



## Highlights and Key Issues

- The Chinese economy expanded by 7.4% year-on-year in Q3, down from 7.6% in Q2, but stronger than we had expected. Of particular surprise was the implied quarterly growth rate; based on the seasonally adjusted data released by the NBS, the economy expanded at an annualised rate of 9.1%, the strongest since 2011Q3.
- Although the apparent strength of Q3 was slightly unexpected, there have been clear indications that economy was strengthening at the end of Q3. Industrial production growth edged up in September, while the flash HSBC PMI for manufacturing improved in October, indicating that the stronger momentum continued into Q4.
- Exports were stronger in September and there are also signs that the government's measures to stimulate the domestic economy are feeding through. Credit growth picked up in September with loans rising over 16% year-on-year, compared with a low of 15% in January, which is benefiting investment.
- The 18th Congress of the Communist Party meets around mid November to anoint Xi Jinping as the new President and announce the rest of the committee of the Politburo that will oversee policy for the next decade. There is unlikely to be a significant change of direction of policy and the next five-year plan will focus on rebalancing the economy.

<b>Forecast for China</b>						
<b>(Annual percentage changes unless specified)</b>						
	2011	2012	2013	2014	2015	2016
<b>Domestic Demand</b>	8.8	8.1	8.8	9.2	8.7	8.1
<b>Private Consumption</b>	8.5	8.4	9.3	9.8	9.5	9.4
<b>Fixed Investment</b>	9.2	7.4	8.2	8.8	8.0	6.8
<b>Government Consumption</b>	9.4	9.7	9.7	9.3	8.8	8.4
<b>Exports of Goods and Services</b>	3.9	2.4	6.7	8.9	8.7	8.2
<b>Imports of Goods and Services</b>	2.7	2.6	9.0	9.4	9.2	8.8
<b>GDP</b>	9.3	7.5	8.1	9.0	8.7	8.1
<b>Manufacturing (value-added)</b>	13.8	9.9	10.9	11.8	10.9	8.7
<b>Consumer Prices</b>	5.4	2.7	2.6	3.5	3.6	3.2
<b>Current Balance (% of GDP)</b>	2.8	3.0	3.0	2.7	2.5	2.3
<b>Government Budget (% of GDP)</b>	-1.1	-2.9	-2.9	-2.3	-2.4	-2.4
<b>Current Account (\$bn)</b>	201.7	244.7	280.1	290.1	303.1	315.7
<b>Total Trade Balance (\$bn)</b>	102.6	128.9	134.3	133.3	142.3	145.3
<b>Short-Term Interest Rates (%)</b>	5.29	4.58	3.81	3.75	4.25	4.75
<b>Exchange Rate (Per US\$)</b>	6.46	6.31	6.19	6.00	5.81	5.67

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## Overview

### GDP grew by 7.4% in Q3...

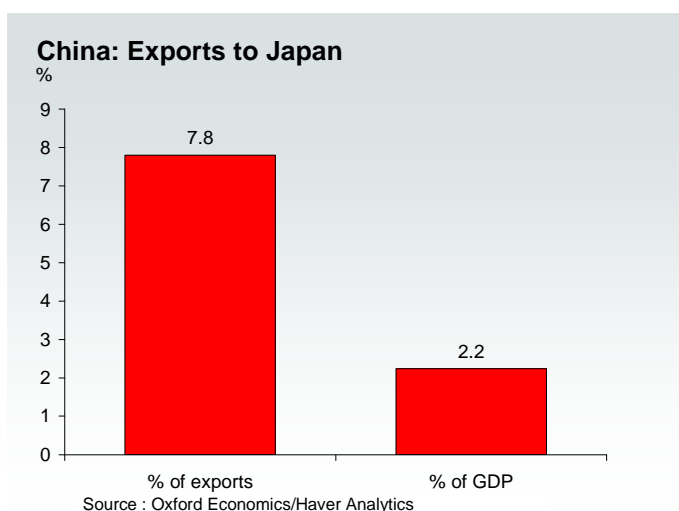
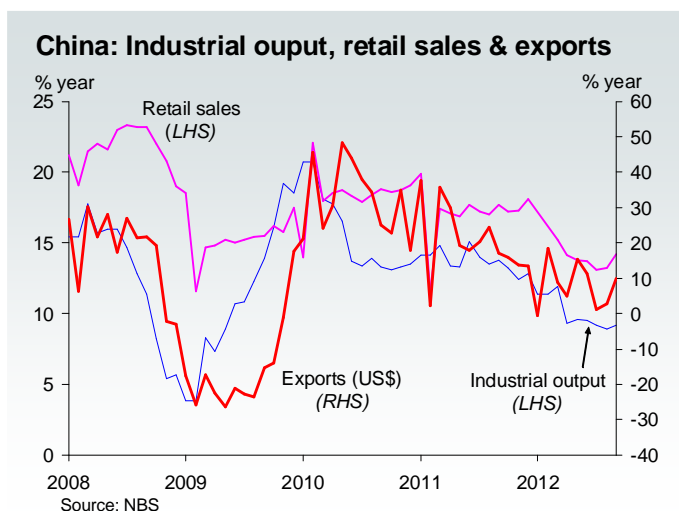
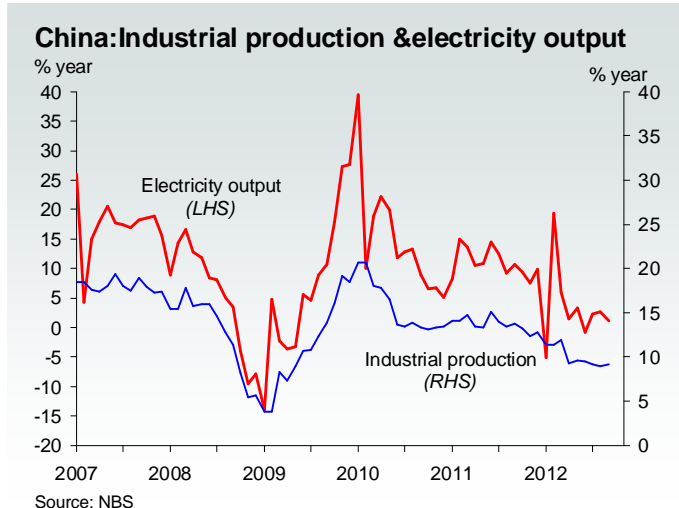
- The Chinese economy expanded by 7.4% year-on-year in Q3, down from 7.6% seen in Q2, but stronger than we had expected. Of particular surprise was the implied quarter-on-quarter growth rate; based on the seasonally adjusted data released by the NBS, the economy expanded at an annualised rate of 9.1%, the strongest since 2011Q3. This pace of growth seems to contradict the raft of indicators such as exports, electricity consumption, rail freight and PMIs that pointed to the soft patch extending over the summer.

