 9x from 2004.
- The trade surplus was 6.7% of GDP, down from 7.3% in 2007.
- Export growth has been decelerating since early 2007, thanks to high base effects and softening demand in the key US market.
- Exports took another sharp turn down in Q4 08, as trade finance dried up and Europe slid into recession.
- But the surplus continued to grow as imports fell even more sharply.

Latest developments (cont)

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- Global demand slowdown has hit Chinese exports across the board, but processing/assembly exports (which tap into US consumer demand) have been hit worst.
- Because it is often the low-cost producer, China can still pick up market share even in a downturn, so will fare better than its Asian neighbors.
- A concern is that Chinese imports from the rest of Asia are now falling – in effect China is extracting net demand from Asia.
- If investment-heavy stimulus takes off, China may return as a source of net demand for Asia, importing more raw materials and capital goods.

Export/import growth (USD)

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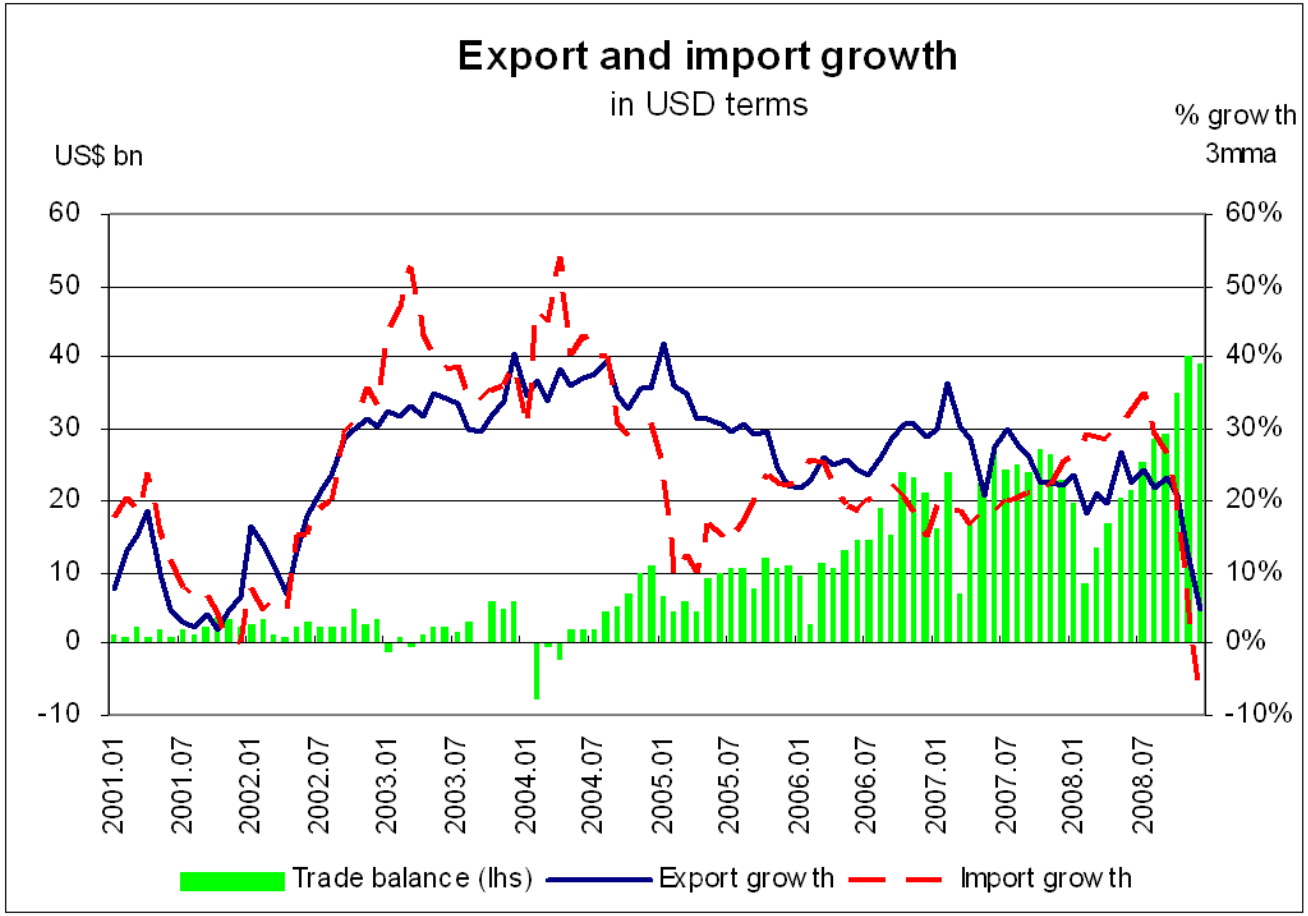

Trade surplus: peaked.

- Variability in trade surplus is explained more by shifts in import demand than by export growth, which is stabler. Import demand is mainly driven by investment.
- Export growth has trended down since Jan 07, and in Dec 08 was weakest since 2001 US recession.
- But imports declined more, resulting in bigger surplus.
- Surplus should shrink a bit in 09 as imports recover but exports stay weak.

2007-08 trade, US$ bn

	Ex	Im	Bal
2007Q4	340	264	76
2008Q1	306	265	41
Q2	361	303	58
Q3	408	325	83
Q4	355	240	115

Export/import growth (RMB)

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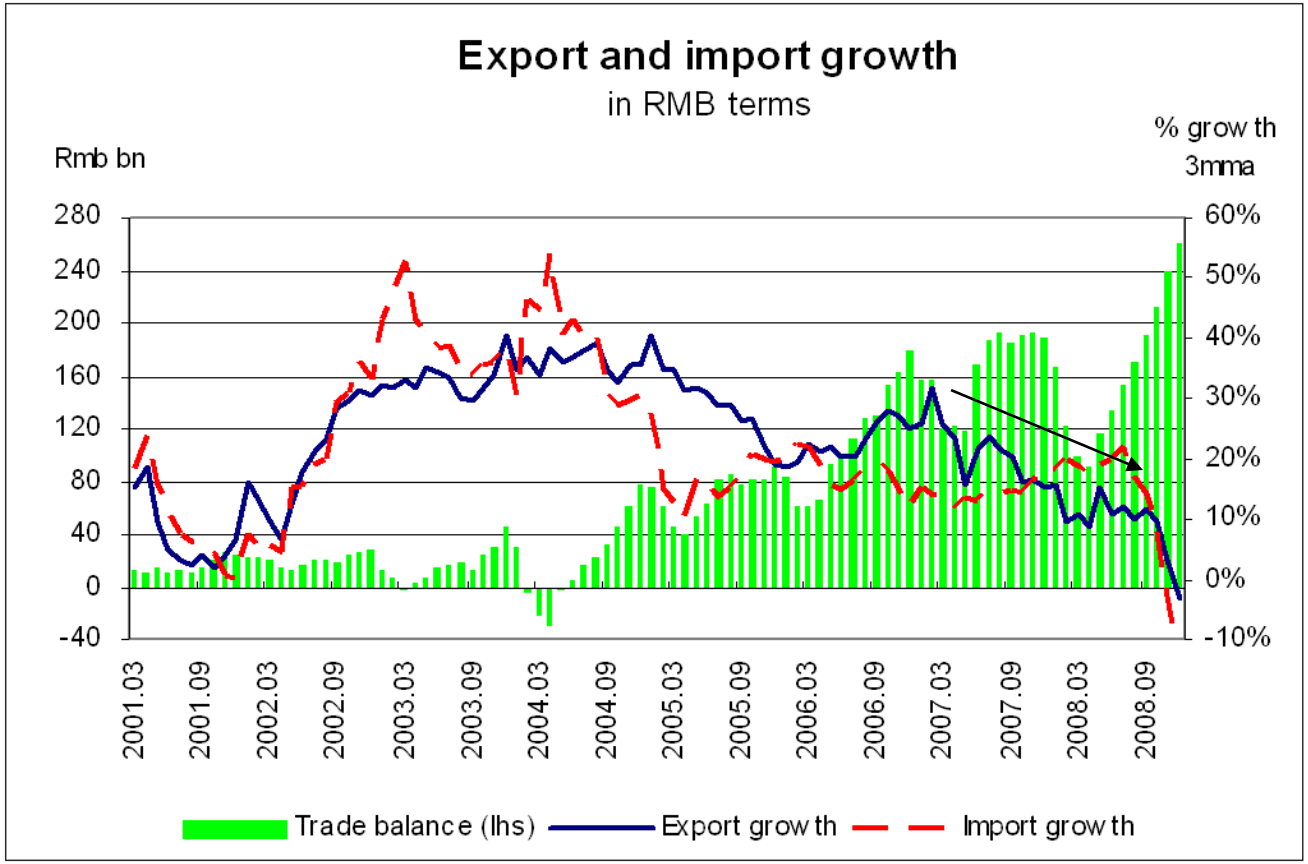

Rmb values give a better picture of trade trends.

