Northern Trust

DAILY GLOBAL
COMMENTARY

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

James Pressler
jap10@ntrs.com

China: Signs of a Recovery – Already?

April 2, 2009

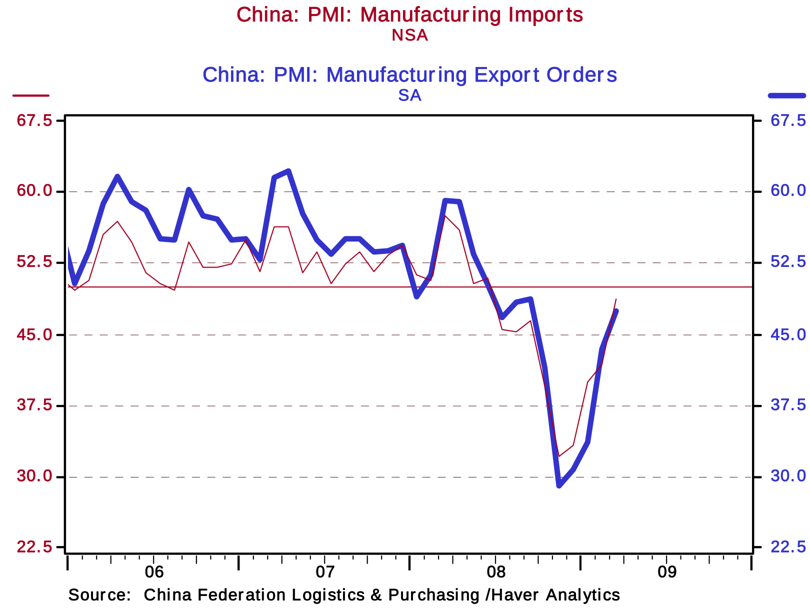
We are just over six months into this global financial crisis, and most major economies have yet to get back on their feet. Yet somehow, the numbers coming out of Beijing suggest that the Chinese economy has already dusted itself off and is preparing to take off at a dramatic pace. Is such a quick recovery possible, and if so, how do other countries get in on it?

Our first piece of evidence is found within today's PMI release for March. Given the particular survey methodology behind this index, we do not give the PMI significant attention, although it does carry weight in the markets at large. The overall PMI rose above the breakeven line of 50, and new orders broke above the line for the second consecutive month. These numbers suggest that the manufacturing sector of the economy was in contraction for about five months and below its usual pace for about nine months. Considering the wealth of anecdotal discussion of widespread shutdowns and mass layoffs, it seems odd to think that the worst has passed.

Chart 1

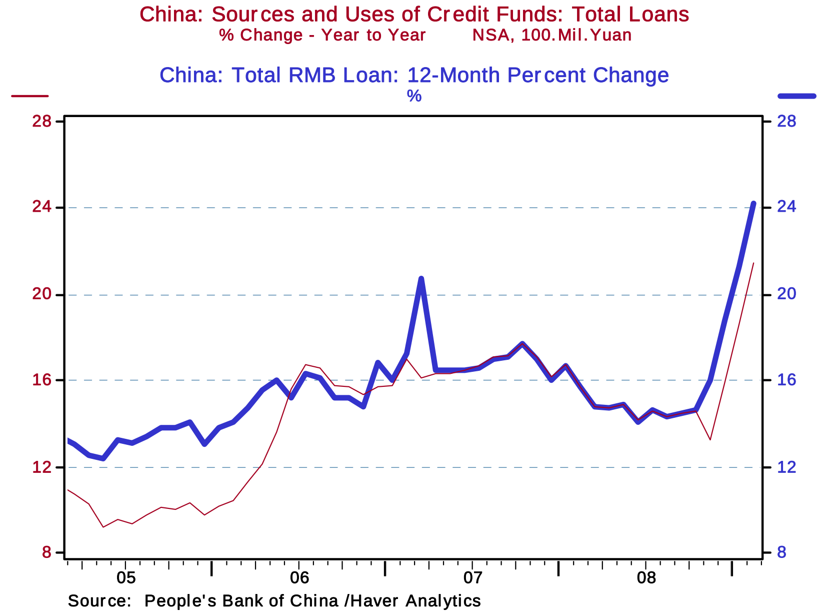
It also seems odd to see that another key category of the overall PMI – export orders – is doing surprisingly well. While neither the export orders index nor the imports index has crossed above 50, they both have come back from horrible droughts and appear set to break the line in April. Again, this is reassuring to see, but it does seem odd that this same kind of turnaround has not been witnessed in China's main trading partners. For all the energy of China's export recovery, few countries are showing any increased import demand these days, and those countries that supply China with economic inputs have not been bragging about a recovery in sales.

Chart 2



One indicator that we do pay particular attention to is bank credit, and several sources in Beijing suggest that lending has been dramatic through Q1. The People's Bank of China (PBoC) reports that lending has spiked since November, with the main indicators exceeding the 17% rate officials are comfortable with. This growth is driven primarily by the government's fiscal stimulus drive and its call for banks to lend more vigorously to offset the economic slowdown. From this perspective it is difficult to argue against the figures, and we recognize that plenty of entities will be putting large amounts of yuan to work in the coming months.

Chart 3



The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

Our main concern for the near-term, however, focuses on how these funds will be put to use. The Chinese banking system has been improving its balance sheets over the past few months, but a significant amount of non-performing loans and 'special mention' loans still weigh on the sector's ability to generate credit. If this wild growth in credit generation does not ignite self-sustaining economic activity, there is every chance that today's big loans could become tomorrow's burdens. For now we remain cautious – more so than the rallying Asian markets – and wait for more signals that can either confirm or refute all this economic activity.