- Although the apparent strength of Q3 was slightly unexpected, there have been clear indications that economy was strengthening at end-Q3. Industrial production growth edged up in September, while the flash HSBC PMI for manufacturing improved in October, indicating that the stronger momentum continued into Q4.

### ...boosted by stronger exports...

- Key to the respite for Chinese industry was a pick-up in exports, which expanded by 9.9% in September, recovering from a very weak August and July. This rebound came despite continued weakness in Europe, thanks to stronger exports to elsewhere in Asia and the US. We expect the global economy to continue to strengthen, albeit modestly, and for exports to grow by around 7% next year. However, exports are vulnerable to a worsening of the Eurozone crisis and the potential US 'fiscal cliff', and would be severely affected should one of these scenarios unfold.

- The dispute with over the Senkaku/Diaoyu Islands is also disrupting trade with Japan. Japan is an important trading partner for China, with around 8% of exports going there, and any disruption to exports would have severe repercussions for the Chinese economy. At the moment, Japan seems more vulnerable to the dispute with Chinese consumers boycotting Japanese products, with Toyota and Honda appearing hard hit. But an ongoing dispute could be detrimental to China; Japan has invested around US\$80bn in China since 1991, accounting for around 6% of foreign capital over that period, and Japan may look to establish production bases elsewhere should the dispute drag on.



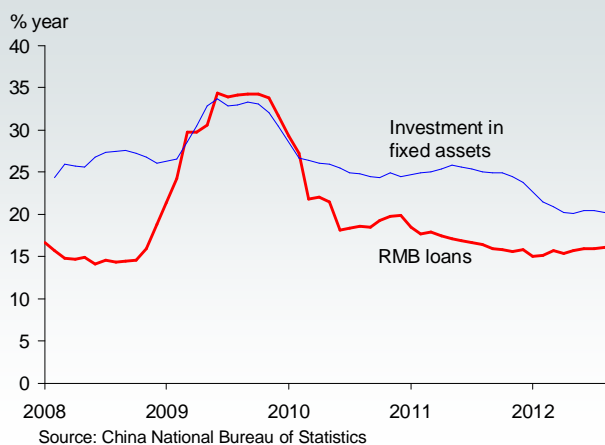
### ...but domestic economy also firming

- There are also signs that the government's measures to stimulate the domestic economy are feeding through. Credit growth picked up in September with loans increasing 16.3% year-on-year, up from a low of 15% in January. In recent months, the central bank has avoided further cuts in reserve requirements and interest rates, instead undertaking open-market operations to ensure there is sufficient liquidity in the banking system.
- Ensuring the bank credit channel is working is important for local governments to implement the infrastructure projects that have been announced, especially in the face of falling revenues from land sales. Local governments had a deficit of 8.5% of GDP in 2011, and their finances will be left with an even larger hole following the slump in the property market. In practice, banks fund most local government debt, which stood at CNY10.7 trillion or 26.7% of GDP in 2010 and has probably increased since then. The positive impact of increased lending is seen in a pick-up in investment growth at end-Q3.

