

# ASIAN WEEKLY ECONOMIC INSIGHTS



September 17, 2004

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# Asian Economic Insights

## China's Inventory Health Check

### Across-the-Board Stockpiling

The pace of inventory buildup in China has been alarming this year. Growth in both nominal and real (excluding the valuation adjustments by the State Statistical Bureau) terms have picked up remarkably from below 3% yoy in late 2002 to 11-13% yoy in late 2003, and further to some 20% yoy in July 2004. Moreover, the real inventory/GDP ratio, after reaching a trough of 6.7% in late 2002, has revived drastically and has reached the post-bubble peak of 7.5% in July (see **Display 1 and 2**).

Stockpiling is across the board. Comparing the level of the three-month moving averages of inventories between July and last December, total inventories grew 15% (real), chemicals and metals up 21%, machinery and equipment (including electrical and electronics) up 13%, mining up 11%, and manufacturing and processing up 9%.

While the stock building of metals and construction materials is well anticipated because of the government's investment crackdown, the growth of tech-related inventories have also been staggering (see **Display 3**). Our estimation suggests that the stocks of electrical, electronics and communication equipment have expanded by some 14% (real) between July 2004 and December 2003, and by 23% (real) on a twelve month to July 2004. The stock buildup of mobile phone handset is reported to be particularly serious, partly due to the product-cycle

factor and partially the result of demand slowdown from the frenetic pace of expansion last year (from about 25+% growth in 2003 to the currently 12-13% yoy).

### Will This Cause a Major Macroeconomic Disruption?

No, as long as the demand dynamics remain sound. As argued in previous writings, the bright spot has been the persistent decline in China's real inventory/industrial sales ratio. Although the inventory/sales ratio has moved sideways since the beginning of this year and has shown sign of a bottoming out, the ratio remains subdued and is still contained at a historically low level (see **Display 4**). Moreover, growth of real industrial sales has continued to outpace the expansion of inventories (see **Display 5**). The sector-breakdown of industrial sales shows that, while the deceleration of heavy industrial sales have been dramatic over the past six months, light industrial sales remained firm and sales for the export markets continued to stay high (see **Display 6**). The implication is that as long as the expansion of local consumption and exports – the two pillars of economy growth – continue to absorb the industrial stocks generated by existing and new capacities in the coming year, the buildup of inventory will not cause a major disruption to China's macroeconomic adjustment.

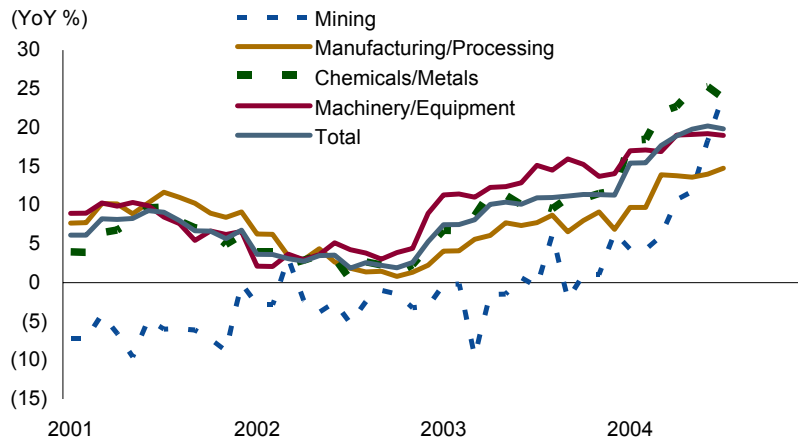
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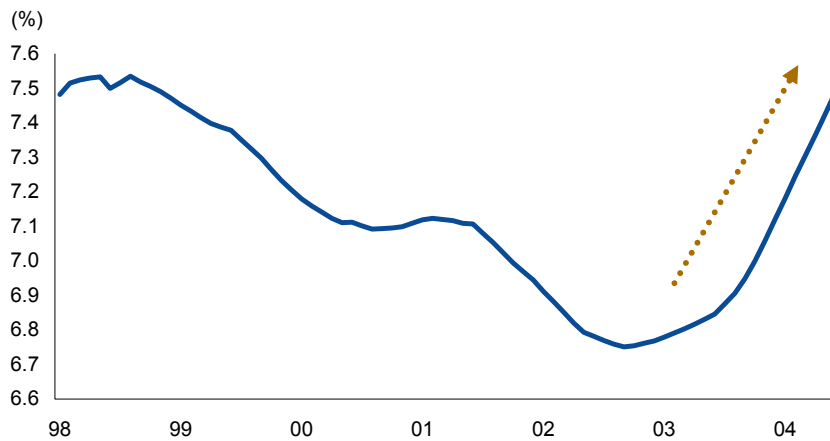
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**Display 1: Across-the-Board Stockpiling**  
China Real Inventory Growth and Sector Breakdown



