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China Slowdown Bolsters Case for Easing of Policy as Yuan Slides: Economy

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China's economic growth slowed in the first two months of the year, with both exports and domestic demand moderating faster than analysts had forecast, building the case for Premier Wen Jiabao to accelerate stimulus measures.

The world's second-largest economy had the biggest trade deficit last month in at least 22 years, the weakest January- February factory-production gain since 2009 and retail sales below the median economist estimate, government data showed March 9 and 10.

Central bank Governor Zhou Xiaochuan said today that the nation has large scope in theory for lowering banks' reserve requirements, and the yuan tumbled after officials weakened the reference rate. Moderating inflation and Europe's faltering export demand may encourage the government to loosen credit and pause on currency gains, with the yuan down 0.5 percent this year against the dollar after climbing 4.5 percent in 2011.

"We are likely to see another cut sometime soon" in the required-reserves ratio, Brian Jackson, a Hong Kong-based economist with Royal Bank of Canada, said in a Bloomberg Television interview. "If you look at the January and February numbers combined, whether it's trade, whether it's industrial production, it all shows a pretty clear picture of things continuing to slow down since the start of the year."

The yuan fell 0.2 percent to 6.3239 as of 12:11 p.m. in Shanghai, the biggest decline since Jan. 20, after the central bank weakened the daily reference rate by the most since August 2010. The MSCI Asia Pacific index of stocks fell 0.6 percent as of 2:20 p.m. in Tokyo.

Vietnam Cuts Rates

In Asia, officials are weighing the need to preserve firepower for any deterioration in Europe with controlling inflation. Vietnam cut benchmark rates today, reducing the refinancing rate to 14 percent from 15 percent. India last week unexpectedly reduced its cash reserve ratio and Australia's central bank said it has scope to lower rates, while South Korea and Indonesia held off from stimulus.

Speaking at a briefing in Beijing as part of the annual meeting of the National People's Congress, Zhou said changes in capital flows and foreign-exchange reserves were key factors in decisions on bank reserve ratios, cut in February for the second time in three months. He said that such reductions were not an indication of policy loosening.

In a statement, the central bank reaffirmed a "prudent" monetary policy, to be fine-tuned as needed, and said "new ideas" will be used in managing the world's largest foreign- currency reserves of $3.18 trillion.

European Data

Stocks around the world rallied at the end of last week as Greece's private creditors agreed to a debt swap, the U.S. reported job growth that exceeded forecasts and China's data spurred talk of new stimulus. The U.S. Standard & Poor's 500 Index gained 0.4 percent on March 9.

In Asia, a Malaysian report today may show that industrial production growth slowed in January, according to the median estimate in a Bloomberg survey of economists, while Japan reported better-than-estimated machinery orders for January.

In Europe, Italy may report today that gross domestic product shrank 0.7 percent last quarter from the previous three- month period, confirming a preliminary estimate, according to another survey of analysts. In the U.S., the Treasury Department may say the government's budget deficit widened in February.

China will keep the exchange rate "basically stable at an appropriate and balanced level," Wen, 69, said in the opening speech to the National People's Congress on March 5. He announced an economic-growth target for 2012 of 7.5 percent, down from the 8 percent goal in place since 2005.

Appreciation in the yuan will be "difficult," said Shen Jianguang, a Hong Kong-based economist for Mizuho Securities Asia Ltd., who previously worked for the International Monetary Fund and European Central Bank.

Rate, Ratio Cuts

Zhang Zhiwei, chief China economist at Nomura Holdings Inc. in Hong Kong, is forecasting an interest-rate reduction this month and lower reserve requirements starting in April.

Zhou, 64, said inflation-adjusted interest rates may remain negative for some time and that a too-rapid increase in the benchmark one-year deposit interest rate, now at 3.5 percent, would lead to large capital inflows, given that “some developed countries are implementing very loose monetary policy and global liquidity is quite ample.”

He didn’t discuss how so-called real interest rates turned positive for the first time in more than two years with last week’s report of 3.2 percent inflation in February.

In China, the February trade shortfall of $31.5 billion reported March 10 by the customs bureau in Beijing was the first in a year and four times the size of the previous largest deficit. Exports (CNFREXPY) rose 18.4 percent from a year earlier, while imports gained 39.6 percent.

No Conclusions

Zhou cautioned against making any conclusions from the deficit, saying trade has seasonal distortions at the beginning or end of the year. “We may need a relatively long time to observe it,” he told reporters.

Data in the first two months are distorted by the timing of a Lunar New Year holiday, which fell in January this year and February in 2011. Analysts forecast a 31.1 percent increase in overseas sales and a 31.8 percent rise in inbound shipments, according to the median estimates in Bloomberg News surveys.

The rise in China’s consumer prices in February was the least in 20 months. Industrial production gained 11.4 percent in January and February, less than forecast.

Retail sales rose 14.7 percent in the first two months from a year earlier, below the median economist estimate of 17.6 percent. New local-currency loans in February were 710.7 billion yuan ($113 billion), the People’s Bank of China said March 9, lagging behind the median forecast of 750 billion yuan.

‘Timely’ Adjustments

Wen, in his work report to lawmakers last week, said the government will “carry out timely and appropriate anticipatory adjustments and fine-tuning” of fiscal and monetary policies.

Suntech Power Holdings Co., the largest maker of solar panels, said increased competition and government subsidy cuts will lead to a first-quarter drop in shipments, according to a statement March 8 from the Wuxi, China-based company. Deliveries in the first quarter will decline by about 30 percent from the fourth quarter, it said.

“Clearly, exports are still not strong enough to shore up 8 percent to 9 percent growth for China,” said Ken Peng, a Beijing-based economist at BNP Paribas SA. “More policy support is necessary in coming months to ensure sufficient funding for investment.”

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