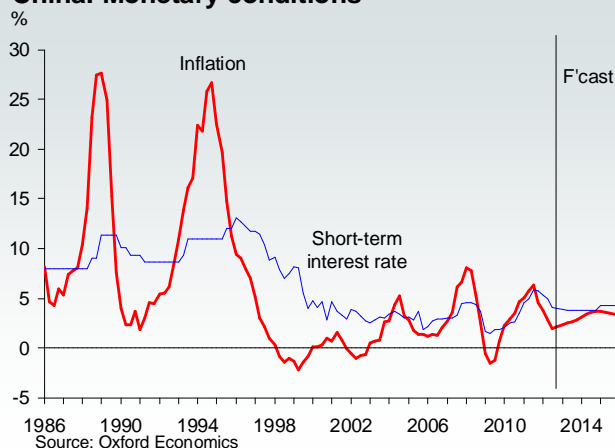
### Leadership change to be announced

- There is also the likelihood that further stimulus measures will be implemented once the new leaders are announced. The 18th Congress of the Communist Party meets in mid November to anoint Xi Jinping as the new President and announce the rest of the standing committee of the Politburo that will oversee policy for the next decade. Little is known of the likely impact on policy of the leadership change, but there is unlikely to be a significant change of direction and the next five-year plan will focus on rebalancing the economy. However, the impending leadership change has probably constrained – or limited the willingness – of the current leadership to implement more policy support. The new leadership will probably have more scope to act, although a stimulus package of the order of the one seen in 2009 is unlikely.
- The slowdown in China has been longer and deeper than expected but policy measures are starting to take effect and more could be in the pipeline. This should help the government meet its growth target of 7.5% for this year and contribute to GDP growth accelerating to around 8% in 2013, but a return to double-digit growth is unlikely and risks remain skewed to the downside.

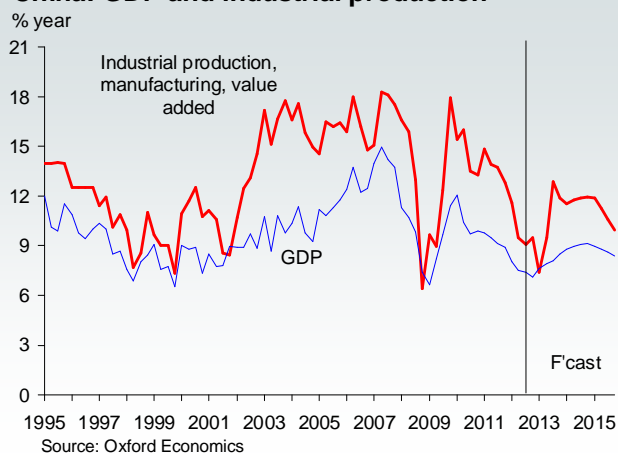
#### China: Total RMB loans and investment



#### China: Monetary conditions



#### China: GDP and industrial production



### Key Indicators: China

Percentage changes on a year earlier unless otherwise stated

	Industrial value added	CPI	Food Prices	RPI	Exports US\$ %	Imports US\$ %	Trade balance (US\$ mn)	Retail sales
<b>Sep</b>	13.8	6.1	13.4	6.0	17.0	20.7	14602	17.7
<b>Oct</b>	13.2	5.5	11.9	5.3	15.9	28.7	17041	17.2
<b>Nov</b>	12.4	4.2	8.8	4.0	13.7	22.0	14573	17.3
<b>Dec</b>	12.8	4.1	9.1	3.8	13.4	11.9	16484	18.1
<b>2012</b>								
<b>Jan</b>	11.4	4.5	10.5	4.1	-0.6	-15.3	27181	14.7
<b>Feb</b>	11.4	3.2	6.2	2.9	18.4	39.6	-31519	14.7
<b>Mar</b>	11.9	3.6	7.5	3.5	8.9	5.4	5355	15.2
<b>Apr</b>	9.3	3.4	7.0	3.1	5.0	0.3	18559	14.1
<b>May</b>	9.6	3.0	6.4	2.5	15.3	13.2	18122	13.8
<b>Jun</b>	9.5	2.2	3.8	2.9	11.3	6.2	31803	13.7
<b>Jul</b>	9.2	1.8	2.4	0.8	1.0	4.7	25144	13.1
<b>Aug</b>	8.9	2.0	3.4	1.0	2.7	-2.5	26573	13.2
<b>Sep</b>	9.2	1.9	2.5	-	9.9	2.4	27670	14.2

