

33. CHINA

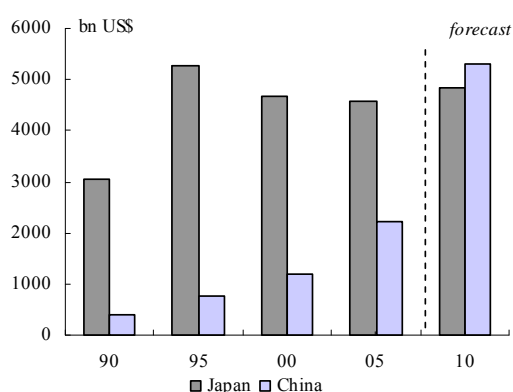
Fighting the negative consequences of very loose monetary policies

Strong growth performance in 2009...

China has been one of the first countries to overcome the consequences of the financial crisis which hit the world after the failure of Lehman Brothers in September 2008. While quarterly growth is estimated to have been weak in the last quarter of 2008, available estimates show that since the second quarter of 2009, seasonally-adjusted quarterly growth has been clearly higher than 2%.

Due to the fast implementation of the fiscal stimulus package, China's GDP growth decelerated only from 9.6% in 2008 to 8.7% in 2009. In spite of a negative contribution to growth by net exports of -3.9 pps., stimulus-driven investment contributed 8 pps. to GDP growth, with resilient private consumption adding another 4.6 pps. The strong growth performance in 2009 was also supported by monetary policy, which had turned very loose at the end of 2008. As a consequence of this policy, new loans were up by RMB 9.6 trillion, bringing the total outstanding loans to RMB 40 trillion, and the supply of broad money M2 increased by 27.7% y-o-y at the end of 2009.

Graph II.33.1: Nominal GDP Japan vs China



For the year 2009 as a whole, China's exports reached USD 1201.7 bn, down by 16% in value terms on 2008. With imports declining 11.2% on the year to USD 1005.6 bn, the trade surplus for 2009 reached USD 196.1 bn, down by 34.2% compared to the 2008 record surplus of USD 295.5 bn (Chinese statistics). While this decline in the trade surplus is clearly welcome from the point of view of global imbalances, the 2009 surplus is still among the highest on record. With the current

account surplus still high at 6.1% of GDP, China's foreign exchange reserves rose by USD 453 bn in 2009 to reach USD 2.4 trillion at the end of last December.

...continuing into 2010

In the first quarter of 2010, Chinese exports were actually up by 31.4% on the year, while imports rose by 63.6%. The combined trade surplus in the first quarter of this year reached USD 14.5 bn. This surplus should, however, be interpreted with extreme caution, because the recent strong rise in imports was driven by the knowledge, that with the beginning of the new year, a rush on new bank loans was to be expected as well as the ensuing launch of many new (stimulus driven) investment projects.⁽⁸⁰⁾

With an overall trade volume of USD 101.5 bn in the first quarter 2010, the EU remained by far the single most important trade partner of China, followed by the US (USD 78.1 bn), Japan (USD 63.6 bn) and ASEAN (USD 62.9 bn.). The trade surplus of Japan reached USD 12.2 bn and the deficits of the EU and the US USD 29.3 bn respectively USD 30.8 bn.

Among EU Member States, Germany posted a surplus of USD 1.8 bn, while France (USD 2.7 bn) and Italy (USD 3.1 bn) continued to see a rise in their bilateral trade deficits with China.⁽⁸¹⁾

GDP in the first quarter of 2010 was up by 11.9% y-o-y. This strong growth performance was driven by fixed asset investments, which were up by 26.4% (in nominal terms) in the first quarter of this year compared to the same period of last year. As a consequence of the early launch of the Chinese stimulus package (4 November 2008), fixed asset investment had already jumped by 24.2% y-o-y in early 2009. Therefore, no base effect can be called upon in this case. The fact that local government investment was up by 28.2% y-o-y (compared to a growth rate for central government investment of 9.1%) underlines the fast growing risk to local

⁽⁸⁰⁾ Given that the central government has fixed an annual target for new loans and that people are afraid of too much credit demand, everybody felt obliged to get a loan as early as possible at the beginning of 2010.

⁽⁸¹⁾ All 2010 trade figures according to China's custom authority.

government finances (assuming that the marginal profitability of investment decreases).

Policy stimulus exacerbated internal imbalances

Investment in real estate also increased strongly in the first two months of 2010, rising 31.1% y-o-y (this time, however, against the background of stagnation in the same period of 2009). In February, the sales price of buildings in the 70 biggest cities was up by 1.2% on the month and by 10.7% on the year. There are large discrepancies among these cities, the rises ranging from 50% and more in the 'trendy' southern cities like Haikou and Sanya and declines also observed in some other cities. Many observers claim that these statistics do not fully reflect actual developments and that there is already a real-estate bubble. However, the government has just introduced new measures to avoid the building up of a real-estate bubble like raising the required down-payment and increasing interest rates for second mortgages.

Price developments

Developments on the price front are worse than anticipated in the autumn. Due primarily to the impact of bad weather on food prices and to the rise in the price of housing, consumer prices in March were still up by 2.4% on the year. What is more, the attainment of the 3% inflation target for 2010 will now have to rely to a large degree on the slightly optimistic assumption that weather conditions in the rest of the year will be favourable and will again ensure good harvests in 2010.