- USD trade figures mask the impact of a rising Rmb since mid-2005.
- In Rmb terms, the long slowdown in export growth since early 2007 is more visible.
- USD figures also exaggerate the rate of surplus growth.
- In Rmb terms the Q4 08 surplus was up 39% yoy, vs 51% in USD terms

2007-08 trade, Rmb bn

	Ex	Im	Bal
2007Q4	2,510	1,948	562
2008Q1	2,173	1,878	295
Q2	2,498	2,096	402
Q3	2,790	2,220	570
Q4	2,423	1,642	781

Imports and investment

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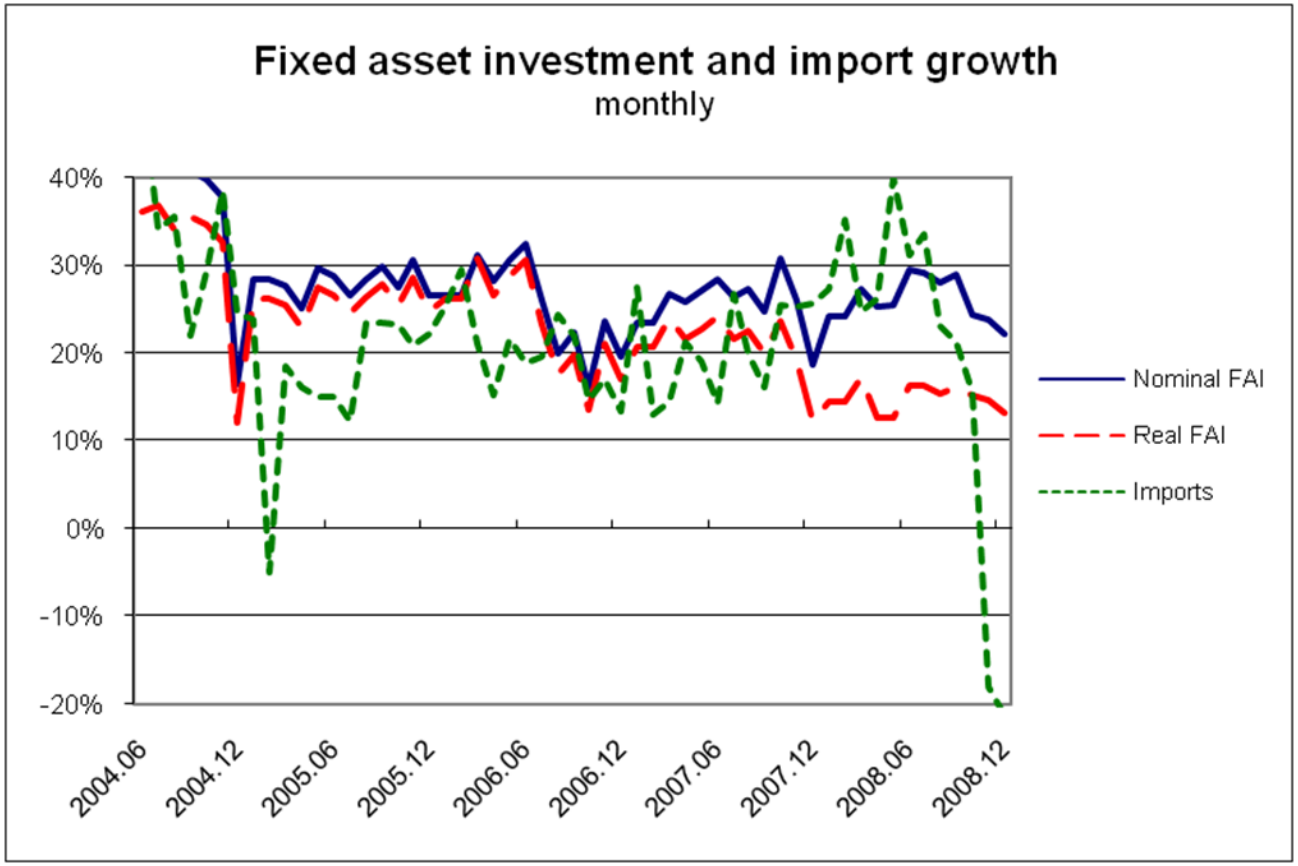

Import/FAI relation broke down in Q4 08.

- Generally imports correlate with growth in fixed asset investment (FAI), with a 3-mo lag.
- About three-quarters of imports relate to investment demand (capital goods and raw materials).
- The import collapse in Q4 08 far exceeded what could have been expected from the drop in FAI.
- One explanation: de-stocking of basic material inventories. This should end by Q2 09.
- Another: sharp rise in commodity prices (esp oil) in early 08 followed by collapse, which inflated then depressed import value.

Trade volumes

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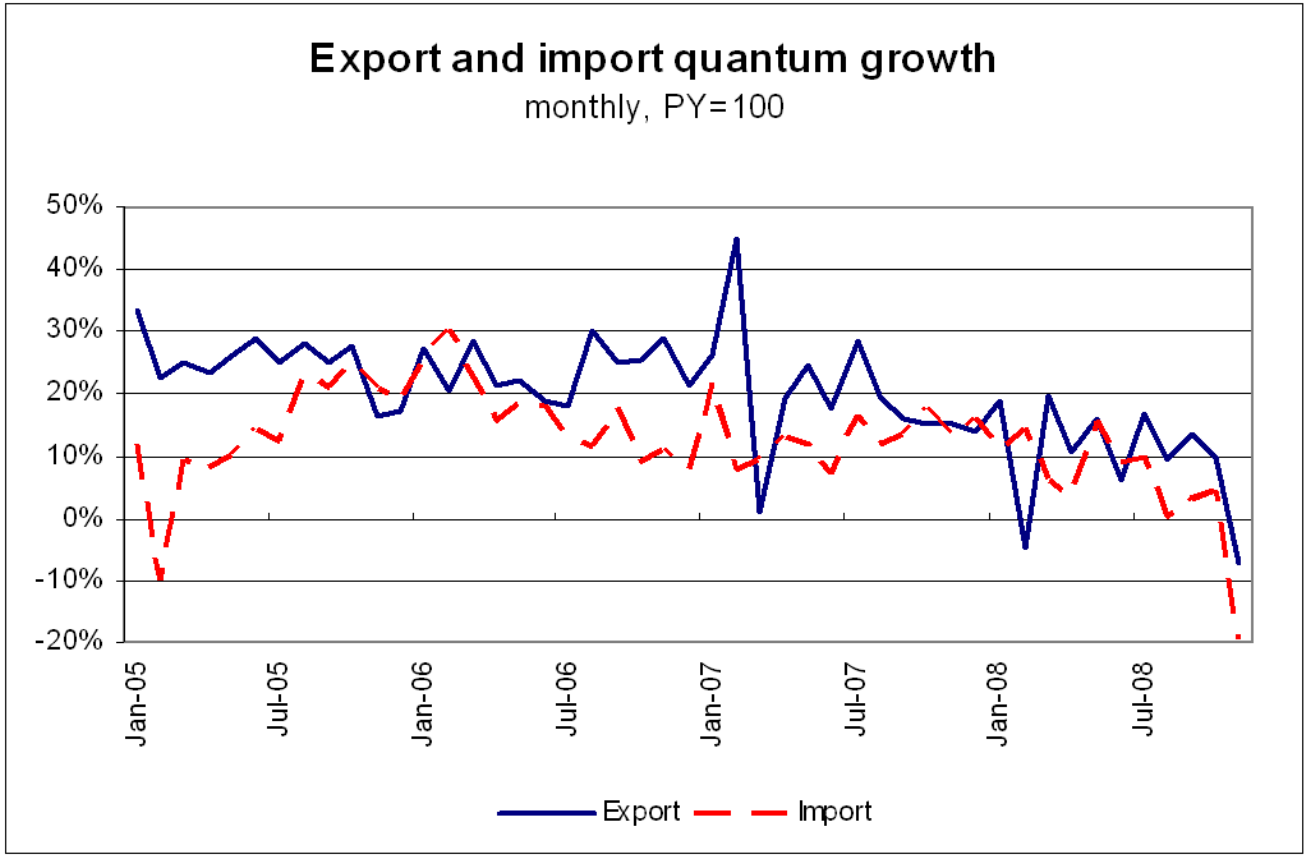

Chinese trade volume data is not very useful.

- China's trade volume indices are of some help in correcting for price effects in nominal trade value data.
- But the short time series (data available only since Jan 2005) and questions about how the data are compiled limit these series' usefulness.
- For a better picture of export volumes, look at container throughput (next slide).

Container volumes

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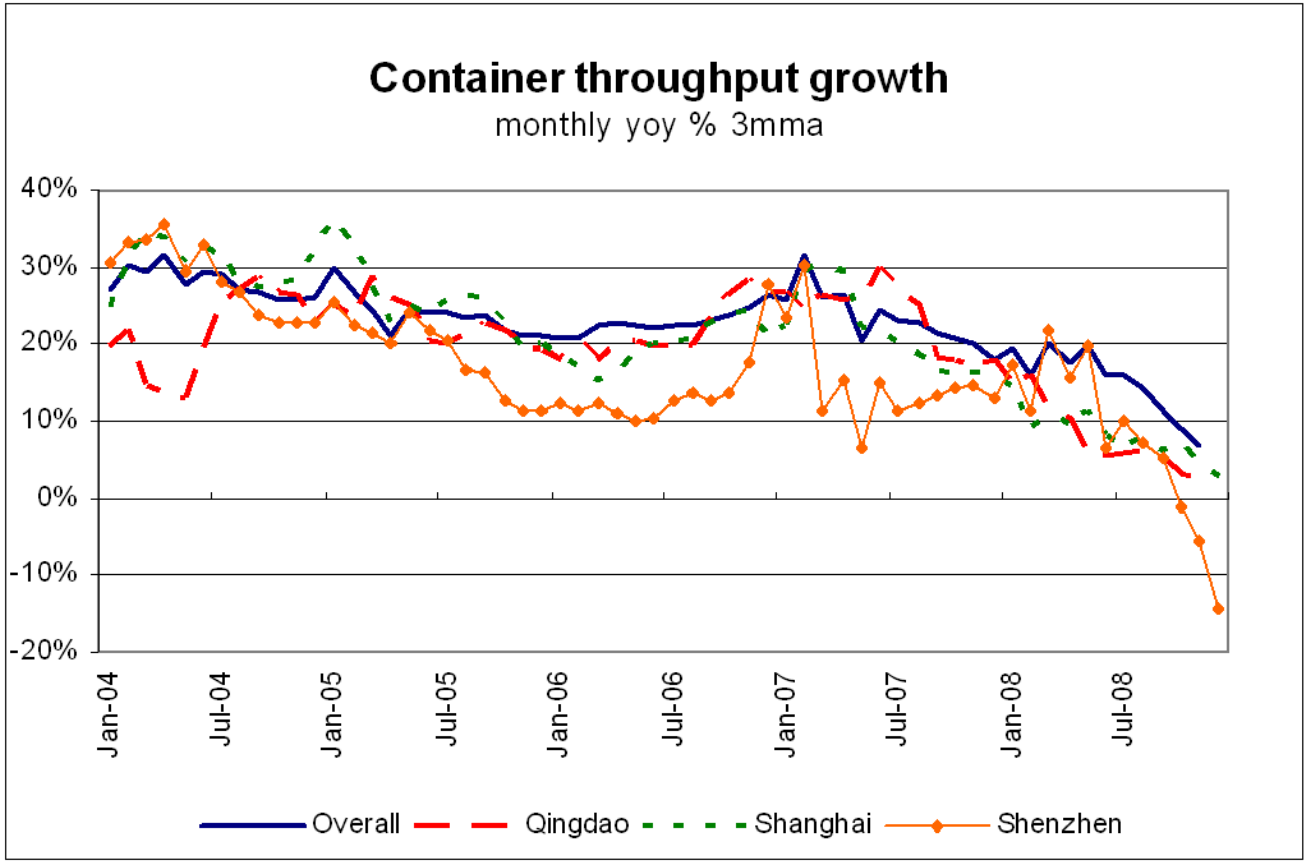

Shenzhen worse off than other container ports.