### Financial Indicators: China

Percentage changes on a year earlier unless otherwise stated

	Loans rate %	RMB Loans	Exchange rate Yuan/€ avg.	Exchange rate Yuan/\$ avg.	Exchange rate Yuan/100Yen	Share price Shanghai A	Reserves US\$ Bn	Imports Cover
<b>Sep</b>	6.56	15.9	8.78	6.39	8.32	2577	3201.7	20.7
<b>Oct</b>	6.56	15.8	8.75	6.37	8.31	2515	3273.8	23.3
<b>Nov</b>	6.56	15.6	8.62	6.36	8.19	2573	3220.9	20.2
<b>Dec</b>	6.56	15.8	8.35	6.35	8.16	2356	3181.1	20.1
<b>2012</b>								
<b>Jan</b>	6.56	15.0	8.15	6.32	8.21	2357	3253.6	26.5
<b>Feb</b>	6.56	15.2	8.34	6.30	8.03	2479	3309.7	22.7
<b>Mar</b>	6.56	15.7	8.34	6.31	7.66	2497	3305.0	20.6
<b>Apr</b>	6.56	15.4	8.30	6.31	7.76	2468	3298.9	22.8
<b>May</b>	6.56	15.7	8.10	6.33	7.94	2502	3206.1	19.7
<b>Jun</b>	6.31	16.0	7.98	6.36	8.02	2391	3240.0	21.8
<b>Jul</b>	6.00	16.0	7.82	6.37	8.07	2271	3240.0	21.3
<b>Aug</b>	6.00	16.1	7.89	6.36	8.08	2215	3272.9	21.6
<b>Sep</b>	6.00	16.3	8.14	6.32	8.09	2168	3285.1	20.7

## CHINA

**TABLE 1 SUMMARY ITEMS**  
 Annual Percentage Changes, Unless Otherwise Specified

	CONSUMERS EXPEND- ITURE (C)	TOTAL FINAL EXPENDITURE (TFE)	TOTAL FIXED INVESTMENT (IF)	GROSS DOMESTIC PRODUCT (GDP)	INDUSTRIAL PRODUCTION (GROSS) (IPVA)	TOTAL EMPLOYMENT (ET)	AVERAGE EARNINGS (ER)	WHOLE ECONOMY PRODUCTIVITY (GDP/ET)	COMPETIT- IVENESS (2008=100) (WCR)	CONSUMER PRICE INDEX (CPI)	RETAIL PRICE INDEX (RPI)
<b>YEARS BEGINNING Q1</b>											
2011	8.47	7.53	9.17	9.30	13.79	0.40	14.95	8.86	122.93	5.41	4.93
2012	8.38	6.74	7.40	7.50	9.86	0.39	14.77	7.08	134.10	2.69	2.27
2013	9.34	8.30	8.17	8.08	10.90	0.38	14.45	7.67	146.20	2.58	2.36
2014	9.76	9.15	8.76	9.01	11.79	0.46	13.88	8.51	158.67	3.45	3.53
2015	9.52	8.71	8.00	8.68	10.90	0.57	13.24	8.07	170.89	3.56	3.70
2016	9.40	8.11	6.76	8.08	8.70	0.60	12.68	7.43	182.11	3.17	3.20
<b>2011</b>											
I	9.72	9.70	9.65	9.77	14.85	0.38	14.24	9.36	119.56	5.07	4.20
II	8.60	7.91	9.37	9.49	13.93	0.39	15.39	9.07	120.18	5.73	5.13
III	7.95	7.04	9.03	9.15	13.77	0.40	15.79	8.71	123.11	6.27	6.03
IV	7.93	6.14	8.81	8.94	12.80	0.41	14.51	8.49	128.87	4.60	4.36
<b>2012</b>											
I	8.34	5.95	8.75	8.05	11.60	0.43	15.06	7.58	129.21	3.77	3.50
II	8.78	7.14	7.92	7.60	9.47	0.39	14.90	7.18	132.75	2.86	2.33
III	8.66	6.53	7.00	7.40	9.10	0.37	14.80	7.00	134.88	1.97	1.72
IV	7.88	7.17	6.40	7.12	9.53	0.37	14.34	6.73	139.55	2.17	1.56
<b>2013</b>											
I	8.33	7.32	7.12	7.62	7.38	0.37	14.91	7.22	140.54	2.33	1.73
II	8.67	7.09	7.99	7.92	11.06	0.37	14.59	7.52	144.10	2.52	2.79
III	9.41	8.97	8.41	8.11	12.88	0.39	14.41	7.69	148.06	2.62	2.21
IV	10.49	9.42	8.84	8.51	11.90	0.40	13.91	8.07	152.11	2.84	2.69
<b>2014</b>											
I	10.11	9.32	8.93	8.79	11.55	0.42	14.37	8.34	152.26	3.15	3.12
II	9.85	9.22	8.84	8.97	11.76	0.45	14.02	8.48	156.75	3.36	3.42
III	9.66	9.09	8.73	9.09	11.89	0.48	13.82	8.58	160.79	3.57	3.70
IV	9.53	9.02	8.61	9.12	11.94	0.50	13.32	8.58	164.90	3.72	3.89
<b>2015</b>											
I	9.57	8.95	8.44	8.98	11.91	0.53	13.71	8.41	165.66	3.72	3.90
II	9.52	8.80	8.21	8.83	11.26	0.56	13.37	8.22	169.19	3.62	3.76
III	9.51	8.67	7.93	8.63	10.62	0.59	13.16	7.99	172.59	3.52	3.64
IV	9.49	8.51	7.58	8.42	9.98	0.60	12.73	7.78	176.13	3.42	3.51
<b>2016</b>											
I	9.46	8.34	7.24	8.32	9.38	0.60	13.07	7.67	176.54	3.32	3.39
II	9.46	8.20	6.90	8.17	8.87	0.60	12.79	7.52	180.45	3.22	3.26
III	9.39	8.06	6.62	8.02	8.46	0.60	12.63	7.38	183.91	3.12	3.14
IV	9.31	7.91	6.42	7.89	8.20	0.60	12.25	7.25	187.55	3.02	3.01