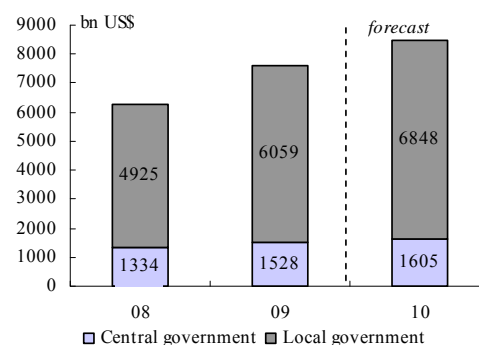
The inflationary risks are also evident from producer prices, which in March were up by 5.4% on the year. Developments on the monetary side do not really feed optimism either, given that new loans in February still reached around RMB 700 bn. Although this is clearly lower than the rise in January (RMB 1390 bn), the combined number still comes close to 30% of the 2010 target of RMB 7.5 trillion. Not surprisingly under these circumstances, M2, the relevant indicator for money supply, was also up 25.5% y-o-y.

High carry-over into 2010

China's economy is likely to show very strong quarterly growth rates in the first half of 2010. However, in the second half of the current year, quarterly growth is expected to decline somewhat

as a consequence of the running out of the stimulus' measures and of the monetary tightening started by the People's Bank of China (PBoC) early this year (rise in the reserve requirement ratio by 100 basis points since 18 January). With a carry-over currently estimated at around 4 pps. of GDP, China's growth rate in 2010 is still likely to reach double-digit figures again: while private consumption is foreseen to remain resilient, the growth contribution of investment to GDP growth could decline compared to the extremely high contribution reached last year. On the other hand, the external environment is likely to be more favourable to Chinese exporters which would imply a less negative contribution to growth from net exports. On the basis of these factors, China's growth rate in 2010 is likely to be close to 10½%, making China the second largest economy in the world (at market exchange rates).

Graph II.33.2: China - Government expenditure



Source: Ministry of Finance China

While the general government deficit in 2009 was probably lower than the official target of 3% of GDP and is likely to remain below 3% also in the current year, the financing via the banking system of many measures of the stimulus package might in the medium-term cause the ratio of non-performing loans to rise considerably.

Local governments might also end up with considerable fiscal problems, if currently launched projects yield less than optimistically anticipated. Sub-central levels of government are normally not allowed to incur debt, although this rule was relaxed for the years 2009 and 2010, when the central government allowed them to issue bonds of RMB 200 bn per year. As this amount turned out not to be sufficient to finance all the envisaged projects, these levels of government set up 'special vehicles' which then asked for normal bank loans. Given that the amounts involved are estimated to

be very high (some analysts give a figure of new loans to local levels of government of up to RMB 7 trillion), there is rising concern about defaults.

However, the low debt level at the general government level and the huge accumulation of foreign-exchange reserves (close to USD 2.5 trillion as of end March 2010) would probably allow China's central government to bail out again the banking system (and local governments) in case of need.

Developments in 2011

On the basis of the no-policy-change assumption China's economy is likely to see slightly lower growth rates in 2011. Given the expected slowdown in growth in the second half of the

current year, the carry-over into 2011 could be considerably lower than the carry-over into 2010. Furthermore, the end of the stimulus package should imply another decline in the growth contribution from investments. The growth contribution from private consumption and net exports, however, is projected to remain close to the 2010 level. All in all, GDP growth next year is likely to ease to around 9.4%.

Risks for 2011 are slightly biased to the upside: According to available information, the new Five-year-plan starting in 2011 will put a stronger focus on the promotion of private demand, although the measures on how to achieve this are only partially known and remain to be elaborated in more detail.

Table II.33.1:

Main features of country forecast - CHINA

	2008			92-05	Annual percentage change					
	bn CNY	Curr. prices	% GDP		2006	2007	2008	2009	2010	2011
GDP	31404.5	100.0		10.2	11.7	13.0	9.7	8.7	10.3	9.4
Private consumption	10839.22	34.5		-	-	-	-	-	-	-
Public consumption	4072.04	13.0		-	-	-	-	-	-	-
Gross fixed capital formation	110919.4	43.1		-	-	-	-	-	-	-
of which : equipment	-	-		-	-	-	-	-	-	-
Change in stocks as % of GDP	-	-		-	-	-	-	-	-	-
Exports (goods and services)	14306.94	45.6		-	17.2	35.0	13.4	-10.3	12.3	8.4
Final demand	-	-		-	-	-	-	-	-	-
Imports (goods and services)	9559.5	30.4		-	16.5	11.3	14.0	1.9	18.0	7.0
GNI (GDP deflator)	-	-		-	-	-	-	-	-	-
Contribution to GDP growth :										
Domestic demand				-	-	-	-	-	-	-
Stockbuilding				-	-	-	-	-	-	-
Foreign balance				-	-	-	-	-	-	-
Employment				1.1	0.8	0.8	0.6	-	-	-
Unemployment (a)				3.3	4.1	4.0	4.2	-	-	-
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households				-	-	-	-	-	-	-
GDP deflator				-	3.6	7.4	6.5	-1.9	2.4	2.6
Private consumption deflator				-	-	-	-	-	-	-
Index of consumer prices (c)				5.6	1.5	4.8	5.9	0.7	3.9	4.9
Trade balance (b)				2.7	8.2	9.3	8.3	6.1	4.3	4.9
Current account balance (b)				2.1	9.5	11.0	9.8	6.1	5.6	5.7
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	-	-	-
General government balance (b)				-1.5	-0.8	0.6	-0.4	-	-	-
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.