- The best measure of export volume is container throughput at key ports.
- Our chart shows container volume growth for all China and key ports in north, east and south.
- Again, a steady decline in container volume growth is visible since early 2007.
- Shenzhen figures are more volatile and decline is more pronounced.
- Volatility reflects ability of Guangdong exporters to port-shop between Shenzhen and Hong Kong.
- Steeper decline suggests that Guangdong exporters have been worse hit than those in other regions.

Processing vs normal trade

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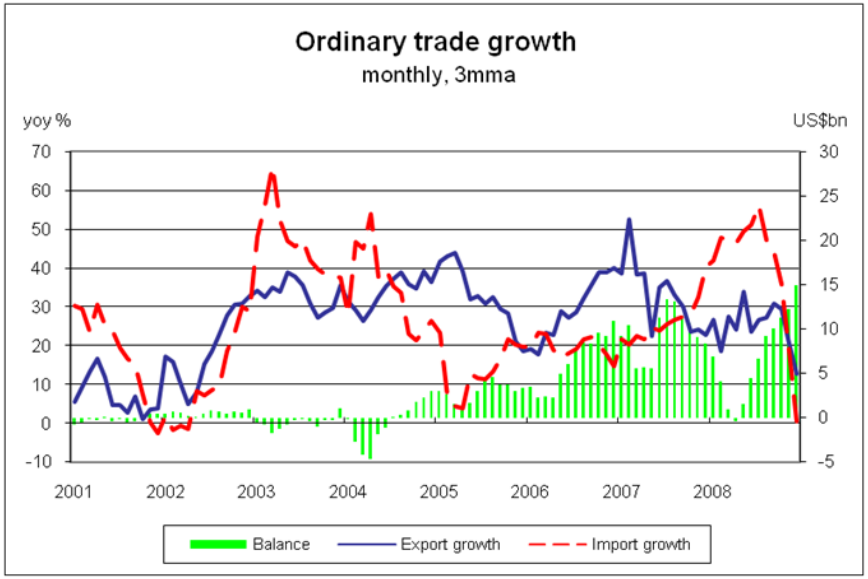
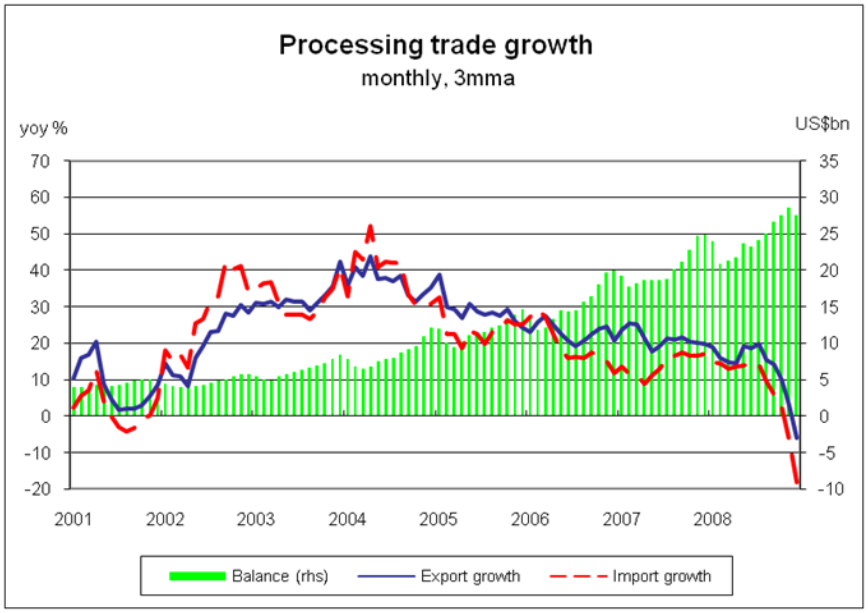
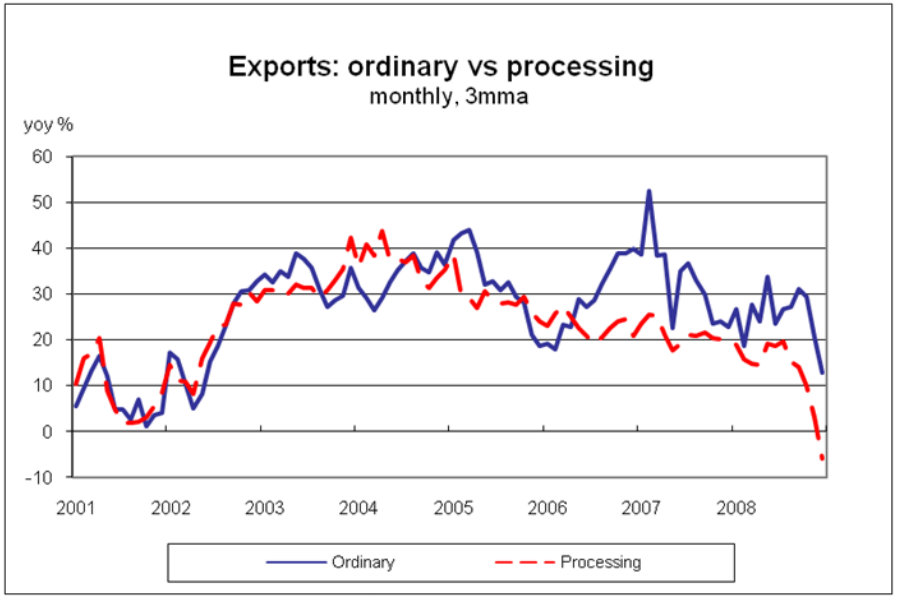


Processing trade takes a hit.

- Through 2004 most of China's trade surplus came from assembly and processing.
- Since 2005 ordinary trade has taken over as the driver of exports and the trade surplus.
- All types of exports saw weaker growth, but processing exports (which tend to be consumer goods) were hit harder.
- Note however that processing exports and imports fall in tandem so the surplus is not reduced.





Export prices

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- China export prices began to rise modestly in 2007, almost entirely because of an appreciating currency. Higher labor/material costs tended to be absorbed by exporters.
- Since mid-08 China export price rises have begun to tail off.
- China does <u>not</u> drive global inflation so long as its relatively low-cost exports can take market share from higher-cost producers.

Export price indices

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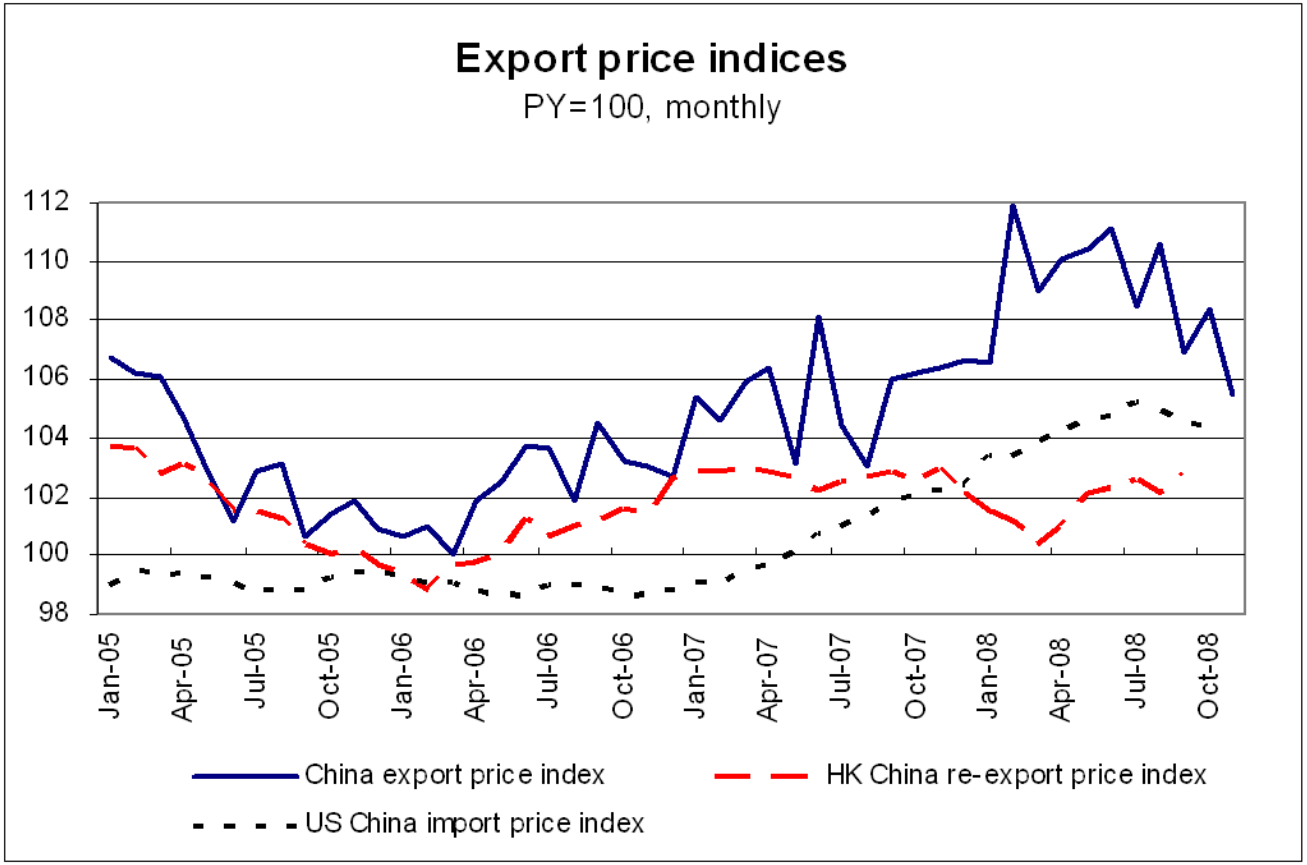

Explanation

US: Index of import prices from China. (Compiled by US Bureau of Labor Statistics.) Prices adjusted for changes in quality and composition.