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## CHINA

**TABLE 2 SUMMARY TABLE**

	TRADE BALANCE (US\$ BN)	CURRENT ACCOUNT (US\$ BN)	CURRENT ACCOUNT (% OF GDP)	GOVT. FINANCIAL DEFICIT (YUAN BN)	GOVT. FINANCIAL DEFICIT (% OF GDP)	SHORT TERM INTEREST RATE	SPREAD OVER US SHORT TERM RATE	REAL INTEREST RATE (%)	EQUILIBRIUM EXCHANGE RATE PER US DOLLAR	DOLLAR EXCHANGE RATE
	(BVIS/)	(BCU\$/	(BCU\$*100	(-GB)	(-GB*100	(RSH)	(RSH-RSH US)	(Note 2)	(RXEQUIL)	(RXD)
<b>YEARS BEGINNING Q1</b>										
2011	157.9	201.7	2.8	537.3	1.1	5.3	4.9	-0.1	5.5	6.5
2012	208.8	244.7	3.0	1518.5	2.9	4.6	4.1	1.9	5.5	6.3
2013	226.8	280.1	3.0	1701.6	2.9	3.8	3.4	1.2	5.4	6.2
2014	246.3	290.1	2.7	1507.7	2.3	3.8	3.3	0.3	5.4	6.0
2015	277.6	303.1	2.5	1708.6	2.4	4.3	3.8	0.7	5.3	5.8
2016	306.1	315.7	2.3	1908.1	2.4	4.8	4.0	1.6	5.2	5.7
<b>2011</b>										
I	-0.7	-1.3	-0.1	-807.6	-8.3	4.6	4.3	-0.5	5.5	6.6
II	46.7	89.1	5.3	-436.9	-4.0	5.0	4.7	-0.7	5.5	6.5
III	63.8	64.9	3.6	25.8	0.2	5.8	5.5	-0.4	5.5	6.4
IV	48.1	49.0	2.1	1756.0	11.6	5.7	5.3	1.1	5.5	6.4
<b>2012</b>										
I	11	13	0.1	-585.8	-5.4	5.3	4.8	1.6	5.5	6.3
II	68.8	75.9	4.0	-404.4	-3.4	5.0	4.5	2.1	5.5	6.3
III	79.5	93.0	4.7	343.3	2.7	4.0	3.6	2.1	5.5	6.4
IV	59.3	74.5	2.9	2165.4	13.3	4.0	3.5	1.8	5.5	6.3
<b>2013</b>										
I	11	11.0	0.6	-541.6	-4.5	3.9	3.5	1.6	5.4	6.2
II	48.1	62.2	2.9	-607.5	-4.5	3.8	3.4	1.3	5.4	6.2
III	99.9	115.0	5.1	358.8	2.6	3.8	3.3	1.1	5.4	6.2
IV	77.7	91.9	3.1	2492.0	13.8	3.8	3.3	0.9	5.4	6.1
<b>2014</b>										
I	5.2	15.8	0.7	-779.7	-5.8	3.8	3.3	0.6	5.4	6.1
II	53.4	65.4	2.6	-841.8	-5.6	3.8	3.3	0.4	5.4	6.0
III	106.9	118.3	4.6	331.5	2.1	3.8	3.3	0.2	5.4	6.0
IV	80.9	90.6	2.7	2797.7	13.9	3.8	3.3	0.0	5.3	5.9
<b>2015</b>										
I	6.6	12.8	0.5	-884.1	-5.9	4.3	3.8	0.5	5.3	5.9
II	60.4	68.1	2.4	-922.9	-5.5	4.3	3.8	0.6	5.3	5.8
III	120.2	126.9	4.3	381.2	2.2	4.3	3.8	0.7	5.3	5.8
IV	90.4	95.3	2.5	3134.5	14.1	4.3	3.8	0.8	5.3	5.8
<b>2016</b>										
I	6.1	6.9	0.2	-993.7	-6.0	4.8	4.1	1.4	5.2	5.7
II	66.7	70.8	2.2	-1034.7	-5.6	4.8	4.0	1.5	5.2	5.7
III	134.0	137.2	4.1	426.2	2.3	4.8	3.9	1.6	5.2	5.6
IV	99.4	100.8	2.3	3510.4	14.3	4.8	3.8	1.7	5.2	5.6

