

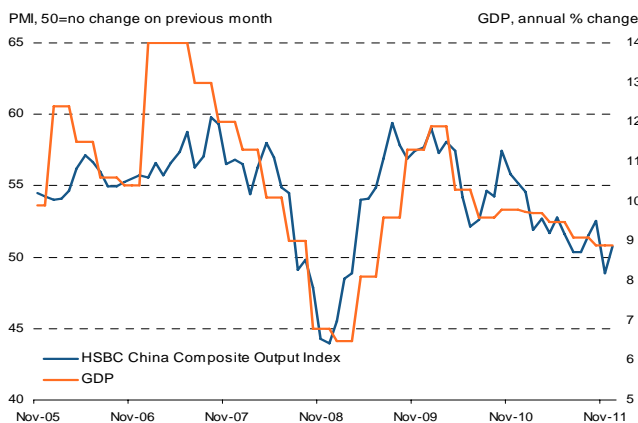
China

China to continue along path of gradual policy easing

- **China's GDP growth slows from 9.1% to 8.9% in Q4, but surprises to upside**
- **Message from monthly economic indicators is that soft landing on track**
- **Gradual policy easing set to continue unless headwinds from Europe or property market correction intensify**

China's economy grew at its weakest annual rate for two-and-a-half years in the final quarter of 2011. Gross domestic product (GDP) growth slowed for the fourth successive quarter, dropping from 9.1% in the third quarter to 8.9%. The easing in the annual rate of increase reflected a slowing in the quarterly pace of expansion from 2.3% in the previous two quarters to 2.0%. The weaker growth was attributed to softening export demand and slower growth of fixed asset investment, in part reflective of a cooling of China's real estate sector.

Gross domestic product

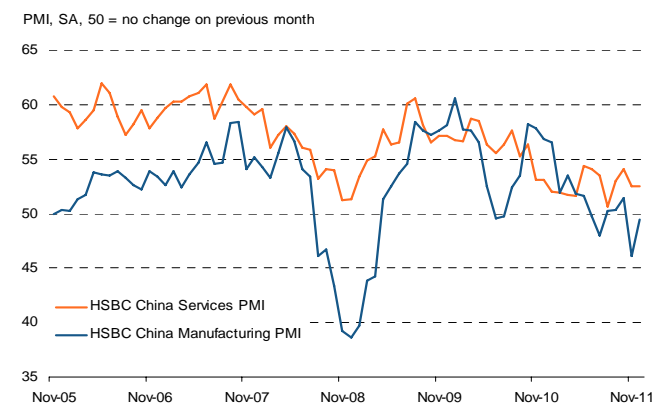


Sources: Markit, HSBC, NBS.

The slowdown was less steep than many analysts had expected, however, and was accompanied by better-than-expected data on industrial production and retail sales for December. This better than anticipated performance may be due to analysts' expectations being once again based on manufacturing data, ignoring the services economy, which continued to

show expansion up to the end of last year, albeit down from rates of growth seen following the post-financial crisis policy stimulus.

Manufacturing & Services PMIs

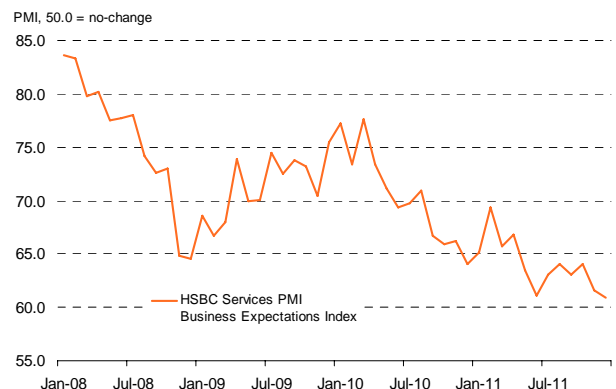


Sources: Markit, HSBC.

The weighted average of output growth from the HSBC manufacturing and services PMIs in fact eased only marginally between the third and fourth quarters of last year, to the weakest since the first quarter of 2009 (roughly in line with the official data).

A worrying development has been a deterioration in the outlook among service providers, meaning the boost to economic growth provided by this sector late last year could fade in 2012. Business optimism for the year ahead fell below that seen even at the height of the financial crisis in 2008-09 during December.

Service sector business confidence



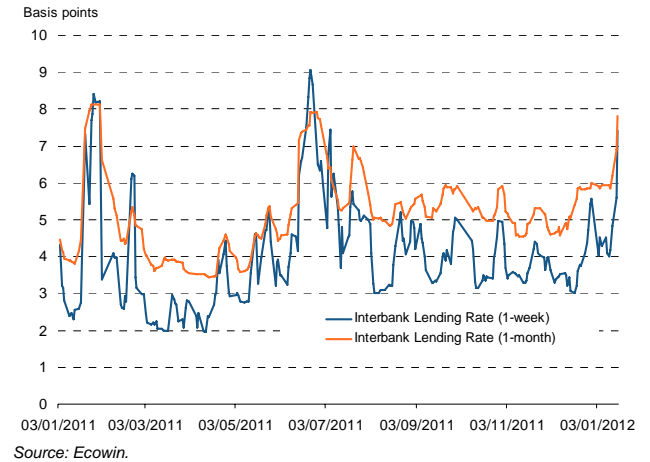
Sources: Markit, HSBC.

Beijing to continue along path of steady and prudent policy easing

Given the deteriorating economic performance in many of China's key export markets (notably the eurozone), domestic property market worries and associated anxiety among more domestically-focused companies, weaker growth looks likely in 2012.

However, the current data flow suggests that a "soft landing" scenario is on the cards, meaning the authorities are likely to persist with gradual policy easing at present rather than adopting a more aggressive stance as they did in response to the 2008-09 financial crisis. With this in mind, further monetary easing through reductions in the amount of reserves banks are required to hold on deposits, known as the reserve requirement ratio (RRR), are likely in the coming months and perhaps even before the New Year festivities given today's surge in money market rates.

Money market rates



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Alex Hamilton

Economist

Markit

Tel: +44 1491 461 076

Email: alex.hamilton@markit.com

<http://twitter.com/MarkitEconomics>

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