HK: Index of re-export prices. Unit values, not adjusted for changes in quality and composition. Biased toward south China's light-industrial export basket.

China: Index of export prices. Unit values, not adjusted for changes in quality and composition. Highly volatile values makes data reliability suspect.

The rise in China export prices is abating.

- Of the three available indices of Chinese export prices, the most reliable is that compiled by US Bureau of Labor Statistics.
- In summer 2007 this index moved into positive territory for the first time and kept rising. But it fell to 105.5 in Nov 08, down from 111.9 in Feb.
- HK and China export price indices are problematic.
- HK index of re-exports from China is biased towards low-value exports from south China, and includes mark-ups by Hong Kong intermediaries.
- China's own export price index does not adjust for quality changes.

Export prices: currency-adjusted

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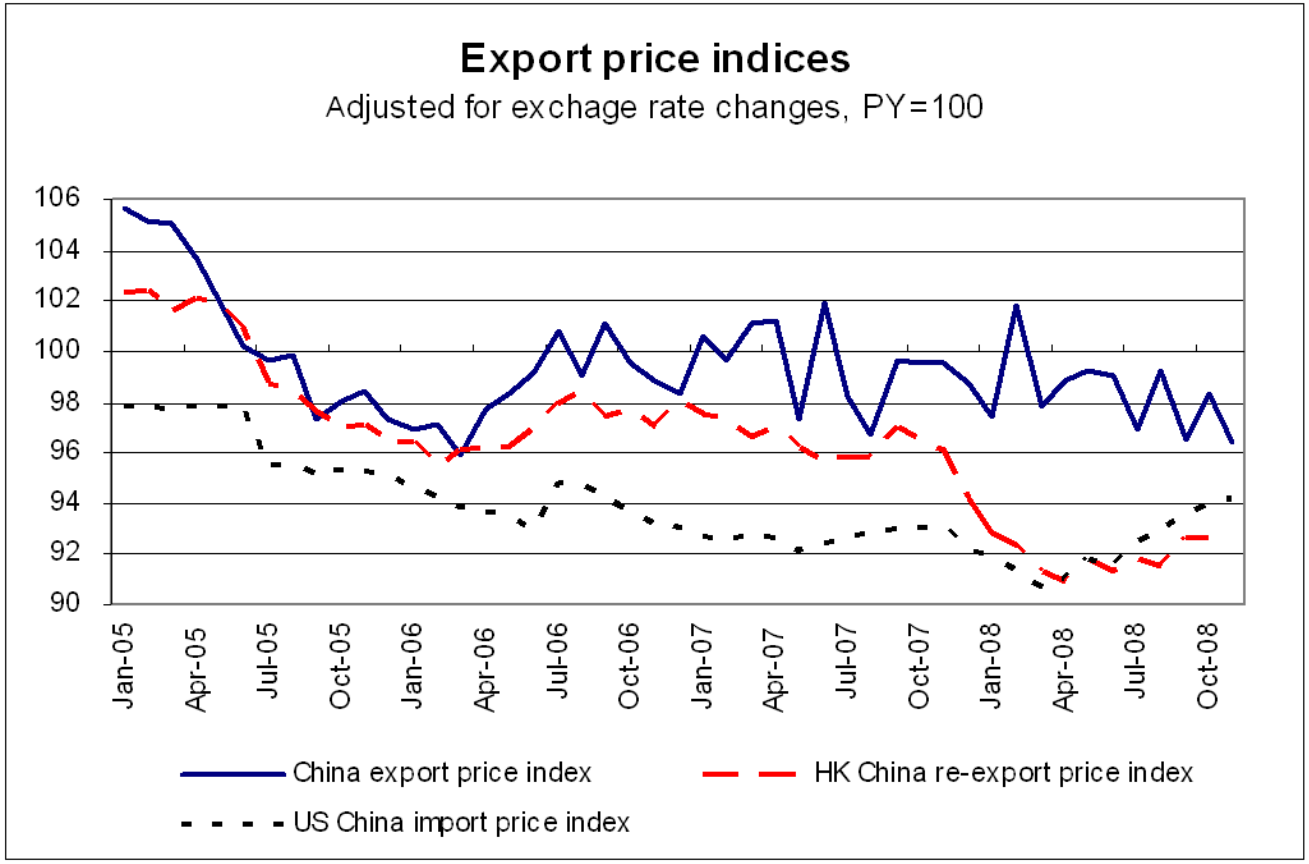

In Rmb terms, Chinese export prices are still falling.

- This chart adjusts the export price indices for changes in the Rmb exchange rate vs the HK dollar and US dollar.
- It shows that all of the increase in Chinese export prices since 2006 is attributable to the rise in the exchange rate, not an increase in the Rmb cost of China-sourced goods.
- The US index of China import prices does show upward momentum in 2008.

Composition of trade

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- Export mix is shifting from traditional light industry to heavy industry.
- Most of the rise in heavy industrial exports comes from basic metal products; China is still a large net importer of capital goods.
- Raw materials surged from 14% to 30% of the import bill in 2002-08.
- The Q4 08 collapse in import value was largely a function of raw materials, with lower prices and de-stocking playing big roles. Therefore import growth is likely to recover by mid-09.

Export composition

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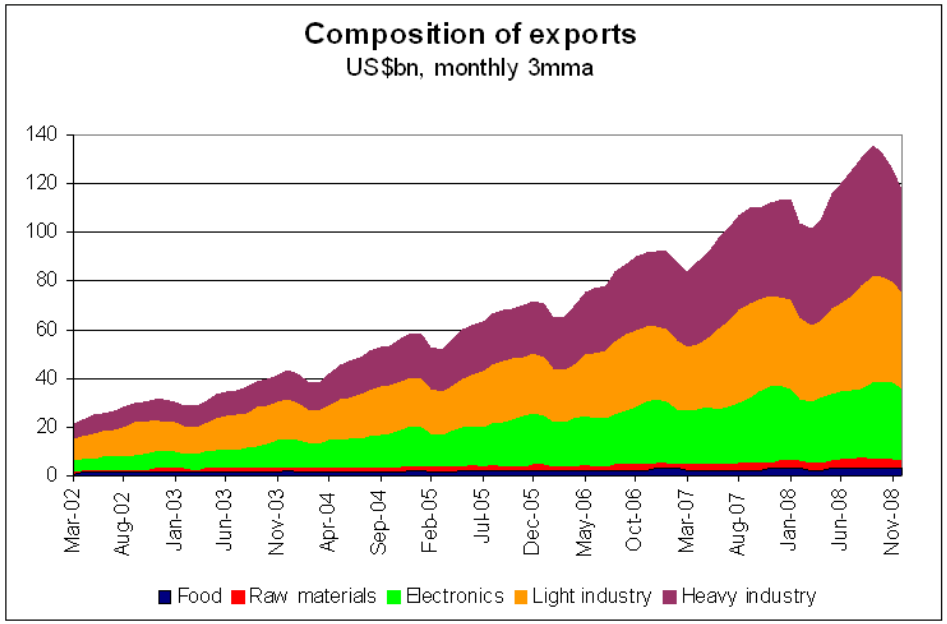

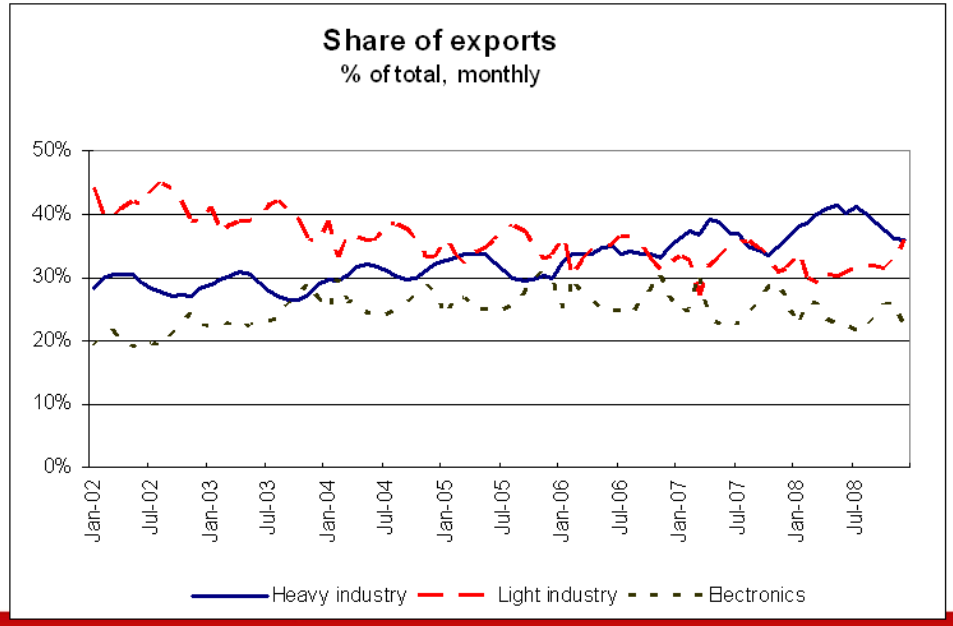

A shift from light to heavy.

- Export composition has shifted: heavy industrial products are displacing traditional light industrial ones.
- Electronics exports are still rising in value but their share of the total seems to have peaked.