Source: CEIC and Alliance Fixed Income estimates, September 17, 2004

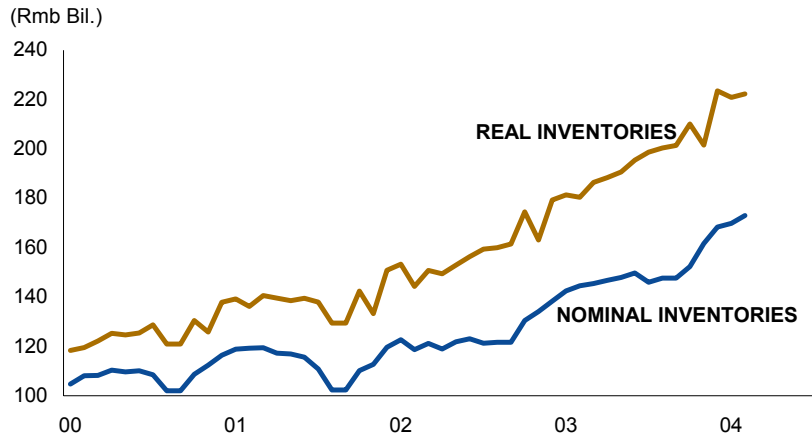
**Display 2: Sharp Rebound of Inventories as a Share of GDP**  
China Real Inventory/GDP Ratio



Source: CEIC and Alliance Fixed Income estimates, September 17, 2004

### Display 3: Inventory Buildup in Tech-Related Sector

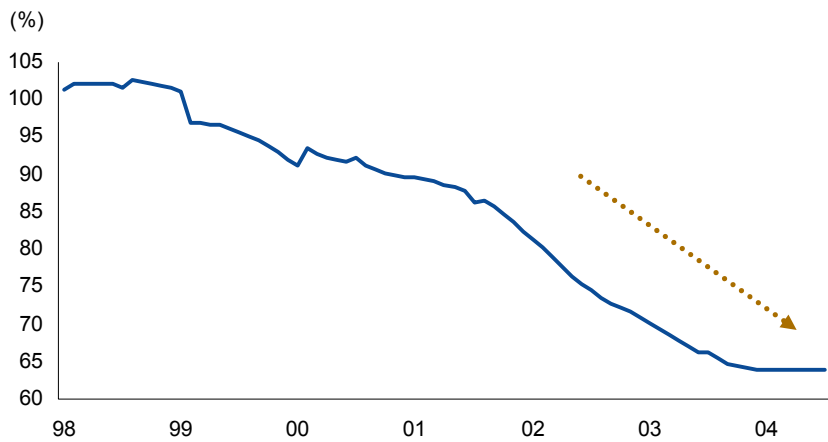
China Inventories in Electrical, Electronics and Communication Sector



Source: CEIC and Alliance Fixed Income estimates, September 17, 2004

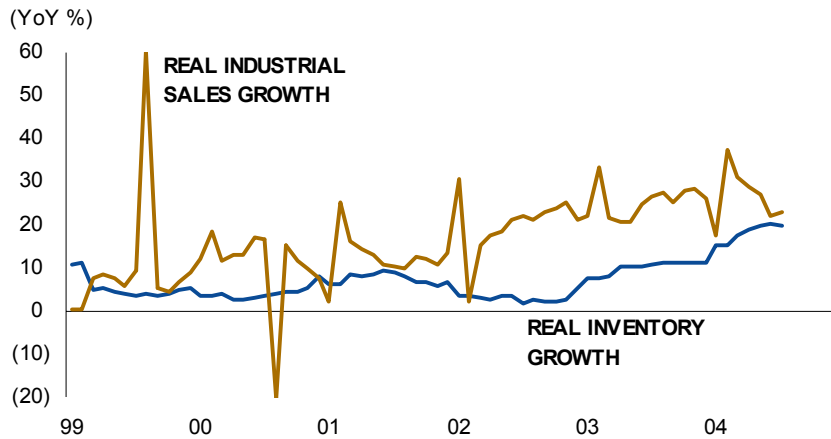
### Display 4: Inventories Continue to Look Fine as a Share of Sales

China Real Inventory/Industrial Sales Ratio



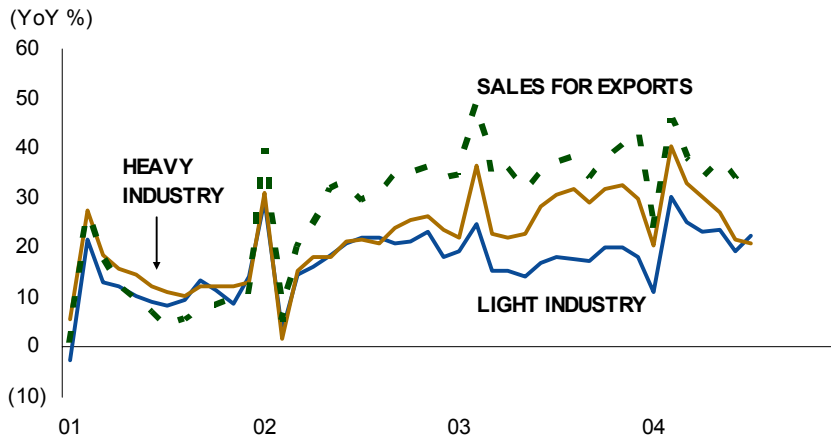
Source: CEIC and Alliance Fixed Income estimates, September 17, 2004

**Display 5: Growth of Sales Continue to Outpace Inventory**  
 China Real Inventory and Real Industrial Sales Growth



Source: CEIC and Alliance Fixed Income estimates, September 17, 2004

**Display 6: Exports and Consumption Underpinning Industrial Sales**  
 China Sector-Breakdown of Industrial Sales (Real Growth Rates)



Source: CEIC and Alliance Fixed Income estimates, September 17, 2004