Note 2: REAL INTEREST RATES = Nominal interest rate (RNL or RSV) - % change in CPI

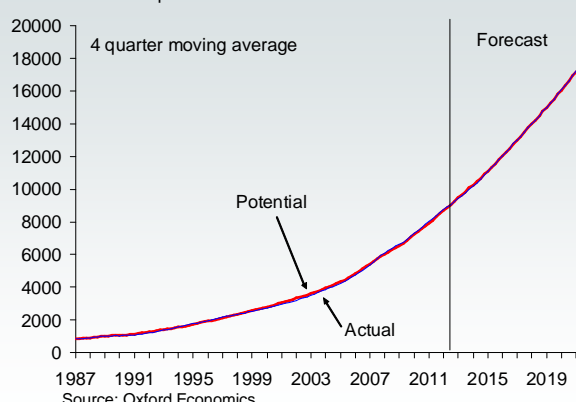
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## Potential output growth 7.8%pa

- Potential output is projected to rise by 7.8%pa over the next 10 years, a significantly lower rate than in the previous decade. GDP is set to expand by 7.5% in 2012, having grown by 9.3% in 2011 and to be slightly above potential growth at 8.1% in 2013. As a result, the large output gap of 1.1% in 2011 will contract in 2012 to 0.2% and increase in 2013 to 0.8%, and it is not forecast to close fully until 2015.
- The main contribution to growth in potential output over the coming decade comes from expanding total factor productivity.
- The 0.2%pt contribution from expanding labour usage reflects the 0.2%pa rise in the working population over the next ten years and a decrease in the participation rate which combine to boost the labour supply by 0.4%pa. For the capital stock's contribution of 3.4%pt, the main factor is significantly lower investment growth (at 6.4%pa) than in the previous decade. Finally, total factor productivity growth's significantly lower contribution of 4.3%pt reflects the worse contribution to potential growth from factors influencing production other than labour and capital over the coming decade.

### China: Actual & potential output

Yuan billion 2005 prices



### Potential GDP and Its Components Average Percentage Growth

	2002-2011	2012-2021
Potential GDP*	10.1	7.8
Labour Supply	0.7	0.4
Capital Stock	12.9	9.6
Total Factor Productivity	5.1	4.3

\* $\ln(\text{Potential GDP}) = 0.65 \cdot \ln(\text{Employment at NAIRU}) + 0.35 \cdot \ln(\text{Capital Stock}) + \ln(\text{Total Factor Productivity})$

## Long-Term Forecast for China

(Average annual percentage change unless otherwise stated)

	2002-2006	2007-2011	2012-2016	2017-2021
<b>GDP</b>	10.6	10.5	8.3	7.2
<b>Consumption</b>	8.7	10.3	9.3	8.3
<b>Investment</b>	17.1	12.9	7.8	6.4
<b>Government Consumption</b>	4.3	6.7	9.2	7.8
<b>Exports of Goods and Services</b>	23.6	5.6	7.0	7.0
<b>Imports of Goods and Services</b>	19.5	5.6	7.7	7.6
<b>Unemployment (%)</b>	4.2	4.1	4.0	3.9
<b>Consumer Prices</b>	1.5	3.7	3.1	3.0
<b>Current Balance (% of GDP)</b>	4.6	6.2	2.7	1.7
<b>Exchange Rate (vs US\$)</b>	8.2	6.9	6.0	5.3
<b>General Government Balance (% of GDP)</b>	-1.6	-1.0	-2.6	-2.9
<b>Short-term Interest Rates (%)</b>	3.0	3.5	4.2	5.0
<b>Working Population</b>	1.5	0.9	0.4	-0.1
<b>Labour Supply</b>	0.6	0.7	0.4	0.3
<b>Participation Ratio</b>	82.7	80.5	80.6	81.6
<b>Labour Productivity</b>	9.9	10.1	7.8	6.7