Share of export value

	2002	2008
Heavy	29%	39%
Light	42%	32%
Electronics	21%	24%
Other	8%	6%

Contribution to export growth, 2002-08

Heavy	42%
Light	29%
Electronics	25%

Export growth by sector

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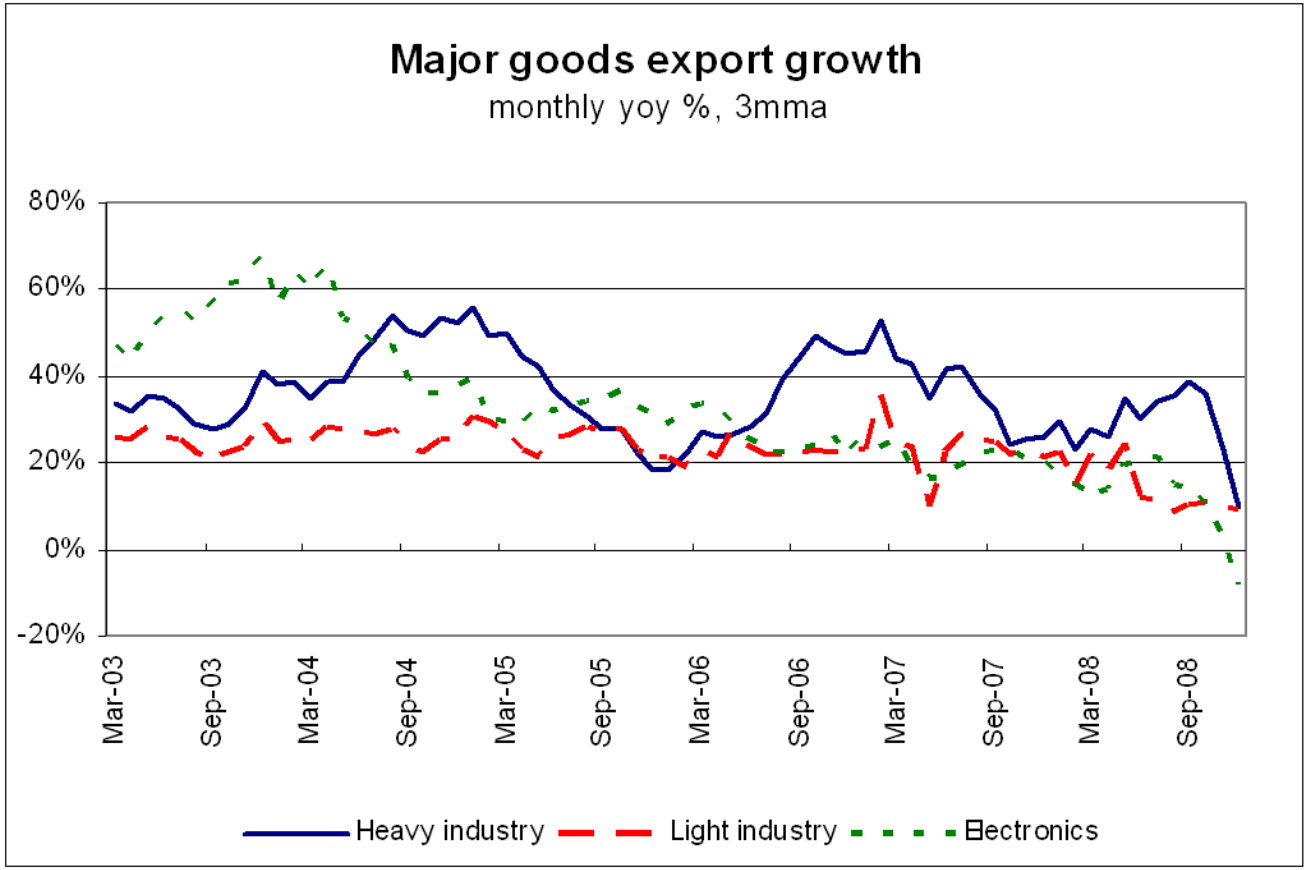

Collapse in export growth is broad-based.

- All major export sectors shared in the Q4 08 drop-off.
- 3mma figures disguise more dramatic Dec numbers: -19% for electronics. -4% for heavy industry, and anemic +10% for light industry.
- For most of 07-08, heavy industry was by far the biggest driver of export growth.
- This reflects both a move up the value chain into production of more sophisticated machinery, and a big increase in exports of basic materials like steel and aluminium.

Import composition

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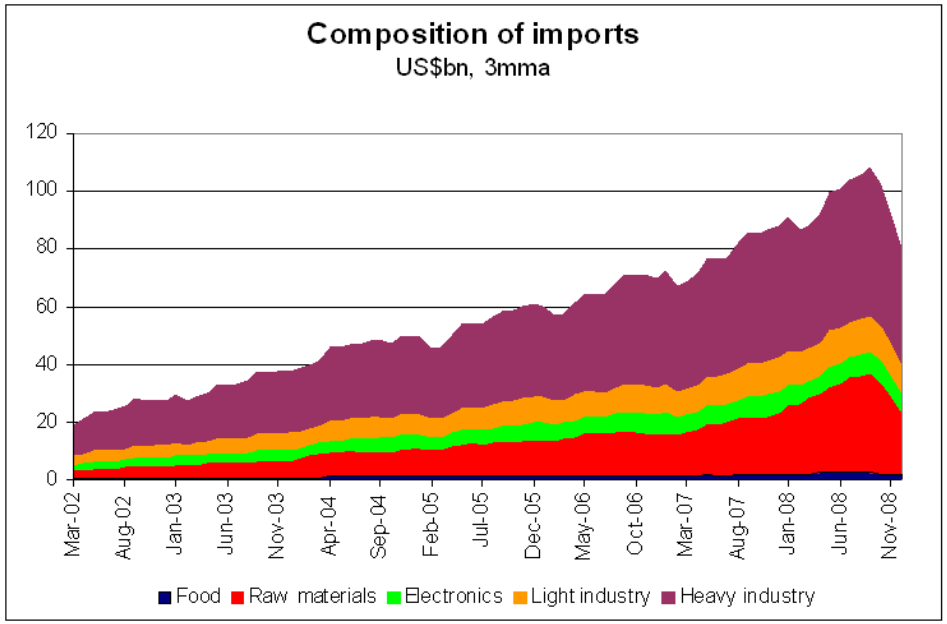

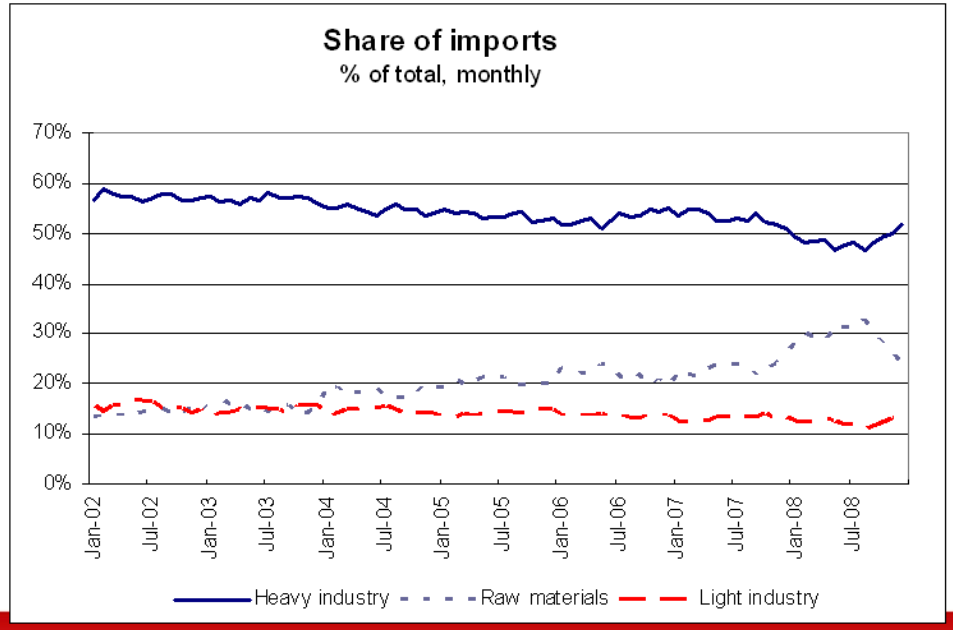

Imports: investment-heavy

- Capital goods and raw materials make up three-quarters of China's imports; consumption goods are a small share.
- Raw materials rose from 14% of the import bill in 2002 to 30% in 2008.

Share of import value

	2002	2008
Heavy industry	57%	48%
Raw materials	14%	30%
Light industry	16%	12%
Electronics	11%	7%
Food	3%	2%

Contribution to import growth, 2002-08

Heavy industry	45%
Raw materials	35%
Light industry	11%
Electronics	6%
Food	2%

Import growth by sector

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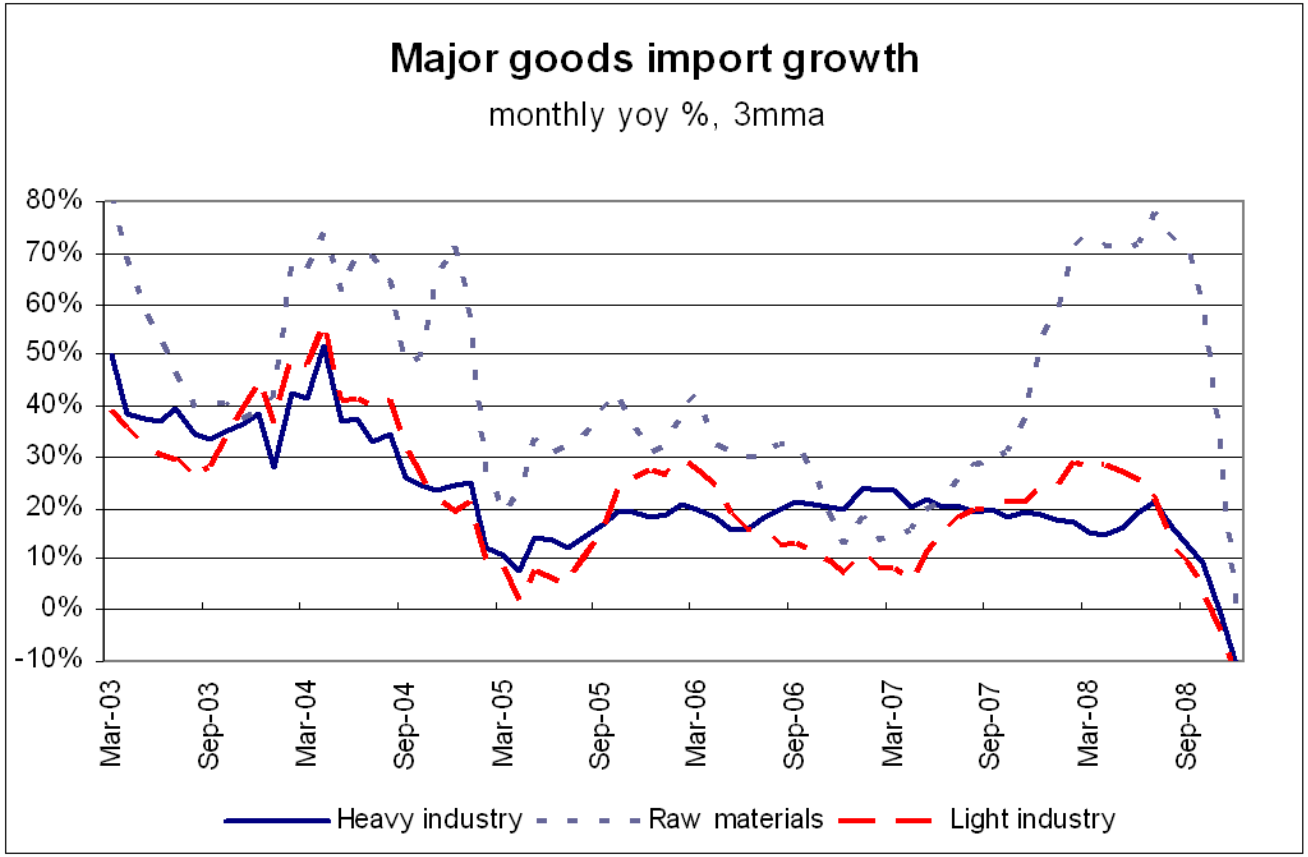

Commodity-price whiplash.

- The extreme import decline in Q4 08 owes a lot to commodity prices.
- High commodity prices caused raw material import value growth to surge from 26% in Aug 07 to 85% in Feb-May 08. The later collapse of prices led to a big fall in import value.
- Dec raw material import value was down –12% yoy.
- Growth in other imports also fell sharply in Q4 08, as investment demand fell.
- Expect a recovery of import volumes in Q2 09 as construction demand increases. Yoy growth will spike in Q4 after lagged price effects vanish.

Trade balance composition

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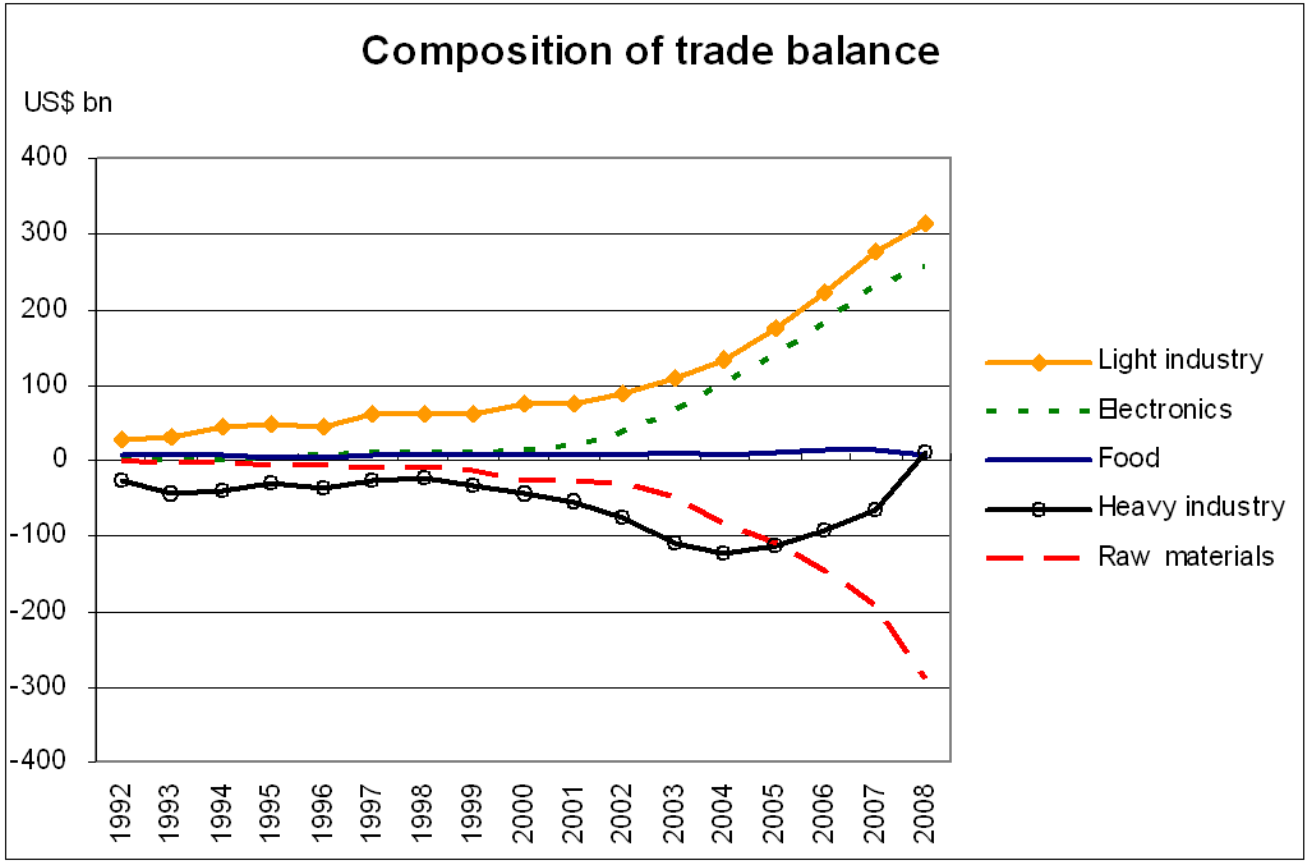

Bigger trade surplus: it's all about electronics and metals.

- Electronics contributed most (+US$129 bn) to the post-2004 trade surplus increase.
- Next was metals (+US$49 bn), which halted a growing deficit in heavy industrials.
- Traditional light industrials have also seen expanded surpluses.
- Deficits in raw materials and machinery continue to increase.

Surplus by category, US$ bn

	2007	2008
Light industry	276	315
Electronics	231	255
Food	12	8
Heavy industry	(64)	11
Raw mats	(193)	(292)

Direction of trade

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- Growth in exports to US started to slow noticeably in Jan 2007; Nov 2008 marked another leg down.
- Europe, the other key export market, began to collapse in Q4 08.
- In 2002-07 China added net demand to Asia as a big importer of components, raw materials and capital goods.
- But in Q4 08 China started to withdraw net demand from Asia, and its regional deficit shrank.
- If investment spending recovers, Japan and Korea will benefit. But Taiwan and ASEAN are tied to China via the electronics cycle and are in for a rougher time.

Net trade with US

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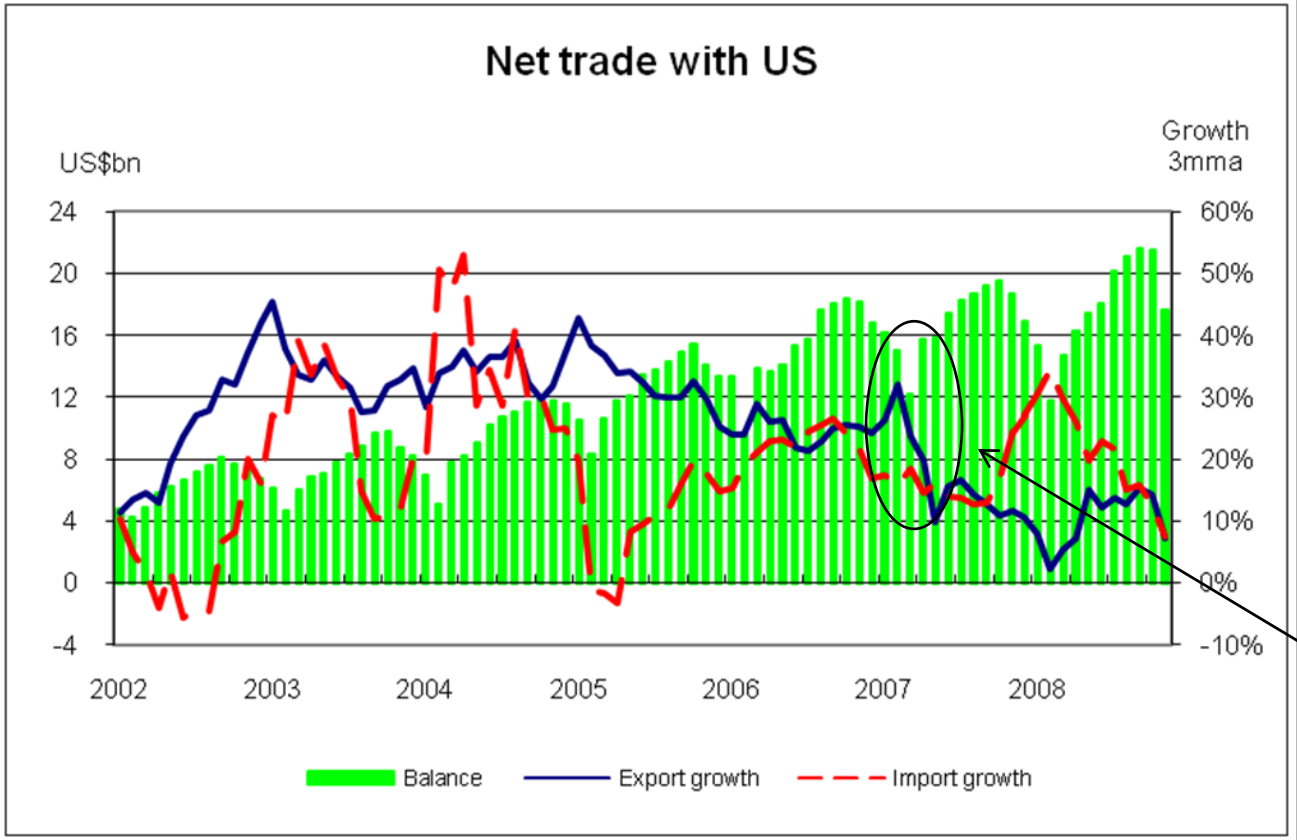

Exports to US have been slowing for two years.

- The US market is not as important as it used to be. In 2008, 21% of China's exports went to the US, down from 33% in 2001.
- Average monthly surplus grew from US$6.4bn in 2002 to US$17.8bn in Jan-Nov 2008.
- Sharp slowdown in exports to the US began in Q2 07 – long before the seizing up of consumer confidence and trade finance in late 2008.