## Long-Term Forecast for China

Annual percentage changes unless otherwise specified

	2002-2011	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
<b>GDP</b>	10.6	9.6	9.2	10.4	9.3	7.5	8.1	9.0	8.7	8.1	7.5	7.4	7.2	7.0	6.9	7.7
<b>Consumption</b>	9.5	9.5	11.0	11.4	8.5	8.4	9.3	9.8	9.5	9.4	9.1	8.9	8.3	7.7	7.3	8.8
<b>Investment</b>	15.0	9.2	22.2	11.3	9.2	7.4	8.2	8.8	8.0	6.8	6.2	6.2	6.4	6.6	6.7	7.1
<b>Government Consumption</b>	5.5	4.8	3.8	6.9	9.4	9.7	9.7	9.3	8.8	8.4	8.3	8.1	7.9	7.5	7.2	8.5
<b>Exports of Goods and Services</b>	14.3	-1.1	-11.2	25.9	3.9	2.4	6.7	8.9	8.7	8.2	7.7	7.1	6.7	6.6	6.6	7.0
<b>Imports of Goods and Services</b>	12.3	-6.0	5.2	18.4	2.7	2.6	9.0	9.4	9.2	8.8	8.4	8.0	7.6	7.2	7.0	7.7
<b>Unemployment (%)</b>	4.1	4.1	4.3	4.2	4.1	4.1	4.0	4.0	4.0	3.9	3.9	3.9	3.8	3.8	3.8	3.9
<b>Consumer Prices</b>	2.6	5.9	-0.7	3.3	5.4	2.7	2.6	3.5	3.6	3.2	3.0	3.0	3.0	3.0	3.0	3.1
<b>Current Balance (% of GDP)</b>	5.4	9.3	4.9	4.0	2.8	3.0	3.0	2.7	2.5	2.3	2.1	1.9	1.6	1.5	1.5	2.2
<b>Exchange Rate (per \$)</b>	7.6	6.9	6.8	6.8	6.5	6.3	6.2	6.0	5.8	5.7	5.5	5.4	5.3	5.2	5.1	5.6
<b>General Government Balance (% of GDP)</b>	-1.3	-0.4	-2.3	-1.7	-1.1	-2.9	-2.9	-2.3	-2.4	-2.4	-2.5	-2.7	-2.9	-3.1	-3.3	-2.8
<b>Short-term Interest Rates (%)</b>	3.3	4.3	1.7	2.7	5.3	4.6	3.8	3.8	4.3	4.8	5.0	5.0	5.0	5.0	5.0	4.6
<b>Working Population</b>	1.2	1.0	0.9	0.8	0.7	0.6	0.5	0.4	0.3	0.1	0.0	-0.1	-0.1	-0.1	0.0	0.2
<b>Labour Supply</b>	0.7	0.7	0.6	1.1	0.8	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
<b>Participation Ratio (%)</b>	81.6	80.5	80.2	80.5	80.6	80.6	80.6	80.6	80.6	80.7	81.0	81.3	81.7	82.0	82.2	81.1
<b>Labour productivity</b>	10.0	9.2	8.9	10.0	8.9	7.1	7.7	8.5	8.1	7.4	6.9	6.9	6.7	6.6	6.6	7.2
<b>Employment</b>	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.6	0.6	0.6	0.5	0.4	0.4	0.3	0.5
<b>Output gap (% of potential GDP)</b>	-0.8	1.4	0.6	0.9	1.1	0.2	-0.8	-0.5	0.0	0.1	0.0	0.0	0.1	0.0	0.0	-0.1

## Background

- From a minor economy with little trade with the outside world in the 1970s and early 1980s, China has transformed itself through structural reforms and its entry to the WTO in 2001, and is now the world's largest exporter and the second largest oil consumer. The IMF estimated GDP in 2011 at US\$7.3 trillion, second in the world behind the US (US\$15.1 trillion), but on a PPP basis the gap is much closer as China's GDP in 2011 was estimated at US\$11.3 trillion.
- But with its population of 1.3bn, China is still a surprisingly poor country with an estimated GDP per capita on a PPP basis of US\$8,382 in 2011, similar to Ecuador and lower than Thailand but well ahead of India, and there is still huge potential to develop the consumer market. As an illustration, China is now the largest consumer and producer of cars. Income disparities have grown as urbanisation has boosted prospects in the cities, although even in Beijing and Shanghai average salaries are still well below rates in Korea and Hong Kong.
- Real GDP growth has been remarkably strong and stable over the period of China's transformation, with the pace only dropping significantly below 8-10% during the period of difficult reforms of state-owned enterprises in the early 1990s and during the Asian crisis, when growth slowed to 6-8%. Similar to the recent period, stable growth was achieved during the Asian crisis through a surge in government-led investment. Strong growth over the past two decades has been helped by reforms such as the unification of the currency rates and liberalisation of the current account in the early 1990s. In 2005, China began a gradual appreciation of the yuan against the US dollar but this was suspended at the end of 2008 when the global financial crisis hit. In March 2010, the governor of the People's Bank of China called the recent stability of the exchange rate a "special policy" during a "special period". However, the authorities' concerns about domestic overheating and the ability to pursue an effective monetary policy was always likely to lead to a return to the policy of gradual appreciation, and the central bank signalled this in June 2010.
- Cycles in China tend to be driven by investment, which represented over 40% of GDP in 2004-07. After a few years of double-digit growth, output growth peaked in 2007. With inflation over 9% in 2007, interest rates rose and the government cut back on the availability of credit to prevent further overheating and the bursting of a property bubble (particularly in commercial property and luxury flats in urban areas). The impact of tighter policy coincided with the global financial crisis and downturn in trade flows, with growth slowing to just over 6% in 2009Q1. But the government response was swift and effective with a headline fiscal package of CNY4 trillion to be spent mainly on major infrastructure investment, with almost half allocated to higher transport spending. While not all of this was new spending, the government was very effective at mobilising credit, with the annual growth in CNY loans rising over 30%. This led to a surge in investment that effectively counteracted the global downturn with GDP growth for 2009 as whole at 9.2% and then rising back above 10% in 2010.
- The high level of investment in China is supported by a high average household savings ratio estimated to be in the 25-30% range, driven in part by high precautionary savings in the face of the breaking of the 'iron rice bowl' and low public spending on health, education and pensions. The government has focused on boosting rural incomes and higher spending on health, including CNY850bn to be spent by 2011 to provide basic medical insurance for at least 90% of the population. Financial sector reform to provide a greater range of savings instruments for household and corporates as well as the extension of land rights to rural areas to allow the use of land as collateral will be important to the development of China's consumer market.
- The speed and extent of the recent boom in investment, and in particular the burden on local government finances through quasi state-owned entities, often called 'Urban Development and Construction Companies' which finance local investment, has raised concerns about a future rise in non-performing loans. Given China's still-low level of development, there is plenty of scope for infrastructure investment to yield high returns but the second generation of investment projects with an emphasis on public housing and other social spending may have lower financial returns, placing a burden on finances. However, the current level of non-performing loans is low and, if economic growth remains stable, the strength of central government finances will be able to withstand a rise in local non-performing loans and liabilities. But if growth falters, the outlook may not be so sanguine.