Export growth to US (yoy)

2002-06 avg	23%
2007	12%
2008 Jan-Nov	10%
2008 Nov	-6%

Net trade with EU-12

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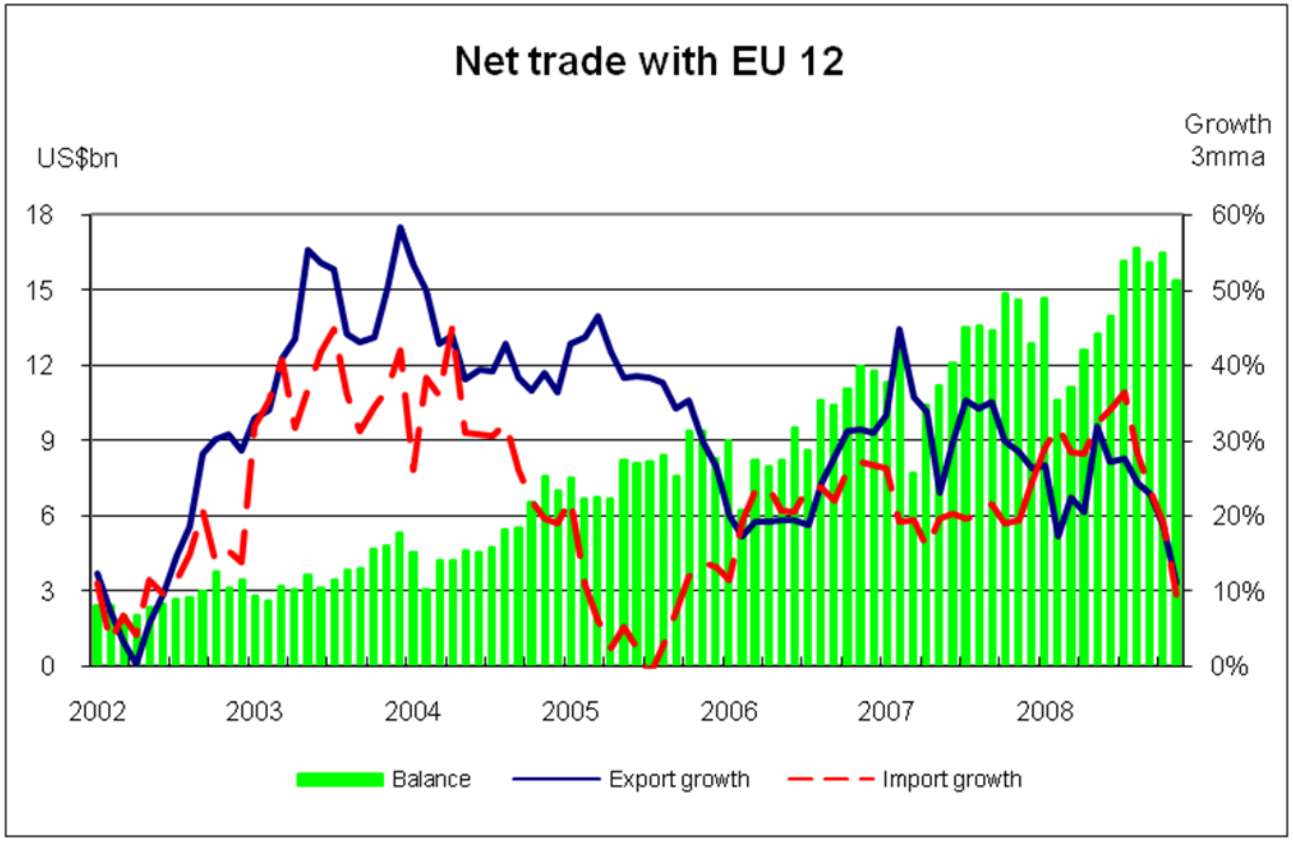

Strong European export market is collapsing.

- The EU-12 is now as important a market for Chinese exports as the US.
- EU-12's share of Chinese exports has stayed constant at 20-21% since 2002.
- Average monthly surplus grew from US$2.7 bn in 2002 to US$14.2 bn in 08.
- Rise of Euro/USD accounts for 36% of the rise in USD value of Chinese surplus to EU-12 since 2002.
- With Euro weakening and Euroland hitting recession, exports to Europe are collapsing.

Export growth to EU-12 (yoy)

2002-07 avg	27%
2008 Jan-Nov	19%
2008 Nov	-1%

Net trade with Japan

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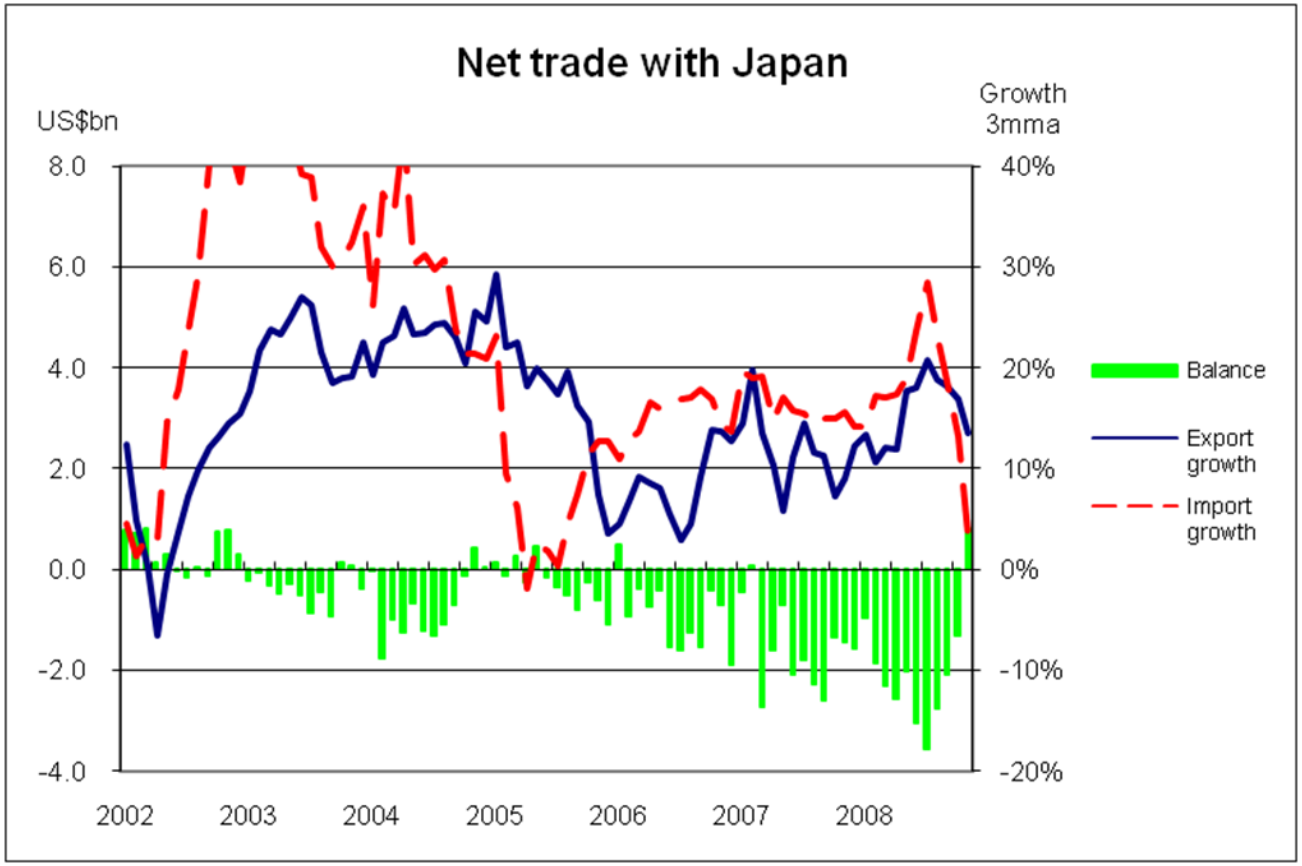

China shock for Japanese exporters.

- Japan's share of China's export market declined from 21% in 2001 to 9% in 08.
- China is a key market for Japanese capital goods. But increasingly these goods are being produced in China (even if by Japanese firms). And Q4 08 Chinese investment slowdown hit Japanese exporters hard.
- Average monthly balance went from +US$0.1 bn in 2002 to -US$2.2 bn in Jan-Nov 08. But import collapse meant Nov surplus of US$0.8bn was biggest since Mar 02.

Import growth from Japan

2002-04 avg	30%
2005-07 avg	13%
2008 Jan-Nov	6%
2008 Nov	-15%

Net trade with ASEAN-5

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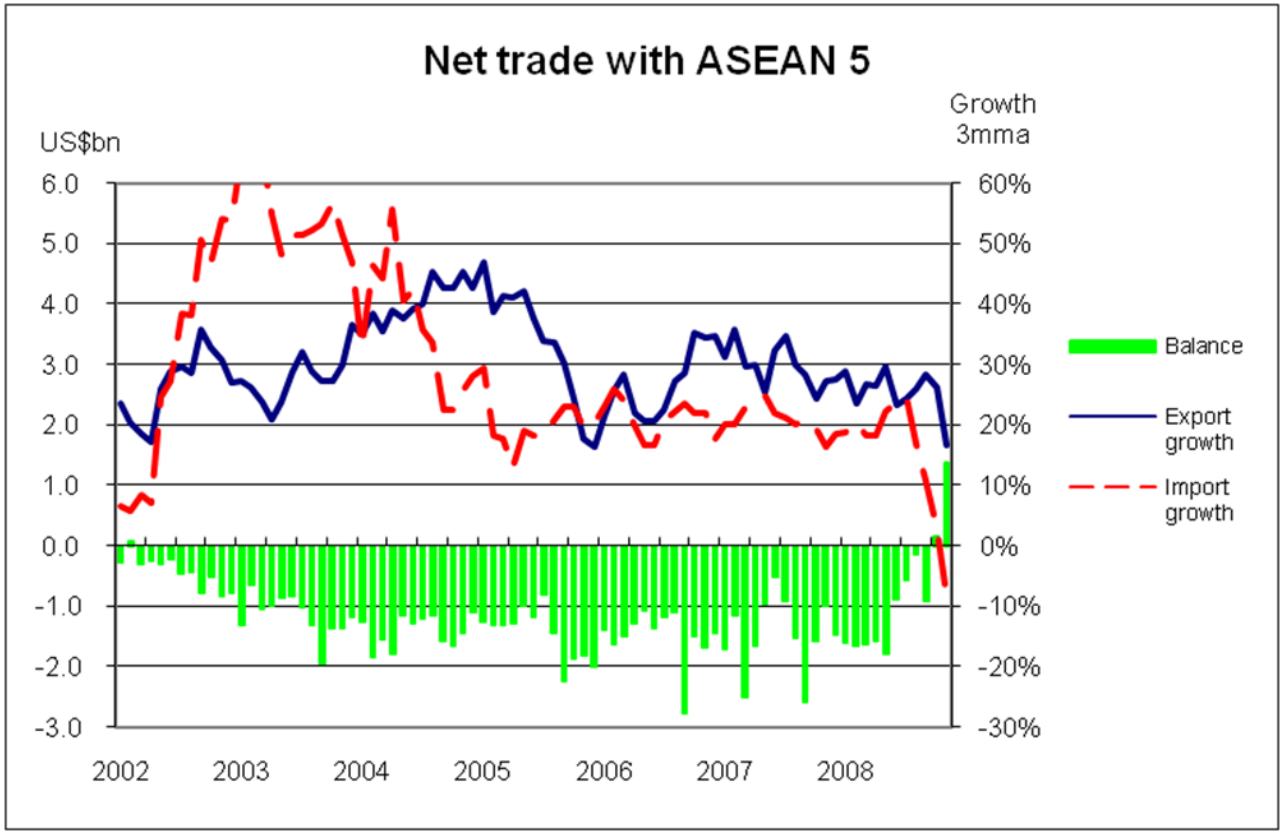

Deficit swings to surplus: China does not provide a demand boost for Asia.

- ASEAN is an important source of raw materials and of components for electronics assembly.
- Average monthly deficit grew from US$0.8 bn in 2002 to US$1.4 bn in 2007.
- But imports collapsed in Nov 08, falling 26% yoy.
- Export growth fell to zero in Nov, down from 25% in Oct.
- The resulting was a swing to surplus, as with Japan.
- So far in the current slowdown, China is not providing a demand boost to the rest of Asia – quite the reverse.

Net trade with South Korea

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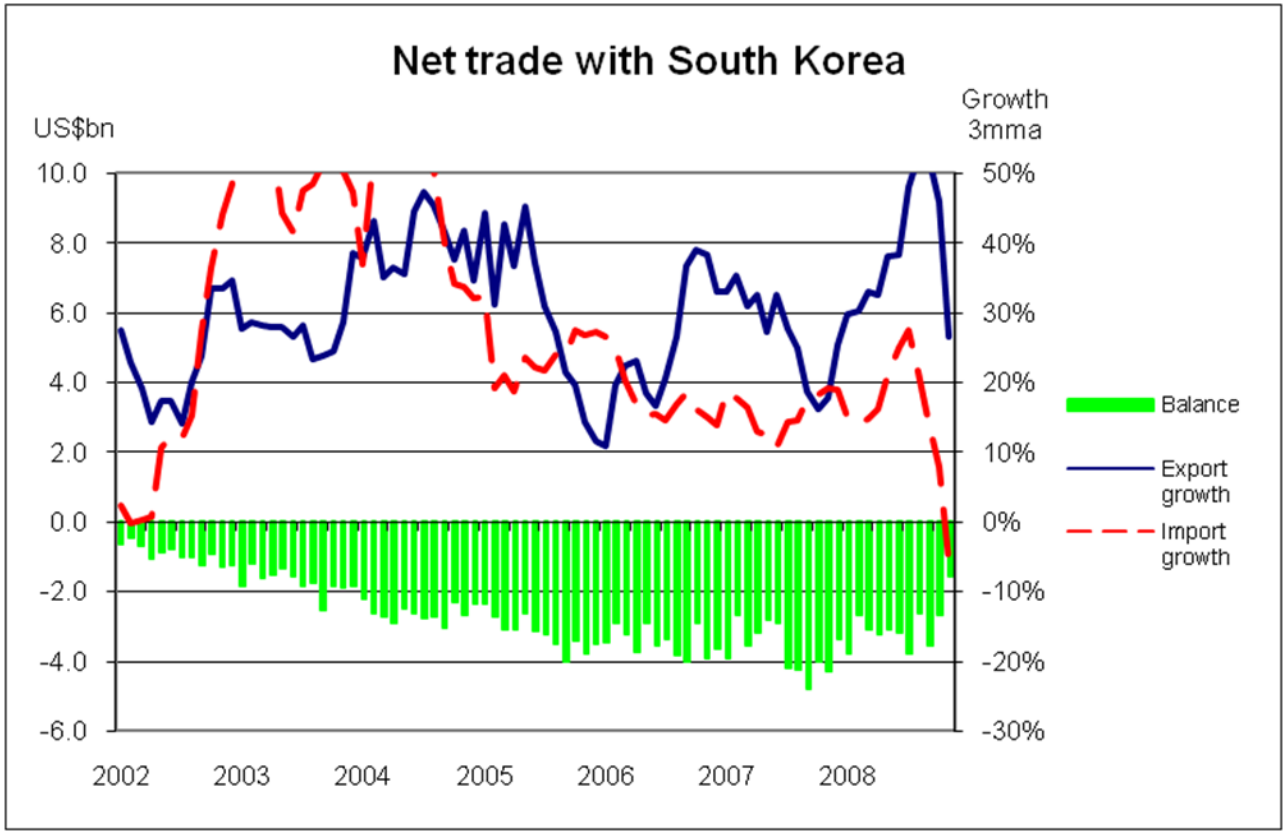

Growing deficit with South Korea.

- South Korea is a major supplier of industrial equipment and electronic components.
- Average monthly deficit grew from US$0.9 bn in 2002 to US$3.2 bn in Jan-Sep 2008.
- As with ASEAN, import growth from Korea has slipped much faster than export growth. In Nov imports fell -30%; exports fell -3%.
- As a result the deficit fell to US$1.6 bn, half the Jan-Sep average.
- Again, China is withdrawing net demand from Asia.

Net trade with Taiwan

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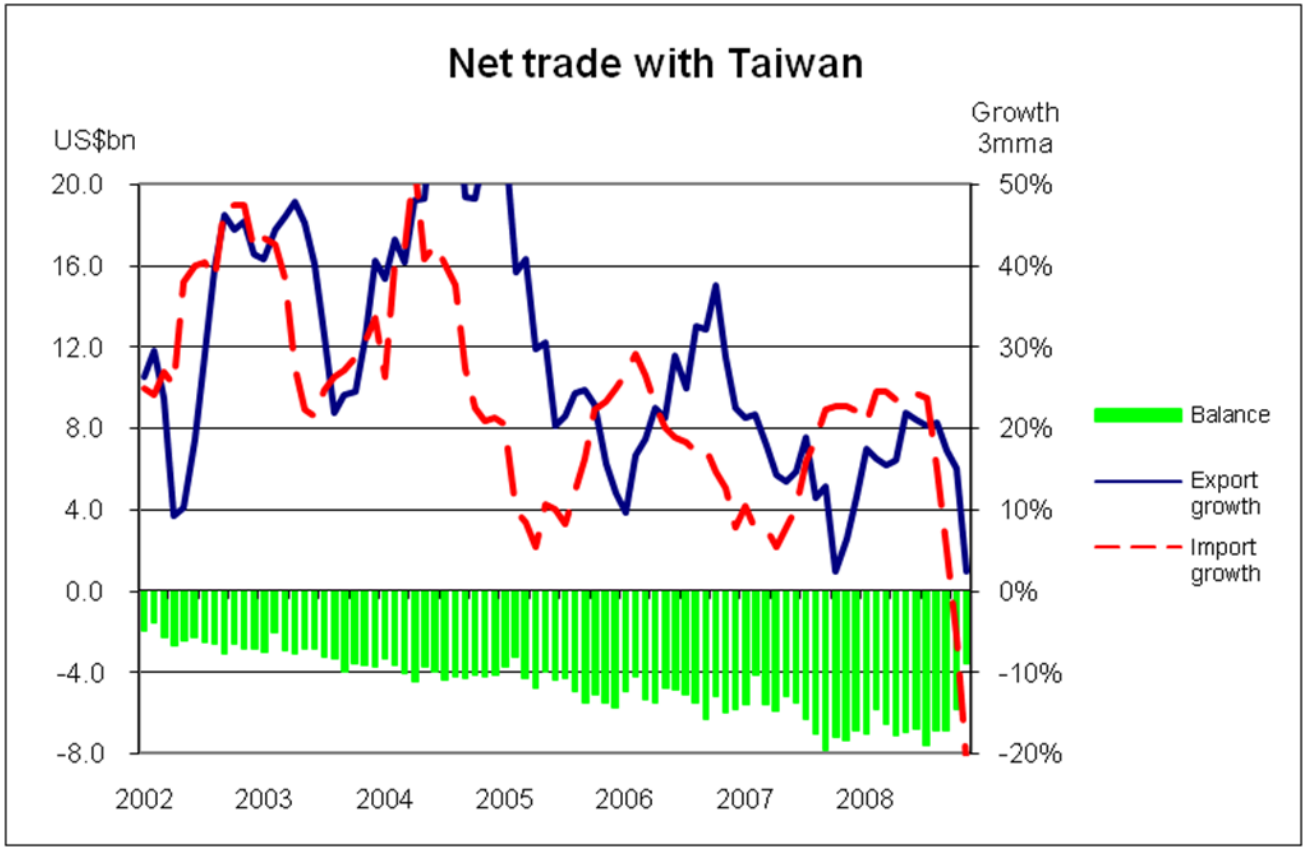

Deficit with Taiwan is flattening.

- Trade pattern with Taiwan is similar to that of Korea, except that the vast majority of imports from Taiwan are electronic components for assembly.
- As a result, import growth leads exports by 8 months, and import decline has been sharper.
- Average monthly deficit rose from US$2.5 bn in 2002 to US$6.9 bn in Jan-Sep 2008.
- In Nov, imports fell -42% yoy, the third straight monthly fall. Exports fell -13%.
- Nov deficit contracted to US$3.5 bn.

Notes

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All data is sourced from China's National Bureau of Statistics via the CEIC database and UN Comtrade.

Dragonomics is an independent research and advisory firm specializing in China's economy and its influence on Asia and the world.

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