## Key Facts

### Politics

Head of state: President HU Jintao  
 Head of government: Premier WEN Jiabao  
 Political system: Communist state  
 Date of next presidential election: 2013  
 Date of next legislative election: 2013  
 Currency: Yuan (CNY) also called Renminbi (RMB)

### Long-term economic & social development

	1980	1990	2000	2011*
GDP per capita (US\$)	193	314	949	5362
Inflation (%)	6.0	3.1	0.3	5.4
Population (mn)	983	1145	1268	1364
Urban population (% of total)	19.6	27.4	35.8	44.0
Life expectancy (years)	66.0	68.1	71.3	73.1

Source : Oxford Economics & World Bank

### Structure of GDP by output

	2009
Agriculture	10.3%
Industry	46.3%
Services	43.4%

Source : World Bank

\* 2011 or latest available year

### Long-term sovereign credit ratings & outlook

	Foreign currency	Local currency
Fitch	A+ (Stable)	AA- (Negative)
Moody's	Aa3 (Positive)	Aa3 (Positive)
S&P	AA- (Stable)	AA- (Stable)

### Structural economic indicators

	1990	1995	2000	2011*
Current account (US\$ billion)	12.0	1.6	20.5	201.7
Trade balance (US\$ billion)	8.6	16.7	24.1	157.9
FDI (US\$ billion)	2.7	33.8	37.5	170.4
Debt service (US\$ billion)	7.1	15.1	26.6	105.0
Debt service (% of exports)	11.7	9.9	9.1	5.1
External debt (% of GDP)	15.5	16.2	12.1	8.3
Oil production (000 bpd)	2774	2990	3249	4073
Oil consumption (000 bpd)	2296	3363	4796	9392

Source : Oxford Economics / World Bank / EIA

### Destination of goods' exports (2010)

European Union (27)	19.7%
United States	18.0%
Hong Kong, China	13.8%
Japan	7.7%
Korea, Republic of	4.4%

Source : WTO



Source : CIA Factbook

Location : Eastern Asia, bordering the East China Sea, Korea Bay, Yellow Sea and South China Sea, between North Korea and Vietnam (CIA Factbook)

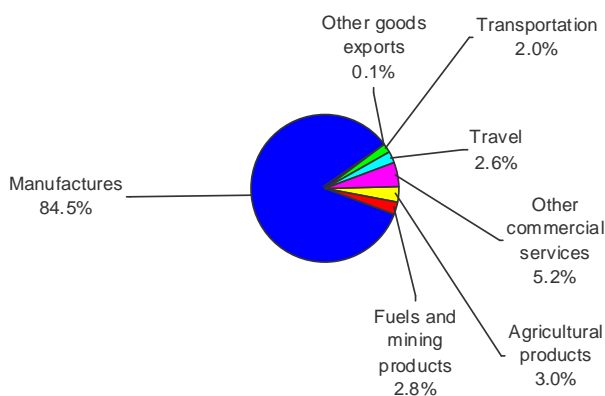
### Corruption perceptions index 2011

	Score
Developed economies (average)	7.70
Emerging economies (average)	3.44
<b>China</b>	<b>3.64</b>
Emerging Asia	3.35

Source: Transparency International

Scoring system 10 = highly clean, 0 = highly corrupt

### Composition of goods & services exports, 2010



Source : WTO